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Credit Opinion: Banco BBM S.A.

Global Credit Research - 15 Dec 2015

Rio de Janeiro, Brazil

Ratings

Category	Moody's Rating
Outlook	Rating(s) Under Review
Bank Deposits	*Baa3/*P-3
NSR Bank Deposits	*Aa1.br/*BR-1
Baseline Credit Assessment	**baa3
Adjusted Baseline Credit Assessment	**baa3
Counterparty Risk Assessment	*Baa2(cr)/*P-2(cr)
Senior Unsecured -Dom Curr	**Baa3
NSR Senior Unsecured	**Aa1.br

* Rating(s) within this class was/were placed on review on December 10, 2015
** Placed under review for possible downgrade on December 10, 2015

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Key Indicators

Banco BBM S.A. (Consolidated Financials)[1]

	[2]**6-15**	[2]**12-14**	[2]**12-13**	[3]**12-12**	[3]**12-11**	**Avg.**
Total Assets (BRL billion)	**3.2**	**3.1**	**3.2**	**2.7**	**2.3**	[4]**8.1**
Total Assets (USD billion)	**1.0**	**1.2**	**1.4**	**1.3**	**1.3**	[4]**-4.8**
Tangible Common Equity (BRL billion)	**0.6**	**0.6**	**0.6**	**0.5**	**0.5**	[4]**3.0**
Tangible Common Equity (USD billion)	**0.2**	**0.2**	**0.2**	**0.3**	**0.3**	[4]**-9.4**
Problem Loans / Gross Loans (%)	**2.1**	**0.2**	**0.9**	**0.1**	**0.5**	[5]**0.8**
Tangible Common Equity / Risk Weighted Assets (%)	**18.6**	**18.5**	**21.3**	**19.2**	**19.9**	[6]**19.5**
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	**4.0**	**0.5**	**2.0**	**0.3**	**0.8**	[5]**1.5**
Net Interest Margin (%)	**3.4**	**3.6**	**5.7**	**5.2**	**2.8**	[5]**4.2**
PPI / Average RWA (%)	**1.3**	**1.6**	**3.9**	**2.3**	**1.0**	[6]**2.3**
Net Income / Tangible Assets (%)	**1.1**	**1.4**	**1.5**	**1.6**	**2.9**	[5]**1.7**
Cost / Income Ratio (%)	**67.1**	**61.5**	**46.9**	**55.4**	**78.3**	[5]**61.8**
Market Funds / Tangible Banking Assets (%)	**58.9**	**44.9**	**37.2**	**50.4**	**44.5**	[5]**47.2**
Liquid Banking Assets / Tangible Banking Assets (%)	**57.1**	**47.6**	**43.8**	**43.9**	**39.5**	[5]**46.4**
Gross loans / Due to customers (%)	**187.8**	**178.1**	**130.3**	**200.6**	**149.1**	[5]**169.2**

Source: Moody's

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel III - fully-loaded or transitional phase-in; LOCAL GAAP [3] Basel II; LOCAL GAAP [4] Compound Annual Growth Rate based on LOCAL GAAP reporting periods [5] LOCAL GAAP reporting periods have been used for average calculation [6] Basel III - fully-loaded or transitional phase-in & LOCAL GAAP reporting periods have been used for average calculation

Opinion

SUMMARY RATING RATIONALE

On 10 December 2015, Moody's placed on review for downgrade the deposit and senior debt ratings assigned to Banco BBM S.A. (BBM). This rating action followed the announcement of the review for downgrade of Brazil's Baa3 bond rating on 9 December 2015. BBM's ratings are closely linked to the sovereign credit position and economic potential. Therefore, the conclusion of the review for downgrade is subject to the conclusion of the review of the sovereign issuer and bond ratings.

At the same time, Banco BBM S.A.'s (BBM) baseline credit assessment (BCA) of baa3 is challenged by the fact that the ongoing economic recession poses downside risks to its financial performance, and especially to its asset quality and profitability, because its loan book and revenue streams is less diversified than similarly rated Brazilian universal banks. The deterioration of the operating environment, in line with Moody's expectation of economic contraction until 2016, creates lingering pressures on companies and households repayment capacity, and reduces confidence and business volumes. In this context, risks are skewed to the downside, and may lead to a higher and faster-than-expected strain on its financial profile.

The bank's BCA also incorporate the degree of sector and borrower concentration in the loan book, which increases the susceptibility to asset risk volatility, particularly in the current economic recession. Also, a potential decline in credit quality would continue to demand higher provisions, and therefore, pressure profitability in an environment of more limited business volumes, despite rising credit spreads.

BBM's financial profile also incorporate the effectiveness in its credit risk management, as evidenced by reduced charge-offs through the cycles. BBM's disciplined leverage target, which does not exceed three times its shareholders' equity, reduces the potential impact of loan losses in its capitalization, which is currently strong relative to peers', with a tangible common equity to risk-weighted assets of 18.6% in June 2015. Nevertheless, loan concentration in risky economic sectors and the deteriorating operating environment have led NPLs to increase to 2.1% in June 2015, up from 0.5%. The bank' structural reliance on market funding is offset by high liquidity.

On 19 May 2015, Bank of Communications Co., Ltd. (BoCom, A2 stable, baa3) announced the acquisition of an 80% stake in BBM. Upon the conclusion of this deal, which is subject to approval of authorities in Brazil and China, Moody's will incorporate into BBM's ratings an assessment of affiliate support from BoCom. At the same time, Moody's will reassess BBM's financial profile, which may be positively or negatively affected by potential shifts in its strategy and risk appetite under new ownership.

BBM's deposit and senior unsecured ratings of Baa3 derive from its baa3 BCA, and do not benefit from government support uplift given the bank's modest market share of domestic deposits.

Rating Drivers

Asset risk supported by effective credit risk management, while potentially pressured by sector and borrower concentration

Strong capitalization

Market funding dependence partially offset by sizeable cash position and disciplined asset & liability management

Profitability is subject to volatility in periods of downturn given the high relevance of loan revenues

Ratings are currently on review for downgrade in line with the sovereign bond rating

Rating Outlook

All ratings assigned to BBM are currently on review for downgrade in line with the review for downgrade process announced at Brazil's Baa3 bond rating on 9 December 2015.

What Could Change the Rating - Up

At this juncture, there is no upward rating pressure on BBM's Baa3 deposit ratings. The stabilization of BBM's outlook could derive from its ability to keep adequate asset risk and profitability, despite the weak economic environment, coupled with the maintenance of strong capitalization.

What Could Change the Rating - Down

The review for downgrade will be concluded upon the conclusion of the review for downgrade on Brazil's issuer and bond rating that started on 9 December 2015. BBM's ratings are constrained by the sovereign bond rating of Baa3.

Negative pressures on BBM's BCA and ratings would also derive from a significant deterioration in its asset risk that results in a meaningful profitability reduction, or a relevant deterioration in its liquidity management standards.

Also, a downgrade (or upgrade) of BBM's BCA and ratings could derive from the completion of its acquisition by BoCom.

DETAILED RATING CONSIDERATIONS

CONSERVATIVE APPROACH IN CURRENT ECONOMIC ENVIRONMENT

We score asset risk as baa3, which reflects its low historical non-performing loan ratios and reduced charge offs, supported by strict underwriting standards. Also, it factors the bank's sector concentration exposure, particularly on sugar & alcohol and construction industries, which however, are mitigated by a high degree of collateralization.

Despite BBM's efforts to increase credit leverage, its loan book has remained relatively stable since 2012, given its conservative risk management standards. In 1H15 the loan book amounted to R$1.2 billion, with a problem loan ratio somewhat in line with, at 2.14%% (0.22% in 2014) and high reserve coverage, of 210%%. In addition, its loan leverage of 2.0x versus shareholders' equity further denotes the bank's currently conservative position towards credit risk.

Strong credit underwriting policies and entrenched controls have protected the bank from credit and market risk disruptions through economic cycles. Historically, BBM has had low NPL ratios, supported by a rigid and recognized risk management architecture and control parameters that have proven capable of supporting the bank's risk appetite as well as collateralization of the portfolio in previous bad cycles.

The bank's loan portfolio is relatively concentrated, with the 20 largest loans representing 37.1% of total loans in 1H15, and 20.2% of tangible common equity.

HIGH CAPITAL RATIO

We score capital as a2, which takes into consideration its current position and expected capital consumption.

BBM has historically preserved a comfortable capital cushion to absorb both expected and unexpected losses in the credit and trading portfolio. In 1H15, BBM's tangible common equity to risk-weighted assets was 18.6%.

In addition, limited credit leverage sustains the maintenance of high capital ratios. Management indicates that a maximum credit leverage target of three times equity, with an actual leverage below target at 2.0 times equity.

LOWER PROFITABILITY AND HIGH RESERVE COVERAGE SHOW EFFECT OF WEAKER ECONOMY

We score profitability as ba1, which factors the expected incremental pressures from higher loan loss provisions, and low revenue diversification coupled with intrinsic dependence on loan revenues.

In 1H15 net income to tangible banking assets fell to 1.1%, versus 1.6% in 2014, on the back of higher credit costs. Loan loss provisions amounted to BRL 9.5 million in 1H15, up from BRL 5.3 million in the twelve months ended in December 2014. At the same time, although the credit spreads in the local market have been widening, the bank's net interest margin was slightly lower in the 1H15 in view of the 21% reduction of the loan portfolio.

DEFENSIVE LIQUIDITY MANAGEMENT

We factor liquidity as ba3, which factors the bank's high reliance on market funding, but also offset by a large amount of liquid assets and a favorable tenor gap in its balance sheet.

BBM is a wholesale-funded institution, demonstrating management's clear and successful efforts to increase the mix and tenor. Concentration of its deposit base increased slightly with the 20 largest depositors accounting for 75% of total deposits in 1H15. However, it is mitigated by BBM's tight gap controls and conservative hedging policies, which are part of the bank's business-sustainability philosophy. The bank has been managing tenor gaps and costs by issuing local currency banknotes "letras financeiras" (minimum 2-year tenor) and other asset-backed securities such as agribusiness linked notes and RMBS, taking advantage of increased demand for fixed income bonds, which in some cases have lower costs because banks are not required to place reserve requirements at the Central Bank. These local currency instruments accounted for BRL 1.5 billion in 1H15, representing 78% of funding mix. Also, the bank has limited reliance on foreign currency lines, representing 10% of total funding, mostly represented by a term line from IFC.

The bank's large position in government securities works as a cushion in times of stress together with a conservative cash policy, which is comfortable and meets the bank's 180-day horizon obligations. BBM also adopts strong rules that prioritize the duration of deposits that allow the bank to work with no liquidity gap, different from most of its peer's.

BANCO BBM'S BCA IS SUPPORTED BY ITS MACRO PROFILE OF MODERATE +

Brazil's macro profile reflects its large and diversified economy, its high and rising indebtedness and the dominance of public sector banks. Notwithstanding the size of the economy, growth has fallen below potential for more than three consecutive years, weighed down by increased economic uncertainty, a slowdown in consumption and weak investment. In addition, persistently high inflation has raised questions regarding the credibility of the central bank's inflation targeting regime. Moreover, the banking system has become bifurcated, with public banks controlling a 54% share of the system's credit market as a result of years of rapid loan growth driven by government stimulus measures, while private banks remained more conservative. However, loan growth has moderated over the past year, which has alleviated pressure on banks' capital and funding following a period of robust credit market expansion. Brazil`s sizeable international reserve position, limited reliance on foreign borrowings and sound banking system support its low susceptibility to event risk.

Notching Considerations

GOVERNMENT SUPPORT

The ratings of Banco BBM do not benefit from any support uplift because of the bank's modest market share in the domestic deposits.

COUNTERPARTY RISK ASSESSMENT

Moody's has assigned a Counterparty Risk Assessment (CR Assessment) to BBM of Baa2(cr) for long-term and Prime-2(cr) for short-term. This CR Assessment is in line with the bank's adjusted BCA of baa3 and reflects an issuer's probability of defaulting on certain operating liabilities and other contractual commitments that are less likely to be subject to the application of a resolution tool to ensure the continuity of operations. The CR Assessment is not a rating. The CR Assessment also reflects the anticipated seniority of these obligations in the liabilities hierarchy. The CR Assessment also incorporates other steps authorities can take to preserve the key operations of a bank should it enter a resolution.

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 Factors

Banco BBM S.A.

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

Financial Profile						
Factor	**Historic Ratio**	**Macro Adjusted Score**	**Credit Trend**	**Assigned Score**	**Key driver #1**	**Key driver #2**
Solvency						
Asset Quality						
Problem Loans / Gross Loans	2.1%	baa1	↓↓	baa3	Sector concentration	
Capital						
TCE / RWA	18.6%	a1	↑↑	a2	Expected trend	
Profitability						
Net Income / Tangible Assets	1.1%	baa2	↑↑	ba1	Expected trend	
Combined Solvency Score		a3		baa2		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	44.9%	b2	↓↓	b3	Market funding quality	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	47.6%	a3	↑↑	baa1	Quality of liquid assets	
Combined Liquidity Score		ba2		ba3		

Financial Profile	**baa3**

Qualitative Adjustments	Adjustment
Business Diversification	0
Opacity and Complexity	0
Corporate Behavior	0
Total Qualitative Adjustments	**0**

Sovereign or Affiliate constraint	Baa3
Scorecard Calculated BCA range	**baa2-ba1**
Assigned BCA	**baa3**
Affiliate Support notching	0
Adjusted BCA	**baa3**

Instrument class	Assigned LGF Notching	Additional Notching	Preliminary Rating Assessment	Government Support	Local Currency Rating	Foreign Currency Rating
Counterparty Risk Assessment	--	--	--	--	Baa2(cr) RUR Possible Downgrade	--
Deposits	--	--	--	--	Baa3 RUR Possible Downgrade	Baa3 RUR Possible Downgrade
Senior unsecured bank debt	--	--	--	--	Baa3 RUR Possible Downgrade	Baa3 RUR Possible Downgrade

- Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.

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