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Credit Opinion: Banco BBM S.A.

Global Credit Research - 01 Nov 2010

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+

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Key Indicators

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

	[2]6-10	[2]12-09	[2]12-08	[3]12-07	[3]12-06	Avg.
Total Assets (BRL billion)	5.04	10.60	14.18	17.34	12.40	[4]-20.16
Tangible Common Equity (BRL billion)	0.63	0.63	0.71	0.99	0.60	[4]0.98
Total Assets (USD billion)	2.80	6.08	6.08	9.74	5.81	[4]-16.70
Tangible Common Equity (USD billion)	0.35	0.36	0.30	0.56	0.28	[4]5.34
PPI / Avg RWA	2.24%	2.29%	1.40%	15.44%	6.02%	[5]1.98%
Net Income / Avg RWA	1.26%	1.49%	1.87%	10.29%	4.06%	[5]1.54%
(Market Funds - Liquid Assets) / Total Assets	0.04%	2.05%	51.23%	15.72%	16.83%	[6]17.17%
Core Deposits / Average Gross Loans	46.78%	44.20%	50.19%	86.76%	81.33%	[6]61.85%
Tier 1 Ratio	20.69%	14.53%	14.53%	16.28%	14.88%	[5]16.58%
Tangible Common Equity / RWA	20.25%	14.15%	14.21%	16.06%	14.57%	[5]16.20%
Cost / Income Ratio	64.56%	61.16%	72.65%	17.34%	31.46%	[6]49.43%
Problem Loans / Gross Loans	10.56%	4.46%	0.11%	1.03%	0.56%	[6]3.34%
Problem Loans / (Equity + Loan Loss Reserves)	10.63%	7.14%	0.40%	3.99%	1.95%	[6]4.82%

Source: Moody's

[1] All ratios are adjusted using Moody's standard adjustments [2] Basel II; LOCAL GAAP [3] Basel I; LOCAL GAAP [4] Compound Annual Growth Rate based on LOCAL GAAP reporting periods [5] Basel II & LOCAL GAAP reporting periods have been used for average calculation [6] 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 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.

The ratings acknowledge the bank's robust risk management and expertise in treasury activities have allowed the franchise to successfully transit between credit, asset 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. While the weight of trading gains in earnings continues to be relevant, the ratings affirmation reflects relevant improvements over the past years towards earnings recurrence, with the increase in commercial lending and removal of proprietary trading activities from the bank's balance sheet.

Traditionally very cautious about credit expansion, BBM decided in mid-2008 to promote a significant deleveraging as management saw uncertain funding and credit environment. As a consequence, recurring profitability levels have been pressured down, indicating the reduced business volumes. Of note, the bank's capital ratios and cash position are sound, which can help it absorb the potential negative effects on performance of this reduction. After June 2009, with some improvement in market conditions, the bank has decided to pick up its lending pace, though, in a very contained fashion. The bank is still challenged to resume loan growth in an uncertain scenario for corporate lending with still restrictive funding alternatives. Currently, BBM is centering efforts to asset management activities, which should have a growing contribution to earnings.

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 should shield the bank from the potential deterioration expected in the corporate and commercial segments in 2009. 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 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, especially with the entrance of the large players.

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.

Rating Drivers

- Sophisticated risk management and expertise allow BBM to successfully adjust its operations -- between credit, asset management and treasury -- through different economic cycles

- Disciplined assets & liabilities management and capital adequacy has been key to support the bank's financial strength

- Need to improve earnings recurrence generation, sustaining performance and profitability improvements at the asset management while maintaining a balanced approach to credit activities

- Still restrictive funding diversification

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, as signaled by BBM's 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 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.

Recent Results and Developments

In the first semester 2010, BBM reported a net income of R$ 23.8 million, a decline of 60.8% when compared to June 2009. The fall in profitability still reflects the bank's continued deleveraging process. The bank posted ROAA and ROAE of 1.0% and 7.3%, respectively. Gross loans amounted to R$756.4 million on a consolidated basis, down by 57% against the already lowered R$1.8 billion portfolio in June 2009.

Since mid-2009, the bank decided to focus on its asset management activities as interest rates lowered and investors started to signalize interest in higher return assets. In the 1H10, assets under management totaled R$6 billion, up by 43% y-o-y, a consistent expansion of the business that acknowledges market recognition on BBM's trading expertise and its capable risk management discipline. Fee income received from its asset management subsidiary (BBM Administração de Recursos DTVM) jumped 59% in 12 months (286% growth from June 2008 to 2009) and responded roughly for 78% of operating income in 1H10. According to management, fee revenues should remain a relevant component of BBM's recurrent earnings stream going forward, as asset management activities becomes one of BBM's business focus. Consolidated NPLs ratio stood at 6.7% in June 2010, well covered by 130% of reserves.

In June 2010, total consolidated assets amounted to R$5 billion, half the size of 2009, as part of the shifts promoted in bank's business mix. The bank maintains a vigilant liquidity approach, based on a conservative cash position (over R$1 billion) built on government securities. Funding is largely composed of time deposits, with low reliance on foreign currency lines, which have reduced significantly since the end of 2008 as part of the bank's credit contraction strategy.

With a low leverage ratio of 1.26x (credit portfolio over equity), both Tier 1 and total capital ratio stood at high 20.7%(no material Tier 2 equity element) in June 2010, leaving substantial room to support growth.

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 BBM's dynamic and capable business model, with a commercial lending operation supported by a prudent risk-evaluation framework that prioritizes the bank's asset quality and liquidity management profile. The three-notch difference between the scorecard outcome of C- and the assigned BFSR of 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 positively since 2003.

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-midsized companies, but it does not possess a major market share within this industry. Up to June 2008, 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 the level of trading gains in earnings and the recent de-leveraging of the bank's credit portfolio, with a decision to focus on asset management business. We view the development of the asset management company as a source of strength for the franchise, as the bank can use its trading expertise, loan origination capacity and risk guidelines to leverage this fee-based business for the bank. As of June 2010, BBM's asset management company has R$6 billion under management, and has presented a fast growth post-Lehman. The group has been taking advantage of the lowering real interest rates, to offer high-return investment options to investors that are already reallocating part of the portfolio's to high-yield assets.

Not until very recently, more than 70% of operating earnings derived 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 with declining interest rates. On the positive side, the credit franchise enhanced by the segregation of trading activities since April 2008, which tends to improve earnings stability, as the portfolio grows, seasons and credit remains robust.

Based on historical behaviors, we see BBM adopting a more cautious credit strategy as the bank resume to loan growth, than those of similar rates banks.

Factor 2: Risk Positioning

Trend: Neutral

BBM's E score on risk positioning is hurt by the influence of executive management and main shareholders at the board, which limits its corporate governance assessment. About 30% of the board of directors is composed by independent members. 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 familiar, 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 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 (69% 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 2% of equity at present, a decision made to shield the bank's future earnings stream, but still taking advantage of arbitrage opportunities in times of heightened volatility..

Factor 3: Regulatory Environment

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

Factor 4: Operating Environment

Trend: Neutral

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

Since 2009, profitability has suffered as the bank reduced the credit portfolio in face of higher risk aversion. Reduced credit income and a hike credit costs exhausted pre-provisions profits. As the bank walked through the negative cycle, cash liquidity was preserved in light of a difficult funding dynamics which required a prudent liquidity management, also a drain to performance.

On the other hand, the asset management activities were reinforced as management foreseen a potential business in times of lowered interest rates, taking advantage of its expertise in proprietary trading activities and strong brand name in treasury. The fast growth of the assets under management has been providing an important revenue component to the consolidated income stream, largely based on fee services coming from its subsidiary of BBM Administração de Recursos DTVM. Fee income from asset management activities has grown over the last three years, accounting roughly for 80% of operating revenues in 1H10.

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.

The bank's cash position is high and comfortable to meet the bank's obligations in the short-term.

Factor 7: Capital Adequacy

Trend: Neutral

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. As of June 2010, the bank has posted a 20.7% BIS ratio.

Factor 8: Efficiency

Trend: Neutral

Further improvement in efficiency cost is critical as the bank resizes its franchise to a cautious approach on lending growth The bank has consistently reduced total administrative expenses since October 2008, reshaping to the new strategic profile. Cost to income ratio came down from peak of 72.7% in 2008 to 64.6% in June 2010.

Factor 9: Asset Quality

Trend: Weakening

Despite the recent deterioration in asset quality indicators, BBM has superior asset quality that 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 has eroded as the economic deceleration unfolded at the end of 2008 and the bank decided to reduce the loan portfolio. The weakening trend I Asset Quality factor is explained the 3-year average that could still deteriorate as 2010 financial metrics is updated. The level of delinquency reported by BBM since the end of 2008 was quite distant from the bank's historically low NPLs ratio, a result from the balance sheet deceleration factor. This should result in a further lower score for the coming year, down from B+ score as of 3-year average 2007 to 2009.

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 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%)						**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**	**Neutral**
Economic Stability					**x**		
Integrity and Corruption				**x**			
Legal System			**x**				
Financial Factors (30%)						**C+**	
Factor: Profitability						**C**	**Weakening**
PPI / Average RWA - Basel II			1.85%				
Net Income / Average RWA - Basel II			1.68%				
Factor: Liquidity						**D**	**Neutral**
(Mkt funds-Liquid Assets) / Total Assets					23.00%		
Liquidity Management			x				
Factor: Capital Adequacy						**A**	**Neutral**
Tier 1 Ratio - Basel II	14.53%						
Tangible Common Equity / RWA - Basel II	14.18%						
Factor: Efficiency						**B**	**Neutral**
Cost / Income Ratio		50.38%					
Factor: Asset Quality						**B+**	**Weakening**
Problem Loans / Gross Loans		1.87%					
Problem Loans / (Equity + LLR)	3.84%						
Lowest Combined Score (9%)						**D**	

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

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current opinions of the relative future credit risk of entities, credit commitments, or debt or debt-like securities. In such a case, “MIS” in the foregoing statements shall be deemed to be replaced with “MJKK”. MJKK is a wholly-owned credit rating agency subsidiary of Moody's Group Japan G.K., which is wholly owned by Moody’s Overseas Holdings Inc., a wholly-owned subsidiary of MCO.

This credit rating is an opinion as to the creditworthiness or a debt obligation of the issuer, not on the equity securities of the issuer or any form of security that is available to retail investors. It would be dangerous for retail investors to make any investment decision based on this credit rating. If in doubt you should contact your financial or other professional adviser.