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Research Update:

Corporacion Financiera de Desarrollo S.A. 'BBB+/A-2' Ratings Affirmed; Outlook Remains Stable

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Table Of Contents

Overview

Rating Action

Rationale

Outlook

Ratings Score Snapshot

Related Criteria And Research

Ratings List

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Corporacion Financiera de Desarrollo S.A. 'BBB+/A-2' Ratings Affirmed; Outlook Remains Stable

Overview

- Peru-based development bank COFIDE has maintained its significant role in the development of infrastructure projects across the country and its very strong link with the government, while maintaining its 'bbb+' stand-alone credit profile (SACP).
- We are affirming our 'BBB+/A-2' issuer credit ratings on COFIDE.
- The stable outlook reflects our view that the rating on COFIDE will likely continue to move in tandem with the sovereign rating since the bank's SACP remains above 'bb+'.

Rating Action

On June 10, 2014, Standard & Poor's Ratings Services affirmed its 'BBB+' long-term and 'A-2' short-term issuer credit ratings on Corporacion Financiera de Desarrollo S.A. (COFIDE). The outlook is stable.

Rationale

The ratings on COFIDE reflect its "adequate" business position, "adequate" capital and earnings, "strong" risk position, and "average" funding and "adequate" liquidity (as our criteria define the term).

Our bank criteria use our Banking Industry Country Risk Assessment (BICRA) economic risk and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating. Our anchor for a commercial bank operating only in Peru is 'bbb'. Peru's economic resilience reflects its sound and consistent economic policies of recent years, such as prudent fiscal performance, which have led to low inflation, and the development of a healthy financial system. GDP per capita of approximately \$6,754 as of year-end of 2012 is one of the lowest in the region and compared with those of Peru's peers in the BICRA group '4' that average about \$14,975. Peru has "low risk" in terms of economic imbalances. Although there has been sustained credit expansion over the past three years, credit to the private sector as a percentage of GDP remains low, growing only moderately over the past decade. The country's current account and external debt positions are manageable and its ability to absorb external shocks has strengthened over time thanks to monetary flexibility, a rules-based fiscal policy, and external assets.

With regard to industry risk, we believe that Peru has a sound regulatory framework and healthy competitive dynamics. However, high dollarization in the economy, especially in the banking system, could weaken the sector's creditworthiness. Our base-case scenario contemplates stable currency and low inflation, therefore, we don't expect significant devaluation in the near future. We also consider that the country's financial system has a healthy and diversified funding mix through deposits, market debt, and external debt (banks and market).

We view the bank's business position as "adequate." COFIDE is the second-largest public bank in Peru, with total assets of about Peruvian sol (PEN) 8.1 billion as of March 31, 2014, and a 19% market share in terms of assets among public banks and 2.6% within the financial system. COFIDE provides financing through Peru's financial institutions, including commercial banks, municipal and rural banks, credit unions, and entities specializing in financing small and midsize enterprises (SMEs). We believe COFIDE has adequate business stability, with its unique role of providing long-term financing to infrastructure projects that are necessary for the country's economic development, and competitive and long-term financing to the SME segment in economic sectors that the government wants to promote. The bank's focus on financing infrastructure projects has increased to about 70% of the bank's lending exposures as of Dec. 31, 2013, from 50% a year before and we expect it to remain stable over the next five years. COFIDE's business diversity is moderate, in our view, compared with universal banks, given its more concentrated product offering. COFIDE's management has successfully executed its operational plans, based on its satisfactory track record.

We view COFIDE's capital and earnings as "adequate," based on our projected risk-adjusted capital (RAC) ratio before diversification of about 7.5% for the next 12-18 months. Our RAC ratio on the bank is weaker than the regulatory capital ratios mainly because of the bank's large equity exposure through its investments in Corporacion Andina de Fomento (CAF; AA-/Stable/A-1+) that attracts higher risk weights under our methodology, since we believe those investments exist to support CAF's capital needs. Our forecast is based on our base-case scenario of loan growth of about 25% each year, stable net interest margin and return on average assets, as well as a dividend payout of 50% of net income in 2014 and 40% in 2015.

We assess COFIDE's risk position as "strong," based on our view that our projected capital ratios overestimate the bank's risks relative to its peers'. COFIDE's SACP incorporates benefits from the bank's role as a service provider to the government. Although we believe that the investments in CAF cannot act as a buffer against unexpected losses, we expect the government to provide capital to COFIDE to offset any such losses.

Although the bank's 10 largest clients represented 70.1% of its total gross loan portfolio as of March 31, 2014, the ultimate loans are less concentrated because it is a second-floor bank. In addition, the loans to SMEs are very granular and if a bank that granted these loans were to default, COFIDE can

take over these loans to recover its funds. The loans for infrastructure projects are not guaranteed by the bank that transfers the funds, so the risk is associated with the project. However, the structure of the infrastructure loans incorporates conservative overcollateralization characteristics, which COFIDE and the funding bank closely analyze to make sure all risks are covered. The bank has a higher proportion of loans denominated in foreign currency (62.5%) than the industry average (44%). However, infrastructure loans in foreign currency are only allocated to infrastructure projects that generate revenues in foreign currency. In addition, the SME loans are typically very granular and short term and the financial institution that distributes them guarantees its repayment, mitigating the risk of default if the Peruvian sol weakens.

We view COFIDE's funding and liquidity as "adequate." Although COFIDE does not receive deposits because it is a second-floor bank, its financial flexibility benefits from the government's guarantee of its financial obligations with multilateral banks. Moreover, COFIDE's government-related entity (GRE) status gives it ample flexibility regarding refinancing, in our view, as seen in the strong demand for the bank's debt issuance. Also, COFIDE has longer-term funding relative to Peru's banking industry average. As of March 31, 2014, its funding mainly consisted of funds from international capital markets 25.7%, International commercial banks 25.2%, Peruvian commercial banks 23.8%, multilateral organizations 13.6%, and local capital markets 11.7%.

According to our methodology for assessing banks' funding and liquidity, COFIDE's metrics are lower than its peers'. The bank's stable funding ratio was 86.4% as of March 2014 and was 80.95% on average for the last three years, while its broad liquid assets covered 68% of its short-term wholesale funding with a three-year average of 51%. However, we expect both--stable funding and liquidity ratios--to improve in the short-term given the bank's funding strategy, aiming at longer term instruments. Moreover, we expect the government to provide extraordinary support if required. COFIDE has an investment PEN2.3 Billion in CAF, which we consider it to be illiquid as this kind of shares could only be owned by a government. This said, we expect the government of Peru to purchase these shares in case COFIDE requires extraordinary support.

In our view, COFIDE is a GRE, based on our criteria, because the government of Peru owns 98.98% of the bank through FONAFE (created in 1999 to oversee the government's corporate activities and equity stakes), with the remainder owned by CAF through preferred shares. We believe there is a "high" likelihood that the government would provide timely and sufficient extraordinary support to COFIDE, if it experiences financial distress. Our view of this support in our assessment of COFIDE is based on its role in promoting and financing investments and public and private infrastructure throughout Peru. In addition, the bank has a "very strong" link with the government.

Outlook

The stable outlook reflects that of the sovereign because the ratings on COFIDE are limited by the rating on the sovereign, the bank's owner through FONAFE. The ratings on COFIDE will likely continue to move in tandem with the sovereign rating as long as the bank's SACP remains above 'bb+'. We don't expect a deterioration in its capital, liquidity and risk positions that would lower the SACP to below 'bbb-' and therefore a potential downgrade on the bank would likely be driven by the sovereign.

Ratings Score Snapshot

Issuer Credit Rating	BBB+/Stable/A-2
SACP	bbb+
Anchor	bbb
Business Position	Adequate (0)
Capital and Earnings	Adequate (0)
Risk Position	Strong (1)
Funding and Liquidity	Average and Adequate (0)
Support	(0)
GRE Support	(0)
Additional Factors	(0)

Related Criteria And Research

Related Criteria

- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010
- Bank Capital Methodology And Assumptions, Dec. 6, 2010

Ratings List

Ratings Affirmed

Corporacion Financiera de Desarrollo S.A.

Counterparty Credit Rating BBB+/Stable/A-2

Senior Unsecured BBB+

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