



ISSUER RATING

Long-term Rating

Outlook: Stable

First rating date: 24/07/2019
Review date: 21/07/2020

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Executive Summary

We change Banco Sabadell S.A.'s unsolicited credit rating (hereinafter, Sabadell) from A-/Negative to BBB+/Stable on the basis of its business model, which is more sensitive both to the SME segment and to the financing of activities directly linked to transport, accommodation and retail, since we consider that this exposure increases its sensitivity to the evolution of the complex macroeconomic scenario caused by COVID-19, not only because of the great impact that we foresee on the Spanish economy (A/ Under observation), but also in the countries where Sabadell is present (United Kingdom and Mexico), where we also expect to observe significant rises in non-performing loans that will lead to a higher volume of provisions that will negatively affect the current levels of profitability and solvency.

Additionally, our credit rating considers the weak economic performance that its British subsidiary (TSB) showed again in 2019 recording losses and that, once the challenges derived from the technological integration have been solved, it continues to have difficulties due to its lower efficiency and the need for a readjustment process that will result in extraordinary expenses that will continue to impair the Group's capacity to improve the organic generation of capital, which once again continued to come almost exclusively from the domestic business.

Despite these challenges, our rating underlines the significant process of reduction of non-performing loans observed in recent years - which continues to exceed the main Spanish banks average - although with a coverage of non-performing loans below its peers that will undoubtedly accentuate its vulnerability in the current unstable economic scenario. Furthermore, it is worth noting the improvement in capital levels, mainly explained by the capital gains from the sale of non-strategic businesses, which place it in a better position to address the expected deterioration of its loan portfolio, in addition to the solid stability of its depositors and the favorable access to the capital markets to complete its funding, as well as the high levels of liquidity supported, among others reasons, by the ECB's ultra-expansive monetary policies, which considerably reduce the possibility of a liquidity shock in the banking industry.

Fundamentals

- ▶ Remarkable levels of efficiency which, however, continue to be limited by TSB's poor performance, pressing negatively on its moderate levels of profitability below its peers.
- ▶ Loan portfolio which, despite its growing diversification, presents greater exposure to the SME segment and to activities related to transport or accommodation, which makes Sabadell more vulnerable to the evolution of the current economic shock than its competitors.
- ▶ Sharp reduction in non-performing loans due to improved macroeconomic conditions and the sale of non-performing portfolios, although with limited coverage that will require greater efforts to address the expected deterioration of the loan portfolio.
- ▶ Gradual increase in capitalization both for recurrent activity and for capital gains from the sale of non-core businesses, improving the risk profile and increasing the margin in relation to minimum regulatory requirements, providing an adequate cushion to deal with the current economic shock.
- ▶ Sound liquidity position with moderate loan-to-deposit ratios and strong performance of the main regulatory requirements, supported by an ultra-expansive monetary policy environment that significantly reduces the possibility of a liquidity shock.

Financial figures

Main financial figures (millions of €)			
	2018	2019	2020 Q1
PROFITABILITY / EFFICIENCY			
Net profit	335	604	94
ROA*	0,15%	0,27%	0,17%
ROE*	2,53%	4,62%	2,89%
Cost-to-income	58,30%	55,60%	49,34%
ASSET QUALITY			
Cost of risk*	0,52%	0,47%	1,07%
NPL ratio	4,22%	3,83%	3,84%
Loan loss reserves / NPL	54,07%	49,58%	52,82%
LIQUIDITY			
Loan-to-Deposit	101,60%	98,60%	99,68%
LCR	157,65%	171,52%	172,13%
SOLVENCY			
CET1 <i>phase-in</i>	11,99%	12,45%	12,16%
CET1 <i>fully loaded</i>	11,11%	11,70%	11,58%
Solvency ratio (<i>phase-in</i>)	14,13%	15,70%	15,73%
RWA density	36,13%	36,02%	36,49%
Leverage*	5,45%	5,80%	5,87%
MARKET VALUATION			
P/BV	0,44	0,44	0,20

Sources: Sabadell, Axesor*

Outlook

Our credit rating with a stable trend is supported by Sabadell's solid capacity to meet its financial obligations in the current complex economic scenario, with adequate levels of liquidity and solvency to tackle the expected deterioration of its loan portfolio, although with a profitability issue that we expect will be accentuated by the additional costs that will be necessary to improve TSB's efficiency.

Sensitivity analysis

At the moment and due to the sharp decline in the global economy, we do not expect an upgrade in Sabadell's rating. On the contrary, the rating could be worsened if a more pessimistic scenario materializes with a recovery of the economy that is longer than expected, causing a strong deterioration in asset quality, an increase in non-performing loans and greater provisioning needs, leading to a reduction in capitalization and profitability more intense than anticipated.

Regulatory information

Sources of information

The credit rating issued in this report is unsolicited. The credit rating is based exclusively on public information, being the main sources the following:

1. Annual Audit Report.
2. Quarterly Financial Report.
3. Corporate Website.
4. Corporate Governance Report.
5. Prudential Relevance Report.
6. Information published in the Official Bulletins.

The information was thoroughly reviewed to ensure that it is valid and consistent, and is considered satisfactory. Nevertheless, Axesor Rating assumes no responsibility for the accuracy of the information and the conclusions drawn from it.

Level of the rated entity participation in the rating process

Unsolicited Credit Rating	
With Rated Entity or Related Third Party Participation	NO
With Access to Internal Documents	NO
With Access to Management	NO

Additional information

- The rating was carried out in accordance with Regulation (EC) N°1060/2009 of the European Parliament and the Council of 16 September 2009, on credit rating agencies, and in accordance with the Outlook Methodology and Banks Rating Methodology that can be consulted on www.axesor-rating.com/en/about-axesor/methodology and according to the Long-term Corporate Rating scale available at www.axesor-rating.com/en/about-axesor/rating-scale.
- Axesor publishes data on the historical default rates of the rating categories, which are located in the central statistics repository CEREP, of the European Securities and Markets Authority (ESMA).
- In accordance with Article 6 (2), in conjunction with Annex I, section B (4) of the Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009, it is reported that during the last 12 months axesor has provided ancillary services to related third parties of the rated entity, but not to the rated entity. However, according to our Conflict of Interest Policy, it does not involve a conflict of interest, since the aggregate sale does not exceed 5% of net turnover.
- The issued credit rating has been notified to the rated entity, and has not been modified since.

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