

Research Update:

Banco de Desenvolvimento de Minas Gerais Outlook Revised To Stable On Lower Asset Risk; 'B' Ratings Affirmed

December 19, 2019

Overview

- BDMG's delinquency levels have been improving materially as economic conditions recover. In our view, considering economic trends and the bank's high loan loss reserves, it's less likely that lower asset quality could impair BDMG's bottom-line results and capitalization levels.
- As a result, we're revising the outlook on our ratings on BDMG to stable from negative. We're also affirming our 'B' global and 'brA-' national scale ratings on BDMG.
- The stable outlook reflects our view that the bank's credit factors should remain unchanged over the next 12 months.

Rating Action

On Dec. 19, 2019, S&P Global Ratings revised its outlook on Banco de Desenvolvimento de Minas Gerais S.A. – BDMG to stable from negative. We also affirmed our long-term 'B' global and 'brA-' national scale issuer credit ratings on the company.

Rationale

The outlook revision takes into account our view that the risk of BDMG's balance sheet worsening further because of Brazil's recent economic crisis has decreased. BDMG's delinquency levels have been improving materially since the first quarter of 2018, thanks to stronger underwriting standards and improving economic conditions. NPLs and charge-offs decreased to 2.7% and 2.4% as of September 2019, respectively, against 5.0% and 7.4% one year before. In addition, BDMG's coverage ratio (loan loss reserves/NPLs) was high, at about 386% as of the same date, illustrating that bank's capitalization is well protected against unexpected volatility. Moreover, we expect that the Brazilian economy will continue to recover in the next two years, supporting the bank's efforts to stabilize asset quality metrics and reducing the need for additional provisions. Therefore, we believe that a deterioration in asset quality that could impair the bank's bottom-line results and

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capitalization levels is less likely.

In our view, the bank's asset risk remains high, given that restructured loans represented 21% of its credit portfolio as of September 2019. In addition, the bank's 20 largest exposures represent 29% of the credit portfolio, which is higher than peers. However, we believe that the risk of the bank's asset quality worsening due to restructured loans has decreased, and we forecast stable asset quality metrics in the next two years.

On the other hand, we expect BDMG's bottom-line results to remain weak, with return on equity (ROE) of 0%-3% in the next two years. We believe it will be a challenge for BDMG to stabilize its operating revenues, which have decreased because of its deleveraging and lower interest rates. The bank's loan portfolio contracted again this year as underwriting standards became more strict, credit lines with BNDES decreased, and demand for credit remained low. We also believe that competitive pressures may continue to threaten its capacity to generate stable revenues, which may hurt the bank's operating performance in the next few years.

Outlook

The stable outlook on BDMG reflects our view that the bank's credit factors will remain unchanged over the next 12 months. We expect the bank's results to remain weaker than the industry's average, with ROE of 0%-3% in the next two years, despite improved asset quality metrics. Nevertheless, we expect the bank to maintain solid capitalization metrics, with a forecasted risk-adjusted capital (RAC) ratio of 12.5%-13.0% in the next two years.

Downside scenario

We could lower the rating if BDMG's credit portfolio and revenues drop materially, making it more vulnerable to adverse operating conditions.

Upside scenario

We could upgrade BDMG if asset quality improves significantly, with a notable reduction of restructured loans. Due to the long-term nature of BDMG's loan portfolio, we believe an upgrade is unlikely in the next few years.

Ratings Score Snapshot

Issuer Credit Rating

Global scale:	B/Stable/--
National scale:	brA-/Stable/--
SACP:	b
Anchor:	bb+
Business position:	Weak (-2)
Capital and earnings:	Strong (+1)
Risk position:	Weak (-2)
Funding and liquidity:	Below average and adequate (-1)

Support	0
GRE support	0
Group support	0
Sovereign support	0
Additional factors	0

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Methodology For National And Regional Scale Credit Ratings, June 25, 2018
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 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: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
Banco de Desenvolvimento de Minas Gerais S.A. - BDMG		
Issuer Credit Rating	B/Stable/--	B/Negative/--
Brazil National Scale	brA-/Stable/--	brA-/Negative/--

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