MOODY'S
INVESTORS SERVICE

Rating Action: Moody's downgrades Banco Industrial do Brasil's ratings, outlook stable

22 May 2020

New York, May 22, 2020 -- Moody's Investors Service, ("Moody's") has today downgraded Banco Industrial do Brasil S.A. (BIB)'s ratings, including the long-term local currency deposit ratings to Ba3, from Ba2, the long-term national scale deposit rating to A2.br from Aa3.br, as well as the long-term counterparty risk ratings to Ba2, from Ba1, in local and foreign currencies. Moody's also downgraded BIB's assessments, including the baseline credit assessment (BCA) to ba3, from ba2, and long-term counterparty risk assessments to Ba2(cr), from Ba1(cr).

The downgrade of BIB's ratings and assessments reflects Moody's view that the Brazilian economy will contract in 2020 as a result of the coronavirus outbreak, which will likely have a direct negative impact on BIB's and other Brazilian banks' asset quality and profitability. Moody's regards the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety.

The following ratings and assessments were downgraded:

- Long-term global local currency deposit rating to Ba3, from Ba2; stable outlook

- Long-term global local currency counterparty risk rating to Ba2, from Ba1

- Long-term global foreign currency counterparty risk rating to Ba2, from Ba1

- Long-term Brazilian national scale deposit rating to A2.br, from Aa3.br

- Long-term Brazilian national scale counterparty risk rating to Aa2.br, from Aaa.br

- Long-term counterparty risk assessment to Ba2(cr), from Ba1(cr)

- Baseline credit assessment to ba3, from ba2

- Adjusted baseline credit assessment to ba3, from ba2

The following ratings and assessments were affirmed:

- Short-term global local currency deposit rating of Not Prime

- Long-term global foreign currency deposit rating of Ba3, stable outlook

- Short-term global foreign currency deposit rating of Not Prime

- Short-term global local currency counterparty risk rating of Not Prime

- Short-term global foreign currency counterparty risk rating of Not Prime

- Short-term counterparty risk assessment of Not Prime(cr)

- Short-term Brazilian national scale deposit rating of BR-1

- Short-term Brazilian national scale counterparty risk rating of BR-1

- Outlook, Remains Stable

RATINGS RATIONALE

The downgrade of BIB's ratings and assessments reflects the bank's weakening asset quality following the rapid growth of its loan book beyond its traditional working capital lending expertise, and the consequent accumulation of renegotiated loans, which also weigh on BIB's profitability and liquidity. BIB's above-peers' capitalization and its adequate profitability support the bank's resilience against unexpected losses and are relative strengths compared to other rating factors.

BIB's loan portfolio increased a cumulative 29% over the past two years ending 2019, a level that was more than double the system's 12% growth in the period. Rapid loan growth could mask weakness in underwriting and results in a large portion of the loan portfolio being unseasoned. This loan growth has occurred at a time when the market, and particularly lending to small and medium size companies, has become more competitive. As a result, the bank's nonperforming loan (NPL) ratio rose to 1.8% of total loans in 2019, from 0.8% in 2018, reflecting the seasoning of new loans and some punctual and large problem exposures. Moody's notes that although BIB's NPL ratio has been historically below the system's average and aligned to other periods, the recent increase in the share of renegotiated loans combined with loan loss provisions below 100%, even according to local rules, and higher loan concentration amongst larger companies, as suggested by growing credit exposure to its largest borrowers relative to tangible common equity (TCE), expose its asset quality to volatility.

Moody's anticipates BIB's asset quality metrics to weaken because of the deteriorating economic activity and employment due the coronavirus pandemic outbreak, notwithstanding the authorities' supportive policy measures. The severity of the crisis will depend on the level of disruption caused by sustained pullback in local consumption and extended closure of business that hurt companies' financials, causing layoffs and weighting on market sentiment, and which is still uncertain at this point.

This challenging economic environment is creating strains for mid-sized banks, including BIB, which are more vulnerable to downturns given their less diversified loan book, revenue stream and funding sources. Lower business volumes combined with higher credit and funding costs will weight on BIB's profitability.

BIB's ratings have been further constrained by its reliance on confidence-sensitive market funding and modest level of liquid assets. About 50% of the bank's domestic funds are sourced from institutional investors, including asset management firms, and financial institutions, resulting in a highly concentrated and expensive funding profile, and which is exposed to shifts in market dynamics, particularly under the current unfavorable market conditions. The bank has trying to increase granularity of such deposits by accessing long-term retail deposits through digital platforms, although they are still incipient. We note, however, that BIB is in the position to benefit from temporary support measures introduced by the authorities to address banks' funding and liquidity needs, including the issuance of guaranteed deposits and guaranteed notes. Under such conditions, we expect BIB dependence on market funds to increase in the short term.

At the same time, Moody's acknowledges that the bank's capital base, measured as Moody's tangible common equity (TCE) relative to risk weighted assets (RWA) at 15% remains adequate to provide additional protection against loan losses. Albeit lower than the 16% level reported in 2018, we expect that a slowdown in loan origination over the next months and temporary regulatory measures, including the capping of dividends to a maximum statutory 25% and lowering of capital conservation buffer requirements, will preserve the bank's capital in the face of coronavirus outbreak' effects on asset quality and profitability.

Profitability, measured as net income to tangible assets, was 1.8% in December 2019, above the 1.56% average for the period 2014-18. BIB's bottom-line results increased 22% to BRL61 million from a year prior, reflecting higher income from loans and lower funding costs. As a result, the bank's net interest margin peaked at 6.2% in December 2019, from the 5.5% average reported for the past five years, already reflecting its strategy of expanding loans into higher yields operations. BIB's good results, however, were also supported by non-recurrent events including a one-off reversal of contingencies and one- off- deferred asset gains derived from the increase in social contribution taxes, which offset the effect of high provisions for credit losses in the period. To the extent new lending activity remains limited and credit costs high, further pressures on profitability will materialize.

Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1133569 . Today's rating action reflects the potential deterioration in BIB's credit quality and profitability in the context of uncertain credit conditions, including the breadth and severity of the coronavirus pandemic, which limit the prospects for positive developments.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

Upward pressures on BIB's ratings could result from improved asset risk and profitability metrics, which would support high capitalization. There could be negative pressure on BIB's ratings, stemming from material asset-quality deterioration and lower profitability as a result of higher provisions and an increase in funding costs. A consistent decline in profitability could hurt the bank's ability to replenish capital through earnings, which could be negative in the long run.

METHODOLOGY USED

The principal methodology used in these ratings was Banks Methodology published in November 2019 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1147865 . Alternatively, please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

BIB is headquartered in São Paulo, Brazil, with assets of BRL 3.5 Billion and shareholders' equity of BRL 540 million as of 31 December 2019.

Moody's National Scale Credit Ratings (NSRs) are intended as relative measures of creditworthiness among debt issues and issuers within a country, enabling market participants to better differentiate relative risks. NSRs differ from Moody's global scale credit ratings in that they are not globally comparable with the full universe of Moody's rated entities, but only with NSRs for other rated debt issues and issuers within the same country. NSRs are designated by a ".nn" country modifier signifying the relevant country, as in ".za" for South Africa. For further information on Moody's approach to national scale credit ratings, please refer to Moody's Credit rating Methodology published in May 2016 entitled "Mapping National Scale Ratings from Global Scale Ratings". While NSRs have no inherent absolute meaning in terms of default risk or expected loss, a historical probability of default consistent with a given NSR can be inferred from the GSR to which it maps back at that particular point in time. For information on the historical default rates associated with different global scale rating categories over different investment horizons, please see https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1216309 .

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found at: https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

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These ratings are solicited. Please refer to Moody's Policy for Designating and Assigning Unsolicited Credit Ratings available on its website www.moodys.com.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1133569 .

At least one ESG consideration was material to the credit rating action(s) announced and described above.

The Global Scale Credit Rating on this Credit Rating Announcement was issued by one of Moody's affiliates outside the EU and is endorsed by Moody's Deutschland GmbH, An der Welle 5, Frankfurt am Main 60322, Germany, in accordance with Art.4 paragraph 3 of the Regulation (EC) No 1060/2009 on Credit Rating Agencies. Further information on the EU endorsement status and on the Moody's office that issued the credit rating is available on www.moodys.com.

Please see www.moodys.com for any updates on changes to the lead rating analyst and to the Moody's legal entity that has issued the rating.

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Theresangela Araes
Vice President - Senior Analyst
Financial Institutions Group
Moody's America Latina Ltda.
Avenida Nacoes Unidas, 12.551
16th Floor, Room 1601
Sao Paulo, SP 04578-903
Brazil
JOURNALISTS: 0 800 891 2518
Client Service: 1 212 553 1653

M. Celina Vansetti-Hutchins
MD - Banking
Financial Institutions Group
JOURNALISTS: 1 212 553 0376
Client Service: 1 212 553 1653

Releasing Office:
Moody's Investors Service, Inc.
250 Greenwich Street
New York, NY 10007
U.S.A.
JOURNALISTS: 1 212 553 0376
Client Service: 1 212 553 1653