

Rating Action: Moody's America Latina rates Desenbahia Ba2/Aa2.br; negative outlook

Global Credit Research - 05 Apr 2016

Sao Paulo, April 05, 2016 -- Moody's America Latina assigned global scale long and short-term local currency issuer ratings of Ba2 and Not Prime, and Brazilian national scale issuer ratings of Aa2.br and BR-1, for long and short-term respectively, to Desenbahia - Agência de Fomento do Estado da Bahia S.A. (Desenbahia), owned by the state of Bahia (Ba2 negative). At the same time, Moody's assigned the entity a baseline credit assessment (BCA) of ba3. The outlook on the global scale issue rating is negative, in line with the negative outlook assigned to its controlling shareholder's rating. This is the first time Moody's assigns ratings to Desenbahia.

The following assessment and ratings were assigned to Desenbahia -- Agencia de Fomento do Estado da Bahia S.A.:

Baseline credit assessment of ba3

Long-term local currency issuer rating of Ba2, negative outlook

Short-term local currency issuer rating of Not Prime

Long-term Brazilian national scale issuer rating of Aa2.br

Short-term Brazilian national scale issuer rating of BR-1

RATINGS RATIONALE

The Ba2 issuer rating incorporates Desenbahia's ownership by the state government of Bahia (Ba2 negative), as well as its policy role as the development agency for the state government, engaged in providing long-term financing to municipalities and to small and micro enterprises. Moody's noted that in accordance with its rating methodology for government related issuers (GRI), the ratings for Desenbahia reflect the combination of two inputs: (1) the agency's intrinsic financial profile, which is reflected in a baseline credit assessment (BCA) of ba3; and 2) the incorporation of the probability of a high support and very high dependence from its shareholder. Our support e assessment takes into account the agency's role as a financial arm of the government with full strategic alignment to the state's social and economic development initiatives. It also incorporates the consistent dividend reinvestment policy and conservative capital levels maintained by shareholders, indicative of the state government's commitment and willingness to support the agency's operations, while enhancing its financial flexibility. For that reason, Desenbahia's Ba2 issuer rating benefits from a one-notch uplift from its standalone ba3 assessment.

In assigning an unsupported baseline credit assessment of ba3, Moody's notes that Desenbahia is a small regional franchise with limited business diversification and relative concentrated loan portfolio by borrower and by sector. While the asset quality indicators have historically remained better than the average presented by its peer development agencies, there are indications of deterioration over the past 12 months in the form of an increase in loan renegotiations and rising credit costs. About 34% of its loan book relate to agribusiness, an important economic segment for the state of Bahia. Desenbahia also lends to municipalities, which made roughly 16% of total loans in 2015, a portfolio that is predominantly guaranteed by tax transfers from the state government, and therefore, carry limited credit risk, as reflected in the agency's asset quality. The largely secured nature of the loan book also compensate the risks of relative loan concentration to a single class of borrowers or to specific segments. Future plans to enter private-public participation deals with large corporations investing in the state, such as in the energy sector, a strategy aligned to its policy role, could increase concentration risk.

The ba3 BCA also reflects rapid loan growth pace in 2015, despite the rising risk conditions in Brazil, which, however, is supported by a robust capitalization of 52.75% as of December 2015, an important buffer against credit losses. While Desenbahia's high profitability in 2015 was boosted by non-recurring gains from the sale of its former headquarters, we note that the company's recurring earnings generation will remain pressured by

higher credit costs on the back of the negative macro trends. The agency's plans to tap international credit facilities from multilateral banks is a positive diversification of its funding sources, however, these high cost resources may further strain its future profitability.

By the same token, in its role as a policy entity, Desenbahia may be exposed to political interference from the local government in its asset allocation decisions, and despite its track record of good governance practices. We view these challenges as constraining factors to the ratings.

WHAT COULD MAKE THE RATING GO UP

At this juncture, there is no upward rating pressure on Desenbahia's standalone ratings, particularly given Brazil's challenging operating environment.

WHAT COULD MAKE THE RATING GO DOWN

A weakening of entity's financial fundamentals, particularly resulting from a significant deterioration in the quality of the loan book, would have negative effect on the BCA. A downgrade of its shareholder's rating would also affect Desenbahia's supported issuer rating of Ba2.

USED METHODOLOGIES

The principal methodology used in rating was Government-Related Issuers published in October 2014. Please see the Ratings Methodologies page on www.moody.com.br for a copy of this methodology.

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Desenbahia -- Agencia de Fomento do Estado da Bahia S.A. is headquartered in Salvador, Bahia and had total assets of BRL1,124 million (\$284.1 million) and total equity of BRL570million (\$144.1 million) as of 31 December 2015.

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