Credit Rating Announcement

21 September 2020

Scope places Bankia SA's ratings under review for upgrade (BBB+ issuer rating)

The rating action follows the announcement by Bankia and Caixabank that the boards of the two banks have reached an agreement and aim to merge the two entities.

Rating action

Scope Ratings has today placed under review the BBB+ issuer rating on Bankia SA, for a possible upgrade.

The agency has also placed under review the BBB+ rating on preferred senior unsecured debt as well as the BBB rating on non-preferred senior unsecured debt and the S-2 short term rating. All ratings are under review for upgrade.

Rating rationale

The rating action follows the announcement by Bankia and Caixabank that the boards of the two banks have reached an agreement and aim to merge the two entities. The merger is subject to approval by shareholders and regulators.

Should the transaction go ahead, Scope believes that the merged entity will have a stronger credit profile than Bankia's. Caixabank is a larger and more diversified bank, with solid financial fundamentals.

The combined bank would command a very high domestic market shares in loans (25%) and deposits (24%) in Spain and display a higher degree of regional diversification within Spain and in Portugal. The merged entity would also be a market leader in bancassurance and wealth management, where Caixabank is already a strong player. Positively, Scope also notes that the merger will enhance the ability to invest in digitalisation, which the agency believes will be a key competitive element going forward.

The NPL ratio of the combined entity would stand at 4.1%, with coverage of 64%. This is the result of the material effort from both banks management teams to derisk their respective balance sheets in recent years. Scope expects asset quality metrics to deteriorate going forward, as a result of the Covid-19 recession. However, Caixabank will be better placed to absorb higher risk cost due to the expected cost and revenue synergies from the merger. With a strong bancassurance and wealth management franchise, the group will be well equipped to withstand a prolonged period of ultra-low interest rates, as revenues from ancillary businesses could offset the continued pressure on interest margins. Pre-provision profitability will benefit from planned cost synergies of EUR 770bn, 42% of Bankia's 2019 cost base, and revenue synergies of EUR 290m. Management expects the combined entity to reach a return on tangible equity above 8% by 2022. This expectation is based on analysts' consensus forecasts and includes planned synergies.

The new entity would be adequately capitalised, targeting a CET1 ratio range of 11% to 11.5%, 250bps-300bps above the expected SREP requirement. This is not as strong as Bankia's solvency, as some of the excess capital in the combined entity will be used to fund, from a capital perspective, restructuring costs of EUR 2.2bn.

Key rating drivers

- Planned merger with Caixabank
- Focused retail and commercial banking franchise in Spain
- Rapidly deteriorating economic environment, which could affect the bank's performance going forward
- Strong management track record of strategic delivery, though profitability remains the bank's Achilles heel
- Effective derisking of legacy bad assets, but Covid-19 recession will pose new challenges

Rating-change drivers

Positive rating-change drivers include:

- Successful completion of merger with Caixabank

Negative rating-change drivers include:

- A worse-than-expected deterioration in credit quality
- A significant deterioration in Spain's sovereign credit strength

Scope also flagged M&A activity as a potential rating-change driver. If executed well, an acquisition could increase the bank's geographic and product diversification, and boost its domestic market shares; however, M&A could also be detrimental to the credit if it resulted in a material weakening of financial fundamentals.

In the case of the announced transaction, we believe the impacts on credit risk will be largely positive.

Rating driver references
1. Merger deal announcement

Stress testing & cash flow analysis
No stress testing was performed. No cash flow analysis was performed.

Methodology
The methodology/ies used for this rating(s) and/or rating outlook(s) Bank Rating Methodology, 4 May 2020 is available on https://www.scoperatings.com/#!methodology/list.
Information on the meaning of each rating category, including definitions of default and recoveries can be viewed in the "Rating Definitions - Credit Ratings and Ancillary Services" published on https://www.scoperatings.com/#!governance-and-policies/rating-scale. Historical default rates of the entities rated by Scope Ratings can be viewed in the rating performance report on https://www.scoperatings.com/#governance-and-policies/regulatory-ESMA. Please also refer to the central platform (CEREP) of the European Securities and Markets Authority (ESMA): http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml. A comprehensive

clarification of Scope's definitions of default and rating notations can be found at https://www.scoperatings.com/#governance-and-policies/rating-scale. Guidance and information on how Environmental, Social or Governance factors (ESG factor) are incorporated into the rating can be found in the respective sections of the methodologies or guidance documents provided on https://www.scoperatings.com/#!methodology/list.
The rating outlook indicates the most likely direction of the rating if the rating were to change within the next 12 to 18 months.

Solicitation, key sources and quality of information

The rated entity and/or its agents participated in the rating process.
The following substantially material sources of information were used to prepare the credit rating: public domain, the rated entity, Scope internal sources.
Scope considers the quality of information available to Scope on the rated entity or instrument to be satisfactory The information and data supporting Scope's ratings originate from sources Scope considers to be reliable and accurate. Scope does not, however, independently verify the reliability and accuracy of the information and data.
Prior to the issuance of the rating or outlook action, the rated entity was given the opportunity to review the rating and/or outlook and the principal grounds on which the credit rating and/or outlook is based. Following that review, the rating was not amended before being issued.

Regulatory disclosures

This credit rating and/or rating outlook is issued by Scope Ratings GmbH, Lennéstraße 5, D-10785 Berlin, Tel +49 30 27891-0.
Lead analyst: Marco Troiano, Executive Director
Person responsible for approval of the rating: Dierk Brandenburg, Managing Director
The ratings/outlooks were first released by Scope on 30 November 2017. The ratings/outlooks were last updated on 31 July 2020.

Potential conflicts

Please see www.scoperatings.com for a list of potential conflicts of interest related to the issuance of credit ratings.

Conditions of use / exclusion of liability

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