Credit Opinion: Banco BBM S.A.

Banco BBM S.A.

Rio de Janeiro, Brazil

Ratings

Category	Moody's Rating
Outlook	Stable
Bank Deposits -Fgn Curr	Ba2/NP
Bank Deposits -Dom Curr	Ba1/NP
NSR Bank Deposits -Dom Curr	Aa2.br/BR-1
Bank Financial Strength	D+

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Key Indicators

Banco BBM S.A.

	[1][2]**Dec-08**	**Jun-08**	**Dec-07**	**Jun-07**	**Dec-06**	[3]**Avg.**
Total Assets (US$B)	**6.07**	**8.48**	**9.79**	**8.65**	**5.80**	[4]**2.27**
Share Equity (US$M)	**315**	**548**	**567**	**469**	**311**	[4]**0.71**
Pre-Provision Profit/Tt.Avg. Assets	**0.50**	**0.68**	**4.96**	**4.51**	**1.81**	**2.49**
ROAA	**0.67**	**0.92**	**3.31**	**2.95**	**1.24**	**1.82**
NIM	**1.51**	**1.68**	**5.82**	**5.17**	**2.37**	**3.31**
Oper Expenses/Gross Op. Revenues	**79.69**	**59.75**	**17.58**	**17.74**	**32.18**	**41.39**
NPL/Gross Loans & Lease	**--**	**--**	**--**	**--**	**--**	**--**
BIS Ratio	**14.53**	**16.55**	**16.30**	**17.02**	**16.09**	**16.10**

[1] As of December 31. [2] Statement period in which the bank switched to Basel II accounting framework. [3] The average calculations are based on Basel I and Basel II data where applicable. [4] Compound annual growth rate.

Opinion

SUMMARY RATING RATIONALE

Moody's assigns a D+ (D plus) bank financial strength rating (BFSR) for Banco BBM based on the bank's focused operations as a lender to upper middle-market companies and on its long track record of successful 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.

Moody's ratings reflect the focused credit operation and fast expansion of BBM's commercial loan book over the last four years, while management moves the franchise toward an earnings stream that is based more on credit, improving recurrence. Historically, the bank's earnings relied on BBM's traditionally important proprietary trading activities; however, as the loan book grows within adequate credit costs and treasury reshapes to a corporate-driven platform, earnings recurrence is likely to increase.

Traditionally very cautious about credit expansion, BBM decided in mid-2008 to greatly reduce loan origination as management saw a weaker funding and credit environment and Brazil's economy decelerated. As long as the bank sees funding dynamics and the credit environment as cloudy, recurring profitability ratios are not likely to improve because of reduced business opportunities. The bank's capital ratios and cash position are sound, which can help it absorb the potential negative effects on performance of this reduction.

While BBM's asset quality metrics are still superior to those of some of its peers, its 2008 ratios have shown a slight weakening as the brake on growth plans brought some risk concentration on the portfolio relative to what it was there before. The strict credit risk management and good level of collateralization of its loan book may somewhat shield the bank from the potential deterioration expected in the corporate and commercial segments in 2009. In addition, BBM's rigid liquidity management philosophy and relatively restrictive leverage guidelines help the bank to withstand the difficult times for the system's midsize banks during the fourth quarter, caused by the selectiveness of local investors.

The ratings are still constrained by the intrinsic vulnerability of this type of wholesale funding and also the challenge faced by BBM's operations of lending in a competitive segment with many rivals. They are also constrained by the slowdown in the growth of the credit portfolio in a time of economic deceleration.

Banco BBM focuses on a selective wholesale banking business, which has resulted in high-quality, largely secured, short- and medium-term loan exposures to the bigger mid-sized companies. Loan originations benefit from the bank's ability to leverage its research operations -- an activity that is well recognized in the local market. Liquidity management is good, given the conservative nature of BBM's balance sheet, and despite the wholesale funding profile of BBM. The bank's risk management, which is efficiently operated by a skilled supervisory team and adequate governance, is quite stringent.

Credit Strengths

- Superior credit and risk management culture, leading to a low loss history in credit activities

- Sophisticated risk controls, particularly when compared to the market's

- Executive commitment strongly influenced by partnership structure

- Highly qualified staff

- Improving business mix supports diversification of future earnings

Credit Challenges

- Sustaining profitability levels while the bank reduces origination as it adopts a careful approach towards credit during an economic slowdown

- History of volatile treasury-related activities, a problem recently solved by the segregation of the proprietary trading platform to its asset management company (April 2008)

- Still-expensive and concentrated funding structure, though partially mitigated by prudent management

- Highly competitive market

Rating Outlook

All the ratings have a stable outlook. BBM's consistent operating efficiency, good financial fundamentals, and effective handling of lending opportunities all bolster this outlook. The outlook is also supported by management's diversification efforts in earnings and funding, as well as by the conservative risk culture and the shareholders' demonstrated capital-protection policy.

What Could Change the Rating - Up

Positive ratings pressure would be forthcoming should sustainable recurring earnings flow from the bank's proposed commercial-growth strategy, as this proves successful. Management's efforts to diversify its funding structure are already underway, as signaled by BBM's recent access 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, 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 declines.

Recent Results and Developments

After record profitability in 2007 when trading gains boosted bottom line results, Banco BBM reported net income of R$93.5 million for 2008, a poor performance negatively influenced by the hike in funding costs and a move to preserve liquidity by limiting loan origination in the period, as many other banks in the system have done.

In the context of higher risk aversion throughout 2008, the credit portfolio reduced roughly 30% in 12 months. In fact, the year-end balance sheet still shows a superior asset quality ratio at a low 0.64%, when considering the past-due loans over 90 days, and a very comfortable coverage ratio.

The heightened market volatility during the month of October resulted in sharp depreciation of the Brazilian currency, equities, and interest rates, together with much tighter liquidity conditions. Banco BBM reported manageable exposure to currency risk both on its proprietary and client related positions. Moreover, the bank was able to retain an adequate liquidity profile largely composed of liquid government securities. Its total deposits were R$2.5 billion as of end of December, a 30.6% decrease in the quarter.

BBM maintains a good capitalization level with the BIS ratio at nearly 14.5%. As part of the decision to reduce the credit book, management decided to diminish equity size in a year of limited growth opportunities, as the scarcity of liquidity is likely to persist.

DETAILED RATING CONSIDERATIONS

Detailed considerations for Banco BBM's currently assigned ratings are as follows.

Bank Financial Strength Rating

Moody's assigns a D+ rating, reflecting the dynamic expansion of the bank's franchise, particularly of its middle market-lending segment, which is backed by a proven and conservative risk-evaluation framework. The two-notch difference between the scorecard outcome C and the assigned BFSR D+ lies on the volatile earnings profile coming from historically important proprietary trading gains. Nevertheless, the commercial lending business -- which is high-yielding -- has been influencing recurring earnings both continuously and positively.

On the back of this unpredictable component of revenue up until mid-2008, the bank counts on sophisticated-risk management controls and risk intelligence -- both above market standards -- as well as a highly qualified management team that is taking on competition by offering tailor-made products and services.

Moody's BFSR scorecard outcome was positively influenced by BBM's sound financial fundamentals, yielding a B-score overall. Profitability still lags peers', however, reflecting the high volume of low-yield trading gains. The high scores on Regulatory Environment also boost Moody's ratings.

Qualitative Rating Factors (70% weighting)

Factor 1: Franchise Value

Trend: Neutral

BBM's business franchise has been anchored on well-established wholesale-banking activities and a long track record of robust performance from proprietary trading operations. BBM has experience in the lending business since its inception, although the bank has shifted from its original target clients over the last few years.

In times of stress, the bank tends to adopt a more conservative attitude towards risk. At present, BBM holds a well-defined niche position focusing on upper-mid sized companies, but it does not possess a major market share within this industry. Up to 2007, the bank maintained an above-average rate of loan disbursement growth over the last three years when compared with its national peers', suggesting its keen appetite for rapid expansion.

The bank's diversification strategy is still working through results, as indicated by a high degree of volatility in its earnings stream (more than 70% of operating earnings from trading-related gains). Despite an established focus and well-disciplined risk-management framework, BBM is challenged to expand market share in a highly competitive environment--one dominated by major banks and foreign players. Scale should be a limiting factor in a more aggressive lending market.

Management has also been moving towards other business opportunities involving payroll lending and it has been considering establishing a portfolio of real estate loans, especially one focused on the commercial side. The motivation is improved cross-selling and stronger recurring earnings.

On the positive side, the credit franchise has been enhanced by the segregation of trading activities since May 2008, which tends to improve earnings stability, as the portfolio grows, seasons and credit remains robust. However, potential changes in credit dynamics as a result of a challenging funding market and a latent slowdown in growth rates should constrain business expansion. Supported by historical behaviors, we see BBM adopting a more cautious credit strategy in times of uncertainties, which could reduce credit income flow.

Factor 2: Risk Positioning

Trend: Neutral

BBM's E score on risk positioning is hurt by the oversight board's lack of independence, which limits its corporate governance assessment. The bank counts on rigid and recognized risk management tools and control parameters, developed in-house. This provides a high level of comfort to trade in the local market, as well as aiding international positioning. Although ownership control is familial, BBM is structured under a partnership, providing better governance than most other family-owned institutions.

The risk management function is completely detached from performance, although the key position on risk controls is performed by the CEO and also by the representative of the controller, the main shareholder of the institution. Consequently, this situation presents what we consider to be a "key man" risk.

Despite the tight controls, the bank's financial reporting is fairly limited, with restricted information on business lines, risk weighted assets, and Tier 1 equity.

The existing concentration of large groups is managed through a secured portfolio (80% of the portfolio is collateralized) and by the application of high credit standards, as indicated by the low levels of non performing loans. BBM maintains a high level of liquidity on its balance sheet, which is largely encompassed by federal T-bills and overnight "repos."

Nevertheless, funding is mostly from the instruments of institutional investors, which tend to be expensive in nature; moreover, these are increasing in tenor length as they are part of meeting management's diversification targets. Market risk appetite for a credit bank is still reasonable, although BBM reshaped its risk guidance in May 2008 when management lowered the VaR limit from 5% to 1% of equity, a decision made to shield the bank's future earnings stream from market volatility.

Factor 3: Regulatory Environment

Moody's will comment on the Brazilian regulatory environment in a separate report.

Factor 4: Operating Environment

Trend: Improving

Moody's grades the Brazilian operating environment at D. The D derives from a score of E for economic stability (measured as nominal GDP volatility over the 20-year period of 1985-2005), and there is also D rating for integrity and corruption. The integrity and corruption index is based on data from the World Bank, which ranks approximately 200 countries worldwide.

The legal system's score of C indicates the average length of time required for the execution of guarantees in Brazil in the absence of reliable references for mortgage foreclosure.

Quantitative Rating Factors (30% weighting)

Factor 5: Profitability

Trend: Weakening

BBM presents a long track record of positive, strong performance, despite market volatility over the last five years.

Although in April 2008 the bank segregated the volatile earnings-piece that have played an important role in limiting sustainability, 2008 performance was hit by the hike in deposit-costs combined with the hard brake on credit activities that was applied extensively at the end of 2008. BBM reported pre-provisions income of R$70.3million, or one-tenth of prior year's core profitability. Recurring profitability ratios are less likely to improve because of reduced business opportunities.

BBM has consistently reported low credit cost since 2003. Margins are still low as a result of the competitive environment but this time they are also affected by increased funding costs. A fee-based operation, BBM's asset management activities will have growing importance, as the bank continues to restrict growth in a time of economic and funding unpredictability. Fee income from asset management activities has grown over the last three years.

Factor 6: Liquidity

Trend: Neutral

BBM is a wholesale-funded institution, demonstrating management's clear and successful efforts to increase the mix and tenor. BBM has tight gap controls, and conservative hedging policies, which are part of the bank's business-sustainability philosophy. The large position in government securities works as a cushion in times of stress. The weakening trend evidences the vulnerability of its wholesale nature funding structure.

Factor 7: Capital Adequacy

Trend: Weakening

Strong capitalization is contractually supported by shareholders. As the credit scenario deteriorates, capital should be pressured.

Factor 8: Efficiency

Trend: Weakening

BBM has a lean cost structure with clear effects on cost control. However, as market conditions turned challenging, BBM moved to reshape its franchise, which had been prepared to support growth, and quickly resized it to align it with prospectively reduced performance. That move involved reductions of staff and infrastructure. The bank reduced the payroll by 15% in November, generating an increment in administrative expenses in the quarter.

Factor 9: Asset Quality

Trend: Weakening

Superior asset quality warrants a score of A. There is a high degree of selectiveness in credit relationships, which is reflected by the bank's low non-performing ratio over the last three years. BBM's delinquency ratio is far below its peers' indicators. The asset quality is also backed by adequate safeguards through guarantees and collateral.

BBM operates credit lines on a transaction-specific basis. Credit quality might erode to some degree in coming periods on the back of unfavorable market conditions and the economic deceleration, which have already led to an increases in the provisioning level, which reflects weakening asset quality overall.

The ample provisioning cushion built up by the bank against problematic loans works as a neutralizer for increased NPLs.

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 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 Ba2 foreign currency deposit rating for Banco BBM, which is 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.

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 external elements of support into the bank's Baseline Risk Assessment. In calculating the GLC rating for a bank, the JDA methodology also factors in the rating of the support provider, in the form of the local currency deposit ceiling for a country, Moody's assessment of the probability of government support for the bank in case a stress situation occurs and the degree of dependence between the issuer rating and the LCDC.

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. An 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 reminded 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%)						**D+**	
Factor: Franchise Value						**D**	**Neutral**
Market Share and Sustainability				**x**			
Geographical Diversification				**x**			
Earnings Stability				**x**			
Earnings Diversification [2]							
Factor: Risk Positioning						**E**	**Neutral**
Corporate Governance [2]					**x**		
- Ownership and Organizational Complexity				x			
- Key Man Risk				x			
- Insider and Related-Party Risks					x		
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**	**Improving**
Economic Stability					**x**		
Integrity and Corruption				**x**			
Legal System			**x**				
Financial Factors (30%)						**B**	
Factor: Profitability						**A**	**Weakening**
PPP % Avg RWA - Basel II	9.58%						
Net Income % Avg RWA - Basel II	6.83%						
Factor: Liquidity						**C-**	**Neutral**
(Mkt funds-Liquid Assets) % Total Assets					21.69%		
Liquidity Management		x					
Factor: Capital Adequacy						**A**	**Weakening**
Tier 1 ratio (%) - Basel II	15.74%						
Tangible Common Equity / RWA - Basel II	15.74%						
Factor: Efficiency						**A**	**Weakening**
Cost/income ratio	43.15%						
Factor: Asset Quality						**A**	**Weakening**
Problem Loans % Gross Loans	0.46%						
Problem Loans % (Equity + LLR)	1.69%						
Lowest Combined Score (9%)						**C-**	
Economic Insolvency Override						**Neutral**	
Aggregate Score						**C-**	
Assigned BFSR						**D+**	

[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