

RatingsDirect®

Banco do Estado do Para S.A.

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Banco do Estado do Para S.A.

SACP	bb-	+	Support	0	+	Additional Factors	0
Anchor	bb+		ALAC Support	0		Issuer Credit Rating BB-/Negative/B	
Business Position	Weak	-2	GRE Support	0			
Capital and Earnings	Adequate	0	Group Support	0			
Risk Position	Moderate	-1	Sovereign Support	0			
Funding	Above Average	+1					
Liquidity	Strong						

Major Rating Factors

Strengths:	Weaknesses:
<ul style="list-style-type: none"> • Strong profitability and internal capital generation. • Comfortable liquidity position. • Low funding cost. 	<ul style="list-style-type: none"> • Minimal cross selling of products and few business lines. • Geographic and counterparty concentrations.

Outlook: Negative

The negative outlook over the next 12 months on Banco do Estado do Para S.A. (Banpara) reflects the negative trend of our Banking Industry Country Risk Assessment (BICRA) of Brazil. We believe that Brazil's still challenging economic and political conditions could affect regional business activity, the state of Para's fiscal conditions, and individuals' payment capacity; which are important factors for Banpara's financial performance.

Downside scenario

We could lower the ratings on Banpara if we were to revise Brazil's BICRA to a weaker category. In that scenario, we would incorporate into our assessment higher risks in the domestic financial system that would weigh on banks.

Upside scenario

We could revise the outlook on Banpara to stable if we see lower economic and industry risks in Brazil's BICRA and revise those trends back to stable.

Rationale

Our ratings on Banpara reflect its narrow business lines--it mainly offers payroll deductible lending to the state's public employees and retirees--and our expectation that Brazil's current economic conditions constrain diversification. The ratings also reflect the bank's adequate capitalization levels, due to an average risk-adjusted capital (RAC) ratio of 8.0%-8.5% for the next 18-24 months, supported by strong profitability metrics and historically stable dividend payouts. Banpara has improved its asset quality metrics after it reduced its exposure to small and midsize enterprise (SMEs) lending. We currently view its payroll loans as less vulnerable to the country's economic downturn than corporate lending activities, which should continue supporting low delinquency levels. Still, the bank is highly exposed to counterparty concentration, given that its payroll portfolio performance relies on the state to provide timely payments to its employees. Banpara also has abundant access to retail funding thanks to its widespread branch network across the state of Para, its well-recognized regional brand, and its position as the state's financial agent. Its stable and diverse deposits are crucial for the bank's strong liquidity position, which provides a comfortable cushion against financial obligations for the next 12 months. Additionally, we don't incorporate any notching of government support into the bank's stand-alone credit profile (SACP).

Banpara has a similar role compared to other rated banks in the region such as BRB - Banco de Brasilia S.A. (BRB; B+/Positive/B) and Banco do Estado do Rio Grande do Sul S.A. (Banrisul; BB-/Stable/--), both owned by their respective state's governments. We also consider other public banks for peer comparison purposes: Banco de Desenvolvimento de Minas Gerais S.A. – BDMG (BDMG; B-/Watch Pos/--), Banco do Nordeste do Brasil S.A. (BNB; BB-/Stable/B), and other private banks with relevant exposure to payroll.

Anchor: 'bb+' for banks operating in Brazil

Under our bank criteria, we use our BICRA's economic and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating. Our anchor for a commercial bank operating only in Brazil is 'bb+', based on the country's economic risk score of '7' and an industry risk score of '5'. (please see "Banking Industry Country Risk Assessment: Brazil," published Feb. 2, 2018, on RatingsDirect).

Table 1

Banco do Estado do Para S.A. Key Figures					
--Year-ended Dec. 31--					
(Mil. R\$)	2018*	2017	2016	2015	2014
Adjusted assets	7,154.0	6,850.8	6,263.4	5,240.0	5,005.6
Customer loans (gross)	4,266.9	3,837.0	3,626.0	3,358.0	3,036.5
Adjusted common equity	1,053.6	938.4	756.6	662.7	542.6
Operating revenues	1,156.2	1,309.0	1,107.3	1,006.7	863.3
Noninterest expenses	656.1	858.0	704.1	590.1	473.0
Core earnings	215.5	264.0	230.3	204.5	148.2

*Data as of Sept. 30. R\$--Brazilian real.

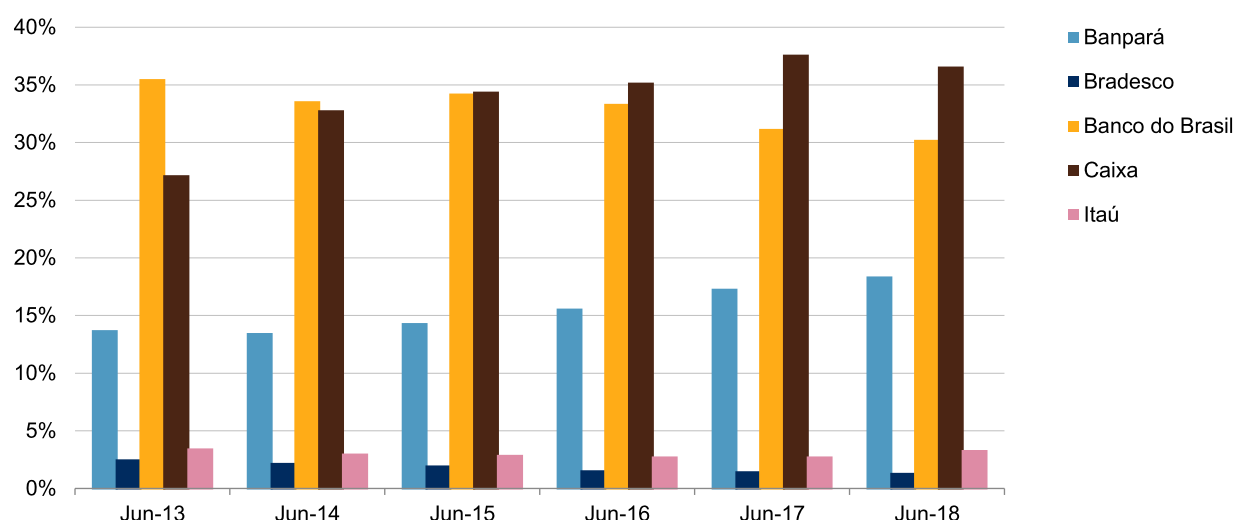
Business position: Concentration in the state of Para and narrow product diversification

The bank's narrow product and service offerings and its client base, which is concentrated in the state's public employees and retirees, limit Banpara's business position. Although it accounts for less than 1% of the financial system's total loans, the bank has a relevant presence in the state in which it operates--mainly because of its exclusive access to the local government's payroll. As of June 2018, Banpara had about 18.1% of market share in Para, up from 13.2% six years ago (Banrisul has 20.4% in Rio Grande do Sul and BRB 5.1% in the Brazilian Federal District).

Banpara's main local competitors are the federal banks--Banco do Brasil and Caixa Economica Federal--that each have more than 25% of the local market share. However, we expect Banpara to continue increasing its presence amid its expanding branch network and growth of its payroll management base through the state's municipalities. In addition, unlike other public banks, Banpara has accumulated capital in the past five years and its comfortable capital position should support business growth in the following few years, while its competitors struggle with regulatory capital restrictions.

Chart 1

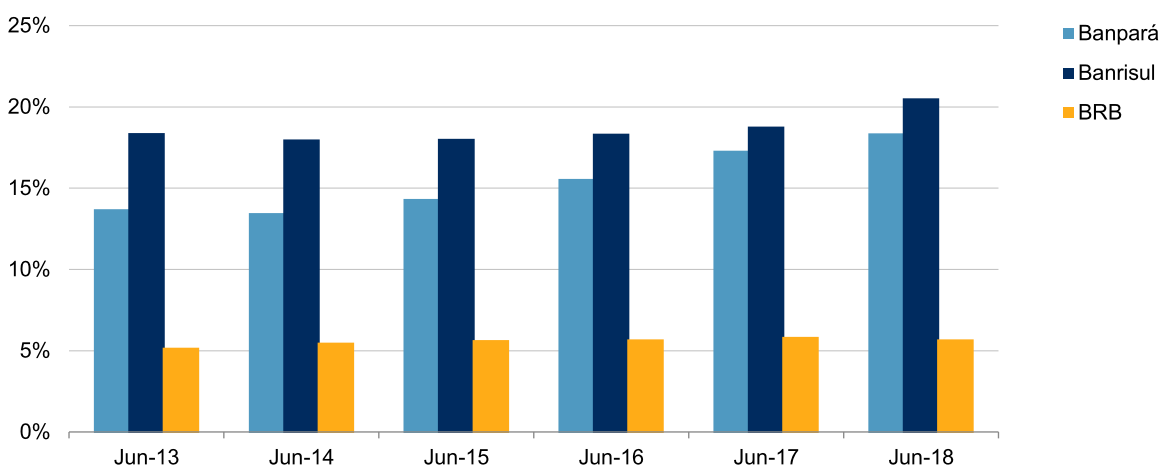
Loan Market Share In The State Of Para



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Chart 2

Loan Market Share In Banks' Respective States

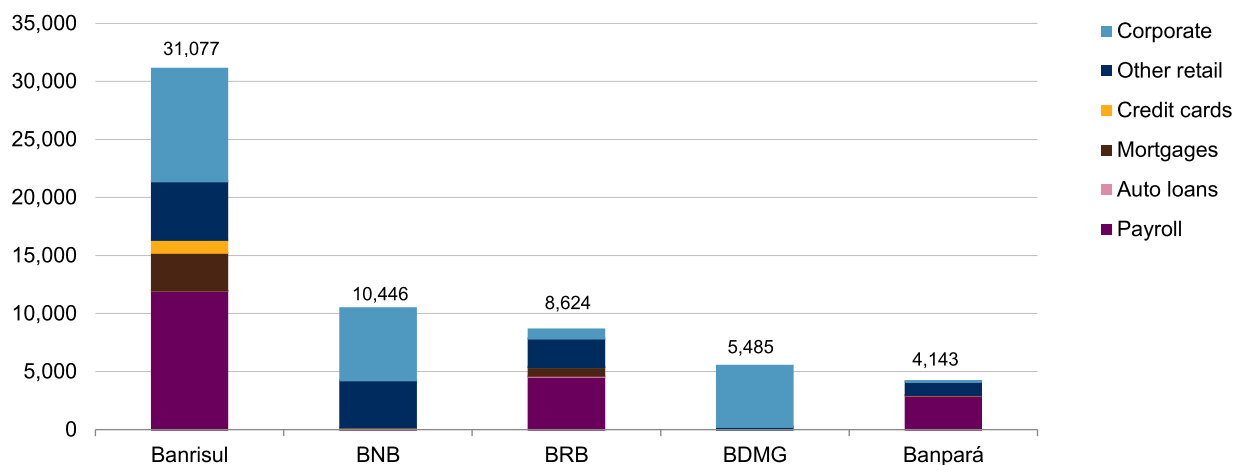


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The payroll-deductible lending and consumer financing segments account for around 71% and 29%, respectively, of Banpara's total loans, which is less diversified than its peers. However, its limited diversification towards riskier segments has also contributed to sound financial stability during the economic recession in the last few years. Regional banks that had previously served the corporate lending business confronted high credit loss provisioning. We expect Banpara to remain focused on its current business structure in the next two years.

Chart 3

Loan Breakdown - June 2018 (Mil. R\$)



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Helder Barbalho from the center-oriented party Movimento Democrático Brasileiro (MDB) was recently elected as the next governor of the state of Para. Although we could see changes in the bank's management next year, Banpara operates under the Law 13.303 that sets minimum requirements for appointing state-owned companies' board members.

Table 2

Banco do Estado do Para S.A. Business Position					
	--Year-ended Dec. 31--				
(%)	2018*	2017	2016	2015	2014
Loan market share in country of domicile	N/A	0.1	0.1	0.1	0.1
Deposit market share in country of domicile	N/A	0.2	0.2	0.2	0.2
Return on average common equity	25.8	27.9	30.4	32.4	27.5

*Data as of Sept. 30. N/A--Not applicable.

Capital and earnings: Sound internal capital generation supports its expansion throughout the state

Banpara's capital and earnings assessment stems from the bank's adequate capital base and historically strong profitability. The bank's RAC ratio should average 9.0%-9.5% for the next 18-24 months. Its return on average adjusted assets (ROAA) was around 4% and its return on equity (ROE) was 31% at the end of last year; we expect these to remain strong because of its high payroll business margins and low-cost funding base. In addition, its retention rate of earnings is consistent and higher than that of peers, indicating shareholders' commitment to the bank. Our forecast considers our base-case scenario, which includes the following assumptions:

- Brazil's real GDP growth of 1.4% in 2018 and 2.2% in 2019;
- Banpara's loan growth of 10% in 2018 and 12% in 2019, in nominal terms, mainly driven by its payroll deductible loans;
- Net interest margins (NIMs) above 20% for the next two years, combining its low funding cost and attractive spreads on payroll lending;
- Strong profitability metrics, with ROAA of 3.5%-4.0% for the next two years;
- Stable non-performing loans (NPLs), which are low compared to peers. These should remain low as long as the state maintains balanced fiscal metrics; and
- Dividend payout of 40%, in line with historical figures.

Table 3

Banco do Estado do Para S.A. Capital And Earnings					
	--Year-ended Dec. 31--				
(%)	2018*	2017	2016	2015	2014
Tier 1 capital ratio	23.3	23.3	21.4	20.7	19.4
S&P Global Ratings' RAC ratio before diversification	N/A	N/A	7.5	8.5	N/A
S&P Global Ratings' RAC ratio after diversification	N/A	N/A	6.4	7.1	N/A
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	100.0
Net interest income/operating revenues	85.2	90.1	91.0	91.1	91.9
Fee income/operating revenues	7.2	7.1	7.3	7.1	6.9

Table 3

Banco do Estado do Para S.A. Capital And Earnings (cont.)					
	--Year-ended Dec. 31--				
(%)	2018*	2017	2016	2015	2014
Noninterest expenses/operating revenues	56.7	65.6	63.6	58.6	54.8
Preprovision operating income/average assets	9.4	6.8	6.9	8.1	8.1
Core earnings/average managed assets	4.0	4.0	4.0	4.0	3.1

*Data as of Sept. 30. N/A--Not applicable.

Risk position: Sound asset quality tempered by counterparty and geographic concentrations

Banpara has posted sound asset quality and conservative risk management in the last two years, but this is somewhat mitigated by counterparty and geographic concentrations. Despite some asset quality deterioration led by its SMEs portfolio in 2013 and 2014, the bank was able to quickly control delinquency levels because of its low exposure to cyclical sectors (those sectors currently represent less than 0.2% of total loans). As of December 2017, NPLs and charge-offs were at 2% and 1.6%, respectively, the lowest compared to peers (see the chart below). Additionally, the bank's loan-loss reserves cover 172% of its NPLs, consistent with its conservative underwriting standards. Banpara has a fragmented customer base reflected in low loan single-name concentration: its 20 largest borrowers represent less than 0.4% of total loans as of June 2018. Still, the bank is subject to significant counterparty risk, given the importance of Para maintaining regular payroll payments. In light of challenging economic conditions and weaker tax collection, several Brazilian states delayed payroll payments in the last 12 months. Para wasn't among them, and we don't factor delayed payroll payments into our base-case scenario for the next two years.

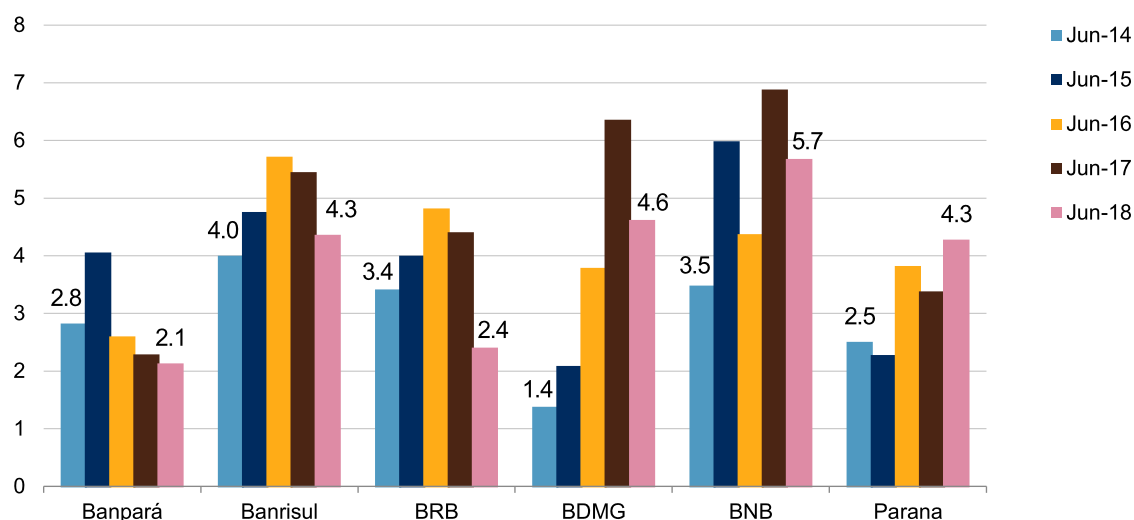
Table 4

Banco do Estado do Para S.A. Risk Position					
	--Year-ended Dec. 31--				
(%)	2018*	2017	2016	2015	2014
Growth in customer loans	14.9	5.8	8.0	10.6	11.6
Total diversification adjustment/S&P Global Ratings' RWA before diversification	N/A	N/A	16.5	19.1	N/A
Total managed assets/adjusted common equity (x)	6.9	7.4	8.4	8.0	9.3
New loan loss provisions/average customer loans	2.3	1.7	2.2	3.8	5.6
Net charge-offs/average customer loans	1.4	1.6	1.7	2.8	2.9
Gross nonperforming assets/customer loans + other real estate owned	1.9	2.0	2.4	2.8	4.5
Loan loss reserves/gross nonperforming assets	172.7	172.5	169.5	166.8	128.5

*Data as of Sept. 30. N/A--Not applicable.

Chart 4

Gross NPAs/Customer Loans (%)



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Funding and liquidity: Stable deposit base and strong liquidity

Unlike other small Brazilian banks, Banpara's funding base enjoys relative stability. Its funding mainly consists of deposits from retail clients and related parties, the latter of which are the state government, municipalities, and the judiciary. As of June, funding from related parties represented 41% of the bank's total funding, down from 50% at the end of 2012. The state government receives deposits from ongoing judicial processes and trials and then invests these in the bank. Funds from state-owned companies make up the remaining portion of the related parties' deposits. According to a state decree, the state-owned companies must have current accounts and investments in Banpara. The bank has also diversified its funding base in the past four years to rely less on government deposits. The remaining 59% of its funding mainly consists of retail depositors with better-than-average stability, given that Banpara manages the state's payroll. The bank's stable funding ratio was about 130% as of June 2018, in line with its three-year average of 119%.

The bank also has a very comfortable liquidity position, given its large volume of liquid assets. Its broad liquid assets were about 4.3x as of June, while customer loans to core deposits remain low at 74% against a three-year average of 82%. Furthermore, according to the central bank, none of Banpara's time deposits had liquidity conditions as of June. We expect the bank's liquidity to remain stable given its strategy to operate with comfortable levels of regulatory capital and liquidity.

Table 5

Banco do Estado do Para S.A. Funding And Liquidity					
	--Year-ended Dec. 31--				
(%)	2018*	2017	2016	2015	2014
Core deposits/funding base	87.4	89.4	75.4	86.4	90.2
Customer loans (net)/customer deposits	81.4	74.2	88.2	84.9	74.1
Long-term funding ratio	89.3	90.9	78.5	88.2	91.3
Stable funding ratio	121.8	129.6	112.7	115.1	123.6
Short-term wholesale funding/funding base	12.6	10.6	24.6	13.6	9.8
Broad liquid assets/short-term wholesale funding (x)	2.9	3.8	1.6	2.3	3.4
Net broad liquid assets/short-term customer deposits	38.0	46.3	28.1	23.9	29.1
Short-term wholesale funding/total wholesale funding	100.0	100.0	100.0	100.0	100.0

*Data as of Sept. 30.

Support: The SACP doesn't include any notches of government support

The state of Para owns 99.98% of Banpara. We view the likelihood of government support to the bank as moderate, given the latter's limited importance to, and its strong link with, the government. We base this assessment on the state government's majority control of the bank, Banpara's role as the state's financial agent, and the bank's mission to expand banking services to Para's isolated municipalities. On the other hand, we believe another lender could eventually replace Banpara's services, limiting the likelihood of government support.

Related Criteria

- General Criteria: Methodology For National And Regional Scale Credit Ratings, June 25, 2018
- 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: Group Rating Methodology, Nov. 19, 2013
- Criteria - Financial Institutions - Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Anchor Matrix										
Industry Risk	Economic Risk									
	1	2	3	4	5	6	7	8	9	10
1	a	a	a-	bbb+	bbb+	bbb	-	-	-	-
2	a	a-	a-	bbb+	bbb	bbb	bbb-	-	-	-
3	a-	a-	bbb+	bbb+	bbb	bbb-	bbb-	bb+	-	-
4	bbb+	bbb+	bbb+	bbb	bbb	bbb-	bb+	bb	bb	-
5	bbb+	bbb	bbb	bbb	bbb-	bbb-	bb+	bb	bb-	b+
6	bbb	bbb	bbb-	bbb-	bbb-	bb+	bb	bb	bb-	b+
7	-	bbb-	bbb-	bb+	bb+	bb	bb	bb-	b+	b+
8	-	-	bb+	bb	bb	bb	bb-	bb-	b+	b
9	-	-	-	bb	bb-	bb-	b+	b+	b+	b
10	-	-	-	-	b+	b+	b+	b	b	b-

Ratings Detail (As Of November 27, 2018)

Banco do Estado do Para S.A.

Issuer Credit Rating

BB-/Negative/B

Brazil National Scale

brAA+/Negative/brA-1+

Issuer Credit Ratings History

18-Aug-2017

BB-/Negative/B

23-May-2017

BB-/Watch Neg/B

14-Mar-2016

BB-/Negative/B

17-Feb-2016

BB-/Watch Neg/B

17-Apr-2015

BB-/Negative/B

20-May-2014

BB-/Stable/B

26-Mar-2014

BB+/Watch Neg/B

11-Jul-2018

Brazil National Scale

brAA+/Negative/brA-1+

18-Aug-2017

brA+/Negative/brA-1

23-May-2017

brA-/Watch Neg/brA-2

14-Mar-2016

brA-/Negative/brA-2

17-Feb-2016

brA+/Watch Neg/brA-1

17-Apr-2015

brAA-/Negative/brA-1

20-May-2014

brAA-/Stable/brA-1

26-Mar-2014

brAA+/Watch Neg/brA-1

Sovereign Rating

Brazil

BB-/Stable/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.

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