

CREDIT OPINION

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Update

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Corporacion Financiera de Desarrollo S.A.

Update to credit analysis

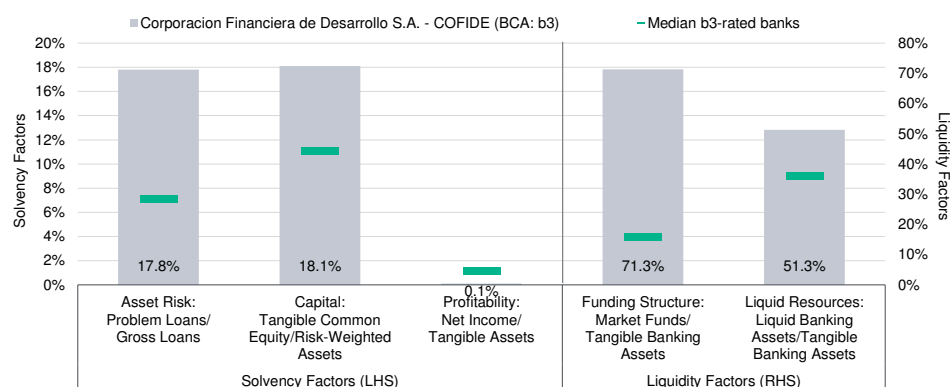
Summary

We assigned long-term local- and foreign-currency issuer ratings of Baa3 to [Corporacion Financiera de Desarrollo S.A.](#) (COFIDE), which are derived from its standalone Baseline Credit Assessment (BCA) of b3 and our assessment of a very high probability of support from the [Government of Peru](#) (A3 stable) in case of need. COFIDE's ratings reflect its weak asset-risk profile and profitability.

The company's asset risk has deteriorated significantly since the second quarter of 2017 because several infrastructure projects to which COFIDE had large exposures had been put on hold because of the corruption scandals related to public infrastructure projects last year in Peru. The company expects most of these loans to start performing again once the projects restart or to recover a substantial portion of any losses, but we believe there is a very high degree of uncertainty regarding the ultimate recovery prospects, which will depend on how much the projects are delayed and how much the construction costs increase.

Exhibit 1

Rating Scorecard - Key Financial Ratios



Source: Moody's Financial Metrics

Credit strengths

- » High probability of support from the government because of its ownership, policy mandate and financial links

Credit challenges

- » Large and increasing exposure to long-term project finance, which led to severe asset-risk deterioration

- » Moderate loss-absorption capacity of capital
- » Increasing leverage and improving liquidity
- » Worsening profitability, strained by low margins, high provisions and operating costs relative to earnings

Outlook

The outlook on all of COFIDE's ratings is negative, reflecting the risk that further increases in delinquencies and the resulting need for additional provisions may exceed our expectations.

Factors that could lead to an upgrade

While upward movement in COFIDE's standalone BCA is unlikely, given the negative pressure, the outlook could stabilize if the company is able to absorb further provisioning expenses without a significant deterioration in its capital ratio.

Factors that could lead to a downgrade

Downward pressure on the standalone BCA could result from a significant decline in capitalization or a deterioration in asset quality beyond our expectations.

Key indicators

Exhibit 2

Corporacion Financiera de Desarrollo S.A. (Consolidated Financials) [1]

	9-18 ²	12-17 ²	12-16 ²	12-15 ²	12-14 ²	CAGR/Avg. ³
Total Assets (PEN million)	11,124	11,973	13,437	13,545	9,715	3.7 ⁴
Total Assets (USD million)	3,372	3,695	4,008	3,971	3,264	0.9 ⁴
Tangible Common Equity (PEN million)	1,892	1,882	2,420	2,371	1,890	0.0 ⁴
Tangible Common Equity (USD million)	574	581	722	695	635	-2.7 ⁴
Problem Loans / Gross Loans (%)	17.8	18.1	0.3	0.7	2.5	7.9 ⁵
Tangible Common Equity / Risk Weighted Assets (%)	18.1	15.6	19.0	20.0	117.3	38.0 ⁶
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	34.3	41.4	0.9	1.9	5.8	16.9 ⁵
Net Interest Margin (%)	0.4	0.6	1.3	1.7	1.9	1.2 ⁵
PPI / Average RWA (%)	0.9	-	1.1	1.8	1.6	1.4 ⁶
Net Income / Tangible Assets (%)	0.1	0.0	0.6	0.6	0.8	0.4 ⁵
Cost / Income Ratio (%)	40.7	50.0	37.5	35.1	48.2	42.3 ⁵
Market Funds / Tangible Banking Assets (%)	69.5	71.3	68.0	68.9	62.2	68.0 ⁵
Liquid Banking Assets / Tangible Banking Assets (%)	58.9	51.3	28.3	27.8	21.2	37.5 ⁵
Gross Loans / Due to Customers (%)	3,780.6	4,159.2	5,866.3	3,369.1	2,704.6	3,976.0 ⁵

[1] All figures and ratios are adjusted using Moody's standard adjustments. [2] Basel II; LOCAL GAAP. [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. [6] Simple average of Basel II periods presented.

Source: Moody's Financial Metrics

Profile

Corporacion Financiera de Desarrollo S.A. (COFIDE) operates as a development bank in Peru. The company offers loans, investments and guarantees for (1) the execution of infrastructure and productive investment projects; (2) financial intermediation programs and lines, including loans to small and micro-enterprises; and (3) entrepreneurship consultancy and training services. COFIDE also provides financial education and business training to loans and savings associations, and treasury and investment management services.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moody's.com for the most updated credit rating action information and rating history.

The company was incorporated in 1971 and is based in Lima, Peru. COFIDE is a subsidiary of El Fondo Nacional de Financiamiento de la Actividad Empresarial del Estado (FONAFE, the National Fund for the Financing of State Entrepreneurial Activities).

Detailed credit considerations

Very high probability of government support because of its ownership, policy mandate and financial links

COFIDE is 99% owned by the Peruvian government via its holding company FONAFE. The entity's Baa3 issuer ratings benefit from six notches of uplift from the b3 standalone BCA, based on our assumption of a very high probability of support from the Peruvian government, given its ownership, financial links and mandate to promote economic growth. About half of COFIDE's loans are funded directly by the government through capital or through guaranteed funding. In addition, the company's management and board of directors are appointed by FONAFE.

COFIDE's capitalization plan is a clear indication of the government's very high willingness to provide extraordinary financial support to the company, as well as its public policy mandate to help promote economic growth by financing targeted sectors such as infrastructure and small and medium-sized enterprises (SMEs). The company is likely to continue to play an important role in helping the country fulfill its significant infrastructure needs.

Large and increasing exposure to long-term project finance

Asset-quality risk is inherent in COFIDE's sizable portfolio of infrastructure loans, particularly because the company retains the credit risk of the projects it helps finance, although loans are made through other financial institutions. COFIDE assesses both the creditworthiness of the on-lending institution and the cash flow of the project. COFIDE also buys bonds and issues guarantees related to infrastructure projects.

As part of COFIDE's mandate, the company is responsible for channeling funds to infrastructure projects. The company's loan portfolio contracted significantly in 2017 and in first 9 months of 2018 - down 20.9% as of September 2018 from YE2018, and it is still largely focused on infrastructure projects related to energy and transportation. Although the company lends to such projects through financial institutions and has historically recorded these loans as exposures to the financial institutions, it retains full project risk exposure.

The company's nonperforming loan ratio was very high at 17.8% as of September 2018, slightly lower than the 18.1% registered as of year-end 2017, as several infrastructure projects to which COFIDE had large exposures had been put on hold because of corruption scandals related to public infrastructure projects in 2016-17 in Peru. Nonetheless, nonperforming loans fell significantly to 22% as of Q3 2018 as in June 2018 the entity written off past due loans which had been fully provisioned.

The slowdown in the rise of delinquencies, in part, is a result of the establishment of tighter underwriting standards for future financings by the company's new administration, which limited COFIDE's exposure to a single project to 25%, or up to 50% as an exception with FONAFE's board approval, versus up to 100% of exposure in the past. In addition, the company has started recording these loans as direct exposures to the projects themselves, rather than to the banks through which COFIDE lends. Reserves covered 17.21% of the company's total loans as of September 2018, higher than the 4.66% for commercial banks, indicative of the higher risk associated with long-term project finance. According to the issuer periodic reports, the loan portfolio clean up has finalized.

Loans to SMEs and microfinance entities constitute roughly 10% of the loan book and are also made through financial institutions. COFIDE's direct risk exposure is to the financial institution and not to the SME or microfinance borrower. If the financial institution defaults, however, the right to collect on the loans transfers automatically to COFIDE. In this case, the company assesses the creditworthiness of on-lending institutions and relies on them to assess the credit risk of the SME and microfinance borrowers.

Loanbook related to infrastructure project financing have been reducing its share given higher exposure to corporate loans and to SMEs. Currently, each of these exposures represent one third of total loans.

One of COFIDE's objective is to grow in businesses focused on its role as Development Bank, and in that line, it aims to reinforce its promoter role in generation of pioneering and sustainable companies, SME and startups, for example, providing partial portfolio credit collateral for financial institutions, reducing their portfolio credit risk and expanding their possibilities of increasing credit facilities in those segments; developing a multibank factoring platform and Financial Platform for small and medium companies, in order to improve financial access to pre and post export financing and international factoring.

COFIDE has a dedicated chief risk officer who reports to the CEO. A risk committee of eight members meets twice a month, and includes the board chairman, the CEO and the chief risk officer.

Capital has moderate loss-absorption capacity

The [Development Bank of Latin America \(Corporacion Andina de Fomento, "CAF"\)](#) (Aa3, stable) shares held on COFIDE's balance sheet totaled \$610 million and absorbed most of its tangible equity of \$702.1 million, thus limiting its loss-absorption capacity for loan and investment books. This capital constraint is being progressively alleviated to a degree, because of significant efforts by the company's board of directors to increase capital.

In December 2017, the company's board approved the capitalization of multilateral borrowings for \$102 million, which took place in January 2018. Furthermore, the company's capital has been supported by periodic capital injections from the government to support loan growth. A capital injection of \$50 million took place in May 2018, and in June 2018 loan loss provisions against Capital were accrued for \$151 million.

In addition, the national government has committed to acquire up to 20% of COFIDE's CAF shares — as described in a comfort letter issued in May 2017. Moreover, the government has committed to reinvest future dividends for 2017-18. Despite this plan, COFIDE's loss-absorption capacity is likely to remain very weak in our view because its remaining CAF shares will continue to account for the large majority of its capital.

COFIDE's new approach to ensure sustainability and corporate governance standards is based on an organizational restructuring and top management positions downsizing, integral loan process review and Corporate Governance reinforcement (CAF), new risk committees (Eligibility Committee / Loan Portfolio Review Committee), a new Compliance Unit and New Risk Management Structure, and to reinforce Internal Audit, Business Conduct and Compliance Committees.

The entity's capital metrics complies and exceeds Peruvian capital regulations. COFIDE's capital ratio was 29.9% as of September 2018, while its tangible common equity/risk-weighted assets was 18.1%, enabling the entity to continue to expand its business volume. New dividend policy allows capitalization of 100% of After Tax Net Income (2017 – 2018).

Increasing leverage and increasing liquidity

COFIDE's leverage has been increasing over the last four years to support loan growth, largely driven by debt issuances in the international market and bank borrowings, which also serve to diversify its funding. The leverage increase is because of several bond issuances - \$800 million senior bonds issued in 2015, \$300 million issuance of five-year senior bonds in 2014, \$300 million issuance of 15-year subordinated bonds in the international market and the \$500 million issuance of 10-year global bonds in 2012.

The entity's market funds/tangible banking assets decreased slightly to 69.5% as of September 2018 from 71.3% as of year-end 2017. Most borrowings coming from multilateral entities and government agencies are granted or guaranteed by the Republic of Peru. Moreover, efforts to extend maturities have improved tenor matches with COFIDE's long- and medium-term infrastructure and SME credit portfolios that have tenors averaging eight and five years, respectively.

Maturities of US dollar liabilities were extended to an average of less than 10 years as of September 2018, while the average maturity of the local-currency liabilities also increased to more than 10 years. The company has placed bonds in the domestic market with up to 30-year maturities. The improvement in tenor matches are in line the improving liquidity metrics, which rose to 58.9% from 28.3% in 2016. The company has also maintained an adequate coverage of short-term liabilities through solid asset and liability management.

Worsening profitability, strained by low margins, and high provisions and operating costs relative to earnings

COFIDE's earnings generation capacity is limited by low margins relative to operating costs despite robust loan growth. The overall profitability is also deterred by the large holding of CAF shares that do not generate dividends for COFIDE. Almost three-quarters of the company's financial income comes from investment financing, largely focused on infrastructure, mainly energy and transportation, and the remaining income is driven by financial intermediation.

Although COFIDE has historically carried very high loan-loss reserves, the increase in delinquencies obliged it to hike its provisions substantially. During 2017, the hike in provisioning, together with a decline in interest income, generated net losses. In 2018, as of Q3

2018 COFIDE was able to register a mild positive result totaling \$3.2 million, which equals 0.13% of its tangible assets on an annualized basis. Operating expenses remained below 1% of the entity's total assets, similar to the average posted by commercial banks.

Support and structural considerations

Government support

COFIDE's issuer rating is based on the b3 standalone BCA that benefits from six notches of uplift to Baa3, reflecting our assumption of a very high probability of support from the Peruvian government, given its ownership, financial links and public policy mandate to help promote economic growth.

Counterparty Risk Ratings (CRRs)

CRRs are opinions of the ability of entities to honor the uncollateralised portion of non-debt counterparty financial liabilities (CRR liabilities) and also reflect the expected financial losses in the event such liabilities are not honoured. CRR liabilities typically relate to transactions with unrelated parties. CRRs are distinct from ratings assigned to senior unsecured debt instruments and from issuer ratings because they reflect that, in the event of a resolution, CRR liabilities might benefit from preferential treatment compared with senior unsecured debt. Examples of CRR liabilities include the uncollateralised portion of payables arising from derivative transactions and the uncollateralised portion of liabilities under sale and repurchase agreements.

COFIDE's local and foreign currency CRRs are positioned at Baa2/P-2.

Counterparty Risk (CR) Assessment

CR Assessments are opinions of how counterparty obligations are likely to be treated if a bank fails and are distinct from debt and deposit ratings in that they (1) consider only the risk of default rather than both the likelihood of default and the expected financial loss suffered in the event of default and (2) apply to counterparty obligations and contractual commitments rather than debt or deposit instruments. The CR assessment is an opinion of the counterparty risk related to a bank's covered bonds, contractual performance obligations (servicing), derivatives (e.g., swaps), letters of credit, guarantees and liquidity facilities.

COFIDE's CR Assessment is positioned at Baa2(cr)/P-2(cr)

About Moody's bank scorecard

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Rating methodology and scorecard factors

Exhibit 3

Corporacion Financiera de Desarrollo S.A.

Macro Factors

Weighted Macro Profile	Moderate	100%
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Factor	Historic Ratio	Initial Score	Expected Trend	Assigned Score	Key driver #1	Key driver #2
Solvency						
Asset Risk						
Problem Loans / Gross Loans	17.8%	b3	← →	b2	Sector concentration	Expected trend
Capital						
TCE / RWA	18.1%	a2	← →	caa2	Stress capital resilience	Expected trend
Profitability						
Net Income / Tangible Assets	0.1%	b2	← →	caa2	Expected trend	
Combined Solvency Score		ba2		caa1		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	71.3%	caa3	← →	caa2		
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	51.3%	a2	← →	baa2	Quality of liquid assets	Expected trend
Combined Liquidity Score		ba3		b1		
Financial Profile				b3		
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				0		
Sovereign or Affiliate constraint:				A3		
Scorecard Calculated BCA range				b2-cao1		
Assigned BCA				b3		
Affiliate Support notching				0		
Adjusted BCA				b3		

Instrument class	Loss Given Failure notching	Additional Notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating
Counterparty Risk Rating	1	0	b2	6	Baa2	Baa2
Counterparty Risk Assessment	1	0	b2 (cr)	6	Baa2 (cr)	--

[1] Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.

Source: Moody's Financial Metrics

Ratings

Exhibit 4

Category	Moody's Rating
CORPORACION FINANCIERA DE DESARROLLO S.A.	
Outlook	Negative
Counterparty Risk Rating	Baa2/P-2
Baseline Credit Assessment	b3
Adjusted Baseline Credit Assessment	b3
Counterparty Risk Assessment	Baa2(cr)/P-2(cr)
Issuer Rating	Baa3

Source: Moody's Investors Service

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