

# Credit Outlook

18 November 2021

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## FIRST READS

# BBVA's offer for Garanti BBVA is credit positive for Turkish banks

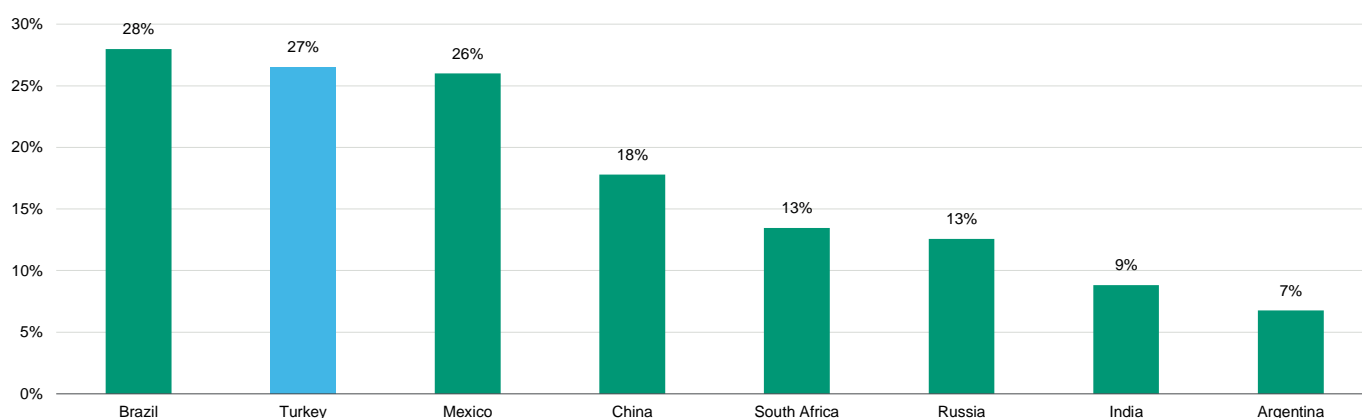
On 15 November, Spain's [Banco Bilbao Vizcaya Argentaria, S.A.](#) (BBVA, A2/A3 stable, baa2<sup>1</sup>) launched a €2.25 billion equity bid for the 50.15% of its listed Turkish subsidiary [Turkiye Garanti Bankasi S.A.](#) (Garanti BBVA, B2/B2 negative, b3) that it does not already own. The bid by a global financial institution is credit positive for Turkish banks because it helps restore investor confidence in the country's banking system.

Policy uncertainty in Turkey, particularly the lack of monetary policy credibility, has eroded investor appetite amid a reference rate of 16% and high inflation of 19.9% as of the end of October. Turkey's currency has depreciated around 28% year to date, and [financial conditions](#) in the country have been volatile and tight, particularly in the bond market. These conditions constrain market access for Turkish banks.

Investor sentiment is key for Turkish banks because their reliance on market funding is one of the highest among emerging markets at 27% of total funding (see exhibit). Despite this volatility, BBVA considers Turkey a core, strategic market with long-term potential.

### High market funding makes Turkish banks reliant on investor confidence

Market funds % total funding at the end of 2020



Source: Moody's Investors Service

Despite BBVA's investment helping to enhance investor confidence in Turkish banks, and potentially strengthening their funding capacity, the bid provides no additional credit benefits for Garanti BBVA specifically. This is because BBVA already has full management control of Garanti BBVA, the Turkish bank is already well integrated into the larger group, particularly in terms of risk management, and Garanti BBVA is fully consolidated into BBVA's accounts. As such, we do not expect full ownership by BBVA to lead to either a higher likelihood of group support in case of need or greater integration with the group.

The offer, for which the bank expects to receive regulatory approval and which it expects to close in first-quarter 2022, is subject to no conditionality and BBVA will be satisfied with any resulting level of ownership (i.e., there is no minimum ownership target).

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on [www.moody's.com](http://www.moody's.com) for the most updated credit rating action information and rating history.

The shares not held by BBVA are widely held on the Istanbul Stock Exchange. The offer price is a 34% premium over the volume-weighted average price of the past six months, which is likely to ensure a satisfactory acceptance of the offer. The ongoing currency depreciation in Turkey has made the transaction more attractive for BBVA by cutting the Turkish lira's purchasing power in euros to about one-quarter compared to November 2014, when BBVA first acquired a 14.9% stake in Garanti BBVA for €2 billion.

## Endnotes

<sup>1</sup> The ratings shown are the banks' domestic deposit rating, senior unsecured debt rating if available and Baseline Credit Assessment.

## FIRST READS

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# Criminal charges related to past operations in Sudan are credit negative for Lundin Energy

Originally [published](#) on 12 November 2021

On 11 November, [Lundin Energy AB](#) (Baa3 stable) announced that the Swedish Prosecution Authority had criminally charged Board Chairman Ian H. Lundin in relation to operations in Sudan from 1999-2003 and Director Alex Schneider in relation to Sudan operations 2000-03. The charges include claims against Lundin for a corporate fine of SEK3 million and forfeiture of economic benefits of around SEK1.4 billion (around \$160 million), which according to the Swedish Prosecution Authority represents the value of the gain of SEK720 million that Lundin made on the sale of the business in 2003.

Although the company's cash flow could comfortably cover the fine's potential cash outflows without jeopardizing credit quality, the charges are a reputational risk for the company and are credit negative. Lundin's Baa3 rating assumes that the company will not face meaningful operational challenges as a reputational consequence of the charges.

Quantitatively, we do not expect that the company would need to raise funding to cover the charges, especially if the current strong momentum in oil and gas continues into 2022. In third-quarter 2021 alone, the company generated more than \$500 million of (Moody's-defined and adjusted) free cash flow, which would have already covered any potential outflows. In addition, as of the end of September, the company had around \$850 million cash and cash equivalents on its balance sheet, supported by access to a largely undrawn \$1.5 billion committed revolving credit facility, and no imminent refinancing risk. In any case, any corporate fine or forfeiture of economic benefits would only be imposed after an adverse conclusion of a trial. The amounts are also well below the original estimates that Lundin disclosed as contingent liabilities in its reporting.

The investigation, the start of which dates back to 2010, alleges that Lundin and Schneider were complicit in crime against international law, gross crime, in Sudan 1999-2003 and 2000-03. Lundin entered Sudan in February 1997 when it signed an agreement with the country's government to explore for oil in an area called Block 5A, in the then southern part of Sudan in Unity State, an area that today belongs to the independent state of South Sudan. Shortly after the agreement was signed, Lundin formed a consortium with several other oil and gas companies, which worked together until Lundin divested its interest in Block 5A to Petronas in 2003. Lundin currently operates exclusively in Norway.

Following the charges, Lundin has declined to stand for re-election as chairman of the board at Lundin's 2022 annual general meeting. The company refutes all allegations of wrongdoing by any of its representatives and does not foresee any effect on its operational and financial guidance. Both Lundin and Schneider deny the charges and expect to remain on the board as directors. The wider management and operations of Lundin remains unaffected.

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## Sinclair's renewal of carriage agreement with DISH is positive for STG, but negative for Diamond

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On 15 November, [Sinclair Broadcast Group, Inc.](#) (SBG) announced that it had reached an agreement with [DISH Network Corporation](#) (B2 stable) regarding carriage of [Sinclair Television Group, Inc.](#)'s (STG, Ba3 stable) broadcast channels on the pay-TV operator.

The news is credit positive for STG because it ends more than four months of negotiations and uncertainty over STG's long-term retransmission fee revenue. The two companies had been locked in short-term renewals since a previous carriage agreement expired in August. The new contract is multiyear and although pricing terms were not announced, we expect that it will lead to some increase in retransmission fee revenue at STG.

While the announcement is positive for STG, sister company [Diamond Sports Group, LLC](#) (Caa2 negative), owner of Bally Sports, which owns regional sports networks, was left out of the renewal. DISH decided not to renew its carriage of Diamond's regional sports networks (RSNs) in 2019 before SBG completed its acquisition of RSNs from [The Walt Disney Company](#) (A2 stable).

Since then, various events have influenced the likelihood of a renewal. First, the COVID-19 pandemic and its decimation of live sports events during 2020 made it less likely. Then came hope with the resumption of live sports but no renewal was announced. And finally the renegotiation of STG's broadcast channels' carriage, which could have paved the way for carriage of the RSNs as part of a packaged deal. Given the latest announcement, DISH is unlikely to renew RSN carriage agreements in the long term. With Diamond's recently updated EBITDA guidance excluding any potential revenue from DISH, we expect Diamond's Moody's-adjusted gross leverage to be in the low teens in 2021, raising even further the potential of a distressed exchange.

Hunt Valley, Maryland-based STG owned and operated 188 television stations across 88 markets as of year-end 2020, broadcasting more than 600 channels across the US. The station group reaches approximately 25% of the US population (taking into account the UHF discount). The affiliate mix is diversified across primary and digital sub-channels, including ABC, CBS, NBC and FOX.

The company also owns a local cable news network in Washington, DC, four radio stations and the Tennis Channel. Members of the controlling Smith family exercise control over most corporate matters SBG, STG's ultimate parent, with four of the nine board seats and approximately 81% of voting rights (through the dual class share structure). Consolidated net revenue for 2020 was approximately \$3.18 billion.

Diamond, which is also based in Hunt Valley, was in 2019 and is through which SBG executed its acquisition of the Disney RSNs. Diamond owns and operates 22 RSNs that broadcast professional basketball, hockey and baseball games on pay-TV platforms. In 2020, Diamond generated revenue of \$2.7 billion in 2020.

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## Intertrust's proposed takeover by private-equity firm CVC is credit negative

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On 12 November, Netherlands-based [Intertrust N.V.](#) (Ba2 negative) announced that its exclusive discussions with funds advised by CVC Capital Partners in relation to a potential voluntary public offer for all issued and outstanding shares of Intertrust. As part of the proposed transaction, Intertrust and CVC are also contemplating a strategic combination of Intertrust and [TMF Sapphire Midco B.V.](#) (B3 positive), a leading multinational professional services business. An agreement relating to the proposed transaction is subject to approval by Intertrust's management board and supervisory board.

Although full details were not disclosed, we expect that the proposed transaction would be credit negative for Intertrust because it would likely lead to a deterioration of its key debt metrics and to more aggressive financial policies than currently factored in its rating. The private equity business model typically involves an aggressive financial policy and a highly leveraged capital structure to extract value.

At the same time, the proposed combination of Intertrust with TMF would create one of the largest business services platforms globally and significantly strengthen its business profile with greater scale and diversification. We also recognize the likely integration challenges linked to a potential merger.

Intertrust's Moody's-adjusted gross leverage was around 5.0x at the end of September 2021, above the 3.0x-4.5x expected range for its Ba2 rating, making Intertrust weakly positioned in the Ba2 category as reflected in the negative outlook. Intertrust's Ba2 rating incorporates our expectation for its Moody's-adjusted gross leverage to decline to below 4.5x in 2022 based on our forecasts of the current outstanding debt before any effects from the proposed transaction. The outstanding debt includes approximately €500 million of senior unsecured notes, with a 101% change-of-control put provision, and around €350 million of senior unsecured term loans. In addition, the rating captures the company's current financial policy, which is to reduce adjusted net debt/EBITDA to below 3.4x by year-end 2021 from 3.8x at year-end 2020, and the company's mid-term net leverage target of around 3.0x.

CVC made an indicative offer of €18 a share in cash, which values Intertrust's equity at around €1.63 billion, implying a 43% premium on the previous closing share price and the enterprise value multiple at around 11x EBITDA (based on company-adjusted EBITDA as of last 12 months to September). In light of the proposed transaction, Intertrust suspended its €100 million share buyback programme, which it announced in September.

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## TMF's proposed combination with Intertrust enhances business profile but final credit effect depends on financing

Originally [published](#) on 16 November 2021

On 12 November, [Intertrust N.V.](#) (Ba2 negative), a leading specialized administration services provider, announced that it has entered into exclusive discussions with CVC Capital Partners in relation to a potential public cash offer for all issued and outstanding shares of Intertrust. As part of the proposed transaction, CVC is contemplating a strategic combination of Intertrust with [TMF Sapphire Midco B.V.](#) (B3 positive), which CVC has owned since 2018.

The proposed combination of TMF with Intertrust would create one of the largest business services platforms globally and significantly strengthen the business profile, with greater scale and diversification. At the same time, we also recognize the integration challenges linked to the potential merger.

While the merger with Intertrust would enhance TMF's business profile, the ultimate credit impact would depend on the financing structure of the proposed transaction, which has not been publicly disclosed yet, and the likely trajectory of credit metrics in the next 12-18 months, including the potential for synergies, as well as integration costs. We will continue to monitor the company's announcements and comment further as more details about the transaction emerge.

Prior to this transaction, TMF's corporate family rating (CFR) was strongly positioned in the B3 category, as reflected in the positive outlook, with Moody's adjusted gross leverage estimated to be at around 6.3x by year end 2021 (excluding bank overdrafts), which was at the lower end of the expected range of 6x-8x for its current rating. TMF's year-to-date September 2021 (YTD Sep-21) operating results are robust and the company is on track to meet its budget for the full-year 2021. TMF recorded a year-on-year organic revenue growth of 7% and company-adjusted EBITDA growth of 16% in the period YTD Sep-21. Its Free Cash Flow generation was positive in the same period, supporting its good liquidity position.

CVC has entered into exclusive discussions with Intetrust in relation to a potential public cash offer €18 a share in cash, for all issued and outstanding shares, which values Intertrust's equity at around €1.63 billion and implies an enterprise value (EV) multiple at around 11x Intertrust's EBITDA. An agreement relating to the proposed transaction is subject to approval by Intertrust's management board and the supervisory board. CVC paid a consideration of €1.75 billion, when it acquired TMF in 2018, implying a EV multiple of around 11x based on its 2017 pro forma adjusted EBITDA.

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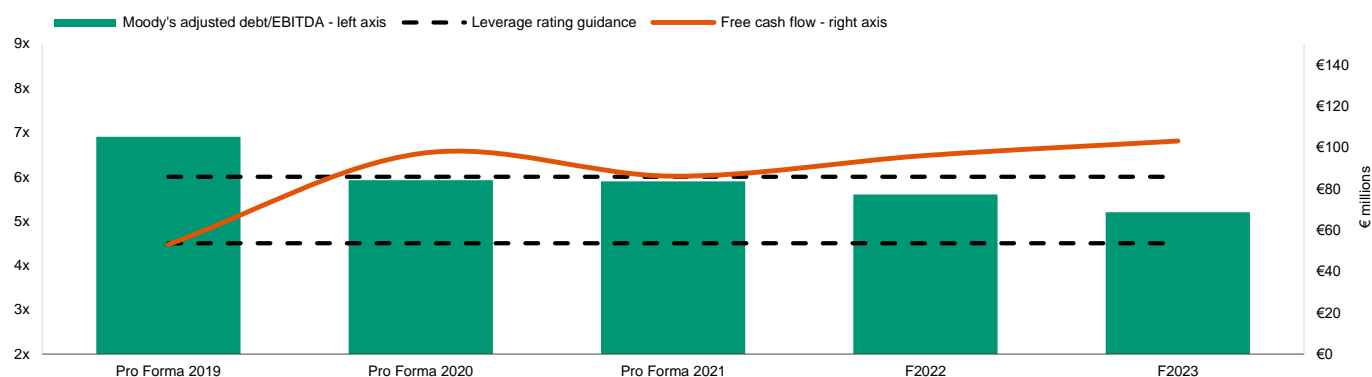
## Dedalus' debt-funded bolt-on acquisitions delay deleveraging

Originally [published](#) on 16 November 2021

On 15 November, healthcare software maker [Dedalus S.p.A.](#) (B2 stable) announced its intention to raise a €150 million add-on to its existing term loan to finance four bolt-on acquisitions, repay current drawings under the revolving credit facility and preserve excess cash for general corporate purposes.

We expect the transaction would increase Dedalus' leverage by 0.2x to 6.0x at year end, at the top end of the 4.5x-6.0x range set for the B2 rating, a credit negative (see exhibit). However, considering the company's solid performance and good revenue visibility, we expect deleveraging going forward on the back of solid free cash flow generation.

### Moody's-adjusted debt/EBITDA would be at the upper end B2 rating guidance following the transaction



Source: Moody's Investors Service

Given the company's acquisitive business model, we expect future acquisitions. If such acquisitions are fully debt-funded, we see only limited capacity in its B3 rating category given the high acquisition multiples of the industry as well as time and management capacity to execute planned synergies. A mitigating upside would occur if the €32 million excess cash proceeds from the transaction are used for acquisitions that generate positive EBITDA. In line with the add-on of the term loan, Dedalus plans to increase its revolving credit facility by €55 million to €165 million, which could be used for future acquisitions.

Dedalus is continuing its strategy to consolidate the pan-European software healthcare market and enhance its cloud-based capabilities with the envisaged acquisitions. The acquisition multiples of the four targets are with around 13x EBITDA on average high, but the specialised niche players fit well into Dedalus' existing product offering and provide potential for cross selling and synergies. On a combined base, the targets generate only around €16 million revenue with pro forma reported EBITDA of €7 million and represent only 2%-3% of the Dedalus group. The recurring revenue base should slightly increase toward 60% pro forma for the acquisitions given the relatively higher share compared to Dedalus. We see limited integration risks of these smaller targets into the company, we believe that the high pace of acquisitions since 2020, including the larger Aceso and DXC acquisitions, incur high integration and execution risks that can delay synergy realization. The company aims to finalize the integration of all acquisitions by the end of 2023.

Dedalus has had solid performance post-Covid with high single-digit revenue growth while Moody's-adjusted EBITDA margins were stable above 27%. As of August 2021, Dedalus' order book (including maintenance for the next 12 months) was €739 million, providing around one year revenue visibility. We believe that the company will continue to grow revenue in 2022 by around 6% on the back of positive market sentiment and a high need for digitization especially in the healthcare industry while expected synergies should contribute to a slight margin expansion. As a result of the asset light business model and absent further acquisitions, we expect Dedalus to generate around €80-€90 million free cash flow in 2021 with further upside toward €100 million in 2022.



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## Transfer of 100% stake in KazTransGas to Samruk-Kazyna is credit negative for KazMunayGas

Originally [published](#) on 12 November 2021

On 10 November, [KazMunayGas NC JSC](#) (KMG, Baa2 stable) announced that it had transferred its 100% stake in [JSC KazTransGas](#) (KTG, Baa2 stable) to its controlling shareholder, Kazakhstan's [Sovereign Wealth Fund Samruk-Kazyna JSC](#) (Samruk-Kazyna, Baa2 stable), for 1 tenge (\$0.0023).

The transaction is credit negative for KMG because it will reduce its asset base, business diversification, EBITDA and cash generation capacity and stability, and increase its leverage in 2022, all without adequate compensation. In the 12 months that ended 30 June, KTG generated 29% of KMG's consolidated EBITDA and 35% of its retained cash flow (RCF), and held 13% of its consolidated total debt (all metrics are Moody's-adjusted).

KMG's credit metrics will moderately weaken starting in 2022, when it will fully deconsolidate KTG. (At year-end 2021, KMG will deconsolidate KTG's debt and other balance sheet metrics, but will consolidate KTG's revenue, earnings and cash flow generated before 9 November.) As of year-end 2022, we estimate KMG's debt/EBITDA of 2.7x and RCF/net debt of 23%, which we estimate 0.3x higher and three percentage points lower than they would have been in the absence of the transaction (all metrics are Moody's-adjusted) and assuming no major increase in KTG's debt.

Such metrics would still be commensurate with the company's ba2 BCA, which is a measure of the company's standalone credit strength within the framework of our Government-Related Issuers rating methodology. Therefore, the transaction has no immediate implications for KMG's credit rating and BCA.

The transaction is credit neutral for KTG, assuming no immediate changes to its assets, operations, strategy, financial and dividend policies, and investment programme. In the medium term, the company's investment programme could expand to cover new midstream and downstream projects, which would likely increase its leverage if financed with debt. The transaction is also credit neutral for Samruk-Kazyna, which consolidated KTG before the transfer via its controlling stake in KMG.

KTG generates most of its EBITDA from export sales of gas produced mainly by the Tengiz, Kashagan and Karachaganak projects in Kazakhstan, which it purchases from project operators at relatively low prices, as well as from export and transit gas transportation. Its domestic gas transportation and sales operate at breakeven or are loss-making. KTG's gas export sale and transportation business generates substantial and more stable EBITDA than KMG's core upstream and downstream businesses.

We consider the probability of government support for both KMG and KTG in the event of financial distress as high because both companies are strategic government assets. KTG's transfer to Samruk-Kazyna's direct ownership is part of the government's strategy to develop KTG as a national operator specialising in gas exploration, production and transportation.

Kazakhstan mainly produces oil, which accounts for the bulk of its hydrocarbon reserves. In 2020, it produced 85.7 million tonnes of oil and 55.2 billion cubic meters (bcm) of gas. KMG produced 8.2 bcm, or around 15%, of the country's total gas output in 2020, including the company's shares in the output of the Tengiz, Kashagan and Karachaganak projects, which are operated under production-sharing agreements (PSAs). KMG has a 20% stake in the Tengiz PSA, a 10% stake in the Karachaganak PSA and an 8.44% stake in the Kashagan PSA.

KTG's own gas production in 2020 was below 0.4 bcm. The company intends to increase its gas reserves through geological exploration, develop the fields with high gas production potential, and invest in gas processing projects. However, we do not expect a major increase in its gas production in the medium term because of a current lack of new large gas projects in Kazakhstan.

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## Cancellation of Arabian Centres' deed to land for new Riyadh mall is credit negative

Originally [published](#) on 17 November 2021

On 11 November, [Arabian Centres Company](#) (ACC, Ba2 negative) announced that the Saudi Arabian Supreme Court on 7 March had canceled the deed to the land on which it was developing a new mall, the Jawharat Riyadh, in the Saudi Arabian capital Riyadh. The mall has 130,000 square metres of gross leasable area and an expected opening date in the second half of ACC's fiscal year ending March 2024.

The court decision is credit negative for ACC because it will reduce its ability to access secured funding. ACC could also lose its investments in the land, including the cost of purchase and capital spending to date. Such a development, although unlikely according to ACC, would require it to write off around 10% of its total assets, weakening its leverage and balance sheet.

The Supreme Court's decision forms part of an administrative review for an area of 2 million square metres, including ACC's land plot, that concluded that there could be potential irregularities in the procedural steps under which the [Government of Saudi Arabia](#) (A1 stable) granted the land to its original owner. The land was then sold to multiple investors and ACC purchased it from a private real estate investment company in November 2013 for SAR1.77 billion (\$472 million). ACC has already spent SAR628 million on the project and obtained 15 construction permits.

ACC is disputing the Supreme Court's decision and has contacted the Royal Court in Saudi Arabia to seek a resolution to the matter, based on a 2021 royal decree that provides buyers such as ACC with immunity from any consequences arising from administrative irregularities in the transfer of title deeds. ACC has not taken any provisions for write-offs on the land and is continuing with its investments of SAR1.53 billion, in line with the current schedule.

Although it is unclear when the issue will be resolved, because ACC does not currently hold the title deed its access to secured funding has declined because it is losing a sizeable unencumbered asset. There is also a risk, though very limited according to ACC, that the company will need to write off the land and mall project from its books. The land is recorded at book value on its balance sheet and accounted for around 10% of total assets as of September 2021. In this scenario, ACC would have the option, via the legal route, to claim back the acquisition cost of the land. The company's total exposure would be limited to the development costs of SAR628 million.

A write-off would have no effect on ACC's cash flow but would increase its balance sheet-based leverage. On a pro forma basis, its Moody's-adjusted total debt/assets would increase to 70.1% from 63.3% and unencumbered assets/total assets would decrease to 60.1% from 64.0% as of September 2021.

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## MTN's sale of South African tower portfolio to IHS is credit positive for both companies

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On 17 November, [MTN Group Limited](#) (Ba2 negative) announced an agreement to sell 5,709 of its 12,800 mobile towers in South Africa to [IHS Holding Limited](#) (B2 negative) for ZAR6.4 billion (around \$413 million). IHS will introduce a minimum 30% South African Broad Based Black Economic Empowerment (BBBEE) entity to the shareholding but will have full operational control and consolidate the South African tower business.

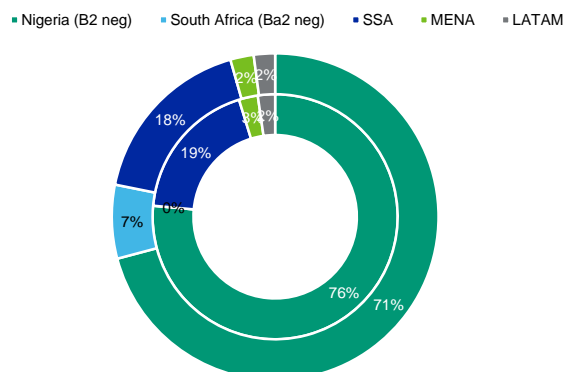
The transaction is credit positive for both MTN and IHS. For MTN, the transaction forms part of the company's plan to streamline its portfolio, raise \$1.7 billion from asset disposals over the next three-five years and improve the company's financial flexibility. For IHS, the acquisition increases scale and geographic diversification away from [Nigeria](#) (B2 negative) while keeping well within Moody's leverage tolerance for the B2.

For the disposal, MTN will receive proceeds of ZAR6.4 billion upfront, but will also enter into a long-term agreement with IHS to lease back the towers, which will create a lease liability. This increase in lease liabilities will, however, be largely offset through deconsolidation of ZAR4.6 billion of ground leases attached to the towers. We therefore estimate the leverage and cost impact for the South African operations will be insignificant. At the same time the transaction proceeds will increase the company's cash balance and thereby enhance liquidity and financial flexibility. Management has a strong track record of complying with announced financial policy targets and we therefore expect the company to remain within its holdco net leverage target of below 1.5x (1.2x as of September 2021) and meet its investment targets before applying proceeds for shareholder returns.

For IHS, the acquisition will add scale, increasing the company's tower portfolio by 19% to over 36,000 towers from around 30,500. It will also give IHS a sizeable tower presence in South Africa, making it the largest independent tower operator in South Africa, holding around 17% of the total 34,000 towers in the country. At the same time, the addition of the South African tower portfolio will improve IHS' geographic diversification and reduce its operational concentration in Nigeria, where the company is exposed to high social, political, economic and regulatory risks. [South Africa](#) (Ba2 negative), which has a lower sovereign credit risk environment, will initially contribute around 13% of group revenue (around \$220 million) and 7% of group EBITDA (about \$80 million) and reduce the contribution from Nigeria to 64% from 73%, and 71% from 76%, respectively (see exhibit). While this is an improvement in diversification, the concentration to Nigeria remains material and continues to be a credit constraint.

### IHS remains concentrated in Nigeria, despite a sizable exposure to South Africa

EBITDA split by region (inner circle = LTM September 2021; outer circle = pro forma EBITDA)



SSA: Sub-Saharan Africa; MENA: Middle East and North Africa; LATAM: Latin America  
Sources: Company financials and presentations

The transaction will initially be margin dilutive for IHS with its Moody's adjusted EBITDA margin (pro forma) dropping to 57% from 59% for the last 12 months (LTM) ended September 2021. South Africa is a relatively mature and highly competitive mobile market with broad tower coverage from the major three mobile network operators, Vodacom (around 9,000 mobile towers), MTN (about 12,800) and [Telkom SA SOC Ltd](#) (Ba2 negative) (about 6,500). As such, we expect it will be difficult to add Vodacom or Telkom as tenants on a large number of towers and the ability to improve the co-location rate and margins will likely be slow.

Despite IHS's single customer exposure to MTN, the counterparty risk is mitigated by MTN's Ba2 rating, reflecting its strong market position in South Africa (number 2 with a roughly 30% subscriber market share) and moderate leverage. The leases will be denominated in rand, which will create some currency exposure against IHS' mostly dollar denominated debt.

IHS will fund the ZAR6.4 billion purchase consideration with local currency opco debt and equity, with IHS's 70% share being funded from existing cash balances and proceeds from the proposed bond issuance. This will increase its Moody's adjusted leverage to around 3.5x from 2.8x as of LTM September 2021, well within our rating downgrade guidance of 5.5x.

The transaction is subject to various regulatory approvals and is expected to close during the first quarter of 2022.

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## Yuexiu Transport's spin-off and setup of an infrastructure REIT are credit positive

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On 14 November, [Yuexiu Transport Infrastructure Limited](#) (Baa2 stable) announced that it had obtained approvals from regulators to proceed with the proposed spinoff and setting up of an infrastructure real estate investment trust (infra REIT). The transaction involves the separate listing of Hanxiao Expressway on the Shenzhen Stock Exchange through the establishment of the Infra REIT as a close-ended publicly listed infrastructure securities investment fund. Yuexiu Transport intends to sell 70% of its equity interest in Hanxiao Expressway to the infra REIT and retain 30% ownership after the deconsolidation. The proposed transaction is conditional on approvals relating to the subscription of investors and regulatory requirements for a public offering.

The proposed spin-off would be credit positive because Yuexiu Transport can monetize its assets, shorten investment cycles and obtain sales proceeds through disposals to the REIT.

Although the spinoff will reduce recurring revenue, the one-off sale proceeds could partially ease the company's sizable financing requirement from its expansion plan for the GNSR Expressway in Guangzhou, which has an estimated investment amount of RMB12.7 billion. Also, the company will receive dividend income from the Infra REIT as a minority investor as well as management fees as the operation management company. Before the asset disposal, Hanxiao Expressway accounted for around 6% of Yuexiu Transport's total revenue and gross profit, and less than 2% of its total debt.

However, Yuexiu Transport's financial leverage will remain under pressure from its huge expansion plan for the GNSR Expressway and the potential acquisition of the Lanwei Expressway in Henan province from its parent company. Furthermore, the company is still recovering from its RMB6 billion acquisition of three expressway projects in Hubei province in 2019. In the last 12 months ended June 2021, the company's funds from operations/debt was 13%, compared with 21%-28% in 2017-18, before the acquisition in 2019.

We expect Yuexiu Transport to continue to broaden its financing channels through the disposal of assets to Infra REITs in the future. Infra REITs are a new financing model in China designed to support future infrastructure investments and control leverage in the infrastructure sector.<sup>1</sup>

### Endnotes

<sup>1</sup> See [Infrastructure & Project Finance – China: Infrastructure REITs expand financing channels for infrastructure companies](#), 15 June 2021.

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## Latest disposal of nonperforming exposures accelerates Bank of Cyprus' balance sheet clean-up

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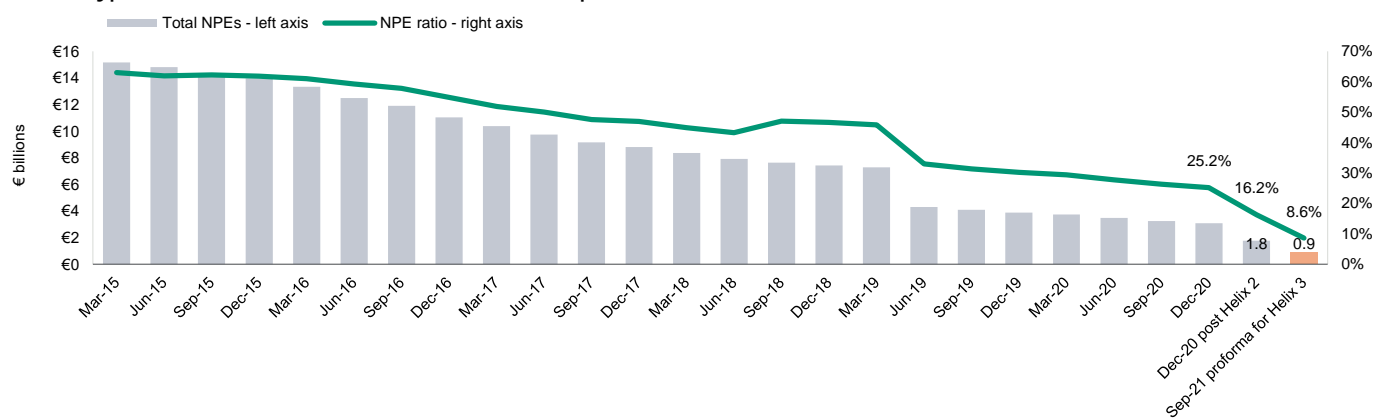
On 15 November, [Bank of Cyprus Public Company Limited](#) (B1 positive, b3<sup>1</sup>) announced an agreement to sell a portfolio of nonperforming loans with a gross book value of €577 million at 30 June 2021, as well as real estate properties with a book value of €121 million at 30 June 2021 to funds affiliated with Pacific Investment Management Company LLC (PIMCO), a global fixed-income investment manager.

The transaction, termed Helix 3 and part of the bank's balance sheet de-risking efforts, will reduce Bank of Cyprus' stock of legacy nonperforming exposures (NPEs) by 36% and reduce its stock of real estate property by 9% compared to June 2021, a credit positive. Despite difficult market conditions, this is Bank of Cyprus' third NPE sale in the past 15 months, following agreements to sell NPE portfolios with a gross book value of close to €1.3 billion to PIMCO, announced in [August 2020](#) and in [January 2021](#) (together known as Helix 2) and completed in June 2021.

Pro forma for the latest sale, which includes primarily loans to retail clients, and organic reductions during the first nine months of 2021, the bank's high NPEs will halve to €900 million as of September 2021 from €1.8 billion as of December 2020 including Helix 2. Likewise, the bank's ratio of NPEs to gross loans will decline significantly to 8.6% as of September 2021 from 16.2% as of year-end 2020 (it was 25.2% before Helix 2), as shown in the exhibit below.

Exhibit 1

### Bank of Cyprus' latest NPE sale will accelerate the clean-up of its balance sheet



Source: Bank of Cyprus

Upon the transaction's completion, Bank of Cyprus will receive €385 million and expects the transaction to add 66 basis points to its Common Equity Tier 1 ratio, which was 14.2% as of June 2021<sup>2</sup> and add around €21 million to its income statement. This compares with a broadly neutral capital effect from the two previous large NPE sales (Helix 1, a €2.7 billion [gross NPE sale completed in 2019](#), and Helix 2) combined. The bank expects to complete the transaction in the first half of 2022, subject to a number of conditions, including customary regulatory and other approvals.

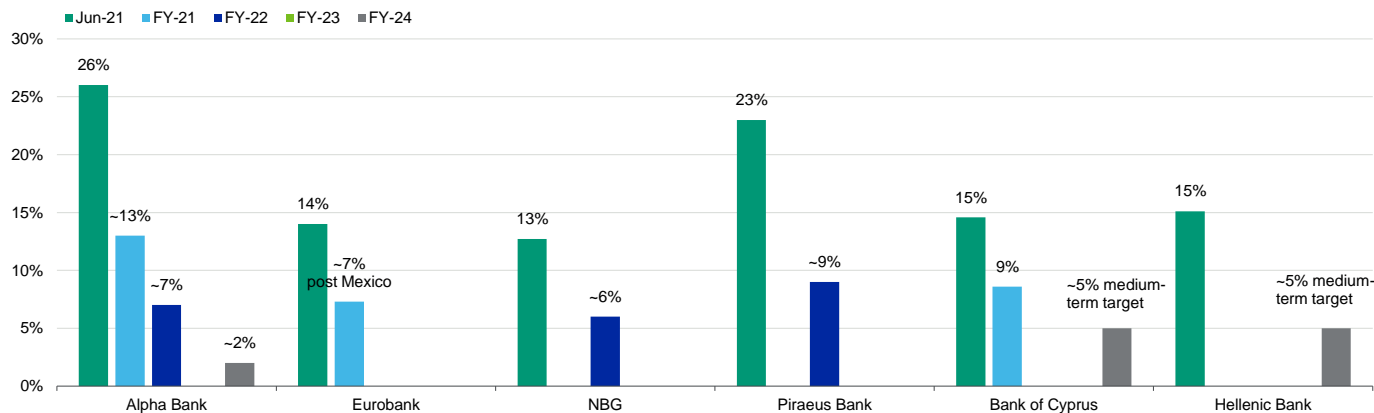
Bank of Cyprus has made significant progress in improving its asset quality in recent years and following this sale, the bank is currently best positioned within its [peer group of Greek and Cypriot lenders](#) (see Exhibit 2), which have had the highest stock of NPEs in Europe in recent years. The bank has reduced its stock of legacy NPEs by 94% from the peak in March 2015 (€15.2 billion), lowering its NPE ratio to 8.6% from 63% over the period. With this transaction, the bank achieves its strategic target of reducing its NPEs to a single digit by 2022 and is on track to achieve its target of a 5% NPE ratio from 2023 onward. The bank will continue to work toward this



goal while managing the post-pandemic NPE inflow, while simultaneously off-loading of legacy problematic loans, which will allow the bank to focus on building more sustainable profitability, which remains structurally weak for the bank.

Exhibit 2

**Bank of Cyprus is on track to achieve its target of a 5% NPE ratio from 2023 onward**  
**Comparison with peer group of Greek and Cypriot lenders**



NBG = [National Bank of Greece S.A.](#) (B2 positive, b3); Piraeus = [Piraeus Bank S.A.](#) (B3 positive, caa1); Eurobank = [Eurobank S.A.](#) (B2 positive, b3); Alpha Bank = [Alpha Bank S.A.](#) (B2 positive, b3); Hellenic Bank = [Hellenic Bank Public Company Ltd](#) (B1 positive, b3)

For Hellenic Bank figures exclude NPEs guaranteed by the government. Mexico refers to a Greek NPE securitisation currently in progress.

Sources: *The banks*

The NPE sales significantly reduce asset and capital risks for Bank of Cyprus, with the bank's Texas ratio (NPEs divided by the sum of shareholders' equity and accumulated provisions, based on reported figures), a ratio indicating the vulnerability of capital and reserves to NPEs, falling to less than 40% following this sale, from above 150% in 2015, when the bank carried peak legacy NPEs on its balance sheet.

A residual risk is the bank's €1.4 billion of accumulated foreclosed property, representing around 70% of shareholders' equity as of June 2021. Partly mitigating the risk of losses upon disposal of these properties are the buffers that the bank has built on its balance sheet, given that it on boards assets at a 25%-30% discount from the current prices. However, potentially unfavorable (to creditors) changes in the foreclosure framework pursued by Cypriot authorities risks lengthening the foreclosure process and negatively affecting the recovery value of collateral.

## Endnotes

**1** The bank ratings shown in this report are Bank of Cyprus' deposit rating and Baseline Credit Assessment.

**2** On a transitional basis.

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## New regulations will strengthen Tanzanian banks governance

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On 10 November, Bank of Tanzania (BoT), the central bank, published [banking and financial institutions corporate governance regulations](#) that detail the appointment, responsibilities and terms of banks' boards of directors and senior management, among other governance issues. The requirements are credit positive for [Tanzania's](#) (B2 stable) banks because they will enhance their management quality and corporate governance.

The regulations introduce a 10-year term limit for bank board members and CEOs<sup>1</sup>. Term limits will reduce the risk that underperforming CEOs or board members become entrenched, and will likely enhance succession planning for banks. Among the Tanzanian banks we rate, [CRDB Bank Plc](#) (B2 stable, b2<sup>2</sup>) appointed its CEO in 2018, while [NMB Bank Plc's](#) (B2 stable, b2) CEO was appointed in 2020.

The regulations also bar former board members and CEOs from appointment to comparable roles in a Tanzania-based bank, bank subsidiary or other type of financial institution for a period of three years after the conclusion of the last appointment. This restriction will limit people from holding board seats simultaneously at multiple financial institutions, which often results in questionable related-party lending. At the same time, BoT is limiting insider lending total exposure – directly or indirectly – at 25% of a bank's core capital and all insider loans must be made on a secured basis, limiting losses in the event of default.

A board must have a minimum of two independent directors, and those directors must possess relevant experience in banking, finance, accounting, auditing, law or economics. In addition, banks must carry out induction and training programmes for directors. Relevant expertise and training will enhance board members' capacity to properly assess management decisions and strategy, interpret financial statements and evaluate the effect of relevant laws and regulations on bank operations.

BoT has strengthened boards' effectiveness by requiring banks to carry out periodic performance assessments of boards, committees and board members. Although optional, these assessments can be conducted by external, independent parties, providing objectivity, fresh perspectives and an ability to compare performance with peers. Additionally, board members will be required to attend at least 75% of the board meetings in a year. These requirements will reduce the risk of disinterested board members and strengthen a board's oversight capacity.

Weaker board oversight and lapses in underwriting processes at some Tanzanian banks has contributed to banks' high assets risks. On 7 November, following a review of banks' nonperforming loans (NPLs), BoT cited as root causes of high NPLs at banks the granting of loans by bank officers without following procedures and fraud or corruption or other practices that are tantamount to lack of integrity. Although lower than Kenya's 14.6%, Tanzania's NPL ratio was 8.7% as of March 2021, which is higher than the ratios of banks in Uganda (5.3%) and Rwanda (4.4%). Adherence to policies and processes is particularly important given Tanzanian banks' high proportion of loans to households and small and midsize enterprises, which account for 37% of total loans. NPL ratios at the banks we rate are lower than the system average at 3.8% for NMB and 3.5% for CRDB as of September 2021.

Despite the new regulations, there is more to do to strengthen governance regulations and align with global best practices. For example, two independent board members may not provide sufficient independence at large boards. As well, the minimum board size of five members exposes small and midsize banks to the risk of domineering executives who tend to be founders or family members. CRDB's board has 13 members, while NMB has nine, and we believe these sizes do not expose the boards to domination by individual directors. Additionally, these boards are not so large that individual contributions are diluted and decision-making is incohesive.

### Endnotes

<sup>1</sup> There is a two-year moratorium for board members and CEOs that have already served for 10 years

<sup>2</sup> The bank ratings shown in this report are the bank's deposit rating and Baseline Credit Assessment

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## Manulife's US variable annuity reinsurance deal with Venerable is credit positive

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On 15 November, [Manulife Financial Corporation](#) (MFC), holding company to [The Manufacturers Life Insurance Company](#) (insurance financial strength A1 stable), announced that it had reached an agreement with private-equity firm Venerable Holdings Inc., whereby Venerable will assume more than 75% of MFC's legacy US variable annuity (VA) block. The transaction is credit positive for both MFC and its wholly owned subsidiary, [John Hancock Life Insurance Company \(U.S.A.\)](#) (insurance financial strength A1 stable), which wrote the business, because it will reduce consolidated interest rate and equity risk as well as earnings volatility. Additionally, the reinsurance deal will significantly reduce MFC's exposure to guaranteed VA values. However, a consequence for MFC of the transaction is lower earnings and counterparty risk.

As of 30 September, the VA block, which consists primarily of certain legacy VA policies with guaranteed minimum withdrawal benefits (GMWB), that Venerable is assuming equaled approximately 76% of MFC's US VA guaranteed account value, including approximately 143,000 policies with a GMWB rider and 20,000 policies with a guaranteed minimum death benefit (GMDB) rider. At year-end 2020, John Hancock's total US statutory VA statutory account value was just over \$30 billion (excluding intercompany business ceded to Bermuda), or about 10% of its almost \$300 billion of general and separate account liabilities. MFC said that the transaction could reduce by about 10% the net potential effect (after hedging) on its total consolidated net income attributed to shareholders.

The transaction is also an important step in MFC's quest to reduce its exposure to higher-risk legacy blocks at John Hancock, which also includes guaranteed universal life insurance policies (CAD28 billion) and long-term care business (approximately CAD29 billion of gross statutory reserves). The parties expect the transaction to close in the first quarter of 2022. Additionally, MFC expects to release approximately CAD2 billion of capital as a result of the transaction, which will consist of a gain of CAD750 million that will be recorded at closing, and the release of CAD1.3 billion in net Life Insurance Capital Adequacy Test capital.

Concurrently, MFC announced its intention to use up a significant portion of this released capital by increasing the number of shares it may purchase for cancellation under its previously proposed normal course issuer bid (NCIB), which is subject to approval by Canada's Office of the Superintendent of Financial Institutions and the Toronto Stock Exchange. The NCIB increase to 97 million common shares is 5% of MFC's issued and outstanding common shares as of 31 October 2021, which is up from the initial proposal of 2%, and aims to neutralize the effect that the reduced earnings will have on MFC's earnings per share. This return of capital is shareholder friendly, but for bondholders is credit negative.

Since the transaction uses reinsurance instead of a true sale of the VA block, it exposes MFC to counterparty risk. Under the terms of the agreement, John Hancock's reinsurance obligations will be secured by Venerable in a comfort trust, with assets in excess of statutory reserve requirements, and an initial deposit of approximately \$1.3 billion of assets to be transferred by Venerable to the trust on closing. This arrangement should help reduce potential counterparty risk to Venerable in the event that Venerable encounters stress and the liabilities are "recaptured," or returned to John Hancock. MFC plans to continue to administer the policies, helping to smooth the transition for policyholders in a transaction that can otherwise be disruptive.

While this business is profitable, it is also volatile, and MFC expects the transaction to reduce its annual net income attributed to shareholders by approximately CAD200 million (on a Canadian IFRS basis). However, the effect will decline as the book runs off. Additional details of the deal's structuring, which are key to understanding other risks to MFC, were not disclosed, including the US statutory effect on John Hancock's earnings, which is a key driver of its dividend capacity to MFC, or its regulatory risk-based capital ratio. Moreover, the companies did not provide details on how MFC plans to unwind its existing VA hedges, which could lead to additional losses.

This transaction continues an industrywide trend, whereby insurance companies exit VA legacy businesses that they consider volatile and interest rate sensitive (see exhibit).

Exhibit 1

## Recent variable annuity transactions

Date of Transaction	Buyer	Buyer Type	Seller	Target Business	Credit Implications for Seller	Deal Structure
11/15/2021	Venerable Holdings Inc.	Private Equity	Manulife Financial Corporation	U.S. Variable Annuity block	Positive	Reinsurance
9/21/2021	Fortitude Re. Co. Ltd.	Private Equity	Prudential Financial Inc.	Prudential Annuities Life Assur. Corp. (Variable Annuities)	Positive	Sale
10/27/2020	Venerable Holdings Inc.	Private Equity	Equitable Holdings, Inc.	Variable annuity business and reinsurance entity	Positive	Reinsurance

Sources: The companies and Moody's Investors Service

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## Bulgaria's parliamentary election outcome increases chances to break political stalemate, a credit positive

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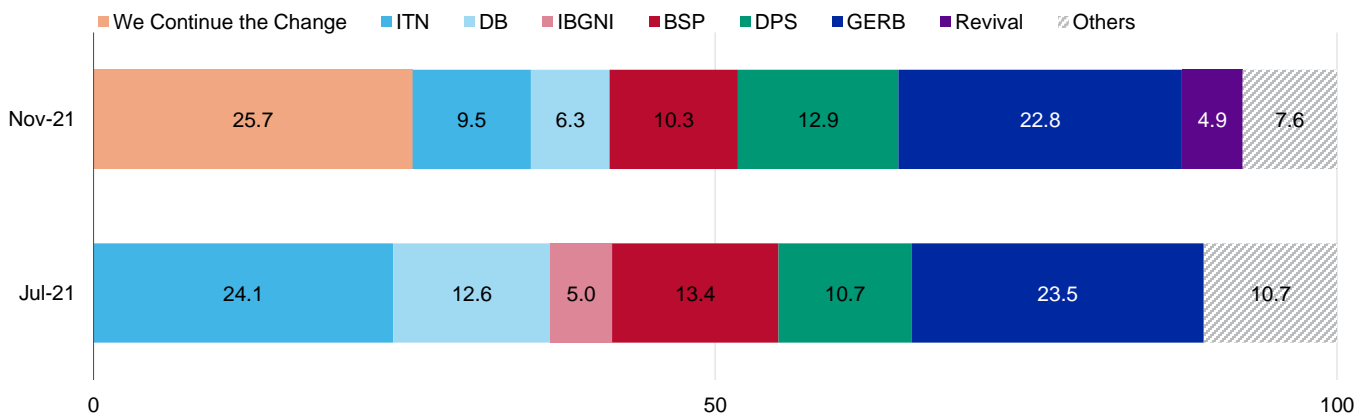
On 14 November, the preliminary results of [Bulgaria's](#) (Baa1 stable) general election suggest an increased likelihood of forming a governing coalition, after two rounds of inconclusive outcomes earlier this year.

The vote yielded a surprise victory for the recently formed centrist, anti-corruption We Continue the Change (WCC) party. The WCC party is led by two former ministers from the caretaker government, which won 25.7% of the vote, according to preliminary results (see Exhibit 1). The outgoing center-right GERB led by former prime minister Boyko Borissov came in second with 22.8%, slightly down from 23.5% in July. The anti-establishment party, There are Such People (ITN), which came in first at the July vote, won less than 10% of vote after failing to form a coalition.

Exhibit 1

### We Continue the Change emerged as the surprise winner in the November vote

Preliminary results, % of the popular vote



Preliminary results with 99.51% of the votes counted.

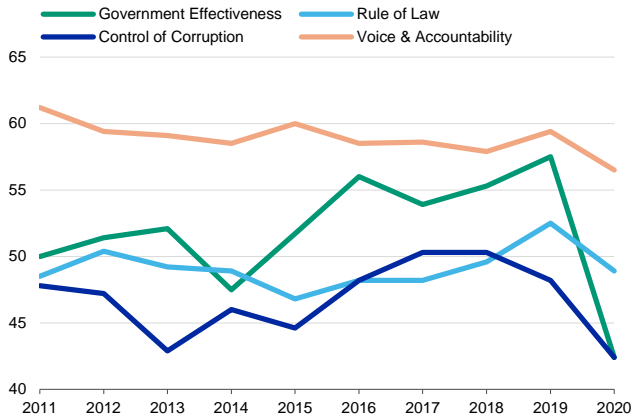
Source: Bulgaria's Central Electoral Commission

The WCC's strong performance opens the door to a broad coalition including ITN, center-right DB and left-wing BSP. We expect a swift start of the negotiations toward a new governing coalition. The coalition will have to tackle important legislative priorities, including passing the 2022 state budget and addressing a deteriorating health situation, with Bulgaria having the lowest vaccination rate in the European Union.

Bulgaria also held presidential elections, in which incumbent Rumen Radev won about 49.5% in the first round, well ahead of the GERB-supported candidate, who won 22.9%.

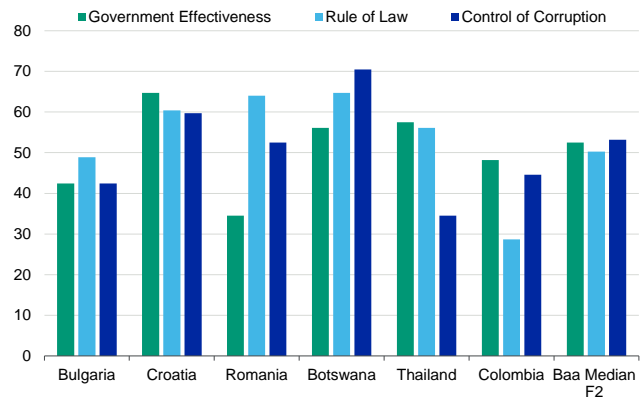
A new government with a legislative majority would facilitate the finalization of Bulgaria's NextGen EU plan, which was submitted to the European Commission in mid-October. The plan, under which Bulgaria requested €6.6 billion (10.8% of 2020 GDP) has the potential to boost growth and provide an important medium-term policy anchor in a wide set of policy areas, including green transition, digitalization and social inclusion. It includes a series of investment projects and reforms to which the funding will be tied, making the ability to carry out the ambitious reform agenda a critical component to receiving the funds. WCC was elected following a strong anti-corruption campaign, raising expectations that the party will prioritize institutional reforms to improve the rule of law and control of corruption. According to World Bank indicators, Bulgaria's performance has been deteriorating since 2019 (see Exhibits 2 and 3).

Exhibit 2  
**Progress with regards to the rule of law and judicial institutions has stagnated and partially reversed**  
 Percentile rank based on Moody's rated universe



Sources: The World Bank and Moody's Investors Service

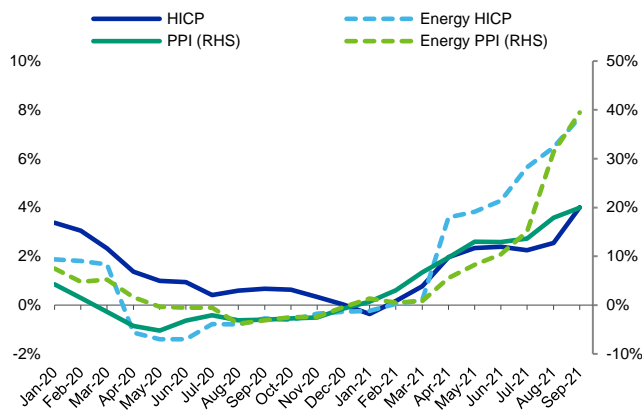
Exhibit 3  
**Bulgaria ranks below global peers with regards to control of corruption and rule of law**  
 Percentile ranks based on Moody's rated universe (2020)



F2 refers to Factor 2 of the Moody's Sovereign Ratings Methodology, which measures Institutional and Governance strength  
 Sources: The World Bank and Moody's Investors Service

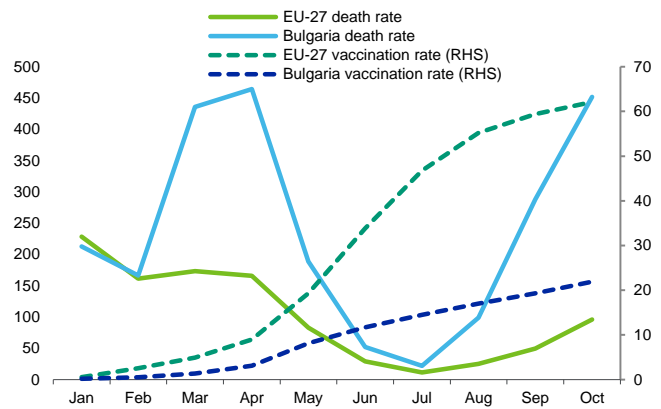
Despite an increased chance of breaking the political stalemate that has paralyzed policymaking in recent months, WCC will have to manage a complex coalition in a highly fragmented political landscape. Therefore, we expect the future coalition to be fragile and subject to change in sentiment. Bulgaria is also facing a deteriorating economic outlook with soaring energy prices (see Exhibit 4) and a surge in COVID-19 cases as vaccine hesitancy has kept vaccination levels under 25% of the total population, the lowest rate in the EU (see Exhibit 5).

Exhibit 4  
**Rising energy prices have been driving inflation higher in recent months**  
 Harmonized Consumer Price Index, % yoy change (LHS), Producer Price Index, % yoy change (RHS)



Sources: Eurostat and Moody's Investors Service

Exhibit 5  
**Low vaccination rates leaves Bulgaria highly exposed to a surge in COVID-19 cases**  
 COVID-related death rate, per million (LHS), vaccination rate, % (RHS)



Source: Mathieu, E. et al. Global database of COVID-19 vaccinations. Nat Hum Behav (2021)

A failure to build a stable coalition would prolong the current political gridlock, increase fiscal pressure and potentially slow the absorption of EU funding. In the medium term, it would also hamper reforms in key areas identified by the European Commission, including the labour market, social inclusion and health services, but also in areas such as the effectiveness of the judicial system and the fight against corruption.

However, even in that case, we do not expect major changes in Bulgaria's stance on key policy areas such as euro area accession and prudent macroeconomic management. Memories of the 1997 economic and financial crisis remain strong among policymakers and voters, underpinning the national consensus around a strong and credible currency board. In early July, the caretaker government confirmed Bulgaria's intention to adopt the euro in January 2024.

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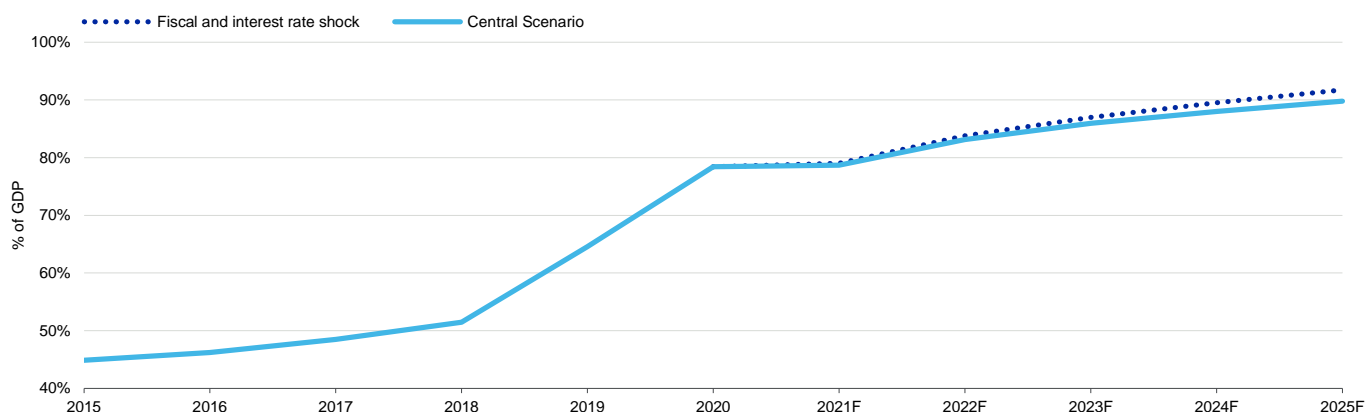


## South Africa's midterm budget statement achieves tight balancing act, but fiscal risks remain elevated

On 11 November, the government of [South Africa](#) (Ba2 negative) released its medium term budget policy statement (MTBPS), with revised fiscal targets for fiscal 2021 (ending 31 March 2022). The government raised its revenue<sup>1</sup> expectations for fiscal 2021 by 10% (or 2% of GDP) compared to its February 2021 budget statement, allocating nearly half of the extra revenue to deficit reduction and the remainder for financing additional spending on social and economic priorities. By doing so, it managed to preserve both fiscal credibility and support to the economy. The government is also projecting narrower fiscal deficits in fiscal 2022-24, although those revisions are smaller than for fiscal 2021.

Narrower deficits will slow the rise in government debt, but higher than currently planned spending is a key source of risk. We project debt will continue to rise for the foreseeable future, reaching 90% of GDP by fiscal 2025 (see Exhibit 1).

### South Africa's debt will remain on an upward trajectory



Our standard combined shock corresponds to a shock equivalent to 0.5 standard deviations (calculated over a 10-year period) to the primary balance and interest rate. For South Africa, this corresponds to a 0.3 percentage point shock to the primary balance and 0.5 percentage points to the interest rate. From 2019 onward, we include guarantees to state-owned enterprises.

Source: Moody's Investors Service

The government revised its revenue target following two main developments. First, its revenue collection in fiscal 2020 was 3% higher than expected in the February budget (although still down 8% compared to the year before), which has a base effect in fiscal 2021. Second, higher commodity prices in 2021 have boosted earnings and taxes paid by corporates in the commodities sector.

The government allocated almost half of its extra revenue to reducing the budgeted fiscal 2021 deficit to 7% of GDP from 9% budgeted in February (and 10% in fiscal 2020). The remainder has served to finance spending in health, social protection, employment and security, which became critical in July following [violent protests](#). However, an upward revision in GDP following rebasing (which took place between the two budget exercises) and higher-than-forecast growth accounted for 1% of GDP of the improvement in the deficit.

The MTBPS also lowers the fiscal deficit targets for fiscal 2022-24, relying on two prudent assumptions. The National Treasury assumes that the revenue windfall in fiscal 2021 is mostly a one-off and will therefore not carry over into subsequent years. It also projects low nominal GDP growth of 2.9% in fiscal 2022, 5.5% in fiscal 2023 and 6.3% in fiscal 2024.

Despite the prudent macroeconomic assumptions underlying the government's budget revisions, the usual risks from state-owned enterprise (SOE) support (including to the national electricity company, [Eskom Holdings SOC](#) [Caa1 negative]) higher interest rates and the wage bill remain.

Moreover, risk of renewed social tensions requiring further government spending has resurfaced and will remain for some time. Unwinding the social measures financed by the revenue windfall this year will be challenging. There have been no fundamental changes to social protection programmes, despite earlier talks within the ruling African National Congress (ANC) party regarding a universal basic income. In case of any reform, we think it likely that the government will make it budget-neutral, at least at the onset of the reform.

Finally, the government's debt burden will remain on an upward trajectory through the medium term, even if rising at a slower pace than we or the government had previously projected. Indeed primary deficits will persist over the coming years while the government's interest rate on debt will likely remain well above GDP growth.

## Endnotes

<sup>1</sup> All fiscal data discussed are for the main budget, a sub-set of the consolidated government, and where the deficit is covered by debt.

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# COP26 pledges point to accelerated energy transition; implementation is key hurdle

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Governments, financial institutions and companies made a series of pledges before and during the recent COP26 UN climate conference that add to increasing momentum toward a more rapid energy transition than previously expected. In particular, growing collaboration between state and non-state actors has the potential to significantly accelerate the pace of the transition. For example, the UN-backed Race to Zero Campaign now has nearly 7,000 non-state actors committed to halving emissions by 2030, including many major financial institutions. If these commitments lead to the implementation of actionable steps, policies and interim targets to achieve a rapid energy transition, there would be broad credit implications across rated sectors and the global economy.

**New pledges, if implemented, would put the world on a more rapid path toward decarbonisation.** Unilateral pledges and multilateral agreements from countries before and during the COP26 conference provide additional momentum toward energy transition, and will lead to an acceleration in the transition pace if followed by tangible actions and interim steps. However, actionable interim steps, particularly those that focus on plans to reduce emissions this decade, will be major factors in assessing the credit implications of these high-level commitments.

Notable announcements by countries include:

- » **Net-zero pledges:** [India](#) (Baa3 stable) committed to reach net-zero emissions by 2070. The announcement follows earlier commitments by the [US](#) (Aaa stable) and the [EU](#) (Aaa stable) to reach net-zero greenhouse gas emissions by 2050; [China](#) (A1 stable) has pledged to reach carbon neutrality by 2060.
- » **Coal phaseout:** At least 23 countries have made new commitments to phase out coal power, including five of the world's top 20 coal power-using countries.
- » **Methane emissions:** More than 100 countries joined a coalition led by the US and the EU to cut 30% of methane emissions by 2030.

In addition, the final text of the multilateral agreement reached at the conclusion of the conference referred to an acceleration of "efforts towards the phase-down of unabated coal power and inefficient fossil fuel subsidies," as well as a commitment by all countries to revisit and strengthen their 2030 emissions targets, known as Nationally Determined Contributions (NDCs), next year.

**Shifts in financing flows will likely become a significant credit transmission channel.** The increasing commitments from the financial sector also reinforce the momentum toward a more rapid transition. Banks and asset managers representing 40% of the world's financial assets pledged to align their portfolios with science-based net-zero targets.

These commitments indicate that shifts in financing flows toward carbon-neutral or carbon-negative sectors and technologies and away from carbon-intensive ones will likely become an important credit transmission channel. If the financial sector implements these commitments, pressures will increase on public and private-sector entities that rely on emissions-intensive activities as a source of revenue.

We estimate that G-20 financial institutions collectively have nearly \$22 trillion in exposure to carbon-intensive sectors, which represents 20% of their total portfolios, on average. In addition, banks and asset owners will serve a prominent role in funding decarbonisation technologies bringing new business opportunities for them. At the same time, investments in new and unproven technologies will also entail risks.

**More rapid transition would increase credit pressure for many sectors and entities.** A more rapid energy transition would raise credit pressures for carbon-intensive sectors and countries, as it would threaten existing business and economic models for some of

them and require substantial strategic shifts. These include higher capital spending for deploying and researching cleaner and more-efficient energy options, and wholesale transformation of hydrocarbon-reliant sovereigns' economies.

At the same time, an accelerated energy transition could also unlock significant investment opportunities in new technologies. Decarbonisation of carbon-intensive sectors will necessitate investment in emerging technologies such as green hydrogen, biofuels, battery storage and critical minerals, as well as carbon capture, storage and utilisation.

Companies that are at the forefront of clean energy investment and innovation will likely benefit from increasing government support, and will have sizable market share potential if these technologies prove commercially viable. Energy transition represents a \$45 trillion investment opportunity globally over the next two decades, according to Moody's Analytics estimates.

**Credit pressure will remain modest for many countries and sectors unless commitments are reinforced with substantial action.** Credit pressure from the energy transition are at present modest and manageable for most countries and sectors, as the pace of policy and market shifts substantially lags the ambition of commitments made and initiatives announced.

We use scenarios to assess the credit implications of carbon transition risk, including in our carbon transition assessment (CTA) scores for nonfinancial companies. These scores identify the risks to individual debt issuers in carbon-intensive sectors from the transition to a lower-carbon economy.

As a baseline scenario for assessing the credit implications of the energy transition, we use a decarbonisation pathway that is consistent with the International Energy Agency's (IEA's) Stated Policies Scenario (STEPS). This scenario, which is updated annually, does not take it as a given that governments will reach all announced goals. It includes NDCs, together with a more granular, sector-by-sector look at what has been put in place to reach these and other energy-related objectives. STEPS takes into account not only existing policies and measures, but also those under development.

In addition, as a test of rated entities' resilience to a more accelerated decarbonisation pathway, we also use a second scenario consistent with the IEA Sustainable Development Scenario (SDS). The SDS is a more rapid emissions reduction pathway than STEPS and is compatible with the Paris Agreement goal of staying "well below" 2°C of global warming by the end of this century. In this scenario, all current net-zero pledges are achieved in full and extensive efforts are put in place to realise near-term emissions reductions. Under the SDS, advanced economies would reach net-zero emissions by 2050, China around 2060, and all other countries by 2070 at the latest. Without assuming any net-negative emissions, this scenario is consistent with limiting the global temperature rise to 1.65°C (with a 50% probability).

Policies and regulations currently in place still fall short of what is required for meeting most of the long-term commitments that countries have made, as well as the temperature goals of the Paris Agreement, which were renewed in Glasgow. As a result, our baseline expectations for the pace of carbon transition remain anchored around the STEPS scenario, the implications of which are captured in our ratings and assessed in our CTA scores.

The new announcements, however, have increased the likelihood of a more rapid energy transition scenario becoming a reality. Using newly released numbers by the IEA, we estimate that successful implementation of the new pledges, would cover 70% of the emissions reductions needed to reach SDS annual CO<sub>2</sub> emissions by 2050, as Exhibit 1 shows. Pre-COP26, that figure was about 50%. It is worth noting that a scenario that previously was used mainly as a theoretical exercise, such as SDS, is gradually becoming a more real-world possibility.

## New COP26 pledges have increased the potential of reaching SDS by 2050

Comparison of IEA projections for CO2 emissions and global warming if announced pledges are fully implemented, both before and after COP26 announcements

Scenario	Net CO2 emissions by 2050 (GtCO2)	% of the way to SDS*	Implied global warming by 2100**
Baseline scenario (IEA Stated Policies Scenario)	33.90	0%	2.6 C
IEA Announced Pledges Scenario (pre-COP26)	20.73	51%	2.1 C
IEA Announced Pledges Scenario (4 November)	15.90	70%	1.8 C
IEA Sustainable Development Scenario	8.17	100%	1.6 C

\* Difference in emissions between the baseline scenario and the Sustainable Development Scenario (SDS). \*\* Median global temperature increase above the 1850–1900 average, with 50% probability.

Source: International Energy Agency and Moody's Investors Service

If the implementation of new policies and initiatives accelerate the pace of transition, this would likely be reflected in changes to the STEPS scenario and in our assessment of the likelihood of a more rapid longer-term transition as represented by the SDS scenario. This would undoubtedly increase the credit implications of transition for many debt issuers. For example, using Component D of our CTA scores, which gauges the readiness of issuers for a rapid carbon transition as laid out by the SDS scenario, we estimate that almost half of scored companies (which includes some of the largest companies in their sectors) currently are not well-positioned for a rapid carbon transition scenario. A significant concentration of these companies is in the oil and gas and airlines industries, underscoring the vulnerability of carbon-intensive sectors to a potential acceleration of transition in line with country pledges.

The pace of the transition will not be uniform and will vary by sector and region depending on the evolution of regulation and technology in different industries. For example, the pace of change – and the associated credit impact – is much more visible in the power and auto sectors in the EU and the [UK](#) (Aa3 stable) than it is in Asia.

Among industries, auto manufacturing is one of the best examples of fast adjustment to rapid energy transition. Many global automakers are successfully executing strategies to decarbonise their fleets at a pace faster-than-expected than even 2 years ago. European automakers, for example, have set forth plans that indicate an electric vehicle adoption rate that is far ahead of what is expected through regulations. As a result, we have scored 18 out of 19 global automakers as well-positioned for Component D under our CTA framework. Nevertheless, electric vehicles currently account for only a relatively small percentage of global auto unit sales and there remain significant execution risks for the sector.<sup>1</sup>

Among hydrocarbon-reliant sovereigns, institutional and financial capacity to adjust by diversifying economic activity and revenue sources away from hydrocarbons varies greatly and is reflected in our ratings. For example, availability of financing may constrain the ability of emerging market countries to adjust their economies, with varying capacity to fund these investments from domestic capital markets.<sup>2</sup>

## Endnotes

<sup>1</sup> See [Carbon Transition - Global: As Paris Agreement goals challenge large emitters, some sectors are making progress](#), 4 November 2021.

<sup>2</sup> See [Sovereigns - Emerging markets: Concessional and market-based financing vastly undershoots climate-resilience funding needs](#), 26 October 2021.

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# Changing migration trend in CEE and Baltics will ease but not offset economic and fiscal pressure from ageing

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Migration patterns in Central and Eastern Europe (CEE) and the Baltics were changing before the coronavirus outbreak from emigration to immigration, and we expect that the pandemic disruption to migration flows will not alter this long-term, structural trend. However, the shift from emigration to immigration in the CEE-Baltics will alleviate rather than offset the impact of declining working age populations on the growth potential and economic strength of most sovereigns in the region. The effects on limiting increasing costs of pensions and ageing will be highly limited.

- » **Pre-pandemic shift reversed decade-long trend of net emigration from the region.** Falling emigration and higher immigration from neighbouring non-EU countries saw most of the eight countries that joined the [EU](#) (Aaa stable) in 2004<sup>1</sup> reverse historic emigration flows in 2017-19. [Croatia](#) (Ba1 stable), [Romania](#) (Baa3 stable) and [Bulgaria](#) (Baa1 stable) lag behind the former countries but also saw migration trends improve in 2018-2019.
- » **Current trends have structural drivers and are unlikely to be derailed by the pandemic.** While the pandemic disrupted migration flows for some in 2020, we expect that the trend of increasing net immigration will persist as the key drivers are structural, principally a continued narrowing of wage gaps with western Europe and a stricter post-Brexit immigration regime in the [UK](#) (Aa3 stable).
- » **Migration shift will alleviate but not offset economic and fiscal pressure from ageing.** For all bar the [Czech Republic](#) (Aa3 stable), [Estonia](#) (A1 stable) and [Slovenia](#) (A3 stable), immigration is likely to slow rather than prevent the decline in working-age populations driven by ageing, which is a key constraint on economic strength and credit profiles in the region. Moreover, higher immigration will only have a negligible impact on reducing the cost of ageing for sovereigns such as [Slovakia](#) (A2 stable), Slovenia and Romania that face the greatest increases on pension spending.
- » **Ageing in neighbouring countries and anti-immigration sentiment could slow migration trends.** A decline in the working-age populations of both EU and non-EU neighbouring countries together with sceptical attitudes to non-EU immigration can also limit the supply of immigrant labour.

[Click here](#) for the full report.

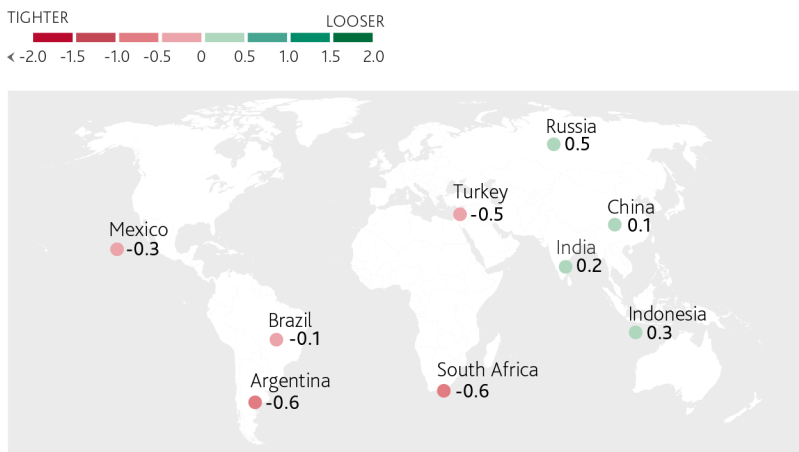
## Endnotes

<sup>1</sup> The Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Slovakia, Slovenia

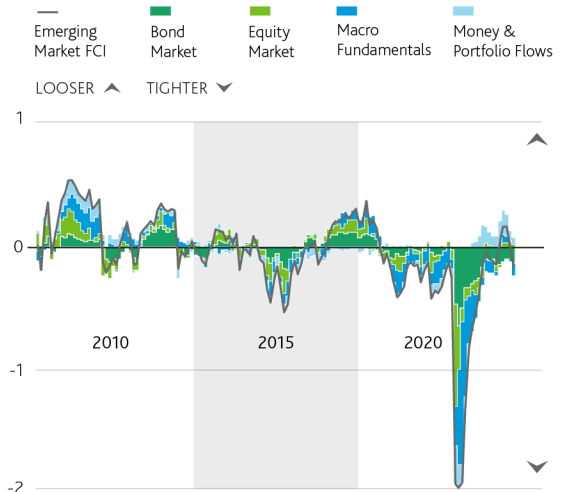
# November 2021 Emerging Markets Financial Conditions Monitor

Financial conditions in emerging markets improved in October relative to September and August, but are still tighter than the long-term average. Financial conditions have deteriorated noticeably in Turkey, tightened further in South Africa and improved in Indonesia and China. Inflation remains above target in most major EM economies. [Click here](#) for the full report.

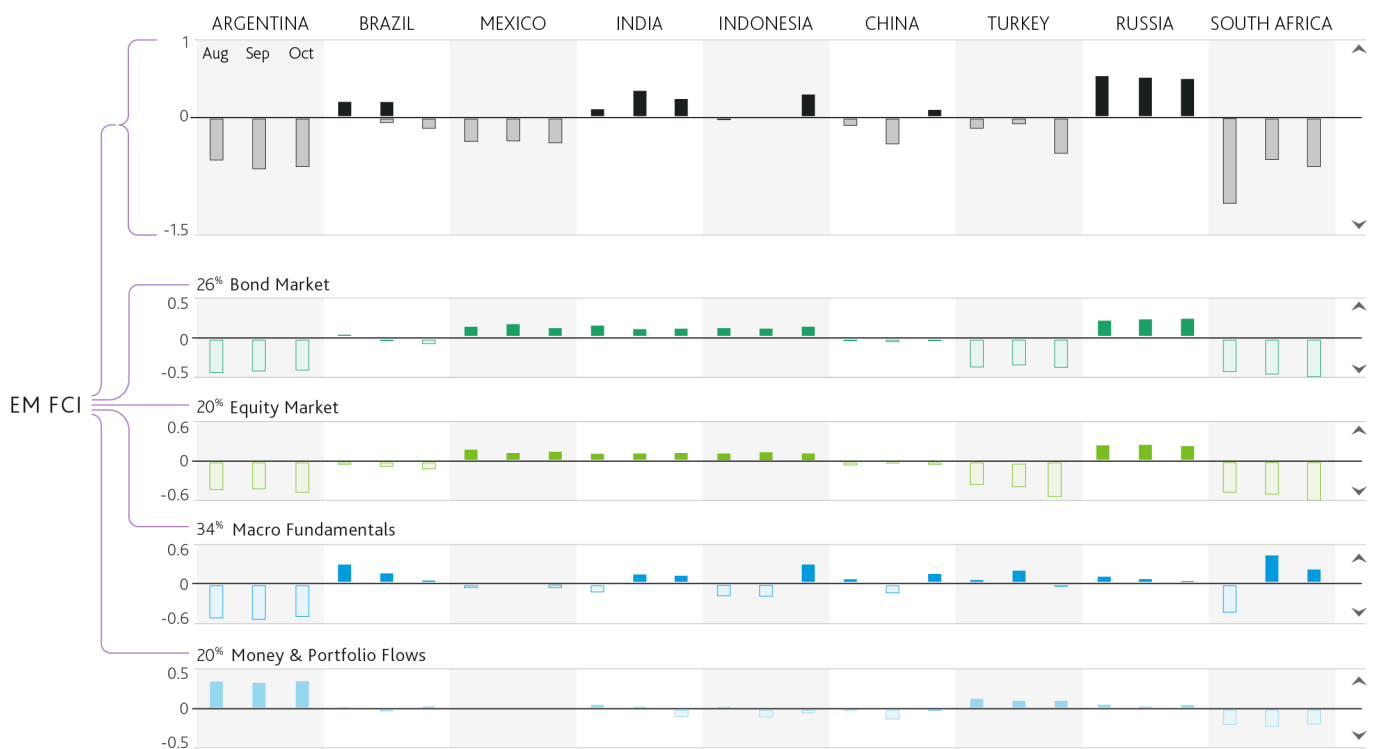
## Emerging Market Financial Conditions in October



## EM FCI trends – longer term view



## 3 month ( Aug-Sept-Oct) view of FCI by Country



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