Banco Santander (SAN)

Updated January 31st, 2019 by Eli Inkrot

Key Metrics

Current Price:	$5	**5 Year CAGR Estimate:**	13.2%	**Volatility Percentile:**	72.0%
Fair Value Price:	$6	**5 Year Growth Estimate:**	3.8%	**Momentum Percentile:**	8.7%
% Fair Value:	83%	**5 Year Valuation Multiple Estimate:**	3.8%	**Growth Percentile:**	21.4%
Dividend Yield:	5.6%	**5 Year Price Target**	$7	**Valuation Percentile:**	83.3%
Dividend Risk Score:	F	**Retirement Suitability Score:**	C	**Total Return Percentile:**	85.8%

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 (13%), Santander Consumer Finance (13%), Mexico (8%), Chile (6%), USA (5%), Portugal (5%), Poland (3%) and Argentina (1%). The $78 billion market cap company has 13,217 branches, with 202,000+ employees serving 144 million customers.

On January 30th, 2019 Santander released fourth quarter and full year 2018 results. For the quarter the company reported 9.06 billion euros (~$10.69 billion USD, using average exchange rates) in net interest income, an 8.5% increase compared to the last quarter and 2.07 euros (~$2.44 billion USD) in attributable profit, a 3.9% increase. For the full year Santander reported 34.34 billion euros (~$40.52 billion USD) in net interest income, a 0.1% increase and 7.81 billion euros (~$9.22 billion USD) in attributable profit, an 18.0% increase as compared to 2017 driven by strong results in Brazil, Spain, Mexico and the U.S. Earnings-per-share totaled 0.449 euros or ~$0.53 USD, representing an 11.2% increase, while tangible book value per share equaled 4.19 euros or ~$4.94 USD. The company's fully loaded Common Equity Tier 1 ratio was 11.30% against 10.84% in 2017 and 10.55% in 2016.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	$1.45	$1.25	$0.84	$0.29	$0.54	$0.64	$0.45	$0.45	$0.46	$0.53	***$0.58***	***$0.70***
DPS	$0.86	$0.80	$0.78	$0.79	$0.83	$0.73	$0.22	$0.22	$0.26	$0.27	***$0.27***	***$0.32***
Shares	8,229	8,329	8,909	10,321	11,333	12,584	14,434	14,582	16,136	16,237	***16,700***	***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 and the company has yet to hit pre-recession earnings-per-share. However, there has been stability in the last 5 years, as the dividend is being rebased and earnings have started to slowly grow.

Future growth could be aided by rising 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	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	11.5	8.5	9.1	27.8	16.6	13.3	11.0	11.6	14.3	8.5	***8.3***	***10.0***
Avg. Yld.	5.2%	7.6%	10.3%	9.8%	9.3%	8.6%	4.4%	4.2%	4.0%	6.0%	***5.6%***	***4.6%***

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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 near 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. The P/E ratio has drifted down slightly since our last update, implying the potential for a bit multiple expansion in the future.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2024**
Payout	59%	64%	93%	272%	154%	114%	49%	49%	57%	51%	***47%***	***46%***

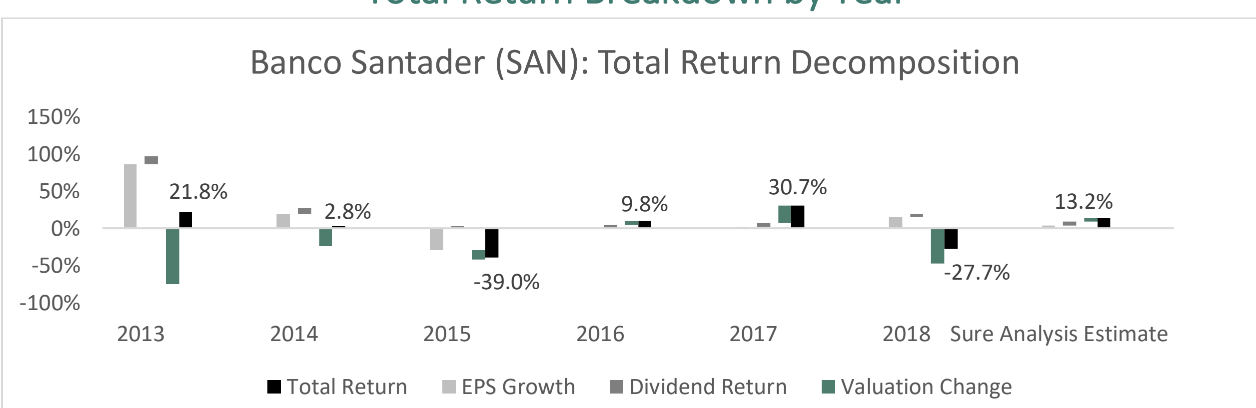
Santander has a few advantages over your typical bank, stemming from its top-five deposit market share in countries like Spain, Brazil, Mexico, Chile and Argentina. The wide geographical base gives the company multiple positions in markets that are not necessarily correlated.

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 action. Still, today things are looking better, with capital ratios improving and a more logical dividend payout ratio.

Final Thoughts & Recommendation

Since our last update shares are down slightly, with earnings coming in more or less in-line with expectations. This makes the security a bit more attractive and indeed 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 fully 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	6718.2	6723.1	7320	8307	8657	9021	9675	9946	11325	12444
Gross Profit	4586.8	4539.4	5034	5496	5876	6019	6356	6602	7495	8173
Gross Margin	68.3%	67.5%	68.8%	66.2%	67.9%	66.7%	65.7%	66.4%	66.2%	65.7%
SG&A Exp.	2625.1	2506.3	2707	3150	3367	3467	3547	3610	4137	4552
D&A Exp.	387.6	385.3	223	282	277	307	378	397	546	642
Operating Profit	1553.9	1661.4	1875	1762	1915	1878	2007	2157	2324	2463
Op. Margin	23.1%	24.7%	25.6%	21.2%	22.1%	20.8%	20.7%	21.7%	20.5%	19.8%
Net Profit	1147.8	1107.4	1273	1345	1298	1006	515	1439	1647	1020
Net Margin	17.1%	16.5%	17.4%	16.2%	15.0%	11.2%	5.3%	14.5%	14.5%	8.2%
Free Cash Flow	1020.7	1329.4	1365	1208	1447	1691	1549	711	1425	961
Income Tax	432.4	516.5	456	341	407	206	645	296	274	1043

Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Total Assets	7603.3	9071.3	10895	12146	13206	15743	17279	16223	20435	22197
Cash & Equivalents	701.1	658.7	1758	905	1395	1339	1795	3379	3316	2542
Acc. Receivable	1129.5	1147.1	1252	1417	1430	1518	1572	1662	1967	2198
Inventories	952.7	943	1057	1283	1265	1422	1588	1639	2030	2465
Goodwill & Int.	935.5	1591.5	1775	3514	3566	5833	6204	5930	9864	10645
Total Liabilities	2196.6	2476.2	3721	4463	4609	6696	8684	7712	10885	12217
Accounts Payable	274.3	200.2	292	345	288	314	329	410	437	487
Long-Term Debt	20.5	18	1021	1768	1762	2764	3973	3998	6914	7222
Total Equity	5406.7	6595.1	7174	7683	8597	9047	8595	8511	9550	9966
D/E Ratio	0.00	0.00	0.14	0.23	0.21	0.31	0.46	0.47	0.72	0.72

Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Return on Assets	15.3%	13.3%	12.8%	11.7%	10.2%	7.0%	3.1%	8.6%	9.0%	4.8%
Return on Equity	21.3%	18.5%	18.5%	18.1%	15.9%	11.4%	5.8%	16.8%	18.2%	10.5%
ROIC	21.2%	18.4%	17.2%	15.2%	13.1%	9.1%	4.2%	11.5%	11.4%	6.1%
Shares Out.	396.4	397.9	391.1	381	380.5	377.9	378.8	373.0	375.0	374.4
Revenue/Share	16.24	16.83	18.32	21.33	22.60	23.61	25.27	26.11	29.92	32.74
FCF/Share	2.47	3.33	3.42	3.10	3.78	4.43	4.05	1.87	3.76	2.53

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