

# RatingsDirect®

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## Summary:

# Corporacion Financiera de Desarrollo S.A.

### Primary Credit Analyst:

Rafael Janequine, Sao Paulo (55) 11-3039-9786; rafael.janequine@spglobal.com

### Secondary Contact:

Ivana L Recalde, Buenos Aires (54) 114-891-2127; ivana.recalde@spglobal.com

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Summary:

# Corporacion Financiera de Desarrollo S.A.

<b>SACP</b>	<b>bb-</b>		+	<b>Support</b>	<b>+4</b>	+	<b>Additional Factors</b>	<b>0</b>
<b>Anchor</b>	<b>bbb-</b>			<b>ALAC Support</b>	<b>0</b>		<b>Issuer Credit Rating</b>  <b>BBB/Negative/A-2</b>	
<b>Business Position</b>	Moderate	-1		<b>GRE Support</b>	<b>+4</b>			
<b>Capital and Earnings</b>	Moderate	-1		<b>Group Support</b>	<b>0</b>			
<b>Risk Position</b>	Moderate	-1		<b>Sovereign Support</b>	<b>0</b>			
<b>Funding</b>	Average	0						
<b>Liquidity</b>	Adequate							

## Major Rating Factors

Strengths:	Weaknesses:
<ul style="list-style-type: none"> <li>• Strong evidence of the government's commitment to support the bank if financial stress persists; and</li> <li>• Favorable economic growth prospects.</li> </ul>	<ul style="list-style-type: none"> <li>• Asset quality deterioration due to weakening quality of loans to the infrastructure sector; and</li> <li>• High credit exposure, stemming from a focus on lending to the infrastructure sector, may continue pressuring capitalization levels throughout 2018.</li> </ul>

## Outlook: Negative

The negative outlook reflects the possibility of a downgrade in the next 12-24 months in a scenario of continued instability in the infrastructure sector that further erodes the bank's credit fundamentals.

### Downside scenario

We could lower the ratings in the next 12-24 months if COFIDE's risk-adjusted capital (RAC) ratio drops to consistently below 5% or its business stability deteriorates more than we expect due to difficulties in restarting infrastructure projects in Peru after the impact from corruption scandals related to Lava Jato. Higher risk could stem from faster-than-expected asset quality erosion or delays in infrastructure investments because of ongoing corruption investigations.

### Upside scenario

We could revise the outlook to stable if credit losses were to shrink as a result of new auctions to construct new infrastructure projects, asset sales, or pre-payments of problematic credit exposures, and if the bank improves its capitalization levels. The recently approved infrastructure law and related regulations could help get projects back on track and revive the construction sector, which could bolster the bank's revenue generation and financial stability. On the other hand, an upgrade is limited at this point because we would have to raise COFIDE's stand-alone credit profile (SACP) by two notches in order to trigger an upgrade, which is very unlikely in the next 12-24 months.

## Recent Developments Since Our Last Review

### Capital injections:

- In November 2017, the government-owned fund, El Fondo Nacional de Financiamiento de la Actividad Empresarial del Estado (FONAFE), injected \$18 million into Corporacion Financiera de Desarrollo S.A. (COFIDE) as part of commitment to recapitalize dividends COFIDE paid during the year.
- In January 2018, the government injected \$102 million in capital into the bank to cover the sovereign-guaranteed debt that was previously transferred to COFIDE.
- In May 2018, the government injected \$51 million in capital.

### Credit-related events:

- In September 2017, COFIDE deducted \$119 million from its capital base, owing to accrued interest from troubled loans to the Gasoducto Sur Peruano pipeline and COSAC transportation system.
- In December 2017, COFIDE increased loan loss reserves by \$167 million against capital to address regulatory provision deficiencies that were identified earlier that year.
- On May 9, the Peruvian government approved the regulations package for the Law 30737 that was passed on March 20. This law replaced the 2017 anti-graft decree that imposed financial restrictions on construction companies that acknowledged or have been found guilty of corruption.
- In June 2018, COFIDE has written off its loans to Gasoducto Sur Peruano (\$140 million), Líneas de Transmisión Peruanas (\$63 million), and Generadora Eléctrica Molloco (\$30 million) after completing 100% of provisions for those

exposures.

## Rationale

Over the last two years, credit fundamentals of COFIDE were importantly affected by a massive corruption probe in Brazil, known as Lava Jato, that spread to Peru and impaired the infrastructure and construction sectors in the country. The Brazilian construction giant Odebrecht S.A. admitted to bribing Peruvian officials in exchange for receiving contracts. In response, the government passed a decree in early 2017 with the objective of sanctioning construction companies operating in Peru that admitted, or were found guilty of, corruption. However, the decree has caused financial difficulties among construction companies, because they had trouble accessing financing for their projects. As a result, infrastructure construction in Peru has ground to a halt, impairing the country's economic conditions. To get these projects restarted, Congress has passed legislation recently to replace the last year's decree. (See "Will Peru's New Infrastructure Law Help Unshackle Economy And Provide Relief To Banks?," May 24, 2018)

COFIDE's weakening credit profile stems from souring loans to the construction companies. The bank's nonperforming loans soared close to 30% of total loans during 2018 due to the rising exposure to overdue loans and the shrinking portfolio, which dropped to about PEN5.3 billion as of June 2018 from PEN7.7 billion a year earlier given higher prepayments and slow pace of lending. (The overdue loan amount jumped to PEN1.7 billion in March 2018 from PEN200 million in March 2017, but dropped to approximately PEN950 million as of June 2018 after three large loans were written off.)

Nevertheless, COFIDE's credit losses and capitalization levels are very much in line with our last forecast thanks to the government ongoing support, which also underpins the bank's credit quality. COFIDE strengthened its capital position to address the rising provisions, allowing the bank to maintain its RAC ratio above 5%. We expect coverage levels to be recover to about 100% given that the government injected about \$153 million in capital to adjust COFIDE's loan-loss reserves, as seen in its first-half 2018 financial figures. The bank doesn't have large liquidity needs in the next 12 months.

## 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: Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Financial Institutions - Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions,

Nov. 9, 2011

- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

## Related Research

- Banking Industry Country Risk Assessment: Peru, July 17, 2017

Anchor Matrix										
Industry Risk	Economic Risk									
	1	2	3	4	5	6	7	8	9	10
1	a	a	a-	bbb+	bbb+	bbb	-	-	-	-
2	a	a-	a-	bbb+	bbb	bbb	bbb-	-	-	-
3	a-	a-	bbb+	bbb+	bbb	bbb-	bbb-	bb+	-	-
4	bbb+	bbb+	bbb+	bbb	bbb	bbb-	bb+	bb	bb	-
5	bbb+	bbb	bbb	bbb	bbb-	bbb-	bb+	bb	bb-	b+
6	bbb	bbb	bbb-	bbb-	bbb-	bb+	bb	bb	bb-	b+
7	-	bbb-	bbb-	bb+	bb+	bb	bb	bb-	b+	b+
8	-	-	bb+	bb	bb	bb	bb-	bb-	b+	b
9	-	-	-	bb	bb-	bb-	b+	b+	b+	b
10	-	-	-	-	b+	b+	b+	b	b	b-

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