abrdn Investments

Frontier debt: Generating alpha in the ‘new Emerging Markets’

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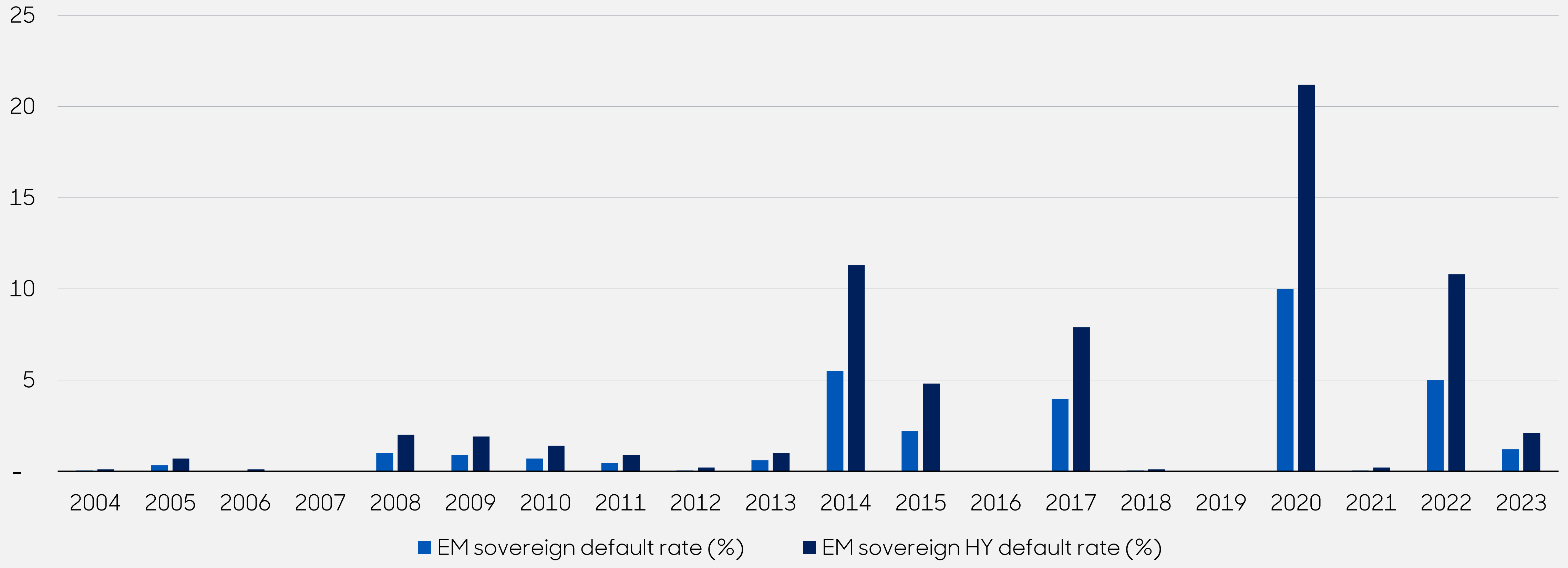
Sovereign debt defaults: Risk or opportunity?

Owing to challenging market conditions there has been an increase in EM sovereign defaults in recent years

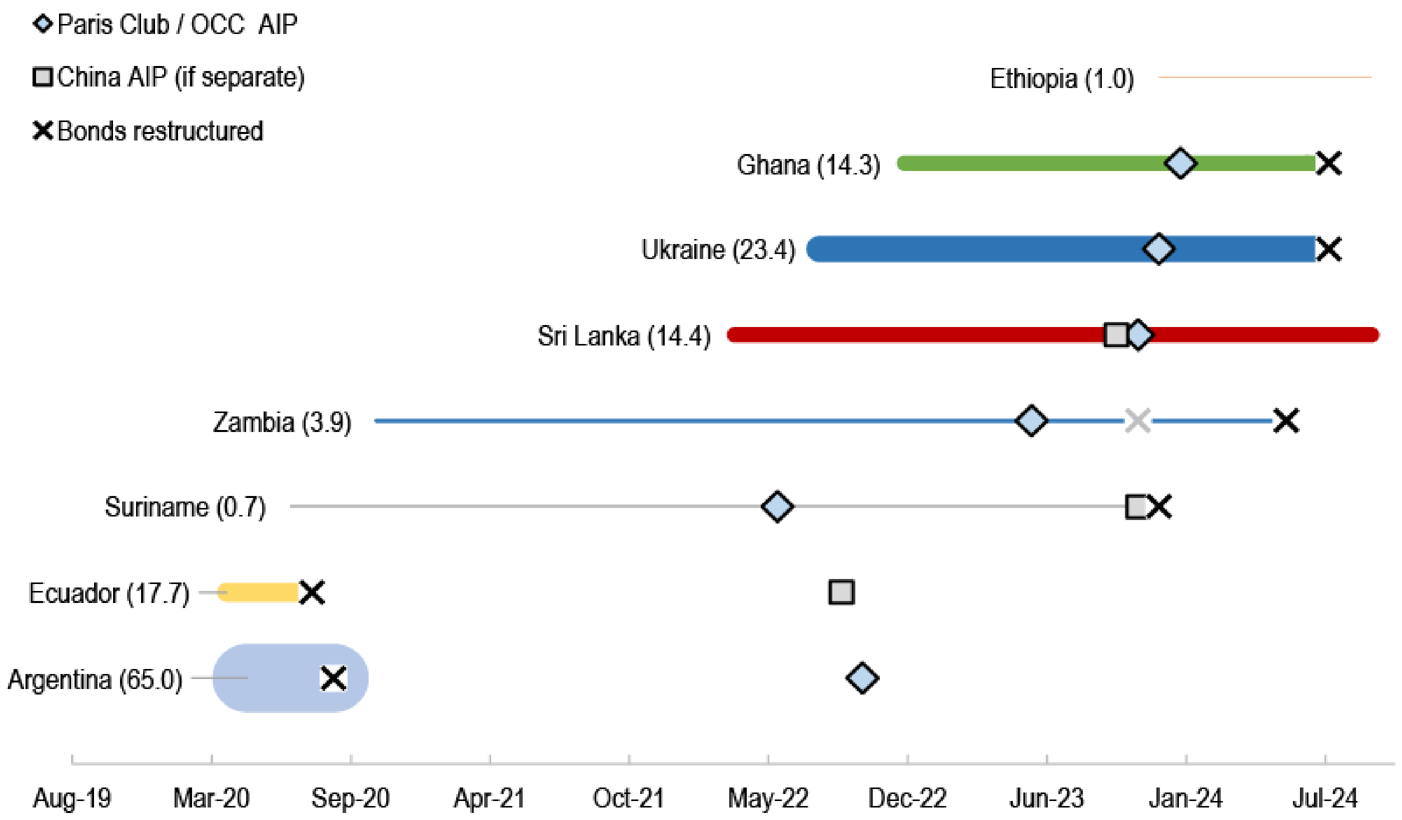
EM sovereign overall and EM sovereign HY default rates (%)



Source: JP Morgan, November 2024.

2024 has seen the completion of several landmark debt restructurings

State-Contingent Debt Instruments have become a key tool to smooth over differences between debtors and creditors

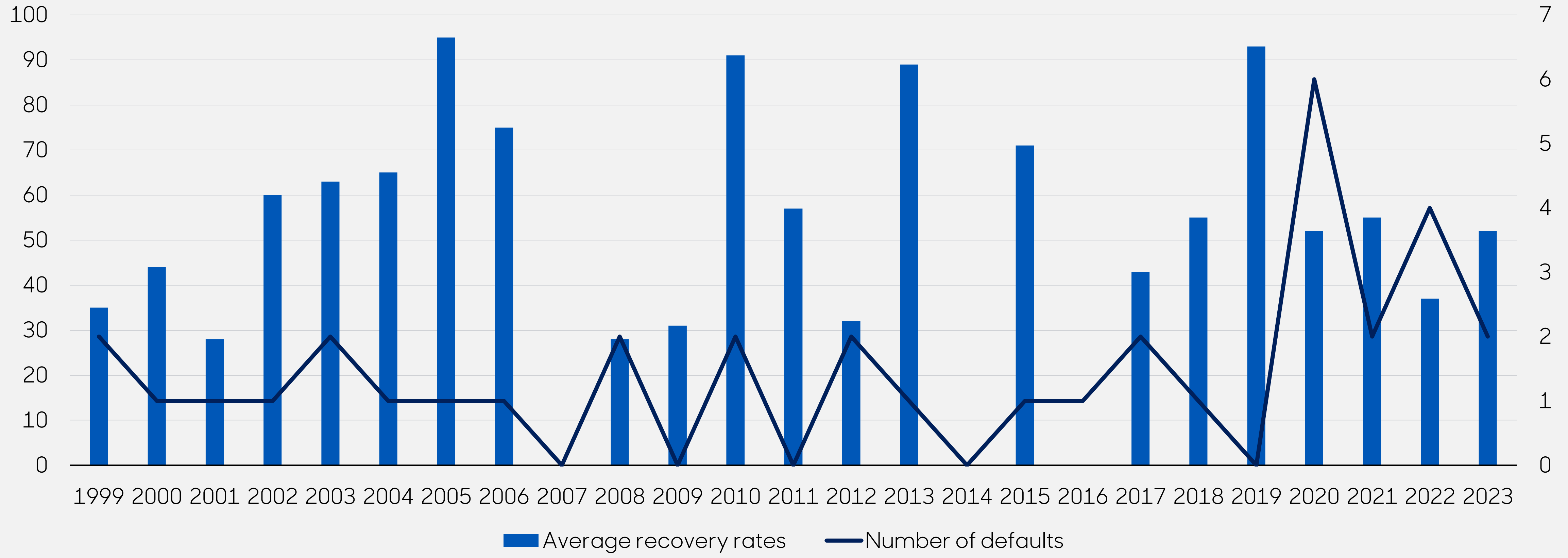


Source: JP Morgan, November 2024

Historical recovery rates have settled at 30-40s or 60-70s range

Restructured situations in 2024 have seen price recovery levels of more than 50% from the date of default/moratorium

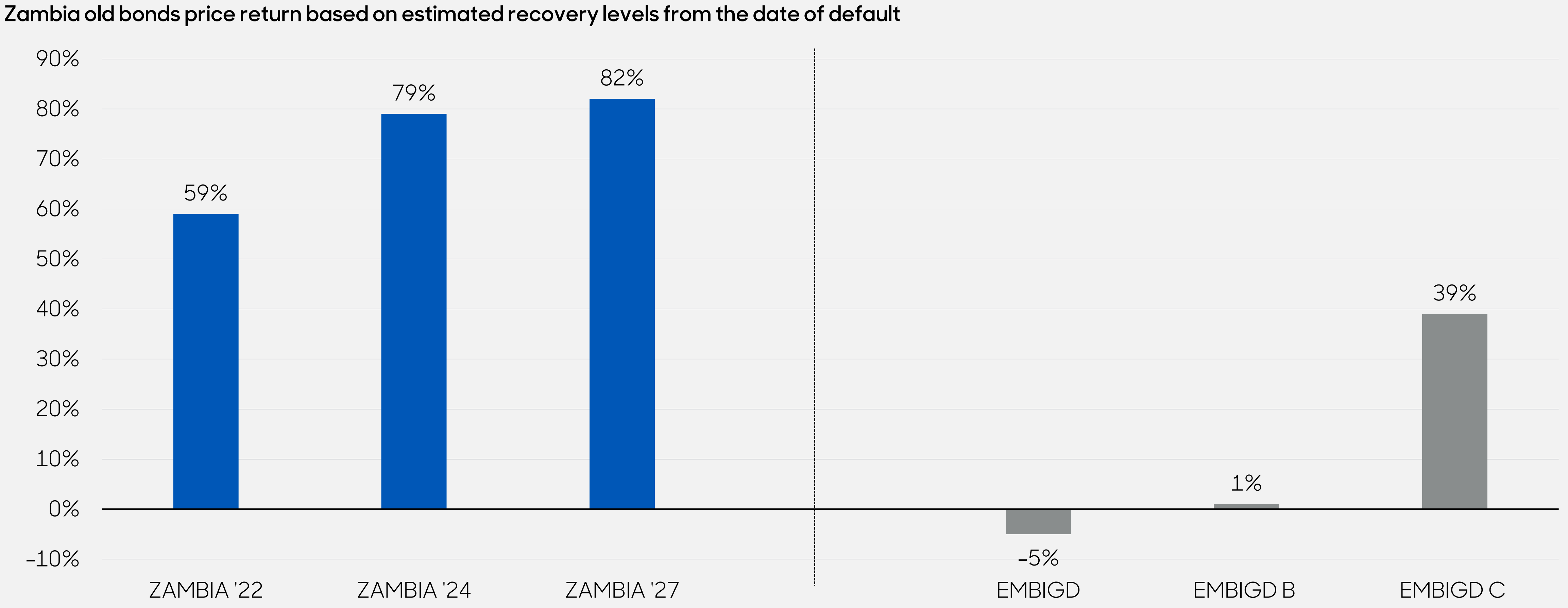
LHS: Annual average recovery rates (%); RHS: Number of EM sovereign defaults in a year



Source: Bloomberg. For illustrative purposes only. No assumptions regarding future performance should be made.
Zambia: Pricing date: 11 June 2024 and default date: 14 October 2020

Defaulted bonds in Zambia have significantly outperformed the mainstream EM index

Total return over the defaulted period on bonds in Zambia was on average 78% more than on the mainstream EM index



Source: Bloomberg. For illustrative purposes only. No assumptions regarding future performance should be made.
Zambia: Pricing date: 11 June 2024 and default date: 14 October 2020

How do we approach sovereign debt restructurings at abrdn?

Key steps in assessing sovereign defaults

Having legal and restructuring expertise on the team is an essential part of the toolkit

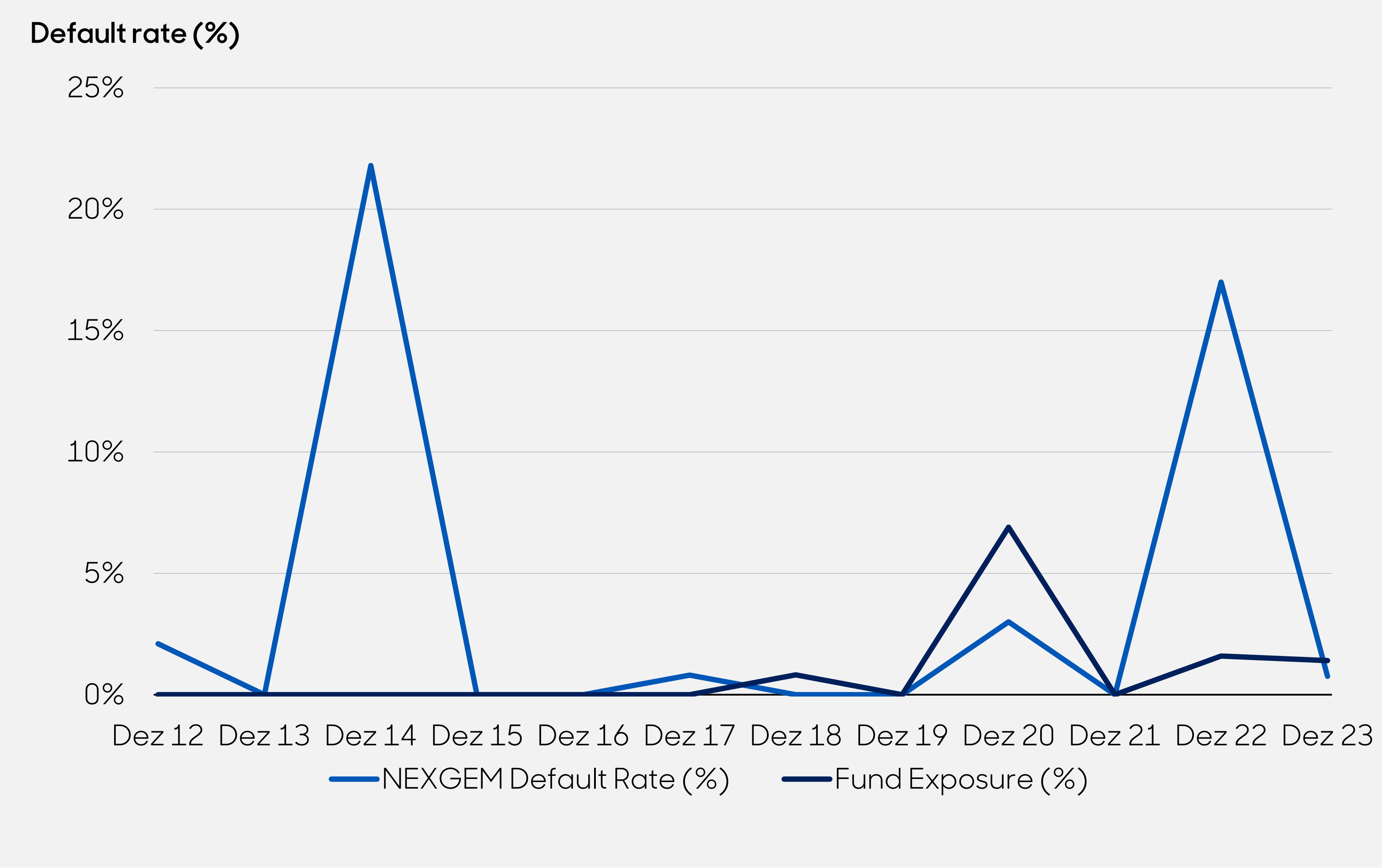
Example: Ghana

- Ghana announced it would stop servicing its external debt in December 2022
- Debt servicing on $13bn Eurobonds was halted but the partially guaranteed World Bank bond remained current
- Eurobonds had been trading at distressed prices for over a year prior to default
- Fundamental analysis complemented by our recovery model with input from our quantitative analyst
- Recover model included a range of scenarios on the size of the principal haircut and exit yields in order to assess the risk-return on the defaulted bonds
- We also used the metrics from the IMF LIC DSA to assess the recovery value
- We started to build a position on the bonds in the mid-30s in early 2023 as we thought prices had overshot on the downside
- Abrdn played a lead role in selecting the financial and legal advisors for the Steering Committee formed in late 2022
- We held regular meetings with our advisors in 2023, restructuring terms proposed in Oct but Ghana did not respond until January 2024
- The delay was unfortunate, but we reached AIP with Ghana in April 2024 although it had one breach on the DSA parameters
- Terms were revised to comply with the DSA, and we reached an agreement in June 2024 with new bonds issued in October

Source: abrdn, November 2024

We have a strong track record of avoiding credit events...

We bought Zambia, Ghana and Ecuador at distressed levels as we expected restructurings to result in higher recovery values



Country	Default Date NEXGEM	Default Date abrdn FBF
Venezuela	–	Jan. 2018
Belize	Aug. 2012	–
Argentina	Jul. 2014	–
Mozambique	Jan. 2017	–
Ecuador	–	Apr. 2020
Zambia	Nov. 2020	Nov. 2020
Suriname	Nov. 2020	–
Sri Lanka	Apr. 2022	–
Ghana	Dec. 2022	Dec. 2022
Ethiopia	Dec. 2023	Dec. 2023

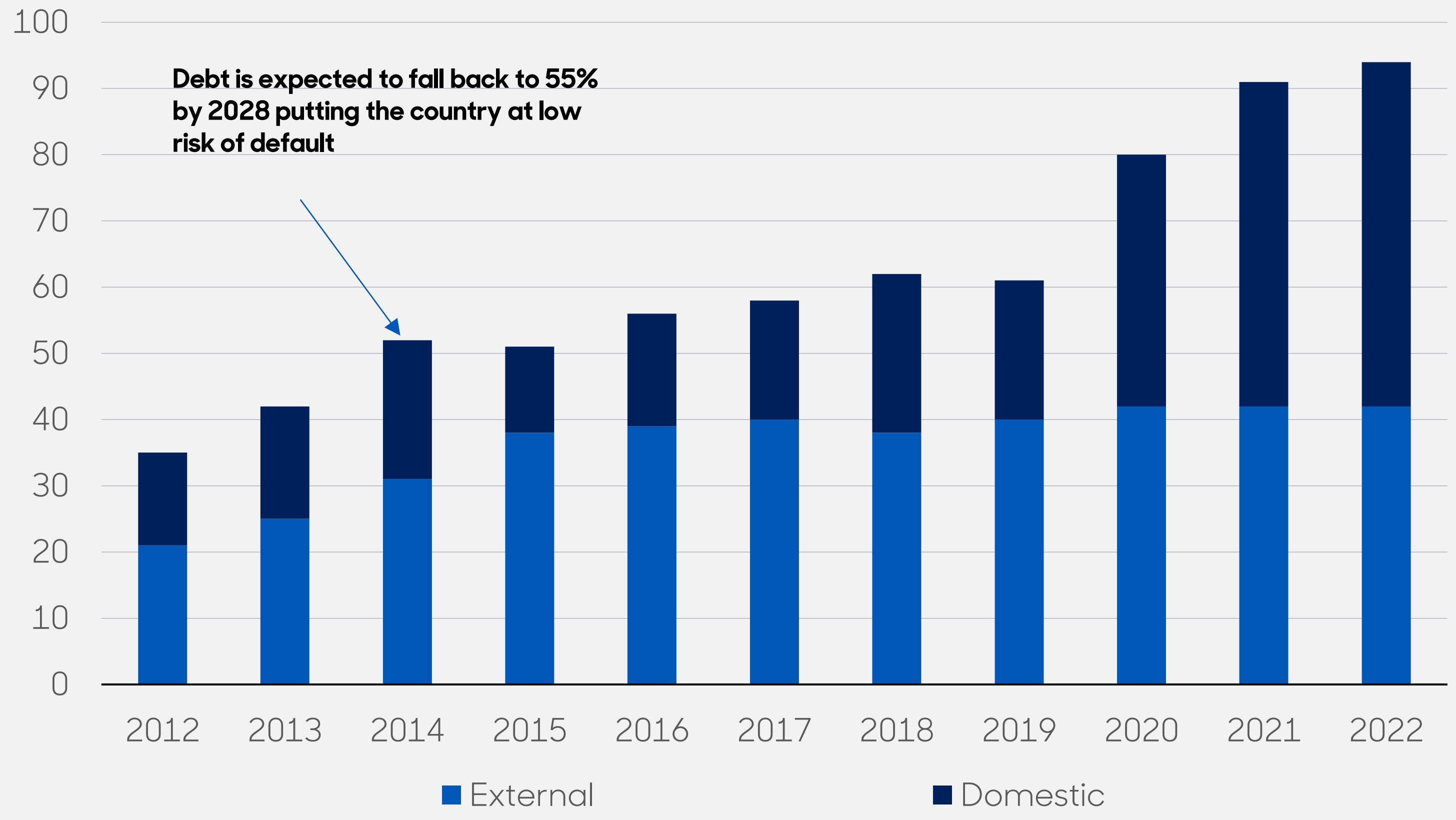
Source: JP Morgan, abrdn, November 2024

…and often initiate positions in distressed credits post the default

Our positioning in Ghana has been a strong contributor to relative performance following default in Dec 22

- Ghana defaulted on its Eurobonds in Dec 2022
- We had been reducing our exposure going back to 2021
- We began adding to our position in the mid 30s, reflecting our view that the market was too bearish on the recovery value
- Restructuring agreement based on recovery of 55 cents but was just under 60 cents due to lower exit yields on the new bonds
- Our view on the debt restructuring was well informed given we were part of the Steering Committee through the whole of the restructuring process

Public Debt (in % of GDP)



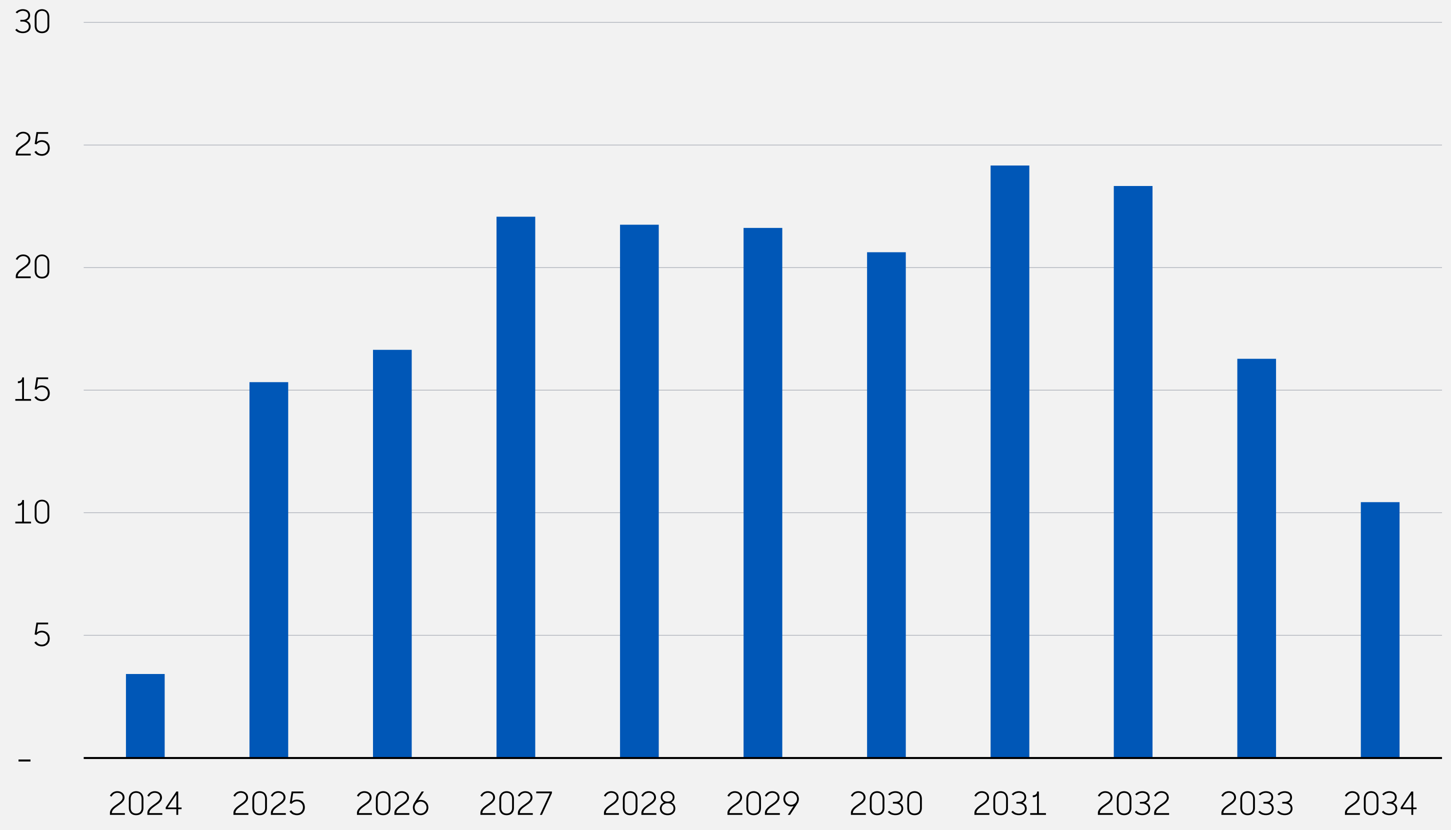
Source: Ghanian authorities and IMF staff calculations, 31 December 2023

Where next for frontier bond markets?

Frontier maturity schedule remains manageable over next few years

A lighter maturity schedule reduces the probability of credit events

Frontier Sovereign Maturities ($bn)



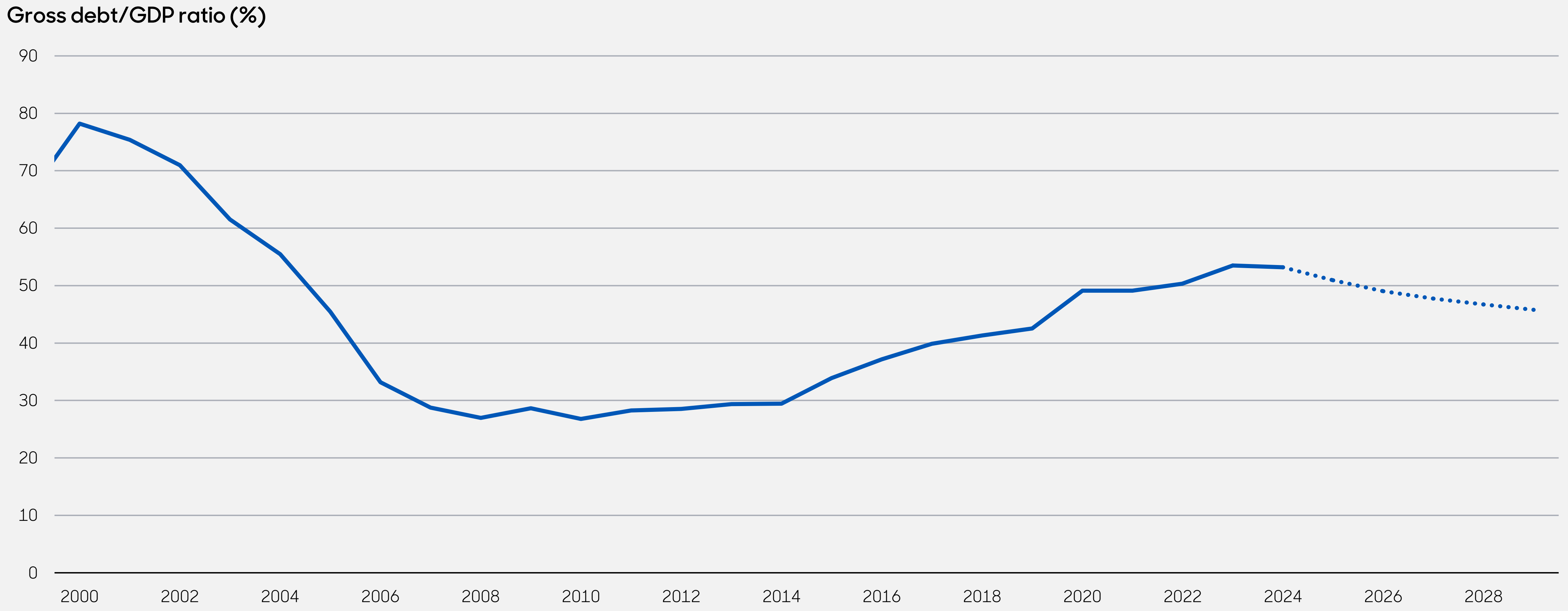
Source: IMF, Word Bank, October 2024

Upcoming maturities in 2025

Year	Amount ($bn)
Egypt	3.08
Nigeria	1.12
Tunisia	1.05
Angola	0.86
Gabon	0.61
Costa Rica	0.50
Pakistan	0.50
Dominican Republic	0.36
Iraq	0.34
Armenia	0.31
Kenya	0.30

Whilst debt balances are undergoing their most meaningful decline in two decades

Coupled with a lighter maturity schedule, this reduces the probability of credit events

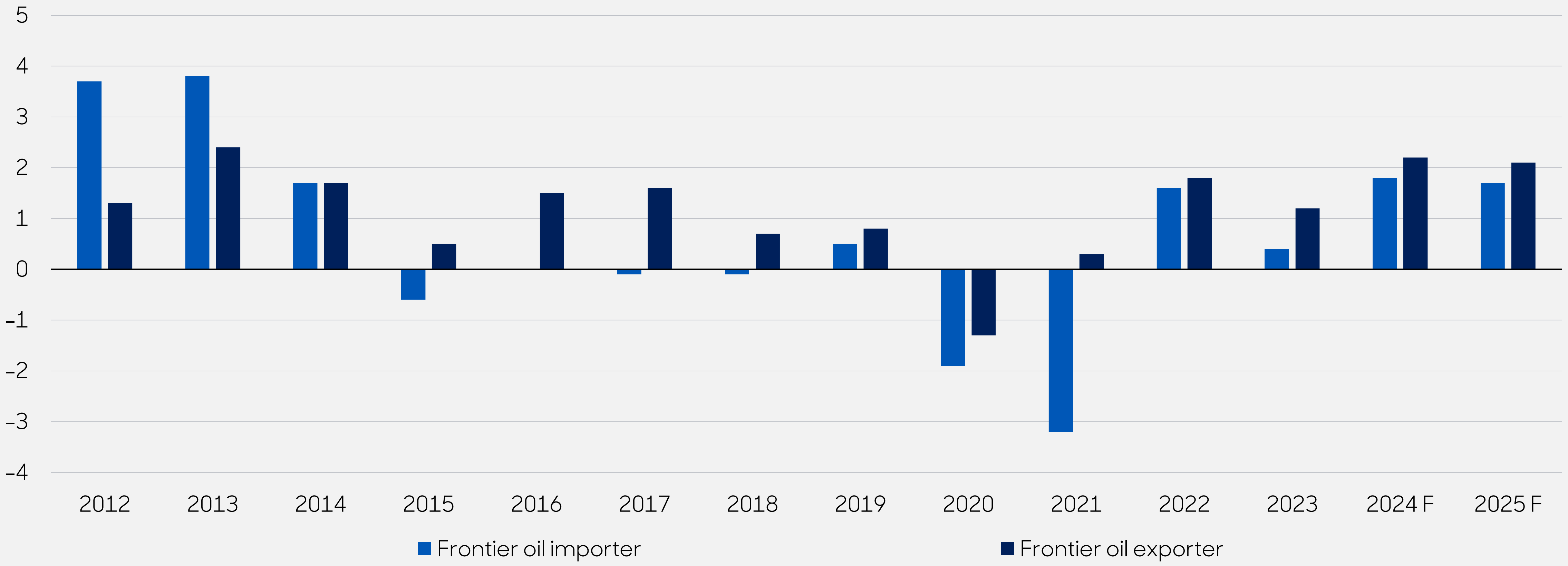


Source: IMF, October 2024. Forecasts are not a reliable indicator of future results and there can be no guarantee that these will be achieved

A frontier growth premia continues to exist vs developed markets

Despite the headwinds faced, frontier economies have continued to show resilient growth

Real GDP growth premia vs. United States (%)



Source: IMF WEO, October 2024. Forecasts are not a reliable indicator of future results and there can be no guarantee that these will be achieved

Q&A

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