CREDIT OPINION
16 December 2021

Update

Rate this Research

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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Development Bank of Southern Africa

Update to credit analysis

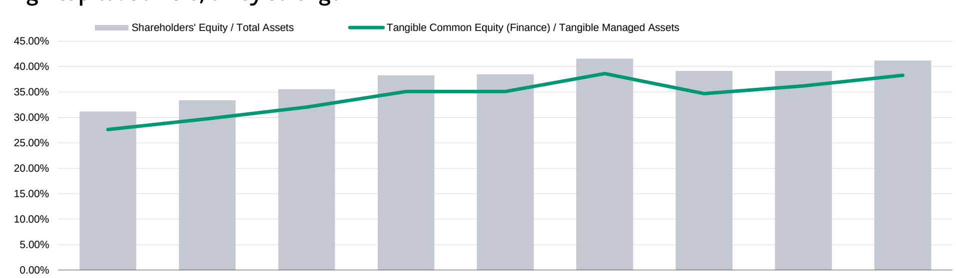
Summary

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 assumption 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: positively, the bank's high capital buffers, with a tangible common equity (TCE)-to-tangible managed assets ratio of 38% as of September 2021, which provide the bank with significant capacity to absorb unexpected losses; more negatively, the rising macroeconomic challenges and industry risks translate into profitability pressures and high asset risks (Stage 3 loans accounted for 6.9% of gross loans as of September 2021, with Stage 2 loans, some of which are performing but carry a higher risk, accounting for an additional 34.8%).

DBSA also faces potential funding challenges, in view of disruptions in the local capital (fixed-income) market and upcoming sizeable debt maturities (of around ZAR9 billion over March 2021-22). However, management's initiatives to increase its cash buffers and raise new funding (more than ZAR23.5 billion were raised during the fiscal year that ended March 2021 will moderate the risk.

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

» 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 sizeable upcoming debt maturities, although 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 the key financial 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 the bank maintains a good 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 because of a significant deterioration in asset-quality metrics or a further tightening of its funding and liquidity positions would also likely exert downward rating pressure.

Key indicators

Exhibit 2

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

	09-21[2]	03-21[2]	03-20[2]	03-19[2]	03-18[2]	CAGR/Avg.[3]
Total managed assets (ZAR Million)	100,380.9	100,047.7	100,465.1	89,492.4	89,213.5	3.4[4]
Total managed assets (USD Million)	6,672.0	6,775.4	5,625.1	6,205.6	7,529.4	(3.4)[4]
Net Income / Average Managed Assets (%)	4.5	1.4	0.5	3.5	2.6	2.5[5]
Tangible Common Equity (Finance) / Tangible Managed Assets (%)	38.3	36.2	34.7	38.6	35.1	36.6[5]
Problem Loans / Gross Loans (Finance) (%)	6.9	7.7	7.2	4.9	4.5	6.2[5]
Net Charge-offs / Average Gross Loans and Leases (%)	0.0	0.1	0.3	0.3	0.1	0.2[5]
Debt Maturities Coverage (%)	--	90.9	22.2	17.1	54.6	46.2[5]
Secured Debt / Gross Tangible Assets (%)	20.5	0.8	0.5	0.0	0.0	4.4[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

Development Bank of Southern Africa (DBSA) is a government-owned development finance institution that delivers developmental infrastructure in South Africa and the rest of the African continent. Around 73% of DBSA's gross loans were concentrated in South Africa, with the remainder disbursed in the wider sub-Saharan Africa region, including Zambia, Angola, Ghana and Zimbabwe.

Detailed credit considerations

DBSA's high capital buffers provide solid loss absorbance capacity

We assign a capital score of A2, three notches below the initial score. The assigned score captures DBSA's solid capital levels, but also the current difficult operating environment, which is likely to exert some negative pressure on borrowers' repayment capacity and on the bank's current capital buffers.

DBSA maintains strong capital buffers, with a TCE-to-tangible managed assets ratio of 38% as of September 2021. Such capital buffers provide significant capacity to both absorb unexpected credit losses as well as growing assets. The bank is obliged by the DBSA Act to maintain a maximum debt-to-equity ratio of 250%. As of March 2021, this ratio was around 152%, without incorporating the ZAR20 billion callable capital, which requires parliamentary approval for release.

DBSA has historically benefitted from capital support from the government, including disbursements of around ZAR7.9 billion in 2013-16. The bank also does not pay dividends, which helps its grow its capital organically. DBSA's management is also monitoring economic capital requirements and plans to more formally apply the Basel principles, even though it is not a regulated bank.

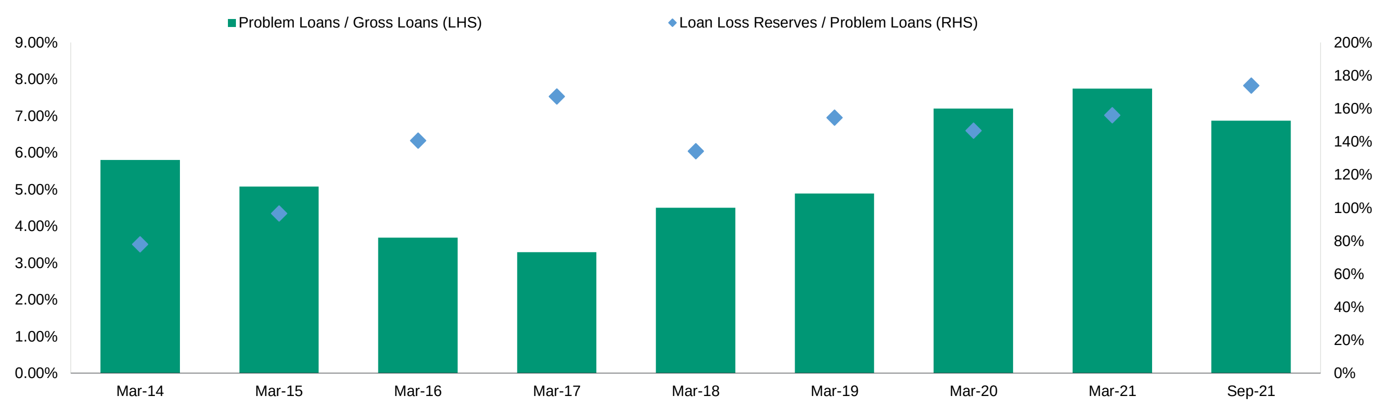
High asset risks, reflecting the difficult macroeconomic conditions, high credit concentrations and riskier foreign assets

We assign a weighted average asset risk score of B2, six notches below the initial score, capturing its high single-name concentrations, the difficult operating conditions and problematic foreign projects.

DBSA reported an improvement in its nonperforming loans (NPLs)-to-gross loans ratio which reduced to 6.9% as of September 2021. However, Stage 2 loans remain large, accounting for an additional 34.8% 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 — beyond 2021, we expect South Africa's real GDP growth to settle at around 1%, well below the country's potential and the rate required to create a reasonable amount of new jobs — and the high credit concentrations that exposes the bank to vulnerability of large NPLs in case of a default by a few borrowers. Similarly, we expect the bank's annual provisioning charges (of around 1.2% of gross loans for the fiscal year 2021) to remain elevated, despite the significant drop in provisions during the six months to September 2021 (to 0.7% of gross loans).

Exhibit 3

The still-difficult operating environment will strain DBSA's asset-quality metrics



Sources: The bank and Moody's Investors Service

DBSA continues to exhibit high credit concentrations: the bank's 10 largest exposures constitute more than 50% 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 weaken the bank's financial fundamentals. Given the bank's mandate, DBSA maintains a significant exposure to state-owned enterprises, some of which are troubled financially, and in cases where the debt is not secured or guaranteed by the government, losses incurred in event of default can be material. Similarly, DBSA's non-South African portfolio (specifically the Zambian exposures) is substantially riskier, with NPLs at more than 20% of gross loans.

Against these risks, we understand that the bank has tightened its lending criteria and will likely reduce some of the riskier foreign exposures, while the bulk of its exposures to the South African municipal sector is in the more resilient Metro segment. Historically low write-offs also suggest that most borrowers eventually repay their dues to the DBSA.

Profitability recovery will likely be slowed down by a challenging operating environment

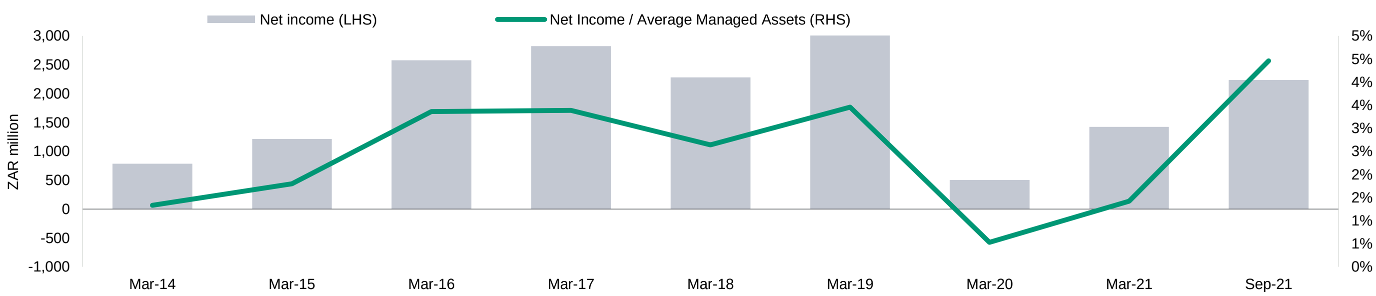
We assign a B1 profitability score, four notches below the initial score, reflecting historical and potential earnings volatility and the difficult operating environment that will likely continue to strain DBSA's earnings-generating capacity.

For the six months to September 2021, DBSA reported net profit of ZAR2.2 billion (fiscal 2021: ZAR1.4 billion), which shows a good net income to average managed assets of 4.5%. (annualised return on equity is 10.8% against an average 13.1% return by commercial banks, indicating DBSA's low leverage). Net interest income increased 29% in September 2021 from a year earlier to ZAR2.9 billion, and remains DBSA's dominant revenue source. Reported foreign-exchange gains of ZAR179 million (fiscal 2021: loss of ZAR893 million) and lower provisioning costs of ZAR395 million (fiscal 2021: ZAR1.2 billion) further supported profitability recovery.

DBSA made significant efforts to streamline its operations and contain its costs, achieving a cost-to-income ratio of around 20% in September 2021, down from 49% 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 in view of 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, while currency movements and revaluations of financial instruments will add to earnings volatility.

Exhibit 4

Profitability has recovered but its growth will likely slow down



Sources: The bank and Moody's Investors Service

Funding risks in view of still-tight local capital markets, but alternative funding has been sourced

We assign weighted average cash flow and liquidity scores of B2, six 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, although market are opening up.

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 ZAR56 billion as of September 2021 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 still-tight local capital market conditions where the bank, other than for some private placements, has not tapped the market for the past several months. DBSA also maintains a short-term maturity profile for its liabilities, with an estimated ZAR9 billion of credit facilities (capital and interest) maturing between March 2021 and March 2022. To address these challenges, management closely monitors its liquidity position and has has raised an additional ZAR23.5 billion of new funding in order to cover any liquidity gaps. The bank also reduced its loan disbursements, and thus retaining liquidity in order to meet its maturing liabilities where necessary. These initiatives have allowed the bank to significantly build up its liquidity buffers to more than ZAR7 billion as of September 2021.

Operating environment

We assign a B1 score to DBSA's Operating Environment. The score is based wholly on our assessment of the (B) Industry Risk of South African industrial and infrastructure lenders, to reflect our expectations of high industry risks, with DBSA focused 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 macroeconomic 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 because of ongoing difficult macroeconomic conditions. These factors expose finance companies to increased event risk and to sharply rising NPLs. Based on these 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

DEVELOPMENT BANK OF SOUTHERN AFRICA's ESG Credit Impact Score is Moderately Negative CIS-3

Exhibit 5

ESG Credit Impact Score

CIS-3

Moderately Negative

For an issuer scored CIS-3 (Moderately Negative), its ESG attributes are overall considered as having a limited impact on the current rating, with greater potential for future negative impact over time. The negative influence of the overall ESG attributes on the rating is more pronounced compared to an issuer scored CIS-2.

Source: Moody's Investors Service

DBSA's ESG Credit Impact Score is moderately negative (**CIS-3**). The score reflects that ESG considerations having a limited impact on the current rating, as Government support and sizeable capital buffers mitigates the exposure to ESG risks.

Exhibit 6
ESG Issuer Profile Scores

ENVIRONMENTAL	SOCIAL	GOVERNANCE
E-3	S-3	G-3
Moderately Negative	Moderately Negative	Moderately Negative

Source: Moody's Investors Service

Environmental
DBSA faces moderate environmental risks primarily because of its portfolio exposure to carbon transition and water management risks. In line with peers, it is facing mounting business risks and stakeholder pressure to meet broader carbon transition goals. In response, DBSA is developing its climate risk and portfolio management capabilities.

Social
DBSA faces moderate social risks, partly reflecting its social and policy mandate linked to the company's government ownership. DBSA is also heavily exposed to local governments that are themselves exposed to social unrest, income inequalities and related social risks. DBSA has limited direct exposure to retail clients, which reduces the exposure to customer relations risk.

Governance
DBSA's governance risks are moderate, reflecting its public ownership. Financial strategy and risk management is constrained by the bank's very high single-name and sector concentrations, partly reflecting the government's influence over its mandate and decision-making process. Governance risks are partly mitigated by DBSA's increased focus on risk management and improved management capabilities.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

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. However, 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 7

Development Bank of Southern Africa

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%	1.42%	Baa3	B1	Earnings volatility	Expected trend
Capital Adequacy and Leverage						
Tangible Common Equity / Tangible Managed Assets (%)	25%	38.29%	Aa2	A2	Expected trend	
Asset Quality						
Problem Loans / Gross Loans (%)	10%	7.74%	Caa1	Caa3	Expected trend	Portfolio composition
Net Charge-Offs / Average Gross Loans (%)	10%	0.23%	Aaa	Baa3	Expected trend	Portfolio composition
Weighted Average Asset Risk Score			**Baa2**	**B2**		
Cash Flow and Liquidity						
Debt Maturities Coverage (%)	10%	90.88%	Ba2	Caa1	Pro-forma adjustments	Other adjustments
FFO / Total Debt (%)	15%	7.66%	B2	B3	Expected trend	
Secured Debt / Gross Tangible Assets (%)	20%	0.78%	Aa1	B1	Other adjustments	
Weighted Average Cash Flow and Liquidity Score			**Baa2**	**B2**		
Financial Profile Score	**35%**		**A3**	**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 8

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 9

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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