BBVA SA
Issuer Rating Report

STABLE
A+

Overview

Scope Ratings assigns an Issuer Rating of A+ and a short-term debt rating of S-1+ to BBVA SA, both with Stable Outlook. The agency also rates the institution's senior unsecured debt not eligible for MREL at A+, and its senior unsecured debt eligible for MREL at A. These ratings do not apply to the unguaranteed subsidiaries of the rated parent.

The ratings were not solicited by the issuer. Both ratings and analysis are based solely on publicly available information. The issuer has participated in the process.

Highlights

- The ratings are based largely on the strength and reliability of BBVA's retail and commercial banking franchises in several countries and on the strong market positioning in its main countries of operation.
- The high degree of diversification has helped BBVA deliver significant profits despite the stressed operating environment in Spain and enabled it to generate capital organically. The bank has withstood harsh conditions, peaking with a collapse in its domestic real estate market, significant stress to funding markets and sharply rising yields on domestic sovereign bonds in 2011 and 2012. Despite this, the bank's capital base has kept growing throughout.
- With the domestic economic environment improving, the burden of Spanish legacy assets on the group's earnings capacity has declined. The recovery, if sustained, should also have a positive impact on the sustainability of public debt, which remains a concern to us. However, we underscore that we do not automatically link BBVA's rating with the credit standing of the Spanish sovereign.

Rating drivers (summary)

The rating drivers, in decreasing order of importance in the rating assignment, are:

- Retail-focused, globally diversified revenue and earnings streams with strong market positions in several key markets (Spain, US Sunbelt, Mexico, Turkey, Argentina, Venezuela, Colombia, Peru)
- Material exposure to Spanish sovereign risk, which remains a potential weakness
- Improving profitability as the bank gradually deals with legacy real-estate non-performing assets
- In extremely stressed crisis scenarios, the possibility that intervention by host or home regulators limit the mobility of capital and liquidity within the group

Ratings & Outlook

Issuer Rating	A+
Outlook	Stable
Senior unsecured debt	A+
Senior unsecured debt (MREL/TLAC eligible)	A
Additional Tier 1 instruments	BB+
Short term debt rating	S-1+
Short term debt rating outlook	Stable
Covered bonds ratings	AAA
Covered bonds outlook	Stable

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Rating change drivers

Further improvements in the group's relative capital position. While greatly improved in recent years, BBVA's capital position lags peers' on a fully loaded CRD4 CET1 basis. This is partly the result of the high average risk intensity of the balance sheet. BBVA's fully loaded leverage ratio of 6.6% (Q4 2017) is significantly higher than that of peers.

Significant worsening of Mexican earnings capacity and asset quality. BBVA group's profitability currently relies on Mexico contributing approx. 40% of net profit in 2017. Should the earnings capacity of this business be dented, the capital generation of BBVA could be impacted.

Renewed tension on Spanish bank and sovereign debt. Tensions surrounding peripheral European assets were sedated for the past few years by a strongly accommodative monetary policy. As economic recovery takes hold in Europe, the European Central Bank will gradually remove its support. The pace of asset purchases, including public sector bonds, will gradually reduce over 2018, an initial step towards normalisation of policy, with increases in policy rates likely to follow – albeit gradually. Despite not directly affecting the P&L, rising yields on the bank's Spanish sovereign bond holdings would raise questions on BBVA's capital levels. To some extent, however, we take comfort in the promising economic performance of Spain after the crisis.

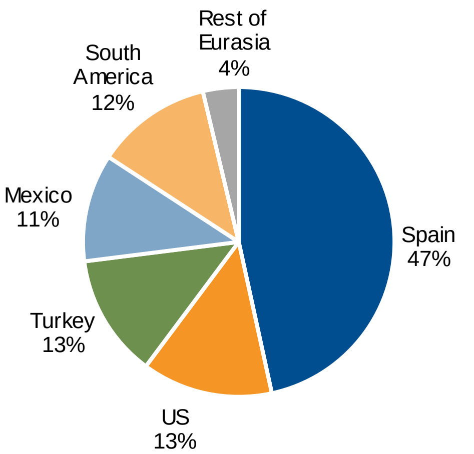
Rating drivers (details)

Retail-focused, globally diversified revenue and earnings streams with strong market positions in several key markets

BBVA offers predominantly retail banking services to customers in Europe, Asia and the Americas.

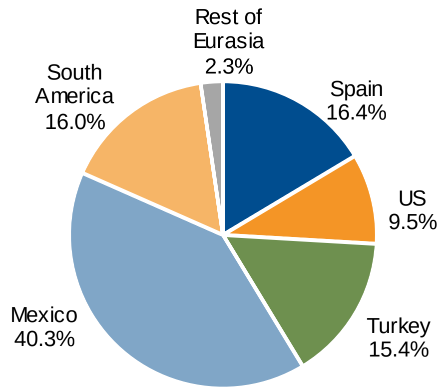
With over 3,000 branches and over EUR 300bn in banking assets in Spain, BBVA is the third-largest bank in the country, having materially strengthened its franchise through the acquisition of Unnim and Caixa Catalunya during the crisis. With these acquisitions, BBVA has gained a strong footing in the economically attractive Spanish region of Catalonia. The need to provision for deteriorating asset quality in Spain during the last crisis has depressed BBVA's profitability for some years, but non-Spanish income has allowed BBVA to maintain a positive bottom line at group level in most quarters. While the bulk of the bank's activity remains in Spain, BBVA's emerging-market operations have not only helped the bank to navigate the crisis that engulfed its home country, but also continue to provide a good degree of business and revenue diversification. The bulk of BBVA's group profits is derived from emerging markets, particularly Turkey and Mexico: in 2017, Mexico contributed 40.3% of group net profit, whereas Spain's share was just 16.4%.

Figure 1: BBVA's loan book, divisional split (2017)



Source: Company data, Scope Ratings
Note: Excludes Corporate Center

Figure 2: BBVA's net attributable profit, divisional split (2017)



Source: Company data, Scope Ratings
Note: Excludes Corporate Center

BBVA's subsidiary Bancomer is the largest bank in Mexico, where it holds a loans market share of over 20%. Acquired in 2000, it has been a key engine for the group's revenue and profit growth over the past decade. The outlook for the country remains positive: lending continues to grow at a double-digit rate, despite having decelerated since 2016.

Turkey is BBVA's other large profit centre, contributing approx. 15% of profit in 2017. BBVA has expanded its presence in Turkey by gradually building up a 49.85% stake in Garanti, which included acquiring an extra 9.95% from Dogus Group in March 2017. Garanti is the third-largest bank in Turkey.

Turkey's macro picture is mixed, with solid mid-single digit GDP growth but relatively high inflation and unemployment. However, low banking penetration and positive demographic trends underpin the case for long-term growth in bank revenues and profits.

In 2017, net profit (excluding the impact from the increased stake) was 40% higher than in 2016, a result of wide operating jaws and controlled asset quality.

BBVA also operates a significant network in the US Sunbelt (10% of 2017 profit), the result of several acquisitions in 2005-2010 (Laredo National Bank, Texas State Bank, State National Bank, Compass, and Guaranty).

A further 16% of 2017 profit was generated by the group's Latin America operations in Argentina, Chile, Colombia, and Peru. BBVA accepted the binding offer from Scotiabank for the acquisition of its subsidiary in Chile, that was announced in November 2017.

Over recent years, BBVA has been investing increasingly in an ambitious transformation plan to strengthen its competitiveness in the digital-banking arms race. During 2017, digital sales increased from 16.8% to 28% of group sales and were the main driver for volume growth across the group's geographies. The number of digital customers is growing fast, driven by mobile banking users, and BBVA reported that at the end of 2017 more than half of customers in Spain, Turkey, the USA, Argentina, Chile and Venezuela had engaged with the bank through digital channels.

Material exposure to Spanish sovereign risk, which remains a potential weakness

Scope rates the Kingdom of Spain at A-, Stable Outlook, highlighting the sovereign's high public debt and still-large deficit as key weaknesses (on Scope's estimations, the deficit will stand at 2.7% of GDP in 2018), although fast-growing GDP will support the gross public/GDP ratio drop in coming years (to 97.9% in 2018 according to Scope estimations).

Based on the 2017 EBA transparency exercise, BBVA had a EUR 48.4bn exposure to Spanish sovereign risk as of June 2017, 110% of its transitional CET1 capital, including bonds and loans, and excluding exposures in insurance companies. This risk concentration makes BBVA's capital ratios sensitive to potential losses on Spanish sovereign debt.

According to Scope calculations, for every 10% loss on Spanish sovereign debt, BBVA's CET1 ratio would decline by about 124 bps, before any tax offset or management actions. That said, such sovereign losses are not our expected scenario, but rather a simplified exercise to assess the group's vulnerability to tail risk.

The risk of a tail event for the Spanish sovereign has receded since the ECB started engaging in increasingly dovish policies in 2012. The launch of quantitative easing has supported the demand for Spanish sovereign bonds while depressing yields.

Improving profitability as the bank gradually deals with legacy real-estate non-performing assets

At year end, BBVA's non-core real estate gross exposure was EUR 15.8bn, predominantly composed of foreclosed real estate assets.

In November 2017, BBVA announced an agreement with a subsidiary of Cerberus to create a joint venture for its Spanish real estate business, reducing most of its exposure to non-core real estate assets. The transaction is expected to close during the second half of 2018.

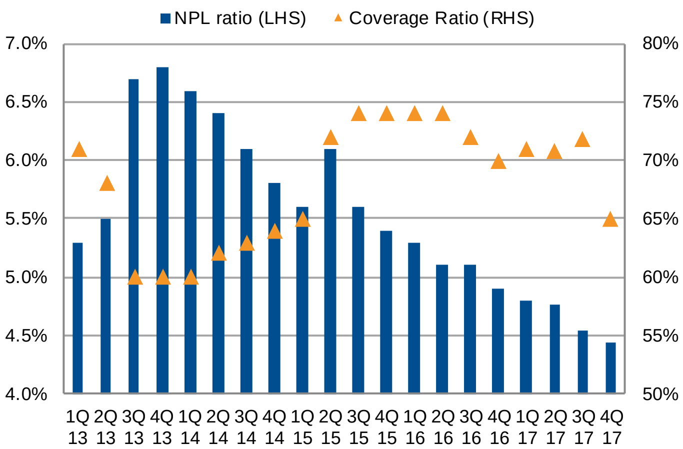
The non-core real estate business covered by the agreement consists of approximately 78,000 properties with a gross book value of about EUR 13bn. The business was valued at approximately EUR 5bn and BBVA will sell an 80% stake in the joint venture to Cerberus for about EUR 4bn.

We anticipate the transaction will put an end to the drag that the non-core division has placed on BBVA's results in recent years, or at least materially reduce it.

Following the deal, BBVA's problematic assets will consist primarily of NPLs, which are still a legacy from the crisis but represent, at this stage, a minor concern.

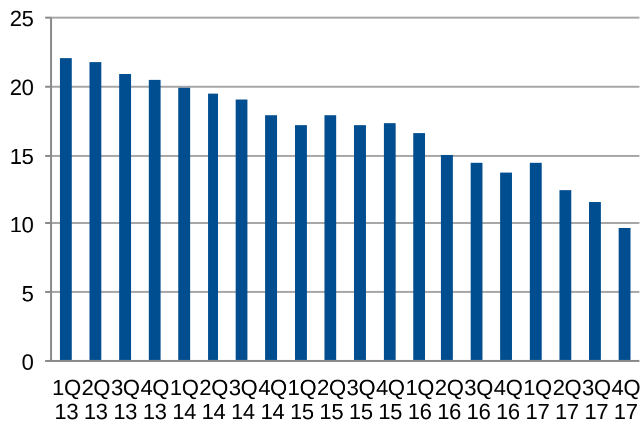
The group NPL ratio, which has been improving since the end of 2013, stood at 4.4% at the end of December 2017 with a coverage ratio of 65%. We see these levels as conservative.

Figure 3: BBVA's asset quality metrics are improving



Source: Company data, Scope Ratings
Note: includes Catalunya Banc from Q2 2015

Figure 4: Spanish real estate division, total assets (EUR bn)



Source: Company data, Scope Ratings

In extremely stressed crisis scenarios, the possibility that intervention by host or home regulators limit the mobility of capital and liquidity within the group

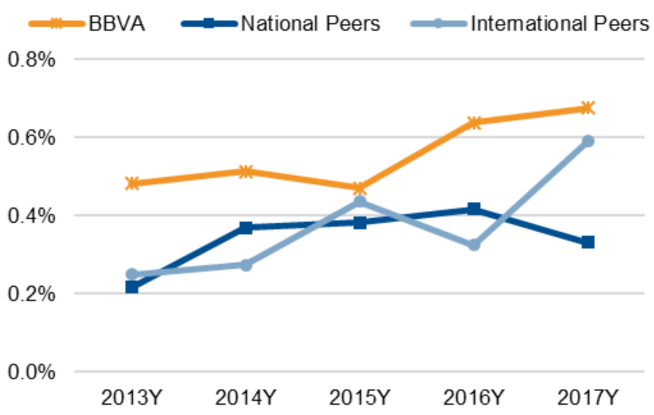
The European sovereign and financial crisis has shown that intragroup capital and liquidity mobility across geographies can significantly diminish during periods of stress, limiting a cross-border banking group's financial flexibility when most needed. Faced with such restrictions, some banking groups may take steps ranging from the listing of a minority stake to the disposal of the entire business in order to unlock capital from a subsidiary. The extent to which cross-border banking groups have such alternatives at their disposal mitigates this risk.

Conversely, we acknowledge that BBVA's subsidiarisation limits the risk of contagion between units. Indeed, we look favourably at cross-border banking organisations that display reassuring capital and liquidity metrics at both group and subsidiary level. We have noted that the European Banking Union should eliminate doubts around the effectiveness of regulation and supervision in individual countries and allow investors to compare banks across Europe based on intrinsic credit strength. As such, it should also reduce the risk of regulatory ring-fencing within Europe.

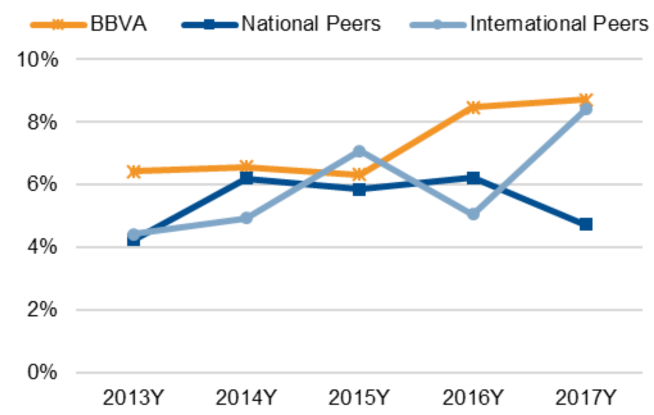
However, while the Banking Union will likely improve confidence in BBVA's home supervision framework, we note that many of BBVA's host supervisors will remain outside the eurozone and, as such, the risk that capital and liquidity may be ring-fenced at times of stress cannot be excluded.

I. Appendix: Peer comparison

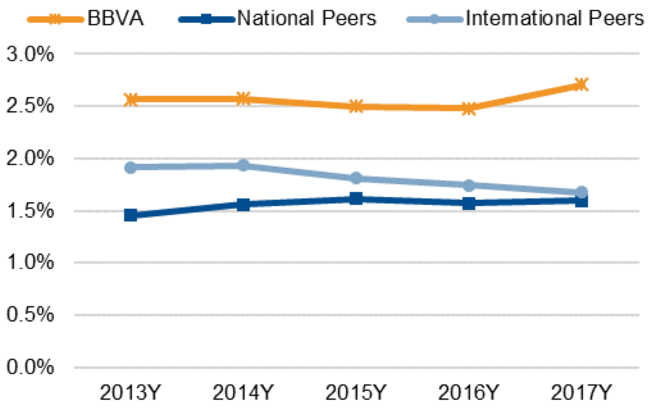
ROAA



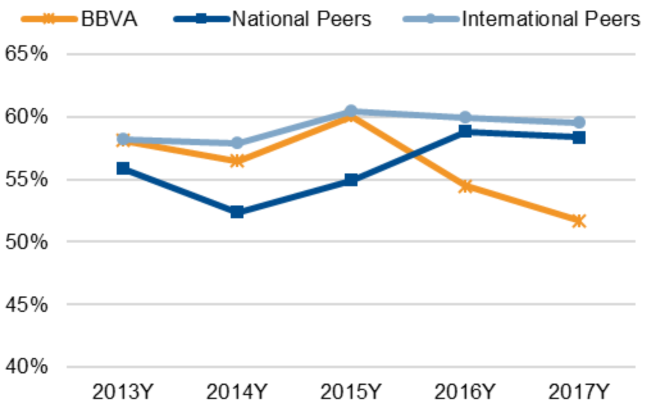
Return on average equity (ROAE)(%)



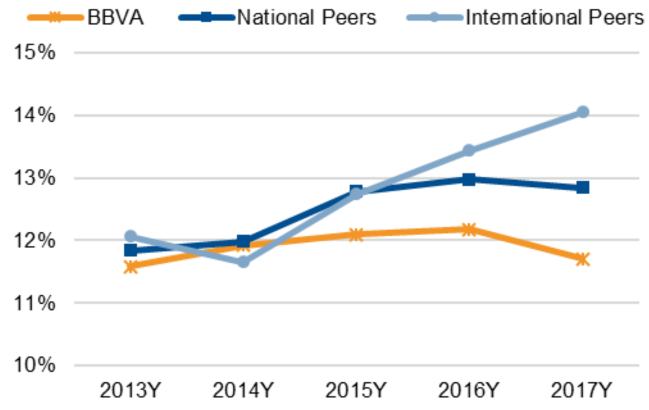
Net interest margin (%)



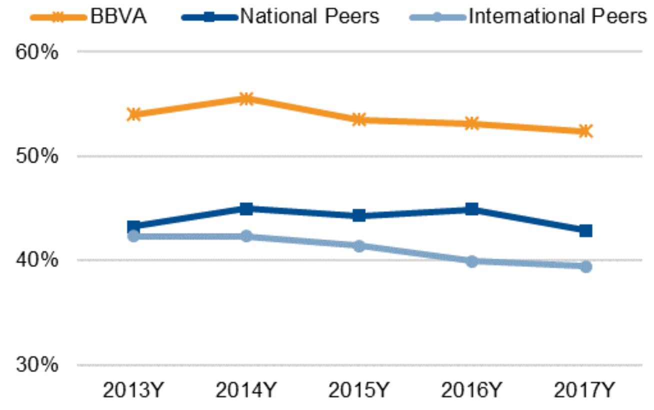
Cost-income ratio (%)



Common Equity Tier 1 (%, transitional)



Asset risk intensity (RWA % total assets)



Source: SNL, Scope Ratings
**National peers: BBVA, Santander, CaixaBank, Banco Sabadell, Bankia, Bankinter, Ibercaja, Liberbank, Unicaja, Kutxabank
International peers: Santander, BBVA, Unicredit, Erste Bank, Nordea, KBC Group, ING Bank, Raiffeisen Bank International, Standard Chartered, Societe Generale, HSBC, Citigroup

II. Appendix: Selected Financial Information – BBVA group

	2013Y	2014Y	2015Y	2016Y	2017Y
Balance sheet summary (EUR m)					
Assets					
Cash and interbank assets	61,267	58,489	76,491	80,307	76,241
Total securities	NA	190,097	208,034	187,834	160,973
of which, derivatives	NA	46,901	44,484	45,805	NA
Net loans to customers	334,744	338,784	414,230	414,654	387,621
Other assets	NA	44,572	51,100	49,060	65,224
Total assets	**599,517**	**631,942**	**749,855**	**731,856**	**690,059**
Liabilities					
Interbank liabilities	87,746	93,361	108,630	98,241	91,570
Senior debt	65,497	58,096	65,872	59,145	NA
Derivatives	NA	47,383	45,234	45,465	NA
Deposits from customers	310,176	319,060	403,362	401,465	376,379
Subordinated debt	10,579	14,095	16,109	17,230	NA
Other liabilities	NA	48,339	55,367	54,881	NA
Total liabilities	**554,667**	**580,333**	**694,573**	**676,428**	**636,736**
Ordinary equity	42,419	49,031	47,256	47,309	NA
Equity hybrids	60	67	35	54	NA
Minority interests	2,371	2,511	7,992	8,064	6,979
Total liabilities and equity	**599,517**	**631,942**	**749,855**	**731,856**	**690,059**
Core tier 1/Common equity tier 1 capital	37,492	41,832	48,554	47,370	42,337
Income statement summary (EUR m)					
Net interest income	14,613	14,382	16,022	17,059	17,758
Net fee & commission income	4,431	4,174	4,612	4,718	4,921
Net trading income	2,527	2,134	2,030	1,907	1,740
Other income	-1,214	34	-1,294	918	331
Operating income	**20,357**	**20,724**	**21,369**	**24,603**	**24,750**
Operating expense	11,831	11,701	12,839	13,401	13,068
Pre-provision income	**8,526**	**9,023**	**8,530**	**11,202**	**11,682**
Credit and other financial impairments	5,776	4,340	4,272	3,801	4,803
Other impairments	NA	703	558	657	NA
Non-recurring items	0	0	903	-352	51
Pre-tax profit	**2,750**	**3,980**	**4,603**	**6,392**	**6,931**
Discontinued operations	823	0	0	0	0
Other after-tax Items	0	0	0	0	0
Income tax expense	593	898	1,274	1,699	2,169
Net profit attributable to minority interests	753	464	686	1,218	1,243
Net profit attributable to parent	**2,228**	**2,618**	**2,642**	**3,475**	**3,519**

Source: SNL

III. Appendix: Selected Financial Information – BBVA group

	2013Y	2014Y	2015Y	2016Y	2017Y
Funding and liquidity					
Net loans/deposits (%)	107.9%	106.1%	102.7%	103.2%	103.0%
Liquidity coverage ratio (%)	NA	NA	NA	NA	128.0%
Net stable funding ratio (%)	NA	NA	NA	NA	NA
Asset mix, quality and growth					
Net loans/assets (%)	55.8%	53.6%	55.2%	56.7%	56.2%
Impaired & delinquent loans/loans (%)	NA	7.8%	6.9%	6.4%	NA
Loan-loss reserves/impaired loans (%)	59.5%	62.7%	73.8%	69.7%	65.7%
Net loan growth (%)	-5.2%	4.7%	22.3%	0.1%	-6.5%
Impaired loans/tangible equity & reserves (%)	49.6%	38.8%	39.6%	37.2%	33.7%
Asset growth (%)	-6.0%	8.5%	18.7%	-2.4%	-5.7%
Earnings and profitability					
Net interest margin (%)	2.6%	2.6%	2.5%	2.5%	2.7%
Net interest income/average RWAs (%)	4.5%	4.2%	4.3%	4.3%	4.7%
Net interest income/operating income (%)	71.8%	69.4%	75.0%	69.3%	71.7%
Net fees & commissions/operating income (%)	21.8%	20.1%	21.6%	19.2%	19.9%
Cost/income ratio (%)	58.1%	56.5%	60.1%	54.5%	52.8%
Operating expenses/average RWAs (%)	3.6%	3.5%	3.5%	3.4%	3.5%
Pre-impairment operating profit/average RWAs (%)	2.6%	2.7%	2.3%	2.8%	3.1%
Impairment on financial assets /pre-impairment income (%)	67.7%	48.1%	50.1%	33.9%	41.1%
Loan-loss provision charges/net loans (%)	1.7%	1.3%	1.1%	0.9%	1.2%
Pre-tax profit/average RWAs (%)	0.8%	1.2%	1.2%	1.6%	1.8%
Return on average assets (%)	0.5%	0.5%	0.5%	0.6%	0.7%
Return on average RWAs (%)	0.9%	0.9%	0.9%	1.2%	1.3%
Return on average equity (%)	6.4%	6.6%	6.3%	8.5%	8.7%
Capital and risk protection					
Common equity tier 1 ratio (%, fully loaded)	11.6%	10.4%	10.3%	10.9%	11.1%
Common equity tier 1 ratio (%, transitional)	11.6%	11.9%	12.1%	12.2%	11.7%
Tier 1 capital ratio (%, transitional)	12.2%	11.9%	12.1%	12.9%	13.0%
Total capital ratio (%, transitional)	14.9%	15.1%	15.0%	15.1%	15.4%
Leverage ratio (%)	5.6%	5.8%	6.0%	6.5%	6.6%
Asset risk intensity (RWAs/total assets, %)	54.0%	55.5%	53.5%	53.1%	52.4%
Market indicators					
Price/book (x)	1.2x	1.0x	0.9x	0.9x	1.0x
Price/tangible book (x)	1.5x	1.2x	1.1x	1.1x	1.2x
Dividend payout ratio (%)	NA	90.2%	99.7%	74.0%	NA

Source: SNL

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