S&P Global
Ratings

RatingsDirect®

Banco Daycoval S.A.

Primary Credit Analyst:
Henrique Sznirer, Sao Paulo + 55 11 3039 9723; henrique.sznirer@spglobal.com

Secondary Contact:
Guilherme Machado, Sao Paulo + 30399700; guilherme.machado@spglobal.com

Table Of Contents

Table Of Contents (cont.)

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 those of its peers.	Rising competition from large banks and new players.
Track record of solid management and expertise in collateral management.	Difficult economic conditions in Brazil.
Sound asset quality metrics.	Heavy reliance on wholesale investors for funding.

Our rating on Banco Daycoval S.A. continues to reflect its good profitability and solid track record in lending to small- and mid-size 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 profitability has been outperforming those of its peers due to its rapid loan growth, solid net interest margins, and manageable credit losses. However, the bank is also concentrated in the SME niche, which we see as a relative weakness.

Higher margins offset increasing credit loss provisions in the fourth quarter of 2022. The increase in Daycoval's credit-loss provisions was because of one particular retailer's default. But the bank's profitability metrics improved anyway in the fourth quarter, mainly as a result of higher net interest margins. Overall, Daycoval reported a net income of R$1.1 billion and return on average equity of 20.5% in 2022. Although Daycoval's profits are down from what it had been reporting since 2019, it's still somewhat higher than the industry average.

Daycoval's profitability could fall amid challenging conditions this year. We expect Daycoval's profitability this year will be more pressured than in recent years due to our expectation of lower credit growth and potential for deterioration in the creditworthiness of its customers. We project its return on equity (ROE) to fall to 17%-20% in 2023, which is lower than the 2018-2022 average of 26% but still somewhat higher than what we expect for the industry average.

We expect asset quality to deteriorate in 2023, in line with the industry trend, but it should remain under control. We forecast that nonperforming loans (NPLs) will be 2.5%-3.0% by the end of 2023. NPLs should increase as a result of the default of a large retailer in January, although that loan could still be recovered by the end of the year. SME loans could also face tougher conditions this year, with high interest rates and timid GDP growth potentially contributing to rising NPLs. Still, Daycoval's NPL ratio has generally been sound, and we believe that its loan-loss provisions, which covered about 190% of NPLs as of December 2022, should help it withstand any deterioration in NPLs.

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 national scale ratings would depend on Daycoval's ability to consistently outperform its peers. However, an upgrade on the global scale would only be possible if we simultaneously upgrade Brazil. Moreover, we don't expect major shifts in the bank's credit fundamentals next year because we think it will maintain its current business and funding structure, capitalization, and sound asset quality metrics.

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 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

	--Year ended Dec. 31--			
(%)	**2021a**	**2022a**	**2023f**	**2024f**
Growth in customer loans	25.3	16.6	8.0-12.0	10.0-15.0
Growth in total assets	26.0	12.6	6.0-10.0	9.0-13.0
Net interest income/average earning assets	8.8	7.2	7.5-8.5	7.5-8.5
Return on equity	30.1	20.5	17.0-20.0	19.0-23.0

Banco Daycoval S.A. Key Ratios And Forecasts (cont.)				
	--Year ended Dec. 31--			
(%)	2021a	2022a	2023f	2024f
New loan loss provisions/average customer loans	1.2	1.5	1.75-2.25	1.0-1.5
Gross nonperforming assets/customer loans	1.8	1.9	2.5-3.0	2.0-2.5
Net charge-offs/average customer loans	0.5	0.8	0.75-1.25	1.0-1.5
Risk-adjusted capital ratio	6.3	6.4	6.0-6.5	6.0-6.5

All figures adjusted by S&P Global Ratings. a--Actual. f--Forecast.

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 0.5% in 2023 as tight monetary conditions and high inflation weaken domestic demand. Credit growth will likely moderate amid not just rising inflation, but higher interest rates and sluggish economic growth as well. Asset quality will slip as a result of the economic downturn and the residual effects of the pandemic on certain economic sectors, but credit losses should be manageable because of the high provisioning coverage.

Our industry risk assessment of Brazil reflects its well-developed financial regulations, which are broadly in line with international standards, and the regulator's good track record, which 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 net interest margins should mitigate the impact. The Brazilian banking system has an adequate funding mix with a large and stable core customer deposit base.

Business Position: Revenues Primarily From Wholesale Loans, But Daycoval Has Been Outperforming Peers On Profitability

Daycoval's business position continues to be supported by its sizable and successful operations in collateralized loans to SMEs in Brazil. However, despite its above-average profitability metrics, the bank's business position is constrained by its concentrated revenue, which mainly consists of net interest income from SME loans and its somewhat small market share in nationwide loans.

Daycoval's loan portfolio mostly consists of loans to SMEs. As of December 2022, the bank's expanded loan book amounted to about R$55.4 billion, of which R$41.5 billion (75%) were corporate exposures, R$10.6 billion (19%) were payroll loans, and the rest mainly consisted of auto loans. Daycoval has historically had a strong performance in its corporate loan portfolio due to competent collateral management in its SME business (SME loans granted by Daycoval are generally backed by trade receivables). Out of the collateral backing wholesale operations, about 59% were trade receivables, 16% were Fundo Garantidor para Investimentos, and 8% were real estate properties.

Owing to its extensive track record in its lending niche, Daycoval is able to generate substantial net interest income relative to NPL formation. This, combined with improved efficiency up until 2021, 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 financial system's overall. Daycoval's ROE in that same period was 25.5%, higher than the industry average of 15%. While Daycoval's ROE dipped to 20.5% in 2022 because of tighter reported net interest margins, it was still higher than the industry average.

Capital And Earnings: Projected RAC Ratio Before Diversification Of 6.0%-6.5%

We base our capital and earnings assessment on our forecasted average RAC ratio of 6.0%-6.5% in 2023-2024, 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 6.0% from the past four years. It's one part of a mixed picture for Daycoval's capital and earnings, since we also expect slower credit growth in 2023 and an ROE of 17%-23%. Moreover, the bank's total regulatory capital, its reported Basel ratio of 12.9% as of December 2022, is 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 regulator applies a 0% risk weight.

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

- Real GDP growth in Brazil of 0.5% in 2023 and 2.0% in 2024;
- Overall annual loan portfolio growth of 8.0%-12.0% in 2023 and 10%-15% in 2024;
- A modest recovery in net interest margins after a 2022 drop caused by hedging effects, stiffer competition in corporate lending, and rapid SELIC rate hikes;
- NPLs increasing to 2.5%-3.0% by December (a deterioration in SME loans and the default of an individual retailer) and an increase in net new loan-loss provisions in 2023 to 1.75%-2.25% of the loan portfolio;
- ROE of 17%-23% in 2023-2024; 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 obligor granularity within its portfolio, which partly offset higher risks related to its concentration in the middle-market segment. Daycoval focuses on SME loans, which have intrinsically higher delinquency rates. However, Daycoval's profitability has consistently outperformed its peers, which signals that the bank is adequately pricing its loans relative to risk.

The bank's NPL ratio was at 1.9% in December 2022, in line with recent periods but slightly lower than the pre-pandemic five-year average of 2.8% (2015-2019). Renegotiated credits, which totaled 5.8% of the expanded loan book at the end of 2019, had increased to about 14% by June 2020 before slipping back to about 7% by December 2022. Last year, Daycoval's charge-offs represented 0.8% of the average customer loan portfolio, below the five-year average of 1.2%.

We expect Daycoval's NPL asset quality ratios to worsen in 2023 but remain under control. This rise could result from a significant default event of a retailer and higher interest rates and low GDP growth expectations, which could worsen credit conditions for SMEs. However, we believe that Daycoval's tight underwriting standards, sound collateral management, and flexibility to restructure loans would mitigate the impact of a rise in NPLs on the bank's bottom line. In addition, we believe that Daycoval's loan-loss provisions, which covered 190% of NPLs as of December 2022, are generally conservative and should cover part of the expected asset quality deterioration.

Daycoval's lending portfolio had been growing at a moderately high rate in recent years. Its expanded credit portfolio grew by 33% in 2020 (amid the BNDES FGI program), 27% in 2021, and 19% in 2022. However, we expect Daycoval to decelerate origination in 2023 because of the difficult conditions for SME loans and competition from other banks.

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

We view Daycoval's funding base as less stable and diversified than 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 believe the bank still lacks broader depositor and funding source diversification compared to larger banks. As of December 2022, Daycoval's funding base consisted of deposits (39%), local bonds (30%), borrowings and onlending (15%), repurchase agreements (12%), and international bonds (4%).

The bank's stable funding ratio (SFR) was 74% in December 2022. Daycoval has a good match between assets and liabilities and a positive maturity gap between its loans (average maturity of 276 days) and funding sources (average maturity of 529 days).

We also view Daycoval's liquidity as comfortable. As of December, its broad liquid assets covered 0.7x of its short-term wholesale funding, somewhat below the 2017-2021 average of 1.02x. Those assets also represented 21% 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 as well 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 Credit Indicators

E-1	**E-2**	E-3	E-4	E-5	S-1	**S-2**	S-3	S-4	S-5	G-1	**G-2**	G-3	G-4	G-5

ESG credit indicators provide additional disclosure and transparency at the entity level and reflect S&P Global Ratings' opinion of the influence that environmental, social, and governance factors have on our credit rating analysis. They are not a sustainability rating or an S&P Global Ratings ESG Evaluation. The extent of the influence of these factors is reflected on an alphanumerical 1-5 scale where 1 = positive, 2 = neutral, 3 = moderately negative, 4 = negative, and 5 = very negative. For more information, see our commentary "ESG Credit Indicators: Definition And Applications," published Oct. 13, 2021.

We view ESG factors for Daycoval 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$)	**2022**	**2021**	**2020**	**2019**	**2018**
Adjusted assets	69,704.8	61,931.3	49,159.4	34,892.1	28,979.7
Customer loans (gross)	47,504.2	40,741.8	32,518.0	24,655.9	18,326.8
Adjusted common equity	5,549.6	4,771.9	4,346.9	3,260.5	2,892.4
Operating revenues	4,824.3	4,760.7	4,071.6	3,369.3	3,039.5
Noninterest expenses	2,506.7	1,946.2	1,540.7	1,545.4	1,297.9
Core earnings	1,087.2	1,390.6	1,175.4	1,020.2	642.6

R$--Brazilian real.

Table 2

Banco Daycoval S.A. Business Position

	--Year ended Dec. 31--				
(%)	**2022**	**2021**	**2020**	**2019**	**2018**
Loan market share in country of domicile	N/A	0.6	0.8	0.7	0.5
Deposit market share in country of domicile	N/A	0.4	0.4	0.3	0.2
Return on average common equity	20.5	30.1	29.1	29.4	20.7

N/A--Not applicable.

Table 3

Banco Daycoval S.A. Capital And Earnings

	--Year ended Dec. 31--				
(%)	**2022**	**2021**	**2020**	**2019**	**2018**
Tier 1 capital ratio	12.9	13.0	14.0	13.6	14.1
S&P Global Ratings' RAC ratio before diversification	N/A	N/A	5.5	6.0	5.9

Table 3

Banco Daycoval S.A. Capital And Earnings (cont.)

	--Year ended Dec. 31--				
(%)	**2022**	**2021**	**2020**	**2019**	**2018**
S&P Global Ratings' RAC ratio after diversification	N/A	N/A	4.7	5.2	5.1
Adjusted common equity/total adjusted capital	84.2	82.8	93.6	100.0	100.0
Net interest income/operating revenues	87.1	90.0	90.9	89.1	90.0
Fee income/operating revenues	8.3	6.1	5.9	6.4	5.3
Cost to income ratio	52.0	40.9	37.8	45.9	42.7
Preprovision operating income/average assets	3.5	5.1	6.0	5.7	6.6
Core earnings/average managed assets	1.7	2.5	2.8	3.2	2.4

N/A--Not applicable.

Table 4

Banco Daycoval S.A. Risk Position

	--Year ended Dec. 31--				
(%)	**2022**	**2021**	**2020**	**2019**	**2018**
Growth in customer loans	16.6	25.3	31.9	34.5	20.9
Total diversification adjustment/S&P Global Ratings' RWA before diversification	N/A	N/A	17.5	15.1	16.0
Total managed assets/adjusted common equity (x)	12.6	13.0	11.3	10.7	10.0
New loan loss provisions/average customer loans	1.5	1.2	2.3	2.2	4.2
Net charge-offs/average customer loans	0.8	0.5	1.0	0.8	1.8
Gross nonperforming assets/customer loans + other real estate owned	1.9	1.8	1.8	1.4	2.7
Loan loss reserves/gross nonperforming assets	190.1	219.0	256.7	367.2	219.7

N/A--Not applicable.

Table 5

Banco Daycoval S.A. Funding And Liquidity

	--Year ended Dec. 31--				
(%)	**2022**	**2021**	**2020**	**2019**	**2018**
Core deposits/funding base	36.0	41.3	40.5	36.2	29.6
Customer loans (net)/customer deposits	226.9	194.2	197.4	241.1	267.6
Long-term funding ratio	64.7	73.5	67.0	75.1	60.7
Stable funding ratio	73.8	82.9	77.3	81.9	71.3
Short-term wholesale funding/funding base	39.6	29.7	37.1	28.4	45.1
Broad liquid assets/short-term wholesale funding (x)	0.7	0.9	0.7	0.9	0.8
Broad liquid assets/total assets	20.9	20.4	21.3	19.9	25.5
Broad liquid assets/customer deposits	72.1	62.6	66.8	71.4	114.9
Net broad liquid assets/short-term customer deposits	(86.3)	(22.8)	(79.4)	(12.2)	(58.5)
Short-term wholesale funding/total wholesale funding	60.1	48.9	61.5	44.5	64.1

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 24, 2023)*		
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.