Banco Santander (SAN)

Updated January 27th, 2019 by Eli Inkrot

Key Metrics

Current Price:	$5	**5 Year CAGR Estimate:**	10.5%	**Volatility Percentile:**	71.9%
Fair Value Price:	$6	**5 Year Growth Estimate:**	3.4%	**Momentum Percentile:**	11.5%
% Fair Value:	91%	**5 Year Valuation Multiple Estimate:**	1.9%	**Growth Percentile:**	18.6%
Dividend Yield:	5.2%	**5 Year Price Target**	$7	**Valuation Percentile:**	76.5%
Dividend Risk Score:	F	**Retirement Suitability Score:**	C	**Total Return Percentile:**	75.3%

Overview & Current Events

Banco Santander, headquartered in Madrid, Spain, is a diversified banking business with operations in Retail Banking, Santander Corporate and Investment Banking, Wealth Management, and Spain Real Estate Activity. The company is truly global, with a presence in Europe, North America, and South America. Santander's top markets by attributable profit include Brazil (26% of profit), Spain (17%), United Kingdom (14%), Santander Consumer Finance (13%), Mexico (7%), Chile (6%), USA (6%), Portugal (5%), Poland (3%) and Argentina (1%). The $80 billion market cap company has 13,414 branches, with 201,000+ employees serving 142 million customers.

On October 31st, 2018 Santander released results for the nine months ending September 30th, 2018. For the third quarter, the company reported 8.35 billion euros (~$9.97 billion USD, using average exchange rates) in net interest income, a 1.5% decrease compare to last quarter and 1.99 billion euros (~$2.38 billion USD) in attributable profit, a 17.2% increase. For the nine months Santander reported 25.28 billion euros (~$30.18 billion USD) in net interest income, a 1.6% decrease and 5.74 billion euros (~$6.85 billion USD) in attributable profit, a 13.1% increase driven by strong results in Brazil and Spain. Earnings-per-share totaled 0.331 euros or ~$0.395 USD, representing a 4.7% increase, while tangible book value per share equaled 4.16 euros or ~$4.97 USD. The company's fully loaded Common Equity Tier 1 ratio was 11.11% against 10.8% in year prior.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	$1.79	$1.45	$1.25	$0.84	$0.29	$0.54	$0.64	$0.45	$0.45	$0.46	***$0.55***	***$0.65***
DPS	$0.88	$0.86	$0.80	$0.78	$0.79	$0.83	$0.73	$0.22	$0.22	$0.26	***$0.26***	***$0.32***
Shares	7,994	8,229	8,329	8,909	10,321	11,333	12,584	14,434	14,582	16,136	***16,500***	***18,000***

Note that all of the numbers in this report refer to the Banco Santander American Depository Receipts (ADRs) in USD, listed on the NYSE (ticker: SAN). Keep in mind that the Euro to USD exchange rate has varied over this time, going from roughly 1.3 or 1.4 Euro / USD from 2009 to 2014 to 1.1 or 1.2 Euro / USD from 2015 to 2018. This doesn't' explain all the changes above, but it does offer some partial insight. In addition, the company traditionally pays three cash dividends and one scrip dividend each year (which is why you see the share count marching upward).

The Global Recession hit Santander hard. Current earnings-per-share and dividends are now a shell of their former selves. However, there has been stability in the last half a decade or so.

Future growth could be aided by higher interest rates along with bolt on acquisitions. In addition, the Latin America markets have higher growth rates than their European counterparts. Of course, this is also a point of risk as these markets are not as established and overall credit tends to be more finicky.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	5.2	11.5	8.5	9.1	27.8	16.6	13.3	11.0	11.6	14.3	***9.1***	***10.0***
Avg. Yld.	9.4%	5.2%	7.6%	10.3%	9.8%	9.3%	8.6%	4.4%	4.2%	4.0%	***5.2%***	***4.9%***

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Santander has somewhat of a peculiar trading history, as the dividend was held relatively steady for years even after earnings collapsed. Eventually the high dividend payment caught up with the firm and a dividend cut was required.

Since the dividend cut shares have been trading in a more typical range. We believe a payout ratio around 50% and a dividend yield of about 5% (implying a P/E ratio of around 10 times earnings) is fair for the security. This incorporates the idea of some growth possibilities, but also discounts the security due to a variety of risks and the general notion that bank stocks do not demand a premium valuation. Shares appear nearly fairly valued at this point.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
Payout	49%	59%	64%	93%	272%	154%	114%	49%	49%	57%	***47%***	***46%***

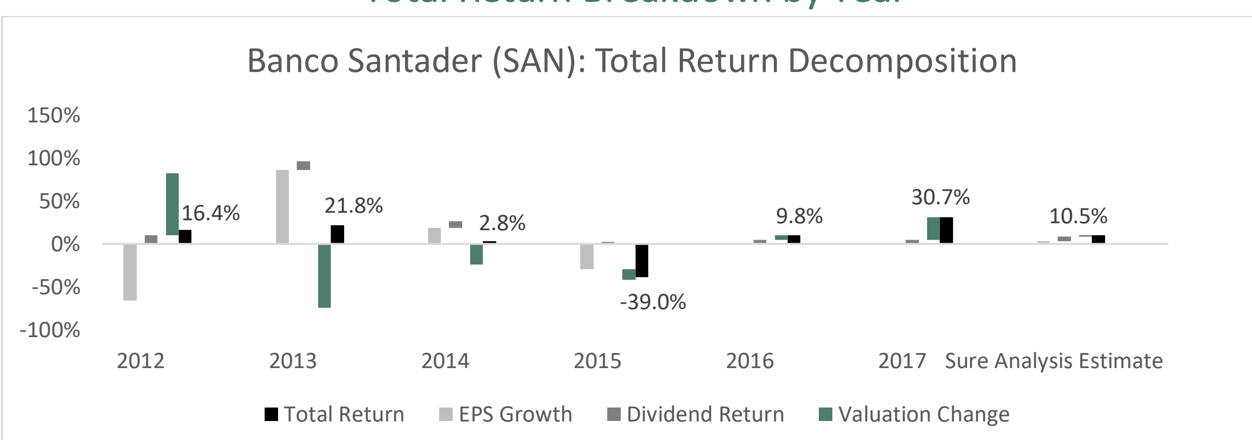
Santander has a few advantages over your typical bank, stemming from its top-five deposit market share in countries like Spain, Brazil, Mexico, Chile and Argentina. The wide geographical base gives the company multiple positions in markets that are not necessarily correlated.

The recession performance and aftermath is noteworthy. Santander went from earning $1.79 per share in 2008 down to $0.84 in 2011 and $0.29 in 2012. Since then earnings have rebounded, but not nearly to the same level. Furthermore, we believe that Santander should have slashed the dividend much earlier. Despite the material and lasting impact to earnings, the dividend continued along as though nothing had changed until 2014. Those four years of a near (or well above) 100% payout ratio required significant dilutive. Still, today things are looking better, with capital ratios improving and a more logical dividend payout ratio.

Final Thoughts & Recommendation

Santander could very well impress in the years to come, as its diverse geographic footprint allows the company to capture outsized growth in various parts of the world. Moreover, with a dividend yield above 5% and a P/E ratio under 10 times earnings, the security looks interesting from a starting valuation standpoint. However, we are cautious on a number of fronts. For starters, you have to consider the currency fluctuations, scrip dividend and dividend tax to own the ADR shares. In addition, the performance after the crisis – including the dividend policy decision – does not set up well for the next crisis to come. And finally, the same avenues for growth – namely faster developing Latin American countries – poise higher sovereign risk and uncertainty. Combined, this factors provide too many unknowns for us to get behind the security. We rate it as a hold today.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Revenue	43374	55457	66282	70652	64580	62234	67078	53524	52466	59337
SG&A Exp.	17123	20673	26688	29178	25107	24758	23835	18465	18972	21651
D&A Exp.	1863	2226	2571	2925	2807	3175	3041	2683	2616	2937
Net Profit	13028	12470	10844	7432	2935	5545	7734	6620	6866	7496
Net Margin	30.0%	22.5%	16.4%	10.5%	4.5%	8.9%	11.5%	12.4%	13.1%	12.6%
Free Cash Flow	22129	-32266	61946	45324	26029	N/A	N/A	-3948	14923	35334
Income Tax	2695	1683	3874	2447	751	2701	4944	2456	3632	4399

Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Total Assets ($B)	1467	1588	1619	1620	1679	1541	1540	1465	1416	1733
Cash & Eq. ($B)	64.0	49.9	103.5	125.0	156.7	106.5	84.9	85.0	80.8	133.2
Goodwill & Int.	28819	36670	37324	36376	37112	36235	36968	32176	31103	34411
Total Liab. ($B)	1371	1482	1512	1516	1572	1431	1431	1357	1307	1605
Accounts Payable	N/A	N/A	3320	2123	1926	1692	1786	N/A	N/A	N/A
Long-Term Debt	379683	52631	40531	29782	24120	22286	N/A	N/A	N/A	N/A
Total Equity	80472	98193	99771	96448	94952	97114	98260	96254	96136	113.4B

Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Return on Assets	0.9%	0.8%	0.7%	0.5%	0.2%	0.3%	0.5%	0.4%	0.5%	0.5%
Return on Equity	16.3%	14.0%	11.0%	7.6%	3.1%	5.8%	7.9%	6.8%	7.1%	7.2%
ROIC	2.8%	4.0%	7.1%	5.3%	2.2%	4.2%	6.4%	6.1%	6.3%	6.3%
Shares Out.	7,994	8,229	8,329	8,909	10,321	11,333	12,584	14,434	14,582	16,136
Revenue/Share	5.93	6.44	7.58	7.89	6.57	5.72	5.64	3.72	3.57	3.84
FCF/Share	3.02	-3.75	7.08	5.06	2.65	-4.63	-1.69	-0.27	1.02	2.29

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.