Banco Santander (SAN)

Updated May 2nd, 2020 by Josh Arnold

Key Metrics

Current Price:	$2.15	**5 Year CAGR Estimate:**	10.5%	**Market Cap:**	$37.1B
Fair Value Price:	$3.40	**5 Year Growth Estimate:**	0.0%	**Ex-Dividend Date:**	N/A
% Fair Value:	63%	**5 Year Valuation Multiple Estimate:**	9.6%	**Dividend Payment Date:**	N/A
Dividend Yield:	0.0%	**5 Year Price Target**	$3.40	**Years Of Dividend Growth:**	N/A
Dividend Risk Score:	N/A	**Retirement Suitability Score:**	N/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 $37 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 first quarter earnings on April 28th, and results were predictably weak. Total revenue was down -2.4% year-over-year to $13.1 billion. Fee income fell -2.7% year-over-year to $3.2 billion, while net interest income was down -2.2% from the year-ago period to $9.42 billion.

Loans to customers were up 3% year-over-year to $1.04 trillion, while deposits rose 1% to $905 billion. That puts the bank's loan-to-deposit ratio at 115%, which is extremely high for any bank. Santander's weak operating history suggests there is little room for additional growth, and high risk of crippling loan defaults because of this.

Adjusted operating profit was up 1% year-over-year, but the bank took $1.8 billion in loan loss provisions against COVID-19-related losses. We've slashed our earnings-per-share estimate down to $0.25 for this year, which would be just half of earnings from 2019. We see Santander as having a very tough 2020.

Santander suspended its dividend indefinitely, and while we believe the bank will pay dividends again, the very weak earnings situation for 2020 has us forecasting no payments this year.

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	***$0.25***	***$0.40***
DPS	$0.80	$0.78	$0.79	$0.83	$0.73	$0.22	$0.22	$0.26	$0.27	$0.26	***---***	***$0.15***
Shares[1]	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 had started to slowly grow before the pandemic hit.

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

[1] 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.

overall credit tends to be more finicky. However, due to extremely low rates around the world, we have cut our growth estimate from 2% annually to 0%. 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	***5.4***	***8.5***
Avg. Yld.	7.6%	10.3%	9.8%	9.3%	8.6%	4.4%	4.2%	4.0%	6.0%	5.9%	***0.0%***	***4.4%***

We are using a normalized earnings power value of $0.40 per share for our valuation and fair value metrics, instead of actual estimates for this year. 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. Indeed, the dividend has been suspended for 2020 for the same reasons.

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 5.4 times earnings power.

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%	---	***38%***

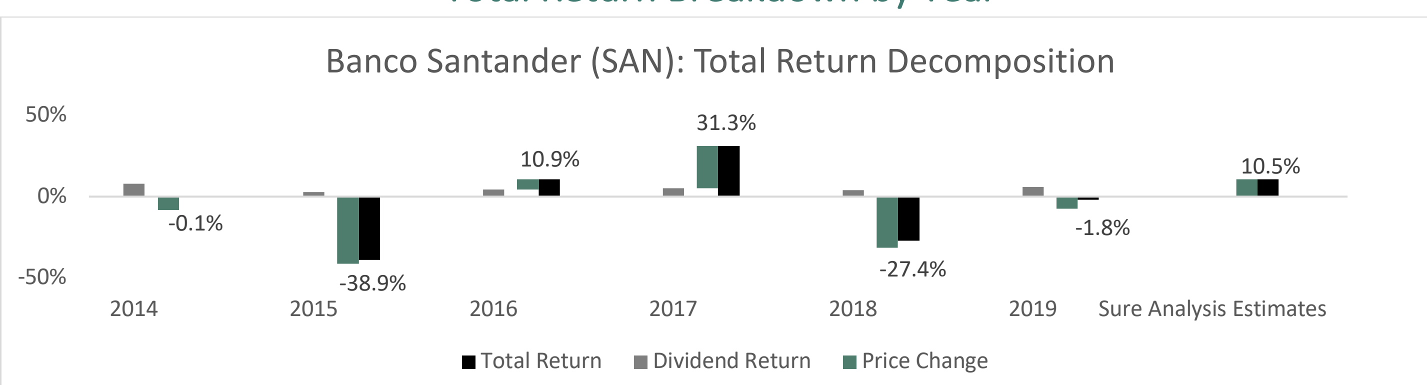
Santander has a few advantages over a typical bank, stemming from its top-five deposit market share in countries like Spain, Brazil, Mexico, Chile and Argentina. The wide geographical base gives the company multiple positions in markets that are not necessarily correlated.

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. We see 2020's recession as damaging as well.

Final Thoughts & Recommendation

We see Santander as undervalued today following yet another selloff in the share price. We are forecasting 10.5% annual total returns, even after accounting for the decline in our estimates. We are reiterating Santander at a hold rating despite high projected total returns because of high risks. The stock no longer offers a dividend, and we think Santander's balance sheet is overly leveraged, increasing risks during a time of economic uncertainty.

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	23729
D&A Exp.	2571	2925	2807	3175	3041	2683	2616	2937	2863	3360
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	-12.0B
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. ($B)	1512	1516	1572	1431	1431	1357	1307	1605	1546	1582
Accounts Payable	3320	2123	1926	1692	1786	N/A	1491	2218	1814	1891
Long-Term Debt	40531	29782	24120	22286	-	-	-	-	-	-
Total Equity ($B)	100	96	95	97	98	96	96	113	110	112
D/E Ratio	0.41	0.31	0.25	0.23	-	-	-	-	-	-

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	-0.73

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