FitchRatings

FITCH DOWNGRADES SPAIN'S CAIXANOVA TO 'BBB+'; TAKES RATING ACTIONS ON MERGER PLAN

Fitch Ratings-London/Barcelona-02 August 2010: Fitch Ratings has downgraded Caixa de Aforros de Vigo, Ourense e Pontevedra's (Caixanova) Long-term Issuer Default rating (IDR) to 'BBB+' from 'A-'. Fitch has also placed Caixanova's ratings on Rating Watch Negative (RWN) to reflect advanced merger talks with Caja de Ahorros de Galicia (Caixa Galicia). A full rating breakdown is provided at the end of this commentary.

Separately, Fitch has today downgraded Caixa Galicia's Long-term IDR to 'BBB' from 'BBB+' and placed it on Rating Watch Evolving (for further information, please see 2 August 2010 comment entitled 'Fitch Downgrades Spain's Caixa Galicia to 'BBB'; Takes Rating Actions on Merger Plan', available on www.fitchratings.com).

The downgrade reflects Caixanova's continuing single-name risk concentration, exposure to both the Spanish property sector and equity investments, and tight core capital. Fitch notes that the continued difficult operating environment could lead to further deterioration in asset quality and weigh on profitability. However, Fitch takes a positive view of management's strategy to continue reducing its equity risk exposure. The ratings also consider the caja's strong regional retail franchise, which provides it with a stable customer deposit base, good management and coverage of impaired assets, and sound liquidity.

On 28 June 2010, the board of directors of Caixanova and Caixa Galicia approved their integration plan. The merged entity will receive EUR1.2bn of funds from Spain's Fund for Orderly Bank Restructuring (FROB) in the form of preference shares convertible into "cuotas participativas". The plan has been approved by the Bank of Spain and the FROB. The RWN reflects Fitch's view that the Long-term IDR of the merged entity will be in the 'BBB' range as Caixanova is merging with a weaker savings bank.

Although the merger is pending approvals from the cajas' governing bodies and the regional government of Galicia, there is a high probability that the merger will take place. Fitch will resolve the RWN once the merger is completed and as details become available. Should the merger not take place, Fitch will review the ratings of Caixanova as a separate entity.

Despite a wider net interest margin and cost control in 2009/Q110, operating profitability has been affected by large credit provisions, some of them prudent. Significant extraordinary income helped support net income and additional provisions. Fitch notes that problem-loan provisions will remain high while business volumes and interest rates continue to be low. Good spread management, generic loan impairment reserves of EUR103m and further asset sales will assist in maintaining profitability in 2010/11.

Caixanova's single-name risk concentration from combined credit and equity risk exposures remains high, but is declining due to stricter limits and equity divestments. Lending exposure to the property sector was slightly above-sector-average at 28% of loans at end-Q110 (largely for well-secured primary residences). Its end-Q110 ratio of impaired/total loans was 4.9% (7.5%, including foreclosures), which is below the sector average. Loan impairment coverage was still good at 60% and foreclosed assets were 21% covered by reserves at end-Q110. Equities, largely in the energy sector, represented a high 135% of end-Q110 Fitch core capital and significant market-value declines were written down in 2008 and 2009.

Liquidity is sound, backed by growing retail deposits (75% of end-Q110 total net loans), good diversification in debt maturities and sizeable liquid assets. At end-2009, the caja's regulatory tier 1 ratio improved to 8.3%, albeit supported by hybrid capital issues.

Caixanova, Spain's ninth-largest savings bank by total assets at end-2009, is retail-focused in the region of Galicia. It has a 49.83% stake in a Galicia-based bank, Banco Gallego.

The rating actions taken with respect to Caixanova are as follows:
Long-term IDR; downgraded to 'BBB+' from 'A-'; placed on RWN
Short-term IDR; rated 'F2' placed on RWN
Individual rating; rated 'C' placed on RWN
Support Rating; affirmed at '3'
Support Rating Floor; affirmed at 'BB+'
State-guaranteed senior debt; affirmed at 'AA+'
Senior unsecured debt; downgraded to 'BBB+' from 'A-'; placed on RWN
Subordinated debt; downgraded to 'BBB' from 'BBB+'; placed on RWN
Upper tier 2 subordinated debt; downgraded to 'BBB-' from 'BBB'; placed on RWN.

In Fitch's rating criteria, a bank's standalone risk is reflected in Fitch's Individual ratings 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, 'Global Financial Institutions Rating Criteria', 'Equity Credit for Hybrids & Other Capital Securities - Amended' and 'Rating Hybrid Securities', all dated 29 December 2009, are available on www.fitchratings.com.

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