Research Update:

Ireland-Based Permanent TSB Group Outlook Revised To Positive On Better Profitability Prospects; Ratings Affirmed

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Overview

- As we expected, cyclical and structural tailwinds have lifted Permanent TSB's profitability, moving it to a more sustainable footing.
- As it embarks on the next phase of its transformation journey, we see scope for further improvement in the group's profitability and competitiveness with its much larger Irish domestic peers, but also some significant challenges.
- We have therefore revised the outlooks to positive from stable on both Permanent TSB Group Holdings PLC (holding company) and Permanent TSB PLC (operating bank) and affirmed the ratings.
- The positive outlook reflects that we could raise our ratings on the group over the next 18-24 months if the bank substantially delivered its business plan, leading to improved sustainability, franchise strength, competitiveness, and revenue diversification.

Rating Action

On May 7, 2024, S&P Global Ratings revised its outlook on Permanent TSB PLC (PTSB) and Permanent TSB Group Holdings PLC to positive from stable. At the same time, we affirmed our 'BBB+/A-2' long- and short-term issuer credit ratings on Permanent TSB PLC and our 'BB+/B' long- and short-term issuer credit ratings on Permanent TSB Group Holdings PLC.

Rationale

Cyclical tailwinds from higher interest rates and the Ulster Bank portfolio acquisition have buoyed PTSB's revenue generation. Year-end 2023 results saw PTSB's earnings buffer turning positive and standing at 0.71%, after trending below zero for several years. We calculate the earnings buffer as the ratio between normalized operating income (operating income net of normalized losses) and S&P Global Ratings-risk-weighted assets. The major driver for this improvement in our earnings buffer measure was almost double net interest income, standing at €620 million, compared with €362 million reported at year-end 2022. This increase largely reflects the direct benefits stemming from a larger customer loan portfolio (€21.7 billion reported at end-2023, compared with €14.8 billion before the Ulster Bank portfolio acquisition); higher interest rates; and a more diversified portfolio, with small and midsize enterprises (SME), asset finance, and consumer finance making up 6% of overall customer loans at year-end 2023.

PTSB's acquisition of Ulster Bank's portfolio as well as actions to continue to consolidate its franchise and further diversify its business lines will drive up profitability over 2024-2026. We expect that PTSB's earnings buffer--as per our calculation--could increase beyond 1% by year-end 2026, thus starting to reduce the gap with peers (above 2% calculated for Bank of Ireland and AIB Group). In particular, we estimate that PTSB's net interest income could increase by a cumulative 8%-10% by year-end 2026, thanks to additional cumulative organic net growth of €1.5 billion-€1.7 billion over 2024-2026; the still favorable interest rate environment; and further diversification into the more remunerative SME and consumer finance space, which we estimate could constitute 10% of the bank's overall portfolio in 2026. Further, we believe that cross-selling opportunities and increases of current account fees could bring about 15% growth in fee income in 2024-2026.

Challenges remain ahead, specifically concerning cost reduction. According to our calculations, PTSB's cost-to-income ratio at year-end 2023 stood at 75%, down from the 99.7% calculated before the Ulster Bank acquisition, but still materially higher than its peers, which report less than 50%. While we expect that PTSB will continue to work on its cost-efficiency in 2024-2026, we believe significant reduction of its cost-base could be difficult at this stage of its transformation journey. In addition to increasing full-time equivalents to accommodate the business growth and diversification into the SME space, we expect that PTSB will continue to invest in technology, to expand process automation and further improve its customer experience through digitization of processes and products. PTSB's high cost-base is the major factor constraining the bank's loss-absorbing capacity, in our view. Further challenges could also come from interest rate cuts or from competitive responses undertaken by other domestic players, like non-bank entities or the two major players in the market, Bank of Ireland and AIB Group.

We expect that PTSB will continue to rely on a solid capital base, asset quality, and additional loss-absorbing capacity (ALAC). In December 2023, PTSB received the supervisor's confirmation that it is no longer prohibited from paying shareholder dividends, although it must have approval from the Central Bank of Ireland. We understand that PTSB will update the market with its distribution policy during 2024. The guidelines will take into account the additional 50 basis-point buffer in the form of common equity tier 1 capital related to PTSB's recent denomination as another systemically important bank, as well as the 50 basis points of countercyclical capital buffer that will become effective from January 2025. At this stage, we expect PTSB to remain well capitalized, with a risk-adjusted capital (RAC) ratio remaining above 15% in 2024-2026, according to our calculation. That said, we continue to apply a qualitative negative notch of adjustment to our capital and earnings assessment, to signal our view that our projected RAC ratio could decrease below 15% in the future. It also reflects our view that PTSB's loss-absorbing capacity should continue to lag its larger group of higher rated peers over the outlook horizon. Furthermore, we expect that PTSB will maintain solid asset quality metrics, while expanding into the potentially riskier SME domestic sector. Finally, our projections also reflect our expectations that PTSB will be able and willing to maintain an ALAC buffer above 8% of our risk-weighted assets.

Outlook

The positive outlook reflects our view that PTSB's business plan will deliver a further improvement in profitability, competitiveness, and a stronger first layer of loss-absorbing capacity.

Downside scenario

We could revise our outlook to stable over the next 12-24 months if we considered it likely that PTSB would miss its financial targets, resulting in performance that did not deliver a further material improvement in its resilience and competitiveness.

Upside scenario

We could raise our ratings on PTSB over the next 12-24 months if the bank substantially delivered on its business plan, leading to improved sustainability, franchise strength, competitiveness, and revenue diversification.

Ratings Score Snapshot

Permanent TSB PLC

	To	From
Issuer Credit Rating	**BBB+/Positive/A-2**	**BBB+/Stable/A-2**
SACP		
Anchor	bbb+	bbb+
Business position	Constrained (-2)	Constrained (-2)
Capital and earnings	Strong (+1)	Strong (+1)
Risk position	Moderate (-1)	Moderate (-1)
Funding and liquidity	Adequate and adequate (0)	Adequate and adequate (0)
Comparable ratings analysis	0	0
Support	+2	+2
ALAC support	+2	+2
GRE support	0	0
Group support	0	0
Sovereign support	0	0
Additional factors	0	0

SACP--Stand-alone credit profile.

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- 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

Ratings List

Ratings Affirmed		
Permanent TSB PLC		
Resolution Counterparty Rating	A-/--/A-2	
Permanent TSB Group Holdings PLC		
Senior Unsecured	BB+	
Ratings Affirmed; Outlook Action		
	To	**From**
Permanent TSB PLC		
Issuer Credit Rating	BBB+/Positive/A-2	BBB+/Stable/A-2
Permanent TSB Group Holdings PLC		
Issuer Credit Rating	BB+/Positive/B	BB+/Stable/B

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.spglobal.com/ratings for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://disclosure.spglobal.com/ratings/en/regulatory/article/-/view/sourceId/504352. Complete ratings information is available to RatingsDirect subscribers at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.spglobal.com/ratings. Alternatively, call S&P Global Ratings' Global Client Support line (44) 20-7176-7176.