

Full Analysis

Banco Sumitomo Mitsui Brasileiro S.A.

March 12, 2024

This English version is provided on request and reflects the translation of the original article published only in Portuguese by S&P Global Ratings on March 12, 2024. In case of any discrepancy between this English version and the original in Portuguese, the Portuguese version shall apply.

SACP		Support		Additional Factors	
				Issuer Credit Rating	
Anchor	bb+	ALAC Support	-	Brazil National Scale brAAA/Stable/brA-1+	
Business Position	Constrained	GRE Support	-		
Capital and Earnings	Adequate	Group Support	Yes		
Risk Position	Moderate	Sovereign Support	-		
Funding	Moderate				
Liquidity	Adequate				
CRA adjustment					

ALAC--Additional loss-absorbing capacity. CRA--Comparable ratings analysis. GRE--Government Related Entity. SICR—Issuer credit rating. SACP--Stand-Alone Credit Profile.

Primary Credit Analyst:

Felipe Ojima
Sao Paulo
55 (11) 3039-4844
felipe.ojima
@spglobal.com

Secondary Contact:

Guilherme Machado
Sao Paulo
55 (11) 3039-9754
guilherme.machado
@spglobal.com

Key Credit Factors

Strengths	Weaknesses
Status as highly strategic subsidiary for its parent, Sumitomo Mitsui Financial Group. Inc. (SMFG/ A-/Stable/-)	Small participation in the Brazilian banking market due to its business model that relies on few business lines and with a narrow customer base.
Comfortable capitalization levels supported by retained earnings.	Despite having good asset quality, high concentration of its loan portfolio exposes the bank to potential impacts on its results from individual borrowers.

The ratings on SMBC Brasil are based on the creditworthiness of its parent. We view Banco Sumitomo Mitsui Brasileiro S.A. (SMBC Brasil) as a highly strategic subsidiary for its parent, the Japanese group SMFG, due to its relevant participation in its strategy, being an important hub to support and maintain business in Latin America. As a result, we consider that the parent will provide support to the bank, if necessary, in most foreseeable circumstances.

Positive operational results, but local balance sheet has growth challenges. In 2023, SMBC Brasil gross financial result showed good resilience due to the continuity of its strategy focused on high credit quality customers. However, the bank did not show significant growth in its loan portfolio on the local balance sheet. We hope that its strategy for 2024, focused on

increasing its range of products, will continue to support the bank's financial results, enabling it to maintain its profitability levels in the coming years.

Healthy asset quality metrics reflect the low-risk profile of the customer base. By focusing on large companies with strong credit quality, mainly multinationals that maintain a relationship with the SMFG group, the bank's asset quality metrics are solid. As of June 2023, SMBC Brasil did not have any due credit for more than 90 days. Furthermore, our assessment also incorporates the risks associated with the concentration in the bank's loan portfolio in a few borrowers. In the first half of 2023, its 20 largest debtors accounted 90.36% of its loan portfolio, higher than the 90.20% in December 2022, still above the market average.

Solid capitalization levels supported by its internal capital generation, maintaining results at positive levels. In June 2023, the bank's Basel III ratio was 22.11%, while its risk-adjusted capital (RAC) ratio reached 11.39% in December 2022. However, we expect a RAC ratio of 9.5%-10% on average over the next two years, given our growth expectation for the bank's loan portfolio.

The ratings also indicate adequate liquidity and funding concentration consistent with asset composition. SMBC Brasil's funding sources are wholesale oriented, which we see as more concentrated than a diversified retail funding base. However, in our view, the bank's funding is appropriate for its asset profile. In addition, the bank has adequate liquidity and benefits from a contingency liquidity line with its parent, which could be accessed in case of stress events.

Outlook

The stable outlook of the long-term issuer credit rating of Banco Sumitomo Mitsui Brasileiro S.A. reflects the outlook on the Brazil sovereign rating for the next 12 months, given the bank's high exposure to the local market. In our view, the bank's discipline and conservative approach in credit origination, with a portfolio aimed at multinationals with high credit quality, should contribute to rating stability. We also expect the bank to maintain adequate liquidity and solid regulatory capital ratios.

Downside scenario

We could downgrade SMBC Brasil following a similar action on Brazil's sovereign rating or if we change our assessment of its status as a highly strategic subsidiary for its group, which we consider unlikely at the moment. A downgrade resulting from a weakening of SMBC Brasil credit factors is also unlikely given our expectation of group support.

Upside scenario

SMBC Brasil is already rated at the highest level on our Brazil's National Scale.

Anchor: 'bb+' for banks operating in Brazil

We classify the Brazilian banking sector in the group '6' under our Banking Industry Country Risk Assessment (BICRA). The anchor for a bank operating only in Brazil is 'bb+'.

In our opinion, Brazil's low-income levels and the government's weak fiscal position constrain the country's economic resilience. We expect economic growth of 2.9% in 2023 due to the very strong performance of agribusiness and its effects on the rest of the economy. Credit growth is likely to be moderate amid persistently higher interest rates, tighter lending practices by private banks, and uncertainty over the economic policies the new government will implement. Asset quality will be pressured by the economic slowdown, low credit growth and high interest rates, but credit losses should be manageable due to the high provisions coverage.

Our industry risk assessment for Brazil reflects its well-developed financial regulation that is broadly in line with international standards, and the regulator's good track record that has helped the Brazilian financial system to withstand economic downturns. The Brazilian banking sector profitability has been resilient thanks to the high provisioning coverage

and a diversified revenue mix, but it will likely decline as provision needs rise, but from solid levels. The Brazilian banking system has an adequate funding mix with a large and stable core customer deposit base.

Business position: Strategy focused on multinational companies results in a concentrated business profile

Our assessment of SMBC Brasil's business position stems from its narrower-than-industry customer base and range of business lines. In our view, the bank has an established niche position, acting focused multinational companies, mainly Asian ones, with high credit quality. However, due to its undiversified customer base, the bank is subject to lower revenue stability since the non-renewal of an individual transaction could have a material impact on the bank's results.

With total assets of about R\$9.3 billion as of June 2023, SMBC Brasil was the 69th largest bank in Brasil in terms of assets, holding a market share of 0.07%. Our assessment considers only SMBC Brasil's local operations, despite its great importance for the group due to its offshore operations, which are allocated outside the bank's Brazilian balance sheet. This factor is incorporated in SMBC Brasil status as a highly strategic subsidiary to SMFG, not on its business position.

In recent years, in order to expand business lines and invest in complementary products, SMBC Brasil has been implementing strategies aimed to diversify its revenue sources. One of the main initiatives was the development of the local debt capital markets area, which adds value to the services that the bank already provides to its customer base, and that began operating in early 2024. Even so, these products are in an initial phase, so we expect that the benefit of the diversification of these new lines will be gradual since the revenue they will generate will still be of little relevance to the bank.

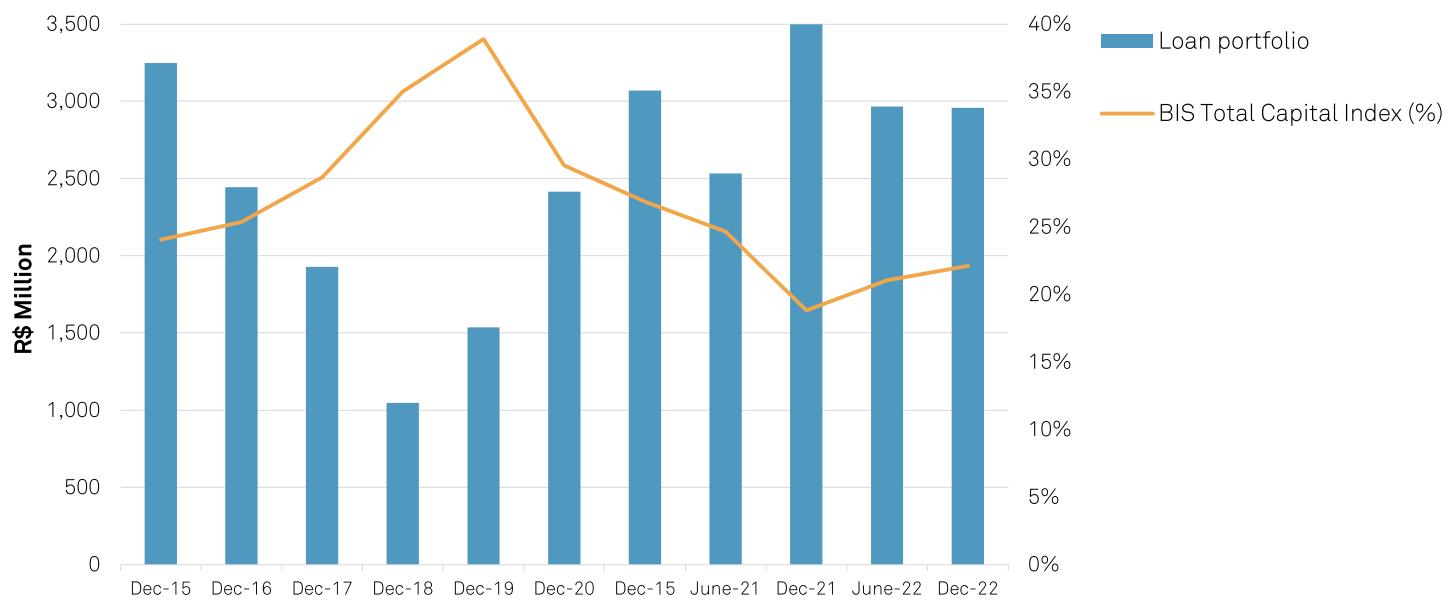
Capital and earnings: Comfortable capital ratios supported by stable results

We base our capital and earnings assessment of SMBC Brasil on our projected RAC ratio between 9.5%-10% for the next two years, which already incorporates its high credit growth prospects. Historically, the bank's regulatory capital ratios have been quite comfortable, with Basel and Tier 1 ratios of 22.11% as of June 2023. This high level of the regulatory capital ratio can be explained by the bank's high capital base and its maintenance of results. For 2024, we expect that the bank will maintain adequate profitability levels and that will retain the earnings for the period, as it happened during the last two years.

Our forecast includes the following base-case assumptions:

- Brazil's real GDP growth of 2.9% in 2023 and 1.5% in 2024;
- Loan portfolio growth of 15% for the next two years;
- Increase in service revenue due to its new strategy of prioritizing the creation of complementary products to serve its customer base;
- Gradual consolidation of the new debt capital markets area and expansion of derivatives products that should complement the bank's revenue as of 2024;
- The bank will maintain adequate asset quality metrics;
- Return on equity (ROE) at 5.5-6.5% in the next two years; and
- We don't expect dividend distribution for the following years, in line with previous years.

Chart 1

Capital ratio versus loan portfolio

Source: S&P Global Ratings

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Risk position: Low risk and high client concentration in its loan portfolio

SMBC Brasil's risk position reflects the low-risk profile of its customer base and its history of low delinquency, which partially mitigates the concentration risk of its portfolio. The bank has a history of low default rates and losses in its credit portfolio due to the niche of low-risk customers in which it operates, that includes large companies, usually multinationals that have a relationship with the SMFG group and that count on the support of their respective parents in case of stress.

However, despite the high credit quality of the bank's customers, our assessment incorporates the risks associated with the high concentration of its loan portfolio in few debtors, which, in our view, exposes it to greater severity of losses in one-off events. Its 20 largest debtors represented 90.36% of its loan portfolio in June 2023, higher than the 90.2% in December 2022, still above the market average. Currently that is the main risk identified for SMBC Brasil, given the volatility that the high provisioning could generate on its results. We recognize, however, that the bank has historically been able to maintain good asset quality and the high concentration comes largely from its focus on large companies, which generally have better credit quality than the market average. In June 2023, the bank did not have any due credit for more than 90 days.

Funding and liquidity: Comfortable liquidity ratios and focus on wholesale funding

Our assessment of SMBC Brasil's funding is based on its reliance on wholesale sources, which we consider to be more concentrated than a diversified retail deposits base. In our view, the bank's funding sources are concentrated on credit lines from its parent company and time deposits from corporate clients. Although we consider the bank's funding sources appropriate for its asset profile, we believe the bank funding base is less diversified and more sensitive relatively to the banking industry in Brazil.

However, SMBC Brasil maintains a healthy liquidity level with broad liquid assets covering its short-term wholesale funding at 1.97x in June 2023. We believe that the bank benefits from the contingency liquidity line from its parent company that it can access in case of stress. The bank also had a high stable funding ratio, at 106.26% in June 2023.

Support: A Highly Strategic subsidiary

Our ratings of SMBC Brasil reflect our opinion about its status as a highly strategic subsidiary for its parent SMFG. In our opinion, SMBC Brasil operations are aligned to the strategy of its parent company and they show a strong integration with the group. Also, we identify a close link between the reputation of the subsidiary and of the parent group. We believe SMFG would provide support to the bank under almost all foreseeable situations. The status of highly strategic subsidiary would allow us to notch up SMBC Brasil ratings up to one level below the Group Credit Profile (GCP) of its parent company, of 'a'. However, the ratings on the bank are limited by the Brazil sovereign ratings due to its exposure to the Brazilian economy and government.

Environmental, Social, and Governance Factors (ESG)

In our view, SMBC Brasil's ESG factors are broadly aligned with those of its industry peers. With governance standards consistent with domestic norms and no major environmental and social factors, these components have no relevant effect on the ratings.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.spglobal.com/ratings for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.spglobal.com/ratings.

Related Criteria And Research

Criteria

- [Financial Institutions Rating Methodology](#), Dec. 9, 2021.
- [Banking Industry Country Risk Assessment Methodology And Assumptions](#), November 9, 2021.
- [General Criteria: Environmental, Social, And Governance Principles In Credit Ratings](#), October 10, 2021.
- [General Criteria: Group Rating Methodology](#), July 1, 2019
- [Methodology For National And Regional Scale Credit Ratings](#), June 8, 2023
- [Risk-Adjusted Capital Framework Methodology](#), July 20, 2017.
- [Principles Of Credit Ratings](#), February 16, 2011.

Related Research

- [Banking Industry Country Risk Assessment: Brazil](#), October 11, 2023.

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