

Business Development Bank of Canada

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Major Rating Factors

Strengths:

- Status as an agent Crown Corporation (an agent of Her Majesty in right of Canada)
- 100% government ownership
- The provision that its debt constitutes a direct obligation of the Government of Canada and is a charge on, and payable out of, the central government's Consolidated Revenue Fund
- Stable track record of financial self-sustainability on core lending business
- Good capitalization

Counterparty Credit Rating

AAA/Stable/A-1+

Weaknesses:

- High-risk nature of the mandate, which focuses on small and midsize enterprises, including subordinate financing investments and venture capital equity investments

Rationale

The ratings on Business Development Bank of Canada (BDC) reflect Standard & Poor's Ratings Services' assessment of the following factors:

- The bank's status as an agent Crown Corporation (an agent of Her Majesty in right of Canada);
- Its ownership by the Government of Canada (AAA/Stable/A-1+); and
- The provision that BDC's debt constitutes a direct obligation of the government and is a charge on and payable out of its Consolidated Revenue Fund (CRF).

Although BDC normally services debt from its own resources, its obligations are full-faith and credit obligations of Canada, with access to the CRF assuring the timeliness of debt service. Because of this, we have equalized the ratings on the bank with those on its owner.

In addition, BDC has a stable track record of financial self-sustainability on its core business of providing long-term loans to Canadian businesses, especially small and midsize enterprises (SMEs). Such loans have for many years accounted for 80%-90% of total assets, and more than 75% of revenue. Net interest income from these loans, together with the much smaller line of subordinate financing loans and investments, has held at about 4%-5% of average assets, always positive, in each of the past 14 fiscal years. This stability has easily offset habitual-but-minor losses (typically below 1% of average assets) on venture capital investments and consulting. Overall, return on assets has slipped down to just below 0.8% in the past two fiscal years, and return on equity likewise shrunk to slightly less than 5%, as the recession has left its mark on BDC results. Nevertheless, by both measures, its returns have been positive in each of the past 14 fiscal years.

Moreover, BDC has long been well-capitalized. Total equity to assets has been more than 16% in each of the past five fiscal years.

These strengths counterbalance what we view as BDC's principal credit weakness: Its high-risk mandate. Canada expects the bank to concentrate on long-term loans, subordinate financing and investments, and venture capital equity investments in Canadian SMEs. Those SMEs, by their nature, are unlikely to have well-established credit histories, track records, or proven technologies. BDC's mandate means it is likely to finance businesses that would have difficulty obtaining similar financing from private-sector institutions.

Still, as it has no legislated monopoly on the provision of credit to any Canadian business sector, it does not face policy environment pressures akin to those faced by the Canadian Wheat Board (AA/Stable/--). On the contrary, with recession and financial crisis, the Canadian government has lately been encouraging BDC to play a larger role in credit provision to the private sector. As part of the Extraordinary Financing Framework announced in its 2009 budget, the government created both the Business Credit Availability Program (BCAP) and the Canadian Secured Credit Facility (CSCF). BDC will participate jointly in the BCAP, together with Export Development Canada (senior unsecured debt rating: 'AAA') and private-sector banks. Together these lenders will provide an additional C\$5 billion in loans and other credit support to creditworthy businesses, of which BDC will likely provide about C\$1 billion (8% of end-fiscal 2009 assets). The CSCF could potentially become a much larger undertaking: here the government has mandated BDC to invest up to C\$12 billion (100% of end-fiscal 2009 assets) in 'AAA' rated asset-backed securities backed by loans and leases on vehicles and equipment, purchased from regulated financial institutions. By Dec. 1, 2009, only one investment (of C\$300 million, or 3% of end-fiscal 2009 assets) had been made under the CSCF. We expect both the BCAP and CSCF to be temporary. The government also provided additional capital to BDC, to help it handle its larger role. The government injected C\$350 million in 2009; its budget for the year also provided the government with the authority to increase its paid-in capital in BDC a further C\$1.5 billion (almost doubling it).

Since April 21, 2008, Canada has met all of BDC's borrowing needs by direct lending (effectively consolidating the bank's borrowing with that of Canada). BDC debt issued before then remains outstanding, with the support structure described above (involving the CRF) unchanged as far as such debt is concerned.

Some BDC pensioners have launched a class-action lawsuit for surplus amounts and reimbursement of certain expenses in the pension plans. The bank believes it has a strong defense against these claims, but it is too early to predict the outcome.

Outlook

The stable outlook on BDC mirrors that on Canada, and reflects Standard & Poor's expectation that the bank will continue to play an important role in Canadian public policy.

Business Development Bank of Canada--Financial Statistics					
	--Fiscal year ended March 31--				
(C\$000s)	2009	2008	2007	2006	2005
Assets	12,090,911	11,423,566	10,804,081	10,311,423	9,445,161
% change	5.8	5.7	4.8	9.2	7.2
Loans (net)	10,607,243	9,637,607	8,770,936	8,273,781	7,582,838
% change	10.1	9.9	6.0	9.1	8.7
Total equity	2,189,564	1,867,317	1,807,718	1,691,277	1,569,569
% change	17.3	3.3	6.9	7.8	28.8

Business Development Bank of Canada--Financial Statistics (cont.)					
Revenues	722,368	519,905	529,331	524,243	464,124
% change	38.9	(1.8)	1.0	13.0	3.5
Noninterest expense	332,587	299,405	296,006	270,219	249,020
% change	11.1	1.1	9.5	8.5	6.2
Net operating income before loss provisions*	389,781	220,500	233,325	254,024	215,104
% change	76.8	(5.5)	(8.1)	18.1	0.6
Loss provisions (LP)	299,214	135,937	95,318	115,843	101,616
% change	120.1	42.6	(17.7)	14.0	(34.3)
Net income	90,567	84,563	138,007	138,181	113,488
% change	7.1	(38.7)	(0.1)	21.8	92.0
Profitability (%)					
Revenues/average assets	6.31	4.78	5.01	5.31	5.09
Net interest income/average assets	4.85	4.54	4.38	4.39	4.41
Noninterest income/average assets	1.46	0.25	0.64	0.92	0.68
Noninterest expense/average assets	2.91	2.76	2.80	2.74	2.73
Net operating income before LP/average assets	3.40	2.03	2.21	2.57	2.36
LP/average assets	2.61	1.25	0.90	1.17	1.11
Net income/average assets (return on assets)	0.79	0.78	1.31	1.40	1.24
Net interest income/revenues	76.81	94.80	87.32	82.65	86.69
Noninterest income/revenues	23.19	5.20	12.68	17.35	13.31
Noninterest expense/revenues	46.04	57.59	55.92	51.54	53.65
Net operating income before LP/revenues	53.96	42.41	44.08	48.46	46.35
LP/revenues	41.42	26.15	18.01	22.10	21.89
Net income/revenues	12.54	16.27	26.07	26.36	24.45
Net income/average total equity (return on equity)	4.53	4.75	7.89	8.48	8.14
Liquidity (%)					
Loans (net)/assets	87.73	84.37	81.18	80.24	80.28
Capital(%)					
Total equity/assets	18.11	16.35	16.73	16.40	16.62
Total equity/loans (net)	20.64	19.38	20.61	20.44	20.70
Dividend payout ratio†	17.62	25.42	15.63	11.92	10.91
Asset quality					
Loan loss provision/average loan portfolio (gross)	2.17	1.04	0.75	1.05	0.70
Loan loss reserves/loan portfolio (gross)	5.90	5.24	5.45	5.67	5.99
Impaired loan portfolio/loan portfolio (gross)	4.58	2.89	3.09	3.41	3.89
Loan loss reserves/impaired loan portfolio	128.82	181.52	176.44	166.09	154.04

*Loss provisions include both loan loss provisions and change in unrealized depreciation of venture capital investments. †Aggregate dividend paid on preferred and common shares.

Ratings Detail (As Of December 23, 2009)*

Business Development Bank of Canada

Counterparty Credit Rating

AAA/Stable/A-1+

Ratings Detail (As Of December 23, 2009)* (cont.)	
Counterparty Credit Ratings History	
11-Mar-2003	AAA/Stable/A-1+
Sovereign Rating	
Canada	AAA/Stable/A-1+
Related Entities	
Bank of Canada	
Issuer Credit Rating	AAA/Stable/A-1+
Canada	
Issuer Credit Rating	AAA/Stable/A-1+
Commercial Paper	A-1+
<i>Canadian National Scale Commercial Paper Rating</i>	A-1(HIGH)
Senior Lien (1 Issue)	AAA
Senior Unsecured (172 Issues)	AAA
Short-Term Debt (2 Issues)	A-1+
Canada Mortgage and Housing Corporation	
Issuer Credit Rating	AAA/Stable/A-1+
Senior Unsecured (24 Issues)	AAA
Canadian Wheat Board	
Issuer Credit Rating	AA/Stable/--
Farm Credit Canada	
Commercial Paper	
<i>Local Currency</i>	A-1+
MILIT-AIR Inc.	
Senior Secured (2 Issues)	AAA

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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