

## Chairman's message



Josep Olius Creus, Chairman of Banco Sabadell



Dear shareholder,

In 2016, Banco Sabadell concluded the Triple Plan, which commenced in 2014, with a very positive outcome, having attained satisfactory results in the three main areas of action: profitability, transformation of the balance sheet, of the commercial model and of the production model, and internationalisation.

As for profitability, the results evidence strong net interest income in a context of low rates and an economic background that was more adverse than we projected when designing the plan. The customer spread expanded from 1.86% in 2013 to 2.69% in 2016; we are the financial institution with the best customer spread in Spain and the one that has expanded it the most in the last three years.

In the process of transforming the balance sheet, the volume of doubtful and problem assets has been reduced significantly, in excess of the targets; we are the financial institution that has decreased its NPL ratio the most in Spain, and rank second in terms of the reduction in problem assets.

As for commercial transformation, new technology capabilities have enabled us to continue improving the customer experience, placing us in a leading position in terms of quality of service among large corporations and SMEs.

We also made significant progress in transforming the production model: efficiency has improved as a scalable platform made it possible to absorb a major increase in size, business volume and customer numbers while containing costs.

As for internationalisation, the main developments were the acquisition of UK bank TSB and the move into the Mexican market after obtaining a commercial banking licence. Our goal was to expand the group's international business from 5% to 10% of the total; upon conclusion of the Triple Plan, fully one-third of our lending was outside Spain.

In 2016, group net attributable profit amounted to €710.4 million, a 0.3% increase on 2015, and net interest income totalled €3,837.8 million, a 19.8% increase with respect to the previous year. Outstanding loans expanded in a context of growing competition, and problem assets were reduced by much more than expected. The NPL ratio had declined to 6.1% at 2016 year-end.

These results were achieved against a complex backdrop characterised by moderate economic growth, episodes of instability in the financial markets, particularly in the early part of the year, and a considerable and growing level of political activity.

The UK's decision to abandon the European Union in the June 2016 referendum created a climate of great uncertainty, and this was heightened by the election of Donald Trump in the US presidential elections in November on a programme of interventionist and protectionist political and economic policies.

In spite of the Brexit vote, the UK economy continued to perform well, achieving close to 2.0% growth in the year. The US economy picked up steam as the year advanced, and the labour market performed positively, with unemployment at its lowest since 2007.

In 2016, the Spanish economy again displayed its resilience. GDP achieved 3.2% growth, the same as in 2015, while unemployment was at its lowest level since 2009. Economic activity continues to benefit from exogenous factors such as low oil prices and favourable funding conditions. Long-term Spanish government bond yields reached record lows in a context in which German government bond yields entered negative territory.

It was the first full year in which the first two pillars of Banking Union, the Single Supervisory Mechanism and the Single Resolution Mechanism, were in force, and the

European banking system proved resilient in the face of several episodes of volatility in the financial markets. Banks' capital and leverage ratios showed an improvement on 2015.

Banco Sabadell ended the year with a sound capital position; its Common Equity Tier 1 ratio, in both phase-in and fully-loaded terms, was 12.0% as of 31 December 2016, well above the level required by the European Central Bank. That was an improvement on the ratio as of 31 December 2015, when the fully loaded Common Equity Tier 1 ratio was 11.4%.

The bank achieved solid growth in core banking revenues, i.e. net interest income plus fees and commissions, of 3.7% excluding TSB and 17.9% in the full group, at constant exchange rates, reflecting the franchise's strong position in the market. Fees and commissions increased by 5.6% year-on-year to €1,148.6 million, driven particularly by good performance by asset management fees.

Recurring costs were cut by 1.2% in Spain and 1.1% in the UK. Provisions for loan losses and other impairments amounted to €1,427.1 million, 38.8% less than in 2015 (€2,333.2 million).

Commercial performance in the year was satisfactory, and the volume of outstanding loans expanded despite fierce competition. Gross outstanding loans and advances amounted to €140,557.3 million at 2016 year-end, a 3.9% increase year-on-year in constant exchange rate terms. Customer funds on the balance sheet performed well; in particular, the balance in demand accounts increased by 5.4% Group-wide at constant exchange rates, to €133,456.6 million. Additionally, banks acquired in previous years continued their contribution to expanding market share, improving our position in a range of banking products for both companies and consumers.

Banco Sabadell's focus on the quality of customer service has enabled it to maintain its quality lead over other banks.

At the same time, progress was made with the commercial transformation process by adding new digital capabilities, enhancing commercial procedures, and adapting the branch network to customer needs, the goal being to enhance efficiency and improve the value proposition in order to make Banco Sabadell the leader in customer experience in all segments.

As for transforming the balance sheet, a record €2,961 million of problem assets were shed in 2016 and the strategy of selling assets at an accelerated pace is continuing successfully. During the period covered by the Triple Plan, exposure to problem assets was reduced by €7,411 million, far exceeding the objectives. By the end of 2016, both doubtful exposures and problem assets had been reduced by far more than the Triple Plan objectives, which had been revised in 2015 following two years of faster-than-expected sales.

The loan loss ratio was reduced to 6.1% at 31 December 2016, less than half the figure of 13.6% at the end of 2013, and down from 7.8% at 2015 year-end. The doubtful asset coverage ratio was 51.5% at the end of 2016, and coverage of problem assets had increased to 49.6%.

In this context, the General Meeting of Shareholders is being asked to approve a dividend of €0.05 per share out of 2016 earnings; that includes the interim dividend of €0.02 paid in December 2016 and a supplementary dividend of €0.03 per share to be paid once the General Meeting approves.

In the United Kingdom, TSB is implementing its strategy successfully. Earnings before taxes and extraordinary items increased by 68% year-on-year, and net interest income was 10.9% higher than in 2015. The franchise continues to increase lending,

driven by growth in mortgage brokerage and supported by a steady increase in deposits, reflecting UK customers' trust in TSB.

The process of integrating TSB with Sabadell's technology platform is advancing on schedule and is due to be completed in late 2017. This new technology will enable TSB to offer new products and services to the market more quickly and efficiently.

Business in Mexico, both corporate and business banking, is outstripping the projections made when this project commenced, and the bank is developing a platform to move into personal banking.

Following the success of the Triple Plan, 2017 is a transition year towards a new master plan covering 2018-2020; TSB will be migrated to the Banco Sabadell IT platform this year. This marks a turning point for the development of the UK subsidiary, in terms of both reaping synergies and achieving greater commercial power and operational autonomy for TSB.

The year 2017 will lay solid foundations for a new business plan ranging up to 2020 that can address the challenges and opportunities currently existing in the industry. This plan will provide growth in existing markets, accelerate normalisation of the balance sheet, optimise efficiency, and strengthen the necessary commercial and digital capabilities while maintaining the high quality of service that is a hallmark of Banco Sabadell.

To achieve these goals in the coming years, we can rely on our employees, whose hard work, dedication and professionalism on a daily basis put the Bank in a position to successfully face the challenges that the future may bring.

**Josep Olliu Creus**  
**Chairman**