Banco Santander SA
Issuer Rating Report

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Overview

On February 24, 2015 Scope upgraded Santander's Issuer Credit Strength Rating (ICSR) to A+ (from A), with a stable outlook and confirmed the short term ratings at S-1. The upgrade acknowledges the group's improved capital position, following the EUR 7.5bn capital increase in January, an improving – albeit still relatively weak - asset quality both at group level and in Spain as well as the stronger supervisory framework in Europe which is part of the ongoing progress towards a banking union. The ratings are driven by the bank's strong diversified retail and commercial banking business model, producing a reliable and well-diversified earnings stream and generating capital at the group level. Having withstood the global financial crisis, the Spanish real estate market collapse and the euro area sovereign crisis without damage to capital, the business model of Santander has proven its resilience to shocks in our view.

Due to the group's presence in several developed and emerging markets, we believe a key challenge for Santander will remain being faced with different regulatory requirements by different authorities and ensuring that prudential and supervisory requirements are met not only at the group level, but also locally.

The ratings on Banco Santander SA are based on Santander Group's credit fundamentals and are not applicable to unguaranteed debt issued by subsidiaries of Banco Santander SA.

The assigned ratings are not solicited by the issuer and benefitted from issuer participation in the rating process. For the full list of ratings see the **Ratings list** section at the end of this report.

Rating drivers (Summary)

The ratings drivers, in decreasing order of importance in the rating assignment and as detailed in this report, are:

+	A business model that withstood crisis challenges: cost-efficient provision of retail and commercial banking services (high pre-provision income buffer to absorb credit charges) and resilient group profitability.
+	Globally diversified revenue and earnings streams with strong market positions in several key markets, including Spain, Brazil, UK, Mexico, Chile and Poland.
−	A challenging macro environment in Spain still depressing profitability, although the cleanup of legacy assets is accelerating
+	Ongoing improvement of capital, liquidity and funding position in recent years.
+	European Banking Union likely to provide a stronger supervisory framework
−	Intervention by host or home supervisors could limit intragroup capital and liquidity flows across geographies at times of stress.

Rating change drivers

Further material improvements in Spanish asset quality and profitability. With the tentative recovery in the macro-economic conditions in Spain, Santander's domestic as well as group asset quality has shown clear signs of a turnaround. Group NPLs have started to decline, while inflows of new NPL have slowed down. The latest reported NPL ratio of 5.2% is close to the group's new target of 5%. A firming of the recovery with further declines in the level of problem assets and additional upticks in domestic profitability would accelerate capital formation and strengthen the group's fundamentals, possibly with a positive impact on the rating.

Deterioration of Brazilian asset quality and profitability. Despite accounting for only 10% of group loans, Brazil accounts for 31% of pre-provision profit and 27% of net profit in 2014. Deterioration in asset quality metrics in Brazil could impact the group's profitability.

Material increase in mortgage arrears in the UK due to future rate hikes. Santander UK is mainly a mortgage bank, with a relatively low average loan to value (47% in 2014) and asset performance in the UK is, so far, very reassuring (NPL ratio of 1.8%, cost of risk of 14 bps of loans in 2014). However, with the equivalent of c. EUR 250bn in loans, a material increase in the loss rate could have a significant impact on group profitability. An increase in the risk profile of the UK loan book, potentially driven by material portfolio diversification away from residential mortgages, could also have a negative impact on ratings.

Event risk. Santander has been very active in M&A both before and during the crisis, acquiring banking franchises in several countries, including the UK, the US, Germany and Poland. This strategy goes beyond the group's more traditional effort to grow in Latin America, where the bank rightly claims to have a cultural-related competitive advantage. So far most acquisitions and mergers have been effectively and successfully integrated, but the risk remains that potentially unexpected large transactions could have negative consequences on the group's fundamentals, including prudential metrics.

Recent events

FY 2014 results

Banco Santander reported its Q4 and full year 2014 results on February 3, 2015.

Net income for 2014 was EUR 5.8bn, a 39% growth from 2013 with the rebound in profitability primarily driven by a decline in Spanish loan loss provisions and a strong revenue performance of the UK unit, also supported by currency impacts. Pre-provision income for the group stood at EUR 22.5bn, 3.7% higher compared to 2013, supported by revenue growth of 1.7% and a mild decline of operating expenses. (-0.6% y-o-y). Revenue quality is high, with net interest income (+4% y-o-y) and commissions (+0.8% y-o-y) making up 92% of total revenues.

At the divisional level, we highlight the strong performance of the UK, with a 37% increase in net profit, which was helped by favourable FX movements but also by an increase in net interest margins.

The net income contribution from Brazil remained resilient at EUR 1.6bn despite a depreciating real and grew 8% y-o-y at constant exchange rates, with lower provisions (-18% y-o-y at constant FX) more than offsetting weaker revenue (-3% y-o-y at constant FX). The financial performance as well as the evolution in asset quality are consistent with the shift in loan mix, with strong growth (over 30% y-o-y) in lower risk segments (mortgages and large corporates) and a mildly declining loan book in consumer credit, automobile finance, cards and personal loans.

Spain delivered 140% y-o-y growth in net profit, primarily accounted for by lower provisions (-28% y-o-y) but also by a 7% decline in operating expenses against flat revenues.

In general, we note that the improvement in net profits did not come at the expense of the balance sheet and that the 14.4% decline in loan loss provisions reflects a parallel improvement in asset quality: the group's NPL ratio declined 42bps compared to December 2013 and across the main units, including Spain, Brazil and the UK, while NPL coverage was reinforced further during the year, reaching 67.2% at the end of 2014, compared to 64.9% in 2013. We also note the continued clean-up of legacy non core real estate assets in Spain, with non core loans declining 34% y-o-y.

Following the recent changes at the group, which included a reduction in the number of divisions, several top management changes, a capital increase and a change in dividend policy, Santander's new Executive Chairman presented a strategic review for the group. The new strategy, branded "Simple, Personal and Fair" aims to increase customer loyalty while achieving operational excellence, placing more emphasis on digital channels. The bank also introduced new financial targets for 2017 based on the new strategy, including a target for the fully loaded CET1 ratio of 10-11% and a return on tangible equity (ROTE) of 12-14% and an NPL ratio of below 5%. These targets are to be achieved mostly through organic growth.

Capital strengthening

On January 8, 2015, Banco Santander announced a EUR 7.5bn capital increase, aimed at strengthening its capital base and enabling the group to capture organic growth opportunities in the countries where it operates. At the same time the group announced a change in its dividend policy, cutting the annual dividend to EUR 0.20 per share, in four quarterly dividends, of which three to be paid in cash. Going forward, the group aims at a cash payout ratio of 30-40%.

The capital increase would add 140bps to Santander's fully loaded CRD4 CET1 ratio, taking the ratio from 8.3% to 9.65%. The group now plans to maintain a CET1 ratio of 12%-12.5% (transitional basis) and of 10%-11% (fully loaded basis) in 2015-2016.

Results of the Comprehensive Assessment

The results of the Comprehensive Assessment were positive for Santander, with very limited AQR adjustments and a resilient performance in the stress test, despite the somewhat weaker starting position with regards to fully loaded capital, reflecting to the strong capital generation of the group.

The AQR yielded no negative surprises with adjustments of just 4bps. Both the non performing exposures and coverage ratios remained broadly intact with adjustments of less than 50bps.

The results of the Stress Test (adverse scenario) for Santander are impacted by strong declines in the cumulative operating profits, with pre provision profits falling by more than 50% in 2016. The Brazilian operations of Santander, experience a large shock in the amount of provisions from EUR 8.8bn in 2014, through 2016 at EUR 17.8bn (adverse scenario). We note however that this is based on a static balance sheet assumption, and that management actions could in fact counter the impacts. For example, the Brazilian loan portfolio has generally a low duration, and tightening lending criteria could result in a faster reduction of the exposure.

Nevertheless, the 2016 CET1 ratio of Santander only declines to 8.95% under the adverse scenario, which is a reassuring result, with the total decline (140bps) being among the lowest declines in our rated banks universe.

On a fully loaded basis, Santander would finish the exercise in 2016 with a ratio of 7.33%, in line with the average results of our rated banks universe. The leverage ratio post AQR is 4.47%.

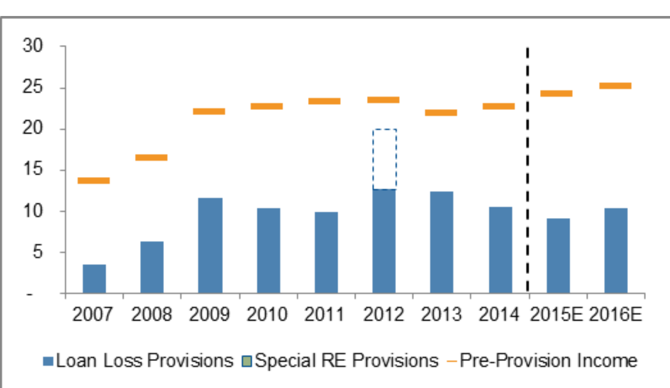
Rating drivers (Details)

1. **A business model that withstood crisis challenges: cost efficient provision of retail and commercial banking services (high pre-provision income buffer to absorb credit charges) and resilient group profitability.**

Santander's diversified retail business model has had a very good track record in recent years. Despite significant challenges due to the burst of a domestic credit and real estate boom, as well as a sovereign crisis, the group was able to survive and emerge in a reassuring shape thanks to its earnings resilience. With a group cost-income ratio of approximately 47% (average 2012-2014), Santander makes on average about EUR 22bn in pre-provision profit annually. This gives it a buffer that can absorb a wide range of adverse asset quality shocks.

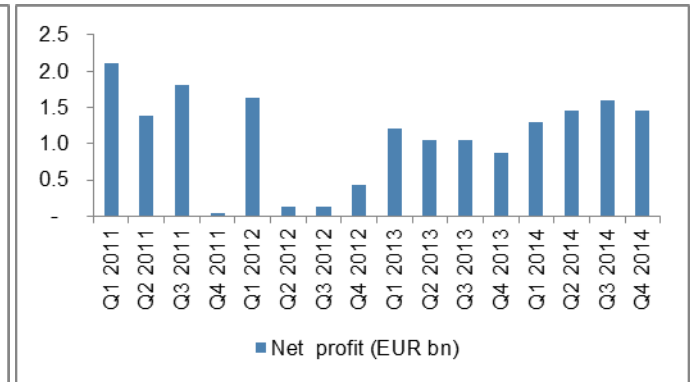
As shown in Chart 1a, this pre-provision profit buffer was sufficient to absorb significant losses throughout the crisis, including the extraordinary provision on real estate assets from the royal decrees in 2012. Indeed, we note that Santander has not posted a single quarter of net losses since the beginning of the global financial crisis and that its profitability has shown little volatility if we exclude the quarters of 2011 and 2012 when special real estate provisions were booked (see chart 1.b)

Chart 1.a: Recurring pre-provision profitability vs LLC, 2007-2016E



Source: Company data, Scope Ratings

Chart 1.b: Santander's quarterly net profit, 2011-2014



Source: Company data, Scope Ratings

This fact gives us some comfort about the group's protection against future risks: our forward-looking estimates point to a pre-provision profit buffer of approximately EUR 25bn in 2015, which would act as a first line of defence against adverse asset quality shocks.

We have stressed our group earnings and capital forecasts for Santander under several different adverse asset quality shocks to the group's main risk exposures (Spain, Brazil, UK) to test the bank's vulnerability to such shocks.

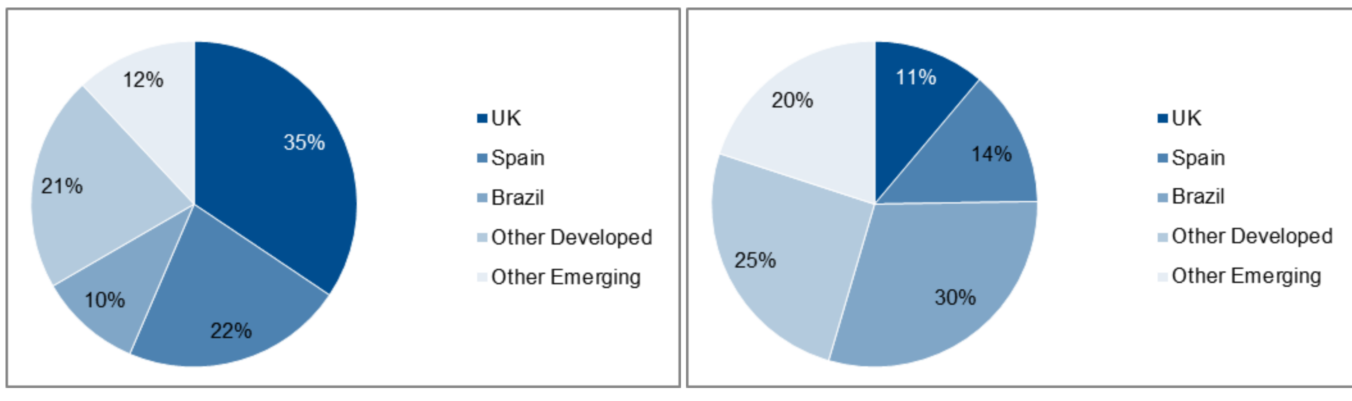
Our conclusion is that there is no single realistic asset quality shock that, in isolation, would pose a threat to group's solvency. As an example, raising the 2015 LLC rate for Spain (including run-off RE assets) fivefold (from our current estimate of 93bps to 464bps) would still leave the group with a pretax profit of EUR5.0bn. Similarly, raising Brazil LLC estimate from the current 680bps of loans to over 2000bps (basically trebling it, equivalent to charging off a fifth of the loan book in one year), would only produce a pretax loss of EUR1bn at group level. Our current estimate for the UK LLC rate is 20bps in 2015. Multiplying this estimate by five times would still see Santander profitable both at group level and in the UK.

Naturally, should several stresses materialise at once, group's profits and capital would be more severely impacted.

2. Globally diversified revenue and earnings streams with strong market positions in several key markets, including Spain, Brazil, UK, Mexico, Chile, Poland

Significant geographical diversification is a key positive driver for Santander's rating. The group comprises several retail and commercial banks in the Americas and Europe, servicing over 100 million customers globally. As shown in Chart 2.a and 2.b, mature markets still account for a majority of the loan book (c. 80%), but half of Santander's earnings power (as measured by pre-provision profit) is actually derived from the emerging markets franchises.

Chart 2.a: Santander Loan book split, 2014 | Chart 2.b: Santander pre-provision profit split, 2014



Source: Company data, Scope Ratings | *Source: Company data, Scope Ratings*

Going forward it is likely that faster underlying economic growth as well as additional potential for increased catch up in credit penetration in selected countries and segments (e.g. mortgages in Brazil) will likely lead to an increased contribution of emerging economies to Santander's loan book, although this may be balanced, in terms of earnings contribution, by lower margins as the loan mix shifts to lower risk, lower margin products.

As such, our positive view of the Group's international franchise does not relate only to its potential for higher revenue growth, but especially to the earnings smoothing provided by the diversification: it would take synchronised recessions in the different countries of operation to seriously threaten group solvency.

The Santander franchise has been built over several years, mostly through acquisitions. In that respect, we believe Santander's track record in acquisitions and integrations is positive so far. Since 2007, it has acquired several competitors in its core geographies at attractive prices, often benefitting from public backstops to risk, as was the case with the acquisition of Bradford & Bingley and Alliance & Leicester in the UK. Other major acquisitions in recent years include ABN AMRO Banco Real in Brazil, Sovereign Bank in the US and Zachodni WBK and Kredyt bank in Poland, as well as the SEB retail business in Germany. We note that, despite a strong appetite for inorganic growth, Santander's franchise remains fairly focused, with top three market positions in most of its core markets (see Table 1 for details).

Table 1: Santander has a leading franchise with strong market shares in its core countries

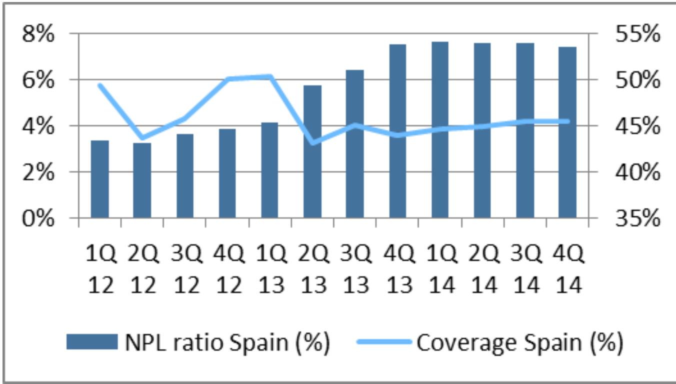
	Spain	Mexico	Brazil	Chile	UK	Poland
Market Share (%)	13%	14%	11%	18%	11%	9%
Market Position (#)	3	3	3*	1	4	3

Source: Company data, 2013
**market position refers to private banks*

3. A challenging macro environment in Spain still depressing profitability, although the clean-up of legacy assets is ongoing

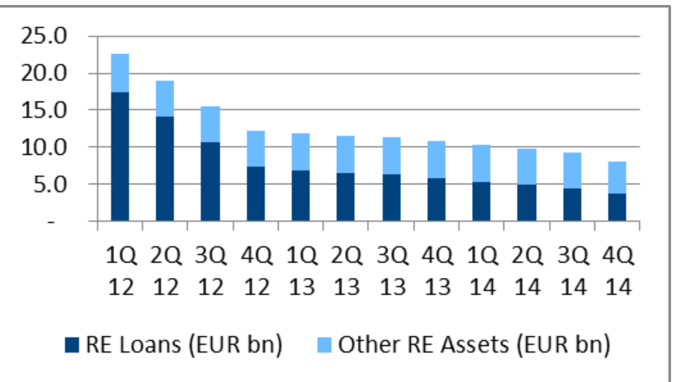
At year end 2014, Santander asset quality is still suffering from the legacy of a real estate boom and bust in Spain. However, both the group and the Spanish NPL ratio have stabilised during the year, with the NPL ratio for Spain declining 19 bps in Q4 2014 to 7.38%. Moreover, we note that the asset reduction in the non core Real estate division is ongoing, which we view as positive.

Chart 3.a: Spanish asset quality has stabilised



Source: Company data, Scope Ratings

Chart 3.b: Real estate legacy assets are declining



Source: Company data, Scope Ratings

Recent quarters have shown signs of a cyclical turnaround in the Spanish economy. Following three years of recession, Spanish GDP has finally turned positive in 2014 and is set to accelerate further to +2.3% in 2015 and +2.5% in 2016, according to European Commission forecasts[1]. If this scenario materialises, we would expect the domestic asset quality and profitability picture to continue to improve. We note, however, that there are still significant headwinds to a sustained growth recovery in Spain. These include:

- A still challenged fiscal situation (government deficit/GDP of 5.6% and public debt/GDP at 98.3% in 2014[2]. The fiscal drag will likely keep weighing on the Spanish recovery in the coming years.
- A significantly negative net international investment position (-98.2% of GDP in 2013), resulting from a prolonged period of accumulated current account deficits. On this particular statistic[3], Spain is very much comparable to Greece (-121% of GDP), Portugal (-116% of GDP) and Ireland (-102% of GDP).

As such, we believe Spain remains prone to a relapse into recession and have therefore taken a cautious approach in forecasting forward profitability for Santander's Spanish unit.

While not anticipating a credit event on the Spanish sovereign, we have also tested the group's resilience against possible restructurings of Spanish sovereign debt, especially in light of the latest political developments in Greece. While Santander's exposure is material (EUR47bn as of year end 2014, including bonds and loans) it remains manageable compared to group's resources. However, any material restructuring would weaken Santander's capital position.

Overall, we consider that the challenging macro environment continues to weigh negatively on the credit assessment of the group.

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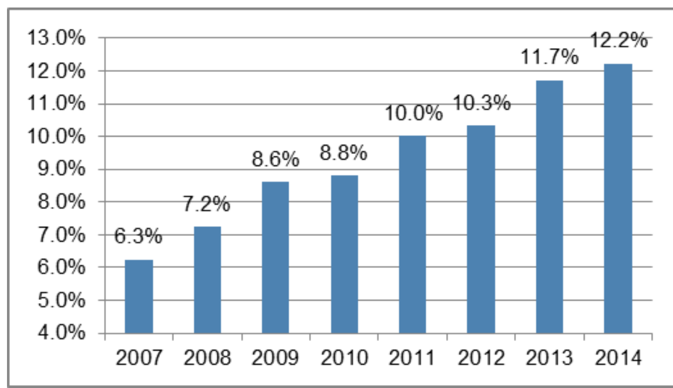
[1] European Commission, Winter Forecast 2015, published on February 2, 2015
[2] Source: European Commission
[3] Source: Eurostat

4. Ongoing improvement of capital, liquidity and funding position in recent years

Santander's capital position has improved materially over the years. Taking into account the capital increase in January 2015, Santander CRD4 CET1 ratio stands at 12.2%on a transitional basis, almost double the level it stood in 2007 (see chart 4.a). On a fully loaded basis, Santander CET1 ratio stands at 9.65%, which in our view is adequate given the group's strong track record of organic capital generation and relatively high asset risk intensity. The group's own target is to operate at a CET1 ratio of 10% to11%.

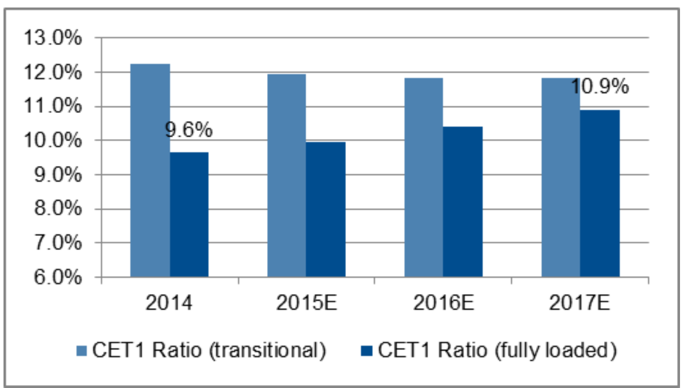
Santander manages to organically generate capital on a group basis, thanks to high risk adjusted profitability. On our estimates, the group will generate, before distributions, circa 120bps of RWA in 2015. After accounting for distributions and RWA growth financing, this should leave c. 37bps to reinforce the fully loaded capital ratio, bringing Santander within its target range towards the end of the year. However, we expect the transitional capital ratio to decline slightly as the CRD4 deduction phase-in will consume c. 50 basis points per year on our estimates. We show the expected path of Santander CET1 ratio over time in Chart 4.b, based on 4% risk weighted assets growth, and cash dividend payout ratio increasing to 30% over time (the group's new dividend policy is to pay out 30-40% of earnings, in cash). Based on these assumptions, the capital ratio will be at the higher end of the target range by 2017, including the gradual phase in CRD4 deductions. These estimates are conservative and do not account for any absorption of DTAs in the period (Spanish DTAs are worth c.100 bps and we expect Spain to be profitable in the coming years) or other capital optimisation actions, such as the migration of the Brazilian model for operational risk to the advanced model, which could release 20-30bps in capital, according to management estimates.

Chart 4.a: CET1* ratio evolution, 2007-2014



Source: Company data, Scope Ratings
**Basel 2 Core Tier 1 Ratio in 2007-2013, CRD4 transitional CET1 ratio in 2014*

Chart 4.b: CRD4 CET1 ratio forecast evolution, transitional vs fully loaded



Source: Company data, Scope Ratings
Note: based on RWAs growth of 4% in 2014-2017, avg. RoRWA of 1.2%

A further confirmation of such resilience emerged from the October 2014 comprehensive assessment, where the impact of the adverse scenario stress test on Santander's capital position was a relatively contained 140bps.

The funding and liquidity position has also significantly improved since the beginning of the crisis: the group's loan-to-deposit ratio went from over 160% in 2007 to c.119% in 2014. This has been the result of aggressive deposit acquisition (organic and inorganic) on the one hand and fast asset deleveraging, especially in Spain and Portugal, on the other. Going forward, there is still scope to rebalance the funding profiles of some subsidiaries, but we see the group funding profile as adequate and in line with international peers.

5. European Banking Union likely to provide a stronger regulatory and supervisory framework

Despite its fundamental strength, Santander credit risk perception has suffered in the past from a general distrust in the strength of the regulatory and supervisory framework in Spain. Going forward, Scope believes that the emergence of the Banking Union (BU) will eliminate doubts around the appropriateness of the regulation and supervision in any individual countries and allow investors to compare banks based on their intrinsic credit strength.

In particular, the introduction of a single rulebook (CRD4/CRR) provides more comparability between the reported prudential measures of European banks. Such convergence is ongoing during the phase-in period of the new capital and liquidity requirements and will be completed within the next half decade.

Similarly, the Single Supervisory Mechanism (SSM) represents a significant reassurance that all European banks are subject to the same strict standards of supervision, limiting concerns relating to possible regulatory forbearance or political interference in the supervisory process. With responsibility for supervision moved to a single, supranational and independent actor such as the ECB, the risk of inconsistent or incoherent application of the rules across the Eurozone (and the other countries subject to the SSM) is materially reduced.

The successful completion of the Comprehensive Assessment (CA) in 2014 has further validated asset quality and dispelled concerns of hidden losses from legacy exposures. In the case of Santander, the results of the Comprehensive assessment were particularly encouraging, as Santander NPL ratio was only adjusted by 4 basis points and the stress test only resulted in a 140bps decline in the CET1 ratio, one of the lowest among large European banks.

Moreover, the creation of a single resolution mechanism (SRM) will further delink Santander fortunes from that of other Spanish banks and loosen the bank-sovereign link further. With the Bank Resolution and Recovery Directive (BRRD) in force since 2015, government finances are much better protected from the contingent risk of a bank failing. Under BRRD, several supervisory actions, including the bailin of a large portion of bank liabilities, would buffer taxpayer money from the failure of a weak bank.

6. Intervention by host or home supervisors could limit intragroup capital and liquidity flows across geographies at times of stress

The recent financial crisis has shown that, in a period of stress, intragroup capital and liquidity mobility across geographies can be significantly constrained, limiting a cross-border banking group’s financial flexibility at a time when it needs it the most. Faced with such restrictions, steps ranging from the listing of a minority stake to the disposal of the entire business may be used by some banking groups as alternatives to unlocking capital from a subsidiary, for example. The extent to which cross-border banking groups have such alternatives at their disposal represents a mitigation to this risk.

Against this background, we look favorably at cross-border banking organizations that display reassuring capital and liquidity metrics not only at group level, but also at the subsidiary level.

Peer comparison

At Scope Ratings, we compare banks within peer groups at domestic and cross border levels.

Santander's national peer group comprises mainly BBVA, Bankia and Caixabank, although it also includes mid-sized banks such as Sabadell, Popular and Bankinter. While Santander and BBVA pursued an international expansion whereby Spain now represents approximately one-quarter and one-half of their respective loan portfolios, the rest of their peers are largely domestic lenders.

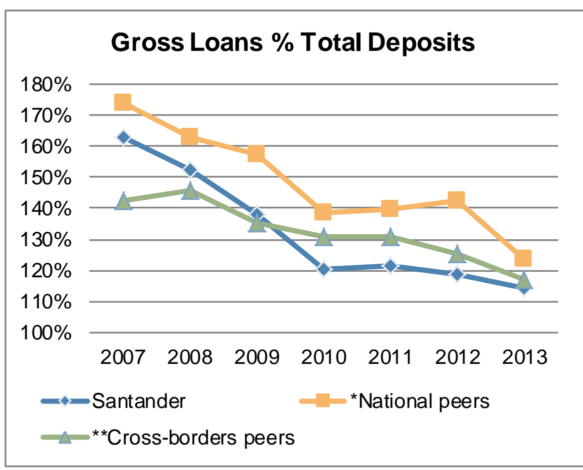
At the cross border level, we compare Santander with large and diversified retail banks, including Unicredit, KBC, RBS, ING, Erste Bank, Nordea, Commerzbank and RZB, as well as BBVA. The peer group is heterogeneous but its components share a predominant weight of retail in the banks' business model and exposure to several developed and emerging markets. While BBVA shares with Santander a significant presence in Latin America, Unicredit, KBC, Erste and Raiffeisen have a more significant presence in central and eastern Europe. Nordea, RBS, Commerzbank and ING are relatively less exposed to the growth (and risks) of developing markets. Several of the above names fall under the definition of systemically important financial institutions and as such are required to carry additional capital buffers (1% in the case of Santander).

Despite the asset quality problems from its home business, Santander compares favourably with both domestic and international peers when it comes to asset quality and profitability. Compared with domestic peers, this can be ascribed to the well-executed diversification strategy. The profitability gap with international peers, on the other hand, reflects a higher (risk-adjusted) revenue productivity of banking assets in Latin America as well as the superior cost efficiency of Santander's operations. With a group cost-to-income ratio of approximately 47% in 2014, Santander is among the most efficient banks in Europe. While we anticipate some decline in revenue margins in Latin America as the credit markets deepen and the business mix shifts towards secured credit, we expect the process of convergence in profitability to be slow and gradual (although not linear).

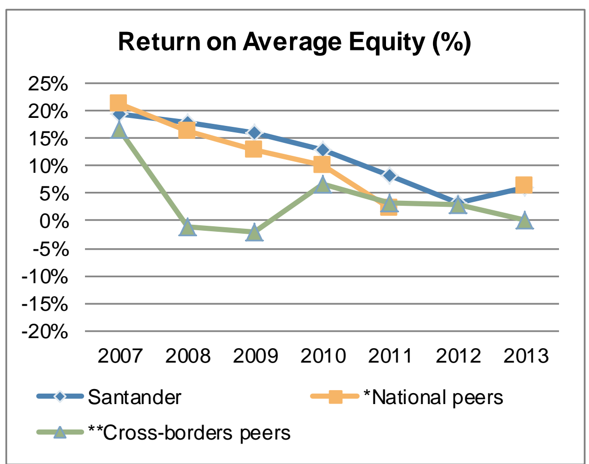
From a funding and liquidity perspective, Santander's deleveraging in Spain and aggressive deposit acquisition campaigns in Spain and the UK have succeeded in bringing down the group's loan-to-deposit ratio to c.119% from over 160% in 2007, which is lower than both national and cross-border peers.

Following the capital increase in January 2015, the bank is now aligned to its peer group on a fully loaded CRD4 CET1 ratio basis and stronger than peers on a transitional basis, despite the high loan content of Santander's balance sheet. The bank's leverage ratio is stronger than its peer group. Santander's capital position could further benefit, in time, from a convergence towards a more level playing field due to RWA harmonisation, where Spanish practices are particularly conservative.

Peer Comparison - Santander group

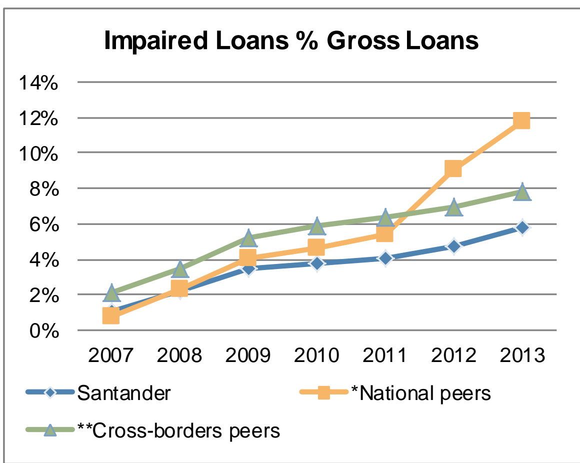


Source: SNL Financial, Scope Ratings

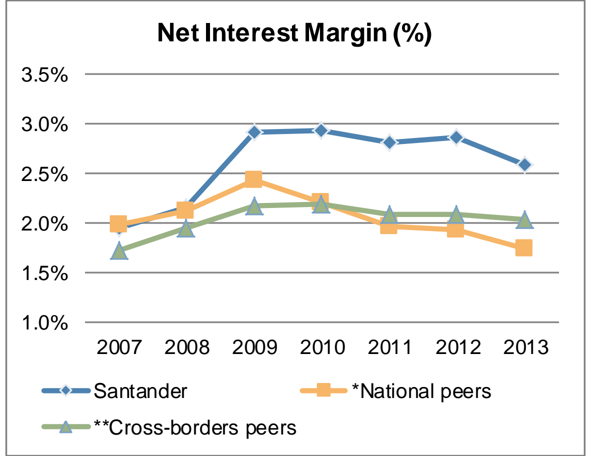


Source: SNL Financial, Scope Ratings

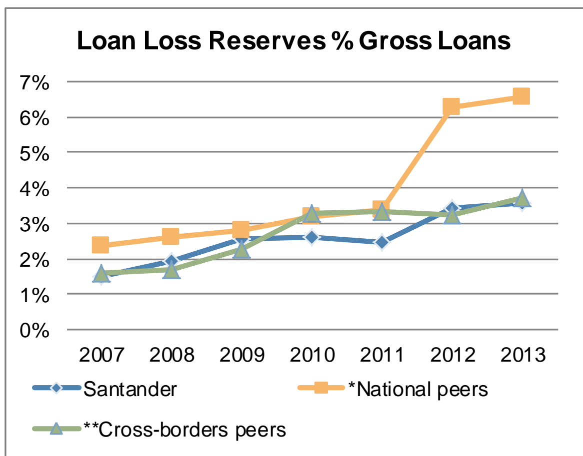
**2012 average for National peers is skewed by one bank posting a large loss*



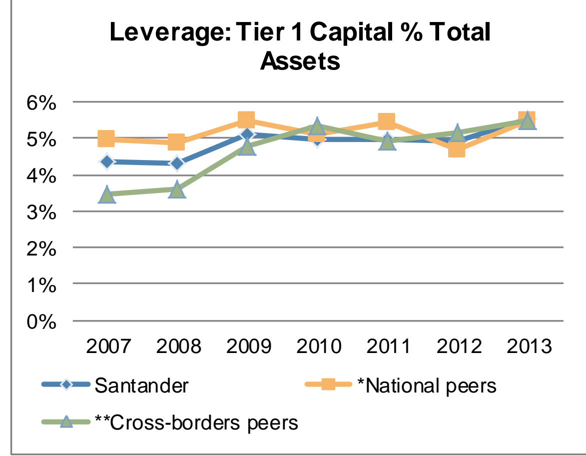
Source: SNL Financial, Scope Ratings



Source: SNL Financial, Scope Ratings



Source: SNL Financial, Scope Ratings



Source: SNL Financial, Scope Ratings

*National peers : Santander, BBVA, Caixabank, Bankia, Sabadell, Popular, Bankinter.

**Cross-border peers based on business model : Santander, BBVA, Unicredit, RBS, Erste Bank, RZB AG, Commerzbank, Nordea, KBC, Danske Bank, ING Bank.

Selected Financial Information - Santander group

	2008	2009	2010	2011	2012	2013	2014	2015E	2016E
Balance Sheet summary (EUR billion)									
Assets									
Cash and Interbank Assets	124.6	114.7	157.6	148.2	192.4	152.1	122.5	175.1	171.6
Total Securities	124.7	174.0	174.3	154.0	152.1	142.2	222.8	211.7	201.1
Derivatives	107.9	69.1	82.8	114.4	120.5	68.8	84.0	84.4	84.8
Net Loans to Customers	626.9	682.6	722.5	748.5	719.1	668.9	734.7	749.4	764.4
Other Assets	65.6	70.2	79.8	85.8	85.5	83.7	102.2	101.1	100.1
Total assets	**1,049.6**	**1,110.5**	**1,217.0**	**1,251.0**	**1,269.6**	**1,115.6**	**1,266.3**	**1,321.7**	**1,322.0**
Liabilities									
Interbank liabilities	129.9	142.1	140.1	143.1	153.0	109.4	147.8	199.7	193.7
Senior Debt	236.4	212.0	192.9	197.4	206.0	175.5	196.9	177.2	159.5
Derivatives	95.6	64.7	82.7	110.4	116.8	64.3	79.0	79.4	79.8
Deposits from Customers	420.2	507.0	616.4	632.5	626.6	607.8	647.6	667.1	687.1
Subordinated Debt + Non Equity Hybrids	38.9	36.8	30.5	23.0	18.2	16.1	17.1	15.4	13.9
Other Liabilities	68.7	74.1	74.9	63.8	67.7	62.6	88.1	88.2	88.2
Total Liabilities	**989.6**	**1,036.7**	**1,137.5**	**1,170.2**	**1,188.3**	**1,035.7**	**1,176.6**	**1,226.9**	**1,222.2**
Ordinary Equity	50.4	61.5	65.0	65.8	71.6	70.4	80.6	85.7	90.7
Equity Hybrids	7.2	7.2	8.7	8.7	0.3	0.2	0.2	0.2	0.2
Minority Interests	2.4	5.2	5.9	6.4	9.4	9.3	8.9	8.9	8.9
Total Liabilities and Equity	**1,049.6**	**1,110.5**	**1,217.0**	**1,251.0**	**1,269.6**	**1,115.6**	**1,266.3**	**1,321.7**	**1,322.0**
Core Tier 1 / Common Equity Tier 1 Capital	37.2	48.4	53.2	56.7	57.6	57.3	56.3	61.1	66.2
Income Statement summary (EUR billion)									
Net Interest Income	17.5	26.3	29.0	29.1	29.9	28.4	29.5	32.6	34.1
Net Fee & Commission Income	8.3	9.1	9.7	10.2	10.3	9.6	9.7	10.3	10.9
Net Trading Income	3.5	4.2	2.6	2.3	2.7	3.5	2.8	2.4	2.4
Other income	1.6	0.6	0.5	1.1	0.5	0.4	0.5	0.6	0.6
Operating Income	**30.9**	**40.2**	**41.7**	**42.8**	**43.4**	**41.9**	**42.6**	**45.9**	**48.0**
Operating Expense	14.5	18.2	19.1	19.6	20.0	20.2	20.0	20.7	21.2
Pre-provision Income	**16.3**	**22.0**	**22.6**	**23.2**	**23.4**	**21.8**	**22.6**	**25.2**	**26.8**
Loan Loss Provision charges	6.3	11.6	10.4	9.9	12.6	12.3	10.6	12.3	12.7
Other Impairments	1.0	0.2	0.3	0.2	0.9	0.5	0.4	0.3	0.3
Non-recurring items	1.8	0.3	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Pre-tax Profit	**10.8**	**10.6**	**12.0**	**8.6**	**5.4**	**7.4**	**9.7**	**11.4**	**12.7**
Discontinued Operations	0.3	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0
Income Tax Expense	1.8	1.2	2.9	2.5	2.3	2.0	2.7	2.8	3.2
Net Profit Attributable to Minority Interests	0.5	0.5	0.9	0.8	0.9	1.2	1.2	1.7	1.9
Net Profit Attributable to Parent	**8.9**	**8.9**	**8.2**	**5.4**	**2.3**	**4.2**	**5.8**	**6.8**	**7.6**

Source: SNL Financial and Scope Ratings for historical figures. Scope's forecasts are based on publicly available information and were last updated on February 18, 2015. Please refer to "Methodologies Used for this Report" for further details.
[1] CRD 4 (fully loaded) basis from 2014 onwards

Ratios - Santander group

	2008	2009	2010	2011	2012	2013	2014	2015E	2016E
Funding/Liquidity									
Gross loans % Total deposits	152.1%	138.2%	120.4%	121.3%	118.8%	114.1%	117.6%	116.0%	114.5%
Total deposits % Total funds	50.5%	56.0%	62.4%	63.0%	62.4%	66.9%	64.1%	63.0%	65.2%
Wholesale funds % Total funds	49.5%	44.0%	37.6%	37.0%	37.6%	33.1%	35.9%	37.0%	34.8%
ASSET MIX, QUALITY AND GROWTH									
Total loans % Funded assets	67.0%	67.0%	65.4%	67.3%	64.6%	66.0%	64.2%	62.3%	63.3%
Impaired loans % Gross loans	2.2%	3.4%	3.8%	4.1%	4.7%	5.8%	5.3%	4.7%	4.2%
Loan loss reserves % Impaired loans	89.1%	74.4%	70.0%	60.2%	72.0%	61.8%	67.2%	67.2%	67.2%
Gross loan growth (%)	10.3%	9.6%	5.9%	3.4%	-3.0%	-6.8%	9.8%	1.6%	1.6%
Impaired loan growth (%)	130.5%	71.7%	16.0%	12.2%	12.9%	14.2%	0.3%	-10.0%	-10.0%
Funded assets growth (%)	11.0%	9.6%	8.5%	0.6%	1.1%	-8.8%	12.9%	4.6%	0.0%
EARNINGS									
Net interest income % Revenues	56.8%	65.4%	69.4%	68.1%	68.9%	67.8%	69.3%	71.0%	71.0%
Fees & commissions % Revenues	26.8%	22.6%	23.2%	23.9%	23.6%	23.0%	22.8%	22.4%	22.7%
Trading income % Revenues	11.2%	10.6%	6.3%	5.4%	6.2%	8.3%	6.7%	5.3%	5.0%
Other income % Revenues	5.2%	1.4%	1.2%	2.6%	1.2%	0.9%	1.2%	1.3%	1.3%
Net Interest Margin (%)	2.2%	2.9%	2.9%	2.8%	2.9%	2.8%	2.9%	3.0%	3.0%
Pre-provision Income % Risk-weighted assets (RWAs)	3.2%	3.9%	3.7%	4.1%	4.2%	4.4%	3.9%	4.1%	4.2%
Loan loss provision charges % Pre-provision income	38.4%	52.6%	45.9%	42.7%	54.0%	56.7%	46.8%	48.7%	47.4%
Loan loss provision charges % Gross loans (cost of risk)	1.0%	1.7%	1.4%	1.3%	1.7%	1.7%	1.5%	1.6%	1.6%
Cost income ratio (%)	47.1%	45.3%	45.7%	45.7%	46.0%	48.1%	47.0%	45.1%	44.1%
Net Interest Income / Loan Loss Charges (x)	2.8	2.3	2.8	2.9	2.4	2.3	2.8	2.7	2.7
Return on average equity (ROAE) (%)	18.0%	16.0%	13.0%	8.2%	3.3%	5.9%	7.7%	8.2%	8.6%
Return on average funded assets (%)	0.6%	0.6%	0.5%	0.3%	0.1%	0.3%	0.3%	0.4%	0.4%
Retained earnings % Prior year's book equity	8.6%	9.1%	7.7%	5.1%	1.7%	4.4%	5.8%	6.0%	5.9%
Pre-tax return on core tier 1 capital	29.2%	21.9%	22.6%	15.2%	9.4%	12.8%	17.3%	18.6%	19.1%
CAPITAL AND RISK PROTECTION [1]									
Common equity tier 1 ratio (common equity tier 1 capital % RWAs)	7.2%	8.6%	8.8%	10.0%	10.3%	11.7%	9.6%	9.9%	10.4%
Tier 1 leverage ratio (%)	4.3%	5.1%	5.0%	5.0%	4.9%	5.5%			
Median of tier 1 leverage ratio and core tier 1 ratio (%)	5.8%	6.9%	6.9%	7.5%	7.6%	8.6%			
Total loss coverage (core tier 1 + loan loss provisions) % RWAs	9.7%	11.8%	12.0%	13.3%	14.9%	16.8%	14.3%	13.9%	13.9%
Non-senior bailinable debt Cushion (as % of Total liabilities)	4.6%	4.2%	3.4%	2.7%	1.6%	1.6%			
Asset risk intensity (RWAs % Total assets)	49.0%	50.6%	49.7%	45.2%	43.9%	43.9%	46.1%	46.5%	48.1%

Source: SNL Financial and Scope Ratings for historical figures. Scope's forecasts are based on publicly available information and were last updated on February 18, 2015. Please refer to "Methodologies Used for this Report" for further details.
[1] CRD 4 (fully loaded) basis from 2014 onwards

Ratings	
Issuer Credit-Strength Rating	**A+**
Outlook	Stable
Senior unsecured debt	A+
Additional Tier 1 instruments	BBB-
Short term debt rating	S-1
Short term debt rating outlook	Stable

Ratings history (ICSR)		
24/02/2015	**A+**	Upgrade
12/01/2015	**A**	Review (↑)
01/04/2014	**A**	First assignment

Methodologies used for this report

For the rating and analysis contents of this report, Scope has used the following methodologies which were published on www.scoperatings.com:

"Bank Rating Methodology" (February 2014)

"Forecasting Bank Financials Methodology" (February 2014)

Forecasting bank financials: Forward-looking estimates are an important analytical tool underpinning Scope's bank ratings. These forecasts cover the current financial year (before final year-end figures are published by the bank) plus the forthcoming two years. Depending on the complexity of the bank being assessed, different forecasting tools will be used. For a majority of banks operating primarily commercial and retail banking franchises (loans and deposits) the analysis is underpinned by an **accounting** forecast of the balance sheet and profit and loss account. For more complex groups with multiple ranges of activities – notably those with material wholesale and investment banking operations – Scope uses an **analytical** forecast, relying on the bank's business-line reporting to come up with plausible estimates. For all banks Scope also includes a **regulatory metrics** forecast, considering the growing importance of this aspect in bank analysis.

Scope will not aim to forecast financials when it considers the public disclosure of the bank as insufficient for a transparent and credible outcome.

All Scope's bank financial forecasts are based on public information. For its forecasts Scope will not use any non-public information or data, even if such information or data were provided by rated banks. Scope's forecasting process is transparent, with a detailed roadmap provided in its *"Forecasting bank financials"* methodology.

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