



Rating_Action: Moody's assigns first time B1 deposit ratings to Banco Topázio; outlook stable

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New York, March 23, 2023 – Moody's Investors Service ("Moody's") has today assigned first-time B1 long-term and Not Prime (NP) short-term local and foreign currency deposit ratings to Banco Topázio S.A. (Topázio), as well as Ba3 and Not Prime counterparty risk ratings, for long and short-term, respectively. At the same time, Moody's also assigned baseline credit assessment (BCA) and adjusted BCA of b1 as well as long and short-term counterparty risk assessments (CRA) of Ba3(cr) and Not Prime(cr), respectively. The outlook on the deposit ratings is stable.

RATINGS RATIONALE

Topázio's b1 BCA incorporates the bank's recurring earnings generation over the past two years, supported by a strategy primarily focused on providing foreign exchange services, as well as extending short-term credit facilities to small and medium size enterprises (SMEs). The bank has explored business synergies with Ebanx, a Brazilian cross-border payment platform for global technology firms that acquired a 30% equity stake at the bank in 2021, and other well-established companies, including Ticket Soluções and Saque e Pague, to reinforce Topázio's credit strategy and its operation of "Bank-as-a-Service". The b1 BCA also reflects the bank's limited funding diversification, that relies on brokered deposits, a negative driver on its financial profile that is counterbalanced by its prudent liquidity management.

Since January 2019, Topázio has reduced loan origination, resulting in a 73% decline of its loan book up to December 2022, which resulted in a lower 0.5x leverage to tangible common equity (TCE), from 6x in 2019. The bank has tightened the underwriting standards of its traditional short-term working capital financing business and increased focus on discount of self-liquidating credit card receivables of SMEs and commercial merchants. While this strategy has helped Topázio improve nonperforming loans to 1.9% of gross loans at the end of 2022, from as high as 6.5% in December 2019, its credit business remains largely sensitive to the challenging economic cycle in 2023. To help mitigate credit risk, the bank's loan loss reserves accounted for 445% of nonperforming credits in December 2022. Moreover, the short-term nature and high granularity of its loan book also aid in offsetting the rising asset risks Topázio faces amid high interest rates and slow economic activity.

In addition, the moderation in loan origination has been compensated by the strong growth of its fee-based activities related to foreign-exchange (FX) operations, largely associated with Ebanx. The bank reinforced its governance and risk management structure over the past two years to support this enhanced FX business platform, although operational risks related to these activities remain high.

The BCA of b1 also acknowledges Topázio's strong profitability ratio reported over the past two years that averaged over 2% of tangible banking assets, but also takes into account the short track record of this new strategy that will continue to face strong competition. As the bank's business strategy matures, we expect earnings recurrence to provide consistent capital replenishment that will continue to support growth. In December 2022, Topázio's ratio of TCE to

risk-weighted assets (RWAs) was 16.2%, with RWAs factoring 100% risk-weighting on the bank's sizeable holdings of government securities. In addition, shareholders have historically supported the bank's growth strategy through capital injections and maintained low average dividend payout ratio of 11.8% in the last two years.

The short-term profile of credit portfolio and diligent management of maturity mismatches and concentrations, combined with an adequate liquidity position fully made up from government securities partially offset the predominance of broker-deposits, which could expose the bank's liquidity profile to changes in the commercial strategy of a few market-dominant investment houses.

The assigned ratings also incorporate environmental, social and governance (ESG) considerations, as per Moody's Investors Service's General Principles for Assessing Environmental, Social and Governance Risks Methodology. Moody's assessment of the bank's exposure to governance risks is moderately negative, reflected in a Governance Issuer Profile Score (IPS) of G-3, largely stemming from the controlling ownership by one-single family, limited track record after the bank's strategic repositioning in recent years, and relevant partnerships with related-parties that can give rise to conflicts of interest. The bank's risk management, compliance and reporting policies are in line with industry best practices.

The stable outlook is a reflection of Moody's view that Topázio's credit profile will remain stable over the next 12-18 months.

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

Upward pressure on Topázio's b1 BCA could arise from a consistent and sustainable growth in its Bank-as-a-Service and lending businesses, increasing business diversification and recurrent earnings generation capacity. Enhanced access to a more diverse funding mix and lower reliance on third party brokers deposits could also be positive for the BCA.

Evidence of weakening in credit underwriting standards or operational controls, or a sudden deterioration in the bank's earnings potential that could result from changes in the regulatory framework or termination of key business partnerships could have a negative pressure on Topázio's BCA. A sustained decline in capital or liquidity position could also add downward rating pressure.

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.

REGULATORY DISCLOSURES

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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Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at https://ratings.moodys.com/documents/PBC_1288235.

At least one ESG consideration was material to the credit rating action(s) announced and described above.

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