

CREDIT OPINION

24 October 2017

Update

Rate this Research >>

Contacts

Georges Hatcherian +52.55.1555.5301
 AVP-Analyst
 georges.hatcherian@moodys.com

Felipe Carvallo +52.55.1253.5738
 VP-Senior Analyst
 felipe.carvallo@moodys.com

Aaron Freedman +52.55.1253.5713
 Associate Managing Director
 aaron.freedman@moodys.com

Anna Chabanenko +52.55.1555.5323
 Associate Analyst
 anna.chabanenko@moodys.com

CLIENT SERVICES

Americas 1-212-553-1653

Asia Pacific 852-3551-3077

Japan 81-3-5408-4100

EMEA 44-20-7772-5454

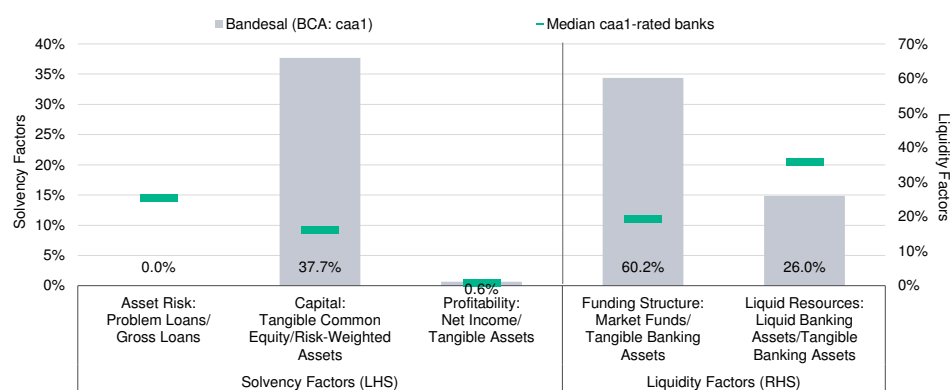
Banco de Desarrollo de El Salvador

Semiannual Update

Summary

Banco de Desarrollo de El Salvador (Bandesal)'s caa1 Baseline Credit Assessment (BCA) is in line with the Salvadoran government Caa1 long term rating, which reflects our view that the creditworthiness of the bank is intrinsically interlinked with that of the government, as its funding, liquidity position and market access are closely tied to El Salvador's own liquidity pressures. Similarly, its Caa1 long-term foreign currency issuer rating is at the level of the sovereign rating as well.

Exhibit 1

Rating Scorecard - Key Financial Ratios


Source: Moody's Financial Metrics

Credit Strengths

- » Strong asset quality supported by Badesal's preferred creditor status
- » Robust core capitalization

Credit Challenges

- » Reliance on wholesale market funds adds to refinancing risks
- » Pressures on profitability due to rising credit costs amid low net interest margins
- » Badesal's BCA is constrained by El Salvador's "Very Weak +" Macro Profile

Rating Outlook

The outlook on Badesal's long-term foreign currency issuer rating is stable in line with the stable outlook on El Salvador's government bond rating

Factors that Could Lead to an Upgrade

As Badesal's financial strength is limited by the creditworthiness of the Salvadoran government, upward pressures are limited as the Bank's BCA is already at the level of El Salvador's Caa1 sovereign rating.

Factors that Could Lead to a Downgrade

If El Salvador's government bond rating is downgraded further, Badesal's ratings and assessments are likely to be downgraded again as well.

Key indicators

Exhibit 2

Banco de Desarrollo de El Salvador (Consolidated Financials) [1]

	6-17 ²	12-16 ²	12-15 ²	12-14 ²	12-13 ²	CAGR/Avg. ³
Total Assets (USD million)	578	591	561	522	541	1.9 ⁴
Tangible Common Equity (USD million)	228	227	223	219	215	1.7 ⁴
Tangible Common Equity / Risk Weighted Assets (%)	37.7	39.4	40.7	41.8	34.4	38.8 ⁵
Net Interest Margin (%)	2.0	2.2	2.2	2.5	2.3	2.2 ⁶
PPI / Average RWA (%)	1.0	1.1	1.2	1.6	1.2	1.2 ⁵
Net Income / Tangible Assets (%)	0.6	0.8	0.9	0.9	0.9	0.8 ⁶
Cost / Income Ratio (%)	50.6	49.3	46.8	39.1	41.1	45.4 ⁶
Market Funds / Tangible Banking Assets (%)	60.2	61.2	59.7	57.5	59.3	59.6 ⁶
Liquid Banking Assets / Tangible Banking Assets (%)	26.0	28.0	28.8	28.4	35.2	29.3 ⁶

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel I; 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 Basel I periods presented [6] Simple average of periods presented for the latest accounting regime.

Source: Moody's Financial Metrics

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.

Profile

Bandesal is a Salvadoran development bank 100% controlled by the government. The bank is primarily focused on indirect lending via other financial institutions to micro and medium enterprises, while the share of direct lending in its loan book is low. In accordance with the Development Bank Law ([Ley del Sistema Financiero para el Fomento del Desarrollo](#)), Bandesal cannot take deposits.

As of June 2017 the bank reported \$578 million of assets.

Detailed credit considerations

Reliance on wholesale market funds adds to refinancing risks

Bandesal depends entirely on wholesale funding as it cannot take deposits from the public according to the Development Bank Law. As of June 2017, lines from commercial banks and Central Reserve Bank of El Salvador comprised 58% of its total assets, while the bank did not have any debt issuances outstanding.

Funding is medium-term in nature, with the majority of it being due in more than one year as of June 2017. This allows an adequate match with the longer loan portfolio, as the majority of it also matures in more than one year. As a result, Bandesal shows positive cumulative tenor matches over the short term.

Liquid assets comprised 26% of total assets as of June 2017, down from 35% and 40% in 2013 and 2012 as the bank used them to fund growth in the past. Liquidity is largely invested in Salvadoran government securities as well as bank deposits and cash.

However, if the Salvadoran government continues to rely on short-term debt financing due to its inability to recur to long-term indebtedness, Bandesal's funding and liquidity profile could deteriorate as the bank's liquidity position and market access are closely tied to the government's own funding and liquidity profile.

Pressures on profitability due to rising credit costs amid low net interest margin

Bandesal's profitability has historically been modest, with return on assets consistently below 1%. This derives from thin net interest margins, which averaged a modest 2% since 2010, a by-product of the bank's developmental role and a loan book largely devoted to financial institutions.

As of June 2017, the net income to tangible assets stood at 0.64%, slightly up from 0.58% registered during the first half of 2016. Though NIMs stood at moderate 2% for both periods, the net income was 8% higher as of June 2017 than a year ago, supported by relatively volatile items such as higher fee and commission income as well as reserve reversals. These items helped offset increased credit cost, which jumped to 29% of pre provision income, from 16% year earlier.

At the same time, high operating costs continued to put pressure on returns. As of June 2017, Bandesal, despite not having a branch network, had a cost-income ratio of a high 51%.

Strong asset quality supported by Bandesal's preferred creditor status

Asset quality remains a strength for Bandesal given its preferred creditor status in El Salvador, coupled with prudent risk management and reserving practices. Per article 6 of the Development Bank Law, Bandesal can have access to the reserve accounts of regulated banks and some non-banks at the central bank, to ensure proper and timely payment of a given loan. The portfolio of loans to unregulated saving banks ("cajas"), cooperatives and direct lending is not covered by this mechanism. As of June 2017, Bandesal had a preferential creditor status on most of its portfolio. Nonperforming loans have been posted at zero since 2006.

Bandesal constitutes provisions for possible loan and investment losses. The loan-loss reserve policy includes a 1% voluntary reserve in addition to specific reserves, a policy based on forward-looking risk profiles. As of June 2017, loan loss reserves stood at 3.3% of gross loans, slightly above the last three-year average of 3%.

The five and ten largest borrowers comprised 46% and 74% of total gross loans. Largest exposures are largely devoted to government-owned banks and large domestic private commercial banks. Bandesal direct lending encompasses around 7% of its total gross loans.

Robust core capitalization

Historically, Bandesal has maintained strong risk-weighted capitalization that allows for a substantial cushion to absorb losses. As of June 2017, tangible common equity represented about 38% of adjusted risk-weighted assets.

Bandesal's BCA is constrained by El Salvador's "Very Weak +" Macro Profile

El Salvador has a small economy with weak growth prospects, weighed down by low investment and limited improvements in productivity. Although dollarization has helped keep inflation low, it has also limited the economic policy tools available to local authorities to spur greater economic growth. In addition, the country has a fragile rule of law and suffers from widespread security problems. Credit penetration is in line with the average across Latin America, although loan growth has lagged other regional peers as a result of the country's lackluster economic expansion. Asset risks related to exposures to short-term government securities (LETES) have risen this year as a result of the government's liquidity strains. Further, consumer lending growth has accelerated in recent years, leaving banks more susceptible to asset quality problems in the event of a more pronounced downturn in the economy, or a decline in remittances. The Salvadoran banking system is largely foreign owned and moderately concentrated.

Rating methodology and scorecard factors

Exhibit 3

Banco de Desarrollo de El Salvador

Macro Factors

Weighted Macro Profile	Very Weak +	100%
------------------------	-------------	------

Factor	Historic Ratio	Macro Adjusted Score	Credit Trend	Assigned Score	Key driver #1	Key driver #2
Solvency						
Asset Risk						
Problem Loans / Gross Loans	0.0%	ba1	← →	b3		
Capital						
TCE / RWA	37.7%	ba1	← →	b3		
Profitability						
Net Income / Tangible Assets	0.6%	caa1	← →	b3		
Combined Solvency Score		ba2		b3		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	61.2%	caa3	← →	caa3		
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	28.0%	b3	← →	b3		
Combined Liquidity Score		caa2		caa2		
Financial Profile						
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				0		
Sovereign or Affiliate constraint:				Caa1		
Scorecard Calculated BCA range				b3-caa2		
Assigned BCA				caa1		
Affiliate Support notching				0		
Adjusted BCA				caa1		
Instrument class						
	Loss Given Failure notching	Additional Notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating
Senior unsecured bank debt	0	0	caa1	--	--	Caa1

Source: Moody's Financial Metrics

Support and structural considerations

Foreign currency issuer rating

Bandesal's Caa1 foreign currency issuer rating, with a stable outlook, is in line with El Salvador's Caa1 government bond rating, also with a stable outlook. It also reflects our assessment of a high probability of extraordinary public support to the bank in the case of need, though this assessment does not yield in a rating uplift at this time.

About Moody's bank scorecard

Our Scorecard is designed to capture, express and explain in summary form our Rating Committee's judgment. When read in conjunction with our research, a fulsome presentation of our judgment is expressed. As a result, the output of our Scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The Scorecard output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

Ratings

Exhibit 4

Category	Moody's Rating
BANCO DE DESARROLLO DE EL SALVADOR	
Outlook	Stable
Baseline Credit Assessment	caa1
Adjusted Baseline Credit Assessment	caa1
Issuer Rating	Caa1

Source: Moody's Investors Service

© 2017 Moody's Corporation, Moody's Investors Service, Inc., Moody's Analytics, Inc. and/or their licensors and affiliates (collectively, "MOODY'S"). All rights reserved.

CREDIT RATINGS ISSUED BY MOODY'S INVESTORS SERVICE, INC. AND ITS RATINGS AFFILIATES ("MIS") ARE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES, AND MOODY'S PUBLICATIONS MAY INCLUDE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES. MOODY'S DEFINES CREDIT RISK AS THE RISK THAT AN ENTITY MAY NOT MEET ITS CONTRACTUAL, FINANCIAL OBLIGATIONS AS THEY COME DUE AND ANY ESTIMATED FINANCIAL LOSS IN THE EVENT OF DEFAULT. CREDIT RATINGS DO NOT ADDRESS ANY OTHER RISK, INCLUDING BUT NOT LIMITED TO: LIQUIDITY RISK, MARKET VALUE RISK, OR PRICE VOLATILITY. CREDIT RATINGS AND MOODY'S OPINIONS INCLUDED IN MOODY'S PUBLICATIONS ARE NOT STATEMENTS OF CURRENT OR HISTORICAL FACT. MOODY'S PUBLICATIONS MAY ALSO INCLUDE QUANTITATIVE MODEL-BASED ESTIMATES OF CREDIT RISK AND RELATED OPINIONS OR COMMENTARY PUBLISHED BY MOODY'S ANALYTICS, INC. CREDIT RATINGS AND MOODY'S PUBLICATIONS DO NOT CONSTITUTE OR PROVIDE INVESTMENT OR FINANCIAL ADVICE, AND CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT AND DO NOT PROVIDE RECOMMENDATIONS TO PURCHASE, SELL, OR HOLD PARTICULAR SECURITIES. NEITHER CREDIT RATINGS NOR MOODY'S PUBLICATIONS COMMENT ON THE SUITABILITY OF AN INVESTMENT FOR ANY PARTICULAR INVESTOR. MOODY'S ISSUES ITS CREDIT RATINGS AND PUBLISHES MOODY'S PUBLICATIONS WITH THE EXPECTATION AND UNDERSTANDING THAT EACH INVESTOR WILL, WITH DUE CARE, MAKE ITS OWN STUDY AND EVALUATION OF EACH SECURITY THAT IS UNDER CONSIDERATION FOR PURCHASE, HOLDING, OR SALE.

MOODY'S CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT INTENDED FOR USE BY RETAIL INVESTORS AND IT WOULD BE RECKLESS AND INAPPROPRIATE FOR RETAIL INVESTORS TO USE MOODY'S CREDIT RATINGS OR MOODY'S PUBLICATIONS WHEN MAKING AN INVESTMENT DECISION. IF IN DOUBT YOU SHOULD CONTACT YOUR FINANCIAL OR OTHER PROFESSIONAL ADVISER. ALL INFORMATION CONTAINED HEREIN IS PROTECTED BY LAW, INCLUDING BUT NOT LIMITED TO, COPYRIGHT LAW, AND NONE OF SUCH INFORMATION MAY BE COPIED OR OTHERWISE REPRODUCED, REPACKAGED, FURTHER TRANSMITTED, TRANSFERRED, DISSEMINATED, REDISTRIBUTED OR RESOLD, OR STORED FOR SUBSEQUENT USE FOR ANY SUCH PURPOSE, IN WHOLE OR IN PART, IN ANY FORM OR MANNER OR BY ANY MEANS WHATSOEVER, BY ANY PERSON WITHOUT MOODY'S PRIOR WRITTEN CONSENT.

All information contained herein is obtained by MOODY'S from sources believed by it to be accurate and reliable. Because of the possibility of human or mechanical error as well as other factors, however, all information contained herein is provided "AS IS" without warranty of any kind. MOODY'S adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources MOODY'S considers to be reliable including, when appropriate, independent third-party sources. However, MOODY'S is not an auditor and cannot in every instance independently verify or validate information received in the rating process or in preparing the Moody's publications.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability to any person or entity for any indirect, special, consequential, or incidental losses or damages whatsoever arising from or in connection with the information contained herein or the use of or inability to use any such information, even if MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers is advised in advance of the possibility of such losses or damages, including but not limited to: (a) any loss of present or prospective profits or (b) any loss or damage arising where the relevant financial instrument is not the subject of a particular credit rating assigned by MOODY'S.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability for any direct or compensatory losses or damages caused to any person or entity, including but not limited to by any negligence (but excluding fraud, willful misconduct or any other type of liability that, for the avoidance of doubt, by law cannot be excluded) on the part of, or any contingency within or beyond the control of, MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers, arising from or in connection with the information contained herein or the use of or inability to use any such information.

NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY SUCH RATING OR OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MOODY'S IN ANY FORM OR MANNER WHATSOEVER.

Moody's Investors Service, Inc., a wholly-owned credit rating agency subsidiary of Moody's Corporation ("MCO"), hereby discloses that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by Moody's Investors Service, Inc. have, prior to assignment of any rating, agreed to pay to Moody's Investors Service, Inc. for appraisal and rating services rendered by it fees ranging from \$1,500 to approximately \$2,500,000. MCO and MIS also maintain policies and procedures to address the independence of MIS's ratings and rating processes. Information regarding certain affiliations that may exist between directors of MCO and rated entities, and between entities who hold ratings from MIS and have also publicly reported to the SEC an ownership interest in MCO of more than 5%, is posted annually at www.moody.com under the heading "Investor Relations — Corporate Governance — Director and Shareholder Affiliation Policy."

Additional terms for Australia only: Any publication into Australia of this document is pursuant to the Australian Financial Services License of MOODY'S affiliate, Moody's Investors Service Pty Limited ABN 61 003 399 657 AFSL 336969 and/or Moody's Analytics Australia Pty Ltd ABN 94 105 136 972 AFSL 383569 (as applicable). This document is intended to be provided only to "wholesale clients" within the meaning of section 761G of the Corporations Act 2001. By continuing to access this document from within Australia, you represent to MOODY'S that you are, or are accessing the document as a representative of, a "wholesale client" and that neither you nor the entity you represent will directly or indirectly disseminate this document or its contents to "retail clients" within the meaning of section 761G of the Corporations Act 2001. MOODY'S credit rating is an opinion as to the creditworthiness of a debt obligation of the issuer, not on the equity securities of the issuer or any form of security that is available to retail investors. It would be reckless and inappropriate for retail investors to use MOODY'S credit ratings or publications when making an investment decision. If in doubt you should contact your financial or other professional adviser.

Additional terms for Japan only: Moody's Japan K.K. ("MJKK") is a wholly-owned credit rating agency subsidiary of Moody's Group Japan G.K., which is wholly-owned by Moody's Overseas Holdings Inc., a wholly-owned subsidiary of MCO. Moody's SF Japan K.K. ("MSFJ") is a wholly-owned credit rating agency subsidiary of MJKK. MSFJ is not a Nationally Recognized Statistical Rating Organization ("NRSRO"). Therefore, credit ratings assigned by MSFJ are Non-NRSRO Credit Ratings. Non-NRSRO Credit Ratings are assigned by an entity that is not a NRSRO and, consequently, the rated obligation will not qualify for certain types of treatment under U.S. laws. MJKK and MSFJ are credit rating agencies registered with the Japan Financial Services Agency and their registration numbers are FSA Commissioner (Ratings) No. 2 and 3 respectively.

MJKK or MSFJ (as applicable) hereby disclose that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MJKK or MSFJ (as applicable) have, prior to assignment of any rating, agreed to pay to MJKK or MSFJ (as applicable) for appraisal and rating services rendered by it fees ranging from JPY200,000 to approximately JPY350,000,000.

MJKK and MSFJ also maintain policies and procedures to address Japanese regulatory requirements.

REPORT NUMBER 1096793

Contacts

Georges Hatcherian 52-55-1555-5301
AVP-Analyst
georges.hatcherian@moodys.com

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454