MOODY'S
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Credit Opinion: Bank Zachodni WBK S.A.

Global Credit Research - 27 May 2011

Warsaw, Poland

Ratings

Category	**Moody's Rating**
Outlook	Stable
Bank Deposits	Baa1/P-2
Bank Financial Strength	D+

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Key Indicators

Bank Zachodni WBK S.A. (Consolidated Financials)[1]

	[2]**12-10**	[2]**12-09**	[2]**12-08**	[3]**12-07**	[3]**12-06**	**Avg.**
Total Assets (PLN billion)	**53.2**	**54.1**	**57.4**	**41.3**	**33.0**	[4]**12.7**
Total Assets (EUR million)	**13,410.8**	**13,168.0**	**13,944.4**	**11,491.2**	**8,615.7**	[4]**11.7**
Total Assets (USD million)	**17,991.1**	**18,892.6**	**19,383.4**	**16,800.7**	**11,361.1**	[4]**12.2**
Tangible Common Equity (PLN billion)	**6.0**	**5.3**	**4.5**	**3.9**	**3.3**	[4]**16.1**
Tangible Common Equity (EUR million)	**1,518.2**	**1,296.8**	**1,083.6**	**1,074.4**	**866.1**	[4]**15.1**
Tangible Common Equity (USD million)	**2,036.7**	**1,860.6**	**1,506.3**	**1,570.9**	**1,142.0**	[4]**15.6**
PPI / Avg RWA (%)	**4.3**	**3.8**	**3.6**	**--**	**5.0**	[5]**3.9**
Net Income / Avg RWA (%)	**2.5**	**2.2**	**2.2**	**--**	**3.9**	[5]**2.3**
(Market Funds - Liquid Assets) / Total Assets (%)	**-17.9**	**-9.6**	**-9.7**	**-24.1**	**-31.3**	[6]**-18.5**
Core Deposits / Average Gross Loans (%)	**119.9**	**113.8**	**140.2**	**139.1**	**132.6**	[6]**129.1**
Tier 1 Ratio (%)	**13.8**	**12.3**	**10.1**	**--**	**--**	[5]**12.1**
Tangible Common Equity / RWA (%)	**15.2**	**12.8**	**10.1**	**--**	**15.3**	[5]**12.7**
Cost / Income Ratio (%)	**49.9**	**50.0**	**51.6**	**53.4**	**55.3**	[6]**52.1**
Problem Loans / Gross Loans (%)	**6.8**	**5.5**	**2.9**	**2.8**	**4.5**	[6]**4.5**
Problem Loans / (Equity + Loan Loss Reserves) (%)	**29.2**	**27.7**	**17.7**	**14.0**	**17.9**	[6]**21.3**

Source: Moody's

[1] All ratios are adjusted using Moody's standard adjustments [2] Basel II; IFRS [3] Basel I; IFRS [4] Compound Annual Growth Rate based on IFRS reporting periods [5] Basel II & IFRS reporting periods have been used for average calculation [6] IFRS reporting periods have been used for average calculation

Opinion

SUMMARY RATING RATIONALE

The standalone bank financial strength rating (BFSR) of D+ assigned to Bank Zachodni WBK SA (BZ WBK), with a stable outlook, maps to Baa3 on the long-term scale. The rating reflects BZ WBK's established market position in the corporate segment, strong multi-channel distribution network, good track record in managing its cost base and historically above-average profitability. The rating is constrained by the bank's relatively high exposure to the risky real estate financing segment, high credit concentrations and its underdeveloped retail franchise.

BZ WBK's long-term global local currency (GLC) deposit rating of Baa1 is based on (i) the bank's stand-alone long-term scale rating of Baa3, (ii) our assessment of a high probability of systemic support for the bank in the event of need and (iii) after the completion of acquisition by the Banco Santander (rated Aa2/P-1/B-/negative) we also factor in a moderate probability of parental support .

These considerations result in a two notches of uplift derived both from parental and systemic support to long-term GLC deposit rating of Baa1 from BZ WBK's Baa3 on the stand-alone long-term scale.

BZ WBK's foreign currency deposit rating is Baa1 and is not constrained by the foreign currency bank deposit ceiling of A2.

Credit Strengths

- Stable customer base and diversified franchise that proved resilient in the current downturn

- The bank maintained good cost control and efficiency in the post-crisis period

- Above average profitability and high interest margins compared with the peer group

- Leading market share in the fee-generating mutual funds segment

Credit Challenges

- Sizeable albeit decreasing exposures to real estate development and land financing with very high non - performing assets

- High, although stabilising NPLs in the corporate segment

- The market for corporate customer deposits remains very price sensitive, although prices have stabilized in the recent past

- The bank's retail mortgage portfolio is exposed to FX devaluation risk, with the majority of FX mortgages are denominated in Swiss franc.

Rating Outlook

The outlook on all ratings has been changed to stable and is based on our opinion that the bank's performance is expected to stabilise with positive growth momentum in the medium-term, supported by its good efficiency and above-average profitability.

What Could Change the Rating - Up

A positive development of BFSR, in the medium-term, could be triggered by a successful integration of BZ WBK into Santander and furthermore by decrease in industry and single-name concentration risks, significant improvement in asset quality (particularly in real estate segment) and internal capital generation. We however note that the bank's BFSR is well positioned compared with its immediate rated peer group and the largest players in the Polish market.

What Could Change the Rating - Down

A downgrade of BZ WBK's BFSR could be triggered by significant loan loss charges and pressure on capital. A relatively large, albeit decreasing, exposure to commercial real estate has some potential of undermining so far good performance of the bank. Inability to maintain its currently favourable loan-to-deposit ratio would also be an important rating driver.

Recent Results and Developments

In April 2011 the long-term bank-deposit ratings of BZ WBK were upgraded to Baa1 from Baa2 concluding the review for possible upgrade initiated in Q4 2010. The rating action followed the completion of the acquisition by Banco Santander, which on 1st of April 2011. Currently the Spanish parent holds 95.86% of the bank's share capital with the same percentage of votes.

BZ WBK recorded net profit of PLN270 million (EUR67.5 million) in Q1 2011 up by 15% year-on-year. The trend was driven mainly by net interest income which increased by 17%. Total assets were at PLN65.5 billion (EUR16.4 billion) for the same period up by 23% from end-2010 mainly due to the settlement overnight of BZWBK sale proceeds.

The bank's performance for the full year 2010 also improved, with net profit at PLN974 million (EUR245 million) compared to PLN885 million in 2009. The trend was largely driven by higher net interest income and lower provisioning. The bank's total assets decreased by 1.7% to PLN53.2 billion (EUR13.4 billion) over the same period, mainly due to the reduction in the real estate loan portfolio. The bank's Tier 1 was at 13.8% which was up from 12.3% at end-2009.

DETAILED RATING CONSIDERATIONS

Detailed rating considerations for BZ WBK are as follows:

Bank Financial Strength Rating

The Bank financial strength rating (BFSR) of D+ assigned to Bank Zachodni WBK SA (BZ WBK), with a stable outlook which maps to Baa3 on the long-term scale. The rating reflects BZ WBK's established market position, strong multi-channel distribution network, good track record in managing its cost base and historically above-average profitability. The rating is constrained by the bank's relatively high exposure to the risky real estate financing segment, high credit concentrations and its underdeveloped retail franchise.

As a point of reference, the assigned rating is two notches lower than the outcome of the Bank financial strength scorecard, which generates a C score. We view the D+ BFSR as an appropriate measure of the bank's financial strength given the risks associated with the bank's land financing portfolio and price-sensitivity of some of its corporate depositors.

Qualitative Rating Factors (70%)

Factor : Franchise Value

Trend: Neutral

BZ WBK is the fifth-largest bank in Poland by assets with market shares of customer deposits and loans of 5.4 and 4.2%, respectively, at end-2010). The bank has a well-established franchise in corporates, focusing on large and medium-sized clients, where competition is strongest. However, in recent years, the bank has also been actively focusing on SMEs. Corporate activities represented 34% of BZ WBK's pre-tax income in 2010.

The bank has tried to expand its relatively underdeveloped retail segment by growing its mortgage lending operations. As at end-2010, mortgages represented over 20% of the total loan portfolio and grew by 14% year-on-year basis. Around 36% of its mortgages are denominated in FX (mostly in Euros), which increases the bank's risk profile, due to the potential impact of heightened exchange rate volatility. Retail activities represented almost 29% of BZ WBK's pre-tax income in 2010. Although we note that current market conditions are relatively benign for such expansion, we also note that some retail segments remain relatively overheated with higher risk profile (e.g. consumer lending).

The bank's retail franchise is supported by the fact that it has the third-largest branch network in Poland, which comprised 527 branches at end-2010. However, it faces stiff competition in the retail segment and still lags behind its immediate peers in terms of retail customer penetration.

The bank's other important business lines include leasing and factoring, which amounted to 9% of the total loan portfolio at end-2010; it is increasingly focusing on the leasing of machinery and equipment, alongside the leasing of new vehicles.

BZ WBK remains very active in asset management and mutual funds, where it has a third largest market share, which stood at 9.1% at end-2010. The bank lost some of its market share as the volume of mutual funds and assets under management decreased by 2% in 2010 . BZ WBK has also a significant market share in brokerage, where it ranks third in the equity futures and options markets.

We consider that the acquisition by Banco Santander should have a positive medium-term effect on bank's franchise value given the group's experience in retail banking and in integrating and managing international subsidiaries. The fact that the Santander group has been historically present in the Polish market since 2003 mainly as a leading consumer lender is also an advantage.

BZ WBK scores C+ for franchise value; given its relatively established position in the market, we regard this score adequate at this stage.

Factor: Risk Positioning

Trend: Neutral

Like its peers in the region, BZ WBK's risk profile has been adversely affected by the ongoing downturn influenced by a high level of exposure to the commercial real estate segment. Asset quality deterioration was most visible in commercial property loans, of which 10.4% were non-performing at end-2010 compared with 6.82% for the total loan portfolio, however the trend was partly driven by a decreasing denominator. Provisions for commercial real-estate was PLN237 million out of total PLN1.36 billion at end-2010.

However, borrower concentration remains very high and scores E. This is common for the majority of those Polish banks whose corporate portfolios represent a large share of their loans.

BZ WBK maintains sufficient liquidity, and its liquidity management practices remain good, which underpins the bank's liquidity management score of B. We also note that 60% of customer deposits is retail with remainder in SMEs and corporate.

The bank's market risk appetite, as measured by its VaR numbers and stress test results, is modest, since it does not have any significant proprietary trading positions. However, we note that there was a notable adverse effect on the bank's provisioning needs due to the write-down of customer FX option derivatives in 2009, indicating a higher risk-taking appetite by the bank than it is suggested by VaR measures. We note that bulk of the FX related provisioning was in Q1 2009 (PLN24 million) and another PLN5 million in Q2 2009. We note that there have been no FX option related losses reported since then.

The bank's risk positioning scores C- and is weighed down by borrower and industry concentrations.

Factor: Regulatory Environment

Refer to Moody's latest Banking System Outlook on Poland, published in November 2010, to obtain a detailed discussion of the regulatory environment.

Factor: Operating Environment

Trend: Neutral

This factor is common to all Polish banks. Refer to the Moody's latest Banking System Outlook on Poland, published in November 2010, to obtain a detailed discussion of the operating environment.

Quantitative Rating Factors (30%)

Factor: Profitability

Trend: Neutral

BZ WBK's profitability improved in 2010 due to lower provisioning and higher net interest income and compares favourably to its Polish peer average. Risk weighted pre-provision income increased to 4.34% in 2010 from 3.83% in 2009 and net income to 2.55% from 2.19% in the same period. Net interest margin was 3.36% in 2010 after up from2.8% in 2009. The margins were supported by lower pressure on deposit prices and cheaper FX funding.

Net interest and fee and commissions income were the dominant sources of revenue. The main share from fee and commission income were fees from loans followed by current accounts and money transfers. The reliance on trading income is relatively low and is approximately 15% of operating income at end-2010.

Currently the bank scores A which is based on historical averages and one of the highest scores compared to its peer group.

Factor: Liquidity

Trend: Neutral

BZ WBK's liquidity score is underpinned by the bank's strong customer funding and its limited reliance on the wholesale market (12.2% of total funding in YE2010). The bank's deposit base improved by 2% in 2010 due to higher inflow of corporate deposits. The average loan-to-deposit ratio remains strong, at around 85% at end-10 and is better than the average for its rated Polish peers at 113% for the same period.

The share of liquid assets in total assets remained comfortable at 26% at end-2010 (27.5% at end-2009) and compares favourably to its Polish peers.

BZ WBK scores B+ for liquidity with a neutral outlook.

Factor: Capital Adequacy

Trend: Neutral

BZ WBK has strong capital adequacy, as measured by its total capital ratio of 15.7% at end-2010, up from 12.97% at end-2009. The Tier 1 ratio stood at 13.8% for the same period compared with 12.3% at end-2009. The trend was underpinned by reduction in risk-weighted assets. The bank is expected to pay out PLN584.6 million in dividends in 2011 which represent 60% of last year's profit. The bank also paid out dividend from 2009 profit at 33% payout ratio.

BZ WBK scores high at A for this factor, which compares favourably with its peer group.

Factor: Efficiency

Trend: Neutral

BZ WBK's efficiency has been stable in at 50% in 2010. This compares favourably with the ratios of its regional peers. The bank has commenced a number of cost-cutting initiatives including reducing salaries and headcount. However, we do not see further scope for reducing expenses at this stage and any improvement will be likely driven by growth in revenues.

We expect the bank's efficiency, which scores B, to remain in the current range in the short-term.

Factor: Asset Quality

Trend: Weakening

In 2010, the loan portfolio contracted by 4% to PLN34.2 billion. BZ WBK's loan portfolio is dominated by corporate lending, with mortgages and other retail lending representing 33% of the total at end-2010. In addition, we note that there is a high concentration on commercial real estate with exposure of PLN9.9 billion which account for almost 27.9% of total loans. Commercial development and land acquisitions, which we consider to be high-risk segments, represented around 28% (or PLN2.8 billion) of the commercial real estate portfolio.

In retail mortgages, there is also a significant element of FX-denominated lending (36% of total mortgages). The bank resumed providing FX lending (mostly in Euros) in Q1 2010, after a temporary suspension in 2009. Although the asset quality of mortgages denominated in FX remains good we maintain that in the event of currency volatility customer affordability can be stretched and result in high delinquency rates with impaired collateral valuations.

Due to the fact that the bank's loan portfolio has a relatively high risk profile and there is likely to be an increase in the non-performing loans in its corporate portfolio, we assign a weakening trend to BZ WBK's asset quality score of D+.

Global Local Currency Deposit Rating (Joint Default Analysis)

We assign a long-term GLC deposit rating of Baa1 to BZ WBK. The rating reflects the bank's BCA of Baa3 and is supported by Poland's government bond rating of A2. In light of BZ WBK's good nationwide market share and importance to the Polish banking system, we assess the probability of systemic support for BZ WBK in the event of need as high. After the acquisition by the Banco Santander (rated Aa2/P-1/B-/negative) probability of parental support in case of need is considered as moderate. Under the Joint Default Analysis (JDA) methodology, these considerations result in two-notch uplift in the long-term GLC deposit rating to Baa2 from the Baa3 BCA.

Foreign Currency Deposit Rating

We assign a Baa1 long-term foreign currency deposit rating to BZ WBK.

ABOUT MOODY'S BANK RATINGS

Bank Financial Strength Rating

Moody's Bank Financial Strength Ratings (BFSRs) represent Moody's opinion of a bank's intrinsic safety and soundness and, as such, exclude certain external credit risks and credit support elements that are addressed by Moody's Bank Deposit Ratings. BFSRs do not take into account the probability that the bank will receive such external support, nor do they address risks arising from sovereign actions that may interfere with a bank's ability to honor its domestic or foreign currency obligations. Factors considered in the assignment of BFSRs include bank-specific elements such as financial fundamentals, franchise value, and business and asset diversification. Although BFSRs exclude the external factors specified above, they do take into account other risk factors in the bank's operating environment, including the strength and prospective performance of the economy, as well as the structure and relative fragility of the financial system, and the quality of banking regulation and supervision.

Global Local Currency Deposit Rating

A deposit rating, as an opinion of relative credit risk, incorporates the BFSR as well as Moody's opinion of any external support. Specifically, Moody's Bank Deposit Ratings are opinions of a bank's ability to repay punctually its deposit obligations. As such, they are intended to incorporate those aspects of credit risk relevant to the prospective payment performance of rated banks with respect to deposit obligations, which includes: intrinsic financial strength, sovereign transfer risk (in the case of foreign currency deposit ratings), and both implicit and explicit external support elements. Moody's Bank Deposit Ratings do not take into account the benefit of deposit insurance schemes which make payments to depositors, but they do recognize the potential support from schemes that may provide assistance to banks directly.

According to Moody's joint default analysis (JDA) methodology, the global local currency deposit rating of a bank is determined by the incorporation of external elements of support into the bank's Baseline Credit Assessment. In calculating the Global Local Currency Deposit rating for a bank, the JDA methodology also factors in the rating of the support provider, in the form of the local currency deposit ceiling for a country, Moody's assessment of the probability of systemic support for the bank in the event of a stress situation and the degree of dependence between the issuer rating and the Local Currency Deposit Ceiling.

National Scale Rating

National scale ratings are intended primarily for use by domestic investors and are not comparable to Moody's globally applicable ratings; rather they address relative credit risk within a given country. A Aaa rating on Moody's National Scale indicates an issuer or issue with the strongest creditworthiness and the lowest likelihood of credit loss relative to other domestic issuers. National Scale Ratings, therefore, rank domestic issuers relative to each other and not relative to absolute default risks. National ratings isolate systemic risks; they do not address loss expectation associated with systemic events that could affect all issuers, even those that receive the highest ratings on the National Scale.

Foreign Currency Deposit Rating

Moody's ratings on foreign currency bank obligations derive from the bank's local currency rating for the same class of obligation. The implementation of JDA for banks can lead to high local currency ratings for certain banks, which could also produce high foreign currency ratings. Nevertheless, it should be noted that foreign currency deposit ratings are in all cases constrained by the country ceiling for foreign currency bank deposits. This may result in the assignment of a different, and typically lower, rating for the foreign currency deposits relative to the bank's rating for local currency obligations.

Foreign Currency Debt Rating

Foreign currency debt ratings are derived from the bank's local currency debt rating. In a similar way to foreign currency deposit ratings, foreign currency debt ratings may also be constrained by the country ceiling for foreign currency bonds and notes; however, in some cases the ratings on foreign currency debt obligations may be allowed to pierce the foreign currency ceiling. A particular mix of rating factors are taken into consideration in order to assess whether a foreign currency bond rating pierces the country ceiling. They include the issuer's global local currency rating, the foreign currency government bond rating, the country ceiling for bonds and the debt's eligibility to pierce that ceiling.

About Moody's Bank Financial Strength Scorecard

Moody's bank financial strength model (see scorecard below) is a strategic input in the assessment of the financial strength of a bank, used as a key tool by Moody's analysts to ensure consistency of approach across banks and regions. The model output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

Rating Factors

Bank Zachodni WBK S.A.

Rating Factors [1]	**A**	**B**	**C**	**D**	**E**	**Total Score**	**Trend**
Qualitative Factors (70%)						**C-**	
Factor: Franchise Value						**C+**	**Neutral**
Market Share and Sustainability		**x**					
Geographical Diversification			**x**				
Earnings Stability			**x**				
Earnings Diversification [2]							
Factor: Risk Positioning						**C-**	**Neutral**
Corporate Governance [2]							
- Ownership and Organizational Complexity							
- Key Man Risk							
- Insider and Related-Party Risks							
Controls and Risk Management		**x**					
- Risk Management			x				
- Controls	x						
Financial Reporting Transparency		**x**					
- Global Comparability	x						
- Frequency and Timeliness	x						
- Quality of Financial Information			x				
Credit Risk Concentration					**x**		
- Borrower Concentration					x		
- Industry Concentration		x					
Liquidity Management		**x**					
Market Risk Appetite			**x**				
Factor: Operating Environment						**D**	**Neutral**
Economic Stability					**x**		
Integrity and Corruption				**x**			

Legal System			**x**				
Financial Factors (30%)						**B-**	
Factor: Profitability						**A**	**Neutral**
PPI / Average RWA - Basel II	3.91%						
Net Income / Average RWA - Basel II	2.30%						
Factor: Liquidity						**B+**	**Neutral**
(Mkt funds-Liquid Assets) / Total Assets	-12.40%						
Liquidity Management		x					
Factor: Capital Adequacy						**A**	**Neutral**
Tier 1 Ratio - Basel II	12.07%						
Tangible Common Equity / RWA - Basel II	12.69%						
Factor: Efficiency						**B**	**Neutral**
Cost / Income Ratio		50.52%					
Factor: Asset Quality						**D+**	**Weakening**
Problem Loans / Gross Loans				5.06%			
Problem Loans / (Equity + LLR)			24.86%				
Lowest Combined Score (9%)						**D+**	
Economic Insolvency Override						**Neutral**	
Aggregate Score						**C**	
Assigned BFSR						**D+**	

[1] - Where dashes are shown for a particular factor (or sub-factor), the score is based on non public information [2] - A blank score under Earnings diversification or Corporate Governance indicates the risk is neutral