MOODY'S INVESTORS SERVICE

CREDIT OPINION

1 March 2019

Update

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RATINGS

Development Bank of Southern Africa

Domicile	Johannesburg, South Africa
Long Term Rating	Baa3
Type	LT Issuer Rating - Fgn Curr
Outlook	Stable

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.

Contacts

Constantinos Kypreos +357.2569.3009
Senior Vice President
constantinos.kypreos@moodys.com

Agatha Charalambous +357.2569.3046
Associate Analyst
agatha.charalambous@moodys.com

Jean-Francois Tremblay +44.20.7772.5653
Associate Managing Director
jean-francois.tremblay@moodys.com

Carola Schuler +49.69.7073.0766
MD-Banking
carola.schuler@moodys.com

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Development Bank of Southern Africa

Update following rating affirmation

Summary

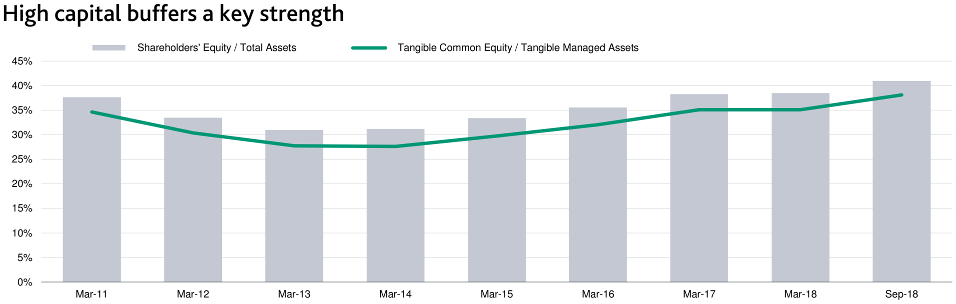
We assign Baa3/Prime-3 issuer ratings to Development Bank of Southern Africa (DBSA), which reflects DBSA's standalone assessment of ba2, and two notches of uplift, incorporating our assumption of a high probability of government support from South Africa (Baa3 stable) in case of need, owing to its full government ownership, developmental mandate and evidence of past capital support. The issuer outlook is stable. We also assign Aa1.za/P-1.za national-scale issuer ratings.

DBSA's standalone assessment of ba2 reflects two contrasting factors: (1) The bank's high capital buffers, with a tangible common equity (TCE)-to-tangible managed assets ratio of 38.2% as of September 2018, which provide the bank with significant capacity to absorb unexpected losses; and (2) the still challenging operating environment, which, combined with DBSA's countercyclical/development mandate and high credit concentrations, translates into high asset risks.

DBSA has historically displayed a stable funding profile and was able to roll over maturing debt and raise necessary new funding. However, DBSA, as a development finance institution, has an aggressive balance-sheet growth strategy that will require it to find new funding sources in an environment where debt and capital markets remain volatile.

Exhibit 1

High capital buffers a key strength



Sources: Moody's Financial Metrics, 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

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

» Despite a historically stable funding profile, DBSA's future plans will require it to find new funding sources in an environment where these are limited and where the debt and capital markets remain volatile

Rating outlook

The stable outlook assigned to DBSA is predominantly driven by the stable outlook assigned to the sovereign rating. It also balances DBSA's relatively high capital levels and assumptions that government support will be forthcoming in case of need, against its high asset risks and projections for strong balance sheet growth that will require it to raise significant new funding.

Factors that could lead to an upgrade

Positive rating action will require a significant improvement in macro-economic conditions, also leading to an improvement in the sovereign credit profile. DBSA's standalone assessment could improve following a reduction in credit concentrations and better matching the maturity profile of its liabilities to that of its assets. However, a mildly stronger standalone credit profile would likely compress the currently applicable two-notch rating uplift, because DBSA's foreign-currency Baa3 issuer rating is already at the level of the sovereign rating.

Factors that could lead to a downgrade

Any weakening of the South African government's credit profile and/or willingness to support DBSA, or any significant deterioration in its capacity to extend financial support, could negatively affect its issuer ratings. In addition, a weakening of DBSA's standalone assessment, driven by a material deterioration in asset quality metrics, would also likely exert downward rating pressure.

Key indicators

Exhibit 2

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

	3-18[2]	3-17[2]	3-16[2]	3-15[2]	3-14[2]	CAGR/Avg.[3]
Total managed assets (ZAR thousand)	89,213,470	83,654,768	82,347,538	70,946,029	63,838,762	8.7[4]
Total managed assets (USD thousand)	7,529,357	6,238,820	5,598,826	5,855,445	6,069,535	5.5[4]
Pretax Preprovision profits / Average Managed Assets (%)	3.4	3.8	5.2	2.9	-	3.8[5]
Net Income / Average Managed Assets (%)	2.6	3.4	3.4	1.8	-	2.8[5]
Secured Debt / Gross Tangible Assets (%)	0.0	0.0	0.0	0.0	0.0	0.0[5]
Tangible Common Equity (Finance) / Tangible Managed Assets (%)	35.1	35.1	32.0	29.7	27.6	31.9[5]
Problem Loans / Gross Loans (Finance) (%)	4.5	3.3	3.7	5.1	5.8	4.5[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 Financial Metrics

Profile

The Development Bank of Southern Africa (DBSA), with total assets of ZAR88.6 billion as of September 2018, is a government-owned development finance institution, delivering developmental infrastructure in South Africa and the rest of the African continent. Around 79% of DBSA's gross loans as of March 2018 were concentrated in South Africa. The remainder was exposed to the wider Sub-Saharan Africa region, particularly Zambia at 7.4% and Angola, Zimbabwe, Ghana which each stood at around 3% of gross loans.

Detailed credit considerations

DBSA's high capital buffers are its major strength

We assign a capital score of A2, two notches below its initial score, reflecting the projected strong balance sheet growth that is likely to place some pressure on the current capital buffers.

DBSA maintains strong capital buffers, with an equity-to-assets and TCE-to-managed assets ratios of 41% and 38.2%, respectively, as of September 2018. The bank 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 a significant capacity to both absorb unexpected credit losses and grow its balance sheet, while the impact of IFRS9 implementation was modest (ZAR203 million). Nonetheless, we expect a gradual drop in DBSA's capital metrics, partly because of the bank's strategy to accelerate its infrastructure funding to municipalities, state-owned entities, regional partners, public-private partnerships and also support infrastructure projects related to green energy.

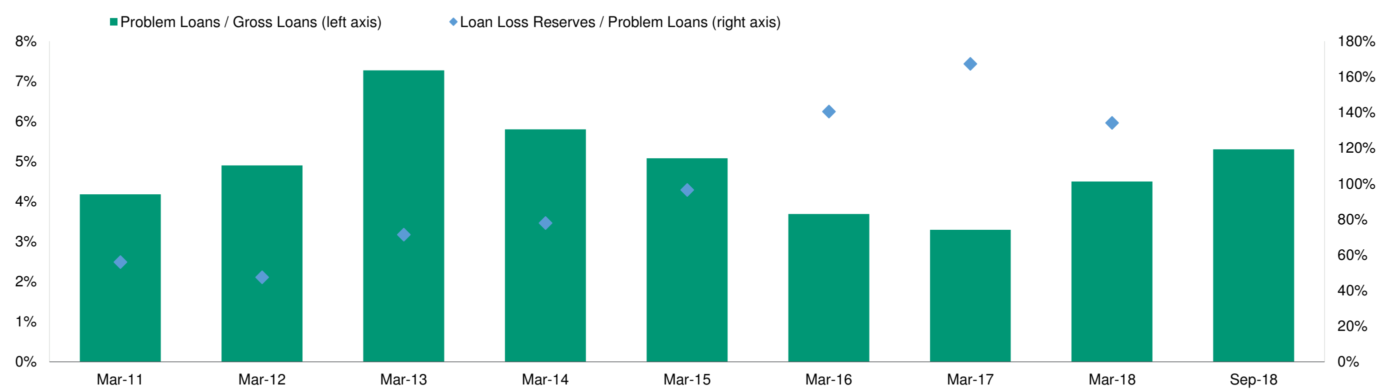
The bank is obliged by the DBSA Act to maintain a maximum debt-to-equity ratio of 250%. As of March 2018, this ratio stood at around 156.2%, while if we also include the ZAR20 billion "callable" capital (which requires parliamentary approval for release) the ratio drops to 98.7%. Management is also monitoring "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 its initial score, capturing high single-name and sectoral concentrations.

DBSA reported a non-performing loans (NPL)-to gross loans ratio of 5.2% of gross loans as of September 2018 (March 2018: 4.5%). We expect on-going pressures on its asset quality metrics as a result of both the still challenging operating environment – for 2019 and 2020 we forecast GDP growth rates of 1.3% and 1.5%, respectively, well-below 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 0.8% of gross loans for the year ended March 2018) to increase to around 1.5% of gross loans, which has been the average provisioning rate over the past five years.

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



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

DBSA continues to exhibit high credit concentrations; we estimate that DBSA's 10 largest exposures comprise 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 (B2, negative), the troubled electricity generator, estimated to make up more than 19% of gross loans. Eskom's debts to DBSA are unsecured, in contrast to most of Eskom debt that carries a government guarantee.

Higher pockets of risk also reside within DBSA's exposures to (1) the wider sub-Saharan African region; (2) exposure to private-sector intermediaries, which constituted around 64% of its total NPLs but only 26% of its loan book; and (3) the smaller South African municipalities.

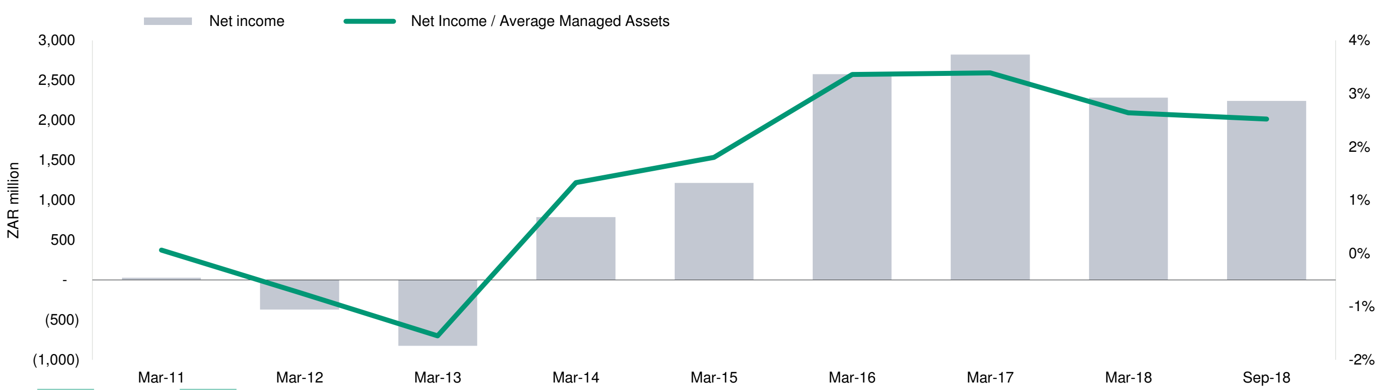
Moderate - but volatile - earnings generating capacity

We assign a Ba3 profitability score, five notches below its initial score, reflecting historical and potential earnings volatility.

For the year ended March 2018, DBSA reported bottom-line profit of ZAR2.283 billion (March 2017: ZAR2.821 billion), translating into a return on equity of 6.7% (against an average 16% return by commercial banks) and a net income on average managed assets of 2.6%. Net interest income remains DBSA's dominant revenue source (up 5% to ZAR3.845 billion), while the drop in profits related to higher provisioning costs of ZAR623 million (March 2017: ZAR339 million) and lower equity gains of ZAR175 million (March 2017: ZAR664 million). For the six months to September 2018, DBSA reported a 54% increase in bottom-line profits to ZAR2.244 billion (H1-2017: ZAR1.454 billion), on the back of higher foreign exchange and revaluation gains, and despite a further increase in provisioning charges.

DBSA made significant efforts to streamline its operations and contain its cost base, achieving a cost-to-income ratio of around 24% in March 2018, 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 rising provisioning requirements on the back of the still challenging operating conditions. We do, however, expect DBSA's results to be less volatile going forward, as management has decided to hedge a significant portion of its interest rate and exchange rate risks.

Exhibit 4
Volatile bottom line profits



Source: Moody's Financial Metrics, DBSA's financials

A historically stable funding profile, although DBSA's future plans will require it to find new funding sources in an environment where debt and capital markets remain volatile

We assign a weighted average Cash Flow and Liquidity Score of Ba3, four notches below its 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 ZAR50.8 billion in September 2018 from ZAR35.9 billion in March 2013. The bank maintains a relatively diversified funding profile by (1) tapping the local capital markets via a 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 19% of the total maturing in over five years and an additional 62% maturing between two and five years. Management estimates the 12 month cumulative liquidity gap at around ZAR3.8 billion, while the Moody's adjusted 12 month maturities coverage ratio (which includes around ZAR2.5 billion of committed undrawn lines) is estimated at 79%. 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 remains, however, dependent on market funding at a time when it plans for aggressive balance-sheet growth in an effort to deepen its developmental impact; it 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 Ba2 score to DBSA's operating environment, based wholly on our assessment of the industry risk of South African industrial and infrastructure lenders.

Macro-level indicator

The macro level indicators does not have any weighting in the scorecard, since the macro-level indicator score (Baa2) is higher than the Ba industry risk score.

Industry risk

The Ba industry risk score reflects the finance companies' high market share in South Africa's industrial and infrastructure lending market; ongoing 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, as the market is open to both banks and the capital markets, but access to long-term funding and substantial capital is required. These strengths are, however, balanced against strong competition from the country's leading banks (which also translates to a limited pricing power for the finance companies) and relatively high regulatory/legal risks relating to potential changes to South Africa's Mining Charter and upcoming Land Reforms.

Corporate governance remains a key credit consideration

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 further strengthen governance; these were aimed at ensuring that directors' decisions remain free from any conflicts, and to tighten 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 going forward.

Support and structural considerations

High probability of government support given government ownership and policy mandate

DBSA's Baa3 long-term issuer rating benefits from a two-notch uplift from the bank's standalone assessment of ba2 owing to a high probability of support from the South African government. Our assumption of a high probability of government support is underpinned by (1) DBSA's 100% government ownership, with no medium-term plans to divest its stake; (2) a history of the government providing ongoing capital support; and (3) the lack of any legal barriers for DBSA's timely support. Ongoing support to state-owned-enterprises has led to a deterioration in government finances but we continue to assess government support to be a policy priority, which will continue to come at the detriment of further fiscal erosion.

In addition, DBSA has a crucial role in the development of South Africa's economic, institutional and social infrastructure, including its mandate to promote the government's economic growth and development plans. In recent years, the bank's links with the government have been further strengthened owing to the financial institution's important role in promoting South Africa's New Growth Path. DBSA also acts as a vital financial intermediary between the financial markets and the local authorities, including smaller municipalities with limited access to the capital markets, as well as private entities with difficulties in obtaining commercial financing.

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 in terms of 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.

The very high default dependence reflects the high probability that, in the event of a sovereign credit default, the risk of a potential financial crisis affecting DBSA is quite high, given (1) the clear operational links to the government, whereby DBSA has an explicit and well-recognised mandate to implement specific government policies; (2) the geographical focus of the bank's activities in South Africa; and (3) the bank's high exposure to the local government and public utility sectors.

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 Development Bank of Southern Africa were Finance Companies published in December 2018, and Government-Related Issuers published in June 2018.

Exhibit 5
Development Bank of Southern Africa

Financial Profile	Historical Factor Weights	Historic Ratio	Initial Score	Assigned Score	Key driver #1	Key driver #2
Profitability						
Net Income / Average Managed Assets (%)	10%	2.64%	A3	**Ba2**	Earnings volatility	Expected trend
Capital Adequacy and Leverage						
Tangible Common Equity / Tangible Managed Assets (%)	25%	35.10%	Aa3	**A2**	Excessive growth	
Asset Quality						
Problem Loans / Gross Loans (%)	10%	4.50%	B1	**Caa3**	Expected trend	Portfolio composition
Net Charge-Offs / Average Gross Loans (%)	10%	0.22%	Aaa	**Baa3**	Expected trend	Portfolio composition
Weighted Average Asset Risk Score			Baa1	**B2**		
Cash Flow and Liquidity						
Debt Maturities Coverage (%)	10%	47.41%	B2	**Ba3**	Pro-forma adjustments	Other adjustments
FFO / Total Debt (%)	15%	7.49%	B3	**B3**		
Secured Debt / Gross Tangible Assets (%)	20%	0.00%	Aaa	**Ba1**	Other adjustments	
Weighted Average Cash Flow and Liquidity Score			**Baa2**	**Ba3**		
Financial Profile Score	**1**		**A3**	**Ba2**		

Operating Environment					
Home Country	Factor Weights	Qualitative Scale	Score		
Macro Level Indicator	0%		Baa2		
Economic Strength	25%	Moderate +			
Institutional Strength	50%	Moderate +			
Susceptibility to Event Risk	25%	Low +			
Industry Risk	100%		Ba		
Home Country Operating Environment Score			Ba2		
	Factor Weights			Score	Comment
Operating Environment Score	**0**			**Ba2**	

ADJUSTED FINANCIAL PROFILE		Score
Adjusted Financial Profile Score		**Ba2**
Financial Profile Weight	100%	
Operating Environment Weight	0%	

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	**Ba2**	
		Comment
Sovereign or parent constraint	**Baa3**	
Standalone Assessment Range	ba1 - ba3	
Assigned Standalone Assessment	**ba2**	

Exhibit 6

Government -Related Issuer	Factor
a) Standalone Credit Profile	Ba2
b) Government Local Currency Rating	Baa3
c) Default Dependence	Very High
d) Support	High
e) Final Rating Outcome	Baa3

[1] Capped at Ba; the risk management sub-factor score will not exceed the weighted average of scores assigned to a firm's other risk positioning sub-factor 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 Financial Metrics

Ratings

Exhibit 7

Category	Moody's Rating
DEVELOPMENT BANK OF SOUTHERN AFRICA	
Outlook	Stable
Issuer Rating	Baa3
NSR Issuer Rating	Aa1.za
ST Issuer Rating	P-3
NSR ST Issuer Rating	P-1.za

Source: Moody's Investors Service

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