MOODY'S INVESTORS SERVICE

CREDIT OPINION
24 November 2022

Update

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RATINGS

Development Bank of Southern Africa

Domicile	Johannesburg, South Africa
Long Term Rating	Ba3
Type	LT Corporate Family Ratings
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.

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Development Bank of Southern Africa

Update to credit analysis

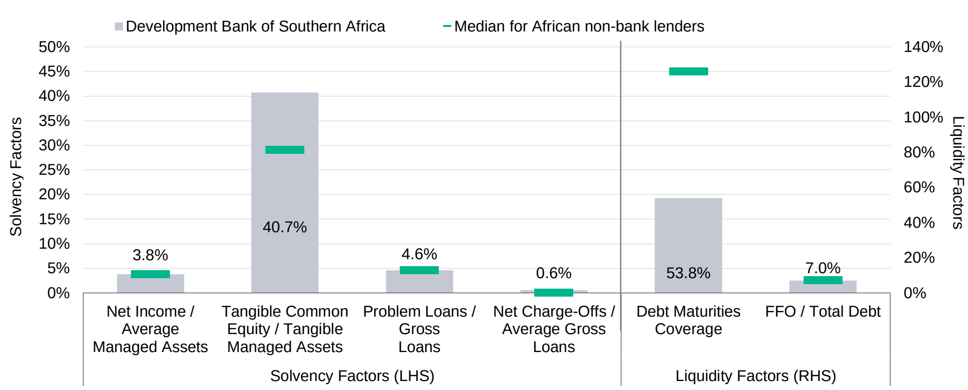
Summary

Development Bank of Southern Africa's (DBSA) Ba3 corporate family rating (CFR) reflects its Baseline Credit Assessment (BCA) of b1 and one notch of rating uplift, incorporating our assumption of a "strong" probability of support from the Government of South Africa (Ba2 stable). The support assumption reflects DBSA's 100% government ownership and its developmental mandate. 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 Aa3.za/P-1.za. The issuer outlook is stable.

DBSA's BCA of b1 reflects two contrasting factors: its high capital buffers, with a tangible common equity (TCE)-to-tangible managed assets ratio of 41% as of March 2022, which provide DBSA with significant capacity to absorb unexpected losses; and our assessment of high asset risks, reflecting the modest economic growth and high industry risks, but also DBSA's high sector and single-name concentrations. As of March 2022, Stage 3 loans accounted for 4.6% of gross loans, while Stage 2 loans accounted for an additional 33.3%.

Following the disruptions in the local debt capital market that were triggered by the failure of state-owned Land Bank in April 2020, funding conditions have improved. In addition, management is following a more conservative liquidity approach, increasing its cash buffers and more closely monitoring its assets and liabilities maturities mismatches. Challenges remain, however, as DBSA retains its reliance on more confidence-sensitive market funding and has committed to sizeable new loan disbursements as part of its mandate.

Exhibit 1
Rating scorecard - Key financial ratios



Source: Moody's Investors Service

Credit strengths

» Solid capital buffers, sufficient to absorb unexpected credit losses

» "Strong" probability of government support

Credit challenges

» High industry risks and still challenging macro conditions

» High asset risks, partly reflecting single-name and industry credit concentrations

» Improved, but still challenging, funding and liquidity conditions

Outlook

The stable issuer outlook is partly driven by the stable outlook on the sovereign rating, which informs our government support assumptions. The stable outlook further recognises that the strong capital buffers help cushion asset risks and pressures from a low growth environment.

Factors that could lead to an upgrade

Upward pressure on DBSA's ratings would require both a more robust operating and macro environment accompanied by a higher sovereign rating; and/or a significant strengthening of asset quality metrics, and of its funding profile.

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 the ratings of DBSA. In addition, a weakening of the stand-alone credit profiles, driven by a deterioration in asset quality, liquidity and capital buffers, would also exert downward ratings pressure.

Key indicators

Exhibit 2

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

	03-22[2]	03-21[2]	03-20[2]	03-19[2]	03-18[2]	CAGR/Avg.[3]
Total managed assets (ZAR Million)	100,028.0	100,047.7	100,465.1	89,492.4	89,213.5	2.9[4]
Total managed assets (USD Million)	6,845.4	6,775.4	5,625.1	6,205.6	7,529.4	(2.4)[4]
Net Income / Average Managed Assets (%)	3.8	1.4	0.5	3.5	2.6	2.4[5]
Tangible Common Equity (Finance) / Tangible Managed Assets (%)	40.7	36.2	34.7	38.6	35.1	37.1[5]
Problem Loans / Gross Loans (Finance) (%)	4.6	7.7	7.2	4.9	4.5	5.8[5]
Net Charge-offs / Average Gross Loans and Leases (%)	0.6	0.1	0.3	0.3	0.1	0.3[5]
Debt Maturities Coverage (%)	53.8	90.9	22.2	17.1	54.6	47.7[5]
Secured Debt / Gross Tangible Assets (%)	0.0	0.8	0.5	0.0	0.0	0.3[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 extended to South Africa borrowers, with the remainder disbursed in the wider sub-Saharan Africa region, including Zambia, Angola, Ghana and Zimbabwe. Management focus has also shifted towards collaboration and co-funding of projects with other parties; an example of this is the set up of the Infrastructure Fund, a blended-finance infrastructure platform aimed at transforming the state's approach to infrastructure financing by bringing together public and private stakeholders and creating blended finance products and solutions.

Detailed credit considerations

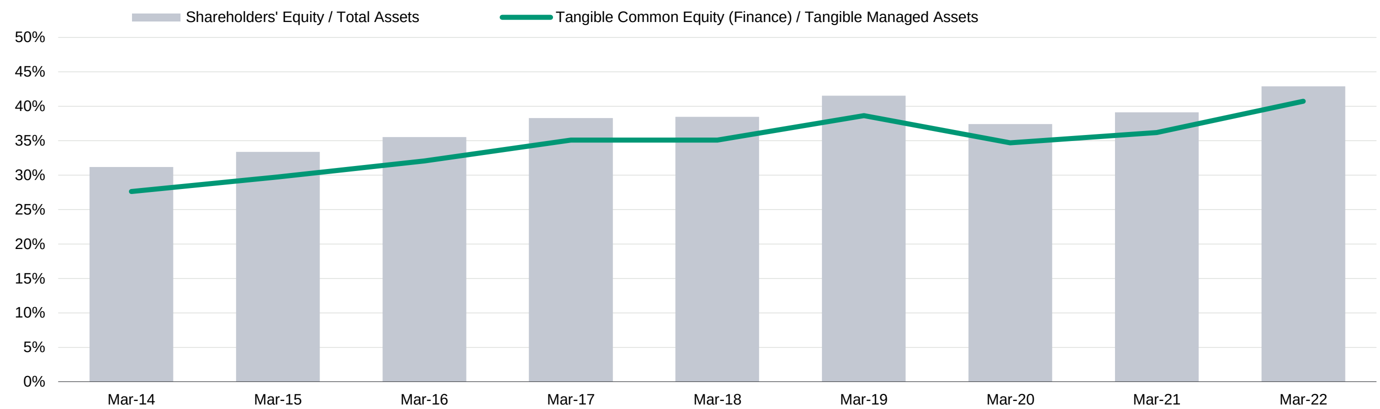
DBSA's high capital buffers provide solid loss absorbance capacity

We assign a capital score of A1, two notches below the initial score. The assigned score captures DBSA's solid capital levels, but also the still-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 41% as of March 2022. 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 2022, this ratio was around 130%, without incorporating the ZAR20 billion callable capital, which requires parliamentary approval for release.

Exhibit 3

High capital buffers, a key strength



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

DBSA has historically benefitted from capital support from the government, including disbursements of around ZAR7.9 billion in 2013-16, and does not pay dividends. 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. This will provide a more accurate estimate of the bank's risk-adjusted capital and will improve disclosure and capital quality overtime.

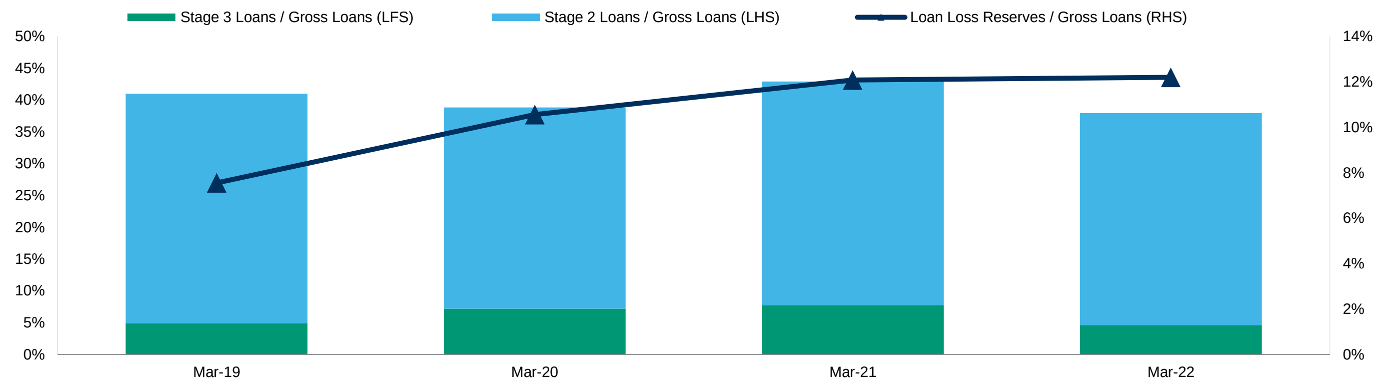
High asset risks, reflecting the challenging credit conditions, high credit concentrations and riskier foreign assets

We assign a weighted average asset risk score of B3, capturing DBSA's high single-name and sectoral concentrations, the difficult credit environment, problematic foreign projects and a high proportion of (under-performing) Stage 2 loans.

DBSA reported an improvement in its nonperforming loans (NPLs)-to-gross loans ratio, which reduced to 4.6% as of March 2022. However, Stage 2 loans remain large, accounting for an additional 33.3% of gross loans. We expect DBSA's asset-quality metrics to remain under pressure as a result of both the still-difficult credit conditions — we expect South Africa's real GDP growth to settle at around 1.5% in 2023, well below the country's potential and economic growth 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. Balance sheet provisions accounted for 12% of gross loans as of March 2022.

DBSA continues to exhibit high credit concentrations: the bank's 10 largest exposures constitute around 56% of total assets. We view such high credit concentrations as a vulnerability to DBSA's asset risk profile because a default by any of these large borrowers could weaken the bank's solvency. Given its mandate, DBSA maintains a significant exposure to state-owned enterprises and to local municipalities, with the latter accounting for one-third of its loan book as of March 2022. Similarly, DBSA's non-South African portfolio (specifically the Zambian exposures) is substantially riskier, with NPLs at more than 20% of gross loans.

Exhibit 4
High asset risks, as indicated by the high proportion of Stage 2 and 3 loans



Sources: The bank and Moody's Investors Service

Against these risks, we understand that management has tightened its lending criteria and will likely reduce some of the riskier foreign exposures, while the bigger of its exposures to the South African municipal sector is in the more resilient Metro segment. Historically low write-offs also indicate that most borrowers eventually repay their dues to the DBSA. According to management, recoveries of non-performing loans amounted to ZAR2 billion over the past two years.

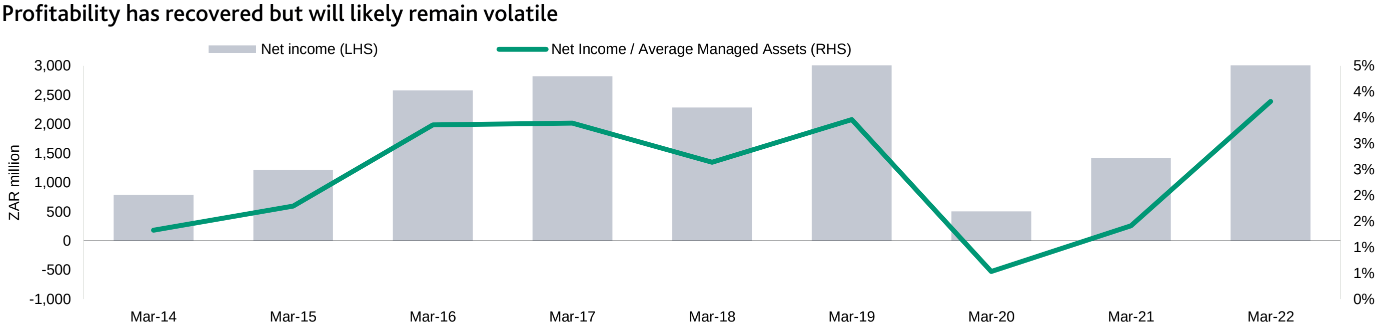
Profitability remains modest

We assign a Ba3 profitability score, four notches below the initial score, reflecting historical and potential earnings volatility given DBSA's development mandate and related investments in riskier assets, and the still challenging credit conditions.

For fiscal 2022, DBSA reported net profit of ZAR3.8 billion (fiscal 2021: ZAR1.4 billion), with the net income to average managed assets ratio at 3.8%. Net interest income increased by 18% in March 2022 to ZAR5.8 billion, and remains DBSA's dominant revenue source. Reported foreign-exchange gains of ZAR156 million (fiscal 2021: loss of ZAR893 million) and moderate provisioning costs of ZAR1.0 billion further supported the recovery in profits. DBSA made significant efforts to streamline its operations and contain its costs, achieving a cost-to-income ratio of around 23% in March 2022, down from 51% as of the end of March 2013.

Going forward, we expect DBSA's earnings-generating capacity to remain both volatile and under pressure, in view of the still fragile operating conditions, rising funding costs and its limited revenue diversification (beyond interest income). Lower new loan disbursements — as management focuses on maintaining adequate liquidity that will allow it to meet its own liabilities — will also contain revenue growth potential, while currency movements and revaluations of financial instruments will add to earnings volatility.

Exhibit 5
Profitability has recovered but will likely remain volatile



Sources: The bank and Moody's Investors Service

Funding conditions have improved and management is following a more conservative liquidity strategy, but risks remain in view of DBSA's dependence on market funding

We assign weighted average cash flow and liquidity scores of B2, 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 still fragile local debt capital market conditions.

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 March 2022 from ZAR35.9 billion in March 2013. The bank also maintains a relatively diversified funding profile by tapping the local debt 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 international 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, and given the short-term maturity profile for its liabilities. DBSA has tapped local investors via private placements, but has also diversified its funding sources while lengthening the tenor of its liabilities by securing new funding from international developmental institutions. Management has also set an internal requirement to hold minimum liquidity of at least 10% of DBSA's liabilities.

Over the next six months, DBSA has sizeable funding liabilities that mature, the largest of which are the **DV23 bonds** of ZAR7.8 billion due in February 2023. We understand that current DBSA liquidity exceeds ZAR9 billion, while there is investor appetite to switch part of these bonds into new longer dated bonds.

Operating environment

We assign a B1 score to DBSA’s Operating Environment (at the upper end of the allowable range). 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 challenging, with persistently low growth and fiscal pressures. Progress on structural economic reforms has been 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, for example, to 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 rising NPLs. Non-bank financial entities are also disadvantaged – relative to banks – in terms of their product suite, which remains narrower and primarily dependent on interest income.

ESG considerations

Development Bank of Southern Africa's ESG Credit Impact Score is Moderately Negative CIS-3

Exhibit 6
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 7
ESG Issuer Profile Scores

ENVIRONMENTAL
E-3
Moderately Negative

SOCIAL
S-3
Moderately Negative

GOVERNANCE
G-3
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 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 8

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%	1.92%	Baa2	Ba3	Earnings volatility	Expected trend
Capital Adequacy and Leverage						
Tangible Common Equity / Tangible Managed Assets (%)	25%	40.73%	Aa2	A1	Expected trend	
Asset Quality						
Problem Loans / Gross Loans (%)	10%	6.52%	B3	Ca	Expected trend	Portfolio composition
Net Charge-Offs / Average Gross Loans (%)	10%	0.57%	Aa1	Ba1	Expected trend	Portfolio composition
Weighted Average Asset Risk Score			**Baa2**	**B3**		
Cash Flow and Liquidity						
Debt Maturities Coverage (%)	10%	53.85%	B1	Caa1	Pro-forma adjustments	Other adjustments
FFO / Total Debt (%)	15%	7.03%	B3	B3	Expected trend	
Secured Debt / Gross Tangible Assets (%)	20%	0.00%	Aa1	B1	Other adjustments	
Weighted Average Cash Flow and Liquidity Score			**Baa2**	**B2**		
Financial Profile Score	**35%**		**Baa1**	**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

Government-Related Issuers	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

Ratings

Exhibit 9

Category	Moody's Rating
DEVELOPMENT BANK OF SOUTHERN AFRICA	
Outlook	Stable
Baseline Credit Assessment	b1
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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