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Banco Daycoval S.A.

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Banco Daycoval S.A.

Ratings Score Snapshot

Issuer Credit Rating
BB-/Stable/B
Brazil National Scale
brAA+/Stable/brA-1+

SACP: bb- → **Support: 0** → **Additional factors: 0**

Anchor	bb+	
Business position	Moderate	-1
Capital and earnings	Moderate	0
Risk position	Adequate	0
Funding	Moderate	-1
Liquidity	Adequate	
CRA adjustment		0

ALAC support	0
GRE support	0
Group support	0
Sovereign support	0

Issuer credit rating
BB-/Stable/B

ALAC--Additional loss-absorbing capacity. CRA--Comparable ratings analysis. GRE--Government-related entity. ICR--Issuer credit rating. SACP--Stand-alone credit profile.

Credit Highlights

Key strengths	Key risks
Profitability metrics that are generally better than the banking industry average.	Rising competition from large banks and new players.
Track record of solid management and expertise in collateral management.	Difficult economic conditions in Brazil.
Record of sound asset quality metrics.	Heavy reliance on wholesale investors for funding.

Our rating on Banco Daycoval S.A. continues to reflect its track record of good profitability and solid performance in lending to small and midsize enterprises (SMEs), but also its somewhat concentrated operations. Daycoval's business position benefits from its sizable and successful operations in collateralized loans to SMEs in Brazil, its growing share of loans to larger corporations, and its relevant operations in payroll and auto loans. Its profitability has generally outperformed those of its peers due to solid net interest margins and manageable credit losses.

In addition, due to its experience in the business, Daycoval has generally been resilient during times of increasing losses in corporate loans. Nonetheless, the bank has a sizable exposure to the SME niche, which we view as a relative weakness.

Despite higher losses and lower margins, Daycoval's profitability has remained higher than the industry's average. 2023 was a challenging year for the Brazilian SME market and for corporate loans in general, as interest rates remained high and due to the default of one large Brazilian retailer to which Daycoval was exposed. As a result, Daycoval's loan book grew less than in previous years as credit loss provisions increased and margins somewhat tightened. Nonetheless, the bank was able to manage its operations and its profitability remained higher than the industry average.

Overall, Daycoval reported a steady net income of R$1.1 billion and return on average equity (ROAE) of 18.6% in 2023. This level of ROAE, although the lowest since 2018, was close to the bank's 10-year average of 20.9%.

We predict better bottom-line results in 2024 as falling interest rates and more benign conditions foster loan origination. We expect that Daycoval will resume its credit growth this year amid better conditions for corporations and because we predict lower credit losses for SMEs. Considering this, we project its return on equity (ROE) to stay at 18%-22% in the next two years, which is lower than the 2019-2023 average of 25.5% but still somewhat higher than what we expect for the industry average and in line with the bank's 10-year average.

We expect asset quality to gradually improve in 2024, in line with the industry trend, although we still see pressure on SME loans in Brazil. We forecast that nonperforming loans (NPLs) will be 2.5%-3.0% by the end of 2024, down from 3.3% at the end of 2023. NPLs should decrease as defaulted loans are charged off and as credit conditions for corporations gradually improve.

Generally, despite its sizable exposure to SMEs, Daycoval's NPL ratios have generally been better than those of its peers, while its loan-loss provisions and collateral management policies have continued cushioning deterioration in its borrowers' creditworthiness. However, we still see downside risks for SME loans in general, because we anticipate interest rates in Brazil and globally to remain high.

Outlook

The stable outlook on Daycoval reflects our expectation of no rating changes in the next 12 months. In our opinion, the bank will continue to report above-average financial performance and sound asset quality metrics.

Upside scenario

Prospects for raising our ratings on Daycoval would depend on the bank's ability to consistently outperform its peers while it diversifies its revenue base and maintains manageable asset quality metrics and stable capital ratios.

Downside scenario

We could lower the ratings on Daycoval if its risk-adjusted capital (RAC) ratio drops and stays below 5%, which could happen if there's faster-than-expected loan growth or eroding asset quality. Our base-case scenario considers that Daycoval will keep its asset quality metrics slightly better than the system's average and will have the profitability to support its expected credit growth in the next two years.

Key Metrics

Banco Daycoval S.A.--Key ratios and forecasts				
	--Fiscal year ended Dec. 31 --			
(%)	2022a	2023a	2024f	2025f
Growth in customer loans	16.6	0.0	8.0-12.0	10.0-14.0
Growth in total assets	12.6	10.6	8.0-12.0	10.0-14.0
Net interest income/average earning assets (NIM)	7.2	7.3	7.25-7.75	7.25-7.75
Cost to income ratio	52.0	52.5	50.0-55.0	50.0-55.0
Return on average common equity	20.6	18.6	18.0-22.0	18.0-22.0
Return on assets	1.7	1.5	1.5-1.8	1.5-1.8
New loan loss provisions/average customer loans	1.5	2.3	1.5-2.0	1.5-2.0
Gross nonperforming assets/customer loans	1.9	3.3	2.5-3.0	2.25-2.75
Net charge-offs/average customer loans	0.8	1.2	1.5-2.0	1.0-1.5
Risk-adjusted capital ratio	6.7	6.8	6.0-7.0	6.0-7.0

All figures are S&P Global Ratings-adjusted. a--Actual. f--Forecast. NIM--Net interest margin.

Anchor: 'bb+' For Banks Operating Only In Brazil

Under our bank criteria, we use our Banking Industry Country Risk Assessment's (BICRA) 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 mostly in Brazil is 'bb+', based on the country's economic risk score of '7' and an industry risk score of '5'.

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 because of very strong agricultural performance and its spillover effects on the rest of the economy. Credit growth will likely moderate amid interest rates that stay higher for longer, private banks' tighter underwriting practices, and uncertainty regarding the economic policies the federal government will implement. Asset quality will slip as a result of the economic downturn, low credit growth, and high interest rates, but credit losses should be manageable because of the high provisioning 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 domestic financial system withstand the last economic downturn. Brazilian banks' profitability has remained resilient thanks to the high provisioning coverage and diversified revenue mix. Profitability will likely slip as provisioning needs rise, but from good levels. The Brazilian banking system has an adequate funding mix with a large and stable core customer deposit base.

Business Position: Revenues Concentrated on Wholesale Loans But With Solid Collateral Management

Its sizable and successful operations in collateralized loans to SMEs in Brazil, its growing share of loans to larger corporations, and its relevant exposure to payroll and auto loans continue to support Daycoval's business position. However, despite its track record of above-average profitability, we believe that Daycoval's revenue base is less diversified than peers, which constrains its business position. Our assessment also reflects Daycoval's limited market share of domestic loans because its credit portfolio represented about 0.6% of total loans in the Brazilian financial system as of June 2023.

Daycoval's loan book has historically been tilted toward SME loans, which generally tend to be more sensitive to economic swings. However, Daycoval has been growing its exposure to larger corporations in recent years while reducing its exposure to SMEs. Additionally, over the years, the bank has had sound performance in its corporate loan portfolio. We believe that this success reflects Daycoval's expertise in this segment and its effective collateral management policies, because SME loans are generally collateralized by trade receivables (56.7% of all secured loans). Also, in addition to corporate exposures, Daycoval has historically had relevant operations in payroll-deductible loans and auto loans, which, combined, correspond to about one-fourth of the bank's extended credit portfolio.

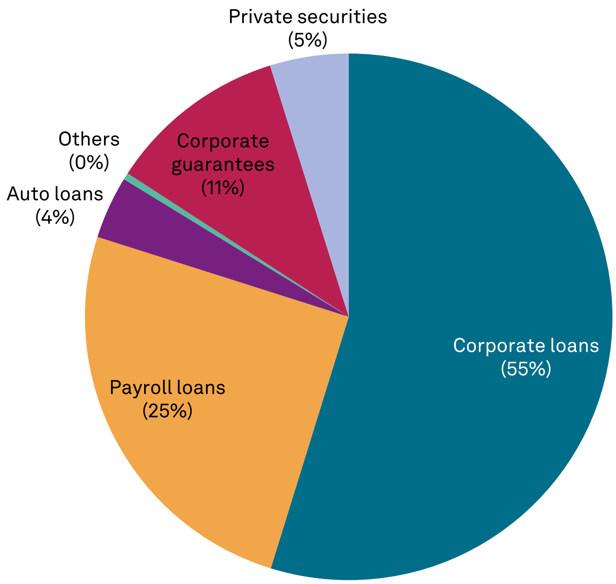
Due to its extensive track record in its lending niches, Daycoval is able to generate substantial net interest income relative to NPLs. This, combined with improved efficiency, fueled above-average profitability metrics for several years straight. Between 2017 and 2021, Daycoval's average return on assets was 2.7%, much higher than the 1.4% average return posted by the overall financial system. Daycoval's ROE in that same period was 25.5%, higher than the industry average of 15.0%.

While Daycoval's ROE dipped to 20.5% in 2022 and, later in 2023, to 18.6% amid tighter reported net interest margins and higher loan loss provisions, it was still higher than the industry average. We think that Daycoval will continue reporting solid profits over the next few years and expect ROE to be between 18% and 22%.

Chart 1

Extended credit portfolio composition

As of December 2023



Source: S&P Global Ratings.

Capital And Earnings: Projected RAC Ratio Before Diversification Of 6.0%-7.0%

We base our capital and earnings assessment on our forecast average RAC ratio of 6.0%-7.0% in 2024-2025, which is slightly above the ratios we expect for most rated banks operating in Brazil. Our projection is in line with Daycoval's RAC ratio of about 6.8% for 2023 and its five-year average RAC of 6.3%. This projection balances the effects from our expectation that Daycoval will resume credit growth in 2024 and that ROE will be of 18%-22%. In addition, the bank's total regulatory capital--its reported Basel ratio of 13.9% as of December 2023--remains above the regulator's minimum capital requirement of 10.5%.

To evaluate banks' capitalization level, we apply globally our risk-adjusted capital framework (RACF), regardless of regional regulations and banks' internal risk measures. Our RAC ratio compares our definition of total adjusted capital (TAC) to our risk-weighted assets, reflecting a risk metric that's globally more comparable than regulatory ratios. The main difference regarding our methodology and local regulation is that we apply charges to sovereign bond exposures based on our ratings on a country, while the Brazilian regulator applies a 0% risk weight.

Our RAC forecast considers our base-case scenario assumptions, which include:

- Real GDP growth in Brazil of 1.5% in 2024 and 1.9% in 2025;
- Overall annual loan portfolio growth of 8.0%-12.0% in 2024 and 2025;
- A modest recovery in net interest margins after a drop in 2022;
- NPLs receding to 2.5%-3.0% by December 2024, down from 3.3% in December 2023, and a moderation in net new loan-loss provisions in 2024 to 1.5%-2.0% of the loan portfolio;
- ROE of 18%-22% in 2024-2025; and
- Dividend payouts of 40%-45% of net income in the coming years, in line with historical figures.

Risk Position: Collateral Management And Low Customer Concentration Offset SME Risks

Daycoval's risk position reflects its overall solid loan book performance, good collateral management, and adequate customer diversification within its portfolio, which partly offset higher risks related to its sizable exposure to the middle-market segment. Daycoval has historically had sizable operations in the SME segment, which has intrinsically higher delinquency rates. However, the bank's profitability has consistently outperformed its peers, which signals that it's adequately pricing its loans relative to risk. Moreover, the bank's growing share of larger corporations in its corporate loan book and relevant operations in payroll and auto loans also help to mitigate its SME exposure.

Throughout 2023, Daycoval's asset quality metrics somewhat worsened as a large Brazilian retailer defaulted and as credit conditions for SMEs became more challenging. As of December 2023, the bank's NPL ratio was 3.3%, above its five-year average of 1.9% (2018-2022) but in line with the banking industry. This deterioration also reflected the still high interest rates in Brazil, which particularly hampered SME loans. In the same period, Daycoval's charge-offs amounted to 1.2% of its average customer loan portfolio, in line with past figures and with its five-year average of 1.0%.

Nonetheless, Daycoval's track record of solid performance, tight underwriting standards, and sound collateral management have continued to offset the bank's exposure to SMEs. In 2023, Daycoval decelerated its credit origination in order to mitigate the impacts of rising delinquencies in SME loans in the industry. As a result, the bank's credit portfolio grew about 3% last year--considerably below its historical growth rate. Moreover, Daycoval has low customer concentration. Its largest 20 customers' exposure hasn't surpassed 10% in the past five years.

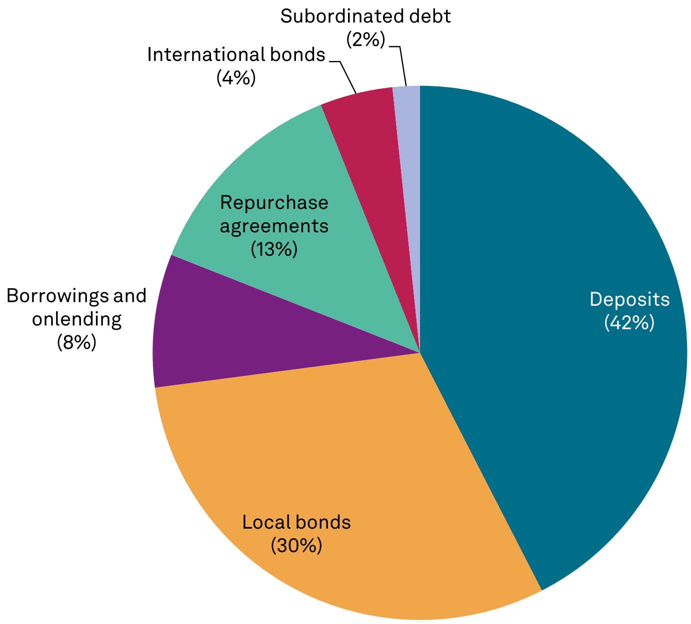
We expect Daycoval's NPL ratio to somewhat improve in 2024. We forecast a year-end NPL ratio of 2.5%-3.0% for the bank. However, we still see downside risks for SME loans in general, as interest rates in Brazil and abroad will remain high. Still, we think that Daycoval's tight underwriting standards, sound collateral management, and flexibility to restructure loans will mitigate the impact of a rise in NPLs on the bank's bottom line.

Funding And Liquidity: Wholesale-Oriented Funding Profile And Comfortable Liquidity Cushion

We view Daycoval's funding base as less stable and diversified than the industry average, because it consists mostly of wholesale deposits and institutional investors, which tend to be less stable than a diversified retail deposit base. Therefore, we think the bank still lacks broader depositor and funding source diversification compared to larger banks.

Chart 2

Funding composition
As of December 2023



Source: S&P Global Ratings.

The bank's stable funding ratio (SFR) was 75% in December 2023. Daycoval has a good match between assets and liabilities and a positive maturity gap between its loans (average maturity of 391 days) and funding sources (average maturity of 516 days).

We view Daycoval's liquidity as comfortable. As of the end of 2023, its broad liquid assets covered 0.7x of its short-term wholesale funding, in line with the 2018-2022 average of 0.8x. Those assets also represented 26% of the bank's total assets as of December. Daycoval's time deposits don't have an early redemption option, according to the central bank. Its liquidity benefits from the short-term nature of its lending, which provides the bank with the flexibility to decrease its lending position if needed.

Environmental, Social, And Governance

ESG factors have no influence on our analysis of Daycoval, and we view these factors as broadly in line with those for the industry and domestic peers. Governance standards are consistent with domestic regulation, while environmental and social factors are not significantly relevant in our rating on the bank.

Key Statistics

Table 1

Banco Daycoval S.A.--Key figures					
	--Year-ended Dec. 31--				
(Mil. R$)	**2023**	**2022**	**2021**	**2020**	**2019**
Adjusted assets	77,096.7	69,704.8	61,931.3	49,159.4	34,892.1
Customer loans (gross)	47,501.8	47,504.2	40,741.8	32,518.0	24,655.9
Adjusted common equity	6,129.0	5,549.6	4,771.9	4,346.9	3,260.5
Operating revenues	5,534.1	4,824.3	4,760.7	4,071.6	3,369.3
Noninterest expenses	2,904.4	2,506.7	1,946.2	1,540.7	1,545.4
Core earnings	1,095.2	1,087.2	1,390.6	1,175.4	1,020.2

R$--Brazilian real.

Table 2

Banco Daycoval S.A.--Business position					
	--Year-ended Dec. 31--				
(%)	**2023**	**2022**	**2021**	**2020**	**2019**
Loan market share in country of domicile	N/A	0.6	0.6	0.8	0.7
Deposit market share in country of domicile	N/A	0.4	0.4	0.4	0.3
Return on average common equity	18.6	20.6	30.1	29.1	29.4

N/A--Not applicable.

Table 3

Banco Daycoval S.A.--Capital and earnings					
	--Year-ended Dec. 31--				
(%)	**2023**	**2022**	**2021**	**2020**	**2019**
Tier 1 capital ratio	13.9	12.9	13.0	14.0	13.6
S&P Global Ratings' RAC ratio before diversification	6.8	6.7	6.3	5.5	6.0
S&P Global Ratings' RAC ratio after diversification	6.0	5.7	5.3	4.7	5.2
Adjusted common equity/total adjusted capital	85.5	84.2	82.8	93.6	100.0
Net interest income/operating revenues	86.6	87.1	90.0	90.9	89.1
Fee income/operating revenues	8.4	8.3	6.1	5.9	6.4
Cost to income ratio	52.5	52.0	40.9	37.8	45.9
Preprovision operating income/average assets	3.6	3.5	5.1	6.0	5.7
Core earnings/average managed assets	1.5	1.7	2.5	2.8	3.2

Table 4

Banco Daycoval S.A.--Risk position

	--Year-ended Dec. 31--				
(%)	**2023**	**2022**	**2021**	**2020**	**2019**
Growth in customer loans	(0.0)	16.6	25.3	31.9	34.5
Total diversification adjustment/S&P Global Ratings' RWA before diversification	14.3	16.6	19.6	17.5	15.1
Total managed assets/adjusted common equity (x)	12.6	12.6	13.0	11.3	10.7
New loan loss provisions/average customer loans	2.3	1.5	1.2	2.3	2.2
Net charge-offs/average customer loans	1.2	0.8	0.5	1.0	0.8
Gross nonperforming assets/customer loans + other real estate owned	3.3	1.9	1.8	1.8	1.4
Loan loss reserves/gross nonperforming assets	133.7	190.1	219.0	256.7	367.2

Table 5

Banco Daycoval S.A.--Funding and liquidity

	--Year-ended Dec. 31--				
(%)	**2023**	**2022**	**2021**	**2020**	**2019**
Core deposits/funding base	41.9	36.0	41.3	40.5	36.2
Customer loans (net)/customer deposits	173.5	226.9	194.2	197.4	241.1
Long-term funding ratio	61.9	64.7	73.5	67.0	75.1
Stable funding ratio	75.0	73.8	82.9	77.3	81.9
Short-term wholesale funding/funding base	42.5	39.6	29.7	37.1	28.4
Broad liquid assets/short-term wholesale funding (x)	0.7	0.7	0.9	0.7	0.9
Broad liquid assets/total assets	25.6	20.9	20.4	21.3	19.9
Broad liquid assets/customer deposits	75.3	72.1	62.6	66.8	71.4
Net broad liquid assets/short-term customer deposits	(60.5)	(86.3)	(22.8)	(79.4)	(12.2)
Short-term wholesale funding/total wholesale funding	71.2	60.1	48.9	61.5	44.5

Banco Daycoval S.A.--Rating component scores

Issuer Credit Rating	**BB-/Stable/B**
SACP	bb-
Anchor	bb+
Economic risk	7
Industry risk	5
Business position	Moderate
Capital and earnings	Moderate
Risk position	Adequate
Funding	Moderate
Liquidity	Adequate
Comparable ratings analysis	0
Support	0
ALAC support	0
GRE support	0
Group support	0
Sovereign support	0

Banco Daycoval S.A.--Rating component scores (cont.)	
Issuer Credit Rating	**BB-/Stable/B**
Additional factors	0

ALAC--Additional loss-absorbing capacity. GRE--Government-related entity. SACP--Stand-alone credit profile.

Related Criteria

- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Dec. 9, 2021
- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology, Dec. 9, 2021
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- 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: Principles Of Credit Ratings, Feb. 16, 2011

Ratings Detail (As Of February 29, 2024)*		
Banco Daycoval S.A.		
Issuer Credit Rating		BB-/Stable/B
Brazil National Scale		brAA+/Stable/brA-1+
Issuer Credit Ratings History		
18-Mar-2019		BB-/Stable/B
16-Aug-2017		BB-/Negative/B
23-May-2017		BB-/Watch Neg/B
18-Mar-2019	*Brazil National Scale*	brAA+/Stable/brA-1+
11-Jul-2018		brAA+/Negative/brA-1+
16-Aug-2017		brA+/Negative/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.