Banco Santander (SAN)

Updated July 31st, 2020 by Josh Arnold

Key Metrics

Current Price:	$2.10	**5 Year CAGR Estimate:**	4.4%	**Market Cap:**	$37.3 B
Fair Value Price:	$2.45	**5 Year Growth Estimate:**	0.0%	**Ex-Dividend Date:**	N/A
% Fair Value:	86%	**5 Year Valuation Multiple Estimate:**	3.1%	**Dividend Payment Date:**	N/A
Dividend Yield:	0.0%	**5 Year Price Target**	$2.45	**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 11,800 branches, with 194,000 employees serving tens of millions of customers around the globe. Santander reports results in euro, but all numbers for this report are in U.S. dollars.

Santander reported second quarter earnings on July 29th, with results coming in extremely weak, as Santander posted the largest quarterly loss ever in its 160-year history. Net interest income was down -9% quarter-over-quarter to $9.1 billion, while noninterest income declined slightly more quickly than that, so total revenue was down -11%.

Total assets were up 2.1% quarter-over-quarter, while total loans were essentially flat. Customer deposits were up 4%, helping to bring the bank's loan-to-deposit ratio down a bit, which was welcomed. That ratio now stands at 110%, down from 114%. That's still extremely high and we note that investors should be cautious, particularly considering the struggles faced by the European economy, and the credit risk that brings to Santander.

We've left our estimate of earnings-per-share the same for this year at $0.25, but have cut our estimate of earnings power to $0.35 per share on continued weakness. Santander posted a -$13 billion loss in Q2, although most of that was non-cash charges. Still, the bank's earnings outlook is bleak at this point.

The European Central Bank also said in late-July that it was requesting all large European banks to suspend dividends until at least January 2021. Santander suspended its dividend earlier this year, but did propose a €0.10 scrip dividend, wherein it would issue new shares to shareholders rather than cash.

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***	***$0.35***
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***	***20,000***

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 had traditionally paid 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.

[1] Share count in millions

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Santander's 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. 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	***6.0***	***7.0***
Avg. Yld.	7.6%	10.3%	9.8%	9.3%	8.6%	4.4%	4.2%	4.0%	6.0%	5.9%	**---**	***6.1%***

We are using a normalized earnings power value of $0.35 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 cash 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 7 times earnings, due to the obvious growth struggles the company is facing, in addition to the lateness of the global economic cycle. With shares trading at 6 times earnings power this could imply a valuation tailwind.

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%	**---**	***43%***

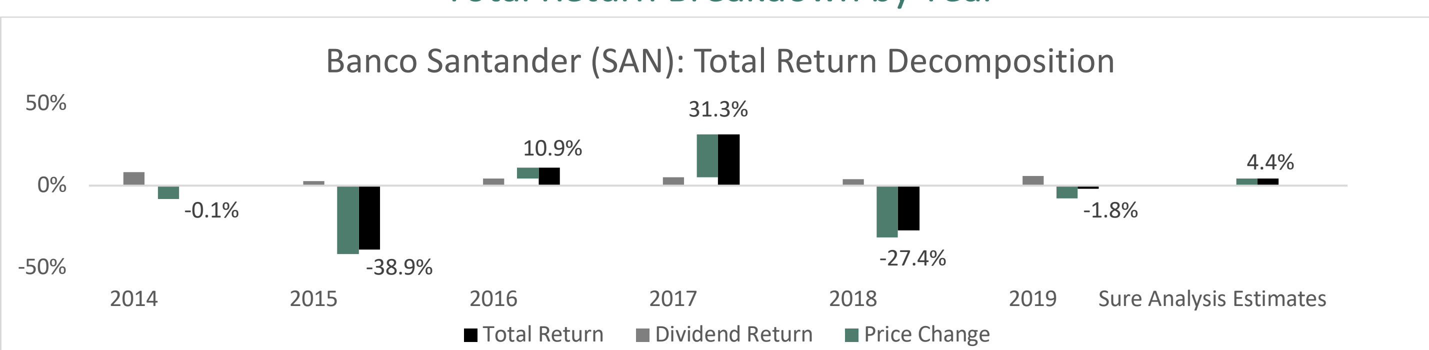
Santander has a few advantages over a typical bank, stemming from its top-five deposit market share in countries like Spain, Brazil, Mexico, Chile and Argentina. The wide geographical base gives the company multiple positions in markets that are not necessarily correlated.

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 had 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 are forecasting 4.4% annual total returns, even after accounting for the recent share price decline. We are moving Santander to a sell rating due to unattractive growth prospects and a risky business model. The stock no longer offers a dividend and 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. ($B)	1512	1516	1572	1431	1431	1357	1307	1605	1546	1582
Accounts Payable	3320	2123	1926	1692	1786	---	1491	2218	1814	1891
Long-Term Debt	40531	29782	24120	22286	---	---	---	---	---	---
Total Equity ($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.