FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Bank of Africa at 'BB'; Outlook Stable

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Fitch Ratings - London - 15 Feb 2021: Fitch Ratings has affirmed Bank of Africa's (BOA) Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDRs) at 'BB' with a Stable Outlook. Fitch has also affirmed BOA's Viability Rating (VR) at 'bb-'. A full list of rating actions is below.

KEY RATING DRIVERS

IDRS, NATIONAL RATINGS, SUPPORT RATING AND SUPPORT RATING FLOOR

BOA's IDRs, National Ratings (NR), Support Rating (SR) and Support Rating Floor (SRF) are driven by a moderate probability of support from the Moroccan sovereign (BB+/Stable). The Stable Outlook on the Long-Term IDRs mirrors that on the sovereign rating of Morocco.

Fitch believes the Moroccan authorities' propensity to support the banking sector remains high. This considers the role the banking sector plays in

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financing the economy and the authorities' drive to preserve financial stability as the country implements its economic-development plans.

BOA is the third-largest Moroccan bank with a market share of approximately 13% of loans and deposits at end-9M20. It is classified as a domestic systemically important bank (DSIB) in Morocco, and Fitch believes the authorities would have a high propensity to support BOA if required. However, our view of the overall probability of support considers limitations of the sovereign's financial flexibility (in view of widening fiscal deficits and a rising government debt/GDP to 68.5% in 2021 from 56.4% in 2019), which is reflected in the SRF being notched down from the sovereign rating.

VR

The VR of BOA considers its solid franchise in Morocco and pan-African presence, which brings diversification benefits to its business model but also exposes it to less developed and more volatile operating conditions. Its stable performance record and fairly strong funding and liquidity are counterbalanced by its weak capital position and asset-quality pressures heightened by the pandemic fallout.

We expect operating conditions for banks to remain challenging in 2021 compared with pre-pandemic. After an expected GDP contraction of 6.5% in 2020, Fitch expects Morocco's GDP to grow 5% in 2021, although we see some downside risks to macroeconomic performance from the uncertainty surrounding the future course of the health crisis. As a result of the contraction in domestic output, formal unemployment rose to 11.9% at end-2020 from 9.2% at end-2019.

Pandemic-related support measures, including loan moratoria to customers, which expired at end-June 2020 for most sectors, and extension of state-guaranteed loans for a total amount of about MAD55 billion (end-2020: equivalent to 6% of sector loans) have supported sector growth and limited, to some extent, the negative impact on banks' asset-quality metrics. We expect the underlying deterioration in loan quality to continue to feed through reported metrics in 2021, while a weaker-than-expected economic recovery could lead to sharper deterioration.

BOA is a universal commercial pan-African bank based in Morocco (end-1H20: 62% of total assets). It has a strong franchise in its home market, although its market share is below that of the other two D-SIBs. BOA operates across 20 African countries, underpinning its ability to serve continental trade flows. It was rebranded Bank of Africa in 2020 (previously known as BMCE Bank S.A.) to emphasise its pan-African commitment. Net income contribution from Moroccan and African operations was equally balanced in 1H20.

Tight capital ratios have constrained BOA's lending growth, resulting in the bank's various capital-raisings in recent years. In 2020, Damane products in Morocco (end-2020: MAD6.8 billion; equivalent to 4% of end-9M20 consolidated gross loans) underpinned loan growth (9M20: 2.7%). These loans were granted with up to a two-year grace period to companies negatively affected by the pandemic, and benefit from a state guarantee partly mitigating credit risks. Growth from the bank's international operations was more subdued in 2020.

BOA intends to grow higher-risk SME lending across all markets in the medium term, in line with governmental policies to support the SME segment. However, it intends to maintain a cautious approach until economic conditions improve, by focusing on the large corporate segment, retail mortgages and state-guaranteed loan products in Morocco.

The bank's impaired loans ratio (end-1H20: 9.5%) has gradually deteriorated in recent years and is above that of other Moroccan D-SIBs. The higher non-performing loan (NPL) ratio in BOA's African operations weighs on our asset-quality assessment. Its Stage 2 loans ratio is increasing (end-1H20: 8.6% of gross loans; end-2019: 8.2%) but broadly in line with the average of Fitch-rated Moroccan banks. Total reserve coverage of NPLs (85%) is reasonable but slightly below most peers'.

Asset quality was also negatively affected by the impact of the pandemic on SMEs' and retail borrowers' debt-servicing ability. BOA deferred interest and principal payments falling due in 1H20 for MAD21 billion of loans (11% of gross loans) for coronavirus-related reasons. Although a high majority of loans were performing at end-2020, we believe this portfolio carries high seasoning risk and remains highly sensitive to the course of the health crisis and potential further restrictions on mobility, particularly for transportation- and tourism-related exposures.

Fitch's base case expects the bank's stage 3 loans to increase to around 12% of gross loans by end-2022, driven by persisting pressures on borrowers' debt-servicing ability as support measures expire.

BOA has historically performed in line with most peers, due to a stable and adequate net interest margin (NIM; 9M20: 3.5%) and fee income contribution from its international network. However, operating profitability was dented by a one-off contribution of MAD1 billion to the country's Covid-19 fund, as for other local banks. Operating profit/risk-weighted assets (RWAs) in 1H20 was 0.7%, and 1.5% excluding the contribution.

The cost of risk also rose above historical average (9M20: 1.8%; 2019: 1.1%), partially reflecting the front-loading of provisions set aside due to revised inputs in IFRS 9 models. We expect operating profitability to recover to 1.3%-1.6% of RWAs in 2021-2022, supported by the absence of one-off costs and improving business conditions, which will help non-interest revenues. However, it should remain slightly below historical average due to a still high cost of risk, uncertain recovery prospects on problem loans and lower interest rates.

Capitalisation is a rating weakness for BOA despite various capital-boosting initiatives in 2019 (MAD3.6 billion) and 2020 (MAD1 billion). Its core equity Tier 1 (CET1) ratio of 8.8% at end-1H20 (end-2019: 9.5%) is lower than most domestic-rated peers' and managed tightly against minimum requirements (7.5% for the CET1 ratio until June 2022; 8% excluding this temporary regulatory forbearance). Unreserved Stage 3/CET1 was a low 12% at end-1H20 but the stock of foreclosed assets (equivalent to 14% of equity at end-1H20) also weighs on our assessment.

BOA plans further capital-strengthening measures in 2021, such as further rights and additional Tier 1 (AT1) debt issues. It should provide the bank with increased capital cushions over relaxed minimum regulatory requirements.

Total regulatory capital at BOA is higher (end-1H20: 12.1%) than its CET1 ratio, underpinned by a buffer of AT1 and Tier 2 subordinated debt (a combined 310bp of RWAs at end-1H20). Pre-impairment profitability (9M20:

an annualised 2.7% of gross loans; 2019: 3.1%) also provides a healthy buffer to absorb losses through the income statement.

We view BOA's funding and liquidity profile as a rating strength. Its loans/deposits ratio (end-1H20: 96%) is below that of most peers and historically below 100%. The bank's funding is primarily sourced from largely short-term, granular and stable customer deposits (69% of total funding), resulting in low single-name concentration. Moroccan deposits (65% of customer deposits) largely comprise low-cost current and savings accounts (79% of total domestic deposits).

Liquidity is well-managed and the bank maintains a healthy stock of Basel III high-quality liquid assets (end-1H20: 12% of total assets or 20% of total customer deposits). Its regulatory liquidity coverage ratio (LCR) was an adequate 146% at end-1H20 (versus a minimum requirement of 100%), although it was down from 254% at end-2019, reflecting an increase in central bank funding in 1H20. International subsidiaries are self-funded and in general have liquid balance sheets supported by a high proportion of assets in cash and equivalents and local-currency sovereign securities.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to negative rating action/downgrade:

BOA's IDRs and SRF would be downgraded and revised lower, respectively, if the Moroccan state's ability or propensity to support the bank has weakened.

A downgrade of the Support Rating would require a multi-notch downgrade of the Moroccan sovereign rating.

BOA's VR is sensitive to further deterioration in the operating environment and adverse developments surrounding the future course of the health crisis. The VR could be downgraded if BOA's asset quality deteriorates markedly, particularly if the stage 3 loans ratio sustainably exceeds 14%, resulting in a significant weakening of the bank's profitability and capital position. A decrease in the CET1 buffers over the minimum regulatory requirements to below 100bp is also rating-negative.

The National Rating could be downgraded if the bank's LTLC IDR is downgraded and Fitch believes BOA's creditworthiness has weakened relative to other rated Moroccan issuers'.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

An upgrade of BOA's Long-Term IDRs could be primarily driven by an upward revision of the SRF. However, the latter would require an upgrade of the sovereign's Long-Term IDRs, and this is not our base case given the Stable Outlook on Morocco's sovereign rating.

An upgrade of the VR is unlikely in the near term, although it could result from a sustained improvement in the operating environment in the medium term or a sustained material strengthening of the bank's earnings capacity and capital position.

The National Rating could be upgraded if Fitch believes BOA's creditworthiness has improved relative to other rated Moroccan issuers'.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Financial Institutions and Covered Bond issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit [https://www.fitchratings.com/site/re/10111579]

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS

BOA's Long-Term IDRs are driven by a moderate probability of support from the Moroccan sovereign.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT	RATING			PR
Bank of Africa	LT IDR	BB Rating Outlook Stable	Affirmed	BB Ou Sta
	ST IDR	B	Affirmed	B
	LC LT IDR	BB Rating Outlook Stable	Affirmed	BB Ou Sta
	LC ST IDR	B	Affirmed	B

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VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Bank Rating Criteria (pub. 28 Feb 2020) (including rating assumption sensitivity)

National Scale Rating Criteria (pub. 22 Dec 2020)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

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Bank of Africa	UK Issued, EU Endorsed

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