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INVESTORS SERVICE

**Credit Opinion: Banco Industrial do Brasil S.A.**

Global Credit Research - 20 Mar 2015

*Sao Paulo, Brazil*

## Ratings

| Category | Moody's Rating |
|---|---|
| Outlook | Stable |
| Bank Deposits | Ba2/NP |
| NSR Bank Deposits -Dom Curr | A1.br/BR-1 |
| 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]12-14 | [2]12-13 | [3]12-12 | [3]12-11 | [3]12-10 | Avg. |
|---|---|---|---|---|---|---|
| Total Assets (BRL billion) | 2.5 | 2.2 | 2.6 | 2.4 | 2.2 | [4]3.5 |
| Total Assets (USD billion) | 0.9 | 0.9 | 1.3 | 1.3 | 1.3 | [4]-8.0 |
| Tangible Common Equity (BRL billion) | 0.5 | 0.5 | 0.4 | 0.4 | 0.4 | [4]3.8 |
| Tangible Common Equity (USD billion) | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | [4]-7.7 |
| Problem Loans / Gross Loans (%) | 1.1 | 2.9 | 0.8 | 1.5 | 0.8 | [5]1.4 |
| Tangible Common Equity / Risk Weighted Assets (%) | 16.0 | 16.8 | 15.4 | 15.5 | 16.9 | [6]16.4 |
| Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%) | 3.8 | 9.3 | 2.9 | 5.1 | 2.4 | [5]4.7 |
| Net Interest Margin (%) | 4.7 | 5.4 | 3.9 | 4.1 | 5.3 | [5]4.7 |
| PPI / Average RWA (%) | 2.6 | 3.3 | 2.5 | 2.1 | 3.1 | [6]2.9 |
| Net Income / Tangible Assets (%) | 1.6 | 1.5 | 1.7 | 1.2 | 1.8 | [5]1.6 |
| Cost / Income Ratio (%) | 53.6 | 47.2 | 52.5 | 56.6 | 48.7 | [5]51.7 |
| Market Funds / Tangible Banking Assets (%) | 33.6 | 42.0 | 49.3 | 42.6 | 38.6 | [5]41.2 |
| Liquid Banking Assets / Tangible Banking Assets (%) | 29.4 | 18.6 | 29.1 | 33.3 | 33.3 | [5]28.7 |
| Gross Loans / Total Deposits (%) | 135.1 | 210.9 | 157.2 | 127.7 | 106.2 | [5]147.4 |

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

Banco Industrial do Brasil S.A.'s (BIB) baseline credit assessment (BCA) of ba2 reflects the bank's robust capital base and good asset quality, which results from BIB's disciplined operation and management's conservative lending policy. At the same time, the BCA reflects the modest growth rate of the bank's loan portfolio, a consequence of the current challenging condition in the small- and mid-sized companies (SMEs) credit market, and the bank's wholesale funding structure.

BIB'S RATING IS SUPPORTED BY BRAZIL'S MODERATE+ MACRO PROFILE

As a bank with operations totally comprised within the domestic territory, BIB is solely influenced by Brazil's Macro Profile of Moderate+. Brazil's macro profile reflects its large and diversified economy, its high and rising indebtedness and the dominance of public sector banks. Notwithstanding the size of the economy, growth has fallen below potential for more than three consecutive years, weighed down by increased economic uncertainty, a slowdown in consumption and weak investment. In addition, persistently high inflation has raised questions regarding the credibility of the central bank's inflation targeting regime. Moreover, the banking system has become bifurcated, with public banks controlling a 54% share of the system's credit market as a result of years of rapid loan growth driven by government stimulus measures, while private banks remained more conservative. However, loan growth has moderated over the past year, which has alleviated pressure on banks' capital and funding following a period of robust credit market expansion. Brazil`s sizeable international reserve position, limited reliance on foreign borrowings and sound banking system support its low susceptibility to event risk.

**Rating Drivers**

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

- Historically low leverage, when compared with local peers'

- Adequate profitability

- Funding dependence on wholesale deposits

- Robust capitalization levels

**Rating Outlook**

The outlook on all ratings is stable.

**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**

The financial data in the following sections are sourced from BIB's financial statements unless otherwise stated.

DELINQUENCY LEVELS BELOW HISTORIAL AVERAGE, DESPITE CHALLENGING MARKET CONDITIONS

BIB has a score of ba2 for asset risk, which is underpinned by the low concentration of loan operations reported by the bank. The 20 largest borrowers represented 68.1% of tangible common equity (TCE) in the 3Q14 and 79.3% in 2013. Moreover, exposure to individual economic segments is also adequate, with loans to clients in the services segment accounting for 109% of TCE. The ba2 score also incorporates the large participation of revenues from trading-related activities in the bank's bottom-line result, which denotes market risk. In June 2014, revenues from securities accounted for 15% of total revenues, and foreign exchange operations answered for 25% of all revenues.

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. 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.

CAPITAL RATIOS REMAIN ADEQUATE

We assign a score of baa1 for BIB's capital, which reflects the bank's good capital position, with a TCE to risk-weighted assets (RWA) ratio of 16% in June 2014. At the same date, BIB's total capital ratio stood at 18.5%, down from 19.9%, in June 2013.

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.

PROFITABILITY RATIOS ARE RELATIVELY STABLE, REFLECTING REDUCTION IN CREDIT COSTS

Our assessment of ba3 for BIB's profitability incorporates the low volatility in earnings reported by the bank in recent years. BIB has a track record of modest, but steady profitability indicators. 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.

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.

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, which was driven by significant decrease in provisions for loan losses and by increase in revenues from loan operations. 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.

FUNDING REMAINS CONCENTRATED

The b3 score for BIB's funding structure reflects the bank's reliance on wholesale-based deposits and the high concentration of depositors in its funding base, as the 20 largest depositors account for roughly 49% of the bank's deposits. The b3 score also incorporates the concentration of BIB's funding base towards more confidence sensitive investors, such as financial institutions and asset managers, representing 52% and 30%, respectively, of bank's total funding in 3Q14.

Nevertheless, BIB's funding base has shown qualitative improvement 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.

LIQUIDITY IS COMFORTABLE

We assess BIB's liquid resources as baa3, which reflects the bank's adequate level of available cash relative to deposits and to equity - 44% and 145%, respectively, in year-end 2014. The weak economic environment, low credit appetite in the SME segment, and increased conservatism in originating loans caused BIB's loan operations to decline allowed the bank to sustain conservative pool of available cash in the past two years.

**Notching Considerations**

In the absence of a bail-in resolution regime framework in Brazil, the ratings of subordinated debts, bank hybrids, and contingent capital securities follow the "Additional Notching Guidelines", as per the "Global Banks" Methodology. In these cases, the approach takes into account other features specific to debt classes, resulting in additional notching from the adjusted baseline credit assessment (BCA) of the issuer.

GOVERNMENT SUPPORT

We believe there is a low likelihood of government support for BIB's rated deposits, which reflects the bank's small share of deposits and assets in Brazil's banking system.

ABOUT MOODY'S BANK SCORECARD

Our Scorecard is designed to capture, express and explain in summary form our Rating Committee's judgment. When read in conjunction with our research, a fulsome presentation of our judgment is expressed. As a result, the output of our Scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The Scorecard 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.**

| **Macro Factors** | |
|---|---|
| **Weighted Macro Profile** | **Moderate +** |

| **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* | 1.6% | a3 | ↓ | ba2 | Single name concentration | Sector concentration |
| **Capital** | | | | | | |
| *TCE / RWA* | 16.0% | a2 | ←→ | baa1 | Nominal leverage | |
| **Profitability** | | | | | | |
| *Net Income / Tangible Assets* | 1.6% | a3 | ↓ | ba3 | Earnings quality | |
| **Combined Solvency Score** | | a3 | | ba1 | | |
| **Liquidity** | | | | | | |
| **Funding Structure** | | | | | | |
| *Market Funds / Tangible Banking Assets* | 33.6% | ba3 | ←→ | b3 | Deposit quality | |
| **Liquid Resources** | | | | | | |
| *Liquid Banking Assets / Tangible Banking Assets* | 29.4% | baa2 | ←→ | baa3 | Quality of liquid assets | |
| **Combined Liquidity Score** | | ba1 | | ba3 | | |

| **Financial Profile** | **ba2** |
|---|---|

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

| | |
|---|---|
| **Adjustments** | |
| Sovereign or Affiliate constraint | Baa2 |
| Scorecard Calculated BCA range | **ba1 - ba3** |
| **Assigned BCA** | **ba2** |
| Affiliate Support notching | **0** |
| **Adjusted BCA** | **ba2** |

| Instrument Class | Loss Given Failure notching | Additional notching | Preliminary Rating Assessment | Government Support notching | Local Currency rating | Foreign Currency rating |
|---|---|---|---|---|---|---|
| Deposits | 0 | 0 | ba2 | 0 | Ba2 | Ba2 |

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