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Banco Daycoval S.A.

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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
Sound profitability and asset quality metrics that are better than those of its peers.	Rising competition from large banks and new players.
Solid management track record and good expertise in collateral management.	Weak economic growth in Brazil, exacerbated by the COVID-19 pandemic.
Stable asset quality metrics despite challenging economic conditions.	High reliance on wholesale investors for funding.

Our rating on Daycoval continues to reflect its good profitability and solid track record in loans to small and midsize enterprises (SMEs), but also its concentrated operations. Daycoval's business position benefits from its sizable and successful operations in collateralized loans to small and midsize enterprises (SMEs) in Brazil. Its profitability has been outperforming its peers due to its rapid loan growth, adequate loan pricing, and manageable credit losses. However, the bank is also concentrated in the SME niche, which we see as a relative weakness.

Despite its strong performance last year, we think Daycoval's profitability could fall amid challenging conditions this year. In our opinion, 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 20%-25% in the upcoming years. This is lower than the ROE the bank had in 2020 (29.1%) and in 2021 (30.1%), but still higher than the industry average.

Despite the weak credit conditions, we expect the bank's asset quality to remain under control in 2022. We forecast that nonperforming loans (NPLs) will end 2022 at 2.0%-2.5%. In 2020 and 2021, Daycoval's NPL ratio was better than usual due to renegotiations and overall better NPLs in the Brazilian banking system. However, we believe that Daycoval's NPLs will follow the Brazilian banking system's trend and slightly worsen this year compared to last year due to weaker credit conditions. On the other hand, Daycoval's loan loss provisions, which covered about 220% of NPLs as of December 2021, will adequately cover the potential deterioration in NPLs.

Outlook

The stable outlook on Daycoval reflects our view that we don't expect any rating changes in the next 12 months resulting from the bank's stand-alone credit profile. In our opinion, the bank will continue to report a strong financial performance and stable asset quality metrics.

Upside scenario

In our view, an upgrade of Daycoval would depend on its ability to continue 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 in the next year because we think it will maintain its current business and funding structure, capitalization, and sound asset quality.

Downside scenario

We could lower the ratings on Daycoval if the bank's risk-adjusted capital (RAC) ratio drops to consistently below 5% because of faster-than-expected loan growth or eroding asset quality. Our base case considers that Daycoval will keep asset quality metrics slightly better than the system's average and will have good profitability to support credit growth in the next two years.

Key Metrics

Banco Daycoval S.A. Key Ratios And Forecasts*

	--Fiscal year ended Dec. 1 --			
	2020a	**2021a**	**2022f**	**2023f**
Growth in operating revenue (%)	20.8	16.9	10.0-14.0	7.0-10.0
Growth in customer loans (%)	31.9	25.3	8.0-12.0	8.0-12.0
Growth in total assets (%)	40.9	26.0	5.0-10.0	5.0-10.0
Net interest income/average earning assets (NIM) (%)	9.9	8.8	8.5-9.5	8.5-9.5
Cost to income ratio (%)	37.8	40.9	40.0-43.0	41.0-44.0
Return on equity (%)	29.1	30.1	22.0-26.0	22.0-26.0
Return on assets (%)	2.8	2.5	1.9-2.3	2.0-2.4
New loan loss provisions/average customer loans (%)	2.3	1.2	1.8-2.2	1.5-2.0
Gross nonperforming assets/customer loans (%)	1.8	1.8	2.0-2.5	2.0-2.5
Net charge-offs/average customer loans (%)	1.0	0.5	0.9-0.9	1.1-1.1

Banco Daycoval S.A. Key Ratios And Forecasts* (cont.)				
	--Fiscal year ended Dec. 1 --			
	2020a	**2021a**	**2022f**	**2023f**
Risk-adjusted capital ratio (%)	5.5	5.5	5.5-6.0	5.7-6.3

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

Anchor:'bb+' For Banks Operating Only In Brazil

We classify the banking sector of Brazil in group '6' under our Banking Industry Country Risk Assessment (BICRA). Other countries in group '6' include China, Colombia, Portugal, Indonesia, Brunei, Thailand, Trinidad and Tobago, South Africa, and Uruguay. Our bank criteria use our BICRA economic risk and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating. The anchor for banks operating only in Brazil is 'bb+'.

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 4.8% in 2021, although economic performance will remain mediocre in the next few years, absent a faster pace of reform approvals. Asset quality metrics remain stronger than we expected, and should slightly weaken due to the softer economic performance we expect for 2022 and the weaker credit growth. However, they should remain manageable thanks to banks' conservative growth strategies before the pandemic.

Our industry risk assessment for Brazil reflects its well-developed financial regulation that is broadly in line with international standards, and the regulator's good track record that has helped the domestic financial system withstand the last economic downturn. We expect profitability to continue improving in 2022, reflecting lower provisioning needs. As interest rates pick up, banks' net interest margins should be resilient thanks to their ability to transfer the higher funding costs to ultimate borrowers and to the high share of variable rate loans and the short tenor of the bulk of fixed rate loans. The Brazilian banking system has an adequate funding mix with a large and stable core customer deposit base.

Business Position: Business Profile More Concentrated Than Other Multipurpose Universal Banks

Daycoval's business position continues to be supported by its sizable and successful operations in collateralized loans to SMEs in Brazil. However, the bank's business position is also constrained by its concentrated revenue composition, which is mainly composed of net interest income from SME loans, and the bank's somewhat small market share in terms of nationwide loans.

Daycoval's loan portfolio is mostly composed of loans to SMEs. As of December 2021, the bank's expanded loan book amounted to about R$46 billion, of which R$36 billion (77%) were corporate exposures, R$8.5 billion (18.6%) were payroll loans, and the rest was mainly composed 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 58%

were trade receivables, 19% FGI (Fundo Garantidor para Investimentos), and 8% were real estate properties.

Daycoval rapidly increased loan disbursements through the BNDES FGI program in the past two years, which represented about 17% of the bank's wholesale loan portfolio as of December 2021. The government designed the program to provide credit for SMEs facing financial hardship during the pandemic. These loans have special terms and conditions, and BNDES guarantees up to 80% of the loan amount if the borrower defaults. In our view, although the program is temporary, Daycoval's client base could expand from it.

The bank's strategy is to increase its client base and operations, which has generated record profits in the past few quarters. However, we believe the stiff competition in Brazil's banking sector may challenge this trend. We expect competition from large banks and new players to pressure Daycoval's margins, gradually hindering the rise in ROE in the next few years.

Capital And Earnings: RAC Ratio Before Diversification Of 5.0%-6.0% For The Next Two Years

We base Daycoval's capital and earnings assessment on our forecasted average RAC ratio of 5.0%-6.0% for the next two years, which is in line with most rated banks operating in Brazil. Moreover, the bank's total regulatory capital ratio was 13.0% in December 2021, 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.

Daycoval's RAC ratios have decreased in recent years due to the bank's rapid credit growth. However, the bank has issued perpetual subordinated notes that, to some extent, mitigated the impact of credit growth on the RAC ratio. In upcoming years, we expect Daycoval's credit growth to slow but profitability to stay high, with the bank reinvesting about half of it, such that we predict that RAC will gradually increase to close to 6.0% by 2023.

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

- Brazil's real GDP growth of 0.8% in 2022 and 2.0% in 2023;
- Overall annual loan portfolio growth of about 10% in the next two years;
- Net interest margins (NIMs) remaining lower than usual in 2022 and 2023, but somewhat higher than 2021 due to stiffer competition in corporate lending and compressing margins in payroll loans;
- ROE of 22%-26% between 2022 and 2023 as origination decelerates and credit quality metrics worsen as GDP growth slows.
- NPLs of 2.0%-2.5% by the end of 2022; and
- A dividend payout of 45% of net profit in the following years, in line with historical figures.

Risk Position: Conservative Collateral Management And Low Customer Concentration Offset Higher Risk From The Middle-Market Sector

Daycoval's risk position reflects its overall solid loan book performance, good collateral management, and adequate obligor granularity within its portfolio, which partially 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 1.8% in December 2021, slightly lower than its pre-pandemic three-year average of about 3.2% (2016-2019). During the pandemic, Daycoval's NPL ratio remained lower than usual amid a moderate amount of renegotiated loans. NPLs were at a low of 1.4% at the end of 2019, initially increased to 2.3% in June 2020, and remained close to 2.0% after that. Renegotiated loans, which totaled 5.8% of the expanded loan book at the end of 2019, increased to about 14.0% in June 2020, but slipped to 7.2% by December 2021. Furthermore, for the past two years, Daycoval's charge-off ratio averaged 0.8%, below its pre-pandemic three-year average of 1.4%.

Despite the weak credit conditions, we expect the bank's asset quality to remain under control in 2022 given moderate risk appetite, tight underwriting standards, and flexibility to restructure loans to mitigate potential losses stemming from higher risk in the economy. We forecast that NPLs will end 2022 at 2.0%-2.5%, which represents a deterioration from the numbers reported during the pandemic, but are still stronger than those during the 2015-2016 financial crisis. We believe that Daycoval's loan loss provisions, which covered about 220% of NPLs as of December 2021, will adequately cover the potential deterioration in NPLs. Management's capacity to maintain collateral's sound quality to secure Daycoval's loan operations will be key to mitigate credit losses in the next few years.

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. Thus, we believe the bank still lacks broader depositor and funding source diversification compared to larger banks. As of December 2021, Daycoval's funding base consisted of deposits (45%), local bonds (31%), borrowings and onlending (19%), and international bonds (6%).

The bank's stable funding ratio (SFR) was 83% in December 2021. Daycoval has a good match between assets and liabilities and a positive maturity gap between its loans (average maturity of 297 days) and funding sources (average maturity of 542 days).

We also view Daycoval's liquidity as comfortable. As of December 2021, Daycoval's broad liquid assets covered 0.9x of its short-term wholesale funding, slightly below the average of the past four years (2017-2020) of 1.06x. Moreover, Daycoval's time deposits don't have an early redemption option, according to the central bank. Its liquidity also benefits 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$)	**2021**	**2020**	**2019**	**2018**	**2017**
Adjusted assets	61,931.3	49,159.4	34,892.1	28,979.7	23,786.2
Customer loans (gross)	40,741.8	32,518.0	24,655.9	18,326.8	15,162.0
Adjusted common equity	4,807.0	4,346.9	3,260.5	2,892.4	2,679.3
Operating revenues	4,760.7	4,071.6	3,369.3	3,039.5	2,549.6
Noninterest expenses	1,946.2	1,540.7	1,545.4	1,297.9	1,211.2
Core earnings	1,390.6	1,175.4	1,020.2	642.6	511.1

R$--Brazilian real.

Table 2

Banco Daycoval S.A. Business Position

	--Year-ended Dec. 31--				
(%)	**2021**	**2020**	**2019**	**2018**	**2017**
Loan market share in country of domicile	N/A	0.8	0.7	0.5	0.4
Deposit market share in country of domicile	N/A	0.4	0.3	0.2	0.2
Return on average common equity	30.1	29.1	29.4	20.7	18.4

N/A--Not applicable.

Table 3

Banco Daycoval S.A. Capital And Earnings

	--Year-ended Dec. 31--				
(%)	**2021**	**2020**	**2019**	**2018**	**2017**
Tier 1 capital ratio	13.0	14.0	13.6	14.1	14.9
S&P Global Ratings' RAC ratio before diversification	N/A	5.5	6.0	5.9	N/A
S&P Global Ratings' RAC ratio after diversification	N/A	4.7	5.2	5.1	N/A
Adjusted common equity/total adjusted capital	82.9	93.6	100.0	100.0	100.0
Net interest income/operating revenues	90.0	90.9	89.1	90.0	88.3
Fee income/operating revenues	6.1	5.9	6.4	5.3	5.3
Cost to income ratio	40.9	37.8	45.9	42.7	47.5
Preprovision operating income/average assets	5.1	6.0	5.7	6.6	5.9
Core earnings/average managed assets	2.5	2.8	3.2	2.4	2.2

N/A--Not applicable.

Table 4

Banco Daycoval S.A. Risk Position

	--Year-ended Dec. 31--				
(%)	**2021**	**2020**	**2019**	**2018**	**2017**
Growth in customer loans	25.3	31.9	34.5	20.9	9.6
Total diversification adjustment/S&P Global Ratings' RWA before diversification	N/A	17.5	15.1	16.0	N/A
Total managed assets/adjusted common equity (x)	12.9	11.3	10.7	10.0	8.9
New loan loss provisions/average customer loans	1.2	2.3	2.2	4.2	3.8
Net charge-offs/average customer loans	0.5	1.0	0.8	1.8	1.6
Gross nonperforming assets/customer loans + other real estate owned	1.8	1.8	1.4	2.7	3.3
Loan loss reserves/gross nonperforming assets	219.0	256.7	367.2	219.7	183.9

N/A--Not applicable.

Table 5

Banco Daycoval S.A. Funding And Liquidity

	--Year-ended Dec. 31--				
(%)	**2021**	**2020**	**2019**	**2018**	**2017**
Core deposits/funding base	41.3	40.5	36.2	29.6	65.3
Customer loans (net)/customer deposits	194.2	197.4	241.1	267.6	123.9
Long-term funding ratio	73.5	67.0	75.1	60.7	84.2
Stable funding ratio	83.4	77.3	81.9	71.3	97.7
Short-term wholesale funding/funding base	29.7	37.1	28.4	45.1	18.5
Broad liquid assets/short-term wholesale funding (x)	0.9	0.7	0.9	0.8	1.8
Broad liquid assets/total assets	20.8	21.3	19.9	25.5	25.2
Broad liquid assets/customer deposits	64.0	66.8	71.4	114.9	52.2
Net broad liquid assets/short-term customer deposits	(19.5)	(79.4)	(12.2)	(58.5)	40.5
Short-term wholesale funding/total wholesale funding	48.9	61.5	44.5	64.1	53.4

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, July 1, 2019
- 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 16, 2022)*		
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
23-May-2017		brA/Watch Neg/brA-2
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.