

CREDIT OPINION

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Update

✓ Rate this Research

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FONPLATA – A2 stable

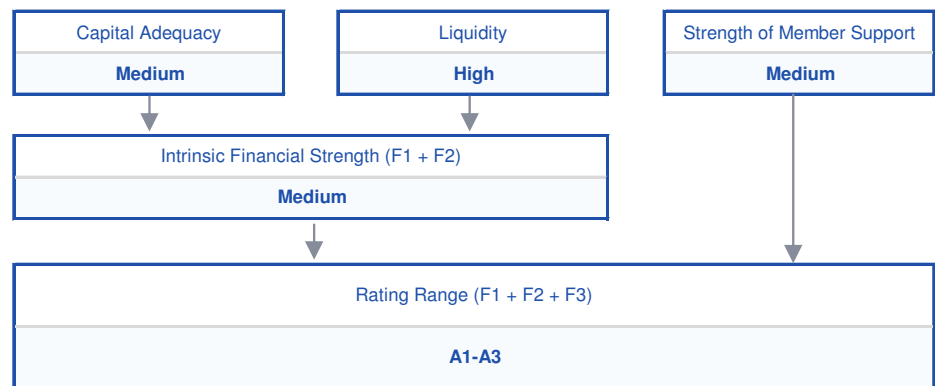
Regular update

Summary

FONPLATA's credit profile balances the development bank's strong capital adequacy and liquidity metrics with our expectation of their gradual decline over the medium term as the bank takes on additional leverage to fund its growing portfolio. FONPLATA's credit profile also reflects its high portfolio and shareholder concentration, combined with its limited track record of issuing debt in the capital markets. Despite significant lending concentration, the bank enjoys a long history of zero nonperforming loans (NPLs).

Exhibit 1

FONPLATA's credit profile is determined by three factors



Source: Moody's Investors Service

Credit strengths

- » Strong balance sheet with an asset coverage ratio in excess of 100%
- » Long history of zero NPLs
- » Healthy liquidity position to continue despite plans to increase leverage

Credit challenges

- » Challenging operating environment
- » High concentration in the loan portfolio and shareholder base
- » Limited track record of issuing debt in the capital markets

Rating outlook

The stable outlook reflects a balance of risks to the rating. Our expectation that FONPLATA's capital adequacy will gradually weaken, as the institution begins to leverage its balance sheet, is incorporated into the rating and considers that the asset coverage ratio will likely remain around 100%. We also expect that future lending will continue to benefit from preferred creditor status and focus on the public sector, which provides further support to the stable outlook.

Factors that could lead to an upgrade

Upward pressure on the rating would arise if: (1) the implementation of FONPLATA's growth and debt strategies in the 2018-21 period led to a deterioration in capital adequacy and liquidity indicators that is much smaller than we anticipate; and (2) the bank builds a track record of accessing diversified funding sources. The inclusion of highly-rated investment grade members that would bolster the quality of shareholder support would add further support to the rating.

Factors that could lead to a downgrade

Conversely, downward pressure on the rating would arise if key capital and liquidity metrics were to deteriorate more significantly than anticipated, below the metrics of similarly-rated peers, as a result of the bank's growth strategy.

Key indicators

FONPLATA	2013	2014	2015	2016	2017	2018
Total Assets (USD million)	520	573	628	759	852	1,039
Return on Average Assets (%)	1.5	1.4	1.2	2.1	2.6	2.1
Usable Equity/Gross Loans Outstanding + Equity Operations (%) [1]	166.0	152.8	136.6	134.8	123.2	162.6
Gross NPLs/Gross Loans Outstanding (%) [2]	0.0	0.0	0.0	0.0	0.0	0.0
ST Debt + CMLTD/Liquid Assets (%) [3]	0.0	0.0	0.0	0.0	0.0	1.2
Total Debt/Discounted Callable Capital (%) [4]	0.0	0.0	0.0	9.8	15.3	18.7

[1] Usable equity is total shareholder's equity and excludes callable capital

[2] Non performing loans

[3] Short-term debt and currently-maturing long-term debt

[4] Callable capital pledged by members rated Baa3 or higher, discounted by Moody's 30-year expected loss rates associated with ratings

Source: Moody's Investors Service

Detailed credit considerations

The "Fondo Financiero para el Desarrollo de la Cuenca del Plata" (FONPLATA) is a multilateral development bank (MDB) focused mainly on the South American region of its member countries and their integration into the global marketplace.

FONPLATA's A2 rating is based on our "Medium" assessment of the bank's intrinsic financial strength and strength of member support. In particular, the bank's financial strength is supported by: (1) our expectation that strong solvency metrics will persist, despite the expected increase in leverage; and (2) a strong liquidity position.

We assess **capital adequacy** to be "Medium," which reflects the bank's strong asset coverage and history of zero nonperforming loans. Although FONPLATA enjoys an outstanding capital position, this balance sheet strength is tempered by an anticipated decline in the asset coverage ratio and an increase in the leverage ratio as the fund pursues a more aggressive lending and borrowing strategy over the next 2-3 years. The factor score also reflects a challenging operating environment, given strong macroeconomic linkages among the five member countries: [Argentina \(B2 stable\)](#), [Bolivia \(Ba3 stable\)](#), [Brazil \(Ba2 stable\)](#), [Paraguay \(Ba1 stable\)](#) and [Uruguay \(Baa2 stable\)](#).

From 2008 to 2015 FONPLATA's asset coverage ratio averaged 175%, but it has declined since 2016 as the fund began to expand lending activities in line with its redefined mission. Looking forward, we expect the asset coverage ratio to decline further to approximately 100% by 2020, as increases in lending outpace installment payments of paid-in capital. Until 2016, FONPLATA operated entirely without debt on its balance sheet, and thus reported a debt-to-equity ratio of zero. In recent years the bank has begun to

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modestly increase its use of leverage. We expect debt-to-useable equity to rise, but remain at low levels, over the medium term. FONPLATA's borrower quality has remained steady at Ba2 over the past three years, and nonperforming loans have remained at zero over the past decade¹.

We set **liquidity** at "High" which reflects of our expectation that metrics will remain sound despite the bank's plans to gradually increase leverage over the medium term. FONPLATA's lack of debt has historically limited liquidity risks to the adequate management of its investment portfolio, with most of its treasury assets invested in high-quality instruments. Looking forward, as the bank increases leverage, liquidity ratios such as the debt service coverage ratio, will deteriorate somewhat, but still compare relatively favorably to peers. Our assessment also captures the highly liquid nature of its assets and conservative risk management policies, balanced by a limited track record of issuing debt in the capital markets.

Finally, we assess the **strength of member support** as "Medium." FONPLATA has a low weighted median shareholder rating of Ba2, a measure of shareholders' ability to provide extraordinary support. However, this is countered by the high willingness of its members to provide extraordinary support. The presence of callable capital from an investment grade country, Uruguay, is another supporting feature for a "Medium" score assessment. The strength of member support considers a negative adjustment due to linkages among shareholders and a correlation between members and assets, as the loan book expands in coming years.

Recent developments

FONPLATA continued to expand its portfolio in 2018, with gross loans reaching a record of \$803 million. The bank's lending has continued to support its mission of improving infrastructure and integration across the five member countries. In line with growth in loan approvals, the lending portfolio expanded by 21% in 2018, maintaining a robust average annual growth rate of 21% since 2013. Looking forward, FONPLATA will continue to expand its loan book in accordance with the business plan presented during its second capital increase.

On 11 February 2019, FONPLATA issued the first international bond in its history for a total of CHF 150 million (\$151.5 million) at a tenor of five-years and a coupon of 0.578%. The issuance was oversubscribed, with demand reaching CHF 225 million. FONPLATA's recent entrance into international capital markets follows a steady trend towards expanding the sources of its funding, which began with an arrangement with [CAF \(Aa3 stable\)](#) in November 2016 to establish a revolving line of credit up to \$75 million to supplement liquidity. In 2017, FONPLATA took in \$10 million worth of US dollar-denominated deposits from the Central Bank of Bolivia, the first operation of its kind in FONPLATA's history.

The bank's leverage ratio through year-end 2018 increased to 8.3% from 3.2% in 2017 because the increase in debt outweighed the increase in available equity from paid-in capital. We expect the leverage ratio to be above 10% in 2019, after the new bond issuance is accounted for. Despite the magnitude of this change, FONPLATA's leverage ratio will still compare favorably to the median leverage ratio of about 32% for A-rated MDB peers over the past three years.

The bank has continued to increase its income since it began expanding its loan book in 2015, benefiting from both a growing loan book and improving performance ratios. Net income grew to about \$27 million from about \$20 million in 2017, a 32% increase, driven primarily by steady growth in net interest income. For 2018, net interest income grew by 44%, higher than the average growth rate of the past four years of 34%. Meanwhile, the bank's return on assets (ROA) increased to 2.8% in 2018 from 2.5% in 2016 and return on equity (ROE) increased to 3.0% in 2018 from 2.6% in 2017.

The bank's capital increase approved in January 2016 brought in additional paid-in capital in 2018 and will be fully implemented by 2024. Authorized capital remained stable at \$3 billion, while paid-in capital rose to \$818 million from \$706 million in 2017. Importantly, our calculations of discounted callable capital only include potential contributions from investment grade members. As such, we calculate potential callable capital as \$184 million in 2018, well below the nominal figure of \$1.7 billion.

The macroeconomic climate of FONPLATA's five member countries is an important factor in the bank's overall credit profile, due to the concentration of loans and economic linkages among members. While all five of FONPLATA's member countries have stable outlooks as of June 2019, as opposed to negative outlooks on Brazil, Bolivia and Uruguay through the first half of 2017, economic prospects have dampened due to the negative impact of rising trade and geopolitical tensions on global growth. This is reflected in our median real GDP growth forecast for the five member countries, which is a modest 1.8% for 2019. In Brazil, weak industrial production and

investment have led to a downward revision of our real GDP growth forecasts to 1.3% and 2.0% in 2019 and 2020, respectively. Meanwhile, we expect Argentina's economy to contract, for a second year running, by 1.5% in 2019 and expand by 1.5% in 2020. Notwithstanding the idiosyncratic, high inflation of Argentina during its currency crisis, we expect average inflation to remain around 4% through next year in the bank's remaining member countries.

Despite the lower growth prospects for the region, the bank's track record of zero non-performing loans and its preferred creditor status support the rating and stable outlook.

Rating methodology and scorecard factors

Rating Factors - Fondo financiero para el desarrollo de la Cuenca del Plata

Rating Factors	Factor Weight	Factor Score
Factor 1: Capital Adequacy	60%	Medium
Factor 2: Liquidity	40%	High
Intrinsic Financial Strength (F1 + F2)	Preliminary Rating Range	Medium
Factor 3: Strength of Member Support	+3, +2, +1, 0 notches	Medium
Rating Range (F1 + F2 + F3)		A1-A3
Assigned Rating		A2

Note: While the information used to determine the grid mapping is mainly historical, our ratings incorporate expectations around future metrics and risk developments that may differ from the ones implied by the rating range. Thus, the rating process is deliberative and not mechanical, meaning that it depends on peer comparisons and should leave room for exceptional risk factors to be taken into account that may result in an assigned rating outside the indicative rating range. [For more information please see our Multilateral Development Banks and Other Supranational Entities rating methodology.](#)

Footnotes:

(1) Rating Range: Factor 1, Capital Adequacy, and Factor 2, Liquidity, combine according to the weights indicated into a construct we designate as Intrinsic Financial Strength (IFS). A notching system combines IFS and Factor 3, Strength of Member Support.

(2) 5 Ranking Categories: Very High, High, Medium, Low, Very Low.

Source: Moody's Investors Service

Moody's related publications

- » **Rating Action:** [Moody's affirms FONPLATA's A2 rating, maintains stable outlook](#), 1 November 2018
- » **Credit Opinion:** [Update following rating affirmation, outlook unchanged](#), 1 November 2018
- » **Rating Methodology:** [Multilateral Development Banks and Other Supranational Entities](#), 17 September 2018

Endnotes

- ¹ Loans are considered nonperforming after 180 days of payment delay

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