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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

SACP	b

Anchor	bb+	
Business Position	Weak	-2
Capital and Earnings	Strong	+1
Risk Position	Weak	-2
Funding	Below Average	-1
Liquidity	Adequate	

+

Support	0
ALAC Support	0
GRE Support	0
Group Support	0
Sovereign Support	0

+

Additional Factors	0

Issuer Credit Rating
B/Stable/--

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 focus to decrease dependence on BNDES funding.
Good relationship with foreign multilateral agencies, given the bank's development role.	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 clients and geography. Banco de Desenvolvimento de Minas Gerais S.A. – BDMG's loan portfolio is concentrated in the state of Minas Gerais, where the bank provides mainly working capital and long-term loans for local companies and municipalities. However, BDMG aims to expand its operations into neighboring states, which now account for about 11% of the portfolio. Currently, the bank's 20 largest clients represent 25.5% of total loans.

Despite weak economy, BDMG has been improving bottom-line results. After a robust expansion in the second half of 2020, the bank's loan volume was stable until June 2021, at R$5.9 billion. BDMG posted solid financial results, with net income increasing 112%, to R$54 million, mainly due to higher margins and stable asset quality metrics. BDMG has also been making efforts to strengthen its relationship with foreign multilateral agencies, and as a result, has diversified its funding sources by gradually decreasing the high share of BNDES' funding.

The bank's percentage of renegotiated loans is higher than the industry average. Because of BDMG's development role and the pandemic-induced economic shock, the percentage of the bank's restructured loans rose significantly to 35.7% of total loans as of June 2021. We believe the renegotiation measures are part of the bank's mission to support the state economy and its customers, but the high level of renegotiated loans causes asset risk to remain high. However, the bank tracks closely these loans, of which 54.7% are already performing for more than 12 months after the agreement, which in our view, mitigates the risk of material losses.

BDMG has stronger capitalization levels than those of peers. As of June 2021, the bank's Basel III ratio was 24.6%, while its risk-adjusted capital (RAC) ratio was 13.2%. We expect its RAC ratio to be 10%, on average, in the next two years, supported by its internal capital generation with income retention. Moreover, despite the weak finances of the state of Minas Gerais (SD/--/--), the bank's controlling shareholder, we believe that Brazil's Fiscal Responsibility Law and banking regulations have protected BDMG from an extraordinary intervention. The state has been supporting BDMG's capital position to allow it to continue expanding its credit portfolio.

Outlook: Stable

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 a stable financial performance, continue diversifying its funding sources, and keep its prudent liquidity management. Furthermore, we expect the bank to maintain capitalization metrics above those of peers, with a forecasted RAC ratio of 10%, on average, 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 operating 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 continues improving, 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 business concentration.

Key Metrics

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

	--Fiscal year ended Dec. 31--				
	2019a	**2020a**	**2021f**	**2022f**	**2023f**
Growth in operating revenue (%)	(29.6)	22.7	20.2-24.7	6.0-7.5	4.5-5.5
Growth in customer loans (%)	(13.3)	34.2	4.5-5.5	2.0-2.5	(3.5)-(4.5)
Growth in total assets (%)	(7.5)	39.4	6.0-7.0	(0.6)-(0.8)	(4.0)-(5.0)
Net interest income/average earning assets (NIM) (%)	5.9	6.4	6.5-7.5	6.5-7.5	7.0-7.5
Cost to income ratio (%)	63.4	48.2	39.0-41.0	39.0-41.0	39.0-41.0
Return on equity (%)	4.7	1.4	3.5-4.0	4.0-4.5	4.5-4.9
Return on assets (%)	1.3	0.3	0.8-1.0	0.9-1.1	1.0-1.3
New loan loss provisions/average customer loans (%)	2.1	3.9	3.2-3.6	3.3-3.6	3.0-3.3
Gross nonperforming assets/customer loans (%)	2.2	1.9	2.1-2.3	2.3-2.6	3.5-3.9
Net charge-offs/average customer loans (%)	2.3	(0.8)	0.3-0.3	0.5-0.5	0.5-0.5
Risk-adjusted capital ratio (%)	13.9	10.0	10.0-10.5	10.0-10.5	11.0-11.5

*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

S&P Global Ratings classifies the banking sector of Brazil in group '6' under its Banking Industry Country Risk Assessment (BICRA). Other countries in group '6' include China, Colombia, Portugal, Indonesia, Brunei, Thailand, Trinidad & Tobago, South Africa, and Uruguay. Our bank criteria use our BICRA economic risk and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating. 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. The fiscal profile is set to improve in 2021 following a severe deterioration amid the pandemic, but debt will remain elevated. We expect economic growth of 5.1% in 2021, although economic performance will remain mediocre in the medium term, absent a faster pace of reform approvals. We forecast lower provisioning needs for Brazilian banks in 2021 because we expect businesses and individuals' debt payment capacity to improve as the economy continues to rebound. Asset quality has so far performed better than we expected, but it's likely to worsen as loan deferral programs end. However, the rise in provisioning coverage last year puts banks in a good position to deal with this deterioration.

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 was relatively resilient in 2020 thanks to the strong margins, high provisioning coverage prior to the pandemic, and diversified revenue mix. We expect profitability to improve in 2021 as provisioning needs moderate. The Brazilian banking system has an adequate funding mix with a large and stable core customer deposit base.

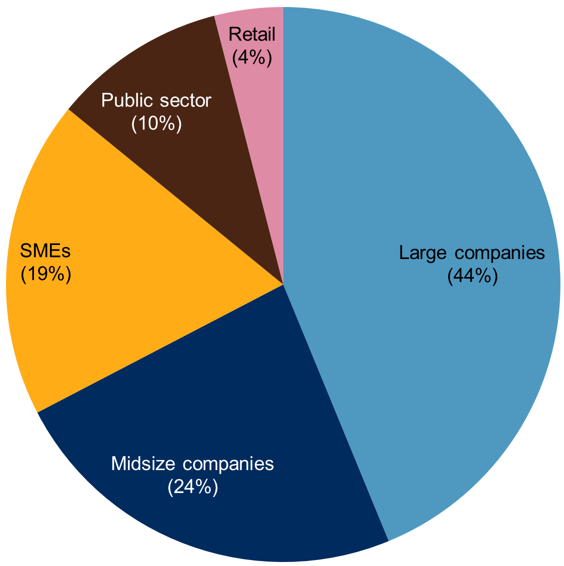
Business Position: Geographic Concentration In The State Of Minas Gerais

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 this June. The bank 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. 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 for investments for local companies and municipalities.

Due to the COVID-19 pandemic during 2020, the bank reversed the contraction of its portfolio by offering lines of credit with special conditions. After a strong expansion in the second half of 2020, the bank's loan volume was stable until June 2021, at R$5.9 billion. It consisted of loans to large companies (43.8%), midsize companies (23.6%), small- to mid-size enterprises (SMEs; 18.5%), public sector (10%), and retail clients (4%). BDMG's client base also increased by 24%, reaching 28,640 clients by the end of the second quarter of the year. Nevertheless, we still believe that competitive pressures may threaten 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 improve in the next two years, with return on equity (ROE) of 4.0%-4.5%.

Chart 1

BDMG Loan Portfolio Breakdown
As of June 2021



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 24.6% as of June 2021, and we project that its RAC ratio will be around 10%, on average, for the next few years. Our forecast considers our base-case scenario, which includes the following assumptions:

- Brazil's GDP to grow 5.1% in 2021 and 1.8% in 2022;
- Loan portfolio growth of 5% in 2021 and 2% in 2022;
- Better efficiency levels, as a result of the bank's cost-control initiatives over the past years;
- Slightly higher net interest margins (NIMs), due to increasing interest rates in Brazil;
- Nonperforming loans (NPLs) to remain at 2.5%-3.0% in 2021 and 2022, and to increase to about 3.5% in 2023;
- ROE of 4.0%-4.5% 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

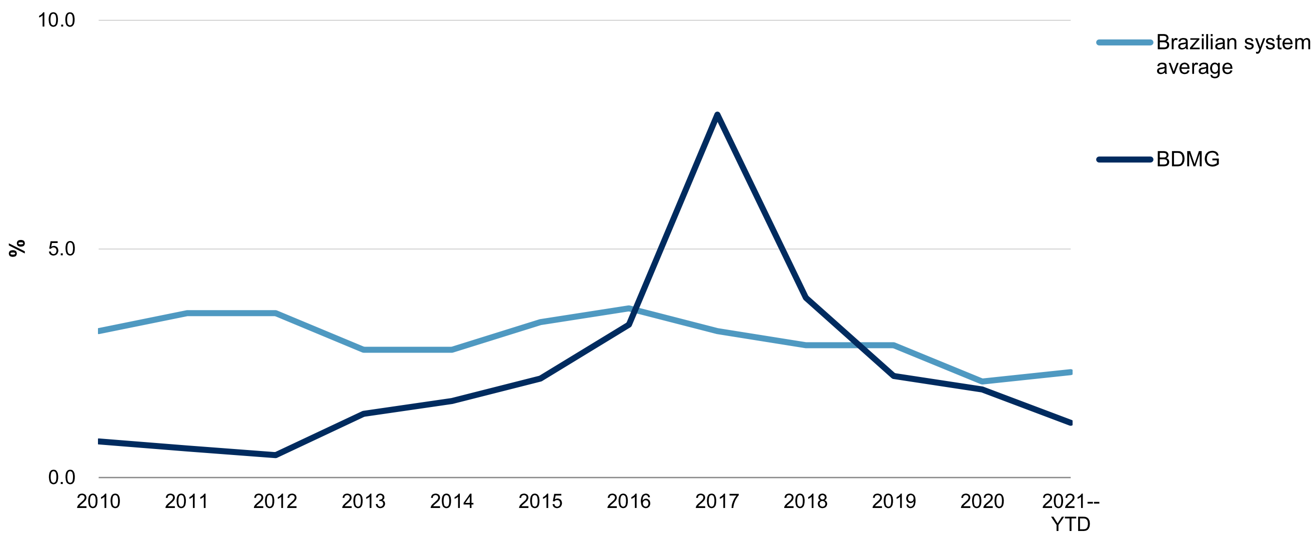
BDMG's risk position reflects the risks associated with a concentrated portfolio and a high amount of renegotiated loans. Due to the COVID-19 pandemic, the bank offered several credit lines and loan moratorium. As a result, the percentage of restructured loans rose sharply from 20% of total credit portfolio in December 2019 to 35.7% as of June 2021. In addition, the bank's 20 largest exposures represent 25.5% 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 the bank's mission to support the state economy and its customers, but the high level of renegotiation causes asset risk to remain high.

Nonetheless, along with adequate provisioning, the bank has been tracking closely the renegotiated loans, and 54.7% of this portfolio is already performing for more than 12 months after the agreement. Likewise, BDMG started reviewing its internal policies to reduce the maximum concentration level for the largest customers, and it already revised the maximum allowed exposure to the single largest customer from 15% to 6% of the total portfolio.

In terms of asset quality ratios, BDMG's NPL plummeted to 2.2% as of December 2019, thanks to stronger underwriting standards and improving economic conditions, from 8.6% in March 2018. This positive trend continued during 2020, with NPLs dropping further to 1.9% at December 2020 and to 1.2% as of June 2021, due to the large amount of renegotiations performed by the bank. By the second quarter of the year, the bank's loan-loss reserves covered 10.5% of the loan portfolio, above its peers' metric.

Chart 2

NPA Comparison



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

Funding And Liquidity: Concentrated Funding Base, But It's Gradually Improving

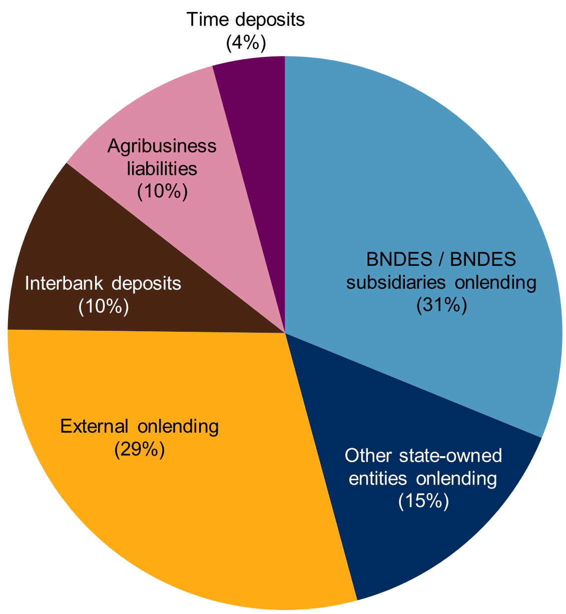
Our assessment of BDMG's funding takes into account its concentrated funding base, which we view as a rating weakness. In contrast to other government-related banks, BDMG has no license to receive retail deposits, which causes a reliance on wholesale funding sources. Following BDMG's efforts to diversify the funding sources and diminish dependence on BNDES and its subsidiaries, funding from the latter dropped to 31% of the total sources from 64% two years ago. Funding from state-owned entities in Brazil such as Funcafé, Fungetur, and FINEP, now represent 15% of BDMG's total funding. Other sources include loans from the development agencies such as Corporación Andina de Fomento, The French Development Agency, and the Inter-American Development Bank.

In October 2021, BDMG reached an agreement with the European Investment Bank (EIB) to a €20 million add-on to the original €100 million loan. The amendment is part of initiatives that followed COP26 Summit, and the resources will be used to finance renewable energy and energy efficiency projects in Minas Gerais, in addition to providing capital for investment projects for micro, small, and medium-size companies.

As a result of the strengthening in BDMG's relationship with foreign development agencies, financing from the latter rose to 29% in June 2021 from 14% as of June 2020. Other funding sources include issuances of agribusiness-linked securities (10%), which represent the bank's only source of retail funding, and time deposits (4%). Due to the long-term maturity profile of its funding base, BDMG's stable funding ratio (SFR) was 97% as of June 2021, which we deem adequate.

Chart 3

Funding Breakdown
As of June 2021



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 the bank 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 2021, BDMG's broad liquid assets (cash, liquid securities, short-term repos, and short-term interbank deposits) totaled R$1.9 billion. The broad liquid assets to short-term wholesale funding ratio reached 1.5x. 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.

Environmental, Social, And Governance (ESG) Factors

We believe BDMG's ESG factors are broadly in line with those for its industry peers. The bank's Socio-Environmental Responsibility Policy was revised based on sustainability practices following the national and international guidelines, and BDMG recently published a framework for the issuance of sustainable bonds.

As a state-owned development bank, BDMG has a role of supporting the economic and social development of the state of Minas Gerais, which differentiates the bank from private peers. On the other hand, we believe its management and overall strategy are somewhat subject to political influence, given that the majority of the board members represent the controlling shareholder, the state government. Nonetheless, the implementation of Law 13,303/16 (the State-Owned Company Act) in 2017 further enhanced the decision-making of board members, which we believe promotes greater transparency in operations and limits political appointments in the bank's executive positions.

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 on our view of the following:

- 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; and
- 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.

Key Statistics

Table 1

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

	--Year ended Dec. 31--				
(Mil. R$)	**2021***	**2020**	**2019**	**2018**	**2017**
Adjusted assets	8,349.2	8,537.9	6,127.4	6,626.3	6,931.6
Customer loans (gross)	5,938.1	6,047.3	4,504.7	5,193.3	6,054.1
Adjusted common equity	1,700.2	1,595.6	1,509.7	1,540.0	1,447.5
Operating revenues	364.0	485.4	395.6	562.0	533.0
Noninterest expenses	120.1	234.0	250.7	226.7	247.9

Table 1

Banco de Desenvolvimento de Minas Gerais S.A.-BDMG--Key Figures (cont.)					
	--Year ended Dec. 31--				
(Mil. R$)	**2021***	**2020**	**2019**	**2018**	**2017**
Core earnings	54.5	26.4	101.4	127.5	(181.7)

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

Table 2

Banco de Desenvolvimento de Minas Gerais S.A.-BDMG--Business Position					
	--Year ended Dec. 31--				
(%)	**2021***	**2020**	**2019**	**2018**	**2017**
Loan market share in country of domicile	0.1	0.1	0.1	0.2	0.2
Deposit market share in country of domicile	0.0	0.0	0.0	0.0	0.0
Return on average common equity	5.5	1.4	4.7	7.5	(10.6)

*Data as of June 30.

Table 3

Banco de Desenvolvimento de Minas Gerais S.A.-BDMG--Capital And Earnings					
	--Year ended Dec. 31--				
(%)	**2021***	**2020**	**2019**	**2018**	**2017**
Tier 1 capital ratio	31.2	27.1	30.2	26.8	25.1
S&P Global Ratings' RAC ratio before diversification	N/A	10.0	13.9	N/A	N/A
S&P Global Ratings' RAC ratio after diversification	N/A	7.3	9.3	N/A	N/A
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	100.0
Net interest income/operating revenues	94.7	84.8	88.8	70.6	95.6
Fee income/operating revenues	4.2	7.1	8.5	6.4	5.9
Cost to income ratio	33.0	48.2	63.4	40.3	46.5
Preprovision operating income/average assets	5.8	3.4	2.3	4.9	3.9
Core earnings/average managed assets	1.3	0.4	1.6	1.9	(2.5)

*Data as of June 30. N/A--Not applicable. RAC--Risk-adjusted capital.

Table 4

Banco de Desenvolvimento de Minas Gerais S.A.-BDMG--Risk Position					
	--Year ended Dec. 31--				
(%)	**2021***	**2020**	**2019**	**2018**	**2017**
Growth in customer loans	(3.6)	34.2	(13.3)	(14.2)	1.5
Total diversification adjustment/S&P Global Ratings' RWA before diversification	N/A	35.8	49.2	N/A	N/A
Total managed assets/adjusted common equity (x)	4.9	5.4	4.1	4.3	4.8
New loan loss provisions/average customer loans	5.0	3.9	2.1	2.9	9.3
Net charge-offs/average customer loans	(2.6)	(0.8)	2.3	5.5	(1.2)
Gross nonperforming assets/customer loans + other real estate owned	1.2	1.9	2.2	3.9	7.9
Loan loss reserves/gross nonperforming assets	878.3	486.4	433.8	271.7	161.5

*Data as of June 30. N/A--Not applicable. RWA--Risk-weighted assets.

Table 5

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

	--Year ended Dec. 31--				
(%)	**2021***	**2020**	**2019**	**2018**	**2017**
Core deposits/funding base	14.5	11.6	11.4	11.6	5.2
Customer loans (net)/customer deposits	675.3	826.4	1,011.6	936.8	2,207.7
Long-term funding ratio	82.5	79.9	80.0	79.6	75.7
Stable funding ratio	97.1	94.0	83.8	86.6	77.3
Short-term wholesale funding/funding base	24.0	26.9	30.2	28.6	32.8
Broad liquid assets/short-term wholesale funding (x)	1.5	1.3	0.9	0.9	0.5
Net broad liquid assets/short-term customer deposits	222.9	209.4	(27.9)	(60.2)	(1,238.0)
Short-term wholesale funding/total wholesale funding	28.1	30.4	34.2	32.4	34.6

*Data as of June 30.

Related Criteria

- 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
- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria | Financial Institutions | Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021

Anchor Matrix

Industry Risk	Economic Risk									
	1	2	3	4	**5**	6	7	8	9	10
1	a	a	a-	bbb+	bbb+	bbb	-	-	-	-
2	a	a-	a-	bbb+	bbb	bbb	bbb-	-	-	-
3	a-	a-	bbb+	bbb+	bbb	bbb-	bbb-	bb+	-	-
4	bbb+	bbb+	bbb+	bbb	bbb	bbb-	bb+	bb	bb	-
5	bbb+	bbb	bbb	bbb	bbb-	bbb-	bb+	bb	bb-	b+
6	bbb	bbb	bbb-	bbb-	bbb-	bb+	bb	bb	bb-	b+
7	-	bbb-	bbb-	bb+	**bb+**	bb	bb	bb-	b+	b+
8	-	-	bb+	bb	bb	bb	bb-	bb-	b+	b
9	-	-	-	bb	bb-	bb-	b+	b+	b+	b
10	-	-	-	-	b+	b+	b+	b	b	b-

Ratings Detail (As Of November 24, 2021)*

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/--
18-Aug-2017		B-/Stable/--
14-Dec-2016		B-/Negative/--
19-Dec-2019	*Brazil National Scale*	brA-/Stable/--
06-Dec-2018		brA-/Negative/--
28-Aug-2018		brBBB-/Watch Pos/--
11-Jul-2018		brBBB-/Stable/--
18-Aug-2017		brB+/Stable/--
14-Dec-2016		brB-/Negative/--
Sovereign Rating		
Brazil		BB-/Stable/B
Brazil National Scale		brAAA/Stable/--
Related Entities		
Minas Gerais (State of)		
Issuer Credit Rating		SD/--/--
Brazil National Scale		SD/--/--

*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.