MOODY'S
INVESTORS SERVICE

Credit Opinion: Banco Regional S.A.E.C.A.

Global Credit Research - 31 Mar 2015

Paraguay

Ratings

Category	Moody's Rating
Outlook	Stable
Bank Deposits -Fgn Curr	Ba2/NP
Bank Deposits -Dom Curr	Ba1/NP
Baseline Credit Assessment	ba2
Adjusted Baseline Credit Assessment	ba2
Senior Unsecured	Ba1

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Key Indicators

Banco Regional S.A.E.C.A. (Unconsolidated Financials)[1]

	[2]9-14	2013	[2]12-12	[2]12-11	[2]12-10	Avg.
Total Assets (PYG billion)	13,339.3	–	9,214.8	8,570.3	7,124.8	[3]17.0
Total Assets (USD million)	2,968.9	–	2,183.6	1,932.4	1,533.9	[3]18.0
Tangible Common Equity (PYG billion)	748.7	–	550.5	474.1	376.6	[3]18.7
Tangible Common Equity (USD million)	166.6	–	130.4	106.9	81.1	[3]19.7
Problem Loans / Gross Loans (%)	2.6	–	2.2	1.7	1.8	[4]2.1
Tangible Common Equity / Risk Weighted Assets (%)	–	–	9.3	8.0	7.5	[5]8.2
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	24.7	–	21.4	17.0	18.0	[4]20.3
Net Interest Margin (%)	3.4	–	4.6	5.1	4.5	[4]4.4
PPI / Average RWA (%)	–	–	3.8	3.8	2.9	[5]3.5
Net Income / Tangible Assets (%)	1.1	–	1.5	1.6	1.1	[4]1.3
Cost / Income Ratio (%)	60.7	–	60.2	57.9	64.3	[4]60.8
Market Funds / Tangible Banking Assets (%)	22.3	–	18.2	20.5	14.7	[4]18.9
Liquid Banking Assets / Tangible Banking Assets (%)	21.7	–	21.1	19.8	19.8	[4]20.6
Gross Loans / Total Deposits (%)	93.6	–	89.0	84.0	81.3	[4]87.0

Source: Moody's

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel I; LOCAL GAAP [3] Compound Annual Growth Rate based on LOCAL GAAP reporting periods [4] LOCAL GAAP reporting periods have been used for average calculation [5] Basel I & LOCAL GAAP reporting periods have been used for average calculation

Opinion

SUMMARY RATING RATIONALE

Moody's has assigned a standalone credit assessment (BCA) of ba2 to Banco Regional S.A.E.C.A. (Regional). The rating is the result of the bank's consolidated position in the Paraguayan banking system as one of the leaders in the market, with a 16.8% of market share of the system's deposits. The rating also incorporates the bank's improving funding profile and earnings generation. Regional's strong franchise in the agribusiness sector, which is key to the Paraguayan economy, provides substantial business and earnings opportunities. Its exposures to small- and medium-sized enterprises are also sizable, at one third of its loans, and support earnings. However, the direct and indirect exposures to agribusiness also suggest a significant sector concentration given that roughly 40% of Regional's total loans are to this sector.

Regional benefits from its partnership with Rabobank Netherlands, which holds an approximately 39% ownership stake as of December 2014, and provides management assistance and technical expertise. In our view, Rabobank's risk-management practices and expertise in the agribusiness segment support Regional's performance and risk discipline, despite the sizable concentration risk in the segment.

Moody´s upgraded the bank's long- and short-term global local-currency deposit ratings to Ba1/Not Prime from Ba2/Not Prime, that derives from the bank's ba2 BCA and the high probability of government support. In addition, Moody's has also upgraded the global foreign currency deposits rating to Ba2/Not prime from Ba3/Not prime, and the foreign currency debt rating to Ba1 from Ba2.

The rating is underpinned by the bank's standalone credit strength, and also takes into account the introduction of the new methodology, and specifically our basic Loss Given Failure (LGF) analysis.

BANCO REGIONAL RATING IS CONSTRAINED BY ITS MACRO PROFILE OF WEAK +

As a primarily domestic bank, the bank's operating environment is heavily influenced by Paraguay and its Macro Profile is thus aligned with that of Paraguay at Weak +. Paraguay's weak if improving institutional framework, heavy dependence on agriculture, and vulnerability to climate-related shocks continue to weigh on the country's macro profile. Political event risk is low despite the impeachment of the president in 2012 and energy exports keep the current account in surplus, limiting vulnerability to international market conditions, an important consideration given the high level of dollarization of the banking system. Banks performance has remained stable despite the country's sometimes volatile economic growth. Lenders have expanded their client base considerably after four years of average annual credit growth of 24%, and we expect growth to slow to a more sustainable annual rate of 15% in 2014.

Rating Drivers

- Leading Position in the Paraguayan Banking System Boosts Earnings and Reflects in Sustained Profitability Ratios

- Stable Core Funding Sources and High Liquidity Profile as a Result of Broad Branch Network

- Relatively Good Asset Quality Metrics Despite Lending Portfolio Concentrated in Agribusiness

- Adequate Capitalization as a Result of Good Earnings Generation

Rating Outlook

The outlook on all ratings is stable.

What Could Change the Rating - Up

Regional's standalone credit assessment is aligned to the government bond rating, given the domestic nature of the bank's franchise and the lack of cross border diversification.

What Could Change the Rating - Down

The bank's BCA would be under stress if Regional suffered a substantial deterioration in its asset quality or in its core earnings profile, or if the operating environment were to materially weaken. In addition, a downgrade of the country´s deposit ceilings would affect its deposit ratings.

DETAILED RATING CONSIDERATIONS

Leading Position in the Paraguayan Banking System Boosts Earnings and Reflects in Sustained Profitability Ratios

The bank is the second largest Paraguayan bank in terms of loans and deposits. During the last 4 years, the bank has been expanding its lending portfolio at an average annual growth rate of 19,7%, above the system's average of 19,3%. Deposits grew 19.28% in 2014, while loans grew 10.45% over the same period.

Regional has a wide coverage throughout the country based on its 37 branches and dependencies, providing a wide range of banking and financial services to the agribusiness sector (which totaled 39.9% of the portfolio), industrial, commercial and services sectors, cooperatives, commercial and foreign trade. Regional also has an small consumer finance business, through personal loans and credit cards, which achieved 5.7% of total lending portfolio. The bank's main core businesses is driven by corporate banking (with 62% of total portfolio), and small and medium size companies (32% of total), chiefly in the form of receivables, working capital credit lines and foreign trade facilities. Regional has good earnings power generation and sustained profitability ratios. The bank's SMEs business is the main driver for the 3.3% net interest margin. Fee income has also became relevant. Nevertheless, Regional's ratings also capture its modest operating efficiency, which has slightly improved to 60.71% from 67.02% the previous year, and will be pressured mostly by increasing personnel expenses.

Stable Core Funding Sources and High Liquidity Profile as a Result of Broad Branch Network

Regional supports its business mainly with deposits, which benefits its financial margins and liquidity position. The bank maintains around 21.65% of liquid assets over total assets. Total deposits jumped 19.28%, to $1.94 billion as of September 2014 from $1.80 billion as of December 2013, to reach 70.8% of total funding, with 51.6% in the form of sight deposits and 48.4% time deposits, relatively aligned to the financial system. The bank's deposits base is well diversified among corporate, retail and private bank clients. As in the case of other banks in the system, the Instituto de Previsión Social, Paraguay' pension, is the largest depositor.

Moody's also points to Regional's steady funding sources as a positive rating driver. Regional has improved its funding mix, which is not only driven by deposits in the domestic market, but also by credit lines from international financial institutions which accounted for 11.5% of total liabilities and, more recently, by a senior debt issuance in the international market for $300 million in early 2014 in order to diversify its foreign currency funding.

Our assigned Funding score reflects the bank's moderate exposure to foreign currency deposits, and recognize the bank's market access and largely core deposits funded structure.

Relatively Good Asset Quality Metrics Despite Lending Portfolio Concentrated in Agribusiness

Regional enjoys good asset quality, as shown in the 2.63% NPL ratio registered as of September 2014, which is above the system's average of 2.01%. The asset quality is largely influenced by the performance of its corporate and SME lending books that relate to agribusiness. Regional has built a significant reserve coverage to withstand potential losses derived from its loan portfolio, with reserves to NPL ratio at 104.94% as of September 2014.

Credit exposure to agriculture accounted for about 40% of the bank's total loans, a profile that reflects the importance of the sector to the economic activity in Paraguay. Combined, the food and agricultural sectors account for one quarter of Paraguay's GDP. However, the cyclicality associated with the agribusiness sector is a challenge for the bank's risk management processes.

Our assigned Asset Risk score indicates that overall, asset risk remains a modest fundamental weakness for the bank. We foresee a potential deterioration of the bank's asset quality profile in light of the seasoning of the recent built loan portfolio, and the potential erosion of the corporate credit quality linked to agribusiness driven by the declining commodity prices.

Adequate Capitalization as a Result of Good Earnings Generation

Regional's recurring profits derive mostly from its corporate and SMEs loans, through interest income or fees. As of September 2014, the bank recorded a net income of $24.71 million, achieving a 1.11% ROAA. Going forward, the bank is planning to deepen its corporate and SMEs franchises, while expanding in the retail segment through personal loans and credit cards.

Regional's comfortable capitalization levels of 12.5% tier 1 ratio as of December 2014, will allow the bank to deepen its business and further loan growth in coming quarters. Increasing domestic credit demand in a benign scenario of an expected 4% growth in real GDP will ensure that Regional's business opportunities are sustainable. Additionally, the bank has Tier 2 capital instruments in the form of a subordinated note of $25.9 million.

Our assigned Profitability score capture the effect of potential fluctuations of the FX rate given the moderate level of dollarization of the bank's balance sheet, and the effect of the likely volatility of the Paraguay GDP over the bank's business volume.

Notching Considerations

AFFILIATE SUPPORT

Moody's assesses a moderate probability of parental support from Rabobank Netherlands, which holds an approximately 39% ownership stake as of December 2014, but Regional does not benefit from this support having a long- and short-term global local-currency deposit ratings of Ba1, that derives from the bank's ba2 BCA.

GOVERNMENT SUPPORT

Banco Regional 's deposit rating has one notch of uplift from the government support reaching a long- and short-term global local-currency deposit ratings of Ba1.

ABOUT MOODY'S BANK SCORECARD

Our Scorecard is designed to capture, express and explain in summary form our Rating Committee's judgment. When read in conjunction with our research, a fulsome presentation of our judgment is expressed. As a result, the output of our Scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The Scorecard output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

Rating Factors

Banco Regional S.A.E.C.A.

Macro Factors	
Weighted Macro Profile	**Weak +**

Financial Profile						
Factor	**Historic Ratio**	**Macro Adjusted Score**	**Credit Trend**	**Assigned Score**	**Key driver #1**	**Key driver #2**
Solvency						
Asset Risk						
Problem Loans / Gross Loans	2.6%	ba2	←→	ba2	Sector concentration	Expected trend
Capital						
TCE / RWA	8.4%	b3	↑	b2	Expected trend	
Profitability						
Net Income / Tangible Assets	1.1%	ba2	←→	ba2	Earnings quality	
Combined Solvency Score		b1		ba3		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	20.1%	ba3	←→	ba1	Market funding quality	Term structure
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	20.8%	ba3	←→	ba2	Access to committed facilities	
Combined Liquidity		ba3		ba1		

Score							

Financial Profile	ba2

Qualitative Adjustments	Adjustment
Business Diversification	0
Opacity and Complexity	0
Corporate Behavior	0
Total Qualitative Adjustments	**0**

Sovereign or Affiliate constraint	Ba1

Scorecard Calculated BCA range	**ba1 - ba3**

Assigned BCA	ba2

Affiliate Support notching	0

Adjusted BCA	ba2

Instrument Class	Loss Given Failure notching	Additional notching	Preliminary Rating Assessment	Government Support notching	Local Currency rating	Foreign Currency rating
Deposits	0	0	ba2	1	Ba1	Ba2
Senior unsecured bank debt	0	0	ba2	1		Ba1

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