Hippocrates Provisional Valuation Report

[Sale of Business scenario]

DRAFT REPORT

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Single Resolution Board (SRB Procurement)
Treurenberg 22,
B-1049 Brussels,
Belgium

6 June 2017

Dear Board members,

We attach our provisional report (the ***Report***) to the Single Resolution Board (***SRB***), which has been prepared for the purpose of providing an independent valuation pursuant to article 36.4 (b), (f) and (g) of the Directive 2014/59/EU on recovery and resolution of credit institutions and investment firms (the ***BRRD***) and the applicable Spanish legislation, namely Law 11/2015, 18 June, on resolution of credit entities which incorporates the BRRD into the Spanish legal system (***Law 11/2015***) and Royal Decree 1012/2015, dated 6 November, which develops the aforementioned Law 11/2015 (***Royal Decree 1012/2015***).

The valuation is to inform the choice of resolution action to be adopted in respect of Hippocrates and other decisions on the implementation of resolution tools ("**Valuation 2**").

In considering the basis for our valuation work, we have had regard to the requirements of article 36 of the BRRD and Chapter III of the EBA Final Draft Technical Standards (2017/ 05) on valuation for the purposes of resolution (the ***EBA Regulatory Technical Standards***). As required by the BRRD, this Report seeks to provide a **fair, prudent, and realistic economic valuation** of the assets and liabilities of Hippocrates. The resulting valuation may depart from going concern and accounting valuations, including in cases where these have been correctly applied.

In light of the challenging liquidity position of Hippocrates, **we have been required to draft this Report in an extremely short period of time**. The principal work has been limited to twelve days since the date on which we had access to the relevant documentation, whereas we would normally expect a project of this nature to take at least six weeks (as initially agreed between the SRB and us on 23 May 2017).

We have therefore, as agreed with you during our call of 28 May 2017, had to strictly prioritise the review of the available information, focussing only on key assets and liabilities where there is considerable valuation uncertainty. It has been based on public information and information uploaded through the SRB sharepoint (the ***SRB Sharepoint***) and a virtual data room available through Intralinks (the ***Virtual Data Room***); we have not had access to certain critical information. We have also had limited opportunity to discuss our conclusions with management, auditors, supervisors, and others familiar with the institution. It would not in any case have been possible to carry out a full assessment of all information necessary for a complete due diligence exercise due to the time available. **This valuation should therefore be regarded as highly uncertain, and provisional for the purposes of article 36 BRRD. A buffer for additional losses which it has not been possible to precisely estimate has accordingly been included in the valuation as required by article 36(9). This buffer is an integral part of the valuation.** Further detail on the basis of our work and limitations is outlined throughout the Report and Appendices (in particular Appendix I), which form an integral part of the Report. The definitive valuation report shall follow as soon as practicable.

The SRB has consulted with us the resolution actions that is considering to adopt. Based on those consultations, this Report assumes as the resolution scenario to be considered **a sale of the whole bank through an open, fair and competitive sale process, using the sale of business tool under article 38 of the BRRD.** We have additionally provided an assessment of the value of the institution in liquidation and the recoveries expected by each class of creditors, as required by Article 36(8) of the BRRD. We note that there is an ongoing private sector sale process during which a range of potential purchasers have had access to a data room. **The best offer received following such a sale process is likely to be the best and most reliable indication of the value of the bank.**

This Report is confidential, has been prepared for, and on the instructions of the SRB and is addressed to the SRB only and solely for the purposes set out here. Once adopted by the SRB, the valuation forms an integral part of the resolution decision and is not subject to a separate right of appeal. You should only be authorized to use it for the purposes of a potential resolution of Hippocrates in accordance with the BRRD and the applicable Spanish legislation, namely Law 11/2015. No other party is entitled to rely on our Report for any purpose and we accept no duty of care or liability to any party who is shown or gains access to this Report.

Yours faithfully,

[redacted]

Deloitte.

Single Resolution Board

1. Executive Summary

1.1. Methodological approach taken

The scenario we have used for determining the economic value is a sale of Hippocrates under the "sale of business" resolution tool. This requires a valuation of the businesses, assets, rights, and liabilities to be sold on commercial terms. That equity valuation results in a range between €1.3bn and € - 8.2bn with our best estimate within that range being €-2.0bn.

Our economic valuation seeks to provide an **estimate of the value which may be offered for the whole bank by a potential purchaser**, following an open, fair, and competitive auction process (a 'disposal value', as required by article 11 of the EBA Regulatory Technical Standards for a sale of business). Given the circumstances of Hippocrates, a number of standard methodologies for bank valuation are unsuitable: the market capitalisation of the bank is volatile and cannot fall below zero; price-to-book multiple valuation approach is not suitable given the expected negative book value; and we have not had access to reliable prospective financial information to support a dividend discount model.

We have adopted a category-by-category approach, adjusting book values of each asset and liability class to estimate existing losses or gains and other adjustments which any buyer would apply to the value. This has been supplemented by assessment of other sources of value adjustments a buyer would consider (both positive and negative: e.g. a strong market position in small and medium enterprises (***SMEs***), the impact of the need to raise additional capital) to translate this into a reasonable estimate of the disposal value of the whole bank.

We have applied specific methodologies for each asset and liability class. Hypotheses and assumptions were built from detailed analysis, sampling, market benchmark data, Bank of Spain data and other sources where available. Additionally, we have estimated potential contingent legal claims based on information available from Hippocrates and market comparators.

The majority of information used is as of 31 March 2017, which has been adopted as the valuation date. The valuation has been conducted on a consolidated basis, as this is the basis on which Hippocrates will be sold.

For each category we have produced a valuation range. Additionally we indicated what in our view could be the best estimate within that range. The range takes into account the inherent uncertainties; both the range and best estimates take into account the requirement in article 36 BRRD to apply a buffer for additional losses where, due to time and information constraints, we have been limited in our ability to assess the valuation.

The sections below detail the most relevant economic value adjustments identified.

1.2. Outcome of the economic valuation

Our provisional valuation focuses on the areas highlighted in article 8 of the EBA Regulatory Technical Standards with the following results:

Area	Adjustments (*) (Euro billion)		
	Best case	Worst case	Best estimate
Loans and receivables	(2.7)	(7.0)	(3.5)
Real estate assets	(2.6)	(3.4)	(3.1)
Deferred tax assets	(2.7)	(3.0)	(2.7)
Legal contingencies	(1.3)	(3.5)	(2.4)
Intangible assets	(2.2)	(2.6)	(2.2)
Equity and Fixed Income	(0.4)	(0.5)	(0.5)
Joint ventures, associates and subsidiaries	0.1	(0.6)	(0.3)
Total adjustments	**(11.8)**	**(20.6)**	**(14.7)**
Consolidated equity as of March 2017	10.8	10.8	**10.8**
Subtotal	**(1.0)**	**(9.8)**	**(3.9)**
Cost savings **	2,3	1.6	1.9
Other sources of valuations adjustments ***	Not quantified	Not quantified	Not quantified
Adjusted equity	**1.3**	**(8.2)**	**(2.0)**

(*) Adjustments are not reflective of an accounting basis

(**) Including restructuring costs

(***) Including potential contractual adjustments, upsides regarding Hippocrates' market position

1.3. Outcome of the alternative insolvency scenario

The valuation must include an estimate of the recoveries which shareholders and creditors would expect to receive in the event that Hippocrates were wound up under a normal insolvency proceedings. This will assist the SRB in evaluating the risk that Hippocrates' shareholders and/or creditors are ultimately assessed to have received worse treatment than if Hippocrates had entered into a normal insolvency proceeding.

The appropriate insolvency proceeding is one governed by Law 22/2003, dated 9 July, on insolvency (***the Spanish Insolvency Law***). There is no specific law governing bank insolvencies in Spain. The Spanish Insolvency Law promotes the sale of the business unit as a whole to preserve value. However given that Hippocrates' banking license will be revoked making the business non-viable, liquidation is likely to begin immediately. Liquidation consists of an accelerated realisation of the assets, with no minimum binding price. Creditors must be paid in accordance with the order stablished hierarchy settled by the Spanish Insolvency Law.

Given the limited availability of data on an individual entity basis, for the purposes of this analysis we have estimated the insolvency outcome for Hippocrates on a consolidated basis. We note that a consolidated insolvency is not legally feasible under Spanish Law.

The information available to us has not been sufficient to construct a detailed and reliable estimate of the creditor hierarchy. This is due principally to the limited availability of information on a legal entity level and on intragroup assets and liabilities, and to the fact that the deteriorating liquidity position of the entity is likely to result in significant changes to the liability structure between the date of the most recent information available to us and the resolution date.

Our methodologies and assumptions for this analysis are outlined in chapter 3 below. The table below shows our best and worst (for creditors) case estimates for potential total recoveries and implied losses on a group level basis. A more granular assessment by legal entity will be provided as available since company information became available as of the date of this report.

(€ billion)	Worst	Best
Total recovery available for creditors	116,5	120,9
Implied losses (for consolidated liabilities and equity as of March 2017)	30,6	26,2

2. Economic Valuation

2.1. Loans and Receivables

Overview

The gross book value of the Hippocrates loan portfolio is €100.8bn, of which 41% are SME loans, 26% are individual mortgages, and 16% are related to construction and property development. The non-performing loan ratio as of 31 March 2017 is 14.9% and the coverage ratio as of the same date is 51.4%.

Methodological approach & hypothesis explanation

A buyer considering the acquisition of a performing loan (***PL***) or non-performing loan (***NPL***) book will typically go through a due diligence and negotiation process that includes a detailed analysis of historic and current data tapes, individual loan files, and collateral valuations. In this instance, although a data tape as of 31 March 2017 has been provided to us (and prospective buyers), the details contained therein are limited and no further due diligence is possible in the time available.

As a result, it has not been possible to carry out a full discounted cash flows (***DCF***) modelling approach to the book that would be sufficiently robust. Instead, with the data, and in the time available, we have taken two approaches to valuation:

- A "bottom-up", adjusted expected losses (***EL***) approach, taking the bank's underlying exposure at default, lifetime probability of default (estimated from the point-in-time probability of default (***PDs***) provided) and loss given default data and adjusting the parameters based on market benchmarks, Bank of Spain benchmarks for loss given default (***LGD***), and Deloitte analysis, all on a conservative basis. This approach essentially mirrors the way in which a bank acquiror would manage the portfolios in the future; and
- For the NPL portfolio only, a market comparison approach where we utilize data on recent Spanish NPL transactions to provide an alternative "top-down" viewpoint of the price that market participants (typically private equity for NPLs) may be willing to pay. This approach takes into account the fact any buyer will consider the NPLs acquired as non-core and may adopt a short term disposal strategy to rapidly reduce the levels of NPL to more acceptable levels.

It should also be noted that the headline characteristics of both performing and non-performing portfolios would appear to be relatively unattractive for many potential buyers, given the high level of unsecured borrowing, high average loan-to-values (***LTVs***) for secured loans, and long weighted average life. There also appears to be a lack of information on line-by-line or portfolio-by-portfolio yield.

For the best case figures we have taken the EL approach for each of the PL and NPL portfolios; for the worst case, we consider a further adjustment to the EL approach for the PL portfolios and the market approach for the NPL portfolios.

Outcome of valuation

The result for the performing portfolio is a valuation adjustment of between €2,194m (best case) and €2,588m (worst case). The results for the non-performing portfolio are a valuation adjustment of between €510m (best case) and €4,374m (worst case).

Our best estimate is a total valuation adjustment for the loan portfolio of €3,542m.

Sources of uncertainty

A number of factors may impact on the loan book valuations we have derived. Potential bank purchasers may adjust pricing to take into account the degree to which portfolios deviate from their target criteria, for example, in terms of loan to value or yield. Potential purchasers may also estimate specific provisions on significant debtors which could cause substantial differences to the methodology we have used which is based on collective impairment. Further, it should be noted that we have performed no analysis on: (i) the quality of the information used in our estimation;

and (ii) the segmentation criteria applied by Hippocrates. These and other additional factors could further impact the indicative pricing we have derived. The provision of additional information and a more appropriate time frame would allow our valuations to be further refined.

2.2. Real estate assets

Overview

The real estate portfolio includes both foreclosed assets (non-current assets held for sale, investment properties and inventories; €10,987m) and own use properties (principally the branches, Abelias office building, and headquarters under construction; €849m). The valuation work has been based on the information provided through the SRB Sharepoint and the Virtual Data Room covering 93% of the portfolio, extrapolated to cover the remaining assets.

The portfolio includes a high proportion of undeveloped land (40%). Hippocrates' foreclosed assets portfolio is concentrated in some of the most oversupplied regions in Spain, with high volumes of unsold property stock. In addition, the liquidity of the portfolio analysed is limited.

Methodological approach and hypothesis explanation

Given the significant size of the non-current assets portfolio, a significant desktop valuation methodology has been undertaken based on a statistical model developed by Deloitte which takes account of the heterogeneity of the Spanish regions and their local specific conditions concerning real estate ("Top-Down" initial approach).

Additionally, to cross-check the output of the desktop exercise, a sampling of the most significant assets has been carried out based on their gross book value (***GBV***) in order to challenge, on an individual basis, the fairness of the third party appraisals provided by Hippocrates ("Bottom-Up" Approach). As of the date of this Report, we have sampled 112 third party appraisal reports and have slightly fine-tuned our valuation methodology benchmarks and assumptions in order to deliver a more accurate "Top-Down" final valuation.

Inventories, investment property, and headquarters were valued using a market approach; branches and other assets used in the course of business were valued based on comparable units.

Outcome of valuation

The foreclosed assets fair value estimate implies a haircut of between 42% and 47% over the appraisals provided by Hippocrates. Most of the inconsistencies identified are due to the inadequate consideration of the ECO rules (approved by means of Ministerial Order (*Orden Ministerial*) ECO/805/2003, dated 27 March), which establishes the mandatory rules for the valuation of real estate in the Spanish banking sector.

This means an estimated shortfall between €2,494m and €3,192m on foreclosed assets.

Tangible assets fair value estimate implies a shortfall between €126m and €231m, which means a haircut from 15% to 27% over their NBV.

Our best estimate is €3.1 bn.

Sources of uncertainty

The tight calendar we have been given to carry out our analysis, the lack of key information provided within the appraisal reports as well as the very limited sample of appraisal reports delivered by Hippocrates, determines the accuracy of the valuation output according to the methodology used. As of the date of this Report, we have carried out a sample of 92 third party appraisal reports that represent 11,2% of their overall GBV. Further sample testing may identify further fine tune required for the massive valuation statistical model ("Top Down" approach).

2.3. Deferred tax assets

Overview

An amount of €5,199m has been recorded as of March 2017 as tax assets, out of which €145m are current tax assets (***CTA***), €2,037m are Protected Deferred Tax Assets (***Protected DTAs***), and €3,017m are Non-Protected Deferred Tax Assets (***Non-Protected DTAs***).

Methodological approach and hypothesis explanation

The majority (>95%) of tax assets relate to Spanish legal entities. The valuation is therefore based on the recoverability of tax assets according to the provisions defined in the Spanish Tax Legislation.

- **CTAs**: Recoverability does not rely on future profits; valued at book value.
- **Protected DTAs**: Recoverability does not necessarily depend on future profits. These assets can be converted into a credit against the Spanish Tax Authorities, where any of the following conditions are met:

  (i) recognition of accounting losses in the audited financial statements;

  (ii) the entity is liquidated or declared insolvent by the relevant court; or

  (iii) otherwise, the asset can be monetised after 18 years as from its initial recognition.

  Valuation adjustments for protected DTAs have been valued as between zero, and the difference between nominal and the discounted value, calculated as the net present value (***NPV***) of the nominal after 14 years (18 years from the recognition year i.e. 2012), discounted at Spanish 10 year Public Bond rates (worst case). Valuation is supported by the fact that protected DTAs are considered as RWAs (at a 100% risk weight) for regulatory capital purposes.
- **Non Protected DTAs**: Recoverability is uncertain and relies on future taxable profits. Valuation will depend on the purchaser's anticipated taxable profits (e.g. Business Plan) and existing levels of tax credits. Given the extent of DTAs in the Spanish banking sector, the most likely potential purchasers are likely to already have sufficient tax credits to absorb losses for a number of years. These have been valued at zero unless compensated with related deferred tax liabilities (i.e. temporary differences, recognised in equity).

Outcome of valuation

The total valuation adjustment on DTAs is estimated as between €2,681m and €2,966m. For non-protected DTAs, we estimate a valuation adjustment of €2,681m (no range). For protected DTAs, we estimate a valuation adjustment of between €0 and €285m

Protected DTAs remain as protected provided that Hippocrates pays every year a 1.5% annual fee through Tax Form 221 (€20m approx. for FY2016)

For Non-Protected DTAs, the recoverability will depend on Hippocrates' anticipated profits (on a stand-alone basis) and on the potential purchaser's tax group anticipated profits (if the purchaser is a Spanish banking group). Conversely, if the purchaser is a foreign bank (not established in Spain yet), the recoverability would only depend on the Hippocrates stand-alone anticipated profits. The potential purchasers of Hippocrates (either Spanish or foreign) could value the Non-Protected DTAs at discounted cash flow basis.

The valuation as zero of Non-Protected DTAs is supported on the following aspects:

- according to the Spanish tax legislation DTAs cannot be sold separately;
- the Hippocrates' business plan we have been provided with is not reliable according to the information furnished by Hippocrates' Board of Directors
- we cannot have access to the potential purchasers' business plans. In addition, there is an annual limitation for offsetting tax losses carry forward of 25% of the taxable base (after Protected DTAs' reversion);

- if Hippocrates is acquired by a Spanish bank, certain limitations for using Non-Protected DTAs (for tax losses carry forward) could arise in case of a potential merger between the purchaser and Hippocrates;
- the adjustment of Non -Protected DTAs would not affect regulatory capital as those assets are already deducted from this calculation on a fully loaded basis.

Our best estimate is a negative adjustment of €2.7bn.

Sources of uncertainty

Although the criteria adopted by Hippocrates for the recognition of Protected DTAs and Non-Protected DTAs seems to be conceptually reasonable according to applicable Spanish tax legislation, we have not had access to the supporting documentation to validate the amount registered.

2.4. Legal contingencies

Overview

There are several legal contingencies that we have identified in our analysis.

Methodological approach and hypothesis explanation

Floor clauses:

We have analysed the management's hypothesis. From our analyses, we have concluded that the management has excluded [redacted] out of a maximum of [redacted]. As we have not had the chance to contrast that information, we have assumed that it is valid. However, we have made the following adjustments according to our experience: [redacted]

Mandatorily convertible notes:

Management has provided for mis-selling claims on convertible notes, based on an [redacted] loss of the fair value for customers considered eligible, and that only those clients contacted by Hippocrates that have rejected Hippocrates' proposal will claim. We have accepted the loss of fair value estimate as reasonable, but adjusted upwards the population of affected customers, with a low and high scenario.

In light of the above, we consider two potential risk scenarios related to the different classification of noteholders, getting to [redacted] (high scenario) and [redacted] (low scenario).

Mortgage loan expenses:

Between January and April 2017, [redacted] clients have claimed a total amount of [redacted] Management has informed that [redacted] based on current industry trends we estimate that between [redacted] of the existing mortgage loans (i.e. [redacted]) will go to court. [redacted]

Capital increases:

[redacted]

[redacted]

Outcome of valuation

We estimate best case valuation adjustments of €1,3bn ([redacted] for floor clauses, [redacted] or mandatory convertible notes, [redacted] for mortgage loan expenses, and [redacted] for capital increases). Our worst case estimate for valuation adjustments is €3,5bn ([redacted] for floor clauses, [redacted] for mandatory convertible notes, [redacted] for mortgage loan expenses, and [redacted] for capital increases).
Our best estimate is €2.4bn.

Sources of uncertainty

No detailed information or legal grounds has been provided concerning management's justification for excluding cases. We have no information about the volume of matured mortgage loans or related notary costs. We have not had access to detailed information on economic impact of other litigation proceedings (such as litigation related to swap, promotor bank guarantees, etc.). We have no information about the provisions recorded under in Hippocrates financial statements under the heading "pending legal issues and tax litigation".

2.5. Joint Ventures, Associates and subsidiaries

Overview

Hippocrates holds a number of equity investments in other companies that mainly focus on credit cards, retail banking, insurance and real estate businesses.

Our analysis has been developed on a consolidated basis, and so this section is limited to joint ventures (***JVs***) and associates. We have analysed investments representing 80% of the total book value out of the total amount of €1.9bn.

Methodological approach and hypothesis explanation

We have performed our work using the market value approach. We would usually provide a crosscheck using other methods, but have been unable to do so due to lack of information.

Within the market approach, we have employed market multiples derived from market prices (from capital markets or transactions) of companies that are engaged in the same or similar lines of business. When available, we have used other market references such as put/call option prices, analyst reports, offers or prices of transactions already announced.

Our approach used for the JVs and associates which subject of analysis are as follows (consolidated book value in brackets):

- **Wizink (€785m)**: valuation range driven by the two 2015 transactions relating to, Hippocrates-e's (Wizink's former name) acquisition of Citibank credit card business in Spain and the sale of 51% of Wizink to Värde Partners.
- **Aliseda Gestión Inmobiliaria (€142m)**: range based on the exercise price of a call option negotiated by Hippocrates to acquire the remaining 51% stake and the book value at consolidated financial statements.
- **Allianz Hippocrates (€403m)**: range defined on the basis of market multiples and consolidated book value.
- **Grupo Financiero Ve por Mas (€106m)**: our valuation is based equity research analysts' valuation, the exercise price of the put option included in the investment agreement.

- **Targobank (€88m)**: on 1 June 2017, Hippocrates announced the sale of its stake in Targobank for a €65m consideration.

Additionally, we have analysed those subsidiaries (fully consolidated and so, not explicitly shown in Hippocrates' consolidated financial statements) that are currently subject to a sale process which may give rise to a capital gain or loss, those being Hippocrates Private Banking, Totalbank and Hippocrates Financial Services.

- Totalbank: Hippocrates' management has informed us that on 18 May 2017 the Board of Directors approved a binding offer for Totalbank for €497m. This value is aligned with analysed market multiples.
- Hippocrates Private Banking: we have estimated a valuation range between €119 - €150m based on multiples from transactions (price / assets under management) and analysts' estimates. This range is consistent with a non-binding offer informed by the management of €125 million.
- Hippocrates Financial Services: Hippocrates sold Hippocrates Financial Services on 5 May 2017 for a total consideration of €39m, which implied a capital gain of €7m on a consolidated basis.

Additionally we have analysed clauses that potentially could allow the investors in JVs to exercise put options that would force Hippocrates to buyback the remaining stakes in case of change of control, estimating that said penalties could be between €0.7bn and €0.8bn. We have considered that penalties are the difference between the contractual cash-outs and the fair value of the stake acquired based on our valuations.

<u>Outcome of valuation</u>

We estimate a valuation adjustment for investment in joint ventures and associates analysed would be in a range between €-0.1bn and €0.4bn. Taking into account capital gains that could be obtained through the sale of the following subsidiaries: Hippocrates Private Banking, TotalBank and Hippocrates Financial Services (around €0.4bn), along with the penalties related to joint ventures and alliances, this range would decrease to from €-0.6bn to €0.1bn.

Our best estimate would be a negative adjustment of €0.3bn based on average values between minimum and maximum range except for Aliseda that is considered as its book value and Grupo Financiero Ve x + in which our best estimate is the price of the put option included in the investment agreement considering current book value.

<u>Sources of uncertainty</u>

In our valuation of the subsidiaries, we have calculated the capital gain relating to the operations considering consolidated book value. It should be noted that these capital gains could differ from those on legal entity basis.

In our estimation of the penalties related to breaking joint ventures and alliances we have not estimated the impact of the future cash flows that Hippocrates would cease receiving or paying. We have not analysed the impact on liquidity, profit and loss and capital treatment arising from the integration of the business. In addition, these options may be subject to negotiations between Hippocrates and its partners and on the strategy of the potential buyer.

Regulatory changes could affect the valuation of Wizink: (i) potential regulatory changes introducing limits to maximum interest rates; and (ii) the impact of the Payment Services Directive 2 (PSD2), which decreases the barriers to entry the payment services industry.

In relation to Allianz Hippocrates, given it is 60% owned by Allianz and 40% by Hippocrates and the existing related distribution agreements that could impact the ease of the sale of the stake to a third party, we understand Allianz would be the most likely buyer. The value of this asset in a potential transaction could vary significantly depending on whether the buyer is interested in joining the Allianz alliance or not.

2.6. Intangible Assets

Overview

Hippocrates' intangible assets comprise goodwill and other intangible assets, which are mainly composed of Banco Pastor's trademark, customer relationships and computer software.

Methodological approach and hypothesis explanation

Our approach used in the valuation of goodwill and other intangible assets is as follows:

- Goodwill: in our view, a potential buyer would not attribute any value for a pre-existing goodwill as it is not an identifiable asset in the context of a business combination.
- Computer software – IT projects: Given time constraints, we have not analysed the information provided regarding software in detail. We have considered that a potential domestic buyer would not attribute any value to the software as it would be able to perform a migration to its platform. An international buyer entering the Spanish market would require a platform and Hippocrates' software would therefore be necessary and in this scenario we have not considered any adjustment to its book value.
- CR – Core Deposit Intangible: in our view, a potential buyer would attribute no value to this intangible asset due to the current significant deposit outflows and interest rate environment.
- Banco Pastor's trademark: Banco Pastor has around 20% of the market share in Galicia. Given the strong presence of Banco Pastor in this area, such brand could be of value for a third party. The value range has been estimated by applying the relief from royalty method (the most commonly used trademark valuation method).

Outcome of valuation

Based on the above the estimated gain or loss from intangible assets would range from €-2.6bn to €-2.2bn. Our best case estimate assumes that the buyer would give value to software and uses royalty savings method for valuing the Banco Pastor brand to arrive at a total loss of intangible assets of €2.2bn. Our best estimate is €-2.2bn.

It should be noted that the adjustments to intangibles would not affect regulatory capital, since those assets are already deducted from these calculations on a fully loaded basis.

Sources of uncertainty

Impairment tests have not been provided, and therefore, we have not been able to analyse the support used by the entity for these assets. However, we must point out that Hippocrates' poor performance in recent years is an indication of potential impairments to intangible assets.

2.7. Equity and Fixed Income

Overview

65% of the equity and fixed income portfolio (€14,534m) are instruments recorded at fair value on Hippocrates' balance sheet. 98% of this fair value portfolio are instruments classified in level one of the hierarchy of fair value. The rest of the portfolio is classified as level 3, including SAREB (*Sociedad de Gestión de Activos Procedentes de la Reestructuración Bancaria, S.A.*) equity securities which amount to €179m and SAREB bonds which amount to €83m.

Methodological approach and hypothesis explanation

For assets traded in an active market (level 1 of fair value hierarchy of IFRS 13) we have used the observed price (Bloomberg and Reuters). For assets not traded in an active market (level 3 of fair value hierarchy of IFRS 13) we have not had enough information to evaluate the expected cash flows and so have made a 20% valuation adjustment.

Outcome of valuation

The net losses of the fixed income portfolio valued at amortized cost, considering the fair value, amount to €0,4bn as of 31 March 2017. The valuation adjustment for the level 3 portfolio is €93m.

For the equity and fixed income portfolio, our best case is €0,4bn and worst case is €0,5bn (including the valuation adjustment for level 3), and our best estimate is a negative adjustment of €0,5bn.

Sources of uncertainty

We have not had access to the characteristics of the level 3 securities nor to the estimation method applied by Hippocrates in order to replicate the valuation.

2.8. Synergies and other critical factors

Overview

The bursting of the real estate bubble in Spain and the European financial crisis, and the current interest rate environment resulting in pressure on interest margins have resulted in the Spanish banking industry not being able, in most cases, to give a return above its cost of equity. As a result there is significant demand for M&A options that may allow Spanish banks to improve their efficiency through obtaining cost synergies.

In order to consider this and other potential sources of value that a buyer may consider, we have made an estimation of potential cost synergies, as it is the key lever for value creation in M&A deals.

Methodological approach and hypothesis explanation

Our estimation of synergies is based on publicly available information about banking industry M&A transactions in Spain. Synergies may vary depending on the acquirer and in particular, they will depend on the branch overlap. The greater branch overlap the higher synergies could be obtained. Cost synergies informed in past deals resulted in savings around [redacted] over the acquisition target's total cost-base.

We have applied this percentage range to Hippocrates' 2017 operating expenses. Given the fact that personnel expenses in 2016 included significant costs related to an exceptional early retirement plan, we have taken as a reference for 2017 the annualized operating expenses of 1Q17.

Outcome of valuation

Based on the above assumptions, the net present value (***NPV***) of total cost synergies after tax would be in a range between of [redacted].

Additionally, we have estimated a range of potential restructuring costs related to those synergies. We have based our estimation on a reference of restructuring costs over annual savings ratio (which implies a payback ratio) of 2.0 to 2.5x. Given that assumption, the restructuring costs related to the amount of estimated synergies would be around [redacted].

Considering the above, the net value for synergies would be in the range: [redacted]

To the best of our knowledge, bidders would never be willing to pay off all the synergies. Bearing this in mind [redacted] which concludes in a range between €1.6 – 2.3 bn, within which our best estimate is €1.9 bn.

Sources of uncertainty

Synergies are highly dependent on the buyer and the amount of those synergies that bidders may be willing to pay would depend on having a competitive sale process.

The restructuring cost estimate has been developed on an overall basis and no detailed analysis of potential cost has been performed.

Our synergies calculation is based on a general tax assumption of nominal rates without any potential DTAs utilisation. Nevertheless, given the current limitations of offsetting tax credits, the impact would not be significant.

Other sources of valuations adjustments

In addition to the costs synergies, we have analysed but not quantified other factors that could be considered by any potential buyer, as follows:

One of the main strengths of Hippocrates is in its small and medium enterprises and professionals market share, closed to 17%. Competitiveness in this segment has increased in the last months due of its high profitability but, despite this situation, Hippocrates has maintained its leadership position. This position could allow the buyer to obtain revenue synergies through cross selling.

On the negative side, any bidder could take into account for the final price the amount of non-performing assets that Hippocrates owns, not only in terms of valuation but also in terms of profitability ratios impact. A potential buyer should also take into account some others specific considerations as funding/capital raising requirements; operational risk considerations; competition restrictions; and shareholders' approval.

We understand that the draft contract terms that have been offered to potential investors as part of the sales process are substantially different from what would be considered as market standard for an M&A transaction in that the seller will be providing, inter alia, no representations and warranties, or other recourse mechanisms to buyers. As such, buyers are essentially exposing themselves to open-ended risks by entering into the contract. Unless a buyer is extremely comfortable with the due diligence conducted, and overall transaction risks, it is likely that an additional price adjustment will be built into the price offered by way of compensation. Since few, if any, direct comparables exist, and the perceived risks created by the contract will be highly specific to the knowledge of each prospective buyer, it has not been possible to provide a quantifiable adjustment to allow for this factor.

3. Liquidation scenario simulation

3.1. Purposes of this simulation

According to article 36 of the BRRD, article 5 of Law 11/2015 and article 7 of Royal Decree 1012/2015, a valuation is required to determine whether Hippocrates' shareholders and/or creditors would have received a better treatment had Hippocrates entered into an ordinary insolvency proceeding provided for under Spanish Insolvency Law.

3.2. Liquidation strategy explanation

The aim of the liquidation stage is to maximise asset recoveries for the purposes of repaying creditors. Spanish Insolvency Law promotes the sale of the business unit as a whole considering it as the best strategy to minimise the loss of value that the liquidation process entails. Where that cannot be done, then assets should be packaged into portfolios or sold piecemeal.

An insolvent liquidation process is by its nature value destructive (assets sold at distressed prices, costs of the process are high, etc.); this is exacerbated in the case of an unplanned process as such.

The process for liquidations in Spain under the Insolvency Act is set out in Annex II.

The change related to the 18 months' practitioners' fee cap are untested in the Courts but may act as a disincentive to a liquidator to run a long term process. For an entity such as Hippocrates, a very short period of 18 months may not be feasible. A process condensed over a short period risks market saturation which would depress prices.

3.3. Creditor hierarchy

Settlement of the debtor's liabilities will be in accordance with the order established in the Report prepared by the insolvency liquidator (foreseen in article 75 of the Spanish Insolvency Law), and in any event according to the hierarchy settled by the said Spanish Insolvency Law:

	Entity
1	Income from secured assets will be applied to the secured credits up to their value.
2	Credits against estate: costs of the process (including: fees of the insolvency practitioner, compensation from collective dismissal, salaries after the declaration of insolvency, any cost rise during the process, etc.)
3	Privileged credits
4	Unsecured creditors
5	Subordinated creditors

It is important to note that under Spanish Insolvency law, intra group debts are subordinated behind unsecured creditors.

3.4. Methodology and hypothesis

For the purposes of this analysis, reflecting a lack of legal entity information, we have (initially) estimated the insolvency of Hippocrates on a consolidated basis despite this is not envisaged under Spanish Insolvency Law. The subordination of intra-group debtors in particular means that this could materially impact on the recovery levels achieved by different classes of creditors.

The liquidation process in Spain is heavily court-driven which would impact on any asset realisation strategy. The liquidation will be subject to Spanish Insolvency Law and will be monitored by a Spanish court, who would appoint the insolvency practitioners from the list proposed by the FROB.

As a result of the liquidation process, certain expenses may arise (legal advisors, court agent -*procurador*-, insolvency administrator, collective dismissal, etc.) which may be material in addition to the foreseen loss of value as a result of the accelerated sale of assets by the insolvency administrator.

Main outcomes and sources of uncertainty

We have modelled the scenario of a 3 years on the basis that the liquidator is still required to maximise realisations and, given the complexity, the Court may be willing to approve a liquidation plan over this period (although at present there seems no way around the fee cap). From a risk perspective (in terms of possible legal challenge to any resolution decision) this provides a more "prudent" basis for decision making.

We set out below a summary of our analysis which shows that in both cases subordinated creditors would achieve no recovery.

Area	Adjustments (*) (Euro billion)	
	Best case	Worst case
Total gross assets per 31 March 2017	147.1	147.1
Total gross assets	**147.1**	**147.1**
Loans and receivables	(9.1)	(12.5)
Real estate assets	(6.5)	(7.0)
Deferred tax assets	(2.7)	(2.7)
Intangible assets	(2.6)	(2.6)
Equity and Fixed Income	(0.4)	(0.5)
Joint ventures, associates and subsidiaries	(0.2)	(0.6)
Total adjustments	**(21.5)**	**(25.9)**
Subtotal – estimated asset realisations	**125.6**	**121.2**
Costs	(1.9)	(1.9)
Subtotal - realisations for creditors	**123.7**	**119.3**
70% of legal contingencies	(2.8)	(2.8)
Total realization for creditors	120,9	116,5

Creditor Hierarchy	Hippocrates Group as at 31 March 2017 per LDT (€'m)	Adjustment for legal claims	Total	Allocation of Best case expected realisations	Implied % shortfall
Secured	35.2		35.2	35.2	
Covered and preferential	36.0		36.0	36.0	
Tax, employee	0.4		0.4	0.4	
Preferential	18.1		18.1	18.1	
Deposits not covered and not preferential	24.7		24.7	34.0	30% shortfall
Other unsecured	20.0	4.0	24.0		
Subordinated - Other	2.0		2.0	-	100% shortfall
	136.4		140.4	123.7	
Of which to legal claims				-2.8	
Total recovery for original creditors as of March 2017				120.9	

Figures for the creditor hierarchy above are from the Liability Data Template as at 31 March 2017.

The group estimated outcome statement ignores the impact of the subordination of intra-group liabilities, which would impact relative recovery percentages.

It should be noted that potentially significant legal claims may arise due to the insolvency proceedings (including mis-selling). We have described these in Annex II.

The principal driver to the value destruction is the level of potential discounting on loan book realisations (NPL assumed sold in year 1, PL assumed run off over 3 years and then a sale of the rump at the level of discount which we would expect a purchaser in the scenario of liquidation to apply given lack of warranties on any sale, limited time for due diligence, etc.), as set out in the table below and in more detail in Annex II.

3.5. Legal entity basis

We are still working on this analysis which is dependent on receipt of legal entity data.

Subject to the above our hypothesis would be that an insolvency would be triggered, first, at the parent level (by withdrawal of the banking licence and petition by the directors to the bankruptcy court).

As noted above, under Spanish Insolvency law, amounts due intra-group are subordinated behind unsecured liabilities (but ahead of AT1). Given the above financial interconnectedness, a liquidation appointment at the parent level may likely lead to insolvent liquidations at certain subsidiaries also, since those entities would no longer be able to call back funds required for day to day purposes.

Appendix I
Scope, basis of work and limitations

Purpose of the Report

The purpose of this Report is providing an independent valuation pursuant to article 36 (b), (f) and (g) of the BRRD and Law 11/2015 and Royal Decree 1012/2015.

The valuation included in this Report is to inform the choice of resolution action to be adopted in respect of Hippocrates and other decisions on the implementation of resolution tools ("Valuation 2").

In considering the basis for our valuation work, we have had regard to the requirements of article 36 of the BRRD, Law 11/2015 and Royal Decree 1012/2015, and Chapter III EBA Regulatory Technical Standards.

As required by the BRRD, this Report seeks to provide a fair, prudent, and realistic economic valuation of the assets and liabilities of Hippocrates. The resulting valuation may depart from going concern and accounting valuations, including in cases where these have been correctly applied.

Limitations, liability and assumptions

- The Report has been prepared for the exclusively use of the SRB. This Report is to be held strictly confidential and nothing contained herein (especially the analyses, recommendations, opinions, conclusions or the identity of Deloitte staff) should be disseminated through advertising media, public relations, media, means of sale, mail, direct transmission, or any other means of communication to anyone other than the SRB without the prior written consent of Deloitte. Neither Deloitte nor any of its affiliates, employees or partners, assume any liability or responsibility, and shall not under any circumstances whatsoever be under any liability or responsibility, for any third party's use, or the results of such use, of any information contained in this Report. Neither Deloitte nor any of its affiliates, employees or partners, assume any liability or responsibility, and shall not under any circumstances whatsoever be under any liability or responsibility, to any party other than the SRB, for whatever the client may or may not do in reliance on the report or any other information, opinions or advice given to the SRB by Deloitte. Any further work done or advice given in relation to the engagement will be on this basis.
- The scope of our Report is limited to that specified in the previous section of this Appendix I. For the avoidance of doubt, we have not prepared and will not prepare a valuation for the purposes of determining whether the conditions for resolution or the write-down or conversion of capital are met.
- In preparing the Report Deloitte has acted as an independent expert.
- The Report, and the information contained herein, does not constitute, and cannot be understood as, any recommendation or advice as to whether any kind of action or process should be initiated by Hippocrates, or as to which resolution tool would be recommendable to implement in Hippocrates in any circumstances.
- The Report does not include verification work and is not, and cannot be used or understood as, an audit report under any auditing standard. No due diligence or other auditing of numbers or data has been performed in this Report, and the SRB has not reviewed the Report, and the information contained herein, for factual accuracy
- Although throughout the Report a number of legal issues have been identified and/or analysed regarding the operation of Spanish Insolvency law, the Report does not constitute the provision of legal advice in any possible way.
- The Report, and the information contained herein, has been prepared based on the unaudited financial information as of 31 March 2017 and all other information provided to us through the SRB Sharepoint and the Virtual Data Room for the exclusively purpose of preparing the Report. The information reviewed consists of copies of the original documents available uploaded through the SRB Sharepoint and the Virtual Data Room.
- The scope of our work to date has been severely limited by the information and time available. We note that access to the SRB Sharepoint was only obtained on 24 May at 18.27 CET and to the

Virtual Data Room on 25 May at 14.00 CET; in this regard, we note a number of important data gaps which are outlined in this Report.

- We may not have identified all facts or information that could be relevant to you.
- According to article 36(13) of BRRD this Report shall be an integral part of the decision to be adopted by the SRB to apply a resolution tool or exercise a resolution power, or the decision to exercise the write down or conversion power of capital instruments. The Report itself shall not be subject to a separate right of appeal but may be subject to an appeal together with the relevant decision adopted by the SRB.
- We have worked under the assumption that no information that might have changed, qualified or replaced our statements and conclusions within this report, has been omitted. Likewise, we have not carried out any review of the completeness, accuracy, truthfulness, authenticity, validity and integrity (or the existence of any other documentation or information that might alter the content or analysis of the same) of the information provided, and we have assumed that this information is accurate, true and complete in all aspects. Unless otherwise noted in the Report, full compliance with all applicable local and national laws and regulations is assumed by us.
- In addition to the foregoing, it must be highlighted that, within the information reviewed, there are a number of data gaps and inconsistencies in the available information. Therefore, other documents we have not had access to or other facts we have not been informed of could exist, which might had altered the content and conclusions herein described.
- Our work has been performed on a desktop basis with only limited access to management.
- We accept no responsibility for the reliability of the information reviewed to the extent it is inaccurate, incomplete or misleading, or for matters not covered by the Report or unidentified due to the limited nature of our enquiries.
- In connection with the foregoing, Deloitte does not accept any responsibility for matters not covered in the Report or omitted due to the limited nature of our review.
- This Report is issued on the understanding that the SRB has drawn our attention to all matters of which they are aware concerning the financial position of Hippocrates which may have an impact on our reports. We have no responsibility to update this Report for events and circumstances occurring after the date of this Report other than for the purposes of providing the definitive valuation as provided for in BRRD.
- Without prejudice to the generality of the foregoing, which applies to all and any of the areas of this Report, we also refer to each of the relevant areas where a section called "Sources of uncertainty" containing specific limitations and assumptions has been included.
- For your convenience, this Report has been made available to you in electronic copy format. Only a final signed copy should be regarded as definitive.

Appendix II
Detailed numerical and methodological information of the Report

Please see documentation attached in Microsoft Power Point format.