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Research Update:

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

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Overview

- Paraguay-based Banco Regional maintained its credit quality despite the rising economic risks in the industry.
- We're affirming our 'BB-' global scale issuer credit and senior unsecured debt ratings on the bank.
- The stable outlook is based on our expectation that the bank will maintain its strong business position, relatively stable asset quality metrics, and an adequate funding and liquidity profile.

Rating Action

On March 2, 2016, Standard & Poor's Ratings Services affirmed its 'BB-' long-term issuer credit and senior unsecured debt ratings on Banco Regional S.A.E.C.A. The outlook remains stable.

Rationale

The ratings on Banco Regional reflect its strong business position among banks in Paraguay, weak capital and earnings based on our forecasted risk-adjusted capital (RAC) ratio of 4.9% for the next 12-18 months, adequate risk position because its asset quality metrics remained adequate despite slumping industry conditions, average funding, and adequate liquidity. The 'BB-' issuer credit rating on the bank reflects its 'bb-' stand-alone credit profile (SACP) because it excludes any external support from the government or the group. Rabobank Financial Institutions Development B.V. owns 40% of the bank, but local shareholders control it.

Our bank criteria use our Banking Industry Country Risk Assessment's 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-'.

We view economic risks in Paraguay to be rising amid high dollarization, economic slowdown, lower commodities prices--on which the bulk of the country's economy depends--and a slowing regional economy. In addition, we believe that Paraguay's low-middle income levels still limit the private sector's leverage capacity, and high dollarization could increase credit risk in the economy. We still consider the sector's nonperforming loans (NPLs) and credit losses to be manageable, although we expect the former ratio to increase to a range of 3.0%-3.5% and the latter to 1.5%-2.0% in the next two

years. As a result, we consider that the economic trend of Paraguay to be negative (see "BICRA On Paraguay Remains At Group '8', Outlook On Two Banks Revised To Negative On Increasing Economic Risk," Oct. 16, 2015).

The banking sector's industry risk reflects our view that Paraguay's regulatory framework is still at least one to two years away from adopting Basel II standards and longer to fully implement them. In terms of competitive dynamics, we believe that high profitability and rapid credit and asset growth in the past few years are a reflection of the sector's aggressive risk appetite. Furthermore, we consider that the presence of relatively large unregulated cooperatives (credit unions) introduce market distortions. Paraguayan banks rely on deposits for funding, but they're increasingly tapping external funding sources due to the rising demand for longer-term and export-oriented loans and the need to match balance sheets. We believe these factors increase the banking sector's vulnerability to a potential global liquidity squeeze. However, we expect the banking sector's net external debt to remain below 10% of system-wide loans for the next two years.

Banco Regional's strong business position reflects its status as one of the largest financial entities in the country. The bulk of its lending goes to the agribusiness sector. These factors provide significant business stability to the bank. As of Dec. 31, 2015, Banco Regional was the second-largest bank in terms of loans, with a market share of 17%, and third largest in terms of assets and deposits, with shares of 15% and 14%, respectively. Banco Regional offers a wide range of products through its 38 branches located in Asunción and throughout Paraguay. Loans to the corporate segment and to small and medium size enterprise (SME) segments accounted for 95% of the bank's total loans. Consumer loans, mainly in the payroll segment, accounted for 5% of the bank's loans compared with the 13% industry average. Over the short to intermediate term, we don't expect major shifts in the bank's loan portfolio composition.

We continue to assess Banco Regional's capital and earning as weak because we expect its RAC ratio, under our methodology, to average about 4.9% for the next 12-18 months. Our forecast incorporates our base-case scenario assumptions, which include:

- Paraguay's real GDP growth of 4.3% in 2015 and 4.5% in 2016 and 2017;
- Annual loan growth of 18% in 2016 and 2017, in nominal terms, above the domestic sector's, due to the likely depreciation of the Paraguayan guarani, given the bank's highly dollarized loan portfolio;
- Stable net interest margins (NIM) of about 5% for 2016-2017;
- Nonperforming loans (NPLs) increasing to about 2.6% in 2016 and to 2.8% in 2017 due to weakening conditions in the agribusiness sector, but reserves should fully cover them; and
- Capital infusion of common stocks of about \$6 million in 2016; and
- Dividend payout of 25% in 2016 and 23% in 2017.

Our RAC ratio calculations included preferred stocks, to which we assign intermediate equity content, and we're not assigning equity content to subordinated bonds, according to our criteria for hybrid instruments. The bank

improved its profitability and efficiency ratios as part of its strategy to lower funding costs, and control administrative expenses by encourage its clients to use self-service technology platforms and automated channels.

We assess Banco Regional's risk position as adequate based on its loan portfolio performance, adequate asset quality metrics, and low business complexity despite rising economic risks in Paraguay and a slowing regional economy. Since its inception in 1991, the bank has focused on the agribusiness sector, which represents about 47% of the bank's total loan portfolio (including agriculture and cattle), compared to the system's 34% 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, the bank operates under a prudent policy in managing currency mismatches. Banco Regional's loan portfolio concentration is manageable, in line with those of its domestic peers. Its 20 largest loans account for about 14% of the total loan portfolio and 1.6x of total equity. In 2015, Banco Regional's asset quality metrics are slightly stronger than industry average, due to tighter origination standards and controls over delinquency, while the system average has deteriorated due to weaker economic conditions. In this sense, the bank's NPLs accounted for 2.4% of total loans as of December 2015, compared with the 2.5% system average, these ratios were 2.2% and 1.8%, respectively as of December 2014. Also, Banco Regional's charge-offs to average customer loans improved to 0.8% from 1.3% in 2014 due to the solving of a punctual case. For the next 12-18 months, we expect the bank to maintain adequate asset quality metrics as it continues to focus on its existing products and on maintaining current origination standards.

In our opinion, Banco Regional's funding is average because it benefits from a stable and relatively diversified deposit base, which represents 74% of its funding, and adequate funding metrics. As of September 2015, the bank's stable funding ratio was 120% and has averaged 117% for the past three fiscal years, and both metrics are in line with those of the bank's rated peers. The bank has gradually diversified its funding base with financial obligations, which represent 13% of total funding, mainly consisting of medium- to long-term loans from first-tier financial institutions, such as International Finance Corp., PROPARCO, Inter-American Development Bank, and Citibank. Senior and subordinated bonds accounted for 12% and 1% of the bank's funding, respectively. We expect Banco Regional to maintain a similar funding structure for the next 12-18 months.

The bank's liquidity is adequate due to its high broad liquid assets over short-term of 3.06x as of September 2015, which surpasses that of other rated banks in the country. As of Dec. 31, 2015, liquid instruments (mainly cash, money market instruments, and central bank securities) represented 25% of total assets and 37% of total deposits. The bank invests its liquid assets in short-term notes, which the central bank issues to regulate liquidity in the banking system.

Outlook

The stable outlook reflects our expectation that the bank will maintain its solid competitive position in the Paraguayan market for the next 12-18 months, RAC ratio of about 4.9% with manageable asset quality metrics close to industry average, and liquidity in line with industry average.

Upside scenario

We could raise the rating on Banco Regional in the next 12-18 months if it strengthens its capitalization metrics, resulting in a RAC of consistently above 5%, while all other credit factors remain unchanged.

Downside scenario

A downgrade is possible if the bank's risk position weakens due to consistently adverse conditions in the agribusiness segment, with recurrent increases in restructured loans and credit losses, or if loan portfolio concentration rises, pushing up credit losses.

Ratings Score Snapshot

Issuer Credit Rating	BB-/Stable/--
SACP	bb-
Anchor	bb-
Business Position	Strong (+1)
Capital and Earnings	Weak (-1)
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 And Research

Related Criteria

- Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015
- Group Rating Methodology, Nov. 19, 2013
- Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011

- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Bank Capital Methodology and Assumptions, Dec. 6, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Ratings Affirmed

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

Counterparty Credit Rating

BB-/Stable/--

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.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column.

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