FitchRatings

Banco Daycoval S.A.

Key Rating Drivers

Strong Company Profile: Banco Daycoval S.A.'s Issuer Default Rating (IDR) reflects its well-established niche franchise, particularly in the SME segment, and a relatively diversified risk profile. This model supports above-peer earnings through the cycles, some risk diversification outside of the SME segment, adequate capitalization, and a stable funding and liquidity profile. The Negative Outlooks on the IDRs reflects the high influence and downside risks from the pressured operating environment.

Reserves Uphold National Ratings: The Outlook on the National Long-Term Rating (NLTR) is Stable and reflects Fitch Ratings' view that the bank's financial profile will remain consistent with its current NLTR over the next two years. Fitch believes Daycoval has enough buffers in the form of capital and excess reserves to absorb potential shocks from a more adverse economic scenario.

SME Franchise Supports Earnings: Daycoval's strong niche footprint and expertise in the SME segment provides it with some pricing power and revenue stability. Pre-impairment profit averaged 5.5% of total assets over the past five years, with limited volatility. Fitch expects credit costs to pressure Daycoval's profitability in 2021 and 2022, but any potential deterioration in the bank's operating profit/risk-weighted assets ratio would be contained well within the benchmark for the bank's rating.

Downside Risks to Asset Quality: Daycoval's asset quality remained adequate through the pandemic. The impaired loan ratio, including 'D'–'H' loans, was 4.4% at March 31, 2021 from 5.9% the prior year. However, Fitch's base case assessment assumes asset quality will remain pressured until at least 2022 due to the still-challenging macroeconomic scenario, but it should remain manageable, aided by the bank's proactive risk management.

Adequate Capitalization: Daycoval maintains moderate capital buffers above regulatory requirements, supported by its good earnings retention rate. The bank's common equity Tier 1 (CET1) ratio reached 13.7% at March 31, 2021. Capital remains sensitive to asset quality shocks in Brazil, but capital at risk from unreserved impaired assets — defined as net impaired loans/ CET1 — at YE 2020 was among the lowest of Fitch-rated Brazilian banks, given Daycoval's excess loan loss reserves, which reflects the bank's conservative capital management.

Stable Funding, Comfortable Liquidity: Daycoval primarily funds its SME-oriented loan book through a combination of wholesale deposits and financial bills (Letras Financeiras), but these have proved stable through the cycle. Daycoval's liquidity buffers adequately cover the bank's limited upcoming maturities.

Rating Sensitivities

Coronavirus Impact, Operating Environment: Fitch will likely downgrade Daycoval's IDRs if there is a more substantial and prolonged deterioration in the domestic operating environment. This could be partially due to the bank experiencing acute deterioration in profitability and asset quality metrics, or if its CET1 ratio is sustained below 12%, without credible prospects to be restored above 12%. The IDRs are also sensitive to a downgrade of Brazil's sovereign rating.

Stable Outlook: A sustained recovery in the macroeconomic environment, including a reduction of vulnerabilities in the Brazilian economy, could underpin a revision to Stable Outlook. A positive rating action to the sovereign would lead to a similar action to the bank.

National Ratings Sensitive to IDR: Changes in Daycoval's IDRs or in the bank's credit profile relative to its Brazilian peers could result in changes to its National Ratings.

Ratings

Foreign Currency	
Long-Term IDR	BB–
Short-Term IDR	B
Local Currency	
Long-Term IDR	BB–
Short-Term IDR	B
Viability Rating	bb–
Support Rating	5
Support Rating Floor	NF
National	
National Long-Term Rating	AA(bra)
National Short-Term Rating	F1+(bra)
Sovereign Risk	
Long-Term Foreign-Currency IDR	BB–
Long-Term Local-Currency IDR	B
Country Ceiling	BB

Outlooks

Long-Term Foreign-Currency IDR	Negative
Long-Term Local-Currency IDR	Negative
National Long-Term Rating	Stable
Sovereign Long-Term Foreign-Currency IDR	Negative
Sovereign Long-Term Local-Currency IDR	Negative

Applicable Criteria

National Scale Rating Criteria (December 2020)

Bank Rating Criteria (February 2020)

Related Research

Fitch Revises Daycoval LT National Rating Outlook to Stable; Affirms IDR at 'BB–' (April 2021)

Fitch Takes Actions on Four Brazilian Wholesale Midsized Banks (April 2021)

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Issuer Ratings (Including Main Issuing Entities)

Rating Level	Rating
Long-Term Foreign-Currency IDR	BB–
Short-Term Foreign-Currency IDR	B
Long-Term Local-Currency IDR	BB–
Short-Term Local-Currency IDR	B
Viability Rating	bb–
Support Rating	5
Support Rating Floor	NF
National Long-Term Rating	AA(bra)
National Short-Term Rating	F1+(bra)
Outlook/Watch	Negative

IDR – Issuer Default Rating.
Source: Fitch Ratings.

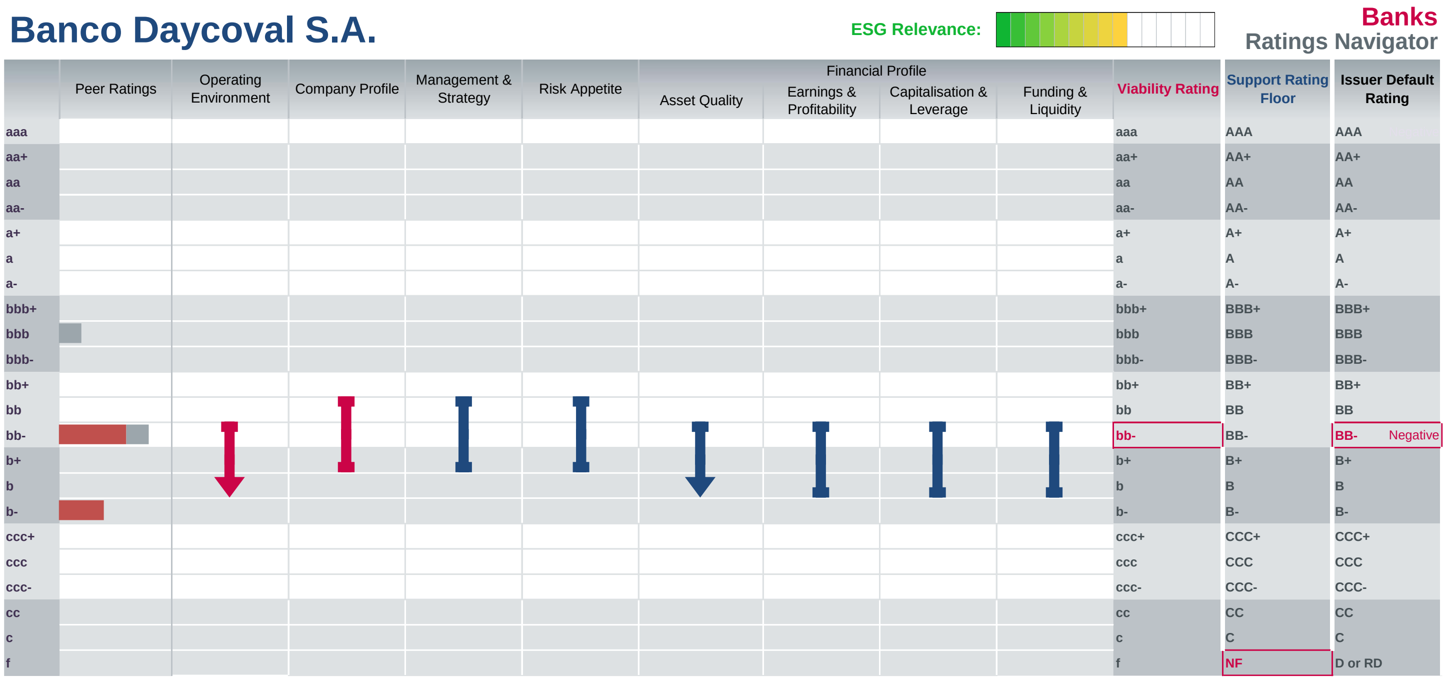
Debt Rating Classes

Rating Level	Rating
Senior Unsecured	BB–

Source: Fitch Ratings.

Senior Unsecured Notes: The notes are rated at the same level as Daycoval's Long-Term IDR, as they rank equal to other senior unsecured debts. Daycoval's ratings reflect its solid company profile, underpinned by a stable franchise and business diversification that is more significant than other midsized Brazilian banks. The ratings also reflect Daycoval's consistent and strong performance track record maintained through the cycle and comfortable capitalization.

Ratings Navigator



Sovereign Support

Support Rating Floor			Value
Typical D-SIB SRF for sovereign's rating level (assuming high propensity)			BB- or B+
Actual country D-SIB SRF			B+
Support Rating Floor:			**NF**
Support Factors	**Positive**	**Neutral**	**Negative**
Sovereign ability to support system			
Size of banking system relative to economy		✓	
Size of potential problem			✓
Structure of banking system		✓	
Liability structure of banking system		✓	
Sovereign financial flexibility (for rating level)		✓	
Sovereign propensity to support system			
Resolution legislation with senior debt bail-in		✓	
Track record of banking sector support		✓	
Government statements of support		✓	
Sovereign propensity to support bank			
Systemic importance			✓
Liability structure of bank			✓
Ownership		✓	
Specifics of bank failure		✓	
Policy banks			
Policy role			
Funding guarantees and legal status			
Government ownership			

Bar Chart Legend

Vertical bars – VR range of Rating Factor

Bar Colors – Influence on final VR

- Higher influence
- Moderate influence
- Lower influence

Bar Arrows – Rating Factor Outlook

⇧	Positive	⇩	Negative
⇳	Evolving	▫	Stable

Support Not Reliable

Daycoval's Support Rating of '5' and Support Rating Floor of 'No floor' reflect Fitch's belief that senior creditors cannot rely on receiving full extraordinary support from the sovereign in the event that Daycoval becomes nonviable.

Company Summary

Strong Niche Franchise

Daycoval has a small market share in Brazil, accounting for less than 1% of the National Financial System's total assets. Daycoval has an established and well-known niche franchise despite its relatively small size, and is a strong player in the SME lending market — 77% of total loans were to SMEs as of March 31, 2021. Daycoval's niche franchise confers some pricing power in the SME segment, which has resulted in business stability and above-peer earnings generation in recent years, when combined with business volume growth.

The bank complements its operation with auto loans, accounting for 3% of the credit portfolio at March 31, 2021, and lower-risk payroll deductible loans, which account for 20% of the portfolio. The latter contributes positively to Daycoval's credit risk profile and provides revenue stability, especially during periods of stress. The bank also owns a relatively small asset manager, whose assets under management totaled BRL6.1 billion as of March 31, 2021.

Management and Strategy

Good Execution of Strategic Objectives

Daycoval's management team, which is made up of the family members of the controlling shareholders and executives from the market, has a good degree of experience and stability. Executive turnover is low and management has a good level of credibility among employees, clients and competitors.

The execution of the bank's strategic plan was better than expected regarding revenue resilience and asset quality through the pandemic-induced downturn, with government relief measures supporting asset quality. The bank also managed to grow new SME lending under the government's Emergency Access to Credit Program. This helped the bank maintain resilient pre-impairment profit within the strategic target.

Daycoval plans to continue focusing on cost control while proactively managing credit exposures that benefit from support measures in 2021. The bank has also been proactive in diversifying funding sources and optimizing its liquidity management, which can be beneficial to margins. Daycoval considered a re-IPO in 2020 to boost capital, but this was called off following the onset of the pandemic. However, Fitch believes the bank's strategic objectives reflect its commitment to maintain conservative capital management, with a target to maintain the regulatory ratio close to 14%.

Risk Appetite

Adequate Underwriting Standards

Credit is Daycoval's main risk, largely stemming from its lending book, which accounts for approximately 61.1% of total assets at March 31, 2021, and securities portfolio, which is approximately 11.7% of the total. Underwriting standards are in line with similarly rated peers, but Daycoval's strong presence in the SME segment results in a slightly larger risk appetite. This has been historically accompanied by wider margins domestically and well-developed risk management tools. The bank's lower risk payroll lending supports its risk appetite assessment and provides a certain degree of protection against the pandemic-induced economic downturn.

New lending increased by 42.3% yoy at March 31, 2021, driven by a significant increase in loans guaranteed by the Investment Guarantee Fund (Fundo Garantidor para Investimentos [FGI]), which represented about 24.3% of the bank's loans to businesses at March 31, 2021. The loan book is short-term in nature and highly granular, which facilitates timely adjustments to underwriting standards and policies, particularly during operating environment volatility.

Daycoval's risk and reporting tools are robust, and risk limits are sound and monitored, although they may fluctuate based on market opportunities. Daycoval's exposure to market risk is very low, as its treasury is mainly responsible for funding, hedging and investment of liquid assets, and does not engage in proprietary trading activities.

Summary Financials and Key Ratios

		March 31, 2021	Dec. 31, 2020	Dec. 31, 2019	Dec. 31, 2018	Dec. 31, 2017
	Three Months – First Quarter	Three Months – First Quarter	YE	YE	YE	YE
	(USD Mil).	(BRL Mil.)	(BRL Mil.)	(BRL Mil.)	(BRL Mil.)	(BRL Mil.)
	Reviewed — Unqualified	Reviewed — Unqualified	Audited — Unqualified	Audited — Unqualified	Audited — Unqualified	Audited — Unqualified
Summary Income Statement						
Net Interest and Dividend Income	200	1,139.0	3,580.6	2,506.5	2,248.5	1,882.9
Net Fees and Commissions	11	60.8	240.7	216.9	160.3	134.3
Other Operating Income	3	16.7	(2.2)	218.2	166.7	119.7
Total Operating Income	214	1,216.5	3,819.2	2,941.6	2,575.5	2,136.9
Operating Costs	66	376.8	1,408.7	1,266.3	1,063.4	944.7
Pre-Impairment Operating Profit	147	839.7	2,410.4	1,675.3	1,512.1	1,192.2
Loan and Other Impairment Charges	12	67.0	528.2	330.4	469.4	407.5
Operating Profit	136	772.7	1,882.2	1,344.9	1,042.6	784.7
Other Non-Operating Items (Net)	0	1.7	11.6	0.1	5.2	16.0
Tax	59	337.7	711.2	324.7	402.0	279.3
Net Income	77	436.7	1,182.6	1,020.3	645.9	521.5
Other Comprehensive Income	(1)	(7.8)	(20.0)	0.0	0.0	0.0
Fitch Comprehensive Income	75	428.9	1,162.6	1,020.3	645.9	521.5
Summary Balance Sheet						
Assets						
Gross Loans	5,856	33,361.7	33,232.1	24,655.9	18,326.9	15,162.0
- of which Impaired	259	1,472.7	1,468.7	1,441.2	1,269.3	1,069.7
Loan Loss Allowances	272	1,547.0	1,534.7	1,266.1	1,099.9	931.0
Net Loan	5,585	31,814.7	31,697.4	23,389.7	17,227.0	14,231.0
Interbank	122	697.1	625.4	724.5	537.9	652.6
Derivatives	267	1,519.3	1,188.7	141.1	400.6	93.8
Other Securities and Earning Assets	2,084	11,872.4	10,020.5	6,264.9	7,007.4	5,539.6
Total Earning Assets	8,058	45,903.4	43,532.0	30,520.2	25,172.8	20,517.0
Cash and Due from Banks	44	249.7	343.0	363.8	153.2	117.1
Other Assets	1,026	5,842.5	5,284.7	4,008.1	3,653.7	3,152.2
Total Assets	9,127	51,995.6	49,159.8	34,892.1	28,979.7	23,786.3
Liabilities						
Customer Deposits	2,419	13,778.3	13,502.7	8,071.6	5,000.2	4,725.3
Interbank and Other Short-Term Funding	515	2,936.1	2,476.6	8,985.9	11,090.7	6,768.6
Other Long-Term Funding	4,306	24,529.4	23,053.2	9,729.1	5,634.1	6,086.2
Trading Liabilities and Derivatives	20	116.7	58.1	101.0	29.7	9.4
Total Funding	7,260	41,360.4	39,090.5	26,887.5	21,754.8	17,589.5
Other Liabilities	1,014	5,778.6	5,642.3	4,308.4	3,987.0	3,186.9
Preference Shares and Hybrid Capital	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Total Equity	853	4,856.7	4,426.9	3,696.2	3,238.0	3,010.0
Total Liabilities and Equity	9,127	51,995.6	49,159.8	34,892.1	28,979.7	23,786.3
Exchange Rate		USD1 = BRL5.6967	USD1 = BRL5.1734	USD1 = BRL4.0301	USD1 = BRL3.8742	USD1 = BRL3.3074

N.A. – Not available.
Source: Fitch Ratings, Fitch Solutions, Banco Daycoval S.A.

Summary Financials and Key Ratios

(%)	March 31, 2021	Dec. 31, 2020	Dec. 31, 2019	Dec. 31, 2018	Dec. 31, 2017
Ratios (Annualized as Appropriate)					
Profitability					
Operating Profit/Risk-Weighted Assets	8.9	5.6	5.0	4.5	3.9
Net Interest Income/Average Earning Assets	10.3	9.9	9.4	10.1	9.6
Non-Interest Expense/Gross Revenue	31.0	36.9	43.0	41.3	44.2
Net Income/Average Equity	38.2	28.8	29.0	20.3	18.4
Asset Quality					
Impaired Loans Ratio	4.4	4.4	5.8	6.9	7.1
Growth in Gross Loans	0.4	34.8	34.5	20.9	9.6
Loan Loss Allowances/Impaired Loans	105.0	104.5	87.9	86.7	87.0
Loan Impairment Charges/Average Gross Loans	0.8	2.0	1.6	2.9	3.0
Capitalization					
Common Equity Tier 1 Ratio	13.7	13.1	13.7	14.1	14.9
Tangible Common Equity/Tangible Assets	7.4	7.0	10.6	11.2	12.7
Net Impaired Loans/Common Equity Tier 1	(1.5)	(1.5)	4.7	5.2	4.6
Funding and Liquidity					
Loans/Customer Deposits	242.1	246.1	305.5	366.5	320.9
Customer Deposits/Funding	33.4	34.6	30.1	23.0	26.9

Source: Fitch Ratings, Fitch Solutions, Banco Daycoval S.A.

Key Financial Metrics — Latest Developments

Downside Risks to Asset Quality

Daycoval's asset quality ratios have remained largely stable through the cycles, despite the slight increase in nonperforming loans (NPLs) during 2020, due the challenging macroeconomic environment. NPLs above 90 days remained low at 1.6% at March 31, 2021, which is virtually in line with YE 2020, despite increased NPLs in auto and payroll portfolios. Unlike other banks, Daycoval renegotiated only 8% (BRL 2.9 billion) of its credit portfolio, signing that borrower's repayment capacity remains broad. The bank significantly increased its additional provisions, which are currently 48.5% above the minimum required.

Fitch expects the economic downturn to result in an uptick of the bank's impaired loan ratio as many borrowers exit the crisis period in weakened financial positions. Government support measures should mitigate short-term pressures, but the ultimate effects remain unclear. The bank's strong reserve coverage of impaired loans — 105% at March 31, 2021 — and the relatively high share of FGI-guaranteed loans — 24% of total loans at March 31, 2021 — provides a cushion against asset-quality pressures.

Good Profitability

Daycoval has healthy operating profitability metrics compared with similarly rated peers, underpinned by resilient revenue generation through the cycle, adequate risk pricing and best-in-class cost efficiency, which was below 45% cost/income at March 31, 2021. Daycoval continued to post solid profitability in 2020, even with the increase of provisioning expenses related to the pandemic.

Daycoval's net interest income generation benefited from strong growth in operations due to FGI guarantees in 2020, supporting pre-impairment operating profit growth of 12% yoy. These factors provided some headroom to book additional loan impairment charges (LICs), which . The annualised LICs/gross loans ratio was 2% during 2020 compared with 1.6% in 2019. Fitch expects Daycoval's profitability to remain in line with historical figures, although downside risks remain should the economic recovery be delayed or weaker than expected.

Conservative Capital Management

Daycoval's capital position benefited from strong capital generation and adequate earnings retention in recent years. This mitigates the risks of operating in a challenging economic environment and provides buffers against unexpected losses. The CET1 ratio of 13.7% at March 31, 2021 was adequately above the minimum requirement of 10.5%, and was virtually stable compared with the prior-year period, despite strong loan growth, partially benefiting from lower risk weighting from FGI loans.

The total capital ratio improved to 15% at March 31, 2021, benefiting from the issuance of BRL297 million of Tier II eligible instruments in the first half of 2020. Capital encumbrance from unreserved impaired loans is not relevant given the bank's excess reserves, which were negative1.5% at March 31, 2021, which is stronger than peers. However, Daycoval's capitalization may be vulnerable to severe shocks to asset quality, although less than for most domestic peers.

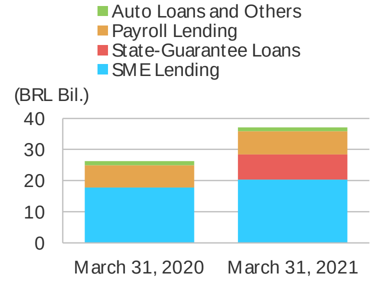
Funding and Liquidity

Daycoval primarily funds its loan book with deposits and retail-distributed financial bills — LCIs and LCAs, which was approximately 44% of total funding at March 31, 2021. This affects its funding base by making use of wholesale funds, which was 56% of total funding at March 31, 2021, but these have been generally stable and relatively well-diversified due to Daycoval's good reputation in domestic debt markets. Customer deposits grew by 65.5% yoy at March 31, 2021, reducing its commercial gap, despite strong loan growth. The bank's adjusted gross loans/deposits ratio slightly increased to 127% at March 31, 2021, from 124% the prior year.

Daycoval's liquidity has historically been very comfortable despite upcoming maturities, and liquid assets totaled BRL9.4 billion at March 31, 2021 (18.1%of total assets). The relative short-term nature of loan assets favors Fitch's asset and liability management assessment — the average maturity of the loan portfolio was 395 days, compared with 510 days for the funding base.

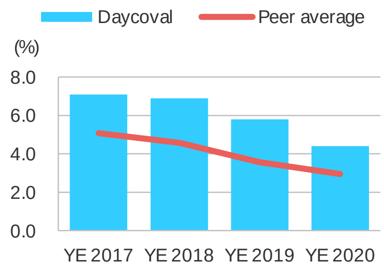
Daycoval's peers include: Parana Banco S.A. (NLTR: AA–[bra]), Banco ABC Brasil S.A. (IDR: BB; NLTR: AAA[bra]), Banco Sofisa S.A. (NLTR: A+[bra]), Banco Alfa de Investimento S.A. (NLTR: AA[bra]),

Loan Book



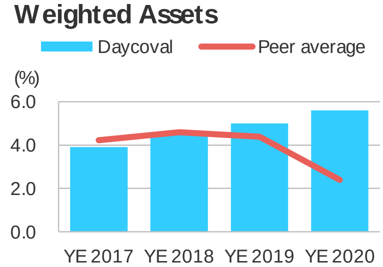
Source: Fitch Ratings, Fitch Solutions, Banco Daycoval S.A.

Impaired Loan Ratio



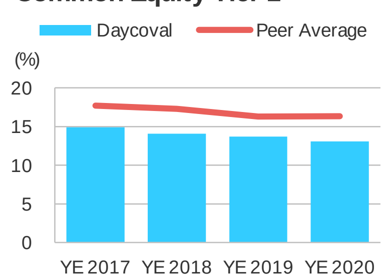
Source: Fitch Ratings, Fitch Solutions, Daycoval, Parana Banco, ABC Brasil, Sofisa, Alfa.

Operating Profit/ Risk Weighted Assets



Source: Fitch Ratings, Fitch Solutions, Daycoval, Parana Banco, ABC Brasil, Sofisa, Alfa.

Common Equity Tier 1



Source: Fitch Ratings, Fitch Solutions, Daycoval, Parana Banco, ABC Brasil, Sofisa, Alfa.

Environmental, Social and Governance Considerations

FitchRatings **Banco Daycoval S.A.** **Banks** Ratings Navigator

Credit-Relevant ESG Derivation

Banco Daycoval S.A. has 5 ESG potential rating drivers

- Banco Daycoval S.A. has exposure to compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security) but this has very low impact on the rating.
- Governance is minimally relevant to the rating and is not currently a driver.

			Overall ESG Scale
key driver	0	issues	5
driver	0	issues	4
potential driver	5	issues	3
not a rating driver	4	issues	2
	5	issues	1

Environmental (E)

General Issues	E Score	Sector-Specific Issues	Reference	E Scale
GHG Emissions & Air Quality	1	n.a.	n.a.	5
Energy Management	1	n.a.	n.a.	4
Water & Wastewater Management	1	n.a.	n.a.	3
Waste & Hazardous Materials Management; Ecological Impacts	1	n.a.	n.a.	2
Exposure to Environmental Impacts	2	Impact of extreme weather events on assets and/or operations and corresponding risk appetite & management; catastrophe risk; credit concentrations	Company Profile; Management & Strategy; Risk Appetite; Asset Quality	1

Social (S)

General Issues	S Score	Sector-Specific Issues	Reference	S Scale
Human Rights, Community Relations, Access & Affordability	2	Services for underbanked and underserved communities: SME and community development programs; financial literacy programs	Company Profile; Management & Strategy; Risk Appetite	5
Customer Welfare - Fair Messaging, Privacy & Data Security	3	Compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security)	Operating Environment; Company Profile; Management & Strategy; Risk Appetite	4
Labor Relations & Practices	2	Impact of labor negotiations, including board/employee compensation and composition	Company Profile; Management & Strategy	3
Employee Wellbeing	1	n.a.	n.a.	2
Exposure to Social Impacts	2	Shift in social or consumer preferences as a result of an institution's social positions, or social and/or political disapproval of core banking practices	Company Profile; Financial Profile	1

Governance (G)

General Issues	G Score	Sector-Specific Issues	Reference	G Scale
Management Strategy	3	Operational implementation of strategy	Management & Strategy	5
Governance Structure	3	Board independence and effectiveness; ownership concentration; protection of creditor/stakeholder rights; legal /compliance risks; business continuity; key person risk; related party transactions	Management & Strategy; Earnings & Profitability; Capitalisation & Leverage	4
Group Structure	3	Organizational structure; appropriateness relative to business model; opacity; intra-group dynamics; ownership	Company Profile	3
Financial Transparency	3	Quality and frequency of financial reporting and auditing processes	Management & Strategy	2
				1

How to Read This Page
ESG scores range from 1 to 5 based on a 15-level color gradation. Red (5) is most relevant and green (1) is least relevant.

The Environmental (E), Social (S) and Governance (G) tables break out the individual components of the scale. The right-hand box shows the aggregate E, S, or G score. General Issues are relevant across all markets with Sector-Specific Issues unique to a particular industry group. Scores are assigned to each sector-specific issue. These scores signify the credit-relevance of the sector-specific issues to the issuing entity's overall credit rating. The Reference box highlights the factor(s) within which the corresponding ESG issues are captured in Fitch's credit analysis.

The Credit-Relevant ESG Derivation table shows the overall ESG score. This score signifies the credit relevance of combined E, S and G issues to the entity's credit rating. The three columns to the left of the overall ESG score summarize the issuing entity's sub-component ESG scores. The box on the far left identifies some of the main ESG issues that are drivers or potential drivers of the issuing entity's credit rating (corresponding with scores of 3, 4 or 5) and provides a brief explanation for the score.

Classification of ESG issues has been developed from Fitch's sector ratings criteria. The General Issues and Sector-Specific Issues draw on the classification standards published by the United Nations Principles for Responsible Investing (PRI) and the Sustainability Accounting Standards Board (SASB).

Sector references in the scale definitions below refer to Sector as displayed in the Sector Details box on page 1 of the navigator.

CREDIT-RELEVANT ESG SCALE

How relevant are E, S and G issues to the overall credit rating?

5	Highly relevant, a key rating driver that has a significant impact on the rating on an individual basis. Equivalent to "higher" relative importance within Navigator.
4	Relevant to rating, not a key rating driver but has an impact on the rating in combination with other factors. Equivalent to "moderate" relative importance within Navigator.
3	Minimally relevant to rating, either very low impact or actively managed in a way that results in no impact on the entity rating. Equivalent to "lower" relative importance within Navigator.
2	Irrelevant to the entity rating but relevant to the sector.
1	Irrelevant to the entity rating and irrelevant to the sector.

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This 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. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.