

### **Rating Action: Moody's downgrades BDMG, affirms Desenvolve SP's ratings; changes outlook to stable.**

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Global Credit Research - 11 Apr 2018

Sao Paulo, April 11, 2018 -- Moody's América Latina Ltda has today downgraded the long-term global local currency issuer rating assigned to the state-owned development bank, Banco de Desenvolvimento de Minas Gerais S.A. (BDMG), to B2, from B1. Moody's also downgraded the bank's long and short-term Brazilian national scale issuer ratings to Ba1.br and BR-4 from Baa3.br and BR-3 respectively, as well as its baseline credit assessment (BCA) to b2 from b1. At the same time Moody's affirmed the long-term global local currency and Brazilian national scale issuer ratings and BCA assigned to the state owned development agency, Desenvolve SP - Agencia de Fomento do Estado de São Paulo (Desenvolve SP). The outlook for both issuers was changed to stable from negative.

This action follows Moody's announcements published on 9 and 10 April 2018 that it has downgraded the issuer rating of the State of Minas Gerais and affirmed the ratings of the State of São Paulo and the Government of Brazil and changed their outlooks to stable from negative. For more information, please refer to the following press releases [https://www.moody's.com/research/Moodys-takes-rating-actions-on-Brazilian-states-and-municipalities--PR\\_381956](https://www.moody's.com/research/Moodys-takes-rating-actions-on-Brazilian-states-and-municipalities--PR_381956) and [https://www.moody's.com/research/Moodys-changes-outlook-on-Brazils-ratings-to-stable-from-negative--PR\\_380048](https://www.moody's.com/research/Moodys-changes-outlook-on-Brazils-ratings-to-stable-from-negative--PR_380048).

The following ratings and assessments of Banco de Desenvolvimento de Minas Gerais S.A. were downgraded:

- Long-term global local currency issuer rating to B2, stable, from B1, negative
- Long-term local currency Brazilian national scale issuer rating to Ba1.br, from Baa3.br
- Short-term local currency Brazilian national scale issuer rating to BR-4, from BR-3
- Baseline credit assessment to b2, from b1

The outlook for Banco de Desenvolvimento de Minas Gerais S.A. was changed to stable from negative.

The following ratings and assessments of Desenvolve SP - Agencia de Fomento do Estado de São Paulo were affirmed:

Desenvolve SP - Agencia de Fomento do Estado de São Paulo:

- Long-term global local currency issuer rating of Ba2, outlook changed to stable from negative
- Short-term global local currency issuer rating of Not Prime
- Long-term local currency Brazilian national scale issuer rating of Aa2.br
- Short-term local currency Brazilian national scale issuer rating of BR-1
- Baseline credit assessment of ba3

The outlook for Desenvolve SP - Agencia de Fomento do Estado de São Paulo was changed to stable from negative.

#### RATINGS RATIONALE

The rating action was prompted by the downgrade and change in outlook to stable, from negative, of the State of Minas Gerais (B2, stable) as well as the affirmation of the ratings and change in outlook to stable, from negative, of the State of São Paulo (Ba2, stable), which in turn followed the change in the outlook of Brazil's sovereign bond rating to stable from negative. The rating action of the State of São Paulo's ratings considers the close macroeconomic and institutional linkages between the state and the federal government. However, the downgrade of the State of Minas Gerais's ratings reflects the further deterioration of the state's fiscal

position in 2017 and the challenges it faces in reducing its fiscal deficits.

In turn, the rating actions on BDMG and Desenvolve SP, reflect the strong macroeconomic and institutional linkages with their state government-shareholders. In addition to determining the agencies' strategies, budgets and objectives, the respective state governments are the sole providers of their equity. Established to act as financial development agents of their state governments, the entities have limited ability to diversify and operate beyond the boundaries of their states. Consequently, they are highly dependent upon and exposed to their local economies and exhibit concentrations in terms of segments, products and borrower types.

As the financial situation of State of Minas Gerais has worsened in recent years, BDMG has also reported much weaker fundamentals, particularly asset quality. In 2017, BDMG's 15 day problem loan ratio rose sharply to 7.9% from just 0.1% a year previously. In addition, the bank registered a significant net loss equal to 2.6% of tangible assets, a direct result of a 224% increase in its provisioning expenses. Along with the bank's continued reliance on wholesale funding from Banco Nacional de Desenvolvimento Econômico e Social (BNDES, local currency bank deposit rating of Ba2, stable) which exposes BDMG to changes in BNDES' lending policies, including reduced rate subsidies, these factors were key in the downgrade of BDMG's ratings. In contrast, the affirmation of Desenvolve SP's BCA reflects its strong capitalization, low delinquency ratios, and sound profitability.

Notwithstanding the downgrades of the government of Minas Gerais and BDMG, Moody's continues to assess as high the willingness of the state governments of both Minas Gerais and Sao Paulo to provide financial support to BDMG and Desenvolve SP if necessary. Desenvolve SP's issuer rating continues to benefit from one notch of uplift for affiliate support from its ba3 BCA. The outlooks on both BDMG and Desenvolve SP are stable, in line with the outlooks on their government-shareholders and the government of Brazil. The stable outlook on BDMG also reflects our expectation that there will be no further deterioration of the bank's asset quality, while Desenvolve SP's outlook considers that its capital and asset quality will remain strong as it expands its loan book amid Brazil's economic recovery.

#### BDMG - WHAT COULD CHANGE THE RATING DOWN

The recent downgrade and the stable outlook on the bank's rating means upward pressure is limited, at this time. If the rating of its government-shareholder is downgraded further, however, BDMG's ratings would face downward pressure as well. Further deterioration in its asset quality, profitability and/or a capital base could also pressure its ratings.

#### Desenvolve SP - WHAT COULD CHANGE THE RATING UP/DOWN

If the rating for its government-shareholder is upgraded, Desenvolve SP's ratings could face upward pressure as well. A significant improvement in profitability as a result of loan growth with limited effect on asset risk and without significantly diminishing its capital base, would put positive pressure on its BCA. However, this would not affect its issuer ratings. The ratings would face downward pressure if either the state government's rating were to be downgraded or the issuer's fundamentals deteriorate significantly.

The methodologies used in these ratings were Banks published in September 2017, and Government-Related Issuers published in August 2017. Please see the Rating Methodologies page on [www.moodys.com.br](http://www.moodys.com.br) for a copy of these methodologies.

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The date of the last Credit Rating Action for Banco de Desenvolvimento de Minas Gerais S.A. was 1/7/2016.

The date of the last Credit Rating Action for Desenvolve SP - Agencia de Fomento do Estado de São Paulo was 31/5/2017

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