Banco Santander (SAN)

Updated November 15th, 2019 by Josh Arnold

Key Metrics

Current Price:	$3.90	**5 Year CAGR Estimate:**	12.0%	**Volatility Percentile:**	63.6%
Fair Value Price:	$4.25	**5 Year Growth Estimate:**	4.0%	**Momentum Percentile:**	11.7%
% Fair Value:	92%	**5 Year Valuation Multiple Estimate:**	1.7%	**Growth Percentile:**	28.1%
Dividend Yield:	7.7%	**5 Year Price Target**	$5.20	**Valuation Percentile:**	81.6%
Dividend Risk Score:	D	**Retirement Suitability Score:**	B	**Total Return Percentile:**	87.3%

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%), The United Kingdom (13%), Santander Consumer Finance (13%), Mexico (8%), Chile (6%), USA (5%), Portugal (5%), Poland (3%) and Argentina (1%). The $65 billion market capitalization company has 13,000 branches, with 200,000+ employees serving 144 million customers.

Santander reported Q3 earnings on October 30th and results were decent. Total revenue grew 2.8% thanks to a robust 4.6% increase in net interest income year-over-year. The gain was primarily attributable to a larger asset base, which grew 5.1% thanks to a 5.7% increase in loans and advances to customers. Deposits rose as well, although not quite as quickly, gaining 4.6%. Interestingly, Santander's loan-to-deposit ratio is 111%, meaning the bank lends $1.11 for every dollar it pulls in via deposits. This extremely high level is very unusual among banks today, and means that, in our view, Santander's ability to grow via lending is quite limited by its ability to pull in further deposits. This increases risk as well as Santander is forced to fund loans via more expensive forms of capital.

Operating income was up 2.9% in Q3 and profit before tax gained 1.7%. Santander's efficiency ratio was outstanding in Q3 at 45.9% of revenue. This value is very low among banks of any size, but large banks in particular as Santander is doing a great job of controlling expenses. However, the gain in operating income was matched by share issuances, so on a per-share basis, no progress was made. Thus, we are maintaining our estimate of $0.50 in earnings-per-share this year after an in-line Q3 report.

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	***$0.50***	***$0.61***
DPS	$0.86	$0.80	$0.78	$0.79	$0.83	$0.73	$0.22	$0.22	$0.26	$0.27	***$0.30***	***$0.36***
Shares[1]	8,229	8,329	8,909	10,321	11,333	12,584	14,434	14,582	16,136	16,237	***16,618***	***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 2019. The company traditionally pays three cash dividends and one scrip dividend each year (which is why the share count rises over time).

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 was rebased and earnings have started to slowly grow.

Future growth should 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. We see 4% annual growth moving forward.

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[1] Share count in millions

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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	***7.5***	***8.5***
Avg. Yld.	5.2%	7.6%	10.3%	9.8%	9.3%	8.6%	4.4%	4.2%	4.0%	6.0%	***7.7%***	***7.1%***

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 normalized range. We have cut our estimate of fair value to 8.5 times earnings from 10 due to the obvious growth struggles the company is facing, in addition to the lateness of the global economic cycle. We therefore see shares as more or less fairly valued today, with an enormous dividend yield.

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%	***60%***	***60%***

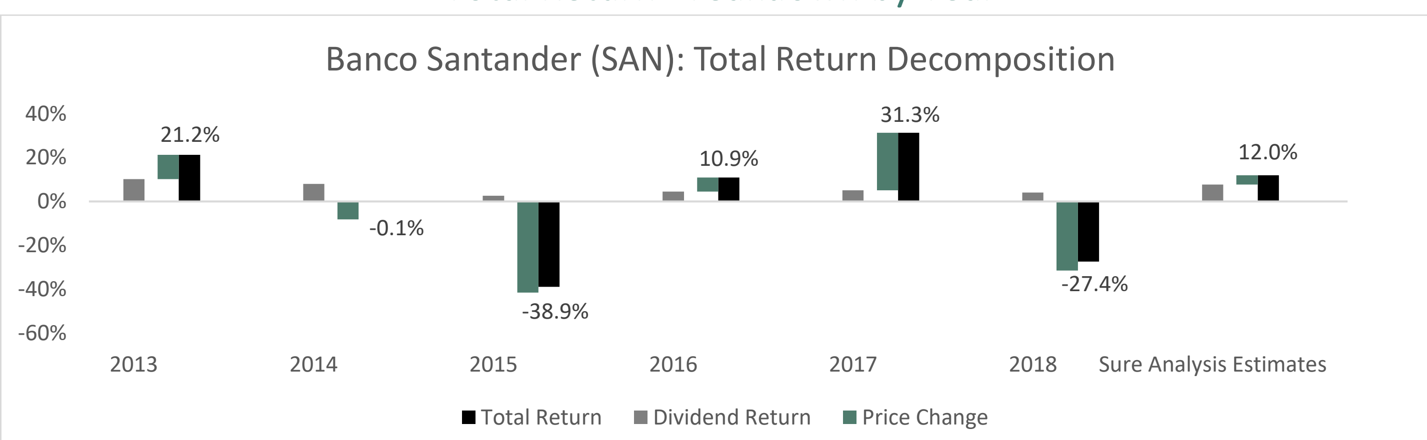
Santander has a few advantages over a typical bank, stemming from its top-five deposit market share in countries like Spain, Brazil, Mexico, Chile and Argentina. The wide geographical base gives the company multiple positions in markets that are not necessarily correlated.

Recession performance and its aftermath are 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 steady and a more reasonable dividend payout ratio.

Final Thoughts & Recommendation

We see Santander as fairly valued today following yet another selloff in the share price. We are forecasting 12% annual total returns, even after accounting for the decline in our fair value estimate. Shares offer a nearly-8% yield, which will make up the bulk of total returns, and barring some economic disaster, the payout should be safe for the foreseeable future. We certainly don't see Santander as one of the stronger global banks, but the stock is reasonably priced and offers a REIT-like yield. For that reason, but also accounting for the inherent risks, we rate Santander a hold.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	55457	66282	70652	64580	62234	67078	53524	52466	59337	51617
SG&A Exp.	20673	27746	30332	26250	26076	25137	19784	20184	23075	24742
D&A Exp.	2226	2571	2925	2807	3175	3041	2683	2616	2937	2863
Net Profit	12470	10844	7432	2935	5545	7734	6620	6866	7496	9222
Net Margin	22.5%	16.4%	10.5%	4.5%	8.9%	11.5%	12.4%	13.1%	12.6%	17.9%
Free Cash Flow	-32266	61946	45324	26029	-50.5B	-20.1B	-3948	14923	35334	-10.3B
Income Tax	1683	3874	2447	751	2701	4944	2456	3632	4399	5769

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets ($B)	1588	1619	1620	1679	1541	1540	1465	1416	1733	1669
Cash & Eq. ($B)	50	103	125	157	106	85	85	81	133	130
Goodwill & Int.	36670	37324	36376	37112	36235	36968	32176	31103	34411	32670
Total Liab. ($B)	1482	1512	1516	1572	1431	1431	1357	1307	1605	1546
Accounts Payable	N/A	3320	2123	1926	1692	1786	N/A	1491	2218	1814
Long-Term Debt	52631	40531	29782	24120	22286	0	0	0	0	0
Total Equity ($B)	98	100	96	95	97	98	96	96	113	110
D/E Ratio	0.54	0.41	0.31	0.25	0.23	0.00	0.00	0.00	0.00	0.00

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	0.8%	0.7%	0.5%	0.2%	0.3%	0.5%	0.4%	0.5%	0.5%	0.5%
Return on Equity	14.0%	11.0%	7.6%	3.1%	5.8%	7.9%	6.8%	7.1%	7.2%	8.2%
ROIC	4.0%	7.1%	5.3%	2.2%	4.2%	6.4%	6.1%	6.3%	6.3%	7.3%
Shares Out.	8,229	8,329	8,909	10,321	11,333	12,584	14,434	14,582	16,136	16,237
Revenue/Share	6.44	7.58	7.89	6.57	5.72	5.64	3.72	3.57	3.84	3.19
FCF/Share	-3.75	7.08	5.06	2.65	-4.63	-1.69	-0.27	1.02	2.29	-0.64

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