

## RATING ACTION COMMENTARY

# Fitch Upgrades Banco Daycoval's IDRs to 'BB' and National Ratings to 'AA+(bra)'; Outlook Stable

Mon 09 Sep, 2024 - 4:47 PM ET

Fitch Ratings - Rio de Janeiro - 09 Sep 2024: Fitch Ratings has upgraded Banco Daycoval S.A.'s (Daycoval) Long-Term (LT) Foreign Currency (FC) Issuer Default Rating (IDR) and LT Local Currency (LC) IDR to 'BB' from 'BB-', Viability Rating (VR) to 'bb' from 'bb-', and LT National Rating to 'AA+(bra)' from 'AA(bra)'. The Rating Outlook is Stable.

In addition, Fitch has affirmed the Government Support Rating (GSR) at 'ns', Short Term (ST) LC and FC IDR at 'B', and the ST National Rating at 'F1+(bra)'.

The upgrades reflect the resilient performance of its financial profile throughout economic cycles, while it has strengthened its risk profile by improving the diversification of clients and sectors covered and increasing its product offerings, especially compared to domestic peers. Daycoval has demonstrated disciplined growth in its credit portfolio, maintaining a conservative risk appetite toward domestic corporates and the middle market, resulting in improved asset quality and earning and profitability metrics.

On Sept. 5, 2024, Daycoval announced that it acquired BMG Seguros S.A. (National Long-Term Insurer Financial Strength A-(bra)/Stable) through its controlled insurer Dayprev Vida e Previdência in order to expand products and services based on diversification. Fitch believes the acquisition, when approved, will have no material impacts on Daycoval's creditworthiness due to its size. BMG Seguros currently represents less than 2% of Daycoval's total assets.

## 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' VR, which is in line with the bank's implied VR. Daycoval's ratings reflect its well-established second-tier banking franchise in

Brazil, along with a strong market position in the Corporate/SMEs business and moderate risk profile that underpins good operating profitability and well-managed asset quality through the cycles.

The ratings also reflect capitalization with adequate buffers over regulatory minimums, prudent liquidity management and a stable funding profile, albeit wholesale oriented.

**Sustainable Business Performance:** Daycoval's revenue profile is mainly focused on net interest income, and 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 (USD1.1 billion in 1H24 on an annualized basis).

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 businesses, all of which helps to defend business volumes through the cycles.

**Moderate Risk Profile:** Fitch has revised its risk profile assessment of Daycoval to 'bb' from 'bb-'. Daycoval's risk profile considers the bank's more diversified loan book compared to mid-sized banks in the country (73% of total assets at the end of June 2024) and its securities portfolio (13%), which is primarily invested in Brazilian government debt.

Despite the concentration of Daycoval's loan book in Corporate/SMEs (70% of total expanded loans), Fitch recognizes the bank's extensive experience and proven risk pricing expertise in this segment, both of which have led to lower credit costs and write-offs relative to peers. In addition, the bank's exposure to payroll deductible loans (27% of total expanded loans), which have less cyclical delinquency rates, has also supported credit costs.

**Well-Managed Asset Quality Risks:** Fitch has revised its asset quality assessment of Daycoval to 'bb' from 'bb-', reflecting the adequate core metrics and the trend toward improvements. Daycoval's impaired loan ratio (D-H risk loans) was 4.5% at June 2024 versus 5.2% in 2023 and in line with the four-year average (4.45%). Daycoval was well-positioned to withstand an increase in delinquency rates in 2022 and 2023, even in more adverse scenarios than we had previously expected from structurally higher rates and inflation.

Fitch expects Daycoval to maintain the core ratio close to 4.0% in 2024 and 2025, driven by write-offs, and a moderation in the inflow of impaired loans. Loan loss provisions for

impaired loans are around 80% and remain at the high end of the company's domestic peers' average.

**Improving Profitability:** Fitch has revised its earnings and profitability assessment of Daycoval to a positive outlook. Daycoval's operating profit/risk-weighted assets (RWAs) ratio of 4.3% in June 2024 improved from 3% in 2003, in line with the bank's four-year average of 4.2%. That is above its peers' average, and underpins our earnings and profitability assessment of the bank at 'bb'.

We expect Daycoval's profitability to remain sound through 2024-2025, as asset-quality risks should gradually ease relative to the prior year. There should also be some moderation on operating expenses after the company's strong business expansion in the previous years.

**Adequate Capitalization:** Fitch believes Daycoval is well-capitalized relative to its risk profile. Daycoval's capital buffers have improved through 2023 and 1H24, reflecting adequate earnings generation and lower risk weighted assets inflation, with a common equity Tier 1 (CET1) ratio of 12% at June 2024.

The bank's total regulatory capital ratio increased to 13.8% given its capital enhancement through the issuance of Tier 1 hybrid instruments from the shareholder. The bank's ratios well exceed the Central Bank regulatory minimum total capital requirement and are in line with Basel III rules.

**Stable Funding and Liquidity:** Daycoval's non-deposit funding to non-equity funding is around 60%, a level that compares favorably to other mid-sized banks in the country. That explains the bank's four-year average core loans-to-deposits ratio of 209% at June 2024, given a lower share of customer deposits relative to peers.

Fitch assigns a funding and liquidity score of 'bb', which is above the implied score of the 'b and below' category and reflects Daycoval's ample liquidity, comfortable asset-liability management and a large proportion of long-term funding given good access to debt markets.

## **RATING SENSITIVITIES**

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

-- Fitch's downward revision of the score of the operating environment in Brazil, for example, due to much slower economic growth than our forecasts, which could result in

pressures on the bank's overall financial performance;

--Asset-quality deterioration that puts downward pressure on the operating profits to RWA ratio consistently below 1.25% of RWAs, and the CET1 ratio falls below 11%.

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

-- A positive rating action on Daycoval's IDRs and VR is limited at this point, considering Brazil's sovereign ratings, operating environment, and the bank's moderate scale and less diversified business model than higher rated peers;

-- In the medium to long term, Daycoval's National Ratings are sensitive to the strengthening of its business profile by a material increase in its TOI level closer to USD3.0 billion, while maintaining its good financial performance.

### **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**

The GSR of 'No Support' (NS) reflects Daycoval's small franchise within the Brazilian financial system (less than 1% of customer deposits at June 2024). 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 of 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 an upgrade of 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 and Liquidity was assigned above the implied 'b' Funding and 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](https://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	BB- Rating Outlook Stable
	Upgrade		
	ST IDR	B Affirmed	B

	LC LT IDR	BB Rating	Outlook Stable	BB- Rating Outlook Stable
	Upgrade			
	LC ST IDR	B	Affirmed	B
	Natl LT	AA+(bra) Rating	Outlook Stable	AA(bra) Rating Outlook Stable
	Upgrade			
	Natl ST	F1+(bra)	Affirmed	F1+(bra)
	Viability	bb	Upgrade	bb-
	Government Support	ns	Affirmed	ns
senior unsecured	LT	BB	Upgrade	BB-

[VIEW ADDITIONAL RATING DETAILS](#)

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**APPLICABLE CRITERIA**

[Metodologia de Ratings em Escala Nacional \(pub. 22 Dec 2020\)](#)

[Metodología de Calificaciones en 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

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Banco Daycoval S.A.

EU Endorsed, UK Endorsed

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