FitchRatings

RATING ACTION COMMENTARY

Fitch Rates UENO Bank's IDR 'BB'; Outlook Stable

Fri 20 Dec, 2024 - 1:34 p.m. ET

Fitch Ratings - New York - 20 Dec 2024: Fitch Ratings has assigned UENO Bank S.A. (UENO) a 'BB' Foreign and Local Currency Long-Term Issuer Default Rating (IDR) and 'B' Short-Term IDR. The Rating Outlook for the Long-Term IDR is Stable. Fitch has also assigned UENO a 'bb' Viability Rating (VR) and 'b+' Government Support Rating (GSR).

KEY RATING DRIVERS

IDRs AND VR

IDRs Driven by Intrinsic Creditworthiness: Ueno's 'bb' VR drives its IDRs. Paraguay's stable operating environment and Ueno's strong capitalization metrics post-merger relative to similarly rated international peers (universal/commercial banks rated in 'bb' category) and the system average highly influence the bank's ratings. Additionally, the VR considers the bank's moderate, albeit small on a regional basis, franchise in Paraguay, sound asset quality, strong profitability, as well as its stable and moderately concentrated funding.

Modest Franchise: Ueno's focuses on the retail banking sector, primarily SMEs, using a fully digital onboarding process to drive growth and scale its business model, according to Fitch. Ueno's VR reflects a strengthened franchise post-merger with Vision, resulting in a 5.6% market share of total assets, 5.8% in deposits, and 4.2% in loans as of October 2024. The bank now serves nearly two million clients, the largest in the banking system. The merger multiplied Ueno's balance sheet by 4.5x, establishing it as a mid-tier institution in Paraguay's.

Strong Capitalization: Fitch considers Ueno's capitalization a key financial strength. Post-merger, the bank's Fitch Core Capital (FCC) ratio rose to 18.3%, exceeding the peers' average of 16.2% in 2023. Fitch anticipates Ueno's capitalization will remain robust due to earnings retention and high transaction and credit lending volumes. THe FCC ratio is expected to stay within 18%-19% in 2025, as Ueno benefits from higher net income despite increased RWAs from 35% loan growth.

Good Asset Quality: Ueno's asset quality is sound, with NPLs at 0.76% (impaired loans over gross loans) in 3Q24, down from the 2020-2023 average of 2.45% and 5.2% in 2019. Fitch attributes this trend to Ueno's strong underwriting standards and risk controls, supported by strong investments in systems and technology. A high loan loss reserve over impaired loans at 9.8x at 3Q24 reflects provisions transferred from former Vision bank to Ueno's balance sheet and separate accounting for legacy NPLs. Fitch believes Ueno's good risk profile and robust technology will help it maintain sound asset quality despite post-merger risks.

Improved Profitability: Ueno reached a strong 7.33% operating profit/RWA in 3Q24 post-merger, driven by a solid net interest margin and strong credit card-related fees from Vision. The bank's efficiency (non-interest expense/gross revenues) improved to 56.3% at 3Q24, better than the four-year average of 62.7%, due to cost-efficient non-banking branches. Fitch expects Ueno's profitability will remain strong, supported by its improved franchise, stable Paraguayan operating environment, higher NIM, credit card fees, and lower funding costs, despite increased RWA from loan growth.

Stable Funding: The bank relies predominantly on customer deposits, which make up 85% of its funding at 3Q24. This reliance allows the entity to maintain an adequate funding cost. The bank's funding is complemented by senior unsecured debt, subordinated debt, and approved credit lines with a number of local financial institutions. The loan-to-deposit ratio was 72.7% and has remained relatively stable, compared to peers. Ueno has a mildly concentrated deposit base, with its top 10 depositors representing 14% of total deposits in the same period.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

VR AND IDRs

--A sustained deterioration in Ueno's FCC ratio to a level below 13% or a reduction of the bank's operating profit to RWA ratio falls and remains below 2%, could be negative for creditworthiness.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

VR AND IDRs

--A consolidation of their business model and risk structure post-merger that leads to an improvement in the bank's overall financial profile.

Government Support Rating (GSR)

UENO's GSR of 'b+' reflects Fitch's opinion that a default of the bank could result in contagion risks for the rest of the system because it is considered a domestic systemically important bank (D-SIB) by the Central Bank of Paraguay (BCP) and has the largest position in terms of the number of clients within the banking system. However, the GSR also reflects that there is limited probability of support being forthcoming because of significant uncertainties about the ability or propensity of the government to do so.

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

-- The GSR could be downgraded if Fitch believes that the government's propensity to support the bank has declined due a material loss in the market share of customer deposits.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

--An upgrade of the GSR is limited and could only occur over time with a material gain in the bank's systemic importance.

VR ADJUSTMENTS

--The Operating Environment score of 'bb' has been assigned above the 'b' category implied score due to the following adjustment reasons: Sovereign Rating (positive).

--The Business Profile score of 'bb-' has been assigned above the 'b' category implied score due to the following adjustment reasons: Business Model (positive).

--The Earnings & Profitability score of 'bb' has been assigned above the 'b' category implied score due to the following adjustment reasons: Historical and Future Metrics (positive).

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

RATING ACTIONS

ENTITY / DEBT	RATING		
Ueno Bank SA	LT IDR	BB Rating Outlook Stable	New Rating
	ST IDR	B	New Rating
	LC LT IDR	BB Rating Outlook Stable	New Rating
	LC ST IDR	B	New Rating
	Viability	bb	New Rating
	Government Support	b+	New Rating

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Bank Rating Criteria (pub. 15 Mar 2024) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Ueno Bank SA	-

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