MOODY'S
INVESTORS SERVICE

CREDIT OPINION
7 June 2017

Update

Rate this Research

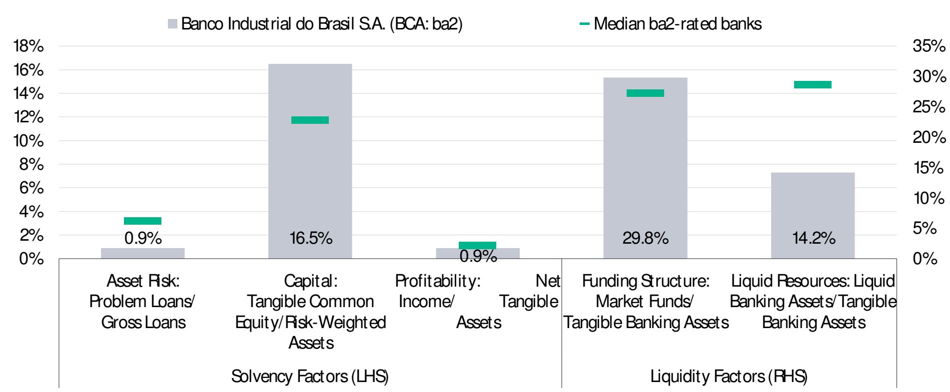
Banco Industrial do Brasil S.A.

Update Following Change in Rating Outlook to Negative

Summary Rating Rationale

The baseline credit assessment (BCA) of ba2 assigned to Banco Industrial do Brasil S.A. (BIB) reflects the bank's adequate capital base and loan delinquency metrics, which results from BIB's disciplined operation and consistent focus in terms of clientele and market niche. At the same time, the BCA reflects high borrower concentration relative to capital, which increases asset risk, and the high participation of wholesale instruments in the bank's funding structure.

Exhibit 1
Rating Scorecard - Key Financial Ratios



Source: Moody's Financial Metrics

Credit Strengths

» Profitability metrics remained adequate, but contracted slightly as a result of the weak economy.

» Adequate capitalization levels.

» Historically low leverage, when compared with local peers.

Credit Challenges

» High borrower concentration relative to capital is negative to asset risk. However, the problem loan ratio declined owing to strong loan growth and reduction in 90-day past due loans.

» Funding dependence on wholesale deposits.

RATINGS

Banco Industrial do Brasil S.A.

Domicile	Sao Paulo, Sao Paulo, Brazil
Long Term Debt	Not Assigned
Type	Not Assigned
Outlook	Not Assigned
Long Term Deposit	Ba3
Type	LT Bank Deposits - Fgn Curr
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Rating Outlook

On 31 May 2017, the outlook on BIB's global local currency deposit rating was changed to negative, from stable, following the change in the outlook on the sovereign bond rating announced on 26 May 2017. The BCA of ba2 and the global local currency deposit rating assigned to BIB are at the same level of the sovereign bond rating.

Factors that Could Lead to an Upgrade

At this juncture, there is no upward pressure on BIB's ratings since they are constrained by the sovereign bond rating of Ba2. Moreover, the challenging economic environment in Brazil is also limiting BIB's ratings.

Factors that Could Lead to a Downgrade

Negative pressure on BIB's ratings could result from asset quality deterioration, which is in line with challenging market conditions within corporate lending, particularly to small and medium-sized companies (SMEs), derived from weak market conditions. BIB's ratings 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 could be negative on the long run.

Key Indicators

Exhibit 2

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

	3-17[2]	12-16[2]	12-15[2]	12-14[2]	12-13[2]	CAGR/Avg.[3]
Total Assets (BRL billion)	2.8	2.9	2.6	2.5	2.2	8.0[4]
Total Assets (USD billion)	0.9	0.9	0.6	0.9	0.9	-1.5[4]
Tangible Common Equity (BRL billion)	0.5	0.5	0.5	0.5	0.5	3.5[4]
Tangible Common Equity (USD billion)	0.2	0.2	0.1	0.2	0.2	-5.5[4]
Problem Loans / Gross Loans (%)	0.9	0.6	1.0	1.1	2.9	1.3[5]
Tangible Common Equity / Risk Weighted Assets (%)	16.5	15.7	15.5	16.0	16.8	16.1[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	3.3	2.4	3.2	3.8	9.3	4.4[5]
Net Interest Margin (%)	5.8	5.2	4.9	5.0	5.8	5.3[5]
PPI / Average RWA (%)	2.5	2.0	2.8	2.6	3.3	2.6[6]
Net Income / Tangible Assets (%)	0.9	1.7	1.8	1.6	1.5	1.5[5]
Cost / Income Ratio (%)	56.3	60.8	51.6	53.6	47.2	53.9[5]
Market Funds / Tangible Banking Assets (%)	25.8	29.8	33.5	33.6	42.0	32.9[5]
Liquid Banking Assets / Tangible Banking Assets (%)	32.8	14.2	26.9	29.4	18.6	24.4[5]
Gross Loans / Due to Customers (%)	147.2	167.1	157.6	149.7	245.9	173.5[5]

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel III - fully-loaded or transitional phase-in; LOCAL GAAP [3] May include rounding differences due to scale of reported amounts [4] Compound Annual Growth Rate (%) based on time period presented for the latest accounting regime [5] Simple average of periods presented for the latest accounting regime. [6] Simple average of Basel III periods presented

Source: Moody's Financial Metrics

Detailed Rating Considerations

ASSET RISK BENEFITED FROM REDUCTION IN PROBLEM LOANS

Despite the weak economic environment, BIB has reported a decline in loan delinquency. The bank's ratio of problem loans, i.e. loans past due over 90 days, to total loans dropped to 0.91% in March 2017, from 2.81% one year before. The better asset quality metric reflected a 24.7% growth of BIB's loan portfolio and a 59.7% decline in the volume of problem loans, which resulted mostly from the bank's effort to renegotiate past due loans. In addition to that, the increase in the small volume of restructured loans to BRL980 thousand, 55.6% year-over-year, also contributed to reduce problem loans, although a 31% decline in loans written-off to BRL2.65

million counterbalanced that effect. Notwithstanding the drop in problem loans, we maintain our view of a challenging scenario for asset quality metrics in 2017 owing to the still fragile condition of the Brazilian economy.

The ba2 score for asset risk assigned to BIB incorporates the bank's high exposure to single name concentration. In March 2017, the 20 largest borrowers accounted for 101.4% of tangible common equity (TCE), down from 116.6% in March 2016, which still indicates high borrower concentration. The ba2 score also incorporates the large participation of revenues from investment in securities relative to total revenues, which denotes market risk. In March 2017, that ratio was at 19.7%, while foreign exchange operations accounted for 8.7% of total revenues.

Although still at an adequate level, the cushion of reserves for loan losses declined to BRL25.4 million from BRL32.1 million in March 2016, as BIB reported reversal of provisions for loan losses of BRL6.6 million in the first quarter of 2017. Despite that, the ratio of reserves to problem loans rose to 143.76%, from 73.21% in March 2016, owing to the decline in problem loans.

Conversely, the bank reported a climb in loans past due between 31 and 60 days. Although still not delinquent according to central bank's regulation, the delayed loans accounted for 1.9% of BIB's total portfolio, or 7.3% of TCE, in March 2017.

MODEST IMPROVEMENT IN CAPITAL

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 16.50% in March 2017, which was slightly lower than 16.67% in the previous year. The modest decline in the ratio resulted from the growth of RWA, reflecting the increase in the bank's loan book and holdings of government securities. Moody's has a more conservative view on capital adequacy and adjusts its TCE to RWA ratio by assigning a 100% weight for government securities and limiting to 10% the amount of deferred tax assets (DTA) that can contribute to TCE. In March 2017, BIB's regulatory capital ratio was 16.4%, lower than 17.25% in March 2016, but still above the regulatory minimum of 11%.

In recent years, BIB has 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. For future quarters, we expect to see a reduction in 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.

NEGATIVE PRESSURE ON PROFITABILITY OWING TO SLOW ECONOMIC ACTIVITY

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 66% of BIB's earnings in March 2017. Loans to small- and mid-sized companies comprised the majority of the bank's loan book (86.5% of total), the remainder being payroll-deductable loans to individuals.

In March 2017, the bank reported net income of BRL5.99 million, which was 14% lower than BRL6.97 million one year before. The bottom line result benefited from a 15.8% drop in interest expenses and a 26.5% rise in interest income, mostly owing to additional revenues from lending activity. On the other hand, BIB's net income was affected negatively by an increase in income tax expense, which went up to BRL6.56 million, from BRL2.76 million in March 2016. The bank's ratio of net income to tangible assets fell to 0.85% in March 2017, from 1.08% in March 2016.

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 39% 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 31% of bank's total funding in March 2017.

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 53% of BIB's total funding in March 2017.

BIB reported an increase of 10.9% to BRL2.02 billion in its funding base compared to the previous year. The bank reported sizeable growth in time deposits, which grew 34% y-o-y to BRL1.05 billion, and posted further issuance of asset-backed securities linked to residential mortgage loans (LCI), up 30% y-o-y to BRL212 million.

LIQUIDITY IS COMFORTABLE

In March 2017, BIB's ratio of liquid banking assets to tangible banking assets was 32.79%, slightly higher than 30.37% in the previous year, reflecting an 11% rise in the net balance of repurchase operations with other banks in the system and a 112.5% growth of the securities portfolio.

We still view BIB's liquidity as adequate, particularly when measuring the volume of available cash to deposits and to equity, of 36% and 87%, respectively, in March 2017. As a result, we assign a score of ba3 for liquidity.

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

Brazil's Moderate macro profile reflects the country's large and diversified economy, balanced by its weak economy's performance following two years of recession and the difficult political scenario which together increase challenges to Brazilian banks' operating environment. The pace of loan growth reduced significantly in 2016 and falling inflation has resulted in monetary policy easing. However, banks remain reluctant to reduce lending rates, which has relieved part of the earnings pressure arising from asset risks. Although public banks hold a 56% share of total loans in Brazil, loan growth at these lenders has slowed significantly since mid 2016, under more prudent government guidelines, which we expect will remain in place, and which will help to reduce pricing and tenor distortions. Capital and funding 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.

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 Methodology and Scorecard Factors

Exhibit 3

Banco Industrial do Brasil S.A.

Macro Factors		
Weighted Macro Profile	**Moderate**	**100%**

Factor	**Historic Ratio**	**Macro Adjusted Score**	**Credit Trend**	**Assigned Score**	**Key driver #1**	**Key driver #2**
Solvency						
Asset Risk						
Problem Loans / Gross Loans	0.9%	a3	←→	ba2	Single name concentration	Sector concentration
Capital						
TCE / RWA	16.5%	a3	←→	baa2	Expected trend	
Profitability						
Net Income / Tangible Assets	0.9%	ba1	←→	ba3	Earnings quality	
Combined Solvency Score		baa1		ba1		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	29.8%	ba2	←→	b3	Deposit quality	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	14.2%	ba3	←→	ba3	Quality of liquid assets	
Combined Liquidity Score		ba2		b2		
Financial Profile				ba2		
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				0		
Sovereign or Affiliate constraint:				Ba2		
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**
Counterparty Risk Assessment	1	0	ba1 (cr)	0	Ba1 (cr)	--
Deposits	0	0	ba2	0	Ba2	Ba3

Source: Moody's Financial Metrics

Ratings

Exhibit 4

Category	Moody's Rating
BANCO INDUSTRIAL DO BRASIL S.A.	
Outlook	Negative(m)
Bank Deposits -Fgn Curr	Ba3/NP

Bank Deposits -Dom Curr	Ba2/NP
NSR Bank Deposits	Aa3.br/BR-1
Baseline Credit Assessment	ba2
Adjusted Baseline Credit Assessment	ba2
Counterparty Risk Assessment	Ba1(cr)/NP(cr)

Source: Moody's Investors Service

REPORT NUMBER 1075724

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