

MOODY'S

INVESTORS SERVICE

Credit Opinion: **Banco BBM S.A.**

Global Credit Research - 16 Dec 2013

Rio de Janeiro, Brazil

Ratings

Category	Moody's Rating
Outlook	Stable
Bank Deposits	Ba1/NP
NSR Bank Deposits -Dom Curr	Aa2.br/BR-1
Bank Financial Strength	D+
Baseline Credit Assessment	ba1
Adjusted Baseline Credit Assessment	ba1

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Key Indicators

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

	[2]6-13	[2]12-12	[2]12-11	[2]12-10	[2]12-09	Avg.
Total Assets (BRL billion)	2.8	2.7	2.3	5.0	10.6	[3]-28.1
Total Assets (USD billion)	1.3	1.3	1.3	3.0	6.1	[3]-32.2
Tangible Common Equity (BRL billion)	0.5	0.5	0.5	0.5	0.6	[3]-3.7
Tangible Common Equity (USD billion)	0.2	0.3	0.3	0.3	0.4	[3]-9.2
Net Interest Margin (%)	6.8	5.2	2.8	1.9	2.5	[4]3.9
PPI / Average RWA (%)	4.5	2.3	1.0	1.5	2.2	[5]2.3
Net Income / Average RWA (%)	1.5	1.7	2.5	1.3	1.4	[5]1.7
(Market Funds - Liquid Assets) / Total Assets (%)	14.5	6.5	5.0	39.8	2.0	[4]13.6
Core Deposits / Average Gross Loans (%)	34.9	57.2	86.3	46.5	44.2	[4]53.8
Tier 1 Ratio (%)	23.6	19.4	20.6	20.4	13.9	[5]19.6
Tangible Common Equity / RWA (%)	23.5	19.4	20.6	20.2	13.5	[5]19.4
Cost / Income Ratio (%)	38.7	55.4	78.3	72.0	61.2	[4]61.1
Problem Loans / Gross Loans (%)	1.2	0.1	0.5	6.7	1.2	[4]1.9
Problem Loans / (Equity + Loan Loss Reserves) (%)	2.2	0.3	0.8	6.1	2.0	[4]2.3

Source: Moody's

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

Opinion

SUMMARY RATING RATIONALE

Moody's assigns a D+ (D plus) bank financial strength rating (BFSR) for Banco BBM that captures a SME focused operation and a long-track record of volatile earnings generation with strong contribution from trading activities, supported by sophisticated risk controls. The D+ BFSR translates into a Baseline Credit Assessment of ba1, which is also the bank's long-term local- currency deposit rating. Systemic support was not considered, given the bank's limited share of the industry's deposit base.

The ratings acknowledge the bank's robust risk management and expertise in treasury activities have allowed the franchise to successfully transit between credit, wealth management and trading across cycles, while the bank has preserved adequate credit quality, disciplined liquidity profile and capital surplus, when compared to similar sized banks. The ratings continue to weigh the volatile earnings component from trading gains which continues to be relevant, despite the recent business re-dimensioning.

Traditionally very cautious about credit expansion, BBM has a track record of volatile recurring earnings as a consequence of decisions to significantly reduce business volumes in downturns, a way to manage uncertain economic scenarios as well as market liquidity issues. Of note, the bank's capital ratios and cash position is conservatively sound, helping to absorb the negative effects of this strategy. Following the crisis, the bank decided to resume to lending business at the end of 2010, though, in a very contained fashion. At present, BBM is challenged to post more sustainable profitability and asset quality metrics.

The strict credit risk management and good level of collateralization of its loan book should shield the bank's return to lending segment. The bank has proven to be able to reshape its strategy during uncertainties and reposition the bank's operations without incurring in risks. In addition, BBM's rigid asset & liabilities management philosophy and relatively restrictive leverage guidelines help the bank to withstand the difficult times for the system's midsize banks, caused by the selectiveness of local investors.

The ratings are still constrained by the intrinsic vulnerability of this type of wholesale funding. Since 2012, the historically high participation of individual clients in traditional deposit has reduced reaching 8% in June 2013 (15% in 2012). These resources have gradually migrated to tax-deductible asset-backed securities so-called LCA (underlined by agribusiness loans) and LCI (by real estate-related loans). However, we still see funding diversification as one key challenge for the expansion of lending business in highly competitive segment.

Rating Drivers

- Sophisticated risk management and expertise allow BBM to successfully adjust its operations -- between credit, wealth management and treasury -- through different economic cycles
- Disciplined assets & liabilities management and capital adequacy has been key to support the bank's financial strength through cycles
- Swings in strategy as the bank adopted a conservative approach to credit risk have affected performance over last 3 years: needs to improve earnings recurrence generation, sustaining performance while maintaining a balanced approach to credit activities
- Still restrictive funding structure with a well concentrated deposit portfolio

Rating Outlook

All ratings have stable outlook.

What Could Change the Rating - Up

Positive ratings pressure would be forthcoming if recurring earnings flow proves to be sustainable. Management's efforts to diversify its funding structure have already been underway, evidenced by BBM's access in Jun/12 to a term IFC (International Financial Corporation) line of credit and by alternative ways it may use to access the capital markets. Sustaining adequate capital levels would also work to push credit quality up in the short run.

What Could Change the Rating - Down

Overaggressive lending practices as the bank resumes to growth, possibly resulting in eroded asset quality, would be harmful to the bank's credit standing. These riskier practices might follow a period of substantial expansion in lending, particularly if such growth is directed towards higher-risk market segments. The ratings could also be hurt if management fails to cope with competitive pressures and/or if profitability erodes. At this point, any loosening of risk management practices or consistent increase in market risk appetite could pressure the

ratings down.

DETAILED RATING CONSIDERATIONS

DEFENSIVE LIQUIDITY MANAGEMENT

BBM is a wholesale-funded institution, demonstrating management's clear and successful efforts to increase the mix and tenor. Concentration of its deposit base improved, as the 20 largest depositors accounted for 20% of total deposits in Jun/13, from 52% in Jun/12, but remains high. However, it is mitigated by BBM's tight gap controls and conservative hedging policies, which are part of the bank's business-sustainability philosophy. In 1Q13, the bank posted a favorable tenor gap of 183 days, thus enhancing from the 282 days in 1Q12. As anticipated, the bank was able to manage tenor gaps and costs by issuing local currency banknotes 'letra financeira' (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 good cost conditions since banks are not required to place reserve requirement at the Central Bank. These local currency instruments increased to R\$ 971 million in 2Q13, from R\$220.4 million in 2011, accounting for 54% of funding mix. Also, the bank has limited reliance on foreign currency lines, representing 22% of total funding, mostly represented by a term line from IFC.

The large position in government securities works as a cushion in times of stress together with a conservative cash policy, which is comfortable to meet the bank's 90-day horizon obligations and strong rules that prioritize the duration of deposits that allows the bank to work with no liquidity gap, different from most of its peer's conditions.

CONSERVATIVE APPROACH UNDER CURRENT ECONOMIC ENVIRONMENT

After boosting loans by 38.6% YoY in FY12, BBM reversed the growth strategy, and shrank the portfolio by 17% in 1H13, to R\$1.1 billion, in view of its worsening economic expectations. The conservative approach also resulted from the increased problem loans, to 1.2% in 2Q13, from 0.1% last year. However, we note that BBM's problem loans are significantly lower than its peers, and its reserve coverage is more conservative, at 298% in 2Q13. Finally, we highlight that 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 cycles. Historically, BBM presented a low NPL ratio below 1%. BBM has a rigid and recognized risk management architecture and control parameters that have proven capable of supporting the bank's risk appetite through cycles. This has provided a high level of comfort to the trading activities, as well as strong framework of collateralization of the portfolio that worked well during 2008 and 2009.

Loan portfolio displays high concentration issues mitigated by strong collateral framework of the portfolio, a factor that is in line with peers'. The existing concentration of large groups is managed through a secured portfolio and by the application of high credit standards, as indicated by the low levels of non-performing loans. In 2012, the 20 largest loans accounted for 35% of total loans and 72% of reported shareholders' equity.

HIGH CAPITAL RATIO, FULLY CONSISTED OF TIER 1

Strong capitalization is contractually supported by shareholders. BBM have historically preserved a comfortable capital cushion to absorb both expected and unexpected losses in the credit and trading portfolio. Capital has always support the strategic repositioning which has been present over the life of BBM, prioritizing risk controls and positive performance.

Also, limited credit leverage sustains the maintenance of comfortable capital position. For 2013, management indicated that a maximum credit leverage of three times the equity to be ideal as the bank expands. In 1H13, the leverage ratio was 2.0 times the equity, and the 27.5% BIS ratio consists of high quality capital, fully including Tier 1 instruments.

LOWER PROFITABILITY RESULTING FROM WEAKER ECONOMY

In 1H13 net income decreased 12% YoY, to R\$ 19.1 million, which in one hand, was enhanced by higher net interest income and cost control, but on the other hand was neutralized by higher loan loss provisions. Net interest income was benefited by higher average loans in 1H13 versus a year before, and cost control resulted in a 4% reduction in non-interest expenses, highlighting the bank's immediate response to slowing business activity. Loan loss provisions were influenced by higher problem loans, and by the bank's conservative approach towards reserve coverage.

With a somewhat active trading desk, BBM's performance carries a volatile component that may expose the bank to adverse scenarios. However, income from treasury activities have reduced over the past years. On a managerial basis, 2012 operating income was composed 58.3% by credit, 34.5% by trading gains, and 7.1% by asset under management, primarily from private banking services. Most of trading earnings are related to spot FX transactions as the bank acts as a FX dealer in the system and proprietary positions in interest rates mitigated by conservative VaR limits in terms of equity; 2% established since May 2009. Over the last 5 years, BBM did not report losses, which proves the bank's strong market risk management.

Going forward, we expect profitability to face a potential volatility, given the ongoing swings in economic indicators, such as interest rate and FX markets, as well as because of the worsening expectations for GDP growth that should constrain the bank's risk appetite.

REGARDED MANAGEMENT, WITH A NICHE OPPORTUNISTIC ACTIVITY

BBM's business franchise has been anchored on wholesale-banking activities and a long track record of robust performance from trading operations. BBM has experience in the lending business since its inception, however the credit strategy depends on credit and funding conditions, rapidly increasing risk aversion and deleveraging the credit portfolio in times of heightened uncertainties. Therefore, earnings stability is the main issue of BBM's franchise, that, different from peers, presents great volatility across the cycles as the focus moves from credit to trading and vice-versa

At present, BBM has a niche operation focused on small and medium size companies with annual sales above R\$ 200 million, with no major market position within this industry. Also, the bank maintains an active proprietary trading, which includes the investment of its liquid assets in government securities, representing approximately 50%-60% of interest income in 1H13.

Global Local Currency Deposit Rating (Joint Default Analysis)

Moody's Ba1 global local-currency deposit rating reflects BBM's very modest participation in the deposit market, and translates, in Moody's view, into no probability of systemic support. The partnership organizational structure, we believe, suggests that support would be forthcoming from this group, as proven by shareholders' historical behavior seeking capital protection. Therefore, the local currency rating is a direct mapping of BBM's ba1 Baseline Credit Assessment.

National Scale Rating

BBM is rated Aa2.br/BR-1 by Moody's on Brazil's National Scale. The rating is supported by creditworthiness in the domestic market; hence, the credit strength also reflects the wholesale nature of its business. This rating derives from the bank's global local-currency rating.

Foreign Currency Deposit Rating

Moody's assigns a Ba1 foreign currency deposit rating for Banco BBM. The rating is no further constrained by the country's foreign currency deposit ceiling for Brazil.

ABOUT MOODY'S BANK RATINGS

Bank Financial Strength Rating

Moody's Bank Financial Strength Ratings (BFSRs) represent Moody's opinion of a bank's intrinsic safety and soundness and, as such, exclude certain external credit risks and credit support elements that are addressed by Moody's Bank Deposit Ratings. Bank Financial Strength Ratings do not take into account the probability that the bank will receive such external support, nor do they address risks arising from sovereign actions that may interfere with a bank's ability to honor its domestic or foreign currency obligations. Factors considered in the assignment of Bank Financial Strength Ratings include bank-specific elements such as financial fundamentals, franchise value, and business and asset diversification. Although Bank Financial Strength Ratings exclude the external factors specified above, they do take into account other risk factors in the bank's operating environment, including the strength and prospective performance of the economy, as well as the structure and relative fragility of the financial system, and the quality of banking regulation and supervision.

Moody's uses the Baseline Credit Assessment (BCA) to map BFSRs onto the 21-point Aaa-C rating scale and like the BFSR, it reflects a bank stand-alone default risk. Each point on the Aaa-C scale represents a specific probability of default and therefore allows Moody's to use the BCA as an input to Moody's Joint Default Analysis

(JDA), described below. The baseline credit assessment reflects what the local currency deposit rating of the bank with the given BFSR would be without any assumed external support from a government or third party.

Global Local Currency Deposit Rating

A deposit rating, as an opinion of relative credit risk, incorporates the Bank Financial Strength Rating as well as Moody's opinion of any external support. Specifically, Moody's Bank Deposit Ratings are opinions of a bank's ability to repay punctually its deposit obligations. As such, Moody's Bank Deposit Ratings are intended to incorporate those aspects of credit risk relevant to the prospective payment performance of rated banks with respect to deposit obligations, and includes: intrinsic financial strength, sovereign transfer risk (in the case of foreign currency deposit ratings), and both implicit and explicit external support elements. Moody's Bank Deposit Ratings do not take into account the benefit of deposit insurance schemes which make payments to depositors, but they do recognize the potential support from schemes that may provide assistance to banks directly.

According to Moody's joint default analysis (JDA) methodology, the global local currency deposit rating of a bank is determined by the incorporation of any external elements of support into the bank's Baseline Credit Assessment. In assigning the local currency deposit rating to a bank, the JDA methodology also factors in the rating of the various potential support providers (parent company, cooperative group, regional or national governments), as well as the degree of dependence that may exist between each one of them and the bank. Moody's assessment of the probability of systemic support (by a national government) is derived from the analysis of the capacity of a government and its central bank to provide support on a system-wide basis. The systemic support indicator is determined for a particular country and serves as an input for all bank ratings in that country. The support indicator can be set at, above or, in rare cases, below the government's local currency bond rating for that country.

National Scale Rating

National scale ratings are intended primarily for use by domestic investors and are not comparable to Moody's globally applicable ratings; rather they address relative credit risk within a given country. A Aaa rating on Moody's National Scale indicates an issuer or issue with the strongest creditworthiness and the lowest likelihood of credit loss relative to other domestic issuers. National Scale Ratings, therefore, rank domestic issuers relative to each other and not relative to absolute default risks. National ratings isolate systemic risks; they do not address loss expectation associated with systemic events that could affect all issuers, even those that receive the highest ratings on the National Scale.

Foreign Currency Deposit Rating

Moody's ratings on foreign currency bank obligations derive from the bank's local currency rating for the same class of obligation. The implementation of JDA for banks can lead to a high local currency ratings for certain banks, which could also produce high foreign currency ratings. Nevertheless, it should be noted that foreign currency deposit ratings are in all cases constrained by the country ceiling for foreign currency bank deposits. This may result in the assignment of a different, and typically lower, rating for the foreign currency deposits relative to the bank's rating for local currency obligations.

Foreign Currency Debt Rating

Foreign currency debt ratings are derived from the bank's local currency debt rating. In a similar way to foreign currency deposit ratings, foreign currency debt obligations may also be constrained by the country ceiling for foreign currency bonds and notes: however, in some cases the ratings on foreign currency debt obligations may be allowed to pierce the foreign currency ceiling. A particular mix of rating factors are taken into consideration in order to assess whether a foreign currency bond rating pierces the country ceiling. They include the issuer's global local currency rating, the foreign currency government bond rating, the country ceiling for bonds and the debt's eligibility to pierce that ceiling.

About Moody's Bank Financial Strength Scorecard

Moody's bank financial strength model (see scorecard below) is a strategic input in the assessment of the financial strength of a bank, used as a key tool by Moody's analysts to ensure consistency of approach across banks and regions. The model 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.

Rating Factors [1]	A	B	C	D	E	Total Score	Trend
Qualitative Factors (70%)						C-	
Factor: Franchise Value						D	Neutral
Market share and sustainability				x			
Geographical diversification				x			
Earnings stability				x			
Earnings Diversification [2]							
Factor: Risk Positioning						D+	
Corporate Governance [2]				x			
- Ownership and Organizational Complexity				x			
- Key Man Risk				x			
- Insider and Related-Party Risks							
Controls and Risk Management			x				
- Risk Management			x				
- Controls		x					
Financial Reporting Transparency				x			
- Global Comparability				x			
- Frequency and Timeliness	x						
- Quality of Financial Information				x			
Credit Risk Concentration			x				
- Borrower Concentration			x				
- Industry Concentration	x						
Liquidity Management				x			
Market Risk Appetite			x				
Factor: Operating Environment						D	Neutral
Economic Stability					x		
Integrity and Corruption				x			
Legal System			x				
Financial Factors (30%)						C	
Factor: Profitability						C+	Neutral
PPI % Average RWA (Basel II)			1.62%				
Net Income % Average RWA (Basel II)		1.85%					
Factor: Liquidity						D	Neutral
(Market Funds - Liquid Assets) % Total Assets				17.09%			
Liquidity Management				x			
Factor: Capital Adequacy						A	Neutral
Tier 1 Ratio (%) (Basel II)	20.14%						
Tangible Common Equity % RWA (Basel II)	20.07%						
Factor: Efficiency						D	Neutral
Cost / Income Ratio				68.56%			
Factor: Asset Quality						B	Improving
Problem Loans % Gross Loans			2.42%				
Problem Loans % (Equity + LLR)	2.38%						
Lowest Combined Financial Factor Score (9%)						D	
Economic Insolvency Override						Neutral	
Aggregate BFSR Score						C-	
Aggregate BCA Score						baa1/baa2	
Assigned BFSR						D+	
Assigned BCA						ba1	

[1] - Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.
[2] - A blank score under Earnings Diversification or Corporate Governance indicates the risk is neutral.



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