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Development Bank of Mongolia LLC

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Table Of Contents

Development Bank of Mongolia LLC

Credit Highlights

Issuer Credit Rating
B/Stable/B

Overview

Key strengths	Key risks
Almost certain likelihood of government support due to the bank's policy role.	Concentrated credit exposure, partly due to the bank's policy function.
	Weak profitability.
	Reliance on wholesale funding.

COVID-19 will continue to dent profitability of Development Bank of Mongolia LLC (DBM). The bank has restructured a large portion of its loan portfolio that was affected by the pandemic. This will continue to pressure margins for at least the next 12-18 months. DBM reported net losses of Mongolian tugrik (MNT) 77.9 billion in 2020 due to reduced interest income and higher credit costs. That said, maximizing profitability is not a key mandate for the bank owing to its policy role.

DBM's asset quality metrics and credit costs will continue to face pressure. The bank has high single name concentration as well as concentration to export-related industries such as mining, agriculture, and transportation. This is in part due to its policy roles. These concentration risks could weaken DBM's asset quality metrics and credit costs, especially if the negative economic impact of COVID-19 is prolonged. This is despite Mongolia's economic growth of about 6.7% in 2021 and 7.0% in 2022, after a 5.4% contraction in 2020.

The likelihood of extraordinary government support to DBM remains almost certain. The bank's critical role as Mongolia's sole policy bank with development and export-import bank functions has expanded amid COVID-19. DBM has supported companies in key industries by restructuring a large portion of their loans. A portion of the bank's financial debenture is also supported by a government guarantee with the last one to mature in 2023.

Outlook

The stable outlook on DBM reflects that on the sovereign credit rating on Mongolia.

We equalize the ratings on DBM with those on the sovereign because we expect the bank to remain a government-related entity with almost certain likelihood of receiving government support on an as needed basis at least for the coming few years. DBM has a critical role as the country's only policy bank with development and export-import bank functions, and has an integral link with the government, its sole owner.

Downside scenario

We could downgrade DBM if we lower the sovereign ratings on Mongolia.

We could also downgrade DBM if the sovereign's willingness to support the bank declines. We believe this scenario is very unlikely in the coming years, given that DBM is the only policy bank in Mongolia.

Upside scenario

We could upgrade DBM if we raise the sovereign ratings on Mongolia and the bank remains a critical policy institution for the government.

Rationale

The ratings on DBM reflect the bank's critical public policy role as Mongolia's only policy bank with development and export-import bank functions, and its integral link with the government, its sole owner. We continue to see an almost certain likelihood that the Mongolian government will provide timely and sufficient extraordinary support to DBM in the event of the bank's financial distress. We therefore equalize the ratings on DBM with those on Mongolia. We do not assign a stand-alone credit profile on DBM because we do not consider it to be a significant rating factor.

We expect DBM to continue to support the country's economic growth and stability as the country's sole policy bank. The bank fulfills its role by providing long-term stable financing facilities to projects that are critical to the country's economic development. It allocates at least 60% of its loans to promote the export sector, such as mining, agriculture, and transportation. In response to the COVID-19 pandemic, the bank has restructured loans of companies in key affected industries including airlines or mining companies upon request. It has also provided new loans to industries such as cashmere production.

We anticipate that the Mongolian government will continue to support DBM on an as-needed basis. The government injected capital of about MNT850 billion in 2016, and MNT120 billion in 2017. We expect the government to inject additional capital if the DBM's capital buffers erode due to a significant increase in credit risks in the loan portfolio, or high loan growth.

Our view of an almost certain likelihood of extraordinary government support is also based on the fact that a portion of DBM's financial debenture is supported by a government guarantee, with the last one to mature in 2023. These guaranteed debentures have cross-default clauses with other senior unsecured bonds. In October 2018, DBM issued a US$500 million bond that was not guaranteed by the government to replace shorter-term borrowings with floating interest rates.

In our view, DBM's financial soundness is very important to the government because it acts as the main funding provider to projects that are critical to the country's export sectors, and therefore economic growth.

We expect DBM's profitability to remain under pressure as the impact of COVID-19 prolongs. The bank realized net losses of MNT77.9 billion in 2020. This was mainly because DBM restructured a large portion of its loan portfolio in the year, leading to reduced interest income and higher credit costs. We expect these restructured loans to continue to exert pressure on margins, despite our expectations of an economic recovery from 2021. We forecast the Mongolian economy will grow about 6.7% in 2021 and 7.0% in 2022, after contracting by 5.4% in 2020.

DBM is also preparing to adopt International Financial Accounting Standards (IFRS) 9 accounting standards, which would lead to additional provisioning, in our view. While commercial banks are required to adopt the standards by end-2021, there is no strict timeline requirement for DBM. That said, DBM does not heavily emphasize profit maximization given its public policy role.

We believe DBM's asset quality will remain weaker and its credit costs will be higher than the domestic industry average. This is because the bank focuses on lending to bankable, export-promoting projects and programs. DBM's loan portfolio is also highly concentrated to a few borrowers. The top five largest borrowers account for about 34% of gross loans as of end-2020. The bank's nonperforming assets ratio, measured as the ratio of gross nonperforming assets to customer loans and other real estate owned, deteriorated to about 26% as of end-2020 from about 19% in 2019. Credit costs (expressed as new loan loss provisions to average customer loans) also deteriorated to about 4.3% in 2020 from about 3.2% in 2019.

We expect DBM to maintain stable funding and liquidity profiles despite a reliance on wholesale funding, in part due to ongoing government support such as direct loans. However, the bank's stable funding ratio has been deteriorating from about 123% as of end-2018 to about 101% as of end-2020. The trend reflects DBM's high loan growth in recent years. The bank's ratio of broad liquid assets to short-term wholesale funding has also deteriorated to about 1.5x as of end-2020 from about 2.7x as of end-2019 mainly due to reduction of liquid assets such as cash during 2020.

Table 1

Development Bank of Mongolia LLC--Key Figures

(Bil MNT)	2020	2019	2018	2017	2016
Adjusted assets	4,192.8	4,270.4	4,261.6	3,743.6	4,843.9
Customer loans (gross)	3,450.5	3,091.7	2,800.8	2,640.9	3,128.4
Adjusted common equity	940.5	1,018.1	976.9	1,058.3	936.9
Operating revenues	86.5	143.5	142.8	93.0	(64.4)
Noninterest expenses	21.3	19.3	15.5	10.7	11.9

Table 1

Development Bank of Mongolia LLC--Key Figures (cont.)					
(Bil MNT)	**2020**	**2019**	**2018**	**2017**	**2016**
Core earnings	(77.9)	2.0	4.2	1.0	(191.7)

MNT--Mongolian tugrik. The government loan book and associated government funding was carved out from DBM's balance sheet at end-2016.

Table 2

Development Bank of Mongolia LLC--Business Position					
(%)	**2020**	**2019**	**2018**	**2017**	**2016**
Return on average common equity	(7.4)	0.2	0.4	0.1	(30.9)

The government loan book and associated government funding was carved out from DBM's balance sheet at end-2016.

Table 3

Development Bank of Mongolia LLC--Capital And Earnings					
(%)	**2020**	**2019**	**2018**	**2017**	**2016**
Tier 1 capital ratio	20.6	29.3	32.0	33.6	30.0
Net interest income/operating revenues	105.8	98.5	85.3	126.7	(144.2)
Fee income/operating revenues	0.0	(0.0)	(0.2)	0.0	(0.2)
Market-sensitive income/operating revenues	17.1	30.6	14.7	(28.3)	245.5
Noninterest expenses/operating revenues	24.6	13.4	10.8	11.5	(18.5)
Preprovision operating income/average assets	1.5	2.9	3.2	1.9	(1.4)
Core earnings/average managed assets	(1.9)	0.0	0.1	0.0	(3.5)

The government loan book and associated government funding was carved out from DBM's balance sheet at end-2016.

Table 4

Development Bank of Mongolia LLC--Risk Position					
(%)	**2020**	**2019**	**2018**	**2017**	**2016**
Growth in customer loans	11.6	10.4	6.1	(15.6)	(37.3)
New loan loss provisions/average customer loans	4.3	3.2	4.0	0.7	2.8
Gross nonperforming assets/customer loans + other real estate owned	26.4	18.9	10.3	7.6	9.4
Loan loss reserves/gross nonperforming assets	63.5	76.3	117.5	107.2	65.8

The government loan book and associated government funding was carved out from DBM's balance sheet at end-2016.

Table 5

Development Bank of Mongolia LLC--Funding And Liquidity					
(%)	**2020**	**2019**	**2018**	**2017**	**2016**
Core deposits/funding base	0.8	0.3	0.3	0.4	0.6
Long-term funding ratio	87.1	89.1	79.3	65.0	58.0
Stable funding ratio	100.6	118.8	122.9	95.2	67.5
Short-term wholesale funding/funding base	17.2	14.7	27.9	49.3	52.7
Broad liquid assets/short-term wholesale funding (x)	1.5	2.7	2.2	1.7	0.5

The government loan book and associated government funding was carved out from DBM's balance sheet at end-2016.

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- 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: 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: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Mongolia 'B' Ratings Affirmed, Outlook Stable, July 29, 2021
- Banking Industry Country Risk Assessment: Mongolia, July 16, 2020

Ratings Detail (As Of August 5, 2021)*	
Development Bank of Mongolia LLC	
Issuer Credit Rating	B/Stable/B
Senior Unsecured	B
Issuer Credit Ratings History	
12-Nov-2018	B/Stable/B
22-Aug-2016	B-/Stable/B
03-Nov-2015	B/Stable/B
Sovereign Rating	
Mongolia	B/Stable/B
Related Entities	
Mongolia	
Issuer Credit Rating	B/Stable/B
Transfer & Convertibility Assessment	B+
Senior Unsecured	B

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.