



Insight beyond the rating.

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DBRS Confirms Banco Popular Español S.A. Ratings at AA, Trend Remains Negative

Bloomberg: DBRS Confirms Banco Popular's Ratings at AA, Trend Still Neg

Issuer: Banco Popular Español S.A.

Industry Group: Financial Institutions

Sub-Industry: Banks & Trusts

DBRS has today confirmed the ratings for Banco Popular Español S.A. (Banco Popular or the Group), including its long-term rating of AA and short-term rating of R-1 (high), following the release of the Group's Q4 and full year 2009 results. This rating confirmation reflects the Group's continued demonstration of its strong fundamentals by generating solid pre-provision profit, or income before provisions and taxes (IBPT), to absorb elevated impairment charges, while concurrently bolstering capital and maintaining strong liquidity. As the third largest commercial banking group in Spain, the ratings also incorporate DBRS's expectation of some form of timely systemic support for Banco Popular in the event of a stress scenario. In light of the still challenging environment, the trend on all ratings remains Negative.

The ratings confirmation is based on Banco Popular's franchise resiliency, recurring revenue generation and its sustained success in managing its expense base, combined with its bolstered reserves, strengthened capital and reinforced liquidity. These strengths are enabling the Group to cope with much increased credit costs and the deterioration in the Spanish economy. Indicative of the Group's resilient franchise was its success in growing lending and deposits in 2009, thereby increasing its market share in a difficult environment. Well-positioned in attractive customer segments, the Group's franchise has a diversified customer base that is focused on small- and medium-sized entities (SMEs), corporates and professionals, which are at the core of the Banco Popular's business model. The Group maintains strong customer relationships through its localized branches. Demonstrating the importance of its customer base, Banco Popular delivered record revenues in 2009, supported by 11.3% growth in net interest income year-over-year. While growing its business, Banco Popular has streamlined its branch network, reduced staff and lowered expenses in 2009, even as it devoted more resources to managing credit. With a record expense ratio of 29.3% for the year, Banco Popular remains a leader in the efficiency of its operations. Overall the bank delivered its highest level of IBPT in 2009, enabling it to absorb elevated credit costs and deliver positive earnings, as it has throughout this crisis.

The Negative trend reflects DBRS's view of the considerable stress that Banco Popular faces in the current environment. While Banco Popular is successfully coping with the challenging environment, it remains exposed to an elevated level of credit problems, the sustained weakness in the economy, increasing market concern about Spain's sovereign position and the continued difficulties in the

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Spanish banking sector, which could affect the financial markets. The Group sees credit impairments as remaining elevated through 2010, though additional deterioration is not expected, as net entries of non-performing loans declined 27.5% quarter-over-quarter and have consistently declined since Q1 2009. Although the deterioration in credit appears to be slowing, DBRS expects asset impairments to remain elevated through 2010, given the sustained weakness in the economy, keeping the Group's earnings under pressure. DBRS is of the view that Banco Popular's strong franchise and its earnings generation resiliency are likely to enable it to weather the expected level of stress. Nevertheless, the Group could come under increased pressure, if the economy fails to recover in 2010 and financial markets become disrupted again. If this stress led to material deterioration in Banco Popular's franchise, its earnings generation capacity or its available resources, the likelihood of a ratings downgrade would increase. Accordingly, DBRS continues to monitor the condition of the Group's franchise, its success in managing its portfolios and its ability to sustain underlying earnings to absorb the elevated cost of credit, while maintaining its strong capital and liquidity.

DBRS views positively Banco Popular's actions to enhance its financial position. The Group has bolstered reserves, bringing its specific coverage ratio to 50.3% from 45.0% in 3Q 2009. Approximately 50% of the Group's loan portfolio is mortgage lending, which is highly collateralized. Taking into account collateral and generic provisions, Banco Popular's coverage ratio stood at 125%. During 2009, the Group offset provisions on real estate assets with profits from real estate sales, such as the sale and leaseback of branches. The Group improved its core capital ratio to 8.61% at 31 December 2009 from 7.17% at the end of 2008 through capital issuances and retained earnings. Its TCE to tangible asset ratio is now 6.5%. The Group has improved its liquidity profile by reducing its reliance on wholesale funding with a year-over-year increase in deposits of 9.1%. Reinforcing this liquidity is a EUR 18.3 billion second line of liquidity, which is double the size from a year ago, that can be pledged to the central bank.

In coping with this environment, DBRS views Banco Popular's ability to sustain its IBPT as a critical component that is underpinned by its operating capabilities and strong franchise. Sustained revenues and controlled expenses drove a strong IBPT of EUR 693 million in Q4 2009, helping the Group to absorb still elevated credit impairments of EUR 526 million, or 76% of IBPT. The Group generated net profits of EUR 115 million in Q4 2009, a decline of 45% from the prior quarter, largely due to increased provisioning. The positive revenue trend reflected the Group's success with the expansion of its net interest margin (NIM) combined with loan and deposit growth. Currently at 2.36%, the Group's NIM has held up well, when compared to 2.41% in Q3 2009 and 2.33% in the prior year's quarter, as funding costs declined substantially. In addition to maintaining low interest costs on its wholesale funding and deposits, Banco Popular manages its loan spreads closely. The Group benefits from annual interest rate resets on its non-mortgage loan portfolio, so that rates can be adjusted upward to reflect the additional risk in lending. Also, about half of its loan portfolio has floors on loan rates and about half of these floors have been activated. This has helped protect the Group's margin from the squeeze due to the decline in rates. Banco Popular also grew its loan portfolio by 5.9% year-over-year, but remained selective, with a focus on supporting its clients, strong credit requirements and no growth in loans to developers or the construction sector. While fees and commissions were down, the Group managed to increase its noninterest revenues that are generated

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across a range of products and activities. On a linked quarter basis, the Group maintained expenses at a normalized run rate of approximately EUR 300 million. Banco Popular's exceptional ability to manage its operations enabled it to maintain its efficiency ratio at 30.0% in Q4 2009, compared to 30.7% in the prior quarter and 35.2% in the prior year's quarter.

Notes:

All figures are in euros unless otherwise noted.

The applicable methodology is Analytical Background and Methodology for European Bank Ratings, Second Edition, which can be found on our website under Methodologies.

This is a Corporate (Financial Institutions) rating.

For more information on this credit or on this industry, visit www.dbrs.com or contact us at info@dbrs.com.

Issuer	Debt Rated	Rating Action	Rating	Trend	Latest Event
Banco Popular Español S.A.	Senior Unsecured Long-Term Debt & Deposit	Confirmed	AA	Negative	02-Feb-10
Banco Popular Español S.A.	Subordinated Debt	Confirmed	AA (low)	Negative	02-Feb-10
Banco Popular Español S.A.	Short-Term Debt & Deposit	Confirmed	R-1 (high)	Negative	02-Feb-10
Popular Capital Europe	Subordinated Debt	Confirmed	AA (low)	Negative	02-Feb-10
Popular Capital S.A.	Preferred Shares	Confirmed	A (low)	Negative	02-Feb-10
BPE Financiaciones, S.A.	Subordinated Debt	Confirmed	AA (low)	Negative	02-Feb-10
BPE Financiaciones, S.A.	Senior Unsecured Long-Term Debt	Confirmed	AA	Negative	02-Feb-10
BPE Finance International Ltd.	Senior Unsecured Long-Term Debt	Confirmed	AA	Negative	02-Feb-10
BPE Capital International	Subordinated Debt	Confirmed	AA (low)	Negative	02-Feb-10
Banco Popular Español S.A.	Senior Notes, Guaranteed by the Kingdom of Spain	Confirmed	AAA	Negative	02-Feb-10

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Press Release



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