

Chairman's letter



Josep Olu Creus, Chairman

Dear shareholder:

Banco Sabadell has ended 2015 with a significant increase in earnings, a large decrease in doubtful balances and troubled assets. Banco Sabadell has also expanded its international footprint with the acquisition of British bank TSB. With this acquisition the objectives established in the second year of the Triple Plan 2014-2016, focused on profitability, transformation and internationalisation, have been fulfilled.

The group posted net profit of €708.4 million, a 90.6% increase compared to the figure for 2014. Excluding TSB, the group's net profit stood at €586.4 million, which in comparable terms to 2014 is a 57.8% increase.

The economic environment has not become fully consolidated, yet the positive expectations from the previous year have been marked by more erratic behaviour in financial markets, still modest global growth, a decline in oil prices to a ten year minimum, and a complex geopolitical situation.

In Europe, politics have taken the centre stage. In this context, it is worth highlighting the uncertainty as to whether Greece would leave the Eurozone in the first half of the year, and the decision to call an EU Membership referendum in the UK after the Conservative Party victory in the elections. In countries such as Spain and Portugal, the electoral processes and subsequent creation of more fragmented Parliaments have also opened the door to political uncertainty.

In spite of this, in terms of activity, the Spanish economy has undoubtedly shown a favourable evolution. GDP recorded more than 3.0% growth, a level not seen since 2007. The low price of crude oil, favourable financing conditions and neutral fiscal policies have all been factors that have boosted domestic activity. In this context, loans to companies and families have continued to normalise, and loan quality has also improved. In the United States, the economy has maintained growth levels similar to 2014, whilst in the United Kingdom the economy has shown a favourable evolution, backed by the good performance of the labour market.

In European construction, work on the Banking Union has continued, with a proposal from the European Commission to create a European Deposits Guarantee Mechanism. The creation of the Capital Markets Union has also continued, with the publication of the Action Plan, which establishes the specific measures to be implemented until 2017. Macprudential policy has acquired relevance in the Eurozone in 2015, and work has continued in the regulatory field to increase solvency in the financial system. All this has been framed within the context of the European Central Bank continuing to relax its monetary policy with the implementation of its asset purchase program and a new reduction of the marginal deposit rate.

Banco Sabadell closes the year in a strong capital position. The capital ratio Common Equity Tier 1 fully loaded at 31 December stands at 11.4%, well above regulatory requirements of 9.25%. The CET1 ratio demanded by the regulator is in the lower range required in Spanish banking, which in Spain, means that Banco Sabadell has a relatively low risk profile. Common Equity Tier 1 phase-in ratio stands at 11.5% at 31 December 2015.

It is important to highlight that events in 2015 show an improvement in all of Banco Sabadell's margins. An excellent management of income in a low interest rate environment has led to a 41.7% increase in net interest income compared to the closing of the previous year and 17.9% year-on-year excluding TSB. Net interest income growth has come hand in hand with a heavy increase in commission based income, 16.5% higher than the previous year, boosted by a surge in asset management.

The extraordinary results from financial operations deriving from the management of the ALCO portfolio, and the negative goodwill generated by the acquisition of TSB, have allowed coverage levels to be strengthened through the allocation of additional provisions.

Operating expenses, i.e. personnel and administrative expenses, continue to be stable on a like-for-like basis. An increase in gross margin, along with the application of cost containment policies, have shown an improvement in effectiveness on a like-for-like basis.

Throughout the year, an increase in both individuals' and businesses' commercial activity has continued to improve in a highly competitive environment, reflecting growth in credit and funds volumes. Market shares continue to increase in all areas, maintaining the same high levels of quality and customer care. Hence, gross loans and advances to customers, excluding the temporary acquisition of assets and the balance of doubtful assets, rose at year end to €140,368 million, showing a 37.1% increase compared to the previous year, and 2.1% without including TSB. On-balance sheet customer funds have risen by 39.2% in 2015 and by 1.9% year-on-year excluding TSB.

This has allowed for an increase in shareholder remuneration, which will be proposed to the General Meeting of Shareholders, to be held on 31 March 2016. As established in the previous year, this remuneration will mainly be paid in scrip dividend, which allows the shareholder to decide whether to accept it in cash or in shares.

If profitability is the first strategic focus of the current Strategic Business Plan, the second is the transformation of the balance sheet. During 2015 important steps forward were taken in the restructuring of the balance sheet. On one hand, the group's NPL ratio significantly decreased by 495 basis points, stands at 7.79% at year end. The stock of doubtful assets fell faster than expected, declining by more than €5,500 million since the implementation of the Triple Plan. Coverage of doubtful balances has continued to improve, reaching 53.64% at 31 December. The volume of troubled assets has also fallen by €3,180 million during 2015, with properties on the balance sheet being marketed at a consistently high rate, with lower discounts.

2015 has been marked by the acquisition of British bank TSB, a milestone which is also a catalyst in the Bank's internationalisation process, which is the third pillar in the Strategic Plan. The international diversification achieved with the acquisition of TSB improves Banco Sabadell's risk profile, whilst also offering an attractive opportunity to operate in a banking market with a stable regulatory framework, attractive yields and good growth prospects. TSB has a strong franchise, a well-respected brand and a well-defined retail bank strategy, in line with Banco Sabadell's strategy and a high growth rate. The fulfilment of the current business plan, the launching of digital services in the United Kingdom, the consolidation of synergies and the upcoming integration onto Banco Sabadell's technological platform, are currently the keys to expanding our Group's capacities in the United Kingdom, and these processes are developing in line with the expected timeframe. Sabadell's experience in business banking and in the SME sector is a value added tool that will widen the range of services offered in this country.

Throughout the year we have also increased our presence in Latin America. In Mexico, solid growth of financing operations in corporate banking, and structured financing via Sabadell Capital have allowed us to reach our annual budget objective six months earlier than anticipated. Last August we also obtained the relevant banking licence to operate in this country, which allows us to begin our work in the business sector.

Furthermore, we have also recently opened representative offices in Colombia and Peru, which are markets with high growth potential, representing another step forward in our expansion into new markets to accompany the Group's corporate customers in each country.

During 2015 Banco Sabadell has maintained the same high level of quality and commitment to its customers during its entire trajectory, with a transparent attitude which leads to long term relationships built on trust. We have made significant achievements in digital transformation, improving our customers' experience. All this is the base of our reputation, which is an asset and an essential part of our Group's business culture and a distinguishing principle in business development. Under the premise of our ethical values and principles Banco Sabadell will continue working to build a future that can guarantee a positive impact on society.

The annual report includes detailed financial information on the development of our business's and our financial results, as well as our business model and the Group's risk and strategic management. The daily contribution, dedication, and professionalism of all the employees at Banco Sabadell have been fundamental in building what is now one of the reference financial institutions in Spain, and these same characteristics are still vital in continuing to develop and achieve our objectives.

Banco Sabadell enters 2016 focused on fulfilling the objectives laid out in the Triple Strategic Plan, whilst also continuing to work on the business plan model for 2017-2019 and strengthening sources of income, whilst maintaining the same high levels of service which the bank is renowned for.

Josep Oliu Creus
Chairman