

Highlights

- Consolidation of the Miami business, attaining a 10% increase in customer business volume and a 62% increase in net profit.
- Development of business finance.
- Launch of lending to individuals.

Business overview

The Other Regions business comprises mainly Mexico, offices in other countries and representative offices that offer a full range of banking and financial services in corporate banking, private banking and commercial banking.

As part of the internationalisation process that commenced under the previous strategic framework, the Bank decided to focus on Mexico, a country that represents a clear opportunity as an attractive market for the banking business and one in which Sabadell has been operating since 1991, first by opening a representative office and then through its interest in Banco del Bajío, held for 14 years (from 1998 to 2012).

The business was established in Mexico through an organic project with the creation of two financial vehicles, starting with a SOFOM (Mexican multi-purpose financial company), which commenced operations in 2014, followed by a bank. The banking licence was obtained in 2015 and the Bank commenced operations in early 2016.

Both vehicles operate using a customer-focused approach, with agile processes, digital channels and no branches. The roll-out of commercial capacities is based on the aforementioned two vehicles and the following business lines:

- Corporate Banking, with the focus on companies and major corporations: 3 branches (Mexico City, Monterrey and Guadalajara) and sector-specific specialisation.
- Banking for Companies, which reproduces the Group's original business relationship model: launched in 2016 with 13 branches and in the growth phase over the next few years.
- Personal Banking, based on a disruptive digital model initially focused on capturing customer funds.

Earnings before taxes

107€M

Moreover, Banco Sabadell has been operating in the US for 25 years via an international full branch managed from Miami and through Sabadell Securities, a securities brokerage and investment advisory firm which has been operating since 2008. These business units together manage the international corporate banking, private banking and commercial banking business in the US and Latin America.

To supplement its structure in Miami, in 2012 the Bank opened a representative office in New York, where a large part of Sabadell's structured financing and syndicated loans business is handled, and in 2015 it opened representative offices in Colombia and Peru, to grow the corporate banking and structured financing business in these two markets. In 2018, a business plan was designed and launched for the representative office in the Dominican Republic, in order to boost the business volume managed in that country. As part of this business plan, the offices were moved and the workforce increased so as to drive and cater for the projected growth.

In addition, Sabadell Miami Branch works with the representative offices in Colombia, Peru and Brazil to provide services to its customers.

Management priorities in 2018

This year Mexico experienced some socio-political and financial uncertainty as a result of i) the renegotiation of NAFTA with the US and Canada, and ii) the presidential election which resulted in a resounding victory for the Morena party, led by Andrés Manuel López Obrador, affording him not only the presidency but also a substantial majority in the country's Congress. Moreover, there

was considerable turbulence in Mexican financial markets at the end of last year, with a significant depreciation of the peso against both the dollar and the euro. Against this backdrop, the performance of Mexican subsidiaries (Banco Sabadell, IBM S.A. and SabCapital Sofom S.A. de C.V.) was exceptional, amply beating expectations and exceeding the budget for the year.

In 2018, our Mexican subsidiaries continued in their efforts to fast-track their route to operational and financial self-sufficiency. In this regard, following initiatives were implemented over the course of the year:

- Ownership restructuring, whereby Banco Sabadell, IBM S.A. now owns 51% of SabCapital Sofom S.A. de C.V. following the acquisition of a 49.3% stake in that company from Banco de Sabadell, S.A. (Spain). As a result, Banco Sabadell's business in Mexico will now be consolidated, thereby offering a more solid financial picture with a view to having a positive impact on its ratings and the cost of funding from other financial institutions.
- The Hidalgo Project, consisting of migrating the IT platform from Spain to the Mexican subsidiaries. This was instrumented through the acquisition of this platform by Banco Sabadell IBM, S.A., accompanied by the recruitment and training of staff, culminating in the successful transfer of skills.
- The Allende Project, focused on developing the capacities to enable Mexican subsidiaries to be self-sufficient in funding terms, which consisted mainly of: i) the launch and rollout of the Personal Banking business, through an app, i.e. an approach to capturing customers with no need to deploy branches, a first in Mexico. Over the course of 2019, it will enable 100% digital customer onboarding, with interviews via videoconferencing, offering a more scalable and efficient model; ii) the creation of a corporate institutional capture team in the area of Corporate and Investment Banking (C&IB), which brought in deposits from local and state governments and major corporations; and iii) the development of a relationship-centric banking model tapping the solid position achieved in Corporate Banking and C&IB to drive growth in Personal Banking for executives and employees of customer companies.

With regard to commercial activity, Corporate Banking logged growth across the board and also broadened its range of products. Business customer numbers expanded by 140%. During the year, the offer of products to business customers was extended and a framework of action for funding the agri-food sector was defined.

Also in 2018, as part of the process of evolving the Group's business model, Corporate Banking was transformed into the Commercial Banking unit by merging all Personal Banking, including both companies and individuals, into a single structure with an integrated and consistent vision and the common objective of developing and deploying a multi-channel product offer supported by a commercial team based on our values: commitment, quality and proximity.

A financial planning exercise was conducted in 2018 in line with that of the Banco Sabadell Group to determine the main lines of strategic action for Banco Sabadell in Mexico to drive greater value creation by the Group's Mexican franchise, as summarised below:

- Enhancement of ROE by increasing revenues without capital consumption (through greater fees and commissions and the development of new business lines, such as trade finance, derivatives, currency trading, etc.).
- Promotion of financial self-sufficiency actions, through i) the incorporation of transactional services and products that increase customer loyalty, ii) improvement of our Personal Banking customer onboarding platform, and iii) optimisation of funding with development and commercial banking.
- Consolidation and fine-tuning of the digital banking model and focus on capturing savings.

Key business data

Net profit amounted to €91 million in 2018, a 2.3% year-on-year increase. Excluding the sale of Sabadell United Bank in 2017, net profit would have increased by 47.9%.

Net interest income amounted to €259 million, an 11.6% decrease year-on-year. Excluding Sabadell United Bank, growth was 26.1%, mainly due to Mexico and the branches in EMEA (Paris, London and Casablanca).

Net fees and commissions declined by 6.6% year-on-year, mainly due to the absence of the contribution from Sabadell United Bank. Excluding SUB, net fees and commissions increased by 3.3%.

The gross margin amounted to €328 million, down 8.4% year-on-year. Excluding Sabadell United Bank, the margin increased by 24.5% due to good performance in Mexico, Miami and the foreign branches in EMEA.

Administrative expenses and depreciation and amortisation charges fell by 4.9% year-on-year. Adjusting for the sale of Sabadell United Bank, this item increased by 21.4% due to higher expenses in Mexico.

Provisions and impairments increased year-on-year as a result of the provisions associated with higher lending in Mexico and Miami, and higher provisions mainly associated with one-off transactions.

The Mexican subsidiaries attained a 2.78% share of the business funding market in 2018, ranking #10 among Mexican financial institutions in this area.

	2017	2018	% 18/17
Net interest income	293	259	(11.6)
Equity-accounted affiliates and dividends	3	3	(17.6)
Fees and commissions (net)	50	47	(6.6)
Net income from financial transactions, and exchange differences	9	10	8.7
Other operating income/expense	3	10	—
Gross income	358	328	(8.4)
Administrative expenses and depreciation and amortisation	(205)	(195)	(4.9)
Operating profit/(loss)	153	133	(13.0)
Provisions and impairments	(24)	(27)	9.4
Gain/(loss) on derecognition of assets, etc.	1	—	—
Profit/(loss) before tax	130	107	(17.9)
Income tax	(37)	(11)	(70.4)
Profit/(loss) after tax	92	96	3.3
Non-controlling interest	4	5	—
Net attributable profit	88	91	2.3
Ratios (%)			
ROE (profit / average shareholders' equity)	8.8%	9.0%	—
Cost: income (general administrative expenses / gross income)	54.5%	56.0%	—
NPL ratio (%)	0.9%	0.3%	—
Stage 3 exposure coverage ratio (%)	113.0%	292.9%	—
Assets			
	15,298	17,822	16.5
Loans and advances to customers (net), excluding repos	8,836	10,896	23.3
Real estate exposure (net)	23	—	(100.0)
Liabilities	14,431	16,789	16.3
On-balance sheet customer funds	5,024	6,328	26.0
Assigned capital	866	1,033	19.2
Off-balance sheet customer funds	1,033	1,023	(1.0)
Other indicators			
Employees	765	908	18.7
Branches	42	42	—

The average exchange rates in 2018 were USD 1.1450, MXN 22.4921 and MAD 10.953 for the income statement, and USD 1.1851, MXN 22.6901 and MAD 10.8752 for the balance sheet.

The average exchange rate in 2017 was USD 1.132, MXN 21.303 and MAD 11.597 for the income statement, and USD 1.199, MXN 23.661 and MAD 11.426 for the balance sheet.

Sabadell Miami Branch is the Bank's largest foreign branch, with over \$12,000 million in business volume.

With its current structure, Sabadell Miami Branch is the largest foreign branch in Florida. It is one of the few financial institutions in the region with the capability and experience to provide a full range of banking and financial services, from highly complex and sophisticated products for large corporate clients, including project finance, through private banking (mostly international), to products and services for professionals and companies of any size.

Private Banking Miami is a business line that offers private banking products and services to Banco Sabadell customers located in Latin America, the Caribbean and the US. This business operates from Miami, where Sabadell has had a full international branch since 1993, and through Sabadell Securities, a brokerage house and investment firm.

The account managers at Sabadell Miami Branch provide a personalised service to clients and offer a catalogue of products that includes custody of securities, active investment advice, discretionary management and treasury services, as well as traditional commercial banking products such as accounts, multi-currency deposits and loans. The account managers are supported by professionals who specialise in developing products that address customers' need to preserve and expand their assets throughout the Americas, based on their profile and chosen investment strategy.

During 2018, the focus of the business was strengthened on the basis of the customer relationship with trusted account managers. These managers combine experience, bringing to bear the best the bank has to offer in order to design and implement solutions that meet customers' needs; constancy, to fulfil the bank's commitments; and empathy, to build relationships of trust with customers based on strong cultural affinity and confidentiality. These three pillars are the foundations of this unit's activities, with the customers' interests to the forefront.

Private Banking Miami offers a range of products and services, from traditional commercial banking products in multiple currencies to a sophisticated investment platform with options adapted to the customer's needs and risk profile. The investment platform varies mainly depending on the level of involvement of the Bank and is mainly comprised of three groups:

- Custody: the bank custodies securities and provides customers with information. The client makes the investment decisions, and the bank executes them.
- Active advisory: a team of investment banking specialists draws up lists of opportunities, and proposals for

investment and for changes in the composition of the portfolio in order to maximise returns within agreed parameters. The client makes the final decisions with regard to their assets, and the bank executes them.

- Discretionary management: the client entrusts their assets to specialised professionals. The Bank defines, implements and controls the investment strategy based on the client's profile and objective.

In addition to the investment platform, Banca Privada Miami provides treasury services that include currency exchange, securities execution desk, derivatives (swaps) and options, as well as structured products.

Corporate Banking Miami, supported by the offices in New York, Peru and Colombia, manages structured financing products, syndicated loans and project finance for large corporations, having achieved a good level of penetration in the energy and tourism sectors, mainly in the United States, Latin America (except Mexico) and the Caribbean.

2018 was a transition year, involving a change in structure. The new structure seeks to increase specialisation in terms of both industry and product. The goal is to approach customers more effectively by focusing on the sectors where the Bank is most competitive and there is scope for organic growth and higher returns.

Project finance deals continue to gain in importance within the portfolio and it is planned to pursue the possibility of becoming one of the leading banks in the United States. There are projects of all kinds in the United States, particularly in sectors where the Bank already has a great deal of experience, such as renewable energies.

In addition, Sabadell's capability in the area of syndication enables it to participate in large deals and increase returns by maximising fees.

Sabadell Securities

Sabadell Securities USA, Inc. is a securities broker and investment advisory firm. Sabadell Securities complements and enhances Sabadell's consolidation strategy with a focus on US-resident customers. It provides investment and wealth management services, mainly to personal banking

and private banking clients. Its business strategy is based on meeting customers' financial needs by providing advice on capital market investments.

Sabadell Securities is a member of the Financial Industry Regulatory Authority (FINRA) and the Securities Investor Protection Corporation (SIPC). It uses the services of Pershing LLC, a Bank of New York Mellon subsidiary, for clearing, custodian and administrative services.

Asset Transformation



Banco Sabadell normalised its balance sheet in 2018 after announcing major sales of institutional portfolios.

Highlights

- Following the sharp reduction in recent years, the Group achieved its main objective of normalising its exposure to non-performing assets in 2018, and has now overcome the period of focusing on this asset class that resulted from the past economic crisis.
- The normalisation of non-performing assets was concentrated particularly in the area of real estate. The priority in 2018 was to make decisive progress in selling non-performing assets to specialised investors, resulting in a number of large transactions that achieved the ambitious targeted reduction in exposure. In 2018, non-performing assets were reduced by over €13,200 million (pro-forma), the largest single reduction since the crisis.
- The sharp reduction in NPAs in 2018 will lead to significant cost savings in future years, estimated at more than €150 million per year.
- In December 2018, it was agreed to sell 80% of real estate subsidiary Solvia, valued at €300 million, resulting in an estimated capital gain of €138 million. This transaction, which is expected to be completed in the first half of 2019, evidences the value created by the Group with this company, one of Spain's leading real estate solutions platforms.