BBVA SA
Issuer Rating Report

SCOPE A+ STABLE

Overview

We have assigned an issuer rating of A+ and a short-term debt rating of S-1+ to BBVA SA, both with a Stable Outlook. We also rate the bank'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 its strong market positioning in its main countries of operation.
- A high degree of diversification has helped the BBVA group to deliver significant profits at the consolidated level, 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, significantly stressed funding markets and sharply rising yields on domestic sovereign bonds in 2011 and 2012.
- Scope sees less positively BBVA's exposure to Turkey, due to the continued political and macro volatility in the country. According to Scope, impacts have been manageable so far, and BBVA's Turkish subsidiary Garanti seems able to withstand high level of loan provisions out of its pre-provision profit.
- With the domestic economic environment improving, the burden of Spanish legacy assets on the group's earnings capacity has eased. The Spanish economic rebound, if sustained, should also have a positive impact on the sustainability of public debt, which remains a concern to us. However, we do not automatically link BBVA's rating to the credit standing of the Spanish sovereign.

Rating drivers (summary)

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

- Globally diversified commercial banking group with strong market positions in Spain, Mexico, the US and Turkey
- Material exposure to Spanish sovereign risk
- Asset quality risks decreasing in Spain, but increasing in Turkey
- The European banking union provides strong regulatory and supervisory framework

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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Bloomberg: SCOP

Rating-change drivers

Evidence that BBVA's investments in digital innovation can lead to material market share gains, especially in the US market. We view BBVA's digital innovation efforts as positive, as they somewhat protect the bank's successful business model from technological disruption. Should they also lead to a further consolidation of BBVA's competitive position in its core markets, the group's credit profile would also benefit.

Significant worsening of Mexican earnings capacity and asset quality. The BBVA group's profitability currently relies on Mexico contributing approx. 40% of net profit in 2018. The capital generation of BBVA could be impacted if the earnings capacity of this business is dented.

Worsening asset quality in Turkey translating into larger than expected losses. Turkey's macro and banking outlook substantially deteriorated in 2018, with GDP growth plummeting from 7.4% in 2017 to 3.5%, inflation rising to 20.30% and the unemployment rate increasing to 12%. Despite the difficult environment and the greater need for credit impairments, BBVA's Turkish subsidiary Garanti remained profitable in 2018. However, should the situation deteriorate further, it could threaten Garanti's credit fundamentals and detract from BBVA group's credit strength.

Rating drivers (details)

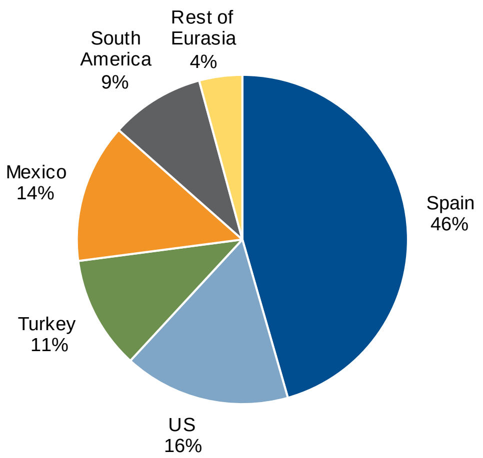
Globally diversified commercial banking group with strong market positions in Spain, Mexico, the US and Turkey

Headquartered in Spain, the BBVA group predominantly offers retail and commercial banking services to customers in selected countries in Europe, Asia and the Americas.

Banking activity in Spain is carried out directly by parent company BBVA SA, while foreign operations are carried out by the group's banking subsidiaries.

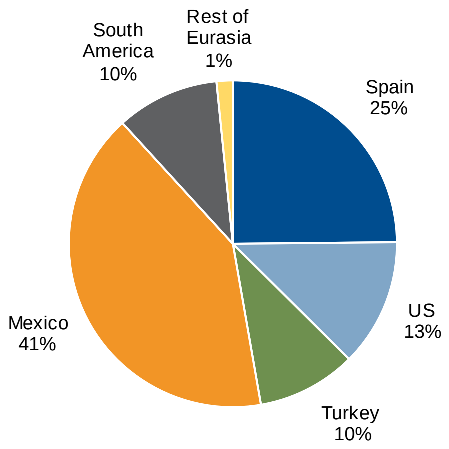
While Spain still accounts for 46% of the loan book (Figure 1), BBVA's foreign operations have gained prominence over the years. Foreign operations delivered a vital flow of dividends which helped absorb losses in domestic operations during the real estate crisis that engulfed Spain in the past decade. Today, Spain has recovered from the crisis but foreign operations continue to provide a good degree of business and revenue diversification. Indeed, more than half of BBVA's group profits is derived from emerging markets, particularly Mexico (Figure 2).

Figure 1: BBVA's loan book, divisional split (2018)



Source: Company data, Scope Ratings
Note: excludes corporate centre

Figure 2: BBVA's net attributable profit, divisional split (2018)



Source: Company data, Scope Ratings
Note: excludes corporate centre

With over 2,800 branches and over EUR 330bn 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. These acquisitions have provided BBVA with a strong footing in the economically attractive Spanish region of Catalonia.

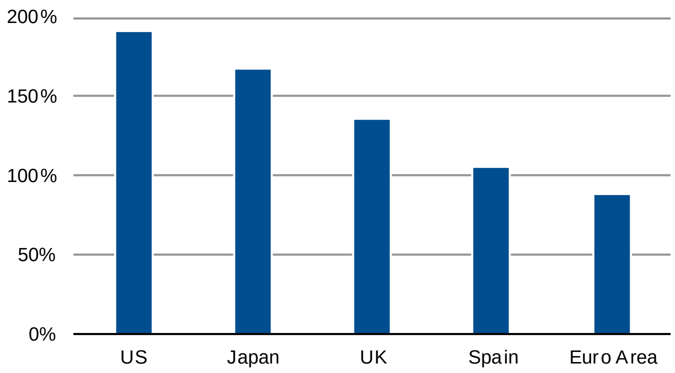
BBVA's subsidiary Bancomer is the largest bank in Mexico, where it holds a loans market share of over 20%. Acquired in 2000, it has been a key engine for the group's revenue and profit growth over the past decade. Despite signs of a possible slowdown in growth, the medium-term outlook for the country remains positive. Private sector credit stood at 35.5% of GDP in 2017, which is low not only by European standards but even by Latin American ones. A further 10% of 2018 profit was generated by the group's South America operations, including Colombia Peru, Chile, Argentina, Uruguay, Paraguay, Venezuela and Bolivia

BBVA also operates a significant network in the US Sunbelt region (13% of 2018 profit), the result of several acquisitions in 2005-2010 (Laredo National Bank, Texas State Bank, State National Bank, Compass, and Guaranty).

Turkey contributed approx. 10% of profit in 2018. BBVA has expanded its presence in the country by gradually building up a 49.85% stake in Garanti, the third-largest bank in Turkey.

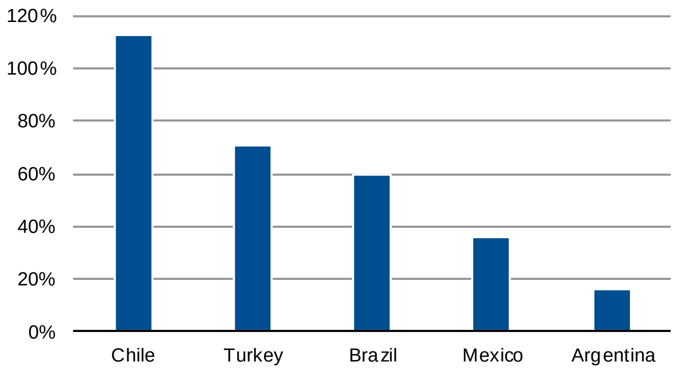
Relatively low banking penetration and positive demographic trends (a double-digit growth rate) underpin the case for long-term growth in bank revenues and profits in Turkey. However, the recent macro instability clouds the short-term outlook and represents a material headline risk for the group.

Figure 3: Private credit/GDP, selected developed markets



Source: World Bank, Scope Ratings

Figure 4: Private credit/GDP, selected developing markets



Source: World Bank, Scope Ratings

Over recent years, BBVA has increasingly invested in an ambitious transformation plan to strengthen its competitiveness in the digital-banking arms race. During 2018, digital sales increased from 27.5% to 40.7% of group sales and were the main driver for volume growth across the group's geographies. BBVA reported that at the end of 2018 27.2m clients were digital, exceeding the 50% goal the group had set for itself.

Mobile banking adoption is a key driver of the fast growth in digital customers. BBVA's mobile customers stood at 23m at the end of 2018 and the group aims for 50% of its customer base to be made up by mobile customers in 2019.

Material exposure to Spanish sovereign risk

Due to its high degree of diversification, we do not automatically link BBVA's rating with the rating of the Kingdom of Spain (A-, stable). However, we deem BBVA's exposure as material and a key credit concentration. As of June 2018[1], BBVA's Spanish sovereign gross exposure of EUR 47.2bn (including bonds and loans) was material in our view. This figure includes EUR 6.9bn of trading assets, EUR 12.7bn in FVOCI assets and EUR 26.3bn in assets held at amortised cost.

Scope rates the Kingdom of Spain at A-, Stable Outlook, highlighting the sovereign's high public debt (97.1% of GDP in 2018) and still-large deficit (2.5% of GDP) as key weaknesses. Fast-growing GDP will, however, support a drop in the gross public debt/GDP ratio in the coming years.

The risk of a tail event for the Spanish sovereign has receded since the ECB started engaging in increasingly dovish policies in 2012. Key among them was the launch of quantitative easing, which supported the demand for Spanish sovereign bonds and depressed yields.

[1] EBA transparency exercise 2018

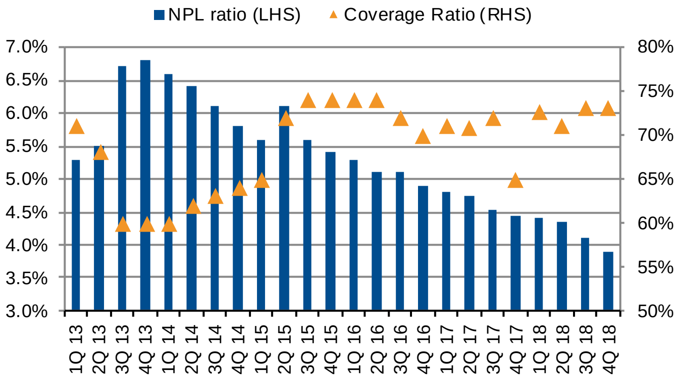
Asset quality risks decreasing in Spain, but increasing in Turkey

In October 2018, BBVA closed a landmark transaction with Cerberus (announced in November 2017) to create a joint venture for its Spanish real estate business, reducing most of its exposure to non-core real estate assets. 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, valued at approximately EUR 5bn. BBVA will retain a 20% stake in the joint venture.

As of December 2018, BBVA's non-core real estate gross exposure was EUR 5.3bn (EUR 2.5bn on a net basis), a decline of approx. two thirds (three fourths on a net basis) compared to the previous year and predominantly composed of foreclosed real estate assets. The non-core division has been dragging on BBVA's profitability since the real estate bust in Spain but its impact has been declined and is currently not material. Since 2019, BBVA has stopped reporting the non-core real estate division separately.

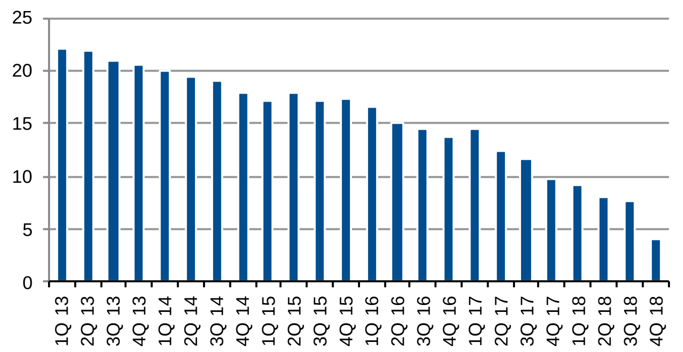
The group's non-performing loan ratio, which has been improving since the end of 2013, stood at 3.9% at the end of December 2018 with a coverage ratio of 73%. We see these levels as conservative.

Figure 5: BBVA's asset quality metrics are improving



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

Figure 6: Spanish real estate division, total assets (EUR bn)



Source: Company data, Scope Ratings

Parts of the Turkish loan book are denominated in foreign currency. We therefore expect to see a further deterioration in asset quality metrics in Turkey as a result of the depreciation of the Turkish lira. However, we believe that under most scenarios such a deterioration should be manageable because Turkey only accounts for about one tenth of the group's loan book.

The European banking union provides strong regulatory and supervisory framework

Despite its fundamental strength, the perception of BBVA's credit risk has suffered from developments in Spain, including the country's significant macro challenges and concerns over its regulatory and supervisory framework. Going forward, we believe the existence of the European banking union will help address doubts around regulation and supervision in any country, and allow investors – as well as euro area supervisors – to compare banks based on intrinsic credit strength.

The Single Supervisory Mechanism (SSM) – which transfers the supervisory role to a single, supranational and independent actor, the ECB – ensures all large European banks are subject to the same strict standards of supervision. Not only does this help to limit concerns over possible regulatory forbearance or political interference in the supervisory process, but it also materially reduces the risk of inconsistent or incoherent application of rules across the euro area.

As BBVA operates in several non-EU jurisdictions, it is also subject to several host country supervisors, increasing the cost (and complexity) of complying with several sets of rules.

The global financial crisis has shown that the mobility of intragroup capital and liquidity across geographies can be significantly constrained during periods of stress, limiting a cross-border banking group's financial flexibility when most needed. Faced with such restrictions, steps ranging from the listing of a minority stake to the disposal of the entire business may be used by some banking groups as an alternative to unlock capital from a subsidiary. The extent to which cross-border banking groups have such options at their disposal mitigates this risk. Against this background, we look favourably upon cross-border banking organisations that display reassuring capital and liquidity metrics, not only at group level but also at subsidiary level. In the case of BBVA, subsidiaries don't benefit from any parent funding support and manage their capital and liquidity independently. There are also no liquidity transfers among subsidiaries.

BBVA's additional Tier 1 instruments: key features and risks

We rate the AT1 securities issued by BBVA at BB+/Stable.

In accordance with our rating methodology for capital instruments, the starting point for notching down when rating capital instruments is provided by the senior non preferred rating of A. The minimum four notches reflect the deeply subordinated status of AT1 capital instruments in the priority of claims, their going-concern loss-absorbing features and investors' exposure to coupon-cancellation risks.

In addition, we add an extra notch for BBVA's AT1s due to the double-trigger structure of the notes, which limits the benefits of earnings diversification in our view.

Figure 7: CRD4 compliant AT1 instruments of BBVA rated by Scope

ISIN	Currency	Issue amount	Coupon (%)	Issue date	Next call date	Conversion type	Trigger (%)	Scope ratings
XS1190663952	EUR	1,500,000,000	6.750	18/02/2015	18/02/2020	Equity conversion	5.125	BB+
XS1394911496	EUR	1,000,000,000	8.875	14/04/2016	14/04/2021	Equity conversion	5.125	BB+
XS1619422865	EUR	500,000,000	5.875	24/05/2017	24/05/2022	Equity conversion	5.125	BB+
US05946KAF84	USD	1,000,000,000	6.125	16/11/2017	16/11/2027	Equity conversion	5.125	BB+
ES0813211002	EUR	1,000,000,000	5.875	24/09/2018	24/09/2023	Equity conversion	5.125	BB+
ES0813211010	EUR	1,000,000,000	6.000	29/03/2019	29/03/2024	Equity conversion	5.125	BB+

Source: BBVA, Scope Ratings

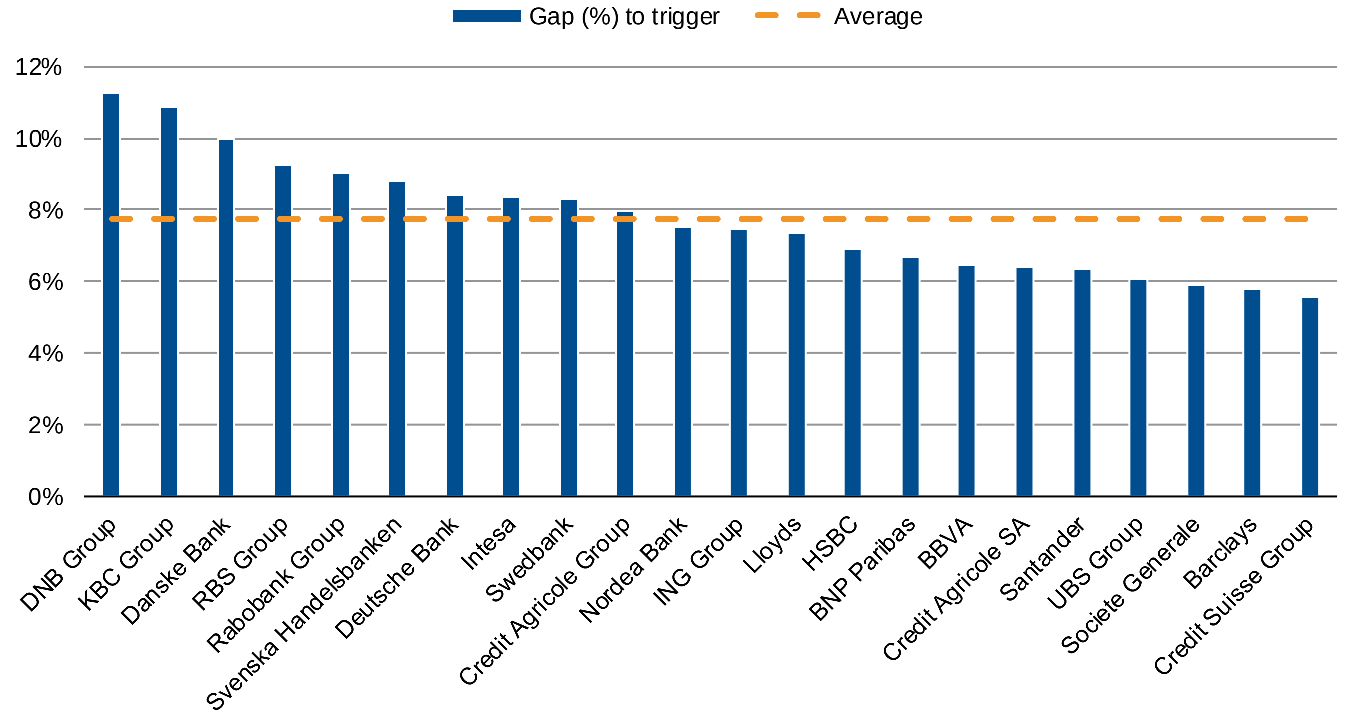
As of Q4 2018, BBVA's gap to the equity conversion trigger was c. 6.5%, lower than the average of large European banks (7.7%).

The distance to the MDA trigger (CET1 ratio requirement including CBR) stood at 2.3%, versus an average of 3.3% for the group of large European banks. This is based on the 2019 SREP requirement.

BBVA has a group target for its CET1 ratio of 11.5% to 12%, implying a management buffer of 224-274 bps to the CET1 SREP requirement for 2019 (9.26%). At the end of 2018, this buffer stood at 208 bps.

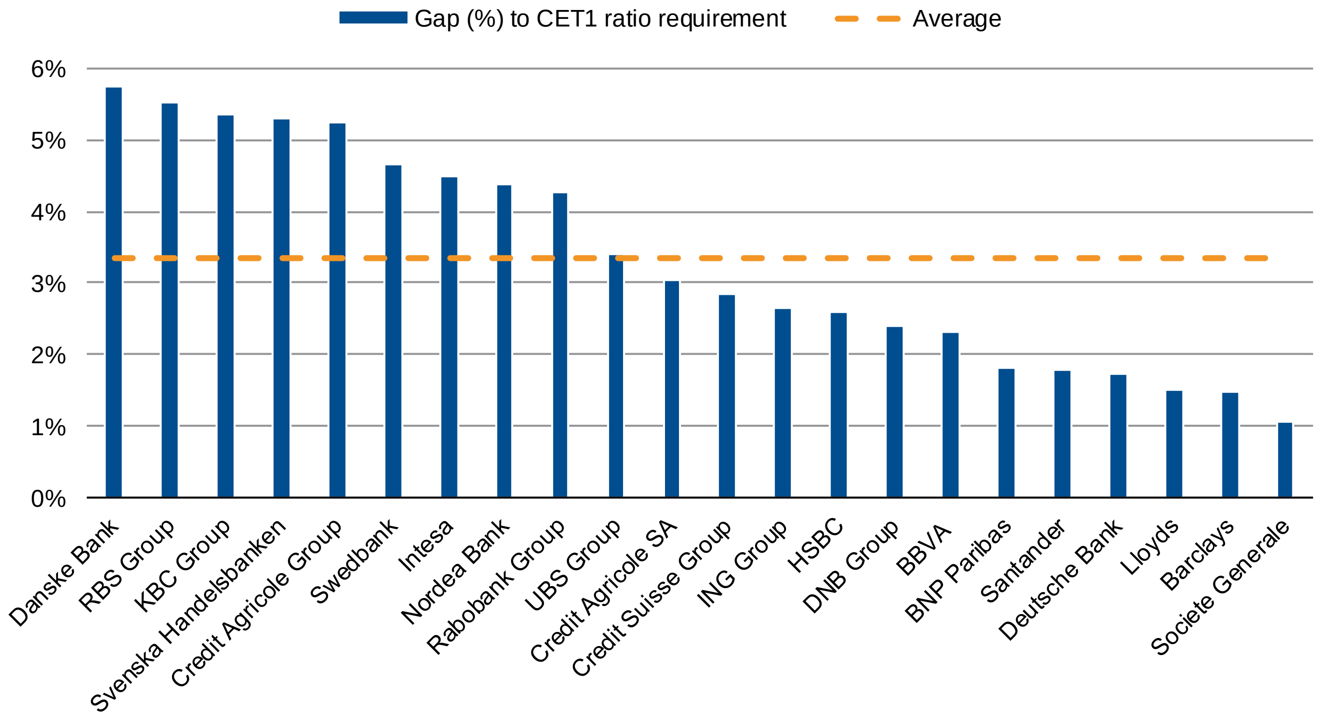
AT1 instruments are perpetual, although they can be called at the discretion of the issuer. So far, most issuers have exercised this option on the first call date.

Figure 8: Gap to trigger, selected European banks



Source: Banks, Scope Ratings

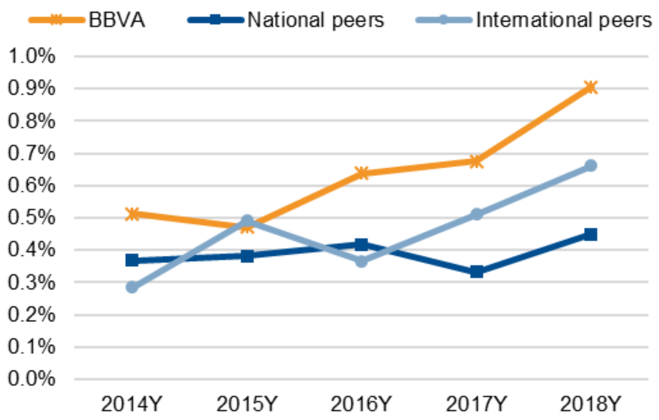
Figure 9: Distance to CBR, selected European banks



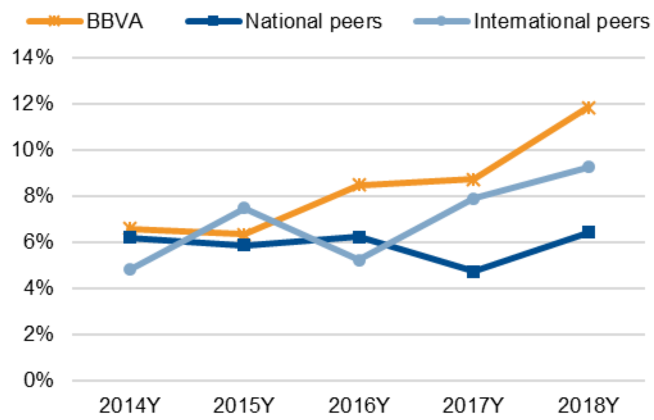
Source: Banks, Scope Ratings

I. Appendix: Peer comparison

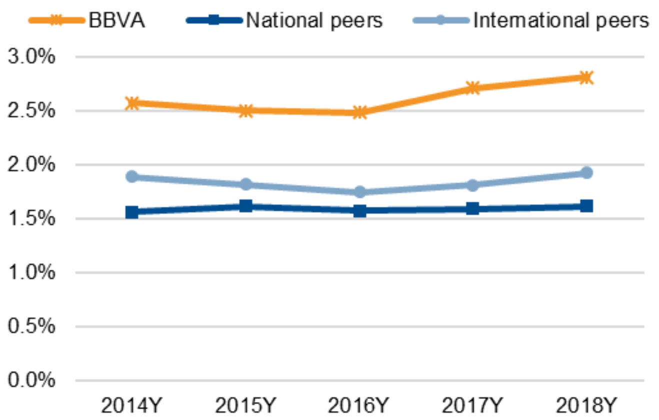
Return on average assets (%)



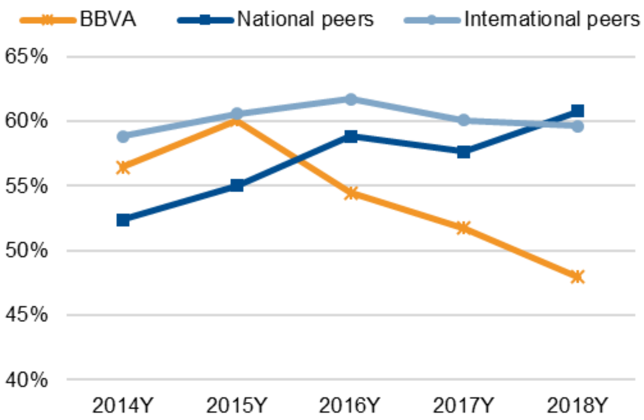
Return on average equity (%)



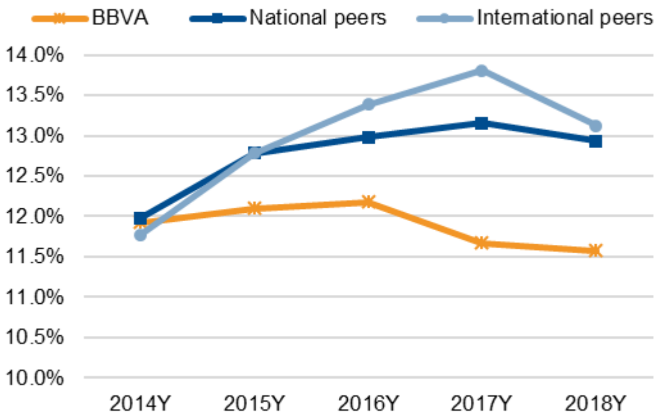
Net interest margin (%)



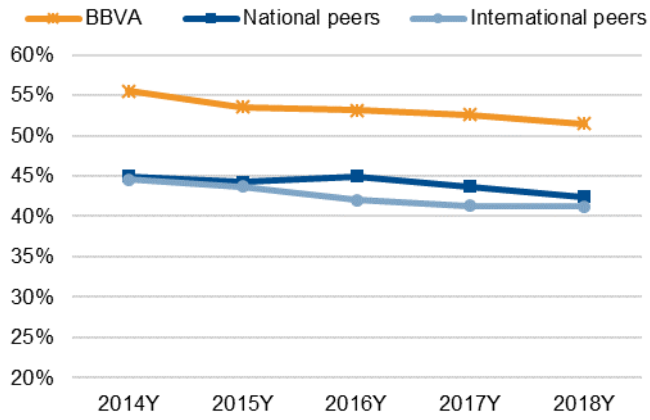
Cost-income ratio (%)



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

	2014Y	2015Y	2016Y	2017Y	2018Y
Balance sheet summary (EUR m)					
Assets					
Cash and interbank assets	58,489	76,491	80,307	76,241	88,062
Total securities	190,097	208,034	187,834	162,729	157,718
of which, derivatives	46,901	44,484	45,805	37,724	33,407
Net loans to customers	338,784	414,230	414,654	388,325	387,850
Other assets	44,572	51,100	49,060	62,764	43,059
Total assets	**631,942**	**749,855**	**731,856**	**690,059**	**676,689**
Liabilities					
Interbank liabilities	93,361	108,630	98,241	91,570	85,457
Senior debt	58,096	66,165	59,387	47,027	46,335
Derivatives	47,383	45,234	45,465	39,042	34,494
Deposits from customers	319,060	403,362	401,465	376,379	388,682
Subordinated debt	14,095	15,815	16,988	16,888	17,635
Other liabilities	NA	NA	NA	NA	NA
Total liabilities	**580,333**	**694,573**	**676,428**	**636,736**	**623,814**
Ordinary equity	49,031	47,256	47,309	46,290	47,060
Equity hybrids	67	35	54	54	50
Minority interests	2,511	7,992	8,064	6,979	5,764
Total liabilities and equity	**631,942**	**749,855**	**731,856**	**690,059**	**676,689**
Core tier 1/Common equity tier 1 capital	41,832	48,554	47,370	42,341	40,311
Income statement summary (EUR m)					
Net interest income	14,382	16,022	17,059	17,758	17,591
Net fee & commission income	4,174	4,612	4,718	4,921	4,879
Net trading income	2,134	2,030	1,907	1,740	1,223
Other income	34	-1,294	918	853	1,478
Operating income	**20,724**	**21,369**	**24,603**	**25,272**	**25,172**
Operating expense	11,701	12,839	13,401	13,067	12,075
Pre-provision income	**9,023**	**8,530**	**11,202**	**12,205**	**13,096**
Credit and other financial impairments	4,340	4,272	3,801	3,680	3,981
Other impairments	703	558	657	522	346
Non-recurring items	0	0	577	1,300	323
Pre-tax profit	**3,980**	**4,603**	**6,392**	**6,931**	**8,446**
Discontinued operations	0	0	0	0	0
Other after-tax Items	0	0	0	0	0
Income tax expense	898	1,274	1,699	2,169	2,295
Net profit attributable to minority interests	464	686	1,218	1,243	827
Net profit attributable to parent	**2,618**	**2,642**	**3,475**	**3,519**	**5,324**

Source: SNL

III. Appendix: Selected Financial Information – BBVA group

	2014Y	2015Y	2016Y	2017Y	2018Y
Funding and liquidity					
Net loans/deposits (%)	106.1%	102.7%	103.2%	103.0%	99.5%
Liquidity coverage ratio (%)	NA	NA	NA	124.0%	127.0%
Net stable funding ratio (%)	NA	NA	NA	NA	NA
Asset mix, quality and growth					
Net loans/assets (%)	53.6%	55.2%	56.7%	56.3%	57.3%
NPLs/net loans (%)	6.8%	6.1%	5.5%	5.0%	4.4%
Loan-loss reserves/NPLs (%)	61.5%	73.8%	69.7%	65.7%	74.6%
Net loan grow th (%)	4.7%	22.3%	0.1%	-6.3%	-0.1%
NPLs/tangible equity and reserves (%)	39.6%	39.6%	37.2%	33.7%	28.8%
Asset grow th (%)	8.5%	18.7%	-2.4%	-5.7%	-1.9%
Earnings and profitability					
Net interest margin (%)	2.6%	2.5%	2.5%	2.7%	2.8%
Net interest income/average RWAs (%)	4.2%	4.3%	4.3%	4.7%	5.0%
Net interest income/operating income (%)	69.4%	75.0%	69.3%	70.3%	69.9%
Net fees & commissions/operating income (%)	20.1%	21.6%	19.2%	19.5%	19.4%
Cost/income ratio (%)	56.5%	60.1%	54.5%	51.7%	48.0%
Operating expenses/average RWAs (%)	3.5%	3.5%	3.4%	3.5%	3.4%
Pre-impairment operating profit/average RWAs (%)	2.7%	2.3%	2.8%	3.2%	3.7%
Impairment on financial assets /pre-impairment income (%)	48.1%	50.1%	33.9%	30.1%	30.4%
Loan-loss provision charges/net loans (%)	1.3%	1.1%	0.9%	0.9%	1.1%
Pre-tax profit/average RWAs (%)	1.2%	1.2%	1.6%	1.8%	2.4%
Return on average assets (%)	0.5%	0.5%	0.6%	0.7%	0.9%
Return on average RWAs (%)	0.9%	0.9%	1.2%	1.3%	1.7%
Return on average equity (%)	6.6%	6.3%	8.5%	8.7%	11.8%
Capital and risk protection					
Common equity tier 1 ratio (%, fully loaded)	9.7%	10.3%	10.9%	11.1%	11.3%
Common equity tier 1 ratio (%, transitional)	11.9%	12.1%	12.2%	11.7%	11.6%
Tier 1 capital ratio (%, transitional)	11.9%	12.1%	12.9%	13.0%	13.2%
Total capital ratio (%, transitional)	15.1%	15.0%	15.1%	15.4%	15.7%
Leverage ratio (%)	5.8%	6.0%	6.5%	6.5%	6.4%
Asset risk intensity (RWAs/total assets, %)	55.5%	53.5%	53.1%	52.4%	51.5%
Market indicators					
Price/book (x)	1.2x	1.1x	1.1x	1.3x	0.8x
Price/tangible book (x)	0.9x	1.0x	0.8x	0.5x	0.3x
Dividend payout ratio (%)	90.2%	99.7%	75.5%	50.0%	34.2%

Source: SNL

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