

Research Update:

# BRB - Banco de Brasilia S.A. Outlook Revised To Negative On Capital, Profitability Strain; 'B+' Ratings Affirmed

September 26, 2023

## Overview

- Lower net interest margins have hit BRB's profitability, which, combined with continued expansion, has pressured capitalization.
- On the other hand, BRB has been searching for ways to improve its capital, such as portfolio sales and potential follow-on process planning.
- We therefore revised our outlook on our 'B+' global scale ratings to negative from stable and affirmed the 'B+' ratings. We also lowered our long-term national scale rating to 'brAA-' from 'brAA'.
- The negative outlook reflects the challenges that BRB faces in stabilizing its capitalization metrics.

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## Rating Action

On Sept. 26, 2023, S&P Global Ratings revised its outlook on its global scale ratings on BRB – Banco de Brasilia S.A. to negative from stable. At the same time, we affirmed our long-term global scale ratings at 'B+' and lowered our long-term national scale issuer credit rating to 'brAA-' from 'brAA'. We also affirmed the short-term global and national scale ratings at 'B' and 'brA-1+', respectively.

## Rationale

**Capitalization ratios have been under pressure in recent quarters.** While the Basel ratio has remained above 14%, the Tier 1 and core capital ratios have been close to minimum levels. In March 2023, the Tier 1 ratio was 8.6%, while the core capital ratio was 7.0%. By June 2023, they had improved to 9.5% and 7.9%. In addition, the risk-adjusted capital (RAC) ratio has tightened, at close to 5.0% as of December 2022. This resulted from a combination of continued credit

expansion and lower profitability, while shareholder payouts have continued.

**We forecast a RAC ratio of about 5.0% by year-end due to lower credit growth and some recovery in profits.** Our view of the bank's capital and earnings is based on our forecast RAC ratio. The 5.0% projection for year-end 2023 and 2024 incorporates some recovery in profits in the second half of 2023 because of portfolio sales with premiums and a declining DI rate, but also growth of 15% in total loans for full-year 2023, which is lower than recent expansion rates. Despite the ratio's predicted stability, it would remain at the lower end of the 5.0%-7.0% range we generally consider appropriate for the current capital assessment.

**Profitability, which used to be a strength for BRB, has declined because of considerably lower net interest margins.** BRB's main business, payroll-deductible loans, suffered from margin compression as the Selic rate went up in 2021 and 2022. Meanwhile, BRB has been gradually shifting its loan book to lower-yielding products, such as mortgage loans, which has also affected margins to some extent. Noninterest expenses have expanded, particularly in 2021, which raised the cost-to-income ratio to more than 80% in the first half of 2023 from about 68% in 2020. As a result, the return on average equity (ROAE) fell to less than 5.0% in the first half of 2023, reaching its lowest semiannual point since 2014, when we first assigned this rating. Between 2016 and 2020, ROAE averaged almost 22%.

**Planned follow-on could alleviate capital pressure, but the timing and amount are uncertain.**

BRB's board of directors has approved the resumption of the company's follow-on process planning, which had been halted when markets cooled down in 2021. However, the potential capital to be raised and the timing of that process are still uncertain, given those factors would also depend on market conditions. Moreover, while it would provide capital relief if successful, the follow-on could also cause the bank to resume its rapid expansion plan, which could add risks in the medium term.

**Funding remains stable, and liquidity remains adequate** The bank benefits from a relatively diversified and stable funding structure compared with those of other midsize banks in the country. This supports BRB's funding stability even in difficult times, such as during the corruption investigation Operation Circus Maximus. The company's broad liquid assets remained solid as of June 2023, covering its short-term wholesale funding by 3.8x, up from an average of 3.1x for the past five years.

## Outlook

The negative outlook reflects our view that we could lower the ratings over the next 12 months. We think BRB is under capital pressure due to its significant growth in recent years, coupled with lower profitability.

## Downside scenario

We could lower the ratings if BRB's capitalization metrics, which include our forecast RAC ratio, consistently weaken to below 5.0%. This could arise from continued poor profitability, absent any material capital raise, which could arise from its planned follow-on or profitability improvement.

## Upside scenario

We could revise the outlook to stable if BRB is able to stabilize its capitalization metrics and improve its profitability, absent any asset quality deterioration.

## Ratings Score Snapshot

Issuer credit rating	B+/Negative/B
SACP	b+
Anchor	bb+
Business position	Constrained (-2)
Capital and earnings	Moderate (0)
Risk position	Moderate (-1)
Funding	Adequate (0)
Liquidity	Adequate (0)
Support	0
ALAC support	0
GRE support	0
Group support	0
Sovereign support	0
Additional factors	0

SACP--Stand-alone credit profile.

## Related Criteria

- General Criteria: National And Regional Scale Credit Ratings Methodology, June 8, 2023
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Dec. 9, 2021
- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology, Dec. 9, 2021
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

## Ratings List

**Downgraded; CreditWatch/Outlook Action; Ratings Affirmed**

	To	From
<b>BRB - Banco de Brasilia S.A.</b>		
Issuer Credit Rating	B+/Negative/B	B+/Stable/B
Brazil National Scale	brAA-/Negative/brA-1+	brAA/Stable/brA-1+

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at [www.spglobal.com/ratings](http://www.spglobal.com/ratings) for further information. Complete ratings information is available to RatingsDirect subscribers at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.spglobal.com/ratings](http://www.spglobal.com/ratings).

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