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CREDIT OPINION
24 November 2020

Update

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Development Bank of Southern Africa

Update following downgrade to Ba3, outlook negative

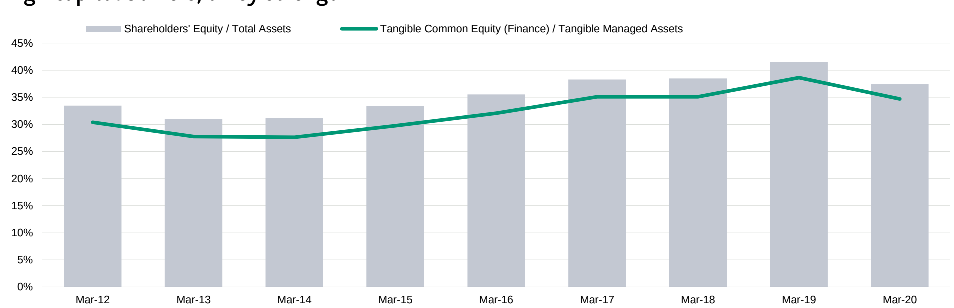
Summary

Development Bank of Southern Africa's (DBSA) Ba3 corporate family rating (CFR) reflects its Baseline Credit Assessment (BCA) of b1 and one notch of uplift, incorporating our assumption of a strong probability of support from the Government of South Africa (Ba2 negative). The support balances DBSA's 100% government ownership and its development mandate, against increased fiscal challenges, with the government more selective in dispersing financial support to state-owned enterprises. We also assign a Ba3 issuer rating, based on the Ba3 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 Aa3.za/P-1.za. The issuer outlook is negative.

DBSA's BCA of b1 reflects two contrasting factors: (i) positively, the bank's high capital buffers, with a tangible common equity (TCE)-to-tangible managed assets ratio of 34.7% as of March 2020, provides the bank with significant capacity to absorb unexpected losses; (ii) more negatively, the rising macro challenges and industry risks — DBSA is increasingly focusing on higher-risk segments and clients, in response to its development mandate and persistently low growth — translate into profitability pressures and high asset risks (Stage 3 loans stood at 7.2% of gross loans as of March 2020, with Stage 2 loans – which are performing but carry a higher risk – accounting for an additional 31.6%).

DBSA is also faced with continuing liquidity challenges, in view of disruptions in the local fixed-income market and a relatively high proportion of debt that matures within one year (around 30% of total debt); however, we do acknowledge management's initiatives to increase its cash buffers and raise new funding (over ZAR14 billion were raised during the six months to September 2020).

Exhibit 1
High capital buffers, a key strength



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

RATINGS

Development Bank of Southern Africa

Domicile	Johannesburg, South Africa
Long Term Rating	Ba3
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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EMEA	44-20-7772-5454

Credit strengths

» Solid capital buffers, sufficient to absorb unexpected credit losses

» The strong probability of support from the South African government

Credit challenges

» Ongoing macroeconomic challenges and rising industry risks, which will continue to strain DBSA's profitability and asset quality

» High credit concentrations

» Disruptions in the local fixed-income market, combined with a relatively high proportion of debt that matures within one year, but risks are mitigated by recent initiatives to increase cash buffers and new funding raised

Outlook

The negative outlook on DBSA's ratings is driven by the negative outlook on the sovereign rating and implies that a potential further weakening of the government's creditworthiness could hurt the bank's ratings as well. The negative outlook further reflects the difficult operating conditions, which also strain the bank's financial performance and standalone assessment. Deteriorating asset quality and profitability, and disruptions in the local capital markets are key challenges.

Factors that could lead to an upgrade

There is a low likelihood of upward rating movement in view of the negative outlook. DBSA's outlook could be changed to stable if the sovereign rating outlook is stabilised and/or the bank maintains a resilient financial performance.

Factors that could lead to a downgrade

Any further weakening in the South African government's credit profile or its willingness to support DBSA could lead to a downgrade. In addition, a weakening in DBSA's BCA, driven by a significant deterioration in asset-quality metrics or a further tightening of its funding and liquidity positions would also likely exert downward rating pressure. Likewise, DBSA's issuer rating could be downgraded if 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]

	03-20[2]	03-19[2]	03-18[2]	03-17[2]	03-16[2]	CAGR/Avg.[3]
Total managed assets (ZAR Million)	100,465.1	89,492.4	89,213.5	83,654.8	82,347.5	5.1[4]
Total managed assets (USD Million)	5,625.1	6,205.6	7,529.4	6,238.8	5,598.8	0.1[4]
Net Income / Average Managed Assets (%)	0.5	3.5	2.6	3.4	3.4	2.7[5]
Tangible Common Equity (Finance) / Tangible Managed Assets (%)	34.7	38.6	35.1	35.1	32.0	35.1[5]
Problem Loans / Gross Loans (Finance) (%)	7.2	4.9	4.5	3.3	3.7	4.7[5]
Net Charge-offs / Average Gross Loans and Leases (%)	0.3	0.3	0.1	0.0	0.5	0.2[5]
Debt Maturities Coverage (%)	22.2	17.1	54.6	--	--	31.3[5]
Secured Debt / Gross Tangible Assets (%)	0.5	0.0	0.0	0.0	0.0	0.1[5]

[1] All figures and ratios are adjusted using Moody's standard adjustments. [2] IFRS [3] May include rounding differences because of the scale of reported amounts. [4] Compound annual growth rate (%) based on the periods for the latest accounting regime. [5] Simple average of periods for the latest accounting regime.
Sources: Moody's Investors Service and company filings

Profile

The Development Bank of Southern Africa (DBSA), with total assets of ZAR100.5 billion as of March 2020, is a government-owned development finance institution that delivers developmental infrastructure in South Africa and the rest of the African continent.

Around 70% of DBSA's gross loans as of March 2020 were concentrated in South Africa. The remainder were in the wider Sub-Saharan Africa region, including Zambia (8%), Angola (6%), Ghana (5%) and Zimbabwe (4%).

Detailed credit considerations

DBSA's high capital buffers are its major strength

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

DBSA maintains strong capital buffers, with a TCE-to-tangible managed assets ratio of 34.7% as of March 2020. It has historically benefitted from 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. The bank is obliged by the DBSA Act to maintain a maximum debt-to-equity ratio of 250%. As of March 2020, this ratio was around 165%; if we also include the ZAR20 billion callable capital (which requires parliamentary approval for release), the ratio drops to 108%. Management is also monitoring economic capital requirements by applying the Basel principles.

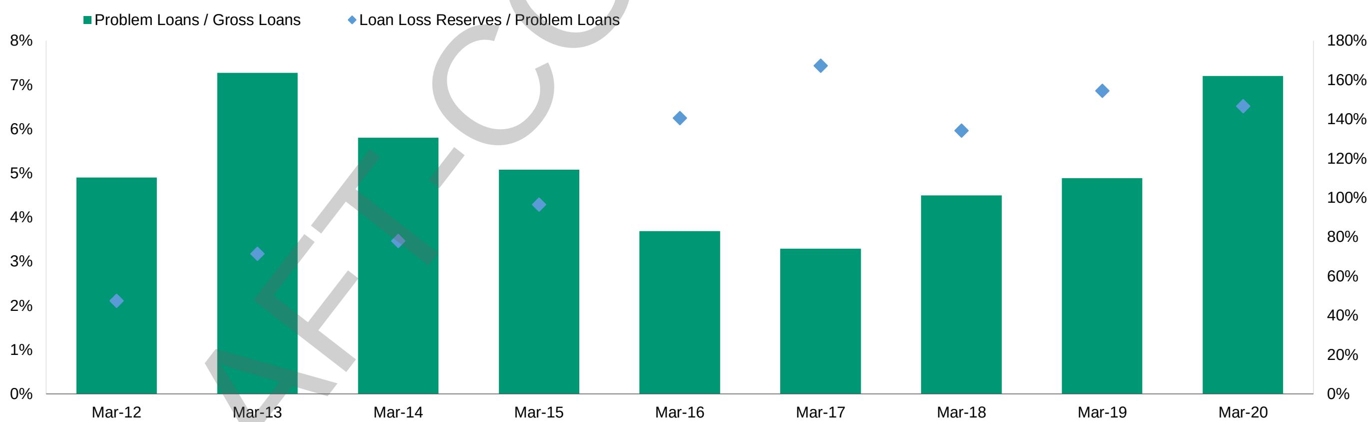
Asset-quality metrics under pressure, partly reflecting high concentrations

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

DBSA reported a nonperforming loans (NPLs)-to-gross loans ratio of 7.2% as of March 2020, with Stage 2 loans accounting for an additional 31.6% of gross loans. We expect the bank's asset-quality metrics to remain under pressure as a result of both the still-difficult operating environment — for 2020 and 2021, we forecast GDP growth rates of negative 6.5% and positive 4.5%, 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 3.8% of gross loans for the fiscal year ended March 2020 [fiscal 2019]) to remain at elevated levels.

Exhibit 3

The still-difficult 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: the bank's 10 largest exposures constitute around 54% of its loan portfolio. 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, Caa1 negative), the troubled electricity generator, estimated to constitute more than 18% of the bank's gross loans. DBSA's loan to Eskom is unsecured, unlike most of Eskom's debt, which carries a government guarantee.

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.

A weakening earnings-generating capacity

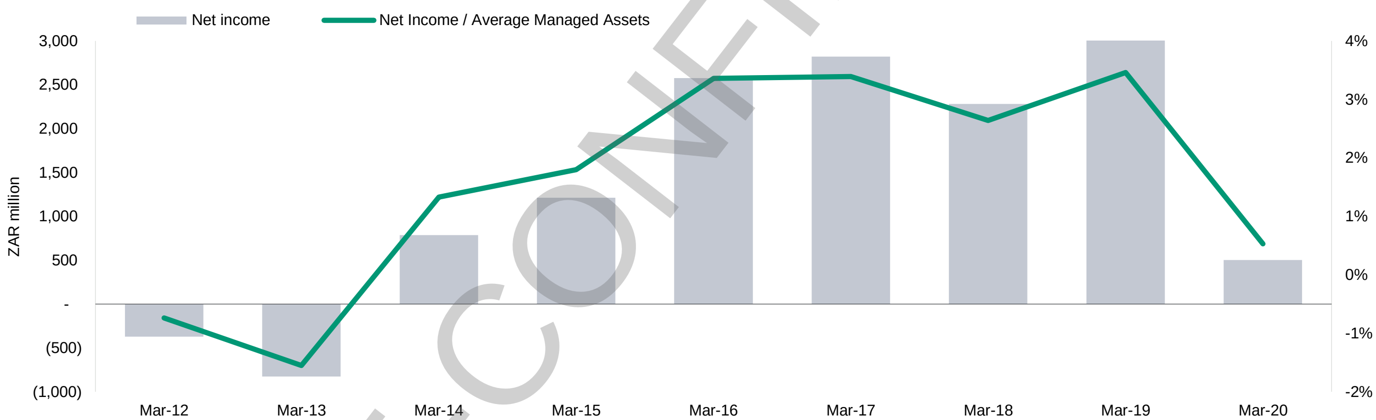
We assign a B1 Profitability score, one notch below the initial score, reflecting historical and potential earnings volatility and the difficult operating environment that will likely continue to strain DBSA's earnings-generating capacity.

For fiscal 2020, DBSA reported bottom-line profit of ZAR504 million (fiscal 2019: ZAR3.1 billion), which translates into an annualised return on equity of 1.4% (against an average 13.4% return by commercial banks) and a net income on average managed assets of 0.5%. Net interest income remains DBSA's dominant revenue source (down 2% to ZAR4.4 billion), while the bank also reported foreign-exchange gains of ZAR1.2 billion (fiscal 2019: ZAR744 million). Bottom-line profit was, however, moderated by higher provisioning costs of ZAR3.6 billion (fiscal 2019: ZAR1.4 billion) and losses on financial assets of ZAR529 million (fiscal 2019: gains of ZAR70 million).

DBSA made significant efforts to streamline its operations and contain its costs, achieving a cost-to-income ratio of around 25% in March 2020, 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. Lower new loan disbursements — as management focuses on maintaining adequate liquidity that will allow it to meet its own liabilities — will also undermine revenue growth potential.

Exhibit 4

Volatile bottom-line profit to remain under pressure



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

Continuing liquidity risks in view of disruptions in the local capital markets, but alternative funding has been sourced

We assign weighted average Cash Flow and Liquidity scores of B2, five 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) and the dislocation in the local capital markets on the back of increased risk aversion by funders.

DBSA has historically 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 ZAR61 billion in March 2020 from ZAR35.9 billion in March 2013. The bank also maintains a relatively diversified funding profile by tapping the local capital markets via an ZAR80 billion domestic medium-term note programme; gaining access to money-market funds and maintaining numerous lines of credits with local banks and financial institutions; and raising funds from development finance institutions.

However, DBSA remains dependent on market funding and is therefore vulnerable to increased risk aversion by institutional investors, especially in the currently tight capital market conditions. DBSA also maintains a short-term maturity profile for its liabilities, with an estimated ZAR18 billion of credit facilities maturing between March 2020 and March 2021. Management monitors its liquidity position closely — and we understand that ZAR14 billion have already been raised between March and September 2020 — while also reducing its loan disbursements; these initiatives have allowed the bank to significantly build up its liquidity buffers to more than ZAR8 billion as of September 2020.

Operating environment

We assign a B1 score to DBSA's Operating Environment, which we have recently lowered from Ba3. The score is based wholly on our assessment of the (B) Industry Risk of South African industrial and infrastructure lenders, lowered from (Ba), to reflect our expectations of rising industry risks, as DBSA is increasingly focusing on higher-risk segments and clients, in response to its development mandate and the ongoing macroeconomic 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 B Industry Risk score. We nonetheless note that macro conditions remain extremely difficult, with persistently low growth and the widespread fiscal pressures facing the government. Progress on structural economic reforms has been very limited amid social and political obstacles, while interest payments are consuming an increasing share of the budget, reducing fiscal space.

Industry risk

The B 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 finance companies) and relatively high regulatory/legal risks relating to changes to South Africa's Mining Charter and upcoming land reforms. Industry risks have also been rising as government-owned finance companies are increasingly focused on high-risk segments, in line with their development mandate, and amidst on-going challenging macro-economic conditions. These factors expose finance companies to heightened event risk and to sharply rising NPLs. Based on these new dynamics, we have recently adjusted our Industry Risk score down to B from Ba, but in terms of the overall Operating Environment score, we decided to stay at the upper end of the range (at B1, from Ba3 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

Strong probability of government support, balancing the 100% government ownership against rising fiscal challenges

DBSA's Ba3 CFR benefits from a one-notch uplift from the bank's BCA of b1 because of a strong probability of support from the South African government. Our assumption of a strong probability of government support reflects DBSA's 100% government ownership, development mandate and history of receiving support; but these parameters are moderated by rising fiscal pressures that compromise the South African government's ability to provide timely and adequate support to state-owned enterprises. Fiscal pressures reduce the capacity the government has available to provide further support to state-owned enterprises. Recent developments, such as the Land and Agricultural Development Bank's failure to make payments of maturing credit facilities that has triggered an event of default, have further informed our assessment.

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 Ba3 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, the 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 Aa3.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 reflect the fact that DBSA is still one of the stronger credits in the country, primarily reflecting its high capital buffers and our assumption of a strong 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 South Africa

Financial Profile	Factor Weights	Historic Ratio	Initial Score	Assigned Score	Key driver #1	Key driver #2
Profitability						
Net Income / Average Managed Assets (%)	10%	0.53%	Ba3	**B1**	Earnings volatility	Expected trend
Capital Adequacy and Leverage						
Tangible Common Equity / Tangible Managed Assets (%)	25%	34.68%	Aa3	**A2**	Excessive growth	
Asset Quality						
Problem Loans / Gross Loans (%)	10%	7.20%	Caa1	**Caa3**	Expected trend	Portfolio composition
Net Charge-Offs / Average Gross Loans (%)	10%	0.27%	Aaa	**Baa3**	Expected trend	Portfolio composition
Weighted Average Asset Risk Score			Baa2	**B2**		
Cash Flow and Liquidity						
Debt Maturities Coverage (%)	10%	22.20%	Caa2	**Caa1**	Pro-forma adjustments	Other adjustments
FFO / Total Debt (%)	15%	5.64%	B3	**B3**		
Secured Debt / Gross Tangible Assets (%)	20%	0.53%	Aa1	**B1**	Other adjustments	
Weighted Average Cash Flow and Liquidity Score			Baa3	**B2**		
Financial Profile Score	**35%**		**Baa2**	**Ba3**		
Operating Environment						
Home Country	**Factor Weights**	**Sub-factor Score**	**Score**			
Macro Level Indicator	0%		Baa2			
Economic Strength	25%	baa3				
Institutions and Governance Strength	50%	baa3				
Susceptibility to Event Risk	25%	baa				
Industry Risk	100%		B			
Home Country Operating Environment Score			B2			
	Factor Weights			**Score**	**Comment**	
Operating Environment Score	**65%**			**B1**		
ADJUSTED FINANCIAL PROFILE				**Score**		
Adjusted Financial Profile Score				**B1**		
Financial Profile Weight	35%					
Operating Environment Weight	65%					
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				**B1**		
					Comment	
Sovereign or parent constraint				**Ba2**		
Standalone Assessment Scorecard-indicated Range				ba3 - b2		
Assigned Standalone Assessment				**b1**		

Source: Moody's Investors Service

Exhibit 6

Government -Related Issuer	Factor
a) Standalone Credit Profile	B1
b) Government Local Currency Rating	Ba2
c) Default Dependence	Very High
d) Support	Strong
e) Final Rating Outcome	Ba3

Source: Moody's Investors Service

Ratings

Exhibit 7

Category	Moody's Rating
DEVELOPMENT BANK OF SOUTHERN AFRICA	
Outlook	Negative
Corporate Family Rating	Ba3
Issuer Rating	Ba3
NSR Issuer Rating	Aa3.za
ST Issuer Rating	NP
NSR ST Issuer Rating	P-1.za

Source: Moody's Investors Service

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