

June 17, 2009

Research Update:

Susquehanna Bancshares Inc. Rating Lowered To 'BBB-' From 'BBB'; Outlook Negative

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Research Update:

Susquehanna Bancshares Inc. Rating Lowered To 'BBB-' From 'BBB'; Outlook Negative

Overview

- We expect Susquehanna's credit quality to deteriorate over the next year.
- We have lowered our counterparty credit rating on Susquehanna Bancshares Inc. to 'BBB-' from 'BBB' and removed it from CreditWatch. The outlook is negative.
- The negative outlook reflects the potential for credit quality and earnings to weaken more than we currently expect.

Rating Action

On June 17, 2009, Standard & Poor's Ratings Services lowered its counterparty credit rating on Susquehanna Bancshares Inc. (Susquehanna) to 'BBB-' from 'BBB'. At the same time, we removed the rating from CreditWatch where it was placed on May 4, 2009, with negative implications. The outlook is negative.

Rationale

The ratings downgrade was made as part of an industry review and follows the publication of our recent criteria on stress testing and U.S. banks (see Related Research). Susquehanna performed worse than some of its peers on our credit stress testing. The downgrade reflects our negative view of the overall banking industry's prospects, as well as our expectations that Susquehanna's asset quality and profitability will remain under pressure over at least the next year. In particular, we expect Susquehanna's large construction and commercial real estate (CRE) loan portfolios to weaken, inhibiting performance through 2009 and into 2010.

Susquehanna's construction lending portfolio (comprising 13% of total loans) has reversed its rapid growth of the past several years, but still represents a significant risk to the bank. In total, CRE loans represent roughly 30% of the loan portfolio after deducting less-risky owner-occupied properties. Susquehanna's earnings have typically been at the low end of the peer group, leaving little room to sustain anticipated losses.

Susquehanna's capital levels fell following its 2007 acquisition of Community Banks Inc., leaving the bank with less of a cushion against excess losses. Although the markets in which Susquehanna operates tend to be less volatile during the economic cycle, we still expect losses will increase in 2009, and will likely put pressure on the company's earnings and capital profiles. Offsetting these weaknesses somewhat are Susquehanna's solid franchise, its good business mix, and its strong funding and liquidity, which we view as strengths that sustain the ratings.

Outlook

The outlook is negative. In our view, Susquehanna has thin capital levels relative to peers', affording it less of a cushion to mitigate losses. If credit quality and earnings deteriorate more than we currently expect under our base case stress factors, the ratings could be downgraded.

Related Research

- "Credit Stress Testing For Financial Institutions," April 29, 2009.
- "Stress Testing U.S. Financial Institutions," April 29, 2009.
- "What Stress Tests Reveal about U.S. Banks' Capital Needs," May 1, 2009.
- "Ratings On 23 Financial Institutions Placed On CreditWatch Negative," May 4, 2009.

Ratings List

Downgraded; CreditWatch/Outlook Action

	To	From
Susquehanna Bancshares Inc. Counterparty Credit Rating	BBB-/Negative/--	BBB/Watch Neg/--
Susquehanna Bancshares Inc. Subordinated	BB+	BBB-/Watch Neg

Servicer Evaluation

Susquehanna Bancshares Inc.

Average/Stable

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