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Research Update:

Banco Regional S.A.E.C.A. 'BB' Ratings Affirmed; Outlook Remains Negative

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Table Of Contents

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Overview

- Paraguay-based Banco Regional maintained its credit fundamentals, while its asset quality metrics slightly improved and are likely to continue so in the coming quarters.
- We're affirming our 'BB' long-term issuer credit and senior unsecured debt ratings on the bank.
- The negative outlook on Banco Regional incorporates the likely impact that a potential revision of Paraguay's Banking Industry Country Risk Assessment (BICRA) to a weaker category--due to rising economic risks for banks operating in the country because of a high dollarization and concentration in cyclical industries amid declining commodities prices and stalling regional and global economies—may have on the bank.

Rating Action

On Jan. 10, 2018, S&P Global Ratings affirmed its 'BB' long-term issuer credit and senior unsecured debt ratings on Banco Regional S.A.E.C.A. The outlook remains negative.

Rationale

The ratings on Banco Regional reflect its sound competitive position as one of the largest financial entities in Paraguay, with leading position in the agribusiness lending segment (including agriculture and cattle), its forecasted risk-adjusted capital (RAC) ratio of about 6.5% for the next 12-18 months, and the expectation that asset quality metrics will continue improving over coming quarters. The ratings also incorporate Banco Regional's funding structure that remained stable and benefits from a healthy deposit base, in line with that of the banking system, as well as its liquidity position that provides adequate cushion to meet short-term obligations.

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 Paraguay is 'bb-' (see "Banking Industry Country Risk Assessment: Paraguay," published Dec. 7, 2016).

We view Banco Regional's business position as a credit strength given the bank's sound competitive position in the Paraguayan financial system, as one of the largest financial entities, with leading position in the agribusiness lending sector and longstanding customer relationships, all of which confer significant business stability. As of Nov. 30, 2017, Banco Regional was the second-largest lender in terms of loans, and the third largest in terms of deposits, with a market share of 15.4% and 11.5%, respectively. Also, it maintained its leading position in loans to the agriculture sector, with a market share of 24% . Banco Regional offers a wide array of products through 37 branches, 88 ATMs, and 53 auto service terminals throughout Paraguay. The bank focuses on lending to the corporate and small- and mid-size enterprise (SME) segments, which accounted for 95% of its total loans. Consumer loans, mainly in the payroll segment, accounted for 5% of the bank's total loans, compared with the 15% industry average. For the next 12-18 months, we expect Banco Regional to maintain its competitive position, with the agribusiness lending unit (accounting for the largest share of the loan portfolio. Furthermore, the bank will focus on enhancing cross selling in the retail and SME segments, and on improving efficiency by encouraging the usage of self-service technology platform and automated channels with strict control of the administrative expenses.

Our forecasted RAC ratio, which should average 6.5% during the next 18-24 months, supports our assessment of the bank's capital and earnings. Our RAC ratio forecast considers our base-case scenario assumptions, which include:

- Paraguay's real GDP growth of 3.8% in 2017, 3.9% in 2018 and 2019.
- Loan portfolio growth of 3.5% in 2017, and 10% in 2018 and 2019, in line with the banking system's growth pace, thanks greater dynamism in the economy, favorable perspectives in the agriculture sector, and some punctual infrastructure projects.
- Slightly lower net interest margins (NIMs), given the high competition in the banking system.
- Core earnings on average adjusted assets of about 1.3% with improving efficiency metrics (measured as non-interest expenses to operating revenue) of 45%-48%, given the bank's efforts to control administrative expenses.
- Nonperforming assets (NPAs; which include repossessed assets and loans more than 60 days past due) of about 4.3% in 2017, improving to 3.4% in 2018 and 2.8% in 2019, given the expected reduction of repossessed assets and the resolution of punctual cases, together with conservative underwriting standards, and net charge-offs to average customer loans at about 1%.
- Dividend payout of 37% in 2018 and 2019.

Our RAC ratio calculations include preferred stocks, to which we assign intermediate equity content, and we don't assign equity content to subordinated bonds, according to our criteria for hybrid instruments.

Banco Regional has manageable asset quality metrics that are slightly better than the industry average and incorporate a reduction in repossessed assets of about 29% between December 2016 and November 2017. Repossessed assets accounted for 1.5% of total loans as of November 2017, down from 2.2% as of December 2016. As a result, the bank's NPAs slightly improved to 4.3% from 4.4% as of December 2016, below the banking industry average of 4.5% as of November 2017. Loan-loss reserves coverage accounted for 71% of NPAs, compared with 58% at the end of 2016 (113% and 117%, respectively, excluding repossessed assets). Also, net charge-offs to average customer loans reached 0.8% as of September 2017 from 2.3% as of December 2016. The bank maintained its low complexity of operations and manageable single-name exposure concentrations, with the top 20 exposures representing about 15.6% of its total loan portfolio and 1.1x its equity as of September 2017. Banco Regional continued to focus on agribusiness lending, which represents about 54% of the bank's total loan portfolio, compared with the financial system's 40% average. As a result, the bank's exposure to dollarization is higher than the system average, because this segment produces commodities priced in dollars. However, Banco Regional operates under a prudent policy in managing currency mismatches. For the next 12-18 months, we expect the bank to continue improving its asset quality metrics, given the maintenance of origination standards, controls over delinquency, resolution of punctual cases, and the sale of repossessed assets.

We believe that Banco Regional's funding has a similar structure to that of the industry, and it relies on a stable customer deposit base, which represented 76% of funding as of September 2017. According to our methodology, the bank's stable funding ratio (SFR) was 119% as of the same date, in line with those of the rated peers. The bank has gradually diversified its funding base with financial obligations that represent 10% of total funding, mainly consisting of medium- to long-term loans from first-tier financial institutions. Senior bonds accounted for 13% of the bank's funding, and subordinated bonds 1%. We expect Banco Regional to maintain a similar funding structure for the next 12-18 months.

Banco Regional has a prudent liquidity management. Its liquidity position can comfortably meet short–term obligations, with a broad of liquid assets to short–term wholesale funding ratio of 3.4x as of September 2017. Also as of the same date, Banco Regional's liquid instruments (mainly cash, money market instruments, and central bank securities) represented 24% of total assets and 36% of total deposits. Like other banks in the country, Banco Regional uses the central bank's securities as a primary instrument for liquidity management. For the next 12-18 months, we expect Banco Regional's liquidity to remain adequate given the manageable refinancing risk.

The 'BB' issuer credit rating on the bank reflects its 'bb' stand-alone credit profile (SACP) because the latter doesn't incorporate any external support from the government or the group. Rabobank Financial Institutions Development B.V. owns 38.65% of the bank, but local shareholders control it.

Outlook

The negative outlook in the next 12 months on Banco Regional reflects our view of the negative economic risk trend in our BICRA on Paraguay and a potential downgrade of the bank if we were revise the BICRA to a weaker category. The latter could stem from rising economic risks for banks operating in Paraguay because of a high dollarization and concentration in cyclical industries amid declining commodities prices and stalling regional and global economies.

Upside scenario

We could revise our outlook on Banco Regional to stable in the next 12 months if we revise our BICRA economic risk trend on Paraguay to stable.

Ratings Score Snapshot

Lead Bank Rating	BB/Negative/--
SACP	bb
Anchor	bb-
Business Position	Strong (+1)
Capital and Earnings	Moderate (0)
Risk Position	Adequate (0)
Funding And Liquidity	Average and Adequate (0)
Support	0
GRE Support	0
Group Support	0
Sovereign Support	0
Additional Factors	0

Related Criteria

- Criteria - Financial Institutions - General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- Criteria - Financial Institutions - Banks: Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Financial Institutions - Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Ratings Affirmed

Banco Regional S.A.E.C.A.	
Counterparty Credit Rating	BB/Negative/--

Senior Unsecured	BB

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.