FitchRatings

Fitch Downgrades BValencia's VR to 'b' on RWN; Places BFA's 'bb-' VR on RWN

Ratings

11 Nov 2011 7:45 AM (EST) Fitch Ratings-London-11 November 2011: Fitch Ratings has downgraded Spain's Banco de Valencia's (BValencia) Viability Rating (VR) to 'b' from 'bb-' and placed it on Rating Watch Negative (RWN). At the same time, the agency has affirmed BValencia's Long-term Issuer Default Rating (IDR) at 'BB-' and Short-term IDR at 'B'. The agency has also placed the Banco Financiero y de Ahorros's (BFA) 'bb-' VR on RWN. BFA is BValencia's major shareholder with a 27.3% stake and it also owns a 52.4% stake in Bankia, the third-largest banking group in Spain. A full list of rating actions is at the end of this comment.

The downgrade of BValencia's VR mainly reflects capital adequacy concerns. On 7 November 2011, BValencia announced that it is presently unable to quantify its provisioning or recapitalisation needs resulting from a Bank of Spain inspection, currently being finalised. The bank's already weak profitability and relatively low capital base could be greatly affected as a result of higher provisioning on real estate exposures, as required by the Bank of Spain.

The RWN on BValencia's VR reflects ongoing uncertainty regarding the amount of new capital which may need to be injected into the bank. Depending on the level of recapitalisation required and the source of such capital, Fitch may consider that the bank has failed. In this case, BValencia's VR may be downgraded to 'f'.

Given the weak prospects for Spain's economic outlook and property market, BValencia's revenues and margins will continue to be affected by weaker volumes, a low interest rate environment and high retail funding costs. Combined with higher provisioning needs arising from its large exposures to real estate foreclosed assets and loans (34% of total loans), this means that BValencia has limited ability to improve capital levels through internal capital generation.

BValencia also has large wholesale funding maturities over the next two years, although strong balance-sheet deleveraging is helping to mitigate high refinancing risks. BValencia has a good regional franchise in Valencia and deposit levels have remained stable.

Fitch acknowledges that the bank will, in the first instance, try to source additional capital from its current shareholders. Given that the amount of new capital required by BValencia has not been quantified, Fitch is unable to determine whether BValencia's shareholders are in a position to meet these capital requirements. The RWN on BValencia's VR will be resolved once details of the recapitalisation plans are announced.

BValencia's Long-term IDR is at its Support Rating Floor and has a Stable Outlook, reflecting Fitch's view of moderate probability of support from Spanish Authorities and ultimately from the Spanish state's Fund for Orderly Bank Restructuring (FROB).

Should BValencia receive FROB funds, the European Commission (EC) could apply certain state aid rules and ultimately impose burden-sharing on the holders of subordinated debt instruments issued by BValencia. Thus, the agency has downgraded BValencia's subordinated debt to 'B-' and placed it on RWN. BValencia's preference shares have also been downgraded to 'C' from 'B-' to reflect a higher overall risk of non-performance.

While BValencia's need for additional capital would, on its own, most likely not have an impact on BFA's ratings, Fitch notes that BFA's cash flows and net income could also be negatively impacted by a potential weakening of dividend flows upstreamed from its investments. Combined with continued negative economic trends in Spain, this may put pressure on BFA's VR and thus, BFA's VR has been placed on RWN. Once Fitch has obtained greater clarity about the extent to which BValencia's recapitalisation affects BFA and updated financial information on BFA, the agency will resolve this RWN.

BValencia is a regional bank mainly operating in Valencia and Murcia with 431 branches at end-Q111.

The rating actions are as follows:

BValencia:
Long-term IDR: affirmed at 'BB-', Stable Outlook
Short-term IDR: affirmed at 'B'
Viability Rating: downgraded to 'b' from 'bb-' and placed on RWN
Individual Rating: downgraded to 'D/E' from 'D' and placed on RWN
Support Rating: affirmed at '3'
Support Rating Floor: affirmed at 'BB-'
Senior unsecured debt: affirmed at 'BB-'
Subordinated debt: downgraded to 'B-' from 'B+' and placed on RWN
Preference shares: downgraded to 'C' from 'B-'

BFA:
Long-term IDR: affirmed at 'BB', Stable Outlook
Short-term IDR: affirmed at 'B '
Individual Rating: 'D' placed on RWN
Viability Rating: 'bb-' placed on RWN
Support Rating affirmed at '3'
Support Rating Floor affirmed at 'BB'
Subordinated debt: 'BB-' placed on RWN
Upper Tier 2 subordinated debt: 'B' placed on RWN
Preference shares: 'B-' placed on RWN
Government-guaranteed debt affirmed at 'AA-'

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Additional information is available at www.fitchratings.com. The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.
Applicable criteria 'Global Financial Institutions Rating Criteria' dated 16 August 2011, 'Rating Hybrid Securities' dated 28 July 2011 and 'Treatment of Hybrids in Bank Capital Analysis' dated 11 July 2011 are available on www.fitchratings.com.

Applicable Criteria and Related Research:
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Rating Hybrid Securities
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