

## CREDIT OPINION

5 December 2023

Update



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### RATINGS

#### Banco Regional de Desenv do Extremo Sul

Domicile	Porto Alegre, Rio Grande do Sul, Brazil
Long Term CRR	Ba1
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Issuer Rating	Not Available
Type	Not Available
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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## Banco Regional de Desenv do Extremo Sul

Update to credit analysis following upgrade to Ba2

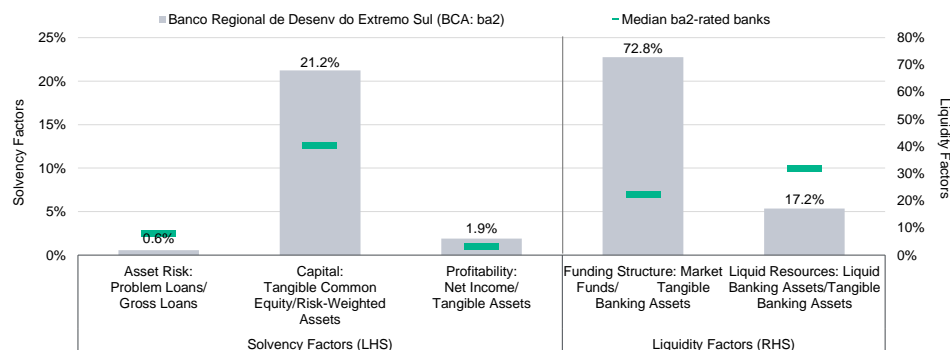
### Summary

[Banco Regional de Desenv do Extremo Sul's](#) (BRDE) BCA of ba2, reflects the bank's established role in fostering development in the southern states of Brazil, its position as one of the largest on-lender of [Banco Nac. de Desenv. Economico e Social's](#) (BNDES, Ba2 stable, ba2<sup>1</sup>) funds to the agricultural sector, and sound capitalization levels. BRDE' stable funding structure is a key factor supporting its ratings, despite its high concentration given the predominance of funds sourced from BNDES. The BCA also incorporates BRDE's loan book concentration by sector and borrower owing to its footprint in the southern states whose economies have relevant contribution from agriculture, in addition to a moderate profitability due to its development bank role.

BRDE's Ba2 issuer rating is derived from its BCA of ba2 and does not receive any support uplift from its owners.

Exhibit 1

#### Rating Scorecard - Key financial ratios Scorecard ratios as of June 2023



For the asset risk and profitability ratios, we calculate the average of the three latest year-end numbers and the latest quarterly data if available, and the ratio used is the weaker of the average and the latest period. For the capital ratio, we use the latest reported figure. For the funding structure and liquid resources ratios, we use the latest year-end figures

Source: Moody's Investors Service

## Credit strengths

- » Established role as a regional development bank, with steady loan growth and focus on the agricultural industry
- » Solid capitalization levels
- » Limited susceptibility to political influence because of its three-state ownership

## Credit challenges

- » Concentrated funding structure, with high reliance on funds from BNDES
- » Geographical and sectorial concentrations

## Rating outlook

The outlook on BRDE's ratings is stable.

## Factors that could lead to an upgrade

- » A rating upgrade at this moment is unlikely because, at ba2, BRDE's BCA is at the same level as the Ba2 Government of Brazil's Ba2 senior unsecured bond rating.

## Factors that could lead to a downgrade

- » A significant weakening of BRDE's financial fundamentals, resulting from a larger-than-expected deterioration in the quality of the loan book and an ensuing reduction in capitalization levels, could have a negative effect on the bank's ratings.

## Key indicators

Exhibit 2

### Banco Regional de Desenv do Extremo Sul (Consolidated Financials) [1]

	06-23 <sup>2</sup>	12-22 <sup>2</sup>	12-21 <sup>2</sup>	12-20 <sup>2</sup>	12-19 <sup>2</sup>	CAGR/Avg. <sup>3</sup>
Total Assets (BRL Million)	19,787.9	19,099.2	17,138.5	16,652.0	16,871.8	4.7 <sup>4</sup>
Total Assets (USD Million)	4,102.0	3,617.4	3,073.4	3,205.9	4,194.1	(0.6) <sup>4</sup>
Tangible Common Equity (BRL Million)	4,183.6	3,940.7	3,488.4	3,223.3	3,024.9	9.7 <sup>4</sup>
Tangible Common Equity (USD Million)	867.2	746.4	625.6	620.6	752.0	4.2 <sup>4</sup>
Problem Loans / Gross Loans (%)	0.6	0.5	0.5	0.4	0.4	0.5 <sup>5</sup>
Tangible Common Equity / Risk Weighted Assets (%)	21.2	20.8	21.1	19.5	19.2	20.4 <sup>6</sup>
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	2.1	1.9	1.7	1.6	1.7	1.8 <sup>5</sup>
Net Interest Margin (%)	6.4	6.3	4.9	4.3	4.3	5.2 <sup>5</sup>
PPI / Average RWA (%)	4.6	4.7	3.5	3.0	3.3	3.8 <sup>6</sup>
Net Income / Tangible Assets (%)	2.4	2.4	1.6	1.2	1.6	1.8 <sup>5</sup>
Cost / Income Ratio (%)	29.9	28.8	34.0	36.0	32.6	32.3 <sup>5</sup>
Market Funds / Tangible Banking Assets (%)	73.4	72.8	73.3	74.6	77.5	74.3 <sup>5</sup>
Liquid Banking Assets / Tangible Banking Assets (%)	15.0	17.2	16.8	17.0	18.2	16.8 <sup>5</sup>
Gross Loans / Due to Customers (%)	82169.6	130702.2	44904.0	--	--	85925.2 <sup>5</sup>

[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 because of the scale of reported amounts. [4] Compound annual growth rate (%) based on the periods for the latest accounting regime. [5] Simple average of periods for the latest accounting regime. [6] Simple average of Basel III periods.

Sources: Moody's Investors Service and company filings

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the issuer/deal page on <https://ratings.moody.com> for the most updated credit rating action information and rating history.

## Profile

Founded in 1961, Banco Regional de Desenv do Extremo Sul (BRDE) is owned by the states of Rio Grande do Sul, Santa Catarina and Parana, which together contribute around 17% of Brazil's GDP. The bank lends directly to private-sector companies, largely agricultural producers, cooperatives and infrastructure projects.

According to its mandate to foster development in the south of Brazil, BRDE's operations are focused on the relatively prosperous states of Parana, Santa Catarina and Rio Grande do Sul. From 2012 to 2016, the bank's loan operations expanded at a compound annual growth rate of around 14%, then remained largely flat until they increased 11.2% in 2022 and 6.3% in the first six months of 2023.

## Detailed credit considerations

### BRDE continues to focus on relevant agricultural sector in southern Brazil

As a result of its importance in southern Brazil, the agricultural sector represents around 50% of BRDE's loans and is split among cattle breeding, protein production, multiple crops, warehouse services and transformation companies. Among the main credit lines offered by the bank are loans to finance machinery acquisition, investments to improve production plants or construct new plants and some working capital financing. For the most part, the bank provides long-term loans and also lends to infrastructure projects, mostly in the energy industry. The credit portfolio has an average maturity of more than seven years.

The bank has acted as a conduit for growth in the agricultural industry in the region. Loan disbursements increased 30.6% year over year as of June 2023, reaching BRL2.1 billion, supported by BRDE's strong relationships with regional credit cooperatives, which channel resources to smaller producers and provide strong loan guarantees.

Similar to other regional development banks, BRDE is also involved in managing funds for federal and state governments. Alongside BNDES, the bank is an agent of the Fundo Setorial do Audiovisual (FSA) fund, which supports film-making and small-scale television industries. BRDE also manages a development fund that channels loans to municipalities in Santa Catarina (FUNDAM). The bank is responsible for the origination of these loans and for monitoring credit allocation, but it does not share credit risk with public funds and receives around 3% of disbursements as management fees.

### Low level of problem loans and high allowances to loan losses provides a cushion for potential asset quality deterioration associated with geographic and sector concentrations

As of June 2023, BRDE's problem loan<sup>2</sup> ratio was 0.6%, slightly higher than 0.4% twelve months earlier. The bank's volume of problem loans remains low, significantly below industry average of 3.1% and in line with that of BNDES, its main source of funding.

BRDE has historically maintained a high reserve coverage. In Q2 2023, reserves for loan losses to problem loans was 296.7%, down from 464.3% a year earlier but still at a high level, alleviating any pressure from increases in problem loans. Net charge-offs represented a gain of 0.5% of gross loans in June 2023, from a gain of 0.4% a year earlier, reflecting the bank's recoveries in the period. Most of the bank's operations are backed by guarantees, which results in a higher recovery of its charge-offs.

BRDE's loan book also shows credit risks associated with relatively high geographic and sectorial concentrations, especially stemming from climate events. BRDE's loan portfolio has traditionally been concentrated on agriculture that accounted for around 50% of loans as of June 2023, and large companies, mainly cooperatives, made up around 43% of disbursements in the first half of 2023. The bank's focus on the southern states constrains its operations to a single region, and also results in a less diversified revenue structure than that of its peers with nationwide coverage.

### High capitalization buffers remains adequate to mitigate concentration risks

BRDE's capitalization, which we measure as tangible common equity/risk-weighted assets (RWA)<sup>3</sup>, increased to 21.2% as of June 2023 from 20.9% in June 2022, and its regulatory Common Equity Tier 1 capital ratio was of 20.5% as of June 2023, well above the minimum regulatory.

We expect BRDE to maintain its capital above the regulatory minimum levels, particularly in light of the creation of a new resolution in 2015, through which the bank will transfer profits into its capital reserves semiannually. Moreover, the bank's bylaws require that the totality of earnings be retained and incorporated into the bank's capital reserves.

### Profitability remains adequate, and has been boosted by higher rates and lower provision expenses

Although BRDE's mandate is not focused on profitability but on increasing lending with the objective of development to ensure economic prosperity and job creation in the south of Brazil, the bank's recurring earnings generation has historically been adequate to maintain capital at sound levels. On June 2023, net income to tangible assets ratio was 2.4%, in line with 2.5% in the same period a year earlier, as results continued to be boosted by credit expansion (+13.0% year over year), higher interest rates in the investment portfolio and the reversion of excess provisions.

In H1 2023, BRDE reversed BRL14.9 million of provisions, slightly higher than the reversal of BRL12.8 million in H1 2022. Net interest income increased 15.3% in the same period, mainly because of interest earned in government securities investments in a high rate environment. On the other hand, operating expenses increased 19.3% in H1 2023 from a year earlier, mainly due to higher personnel, data processing and other general administrative expenses, as well as non-income taxes.

Looking forward we expect these trends to stabilize as the easing cycle on the benchmark rate (Selic) continues and BRDE continue to gradually expand its loan book that will demand loan loss provision expenses to increase.

### Concentrated funding base leaves BRDE susceptible to BNDES' lending policies

Because of its policy role as a development bank, BRDE is not allowed to take deposits from individuals and companies. As a result, as of June 2023, BNDES funds accounted for 68.6% of total loans and 75.2% of the bank's total funding of BRL15.0 billion. The rest of BRDE's funding base is composed of resources from [Caixa Economica Federal \(CAIXA\)](#) (Ba2 stable, ba3), Fundo de Garantia do Tempo de Serviço (FGTS), [Banco do Brasil S.A.](#) (Ba2 stable, ba2) and the federal government, including Financiadora de Estudos, Projetos (FINEP) Fundo Geral do Turismo (FUNGETUR), Fundo de Defesa da Economia Cafeeira (FUNCAFE) and Fundo Constitucional de Financiamento do Centro-Oeste (FCO).

However, since 2018, BRDE has been diversifying its funding sources, accessing multilateral agencies such as the Agence Francaise de Developpement (AFD), [European Investment Bank](#) (EIB, Aaa stable), [Corporacion Andina de Fomento](#) (CAF, Aa3 stable) that together represented 9.6% of its total funding. In addition it has a USD 150mm facility with the [Inter-American Development Bank](#) (Aaa stable) to focus on SME clients. As a result of these efforts, BNDES' resources represented 41.7% of new loans in H1 2023, compared with 94.0% in 2017, and international multilateral funding represented 23.4%. Notwithstanding, we expect the lion's share of funding to continue to come from BNDES.

### BRDE's rating is supported by Brazil's Moderate Macro Profile

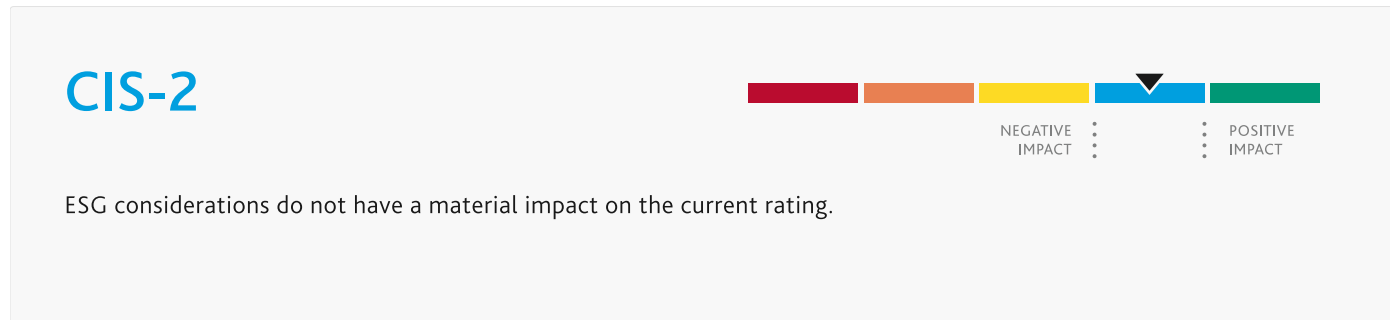
Brazil's (Ba2 stable) Macro Profile of "Moderate" is supported by the country's large and highly diversified economy with limited exposure to external financing risks. It also incorporates improvements in the business environment for banks from recent reforms, including the independence of the central bank; the state-owned company law; labor reform; and a collateral framework that reduced uncertainties about judicial disputes and the potential for political intervention in the financial system. We forecast a real GDP growth to moderate in 2024 and 2025 to 2.0% after growing around 3.0% in the previous couple of years. Our assessment acknowledges the current momentum as Brazil's banking system moves out of the credit cycle's downturn, with declining but still-high delinquency ratios and household indebtedness amid tighter liquidity on global capital markets, which will continue to pressure credit conditions ahead.

## ESG considerations

### Banco Regional de Desenv do Extremo Sul's ESG credit impact score is CIS-2

Exhibit 3

#### ESG credit impact score

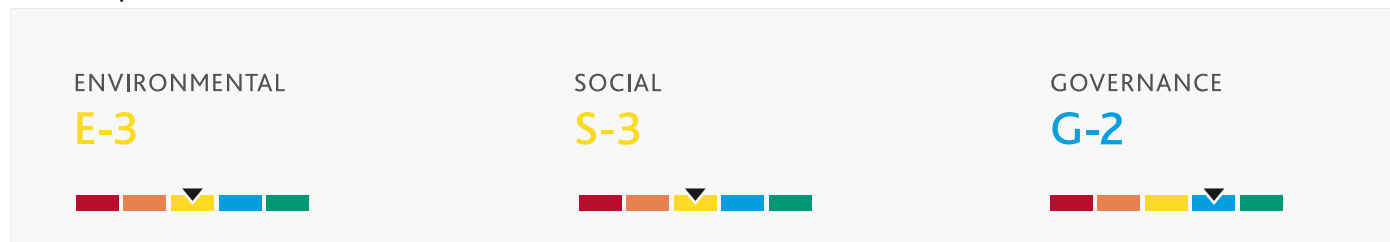


Source: Moody's Investors Service

BRDE's **CIS-2** reflects the limited credit impact of environmental, social and governance factors on the rating to date. Despite the bank's government ownership, its corporate governance practices have remained consistently strong over the past years, supporting the bank's credit profile.

Exhibit 4

#### ESG issuer profile scores



Source: Moody's Investors Service

### Environmental

BRDE faces moderate exposure to environmental risks because of its portfolio exposure to carbon transition and physical climate risks associated with agricultural and industrial loans in the Southern States of the country.

### Social

BRDE faces moderate social risks, reflecting the bank's exposure to risks associated to customer relations and data privacy. BRDE also plays an important role in developing Brazil's Southern states, especially in rural areas by providing long-term financing to the agriculture segment.

### Governance

BRDE present low exposure to governance risks, reflecting the bank's strong corporate governance practices and the good track record of its management in delivering on strategic goals. BRDE's ownership is divided among three different States, which reduces the possibility of political interference and influence its corporate governance practices positively.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click [here](#) to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

## Support and structural considerations

### Notching considerations

In the absence of a bail-in resolution regime framework in Brazil, the ratings follow the additional notching guidelines, according to our Banks rating methodology. In these cases, the approach takes into account other features specific to debt classes, resulting in additional notching from the issuer's Adjusted BCA.

### Affiliate support

BRDE's Adjusted BCA of ba2 receives no uplift from its ba2 standalone BCA.

### Government support

We believe there is a low likelihood of government support for BRDE's liabilities. This reflects the bank's reduced market share of deposits in Brazil.

### Counterparty Risk (CR) Assessment

#### **BRDE's CR Assessment is positioned at Ba1(cr)/Not Prime (cr)**

BRDE's CR Assessment is positioned at Ba1(cr) and Not Prime (cr), which is one notch above the bank's Adjusted BCA of ba2.

### Counterparty Risk Rating (CRR)

#### **BRDE's CRRs is are positioned at Ba1/NP**

BRDE's global local-currency CRRs are positioned at Ba1 and Not Prime, one notch above the bank's Adjusted BCA, reflecting the lower probability of default of CRR liabilities and our expectation of a normal level of loss given default.

### 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 5

### Banco Regional de Desenv do Extremo Sul

Macro Factors							
Weighted Macro Profile		Moderate	100%				
Factor	Historic Ratio	Initial Score	Expected Trend	Assigned Score	Key driver #1	Key driver #2	
Solvency							
Asset Risk							
Problem Loans / Gross Loans	0.6%	a2	↔	ba2	Sector concentration		
Capital							
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)	21.2%	a2	↔	baa2	Expected trend		
Profitability							
Net Income / Tangible Assets	1.9%	baa1	↔	ba2	Earnings quality		
Combined Solvency Score		a2		ba1			
Liquidity							
Funding Structure							
Market Funds / Tangible Banking Assets	72.8%	caa3	↔	b1	Extent of market funding reliance		
Liquid Resources							
Liquid Banking Assets / Tangible Banking Assets	17.2%	ba2	↔	ba2			
Combined Liquidity Score		b3		ba3			
Financial Profile							
Qualitative Adjustments				Adjustment			
Business Diversification				0			
Opacity and Complexity				0			
Corporate Behavior				0			
Total Qualitative Adjustments				0			
Sovereign or Affiliate constraint				Ba2			
BCA Scorecard-indicated Outcome - 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 Rating	1	0	ba1	0	Ba1	Ba1	
Counterparty Risk Assessment	1	0	ba1 (cr)	0	Ba1(cr)		
Senior unsecured bank debt	0	0	ba2	0	Ba2		

[1] Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.

Source: Moody's Investors Service

## Ratings

### Endnotes

- [1](#) The bank ratings shown in this report are the bank's domestic deposit rating (issuer rating when not available), outlook and Baseline Credit Assessment.
- [2](#) We consider as problem loans the loans overdue rated between E and H under Brazilian Central Bank's resolution 2,682/99.
- [3](#) Our preferred measure of capitalization, which deducts from capital the intangible assets and a significant portion of deferred tax assets that do not provide significant loss absorption, and we adjust the bank's RWA by applying a risk factor of 100% to its significant holdings of the Brazilian government securities, weighted 0% by local regulations.



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