S&P Global
Ratings

RatingsDirect®

Banco de Desenvolvimento de Minas Gerais S.A. - BDMG

Primary Credit Analyst:
Pedro Breviglieri, Sao Paulo +55 (11) 3039-9725; pedro.breviglieri@spglobal.com

Secondary Contact:
Guilherme Machado, Sao Paulo (55) 11-3039-9754; guilherme.machado@spglobal.com

Table Of Contents

Banco de Desenvolvimento de Minas Gerais S.A. - BDMG

SACP	b

Anchor	bb+	
Business Position	Weak	-2
Capital and Earnings	Strong	+1
Risk Position	Weak	-2
Funding	Below Average	-1
Liquidity	Adequate	

+

Support	0
ALAC Support	0
GRE Support	0
Group Support	0
Sovereign Support	0

+

Additional Factors	0

Issuer Credit Rating
B/Stable/--

Major Rating Factors

Strengths:	Weaknesses:
• Sound capitalization levels. • Prudent liquidity management.	• Although gradually improving, funding sources are still concentrated in a few providers, especially the Brazilian National Development Bank (BNDES). • Narrow mix of business activities compared to the industry average. • High levels of restructured loans and client concentration in its credit portfolio.

Outlook: Stable

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 return on equity (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.

Rationale

We base our ratings on BDMG on the bank's high client concentration and large stock of restructured loans, concentrated funding base, and narrow geographic mix of business activities. These are counterbalanced by the bank's solid capitalization and prudent liquidity management. Moreover, despite the weak finances of the state of Minas Gerais (SD), the bank's controlling shareholder, we believe that Brazil's Fiscal Responsibility Law, banking regulations and the State-Owned Company Act have protected the bank from an extraordinary negative intervention.

Anchor:'bb+' for banks operating in Brazil

Our bank criteria use our Banking Industry Country Risk Assessment (BICRA) economic risk and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating. The anchor for banks operating only in Brazil is 'bb+'.

In our opinion, Brazil's low income levels and the government's weak fiscal position constrain the country's economic resilience. However, improving business confidence and economic prospects in light of the new government's commitment to implement structural reforms are helping banks stabilize their asset quality metrics and reducing the need for additional provisioning, but the political consensus needed to implement key reforms remains a challenge for the new administration. We project GDP growth to accelerate to 2.0% in 2020 and 2.2% in 2021. Besides improving investor sentiment, a pick-up in bank lending and labor market conditions should grow domestic demand, specifically in investment and household consumption.

Our industry risk assessment for Brazil reflects its well-developed financial regulation that's broadly in line with international standards, and the regulator's good track record that has helped the Brazilian financial system withstand the economic downturn. In addition, the Brazilian banking system has an adequate funding mix with a large and stable core customer deposit base, satisfactory access to domestic and international capital markets, and low dependence on external funding. These strengths are moderated by the large presence of government-owned banks that create distortions. We believe that the new administration, in line with the previous one, is implementing measures to reduce their relative importance over time.

Table 1

Banco de Desenvolvimento de Minas Gerais S.A. - BDMG Key Figures					
		--Year-ended Dec. 31--			
(Mil. R$)	**2019***	**2018**	**2017**	**2016**	**2015**
Adjusted assets	6,182.7	6,626.3	6,931.6	7,604.0	7,292.3
Customer loans (gross)	4,518.3	5,193.3	6,054.1	5,963.8	5,893.1
Adjusted common equity	1,518.9	1,540.0	1,447.5	1,558.3	1,694.7
Operating revenues	314.7	562.0	533.0	488.9	423.0
Noninterest expenses	188.8	226.7	247.9	265.6	228.8
Core earnings	27.1	127.5	(181.7)	27.3	(23.5)

*Data as of Sept. 30. R$--Brazilian real.

Business position: Geographic concentration in the state of Minas Gerais

In our view, BDMG's narrow mix of business activities and its geographic concentration limit its business position. With R$6.2 billion in total assets, the bank still represents less than 1% of the Brazilian banking system as of this September. Furthermore, the bank is concentrated in the state of Minas Gerais due to its role as a regional development bank. BDMG provides mainly working capital and long-term loans for investments for local companies and municipalities.

In 2019, a new government came into power in the state of Minas Gerais, resulting in a change in the bank's management. In line with the rules set forth by the Law 13,303/16 (the State-Owned Company Act), the new senior executives of BDMG have been appointed based on technical criteria and compatible work experience and education for the role, in our view. Several of the bank's executives, including the CEO, Mr. Sérgio Gusmão Suchodolski, previously held senior positions in domestic and foreign development banks and multilateral agencies. We believe that the solid background of the executives may contribute to improved governance, risk management, funding prospects, and strategic direction for the bank in the following years.

Nevertheless, we believe that BDMG's management will face the challenge of stabilizing the bank's operating revenues, which have decreased because of its deleveraging and lower interest rates. As of September 2019, the bank's loan portfolio contracted by 14% compared to the previous 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 to threaten its capacity to generate stable revenues, which may hurt the bank's operating performance in the next few years. Therefore, we expect BDMG's bottom-line results to remain weak in the next two years, with ROE of 0%-3%.

Table 2

Banco de Desenvolvimento de Minas Gerais S.A. - BDMG Business Position					
		--Year-ended Dec. 31--			
(%)	**2019***	**2018**	**2017**	**2016**	**2015**
Loan market share in country of domicile	N/A	0.2	0.2	0.2	0.2

Table 2

Banco de Desenvolvimento de Minas Gerais S.A. - BDMG Business Position (cont.)					
		--Year-ended Dec. 31--			
(%)	2019*	2018	2017	2016	2015
Return on average common equity	1.9	7.5	(10.6)	1.6	(1.4)

*Data as of Sept. 30. N/A--Not applicable.

Capital and earnings: Capitalization levels stronger than peers

BDMG's capitalization is stronger than that of peers, and we expect it to keep supporting its creditworthiness. The bank has a comfortable regulatory capital level of 20.4% as of September 2019, and we project that its RAC ratio will be 12.5%-13.0% for the next few years. Our forecast considers our base-case scenario, which includes the following assumptions:

- Brazil's real GDP growth of 0.8% in 2019, 2.0% in 2020, and 2.2% in 2021;
- The bank's credit portfolio to contract by 15% this year and to remain stable in 2020. We expect the bank to resume growing in 2021 as demand for investments gradually increases;
- BDMG's net interest income to drop compared to the average of the past five years, affected by its credit renegotiation strategy and low interest rates in the country;
- We expect noninterest expenses to grow in line with inflation;
- We expect NPLs to remain stable near this year's levels; 2.5%-3.5%;
- ROE ranging between 0% and 3% for the next two years, adversely affected by low credit growth and lower net interest income; and
- No dividend payments or capital injections.

Table 3

Banco de Desenvolvimento de Minas Gerais S.A. - BDMG Capital And Earnings					
		--Year-ended Dec. 31--			
(%)	2019*	2018	2017	2016	2015
Tier 1 capital ratio	30.0	26.8	25.1	25.2	26.0
S&P Global Ratings’ RAC ratio before diversification	N/A	N/A	N/A	N/A	15.4
S&P Global Ratings’ RAC ratio after diversification	N/A	N/A	N/A	N/A	11.9
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	100.0
Net interest income/operating revenues	89.9	70.6	95.6	88.9	88.2
Fee income/operating revenues	7.9	6.4	5.9	8.3	9.2
Noninterest expenses/operating revenues	60.0	40.3	46.5	54.3	54.1
Preprovision operating income/average assets	2.6	4.9	3.9	3.0	2.8
Core earnings/average managed assets	0.6	1.9	(2.5)	0.4	(0.3)

*Data as of Sept. 30. N/A--Not applicable.

Risk position: High client concentration and weak asset quality

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, against an average of 21% for peers with a similar share of loans to private companies in their portfolios.

However, we believe that the risk of BDMG's balance sheet worsening further has diminished because 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.

Table 4

Banco de Desenvolvimento de Minas Gerais S.A. - BDMG Risk Position

		--Year-ended Dec. 31--			
(%)	**2019***	**2018**	**2017**	**2016**	**2015**
Growth in customer loans	(17.3)	(14.2)	1.5	1.2	9.1
Total diversification adjustment/S&P Global Ratings' RWA before diversification	N/A	N/A	N/A	39.8	29.4
Total managed assets/adjusted common equity (x)	4.1	4.3	4.8	4.9	4.3
New loan loss provisions/average customer loans	2.2	2.9	9.3	2.9	5.1
Net charge-offs/average customer loans	2.4	5.5	(1.2)	3.3	1.7
Gross nonperforming assets/customer loans + other real estate owned	2.7	3.9	7.9	3.3	2.2
Loan loss reserves/gross nonperforming assets	386.4	271.7	161.5	159.3	305.7

*Data as of Sept. 30. N/A--Not applicable.

Funding and liquidity: Concentrated funding base and prudent liquidity management

We believe that BDMG's concentrated funding base is a weakness for the ratings. In contrast to other government-related banks, BDMG has no license to receive retail deposits. Thus, its funding sources are wholesale-oriented; 64% of which consisted of funding from BNDES and its subsidiaries as of September 2019, which we view as a material funding concentration. Still, due to the long-term maturity profile of its funding base, BDMG's stable funding ratio (SFR) was 88.9% as of September 2019, which we deem adequate. Aside from the funding from BNDES, the bank has resources from state-owned entities in Brazil such as Funcafé, FINEP, and Fungetur, which have been gaining importance and represent about 13.5% of the bank's funding. Other funding includes lending from foreign development agencies such as the Development French Agency and the Inter-American Development Bank--lending from abroad made up 10% of the bank's funding as of September. Issuances of agribusiness-linked securities (LCA), which represent the bank's only source of retail funding, accounted for about 6.1% of the funding base as of September.

In our opinion, BDMG has well-defined policies to manage liquidity risk. It assesses liquidity daily and considers different time horizons for its cash flow analysis. The bank also applies stress tests that consider, among other assumptions, a default of its largest clients and a limited ability to roll-over its maturing debt in different time horizons, which it uses to establish a minimum level of liquid assets. In addition, although the bank has obligations to some of the state's creditors, no cross-default clauses exist on the contracts that could accelerate the bank's debt payment.

Finally, BDMG has a contingency plan with established procedures to deal with a breach of liquidity limits: an action plan is defined in an internal committee that reports results recurrently to the board of directors. As of September 2019, BDMG's broad liquid assets (cash + liquid securities + short-term repos + short-term interbank deposits) amounted to R$1.150 billion. The broad liquid assets to short-term wholesale funding ratio reached 1.13x in the same period, which is in line with the industry average. We believe that the bank is likely to survive with no access to market funding for more than six months even under stressful conditions, because nearly all of its funding sources have no daily liquidity.

Table 5

Banco de Desenvolvimento de Minas Gerais S.A. - BDMG Funding And Liquidity

		--Year-ended Dec. 31--			
(%)	**2019***	**2018**	**2017**	**2016**	**2015**
Core deposits/funding base	11.4	11.6	5.2	11.8	13.4
Customer loans (net)/customer deposits	962.6	936.8	2,207.7	927.1	807.1
Long-term funding ratio	81.3	79.6	75.7	84.4	87.2
Stable funding ratio	88.9	86.6	77.3	91.0	96.0
Short-term wholesale funding/funding base	27.6	28.6	32.8	20.8	17.1
Broad liquid assets/short-term wholesale funding (x)	1.1	0.9	0.5	1.1	1.1
Net broad liquid assets/short-term customer deposits	61.1	(60.2)	(1,238.0)	15.4	106.5
Short-term wholesale funding/total wholesale funding	31.1	32.4	34.6	23.5	19.7

*Data as of Sept. 30.

Support: Delinked from the ratings on the state of Minas Gerais

Despite the state's weak finances, we believe that Brazil's Fiscal Responsibility Law, banking regulations, and the State-Owned Company Act have protected the bank from a possible negative intervention from the state of Minas Gerais, the bank's controlling shareholder.

Nevertheless, the bank has a moderately high likelihood of extraordinary support from the state in the event of financial distress. Minas Gerais owns 89.8% of the bank directly and 10.2% indirectly through Companhia de Desenvolvimento de Minas Gerais (CODEMIG) and other state-owned companies. In accordance with our criteria for government-related entities (GREs), we base our assessment on our view of the following:

- BDMG's very important role in the state of Minas Gerais because the bank facilitates access to credit in the state, lending primarily to sectors that the government considers critical for the state's economic development as well as to small to midsize enterprsies (SMEs) that don't have access to credit except through BDMG. The bank is key to the local economy and is important for long-term investments and infrastructure financing; and
- The state's eroded fiscal position, which raises doubts about the government's capacity to support BDMG's debt.

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

Anchor Matrix

Industry Risk	**Economic Risk**									
	1	2	3	4	5	6	**7**	8	9	10
1	a	a	a-	bbb+	bbb+	bbb	-	-	-	-
2	a	a-	a-	bbb+	bbb	bbb	bbb-	-	-	-
3	a-	a-	bbb+	bbb+	bbb	bbb-	bbb-	bb+	-	-
4	bbb+	bbb+	bbb+	bbb	bbb	bbb-	bb+	bb	bb	-
5	bbb+	bbb	bbb	bbb	bbb-	bbb-	**bb+**	bb	bb-	b+
6	bbb	bbb	bbb-	bbb-	bbb-	bb+	bb	bb	bb-	b+
7	-	bbb-	bbb-	bb+	bb+	bb	bb	bb-	b+	b+
8	-	-	bb+	bb	bb	bb	bb-	bb-	b+	b
9	-	-	-	bb	bb-	bb-	b+	b+	b+	b
10	-	-	-	-	b+	b+	b+	b	b	b-

Ratings Detail (As Of December 23, 2019)*	
Banco de Desenvolvimento de Minas Gerais S.A. - BDMG	
Issuer Credit Rating	B/Stable/--
Brazil National Scale	brA-/Stable/--
Issuer Credit Ratings History	
19-Dec-2019	B/Stable/--
06-Dec-2018	B/Negative/--
28-Aug-2018	B-/Watch Pos/--
18-Aug-2017	B-/Stable/--
14-Dec-2016	B-/Negative/--
19-Feb-2016	BB-/Negative/--
17-Feb-2016	BB/Watch Neg/--

Ratings Detail (As Of December 23, 2019)*(cont.)		
10-Sep-2015		BB+/Negative/--
19-Dec-2019	*Brazil National Scale*	brA-/Stable/--
06-Dec-2018		brA-/Negative/--
28-Aug-2018		brBBB-/Watch Pos/--
11-Jul-2018		brBBB-/Stable/--
18-Aug-2017		brB+/Stable/--
14-Dec-2016		brB-/Negative/--
19-Feb-2016		brA/Negative/--
17-Feb-2016		brA+/Watch Neg/--
10-Sep-2015		brAA/Negative/--
Sovereign Rating		
Brazil		BB-/Positive/B
Brazil National Scale		brAAA/Stable/--
Related Entities		
Minas Gerais (State of)		
Issuer Credit Rating		SD/--/--
Brazil National Scale		SD/--/--

*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.