

Research Update:

S-Bank PLC Outlook Revised To Positive On Improved Earnings Capacity And Strengthening Franchise; Affirmed At 'BBB/A-2'

June 29, 2023

Overview

- Finland-based S-Bank PLC's planned acquisition of Svenska Handelsbanken's retail portfolio in Finland complements S-Bank's banking and wealth management business and provides a structural boost to profitability, in our view.
- The bank is well positioned to benefit from the cyclical rise in interest rates and we therefore expect pre-provision income to almost double in 2023.
- We now expect S-Bank to close the gap with peers in terms of earnings capacity and operating efficiency.
- We therefore revised our outlook on S-Bank to positive from stable and affirmed our 'BBB/A-2' ratings on the bank.
- The positive outlook reflects our expectation that S-Bank's profitability and cost efficiency metrics will approach those of higher rated peers and the ongoing acquisition won't compromise its capital, asset quality, or funding position.

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Rating Action

On June 29, 2023, S&P Global Ratings revised its outlook on S-Bank PLC to positive from stable.

At the same time, we affirmed our 'BBB/A-2' long- and short-term issuer credit rating as well as our 'BBB+/A-2' resolution counterparty ratings on the bank.

Rationale

The outlook revision reflects our view that earnings prospects will materially improve in 2023 and beyond. We project that S-Bank will report a sustained improvement in profitability, with return on equity (RoE) exceeding 10% and a cost-to-income ratio below 65% in 2023. The bank is

therefore closer to delivering its long-term financial targets (RoE above 8% and cost-to-income below 60%) and gradually closing the gap with higher-rated peers domestically and elsewhere in the Nordic region. This could lead us to remove our negative comparable rating analysis (CRA) adjustment in the next 12-24 months.

The repricing of the bank's floating-rate-loan portfolio will boost net interest income in 2023.

S-Bank's net interest income is rapidly increasing because the loan portfolio is repricing with higher market rates while the pass-through to deposit customers remains slower. About 85% of the bank's assets are tied to the 12-month Euribor rate. Consequently, we expect the bank's net interest income will improve by almost 70% in 2023. Although operating expenses will rise--due to rising staff costs, general cost inflation, and continued investments in digitalization and automation--we project the bank's pre-provisioning income will almost double in 2023, with the bank likely to maintain this sustained improvement in earnings capacity. The expected improvement will also allow the bank to absorb a potential increase in credit losses from the weaker economic environment in Finland.

The planned acquisition of Handelsbanken's portfolio in the second half of 2024 has the potential to deepen S-Bank's cross-selling between banking and wealth management.

We believe the acquisition of Handelsbanken's €3.6 billion retail loan book, €2.6 billion of assets under management and a network of 23 branches, which is geographically spread across Finland, will allow S-Bank to strengthen its retail franchise and market position. Nevertheless, there are challenges. We do not exclude client attrition prior to closing and maintaining the new customers will depend on S-Bank's successful repositioning of its brand and culture. As a digital lender, S-Bank will need to ensure multi-channel customer experience and service quality to integrate Handelsbanken's customers.

The acquisition is prudently funded, but S-Bank still needs to demonstrate its access to the covered bond market.

The improved earnings and capital generation will support S-Bank's growth ambitions. Furthermore, we expect the cooperative member owners to back S-Bank's acquisition with a €200 million capital injection in 2024. We therefore project S-Bank's risk-adjusted capital (RAC) ratio will exceed 18% through 2024 despite the continued growth, compared with 16.7% at end-2022. S-Bank will fund the acquired loan portfolio through a €2 billion bridge financing provided by Danske Bank A/S. S-Bank aims to diversify its funding profile--which is primarily retail-deposit-based--with covered bond issuance starting from second-half 2023. In our view, this would provide the bank with a stable and cost-efficient funding source to support its growth plans.

We continue to expect that S-Bank could be resilient to parental distress.

We rate S-Bank above the group credit profile of S Group. This reflects our view of S-Bank as an independent and severable entity within the group, with no funding dependency, and separated accounting and reporting procedures. We see the group as having a strong and compelling economic incentive to preserve the bank's credit strength. The authorities' apparent intent to resolve the bank if it failed (as opposed to liquidating it) further confirms the bank's position as a critical service provider in Finland, and also reinforces its financial and operational independence. Nevertheless, we remain mindful that, to a degree, the group could have a negative influence on the bank, as a confidence-sensitive business where there is a wider crossover of franchise and customers with the group.

Outlook

The positive outlook reflects our expectation that S-Bank's profitability and operational efficiency will sustainably improve in the next 12-24 months, benefitting from the higher interest rate environment, increased cross-selling to the existing customer base, and opportunities provided by the acquisition of Handelsbanken's retail portfolio in the second half of 2024.

Upside scenario

We could upgrade S-Bank if the acquisition is well-executed, the bank gains scale as anticipated, and it maintains a sound financial position. This entails a robust RAC ratio above 15% and launch of covered bond issuance to finance the funding gap stemming from the transaction. This could lead us to remove the negative CRA adjustment. However, an upgrade would hinge also on us being highly confident that S-Bank would remain resilient even if the broader S Group were to face difficulty.

We could also take a positive rating action if the bank were to build an additional loss-absorbing capacity (ALAC) buffer sustainably and comfortably above our adjusted threshold of 4%.

Downside scenario

We could revise the outlook back to stable if material execution risks emerge over the medium term or if customer retention following the acquisition proves to be materially weaker than expected. A negative action could also follow if S-Bank's loan growth is more aggressive or departs from its underwriting standards, alongside increased credit losses. This could translate into a RAC ratio below the 15% threshold.

While less likely, we could lower our long-term rating on S-Bank if the parent's creditworthiness weakens and the bank proves either less resilient or more vulnerable to potential negative intervention than we currently expect.

Ratings Score Snapshot

	To	From
Issuer Credit Rating	BBB/Positive/A-2	BBB/Stable/A-2
SACP	bbb	bbb
Anchor	a-	a-
Business position	Constraint (-2)	Constraint (-2)
Capital and earnings	Very strong (+2)	Very strong (+2)
Risk position	Moderate (-1)	Moderate (-1)
Funding and liquidity	Adequate and Adequate (0)	Adequate and Adequate (0)
Comparable ratings analysis	-1	-1
Support	0	0
ALAC support	0	0
GRE support	0	0

	To	From
Issuer Credit Rating	BBB/Positive/A-2	BBB/Stable/A-2
Group support	0	0
Sovereign support	0	0
Additional factors	0	0

SACP--Stand-alone credit profile.

ESG credit indicators: E-2, S-2, G-2

Related Criteria

- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions , Dec. 9, 2021
- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology , Dec. 9, 2021
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings , Oct. 10, 2021
- General Criteria: Group Rating Methodology , July 1, 2019
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology , July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- General Criteria: Principles Of Credit Ratings , Feb. 16, 2011

Related Research

- S-Bank Gains Scale With Acquisition Of Handelsbanken's Finnish Retail Portfolio, June 1, 2023
- Banking Industry Country Risk Assessment Update: May 2023, May 24, 2023
- Finland-Based S-Bank Assigned 'BBB+/A-2' Resolution Counterparty Ratings; 'BBB/A-2' Ratings Affirmed; Outlook Stable, Jan. 26, 2023
- S-Bank PLC, Sept. 22, 2022
- Banking Industry Country Risk Assessment: Finland, June 1, 2022

Ratings List

Ratings Affirmed; Outlook Action

	To	From
S-Bank PLC		
Issuer Credit Rating	BBB/Positive/A-2	BBB/Stable/A-2

Ratings Affirmed

Resolution Counterparty Rating	BBB+/-/A-2	BBB+/-/A-2
Senior Unsecured	BBB	BBB

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceld/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; or Stockholm (46) 8-440-5914

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