



Rating Action: **Moody's affirms Daycoval's Ba2 deposit ratings; outlook stable**

27 Mar 2023

New York, March 27, 2023 -- Moody's Investors Service (Moody's) has today affirmed all ratings and assessments assigned to Banco Daycoval S.A. (Daycoval), including the Ba2 and Not Prime local and foreign currency deposit ratings, long- and short-term, respectively, the Ba2 foreign currency senior unsecured debt rating as well as the (P)Ba2 senior unsecured rating assigned to its \$2 billion Global Medium Term Note Program. At the same time, Moody's also affirmed Daycoval's Ba1 and Not Prime local and foreign currency counterparty risk ratings, long and short-term, respectively. The bank's baseline credit assessment (BCA) and adjusted BCA of ba2 were affirmed as well as its counterparty risks assessments of Ba1(cr) and Not Prime(cr), long- and short-term, respectively. The outlook on the long-term bank deposits and senior unsecured rating remains stable.

RATINGS RATIONALE

The affirmation of Daycoval's ba2 BCA reflects the bank's long-track record of a solid business franchise as a middle-market lender in Brazil, reporting adequate performance over the past two years supported by a disciplined business and risk profile.

Between 2019 and 2022, Daycoval reported a relatively stable problem loan ratio, averaging 1.9% in the period and attesting to the bank's conservative risk guidelines and credits standards. In 2022, the bank's loan book comprised 75% of short-term loans with small and midsize companies (SMEs), 19% of payroll loans to public servants and retirees, and 4% of vehicle financing to individuals. The high share of secured credit products will help Daycoval to mitigate heightened asset risks in 2023 stemming from high interest rates and weakened economic activity in Brazil, which will affect SMEs' loan repayment capacity. Daycoval has historically maintained conservative provisioning buffers, with loan loss reserves representing 4% of gross loans and 1.9x problem loans as of December 2022.

Despite Daycoval's recurring earnings generation, the bank's net income to tangible assets ratio declined to 1.6% in December 2022 from 2.3% in December 2021, affected by higher funding costs in the period, an increase in operating expenses resulting from the bank's business expansion and inflationary pressures. Bottom-line result performance in 2022 was also impacted negatively by higher loan loss provisions expenses, up 52% in the year, reflecting a strong loan growth of 18.7%. Asset under management and custody services also had a higher contribution for non-interest income, which went up 38.6% in the 12 months ended in December 2022 and reached 10% of total revenues.

The ba2 BCA incorporates Daycoval's consistent capital replenishment and strong commitment from its shareholders through different economic cycles. Moody's capital ratio of tangible common equity to risk-weighted assets dropped to 7.85% in December 2022, from 10.93% in December 2019. This decline reflected the accelerated loan book expansion in the past two years and shareholders' strategic decision to replace core capital by an additional BRL953.9 million Tier 1 instruments issued in 2020 and 2021 and fully acquired by shareholders, resulting in enhanced capital efficiency. On a regulatory basis, the bank had a common equity tier 1 ratio of 10.9% in December 2022. In the next 12-18 months, we expect a moderation in lending activities will ease pressures on capital, while a more conservative dividend policy will provide higher internal capital generation and improve the bank's capitalization ratio.

Conversely, the ba2 BCA also considers Daycoval's reliance on institutional resources, similarly to its equally-sized peers. Despite that, the bank has good access to both local and foreign capital markets, which has long supported its diversified funding mix and the medium- to long-term duration of its liabilities. In December 2022, market funds represented 52.6% of tangible banking assets, in line with historical levels. The bank's refinancing risk is counterbalanced by its conservative liquidity management, supported by a positive gap between short-term assets and long-term funding that reduces tenor mismatches.

The stable outlook on Daycoval's Ba2 deposit ratings reflects Moody's expectation that the bank will maintain good asset quality and profitability over the next 12-18 months and will improve capitalization as it moderates loan origination amid weak macro conditions in Brazil.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

At the moment there is no upward pressure on Daycoval's ratings because they are constrained by the Government of Brazil's sovereign bonds rating of Ba2, with stable outlook.

Downward pressure on Daycoval's BCA and ratings could emerge from a sizable 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 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.

METHODOLOGY USED

The principal methodology used in these ratings was Banks Methodology published in July 2021 and available at <https://ratings.moodys.com/api/rmc-documents/71997>. Alternatively, please see the Rating Methodologies page on <https://ratings.moodys.com> for a copy of this methodology.

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For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on <https://ratings.moodys.com/rating-definitions>.

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