

Research Update:

# The Arab Energy Fund (Formerly APICORP)

## 'AA-/A-1+' Ratings Affirmed; Outlook Stable

March 28, 2024

### Overview

- The Arab Energy Fund (TAEF; formerly APICORP) is a commercially focused multilateral lending institution with a mandate to support the energy sectors of members countries of the Organization of Arab Petroleum Exporting Countries.
- We view TAEF's financial profile as extremely strong, based on a risk-adjusted capital ratio of 20.8% and a strong funding and liquidity profile.
- We have therefore affirmed our 'AA-/A-1+' long- and short-term issuer credit ratings on TAEF.
- The stable outlook reflects our expectation that TAEF will continue to fulfil its policy mandate without a deterioration in capital adequacy or liquidity.

### Rating Action

On March 28, 2024, S&P Global Ratings affirmed its 'AA-' long-term and 'A-1+' short-term foreign currency issuer credit ratings on The Arab Energy Fund (TAEF). The outlook is stable.

### Outlook

The stable outlook reflects our expectation that TAEF will continue to support the energy sector in the member countries of the Organization of Arab Petroleum Exporting Countries (OAPEC) while increasing its policy importance by helping advance the energy transition agenda in the region, without a deterioration in capital adequacy or liquidity.

### Downside scenario

We could consider a downgrade over the next 24 months if financial metrics deteriorate markedly, for example because of a rapid buildup of nonperforming assets, or if risk management practices weaken. Additionally, reduced shareholder support or decreasing policy importance would put negative pressure on the rating.

#### PRIMARY CREDIT ANALYST

**Max M McGraw**  
Dubai  
+ 97143727168  
maximillian.mcgraw  
@spglobal.com

#### SECONDARY CONTACT

**Alexander Ekblom**  
Stockholm  
+ 46 84 40 5911  
alexander.ekblom  
@spglobal.com

#### RESEARCH CONTRIBUTOR

**Sanchita Khanna**  
Pune  
sanchita.khanna  
@spglobal.com

#### ADDITIONAL CONTACT

**Sovereign and IPF EMEA**  
SOVIPF  
@spglobal.com

## Upside scenario

Although unlikely over the next 24 months, a strong show of shareholder support, for instance via a significant increase in paid-in capital that enhances TAEF's policy importance to OAPEC member countries, could lead to an upgrade.

## Rationale

The ratings on TAEF are based on our assessment of its adequate enterprise risk profile and extremely strong financial risk profile, resulting in a stand-alone credit profile (SACP) assessment of 'aa-'. We assess TAEF's capital adequacy in our highest category, even without need for extraordinary support from member countries in the form of callable capital.

TAEF was founded in 1975 by 10 OAPEC member countries to finance oil- and gas-related projects in member countries and those in non-member countries that would contribute to knowledge transfer and capacity-building for member countries. Today, TAEF is active in funding energy-sector projects and companies and providing direct equity financing and trade finance solutions in member countries and more than 15 other countries. TAEF works on a commercial basis, with a mandate to make a profit. However, unlike a commercial bank, it does not have a mandate to maximize returns on shareholder equity. We view this mandate as adequate, given that it can largely be fulfilled by other private or domestic public institutions.

The energy sector, especially oil and gas, is the backbone of most member states' economies, making TAEF a strategic partner to support this key sector. The largest business lines for TAEF are project finance and corporate finance. The fund also takes direct stakes in entities via long-term equity investments and provides guarantees and revolving credit facilities. TAEF has a wholesale banking branch in Bahrain, regulated by the Central Bank of Bahrain, to support its trade finance business.

TAEF primarily operates in its member countries. The top five purpose-related exposures (including guarantees and other off-balance-sheet obligations and excluding treasury exposures) are to Saudi Arabia (41%), the United Arab Emirates (UAE; 17%), Bahrain (12%), Qatar (8%), and Egypt (3%). The three largest non-member country exposures are to Oman (7%), Azerbaijan (3%), and the U.S. (2%) at year-end 2023. TAEF has a less developmentally focused mandate when compared with other private-sector-focused multilateral lending institutions (MLIs) and investments tend to be in higher-rated countries, although we note that Bahrain (B+/Stable/B), Egypt (B-/Positive/B), and Oman (BB+/Stable/B) are significant exposures.

Despite a mandate to support the oil and gas sector, TAEF has positioned itself to also help OAPEC member countries with their long-term energy transitions. The fund was previously named Arab Petroleum Investments Corporation, and in December 2023 renamed itself The Arab Energy Fund. Following the 2020-2024 five-year strategy, which developed and embedded environmental, social, and governance (ESG) policy framework in its operations, TAEF's 2023-2028 strategy is aimed at driving sustainable development in the energy sector in OAPEC member countries. It includes planned investments of up to US\$1 billion in decarbonization technologies and supply chains that should help accelerate the shift toward cleaner and more sustainable energy sources. The fund is working to add additional advisory services for member countries on the energy transition (including cleaner and less-carbon-intensive energy production).

TAEF enjoys close relationships with shareholders. We view the establishing agreement as equivalent to a treaty and the fund is exempt from taxation in OAPEC member countries. Board members are normally deputy ministers in the energy or oil and gas ministries of the respective

countries. They meet five times a year, which ensures close collaboration. No member has withdrawn from the fund.

In 2020, shareholders approved an increase in authorized capital to \$20.0 billion from \$2.4 billion and subscribed capital to \$10.0 billion from \$2.0 billion. As a result, callable capital increased to \$8.5 billion from \$1.0 billion, illustrating shareholder support for the fund. We note, however, outside of the founding capital injection of \$340 million in the 1970s, TAEF has never received paid-in capital. The lack of track record of paid-in capital differentiates TAEF from most other MLIs and weighs on our assessment of shareholder support. Instead, the fund builds capital through internal generation, which member countries mostly allow it to keep.

Our assessment of adequate governance and management balances concerns over governance with a strong management framework. The shareholder base is narrow, relative to other similarly rated MLIs, with 10 members, which have low governance indicators on average. The top three shareholders--Kuwait, Saudi Arabia, and the UAE--each control 17% of the fund and a combined 51% of voting rights. All member countries are eligible to borrow from TAEF, exposing creditors to potential agency risk. The fund occasionally pays dividends, which we view as negative because of potential capital base erosion. We note that dividends are more often paid during strong earnings years and timed to not put undue stress on the financial profile. The board has agreed that no dividend will be paid over the next three years in support of TAEF's 2023-2028 strategy.

TAEF's strong internal governance and management framework balances the risks from weaker shareholders. The fund has an independent audit and risk committee. Risk management practices are benchmarked with industry standards and integrated throughout all functions and divisions. The management team has expertise in the energy sector and a strong track record of implementing internal strategy. In line with the commercial mandate, management has maintained a long track record of profitable years and a high return on equity averaging just over 5% over the past five years, which is stronger than most rated MLIs. TAEF recorded record profits in 2023, with net income growing 51% to \$225 million. Total assets grew 12% to just shy of \$10 billion.

We calculate TAEF's risk-adjusted capital (RAC) ratio at 20.8%, using data as of Dec. 31, 2023, and March 2024 parameters, down from 21.6% at end-2022. This decrease was primarily driven by assets increasing at a faster rate than equity, and higher operational risk-weighted assets from the large increase in revenue in 2023. We expect the RAC ratio to stay around the same level over 2024-2025. We believe TAEF would benefit from preferential treatment in the event of convertibility or transfer risk in a member country.

Asset quality at TAEF is relatively high since it does not have a focus on less developed countries. Based on TAEF's internal metrics, the average loan portfolio rating is 'BBB'. Asset performance has been equally as good and nonperforming loans (NPLs) decreased to 0.80% at year-end 2023, down from 1.2% at year-end 2022. There were no new NPLs in 2023. Although TAEF has no direct sovereign exposure, most exposures are to government-related entities. Our assessment of capital adequacy is supported by the high asset quality and the RAC ratio's position close to the 23% threshold for extremely strong capital adequacy.

The fund has a large equity portfolio, accounting for just over 10% of balance sheet assets. About half the equity value comes from TAEF's stake in Ibn Zahr (Saudi European Petrochemical Co.), which has paid consistent dividends and been positively re-valued since TAEF became a shareholder.

The fund maintains a conservative funding profile, with no funding gaps out to five years, based on year-end 2023 data. TAEF funds itself primarily in U.S. dollars and issues both bonds and sukuk. Short-term funding as a percentage of total funding continued to be the same in 2023 at about

20%, from 4% on June 30, 2021. While short-term funding has been a larger part of TAEF's liabilities in the past (for instance 38% in 2016), we expect TAEF to maintain an 80% long-term and 20% short-term funding mix.

Unlike most MLIs, TAEF takes deposits at its wholesale banking branch in Bahrain. Deposits increased in 2023 to \$1.2 billion from \$959 million at year-end 2022. While deposits from shareholders are kept for relationship purposes, TAEF solicits deposits from regional government-related entities, banks, and other MLIs, as well. We expect deposit funding to remain a part of TAEF's short-term funding mix.

The fund maintains a strong liquid asset cushion, accounting for 50% of adjusted total assets as of Dec. 31, 2023. Based on TAEF's internal metrics, more than 77% of the treasury portfolio was rated 'A' or above and 33% 'AAA' in 2023. Our calculations of TAEF's liquidity profile incorporate stressed market conditions and assume no market access. Under these conditions, we estimate liquid assets are sufficient to service its borrowings and maintain normal operations for at least one year, without slowing the pace of planned signed disbursements. For Dec. 31, 2023, and incorporating our updated liquidity haircuts, our 12-month liquidity ratio was 1.3x with scheduled loans disbursements. The six-month ratio was also 2.0x.

Shareholders provided callable capital to TAEF as a form of extraordinary support, if needed. While we already assess TAEF's capital adequacy in the highest category without including callable capital in the calculation, in the unlikely event TAEF's SACP weakens to 'a+' or below because of a weaker capital position, we could assign uplift based on extraordinary support from shareholders rated at least equal to TAEF's SACP, all things being equal. The fund's highest rated shareholders are Qatar (AA/Stable/A-1+) and Kuwait (A+/Stable/A-1).

## Ratings Score Snapshot

Issuer credit rating	AA-/Stable/A-1+
Stand-alone credit profile	aa-
Enterprise risk profile:	Adequate
Policy importance	Adequate
Governance and management expertise	Adequate
Financial risk profile:	Extremely Strong
Capital adequacy	Extremely Strong
Funding and liquidity	Strong
Extraordinary support	0
Callable capital:	0
Group support:	0
Holistic approach	0

## Related Criteria

- Criteria | Governments | General: Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology, Jan. 31, 2022
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10,

- 2021
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
  - General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
  - General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Supranationals Special Edition 2023, Oct. 12, 2023

Ratings List

Ratings Affirmed	
The Arab Energy Fund	
Issuer Credit Rating	
Foreign Currency	AA-/Stable/A-1+

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