FitchRatings

Fitch Downgrades Banco de Valencia to 'BB-'; Outlook Stable Ratings

28 Jul 2011 4:12 PM (EDT) Fitch Ratings-London/Barcelona-28 July 2011: Fitch Ratings has downgraded Banco de Valencia's (BValencia) Long-term Issuer Default Rating (IDR) to 'BB-' from 'BBB-', its Short-term IDR to 'B' from 'F3', its Viability Rating (VR) to 'bb-' from 'bbb-' and its Individual Rating to 'D' from 'C/D'. The agency has simultaneously affirmed its Support Rating at '3' and Support Rating Floor at 'BB-'. The Outlook on the Long-term IDR is Stable. A full list of rating actions is at the end of this comment.

The rating actions reflects BValencia's high risk concentration to the Spanish real estate sector, and tight liquidity and capital levels, particularly in the context of Spain's weak economic environment and difficult access to wholesale markets. Further asset quality deterioration is expected and will require high impairment and other charges which will continue to weigh down the bank's operating profitability and place pressure on capital. In addition, BValencia faces large funding maturities, particularly in 2012. Conversely, the bank has a healthy regional retail franchise which provides it with a relatively stable customer deposit base and it has a strong cost efficiency ratio, partly helped by sharing systems with its main shareholder, Banco Financiero y de Ahorros (BFA; 'A-'/Stable; VR of 'bb-').

Downward pressure on BValencia's VR would arise if the bank fails to deleverage significantly and improve its funding profile and capital ratios, as well as if impaired loans and foreclosed assets continue to rise.

In 2010 and Q111, BValencia's profitability remained under pressure from high funding costs. In 2010, large capital gains from the sale of equity stakes and buybacks of debt were used to build up provisions, although loan impairment charges continued to absorb a large part of pre-impairment operating profit. For the remainder of 2011 and in 2012, pressure on profitability will continue although margin pressure will be alleviated by repricing loans at higher interest rates and recoveries of loans charged-off will help control impairment charges. Furthermore, capital gains from the sale of some equity stakes are expected.

BValencia's large exposure to real estate and construction risks (34% of total lending at end-Q111) has resulted in a significant deterioration of asset quality since 2009. The impaired/total loans ratio was 6.6% at end-Q111 and the bank has recently intensified its charge-off policy and the foreclosure of real estate assets. Including impaired lending, asset foreclosures and charge-offs, the extended impaired to total loans ratio would have been a high 13%. Impaired loans are 42% covered by reserves and foreclosed assets 26% covered, which would help to reduce loss severity.

BValencia's funding is equally derived from customer deposits and wholesale funds (41% each) although liquidity remains tight considering the large maturities the bank faces over the next two years (EUR0.5bn for the remaining part of 2011 and EUR1.9bn for 2012). However, an important deleveraging plan is in place, unencumbered assets of EUR300m exist and a further capacity to issue and retain EUR775m of covered bonds could help the bank to meet its funding needs.

With a Fitch core capital/weighted risks ratio of 7.6%, the bank's capital levels are relatively low.. In light of risk concentration to the real estate sector and Spain's weak economic prospects, in Fitch's view, BValencia may need to raise capital levels further.

BValencia is a regional bank mainly operating in Valencia and Murcia with 431 branches at end-Q111. BValencia is part of BFA, the third largest banking group in Spain. BFA holds 38.4% stake in BValencia.

The rating actions are as follows:

Long-term IDR: Downgraded to 'BB-' from 'BBB-', Stable Outlook
Short-term IDR: Downgraded to 'B' from 'F3'
Viability Rating: Downgraded to 'bb-' from 'bbb-'
Individual Rating: Downgraded to 'D' from 'C/D'
Support Rating: Affirmed at '3'
Support Rating Floor: Affirmed at 'BB-'
Senior Unsecured Debt: downgraded to 'BB-' from 'BBB-'
Subordinated debt: downgraded to 'B+' from 'BB+'
Preference shares: downgraded to 'B-' from 'B+'

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Additional information is available at www.fitchratings.com.

Applicable criteria, 'Global Financial Institutions Rating Criteria', dated 16 August 2010; 'Short-term Ratings Criteria for Corporate Finance', dated 2 November 2010 and 'Treatment of Hybrids in Bank Capital Analysis', dated 11 July 2011 are available at www.fitchratings.com.
In Fitch's rating criteria, a bank's standalone risk is reflected in Fitch's Viability Rating and the prospect of external support is reflected in Fitch's Support ratings. Collectively these ratings drive Fitch's Long- and Short-term IDRs.

Applicable Criteria and Related Research:
Global Financial Institutions Rating Criteria
Short-Term Ratings Criteria for Corporate Finance
Treatment of Hybrids in Bank Capital Analysis