MOODY'S
INVESTORS SERVICE

Credit Opinion: Banco BBM S.A.

Global Credit Research - 29 Feb 2016

Rio de Janeiro, Brazil

Ratings

Category	Moody's Rating
Outlook	Negative
Bank Deposits -Fgn Curr	Ba3/NP
Bank Deposits -Dom Curr	Ba2/NP
NSR Bank Deposits	Aa2.br/BR-1
Baseline Credit Assessment	ba2
Adjusted Baseline Credit Assessment	ba2
Counterparty Risk Assessment	Ba1(cr)/NP(cr)
Senior Unsecured -Dom Curr	Ba2
NSR Senior Unsecured	Aa2.br

Contacts

Analyst	Phone
Alcir Freitas/Sao Paulo	55.11.3043.7300
Ceres Lisboa/Sao Paulo	
M. Celina Vansetti/New York City	1.212.553.1653
Farooq Khan/Sao Paulo	55.11.3043.7300

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 (%)	**46.3**	**28.5**	**13.2**	**50.4**	**44.5**	[5]**36.6**
Liquid Banking Assets / Tangible Banking Assets (%)	**57.1**	**47.6**	**43.8**	**43.9**	**39.5**	[5]**46.4**
Gross loans / Due to customers (%)	**114.0**	**110.2**	**95.5**	**200.6**	**149.1**	[5]**133.9**

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 25 February 2016, Moody's downgraded Banco BBM S.A.'s (BBM) baseline credit assessments (BCAs) and bank deposit and debt ratings that were either constrained by Brazil's sovereign bond rating or were capped by the country ceilings. This rating action followed the downgrade of Brazil's bond rating and the changes in the country ceilings on 24 February 2016.

At the same time, BBM's BCA of ba2 reflects 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'. 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 local currency deposit and senior unsecured ratings of Ba2 derive from its ba2 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

Sovereign bond rating, as its ratings are positioned at the same level of the sovereign rating and country ceilings

Rating Outlook

All ratings assigned to BBM have a negative outlook in line with the sovereign bond rating.

What Could Change the Rating - Up

BB's deposit and senior debt ratings are unlikely to be upgraded because they have a negative outlook and are already positioned at the same level as the sovereign rating, which also has a negative outlook.

What Could Change the Rating - Down

The negative outlooks on the long-term debt and deposit ratings of BBM reflect the negative outlook on the sovereign. These ratings, which remain constrained by the sovereign and/or the country ceilings, will likely be downgraded further if Brazil's sovereign rating and its country ceilings are lowered again.

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 baa2, 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

On 25 February 2016, Brazil's macro profile was changed to Moderate, from Moderate+, following the downgrade of the Brazilian government bond rating to Ba2 negative from Baa3 on review for downgrade, which in turn has caused a downward pressure to the banking country risk (to Moderate+ from Strong-). While the Moderate macro profile continues to reflect the country's large and diversified economy, the combination of ongoing economic recession, persistently high inflation and difficult political scenario increases challenges to Brazilian banks' operating environment. The pace of growth have reduced significantly in 2015 and the tightening monetary policy allowed banks to raise lending rates in 2015, which relieved part of the earnings pressure arising from asset risks. Public banks hold a 56% share of Brazil's loan market, which is reflected in the adjustment for industry structure. Capital and funding will remain adequate, and exposure to international capital markets will remain low. External vulnerability is also limited by Brazil's sizeable international reserves, which reduce the country's sensitivity to external shocks, such as sudden stops in capital flows. The change in the Macro Profile to Moderate led to changes in the macro adjusted scores of the bank's scorecard as per the bank methodology.

Notching Considerations

GOVERNMENT SUPPORT

The ratings of Banco BBM do not benefit from any support uplift given 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 Ba1(cr) for long-term and Not Prime(cr) for short-term. This CR Assessment is in line with the bank's adjusted BCA of ba2 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.

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 Risk						
Problem Loans / Gross Loans	2.1%	baa2	←→	baa3	Sector concentration	
Capital						
TCE / RWA	18.6%	a2	←→	baa2	Expected trend	
Profitability						
Net Income / Tangible Assets	1.1%	baa3	←→	ba1	Expected trend	
Combined Solvency Score		baa1		baa3		
Liquidity						

Funding Structure						
Market Funds / Tangible Banking Assets	28.5%	ba2	←→	b3	Market funding quality	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	47.6%	baa1	←→	baa2	Quality of liquid assets	
Combined Liquidity Score		baa3		ba3		

Financial Profile	**ba1**

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

Soverign or Affiliate constraint:	Baa3
Scorecard Calculated BCA range	**ba1-ba3**
Assigned BCA	**ba2**
Affiliate Support notching	0
Adjusted BCA	**ba2**

Instrument class	Assigned LGF Notching	Additional Notching	Preliminary Rating Assessment	Government Support	Local Currency Rating	Foreign Currency Rating
Counterparty Risk Assessment	1	0	ba1 (cr)	0	Ba1 (cr)	--
Deposits	0	0	ba2	0	Ba2	Ba3
Senior unsecured bank debt	0	0	ba2	0	Ba2	Ba2

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

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