

CreditOutlook

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12 MARCH 2018

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Richard Lane
Senior Vice President
+1.212.553.7863
richard.lane@moodys.com

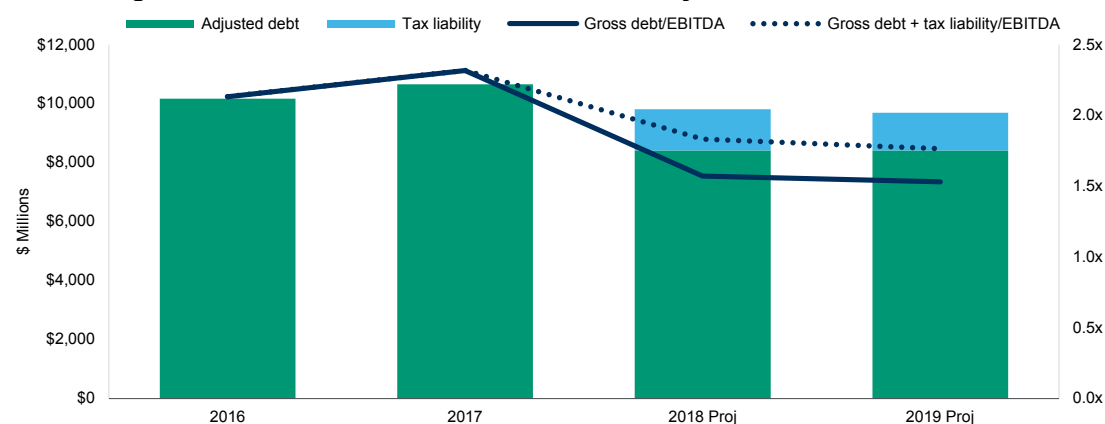
HP Inc.'s debt tender is credit positive

On Friday, [HP Inc.](#) (HPI, Baa2 stable) announced a \$1.75 billion tender for outstanding debt in a credit-positive use of repatriated cash following the passage of the US Tax Cuts and Jobs Act (TCJA). Last month, HPI announced its intention to reduce gross debt, noting also that the TCJA will provide an estimated five-percentage-point decline in its tax rate and increased capacity to invest in its business and return excess cash to shareholders by allowing the company to repatriate its roughly \$5 billion of offshore cash.

As of 31 January 2018, HPI's adjusted gross debt/EBITDA was 2.0x, or about 2.3x including its estimate of a net tax repatriation liability of about \$1.4 billion, which will gradually amortize with the required 8% annual payments during the next five years. A successful debt tender will reduce leverage to 1.6x (1.8x with the tax liability) and our projection of continued steady operational performance will lead to modestly lower leverage in 2019 (see Exhibit 1).

EXHIBIT 1

HP's leverage declines with debt tender, even with tax liability



Sources: Company reports and Moody's Investors Service estimates

HPI maintains a very strong leading position in the worldwide printing market and a worldwide lead in the PC market. HPI's PC unit market share has grown for the past six consecutive quarters to a worldwide lead and company record of 23.5%. For 2017, HP increased PC unit shipments 8.3%, compared with a 1.0% decline for second place Lenovo, 2.7% growth for third place [Dell Inc.](#) (Ba1 stable), and a 0.5% decline for the overall PC market. Amid a stabilizing but still-soft overall PC market, HP and other top players (Lenovo and Dell) have a combined record 61.4% unit market share (up from 59.9% a year ago) and we expect that they will continue to take market share as smaller competitors that lack scale recede.

HPI's results for the fiscal quarter that ended January 2018 included year-over-year revenue growth of 14% to \$14.5 billion (marking five consecutive quarters of double-digit revenue growth), with adjusted EBITDA of \$1.45 billion versus \$1.57 billion a year earlier. The company guided to single-digit growth through the rest of fiscal 2018, which ends in October 2018, reflecting strength across its printing and PC business segments.

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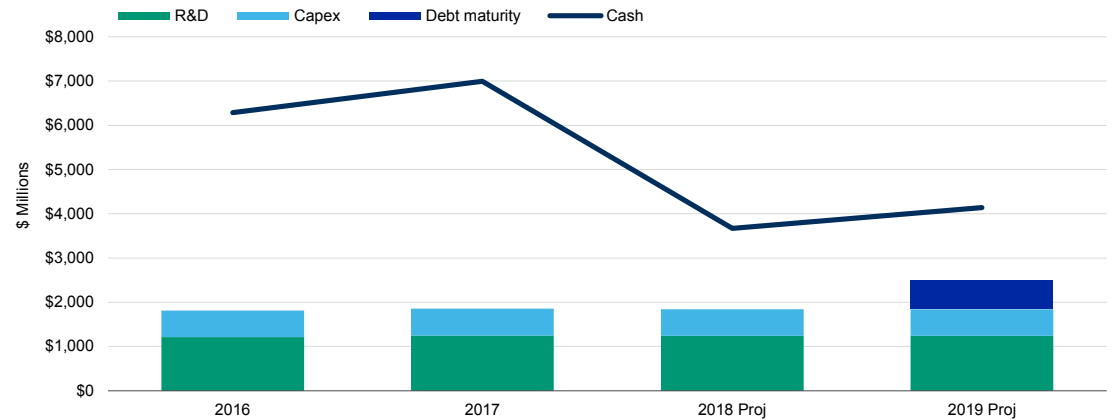
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HPI's liquidity profile will remain very robust. Cash balances will be nearly double the aggregate of annual research and development, capital expenditures and the following year's debt maturities, including the amount owed under the TCJA liability (see Exhibit 2).

EXHIBIT 2

HP's cash is nearly 2x the sum of its annual research and development, capex and debt maturity



Sources: Company reports and Moody's Investors Service estimates

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Richard Lane
Senior Vice President
+1.212.553.7863
richard.lane@moodys.com

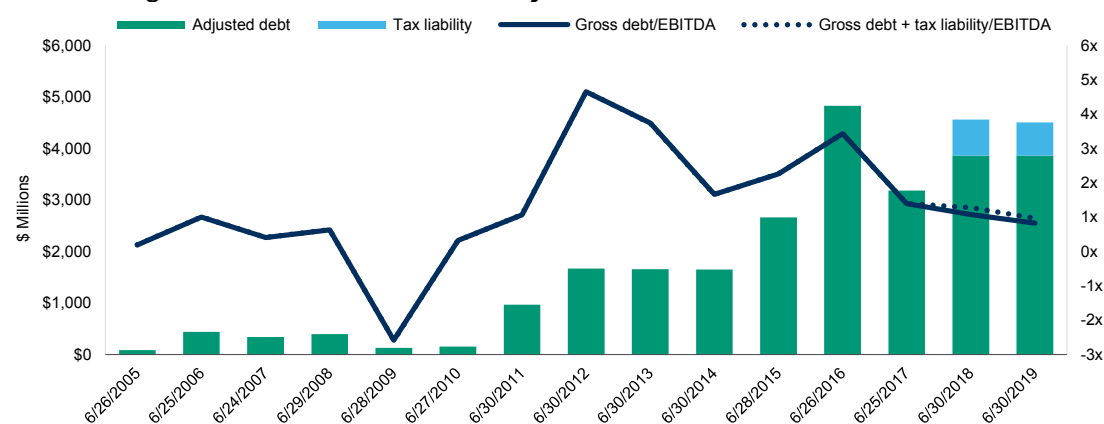
Lam Research's increased dividend plan is credit negative, but its substantial cash covers the effects

Last Tuesday, [Lam Research Corp.](#) (A3 stable) announced plans to more aggressively return cash to shareholders and target a return of at least 50% of cash flow less capital expenditures annually over the next five years. Lam increased its dividend by 120% and added \$2 billion to its remaining \$1 billion share buyback authorization. Following the passage of the US Tax Cuts and Jobs Act (TCJA), Lam took an approximately \$703 million tax charge, which will be paid out over eight years. Overall, we view the TCJA and Lam's financial plans as credit negative because of the significant return of capital to shareholders. Our outlook for Lam's very strong operating results, however, offsets its move to return capital and we expect that the company's leverage will decline while its liquidity profile remains extremely strong, even with the higher returns to shareholders.

As of 24 December 2017, Lam's adjusted gross debt/EBITDA was 1.45x, or 1.69x including the tax repatriation liability of about \$703 million, which will gradually amortize with the required 8% annual payments during the next five years. Tax reform will allow Lam to repatriate the vast majority of its more than \$5 billion of offshore cash and the company will have access to its offshore cash flow generation going forward, a credit positive. As a result, with few acquisition opportunities and strong organic growth drivers, we expect that Lam likely will repay most, if not all, maturing debt (i.e., \$450 million in 2018 and \$500 million in 2020). Combined with our projections for its EBITDA to increase 55% to \$3.6 billion in fiscal 2018, which ends 30 June 2018, we expect leverage to decline. Over the next 18 months, we project Lam's adjusted gross debt/EBITDA to decline to below 1.0x including the tax liability (see Exhibit 1).

EXHIBIT 1

Lam's leverage declines even with its tax liability



Sources: Company reports and Moody's Investors Service projections for 2018-19

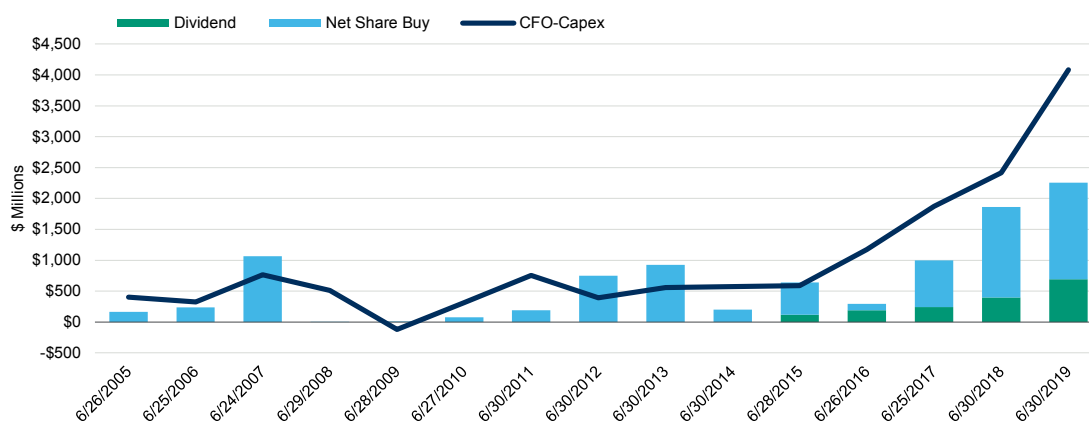
In addition to the expanded share repurchase program, Lam announced a 120% increase in its dividend (following an 11% increase last November). We project that net share repurchases will approximate \$1 billion over the next year, while dividends, adjusting for share count reduction, will increase to about \$680 million. Even with the higher returns to shareholders, we project that Lam's cash flow generation will easily exceed the aggregate of dividends and net share repurchases (see Exhibit 2) based on the company's strong market position and demand [dynamics for semiconductor equipment](#).

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EXHIBIT 2

We estimate that Lam's cash flow less capital expenditures will still exceed its capital return in 2018-19

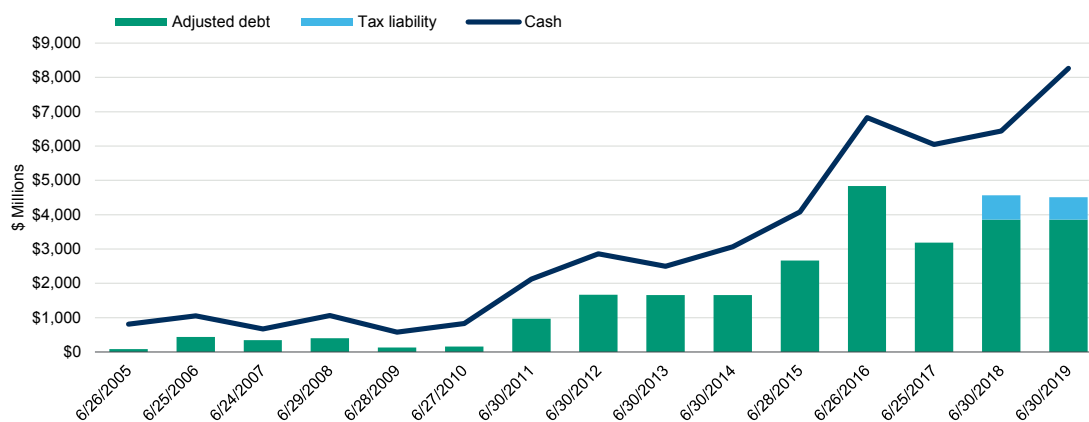


Sources: Company reports and Moody's Investors Service estimates

Despite the stronger returns of cash to shareholders, Lam's liquidity profile will remain extremely robust. We estimate cash balances will exceed adjusted gross debt plus the repatriated cash tax liability by more than \$3 billion in 2019 (see Exhibit 3).

EXHIBIT 3

We estimate that Lam's cash will be nearly double its debt plus tax liability in 2019



Sources: Company reports and Moody's Investors Service estimates

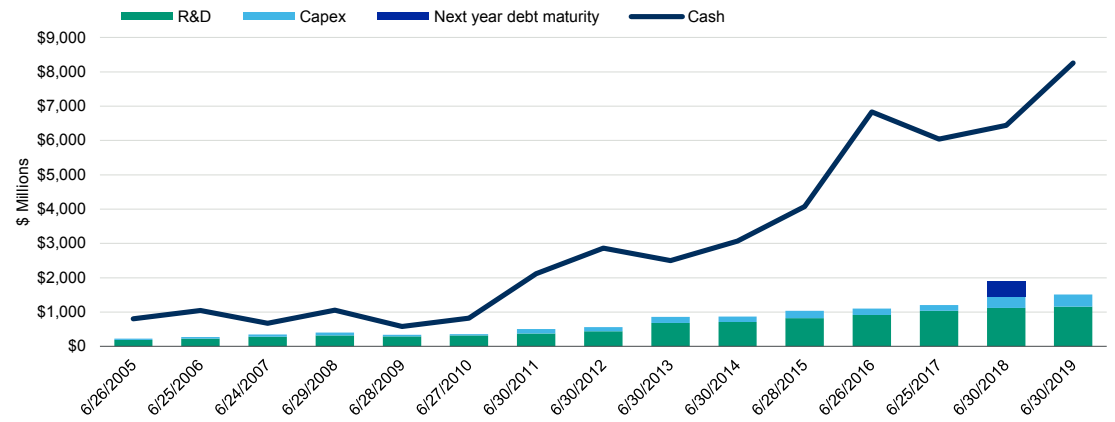
Looked at another way, our projected cash balances for Lam after considering the expanded shareholder returns will approximate 5x the aggregate of annual research and development, capital expenditures, and the following year's debt maturities, including the amount owed under the TCJA liability (see Exhibit 4).

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EXHIBIT 4

We project that Lam's cash will exceed key investment needs and debt maturities fivefold in 2019



Sources: Company reports and Moody's Investors Service estimates

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Andrew Brooks

Vice President - Senior Credit Officer

+1.212.553.1065

andrew.brooks@moodys.com

Hess' share buyback erodes its cash position

Last Thursday, [Hess Corporation](#) (Ba1 stable) announced a \$1.0 billion share buyback on top of a \$500 million share repurchase that the company authorized in late 2017. The additional share buyback is credit negative for Hess, drawing down a cash balance that has protected the oil exploration and production company's liquidity during 13 successive quarterly losses, negative free cash flow and a repositioning of its asset portfolio.

Hess' significant cash balance has long been essential to its liquidity, especially in a turbulent oil market. The company reported \$4.5 billion of balance sheet cash at 31 December 2017, and \$6.0 billion of balance sheet debt. Hess bolstered its cash balance by \$1.8 billion in 2017 from a year earlier, in part by selling \$3.3 billion of assets, including \$2.1 billion of Norwegian North Sea assets in December.

Hess used its sizable cash balance to fund the negative free cash flow generated by the company's \$1.8 billion of capital spending during the year. Its ratio of retained cash flow (RCF) to debt rose to 22% for 2017 from just 8% in 2016.

The \$1.0 billion share repurchase appears ill-timed, however. Hess plans \$2.1 billion in capital spending for 2018, and we expect that lower production levels will reduce RCF/debt to about 15% this year. Hess will generate at least as much negative free cash flow as in 2017, with a drop in production to 245,000-255,000 barrels of oil equivalent, excluding Libya, reflecting both its recent asset sales and a loss of about 15,000 barrels of oil equivalent per day of annualized production from various production shut-ins in the Gulf of Mexico.

Although we expect that Hess this year will have one more significant asset sale, its Danish North Sea production, its cash balances are likely to shrink below \$4.0 billion this year from \$4.5 billion at year-end 2017, and further still as the company ramps up spending to fund its 30% stake in the development of the ever-expanding Stabroek Block offshore of Guyana. ([ExxonMobil Corporation](#) [Aaa stable] is the Guyana project operator, with a 45% stake.) Indeed, Hess' cash was probably already slightly less than \$4.0 billion when it announced its new \$1.0 billion share buyback. In January, Hess redeemed its \$349 million notes due in 2019, and presumably funded additional share repurchases under the existing \$500 million authorization.

Declining coverage metrics, however, may well be temporary. Hess plans to add two rigs in the Bakken Shale of North Dakota late this year, which together with the return to full production in the Gulf of Mexico should improve the company's 2019 operating and financial results, with near breakeven free cash flow and an RCF/debt ratio near 30%.

However, such improvements depend on commodity prices (Hess' crude production is fully hedged only in 2018), as well as execution risk for its current production and future growth, and the very large spending requirements for the initial development of Guyana. Such risks will leave Hess' credit quality with even less margin for error as its cash balance shrinks, particularly with the new \$1.0 billion share repurchase.

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Ed Sustar
Senior Vice President
+1.416.214.3628
ed.sustar@moodys.com

International Paper's proposed acquisition of Smurfit Kappa would be credit negative

Last Tuesday, [International Paper Company](#) (IP, Baa2 stable) announced an unsolicited offer to buy [Smurfit Kappa Group plc](#) (SKG, Ba1 stable), Europe's leading manufacturer of containerboard and corrugated containers, for €8.6 billion (\$10.6 billion) using 60% cash and 40% equity. SKG rejected the offer and IP has not disclosed any information related to the proposed acquisition's synergy benefits or its deleveraging plans.

If completed as proposed, the acquisition would be credit negative for IP because its pro forma financial leverage would increase to 4.6x adjusted debt/EBITDA (excluding synergies) from 3.3x as of 2017. We believe IP essentially would need to apply all of its free cash flow to debt repayment over the next two years to bring its leverage back to 3x, which is one of our quantitative benchmarks for a ratings downgrade. In addition to M&A-related synergies, IP also could sell some assets to generate cash to reduce debt in the wake of a deal for SKG. Given the time typically required to finalize a large, unsolicited, international acquisition, IP has the potential to de-lever to its stated target of less than 3x before closing the SKG transaction.

IP has a good track record of quickly reducing leverage after leveraging up for acquisitions, including Weyerhaeuser's packaging business in 2008 and packaging company Temple-Inland in 2012. Excluding a transaction for SKG, we believe that IP will bring its leverage down to less than 3x this year following its acquisition of Weyerhaeuser's market pulp business in December 2016. We expect IP to prepay debt as earnings increase from operational improvements and the carry forward of higher prices for corrugated container, paper and market pulp.

Acquiring SKG would bring long-term benefits to IP. The addition of SKG's European, US and Latin American operations would enhance IP's geographic diversification and its operational flexibility. The combination of two similar businesses also would generate meaningful operating synergies.

Memphis, Tennessee-based IP is a leading global producer of containerboard and corrugated containers, market pulp and uncoated freesheet paper with annual sales of about \$22 billion.

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Jamie Koutsoukis
Vice President - Senior Analyst
+1.416.214.3845
jamie.koutsoukis@moody.com

Bombardier's planned equity issuance is credit positive

Last Monday, [Bombardier Inc.](#) (B3 negative) said that it had planned to sell equity to strengthen its balance sheet as part of its five-year turnaround plan. The planned equity issuance is credit positive because it will increase Bombardier's already-good liquidity while it continues to generate negative free cash flow.

Bombardier has agreed with its underwriters to raise gross proceeds of CAD638 million through the sale of 168 million Class B shares. The planned stock sale follows the company's November issuance of \$900 million in senior unsecured notes, the proceeds of which it used to tender its \$600 million of debt maturing in 2019 and to add about \$360 million in cash to its balance sheet.

Bombardier will be near cash flow breakeven this year as accelerating production of its C Series commercial jet moves the program toward its own breakeven in 2020 and the Global 7000 business jet program nears entry into service in the latter part of this year. However, we also expect large, quarter-to-quarter swings in working capital as production on the two aircraft programs ramps up, with Bombardier likely to continue burning cash in the first half of the year before swinging to positive cash generation in the second half.

As a result, Bombardier's liquidity is vitally important, especially given that the company's ability to reach cash flow breakeven this year remains uncertain. [Delta Air Lines, Inc.](#) (Baa3 stable) now expects to receive its first C Series deliveries in the second half of this year, rather than in the second quarter as previously planned. The ultimate timing of C Series deliveries and potential expenditures related to the planned construction of a new assembly line in Alabama with [Airbus SE](#) (A2 stable) could affect cash flow.

On a pro forma basis for the approximately \$500 million equity issuance, Bombardier had \$4.8 billion in liquidity at the end of December 2017 (\$3.1 billion of cash, revolver availability of \$400 million at Bombardier Aerospace due in June 2020 and €640 million at Bombardier Transport due in May 2020), compared with debt of \$850 million due in 2020 and \$2.3 billion due in 2021. Bombardier's adjusted leverage, defined as adjusted debt to EBITDA, of 13x at the end of December is very high for its rating and we expect it to remain above 9x in 2018.

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Jeanine Arnold
Vice President - Senior Credit Officer
+49.69.70730.789
jeanine.arnold@moody's.com

Thales' solid 2017 results and 2018 outlook aid credit metrics ahead of debt-funded Gemalto acquisition

Last Tuesday, French aerospace company [Thales](#) (A2 negative) announced its full-year 2017 results, including EBIT of €1.543 billion (or €1.365 billion under IFRS 15) and company-defined free operating cash flow of €1.365 billion, exceeding its targets. Thales also guided to strong EBIT growth of around 20% in 2018 and confirmed that it is on track with regulatory approvals for its €5.6 billion acquisition of Dutch digital security company Gemalto, which is likely to close in the second half of 2018. Thales' solid operating performance last year and its expectation of even stronger earnings this year are credit positive because they support key credit metrics ahead of the Gemalto deal, which we expect Thales will finance with a combination of debt and cash.

Based on our preliminary calculations, adjusted gross debt/EBITDA in 2017 will be in line with the 3.0x we expected, but stronger earnings in 2018 increase the likelihood that leverage pro forma for the Gemalto acquisition will be within, or even better than, the 3.5x-4.0x range we initially expected for this year. Improving business conditions, which underpin Thales' 2018 guidance, are also more likely to support a decrease in leverage to below 3.25x by 2019, one of the key considerations for us to affirm Thales' A2 rating and change the outlook back to stable from negative following our outlook change in December 2017.

Thales' improved business conditions mainly are due to a ramp-up in aircraft production rates, which the company expects will post organic growth this year of 4%-5% and will continue to support the company's aerospace earnings, and higher defence spending in its core markets including France and Australia (because UK defence budgets are not yet final, uncertainty about this market persists). Additionally, the company had a robust order backlog of around €31.9 billion (equivalent to around 2.0x 2017 revenue).

We consider it positive for future earnings that 2017 results showed improved operating performance across all divisions because it points to the company's continuing success in its restructuring and contract execution. A turnaround at the company's previously low-margin transportation division is producing better results, with EBIT-adjusted margins rising to 4.1% in 2017 from 0.7% in 2016 owing to the winding down of zero-margin contracts in its backlog. Better performance across all divisions should also allow Thales to focus more successfully on integrating Gemalto once the transaction closes.

Even with Thales' improved operating performance, our outlook for the company depends on how it finances the Gemalto acquisition, in particular how much of the €5.6 billion consideration will be debt-funded and how much will be paid out of cash reserves. Thales had €4.6 billion of cash on its balance sheet in 2017, up from €3.9 billion in 2016 and higher than our forecast of €4.1 billion, because of stronger free cash flow. Based on our preliminary calculations, Moody's-defined free cash flow was just under €800 million in 2017, higher than the €580 million we had expected. Although some of this variance reflects positive working capital movement, which will partly reverse in 2018 owing to advanced customer payments and cut-off effects, higher cash reserves suggest that Thales will raise less debt to fund the Gemalto transaction.

We continue to believe that the Gemalto acquisition makes strategic sense. It should strengthen Thales' business profile because it will accelerate the company's digital strategy and transform it into a global leader in digital security.

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Maisam Hasnain, CFA
Analyst
+65.6398.8325
maisam.hasnain@moodys.com

Nidhi Dhruv, CFA
Vice President - Senior Analyst
+65.6398.8315
nidhi.dhruv@moodys.com

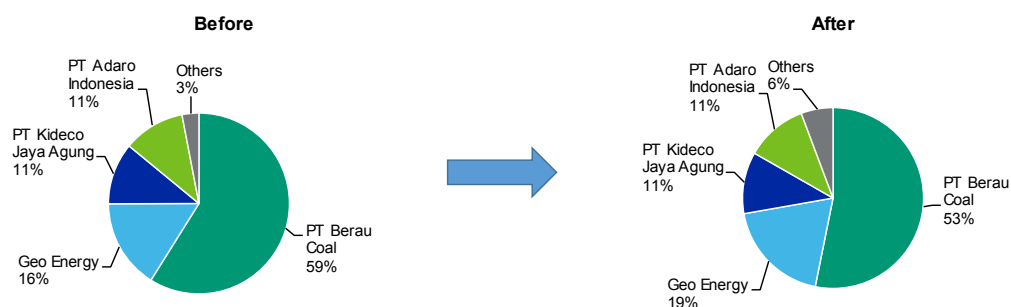
Geo Energy awards mining-service contract to BUMA, a credit positive for both

Last Wednesday, Indonesian coal-mining services contractor [Bukit Makmur Mandiri Utama \(P.T.\)](#) (BUMA, Ba3 stable) entered an approximately IDR7 trillion (\$500 million) contract with PT Tanah Bumbu Resources (TBR), a subsidiary of coal-mining group [Geo Energy Resources Limited](#) (B2 stable), for topsoil removal and coal extraction through the life of TBR's mine. The transaction is credit positive for BUMA because it increases the company's scale, provides cash flow visibility owing to the contract's long-term nature, and reduces customer concentration. For Geo Energy, the mining contract will improve production and sales volumes, and diversify revenue away from its only producing mine at subsidiary PT Sungai Danau Jaya (SDJ).

We estimate the life of TBR's mine at around seven years, which translates into BUMA receiving around \$71 million of incremental revenue each year, a 9% increase from its total revenue of around \$750 million for the 12 months that ended 30 September 2017. BUMA is also the contract miner for SDJ's mine, which is adjacent to the TBR mine. Therefore, BUMA can leverage mining equipment used at SDJ's mine for its mining activity at TBR, reducing the need to purchase additional equipment and saving on its capital spending requirements.

The TBR contract will help reduce BUMA's customer concentration risk because the pro forma revenue contribution from its largest customer, PT Berau Coal, will decline to 53% from 59% for the 12 months that ended 30 September 2017, as shown in the exhibit. Berau Coal is 90%-owned by PT Berau Coal Energy Tbk, which is currently restructuring its debt. BUMA and Geo Energy said mining activity will start this month.

BUMA's revenue contribution from Berau will decline because of its contract with TBR



The increase to 6% from 3% in BUMA's revenue contribution from the Others category primarily reflects a new contract signed with PT Pada Idi in August 2017.

Sources: Company information and Moody's Investors Service estimates

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Geo Energy completed the acquisition of TBR in June 2017 and estimated that TBR had proved and probable coal reserves of 47 million tons, with a minimum average calorific value of not less than 4,200 kilo calories per kilogram. Although commercial production of coal at TBR was delayed for two quarters, Geo Energy's credit profile was not materially affected because of the company's strong liquidity and moderate leverage as measured by Moody's-adjusted debt to EBITDA of around 3.5x as of December 2017.

Over the next 12-18 months, after production at TBR ramps up, we expect Geo Energy to expand its production volume to 11-12 million tons from 7.7 million tons in 2017, and its consolidated revenue to rise to \$400-\$450 million from \$316.3 million in 2017. Based on the company's estimates, TBR will contribute about half of targeted production in 2019-20, and account for 40%-45% of Geo Energy's consolidated revenue over the next two years.

The combined mining plan for SDJ and TBR also allows the company to benefit from cost savings from overburden dumping, which refers to the soil above the minerals being mined. Under the company's plan, the overburden from the TBR mine will be dumped into the SDJ mine. Geo Energy also is in the process of finalizing the coal offtake contract for TBR. Currently, Geo Energy faces customer concentration risks with Engelhart CTP Singapore, a coal trading company with international operations, being the sole offtaker for all the production from the SDJ mine. The company aims to diversify its offtakers for output from the TBR mine to reduce customer concentration risk.

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Infrastructure

Graham Taylor
Vice President - Senior Credit Officer
+44.20.7772.5206
graham.taylor@moodys.com

Rob Dutfield
Associate Analyst
+44.20.7772.3345
rob.dutfield@moodys.com

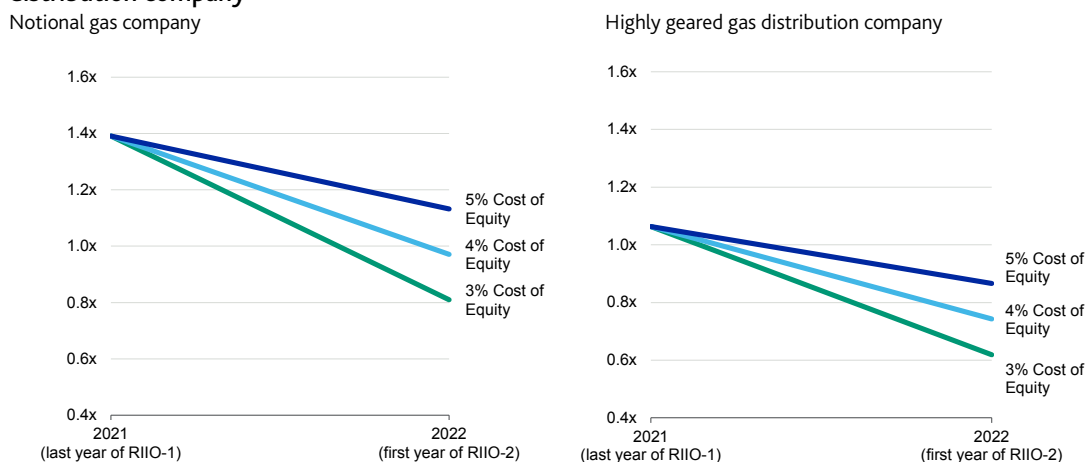
British energy regulator's proposals would reduce returns for network owners

Last Wednesday, Britain's Office of Gas and Electricity Markets (Ofgem) published its proposed approach to regulating the country's energy networks in the next regulatory period, known as RIIO-2, which starts in 2021 for transmission and gas distribution networks and 2023 for electricity distribution networks. The proposal suggests a cut of up to 55% in the allowed cost of equity, on a comparable basis, and less scope for outperformance than most companies are delivering in the current period. The proposals are credit negative for 25 Moody's-rated networks including [National Grid Electricity Transmission plc](#) (A3 stable), [Southern Gas Networks plc](#) (Baa1 stable) and [Electricity North West Limited](#) (Baa1 stable). Ofgem will consult on the proposals before making a decision on key issues this summer.

Based on current market conditions, Ofgem estimates that a "notional" company (that is, a hypothetical company with leverage, borrowing costs and operational performance in line with regulatory assumptions) would expect to earn an equity return of 3%-5% before inflation, which is significantly below the 6%-7% cost of equity now allowed for networks. The effect of such a cut on companies' Moody's-adjusted credit metrics will depend on their capital structures and other factors. We estimate that a notional gas distribution company would have a Moody's-adjusted interest coverage ratio (AICR) of around 1.4x at the end of the current period, the bottom of the 1.4x-1.6x range that we generally regard as consistent with a Baa1 rating. If the allowed cost of equity is cut to 3%-5% in RIIO-2, we estimate that the company's AICR would fall to 0.8x-1.1x. This suggests that even a company leveraged close to regulatory assumptions would come under pressure in RIIO-2. The AICR of a hypothetical company with higher leverage, 85% net debt/regulated asset value, would fall to as low as 0.6x (see Exhibit 1).

EXHIBIT 1

Illustration of Moody's-adjusted interest coverage ratios at a notional and highly geared gas distribution company



AICR for notional company is based on 65% gearing and 25% inflation-linked debt; for highly geared company, AICR is based on 85% ratio of net debt/regulated asset value, 25% inflation-linked debt and performance in line with regulatory assumptions.

Source: Moody's Investors Service

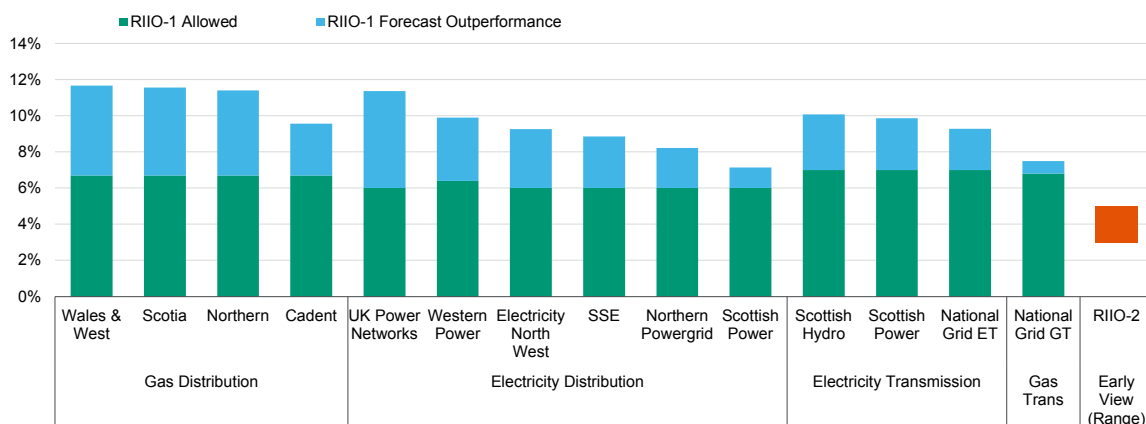
In RIIO-1, companies' AICRs have been supported by operational incentives and underspending as a result of efficiency or reduced investment needs, which have boosted returns on regulatory equity by three to five percentage points for most groups (see Exhibit 2).

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EXHIBIT 2

Networks' returns on regulatory equity to fall sharply under RIIO-2



Source: UK Office of Gas and Electricity Markets

However, the RIIO-2 consultation sets out proposals to make systemic outperformance less likely. If the cost of equity were set at 3%, a notionally financed company would need to achieve 3.5 percentage points of returns on regulatory equity outperformance to achieve a 1.4x AICR, and we think few companies will be able to deliver this given Ofgem's hardening view on what constitutes "too generous" incentives.

Ofgem has recognised the risk that these changes pose to credit metrics and is consulting on a number of measures to support company financeability. One is a switch to a lower inflation benchmark or to nominal returns, which would boost cash flows at the expense of lower asset growth. Another is the introduction of a revenue floor mechanism that would allow companies to raise additional revenue if necessary to meet debt repayments, which could support operating companies' credit quality but at the price of blocking dividend distributions under some scenarios, which would be credit negative for leveraged holding companies such as National Grid and [Western Power Distribution Plc](#) (Baa3 stable).

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Norwegian parliament's debate of Bank Recovery and Resolution Directive is credit negative for banks

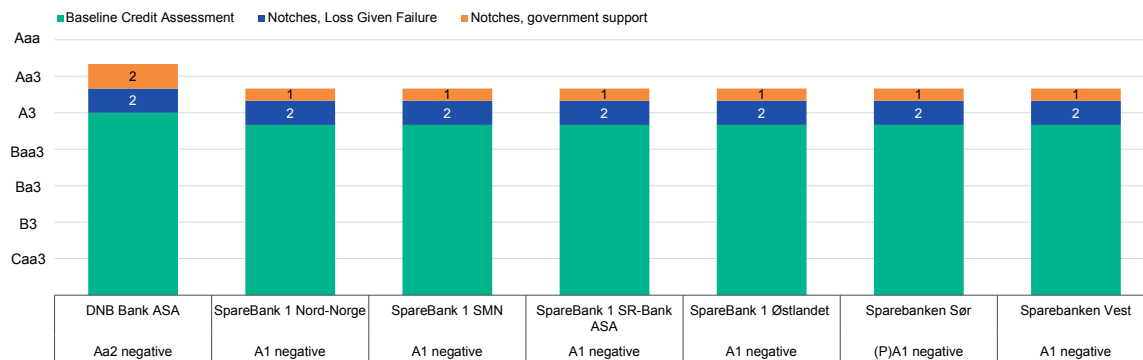
Last Tuesday, Norway's parliament began debating proposed legislation to implement the Bank Recovery and Resolution Directive (BRRD) and an amended deposit guarantee scheme. The intention of the BRRD law is to promote financial stability and ensure that losses are borne by a bank's shareholders and creditors rather than taxpayers. Although the first reading in parliament concluded with a unanimous vote in favour for the proposal, a second reading (at least three days after the initial reading) is required before the bill can be transposed into Norwegian law. The BRRD law's enactment, which we expect within the next few weeks, would be credit negative for seven of the 17 Norwegian banks we rate because it would reduce the probability that they would receive government support in case of need.

In line with the European Union's (EU) BRRD, the proposed legal framework features recovery and resolution plans for banks, early intervention measures and resolution tools including the bail-in of creditors. Additionally, the proposal includes small changes to the current deposit guarantee scheme to align it with that of the EU. However, in contrast to the EU's deposit guarantee scheme limit of €100,000 per depositor per bank, the Norwegian Ministry of Finance has proposed maintaining its current coverage of NOK2 million (approximately €200,000) per depositor in each bank.

The bail-in tool is a central feature in the BRRD framework, intended to reduce the need for government intervention in failing banks. Consequently, government support is less likely for Norwegian banks since bail-in can be used to recapitalise financial institutions and absorb losses.

We currently incorporate a "high" or "moderate" probability of government support in the senior unsecured and deposit ratings of [DNB Bank ASA](#) (Aa2/Aa2 negative, a3¹), [SpareBank 1 SR-Bank ASA](#) (A1/A1 negative, baa1), [SpareBank 1 SMN](#) (A1/A1 negative, baa1), [SpareBank 1 Østlandet](#) (A1/A1 negative, baa1), [SpareBank 1 Nord-Norge](#) (A1/A1 negative, baa1), [Sparebanken Vest](#) (A1/A1 negative, baa1) and [Sparebanken Sør](#) (A1/(P)A1 negative, baa1) (see exhibit). We [assigned](#) negative outlooks to those banks' ratings following the submission of the legislative proposal in June 2017 in anticipation of the law's passage, and the eventual moderation of our government support assumptions, which likely will lead us to remove the one-notch rating uplift incorporated into the banks' ratings.

Seven Moody's-rated Norwegian banks' senior unsecured ratings benefit from government support



Source: Moody's Investors Service

¹ The bank ratings shown in this report are the bank's deposit rating, senior unsecured debt rating and Baseline Credit Assessment.

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We expect Norway's implementation of BRRD to be followed by a minimum requirement for own funds and liabilities (MREL) for each bank within the next 12 months. Nevertheless, no relevant details have been disclosed yet, although the BRRD proposal includes MREL requirements in line with the EU's BRRD. We expect Norwegian banks that will be subject to MREL requirements to gradually change their funding plans by raising non-preferred senior debt instruments in order to be compliant. This likely will provide senior unsecured creditors additional protection against potential losses, which eventually could counterbalance the negative rating effect on banks from revised government support assumptions.

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Credit implications of current events

Olga Ulyanova, FCCA
Vice President - Senior Credit Officer
+7.495.228.60.78
olga.ulyanova@moodys.com

Russian central bank proposes tighter capital requirements for some consumer loans, a credit positive

Last Tuesday, the Central Bank of Russia (CBR) published a draft regulation tightening risk-weighting requirements for consumer loans with an annual percentage rate (APR) of 15%-25%. The stricter requirements would apply to consumer loans issued after 1 May 2018. The higher risk weighting would be credit positive for banks specialising in consumer lending, including [Tinkoff Bank](#) (B1/B1 stable, b1²), [Orient Express Bank](#) (B3/B3 stable, b3) and [Russian Standard Bank](#) (Caa2 negative, caa2). Also affected are large universal banks active in consumer lending that target medium-risk and payroll customers, such as [Sberbank](#) (Ba1/Ba1 positive, ba1) and [Bank VTB PJSC](#) (Ba1/Ba1 positive, b1).

We expect the higher risk weights to incentivise lenders to either reduce lending rates, thereby easing the burden on households, or limit new lending growth in risky loan segments by applying stricter underwriting. Exhibit 1 shows how the risk weights will change following the CBR's amended rules. These risk weights are used to determine regulatory capital adequacy ratios.

EXHIBIT 1

The CBR's proposed changes to consumer loan risk weights

Annual percentage rate	Current risk weights	Risk weights for loans issued after 1 May 2018
0%-15%	100%	100%
15%-20%	100%	110%
20%-25%	110%	120%
25%-30%	140%	140%
30%-35%	300%	300%
More than 35%	600%	600%

Source: Central Bank of Russia

The rationale behind the CBR's proposal is to address the risks linked to accelerated consumer lending growth in recent months. According to the CBR, consumer lending year-on-year growth was 12.6% as of 1 February 2018, with most of the growth occurring between November 2017 and January 2018, when the average growth rate skyrocketed 19% on an annualised basis.

Facing low demand for new lending from corporate borrowers, banks have sought to expand their portfolios by extending more loans to individuals. However, household income has stagnated, leading to an increase in households' debt burden after some deleveraging during Russia's financial crisis in 2014-16 (see Exhibit 2).

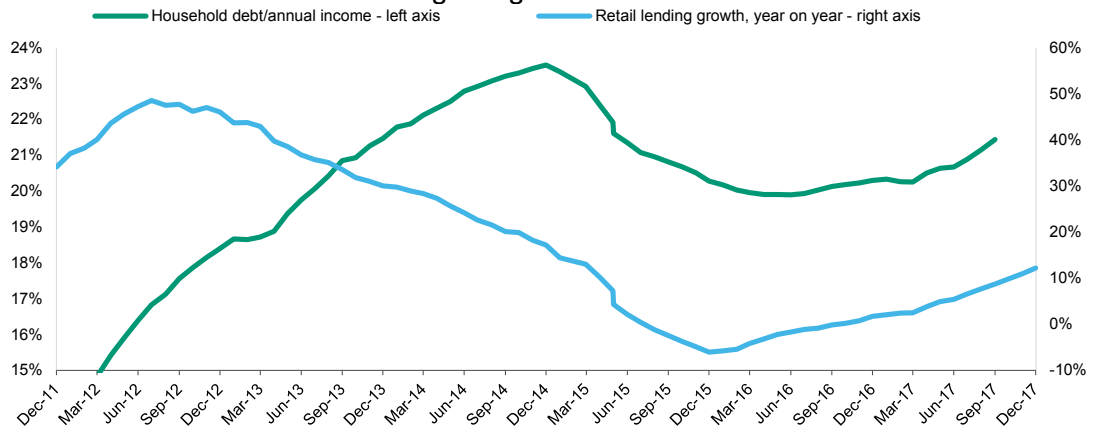
² The bank ratings shown in this report are the bank's domestic deposit rating, senior unsecured debt rating (where available) and Baseline Credit Assessment.

NEWS & ANALYSIS

Credit implications of current events

EXHIBIT 2

Russian households' debt burden has begun to grow

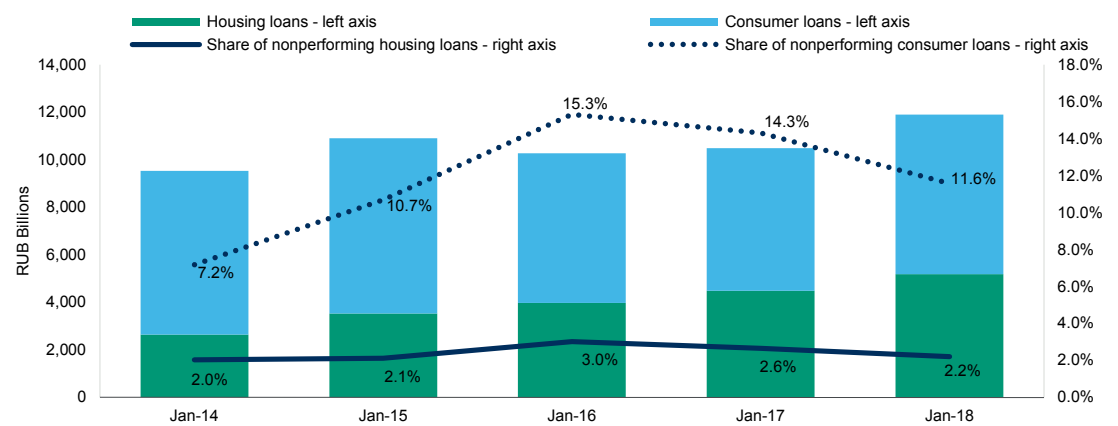


Sources: Central Bank of Russia and Russian State Statistical Service

The unsecured consumer loan segment reports a much higher proportion of nonperforming loans compared with housing loans (see Exhibit 3) because it targets a riskier customer segment. Banks compensate their elevated credit risks on consumer loans by charging high interest rates.

EXHIBIT 3

Unsecured consumer loans nonperforming loan rate is 5x that of housing loans



We define nonperforming loans as loans overdue by more than 90 days.

Sources: Central Bank of Russia

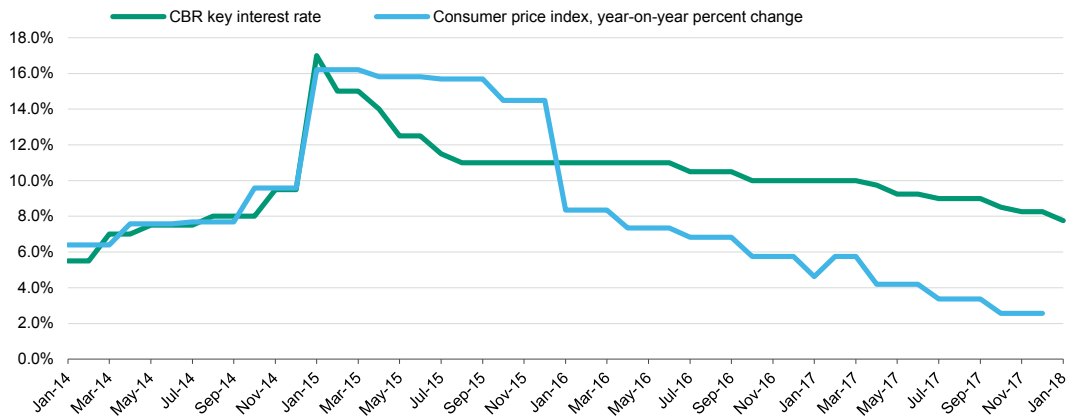
As inflation in Russia declined in 2017 to record-low levels of around 2.5%, the CBR's key interest rate also fell and is now 7.5% (see Exhibit 4). Amid an overall decline in Russia's interest rates, consumer loans with 15%-25% APRs increasingly comprise less creditworthy borrowers, making the loans riskier. It is this threat that the CBR is seeking to minimise by curbing banks' appetite for consumer loans with relatively high APRs.

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Credit implications of current events

EXHIBIT 4

Russia's inflation and interest rates are falling



Sources: Central Bank of Russia and Russian State Statistical Service

We estimate that consumer loans with APRs of 15%-25% prevail in Russian banks' unsecured retail loan portfolios because banks offer such loans, *inter alia*, to their so-called payroll customers (i.e., customers who receive their salaries to the accounts opened with the same banks).

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Credit implications of current events

Peter Mushangwe, CFA
Analyst
+44.20.7772.5224
peter.mushangwe@moody's.com

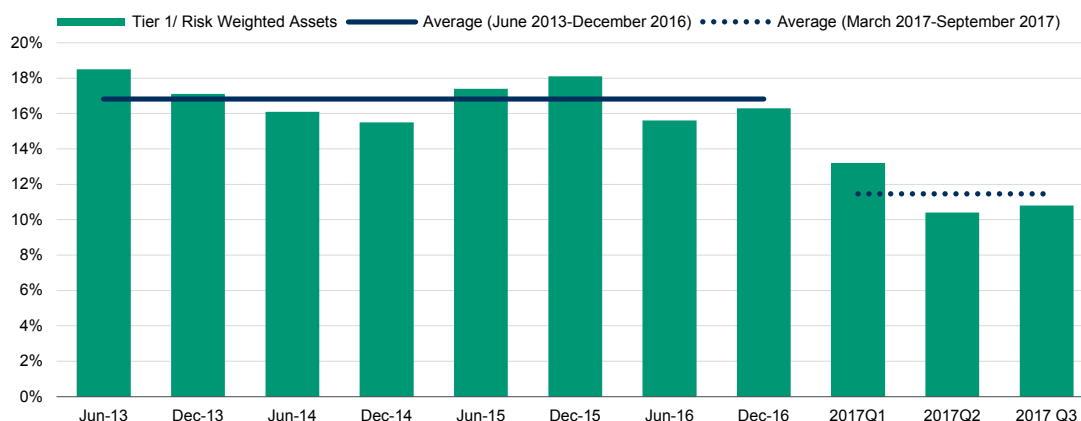
Nigeria's midsize banks' declining capital is credit negative

Last Wednesday, the International Monetary Fund (IMF) released its Nigeria [country report](#), noting that banks' Tier 1 capital ratio had declined to 10.8% in September 2017 from 16.3% in December 2016 and 17.1% in 2013, and is now at its lowest level in the past five years (see Exhibit 1). Meanwhile, the Central Bank of Nigeria's (CBN) last Tuesday [released](#) its bank stress test results, which showed that the banking system's capital vulnerability is driven by midsize³ banks' weaker capital conditions. These trends are credit negative for Nigeria's midsize banks because they limit their loss-absorption capacity against unexpected losses and will restrain their asset growth and revenue generation.

EXHIBIT 1

Nigerian banks' Tier 1 capital ratio fell markedly in 2017

Banks' average Tier 1 capital ratio



Sources: International Monetary Fund and Central Bank of Nigeria

A lower Tier 1 ratio indicates that the capital cushions of banks declined and were less able to absorb any unexpected credit losses amid Nigeria's still-challenging operating environment. Specifically, midsize banks did not hold any capital cushion as of June 2017, with a capital adequacy ratio of minus 6.7% amid rising asset risks as indicated by the increase in the system's average nonperforming loans ratio to 15.1% as of September 2017 from 3.4% in 2013. The system's diminished capacity to absorb unexpected losses is also indicated by a weakening proportion of nonperforming loans net of provisions to capital, which was 43.0% in September 2017 versus 5.9% in 2013.

The CBN's stress test results revealed that midsize banks' capital adequacy ratios would decline to minus 9.9% from minus 6.7% as of June 2017 should the largest five corporate exposures become substandard, one of CBN's stress scenarios. For large banks in that scenario, capital adequacy ratios would decline to 9.2% from 13.1%, while for small-size banks, capital adequacy ratios would decline to 12.1% from 13.5%. The stress test also showed that a 50% increase in nonperforming loans would decrease midsize banks' capital ratio to minus 19.2% from minus 6.7%, compared with 10.2% from 13.1% for large banks and 9.1% from 13.5% for small-size banks, highlighting the higher capital erosion risk faced by Nigeria's midsize banks.

³ The CBN classifies banks with assets equal to or greater than NGN1.0 trillion as large; NGN500 million-NGN1.0 trillion as midsize; and less than NGN500 million as small.

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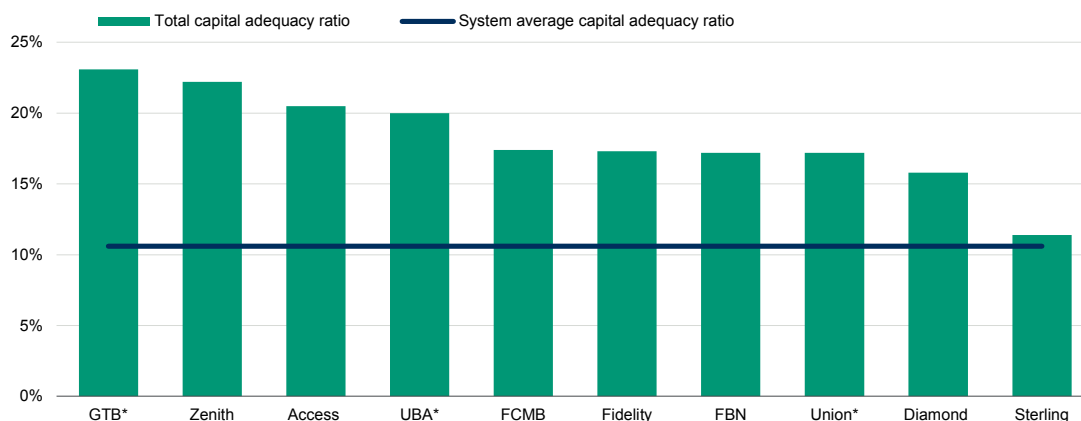
Credit implications of current events

Nigeria's large banks broadly reported high capitalisation levels in 2017. Among large banks for which data were available as of September 2017, [Access Bank Plc](#) (B2 stable, b2⁴) reported a capital adequacy ratio of 20.5 %, 22.2% for [Zenith Bank Plc](#) (B2 stable, b2), 17.2% for [First Bank of Nigeria Limited](#) (B2 stable, b3), 17.4% for FCMB Group, 17.3% for Fidelity Bank Plc, 15.8% for Diamond Bank Plc and 11.4% for [Sterling Bank Plc](#) (B2 stable, b3) (see Exhibit 2).

EXHIBIT 2

Large Nigerian banks had solid capitalisation levels

Total capital adequacy ratios as of September 2017



GTB = Guaranty Trust Bank Plc; Zenith = Zenith Bank Plc; Access = Access Bank Plc; UBA = United Bank for Africa Plc; FCMB = FCMB Group; Fidelity = Fidelity Bank Plc; FBN = First Bank of Nigeria Limited; Union = Union Bank for Africa Plc; Diamond = Diamond Bank Plc; and Sterling = Sterling Bank Plc

*Data for GTB and UBA are as of June 2017. Union's data is our estimate.

Sources: *The banks*

Lower capital also will constrain Nigeria's midsize banks' capacity to grow their business, harming their revenue and delaying capital recovery through profit retention. Additionally, Nigeria's midsize banks face greater risk of losing business to financial technology (fintech) companies because they tend to provide retail banking and payment services to individuals and small and midsize enterprises, a key entry target market for upcoming Nigerian fintechs.

Nevertheless, the CBN issued a [directive](#) in January this year limiting the amount of dividend payout ratios for banks with nonperforming loans and capital ratios beyond certain thresholds. We expect most banks to retain a large portion of their profits this year and build up capital cushions, although we believe profits will be small. Also, the improving Nigerian economy (we expect economy to grow 3.3% this year), following a contraction in 2016 and a slower growth of 1.7% in 2017, will ease the formation of new nonperforming loans in the next 12-18 months.

⁴ The bank ratings shown in this report are the bank's domestic deposit rating and Baseline Credit Assessment.

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Credit implications of current events

Alka Anbarasu
Vice President - Senior Analyst
+65.6398.3712
alka.anbarasu@moodys.com

For India's banks, resolution of Bhushan Steel bankruptcy would be credit positive

Last Wednesday, [Tata Steel Limited](#) (Ba3 stable) announced on the Bombay Stock Exchange that it was the highest bidder to acquire a controlling stake in Bhushan Steel Limited, which is undergoing a resolution under India's 2016 Insolvency and Bankruptcy Code. The sale of Bhushan Steel, which is one of the Indian banking sector's largest nonperforming assets, is credit positive because it will help improve banks' asset quality metrics and sets a precedent for the resolution of other nonperforming assets held by banks, particularly in the steel sector.

Tata did not disclose the final purchase price or the transaction's terms and conditions. Nevertheless, based on media reports, the purchase price could result in a haircut of around 25% for Bhushan Steel's lenders. The Reserve Bank of India, the central bank, has asked banks to provide a minimum of 50% of their respective loan amounts for the account by March 2018. As such, a haircut of less than their provisioning cover likely will result in a write-back of provisions for the banks and help improve profitability.

In addition, depending on individual banks' exposure to the accounts, we expect banks' pro forma reported nonperforming loan ratios as of December 2017 to improve by 50-80 basis points because the exposure will be converted into a standard asset. We expect most rated Indian banks to have some exposure to Bhushan Steel, with the resolution particularly benefitting [State Bank of India](#) (Baa2 stable, ba1⁵), the leader of the consortium of lenders to Bhushan Steel.

Bhushan Steel is one of the banks' 12 large nonperforming assets that last year its lenders took to India's National Company Law Tribunal (NCLT) for a resolution under the Insolvency and Bankruptcy Code. About 40% of banks' nonperforming assets by value, or about INR3.4 trillion, are undergoing resolution under the NCLT, which started in July 2017. Within this 40%, the steel sector constitutes about 35% of the nonperforming assets. Within the steel sector's NPLs, Bhushan Steel assets comprise about a 40% share.

Meaningful resolutions of Bhushan Steel and the other nonperforming assets would significantly improve banks' asset quality metrics. Beyond asset quality, the effect on profitability and capital will depend on the haircuts that lenders take in the resolution process. The Bhushan Steel transaction is an important milestone because it is the first and largest of the 12 large nonperforming assets in the NCLT resolution process. If the other steel assets are resolved with similar haircuts, many banks can expect a positive effect on profitability and capital.

⁵ The bank ratings shown in this report are State Bank of India's deposit rating and Baseline Credit Assessment.

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Credit implications of current events

Insurers

Cigna's announced acquisition of Express Scripts is credit negative

Last Thursday, [Cigna Corporation](#) (Baa1 review for downgrade, insurance subsidiaries' financial strength A1 review for downgrade) announced that it was acquiring [Express Scripts Holding Company](#) (Baa2 direction uncertain), the last remaining, large, independent pharmacy benefits manager (PBM) in the US, in a deal worth just under \$70 billion. The transaction is credit negative for Cigna because it involves a significant increase in debt and goodwill that will weaken Cigna's financial profile. Following the announcement, we [placed](#) Cigna's ratings on review for downgrade.

As part of the deal, Express Scripts shareholders will receive \$97.50 per share, a 31% premium to the pre-announcement closing price. Cigna will finance the transaction with \$26.6 billion of new equity, \$22.5 billion of new debt, plus the assumption of \$13.2 billion of existing Express Scripts debt and available cash.

On a pro forma basis as of year-end 2017, Cigna's leverage, as measured by adjusted debt to capital, will increase to 50.3% from 33.0% and its adjusted debt to EBITDA will rise to 3.5x from 1.4x. Looked at another way, Cigna's debt will increase to \$41.1 billion when the acquisition is fully financed from approximately \$5.4 billion at year-end 2017. The deal also will meaningfully increase goodwill and intangible assets as a percent of shareholder's equity to at least 120% from 69% at year-end 2017, which we view as a proxy for the level of integration risk. Finally, although we expect debt to be well-laddered over various maturities, the company is planning to pay off \$8 billion during the first two years after the transaction close. This should be amply covered by cash flow, but any unforeseen events risk challenging Cigna's cash flow.

By owning Express Scripts, Cigna can presumably focus more on reducing the overall cost of care, and will benefit from Express Scripts' strong unregulated cash flow generation. In 2017, Express Scripts generated \$7.3 billion in EBITDA, versus Cigna's \$4.4 billion, and unlike Cigna's insurance subsidiaries, Express Scripts' unregulated cash flow is entirely available to the parent company.

Beyond the adverse effect on Cigna's financial profile, the acquisition brings operational and strategic risks. Although well-known and factored into Cigna's projections, Express Scripts at the end of 2019 is losing its largest client, Anthem, which contributed about 18% of revenue and 33% of EBITDA in the first quarter of 2017. Anthem is suing Express Scripts for \$15 billion, claiming it has been charged too much according to its contract (Express Scripts is counter-suing). The timing and outcome of this legal battle are unknown and pose a risk. Finally, regulators recently have criticized the non-transparent market within which PBMs operate as contributing to the high cost of certain drugs; any move by regulators to reduce PBMs' margins would be credit negative for the PBM sector.

The acquisition continues a trend of vertical integration among large health insurers that are seeking more control over medical costs. The Cigna-Express Scripts announcement follows the pending combination of [CVS Health](#) (Baa1 review for downgrade), another leading PBM, and [Aetna Inc.](#) (Baa2 stable, insurance subsidiaries' financial strength A2 stable); [UnitedHealth Group Inc.](#)'s (A3 stable, insurance subsidiaries' financial strength A1 stable) announced acquisition of physician group Davita Medical Group; and [Humana Inc.](#)'s (Baa3 stable, insurance subsidiaries' financial strength A3 stable) investment in Kindred Home Health.

Dean Ungar
Vice President - Senior Analyst
+1.212.553.6968
dean.ungar@moody.com

NEWS & ANALYSIS

Credit implications of current events

Dominic Simpson
Vice President - Senior Credit Officer
+44.20.7772.1647
dominc.simpson@moody's.com

James Eck
Vice President - Senior Credit Officer
+1.212.553.4438
james.eck@moody's.com

AXA's purchase of XL Group is credit negative for buyer, positive for target

Last Monday, [AXA](#) (A2 negative) announced plans to acquire Bermuda-based [XL Group Ltd.](#), which issues debt via its subsidiary [XLIT Ltd.](#) (Baa2 review for upgrade) for \$15.3 billion (€12.4 billion) in cash or \$57.60 per XL Group share, a 33% premium to its 2 March closing price. The planned transaction is credit negative for AXA because the proposed financing will significantly increase AXA's financial leverage and substantially increase goodwill on its balance sheet. For XL Group, the transaction is credit positive because the company's private status within a large global insurance group will help it manage volatility associated with catastrophe exposures and (re)insurance pricing cycles, and improve its access to capital following large catastrophic events.

Following the announcement, we [affirmed](#) AXA's A2 rating and those of its main operating subsidiaries (financial strength Aa3), changing AXA's outlook to negative from stable; we [placed](#) the A2 insurance financial strength ratings of XL Group's principal operating subsidiaries and the senior Baa2 rating of XLIT on review for upgrade. The parties expect to complete the transaction during the second half of 2018, pending certain approvals and other closing conditions.

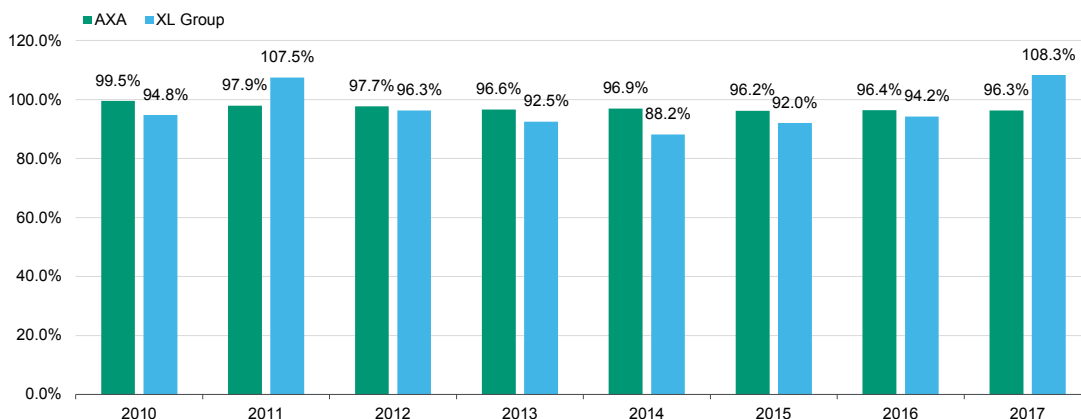
AXA intends to fund the purchase of XL Group with €3.5 billion of cash, the issuance of €3 billion of subordinated debt and €6 billion from both the planned IPO of existing US life insurance and asset management operations and the related pre-IPO transactions. Together with XL Group's existing debt and the additional \$4.4 billion of debt that AXA's US operations plan to raise as part of its pre-IPO restructuring, we estimate that AXA's pro forma Moody's-adjusted financial leverage will increase to more than 30% from around 25% as of year-end 2017. Although AXA aims to reduce its debt gearing to below 28% within two years (including the US IPO-related debt issuance) from an estimated 32% as of year-end 2018, the proposed funding structure presents some execution risk given its linkage to the planned US IPO. If the US IPO is delayed, or if IPO proceeds are below current expectations, AXA risks being forced to tap into its backup bridge financing, further increasing its financial leverage.

An additional challenge associated with the acquisition for AXA is the intrinsic volatility of XL Group's reinsurance business and certain insurance lines, reflecting the significant exposure to natural and man-made catastrophes, as well as the firm's moderate levels of reported profitability in recent years. We consider AXA's currently stable earnings, which benefit from its focus on retail and small and midsize enterprise property and casualty (P&C) risks, a key credit strength. Acquiring XL Group will likely introduce more volatility into AXA's results even as it intends to reduce XL Group's catastrophe exposure post-closing. The deal also carries execution and attrition risk for AXA, given XL Group's reliance on seasoned underwriters. The exhibit below compares the two groups' property and casualty underwriting combined ratios.

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Credit implications of current events

AXA's and XL Group's property and casualty underwriting combined ratios



Sources: The companies

More positively, AXA will benefit from XL Group's extensive global insurance and reinsurance platform, which will significantly enhance AXA's presence in the global P&C commercial lines insurance market. The combined business will be among the largest global P&C commercial lines insurers, with more than €30 billion in annual gross premiums written. XL Group's strongly diversified business, including specialty insurance lines and reinsurance, complements and diversifies AXA's existing commercial insurance lines.

AXA expects XL Group's business to bring material risk diversification and capital benefits under Solvency II of five to 10 percentage points following the approval and integration of XL Group's internal model around 2020. In acquiring XL Group and selling down its existing US life insurance and asset management operations, AXA also is accelerating its ambition of more reliance on technical margins and less on financial market-related earnings. Including XL Group and excluding AXA US, AXA states that the P&C contribution to its 2016 pretax underlying earnings will increase to 50% from 39% on a pro forma basis.

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Credit implications of current events

Sovereigns

Matthew Circosta
Analyst
+65.6398.8324
matthew.circosta@moodys.com

Revised Trans-Pacific Partnership is credit positive for all member nations, but less so without the US

Last Thursday, the 11 members of the Trans-Pacific Partnership (TPP) signed a revised free trade agreement, moving forward without the [US](#) (Aaa stable), which withdrew from the TPP in January 2017. Gains from the renamed Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) will be smaller without US participation, but the trade deal still will boost exports and incomes for all members and help sustain reform efforts in a number of countries, all credit positives.

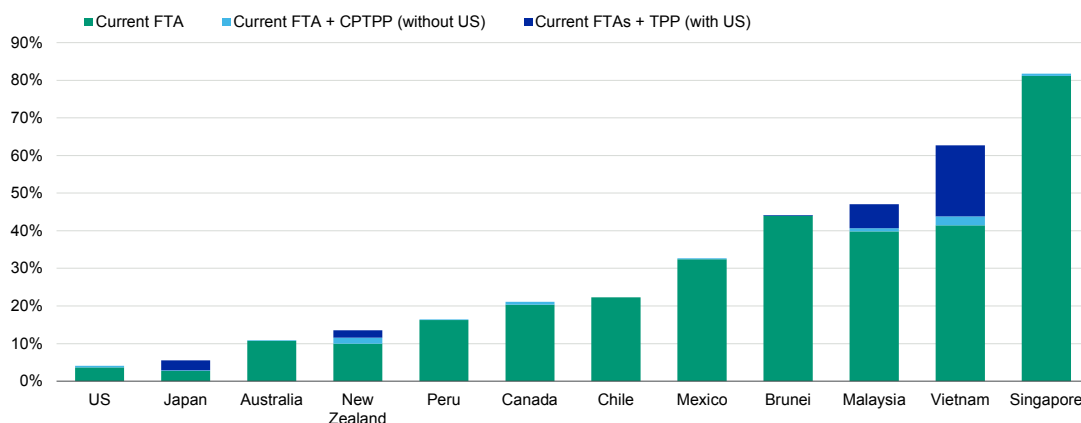
Participating nations are [Australia](#) (Aaa stable), Brunei, [Canada](#) (Aaa stable), [Chile](#) (Aa3 negative), [Japan](#) (A1 stable), [Malaysia](#) (A3 stable), [Mexico](#) (A3 negative), [New Zealand](#) (Aaa stable), [Peru](#) (A3 stable), [Singapore](#) (Aaa stable) and [Vietnam](#) (B1 positive). Analysis by the Peterson Institute for International Economics (PIIE) finds that the CPTPP will generate real income gains of \$157 billion for member countries, compared with \$465 billion for the original TPP, including the US.

Malaysia will be the biggest winner from CPTPP, according to the PIIE analysis. The deal provides Malaysia export access to new markets including Canada, Mexico and Peru, benefiting palm oil, rubber and electronics producers. However, because Malaysia, along with Vietnam, had the most to gain from greater access to the US market under TPP given the scope of current trade agreements (see Exhibit 1), they lost more export opportunity than other signatories after the US withdrawal from TPP.

EXHIBIT 1

Malaysia and Vietnam lost more export opportunity than other CPTPP members without US participation

Total exports of goods covered by free-trade agreements as a percent of GDP in 2016



Sources: International Monetary Fund, Haver Analytics and Moody's Investors Service

Beside Malaysia, real incomes in Singapore, Brunei, Vietnam and Peru will rise by more than 2.0% by 2030 versus a path without CPTPP, according to PIIE (see Exhibit 2).

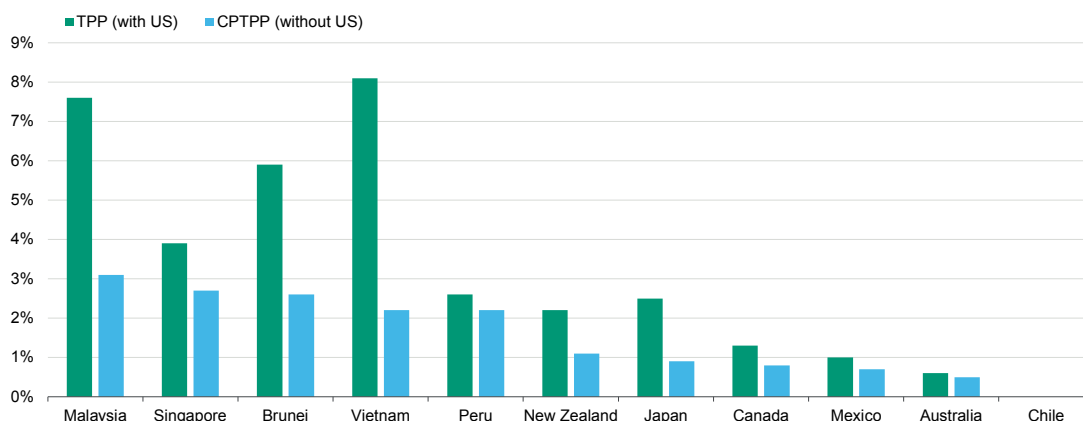
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Credit implications of current events

EXHIBIT 2

CPTPP's effect on real income are highest for Malaysia and Singapore

PIIE estimates of real income percentage changes in 2030 with CPTPP compared with no CPTPP



Source: Peterson Institute for International Economics

The real income gains for Australia, Canada and Mexico are similar to the original TPP deal because these countries already have free trade agreements with the US and they will benefit from growing exports to other CPTPP members. We expect Canada and Mexico to attract more investment from CPTPP members, particularly Southeast Asian exporters looking for greater access to the US market – assuming a smooth resolution on the North America Free Trade Agreement renegotiations. Chile has free-trade agreements in force with all CPTPP signatory countries, so the gains from trade in the CPTPP will be small.

Because the lower trade and non-trade barriers under CPTPP are conditional on country-specific reforms, the agreement also will help to sustain domestic reform momentum. We expect ongoing reform efforts to boost competitiveness and investment, and strengthen institutional quality over time for member nations. The benefits would be greatest for those sovereigns with relatively low governance and competitiveness scores, such as Peru, Vietnam, Mexico and Brunei. However, the suspension of specific provisions from the original agreement could slow reform progress in some countries.

If the CPTPP expands its membership to include other large Asian economies that have expressed interest in joining the deal, including [Indonesia](#) (Baa3 positive), [Korea](#) (Aa2 stable), the [Philippines](#) (Baa2 stable), [Taiwan](#) (Aa3 stable) and [Thailand](#) (Baa1 stable), real income gains for members would be much greater than the current CPTPP deal and higher than the original TPP. The PIIE estimates that the inclusion of the five aforementioned Asian countries would result in real income gains of \$486 billion for member countries.

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Sub-sovereigns

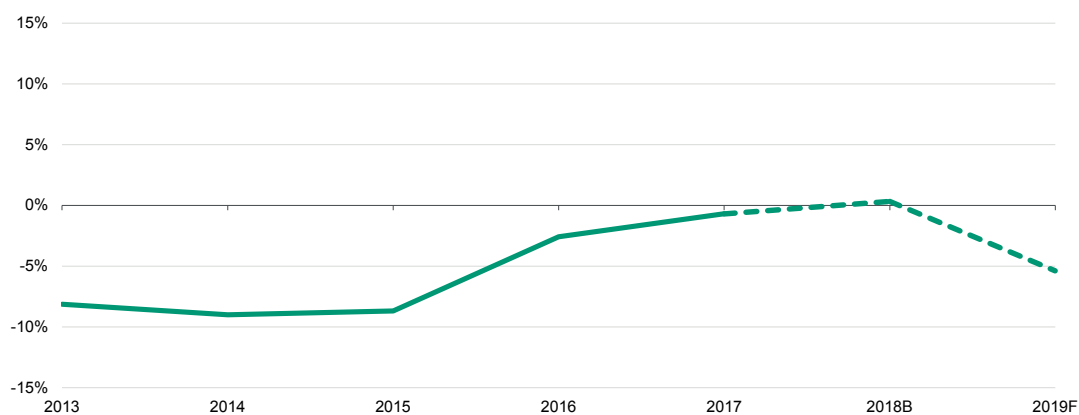
Jonathan Reid
Associate Analyst
+1.416.214.3634
jonathan.reid@moody's.com

Ontario's planned return to deficits is credit negative

Last Wednesday, the Canadian [Province of Ontario](#) (Aa2 stable) outlined its intention to return to deficit for fiscal 2019, which ends 31 March 2019, only one year after posting its first balanced budget in a decade. The return to a deficit would be credit negative for the province because it will necessitate higher debt and indicates that the province's revenue and expenses may be structurally imbalanced. Although the province has not yet presented its budget, it has indicated that its deficit would be less than 1% of GDP, which at the upper threshold would be nearly 6% of total revenue, as shown in Exhibit 1.

EXHIBIT 1

Ontario's consolidated surplus or deficit as a percent of total revenue



Sources: Province of Ontario and Moody's Investors Service forecasts for 2019

In its announcement, Ontario outlined two priorities for increased spending. The first is increased social program spending to support low-income families facing rising costs. The second priority is to support economic growth, even though Ontario's February unemployment rate was its second lowest in the past 25 years and in recent years the province has consistently reported some of Canada's strongest provincial GDP growth.

We forecast that expenditure growth will surpass 5% in both fiscal 2018 and fiscal 2019, compared with less than 3% annually between fiscal 2014 and fiscal 2017. The growth in expenditures is approximately double what Ontario had previously forecast, indicating that the province's ability to limit expenditure growth below that of revenue growth may not be sustainable under its current fiscal structure.

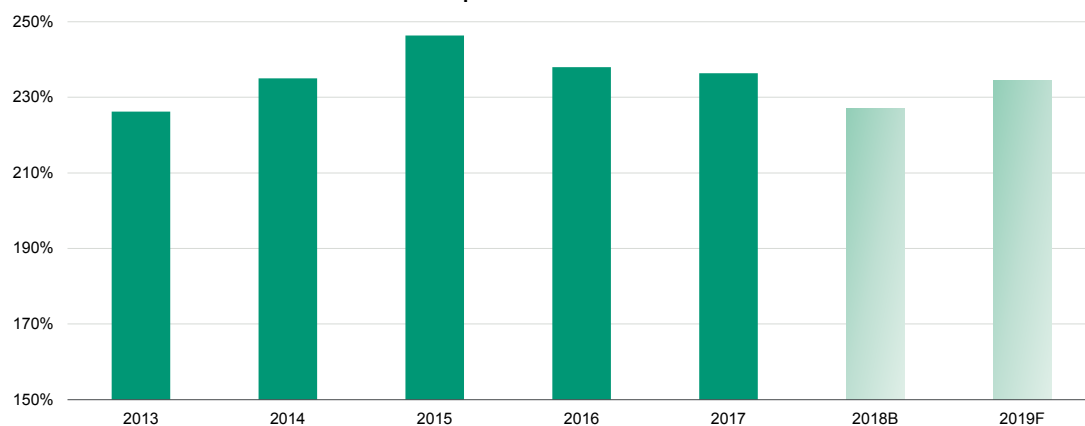
Ontario is the most indebted sub-sovereign that we rate and the additional debt required to finance its 2019 deficit will reverse the province's trend of making modest improvements to its debt burden (see Exhibit 2). We now forecast that Ontario's net direct and indirect debt will surpass 230% of revenue in fiscal 2019, driven by both the need to finance the announced operating deficit and the financing requirements of the planned CAD15.4 billion in capital expenditures.

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Credit implications of current events

EXHIBIT 2

Ontario's net direct and indirect debt as a percent of revenue



Sources: Province of Ontario and Moody's Investors Service

Ontario's willingness to return to deficit falls in line with other provincial governments such as Manitoba and New Brunswick, which over the past two years have postponed the date when they expected to return to fiscal balance, as well as the Canadian government, which stated during the release of its latest budget on 27 February that it would run fiscal deficits for the foreseeable future.

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Credit implications of current events

Alejandro Pavlov
Vice President - Senior Analyst
+54.11.5129.2629
alejandropavlov@moodys.com

Argentine Province of Chubut approves fiscal pact with federal government, a credit positive

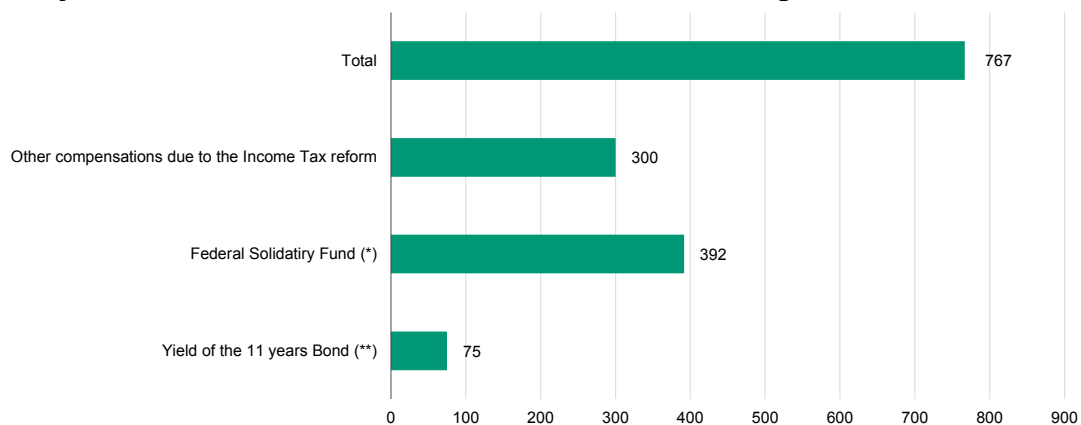
Last Wednesday, the Argentine [Province of Chubut](#)'s (B3 stable) congress approved a fiscal pact with the federal government, originally agreed to by Chubut Governor Mariano Arcioni in November 2017. The pact is credit positive for Chubut, which will receive about ARS800 million of federal transfers, equal to around 2% of its projected 2018 revenue, that it would not have received without the pact.

Because of the federal transfers, Chubut's projected gross operating deficit will be 5% of current revenue, down from the 7% we expected in our base-case scenario for Chubut without the pact. The measure is also credit positive because it forces the province to adhere to the new fiscal responsibility law in force since January, which will limit the province's expenses and growth in the number of public employees.

In November 2017, the majority of Argentina's governors, including Mr. Arcioni, entered an agreement with the federal government that set shared obligations and objectives. Those shared objectives included improving the country's tax structure, approving a new fiscal responsibility law, boosting economic activity and employment, and working together toward a new tax-sharing law. One key objective was offsetting a reduction in federal transfers brought about by income tax reform, with the government committing to compensate provinces that participated in the agreement. The approximately ARS800 million that Chubut will receive this year equals 33% of its projected gross operating deficit, which we estimate at around ARS2.4 billion (or 7% of its current revenue). Exhibit 1 below shows the composition of the different compensation items we estimate that Chubut will receive this year under the agreement, while Exhibit 2 shows our estimate of the agreement's effect on Chubut's gross operating results.

EXHIBIT 1

Moody's estimate of Chubut's federal revenue inflow under the fiscal agreement



* The Federal Solidarity Fund distributes revenue from export duties to the country's provinces based on fixed percentages set in the Tax Sharing Law of 1988.

** The federal government will issue an 11-year bond and grant it to provinces participating in the fiscal agreement.

Sources: Chubut's fiscal agreement and Moody's Investors Service estimates

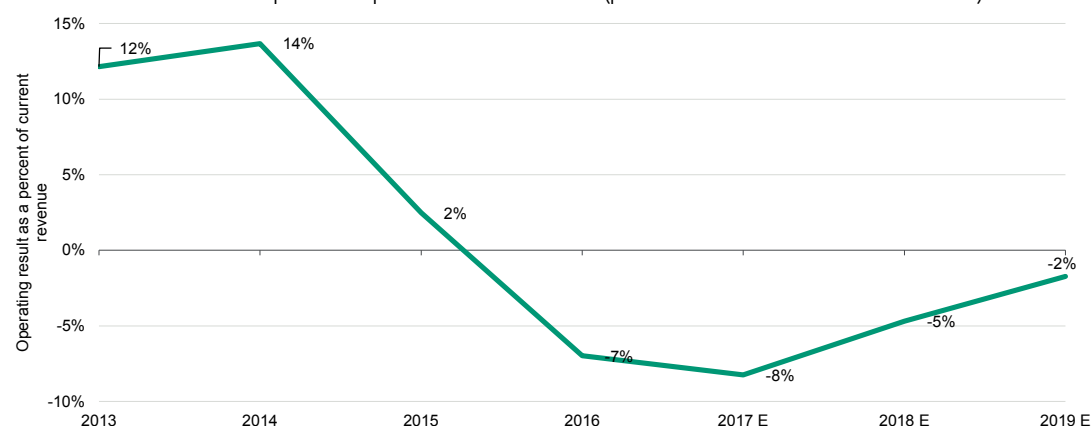
NEWS & ANALYSIS

Credit implications of current events

EXHIBIT 2

Moody's estimate of Chubut's gross operating results

Current revenue less current expenses as a percent of current revenue (provincial administration and other entities)

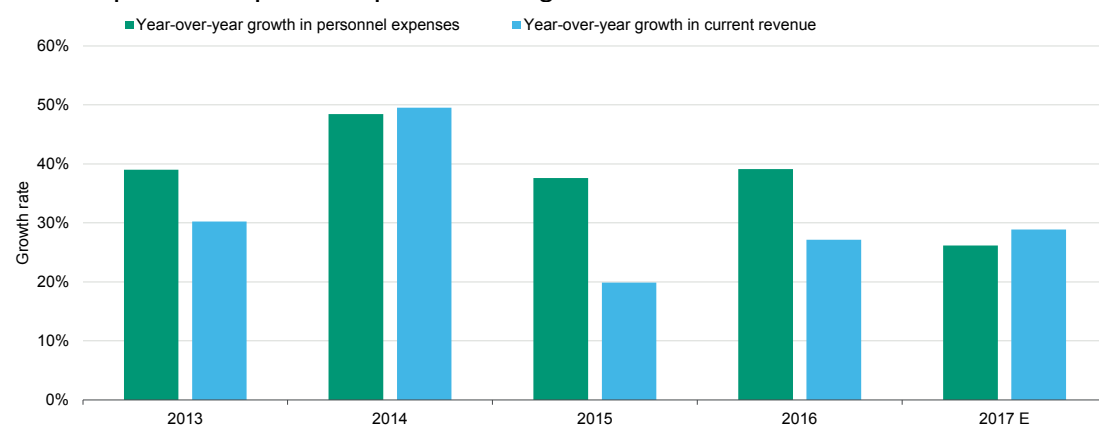


Sources: Chubut's fiscal agreement and Moody's Investors Service estimates

Chubut also must adhere to Argentina's new national fiscal responsibility law, which commits the provinces to limit their expense growth to the inflation rate, and to limit the growth rate of new public employees to the demographic growth rate in each province. Over 2015 and 2016, personnel expenses grew faster than current revenue, worsening Chubut's operating results (see Exhibit 3).

EXHIBIT 3

Chubut's personnel expenses outpaced revenue growth in 2015 and 2016



Sources: Chubut's financial data and Moody's Investors Service

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EDITORS

Jay Sherman and Elisa Herr

SENIOR PRODUCTION ASSOCIATE

Amanda Kissoon

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