

## CREDIT OPINION\*

June, 29, 2022

## Banco de Desenvolvimento de Minas Gerais S.A.

Credit analysis

### Update

#### Ratings

#### BANCO DE DESENVOLVIMENTO DE MINAS GERAIS S.A.

Issuer Rating **BBB+.br**  
Outlook **Positive**

(\*) This publication does not announce a Rating Action and, therefore, should not be considered a Credit Rating Report, pursuant to the provisions of article 16 of CVM Resolution No 9/2020. See the [www.moodylocal.com/country/br](http://www.moodylocal.com/country/br) page to view the Announcements related to the Rating Actions referenced in this publication.

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#### CUSTOMER SERVICE

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	2018	2019	2020	2021	03-22
<b>Indicators</b>					
Problem Loans/Gross Loans	4.0%	2.2%	1.9%	1.2%	1.3%
Loan Loss Reserves/Problem Loans	270%	434%	486%	835%	800%
Tier 1 Capital Ratio	16.3%	20.5%	18.7%	24.9%	26.8%
Net Income/Tangible Assets	1.9%	1.4%	0.3%	2.8%	1.4%
Market Funds/Tangible Banking Assets	58.1%	52.4%	53.2%	49.4%	47.8%
Liquid Banking Assets/Tangible Banking Assets	17.7%	17.1%	23.2%	23.5%	24.9%
<b>BRL (millions)</b>					
Total Assets	6,641	6,141	8,559	8,413	8,351
Shareholders' Equity	1,729	1,820	1,937	2,081	2,217

### Summary

On June 22, 2022, Moody's Local upgraded the issuer rating of Banco de Desenvolvimento de Minas Gerais S.A. (BDMG) to BBB+.br from BBB.br. The outlook is positive.

The issuer rating assigned to BDMG reflects its social mandate of supporting the development in the state of Minas Gerais by providing financing to local companies, which results in loan concentration by geography and by borrowers. The bank has improved its asset quality, although it has benefited from the high level of renegotiated loans. The bank's strong profitability strengthens its credit profile and increases its capital levels through earnings retention. Despite its still-high share of Banco Nacional de Desenvolvimento Econômico e Social – BNDES onlendings, the funding structure has shown positive changes.

The positive outlook is based on our expectation that in the next 12-18 months, the bank will maintain good asset quality and increase the share of funds raised in the retail segment.

## Credit strengths

- » Key role in the regional economic development, which is aligned with the objectives of its owner
- » Consistently high profitability over the years
- » High levels capitalization levels, supported by strong profitability and by earnings retention

## Credit challenges

- » The high geographic and client concentrations result in asset risk volatility
- » Loan portfolio has a large portion of renegotiated loans, which can constrain the good quality of its assets.
- » The reduction of BNDES onlendings on its funding structure can strain the bank's profitability.

## Outlook

The positive outlook reflects our expectation that over the next 12-18 months the renegotiated loans will not affect its asset quality again, and that the bank will steadily expand its loan portfolio, maintaining the current delinquency levels. The positive outlook also incorporates the continuous diversification of the funding structure, increasing the share of retail resources, such as agribusiness linked-notes (Letras de Crédito do Agronegócio) and Bank Certificates of Deposit (CDBs).

## Factors that could lead to an upgrade of the rating(s)

BDMG's rating could be upgraded if the asset remains at the current levels, combined with the reduction in wholesale funding, without affecting profitability levels. Funding through non-earmarked resources is also likely to result in an increase in liquid asset levels.

## Factors that could lead to a downgrade of the rating(s)

A downgrade of the rating is unlikely given the positive outlook. The outlook could be revised to stable if the renegotiations deteriorate, affecting delinquency and profitability levels. A diversification of funding sources that hurts profitability levels, or that has not an adequate liquidity management, could also result in a change in the outlook.

## Profile

Founded in 1962, Banco de Desenvolvimento de Minas Gerais S.A. (BDMG) aims to support the economy of Minas Gerais, promoting the economic, financial and social development of the state. It operates through banking correspondents, business managers and through an on-line platform. The bank is the main structurer of the state in public-private partnership (PPP) operations and one of the main lender of Funcafe (Coffee Economy Defense Fund) program in Brazil.

The shareholder structure consists of the state of Minas Gerais, which holds 91.3% of the share capital, and public entities linked to the state, such as Companhia de Desenvolvimento de Minas Gerais (Codemge) and Minas Gerais Participacoes. As a result of this connection to the local public sector, BDMG has limited capacity to operate beyond the borders of the state, which makes it highly dependent on and exposed to the local economy.

## Key credit considerations

### Loan portfolio shows moderate growth and renegotiation levels result in high loan loss reserves

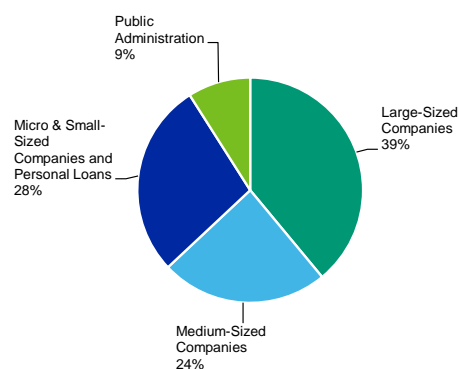
BDMG's credit profile reflects a geographically concentrated loan portfolio due its role as a development bank in Minas Gerais, which may expose the institution to volatility in asset quality, such as the impact on delinquencies reported in 2017 and 2020. The concentration of the loan portfolio by company size hasn't changed much over the years, and the bank still relies heavily on large companies. The main change in that concentration was the reduction in the share of medium-sized companies, with a substantial increase in micro and small companies, driven by loans under Pronampe (National Assistance Program for Micro and Small Businesses, in portuguese) program in response to the pandemic.

To reduce loan concentration, the bank entered into partnerships with credit unions, transferring resources to serve smaller rural producers. This strategy is still small and has reached a concession of BRL33 million, but with its expansion, it is likely that will have a bigger impact on the portfolio and result in greater diversification without affecting credit risk.

In 2020, its loan portfolio expanded strongly because of the disbursements of supporting lines to small and medium-sized companies, with a guarantee of up to 80% from the federal government. This expansion in 2020 ended the downward trend of 2018 and 2019, reductions of 14% and 13%, respectively. The loan portfolio increased, with a relatively stable share of clients refinancing their short- and medium-term loans over the years. The loan portfolio is likely to grow at a moderate pace, focusing on current borrowers.

#### Exhibit 1 - BDMG has maintained a concentration in large and medium-sized companies since 2018

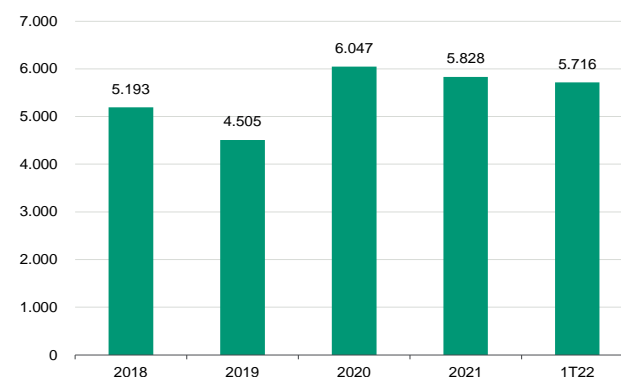
Breakdown of the credit portfolio by segment



Source: BDMG's financial statements, March 2022

#### Exhibit 2 - Evolution of the gross loan

BRL millions

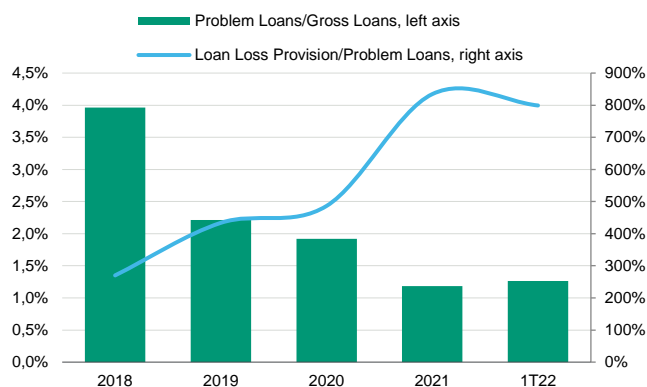


Source: BDMG's financial statements

In terms of asset quality, the bank reported volatility, absorbing the negative impacts of economic downturns. After the deterioration in 2017, delinquency was affected again in 2020, although on a smaller scale. In 2020, the high level of loan renegotiations reduced the bank's problem loans, which, however, resulted in high reserves coverage, above historical levels.

#### Exhibit 3 - Low delinquency and high coverage, benefiting from the increase in renegotiations

Problem Loans/Gross Loans and Loan Loss Reserves Coverage Ratio



Sources: Institutional Presentation, BDMG and Moody's Local Brasil

As a result, the balance of the renegotiated loans in March 2022 was 31% of gross loans, around 10 basis points higher than that reported in 2019. Although the volume of renegotiations is significant within the total portfolio, the bank has specific controls for it, so that the bank can establish that the transactions have been paid for and are resuming the normal operations. Consequently, we understand that renegotiations will not affect the delinquency levels again, but rather affect coverage levels, which can decrease as transactions are paid.

### Maintenance of high levels of capital mitigates potential asset-risk pressures

In recent years, BDMG reported a Tier 1 capital ratio comfortably above the regulatory minimum requirement of 8.5%. The capitalization has been benefited from the bank's net income, capital injections and a moderate loan expansion, which generates less pressure on the growth of risk-weighted assets.

The state of Minas Gerais has historically supported the bank through capital injections and dividend reinvestments, totaling BRL424 million since 2016. In 2020, BRL106 million was injected so that the bank could play a significant role in assisting companies affected by the pandemic. In 2022, the dividends paid in 2021 were reinvested, increasing its capital by BRL107 million in February. This amount is intended to help the municipalities of Minas Gerais that were affected by heavy rains, as part of the BDMG Housing Municipalities program.

### Profitability benefits from BNDES onlendings

BDMG has historically reported strong profitability metrics, although its main focus is on supporting the development of the economy of Minas Gerais. Its funding structure has a strong share of BNDES onlendings, whose funding costs are lower, which has strengthened its profitability. However, the bank has been changing its funding sources, reducing the share of BNDES onlendings and expanding its operations with multilateral agencies. Because these are more expensive resources and the bank does not transfer them in the same way to the customer, we expect its margins to face some pressure.

Historically, the bank has also been affected by loan loss provision expenses, with losses in 2017 and lower levels of net profit in 2020. However, given the high level of loan loss reserves and an adequate performance of renegotiations, we expect that as the transactions are paid, revenue from the reversal of provisions will support profitability levels. In addition to credit operations, the bank generates revenue from the management fees of three funds — two state owned and one private.

### Diversification of funding mitigates the still-strong dependence on BNDES onlendings

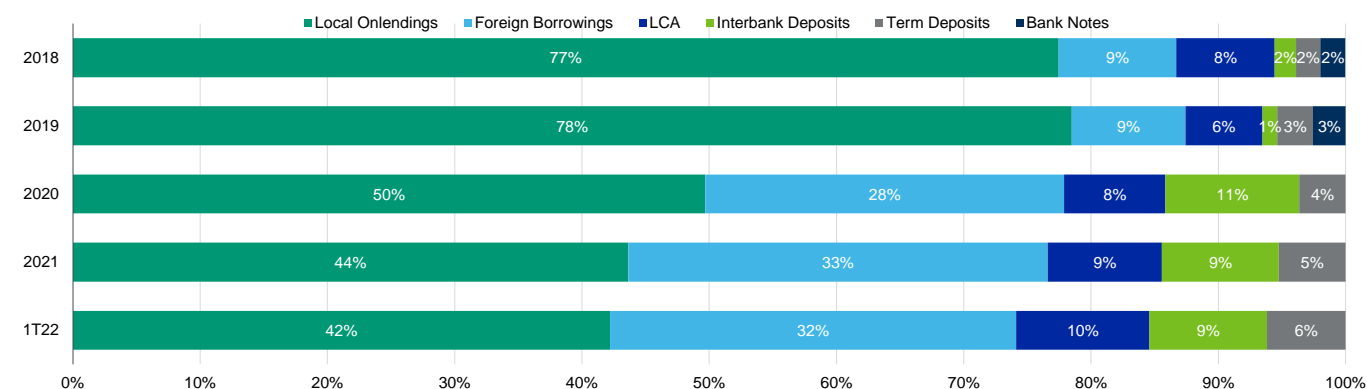
Similar to other regional development banks, BDMG has a funding structure that is very dependent on onlendings, mainly from BNDES. Over the years, the bank has been working to reduce this exposure and diversify its funding sources, and as a result, international funding is becoming increasingly relevant. In March 2022, the total funding was BRL5.0 billion, of which market funding totaled BRL4.0 billion, with a 48% market funding-to-tangible banking assets ratio, which was 5.1 basis points lower than that reported in March 2021.

For the coming years, the bank aims to focus on domestic funding, due to its lower costs. The bank is focusing on increasing LCA resources, because of the good performance in the agricultural sector, CDBs, and resuming funding through bank notes (Letras Financeiras). LCA and CDB funding will help reduce the exposure of market funding, as they are usually negotiated on retail broker platforms, while LFs will still be offered to institutional investors.

BNDES remains the bank's main individual source of funding, at BRL1.4 billion, or 28% of total outstanding funding in March 2022, compared with 66% in 2018. Also, because Minas Gerais is the main coffee-producing state in the country, BDMG plays a major role in the transfer of the resources provided by Funcafe.

Funding from foreign sources totaled BRL1.6 billion in March 2022, more than four times the amount reported in December 2018, representing 32% of total funding. These funds come from six multilateral agencies, with the Development Bank of Latin America (formerly Corporacion Andina de Fomento - CAF) and the European Investment Bank (EIB) being the most important among them. In terms of credit profile, BDMG's partnership with multilateral agencies is positive because it not only helps diversify the bank's funding sources but also requires the bank to comply with operational and performance covenants, thus creating an incentive for better governance practices and financial profile control.

## Exhibit 4 – Diversification of funding sources



Source: BDMG's financial statements

### Increasing levels of liquidity, driven by changes in funding

BDMG has historically reported low levels of liquid assets as its operations, which are focused on onlendings, require lower levels of liquidity because it is supported by the maturity matching of assets and liabilities. With the change in the funding structure, the bank modified its liquid asset management process, and the liquidity ratios have shown growth since 2020, a period during which there was strong capital injection and more significant shifts in the funding structure.

In March 2022, the bank reached its highest level of 24.9%. The liquid assets remain highly concentrated in Brazilian government debt bonds, which represented around 72%. We expect liquidity to continue to move in sync with the changes in the funding structure, and, as a result, remain high.

### Environmental, social and governance (ESG) considerations

BDMG has the main objective of promoting the economic, financial and social development of the state where it operates. Therefore, its operations are closely linked to socio-environmental and governance criteria, taking into consideration, all along the credit decision-making process, the impacts of its operations on the community, the environment and economic development.

The bank has been working hard to support investment in renewable energy and energy efficiency, granting BRL169 million for investments in the segment in 2021, reducing 7,665 tCO<sub>2</sub> in emissions throughout the year. Besides, 16 solar projects and two CGHs (hydroelectric power generating plant) were signed, generating 102 GWh/year, equivalent to the annual energy consumption of more than 34,000 households.

BDMG has low exposure to environmental risks, consistent with our overall assessment for the local banking sector, given the indirect nature of its primary exposures through investment and loan decisions, and we are not aware of any environmental risk factors that may affect the bank's credit profile at the moment. We expect the regulator to promote industrywide standards by defining environmental risk disclosure requirements and establishing quantifiable benchmarks. Although we believe that it will take time for regulatory measures to be implemented, we expect banks to increase their focus on addressing environmental risks. We do not expect environment-related banking regulations to be detrimental to banks' credit strength.

BDMG's exposure to social risks is moderate, consistent with our overall assessment for the local banking sector. The most relevant social risks for banks arise from the way they interact with their customers. Social risks are particularly high in the area of data security and customer privacy, which are mitigated by considerable investments in technology and the banks' long track record of handling sensitive customer data. We are also not aware of any specific social risk factors that could potentially affect the bank's credit profile at the moment.

In terms of the social impact of its operations, BDMG stands out positively. In addition to the disbursement of BRL197 million in 2021 to more than 2,500 entities, under Pronampe, the bank disbursed BRL73 million in products focused on socio-economic development and female empowerment.

Corporate governance is highly relevant to BDMG's credit quality, as it is to all banking sector participants. Corporate governance is a key factor for financial institutions and related risks are normally included in our financial profile assessment. Other factors such as specific corporate behavior, key person risk, internal and related-party risk, strategy and management risk factors, and dividend policy can be captured in individual adjustments to the credit profile. Governance risks are also broadly internal, rather than externally driven. However, we recognize that the Brazilian financial sector is heavily regulated and supervised, increasing the pressure on institutions to follow specific guidelines of transparency and information disclosure, thus mitigating governance risks. Therefore, the corporate governance of BDMG is a key credit consideration and is continuously monitored.

## Support and structural considerations

### Affiliate support

BDMG is controlled by the state of Minas Gerais. However, given the fiscal difficulties faced by the state, we have not incorporated any affiliate support into the ratings. Even so, we understand that the state has been supporting the bank over the years, and the recurring reinvestment of profits implies an explicit interest in maintaining the bank's activities.

### Government support

BDMG's ratings do not incorporate government support because of their low relevance in the financial system as a whole.

## Methodology used in the Rating Actions referenced in this Credit Report

- » Rating Methodology for Banks and Financial Companies, published on June 24, 2021, and available at [www.moodyslocal.com/country/br](http://www.moodyslocal.com/country/br)

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