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Ratings

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BRB - Banco de Brasilia S.A.

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BRB - Banco de Brasilia S.A.

Ratings Score Snapshot

Issuer Credit Rating
B+/Negative/B
Brazil National Scale
brAA-/Negative/brA-1+

SACP: b+ → **Support: 0** → **Additional factors: 0**

Anchor	bb+	
Business position	Constrained	-2
Capital and earnings	Moderate	0
Risk position	Moderate	-1
Funding	Adequate	0
Liquidity	Adequate	
CRA adjustment		0

ALAC support	0
GRE support	0
Group support	0
Sovereign support	0

Issuer credit rating
B+/Negative/B

ALAC--Additional loss-absorbing capacity. CRA--Comparable ratings analysis. GRE--Government-related entity. ICR--Issuer credit rating. SACP--Stand-alone credit profile.

Credit Highlights

Overview	
Key strengths	**Key risks**
Wide presence in the Federal District of Brazil (DF), the Brazilian state with the highest per capita income.	Continued credit growth and lower profitability consuming part of the capitalization buffer.
A significant share of payroll loans to public-sector employees, which generally have low loss rates.	Rapid growth in various asset types and regions poses risks to asset quality metrics and profitability.
Stable and low-cost funding base, given the bank's role as the main financial agent of the DF's government.	Geographical concentration in the state of DF.

Our ratings continue to reflect BRB - Banco de Brasilia S.A.'s solid presence in the DF and its large share of payroll loans, which we believe are relative strengths. We also view BRB's stable and low-cost funding base as supporting the bank's credit quality. On the other hand, the bank's rapid growth of assets and expansion to new asset types and regions continue to pose risks to its asset quality metrics and profitability, in our view.

We forecast a RAC ratio of about 5.0% by year-end due to lower credit growth and some recovery in profits. This incorporates some recovery in profits in the second half of 2023 because of portfolio sales with premiums and a declining interest rate but also 15% total loan growth for full-year 2023, which is lower than recent expansion rates. Although we expect the RAC ratio to be stable at around 5% in 2023 and 2024, it would be at the lower end of the

5.0%-7.0% range we generally consider appropriate for the current capital assessment.

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 in 2021. However, the potential capital to be raised and the timing of that process depend on market conditions and therefore remain uncertain. While the follow-on would provide capital relief if successful, it 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, in our view. 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 improved profitability.

Upside scenario

We could revise the outlook to stable if BRB stabilizes its capitalization metrics and improves its profitability, absent any asset quality deterioration.

Key Metrics

BRB - Banco de Brasilia S.A.--Key ratios and forecasts

	--Fiscal year ended Dec. 31--			
(%)	**2021a**	**2022a**	**2023f**	**2024f**
Growth in operating revenue	8.9	-1.1	6.0-8.0	20.0-25.0
Growth in customer loans	34.2	44.2	13.0-17.0	8.0-12.0
Growth in total assets	24.9	30.8	8.0-12.0	8.0-12.0
Net interest income/average earning assets (NIM)	9.7	7.3	6.5-7.5	7.5-8.5
Cost to income ratio	75.6	80.2	80.0-85.0	70.0-75.0
Return on equity	26.5	12.3	8.0-12.0	10.0-14.0

BRB - Banco de Brasilia S.A.--Key ratios and forecasts (cont.)				
	--Fiscal year ended Dec. 31--			
(%)	2021a	2022a	2023f	2024f
New loan loss provisions/average customer loans	3.6	1.7	1.5-2.0	1.75-2.25
Gross nonperforming assets/customer loans	3.2	2.1	2.0-2.5	2.0-2.5
Risk-adjusted capital ratio	5.7	5.2	5.0-5.5	5.0-5.5

Note: All figures adjusted by S&P Global Ratings. a--Actual. f--Forecast.

Anchor: 'bb+' For Banks Operating In Brazil

We classify the banking sector of Brazil in group '6' under our Banking Industry Country Risk Assessment (BICRA). The anchor for banks operating only in Brazil is 'bb+'.

In our opinion, Brazil's low-income levels and the government's weak fiscal position constrain the country's economic resilience. We expect economic growth of 2.9% in 2023 because of very strong agricultural performance and its spillover effects on the rest of the economy. Credit growth will likely moderate amid interest rates that stay higher for longer, private banks' tighter underwriting practices and uncertainty regarding the economic policies the new government will implement. Asset quality will slip as a result of the economic downturn, low credit growth, and high interest rates, but credit losses should be manageable because of the high provisioning coverage.

Our industry risk assessment for Brazil reflects its well-developed financial regulation that is broadly in line with international standards, and the regulator's good track record that has helped the domestic financial system withstand the last economic downturn. Brazilian banks' profitability remained resilient thanks to the high provisioning coverage and diversified revenue mix. Profitability will likely slip as provisioning needs rise, but from good levels. The Brazilian banking system has an adequate funding mix with a large and stable core customer deposit base.

Business Position: Business Concentration, But Expanding To New Assets And Regions

BRB has significant concentration in the DF, narrow revenue diversification, and limited overall market share. On the other hand, business expansion initiatives and the ongoing growth have been somewhat broadening revenue diversification.

Founded in 1964, BRB has acted as the DF's financial agent to develop the local economy and currently holds a sizable market share of loans in the region. Nevertheless, the bank has only a small market share at the national level. With total assets of about R$45 billion as of June 2023, BRB held 0.3% of market share in terms of total assets in the system. Net interest income on loans has historically represented 75%-80% of operating revenue, while fee income has represented 15%-20%.

The new management that took over BRB in 2019 overhauled the bank's strategic plan, with a greater focus on enhancing governance standards, expanding the customer base, and diversifying the businesses and regions where it operates. Since then, the bank has been transitioning from being a regional bank closely connected to the DF government to one with a greater national presence.

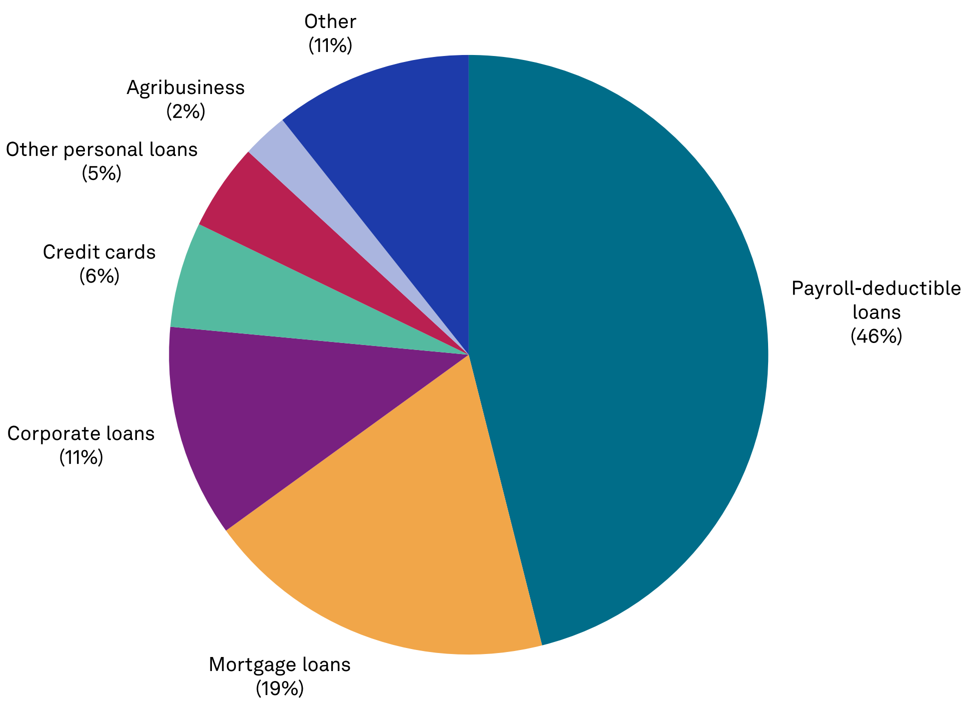
Lending has not only been growing but also diversifying away from payroll loans. Moreover, BRB has been offering a greater number of banking services to its clients and increasing and diversifying fee revenue through new services and strategic partnerships.

BRB's operating revenue has been growing somewhat modestly. On the one hand, the loan book has expanded about 40% per year since the beginning of 2019 until the end of 2022 while fees from insurance brokerage and credit cards drove a moderate increase in fee income. However, net interest margins (NIMs) have fallen due to a shift in portfolio mix to lower-yielding loans, discounts offered at loan renegotiations, and hikes in the central bank's policy rate.

Payroll-deductible loans, which offer relatively good yields at low loss rates, remain BRB's main income source, although their share in the bank's loan book has been falling as other business lines have grown faster. In particular, the bank's residential mortgage book has expanded considerably since December 2019.

Chart 1

BRB's loan book as of March 2023



Source: S&P Global Ratings.

BRB has also established partnerships with firms to boost and diversify its revenue and client base. In mid-2020, the bank signed an alliance with Brazilian soccer team "Flamengo" to form a digital bank aimed at Flamengo's supporters.

The digital bank, Banco Digital Nação BRB FLA, supports BRB's expansion plans. Although not yet profitable, the digital bank had more than 3.5 million accounts as of June 2023, most of which were outside the DF.

The recent strategic initiatives represent a step toward greater revenue diversification. However, we believe that they could still generate risks in the next few years, such as a larger exposure to riskier assets or to segments and regions in which the bank has less expertise.

Nevertheless, BRB's revenue remains geographically concentrated in the DF, which allows it to enjoy a stable client base primarily consisting of government employees with higher-than-average incomes. This client profile and BRB's large exposure to payroll loans have provided the bank with revenue stability in recent years.

In addition, like other government-owned banks, we believe BRB is subject to political risk and strategic decisions that are not profit oriented. In 2019, BRB was subject to an investigation by Brazil's Federal Police that ended with the dismissal of six executives. New management is committed to enhancing the bank's internal controls and has established specific governance indicators and goals.

Capital And Earnings: RAC Ratio At About 5% In The Next Two Years

We expect the RAC ratio will be at about 5.0% in the next few years--stable, although at the lower end of the 5.0%-7.0% range we generally consider appropriate for the current capital assessment. We anticipate profits will recover somewhat in the second half of 2023, driven by portfolio sales with premiums, a declining DI rate, and 15% growth of total loans for full-year 2023, which is lower than recent expansion rates.

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 RAC ratio has tightened, at close to 5.0% as of December 2022. This resulted from continued credit expansion and lower profitability while shareholder payouts have continued.

BRB's main business, payroll-deductible loans, suffered from margin compression as interest rates rose 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 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, return on average equity averaged almost 22%.

To evaluate banks' capitalization level, we apply globally our risk-adjusted capital framework, regardless of regional regulations and each bank's internal risk measures. Our RAC compares our definition of total adjusted capital to our risk-weighted assets, reflecting a risk metric that's globally more comparable than regulatory ratios. The main difference regarding our methodology and local regulation is that we apply charges to sovereign bond exposures based on the ratings on the country, while the regulator applies a 0% risk weight.

Our RAC forecast for BRB incorporates the following base-case assumptions:

- Loan book growing 15% in 2023 and 10% in 2024.
- NIMs improving in the second half of 2023 due to portfolio sales with premiums and beginning of DI rate decline. For 2024, we forecast further improvement in NIMs due to DI rate cuts.
- Nonperforming loans (NPLs) at 2.0%-2.5% in 2023 and 2024.
- Return on equity of 8%-12% in 2023 and 10%-14% in 2024.

Risk Position: Focus On Payroll Loans Supports Asset Quality, But Rapid Expansion Increases Risks

BRB's loan book has a high share of payroll loans, which generally have low loss rates. However, we believe the rapid expansion to segments and regions in which the bank has less expertise poses risks to its asset quality metrics and profitability.

As part of its expansion plan, BRB has been launching new products and services, while increasing exposures to various asset types, such as mortgages, loans to small and medium businesses, credit cards, and loans to other regions, such as northeastern Brazil.

While the bank's rapid growth in its credit card business and an overall deterioration of the Brazilian banking sector's assets caused BRB's NPLs to spike in 2021, its significant share of payroll loans has moderated the impact of credit card deterioration in the loan book. By March 2023, NPLs were 2.1%, almost unchanged from 2.0% at the end of June 2022, after the bank charged off a sizable amount of previously defaulted loans.

In our view, the ongoing expansion to riskier loans could further erode asset quality. However, the pace would depend on the speed of lending growth and economic conditions. Moreover, operating risks could emerge as a result of the ongoing expansion.

Due to its higher focus on individual borrowers, BRB doesn't have significant obligor concentration: its top 10 obligors represented 6.7% of the bank's loan book as of June 2023. On the other hand, BRB has considerable counterparty exposure to the state of DF due to the bank's role as paying agent of payroll-deductible loans and its relevance to the local economy. This exposure can be a positive or a negative factor, depending on the economy's performance.

On the positive side, this concentration offers a stable and lucrative source of income when the state's finances are doing well. However, if the DF's fiscal position deteriorates, potentially delayed salary/pension payments to public servants could hit payroll loan performance. Moreover, the DF's worsening finances could have other indirect effects on the local economy and, consequently, on BRB's loan book. In 2023, the DF's finances have been more stable than in previous years, such that we currently view the payroll loan concentration as favorable for BRB's operations.

The bank's capitalization is also subject to risks from defined-benefit obligations stemming from pension benefits for employees. As of June 2023, gross liabilities of BRB's defined-benefit pension plan represented about 130% of the bank's total adjusted capital, which we view as high. However, we note that the pension plan's assets cover roughly 95% of its liabilities, and only half of the pension obligation is attributable to the bank, given that employees carry half of the plan's risks.

Funding And Liquidity: Stable And Low-Cost Funding Base As The DF Government's Main Financial Agent

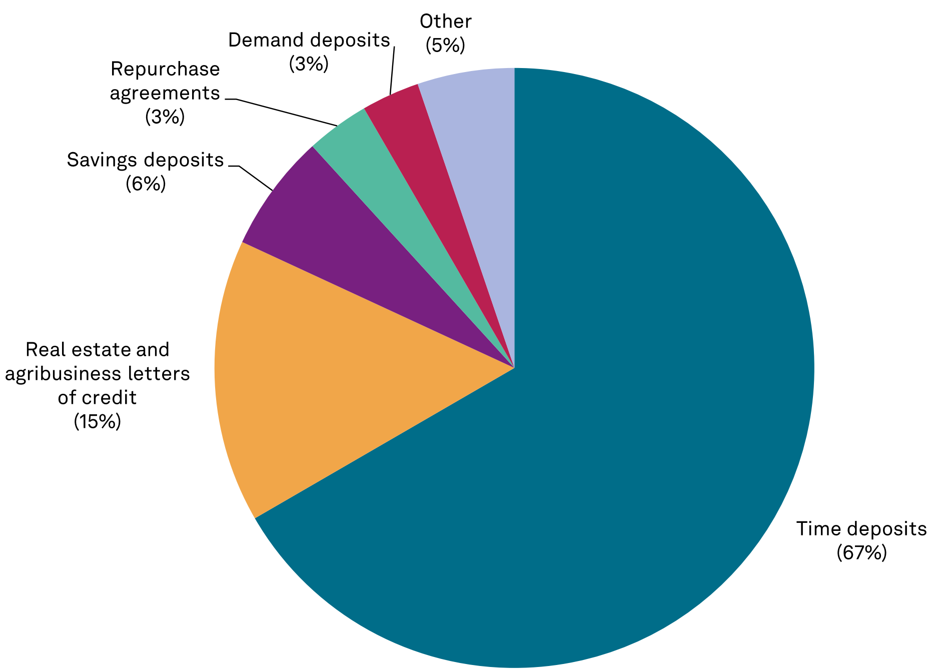
BRB benefits from a relatively diversified and stable funding structure compared with those of other midsize banks in the country. This supports BRB's funding stability even in difficult times, such as during the Operation Circus Maximus corruption investigation. BRB's wide branch network in the state bolsters demand, savings, and time deposits, and its deposit base is stable because of the bank's status as the payment agent of all of the DF's public employees.

Time deposits remain BRB's largest funding source, followed by demand deposits and savings deposits. BRB has also been recently issuing letras financeiras in the capital markets to institutional investors.

Of the total deposits as of June 2023, about 30% were from individuals, 30% were judicial deposits, 12% from companies unrelated to BRB, and the remaining either from the government of DF, related parties, or other financial institutions. The bank doesn't have material funding concentration due to its large and diversified client base. Furthermore, its stable funding ratio was 107% as of June 2023, which supports our funding assessment.

Chart 2

BRB's funding base as of June 2023



Segments may not total 100% due to rounding. Source: S&P Global Ratings.

BRB has generally maintained comfortable liquidity ratios, in our opinion. 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.

Its asset-liability management has also remained adequate, with real time control and surveillance of its funding base compared with the resources applied. It calculates liquidity metrics on a daily basis in accordance with its governance policies, which calculate minimum liquidity metrics for multiple scenarios.

Support: A Limited Link To The Government

We classify BRB as a government-related entity (GRE) with a limited link to the government, which stems from our doubts about the government's capacity to support its GREs. In our view, Brazil's Fiscal Responsibility Law, banking regulations, and BRB's improving corporate governance shield the bank from a hypothetical intervention from the state. Moreover, the DF's finances are stronger than in previous periods.

However, the DF remains a key risk exposure to BRB due to the state's role as a paying agent of payroll-deductible loans, which represent a large share of the bank's assets, and the importance of the DF's fiscal health to the local economy. (The public sector contributes more to DF's GDP than in other Brazilian states.) Therefore, we still believe that a deterioration in DF's credit quality could harm the bank's asset quality and bottom-line results.

Environmental, Social, And Governance

We believe BRB's governance has improved since the 2019 investigation of potential corruption schemes. The investigation ended with the dismissal of six executives, and new management has been committed to enhance the bank's governance and internal controls. We don't view environment or social factors as currently affecting the bank's credit quality.

Key Statistics

Table 1

BRB - Banco de Brasilia S.A.--Key figures

		--Year-ended Dec. 31--			
(Mil. R$)	**2023***	**2022**	**2021**	**2020**	**2019**
Adjusted assets	42,743.0	41,277.9	31,539.9	25,191.0	16,896.0
Customer loans (gross)	33,000.3	31,297.8	21,709.1	16,178.1	11,001.4
Adjusted common equity	2,238.8	2,213.5	2,240.2	1,704.6	1,512.3
Operating revenues	835.9	3,247.1	3,284.6	3,015.1	2,641.8
Noninterest expenses	705.8	2,604.2	2,482.3	2,049.5	1,867.2
Core earnings	N/A	166.0	106.9	486.3	452.3

*Data as of March 31. R$--Brazilian real.

Table 2

BRB - Banco de Brasilia S.A.--Business position

		--Year-ended Dec. 31--			
(%)	2023*	2022	2021	2020	2019
Loan market share in country of domicile	0.6	0.6	0.5	0.4	0.3
Deposit market share in country of domicile	0.6	0.6	0.4	0.4	0.4
Return on average common equity	-7.1	12.3	26.5	24.2	27.0

*Data as of March 31.

Table 3

BRB - Banco de Brasilia S.A.--Capital and earnings

		--Year-ended Dec. 31--			
(%)	2023*	2022	2021	2020	2019
Tier 1 capital ratio	9.2	9.1	14.1	13.2	14.6
S&P Global Ratings' RAC ratio before diversification	N/A	5.2	5.7	5.1	6.1
S&P Global Ratings' RAC ratio after diversification	N/A	4.4	4.7	4.4	5.1
Adjusted common equity/total adjusted capital	85.0	87.7	89.8	96.9	100.0
Net interest income/operating revenues	67.1	73.8	75.8	78.6	79.0
Fee income/operating revenues	16.3	15.1	18.8	17.8	16.0
Cost to income ratio	84.4	80.2	75.6	68.0	70.7
Preprovision operating income/average assets	1.2	1.8	2.8	4.6	4.8
Core earnings/average managed assets	N/A	0.5	0.4	2.3	2.8

*Data as of March 31. N/A--Not applicable.

Table 4

BRB - Banco de Brasilia S.A.--Risk position

		--Year-ended Dec. 31--			
(%)	2023*	2022	2021	2020	2019
Growth in customer loans	21.8	44.2	34.2	47.1	28.7
Total diversification adjustment/S&P Global Ratings' RWA before diversification	N/A	18.4	19.6	17.4	20.1
Total managed assets/adjusted common equity (x)	19.2	18.7	14.1	14.9	11.3
New loan loss provisions/average customer loans	2.0	1.7	3.6	1.7	1.4
Net charge-offs/average customer loans	4.5	1.6	0.6	0.0	0.9
Gross nonperforming assets/customer loans + other real estate owned	1.9	2.1	3.2	1.6	1.7
Loan loss reserves/gross nonperforming assets	111.4	109.9	133.2	172.0	213.9

*Data as of March 31. N/A--Not applicable.

Table 5

BRB - Banco de Brasilia S.A.--Funding and liquidity

		--Year-ended Dec. 31--			
(%)	2023*	2022	2021	2020	2019
Core deposits/funding base	88.9	89.5	82.9	77.5	88.4
Customer loans (net)/customer deposits	99.6	96.9	99.0	98.7	89.3
Long-term funding ratio	94.5	94.8	89.2	83.9	94.2

Table 5

BRB - Banco de Brasilia S.A.--Funding and liquidity (cont.)

		--Year-ended Dec. 31--			
(%)	**2023***	**2022**	**2021**	**2020**	**2019**
Stable funding ratio	101.6	102.7	98.7	102.8	110.5
Short-term wholesale funding/funding base	6.0	5.6	12.0	17.7	6.6
Broad liquid assets/short-term wholesale funding (x)	2.8	3.2	2.0	1.9	4.4
Broad liquid assets/total assets	14.4	15.1	19.6	26.7	23.1
Broad liquid assets/customer deposits	19.1	19.9	29.6	42.5	33.1
Net broad liquid assets/short-term customer deposits	17.2	18.6	22.2	31.0	40.4
Short-term wholesale funding/total wholesale funding	49.0	49.6	65.9	77.5	56.8

*Data as of March 31.

BRB - Banco de Brasilia S.A.--Rating component scores

Issuer Credit Rating	**B+/Negative/B**
SACP	b+
Anchor	bb+
Economic risk	7
Industry risk	5
Business position	Constrained
Capital and earnings	Moderate
Risk position	Moderate
Funding	Adequate
Liquidity	Adequate
Comparable ratings analysis	0
Support	0
ALAC support	0
GRE support	0
Group support	0
Sovereign support	0
Additional factors	0

ALAC--Additional loss-absorbing capacity. GRE--Government-related entity. 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 Detail (As Of October 2, 2023)*		
BRB - Banco de Brasilia S.A.		
Issuer Credit Rating		B+/Negative/B
Brazil National Scale		brAA-/Negative/brA-1+
Issuer Credit Ratings History		
26-Sep-2023		B+/Negative/B
20-Mar-2020		B+/Stable/B
19-Feb-2019		B+/Watch Neg/B
26-Sep-2023	*Brazil National Scale*	brAA-/Negative/brA-1+
20-Mar-2020		brAA/Stable/brA-1+
19-Feb-2019		brAA/Watch Neg/brA-1+
Sovereign Rating		
Brazil		BB-/Positive/B
Brazil National Scale		brAAA/Stable/--

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.