# Creditreform Bank Rating
## Banco de Sabadell S.A. (Group)

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| Rating object | Rating information | | |
|---|---|---|---|
| **Banco de Sabadell S.A. (Group)** | **Long Term Issuer Rating / Outlook:** BBB / Stable | | **Short Term:** L3 |
| Creditreform ID: 18644<br>Incorporation: 1881<br>(Main-) Industry: Banks<br>Management: Jaime Guardiola Romojaro (CEO)<br>Josep Oliu Creus (Chairman)<br>José Luis Negro Rodríguez (Director-General Manager) | **Rating of Bank Capital and Unsecured Debt Instruments:** | | |
| | Senior Unsecured: BBB- | Tier 2: BB- | Additional Tier 1: B+ |
| | Rating Date: **29 May 2018**<br>Monitoring until: withdrawal of the rating<br>Rating Type: **unsolicited**<br>Rating Methodology: bank ratings; rating of bank capital and unsecured debt instruments | | |

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## SWOT-Analysis

### Strengths

- \+ Resilient profitability in recent years
- \+ Sufficient liquidity
- \+ Adequate earnings figures
- \+ Valuable brand with focus on individuals and SME

### Weaknesses

- \- Relatively high stock of NPLs
- \- Low capitalization in comparison to the peer group
- \- Moderate growth opportunities in its core market Spain
- \- Did not comply with regulations of the authority concerning the repurchasing of its capital instruments

### Opportunities / Threats

- \+ Improving asset quality through ongoing reduction of NPLs
- \+ Improving economic conditions in Spain
- +/- Digital transformation of the banking business
- +/- Acquisition/Integration of TSB
- \- Impact of Brexit
- \- Relatively high dependence on the economy of the core market Spain
- \- Low-interest rate policy of the ECB puts pressure on profitability
- \- Increasing banking regulation leads to rising costs

## Company Overview

Banco de Sabadell S.A. (hereafter: Sabadell or BS) is a banking group whose roots go back to 1881. Sabadell decided in October 2017 to relocate its registered headquarters from Barcelona to Alicante as a result of the independence ambitions of Catalonia; the operational headquarters, however, remained in Catalonia. The bank is recognized as an “other systemically important institution” (O-SII) and must therefore comply with additional regulatory requirements. With 26,171 employees (average of 2017) and 2,473 branches (thereof 1,880 in Spain) SB serves approximately 12.1 million customers and had total assets of €221 billion in 2017.

Sabadell acts as a universal bank (focus on individuals and SME) with activities in the insurance business, and operates primarily in Spain and the United Kingdom. In addition, SB has 13 representative offices worldwide and a noteworthy business in America, in particular in Mexico. SB is divided into four major business units. *Banking Business Spain* includes SB’s commercial banking and corporate banking activities as well as its activities related to the markets and private banking area. *Asset Transformation* comprehensively manages problematic assets, abnormal risk, as well as real estate exposure, and also sets out and implements the strategy of real estate investee companies. By contrast, *Banking Business UK* comprises the retail business activities of SB’s acquisition of the Trustee Savings Bank plc (TSB) in the United Kingdom. However, SB’s business unit *Other Geographies* mostly comprises SB’s activities in Mexico, but also overseas branches and representative offices that offer all types of banking and financial services related to corporate banking, private banking and commercial banking.

See Chart 1 for the contributions of each business unit to Sabadell’s gross operating income (€5,737 million) and Chart 2 for the contributions to SB’s net profit (€805 million) in 2017.

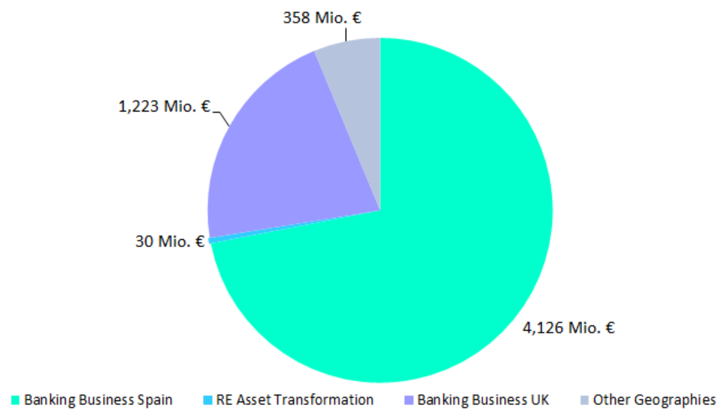


**Chart 1: Gross operating income of each business unit of Sabadell in 2017**
**(Source: Own presentation based on data of Annual report 2017 of Sabadell)**

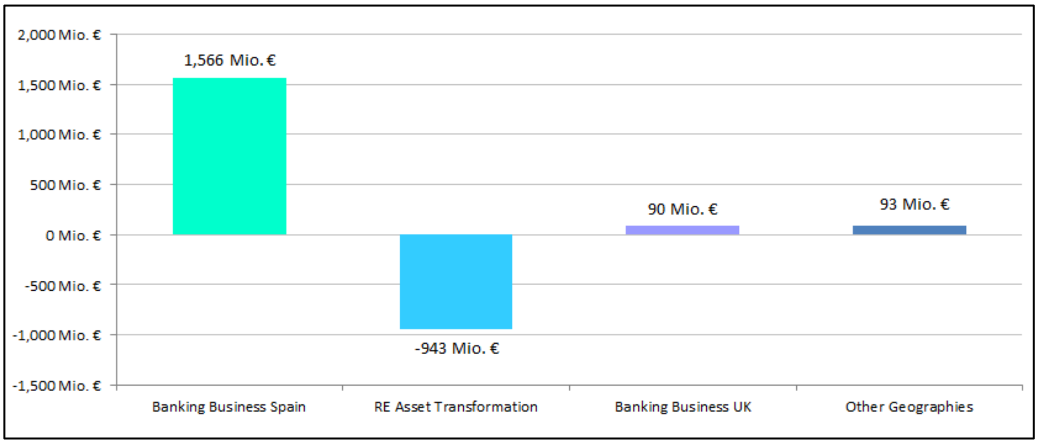


**Chart 2: Net profit of each business unit of Sabadell in 2017**
**(Source: Own presentation based on data of Annual Report 2017 of Sabadell)**

SB's shareholder structure is ordinary. The majority of Sabadell's shares are free floating and the most significant shareholders are BlackRock Inc. with 4.99% and Fintech Investments Ltd. with 3.42% at year-end 2017.

The main subsidiaries and investments of Sabadell can be found in the following chart:

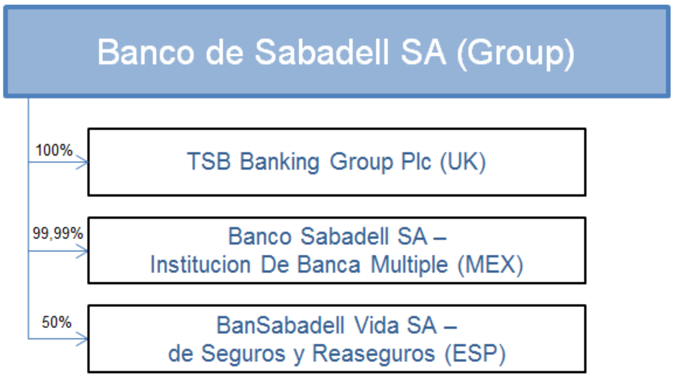


**Chart 3: Main subsidiaries and investments of Sabadell**
**(Source: Own presentation based on data of S&P Global Market Intelligence and Annual Report 2017 of Sabadell)**

On 30 June 2015, Sabadell acquired TSB Banking Group plc – a retail bank located in the United Kingdom with total assets of €39.4 billion at the date of acquisition. The acquisition of TSB enabled Sabadell to access the banking market in the United Kingdom as well as to increase its international operations significantly. Moreover, SB sold its fully-consolidated retail banking subsidiary Sabadell United Bank N.A. (USA) in July 2017. In addition, Sabadell sold its subsidiary Mediterráneo Vida SA, a term life insurance and retirement savings insurance firm in June 2017.

Sabadell is currently pursuing its business plan 2018-2020. According to the plan SB will focus on growing business in its priority markets Spain, United Kingdom and Mexico, and will further strengthen its commercial and digital capabilities, allowing the Bank to continue working towards its main priorities: the improvement of profitability and the reduction of non-performing assets.

# Business Development

## Profitability

Sabadell's operating income amounted to €5.56 billion in 2017, increasing by 4.7% in a year-over-year comparison (€252 million). Net interest income contributed 68.2% to SB's operating income, remaining roughly constant compared to the previous year (-€35 million). However, the significant growth in net interest income in the previous years is mainly attributable to the acquisition of TSB on one hand, and due to lower financing costs on the other. In 2017, TSB contributed €1 billion to SB's net interest income. Net fee and commission income accounted for 22% of operating income, increasing by 6.5% (€75 million) YOY due to the positive performance of service fees as well as asset management fees, and are primarily generated by the business unit *Banking Business Spain*. Net trading income contributed the lowest share of the three main drivers of operating income, accounting for 11.2% and increasing by 20% YOY (€105 million). This item comprises mostly net gains on sold debt securities (in particular public sector debt securities) as well as net gains on the disposal of derivatives.

By contrast, insurance income considers only income/expenses from assets/liabilities under insurance and reinsurance contracts. Other non-interest income consists of various items, such as contributions to deposit guarantee funds, contributions to the resolution fund, as well as expenses associated with non-financial activities.

Operating expenses amounted to €3 billion in 2017, increasing by 3.7% in a year-over-year comparison (€110 million). Personnel expenses, accounting for 50.2% of total expenses in 2017, decreased slightly by €38 million (3%) in a year-over-year comparison due to lower non-recurring staff expenses in 2017. The general increase over the previous years in this item is a result of the integration of TSB. Tech & Communications expenses increased over the past two years due to increased information technology expenses. Other expenses comprise the remaining expenses, and consist of various positions such as outsourced administrative services.

SB's pre-impairment operating profit amounted to €2.5 billion in the fiscal year 2017. Asset write-downs amounted to 2.2 billion in 2017 and consist mainly of €1.157 billion in impairments on loans and receivables as well as of impairments of non-financial assets of €799 million. After deduction of taxes and non-recurring events (most relevant are revenues related to gains of sold assets and a reinsurance commission [Sabadell United Bank, BanSabadell Vida SA and Mediterráneo Vida,]), the operating net profit increased by 12.5% (€89.3 million) at an amount of €805 million in 2017.

Considering SB's first-quarter results for 2018, the bank shows a development in its main sources of operating income comparable to the first quarter of 2017.

A detailed group income statement for the years 2014 - 2017 is shown in Figure 1 below:

| Income Statement | 2014 | % | 2015 | % | 2016 | % | 2017 | % |
|---|---|---|---|---|---|---|---|---|
| **Income (€000)** | | | | | | | | |
| Net Interest Income | 2,259,706 | 50.0% | 3,202,830 | 59.5% | 3,837,752 | 72.2% | 3,802,370 | 68.3% |
| Net Fee & Commission Income | 860,891 | 19.1% | 1,087,763 | 20.2% | 1,148,582 | 21.6% | 1,223,436 | 22.0% |
| Net Insurance Income | -50,367 | -1.1% | -44,205 | -0.8% | -46,722 | -0.9% | -19,047 | -0.3% |
| Net Trading Income | 1,863,160 | 41.3% | 1,261,668 | 23.4% | 517,124 | 9.7% | 622,533 | 11.2% |
| Equity Accounted Results | 101 | 0.0% | 48,795 | 0.9% | 74,573 | 1.4% | 55,186 | 1.0% |
| Dividends from Equity Instruments | 8,628 | 0.2% | 2,912 | 0.1% | 10,037 | 0.2% | 7,252 | 0.1% |
| Rental Revenue | 80,347 | 1.8% | 95,856 | 1.8% | 108,195 | 2.0% | 104,724 | 1.9% |
| Lease and Rental Revenue | NA | 0.0% | NA | 0.0% | NA | 0.0% | NA | 0.0% |
| Other Noninterest Income | -505,778 | -11.2% | -273,816 | -5.1% | -336,964 | -6.3% | -231,767 | -4.2% |
| **Operating Income** | **4,516,688** | **100%** | **5,381,803** | **100%** | **5,312,577** | **100%** | **5,564,687** | **100%** |
| **Expenses (€000)** | | | | | | | | |
| Depreciation and Amortisation | 278,104 | 15.1% | 328,862 | 13.0% | 395,896 | 13.3% | 402,243 | 13.1% |
| Personnel Expense | 1,169,295 | 63.5% | 1,417,493 | 56.0% | 1,595,065 | 53.7% | 1,546,960 | 50.2% |
| Occupancy & Equipment | 152,826 | 8.3% | 211,020 | 8.3% | 249,682 | 8.4% | 229,656 | 7.5% |
| Tech & Communications Expense | 127,453 | 6.9% | 165,831 | 6.6% | 293,552 | 9.9% | 438,059 | 14.2% |
| Marketing and Promotion Expense | 38,765 | 2.1% | 87,497 | 3.5% | 111,148 | 3.7% | 106,706 | 3.5% |
| Other Provisions | -170,094 | -9.2% | -20,216 | -0.8% | -3,044 | -0.1% | 13,864 | 0.5% |
| Other Expense | 244,805 | 13.3% | 340,853 | 13.5% | 326,839 | 11.0% | 342,291 | 11.1% |
| **Operating Expense** | **1,841,154** | **100%** | **2,531,340** | **100%** | **2,969,138** | **100%** | **3,079,779** | **100%** |
| **Operating Profit & Impairment (€000)** | | | | | | | | |
| **Pre-impairment Operating Profit** | **2,675,534** | | **2,850,463** | | **2,343,439** | | **2,484,908** | |
| Asset Writedowns | 2,231,120 | | 2,273,772 | | 1,398,856 | | 2,223,989 | |
| **Net Income (€000)** | | | | | | | | |
| Nonrecurring Revenue | 82,153 | | 231,891 | | 161,900 | | 646,634 | |
| Nonrecurring Expense | 40,174 | | 63,821 | | 87,061 | | 59,300 | |
| **Pre-tax Profit** | **486,393** | | **744,761** | | **1,019,422** | | **848,253** | |
| Income Tax Expense | 109,748 | 22.6% | 32,516 | 4.4% | 303,569 | 29.8% | 43,075 | 5.1% |
| Discontinued Operations | 0 | | 0 | | 0 | | 0 | |
| **Net Profit** | **376,645** | | **712,245** | | **715,853** | | **805,178** | |

**Figure 1: Group income statement**
**(Source: S&P Global Market Intelligence and Creditreform Rating AG)**

Due to Sabadell's increased net profit in 2017, its earnings figures improved in comparison to the previous year. However, the peer group recorded a more distinct improvement. As a result, SB's values of ROAA, ROAE and RORWA are still slightly behind its peers on average. Moreover, the improvement of SB's figures is only attributable to its non-recurring revenues in 2017.

By contrast, although SB noticed a less favorable net interest margin in comparison to the previous year, SB is still clearly above the average of its competitors. In addition, SB's cost income ratios are noticeably lower than the average of its competitors. However, SB's cost income ratio deteriorated significantly since the acquisition of TSB in 2015.

The development of the key earnings figures for the years 2014 - 2017 is detailed as follows:

| Income Ratios (%) | 2014 | % | 2015 | % | 2016 | % | 2017 | % |
|---|---|---|---|---|---|---|---|---|
| Return on Average Assets (ROAA) | 0.23 | 0.13 | 0.38 | 0.15 | 0.35 | -0.03 | 0.38 | 0.03 |
| Return on Equity (ROAE) | 3.46 | 1.69 | 5.93 | 2.47 | 5.53 | -0.40 | 6.15 | 0.62 |
| RoRWA | 0.49 | 0.27 | 0.86 | 0.37 | 0.83 | -0.03 | 0.97 | 0.14 |
| Net Interest Margin | 1.58 | 0.36 | 1.89 | 0.30 | 2.08 | 0.19 | 1.97 | -0.11 |
| Cost income Ratio ex. Trading | 69.39 | -44.12 | 61.44 | -7.95 | 61.92 | 0.48 | 62.32 | 0.40 |
| Cost income Ratio | 40.76 | -23.72 | 47.04 | 6.27 | 55.89 | 8.85 | 55.35 | -0.54 |
| Change in %-Points | | | | | | | | |

**Figure 2: Group key earnings figures**
**(Source: S&P Global Market Intelligence)**

## Asset Situation and Asset Quality

Sabadell's financial assets accounted for 91% of total assets in 2017, increasing by 6.7% (€12.85 billion). Net loans to customers represent the largest share of assets, accounting for 64.9% and decreasing by 1% YOY (€1.5 billion). The decrease is mainly attributable to the sale of Sabadell Bank United, which was partially offset by increased loans of SB. Remarkable is that 60% of SB's loans are secured loans, 30.6% are loans in foreign currencies, and only 6.8% are loans to the general government sector. Total securities, as the second largest asset, represent 12.2% of SB's total assets and decreased by 4.7% YOY (€1.3 billion). This balance sheet item consists primarily of government debt securities. Approximately one half of SB's debt securities are held to maturity, whereas the other half is available for sale. Moreover, Sabadell increased its cash balances at central banks significantly over the previous year. By contrast, SB's amount of net loans to banks is comparable to the previous years and accounts for only 2.4% of total assets. The changes in non-current assets held for sale are attributable to the aforementioned sale of Mediterráneo Vida SA, which was initiated in 2016. The remaining amount in this position comprises mostly foreclosed tangible assets received from SB's borrowers and other debtors.

The group's total assets amounted to €221 billion in 2017, increasing by 4.1% YOY (€8.8 billion).

The development of Sabadell's assets for the years 2014 - 2017 is shown in detail in the following:

| Assets (€000) | 2014 | % | 2015 | % | 2016 | % | 2017 | % |
|---|---|---|---|---|---|---|---|---|
| Cash and Balances with Central Banks | 1,189,787 | 0.7% | 7,343,481 | 3.5% | 11,688,250 | 5.5% | 26,362,807 | 11.9% |
| Net Loans to Banks | 4,623,197 | 2.8% | 5,002,066 | 2.4% | 4,291,996 | 2.0% | 5,379,155 | 2.4% |
| Net Loans to Customers | 110,835,723 | 67.9% | 146,815,737 | 70.4% | 145,173,865 | 68.3% | 143,597,966 | 64.9% |
| Total Securities | 26,785,234 | 16.4% | 28,290,786 | 13.6% | 28,290,286 | 13.3% | 26,961,701 | 12.2% |
| **Financial Assets** | **143,433,941** | **88%** | **187,452,070** | **90%** | **189,444,397** | **89%** | **202,301,629** | **91%** |
| Equity Accounted Investments | 513,227 | 0.3% | 340,996 | 0.2% | 380,672 | 0.2% | 575,644 | 0.3% |
| Other Investments | 0 | 0.0% | 0 | 0.0% | 0 | 0.0% | 0 | 0.0% |
| Insurance Assets | 11,827 | 0.0% | 14,739 | 0.0% | 0 | 0.0% | 0 | 0.0% |
| Noncurrent Assets HFS & Discontinued Ops | 2,249,935 | 1.4% | 2,542,386 | 1.2% | 4,578,694 | 2.2% | 2,561,744 | 1.2% |
| Tangible and Intangible Assets | 5,574,162 | 3.4% | 6,269,096 | 3.0% | 6,610,815 | 3.1% | 6,072,381 | 2.7% |
| Tax Assets | 7,127,981 | 4.4% | 7,255,450 | 3.5% | 7,055,876 | 3.3% | 6,861,406 | 3.1% |
| Total Other Assets | 4,434,600 | 2.7% | 4,753,034 | 2.3% | 4,437,265 | 2.1% | 2,975,511 | 1.3% |
| **Total Assets** | **163,345,673** | **100%** | **208,627,771** | **100%** | **212,507,719** | **100%** | **221,348,315** | **100%** |

**Figure 3: Development of assets**
**(Source: S&P Global Market Intelligence)**

Despite Sabadell's reduction of its relatively high stock of NPLs, SB's asset quality remained roughly at the same level in comparison to the previous year.

The NPL ratio of 5.52%, as well as the NPL / RWA ratio of 10.2% - despite their improvements YOY - remain significantly less favorable in comparison to the peer group. Sabadell is still struggling with legacy issues from their non-performing loan portfolio since the dramatic increase in 2012. Nevertheless, SB records a continuous decline of its NPL stock since 2013 and is still ambitious about reducing its NPL ratio in the upcoming years. Considering the reserves / impaired loans ratio, SB records a declining ratio while the peer group remains roughly on the same level as in the previous year. In addition, the peer group clearly shows a more prudent approach in this respect.

SB's net write-offs / risk-adjusted assets ratio deteriorated over the previous years while that of the peer group improved. However, SB's ratio is still more favorable than those of the peer group. By contrast, the RWA ratio of SB is in line with its competitors, as SB was able to catch up to the peer group in recent years through a reduction of its risk-weighted assets. The reduction of SB's RWA ratio is, among others, attributable to the sale of Sabadell United Bank, as well as the use of new models for retail customers.

In general, SB should continue with its ambitions to reduce its stock of NPL's to improve its asset quality. This would enable SB to catch up to its competitors in the near future.

The development of asset quality figures in the years 2014 - 2017 is detailed as follows:

| Asset-Quality (%) | 2014 | % | 2015 | % | 2016 | % | 2017 | % |
|---|---|---|---|---|---|---|---|---|
| Non Performing Loans (NPL) / Loans | 14.35 | 0.17 | 8.56 | -5.80 | 6.71 | -1.84 | 5.52 | -1.19 |
| NPL / RWA | 21.38 | -0.61 | 14.15 | -7.23 | 11.32 | -2.83 | 10.21 | -1.12 |
| Potential Problem Loans / NPL | 22.19 | 0.85 | 34.48 | 12.29 | NA | NA | NA | NA |
| Reserves / Impaired Loans | 49.10 | -1.55 | 53.00 | 3.90 | 51.04 | -1.96 | 47.37 | -3.67 |
| Net Write-offs / Risk-adjusted Assets | 1.17 | 0.20 | 1.25 | 0.08 | 0.61 | -0.64 | 0.65 | 0.04 |
| Risk-weighted Assets/ Assets | 45.56 | 0.99 | 42.55 | -3.01 | 40.50 | -2.05 | 35.08 | -5.43 |
| Change in %-Points | | | | | | | | |

**Figure 4: Development of asset quality**
**(Source: S&P Global Market Intelligence)**

## Refinancing and Capital Quality

Sabadell's financial liabilities accounted for almost 100% of total liabilities in 2017, increasing by 5.8% YOY (€11.3 billion). Total deposits from customers represent the largest share of SB's liabilities with 65%, remaining almost constant YOY (+€0.9 billion). The majority of customer deposits are deposits on demand (€98 billion). An amount of €42.2 billion are deposits in foreign currencies, which are mainly attributable to TSB. Total deposits from banks correspond to 20.2% of SB's liabilities, increasing by 47.4% YOY (€13.5 billion), mainly due to SB's participation in the targeted longer-term refinancing operations (TLTRO II) of the ECB. Thus, the increase in liabilities is in particular in the item of deposits with agreed maturity. Total debt, accounting for only 11.4% of SB's liabilities, decreased by 10.3% YOY (€2.75 billion) and consists primarily of senior debt (€21.3 billion, thereof: €10.1 billion of covered bonds). Derivative liabilities, accounting for 1.1% (€2.36 billion) of SB's liabilities and consist primarily of interest rate and currency derivatives.

The movement of SB's insurance liabilities respectively non-current liabilities held for sale in 2015 and 2016 are a result of the sale of the aforementioned Mediterráneo Vida SA.

The development of refinancing and capitalization in the years 2014 - 2017 is detailed as follows:

| Liabilities (€000) | 2014 | % | 2015 | % | 2016 | % | 2017 | % |
|---|---|---|---|---|---|---|---|---|
| Total Deposits from Banks | 23,489,739 | 15.4% | 26,290,788 | 13.4% | 28,494,516 | 14.3% | 42,018,347 | 20.2% |
| Total Deposits from Customers | 98,208,370 | 64.6% | 132,891,337 | 67.9% | 134,414,536 | 67.4% | 135,307,437 | 65.0% |
| Total Debt | 21,208,691 | 13.9% | 27,864,371 | 14.2% | 26,533,538 | 13.3% | 23,787,844 | 11.4% |
| Derivative Liabilities | 2,078,289 | 1.4% | 2,182,713 | 1.1% | 3,086,068 | 1.5% | 2,360,622 | 1.1% |
| Securities Sold, not yet Purchased | 176,170 | 0.1% | 151,904 | 0.1% | 59,892 | 0.0% | 69,854 | 0.0% |
| Other Financial Liabilities | 2,673,314 | 1.8% | 2,422,181 | 1.2% | 2,603,270 | 1.3% | 2,971,394 | 1.4% |
| **Total Financial Liabilities** | **147,834,573** | **97%** | **191,803,294** | **98%** | **195,191,820** | **98%** | **206,515,498** | **99%** |
| Insurance Liabilities | 2,224,787 | 1.5% | 2,136,591 | 1.1% | 0 | 0.0% | 0 | 0.0% |
| Non-Current Liab. HFS & Discontinued Ops | 0 | 0.0% | 0 | 0.0% | 2,213,368 | 1.1% | 20,645 | 0.0% |
| Unit-Linked Insurance and Investment Contr. | 164,784 | 0.1% | 81,704 | 0.0% | 0 | 0.0% | 0 | 0.0% |
| Tax Liabilities | 879,855 | 0.6% | 580,357 | 0.3% | 778,540 | 0.4% | 531,938 | 0.3% |
| Noncurrent Asset Retirement Obligations | 122,441 | 0.1% | 115,018 | 0.1% | 114,025 | 0.1% | 101,334 | 0.0% |
| Other Provisions | 272,774 | 0.2% | 231,207 | 0.1% | 192,189 | 0.1% | 216,204 | 0.1% |
| Total Other Liabilities | 630,507 | 0.4% | 911,939 | 0.5% | 934,801 | 0.5% | 740,915 | 0.4% |
| **Total Liabilities** | **152,129,721** | **93.1%** | **195,860,110** | **93.9%** | **199,424,743** | **93.8%** | **208,126,534** | **94.0%** |
| **Total Equity** | **11,215,952** | **6.9%** | **12,767,661** | **6.1%** | **13,082,976** | **6.2%** | **13,221,781** | **6.0%** |
| **Total Passiva** | **163,345,673** | **100%** | **208,627,771** | **100%** | **212,507,719** | **100%** | **221,348,315** | **100%** |
| Deposits from Customers Growth* | -1.16 | NA | 35.32 | 36.48 | 1.15 | -34.17 | 0.66 | -0.48 |
| Change in %-Points | | | | | | | | |

**Figure 5: Development of refinancing and capital adequacy**
**(Source: S&P Global Market Intelligence)**

Sabadell's regulatory capital ratios improved significantly in comparison to the previous year; however, SB is still clearly behind its competitors with its capital ratios.

Sabadell's increase in the CET1 ratio by 1.42 percentage points is a result of retained profits on one hand and SB's decreased risk-weighted assets in comparison to the previous year on the other. In addition, SB achieved a growth of its Tier 1 ratio of 2.32 percentage points through two AT1 issues of €750 million and €400 million in 2017. SB's total capital ratio increased correspondingly. However, all of the three aforementioned regulatory capital ratios are less favorable than the average of SB's competitors. Here, SB should continue with its ambitions to improve its capitalization.
The leverage ratio of SB is, as is the case with its capital ratios, behind that of its competitors. Both SB and the peer group were able to improve in this ratio in the same proportion YOY. Noteworthy is that SB's total equity / total assets ratio has continuously been in decline over recent years. In addition, SB is behind its peer on average in this ratio.

Sabadell's capital ratios are the least favorable performers of all of the areas analyzed.

The development of capital ratios for 2014 - 2017 is detailed as follows:

| Capital (€000) | 2014 | % | 2015 | % | 2016 | % | 2017 | % |
|---|---|---|---|---|---|---|---|---|
| Total Capital | 9,541,892 | 2.59 | 11,417,382 | 19.66 | 11,851,597 | 3.80 | 12,524,251 | 5.68 |
| Total Risk-weighted Assets | 74,417,813 | 2.12 | 88,768,713 | 19.28 | 86,069,980 | -3.04 | 77,638,150 | -9.80 |
| Capital Ratios (%) | | | | | | | | |
| Core Tier 1 Ratio | 11.70 | -0.26 | 11.50 | -0.19 | 12.00 | 0.50 | 13.43 | 1.42 |
| Tier 1 Ratio | 11.70 | -0.26 | 11.50 | -0.19 | 12.00 | 0.50 | 14.32 | 2.32 |
| Total Capital Ratio | 12.82 | 0.06 | 12.86 | 0.04 | 13.77 | 0.91 | 16.13 | 2.36 |
| Leverage Ratio | 5.10 | NA | 4.85 | -0.25 | 4.76 | -0.09 | 4.97 | 0.21 |
| Fully Loaded: Common Equity Tier 1 Ratio | 11.46 | -0.50 | 11.41 | -0.05 | 12.05 | 0.64 | 12.78 | 0.73 |
| Fully Loaded: Tier 1 Ratio | NA | NA | NA | NA | 12.05 | NA | 14.26 | 2.21 |
| Fully Loaded: Risk-weighted Capital Ratio | NA | NA | NA | NA | 13.83 | NA | 16.08 | 2.25 |
| Total Equity/ Total Assets | 6.87 | 0.62 | 6.12 | -0.75 | 6.16 | 0.04 | 5.97 | -0.18 |
| Change in %-Points | | | | | | | | |

**Figure 6: Development of capital ratios**
**(Source: S&P Global Market Intelligence)**

Due to Sabadell's bank capital and debt structure, SB's senior unsecured debt instruments have been notched down by one notch in comparison to the long-term issuer rating. However, SB's Tier 2 capital rating is four notches below the long-term issuer rating based on the bank's capital structure and seniority in accordance with our rating methodology. Additional Tier 1 capital is rated five notches below the long-term issuer rating, reflecting a high bail-in risk in the event of resolution.

## Liquidity

Sabadell's liquidity situation is satisfactory. The bank's liquidity coverage ratio (excluding TSB) is in line with the average of the peer group. However, through the contribution of TSB with a LCR of 295%, the weighted average outperforms the peer group.

The bank's interbank ratio is significantly lower than the average of its competitors and reflects SB's relatively high amount of total deposits from banks in comparison to its net loans to credit intuitions. Sabadell's loan to deposit ratio remained stable and relatively balanced over the previous years and is in line with the average of the peer group.

The development of the liquidity ratios for the years 2014 - 2017 is shown in detail as follows:

| Liquidity (%) | 2014 | % | 2015 | % | 2016 | % | 2017 | % |
|---|---|---|---|---|---|---|---|---|
| Liquidity Coverage Ratio | 114.35 | NA | NA | NA | *132.00 | NA | *168.00 | 36.00 |
| Interbank Ratio | 19.68 | 4.41 | 19.03 | -0.66 | 15.06 | -3.96 | 12.80 | -2.26 |
| Loan to Deposit (LTD) | 112.86 | -0.80 | 110.48 | -2.38 | 108.00 | -2.47 | 106.13 | -1.88 |
| Change in %-Points | | | | | | | | |

*excluding TSB

**Figure 7: Development of liquidity**
**(Source: S&P Global Market Intelligence and SB)**

## Conclusion

Overall, Banco de Sabadell SA (Group) recorded a year of consolidation in 2017; however, SB still has some legacy issues in relation with its high stock of NPL's. In addition, despite strong improvements, SB struggles to keep up with its competitors regarding its regulatory capital ratios.

Despite the low-interest environment in Europe, Sabadell was able to keep a favorable net interest margin and a sound net interest income in 2017, mainly as a result of reduced interest expense. In addition, SB increased its net fee & commission income significantly over the past years. However, SB's operating expenses increased accordingly. As a result of a relatively high stock of NPL's and correspondingly high amounts of asset write-downs, SB struggles to remain profitable. However, SB counteracted this issue in 2017 through various non-recurring revenues, which ultimately led to an improved net profit in comparison to the previous year.

In addition, the aforementioned stock of NPL's has a significant negative impact on SB's asset quality. Here, SB should continue to reduce its NPL stock, respectively to improve its asset quality in the near future. Aside from this, the development of SB's risk-weighted assets is favorable and enables SB to improve its regulatory capital ratios significantly. However, in comparison to its competitors, SB struggles to keep up. A lower dividend payment would mitigate this issue. Notwithstanding, SB complies with all regulatory requirements with its ratios.

Considering SB's deposits from customers, SB records a stable development. Moreover, SB's relatively low value of total debt is remarkable. In general, SB shows a sound funding position. Furthermore, the liquidity situation of the bank is satisfactory.

It remains to be seen to what extent SB will be able to create value out of the acquisition of TSB. On one hand, this acquisition improves SB's geographical diversification and mitigates its dependency on the core market Spain. However, on the other hand, an exchange rate risk arises as a result of the political development in the United Kingdom. Moreover, the decision to move the SB's registered headquarters from Barcelona to Alicante creates a reliability of expectations; however, there remains a degree of political risk due to Catalonia's independence ambitions, which might have a negative impact on SB's business.

In the near future, growing regulations, ongoing digitization, as well as the low-interest rate environment in the EU pose a general challenge for the banking landscape. Notwithstanding, an interest rate reversal is becoming more likely, as well as the termination of the ECB bond-buying program. In particular, a rapid increase in the interest rates goes hand-in-hand with an interest-rate adjustment risk for banks, which have adjusted to long-term low-interest rates.

In a scenario analysis, the rating developed considerably better in the “best case” scenario and significantly less favorable in the "worst case" scenario. The ratings of bank capital and (preferred) senior unsecured debt would behave similarly based on our rating mechanism. These ratings are particularly sensitive to changes in total equity and to bank capital and debt structure in general.

## Ratings Detail

### Bank ratings

The bank ratings are dependent on a host of quantitative and qualitative factors. An improvement in either sub-category may result in a higher rating score.

LT Issuer / Short-Term / Outlook **BBB / L3 / Stable**

### Bank Capital and Debt Instruments Ratings

The ratings for bank capital and debt instruments are inter alia dependent on subordination and relative size of the instrument class, based on the long-term issuer rating of the bank.

‘preferred senior unsecured debt: **BBB-**
Tier 2 (T2): **BB-**
Additional Tier 1 (AT1): **B+**

### Ratings Detail and History

| Ratings | | | |
|---|---|---|---|
| Bank Capital und Debt Instruments | | | |
| Instruments | Rating Date | Publication Date | Ratings |
| Senior Unsecured / T2 / AT1 | 29 May 2018 | 30 May 2018 | BBB- / BB- / B+ |

| Bank Issuer Ratings | | | |
|---|---|---|---|
| Type | Rating Date | Publication Date | Ratings |
| LT Issuer / Outlook / Short-Term | 29 May 2018 | 30 May 2018 | BBB / L3 / Stable |

**Figure 8: Ratings Detail and History**

### Regulatory

Creditreform Rating AG was neither commissioned by the rating object nor by any other third parties for the rating. The analysis took place on a voluntary basis by Creditreform Rating AG and is to be described in the regulatory sense as an unsolicited rating.

The rating is based on publicly available information and internal evaluation methods for the rated bank. The quantitative analysis is based mainly on the latest annual accounts, interim reports, other investor relations information of the bank, and calculated key figures by S&P Global Market Intelligence subject to a peer group analysis were 42 competing institutes.

The information and documents processed satisfied the requirements according to the rating system of Creditreform Rating AG published on the website www.creditreform-rating.de. The rating was carried out on the basis of the rating methodology for unsolicited bank ratings as well as the methodology for the rating of bank capital and unsecured debt instruments in conjunction with Creditreform`s basic document "Rating Criteria and Definitions".

On 29 May 2018, the rating was presented by the analysts to the rating committee and adopted in a resolution.

The rating result was communicated to Banco de Sabadell S.A. (Group) and the preliminary rating report was made available to it. There was no change in the rating score.

The rating is subject to one-year monitoring from the creation date (see cover sheet). Within this period, the rating can be updated. At the latest after one year, a follow-up is required to maintain the validity of the rating.

In 2011 Creditreform Rating AG was registered within the European Union according to EU Regulation 1060/2009 (CRA-Regulation). Based on the registration, Creditreform Rating AG (CRA) is allowed to issue credit ratings within the EU and is bound to comply with the provisions of the CRA-Regulation.

### Conflict of Interests

No conflicts of interest were identified during the rating process that might influence the analyses and judgements of the rating analysts involved or any other natural person whose services are placed at the disposal or under the control of Creditreform Rating AG and who are directly involved in credit rating activities or in approving credit ratings and rating outlooks.

In case of providing ancillary services to the rated entity, CRA will disclose all ancillary services in the credit rating report.

### Rules on the Presentation of Credit Ratings and Rating Outlooks

The approval of credit ratings and rating outlooks follows our internal policies and procedures. In line with our 'Rating Committee' policy, all credit ratings and rating outlooks are approved by a rating committee based on the principle of unanimity.

To prepare this credit rating, CRA has used following substantially material sources:

1. Transaction structure and participants

2. Transaction documents

3. Issuance documents

There are no other attributes and limitations of the credit rating or rating outlook other than those displayed on the CRA website. Furthermore CRA considers satisfactory the quality and extent of information available on the rated entity. In regard to the rated entity Creditreform Rating AG regarded available historical data as sufficient.

Between the time of disclosure of the credit rating to the rated entity and the public disclosure, no amendments were made to the credit rating.

The 'Basic Data' information card indicates the principal methodology or version of methodology that was used in determining the rating, with a reference to its comprehensive description.

In cases where the credit rating is based on more than one methodology or where reference only to the principal methodology might cause investors to overlook other important aspects of the credit rating, including any significant adjustments and deviations, Creditreform Rating AG explains this fact in the rating report and indicates how the different methodologies or other aspects are taken into account in the credit rating. This information is integrated in the credit rating report.

The meaning of each rating category, the definition of default or recovery and any appropriate risk warning, including a sensitivity analysis of the relevant key rating assumptions such as mathematical or correlation assumptions, accompanied by worst-case scenario credit ratings and best-case scenario credit ratings are explained.

The date at which the credit rating was initially released for distribution and the date when it was last updated including any rating outlooks is indicated clearly and prominently in the 'Basic Data' card as a "rating action"; initial release is indicated as "initial rating", other updates are indicated as an "update", "upgrade" or "downgrade", "not rated", "confirmed", "selective default" or "default".

In the case of a rating outlook, the time horizon is provided during which a change in the credit rating is expected. This information is available within 'Basic Data' information card.

In accordance to Article 11 (2) EU-Regulation (EC) No 1060/2009, a registered or certified credit rating agency shall make available, in a central repository established by ESMA, information on its historical performance data including the rating transition frequency and information about credit ratings issued in the past and on their changes. Requested data are available at the ESMA website: https://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml.

An explanatory statement of the meaning of Creditreform`s default rates are available in the credit rating methodologies disclosed on the website.

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