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## **DBRS Confirms Ratings of Banco Popular Español at A (high); Trend Now Negative**

**Industry: Fin.Svc.--Banks & Trusts**

DBRS, Inc. (DBRS) has today confirmed the ratings of Banco Popular Español, S.A. (Popular or the Group), including its Senior Unsecured Long-Term Debt & Deposit rating at A (high) and its Short-Term Debt & Deposit rating at R-1 (mid). The trend on the ratings is now Negative. This rating action follows the completion of Popular's acquisition of Banco Pastor, S.A. (Pastor). The aforementioned ratings have been removed from Under Review with Negative Implications, where they were placed on 10 October 2011, following Popular's announcement that it had made an offer to buy Pastor.

At the same time, Popular's intrinsic assessment (IA) has been confirmed at "A". DBRS maintains its SA-2 support assessment for Popular, which indicates an expectation of timely systemic support in case of need. Accordingly, the final rating of A (high) is one notch above the Group's IA of "A".

The rating confirmation reflects DBRS's view that Popular has the ability to successfully absorb Pastor, while maintaining its franchise strength in core markets and generating ongoing revenues to sufficiently absorb still elevated credit costs and maintain profitability. DBRS is of the view that, with the integration, Popular will continue its conservative strategy with regard to its risk profile, including the recognition of problematic assets at an early stage, and continued investment in technology to improve risk management functionality. Furthermore, the Group continues to build up liquid resources to meet contingency funding needs and bolster its capital levels in order to meet the higher regulatory minimum requirements.

The ratings consider the positive benefits derived from the merger of two complementary franchises. Through the merger, Popular, which is based in Madrid with EUR 130.9 billion in assets at the end of 2011, and Pastor, which is based in Galicia with EUR 30.4 billion in assets at the end of 2011, create a combined entity with a well-balanced retail franchise, an expanded customer base, broader product offerings and increased distribution channels. The larger combined entity has increased scale, depth and presence which is expected to allow the Group to better compete in an increasingly consolidated and competitive market. The Spanish banking sector's consolidation continues through the process of mergers and restructurings, some of which have been assisted by the State-sponsored Fondo de Reestructuración Ordenada Bancaria's (FROB). DBRS notes that Popular's acquisition of Pastor did



not involve the FROB. This merger/restructuring process has resulted in a new competitive domestic landscape, creating some market disruption and uncertainty, while also creating opportunities for stronger, well-perceived banks such as Popular.

DBRS has long viewed Popular's persistent strategy, which has been centred on organic growth, as a significant strength of the organisation. In taking on this relatively sizeable acquisition, the Group is taking a different path. Popular's new strategy is driven by the evolving opportunities that are being created from the restructuring of the Spanish banking market. The acquisition of Pastor demonstrates Popular's ability to adjust to the changing environment, which includes its ability to seize opportunities that have the potential to enhance its franchise. Notably, Pastor's business model focuses on lending to corporates and SME's (66% of total loans to customers), similar to the lending strategy of Popular, where loans to corporates and SMEs represent 67% of the total loan book.

DBRS views the merger as offering Popular the opportunity to increase its market shares in an important, and relatively wealthy, region within Spain – Galicia – by more than doubling its market share by branches to 16.8% in the region. The Group will also increase its market shares by branches in other key markets, including Madrid (increase to 6.5% from 5.2%) and Catalonia (increase to 4.9% from 4.0%). However, as with any merger, integration risks pose challenges. As Popular migrates Pastor to its single technology system, successful completion of the systems conversion remains an important step to be achieved without customer service interruption. With Pastor carrying significant brand recognition in Galicia, the Group will maintain the name in that region, also re-branding Popular branches in the region to the Pastor name. Despite this, all branches will operate on one integrated technology system. This requires Popular to succeed with a sizeable integration, where the Group has some past experience, which includes integrating its own, smaller regional banks and the formation of its joint venture with Crédit Mutuel. Important for a successful integration is Popular's ability to leverage its operating capabilities to achieve cost savings and synergies. If there were significant costs and/or disruptions associated with the integration, this could add negative ratings pressure in the near-term. While additional acquisitions could provide important enhancements to Popular's franchise, negative ratings pressure would likely arise, given that Popular already has committed resources with Pastor.

The Negative trend reflects the ongoing stress in the Euro zone, the disruptions in the financial markets and the weak economic conditions in Spain. This negative external environment is expected to continue to pressure Popular's earnings generation ability going forward, at a time when its contingency resources are more scarce than at the beginning of this sustained crisis. While Popular has managed to cope with the prolonged stress, it remains exposed to the elevated liquidity pressure in the Spanish financial system and the Euro zone generally, the sustained weakness in the economy



and increasing stress on Spain's sovereign position. DBRS notes that further negative action on the sovereign rating (Kingdom of Spain current rating AA (low), Negative trend) could negatively affect the A (high) rating of Popular and its IA, as such action would likely signal further deterioration in the domestic environment.

Adding further to the stress of a sizeable integration in adverse market conditions, the Bank of Spain and the EBA are requiring increased capital levels, which results in Popular needing to bolster capitalisation during a time of unprecedented stress in the markets. Additionally, the Bank of Spain has increased its provisioning requirements for problematic assets from an average coverage ratio of 30% to 50% across the sector. DBRS notes that Popular has largely utilised its stock of generic provisions, though it continues to undertake contingency actions to offset deterioration in real estate exposure. This makes it more critical for Popular to generate positive earnings to cope with the stressed environment and increased requirements. While DBRS views these increased requirements as manageable for Popular, the Negative trend also reflects the elevated stress added by this relatively sizeable merger at a time of increased weakness in the Spanish economy.

#### Notes:

All figures in Euros (EUR) unless otherwise noted.

The principal applicable methodology is the Global Methodology for Rating Banks and Banking Organisations. Other methodologies used include the DBRS Criteria – Intrinsic and Support Assessments. Both can be found on the DBRS website under Methodologies.

The sources of information used for this rating include the issuer and SNL Financial. DBRS considers the information available to it for the purposes of providing this rating was of satisfactory quality.

This credit rating has been issued outside the European Union (EU) and may be used for regulatory purposes by financial institutions in the EU.

Lead Analyst: Roger Lister

Rating Committee Chair: Alan G. Reid

Initial Rating Date: 21 September 2006

Most Recent Rating Update: 9 December 2011

For additional information on this rating, please refer to the linking document under Related Research.



| Issuer                         | Debt Rated                                | Rating Action | Rating       | Trend | Latest Event |
|--------------------------------|---|---------------|--------------|-------|--------------|
| Banco Popular Español S.A.     | Senior Unsecured Long-Term Debt & Deposit | Confirmed     | A (high)     | Neg   | Apr 16, 2012 |
| Banco Popular Español S.A.     | Subordinated Debt                         | Confirmed     | A            | Neg   | Apr 16, 2012 |
| Banco Popular Español S.A.     | Short-Term Debt & Deposit                 | Confirmed     | R-1 (middle) | Neg   | Apr 16, 2012 |
| Popular Capital Europe         | Subordinated Debt                         | Confirmed     | A            | Neg   | Apr 16, 2012 |
| Popular Capital S.A.           | Preferred Shares                          | Confirmed     | BBB (low)    | Neg   | Apr 16, 2012 |
| BPE Financiaciones, S.A.       | Senior Unsecured Long-Term Debt           | Confirmed     | A (high)     | Neg   | Apr 16, 2012 |
| BPE Financiaciones, S.A.       | Subordinated Debt                         | Confirmed     | A            | Neg   | Apr 16, 2012 |
| BPE Finance International Ltd. | Senior Unsecured Long-Term Debt           | Confirmed     | A (high)     | Neg   | Apr 16, 2012 |
| BPE Capital International      | Subordinated Debt                         | Confirmed     | A            | Neg   | Apr 16, 2012 |
| Banco Popular Portugal S.A.    | Senior Unsecured Long-Term Debt & Deposit | Confirmed     | A (low)      | Neg   | Apr 16, 2012 |
| Banco Popular Portugal S.A.    | Short-Term Debt & Deposit                 | Confirmed     | R-1 (low)    | Neg   | Apr 16, 2012 |
| Targobank                      | Senior Unsecured Long-Term Debt & Deposit | Confirmed     | A (high)     | Neg   | Apr 16, 2012 |
| Targobank                      | Short-Term Debt & Deposit                 | Confirmed     | R-1 (middle) | Neg   | Apr 16, 2012 |
| Banco Pastor, S.A.             | Senior Long-Term Debt & Deposit           | Confirmed     | A (high)     | Neg   | Apr 16, 2012 |
| Banco Pastor, S.A.             | Short-Term Debt & Deposit                 | Confirmed     | R-1 (middle) | Neg   | Apr 16, 2012 |

For more information on this credit or on this industry, visit [www.dbrs.com](http://www.dbrs.com) or contact us at [info@dbrs.com](mailto:info@dbrs.com).

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