

Announcement: Moody's reviews Banco Popular's ratings for downgrade and ratings of Banco Pastor for upgrade (Spain)

Global Credit Research - 10 Oct 2011

The review follows the exchange offer made by Popular for 100% of Banco Pastor's shares and mandatory convertibles

Madrid, October 10, 2011 -- Moody's Investors Service has today placed on review for possible downgrade the A2 long-term debt and deposit ratings, the A3 dated subordinated rating, the Ba2 rating on preferred shares and the C- (mapping to a Baa1 on the long-term scale) bank financial strength rating (BFSR) of Banco Popular Español, S.A. (Popular). Moody's also placed Popular's Prime-1 short-term debt and deposit ratings on review for possible downgrade.

At the same time, Moody's has placed on review for possible upgrade the Ba1 long-term debt and deposit ratings, the Ba2 and Ba3 rating on dated and junior subordinated debt, respectively, the B3 rating on preferred shares and the D (mapping to a Ba2 on the long-term scale) BFSR of Banco Pastor, S.A. (Pastor). Pastor's Non-Prime short-term debt and deposit ratings have also been placed under review for possible upgrade.

The Aa2 ratings of both banks government guaranteed debt are not affected by this rating action and remain under review for possible downgrade.

RATINGS RATIONALE

Today's rating announcement follows the exchange offer made on 10 October 2011 by Popular to acquire 100% of Pastor's shares and its existing mandatory convertibles bonds. The offer is subject to the acceptance of at least 75% of the shares. Against this backdrop, Popular has announced that it has already received irrevocable commitments representing 52.3% of Pastor's share capital. The deal is subject to the approval of Popular's shareholders meeting which is expected to take place in December and will be closed in early 2012.

Moody's decision to place Popular's ratings on review for possible downgrade is driven by our view that the combined entity emerging after the integration with Pastor is likely to have a weaker credit profile than Popular's standalone credit strength. Moody's preliminary assessment of the creditworthiness of the merged institution is based on the current standalone credit strength of Popular and Pastor. At end of June 2011, Popular's consolidated assets amounted to € 130 billion which compare to € 31 billion at Pastor.

FOCUS OF THE REVIEW

Moody's rating review will focus on the following:

- The strategic fit of this acquisition for Popular in the domestic market characterized by challenging economic conditions arising from the collapse of the construction and real estate sectors to which both banks are highly exposed.
- An assessment of the expected losses embedded in the new bank's asset portfolios. This will provide a key input to the determination of the new entity's risk absorption capacity, its ability to withstand a deterioration in its loan book and its sovereign exposures, and its capacity to generate capital through stressed core earnings and other capital-growth initiatives. Along these lines, we note that Popular intends to allocate €1.1 billion of provisions (net of taxes) against fair value adjustments and issue € 700 million in convertible bonds to offset the 68 basis points negative impact on core capital stemming from this integration.
- The pro-forma risk-adjusted recurring profitability and cost efficiency indicators of the combined entity.
- The ability of the new entity to address debt maturities in light of the ongoing system-wide constraints to access the capital markets for term funding.

PREVIOUS RATING ACTION & PRINCIPAL METHODOLOGY

The methodologies used in this rating were Bank Financial Strength Ratings: Global Methodology published in February 2007, Incorporation of Joint-Default Analysis into Moody's Bank Ratings: A Refined Methodology published in March 2007 and Moody's Guidelines for Rating Bank Hybrid Securities and Subordinated Debt published in November 2009. Please see the Credit Policy page on www.moody's.com for a copy of these methodologies.

Headquartered in Madrid, Spain, Banco Popular reported total consolidated assets of EUR 130.4 billion as of 30 June 2011.

Headquartered in La Coruña, Banco Pastor reported total consolidated assets of EUR 31.0 billion as of 30 June 2011.

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