

Mexico
Credit Update

Banco Santander

Ratings

Banco Santander, S.A.

Foreign Currency

Long-Term IDR	A-
Short-Term	F2
Outlook	Positive

Local Currency

Long-Term IDR	A-
Short-Term	F2
Outlook	Positive

Individual Support

Individual Support	C 1
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National

Long-Term	AAA(mex)
Short-Term	F1+(mex)
Outlook	Stable

Sovereign Risk

Foreign Long-Term IDR	BBB
Local Long-Term IDR	BBB+
Outlook	Positive

Country Ceiling

Foreign Long-Term	A-
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Financial Data

Banco Santander, S.A. (C.)

	31 Mar 07	31 Dec 06
Total Assets [USDm]	34,851.0	36,940.4
Total Assets [MXPm]	386,194.0	401,949.0
Equity [MXPm]	52,981.0	50,454.0
Net Income [MXPm]	1,363.0	9,235.0
ROA (%)	1.38	2.39
ROE (%)	10.54	20.29
Capital Adequacy (%)	12.99	13.70

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Rating Rationale

- Banco Santander (Santander)'s issuer default ratings (IDRs) reflect the potential support it would receive from its parent, Spain's Banco Santander Central Hispano (SAN), should it be required. The bank's individual rating reflects its overall sound and improving financial condition.
- Profitability has been adequate, previously underpinned by low provisions, well-contained costs and comfortable fee revenue, while constrained by limited margins. However, the quality and composition of earnings is gradually improving, as the balance sheet is shifting towards higher-yielding retail loans from lower yielding IPAB notes and government loans. Coupled with declining funding costs, higher margins are driving stronger profitability, while offsetting the impact of increasing provisions and charge-offs. Santander is challenged to sustain this trend within an increasingly competitive operating environment.
- Despite a rapidly shifting loan mix (consumer and mortgage lending accounted for 29% and 8% of total, respectively, as of March 2007), asset quality remains sound and stronger than its main peers. Past due loans were 1.3% of total, with reserve coverage at 188%. Net charge-offs have grown rapidly to 1% of average loans in 2006 and 2% in 1Q07. Fitch considers this trend is inherent to the changing asset structure. Borrower concentrations are lower than most peers, while related-party exposure is modest. The bank's exposure to sovereign risk declined markedly in March 2007 after a sizeable amortization of IPAB notes, bringing total public sector exposure to 113% of equity (end-2005: 381%).
- Market risks are reasonable and closely monitored, although the bank is very active in trading activities, prominently for hedging purposes. Santander has continued improving its funding structure, while liquidity remains ample.
- Stronger earnings have fueled higher capital ratios. Equity was 13.7% of asset at 1Q07 and non-earning assets were a low 15% of equity. We expect Santander will comfortably absorb the charge for operational risk and higher dividends.

Support

- If Santander ran into difficulties, its primary source of support would be its majority shareholder, SAN (IDR at 'AA'). In Fitch's view, there is a high probability that support from SAN would be forthcoming, if required.

Rating Outlook and Key Rating Drivers

- The positive outlook on the long term IDRs reflects upside potential given the improved operating environment, declining sovereign exposure and the enhanced strategic value of Santander for SAN's operations in Latin America.
- Downside risk for the IDRs would stem from deterioration in the operating environment or the discontinuation of SAN's strong ability or willingness to support Santander, scenarios that Fitch considers highly unlikely at present.
- The bank's individual rating would be positively influenced by sustained improvements in recurring operating profitability, continued achievements in terms of expanding stable funding sources and further diversification in the bank's loan portfolio, business lines and revenue streams.

Profile

- Santander is the result of the merger in 2005 between Banco Santander Mexicano and Banca Serfin, both owned by SAN and operationally integrated for a number of years. Santander is Mexico's third largest bank at end-March 2007, with a market share by loans and deposits of 13.5% and 12.9%, respectively. It has 937 branches and 3,493 ATMs and is 100%-owned by Grupo Financiero Santander (GFS). In turn, GFS is 74.8% owned by SAN and 24.9% by Bank of America.

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