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

Primary Credit Analyst:
Nicole Lazari, CFA, Sao Paulo +55 1138184137; nicole.lazari@spglobal.com

Secondary Contact:
Guilherme Machado, Sao Paulo + 30399700; guilherme.machado@spglobal.com

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

Ratings Score Snapshot

Issuer Credit Rating
B/Stable/--
Brazil National Scale
brA-/Stable/--

SACP: b → **Support: 0** → **Additional factors: 0**

Anchor	bb+	
Business position	Constrained	-2
Capital and earnings	Strong	+1
Risk position	Constrained	-2
Funding	Moderate	-1
Liquidity	Adequate	
CRA adjustment		0

ALAC support	0
GRE support	0
Group support	0
Sovereign support	0

Issuer credit rating
B/Stable/--

ALAC--Additional loss-absorbing capacity. CRA--Comparable ratings analysis. GRE--Government-related entity. ICR--Issuer credit rating. SACP--Stand-alone credit profile.

Credit Highlights

Key strengths	Key risks
Sound capitalization levels, with capital ratios above those of peers.	A narrower mix of business activities than the industry average.
Prudent liquidity management with well-defined policies to mitigate asset-liability mismatches.	Funding concentration among institutional investors, despite efforts to decrease dependence on BNDES' funding.
Solid relationship with foreign multilateral lending agencies, given the bank's development role.	Although improving, weak financial conditions of the state of Minas Gerais could pressure the local economy, weakening the bank's asset quality.

The ratings on the bank are based on its concentrated portfolio in terms of geography. Banco de Desenvolvimento de Minas Gerais S.A. – BDMG lends mostly in the state of Minas Gerais, where the bank provides mainly working capital and long-term loans to local companies and municipalities. However, in addition to having a low concentration by industry, BDMG has been making efforts to diversify its client base by engaging in new business partnerships and expanding its digital channels, while remaining the regional specialist for funding infrastructure projects.

High base interest rate (SELIC) pressures BDMG's margins. BDMG's loan book slightly contracted in June 2022 to R$5.6 billion from R$5.9 billion in June 2021, a resumption of the pre-pandemic trend. The rising basic interest rates reduced the bank's net interest margin to 6.6% from 7.3% in December 2021, but BDMG swung to a profit thanks to lower credit-loss provisions. We expect the bank's net income to continue to recover, gradually increasing credit growth.

The high level of renegotiated loans increases asset quality risk. Given BDMG's role as a development bank, it renegotiated existing loans due to the pandemic's economic fallout. As of June 2022, restructured loans accounted for 30% of total loans, down from 36% for the same date last year. In our view, the still high level of renegotiated loans keeps asset risk high, but also reflects the bank's mission to support the state economy and its customers. In addition, BDMG is closely monitoring these loans, payments on 54% of which have been made for more than 12 months after the agreement, which in our view, mitigates the risk of material losses.

BDMG has stronger capitalization than those of peers. As of June 2022, the bank's Basel III ratio was 26.2%, while its risk-adjusted capital (RAC) ratio was 11.1% in December 2021. We expect the RAC ratio be in the 11.5%-12.0% range in the next two years, backed by modest portfolio growth. Additionally, the state of Minas Gerais (CCC+/--/--), BDMG's controlling shareholder, has been improving its finances and we expect it to keep supporting the bank's capital position. Moreover, BDMG is aiming to strengthen its relationship with foreign multilateral lending agencies, which is diversifying its funding sources, gradually decreasing the share of loans from the Brazilian Development Bank (BNDES).

Outlook

The stable outlook on BDMG reflects our view that its credit factors will remain unchanged for the next 12 months. We expect the bank to maintain an adequate financial performance, continue diversifying its funding sources, while keeping its prudent liquidity management. Furthermore, we expect the bank to maintain capitalization metrics above those of peers, with a forecasted RAC ratio of 11.5%-12.0% in the next two years.

Downside scenario

We could lower the rating if BDMG's credit portfolio and revenues contract sharply, making it more vulnerable to adverse conditions. We could also take a negative rating action if the bank's asset quality deteriorates, causing its RAC ratio to drop below 10% due to credit losses.

Upside scenario

We could upgrade BDMG if its asset quality improves, with a notable reduction of restructured loans. An upgrade would likely also depend on the bank's ability to maintain a stable financial performance with asset quality metrics under control despite the shrinking loan book.

Key Metrics

Table 1

Banco de Desenvolvimento de Minas Gerais S.A.-BDMG--Key Ratios And Forecasts*					
	--Fiscal year ended Dec-31--				
	2019a	**2020a**	**2021a**	**2022f**	**2023f**
Growth in operating revenue (%)	(29.6)	22.7	39.8	(11.0)-(13.0)	4.5-5.5
Growth in customer loans (%)	(13.3)	34.2	(3.6)	2.2-2.7	4.5-5.5
Growth in total assets (%)	(7.5)	39.4	(1.7)	1.0-2.0	3.0-4.0
Net interest income/average earning assets (NIM) (%)	5.9	6.4	7.3	6.5-7.1	6.5-7.1
Cost to income ratio (%)	63.4	48.2	39.2	47.0-49.0	48.0-50.0
Return on equity (%)	4.7	1.4	11.5	5.0-5.5	5.0-5.5
Return on assets (%)	1.3	0.3	2.7	1.2-1.5	1.2-1.5
New loan loss provisions/average customer loans (%)	2.1	3.9	1.9	1.6-1.8	1.6-1.7
Gross nonperforming assets/customer loans (%)	2.2	1.9	1.2	3.0-3.5	3.0-3.5
Net charge-offs/average customer loans (%)	2.3	(0.8)	(1.9)	0.5-0.5	1.0-1.0
Risk-adjusted capital ratio (%)	13.9	10.0	11.1	11.5-12.0	11.5-12.0

*All figures adjusted by S&P Global Ratings. a--Actual. f--Forecast. NIM--Net interest margin.

Anchor: 'bb+' For A Bank Operating Only In Brazil

Under our bank criteria, we use our Banking Industry Country Risk Assessment's (BICRA) economic and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating. Our anchor for a commercial bank operating mostly in Brazil is 'bb+', based on the country's economic risk score of '7' and an industry risk score of '5'. In our opinion, Brazil's low-income levels and the government's weak fiscal position constrain the country's economic resilience. We expect economic growth of 2.5% in 2022 and 0.6% in 2023, as tight monetary conditions and high inflation weaken domestic demand. Credit growth will likely moderate amid rising inflation, increasing interest rates, and sluggish economic growth. Asset quality will slip as a result of the economic downturn and residual effect of the pandemic on certain economic sectors, but credit losses should be manageable because of the high provisioning coverage.

Our industry risk assessment of 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 domestic financial system withstand the last economic downturn. Brazilian banks' profitability has remained resilient thanks to the high provisioning coverage and diversified revenue mix. Profitability will likely slip as provisioning needs rise, but net interest margins should mitigate the impact. The Brazilian banking system has an adequate funding mix with a large and stable core customer deposit base.

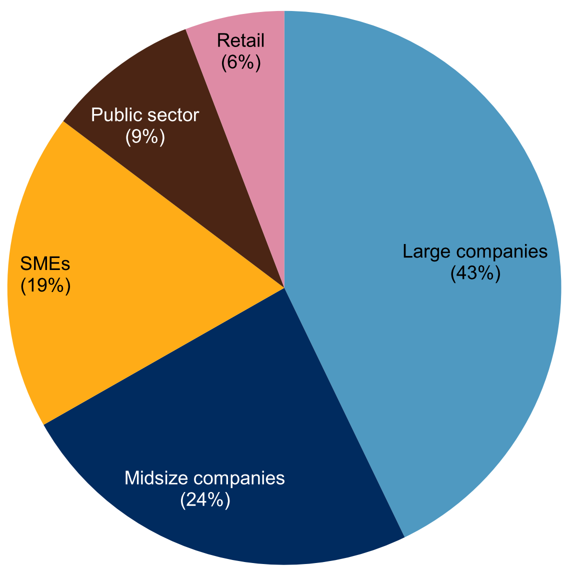
Business Position: Geographic Concentration In The State Of Minas Gerais

Our assessment of BDMG's business position incorporates its narrow mix of business activities and its geographic concentration. The bank's R$8.3 billion in total assets represent less than 1% those of the Brazilian banking system as of June 2022. BDMG mostly operates in the state of Minas Gerais, the second most populous state in the country, with 21 million inhabitants, and the fourth largest in area in the country. However, the bank plans to expand its operations into neighboring states, which now correspond to about 11% of the portfolio. BDMG provides mainly working capital and long-term loans to local companies and municipalities.

After its portfolio paused contracting during 2020, given the granting of pandemic-related credit lines, the bank's loan volume resumed contracting in 2021 and reached R$5.6 billion as of June 2022. The portfolio consists of loans to large companies (42.8%), midsize companies (23.9%), small- to mid-size enterprises (SMEs; 18.5%), public sector (8.9%), and retail clients (5.8%). BDMG is present in 93% of the state's municipalities, and its client base increased by 2.5%, reaching 29,353 clients by the end of the second quarter of the year. Nevertheless, we still believe that competition and Brazil's sputtering economy may sap the bank's capacity to generate stable revenue, which may hurt the operating performance in the next few years. We expect BDMG's bottom-line results to slightly decrease in the next two years, with return on equity (ROE) of 5.5%-6.0%.

Chart 1

BDMG Loan Portfolio Breakdown By Sector
As of June 2022



SME--Small and midsize enterprise. Source: S&P Global Ratings.

Capital And Earnings: Capitalization Levels Stronger Than Those Of Peers

Our assessment of BDMG's capital and earnings is based on its stronger capitalization than that of peers, while we expect it to keep supporting its creditworthiness. The bank had a comfortable regulatory capital level of 26.2% as of June 2022, and we forecast a RAC ratio of 11.5%-12.0% for the next few years. Our forecast considers our base-case scenario, which includes the following assumptions:

- Brazil's GDP increase of 2.5% in 2022 and 0.6% in 2023.
- Loan portfolio growth of 2.5% in 2022 and 5.0% in 2023;
- Slightly lower net interest margins (NIMs);
- Nonperforming assets (NPAs) at 3.0%-3.5% in 2022 and 2023;
- ROE of 5.0%-5.5% for the next two years; and
- We don't expect dividend payments, but the use of interest on own capital as a means of benefiting from the income tax deduction. Historically, the value has been reinvested in the bank.

Risk Position: Client Concentration And High Share Of Renegotiated Loans

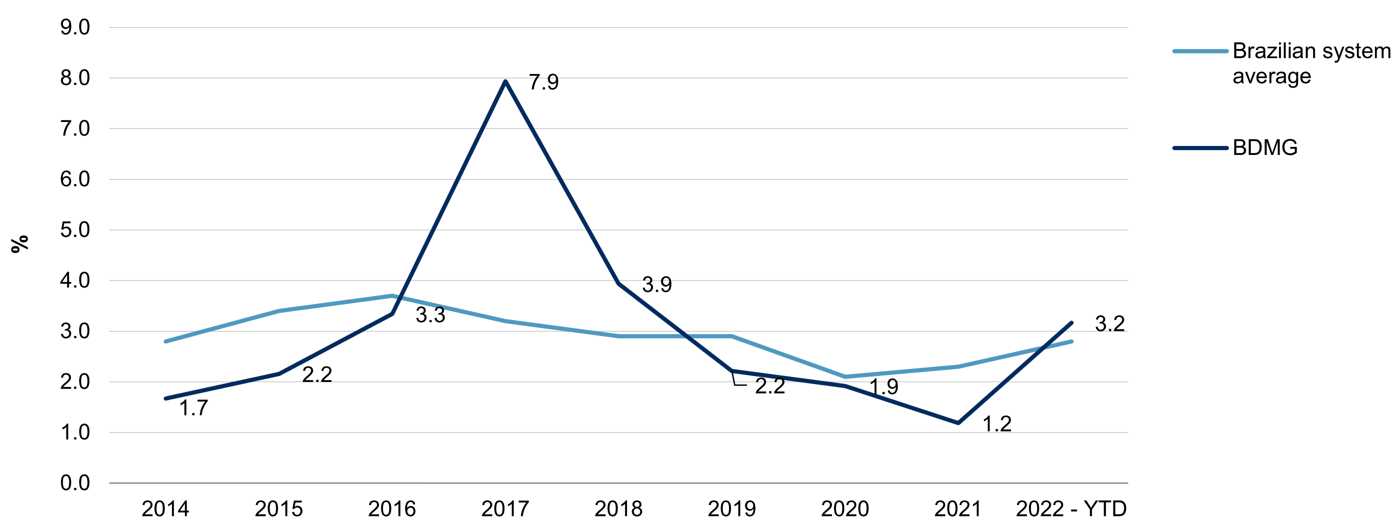
BDMG's risk position reflects the risks associated with a narrow range of lending and a high amount of renegotiated loans. Due to COVID-19, the bank offered several credit lines and loan moratoriums. As a result, the percentage of restructured loans rose sharply to 35.7% of total credit portfolio in June 2021 from 20% in December 2019. During 2022, this amount has been declining and reached 30% in June. Moreover, the bank's 20 largest exposures represent 25% of the credit portfolio, compared with an average of 21% among peers with a similar share of loans to private companies in their portfolios. We understand the above-mentioned origination and renegotiation measures are part of BDMG's mission to support the state economy and its customers, but the still high level of renegotiation is keeping asset risk high.

Nonetheless, along with adequate provisioning, the bank has been monitoring closely the renegotiated loans, and payments on 54% these loans have been made for more than 12 months after the agreement. Likewise, BDMG has been reviewing its internal policies to dilute the share of loans to its largest borrowers, and it revised the maximum allowed exposure to the single largest customer from 15% to 6% of the adjusted common equity.

BDMG's NPAs were constantly decreasing since 2018, thanks to stronger underwriting standards and improving economic conditions. However, as renegotiated loans started to mature, NPAs increased to 3.2% in June 2022. We expect NPAs to remain relatively stable until the end of the year, but to start declining in 2023, approaching historical levels. Additionally, despite weaker asset quality, the bank's loan-loss reserves covered 10.6% of the loan portfolio by the second quarter of the year, above its peers' average.

Chart 2

BDMG's Nonperforming Assets Versus The Brazilian System Average



YTD--Year till date. Source: S&P Global Ratings.

Funding And Liquidity: A Limited, But Gradually Improving, Range Of Wholesale Funding Sources

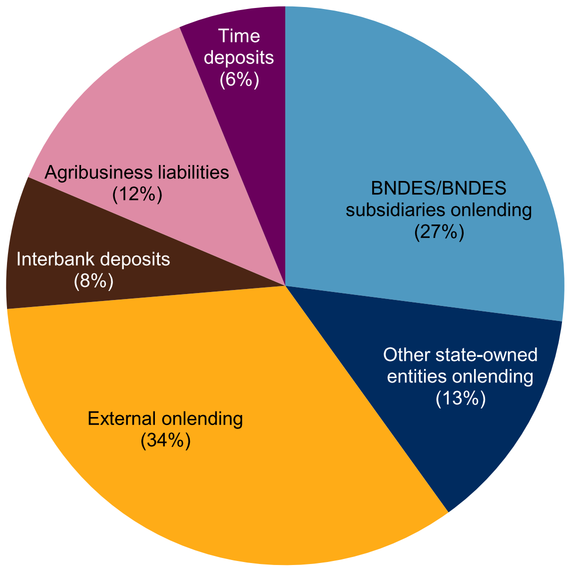
Our assessment of BDMG's funding takes into account its concentrated funding base, which we view as a rating weakness. In contrast to other government-related banks, BDMG has no license to receive retail deposits, which causes a reliance on wholesale funding sources. Given BDMG's efforts to diversify funding sources and diminish dependence on BNDES and its subsidiaries, funding from the latter dropped to 27% of total sources from 64% three years ago. Funding from state-owned entities in Brazil such as Funcafé, Fungetur, and FINEP, currently represent 13% of BDMG's total funding. Other sources include loans from the development agencies such as Corporación Andina de Fomento, European Investment Bank, The French Development Agency, and the Inter-American Development Bank.

In October 2022, the bank secured additional credit line from the New Development Bank (NDB). The $200 million (R$1 billion) loan will be the largest ever that BDMG received, and proceeds will be used to finance loans for transportation, urban mobility, renewable resources, sustainable agriculture, and energy efficiency projects.

As a result of BDMG's closer relationship with foreign lending agencies, financing from the latter rose to 34% in June 2022 from 29% as of June 2021. Other funding sources include issuances of agribusiness-linked securities (12%), which represent the bank's only source of retail funding, and time deposits (6%). Due to the long-term maturity profile of its funding base, BDMG's stable funding ratio (SFR) was 105% as of June 2022, which we deem adequate.

Chart 3

Funding Breakdown
As of June 2022



Source: S&P Global Ratings.

In our opinion, BDMG has well-defined policies to manage liquidity risk. It assesses liquidity daily and considers time horizons for its cash-flow analysis. The bank also applies stress tests that incorporate, 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 BDMG 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 to deal with a breach of liquidity limits, which is defined by an internal committee that reports results to the board of directors on a regular basis. As of June 2022, BDMG's broad liquid assets (cash, liquid securities, short-term repos, and short-term interbank deposits) totaled R$2.1 billion. The broad liquid assets to short-term wholesale funding ratio reached 3.0x. 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.

Support: Delinked From The Ratings On 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 potential intervention from Minas Gerais. Nevertheless, there's a moderately high likelihood of BDMG receiving 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 of the bank as one such entity on the following factors:

- 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 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.
- The state's fiscal strains, which raises doubts about the government's capacity to support BDMG. Still, despite the state's fragile finances, it has been making recurring capital injections into the bank.

Environmental, Social, And Governance (ESG) Factors

ESG Credit Indicators

E-1	**E-2**	E-3	E-4	E-5	**S-1**	S-2	S-3	S-4	S-5	G-1	**G-2**	G-3	G-4	G-5
- N/A					- Social capital					- N/A				

N/A—not applicable. ESG credit indicators provide additional disclosure and transparency at the entity level and reflect S&P Global Ratings' opinion of the influence that environmental, social, and governance factors have on our credit rating analysis. They are not a sustainability rating or an S&P Global Ratings ESG Evaluation. The extent of the influence of these factors is reflected on an alphanumerical 1-5 scale where 1 = positive, 2 = neutral, 3 = moderately negative, 4 = negative, and 5 = very negative. For more information, see our commentary "ESG Credit Indicator Definitions And Applications," published Oct. 13, 2021.

Social factors are a positive consideration in our credit rating analysis of BDMG. The bank has a very important role, according to our GRE methodology, because it's key to the local economy and important for long-term investments and infrastructure financing. As a state-owned development bank, BDMG has an important role in supporting the economic development of the state of Minas Gerais, which differentiates the bank from its private peers. This facilitates access to credit in the state, given that BDMG lends primarily to sectors that are critical to the state's economic and social development, as well as to SMEs that would otherwise not have access to credit.

Key Statistics

Table 1

Banco de Desenvolvimento de Minas Gerais S.A. - BDMG Key Figures					
		--Year-ended Dec. 31--			
(Mil. R$)	**2022***	**2021**	**2020**	**2019**	**2018**
Adjusted assets	8,300.1	8,393.1	8,537.9	6,127.4	6,626.3
Customer loans (gross)	5,562.1	5,827.9	6,047.3	4,504.7	5,193.3
Adjusted common equity	1,807.2	1,716.2	1,595.6	1,509.7	1,540.0

Table 1

Banco de Desenvolvimento de Minas Gerais S.A. - BDMG Key Figures (cont.)

		--Year-ended Dec. 31--			
(Mil. R$)	**2022***	**2021**	**2020**	**2019**	**2018**
Operating revenues	293.6	678.4	485.4	395.6	562.0
Noninterest expenses	140.6	266.1	234.0	250.7	226.7
Core earnings	64.4	233.5	26.4	101.4	127.5

*Data as of June 30. R$--BRL-Brazilian real.

Table 2

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

		--Year-ended Dec. 31--			
(%)	**2022***	**2021**	**2020**	**2019**	**2018**
Loan market share in country of domicile	N/A	0.13	0.14	0.12	0.15
Deposit market share in country of domicile	N/A	0.02	0.02	0.00	0.01
Return on average common equity	6.19	11.51	1.36	4.74	7.50

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

Table 3

Banco de Desenvolvimento de Minas Gerais S.A. - BDMG Capital And Earnings

		--Year-ended Dec. 31--			
(%)	**2022***	**2021**	**2020**	**2019**	**2018**
Tier 1 capital ratio	32.7	31.3	27.1	30.2	26.8
S&P Global Ratings' RAC ratio before diversification	N/A	N/A	10.0	13.9	12.5
S&P Global Ratings' RAC ratio after diversification	N/A	N/A	7.3	9.3	8.6
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	100.0
Net interest income/operating revenues	89.6	81.8	84.8	88.8	70.6
Fee income/operating revenues	7.0	5.7	7.1	8.5	6.4
Cost to income ratio	47.9	39.2	48.2	63.4	40.3
Preprovision operating income/average assets	3.7	4.9	3.4	2.3	4.9
Core earnings/average managed assets	1.5	2.7	0.4	1.6	1.9

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

Table 4

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

		--Year-ended Dec. 31--			
(%)	**2022***	**2021**	**2020**	**2019**	**2018**
Growth in customer loans	(9.1)	(3.6)	34.2	(13.3)	(14.2)
Total diversification adjustment/S&P Global Ratings' RWA before diversification	N/A	36.4	35.8	49.2	45.2
Total managed assets/adjusted common equity (x)	4.6	4.9	5.4	4.1	4.3
New loan loss provisions/average customer loans	1.3	1.9	3.9	2.1	2.9
Net charge-offs/average customer loans	(0.8)	(1.9)	(0.8)	2.3	5.5
Gross nonperforming assets/customer loans + other real estate owned	3.2	1.2	1.9	2.2	3.9

Table 4

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

		--Year-ended Dec. 31--			
(%)	**2022***	**2021**	**2020**	**2019**	**2018**
Loan loss reserves/gross nonperforming assets	334.7	835.1	486.4	433.8	271.7

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

Table 5

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

		--Year-ended Dec. 31--			
(%)	**2022***	**2021**	**2020**	**2019**	**2018**
Core deposits/funding base	18.6	14.2	11.6	11.4	11.6
Customer loans (net)/customer deposits	530.3	691.8	826.4	1,011.6	936.8
Long-term funding ratio	90.0	90.2	79.9	80.0	79.6
Stable funding ratio	105.2	105.3	94.0	83.8	86.6
Short-term wholesale funding/funding base	14.2	13.6	26.9	30.2	28.6
Broad liquid assets/short-term wholesale funding (x)	3.0	2.7	1.3	0.9	0.9
Broad liquid assets/total assets	25.7	23.4	22.9	16.2	16.4
Broad liquid assets/customer deposits	228.4	259.5	295.1	247.1	219.4
Net broad liquid assets/short-term customer deposits	211.3	348.2	209.4	(27.9)	(60.2)
Short-term wholesale funding/total wholesale funding	17.5	15.8	30.4	34.2	32.4

*Data as of June 30.

Banco de Desenvolvimento de Minas Gerais S.A.-BDMG--Rating Component Scores

Issuer Credit Rating	**B/Stable/--**
SACP	b
Anchor	bb+
Economic risk	7
Industry risk	5
Business position	Constrained
Capital and earnings	Strong
Risk position	Constrained
Funding	Moderate
Liquidity	Adequate
Comparable ratings analysis	0
Support	0
ALAC support	0
GRE support	0
Group support	0
Sovereign support	0
Additional factors	0

ALAC--Additional loss-absorbing capacity. GRE--Government-related entity. SACP--Stand-alone credit profile.

Related Criteria

- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Dec. 9, 2021
- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology, Dec. 9, 2021
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- 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: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Hybrid Capital: Methodology And Assumptions, Mar. 2, 2022

Ratings Detail (As Of November 24, 2022)*		
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/--
19-Dec-2019	*Brazil National Scale*	brA-/Stable/--
06-Dec-2018		brA-/Negative/--
28-Aug-2018		brBBB-/Watch Pos/--
11-Jul-2018		brBBB-/Stable/--
Sovereign Rating		
Brazil		BB-/Stable/B
Brazil National Scale		brAAA/Stable/--
Related Entities		
Minas Gerais (State of)		
Issuer Credit Rating		CCC+/Stable/--
Brazil National Scale		brBB/Stable/--

*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.