

Research Update:

Banco de Desenvolvimento de Minas Gerais S.A. Upgraded To 'B+' On Decrease In Renegotiated Loans; Outlook Stable

November 18, 2024

Overview

- Banco de Desenvolvimento de Minas Gerais S.A. (BDMG) decreased its renegotiated loan portfolio to pre-pandemic levels while keeping manageable asset quality metrics.
- In addition, over the past 12 months, BDMG improved its financial performance while maintaining sound capital metrics and a more diversified funding base.
- As a result, we raised our global scale rating on BDMG to 'B+' from 'B' and raised our long-term national scale rating to 'brA+' from 'brA'.
- The stable outlook on the long-term ratings reflects our view that we expect the bank to maintain a stable financial performance and continue diversifying its funding sources while keeping its prudent liquidity management.

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Rating Action

On Nov. 18, 2024, S&P Global Ratings raised its long-term global scale issuer credit rating on BDMG to 'B+' from 'B'. At the same time, we raised the long-term national scale rating on the bank to 'brA+' from 'brA'. The outlook on both ratings is stable.

Rationale

BDMG's renegotiated loans decreased to pre-pandemic levels, mitigating asset quality risk.

Given BDMG's role as a development bank, it offered several credit lines and loan moratoriums during the pandemic. As a result, the percentage of restructured loans rose sharply to 32.5% of total credit portfolio in December 2020 from 20% in December 2019. Since then, the bank was able to effectively manage its asset quality during the last years by closely monitoring those loans and reviewing internal policies. With that, renegotiated loans did not materialize as effective losses and have been decreasing. As of June 2024, restructured loans declined to 15.2% of total

loans from 21.1% as of June 2023. We think BDMG's oversight of this portfolio and guarantee structure partially mitigates the risk of credit losses.

BDMG reported a recurring return on average equity between 5% and 6% in the past two years.

The loan portfolio grew 10% during the last year. It ended June 2024 at Brazilian real (R\$) 6.3 billion versus R\$5.5 billion as of the same period last year. In our view, this indicates a manageable credit portfolio. BDMG also reported stable nonperforming loans (NPLs), averaging 1.6% over the past five years, considerably below market average. It also had lower provisions for credit loss due to the improvement of the quality of the portfolio. The improvement was also driven by the bank's greater presence in the region. Therefore, we believe BDMG has improved its overall credit quality and compared with similarly rated peers.

Despite the challenging macroeconomic conditions in Brazil and pressures to increase interest rates, we are not expecting a decrease in capital or a credit portfolio deterioration for the next two years.

BDMG continues diversifying its sources of funding. BDMG continues to strengthen its relationship with foreign multilateral lending agencies, which is diversifying its funding sources and gradually decreasing the share of funding from the Brazilian Development Bank (BNDES). During the second half of 2024, the bank secured US\$20 million in credit line from the Asian Infrastructure Investment Banking (AIIB). The funds are intended for renewable energy generation projects and businesses that have connectivity with Asia. Despite being positive, we consider multilateral funding sources as more volatile compared with consumer deposits.

The ratings on BDMG reflect its concentrated portfolio by region and above-average capital metrics. The bank lends mostly in the Brazilian state of Minas Gerais, where it provides mainly working capital and long-term loans to local companies and municipalities. We also incorporate its stronger capitalization than those of peers. As of June 2024, the bank's Basel III ratio was 24.7%, and its risk-adjusted capital (RAC) ratio was 12.9% as of December 2023. We expect the RAC ratio to remain above 10.5% within the next two years.

Despite its weak finances, we don't expect negative intervention from the state of Minas Gerais. We believe the state of Minas Gerais (CCC+/Stable), BDMG's controlling shareholder, has not reduced the bank's financial flexibility, including in periods of stress. In addition, BDMG is not depended on ongoing support from the government and we believe that Brazil's Fiscal Responsibility Law and banking regulations have protected the bank from potential intervention from the state.

Outlook

The stable outlook on BDMG reflects S&P Global Ratings' view that we expect its ratings to remain unchanged for the next 12 months. Despite the bank's high growth prospects, we expect its capital ratios to remain above the industry average with adequate liquidity and stable financial performance. Even in a challenging economy, we do not expect BDMG's portfolio to materially deteriorate in the next 12 months.

Downside scenario

We could downgrade BDMG if we observe a significant decline in corporate segment conditions

that hurts its asset quality beyond our expectations. Additionally, an increase in renegotiated loans, accompanied by rising NPLs could also prompt a downgrade. A decline in the bank's RAC capital metric consistently below 10% could also lead to lower ratings.

Upside scenario

We could raise our national scale ratings on BDMG if the bank is able to further improve its financial performance relative to peers, maintaining stable asset quality metrics despite challenging macroeconomic conditions in the corporate sector. We believe raising the global scale rating is unlikely in the next 12 months.

Ratings Score Snapshot

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

Issuer Credit Rating	B+/Stable/--
SACP	b+
Anchor	bb+
Economic risk	7
Industry risk	5
Business position	Constrained (-2)
Capital and earnings	Strong (+1)
Risk position	Moderate (-1)
Funding and Liquidity	Moderate and Adequate (-1)
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 | General: Risk-Adjusted Capital Framework Methodology, April 30, 2024
- 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
- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

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

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