

RATING ACTION COMMENTARY

Fitch Removes Negative Watch and Affirms BRB's Ratings; Outlook Negative

Wed 13 Nov, 2024 - 3:13 PM ET

Fitch Ratings - São Paulo - 13 Nov 2024: Fitch Ratings has removed the Rating Watch Negative (RWN) on Banco de Brasília S.A.'s (BRB) 'B-' Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs), 'B' Short-Term Foreign and Local Currency IDRs, 'b-' Shareholder Support Rating (SSR), 'BBB+(bra)' Long-Term National Rating, and 'b-' Viability Rating (VR), and affirmed the ratings. The Rating Outlook on the Long-Term IDR and National Ratings is Negative.

The RWN removal follows BRB's actions to alleviate pressures on capitalization metrics. In July, a capital increase of BRL294 million was approved, effective on the still-unpublished 3Q24 financial statements. Additionally, a strategic partnership announced in the same month is expected to positively impact the bank's capital, while core profits are also showing an improving trend. In late October 2024, BRB announced a tentative new capital increase of up to BRL750 million, expected to be effective in the first quarter of 2025. These actions provide Fitch with greater visibility regarding the bank's capital metrics, which are likely to improve once effective.

The Negative Outlook reflects a view of the medium-term challenges concerning capitalization, as the agency expects improvements with stable earnings generation and no delays in the expected capital injections. The Outlook also considers the shareholder's propensity to support BRB, which is highly influenced by the timeliness of such support, that has been delayed and kept BRB's core equity regulatory capitalization at low levels, making it highly sensitive to breaching regulatory minimum levels.

KEY RATING DRIVERS

VR and SSR aligned: BRB's VR reflects our view on the medium-term risks to the bank's core capital buffers and business model stabilization. The current VR is one notch below the implied level of 'b', as our view of the entity's capitalization and leverage has a high influence on the VR and is a weakest link in the bank's creditworthiness.

Support Driven Ratings: Although our 'b-' SSR assessment of BRB is at the same level as the bank's standalone profile, as reflected in its 'b-' VR, BRB's IDRs and NS ratings continue to be driven by the ability and willingness of its parent, the Federal District Government (GDF), to provide timely support and the Negative Outlook over these ratings reflects Fitch's view decreases propensity to support the banks.

While we view BRB's gradually recovering performance and the continued adoption of internal capital actions, including the capital increases, as the key drivers for today's removal of RWN, Fitch's view of GDF's credit profile continues to justify a "higher of" approach based on our SSR opinion.

Timeliness Constrains Support: Fitch believes GDF is capable of supporting BRB but its willingness to provide such support has weakened. This is due to BRB's continued weak core capital position and GDF's lack

of capital support for its banking subsidiary. A breach of the minimum required capitalization could pose a risk to the support-based ratings and lead Fitch to reassess BRB's importance to the state.

National Ratings: BRB's National Ratings are notched from Fitch's view of GDF's creditworthiness on the national scale. We believe the bank's National Rating better reflects its creditworthiness relative to its respective supporting entity.

Capital Adequacy Concerns: BRB's common equity Tier 1 (CET1) ratio was 7.34% in June 2024, which Fitch considers a narrow buffer against the minimum requirement of 7.0%. While the Tier 1 and total regulatory capital ratios (8.84% and 13.8%, respectively) have adequate buffers over their minimum requirements, the tighter CET1 reduces its financial flexibility to respond to adverse shocks and grow businesses.

Capital Increase Underway: In July 2024, the bank announced the completion of a capital increase plan, with an amount of BRL294 million placed by its minority shareholders. In October 2024, BRB announced an approval to pursue a new capital increase of up to BRL750 million, which is expected to be effective in the first quarter of 2025. Additionally, during 3Q24 BRB sold a 49.9% stake in Financeira BRB to Kardbank and investor José Ricardo Rezek. The strategic partnership should bring the partner's technology to the bank's clients and is also expected to generate a capital gain for BRB.

In Fitch's view, the completion of these measures should support BRB's capital metrics. Under Fitch's pro-forma calculations, using June 2024 financials, the newly approved capital would potentially benefit CET1 ratio to levels around 8.5%.

Fitch has relied on unaudited interim financial statements and pro forma information provided by BRB's management for the analysis, due to the delayed regulatory reporting of 2Q24 financials. This reliance on unaudited data reduces the agency's visibility and weakens the assessment of BRB's corporate governance, as captured in the business profile assessment.

Execution Risks: Fitch believes BRB's business and earnings profile is pressured by uncertain core earnings prospects and capital constraints, making it difficult for the bank to increase business volumes and defend earnings against shocks in the medium term. To avoid breaching regulatory requirements, management continues to perform risk-weighted asset (RWA) optimization and portfolio sales.

Profitability Uncertainties and Controlled Asset Quality: BRB's operating profit/RWAs ratio was -0.14% in 1H24, from 0.5% in FY23 and a four-year average of 1.65%, as high loan provisions weigh on the bank's profit generation capacity, also negatively impacted by a new district regulation that limited debts in highly-indebted clients' accounts. In 3Q24 the law was considered unconstitutional and stopped affecting the bank's figures. Loans classified in the 'D-H' range were 5.6% of gross loans in 2Q24 (4.3% at YE 2023), impacted by the regulation as well.

Fitch expects BRB's performance in the near term to remain pressured and below its historical average, but to gradually regain traction, as a results of capital increases, and the development of business verticals, partnerships and efficiency measures.

Adequate Funding and Liquidity: BRB's funding and liquidity profile continue to be a rating strength, benefiting from a stable and diversified customer base, and low funding costs. The bank's liquidity position is also adequate against short-term maturities.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

IDRs, SSR AND NATIONAL RATINGS

The ratings could be downgraded, potentially by multiple notches, in the case of a capital breach and/or regulatory intervention. This would weaken our assessment of the state's propensity and ability of support, reflecting a failure to provide extraordinary support in a timely manner.

VR

The VR is mainly sensitive to BRB's capitalization. It could be downgraded if capital optimization measures, including potential reductions in RWAs, were unsuccessful and insufficient to prevent a regulatory capital breach. The ratings would also come under pressure if its earnings prospects materially weaken and delay the improvement of capital generation.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

IDR, SSR, VR and NATIONAL RATINGS

There is limited scope for upward rating action given the Negative Outlook.

Fitch may revise the outlook to stable if there are positive changes in Fitch's assessment of GDF's ability and willingness to provide support to BRB. The Outlook revision would also be contingent to higher CET1 buffers over regulatory minimums, providing more capital relief.

Over time, the ratings could be upgraded if there is a clear path to business model stabilization and sustainable core profitability as well as

adequate capitalization and buffers. The magnitude of the upside potential is contingent to BRB's credit profile after capital measures, and to Fitch's reassessment of BRB VR and SSR once that happens.

BRB's SSR can be revised if there is any change in its strategic importance or changes in the ability or propensity of the GDF to provide support to the bank.

VR ADJUSTMENTS

The VR has been assigned below the implied VR due to the following adjustment reason: Weakest Link - Capitalization & Leverage (negative).

The Business Profile score has been assigned below the implied score due to the following adjustment reason: Management and Governance (negative).

The Asset Quality score has been assigned below the implied score due to the following adjustment reason: Underwriting Standards and Growth (negative).

The Earnings & Profitability score has been assigned below the implied score due to the following adjustment reason: Historical and Future Metrics (negative).

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS

Banco de Brasília's ratings are driven by GDF's internal credit assessment.

ESG CONSIDERATIONS

BRB - Banco de Brasilia SA has an ESG Relevance Score of '4' for Financial Transparency due to delays in the presentation of audited financial statements, that raise concerns about their governance, which has a negative impact on the credit profile, and is relevant to the rating[s] in conjunction with other factors.

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit <https://www.fitchratings.com/topics/esg/products#esg-relevance-scores>.

RATING ACTIONS

ENTITY / DEBT ⚡	RATING ⚡	PRIOR ⚡
BRB - Banco de Brasilia SA	LT IDR B- Rating Outlook Negative Affirmed	B- Rating Watch Negative
	ST IDR B Affirmed	B Rating Watch Negative

LC LT IDR
 B- Rating
 Watch
 Negative
 B- Rating Outlook Negative
 Affirmed

LC ST IDR B Affirmed
 B Rating
 Watch
 Negative

Natl LT
 BBB+(bra) Rating
 Watch
 Negative
 BBB+(bra) Rating Outlook Negative
 Affirmed

Natl ST F2(bra) Affirmed
 F2(bra) Ratin
 Watch
 Negative

Viability b- Affirmed
 b- Rating
 Watch
 Negative

Shareholder Support b-
 b- Rating
 Watch
 Negative
 Affirmed

[VIEW ADDITIONAL RATING DETAILS](#)

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APPLICABLE CRITERIA

[National Scale Rating Criteria \(pub. 22 Dec 2020\)](#)

[Metodologia de Ratings em Escala Nacional \(pub. 22 Dec 2020\)](#)

[Bank Rating Criteria \(pub. 15 Mar 2024\) \(including rating assumption sensitivity\)](#)

[Metodologia de Rating de Bancos \(pub. 15 Mar 2024\)](#)

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BRB - Banco de Brasilia SA

EU Endorsed, UK Endorsed

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