MOODY'S RATINGS

CREDIT OPINION
9 October 2024

Update

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RATINGS

Banco Daycoval S.A.

Domicile	Sao Paulo, Sao Paulo, Brazil
Long Term CRR	Baa3
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Debt	Ba1
Type	Senior Unsecured - Fgn Curr
Outlook	Positive
Long Term Deposit	Ba1
Type	LT Bank Deposits - Fgn Curr
Outlook	Positive

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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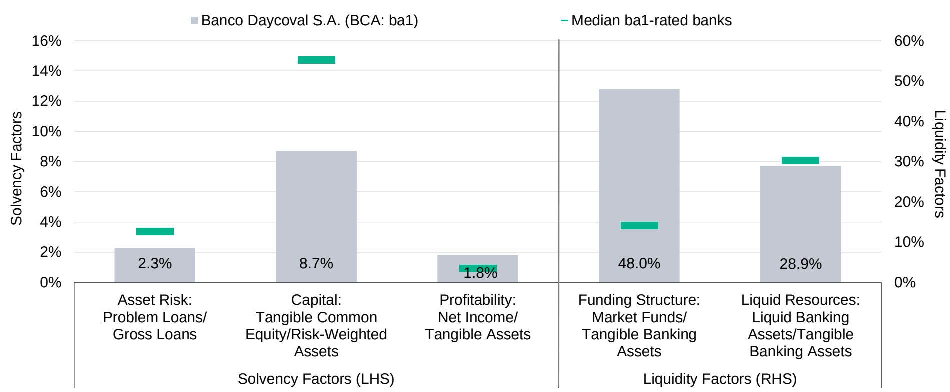
Banco Daycoval S.A.

Update following upgrade to Ba1, outlook remains at positive

Summary

Banco Daycoval S.A.'s (Daycoval) has a Baseline Credit Assessment (BCA) of ba1, which incorporates the bank's consistent earnings generation, historically supported by a disciplined risk profile, relatively low concentration risk and high reserve buffers. Daycoval's adequate leverage ratios and capitalization are also important factors that support the bank's operations in a challenging credit environment. Daycoval's core businesses are lending to small and medium-sized enterprises (SMEs), large companies, vehicle financing and payroll loans to public servants, where margins are likely to be compressed because of fierce competition, particularly in the secured products. Daycoval also earns fees from asset management and capital market activities. Daycoval's ratings outlook remains positive, reflecting the potential impact on its financial profile stemming from an improving operating environment in Brazil (Ba1 positive).

Exhibit 1
Rating scorecard - Key financial ratios
As of June 2024



For the problem loan and profitability ratios, we review the latest three year-end ratios, as well as the most recent intra-year ratio, where applicable, and base our starting point ratio on the weaker of the average of this period and the latest figure. For the capital ratio, we use the latest figure. For the funding structure and liquid asset ratios, we use the latest year-end figures.
Source: Moody's Ratings

Credit strengths

» Traditional lender to corporates and SMEs, with a highly regarded management team and strong risk governance

» Stability in its core earnings stream, supported by portfolio granularity and product diversification

» Adequate capitalization

» Diversified funding structure, which supports the expansion of its retail portfolio (longer tenor), avoiding tenor mismatches

Credit challenges

» Increasing competition on the SME and payroll business is likely to strain margins.

» Upward pressure on asset risk stemming from the SME portfolio as delinquency in the segment increases industrywide.

Rating outlook

The ratings outlook for Daycoval is positive, reflecting the prospective influence on its financial standing that arises from an improving operational environment in Brazil (Ba1 positive).

Factors that could lead to an upgrade

Daycoval's ba1 BCA is currently at the cap of Brazil's Ba1 sovereign rating, therefore it would likely be upgraded only in case of an upgrade of Brazil's rating provided that the bank creditworthiness does not deteriorate.

Factors that could lead to a downgrade

Negative rating pressure would arise if the sovereign bond rating is downgraded because the bank's BCA is at the same level as the sovereign rating. Pressure on the ba1 standalone assessment could result from a deterioration in Daycoval's asset quality, combined with a significant reduction in its earnings, which could arise from a rapid deterioration in the bank's corporate and SME loan book or from increasing borrower-concentration risk. Significant loan growth could particularly compromise the bank's capital structure and asset-quality indicators, whose preservation is key at this rating level.

Key indicators

Exhibit 2
Banco Daycoval S.A. (Consolidated Financials) [1]

	06-24[2]	12-23[2]	12-22[2]	12-21[2]	12-20[2]	CAGR/Avg.[3]
Total Assets (BRL Million)	80,087.5	77,097.6	69,704.9	61,931.6	49,159.8	15.0[4]
Total Assets (USD Million)	14,418.6	15,871.5	13,202.3	11,106.2	9,464.4	12.8[4]
Tangible Common Equity (BRL Million)	6,204.7	5,313.0	4,880.3	4,314.0	3,840.2	14.7[4]
Tangible Common Equity (USD Million)	1,117.1	1,093.8	924.3	773.6	739.3	12.5[4]
Problem Loans / Gross Loans (%)	2.3	3.2	1.9	1.7	1.8	2.2[5]
Tangible Common Equity / Risk Weighted Assets (%)	8.7	8.1	7.9	7.9	9.9	8.5[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	13.7	21.1	13.9	12.4	11.1	14.4[5]
Net Interest Margin (%)	8.1	7.4	7.2	8.8	10.4	8.4[5]
PPI / Average RWA (%)	5.6	4.6	4.4	6.4	8.3	5.9[6]
Net Income / Tangible Assets (%)	2.0	1.4	1.6	2.3	2.4	1.9[5]
Cost / Income Ratio (%)	39.6	46.6	46.1	34.9	32.3	39.9[5]
Market Funds / Tangible Banking Assets (%)	46.5	48.0	52.5	45.6	45.7	47.7[5]
Liquid Banking Assets / Tangible Banking Assets (%)	29.9	28.9	22.8	20.8	20.0	24.5[5]
Gross Loans / Due to Customers (%)	175.3	184.1	240.9	208.5	211.8	204.1[5]

[1] All figures and ratios are adjusted using Moody's standard adjustments. [2] Basel III - fully loaded or transitional phase-in; LOCAL GAAP. [3] May include rounding differences because of the scale of reported amounts. [4] Compound annual growth rate (%) based on the periods for the latest accounting regime. [5] Simple average of periods for the latest accounting regime. [6] Simple average of Basel III periods.
Sources: Moody's Ratings and company filings

Profile

Banco Daycoval S.A. (Daycoval) is a Sao Paulo-based full-service bank that provides loans to corporates, SMEs, auto finance and payroll loans to individuals. The bank has 50 offices that offer lending products to SME, as well as a branch in the Cayman Islands. Established in 1968, Daycoval is 100% owned by the Dayan family. As of June 2024, Daycoval held a 0.5% market share of the system's assets, 0.7% of loans and 0.4% of total deposits.

Detailed credit considerations

Increasing asset risk is mitigated by stringent credit standard and adequate provisioning

The assigned score of baa3 acknowledges Daycoval's well-established risk guidelines and disciplined credit risk standards, despite the recent increase in loan delinquency. As of June 2024, problem loans to gross loans decreased to 2.3%, after peaking 3.6% in June 2023, even though still above the 1.7% average from 2019-2021. The decrease in problem loan was driven by the origination of new loans and the increase in write-off which expanded to 3.9% in June 2024 from 1.0% in June 2023, mainly due to a specific corporate loan. The expanded credit portfolio reached BRL58.4 billion in June 2024, an increase of 10.8% compared to one year prior. The bank also maintained its conservative provisioning policy and the allowance for loan losses ended with BRL1.7 billion, covering 1.54x of its problem loans as of June 2024.

Daycoval's current credit expansion maintained its strategy that prioritizes shorter-term loans to SMEs that are strongly collateralized, which would allow it to rapidly reduce the size of its loan book in case of an unexpected turn in macro conditions. As of June 2024 Daycoval's core operation to companies that accounts to 69% of its total loans, increased 5.1% from a year earlier, while delinquency level reduced to 0.9% from 1.3% a year earlier. The bank also continue to diversify its risk with its secured payroll lending franchise that accounted to 27% of the loan book and expanded 28.6% year-over-year in June 2024 with delinquency ratios at 3.6%. Higher asset risk stems from the bank vehicle financing that accounted to 4.0% of the total loans, and presents 8.6% delinquency ratio in June 2024, and should continue to negatively weigh on the problem loan metric during the next 12 to 18 months.

Although the bank is supported by a stringent risk control over collateral-backing credit activities, the smaller companies segment remain highly vulnerable to uncertainties around the timing and traction of the economic conditions. Nonetheless, we foresee an improvement in Daycoval's asset quality, supported by a more favorable operating environment and a robust collateral structure.

Replenishment capacity and shareholders commitment provide stability to capital metrics

The assigned score of ba3 incorporates Daycoval's adequate capitalization, consistent internal capital generation and the commitment from its shareholders. On regulatory basis Daycoval reported a Common Equity Tier 1 capital ratio of 12.0% as of June 2024 (above the minimum requirement of 8%) similar to the 12.1% reported in June 2023 and higher than 11.2% in June 2022.

In June 2024, Daycoval reported a tangible common equity to risk weighted assets ratio of 8.7%, up from 8.2% in June 2023. Our metric is adjusted by applying a 100% risk weight to the bank's government securities holdings and partial credit to deferred tax assets related to the provisions for loan losses, according to our standard adjustments for Brazilian banks. For the next twelve to eighteen months we expect Daycoval's capitalization to remain fairly stable with the bank cautiously resuming loan growth and replenishing capital thorough earnings retention.

Profitability will be supported by a more favorable operating environment

The assign score of baa2 reflects Daycoval's well-established position that has supported historically steady profitability. As of June 2024, Daycoval's reported a net income of BRL807 million, 76% higher from June 2023(BRL460), mainly benefited from higher interest income and net fees and commissions, that more than offset higher funding costs, a sharp increase on loan loss provision expenses that went up 20% due to the increase in the loan portfolio, and higher operating expenses. Despite the challenges Daycoval's net income-to-tangible assets ratio stood at 2.0% in June 2024, higher than 1.3% a year before, but down from 2.3% for 2021, however still above that of other medium-sized banks in Brazil with similar business profiles.

Competition on its core segment will likely arise from fintechs as well as from larger banks that will continue to search for yield in the SME segment and secured individual lending on payroll loans. Although these factors have negative implications for the bank's future earnings generation, we expect them to be partially offset by a higher fee-based income, as well as efficiency gains from innovation and technology.

Conservative ALM and a diversification of funding sources partially mitigate the banks concentration on market funds

Daycoval has vigilant liquidity management and funding diversification, which support its business expansion into longer-term loans. As a niche bank, however, Daycoval is largely exposed to a highly confidence-sensitive wholesale funding mix, an intrinsic feature of medium-sized institutions. As of June 2024, the market funds accounted for 46.5% of tangible banking assets in line with its peers in the corporate & SME lending segment. Counterbalancing this negative driver, Daycoval has been focusing its efforts on successfully replacing short-term funding with medium and long term funding sources. In the same period, deposits and deposit-like instruments represented roughly 48% of total funding; foreign-currency resources, including bonds, accounted for 14%; and local-currency bank notes (letras financeiras) 37%, including subordinated notes.

As a result Daycoval has been able to keep favorable tenor gap in the maturity of its assets and liabilities, partially mitigating the higher concentration on market funds. However this funding structure leads the bank to operates with lower liquidity levels when compared to its peers, with its liquid banking assets representing 29.9% of tangible banking assets, while the average for peers is 39% for the same ratio. The composition of those elements were factored into our combined liquidity score of ba2.

Daycoval's scores are influenced by Brazil's Moderate Macro Profile

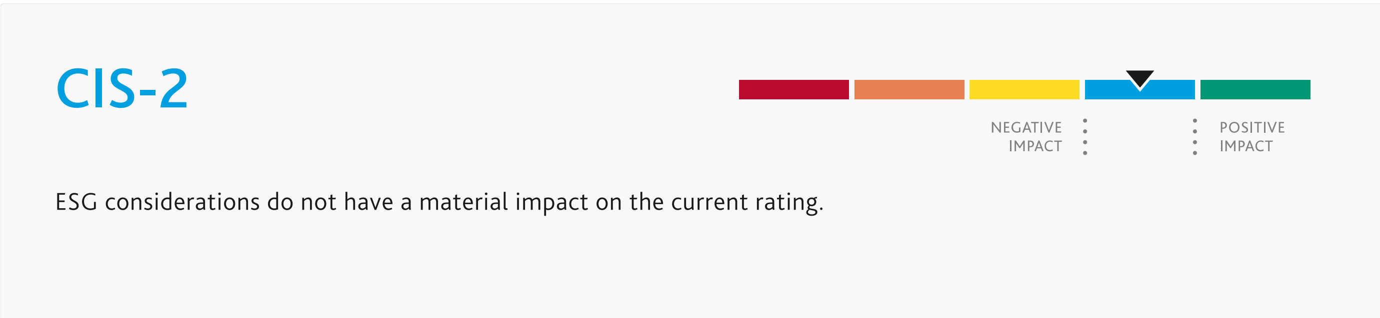
Brazil's (Ba1 positive) Macro Profile of “Moderate” is supported by the country's large and highly diversified economy with limited exposure to external financing risks. It also incorporates our improvements in the business environment for banks from recent reforms, including the independence of the central bank; the state-owned company law; labor reform; and a collateral framework that reduced uncertainties about judicial disputes and the potential for political intervention in the financial system. We forecast a real GDP growth to moderate in 2024 and 2025 to 2.0% and 2.2% respectively, after growing around 3.0% in the previous couple of years.

Our assessment acknowledges the current momentum as Brazil's banking system moves out of the credit cycle's downturn, with declining but still-high delinquency ratios and household indebtedness amid tighter liquidity on global capital markets, which will continue to pressure credit conditions ahead.

ESG considerations

Banco Daycoval S.A.'s ESG credit impact score is CIS-2

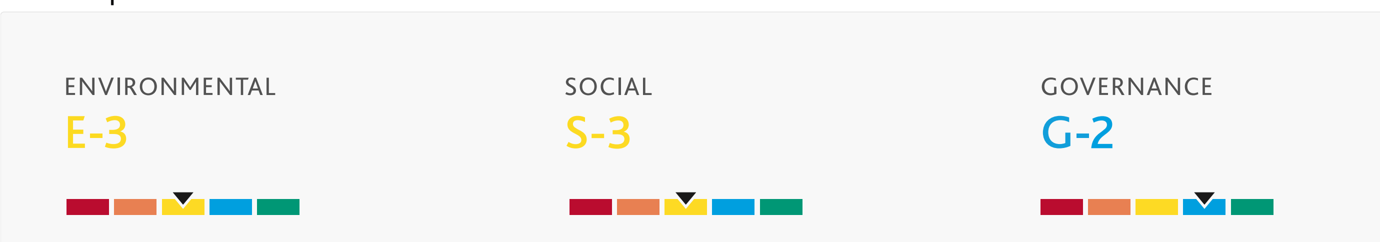
Exhibit 3
ESG credit impact score



Source: Moody's Ratings

Daycoval's **CIS-2** reflects the limited credit impact of environmental and social factors on the rating to date. The bank has a solid track record and a consistent earnings recurrence, on the back of its sound risk management practices.

Exhibit 4
ESG issuer profile scores



Source: Moody's Ratings

Environmental

Daycoval faces moderate exposure to environmental risks because of its portfolio exposure to carbon transition risk, as a bank with large exposure to the corporate segment. In line with its peers, the bank is facing mounting regulatory and stakeholder pressure to meet broader carbon transition goals.

Social

Daycoval faces moderate social risks related to customer relations. The bank's developed policies and procedures, mitigate risk associated with the distribution of financial products such as conduct, regulatory and reputational risks, as well as exposure to litigation; Daycoval has activities primarily in Brazil, a country which has imposed only moderate penalties in relation to consumer protection. Continued investments in technology and the bank's long track record of handling sensitive customer data, as well as appropriate culture and governance that ensure adherence to regulatory standards, help to manage high cyber and personal data risks. Opportunities from financial inclusion are reflected in a better than industrywide exposure to demographic and societal trends.

Governance

Daycoval faces low governance risks, and its risk management, policies and procedures are in line with industry best practices. The bank's ownership is controlled by one family that also holds the majority of the board. The associated governance risks are mitigated by the management team's track record of sustained earnings generation and delivering on strategic goals.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

Support and structural considerations

Affiliate support

No affiliate support is assigned to Daycoval. However, a strong commitment from its shareholders is indicated through capital injection, when needed, and through a conservative leverage (credit to equity) ratio maintained by the bank through the cycles.

Government support

We do not consider any probability of Daycoval receiving systemic support because of the bank's modest share in the deposit market.

Counterparty Risk (CR) Assessment

Daycoval's CR Assessment is positioned at Baa3(cr)/P-3(cr)

Daycoval's CR Assessment of Baa3(cr) is one notch above its Adjusted BCA of ba1, based on our view that senior obligations represented by the CR Assessment will more likely be preserved than senior unsecured debt to minimize losses, avoid the disruption of critical functions and limit contagion. The CR Assessment reflects an issuer's probability of defaulting on certain operating liabilities and other contractual commitments that are less likely to be subject to the application of a resolution tool to ensure the continuity of operations.

Methodology and scorecard

About Moody's Bank Scorecard

Our scorecard is designed to capture, express and explain in summary form our Rating Committee's judgment. When read in conjunction with our research, a fulsome presentation of our judgment is expressed. As a result, the output of our scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The scorecard output and the individual scores are discussed in Rating Committees and may be adjusted up or down to reflect conditions specific to each rated entity.

Daycoval's assigned BCA of ba1 is at the middle of the scorecard-indicated BCA range (see Exhibit 5). Moreover, the Financial Profile score is ba1, same level of its BCA and Brazil's Ba1 sovereign bond rating.

Rating methodology and scorecard factors

Exhibit 5
Rating Factors

Macro Factors						
Weighted Macro Profile	**Moderate**	**100%**				

Factor	Historic Ratio	Initial Score	Expected Trend	Assigned Score	Key driver #1	Key driver #2
Solvency						
Asset Risk						
Problem Loans / Gross Loans	2.3%	baa2	↔	baa3	Collateral and provisioning coverage	Expected trend
Capital						
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)	8.7%	b1	↔	ba3	Access to capital	Capital retention
Profitability						
Net Income / Tangible Assets	1.8%	baa1	↔	baa2	Earnings quality	Expected trend
Combined Solvency Score		ba1		ba1		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	48.0%	b3	↔	b1	Deposit quality	Market funding quality
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	28.9%	baa3	↔	baa3	Expected trend	
Combined Liquidity Score		ba3		ba2		
Financial Profile				ba1		
Qualitative Adjustments				Adjustment		
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				0		
Sovereign or Affiliate constraint				Ba1		
BCA Scorecard-indicated Outcome - Range				baa3 - ba2		
Assigned BCA				ba1		
Affiliate Support notching				0		
Adjusted BCA				ba1		

Instrument Class	Loss Given Failure notching	Additional notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating
Counterparty Risk Rating	1	0	baa3	-	Baa3	Baa3
Counterparty Risk Assessment	1	0	baa3 (cr)	-	Baa3(cr)	
Deposits	0	0	ba1	-	Ba1	Ba1
Senior unsecured bank debt	-	-	-	-		Ba1

[1] Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.
Source: Moody's Ratings

Ratings

Exhibit 6

Category	Moody's Rating
BANCO DAYCOVAL S.A.	
Outlook	Positive
Counterparty Risk Rating	Baa3/P-3
Bank Deposits	Ba1/NP
Baseline Credit Assessment	ba1
Adjusted Baseline Credit Assessment	ba1
Counterparty Risk Assessment	Baa3(cr)/P-3(cr)
Senior Unsecured	Ba1

Source: Moody's Ratings

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