FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Banco Daycoval S.A.'s IDRs at 'BB-'; Outlook Stable

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Fitch Ratings - Rio de Janeiro - 04 Apr 2024: Fitch Ratings has affirmed Banco Daycoval S.A.'s (Daycoval) Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) at 'BB-'. The Rating Outlook on the IDRs is Stable. Fitch has also affirmed the bank's National Long-Term Rating at 'AA(bra)'/Outlook Stable. A full list of rating actions is below.

KEY RATING DRIVERS

Established Segmented Franchise, Strong Earnings: Daycoval's IDRs and National Ratings are driven by its intrinsic strength, as reflected in its 'bb-' Viability Rating (VR), which is in line with the bank's implied VR.

Daycoval's ratings reflect its well-established second-tier banking franchise in Brazil, with a strong market position in the Corporate/SMEs business (large/big companies represent at 38.7% and SMEs at 30.0% of the total credit), and moderate risk profile that underpins good operating profitability and well-managed asset-quality through the cycles. The ratings also reflect capitalization buffers with adequate buffers over regulatory minimums, prudent liquidity management and stable funding profile, albeit wholesale oriented.

Sustainable Business Performance: Daycoval's revenue profile is dependent on net interest income, but the stability of this income has been maintained at a fairly consistent level throughout the cycles. Fitch's 'bb' business profile assessment reflects Daycoval's total operating income (TOI) of USD855 million for the average of 2020-2023. Daycoval's TOI is supported by the bank's well-established and specialized banking franchise in the Corporate/SMEs segment, which provides sound origination capacity, as well as a complementary presence mainly in the secured payroll deduction loan, auto loan and FX business, which helps to defend business volumes through the cycles.

Moderate Risk Profile: Our 'bb-' assessment of Daycoval's risk profile considers the bank's more diversified loan book than mid-sized bank in the country (65% of total assets at end-2023) and securities portfolio (11%), mostly invested in Brazilian government debt. Despite Daycoval's loan book is concentrated in Corporate/SMEs (70% to total expanded loans), which are more sensitive to business cycles, Fitch considers the bank ample experience and demonstrated risk pricing expertise in the segment have resulted in lower credit costs and write-offs compared to peers. The bank's exposure to payroll deductible loans (25% to total expanded loans), that default rates are less cyclical, have supported also the credit costs.

Managed Asset Quality Risks, Adequate Loss Buffers: Daycoval was well positioned to withstand an increase in default rates in 2022 and 2023, even in more adverse scenarios than we had previously expected from structurally higher rates and inflation. Daycoval's front-loading of loan loss provisions in 2020 increased the coverage of impaired loans (D-H) to 105% in that year, allowing the bank to cope with rising default rates in the subsequent years.

Tighter underwriting and a proactive approach to asset quality management led to a mild deterioration in asset quality in 2023, as expected, with an impaired loan ratio of 4.6% to total expanded loans at end-2023 (3.7% if exclude a large corporate client that was 100% provisioned). Fitch expects Daycoval to maintain the core ratio close to 4.5% in 2024 and 2025, driven by write-offs, and a moderation in the inflow of impaired loans. Loan loss provisions for impaired loans are now lower at 84%, but remain at the high end of the domestic peers' average.

Resilient Profitability: Daycoval's operating profit/risk-weighted assets (RWAs) ratio of 3.0% in 2023 remains below the bank's four-year average of 4.2%, but viewed as strong in the context of successive shocks domestically, above its peer average, and underpinning our earnings & profitability assessment on the bank of 'bb'. We expect Daycoval's profitability to remain sound through 2024-2025, as we expect asset-quality risks to gradually ease relative to the prior year and some moderation on operating expenses after strong business expansion in the previous years.

Adequate Capitalization: Fitch believes Daycoval is well capitalized relative to its risk profile. Fitch has revised its capitalization and leverage assessment of Daycoval to 'bb-' from 'b+', reflecting the maintenance of adequate buffers relative to regional peers. Daycoval's capital buffers have improved through 2023 reflecting adequate earnings generation and lower risk weighted assets inflation, with a common equity Tier 1 (CET1) ratio of 11.8% at end-2023.

Stable Funding and Liquidity: The bank's four-year average core loans-to-deposits ratio was 261% at end-2023, given a lower share of customer deposits relative to peers. However, Fitch assigns a funding and liquidity score of 'bb', which is above the implied score of the 'b' and below' category reflecting Daycoval's ample liquidity, comfortable asset-liability management and a large proportion of long-term funding given good access to debt markets. Daycoval's non-deposit funding to non-equity funding is around 60%, level that compare favorable among other mid-sized banks in the country.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

--Daycoval's ratings are vulnerable to a significant weakening of the operating environment in Brazil, for example, due to much slower economic growth than our forecasts, which could result in higher default rates and lead to a deterioration of the bank's asset quality and capital metrics.

--Asset-Quality deterioration or if operating profit falls below 1.25% of RWAs without prospects of recovery in the short term. This is especially true if the CET1 ratio falls below 10% and capital encumbrance by unreserved impaired loans rises materially above current levels on a sustained basis.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

--The combination of a stronger business and risk profile resulting in a stronger level of TOI, while maintaining an impaired loan ratio sustainably below 5%, operating profit/RWA at least above 3% and CET1 ratio consistently above 12%.

--National Ratings are sensitive to strengthening creditworthiness relative to other Brazilian issuers.

OTHER DEBT AND ISSUER RATINGS: KEY RATING DRIVERS

Senior Debt

--Daycoval's senior unsecured debt is rated in line with its IDRs as the likelihood of default on these obligations reflects the likelihood of default of the entity.

GOVERNMENT SUPPORT RATING (GSR)

The GSR of 'No Support' (ns) reflects Daycoval's small franchise within the Brazilian financial system (less than 1% of customer deposits at YE 2023). In Fitch's view, there is no reasonable assumption of support being forthcoming.

OTHER DEBT AND ISSUER RATINGS: RATING SENSITIVITIES

Senior Debt

--Daycoval's senior unsecured debt rating is sensitive to changes in its IDR. Therefore, a downgrade of the bank's IDR would automatically trigger a downgrade on the debt ratings.

--Daycoval's senior unsecured debt rating is sensitive to changes in its IDR. Therefore, an upgrade of the bank's IDR would automatically trigger a upon the debt ratings.

GSR

--Daycoval's GSR of 'ns' is sensitive to changes in Fitch's assessment about the ability and / or propensity of the sovereign to provide timely support to the bank and would only be likely to occur with a significant increase in the bank's systemic importance.

VR ADJUSTMENTS

The VR was assigned in line with the implied VR.

The 'bb-' for Funding & Liquidity was assigned above the implied 'b' Funding & Liquidity Score due to a Non-Deposit Funding adjustment (positive).

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/topics/esg/products#esg-relevance-scores.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Banco Daycoval S.A.	LT IDR	BB- Rating Outlook Stable	Affirmed	BB- Rating Outlook Stable
	ST IDR	B	Affirmed	B
	LC LT IDR	BB- Rating Outlook Stable	Affirmed	BB- Rating Outlook Stable
	LC ST IDR	B	Affirmed	B
	Natl LT	AA(bra) Rating Outlook Stable	Affirmed	AA(bra) Rating Outlook Stable
	Natl ST	F1+(bra)	Affirmed	F1+(bra)
	Viability	bb-	Affirmed	bb-
	Government Support	ns	Affirmed	ns
senior unsecured	LT	BB-	Affirmed	BB-

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

National Scale Rating Criteria (pub. 22 Dec 2020)

Metodologia de Ratings em Escala Nacional (pub. 22 Dec 2020)

Bank Rating Criteria (pub. 15 Mar 2024) (including rating assumption sensitivity)

Metodologia de Rating de Bancos (pub. 15 Mar 2024)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Banco Daycoval S.A.	EU Endorsed, UK Endorsed

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