FitchRatings

FITCH ASSIGNS AFRICAN GUARANTEE FUND 'AA-' IFS RATING; OUTLOOK STABLE

Fitch Ratings-London-08 November 2017: Fitch Ratings has assigned the African Guarantee Fund for Small and Medium-sized Enterprises Ltd (AGF) an Insurer Financial Strength (IFS) rating of 'AA-' (Very Strong). The Outlook is Stable.

KEY RATING DRIVERS
The rating reflects AGF's financially strong owners, very strong capital position, proven business model as provider of local currency guarantees for small and medium sized enterprises (SMEs) in Africa and low investment risk. These strengths are partly offset by the company's small size.

AGF is backed by public institutions, but it is run on a commercial basis, allowing European countries to support the financing of SMEs in Africa without directly committing their own funds. It is owned by the development agencies of Denmark (AAA/Stable; 41.9% at end-2016), Spain (BBB+/Positive; 22.9%) and France (AA/Stable; 16.1%) and by the African Development Bank (AAA/Stable; 11.5%) and the Nordic Development Fund (7.7%).

The owners' commitment to AGF is indicated by their capital contributions to AGF to date and their plans to provide additional paid-in capital and subordinated debt to support AGF's growth strategy. However, there is no formal support, such as the subscription of callable capital or an unconditional guarantee from the public shareholders to support AGF. Consequently, future financial support from the five development agencies cannot be guaranteed. AGF's rating reflects financially strong and committed sponsors but it is not aligned with that of the owners due to the absence of explicit support.

AGF's very strong capitalisation with a gross par-to-capital ratio of around 1.3x at end-2016 is a positive rating driver. Fitch takes into account reinsurance of guarantees (re-guarantees) provided by the Swedish International Development Cooperation Agency (SIDA), United States Agency for International Development (USAID) and the African Trade Insurance Agency (ATI), which results in an exceptionally strong net par-to-capital ratio of 1.2x at end-2016. AGF plans to further extend its capital base by USD420 million by end-2020 through issuing mezzanine/convertible notes (USD336 million) and subordinated debt (USD84 million) to its current owners, other highly rated development finance institutions (DFIs) and non-government organisations. Fitch expects capitalisation to reduce as the company grows, but to remain commensurate with the rating.

As AGF's primary objective is to reduce the funding gap for African SMEs, profitability is not the main performance metric. However, the company was profitable in 2015 and 2016 - just three years after its incorporation in 2012 - and has therefore proven its business model. AGF has a long-term return on capital target of 2.5%-5%, which Fitch views as an achievable target.

The company provides guarantees for non-US dollar denominated debt borrowed by speculative-grade SMEs ("high frequency, high severity" guarantee portfolio as defined in Fitch's Insurance Rating Methodology) and is exposed to currency risk. Fitch views this risk as manageable due to AGF's strong capitalisation. However, it is possible that currency risk will increase as the company grows, and Fitch will continue to closely monitor this exposure.

Fitch regards AGF's investment risk as low. At end-2016 AGF's investments consisted of sovereign and corporate bonds (54%), fixed deposits (42%) and cash (3%).

RATING SENSITIVITIES
A weaker capital position as evidenced by a net par-to-capital ratio, including available capital in the form of subordinated debt, exceeding 2.5x could lead to a downgrade. Any reduction in the commitment by the owners to AGF, possibly as a result of a change in government policy priorities, could also trigger a downgrade.

An upgrade of AGF's rating is unlikely due to its business profile.

Contact:
Primary Analyst
Ralf Ehrhardt
Director
+44 20 3530 1551
Fitch Ratings Limited
30 North Colonnade
London E14 5GN

Secondary Analyst
Harish Gohil
Managing Director
+44 20 3530 1257

Committee Chairperson
Dr Stephan Kalb
Senior Director
+49 69 768076 118

Date of relevant rating committee: 1 November 2017

Media Relations: Athos Larkou, London, Tel: +44 203 530 1549, Email: athos.larkou@fitchratings.com.

Additional information is available on www.fitchratings.com

Applicable Criteria
Insurance Rating Methodology (pub. 26 Apr 2017)
https://www.fitchratings.com/site/re/897260