MOODY'S
INVESTORS SERVICE

Credit Opinion: Banco Industrial do Brasil S.A.

Global Credit Research - 04 Nov 2014

Sao Paulo, Brazil

Ratings

Category	Moody's Rating
Outlook	Stable
Bank Deposits	Ba2/NP
NSR Bank Deposits -Dom Curr	A1.br/BR-1
Bank Financial Strength	D
Baseline Credit Assessment	ba2
Adjusted Baseline Credit Assessment	ba2

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Key Indicators

Banco Industrial do Brasil S.A. (Consolidated Financials)[1]

	[2]**6-14**	[2]**12-13**	[3]**12-12**	[3]**12-11**	[3]**12-10**	**Avg.**
Total Assets (BRL billion)	**2.4**	**2.2**	**2.6**	**2.4**	**2.2**	[4]**1.8**
Total Assets (USD billion)	**1.1**	**0.9**	**1.3**	**1.3**	**1.3**	[4]**-5.2**
Tangible Common Equity (BRL billion)	**0.5**	**0.5**	**0.4**	**0.4**	**0.4**	[4]**3.6**
Tangible Common Equity (USD billion)	**0.2**	**0.2**	**0.2**	**0.2**	**0.2**	[4]**-3.5**
Net Interest Margin (%)	**5.7**	**5.8**	**4.1**	**4.2**	**5.3**	[5]**5.0**
PPI / Average RWA (%)	**3.1**	**3.2**	**2.5**	**2.1**	**3.1**	[6]**3.2**
Net Income / Average RWA (%)	**1.8**	**1.2**	**1.6**	**1.1**	**1.9**	[6]**1.5**
(Market Funds - Liquid Assets) / Total Assets (%)	**14.4**	**26.6**	**21.4**	**10.5**	**6.5**	[5]**15.9**
Core Deposits / Average Gross Loans (%)	**52.8**	**43.4**	**50.1**	**67.0**	**80.8**	[5]**58.8**
Tier 1 Ratio (%)	**18.0**	**16.5**	**15.5**	**15.6**	**17.0**	[6]**17.2**
Tangible Common Equity / RWA (%)	**17.9**	**16.5**	**15.4**	**15.5**	**16.9**	[6]**17.2**
Cost / Income Ratio (%)	**48.3**	**47.2**	**52.5**	**56.6**	**48.7**	[5]**50.7**
Problem Loans / Gross Loans (%)	**1.0**	**2.9**	**0.8**	**1.5**	**0.8**	[5]**1.4**
Problem Loans / (Equity + Loan Loss Reserves) (%)	**3.0**	**9.3**	**2.9**	**5.1**	**2.4**	[5]**4.5**

Source: Moody's

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel III - 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 - transitional phase-in & LOCAL GAAP reporting periods have been used for average calculation

Opinion

SUMMARY RATING RATIONALE

Moody's assigns a standalone baseline credit assessment (BCA) of ba2 to Banco Industrial do Brasil S.A. (BIB), which is equivalent to a bank financial strength of D. BIB's standalone BCA is supported by the bank's well-defined focus on lending to small- and mid-sized companies (SMEs) and by its robust capital base. The bank's financial strength also benefits from BIB's disciplined operation and management's conservative lending policy, which translates into good asset quality. At the same time, the rating reflects the modest growth rate of the bank's loan portfolio, a consequence of the current challenging condition in the SME credit market, and the bank's wholesale funding structure.

In Moody's view, BIB would receive no support from the government should a systemic crisis occur, given the bank's small participation in the retail deposit market in Brazil. Because the absence of systemic support results in no lift in notches from the bank's BCA, Moody's assigns a global local currency (GLC) deposit rating of Ba2 to BIB.

Rating Drivers

- Short-term loan portfolio, with operations backed by guarantees

- Improvement in asset quality, as delinquency ratio drop below its historical average

- Historically low leverage, when compared with local peers'

- Maintained profitability despite lower loan related earnings

- Funding dependence on wholesale deposits

- Robust capitalization levels

Rating Outlook

All ratings have a stable outlook.

What Could Change the Rating - Up

Positive pressure on BIB's ratings could derive from more robust, predictable, and diversified revenue generation and a strengthened franchise as a middle-market lender. Increased diversification in the bank's funding structure could also be positive to ratings, as could maintaining a tight gap in the term structure of assets and liabilities. In addition, ratings could also benefit from further improvement in corporate governance practices.

What Could Change the Rating - Down

Negative pressure on BIB's ratings could result from margin compression and a decline in revenues due to harsher competition in the middle-market lending segment. Ratings may also be pushed down as a result of a potential increase in funding costs, which could eventually hit profitability ratios. A consistent decline in profitability could compromise the bank's capacity to replenish capital through earnings, which is also negative for ratings on the long run.

DETAILED RATING CONSIDERATIONS

DELINQUENCY LEVELS BELOW HISTORIAL AVERAGE, DESPITE CHALLENGING MARKET CONDITIONS

The total volume of loans on BIB's balance sheet increased 8.1% during the 12-month period ending in June 2014 owing to the slow economic activity. The increase in delinquency in the segment of small- and medium-sized enterprises in 2013 and in the first half of 2014 motivated BIB's management to become more conservative towards loan origination. This contrasts with operational growth in 2011 and 2012, when the bank's loan book increased above 30% (year-over-year) in some quarters.

In June 2014, the quality of the bank's loan book improved with non-performing loans to gross loans falling to 1.0%, against 3.3% one year before and below the five-year average of 1.6%. At the same time, loan loss reserves to problem loans returned to 132%, after hitting as low as 80% in June 2013.

The enhancement of the asset quality amid a poor environment for SME lending and the weak economic growth in Brazil reflects the disciplined credit underwriting practices adopted by the management. Nonetheless, borrower concentration increased modestly in the period as a result of management's higher selectivity of clients, with top 20 borrowers representing 21% of the portfolio as of June 2014, up from 19% in June 2013. The increase in concentration is a trend that should be monitored closely going forward.

PROFITABILITY RATIOS ARE RELATIVELY STABLE, REFLECTING REDUCTION IN CREDIT COSTS

In the first half of 2014, the bank reported an increase of 38.1% in net income to BRL23.7 million, from BRL17.2 million in June 2013. The improvement in the bank's bottom-line result was driven by significant decrease in provisions for loan losses to BRL8.1 million, roughly one third of the amount expended in the first half of 2013. Moreover, revenues from loan operations increased by 12.6%, partially boosted by BRL8.2 million in recoveries from credit losses.

Most of the bank's revenues are originated from lending operations, which accounted for approximately 63.6% of BIB's earnings in the first half of 2014. Loans to small- and mid-sized companies comprised the majority of the bank's loan book (85% of total), the remainder being payroll-deducted loans to individuals. Revenues from securities also make an important contribution, accounting for roughly 23.4% of total earnings; they are mostly driven by investment in government securities. The composition of BIB's earning mix has not varied significantly over time, which shows consistency in management's strategy for the bank as well as conservatism related to growth.

As of June 2014, BIB reported net interest margins of 5.7%, compared with 5.9% in June 2013, reflecting a relative stability both in interest income and interest expenses. The bank's ratio of net income to average risk-weighted assets (RWA) increased to 1.8% in the first half of 2014, from 1.3% in June 2013, due to higher bottom-line results combined with a modest increase in assets.

The bank has reported adequate efficiency ratios over the last few years owing to its lean operating structure, and posted an efficiency ratio of 48.3% in June 2014, against 45.8% in June 2013.

FUNDING REMAINS CONCENTRATED, BUT LIQUIDITY IS COMFORTABLE

BIB's funding structure relies mostly on wholesale-based deposits, in the form of time deposits with financial institutions and asset management companies, and shows high concentration in terms of depositors. Therefore, BIB's funding base is quite similar to those of other banks focused on loan operations with small- and mid-sized companies. Nevertheless, BIB's funding base has shown some qualitative improvements over the last four to five years. More specifically, there has been a change in the deposit mix, with an increase in time deposits with companies and financial institutions, accounting for 46.4% of total funding in June 2014.

BIB reported an annual increase of 2.8%, to BRL1.8 billion, in its funding base in June 2014. This was driven primarily by a 13% year-over-year growth in time deposits and an expansion of 64% in interbank deposits, while the volume of debt issued in the local market (letras financeiras) and asset backed instruments (LCAs and LCIs) remained stable. After March 2011, in few occasions, BIB made use of DPGEs as an additional source of funding, which, as of June 2014, accounted for 9.3% of BIB's deposits and 5.1% of total funding.

The bank's participation in international markets includes trade finance facilities with multilateral banks, such as $30 million and $25 million credit lines from IFC and IDB. In December 2010, the bank received a $60 million A/B loan facility from IFC with tenor of up to 5 years, withdrawing $15 million in A loan with the IFC, and a syndicated B loan of $19 million plus Euro 7.7 million. BIB also has a 10-year $15 million subordinated debt with the DEG due January 2017, and an 8-year $15 million senior debt due October 2021 with the same institution.

CAPITAL RATIOS REMAIN ADEQUATE

Banco Industrial do Brasil continues to report good capital position, with a total capital ratio of 18.5% in June 2014, down from 19.9%, in June 2013. The ratio remains well above regulatory minimum of 11% and the bank's leverage of 3.3 continues to be inferior to those reported by other SME lenders in Brazil. The adequate capital cushion presented by BIB reflects the conservative approach of its shareholder towards the expansion of the bank's operation, but also benefits from the moderation in the bank´s lending activities. At this juncture, capital does not represent a credit challenge for the bank.

MODEST FRANCHISE VALUE, WITH SMALL MARKET SHARE

BIB has a modest franchise in the segment of commercial lending to small- and mid-sized companies, with a participation of less than 0.05% in the Brazilian market for loans. Nevertheless, the bank enjoys an adequate track record in the SME market, which has enabled management to develop an expertise in analyzing client risk profiles and becoming familiar with both the organization and the structure of local companies. As a result, BIB has built a portfolio fully backed by guarantees with a good liquidity level. BIB is controlled by a single shareholder (Mr. Carlos

Mansur); however, it does boast a professionalized management.

In 2005, BIB started to operate in the payroll-deductible lending business. However, the fierce competition in the segment, along with the small margins and high costs imposed by third-party intermediates responsible for loan origination, led management to gradually decrease BIB's participation in that segment and to increase its focus on operations oriented to the middle-market segment. In June 2014, loan operations were divided as 84% SME lending and 16% consumer finance products, in the form of payroll loans.

BIB's wholesale operations are concentrated in the southeastern region of Brazil. The bank has seven branches that provide support to its commercial-lending activities.

Global Local Currency Deposit Rating (Joint Default Analysis)

Moody's GLC deposit rating of Ba2 for BIB does not receive any lift from the bank's BCA of ba2 because Moody's believes the Brazilian government would probably not extend any support to the bank should a systemic crisis occur. The reason for this is the insignificant size of BIB's participation in Brazil's retail deposit market.

Moody's also does not consider that support from the main shareholder, Mr. Mansur, would be forthcoming. Nevertheless, Mr. Mansur has already demonstrated his prudent attitude towards BIB's solvency by reinvesting dividends in the bank and by maintaining the capital ratio at a high level. According to management, proceeds from the sale of Mr. Mansur's companies would likely be directed to the bank. Furthermore, Mr. Mansur also maintains resources in the bank in the form of deposit certificates.

National Scale Rating

BIB has Brazilian National Scale Ratings of A1.br and BR-1. The ratings are supported by BIB's creditworthiness in its niche market of commercial lending to SMEs.

Foreign Currency Deposit Rating

Moody's assigns a Ba2 foreign currency deposit rating for BIB. The rating is three notches below the country's foreign currency deposit ceiling of Baa2.

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 Industrial do Brasil 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+**	**Neutral**
PPI % Average RWA (Basel III - transitional phase-in)		3.20%					
Net Income % Average RWA (Basel III - transitional phase-in)			1.22%				
Factor: Liquidity						**D**	**Neutral**
(Market Funds - Liquid Assets) % Total Assets				19.49%			
Liquidity Management				x			
Factor: Capital Adequacy						**A**	**Neutral**
Tier 1 Ratio (%) (Basel III - transitional phase-in)	16.50%						
Tangible Common Equity % RWA (Basel III - transitional phase-in)	16.48%						
Factor: Efficiency						**B**	**Neutral**
Cost / Income Ratio		52.09%					
Factor: Asset Quality						**B+**	**Neutral**
Problem Loans % Gross Loans		1.72%					
Problem Loans % (Equity + LLR)	5.76%						
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						**ba2**	

[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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