

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

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

SACP	b		+	Support	0	+	Additional Factors	0
Anchor	bb+			ALAC Support	0		Issuer Credit Rating <div style="background-color: yellow; padding: 20px; text-align: center; font-weight: bold; font-size: 1.2em;"> B/Stable/-- </div>	
Business Position	Weak	-2		GRE Support	0			
Capital and Earnings	Strong	+1		Group Support	0			
Risk Position	Weak	-2		Sovereign Support	0			
Funding	Below Average	-1						
Liquidity	Adequate							

Major Rating Factors

Strengths:	Weaknesses:
<ul style="list-style-type: none"> • Sound capitalization levels with capital ratios above those of peers. • Prudent liquidity management with well-defined policies to mitigate asset-liability mismatches . 	<ul style="list-style-type: none"> • Concentrated funding sources, especially from the Brazilian National Development Bank (BNDES). • Narrow mix of business activities compared to the industry average • Weak financial conditions of the state of Minas Gerais could pressure the local economy, weakening further the bank's asset quality.

Outlook: Stable

The stable outlook on Banco de Desenvolvimento de Minas Gerais S.A. - BDMG reflects our view that its credit factors will remain unchanged for the next 12 months. We expect the bank's results to remain weaker than the industry's average, with return on equity of 0%-3% in the next two years, despite improved asset quality metrics. Nevertheless, we expect the bank to maintain capitalization metrics above those of peers, with a forecasted risk-adjusted capital (RAC) ratio of 12.5%-13.5% in the next two years.

Downside scenario

We could lower the rating if BDMG's credit portfolio and revenues drop 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 asset quality improves significantly, with a notable reduction of restructured loans. Due to the long-term nature of BDMG's loan portfolio, we believe an upgrade is unlikely in the next few years.

Rationale

We base our ratings on BDMG on its high client concentration and narrow geographic mix of business activities. We also factor in the large stock of restructured loans on its balance sheet and its concentrated funding base. The mitigating factors are the bank's sound capitalization metrics and prudent liquidity management. 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, banking regulations, and the State-Owned Company Act have protected the bank from an extraordinary state intervention.

Due to the pandemic-induced economic shock, the bank revised its portfolio of financial products aiming to offer credit at more favorable conditions to the sectors to structure themselves in the challenging situation, by easing terms for new loans and offering postponements on payments of existing loans. In the first nine months of the year, the bank disbursed a record of R\$2.1 billion in loans, an increase of 162% versus the same period in 2019. The bank funded these loans through its own sources, funding from multilateral lending agencies, and government programs. BDMG's net income in this period decreased 11% in comparison with a year ago period. Renegotiated loans rose to 31% of the portfolio from 21%, underscoring concerns about asset quality. Nevertheless, we view the sharp rise in lending as part of the bank's development and social role during a period of economic crisis.

In 2019 a new state administration took office, prompting changes in the bank's management. The state appointed the new senior executives of BDMG based on technical criteria, while the bank's CEO previously held senior positions in domestic and foreign development banks and multilateral lending agencies. The changes resulted in operating overhauls, such as diversifying funding sources while diminishing dependence on BNDES' funding. We could also observe a strengthening in BDMG's relationship with foreign development agencies, as well as in its efforts to tighten loan origination standards, maintaining its mission of supporting the domestic economy.

Anchor:'bb+' for banks operating in Brazil

Our bank criteria use our Banking Industry Country Risk Assessment (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. On the other hand, the government's reform momentum preceding the COVID-19 pandemic will likely take a step back, at least temporarily, as fiscal efforts are concentrated on supporting workers and companies most severely affected by the downturn. We expect GDP to sharply contract this year (about 4.7%) and grow 3.2% in 2021. This will add pressure to the already fragile corporate and consumer sector.

Our industry risk assessment for 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 Brazilian financial system withstand the last economic downturn. Moreover, the central bank and government have introduced a number of measures to mitigate the impact of economic contraction on the financial system. On the other hand, the Brazilian banking system has an adequate funding mix with a large and stable core customer deposit base, which helps banks cope with the temporary disruption in capital markets.

Table 1

Banco de Desenvolvimento de Minas Gerais S.A.--BDMG Key Figures					
--Year ended Dec. 31--					
(Mil. R\$)	2020*	2019	2018	2017	2016
Adjusted assets	7,557.4	6,127.4	6,626.3	6,931.6	7,604.0
Customer loans (gross)	5,736.7	4,504.7	5,193.3	6,054.1	5,963.8
Adjusted common equity	2,194.0	1,509.7	1,540.0	1,447.5	1,558.3
Operating revenues	318.3	395.6	562.0	533.0	488.9
Noninterest expenses	216.4	250.7	226.7	247.9	265.6
Core earnings	22.6	101.4	127.5	(181.7)	27.3

*Data as of Sept. 30. R\$--Brazilian real.

Business position: Geographic concentration in the state of Minas Gerais

In our view, BDMG's narrow mix of business activities and its geographic concentration limit its business position. With R\$7.6 billion in total assets, the bank still represents less than 1% of the Brazilian banking system as of this September. The bank is concentrated in the state of Minas Gerais, the second-most populous state in the country, with 21 million inhabitants, and the fourth largest. However, the bank plans to expand its operations into neighboring states, which now correspond to 11.4% of the portfolio. BDMG provides mainly working capital and long-term loans for investments for local companies and municipalities.

In the past two years, BDMG's operating revenues decreased due to deleveraging, lower interest rates, and its loan portfolio's contraction, given that underwriting standards became stricter and credit lines from BNDES dropped. Due to the economic crisis stemming from COVID-19, the bank reversed the contracting of its portfolio by offering lines of credit with special conditions. As a result, its portfolio expanded 27% in September 2020, compared with the same period in 2019. BDMG's active client base also increased by 27%, reaching 27,000 clients by the end of the third

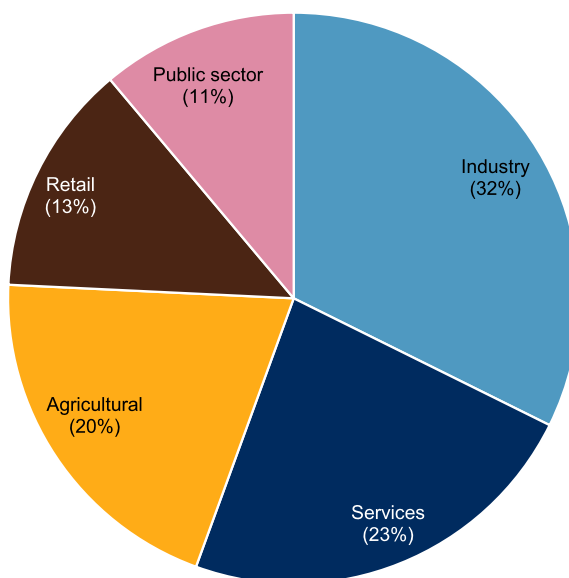
quarter of the year.

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. Therefore, we expect BDMG's bottom-line results to remain weak in the next two years, with ROE of 1.5%-2.0%.

Chart 1

BDMG Loan Portfolio Breakdown By Sector

As of September 2020



Source: S&P Global Ratings.

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Table 2

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

	--Year ended Dec. 31--				
(%)	2020*	2019	2018	2017	2016
Loan market share in country of domicile	N/A	0.1	0.2	0.2	0.2
Deposit market share in country of domicile	N/A	--	0.0	--	0.0
Return on average common equity	1.6	4.7	7.5	(10.6)	1.6

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

Capital and earnings: Capitalization levels stronger than peers

BDMG's capitalization is stronger than that of peers, and we expect it to keep supporting its creditworthiness. The bank has a comfortable regulatory capital level of 18.65% as of September 2020, and we project that its RAC ratio will

be 12.5%-13.5% for the next few years. Our forecast considers our base-case scenario, which includes the following assumptions:

- The bank's credit portfolio to increase by 25% this year and another 5% in 2021;
- BDMG's net interest margins (NIMs) to be lower than the average of the past five years;
- Noninterest expenses to slightly decrease in the next two years because of the bank's cost control initiatives;
- Nonperforming loans (NPLs) to remain around 3.0% in 2020, due to moratoriums offered, but to increase to around 4% until 2021;
- Return on equity of 1.5%-2.0% for the next two years; and
- We don't expect effective 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.

Table 3

Banco de Desenvolvimento de Minas Gerais S.A.--BDMG Capital And Earnings					
	--Year ended Dec. 31--				
(%)	2020*	2019	2018	2017	2016
Tier 1 capital ratio	26.6	30.2	26.8	25.1	25.2
S&P Global Ratings' RAC ratio before diversification	N/A	13.9	N/A	N/A	N/A
S&P Global Ratings' RAC ratio after diversification	N/A	9.3	N/A	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	86.8	88.8	70.6	95.6	88.9
Fee income/operating revenues	7.8	8.5	6.4	5.9	8.3
Cost to income ratio	68.0	63.4	40.3	46.5	54.3
Preprovision operating income/average assets	2.0	2.3	4.9	3.9	3.0
Core earnings/average managed assets	0.4	1.6	1.9	(2.5)	0.4

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

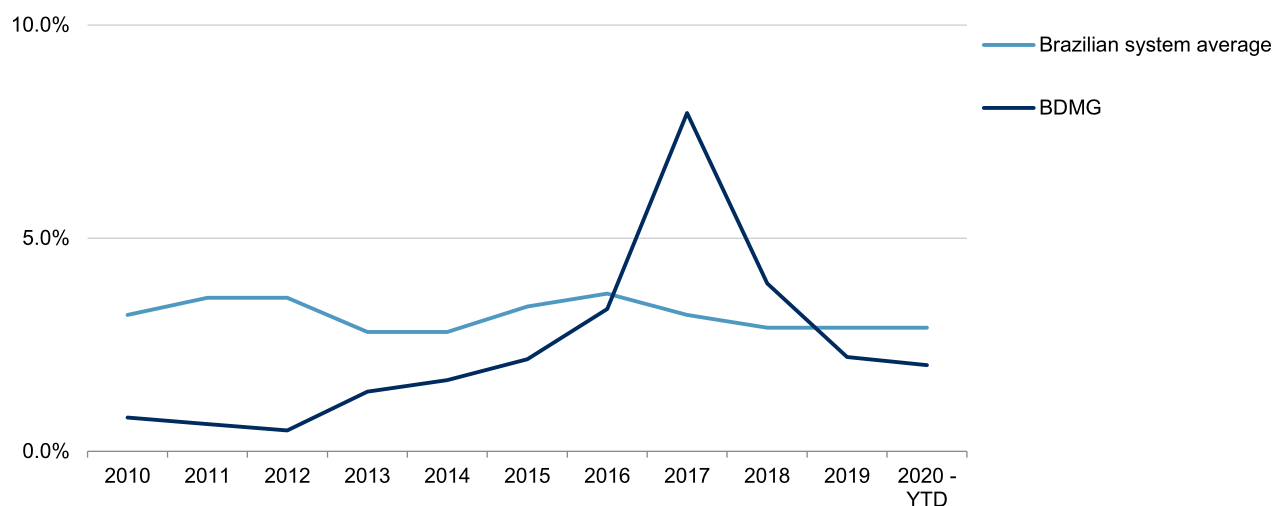
Risk position: High client concentration and weak asset quality

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. Despite the pandemic, this positive trend continued, with NPLs reaching 2.0% and the coverage ratio (loan-loss reserves/NPLs) remaining high at 379% as of September 2020, pointing to the bank's capitalization that's resilient to unexpected volatility. During 2020, BDMG accessed some of the credit lines created by the central bank to help mitigate the impact of COVID-19, such as Pronampe and PEAC, which guarantee up to 80% of the portfolio related to these products, helping managing the risk of credit operations.

In spite of that, the percentage of restructured loans rose sharply from 21% of total credit portfolio in September 2019 to 31% as of September 2020. In addition, the bank's 20 largest exposures represent 26% 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.

Chart 2

NPA Comparison



NPA--Nonperforming asset. YTD--Year to date. Source: S&P Global Ratings.
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Table 4

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

(%)	--Year ended Dec. 31--				
	2020*	2019	2018	2017	2016
Growth in customer loans	36.5	(13.3)	(14.2)	1.5	1.2
Total diversification adjustment/S&P Global Ratings' RWA before diversification	N/A	49.2	N/A	N/A	39.8
Total managed assets/adjusted common equity (x)	3.5	4.1	4.3	4.8	4.9
New loan loss provisions/average customer loans	1.5	2.1	2.9	9.3	2.9
Net charge-offs/average customer loans	(0.2)	2.3	5.5	(1.2)	3.3
Gross nonperforming assets/customer loans + other real estate owned	2.0	2.2	3.9	7.9	3.3
Loan loss reserves/gross nonperforming assets	379.3	433.8	271.7	161.5	159.3

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

Funding and liquidity: Concentrated funding base, but with gradual improvements, and prudent liquidity management

We believe that BDMG's concentrated funding base is a weakness for the ratings. In contrast to other government-related banks, BDMG has no license to receive retail deposits. Even with funding sources as wholesale-oriented, the bank diminished its dependence on funding from BNDES and its subsidiaries to 42% of the total sources from 64% one year ago. Funding mainly from state-owned entities in Brazil such as Funcafé, Fungetur, and FINEP, now represent 18% of total. These entities have provided funding as part of efforts to contain the COVID-19 impact.

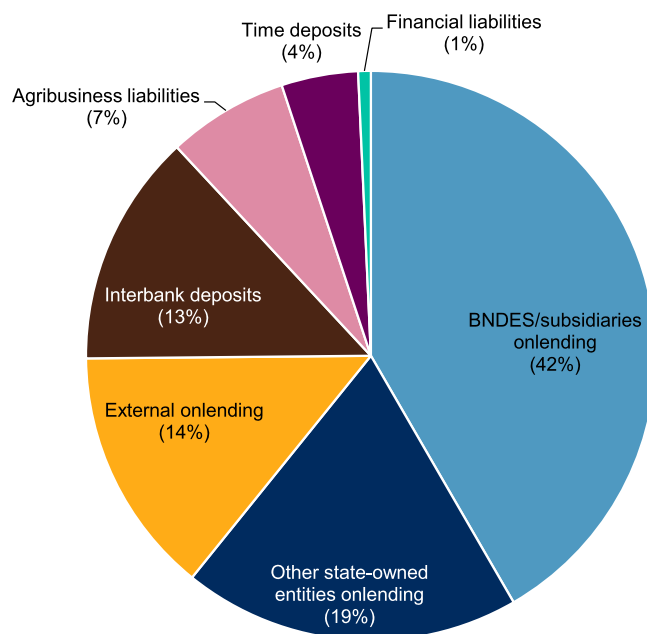
Other funding includes lending from foreign development agencies such as Corporación Andina de Fomento, The French Development Agency, and the Inter-American Development Bank. In May 2020, BDMG signed an agreement with Rio de la Plata Basin Financial Development Fund--a multilateral lender formed by Argentina, Bolivia, Brazil, Paraguay, and Uruguay--to provide \$36 million to complement the credit lines for municipalities in Minas Gerais. BDMG was the first Brazilian public bank to access such funding. As a result, lending from abroad made up 14% of the bank's funding as of September 2020. Issuances of agribusiness-linked securities (LCAs), which represent the bank's only source of retail funding, accounted for about 7% of the funding base as of September 2020.

Due to the long-term maturity profile of its funding base, BDMG's stable funding ratio (SFR) was 81.0% as of September 2020, which we deem adequate.

Chart 3

Funding Breakdown

As of September 2020



Source: S&P Global Ratings.

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In our opinion, BDMG has well-defined policies to manage liquidity risk. It assesses liquidity daily and considers different time horizons for its cash flow analysis. The bank also applies stress tests that consider, 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 with established procedures to deal with a breach of liquidity limits: an action plan is defined in an internal committee that reports results recurrently to the board of directors. As of September 2020, BDMG's broad liquid assets (cash, liquid securities, short-term repos, and short-term interbank deposits) amounted to R\$1.1 billion. The broad liquid assets to short-term wholesale funding ratio reached 0.7x, slightly below industry average. 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.

Table 5

Banco de Desenvolvimento de Minas Gerais S.A.--BDMG Funding And Liquidity					
	--Year ended Dec. 31--				
(%)	2020*	2019	2018	2017	2016
Core deposits/funding base	11.9	11.4	11.6	5.2	11.8
Customer loans (net)/customer deposits	938.7	1,011.6	936.8	2,207.7	927.1
Long-term funding ratio	76.9	80.0	79.6	75.7	84.4
Stable funding ratio	81.1	83.8	86.6	77.3	91.0
Short-term wholesale funding/funding base	32.6	30.2	28.6	32.8	20.8
Broad liquid assets/short-term wholesale funding (x)	0.7	0.9	0.9	0.5	1.1
Net broad liquid assets/short-term customer deposits	(355.5)	(27.9)	(60.2)	(1,238.0)	15.4
Short-term wholesale funding/total wholesale funding	37.0	34.2	32.4	34.6	23.5

*Data as of Sept. 30.

Environmental, social and governance factors ("ESG")

We believe BDMG's environmental, social, and governance credit 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 green 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 the state of 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 possible negative intervention from the state of Minas Gerais, the bank's controlling shareholder.

Nevertheless, the bank has a moderately high likelihood of 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 small to midsize enterprises (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 eroded fiscal position, 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 in the bank.

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

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 December 15, 2020)*

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

Issuer Credit Rating

B/Stable/--

Brazil National Scale

brA-/Stable/--

Ratings Detail (As Of December 15, 2020)*(cont.)

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-Feb-2016		BB-/Negative/--
17-Feb-2016		BB-/Watch Neg/--
19-Dec-2019	<i>Brazil National Scale</i>	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/--
19-Feb-2016		brA/Negative/--
17-Feb-2016		brA+/Watch Neg/--

Sovereign Rating

Brazil		BB-/Stable/B
<i>Brazil National Scale</i>		brAAA/Stable/--

Related Entities**Minas Gerais (State of)**

Issuer Credit Rating		SD/--/--
<i>Brazil National Scale</i>		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.

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