Development Bank of Southern Africa Ltd. Rating Lowered Following Action On South Africa; Outlook Stable

May 11, 2020

PRIMARY CREDIT ANALYST

Ravi Bhatia
London
(44) 20-7176-7113
ravi.bhatia@spglobal.com

SECONDARY CONTACTS

Trevor Barsdorf
Johannesburg
+ 27 11 214 4852
trevor.barsdorf@spglobal.com

Tatonga G Rusike
Johannesburg
(27) 11-214-4859
tatonga.rusike@spglobal.com

Motlanalo Mashoene
Johannesburg
motlanalo.mashoene@spglobal.com

ADDITIONAL CONTACT

EMEA Sovereign and IPF
SovereignIPF@spglobal.com

- On April 29, 2020, we lowered our long-term foreign and local currency ratings on the Republic of South Africa to 'BB-' and 'BB' from 'BB' and 'BB+' respectively.
- In our view, there is an almost certain likelihood that the South African government would provide timely and sufficient extraordinary support to the Development Bank of Southern Africa Ltd. (DBSA) if needed. Consequently, we equalize our ratings and outlook on DBSA with those on South Africa.
- We are therefore lowering our long-term foreign and local currency ratings on DBSA to 'BB-/B' and 'BB/B' respectively.
- The stable outlook mirrors that on South Africa--our ratings on DBSA will move in conjunction with those on the sovereign for as long as we assess the likelihood of government support as almost certain.

LONDON (S&P Global Ratings) May 11, 2020--S&P Global Ratings said today it lowered its long- and short-term foreign currency issuer credit ratings to 'BB-/B' from 'BB/B' and long- and short-term local currency ratings to 'BB/B' from 'BB+/B' on Development Bank of Southern Africa Ltd. (DBSA). The outlook is stable.

We equalize our ratings on DBSA with those on South Africa (foreign currency BB-/Stable/B, local currency BB/Stable/B). This reflects our opinion that there is an almost certain likelihood (as defined in our criteria: "Rating Government-Related Entities: Methodology And Assumptions," published March 25, 2015, on RatingsDirect) that the South African government would provide timely and sufficient extraordinary support to DBSA in the event of financial distress.

This rating action follows our downgrade of South Africa (see "South Africa Ratings Lowered To 'BB-' From 'BB' As COVID-19 Further Impairs Fiscal And Growth Prospects; Outlook Stable," published April 29, 2020). We expect South Africa's already-contracting economy will face a further sharp COVID-19-related downturn in 2020, and that the pandemic will create additional and more substantial headwinds to GDP growth due to a strict domestic lockdown, markedly weaker external demand outlook, and tighter credit conditions.

Consistent with our criteria for government-related entities (GREs), we maintain our view of DBSA's:

- Critical role as one of the South African government's primary vehicles for promoting infrastructure development in the country's public and private sectors.

- Integral link with the South African government, through 100% ownership, ongoing government supervision, and capital injections when required.

Our assessment of the strength and durability of the link between DBSA and the government remains integral, based on 100% ownership and ongoing government supervision. Between 2012 and 2015, the government injected South African rand (ZAR) 7.9 billion into DBSA, reinforcing the shareholder (government) support for DBSA. The bank can also avail callable capital of ZAR20 billion to boost its capital base.

We have revised down our stand-alone credit profile (SACP; not considering the likelihood of extraordinary government support) for DBSA by one notch to 'bb-'. This follows the downward revision of the anchor for South African banks to 'bb' under our Banking Industry Country Risk Assessment (BICRA) for South Africa, which also followed the sovereign downgrade due to expected pressure on loan growth and asset-quality metrics (see "Various Rating Actions Taken On South African Banks Following Sovereign Downgrade," published May 7, 2020).

Within South Africa, DBSA predominantly supports public sector projects in energy, transport, and in metropolitan municipalities where infrastructure projects aim to catalyze economic growth. In 2019 the government set up an infrastructure fund to fast track development projects and its implementation unit sits within DBSA. The bank also plans to increase lending to poorer under-resourced municipalities and the water sector to assist in closing infrastructure gaps. It is, however, limited by the availability and readiness of those entities to create viable financeable projects. Consequently, DBSA support to those municipalities often takes the form of technical assistance grants, capacity-building initiatives, and overall project support. DBSA's ongoing commitment in this respect aims to enhance its developmental role and help spur GDP growth in South Africa.

DBSA also has a mandate for the development of the Southern African Development Community (SADC), primarily infrastructure finance projects that aim to link the region economically. In 2015, DBSA received an even wider mandate to provide lending and support across the rest of Africa. Despite this wider mandate, DBSA will remain mainly concentrated in South Africa, which will make up about 70% of the loan book, with projects outside limited to 30%.

Although trying to fulfil government policy initiatives, DBSA is also guided by commercial viability, as required by its sole shareholder the South African government. Simultaneously, it also considers the goals of enhancing economic growth and regional integration. That said, a recent ZAR3.5 billion loan granted by DBSA to troubled South African Airways (SAA) raises some concerns, given the state of the airline and the impact of the COVID-19 pandemic on it.

We view DBSA's capital and earnings as supportive of the 'bb-' SACP and the remaining factors as less supportive. We note the concentration within the loan portfolio and downside pressure that could emerge on the SACP should the portfolio deteriorate. We assess DBSA's capital and earnings as very strong. At year-end 2019, the risk-adjusted capital (RAC) ratio before adjustments was 16.7%. We expect the RAC ratio to remain at about 15%-17% in 2020-2021, balancing the counter cyclical nature and developmental mandate of DBSA. We consider the bank's earnings to be volatile.

We believe that DBSA's risk position is under pressure, in line with the pressures on the broader South African economy. Nonperforming loans (NPLs) rose to 6.71% at Sept. 30, 2019, compared with 4.89% at March 31, 2019, and breached the 6% internal limit. We expect NPLs to double and peak at 11% in 2020-2021. We consider single obligor concentrations to be high. The top 20 loans accounted for 72% of total loans and 159% of total adjusted capital (TAC) at March 31, 2019. Moreover, the largest exposure--to South African utility Eskom--accounted for 21% of total loans (or about ZAR17.3 billion) and 46% of TAC at the same time. Additionally, the recent DBSA ZAR3.5

billion equity bridge facility to SAA increases the concentration on South African GREs.

We recognize the role of the development bank to act counter-cyclically, along with improved risk management in recent periods in terms of loan underwriting, surveillance, and recovery. Nevertheless, given the challenging macroeconomic environment both within South Africa and the surrounding SADC, combined with loans to troubled state-owned enterprises (such as SAA) that are under pressure, we expect asset-quality metrics will weaken. We forecast credit losses will rise to 2.4% by 2020 and remain above 2.0% for the remainder of the period.

The stable outlook on DBSA mirrors that on South Africa. Our ratings on DBSA will move in conjunction with those on the sovereign as long as we assess the likelihood of extraordinary support is almost certain.

We could lower the ratings on DBSA if we downgraded South Africa. Pressure on the rating could also build if the bank's public-policy role and/or its link with the government were to weaken in combination with a deterioration of its stand-alone credit metrics.

We could raise the ratings on DBSA if we were to upgrade South Africa. We do not expect to rate DBSA higher than the sovereign.

Related Criteria

- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria | Financial Institutions | Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Various Rating Actions Taken On South African Banks Following Sovereign Downgrade, May 7, 2020
- South Africa Ratings Lowered To 'BB-' From 'BB' As COVID-19 Further Impairs Fiscal And Growth Prospects; Outlook Stable, April 29, 2020

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.