MOODY'S
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Credit Opinion: Banco Industrial do Brasil S.A.

Global Credit Research - 01 Mar 2016

Sao Paulo, Brazil

Ratings

Category	Moody's Rating
Outlook	Negative
Bank Deposits -Fgn Curr	Ba3/NP
Bank Deposits -Dom Curr	Ba2/NP
NSR Bank Deposits	A1.br/BR-1
Baseline Credit Assessment	ba2
Adjusted Baseline Credit Assessment	ba2
Counterparty Risk Assessment	Ba1(cr)/NP(cr)

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Key Indicators

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

	[2]12-15	[2]12-14	[2]12-13	[3]12-12	[3]12-11	Avg.
Total Assets (BRL billion)	2.6	2.5	2.2	2.6	2.4	[4]1.2
Total Assets (USD billion)	0.6	0.9	0.9	1.3	1.3	[4]-16.2
Tangible Common Equity (BRL billion)	0.5	0.5	0.5	0.4	0.4	[4]4.0
Tangible Common Equity (USD billion)	0.1	0.2	0.2	0.2	0.2	[4]-13.9
Problem Loans / Gross Loans (%)	1.0	1.1	2.9	0.8	1.5	[5]1.5
Tangible Common Equity / Risk Weighted Assets (%)	15.5	16.0	16.8	15.4	15.5	[6]16.1
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	3.2	3.8	9.3	2.9	5.1	[5]4.9
Net Interest Margin (%)	4.9	5.0	5.8	4.1	4.2	[5]4.8
PPI / Average RWA (%)	2.8	2.6	3.3	2.5	2.1	[6]2.9
Net Income / Tangible Assets (%)	1.8	1.6	1.5	1.7	1.2	[5]1.6
Cost / Income Ratio (%)	51.6	53.6	47.2	52.5	56.6	[5]52.3
Market Funds / Tangible Banking Assets (%)	33.5	33.6	42.0	49.3	42.6	[5]40.2
Liquid Banking Assets / Tangible Banking Assets (%)	28.1	29.4	18.6	29.1	33.3	[5]27.7
Gross loans / Due to customers (%)	157.6	149.7	245.9	216.1	166.3	[5]187.1

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 the foreign currency deposit rating assigned to Banco Industrial do Brasil S.A.'s (BIB) to Ba3, from Ba2, and changed to negative the outlook on the rating. Moody's also changed to negative the outlook on BIB's global local currency deposit rating of Ba2. This rating action followed the downgrade of Brazil's bond rating to Ba2, with negative outlook, on 24 February 2016.

The baseline credit assessment (BCA) of ba2 assigned to BIB reflects the bank's adequate capital base and good asset quality, which results from BIB's disciplined operation and consistent focus in terms of clientele and market niche. 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.

Rating Drivers

- Adequate asset quality, although delinquency ratio has increased slightly due to weak economic scenario

- Historically low leverage, when compared with local peers'

- Adequate profitability

- Funding dependence on wholesale deposits

- Adequate capitalization levels

Rating Outlook

The outlook on all ratings is negative, in line with the negative outlook on Brazil's bond rating.

What Could Change the Rating - Up

At this point, there is low probability of a rating upgrade given the negative outlook on Brazil's bond rating of Ba2, which also constrains the bank's standalone BCA at ba2. Moreover, BIB's ratings are pressured by the weak economic environment in Brazil.

What Could Change the Rating - Down

Negative pressure on BIB's BCA could result from asset quality deterioration, which is in line with challenging market conditions within corporate lending, particularly to SMEs, derived from weak market conditions. The standalone BCA may also be pushed down as a result of a potential decline in profitability associated with higher provisions and of an increase in funding costs. A consistent decline in profitability could compromise the bank's capacity to replenish capital through earnings, which is also negative for the bank's BCA on the long run. Additional downgrade of Brazil's bond ratings and foreign currency deposit ceilings can also move the bank's BCA and ratings down.

DETAILED RATING CONSIDERATIONS

HIGHER DELINQUENCY IN LINE WITH CHALLENGING MARKET CONDITIONS

In 3Q15, BIB reported an increase of 49.8% in non-performing loans (NPLs) to BRL27.6 million compared to 3Q14, which reflected the ongoing deterioration of the credit market in view of the country's weak economy. The increase in NPLs caused BIB's delinquency ratio, measured as loans past due over 90 days to total loans, to rise to 1.6% from 1.31% in the same period, although the ratio remained below the 3.14% disclosed by the bank in 3Q13. BIB also reported an increase in restructured loans to BRL7.07 million, from BRL730 thousand in 3Q14, although they still accounted for only 0.7% of total loans.

Despite low business volume, BIB reported 14% annual growth in total loans in September 2015. The bank also showed an increase in borrower concentration within its loan book, with the 20 largest borrowers representing 109.5% of BIB's tangible common equity (TCE) in 3Q15, up from 68.1% in 3Q14. The ba2 score for asset risk assigned to BIB incorporates the bank's higher exposure to single name concentration and to non-performing loans in the first nine months of 2015. In order to mitigate these risks, BIB created additional loan loss reserves, which went up to 138.7% of NPLs from 105.6% in September 2014.

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 September 2015, revenues from securities accounted for 14.5% of total revenues, and foreign exchange operations answered for 22.6% of all revenues.

CAPITAL RATIOS REMAIN ADEQUATE

We assign a score of baa2 for BIB's capital, which reflects the bank's adequate capital position, with a Moody's ratio of TCE to risk-weighted assets (RWA) of 14.79% in September 2015. At the same date, BIB's regulatory capital ratio was 15.33%, showing a decline from 18.49% in September 2014 as a result of the expansion in loan operations reported by the bank.

Until 2014, BIB reported capital ratios that showed adequate cushion over regulatory minima mostly as a result of consistent and moderate expansion in operations, specifically relative to lending activities. However, part of that capital cushion was consumed by the 14% annual loan growth posted by the bank in 3Q15. For future quarters, we don't expect to see much of capital replenishment through retained earnings owed to negative pressure on profitability, both from the need for higher loan loss provisions and from low business volume.

PROFITABILITY RATIOS ARE RELATIVELY STABLE

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.

A relevant share of the bank's revenues are originated from lending operations, which accounted for approximately 42.7% of BIB's earnings in the third quarter of 2015. Loans to small- and mid-sized companies comprised the majority of the bank's loan book (88.4% of total), the remainder being payroll-deducted loans to individuals.

In September 2015, the bank reported net income of BRL32.8 million, slightly lower from BRL33.1 million in September 2014. The bottom line result benefited from higher revenues from loans, which went up 21% because of growth in loan volume and better spreads, and higher revenues from foreign exchange operations and derivatives. However, these improvements were offset by an increase of 149% in provisions for loan losses, to BRL30.3 million, and by an increase in expenses related to funding operations from abroad, as a result of fluctuations in foreign exchange rates. The bank's ratio of net income to risk-weighted assets (RWA) decreased to 1.01% in the third quarter of 2015, from 1.18% in September 2014, due to lower bottom-line results and larger loan book.

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 45% of the bank's deposits. The b3 score also incorporates the concentration of BIB's funding base towards more confidence sensitive investors, such as asset managers, which represented 27% of bank's total funding in 3Q15.

Nevertheless, BIB has also made efforts to improve the quality of its funding base by changing its deposit mix and growing the participation of less volatile investors, such as companies and financial institutions, which combined position of time deposits accounted for 37% of BIB's total funding in September 2015.

In September 2015, BIB reported a slight decline of 0.45% to BRL1.91 billion in its funding base compared to the previous year. Most of the reduction in funding instruments derived from time and interbank deposits - down 4.9% and 58%, respectively; while the volume of foreign borrowings for trade finance operations went up 29% and funding raised with multilateral institutions increased 61,8%. Although the volume of total funding remained virtually flat, the higher weigh of foreign instruments in the funding mix led to an increase in BIB's funding expenses, given the higher volatility of foreign exchange rate in the period.

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 - 56% and 115%, respectively, in 3Q15.

BIB'S RATING IS SUPPORTED BY THE MODERATE MACRO PROFILE ON BRAZIL

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 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 reduced significantly in 2015 and the tightening monetary policy allowed banks to raise lending rates, 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

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 Rating Methodology: Banks. 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.

COUNTERPARTY RISK ASSESSMENT

CR Assessments are opinions of how counterparty obligations are likely to be treated if a bank fails and are distinct from debt and deposit ratings in that they (1) consider only the risk of default rather than both the likelihood of default and the expected financial loss suffered in the event of default and (2) apply to counterparty obligations and contractual commitments rather than debt or deposit instruments. The CR assessment is an opinion of the counterparty risk related to a bank's covered bonds, contractual performance obligations (servicing), derivatives (e.g., swaps), letters of credit, guarantees and liquidity facilities.

BIB's CR Assessment is positioned at Ba1(cr) and Not Prime (cr), which is one-notch above the bank's Adjusted BCA of ba2, and, therefore, above the deposit rating of the bank, reflecting Moody's view that its probability of default is lower at the operating obligations than of deposits. The CR Assessment at BIB does not benefit from government support, as the government support is not incorporated in the bank's deposit ratings.

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**	**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	1.6%	baa1	↓	ba2	Single name concentration	Sector concentration
Capital						
TCE / RWA	14.8%	baa1	←→	baa2	Risk-weighted capitalisation	
Profitability						
Net Income / Tangible Assets	1.6%	baa1	←→	ba3	Earnings quality	
Combined Solvency Score		baa1		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%	baa3	←→	baa3	Quality of liquid assets	
Combined Liquidity Score		ba2		ba3		

Financial Profile	**ba2**

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

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

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