Chairman’s message

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Josep Oliu Creus, Chairman

Dear shareholder,

In 2018, Banco Sabadell experienced solid growth in revenues, arranged a number of portfolio sales that significantly enhanced its capital position, and concluded the IT migration at TSB, incurring extraordinary costs as a result of incidents during the process.

The economic and financial context during the year gave rise to a number of regulatory and political uncertainties. A noteworthy development on the political front was the resurgence of protectionism, which poses a risk for world economic growth because of its impact on exports, among others. Political developments in general had a growing impact on the financial markets during the year, as the Fed continued with gradual interest rate increases. The financial markets responded with increasing volatility and global financial conditions became strained. The global economy maintained a relatively high rate of growth, supported by factors such as expansive fiscal policy in the United States and China.

In the euro area, the regulatory and political uncertainties were compounded by persisting negative interest rates in a context of low inflation and a still accommodative monetary policy, the main change in which, in the case of the ECB, was the conclusion of the asset purchase programme. As a result, investor perceptions of the European economy, and its banking industry in particular, were affected.

Doubts about Brexit were reflected in slower economic growth in the United Kingdom and also in investors' expectations and their confidence in the broader European economy. The UK labour market continued to perform well, with record low unemployment and dynamic wage performance.

The Spanish economy achieved robust growth, again outstripping the euro area despite expanding more slowly than in previous years. Economic activity was supported by low interest rates and the private sector's improved financial position. Unemployment continued to decline and the real estate market was very active. Spain logged a foreign surplus for the sixth consecutive year and the government deficit was less than 3.0% of GDP.

The banking industry was affected by a more complex and less predictable regulatory framework and, in Spain, by a number of court rulings that negatively impacted perceptions of the stability of the industry's legal framework. The banking system continued to progress in reducing delinquency, while the challenge of profitability persisted. The industry's resilience was demonstrated by the European Banking Authority (EBA) stress tests, in which all tested banks were found to have sufficient capital even in the adverse scenario.

Net profit amounted to €328.1 million in 2018 as a result of the extraordinary negative impact of the TSB technology migration and the provisions booked for the sale of portfolios of non-performing assets. Excluding those effects, net profit would have amounted to €783.3 million, a 9.6% year-on-year increase at constant exchange rates and on a constant consolidation scope basis.

Commercial performance was superb during the year, resulting in 6% growth in outstanding loans (excluding TSB) and a strong increase in banking business. At constant exchange rates and on a constant consolidation scope basis, net interest income increased by 1.1% excluding TSB, while fees and commissions increased by 9.6%, or 11.3% excluding TSB.

Excellent commercial performance was supported by good results in the SME and large corporate segments in Spain and strong growth in Mexico.

Banco Sabadell is committed to commercial and digital transformation and to maintaining its lead in banking for companies and in customer experience. Digital customer numbers increased by 6% in 2018 to 4.7 million and online sales of consumer loans in Spain rose by 39% with respect to the previous year.

Bulk and ordinary sales of non-performing assets in 2018 reduced their balance by €13.2 billion by year-end, altering the Group's risk profile. The ratio of non-performing assets to total assets was cut to 1.8%, with a coverage ratio of 52.1%, while the Group's NPL ratio was reduced to 4.2%; as a result, one of the goals of the 2020 master plan, namely normalisation of the balance sheet, was achieved earlier than expected, marking the end of the lengthy crisis that began in 2008.

The migration of TSB's IT platform was completed in 2018; this lengthy and costly technical process, which commenced in 2015, definitively severed TSB's ties to Lloyds and makes it possible for the bank to develop autonomously in the future, with the flexibility to launch and market new products.

TSB now has a cutting-edge digital platform, putting it in an optimal position for future business development in the United Kingdom. However, at the time of the switch-over there were a number of incidents caused by difficulties in accessing digital and telephone channels, which resulted in additional costs due to the platform itself, to fraud and, above all, to regulated compensation for the customers who were affected. Having completed the necessary migration process, TSB commenced 2019 on a different footing, with the ability to pursue profitable growth, regain a dynamic commercial approach and advance in improving efficiency.

In spite of the additional requirements under IFRS 9 and the year's complexity, the Bank had a CET1 fully-loaded ratio of 11.1% at 2018 year-end (11.3% pro-forma), well above the minimum regulatory capital requirements and sufficient to enable the Board to propose that the General Meeting of Shareholders approve a gross dividend of €0.03 in cash per share out of 2018 income, i.e. a 51% payout.

The year 2018 laid solid foundations from which to move forward. The Bank overcame two major challenges: restoring the balance sheet by shedding real estate, which enhanced its capital position while cutting its cost of risk, and completing the IT migration at TSB. The Bank also modified its organisation structure to strengthen risk control.

The year 2019 marks a new beginning for Banco Sabadell, as it advances towards a substantial improvement in profitability and capacity to generate shareholder value in the coming years. In this endeavour, it is supported by an organisation, resources and a highly committed workforce which, with rigour, hard work and tenacity, will overcome the challenges that the future will bring.

Josep Oliu
Chairman