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CREDIT OPINION

2 April 2020

Update

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RATINGS

Development Bank of Southern Africa

Domicile	Johannesburg, South Africa
Long Term Rating	Ba1
Type	LT Corporate Family Ratings
Outlook	Negative

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Development Bank of Southern Africa

Update following downgrade to Ba1, outlook remains negative

Summary

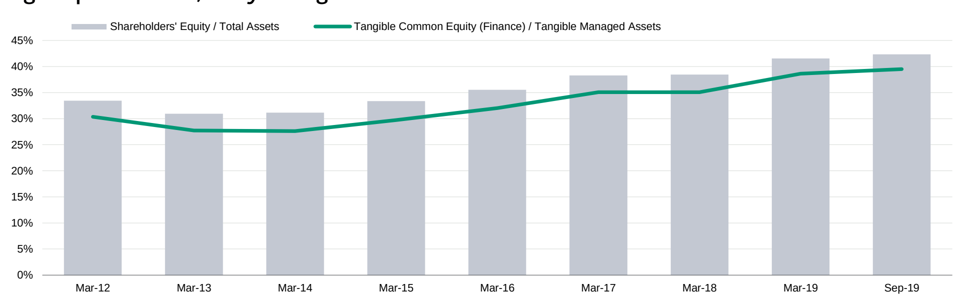
Development Bank of Southern Africa's (DBSA) Ba1 corporate family rating (CFR) reflects its Baseline Credit Assessment (BCA) of ba3 and two notches of uplift, incorporating our assumption of a high probability of support from the Government of South Africa (Ba1 negative), in case of need, because of its full government ownership, development mandate and evidence of past capital support. We also assign a Ba1 issuer rating, based on the Ba1 CFR and the application of our Loss Given Default (LGD) analysis for speculative-grade companies, reflecting the priority of claims and coverage for its capital stock. DBSA's national scale ratings are set at Aa1.za/P-1.za. The issuer outlook is negative.

DBSA's BCA of ba3 reflects two contrasting factors: (1) the bank's high capital buffers, with a tangible common equity (TCE)-to-tangible managed assets ratio of 39.5% as of September 2019, which provide the bank with significant capacity to absorb unexpected losses; and (2) rising industry risks – as DBSA is increasingly focused on higher-risk segments and clients, in response to its development mandate and amidst on-going macro-economic challenges – and high asset risks, reflecting its high credit concentrations and large proportion of Stage 2 and 3 loans.

DBSA has historically displayed a stable funding profile and is able to roll over maturing debt and raise necessary new funding, but nonetheless remains vulnerable to increased risk aversion by institutional investors.

Exhibit 1

High capital buffers, a key strength



Sources: Moody's Financial Metrics and DBSA's financials

Credit strengths

» Solid capital buffers, sufficient to absorb unexpected credit losses

» High probability of government support, which underpins DBSA's ratings

Credit challenges

» Pressure on DBSA's asset-quality metrics, partly reflecting its high credit concentrations

» Ongoing macroeconomic challenges, exacerbated by the impact of the coronavirus pandemic on the global economy

» Rising industry risks, as DBSA is increasingly focused on higher-risk segments and clients, in response to its development mandate and amidst on-going macro-economic challenges

» DBSA's dependence on market funding, which leaves it vulnerable to increased risk aversion by institutional investors

Outlook

DBSA's negative outlook is in line with South Africa's negative rating outlook and reflects the potentially weakening in the government's capacity to extend support in case of need.

Factors that could lead to an upgrade

There is a low likelihood of a rating upgrade in view of the negative rating outlook. DBSA's rating outlook could change to stable if both the sovereign rating outlook is stabilised and DBSA maintains its resilient financial performance.

Factors that could lead to a downgrade

Any weakening in the South African government's credit profile or its willingness to support DBSA could strain the bank's issuer ratings. In addition, a weakening in DBSA's BCA, driven by a material deterioration in asset-quality metrics, would also likely exert downward rating pressure. Likewise, DBSA's issuer rating could be downgraded in there is an increase in leverage through secured borrowings, which would reduce the recovery rate for senior unsecured debt classes, although this remains a low-probability event.

Key indicators

Exhibit 2

Development Bank of Southern Africa (Consolidated Financials) [1]

	03-19[2]	03-18[2]	03-17[2]	03-16[2]	03-15[2]	CAGR/Avg.[3]
Total managed assets (ZAR Million)	89,492.4	89,213.5	83,654.8	82,347.5	70,946.0	6.0[4]
Total managed assets (USD Million)	6,205.6	7,529.4	6,238.8	5,598.8	5,855.4	1.5[4]
Net Income / Average Managed Assets (%)	3.5	2.6	3.4	3.4	1.8	2.9[5]
Tangible Common Equity (Finance) / Tangible Managed Assets (%)	38.6	35.1	35.1	32.0	29.7	34.1[5]
Problem Loans / Gross Loans (Finance) (%)	4.9	4.5	3.3	3.7	5.1	4.3[5]
Net Charge-offs / Average Gross Loans and Leases (%)	0.3	0.1	0.0	0.5	0.4	0.3[5]
Debt Maturities Coverage (%)	16.3	54.6	--	--	--	35.4[5]
Secured Debt / Gross Tangible Assets (%)	0.0	0.0	0.0	0.0	0.0	0.0[5]

[1]All figures and ratios are adjusted using Moody's standard adjustments. [2]IFRS [3]May include rounding differences due to scale of reported amounts. [4]Compound Annual Growth Rate (%) based on time period presented for the latest accounting regime. [5]Simple average of periods presented for the latest accounting regime.
Source: Moody's Investors Service; Company Filings

Profile

The Development Bank of Southern Africa (DBSA), with total assets of ZAR89.7 billion as of September 2019, is a government-owned development finance institution that delivers developmental infrastructure in South Africa and the rest of the African continent.

Around 75% of DBSA's gross loans as of March 2019 were concentrated in South Africa. The remainder was exposed to the wider sub-Saharan Africa region, particularly Zambia (8%) and Angola (5%), and Zimbabwe and Ghana (each at around 3%).

Detailed credit considerations

DBSA's high capital buffers are its major strength

We assign a Capital score of A2, three notches below the initial score, reflecting the current difficult operating environment, which is likely to exert some pressure on borrowers' repayment capacity (see the asset quality section below) and strain the current capital buffers.

DBSA maintains strong capital buffers, with a TCE-to-managed assets ratio of 39.5% as of September 2019. It has historically benefitted from ongoing capital support from the government, including disbursements of around ZAR7.9 billion in 2013-16. DBSA's capital buffers provide significant capacity to both absorb unexpected credit losses and grow the balance sheet, while the impact of IFRS9 implementation was modest (ZAR203 million).

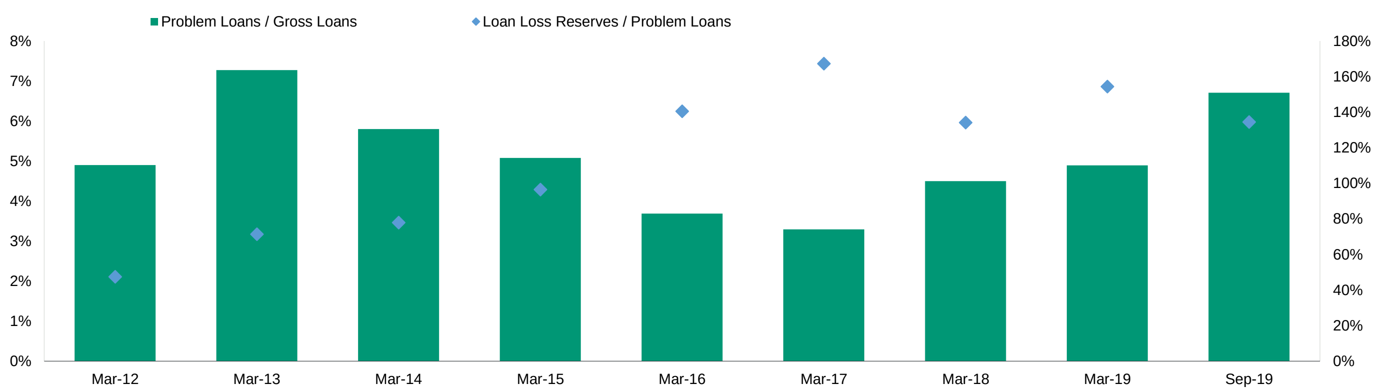
The bank is obliged by the DBSA Act to maintain a maximum debt-to-equity ratio of 250%. As of September 2019, this ratio was around 133.2%, while if we also include the ZAR20 billion callable capital (which requires parliamentary approval for release), the ratio drops to 87.2%. Management is also monitoring economic capital requirements by applying the Basel principles.

Asset-quality metrics under pressure, partly reflecting high concentrations and DBSA's development mandate

We assign a weighted-average Asset Risk score of B2, seven notches below the initial score, capturing high single-name and sectoral concentrations, and the difficult operating conditions.

DBSA reported a nonperforming loans (NPLs)-to-gross loans ratio of 4.9% as of March 2019, but with Stage 2/“underperforming” loans accounting for an additional high 36.1% of gross loans. We expect ongoing pressure on the bank's asset-quality metrics as a result of both the still-challenging operating environment — for 2020 and 2021, we forecast GDP growth rates of -2.5% and 1.1%, respectively, well below the potential and the rate required to create new jobs — and the high credit concentrations that result in elevated credit risks. Similarly, we expect the bank's annual provisioning charges (of around 1.8% of gross loans for the fiscal year ended March 2019 [fiscal 2019]) to remain broadly at these elevated levels.

Exhibit 3
The still-challenging operating environment will strain DBSA's asset-quality metrics



Sources: Moody's Financial Metrics and DBSA's financials

DBSA continues to exhibit high credit concentrations; we estimate that the bank's 10 largest exposures constitute over 50% of its gross loans. We view such high credit concentrations as a moderating factor for DBSA's standalone profile because a possible default by any of these large borrowers could potentially weaken the bank's financial fundamentals. More specifically, we understand that DBSA maintains a significant exposure to Eskom Holdings SOC Limited (Eskom, B3 negative), the troubled electricity generator, estimated to constitute more than 20% of the bank's gross loans. DBSA's loan to Eskom is unsecured, unlike most of Eskom's debt, which carries a government guarantee.

Going forward, we also expect DBSA to be more supportive of existing clients that face difficulties, opting for example to restructure or reschedule exposures rather than maximise recovery levels by prioritising bankruptcy proceedings or similar alternatives.

Moderate, but volatile, earnings-generating capacity

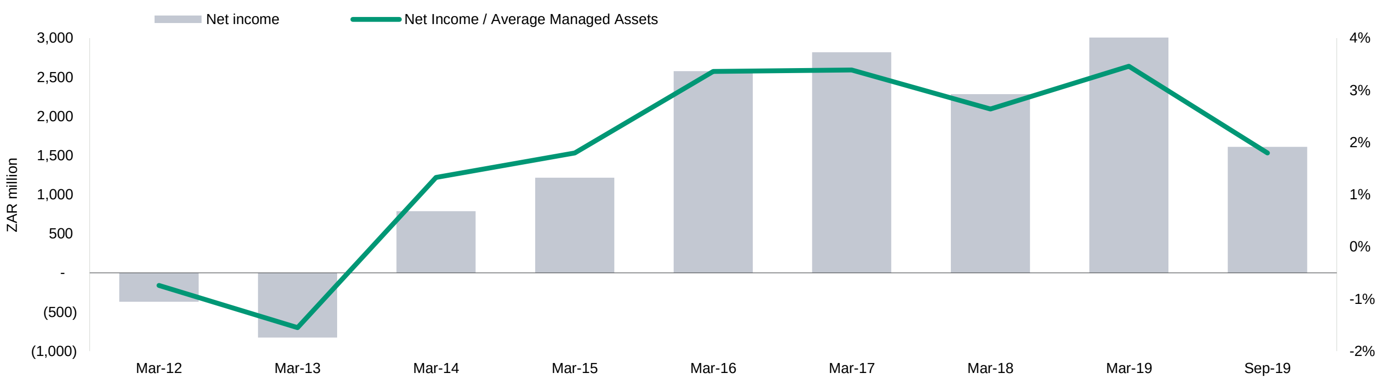
We assign a Ba2 Profitability score, five notches below the initial score, reflecting historical and potential earnings volatility and the difficult operating environment that will likely strain DBSA's earnings-generating capacity.

For the six months ended September 2019, DBSA reported bottom-line profit of ZAR805 million (September 2018: ZAR2.260 billion), which translates into an annualized return on equity of 4.2% (against an average 16% return by commercial banks) and a net income on average managed assets of 1.8%. Net interest income remains DBSA's dominant revenue source (down 3% to ZAR2.174 billion), while the company also reported foreign-exchange gains of ZAR280 million (September 2018: ZAR628 million). Bottom-line profit was, however, moderated by higher provisioning costs of ZAR1,062 million (September 2018: ZAR501 million) and losses on financial assets of ZAR105 million (September 2018: gains of ZAR290 million).

DBSA made significant efforts to streamline its operations and contain its costs, achieving a cost-to-income ratio of around 25% in September 2019, down from 51% as of the end of March 2013. This improvement was achieved despite DBSA's strategy to hire employees with key skills to support business growth. Nonetheless, we expect DBSA's earnings-generating capacity to remain under pressure, primarily because of our expectations of elevated provisioning requirements amid the difficult operating conditions.

Exhibit 4

Volatile bottom-line profit



Sources: Moody's Financial Metrics and DBSA's financials

Historically stable funding profile, but DBSA's dependence on market funding leaves it vulnerable to increased risk aversion by institutional investors

We assign a weighted-average Cash Flow and Liquidity Score of Ba3, four notches below the initial score, primarily to reflect the limited benefits derived from DBSA's very low secured debt, given the limited size and depth of the South African securitisation market.

DBSA has displayed a stable funding profile and has been able to roll over maturing debt and raise necessary new funding. The bank's total borrowings increased to ZAR51 billion in September 2019 from ZAR35.9 billion in March 2013. The bank maintains a relatively diversified funding profile by (1) tapping the local capital markets via an ZAR80 billion domestic medium-term note programme; (2) gaining access to money-market funds and maintaining numerous lines of credits with local banks and financial institutions; and (3) raising funds from development finance institutions.

We understand that a number of new funding lines are under negotiation, while DBSA's funding structure is also well spread over the maturity ladder, with 16% of the total maturing in over five years and an additional 32% maturing between two and five years. Management estimates the 12-month cumulative liquidity gap at around ZAR7.5 billion, while the Moody's-adjusted 12-month maturities coverage ratio (which includes around ZAR1.6 billion of committed undrawn lines) is estimated at 31%. DBSA predominantly raises unsecured debt, which provides it with some financial flexibility to encumber or sell assets if needed, while management manages long-term funding mismatches according to the minimum of a net stable funding ratio of 100% and a minimum liquidity coverage ratio of 100%.

DBSA, however, remains dependent on market funding and is, therefore, vulnerable to increased risk aversion by institutional investors, which may stem from either idiosyncratic or broader systemic concerns (for example, regarding governance issues or the country's macro environment).

Operating environment

We assign a Ba3 score to DBSA's Operating Environment, based wholly on our assessment of the industry risk of South African industrial and infrastructure lenders. DBSA's score is adjusted downwards (from Ba2) to reflect our expectations of rising industry risks, as DBSA is increasingly focused on higher-risk segments and clients, in response to its development mandate and amidst on-going macro-economic challenges.

Macro-level indicator

The Macro-Level Indicator does not have any weight in the scorecard because the Macro-level Indicator score (Baa2) is higher than the Ba Industry Risk score.

We nonetheless note that the global spread of the coronavirus is resulting in simultaneous supply and demand shocks. We expect these shocks to materially slow economic activity, particularly in the first half of this year. The full extent of the economic costs will be unclear for some time. Fear of contagion will dampen consumer and business activity. The longer it takes for households and businesses to resume normal activity, the greater the economic impact. Fiscal and monetary policy measures will likely help limit the damage in individual economies.

Industry risk

The Ba Industry Risk score reflects finance companies' high market share in South Africa's industrial and infrastructure lending market; the current high demand, given the country's needs for infrastructure, energy and industrial projects; and a product base that faces a low risk of obsolescence. Barriers to entry are moderate, with both banks and the capital markets in a position to provide lending for industrial and infrastructure projects; but to compete effectively, market participants need both access to long-term funding and sizeable initial capital. These strengths are, however, balanced against strong competition from the country's leading banks (which also translates into limited pricing power for the finance companies) and relatively high regulatory/legal risks relating to changes to South Africa's Mining Charter and upcoming land reforms.

DBSA is, however, faced with rising industry risks. As a government-owned entity with a development mandate, it is increasingly focused on supporting economic sectors and industries that are of strategic interest to the government, or higher-risk projects and clients that are unable to secure funding from commercial banks. As such risks are not always visible or measurable, we now capture these by adjusting our overall operating environment score downwards to Ba3 (from Ba2 previously).

ESG considerations

In line with our general view on the banking sector, DBSA has a low exposure to environmental risks. See our Environmental risk heat map for further information.

We believe banks, including DBSA, face moderate social risks. See our Social risk heat map for further information.

Governance is highly relevant for DBSA. Corporate governance weaknesses can lead to a deterioration in a bank's credit quality, while governance strengths can benefit its credit profile. Governance risks are largely internal rather than externally driven.

Over the recent past, South African state-owned enterprises have attracted considerable attention, as some have exhibited high-level corruption and state capture. In the case of DBSA, no such issues were raised, while a number of initiatives were taken to strengthen governance further; these initiatives were aimed at ensuring that directors' decisions remain free from any conflicts and tightening controls around lending to politically exposed persons. Nonetheless, corporate governance remains a key credit consideration and, while we do not adjust for corporate behaviour in our scorecard, we will continue to monitor developments.

Support and structural considerations

High probability of government support, given the government ownership and policy mandate

DBSA's Ba1 CFR is two notches above its BCA of ba3, reflecting our high probability of support assumptions from the South African government. Our assumptions are underpinned by DBSA's 100% government ownership, its role in promoting South Africa's New

Growth Path and the history of the government providing ongoing capital support. We note, however, that increased fiscal challenges suggest that the government will be more selective in dispersing financial support to state-owned enterprises. It is for this reason that we cap our support assumptions at “high”.

The Minister of Finance, in his capacity as the bank's governor, determines the bank's mandate and holds the board of directors accountable for managing the organisation to deliver on its mandate. DBSA is regulated under the Public Finance Management Act and the DBSA Act, and submits a corporate plan to the National Treasury, which also documents the key performance measures and targets against which organisational performance is assessed.

Notching considerations

DBSA’s Ba1 issuer rating is based on our LGD analysis for speculative-grade companies, reflecting the priority of claims and coverage in the company's capital stock. In the case of DBSA, issuer ratings are aligned with the CFR, reflecting the absence of structural subordination of unsecured obligations under our LGD model.

National scale ratings

DBSA’s Aa1.za long-term and P-1.za short-term South African national scale ratings are derived from the bank's global scale issuer rating. These ratings demonstrate that DBSA has one of the strongest credits in the country, primarily reflecting its high capital buffers and our assumption of a high probability of government support in case of need.

Source of facts and figures in this report

Unless noted otherwise, we have sourced data relating to systemwide trends and market shares from the central bank. Company-specific figures originate from DBSA's financial statements and Moody's Banking Financial Metrics. All figures are based on our own chart of accounts and may be adjusted for analytical purposes. Please refer to the document Financial Statement Adjustments in the Analysis of Financial Institutions, published on 9 August 2018.

Rating methodology and scorecard factors

The principal methodologies used in rating DBSA were Finance Companies, published in November 2019, and Government-Related Issuers, published in February 2020.

Exhibit 5
Rating factors
Development Bank of Southern Africa

Financial Profile	Factor Weights	Historic Ratio	Initial Score	Assigned Score	Key driver #1	Key driver #2
Profitability						
Net Income / Average Managed Assets (%)	10%	3.17%	A3	**Ba2**	Earnings volatility	Expected trend
Capital Adequacy and Leverage						
Tangible Common Equity / Tangible Managed Assets (%)	25%	38.62%	Aa2	**A2**	Excessive growth	
Asset Quality						
Problem Loans / Gross Loans (%)	10%	4.89%	B1	**Caa3**	Expected trend	Portfolio composition
Net Charge-Offs / Average Gross Loans (%)	10%	0.32%	Aaa	**Baa3**	Expected trend	Portfolio composition
Weighted Average Asset Risk Score			Baa1	**B2**		
Cash Flow and Liquidity						
Debt Maturities Coverage (%)	10%	16.27%	Caa3	**Ba3**	Pro-forma adjustments	Other adjustments
FFO / Total Debt (%)	15%	6.90%	B3	**B3**		
Secured Debt / Gross Tangible Assets (%)	20%	0.00%	Aa1	**Ba1**	Other adjustments	
Weighted Average Cash Flow and Liquidity Score			Baa3	Ba3		
Financial Profile Score	**40%**		**Baa1**	**Ba2**		

Operating Environment			
Home Country			
	Factor Weights	Sub-factor Score	Score
Macro Level Indicator	0%		Baa2
Economic Strength	25%	baa3	
Institutions and Governance Strength	50%	baa2	
Susceptibility to Event Risk	25%	baa	
Industry Risk	100%		Ba
Home Country Operating Environment Score			Ba2

	Factor Weights	Score	Comment
Operating Environment Score	**60%**	**Ba3**	
ADJUSTED FINANCIAL PROFILE		Score	
Adjusted Financial Profile Score		**Ba3**	
Financial Profile Weight	40%		
Operating Environment Weight	60%		
Business Profile and Financial Policy		Adjustment	Comment
Business Diversification, Concentration and Franchise Positioning		0	
Opacity and Complexity		0	
Corporate Behavior / Risk Management		0	
Liquidity Management		0	
Total Business Profile and Financial Policy Adjustments		**Ba3**	
			Comment
Sovereign or parent constraint		**Ba1**	
Standalone Assessment Scorecard-indicated Range		ba2 - b1	
Assigned Standalone Assessment		**ba3**	

Source: Moody's Investors Service

Government -Related Issuer	Factor
a) Standalone Credit Profile	Ba3
b) Government Local Currency Rating	Ba1
c) Default Dependence	Very High
d) Support	High
e) Final Rating Outcome	Ba1

[1]Capped at Ba; the Risk Management subfactor score will not exceed the weighted average of scores assigned to a firm's other risk positioning subfactor scores.
[2] Capped at Ba; the Operating Environment score will not exceed the weighted average of scores assigned to a firm's other non-financial factors.
Source: Moody's Investors Service

Ratings

Exhibit 7

Category	Moody's Rating
DEVELOPMENT BANK OF SOUTHERN AFRICA	
Outlook	Negative
Corporate Family Rating	Ba1
Issuer Rating	Ba1
NSR Issuer Rating	Aa1.za
ST Issuer Rating	NP
NSR ST Issuer Rating	P-1.za

Source: Moody's Investors Service

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Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454