Moody's LOCAL | Brasil

Comunicado de Ação de Rating

BANCO DE DESENVOLVIMENTO DE MINAS GERAIS S.A.

Comunicado de Ação de Rating

SÃO PAULO, 29 DE JUNHO DE 2021

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A Moody´s América Latina Ltda. ("Moody's Local") atribuiu hoje ao Banco de Desenvolvimento de Minas Gerais S.A. (BDMG) o rating de emissor de BBB.br. A perspectiva é estável.

FUNDAMENTOS DO(S) RATING(S)

O rating do BDMG reflete o mandato social do banco de apoiar o desenvolvimento no estado de Minas Gerais através de financiamento de longo prazo para empresas locais, o que resulta em índices de lucratividade modestos e concentração de empréstimos por geografia e por tomador. Ao mesmo tempo, os ratings são amparados pela forte adequação de capital do banco, com um histórico de retenção de lucros e reinvestimentos, uma ferramenta importante para enfrentar o enfraquecimento potencial na qualidade de ativos e pressões de lucratividade derivadas de um volume historicamente grande de renegociações e prorrogações de parcelas de empréstimos. O rating do banco também considera os esforços bem-sucedidos do BDMG em diversificar sua estrutura de captações, acessando fundos de longo prazo de agências multilaterais e investidores domésticos. Os ratings do BDMG não contemplam nenhum aumento de suporte de afiliada, dado a capacidade limitada de seu controlador em prover suporte, ou suporte governamental, dado a sua baixa representatividade no sistema financeiro como um todo. Em dezembro de 2020, o índice de crédito em atraso sobre carteira de crédito foi de 1,9% e o capital regulatório nível 1 foi de 18,7%.

A perspectiva estável reflete a expectativa de manutenção dos fundamentos de crédito consistentes com o atual nível de rating ao longo dos próximos 12-18 meses.

FATORES QUE PODERIAM LEVAR A UMA ELEVAÇÃO OU A UM REBAIXAMENTO DO(S) RATING(S)

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METODOLOGIA UTILIZADA

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Banco de Desenvolvimento de Minas Gerais S.A.	Data de Atribuição do Rating Inicial	Data da Última Ação de Rating
Rating de emissor	29/6/2021	Não aplicável

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MOODY'S
INVESTORS SERVICE

CREDIT OPINION
1 July 2021

Update

Rate this Research

RATINGS

Banco de Desenvolvimento de Minas Gerais S.A.

Domicile	Belo Horizonte, Minas Gerais, Brazil
Long Term CRR	Not Assigned
Long Term Issuer Rating	Not Available
Type	Not Available
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Banco de Desenvolvimento de Minas Gerais S.A.

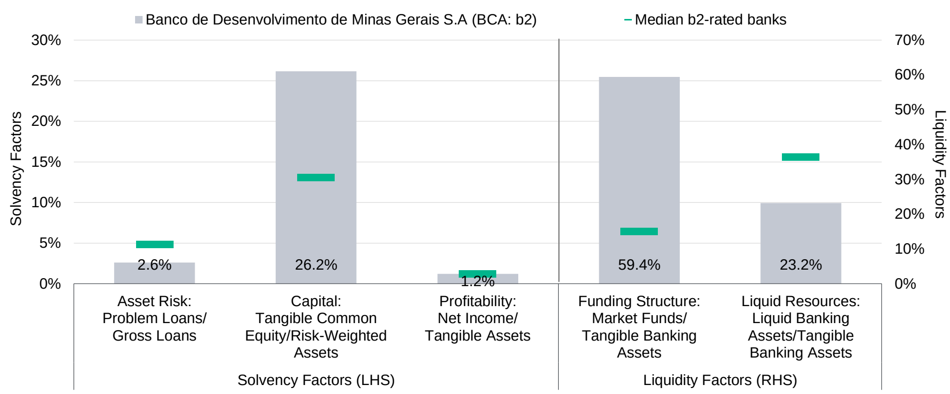
Update following rating affirmation, outlook remains stable

Summary

On 28 June 2021, Moody's affirmed all global ratings and assessments to Banco de Desenvolvimento de Minas Gerais S.A. (BDMG). The B2 issuer rating reflects the bank's entrenched operations in its regional market, as well as the strong alignment with and importance of its operations to the development policy of the State of Minas Gerais (B2 stable), its parent.

BDMG's credit fundamentals, supporting its b2 Baseline Credit Assessment (BCA), reflect its concentrated asset risk by borrower in the state of Minas Gerais, with a focus on large enterprises, despite its recent efforts to diversify loans to micro and small companies. The credit profile also reflects the bank's historically large volume of renegotiations and deferrals that may add volatility to its asset-risk and profitability metrics. At the same time, the bank's rating assessments reflect its robust capitalization that provides a buffer against asset-risk deterioration, and its successful efforts to diversify funding stream by accessing funding from several multilateral agencies and other domestic instruments.

Exhibit 1
Rating Scorecard - Key financial ratios
As of March 2021



Source: Moody's Financial Metrics™

Credit strengths

» Key role in the regional economic development program, which is fully aligned with the objectives of its owner, the State of Minas Gerais

» Very high capitalization levels

» High reserve buffers against unexpected increases in asset risk

Credit challenges

» Concentrated loan portfolio by geography and borrower, which poses higher risk to its asset quality

» Strained profitability because of its concentrated credit stream and the low interest rate environment in Brazil

Outlook

BDMG's ratings have a stable outlook, reflecting our view that the trajectory of the bank's solvency over the next 12-18 months will be in line with the B2 rating. The outlook is also in line with the stable outlook on the State of Minas Gerais' ratings.

Factors that could lead to an upgrade

The bank's ratings could face upward pressure if the ratings of the State of Minas Gerais were upgraded. We could also consider upgrading the bank's ratings and assessments if its asset quality is preserved and profitability improves after government support programs expire and as loan volumes increase. A successful diversification of funding through stable and low-cost resources could also put upward pressure on BDMG's ratings.

Factors that could lead to a downgrade

A downgrade of the ratings of the State of Minas Gerais could put negative pressure on BDMG's ratings, as well as rapid loan growth that leads to an increase in loan losses and a need for additional reserves, which could hurt profitability and its capital.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moodys.com for the most updated credit rating action information and rating history.

Key indicators

Exhibit 2
Banco de Desenvolvimento de Minas Gerais S.A. (Unconsolidated Financials) [1]

	03-21[2]	12-20[2]	12-19[2]	12-18[2]	12-17[2]	CAGR/Avg.[3]
Total Assets (BRL Million)	8,530.0	8,558.9	6,141.4	6,641.0	6,943.6	6.5[4]
Total Assets (USD Million)	1,511.6	1,647.8	1,526.7	1,713.5	2,093.3	(9.5)[4]
Tangible Common Equity (BRL Million)	1,657.9	1,606.2	1,727.9	1,688.4	1,565.1	1.8[4]
Tangible Common Equity (USD Million)	293.8	309.2	429.5	435.6	471.8	(13.6)[4]
Problem Loans / Gross Loans (%)	2.3	1.9	2.2	4.0	8.2	3.7[5]
Tangible Common Equity / Risk Weighted Assets (%)	26.2	23.8	27.1	23.9	22.3	24.7[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	5.9	5.3	4.6	9.2	21.3	9.3[5]
Net Interest Margin (%)	8.5	6.3	6.0	6.0	7.3	6.8[5]
PPI / Average RWA (%)	10.4	4.4	3.1	4.9	3.5	5.2[6]
Net Income / Tangible Assets (%)	1.2	0.3	1.4	1.9	-3.9	0.2[5]
Cost / Income Ratio (%)	19.5	36.1	47.2	33.0	54.1	37.9[5]
Market Funds / Tangible Banking Assets (%)	59.2	59.4	52.4	58.1	63.5	58.5[5]
Liquid Banking Assets / Tangible Banking Assets (%)	24.5	23.2	17.1	17.3	11.7	18.7[5]
Gross Loans / Due to Customers (%)	844.6	911.6	1440.9	1261.3	2532.3	1398.2[5]

[1] All figures and ratios are adjusted using Moody's standard adjustments. [2] Basel III - fully loaded or transitional phase-in; LOCAL GAAP. [3] May include rounding differences because of the scale of reported amounts. [4] Compound annual growth rate (%) based on the periods for the latest accounting regime. [5] Simple average of periods for the latest accounting regime. [6] Simple average of Basel III periods.
Sources: Moody's Investors Service and company filings

Profile

Founded in 1962, Banco de Desenvolvimento de Minas Gerais S.A. (BDMG) is a development bank owned by the State of Minas Gerais. As of March 2021, industry was the largest segment of the bank's portfolio, accounting for 31% of total loans, followed by services (27%), rural and agro-industry (18%), commerce (14%) and public sector (11%).

Detailed credit considerations

Loan portfolio growth and renegotiated loans helped contain problem loans at low levels

In the first three months of 2021, the bank's loan book increased by 35% compared to the first quarter 2020. This fast loan growth, with more than 30% backed by government-sponsored loans, and high volume of loan renegotiations and deferrals have sustained problem loans at low levels, at 2.3% in March 2021 compared with 2.8% a year earlier.

BDMG's loan portfolio has traditionally been geographically concentrated because of its footprint in Minas Gerais, which can expose the bank to asset-quality volatility. However, Minas Gerais is the third largest economy in the country and the second state in terms of population. Additionally, the bank has about 11.4% of its total portfolio in nearby states, such as São Paulo. Overall loan growth in smaller companies and changes in lending limits lead to a more granular loan portfolio by borrower. Out of BRL286.5 million, 3% higher than the same period of 2020, 18% were granted to micro and small companies, with 68% in the form of government-sponsored loans, thus alleviating the asset-risk pressures coming from companies that tend to be more susceptible to economic downturns. Disbursements with own resources have been growing and as of March 2021 represented 55% of total, compared to 40% in the first quarter 2020.

Additionally, the bank's loan portfolio remains relatively concentrated, partially because of the long tenure of outstanding transactions. As of March 2021, its top 20 borrowers represented 25% of the loan book. Large companies continued representing the bulk of loans (38%), followed by medium-sized companies (24%), micro and small companies (27%), and municipalities (11%), as of March 2021. The exposure to municipalities is fully collateralized by tax receivables from the federal and state governments, a strong structure that mitigates risk. As of March 2021, the bank's renegotiated loans reached BRL2.0 billion, 33% of the loan portfolio, which helped improving the NPL ratio. Asset risk is mitigated by strong loan-loss reserves that cover more than 4x problematic loans.

The b1 Asset Risk score factors in both the geographic concentration in Minas Gerais and the still-high borrower concentration, despite the bank's efforts to build a more diversified loan stream. At the same time, the score takes into consideration the likelihood of increased asset-risk pressure, in line with the current adverse operating conditions.

Capital levels declined because of asset growth, but remained strong to withstand asset-risk pressure

BDMG's tangible common equity (TCE)/risk-weighted assets (RWA) reduced to 26.2% in March 2021 from 27.8% in March 2020, because of the aforementioned loan growth in the period. In this capital ratio, we adjust the risk weights of the bank's government securities holdings, in line with Brazil's sovereign rating, and deduct most deferred tax assets from capital. The bank's reported regulatory capital also declined to 23.0% in March 2021 from 20.7% a year earlier, remaining comfortably above the minimum system requirement. Such capital ratios exclude a segregated equity that is required for loan exposures to municipalities, which has been declining because this segregation is no longer required for new loans to municipalities. If we excluded such segregated capital from Moody's adjusted TCE/RWA, the bank's adjusted capital ratio would still be strong at 15%. This capital constitutes an important shield against increasing asset-risk pressures. Also, the state of Minas Gerais has historically supported the bank with capital injections, including BRL112 million throughout 2020, despite limited dividend distributions. Over 2013-19, the bank received more than BRL500 million in fresh capital injection and distributed less than BRL250 million dividends.

Profitability improved on interest income, fees and commissions, and lower total operating costs

In the first three months of 2021, net income increased 15% to BRL26 million from BRL22 million in the year-earlier period, and represented 1.2% of total tangible banking assets, from 1.5% in March 2020. The bank's bottom-line results were supported by higher interest income and fees and commissions income, renegotiation losses and paid guarantees. Net interest income and fees and commissions income increased year-over-year growth in March 2021, with a 165% and 370% growth respectively but were partially offset by BRL109 million loan loss provisions, compared to BRL3 million recovery in the same period of 2020. Meanwhile, total operating expenses decreased 3% in relation to the previous year. BDMG has historically reported modest profitability metrics as part of its social mandate of supporting long-term financing to companies in the state of Minas Gerais. As a result, the net interest margin lies between 4% and 7%. As of March 2021, the net interest margin was 8.5%.

The assigned Profitability score incorporates the bank's low profitability metrics, as well as credit income concentration, which adds some volatility to earnings generation. Potential higher delinquencies that could require additional provisions for credit losses could strain future earnings in a low interest rate environment.

Increasing access to multilateral funds and other instruments has supported a more diversified funding stream

BDMG raises funds mainly from official institutions and programs that provide resources to finance projects in the state of Minas Gerais. As of March 2021, Banco Nacional de Desenvolvimento Economico e Social(BNDES, Ba2 stable, ba2[1]) remained the largest provider, with an amount of BRL1.7 billion, which accounted for 30% of total funding in March 2021, against 75% in 2017.

However, since 2016, the bank has successfully diversified its funding stream through its access to other local and foreign resources, which may also lead to higher funding costs. International funding amounted to BRL1.833 million, sourced by seven multilateral agencies — Corporación Andina de Fomento(CAF, Aa3 stable), Inter-American Development Bank (Aaa stable), Agence Française de Développement, Cargill Financial Services International, European Investment Bank (EIB, Aaa stable), Plata Basin Financial Development Fund (A2 stable) and Inter-American Investment Corporation - BID Invest (Aa1,stable). From these agencies, the balance corresponding to CAF represented 39% of the total. In October 2020, the bank announced a €100 million funding from the EIB to finance renewable energy projects in Minas Gerais. In December 2020, the BDMG became the first Brazilian public bank to issue $ 50 million sustainable bonds in line with Sustainable Development Goals (SDG) from the BID Invest.

In the local market, the bank has funded resources through Special Deposits with guarantee from Brazilian Insurance Corporation (DPGEs), which totaled BRL615 million in March 2021. Despite the fact that BNDES' funds had been key in supporting BDMG's credit expansion in the past, the bank's access to alternative funding sources will support a longer liability structure amid lower dependence on the federal development bank's lending policies.

Lower liquidity buffer following loan-book expansion

The b1 Liquidity score reflects BDMG's adequate liquidity to offset the coronavirus impacts, with liquid assets totaling BRL2.1 billion as of March 2021, 111% higher than a year earlier. As of March 2021, liquid banking assets represented 24.53% of tangible banking assets, down from 16.2% a year earlier. More than 50% of BDMG's liquid banking assets comprise Brazilian government bonds.

BDMG's credit profile reflects Brazil's Moderate - Macro Profile

Brazil's Moderate- Macro Profile incorporates the country's large-scale and highly diversified economy, despite the sharp decline in growth in 2020 because of the negative effect of the pandemic. Brazil's economy contracted by 4.1% in 2020, but we expect it to rebound in 2021, with 1.4% growth. Bank lending is likely to record a moderate rebound in 2021-22. However, we expect banks' pre-provision earnings generation to improve as business volumes benefit from a continued recovery in economic activity. Improving profit will support capital in the coming quarters. Our view of Brazil's operating environment also takes into consideration the challenges related to low government effectiveness and political developments that could still negatively affect the sweeping structural reform agenda. Brazil's Macro Profile also reflects the country's favorable credit conditions, which will benefit from a low interest rate environment supporting credit demand, borrowers' repayment capacity and private consumption

Environmental, social and governance considerations

BDMG's exposure to environmental risks is low, consistent with our general assessment for the global banking sector. See our environmental risk heat maps for further information.

Overall, we believe banks face moderate social risks. 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 sizable technology investments and banks' long track record of handling sensitive client data. Fines and reputational damage because of product mis-selling or other types of misconduct are further social risks. Social trends are also relevant in a number of areas, such as shifting customer preferences toward digital banking services increasing information technology costs, aging population concerns in several countries affecting demand for financial services or socially driven policy agendas that may translate into regulations that affect banks' revenue base. See our social heat maps for further information.

Governance is highly relevant for BDMG, as it is to all participants in the banking industry. Corporate governance weaknesses can lead to a deterioration in a bank's credit quality, while governance strengths can benefit a bank's credit profile. Governance risks are largely internal rather than externally driven, and for BDMG, we do not have any particular governance concerns. Nonetheless, corporate governance remains a key credit consideration and requires ongoing monitoring.

Support and structural considerations

Notching considerations

In the absence of a bail-in resolution regime framework in Brazil, the ratings of subordinated debts, bank hybrids and contingent capital securities follow the Additional Notching Guidelines in accordance with our Banks rating methodology. In these cases, the approach takes into account other features specific to debt classes, resulting in additional notching from the Adjusted BCA of the issuer.

Government support

We believe there is a low likelihood of federal government support for BDMG's debt, which reflects the bank's small share of deposits and assets in Brazil's banking system.

Counterparty Risk (CR) Assessment

CR Assessments are opinions of how counterparty obligations are likely to be treated if a bank fails and are distinct from debt and deposit ratings in that they consider only the risk of default rather than both the likelihood of default and the expected financial loss suffered in the event of default; and apply to counterparty obligations and contractual commitments rather than debt or deposit instruments. The CR Assessment is an opinion of the counterparty risk related to a bank's covered bonds, contractual performance obligations (servicing), derivatives (for instance, swaps), letters of credit, guarantees and liquidity facilities.

BDMG's CR Assessment is positioned at B1 (cr) and Not Prime (cr)

The bank's CR Assessment is positioned one notch above its Adjusted BCA of b2 and, therefore, above its issuer rating, reflecting our view that its probability of default is lower for operating obligations than for deposits. The CR Assessments of BDMG do not benefit from government support.

Methodology and scorecard

About Moody's Bank scorecard

Our scorecard is designed to capture, express and explain in summary form our Rating Committee's judgment. When read in conjunction with our research, a fulsome presentation of our judgment is expressed. As a result, the output of our scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The scorecard output and the individual scores are discussed in Rating Committees and may be adjusted up or down to reflect conditions specific to each rated entity.

Rating methodology and scorecard factors

Exhibit 3

Banco de Desenvolvimento de Minas Gerais S.A.

Macro Factors		
Weighted Macro Profile	**Moderate -**	**100%**

Factor	**Historic Ratio**	**Initial Score**	**Expected Trend**	**Assigned Score**	**Key driver #1**	**Key driver #2**
Solvency						
Asset Risk						
Problem Loans / Gross Loans	2.6%	baa3	↔	b1		
Capital						
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)	26.2%	a3	↔	ba2		
Profitability						
Net Income / Tangible Assets	1.2%	ba1	↔	b3		
Combined Solvency Score		baa2		b1		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	59.4%	caa1	↔	caa1		
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	23.2%	ba2	↔	b1		
Combined Liquidity Score		b2		b3		
Financial Profile				b2		
Qualitative Adjustments				Adjustment		
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				0		
Sovereign or Affiliate constraint				Ba2		
BCA Scorecard-indicated Outcome - Range				b1 - b3		
Assigned BCA				b2		
Affiliate Support notching				-		
Adjusted BCA				b2		

Instrument Class	**Loss Given Failure notching**	**Additional notching**	**Preliminary Rating Assessment**	**Government Support notching**	**Local Currency Rating**	**Foreign Currency Rating**
Counterparty Risk Rating	1	0	b1	0	B1	B1
Counterparty Risk Assessment	1	0	b1 (cr)	0	B1(cr)	

Senior unsecured bank debt	0	0	b2	0	B2

[1] Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.
Source: Moody's Investors Service

Ratings

Exhibit 4

Category	Moody's Rating
BANCO DE DESENVOLVIMENTO DE MINAS GERAIS S.A.	
Outlook	Stable
Counterparty Risk Rating	B1/NP
Baseline Credit Assessment	b2
Adjusted Baseline Credit Assessment	b2
Counterparty Risk Assessment	B1(cr)/NP(cr)
Issuer Rating -Dom Curr	B2
ST Issuer Rating -Dom Curr	NP
PARENT: MINAS GERAIS, STATE OF	
Outlook	Stable
Issuer Rating	B2

Source: Moody's Investors Service

Endnotes

1 The ratings shown are long term local currency deposit rating and Baseline Credit Assessment

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