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

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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

Overview

Key strengths	Key risks
Sound capitalization levels, with capital ratios above those of peers	Challenging conditions in the Brazilian midsize corporate sector
Prudent liquidity management with well-defined policies to mitigate asset-liability mismatches	Still-high levels of renegotiated loans increase asset quality risk, although improving
Solidifying relationship with foreign multilateral lending agencies, given the bank's development role	Funding concentration among institutional investors, despite efforts to decrease share of BNDES' funding

The ratings on Banco de Desenvolvimento de Minas Gerais S.A. - BDMG continue to reflect its concentrated portfolio by region. BDMG lends mostly in the state of Minas Gerais, where it provides mainly working capital and long-term loans to local companies and municipalities. We also incorporate into our rating the bank's low concentration by industry and stronger capitalization than those of peers. As of June 2023, the bank's Basel III ratio was 26.1%, while its risk-adjusted capital (RAC) ratio was 13.2% as of December 2022.

We expect BDMG to maintain stable operating performance despite challenges growing the portfolio. BDMG reported a recurring return on average equity between 5% and 7% in the last two years, while its loan portfolio remained at the same level from June 2023 to June 2022, at about Brazilian real (R$) 5.6 billion. BDGM also reported manageable nonperforming loans (NPLs) despite an overall worsening in the financial system's NPLs due to the retail loan segment. On June 2023, the bank reported NPL metrics of 2.13% against 3.17% reported in June 2022.

The high level of renegotiated loans still 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 2023, restructured loans accounted for 21% of total loans, down from 24.7% for June 2022. In our view, the still-high level of renegotiated loans keeps asset risk high mostly because of the challenging economic conditions for midsize companies. We believe BDMG's oversight of this portfolio and guarantee structure partially mitigates the risk of material losses.

Despite its weak finances, we don't expect negative intervention from the state of Minas Gerais. The state of Minas Gerais, BDMG's controlling shareholder, has been improving its finances. We believe that Brazil's Fiscal Responsibility Law and banking regulations have protected the bank from potential intervention from the state. Moreover, BDMG is strengthen relationship with foreign multilateral lending agencies, diversifying funding sources, and gradually decreasing the share of loans from the Brazilian Development Bank (BNDES).

Outlook

The stable outlook on BDMG reflects S&P Global Ratings' view that we expect its stand-alone credit profile (SACP) to remain unchanged for the next 12 months. We expect the bank's renegotiated loans to keep decreasing to pre-pandemic levels. We also expect BDMG to maintain a stable financial performance, adequate liquidity, and regulatory capital ratios above peers.

Downside scenario

We could downgrade BDMG if we see worsening conditions in the corporate segment that damage its asset quality more than we expect. We could also lower the ratings if renegotiated loans start to rise, followed by an increase in NPLs and worsening financial conditions compared with those of peers. We could also lower the ratings if the bank's capital metrics deteriorate.

Upside scenario

We could upgrade BDMG if the bank is able to further improve its financial performance, with asset quality metrics under control despite worsening macroeconomic conditions in the corporate sector. We could also upgrade BDMG if its asset quality improves, with a notable reduction of restructured loans. An upgrade would also depend on the bank's ability to maintain its strong capital metrics and prudent liquidity management.

Key Metrics

Banco de Desenvolvimento de Minas Gerais S.A.-BDMG- Key Ratios And Forecasts

	--Fiscal year ended Dec. 31 --			
%	**2021a**	**2022a**	**2023f**	**2024f**
Growth in operating revenue	39.8	(17.0)	8.0-10.0	8.0-10.0
Growth in customer loans	(3.6)	(0.5)	5.0-10.0	5.0-10.0
Growth in total assets	(1.7)	(2.6)	5.0-7.0	5.0-7.0
Net interest income/average earning assets (NIM)	7.3	6.4	6.5-7.0	6.7-7.4
Cost to income ratio	39.2	54.8	50.0-53.0	50.0-53.0
Return on average common equity	11.5	6.7	4.5-5.0	5.5-6.0
Return on assets	2.7	1.7	1.0-1.5	1.2-1.7
New loan loss provisions/average customer loans	1.9	1.0	1.0-1.2	1.0-1.2
Gross nonperforming assets/customer loans	1.2	1.8	2.0-2.5	2.0-2.5
Net charge-offs/average customer loans	(1.9)	(1.5)	0.0-0.5	0.0-0.5
Risk-adjusted capital ratio	11.2	13.2	12.5-13.0	12.5-13.0

All figures are S&P Global Ratings-adjusted. a--Actual. e--Estimate. f--Forecast. NIM--Net interest margin.

Anchor: 'bb+' For Banks Operating In Brazil

We classify the banking sector of Brazil in group '6' under our Banking Industry Country Risk Assessment (BICRA). 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. We expect economic growth of 2.9% in 2023 because of very strong agricultural performance and its spillover effects on the rest of the economy. Credit growth will likely moderate amid interest rates that stay higher for longer, private banks' tighter underwriting practices, and uncertainty regarding the economic policies the new government will implement. Asset quality will slip as a result of the economic downturn, low credit growth, and high interest rates, but credit losses should be manageable because of the high provisioning coverage.

Our industry risk assessment for Brazil reflects its well-developed financial regulation that is 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 remained resilient thanks to the high provisioning coverage and diversified revenue mix. Profitability will likely slip as provisioning needs rise, but from good levels. 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 constrained business position incorporate its narrow mix of business activities and geographic concentration. The bank's R$8.2 billion in total assets represent less than 1% of the Brazilian banking system as of June 2023. It mostly operates in the state of Minas Gerais, the second most populous in Brazil, with 21 million inhabitants. BDMG is present in 90% of the state's municipalities and provides mainly working capital and long-term loans to local companies and municipalities.

BDMG's portfolio reached R$5.6 billion on June 2023. The composition consists of loans to large companies (37%), midsize companies (27%), small to midsize enterprises (SMEs; 25%), public sector (9%), and retail clients (2%).

The bank had stable results during the last 12 months, and we believe it will be able to maintain a stable financial performance despite worsening macroeconomic conditions in the Brazilian midsize corporate loan sector. We expect slightly increasing results in the next two years and a return on equity (ROE) of 5.0%-6.0%.

Capital And Earnings: Capitalization Levels Stronger Than Those of Peers

Our assessment of BDMG's strong capital and earnings is based on its stronger capitalization than that of peers, and we expect that to keep supporting BDMG's creditworthiness. The bank had a comfortable regulatory capital level of 26.2% as of June 2023, and we forecast a RAC ratio of 12.5%-13.0% for the next two years. Our forecast considers our base-case scenario, which includes the following assumptions:

- Brazil's GDP increase of 2.9% in 2023 and 1.2% in 2024
- Loan portfolio growth of 5% in 2023 and 2024
- Slightly higher net interest margins (NIMs)
- Nonperforming assets (NPAs) at 1.5%-2.0% in 2023 and 2024
- Return on equity (ROE) of 5.0%-6.0% for the next two years
- 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 narrow range of lending and high amount of renegotiated loans. Because the bank offered several credit lines and loan moratoriums during the pandemic, the percentage of restructured loans rose sharply to 32.5% of total credit portfolio in December 2020 from 20% in December 2019. BDMG has been closely monitoring these loans and reviewing internal policies, and its maximum allowed exposure to a single customer went to 6% of the adjusted common equity from 15%. As a result, since 2021, the renegotiated amount has been declining, until it reached 21% in June 2023, the lowest point during the past four years.

In our view, the still-high levels of renegotiated loans keep asset risk high because of the current challenging economic conditions for midsize companies. These companies are struggling to maintain their credit quality due to persistently high interest rates that increase the debt burden. However, the bank was able to keep manageable asset quality metrics despite its large renegotiated loan portfolio.

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 2.3% in June 2023. 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 10.5% of the loan portfolio by the second quarter of the year, above its peers' average.

Moreover, the bank's 20 largest exposures represent 28% of the credit portfolio, compared with an average of 21% among peers with a similar share of loans to private companies in their portfolios.

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

Our assessment of BDMG's funding and liquidity balances its concentrated funding base with its prudent liquidity management. BDMG's funding base relies mostly on institutional sources, although the bank has been diversifying its funding base and diminish dependence on BNDES and its subsidiaries, which dropped to 22% of total sources in 2023 from 49% four years ago.

In June 2023, the bank reported a total of R$3.1 billion in issuances and deposits. From this, 44% is represented by foreign lending agencies, mainly from Banco Europeu de Investimento (BEI) and the Banco de Desenvolvimento da América Latina (CAF), and Inter-American Investment Corp. (IDB). While the domestic funding sources represented 56%, mostly composed of issuances of agribusiness-linked securities, time deposits, and local issuances.

BDMG is in the process of securing US$200 million (R$1 billion) in credit line from the New Development Bank (NDB) with a guarantee from the Union. In June 2023, the project was sent to approval and, if passed, it will be the largest amount it ever received. BDMG will use proceeds 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 by almost 30% during the last 12 months. Due to the long-term maturity profile of its funding base, BDMG's stable funding ratio (SFR) was 97% as of June 2023, which we deem adequate.

Additional Rating Factors: Delink 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 99.1% of the bank directly and 0.81% indirectly through Minas Gerais Participações (MGI) and Departamento de Estradas e Rodagem MG (DER-MG). In accordance with our criteria for government-related entities, 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)

Social factors are a positive consideration in our credit rating analysis of BDMG. The bank has a very important role, according to our government-related entity 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$	**2023***	**2022**	**2021**	**2020**	**2019**
Adjusted assets	8,166.4	8,169.6	8,393.1	8,537.9	6,127.4
Customer loans (gross)	5,530.7	5,799.6	5,827.9	6,047.3	4,504.7
Adjusted common equity	1,798.2	1,863.0	1,735.4	1,595.6	1,509.7
Operating revenues	325.0	563.2	678.4	485.4	395.6
Noninterest expenses	155.6	308.4	266.1	234.0	250.7
Core earnings	91.0	139.1	233.5	26.4	101.4

*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--			
%	**2023***	**2022**	**2021**	**2020**	**2019**
Loan market share in country of domicile	N/A	0.11	0.13	0.14	0.12
Deposit market share in country of domicile	N/A	0.01	0.02	0.02	0.00

*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--			
%	**2023***	**2022**	**2021**	**2020**	**2019**
Tier 1 capital ratio	29.2	30.5	31.3	27.1	30.2
S&P Global Ratings’ RAC ratio before diversification	N/A	13.2	N/A	10.0	13.9

Table 3

Banco de Desenvolvimento de Minas Gerais S.A. - BDMG Capital And Earnings (cont.)					
		--Year ended Dec. 31--			
%	**2023***	**2022**	**2021**	**2020**	**2019**
S&P Global Ratings' RAC ratio after diversification	N/A	9.5	N/A	7.3	9.3
Adjusted common equity/total adjusted capital	100	100	100	100	100

N/A--Not applicable. *As of June 30.

Table 4

Banco de Desenvolvimento de Minas Gerais S.A. - BDMG Risk Position					
		--Year ended Dec. 31--			
%	**2023***	**2022**	**2021**	**2020**	**2019**
Growth in customer loans	(9.3)	(0.5)	(3.6)	34.2	(13.3)
Total diversification adjustment/S&P Global Ratings' RWA before diversification	N/A	40.0	36.4	35.8	49.2
Total managed assets/adjusted common equity (x)	4.6	4.4	4.9	5.4	4.1

*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--			
%	**2023***	**2022**	**2021**	**2020**	**2019**
Core deposits/funding base	26.6	23.8	14.2	11.6	11.4
Customer loans (net)/customer deposits	396.3	447.2	691.8	826.4	1,011.6
Long-term funding ratio	86.3	85.0	90.2	79.9	80.0
Stable funding ratio	97.9	95.3	105.3	94.0	

*Data as of June 30.

Related Criteria

- General Criteria: National And Regional Scale Credit Ratings Methodology, June 8, 2023
- 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
- 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

Ratings Detail (As Of November 30, 2023)*		
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/--
16-Nov-2023	*Brazil National Scale*	brA/Stable/--
19-Dec-2019		brA-/Stable/--
06-Dec-2018		brA-/Negative/--
Sovereign Rating		
Brazil		BB-/Positive/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.