

**Long-Term Issuer Rating:** BBB

Outlook: stable

Short-Term Rating: L3

Preferred Sen. Unsec. Debt: BBB-

Non-Preferred Sen. Unsec. Debt: BB+

Tier 2 Capital: BB-

AT1 Capital: B+

08 July 2019

## Rating Action:

**Creditreform Rating affirms Banco de Sabadell S.A. (Group) long-term issuer rating at 'BBB' (Outlook: stable). In addition, our ratings of the Group's bank capital and debt instruments are affected by the change in our rating methodology.**

Creditreform Rating (CRA) has affirmed Banco de Sabadell S.A. (Group) long-term issuer rating at 'BBB' and affirms the short-term rating at 'L3'. The rating outlook is stable.

At the same time, we affirm the rating of the Tier 2 capital at 'BB-' and the rating of AT1 capital at 'B+' of Banco de Sabadell S.A. (Group). However, adjustments in our rating methodology for bank capital and debt instruments occurred because of legislative alterations in the European Union. As a result, CRA reclassifies its rating of senior unsecured debt to preferred senior unsecured debt and affirms it at 'BBB-'. In addition, CRA assigns the non-preferred senior unsecured debt, which ranks junior to preferred senior unsecured debt, the following rating: 'BB+'.

Please find a complete list of rating actions regarding the bank at the end of this rating action paper.

## Key Rating Drivers

CRA affirms the rating of Banco de Sabadell S.A. (Group) - in the following referred to as Banco Sabadell - and its bank capital and debt instruments as a result of our updating process for the following reasons:

- Improving asset quality through reduction of its non-performing exposures
- Declining earnings figures, however, mainly driven through various one-off effects
- Adequate but below peer group average capitalization

## Rating Rationale

Banco Sabadell's credit rating affirmation is primarily a result of its improvements in its asset quality. However, this positive development was offset through various negative one-off effects with regard to its earnings figures.

## Profitability

The bank's earnings figures deteriorated significant in comparison to the previous year and are clearly below the average of its competitors in a peer group comparison. However, certain one-off effects (IT migration of TSB and sales of the non-performing assets) affected the banks' earnings figures in the fiscal year 2018. Thus, we expect that the banks' earnings figures will improve and that the bank is able to catch up again to its previous earnings level and to its competitors in the following years.

For details regarding the bank's profitability, we refer to figure 2 and figure 3 in the appendix.

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### **Asset Situation and Asset Quality**

Banco Sabadell's non-performing exposures (NPE) reduced considerably year-over-year. As a result, the banks NPL ratio dropped from 5.14% to 4.22%. However, the banks still displays an above average NPL ratio, while catching up to the average of the peer group. In addition, the banks coverage ratio (impairments / NPL) is in line with the average of the peer group with 53%.

The banks RWA ratio remains stable at 36% and is slightly above the average of its competitors.

We refer to figure 4 and figure 5 in the appendix regarding the details of Banco Sabadell's asset situation and asset quality.

### **Refinancing and Capital Quality**

Banco Sabadell exhibits below average regulatory capital ratios. The reduction year-over-year is among others primarily a result of the implementation of IFRS 9 and some portfolio/assets effects in relation with the impact of the sales of non-performing assets (extraordinary provisions) and the impairment of the holding in SAREB (Spanish Government Company for the Management of Assets proceeding from Restructuring of the Banking System).

The bank targets to improve in its capitalization and expects to reach a fully loaded CET1 ratio by around 12.5% and a total capital ratio of around 16% at year-end 2020.

The ratings of Banco Sabadell's bank capital and debt instruments are affected due to our rating mechanism and the recent change in our methodology.

For details regarding the banks refinancing and capital quality, we refer to figure 6 and figure 7 in the appendix.

### **Liquidity**

In our opinion, the overall liquidity situation of the bank is satisfactory. Noteworthy is the banks stable and balanced loan-to-deposit ratio as well as its relatively high liquidity coverage ratio.

For details regarding the banks liquidity, we refer to figure 8 in the appendix.

### **Outlook**

We consider the outlook of Banco Sabadell's long-term issuer rating and its bank capital and debt instruments as stable. This reflects our view that the banks is likely to improve its earnings figures in the upcoming years while displaying an improving asset quality through the recent and ongoing NPE reductions. However, we will observe if Banco Sabadell is able to regain its previous profitability level.

In addition, we assume a stable political and economic environment in Banco Sabadell's markets of operations, especially in the Catalan region.

### **Scenario Analysis**

In a scenario analysis, Banco Sabadell's rating developed significantly better in the "best case" scenario and considerably worse in the "worst case" scenario. The ratings of bank capital and the senior unsecured debt classes would behave similarly based on our rating mechanism. These ratings are especially sensitive to changes in total equity and to the bank capital and debt structure in general.

We could upgrade Banco Sabadell's long-term issuer credit rating and its bank capital and debt instruments if we see the bank strengthen its capitalization. In addition, a further improvement of the bank's asset quality and a considerable improvement of its earnings figures might lead to an upgrade.

By contrast, a downgrade of Banco Sabadell's long-term issuer credit rating and its bank capital and debt instruments is likely if we see that Banco Sabadell is not able to regain its previous profitability. In addition, a worsening in its capitalization, as well as problems in relations with the bank's reduction of its non-performing assets might lead to a downgrade of the bank's long-term issuer rating and its bank capital and debt instruments.

## CRA's rating actions at a glance

Banco Sabadell S.A. (Group):

- Long-Term Issuer Rating affirmed at 'BBB', stable outlook
- Short-term rating affirmed at 'L3'
- Senior unsecured debt reclassified to preferred senior unsecured debt and affirmed at 'BBB-'
- Non-preferred senior unsecured debt rated at 'BB+'
- Tier 2 capital affirmed at 'BB-'
- AT1 capital affirmed at 'B+'

## 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 / Outlook / Short-Term **BBB / stable / L3**

### 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 (PSU): **BBB-**

Non-preferred senior unsecured debt (NPS): **BB+**

Tier 2 (T2): **BB-**

Additional Tier 1 (AT1): **B+**

## Ratings Detail and History

Please consult our website [www.creditreform-rating.de](http://www.creditreform-rating.de) for additional information regarding the dates of publication.

Figure 1: Ratings Detail and History

Bank Issuer Rating	Rating Date	Publication Date	Result
Initialrating	23.05.2018	04.06.2018	BBB / stable / L3
Rating Update	08.07.2019	10.07.2019	BBB / stable / L3
Bank Capital and Debt Instruments	Rating Date	Publication Date	Result
Senior Unsecured / T2 / AT1 (Initial)	23.05.2018	04.06.2018	BBB- / BB- / B+
PSU / NPS / T2 / AT1	08.07.2019	10.07.2019	BBB- / BB+ / BB- / B+

## Appendix

Figure 2: Group income statement | Source: eValueRate / CRA

Income Statement	2015	2016	2017	%	2018
<b>Income (€000)</b>					
Net Interest Income	3.202.830	3.837.752	3.802.370	-3,3	3.675.184
Net Fee & Commission Income	1.003.344	1.148.582	1.223.436	+9,1	1.335.301
Net Insurance Income	-44.205	-46.722	-19.047	-	-
Net Trading Income	1.346.087	626.624	622.533	-63,8	225.391
Equity Accounted Results	48.795	74.573	308.686	-81,7	56.554
Dividends from Equity Instruments	2.912	10.037	7.252	+12,8	8.180
Other Income	199.758	321.833	739.270	-60,6	291.255
<b>Operating Income</b>	<b>5.759.521</b>	<b>5.972.679</b>	<b>6.684.500</b>	<b>-16,3</b>	<b>5.591.865</b>
<b>Expenses (€000)</b>					
Depreciation and Amortisation	947.112	954.045	1.201.605	-37,3	753.743
Personnel Expense	1.457.341	1.663.053	1.573.560	+1,1	1.590.590
Tech & Communications Expense	252.001	333.893	493.041	+5,1	518.201
Marketing and Promotion Expense	87.497	111.148	106.706	+7,0	114.162
Other Provisions	-20.216	-3.044	13.864	>+100	160.706
Other Expense	787.787	1.022.125	1.095.988	+13,5	1.244.462
<b>Operating Expense</b>	<b>3.511.522</b>	<b>4.081.220</b>	<b>4.484.764</b>	<b>-2,3</b>	<b>4.381.864</b>
<b>Operating Profit &amp; Impairment (€000)</b>					
<b>Pre-impairment Operating Profit</b>	<b>2.247.999</b>	<b>1.891.459</b>	<b>2.199.736</b>	<b>-45,0</b>	<b>1.210.001</b>
Asset Writedowns	1.322.370	557.518	1.212.036	-37,6	755.935
<b>Net Income (€000)</b>					
Non-Recurring Revenue	-	-	-	-	-
Non-Recurring Expense	180.868	314.519	139.447	-74,8	35.201
<b>Pre-tax Profit</b>	<b>744.761</b>	<b>1.019.422</b>	<b>848.253</b>	<b>-50,6</b>	<b>418.865</b>
Income Tax Expense	32.516	303.569	43.075	+94,2	83.635
Discontinued Operations	-	-	-	-	-
<b>Net Profit</b>	<b>712.245</b>	<b>715.853</b>	<b>805.178</b>	<b>-58,4</b>	<b>335.230</b>
Attributable to minority interest (non-controlling interest)	3.804	5.421	3.712	+92,0	7.128
Attributable to owners of the parent	708.441	710.432	801.466	-59,1	328.102

Figure 3: Group key earnings figures | Source: eValueRate / CRA

Income Ratios (%)	2015	2016	2017	%	2018
Cost Income Ratio (CIR)	60,97	68,33	67,09	+11,27	78,36
Cost Income Ratio ex. Trading (CIRex)	79,56	76,34	73,98	+7,67	81,65
Return on Assets (ROA)	0,34	0,34	0,36	-0,21	0,15
Return on Equity (ROE)	5,58	5,47	6,09	-3,32	2,77
Return on Assets before Taxes (ROAbT)	0,36	0,48	0,38	-0,19	0,19
Return on Equity before Taxes (ROEbT)	5,83	7,79	6,42	-2,96	3,46
Return on Risk-Weighted Assets (RORWA)	0,82	0,83	1,04	-0,62	0,42
Return on Risk-Weighted Assets before Taxes (RORWAbT)	0,85	1,19	1,09	-0,57	0,52
Net Interest Margin (NIM)	1,72	1,68	2,19	-0,27	1,91
Pre-Impairment Operating Profit / Assets	1,08	0,89	0,99	-0,45	0,54
Cost of Funds (COF)	0,85	0,68	0,50	+0,07	0,57
Change in %Points					

Figure 4: Development of assets | Source: eValueRate / CRA

Assets (€000)	2015	2016	2017	%	2018
Cash and Balances with Central Banks	7.343.481	11.754.479	26.425.958	-10,7	23.592.633
Net Loans to Banks	5.002.066	4.225.767	5.316.004	+54,2	8.198.763
Net Loans to Customers	146.815.737	145.173.865	143.597.966	-0,4	142.986.822
Total Securities	26.073.834	25.919.666	25.098.648	+7,0	26.844.884
Total Derivative Assets	2.216.952	2.370.620	1.863.053	+11,6	2.079.221
Other Financial Assets	-	-	-	-	-
<b>Financial Assets</b>	<b>187.452.070</b>	<b>189.444.397</b>	<b>202.301.629</b>	<b>+0,7</b>	<b>203.702.323</b>
Equity Accounted Investments	340.996	380.672	575.644	-0,1	574.940
Other Investments	-	-	-	-	-
Insurance Assets	14.739	-	-	-	-
Non-current Assets & Discontinued Ops	2.542.386	4.578.694	2.561.744	+79,1	4.586.923
Tangible and Intangible Assets	6.269.096	6.610.815	6.072.381	-18,3	4.958.845
Tax Assets	7.255.450	7.055.876	6.861.406	-0,0	6.859.405
Total Other Assets	4.753.034	4.437.265	2.975.511	-44,9	1.639.985
<b>Total Assets</b>	<b>208.627.771</b>	<b>212.507.719</b>	<b>221.348.315</b>	<b>+0,4</b>	<b>222.322.421</b>

Figure 5: Development of asset quality | Source: eValueRate / CRA

Asset Ratios (%)	2015	2016	2017	%	2018
Net Loans/ Assets	70,37	68,31	64,87	-0,56	64,32
Risk-weighted Assets/ Assets	41,79	40,48	35,01	+1,09	36,11
NPLs/ Net Loans to Customers	8,60	6,14	5,14	-0,92	4,22
NPLs/ Risk-weighted Assets	14,49	11,47	10,48	-2,42	8,06
Potential Problem Loans/ NPLs	-	-	92,11	+44,71	136,83
Impairments/ NPLs	52,32	49,89	45,88	+7,17	53,05
Net Write-offs/ Net Loans to customers	0,95	0,30	0,81	-0,28	0,53
Net Write-offs/ risk-weighted Assets	1,60	0,51	1,50	-0,55	0,94
Change in %Points					

Figure 6: Development of refinancing and capital adequacy | Source: eValueRate / CRA

Liabilities (€000)	2015	2016	2017	%	2018
Total Deposits from Banks	26.290.788	28.494.516	42.018.347	-2,9	40.798.721
Total Deposits from Customers	132.891.337	134.414.536	135.307.437	+2,8	139.078.942
Total Debt	28.016.275	26.593.430	23.857.698	-5,1	22.646.774
Derivative Liabilities	2.182.713	3.086.068	2.360.622	-0,0	2.360.374
Securities Sold, not yet Purchased	-	-	-	-	-
Other Financial Liabilities	2.422.181	2.568.434	2.971.394	+21,2	3.600.544
<b>Total Financial Liabilities</b>	<b>191.803.294</b>	<b>195.156.984</b>	<b>206.515.498</b>	<b>+1,0</b>	<b>208.485.355</b>
Insurance Liabilities	2.218.295	34.836	-	-	-
Non-current Liabilities & Discontinued Ops	-	2.213.368	20.645	> +100	82.605
Tax Liabilities	580.357	778.540	531.938	-66,9	176.013
Provisions	346.225	306.214	317.538	+46,9	466.379
Total Other Liabilities	911.939	934.801	740.915	+34,3	995.069
<b>Total Liabilities</b>	<b>195.860.110</b>	<b>199.424.743</b>	<b>208.126.534</b>	<b>+1,0</b>	<b>210.205.421</b>
<b>Total Equity</b>	<b>12.767.661</b>	<b>13.082.976</b>	<b>13.221.781</b>	<b>-8,4</b>	<b>12.117.000</b>
<b>Total Liabilities and Equity</b>	<b>208.627.771</b>	<b>212.507.719</b>	<b>221.348.315</b>	<b>+0,4</b>	<b>222.322.421</b>

Figure 7: Development of capital ratios | Source: eValueRate / CRA

Capital Ratios (€000)	2015	2016	2017	%	2018
Total Equity/ Total Assets	6,12	6,16	5,97	-0,52	5,45
Leverage Ratio	4,85	4,73	4,97	-0,10	4,87
Phased-in: Common Equity Tier 1 Ratio (CET1)	11,50	11,94	13,44	-1,46	11,98
Phased-in: Tier 1 Ratio (CET1 + AT1)	11,50	11,94	14,34	-0,92	13,42
Phased-in: Total Capital Ratio (CET1 + AT1 + T2)	12,90	13,74	16,07	-0,58	15,49
Fully Loaded: Common Equity Tier 1 Ratio (CET1)	11,40	11,95	12,79	-1,69	11,10
Fully Loaded: Tier 1 Ratio (CET1 + AT1)	-	11,97	14,27	-1,73	12,54
Fully Loaded: Total Capital Ratio (CET1 + AT1 + T2)	-	13,80	16,02	-1,29	14,73
Change in %Points					

Figure 8: Development of liquidity | Source: eValueRate / CRA

Liquidity (%)	2015	2016	2017	%	2018
Net Loans/ Deposits (LTD)	110,48	108,00	106,13	-3,32	102,81
Interbank Ratio	19,03	14,83	12,65	+7,44	20,10
Liquidity Coverage Ratio	-	-	* 168,00	+0,00	* 168,00
Customer Deposits / Total Funding (excl. Derivates)	68,61	68,46	65,76	+1,16	66,91
Change in %Points					

\* excluding TSB



### **Regulatory**

Creditreform Rating AG was neither commissioned by the rating object nor by any other third party 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 eValueRate / CRA. Subject to a peer group analysis were 38 competing institutes.

The information and documents processed met the requirements of the rating system of Creditreform Rating AG as published on the website [www.creditreform-rating.de](http://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 08 July 2019, the rating was presented by the analysts to the rating committee and adopted in a resolution.

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

The rating is subject to one-year monitoring from the rating date and is valid until withdrawal of the rating. Within this period, the rating can be updated. At the latest after one year, a monitoring 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 this registration, Creditreform Rating AG (CRA) is permitted to issue credit ratings within the EU, and is obligated to comply with the provisions of the CRA-Regulation.

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

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To prepare this credit rating, CRA has used the 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 the 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.

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