MOODY'S
INVESTORS SERVICE

CREDIT OPINION
30 August 2018

Update

Rate this Research

RATINGS

**Banco Bradesco S.A.**

| | |
|---|---|
| Domicile | Osasco, Sao Paulo, Brazil |
| Long Term CRR | Ba1 |
| Type | LT Counterparty Risk Rating - Fgn Curr |
| Outlook | Not Assigned |
| Long Term Debt | (P)Ba2 |
| Type | Senior Unsecured MTN - Fgn Curr |
| 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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CLIENT SERVICES

# Banco Bradesco S.A.

## Update to credit analysis

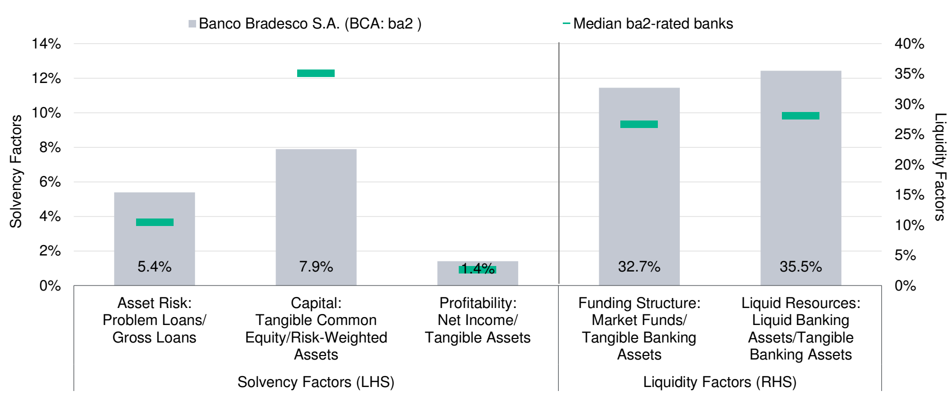
## Summary

Banco Bradesco S.A. (Bradesco) has a Baseline Credit Assessment (BCA) of ba2, which acknowledges the bank's steady recurring earnings generation, combined with disciplined risk management that supports its strong capital replenishment ability. The bank's sound liquidity is characterized by its large market share in core deposits in Brazil, and well-established access to the domestic and international capital markets. Bradesco's problem loan ratio, however, is higher than the industry average and its capital position remains low, according to our metric that is adjusted for the high share of deferred tax assets, compared with its global commercial bank peers. A key strength for Bradesco is its resilient capital replenishment capacity, reflected by the bank's high revenue diversification and solid franchise in retail banking and insurance, which ensure strong earnings stability through the cycles.

Bradesco's ratings are at the same level as Brazil's Ba2 sovereign bond rating. The Aa1.br Brazilian national scale rating assigned to Bradesco is positioned at the top of the range of available options for Ba2-rated issuers in Brazil to reflect the strength of the bank as the second-largest private-sector bank in the country.

Exhibit 1

**Rating Scorecard - Key financial ratios**




*Source: Moody's Financial Metrics*

## Credit strengths

» Solid earnings generation, with high revenue diversification, including an important share from non-credit revenue provided by the bank's leading franchise in health and life insurance, as well as pension funds

» High reserve buffers and a diversified loan portfolio, with a focus on lower-risk lending segments

» Sound liquidity and funding access, with a large and stable portion of core deposits provided by its massive client base and nationwide outreach

## Credit challenges

» Ratings capped by Brazil's Ba2 sovereign bond rating

» Timely achievement of synergy gains to improve efficiency ratios

» Asset-quality indicators still above the industry levels

» Lower-than-peer Moody's-adjusted capital ratio despite steady replenishment resulting from its strong earnings fundamentals

## Outlook

The outlook on Bradesco's long-term deposit and senior ratings is stable, reflecting our expectation that the bank's sound financial fundamentals and the high interconnection of its credit risk to that of the sovereign, which leads the rating to be constrained by the Brazil's Ba2 sovereign rating. The stable outlook on Bradesco's ratings is aligned to the stable outlook on Brazil's sovereign bond rating.

## Factors that could lead to an upgrade

Bradesco's ba2 BCA and Ba2 deposit and senior unsecured debt ratings are at the same level as Brazil's Ba2 sovereign rating. Therefore, there is no upward pressure at this point. However, the BCA and ratings would be upgraded in case of an upgrade at the sovereign rating.

## Factors that could lead to a downgrade

Because the ratings are effectively capped by Brazil's Ba2 sovereign rating, given the strong credit interlinks between the sovereign and the bank, a downgrade of the sovereign rating could lower Bradesco's BCA. The rating could also be strained if the bank experiences a material deterioration in recurring earnings generation triggered by unexpected losses or by a prolonged recession. However, a downgrade of the bank’s BCA would not likely affect its debt and deposit ratings, given the high probability of financial support from the government should the bank face financial stress.

## Key indicators

Exhibit 2

**BANCO BRADESCO S.A. (Consolidated Financials) [1]**

| | 6-18[2] | 12-17[2] | 12-16[2] | 12-15[2] | 12-14[2] | CAGR/Avg.[3] |
|---|---|---|---|---|---|---|
| Total Assets (BRL billion) | 1,239 | 1,211 | 1,180 | 1,019 | 1,032 | 5.4[4] |
| Total Assets (USD billion) | 322 | 365 | 362 | 258 | 388 | -5.2[4] |
| Tangible Common Equity (BRL billion) | 66 | 65 | 53 | 56 | 58 | 3.9[4] |
| Tangible Common Equity (USD billion) | 17 | 20 | 16 | 14 | 22 | -6.5[4] |
| Problem Loans / Gross Loans (%) | 4.7 | 5.5 | 6.7 | 4.7 | 4.1 | 5.1[5] |
| Tangible Common Equity / Risk Weighted Assets (%) | 7.9 | 8.5 | 6.9 | 8.0 | 9.1 | 8.1[6] |
| Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%) | 18.2 | 20.2 | 27.9 | 19.9 | 17.7 | 20.8[5] |
| Net Interest Margin (%) | 5.4 | 7.1 | 8.7 | 6.0 | 6.4 | 6.7[5] |
| PPI / Average RWA (%) | 4.3 | 5.9 | 7.1 | 4.3 | 5.6 | 5.4[6] |
| Net Income / Tangible Assets (%) | 1.5 | 1.2 | 1.3 | 1.7 | 1.5 | 1.4[5] |
| Cost / Income Ratio (%) | 60.8 | 60.0 | 53.9 | 54.7 | 48.8 | 55.6[5] |
| Market Funds / Tangible Banking Assets (%) | 36.1 | 32.7 | 40.2 | 35.3 | 29.1 | 34.7[5] |
| Liquid Banking Assets / Tangible Banking Assets (%) | 39.1 | 35.5 | 37.4 | 30.9 | 36.2 | 35.8[5] |
| Gross Loans / Due to Customers (%) | 116.2 | 122.7 | 145.2 | 164.2 | 149.8 | 139.6[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*

## Profile

Banco Bradesco S.A. is the second-largest privately owned bank in Brazil, and provides a diversified range of financial products and services to retail customers, as well as corporates. The bank has a strong market position in insurance products, with a dominant share in life/pension products in Brazil. Bradesco held a 11% share of the system's loans, around 12% of total deposits in March 2018 and 25.3% of insurance premiums as of June 2018. The bank offers corporate and consumer banking services to about 700 businesses and around 400,000 retail clients, distributed through 4,700 traditional banking branches and strong digital operations. Bradesco is also present in New York, Mexico, Miami, Cayman Islands, Buenos Aires, London, Hong Kong and Luxembourg.

With a free float of 60.87% of total shares (66.11% of voting shares and 25.64% of non-voting shares) as of August 2018, Bradesco is listed on the local stock exchange since 1946 and since 1997 in the US market.

## Detailed credit considerations

### Improving delinquencies, but still remains above industry levels

Bradesco's overall risk management follows conservative policies that ensure resilient asset-quality indicators through the credit cycles. In June 2018, Bradesco reported 90-day delinquencies at 3.9%, in line with the levels before the economic recession in 2015-16. After two years of loan contraction, new loan origination is growing strongly, particularly in the corporate and SME segments, which increased 23.6% in total in the quarter ended 30 June 2018, while loans to individuals have continued to increase consistently since Q3 2017. Overall, total the loan book increased 4% in 12 months, with wholesale loans up 2.1% and loans to individuals up 6.4% between June 2017 and June 2018. As of June 2018, 53.5% of Bradesco loans was to the wholesale segment and 46.5% to individuals.

Furthermore, total nonperforming loans continued to decline in June 2018, accounting for 4.7% of total loans (5.4% in March 2018), the lowest levels since 2015, which reflects the bank's conservative risk appetite, more focused on secured consumer products, combined with portfolio expansion. In the first six months of 2018, the annualized ratio of net charge-offs to total loans declined to 3.6% compared with 6.0% in the same period of 2017, showing a reduction in the volume of charge-offs.

We assess the bank's Asset Risk score at ba1, adjusting 2 notch upward the ba3 macro-assigned score, which takes into account Bradesco's much higher reserves compared with that of its peers, portfolio diversification and improving asset-quality trend. With an expected growth of between 3% and 7% for total loans in 2018, we expect asset quality to continue improving this year, but at a more gradual pace. Delinquencies remain higher than those of its main peers because the bank has more exposure to segments that will take longer to recover, such as the construction sector. In contrast, Bradesco has disciplined risk management policies and ample loss absorption capacity, with loan loss reserves representing 9% of total loans and 191% of nonperforming loans in June 2018. The highly diversified portfolio and ample reserve buffer help shield the bank's capital position from any unexpected asset deterioration.

### Strong capital replenishment capacity

Bradesco's Capital score is b2, adjusted from the historical ratio to reflect the bank's historically strong capital replenishment capacity, where retained earnings were sufficient to replenish its capital on an average of 0.5% every quarter during the crisis, according to our capital metrics. The tangible common equity as a percentage of adjusted risk-weighted assets reached 7.9% as of June 2018, down from 8.5% in 2017, but up from 6.9% in 2016 after the acquisition of HSBC's operations in Brazil. While the bank's capital position remains below the level before the merger, it is in line with that of its peers and ensures that Bradesco will be able to compete more aggressively in the next credit cycle. The focus of loan growth will continue to be secured consumer loans, mortgages and strongly guaranteed wholesale credits targeting efficient capital allocation. In June 2018, despite the 5.2% quarterly increase in total loans, Moody's adjusted total risk-weighted assets increased by 4.1%.

The bank's capital replenishment plan is primarily based on strong internal equity generation, which is likely to improve in the coming years as business volumes increase under a more favorable scenario and the high provisioning levels gradually reverse. Under the local regulatory requirement, the bank reported a Common Equity Tier 1 (CET1) capital ratio of 11.4%, reduced by 100 basis points in the quarter because of mark-to-market adjustments to the securities portfolio and additional prudential adjustments made in the quarter. However, the ratio is well above the minimum total CET1 ratio of 9.5% required by Basel III rules by January 2019.

### Future profitability is challenged by low interest rate environment and still-timid loan origination

We score Bradesco's Profitability at baa2, adjusted by one notch to acknowledge strong recurring earnings generation, driven by a diversified and steady earnings generation capacity, supported by non-interest income activities where the bank has high market participation. Compared with other banks in the system, Bradesco's sizable insurance operations, which accounted for one-third of its bottom-line results, have historically been a market leader in the life and pension plan industries, as well as in the healthcare segment, with a 25.3% market share by premiums.

Future earnings generation will continue to benefit from cost synergies and revenue opportunities related to the acquisition of HSBC's operations in Brazil, and because the bank continues to focus on non-interest income activities and cost-cutting efforts, as well as its digital banking strategy. As the bank's loan growth resumes in 2018, we expect an improvement in net interest income despite potential pressure on margins that might arise from competition and a lower interest rate environment.

Diversification and a focus on cross-selling could help Bradesco manage net interest margin pressure that will stem from fierce competition in the coming years. While Bradesco is likely to maintain a cautious credit strategy in 2018 as economic growth remains weak, profitability will benefit from lower funding costs and improved credit conditions, which should help offset margin pressures and support a pick-up in business volumes. Bradesco's reported margin has gradually declined, staying at 6.4% in June 2018, down 7.2% from the same period in 2017 and 7.4% from June 2016.

In the first six months of 2018, recurring net income increased 9.7% compared with the same period in 2017, totaling BRL10.3 billion, after adjusting for goodwill amortization related to the acquisition of HSBC's operations in Brazil, consolidated in the third quarter of 2016. The bank's good performance in the first half of 2018 was mainly driven by the increase in fee-based income and strong cost controls. Fee and commission income, including earnings from insurance, represented around two-thirds of its bottom-line results in June.

### Steady funding and a strong liquidity

The assigned score for Funding Structure is ba1, reflecting the bank's ample diversification of funding sources, with a steady and broad customer base that accounted for 60.4% of total funding[1] in June 2018, including deposits, letters of credit for real estate and letters of credit for agribusiness, which are deposit-like instruments and largely granular resources.

Institutional resources have a steady behavior through downturns, with Bradesco being considered one of the safe havens by investors. Wholesale resources include (1) local-currency bank notes (letras financeiras), which accounted for 18.9% of total funding in June 2018; (2) domestic onlending resources from government institutions, including lines from the national development bank Banco Nac.

Desenv. Economico e Social - BNDES (BNDES), which represented 4.4% (reflecting BNDES' contraction); and (3) foreign-currency funding (correspondent banking facilities, senior and subordinated notes) and others, accounting for the remaining 16.3% of resources. The diversification of the bank's funding structure, its stability of deposits, and disciplined asset and liability management have ensured adequate duration of the bank's resources. In the quarter ended June 2018, the volume of funding increased 5.6%, in line with the loan portfolio expansion. According to Anbima Ranking, the bank had BRL806.8 billion of assets under management, representing a market share of around 20.5% in June 2018.

Bradesco also has a sound liquidity base, which has been enhanced by the slowdown in loan origination over the past three years. The bank has a proprietary exposure to government securities (excluding exposure owned by the insurance and pension plans) of BRL174.8 billion, accounting for 14.1% of total assets and 264.4% of Moody's tangible common equity in June 2018, which reflects the bank's high correlation with sovereign creditworthiness. Although these securities are a source of immediate liquidity, it is also an important source of risk in case of sovereign stress in times of downturns.

### Bradesco's credit profile reflects Brazil's Moderate- Macro Profile

The Moderate- Macro Profile for Brazil reflects the large scale and diversification of the country's economy, strong international reserves and the improved effectiveness of monetary policy. However, following two years of economic contraction, the economic rebound that started in 2017 has been low, reflecting the political uncertainties surrounding 2018 presidential elections and policy continuity beyond 2019. We expect economic growth to remain moderate in 2018 and 2019, which will support modest lending growth in the next 12 months on the back of low levels of interest rates and inflation, which improve borrowers' repayment capacity. Asset quality is likely to remain stable, with no pressure to funding needs. The slowdown in government-owned banks' lending has reduced market distortions.

## Support and structural considerations

### Government support

We believe there is a high likelihood of government support for Bradesco's rated wholesale deposits and senior unsecured debt. This belief reflects Bradesco's large market share of deposits in Brazil and, hence, the material systemic consequences that would result from an unsupported failure. Nevertheless, Bradesco's deposit rating does not benefit from government support uplift, at this instance, given that the bank's standalone BCA is at the same level as the government bond rating.

### Counterparty Risk (CR) 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 (for example, swaps), letters of credit, guarantees and liquidity facilities.

#### Bradesco's CR Assessment is positioned at Ba1(CR)/Not Prime(CR)

The CR Assessment of Ba1(cr) is one notch above the Adjusted BCA of ba2 based on our view that senior obligations represented by the CR Assessment will be more likely preserved than senior unsecured debt in order to minimize losses, avoid disruption of critical functions and limit contagion. This CR Assessment reflects an issuer's probability of defaulting on certain operating liabilities and other contractual commitments that are less likely to be subject to the application of a resolution tool to ensure the continuity of operations.

### 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.

The Financial Profile score for Bradesco is ba2, the same as its BCA, which is at the same level as Brazil's Ba2 sovereign bond rating.

## Rating methodology and scorecard factors

Exhibit 3

BANCO BRADESCO 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 | 5.4% | ba3 | ←→ | ba1 | Collateral and provisioning coverage | Expected trend |
| Capital | | | | | | |
| TCE / RWA | 7.9% | b3 | ←→ | b2 | Stress capital resilience | Expected trend |
| Profitability | | | | | | |
| Net Income / Tangible Assets | 1.4% | baa3 | ←→ | baa2 | Earnings quality | |
| Combined Solvency Score | | ba3 | | ba2 | | |
| Liquidity | | | | | | |
| Funding Structure | | | | | | |
| Market Funds / Tangible Banking Assets | 32.7% | b1 | ←→ | ba1 | Deposit quality | Market funding quality |
| Liquid Resources | | | | | | |
| Liquid Banking Assets / Tangible Banking Assets | 35.5% | baa3 | ←→ | baa3 | Quality of liquid assets | |
| Combined Liquidity Score | | ba2 | | ba1 | | |
| 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 Rating | 1 | 0 | ba1 | 0 | Ba1 | Ba1 |
| Counterparty Risk Assessment | 1 | 0 | ba1 (cr) | 0 | Ba1 (cr) | -- |
| Deposits | 0 | 0 | ba2 | 0 | Ba2 | Ba3 |
| Senior unsecured bank debt | 0 | 0 | ba2 | 0 | -- | (P)Ba2 |

[1] Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.
*Source: Moody's Financial Metrics*

## Ratings

Exhibit 4

| Category | Moody's Rating |
|---|---|
| **BANCO BRADESCO S.A.** | |
| Outlook | Stable |
| Counterparty Risk Rating | Ba1/NP |
| Bank Deposits -Fgn Curr | Ba3/NP |
| Bank Deposits -Dom Curr | Ba2/NP |
| NSR Bank Deposits | Aa1.br/BR-1 |
| Baseline Credit Assessment | ba2 |
| Adjusted Baseline Credit Assessment | ba2 |
| Counterparty Risk Assessment | Ba1(cr)/NP(cr) |
| Senior Unsecured MTN | (P)Ba2 |
| **BANCO BRADESCO S.A., GRAND CAYMAN BRANCH** | |
| Counterparty Risk Rating | Ba1/NP |
| Counterparty Risk Assessment | Ba1(cr)/NP(cr) |
| Senior Unsecured MTN | (P)Ba2 |
| Subordinate | Ba3 |

*Source: Moody's Investors Service*

## Endnotes

1 Total funding is composed of resources from deposits, bank notes, onlendings, subordinated debt, and others. We are considering the gross funding position, which is not net of reserve requirements placed at the central bank of Brazil (BRL71.4 billion in June 2018) and cash equivalents (BRL1.5 billion in June 2018) as reported by Bradesco. Local currency bank notes (letras financeiras) are not considered as stable as deposits. These funding alternatives are considered market-based sources, given the high ticket largely distributed to qualified institutional investors.

REPORT NUMBER 1137196

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