Banco Santander (SAN)

Updated February 3rd, 2020 by Josh Arnold

Key Metrics

Current Price:	$3.92	**5 Year CAGR Estimate:**	9.9%	**Market Cap:**	$64.5B
Fair Value Price:	$4.50	**5 Year Growth Estimate:**	2.0%	**Ex-Dividend Date:**	04/29/20[1]
% Fair Value:	87%	**5 Year Valuation Multiple Estimate:**	2.8%	**Dividend Payment Date:**	05/08/20[2]
Dividend Yield:	6.6%	**5 Year Price Target**	$5.00	**Years Of Dividend Growth:**	0
Dividend Risk Score:	C	**Retirement Suitability Score:**	A	**Last Dividend Increase:**	N/A

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 12,000 branches, with 196,000 employees serving tens of millions of customers around the globe. Santander reports results in euro, but all numbers for this report are in US dollars.

Santander reported Q4 and full-year earnings on January 29th, and results came in slightly ahead of expectations. The bank reported total assets rose 4.3% to $1.7 trillion, while deposits rose 5.6% to just over $900 billion, and loans increased 6.7% to just over a trillion dollars. Santander's increase in loans brought its year-end loan-to-deposit ratio to 87%, which is fairly high for a large bank, but not to the point of concern. Santander is still trying to grow its way out of the hole it dug for itself during the financial crisis through prudent loan growth.

Net interest income rose 2.7% during the year over 2018 as higher loan balances offset lower rates. Santander's expenses were kept in check as well as its efficiency ratio was flat with 2018 at 47% of revenue, which is outstanding for a large bank. In total, earnings-per-share was essentially flat with 2018, and after accounting for currency fluctuation, declined by a penny from $0.53 to $0.52.

Our initial estimate is for $0.53 in earnings-per-share for this year as we expect the bank to continue to grapple with very low rates, particularly in Europe where Santander has a large presence. We also note that Santander has made great strides with its balance sheet and credit quality, so it is much safer than it has been in past years.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	$1.25	$0.84	$0.29	$0.54	$0.64	$0.45	$0.45	$0.46	$0.53	$0.52	***$0.53***	***$0.59***
DPS	$0.80	$0.78	$0.79	$0.83	$0.73	$0.22	$0.22	$0.26	$0.27	$0.26	***$0.26***	***$0.26***
Shares[3]	8,329	8,909	10,321	11,333	12,584	14,434	14,582	16,136	16,237	16,618	***17,000***	***19,000***

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.

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[1] Estimated date

[2] Estimate date

[3] Share count in millions

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

Future growth could be aided by 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. However, due to extremely low rates around the world, we have cut our growth estimate from 4% annually to 2%. Santander continues to struggle with rates, and we don't see that changing.

Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	8.5	9.1	27.8	16.6	13.3	11.0	11.6	14.3	8.5	8.5	***7.4***	***8.5***
Avg. Yld.	7.6%	10.3%	9.8%	9.3%	8.6%	4.4%	4.2%	4.0%	6.0%	5.9%	***6.6%***	***5.2%***

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. Our fair value estimate is 8.5 times earnings, due to the obvious growth struggles the company is facing, in addition to the lateness of the global economic cycle. We see shares as undervalued today at just 7.4 times earnings, and with an enormous dividend yield.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	64%	93%	272%	154%	114%	49%	49%	57%	51%	50%	***49%***	***44%***

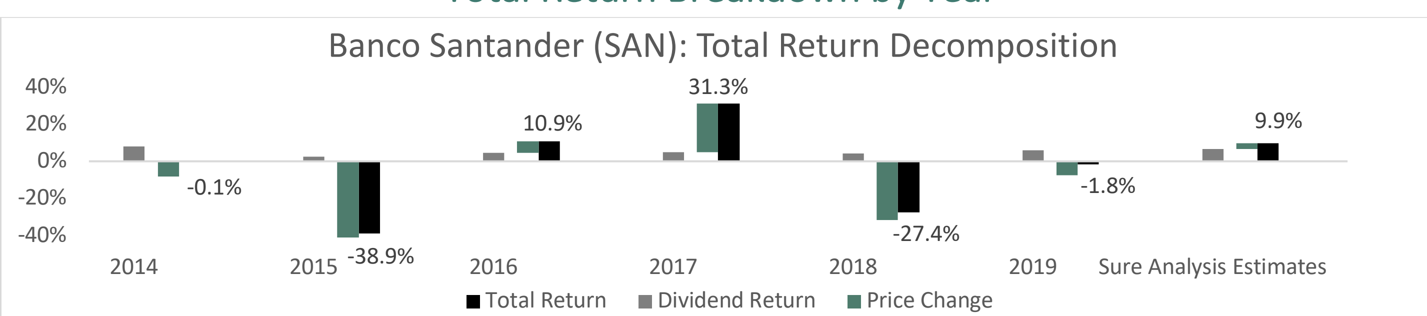
Santander has a few advantages over a typical bank, stemming from its top-five deposit market share in countries like Spain, Brazil, Mexico, Chile and Argentina. The wide geographical base gives the company multiple positions in markets that are not necessarily correlated.

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 undervalued today following yet another selloff in the share price. We are forecasting 9.9% annual total returns, even after accounting for the decline in our growth estimate. Shares offer a 6%+ 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	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	66282	70652	64580	62234	67078	53524	52466	59337	51617	50561
SG&A Exp.	27746	30332	26250	26076	25137	19784	20184	23075	24742	25405
D&A Exp.	2571	2925	2807	3175	3041	2683	2616	2937	2863	
Net Profit	10844	7432	2935	5545	7734	6620	6866	7496	9222	7294
Net Margin	16.4%	10.5%	4.5%	8.9%	11.5%	12.4%	13.1%	12.6%	17.9%	14.4%
Free Cash Flow	61946	45324	26029	-50.5B	-20.1B	-3948	14923	35334	-10.3B	
Income Tax	3874	2447	751	2701	4944	2456	3632	4399	5769	4956

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets ($B)	1619	1620	1679	1541	1540	1465	1416	1733	1669	1706
Cash & Eq. ($B)	103	125	157	106	85	85	81	133	130	113
Goodwill & Int.	37324	36376	37112	36235	36968	32176	31103	34411	32670	31014
Total Liab. ($B)	1512	1516	1572	1431	1431	1357	1307	1605	1546	1582
Accounts Payable	3320	2123	1926	1692	1786	N/A	1491	2218	1814	
Long-Term Debt	40531	29782	24120	22286	0	0	0	0	0	0
Total Equity ($B)	100	96	95	97	98	96	96	113	110	112
D/E Ratio	0.41	0.31	0.25	0.23	0.00	0.00	0.00	0.00	0.00	0.00

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	0.7%	0.5%	0.2%	0.3%	0.5%	0.4%	0.5%	0.5%	0.5%	0.4%
Return on Equity	11.0%	7.6%	3.1%	5.8%	7.9%	6.8%	7.1%	7.2%	8.2%	6.6%
ROIC	7.1%	5.3%	2.2%	4.2%	6.4%	6.1%	6.3%	6.3%	7.3%	5.9%
Shares Out.	8,329	8,909	10,321	11,333	12,584	14,434	14,582	16,136	16,237	16,618
Revenue/Share	7.58	7.89	6.57	5.72	5.64	3.72	3.57	3.84	3.19	2.80
FCF/Share	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.