

Santander Finance Capital S.A. Unipersonal

RISK-TO-PRICE SCORE	
Ticker	ISIN
SAN	ES0213900196
Q1	88.5

The long-lasting European sovereign debt crisis has significantly affected Spanish banks, which have reported disappointing fourth-quarter and year-end results. For example, Banco Santander S.A. and Banco Bilbao Vizcaya Argentaria S.A. released fourth-quarter earnings on Jan. 31 and Feb. 2, respectively, that were 23% and 44% lower than what the consensus expected, according to S&P Capital IQ.

The new government in Spain plans to tighten the rules for accounting for real estate assets on the banks' books. As a result, Banco Santander S.A. took a massive write down of its real estate holdings for 2011, leading to a 98% decline in net income. On Jan. 31, Santander reported that fourth-quarter net income fell to €47 million (\$61.9 million) from €2.1 billion a year earlier, while normalized earnings per share of €7.90 were 5% lower than S&P Capital IQ consensus expectations. Although Santander's shares returned a loss of 21% over the last year, they have outperformed the European financials sector by 5% (see chart 1).

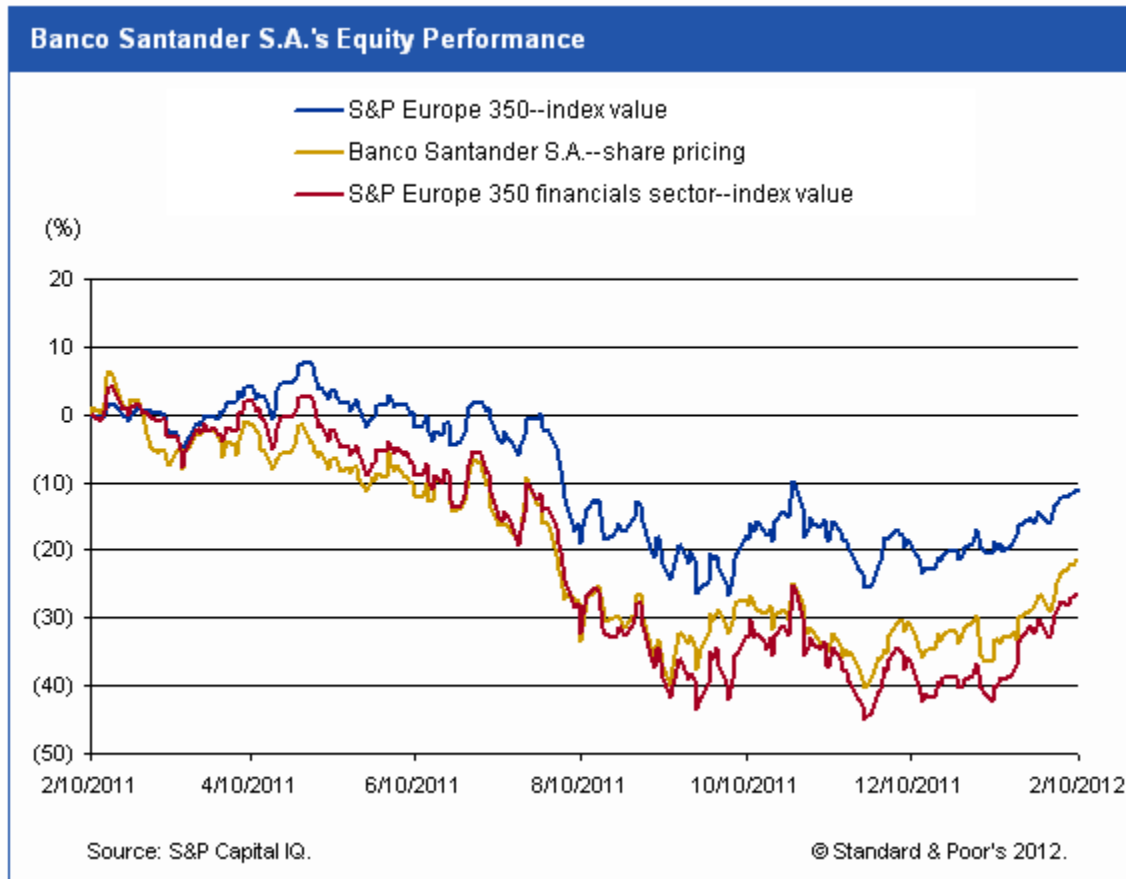
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Chart 1



Despite lower earnings, Santander expects to maintain its dividend of €0.60 a share and forecasts a 15% increase in profits from Brazil, its biggest market. Chairman Emilio Botin reiterated a target he set in September for Santander: to achieve return on equity of 12% to 14% in 2014 "despite the recent worsening of the international environment."

Using our Risk-to-Price (R2P) analytic, the Global Markets Intelligence (GMI) research team wanted to see how Santander's bonds ranked relative to other debentures from the European banking subsector we score. R2P scores measure, on a relative basis, how well a given security compensates investors, through yield, for underlying market and credit risks. The first quartile contains the highest-scoring issues, which best compensate investors for underlying risks; the lowest scores rank in the fourth quartile.

Our screen of European banks returned 579 callable and noncallable debentures with durations of at least one year and initial offering amounts of at least 50 million in the issuing currency. The R2P scores in our query ranged from 2.9 to 167.7 (see table 3 for selected securities from the first quartile).

Of the 16 issues from Banco Santander or its subsidiaries we score, 11 ranked in the top two quartiles. We identified Santander Finance Capital S.A. Unipersonal's 7.375% coupon note with maturity on Dec. 17, 2012, which ranked sixth in our screen in the 97th percentile of the European bond universe. The note offers investors a generous spread of 596 basis points (bps), which translates into a high yield of 7.25% for the short 0.9 year duration. The note's high ranking was due to its low probability of default (PD) of 0.153% (financials sector average of 0.44%), and its relatively low volatility of 0.053%, compared with the sector's volatility of 0.435%. The note's score has improved over time and retained its

ranking since we commented on the issue over two months ago (see "Risk-to-Price Commentary: Banco Santander S.A.," published Dec. 8, 2011, on RatingsDirect; and tables 1 and 2).

Table 1

R2P Score History		
	R2P quartile	R2P percentile
6/30/2010	3	41
12/31/2010	3	33
6/30/2011	1	78
12/31/2011	1	98
2/8/2012	1	97

Table 2

Santander Finance Capital's 7.375% Coupon Note With Maturity On Dec. 17, 2012										
	ISIN	Price	Yield (%)	Volatility (%)	OAS (%)	PD (%)	Duration	R2P score	R2P quartile	R2P percentile
2/8/2012	ES0213900196	100.04	7.247	0.0529	5.963	0.1530	0.9	88.5	1	97
12/8/2011	ES0213900196	99.63	7.749	0.0690	6.002	0.1231	1.0	87.1	1	98

OAS--Option-adjusted spread. PD--Probability of default.

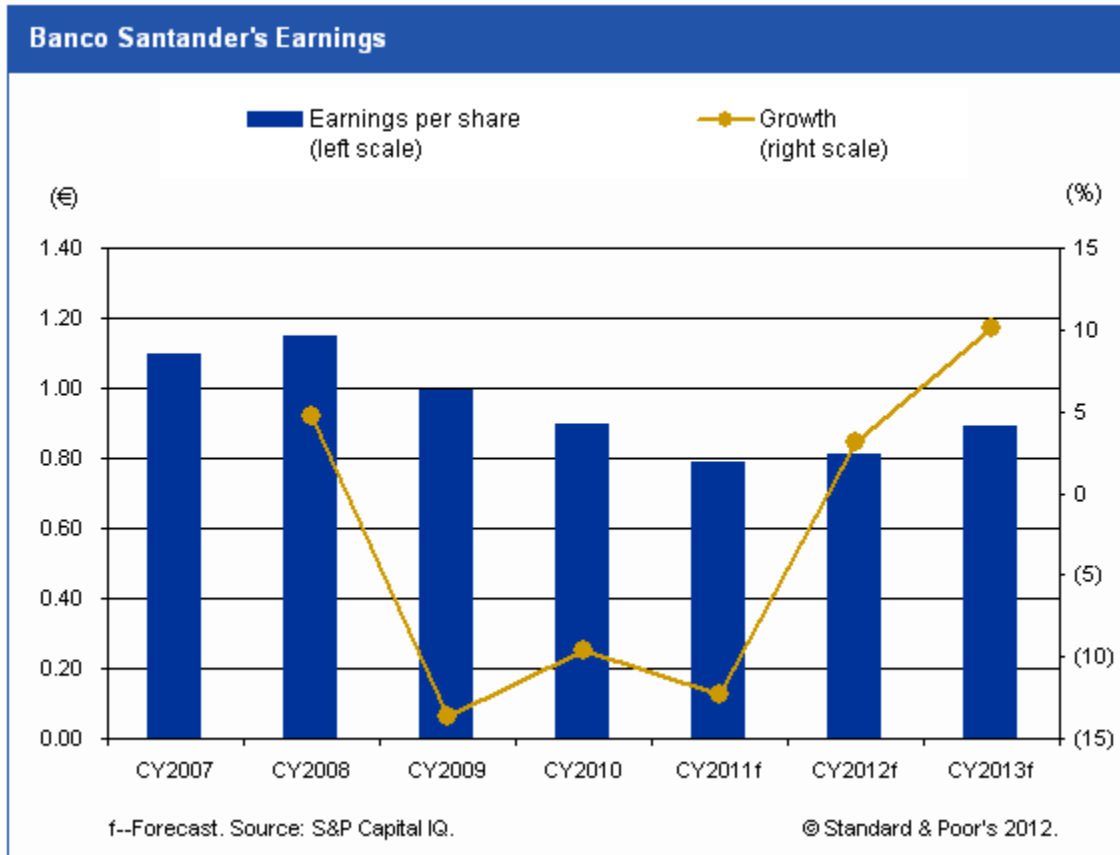
Banco Santander S.A., Spain's biggest lender, provides a range of banking and financial products. The company was founded in 1857 and is based in Madrid, Spain.

As a result of the effect of the sovereign debt crisis on banks, analysts have lowered 2011 earnings forecasts for the European financials sector. Earnings growth for the major financial corporations of the S&P Europe 350 Index dropped from 42% in 2010 to negative 19% in 2011. While analysts have also lowered their 2012 earnings forecasts for the financials sector, they still expect European financials earnings to return to 24% growth this year (see chart 2).

Chart 2

Although Santander's earnings declined in 2011, analysts forecast earnings to recover in 2012 and grow in double digits in 2013, faster than those of the European bank sector (see chart 3).

Chart 3



However, a continued sovereign debt crisis is likely to lower the sector's earnings, and we may see more downward revisions from analysts during the next results season in February and March 2012. So far, the European financials sector has underperformed the S&P Europe 350 Index by 19% over one year.

The GMI research team considers Santander's financial ratios satisfactory. Although Santander's quality of loans has deteriorated slightly over the last few years, this has been an industry trend, rather than a company-specific deterioration. The bank is more profitable than its European peers, measured by the return on assets ratio; and the capital structure is competitive (see table 3).

Table 3

Comparison Of Selected Credit Ratios				
	2007	2008	2009	2010
Return on assets (%)				
Banco Santander S.A.	0.99	0.92	0.87	0.78
Peer group	0.88	0.18	0.65	0.75
Average common equity/average assets (%)				
Banco Santander S.A.	5.73	5.75	5.84	6.17
Peer group	3.91	3.40	3.56	4.55

Table 3

Comparison Of Selected Credit Ratios (cont.)				
Nonperforming loans/total loans (%)				
Banco Santander S.A.	N/A	2.27	3.65	3.94
Peer group	1.41	1.65	2.80	3.13
Tier 1 capital ratio (%)				
Banco Santander S.A.	N/A	N/A	10.10	10.02
Peer group	6.50	6.59	10.27	10.89

N/A--Not applicable. Source: S&P Capital IQ.

Santander had a capital shortfall of €15.4 billion in 2011, the largest under the latest round of European Banking Authority (EBA) stress tests, and only avoided issuance of the new shares in part by making disposals outside its home market. On Jan. 9, Santander said it had plugged the capital gap by selling assets and swapping preferred shares for stock and had met the 9% core capital ratio requirement set under EBA criteria six months ahead of the June deadline.

Standard & Poor's Ratings Services has a 'AA-' rating on the company. The bank's strengths include its "very strong business position, adequate capital and earnings, strong risk position, above-average funding, and sustained earnings outperformance compared with peers," Standard & Poor's said (see "Research Update: Spanish Bank Banco Santander And Core Subsidiaries 'AA-/A-1+' Ratings Affirmed On Bank Criteria Change; Outlook Negative," published Nov. 29, 2011). "The negative outlook mirrors that on Spain. In addition, it reflects our view that, in light of the difficult and uncertain economic environment, Santander may underperform our expectations for capital, profitability, or asset quality."

Equity analysts currently have an overall neutral view on Santander's shares. Of the 37 analysts that follow the company, 11 have either a buy or outperform recommendation, nine have a sell or underperform recommendation, and 17 recommend holding Santander's shares. Since the company reported its results on Jan. 31, its share price has been rising, which supports the high R2P score. Typically, share price gains negatively correlate to a PD on a bond; as the PD improves, R2P scores tend to rise.

If economic growth in the European economy stalls for longer than currently anticipated as a result of the sovereign funding crisis, European banks will face tougher times ahead. Nevertheless, our R2P analytic found issues that compensate investors well for risks. We believe that Santander can carry on in the tougher operating environment better than some of its competitors as a result of the company's robust business and financial metrics and equity market expectations, which will subsequently support the note's high R2P score going forward (see table 4).

Table 4

Risk-to-Price Score Ranking (European Banks Subsector Corporate Debt)														
	ISIN		Offer amount (mil. \$)	Coupon	Price	Yield (%)	Volatility (%)	Maturity	OAS (%)	PD (%)	Duration	R2P score	R2P quartile	R2P percentile
Royal Bank of Scotland PLC	XS0447713735	GBP	200	5.120	100.71	3.673	0.0019	8/21/2012	2.4248	0.3520	0.5	167.7	1	99
Banco Internacional de Credito, S.A.	XS0130374779	EUR	75	6.030	99.07	6.766	0.0149	6/7/2013	5.3297	0.2649	1.3	112.7	1	99
Credit Agricole S.A.	FR0010337097	EUR	480	4.300	99.74	4.348	0.0056	6/26/2018	2.0412	0.3584	5.7	100.4	1	98
Ostfriesische Volksbank eG	AT0000432968	EUR	50	5.500	102.53	2.840	0.0069	1/31/2013	1.5357	0.2232	1.0	99.8	1	98

Table 4

Risk-to-Price Score Ranking (European Banks Subsector Corporate Debt) (cont.)														
Credit Agricole S.A.	FR0010125500	EUR	380	4.100	98.33	4.758	0.0087	10/29/2014	3.0341	0.3584	2.6	99.1	1	98
Santander Finance Capital S.A. Unipersonal	ES0213900196	EUR	60.1	7.375	100.04	7.247	0.0529	12/17/2012	5.9625	0.1530	0.9	88.5	1	97
Credit Agricole S.A.	FR0010521559	EUR	656	4.700	102.29	4.247	0.0065	10/15/2017	1.6408	0.3584	0.7	86.8	1	97
Credit Agricole S.A.	FR0010401026	EUR	419	4.000	96.63	4.963	0.0122	12/22/2015	3.0275	0.3584	3.7	86.4	1	96
Erste Group Bank AG	XS0168112117	EUR	50	5.310	100.98	5.218	0.0128	5/15/2028	2.1829	0.2634	1.2	84.0	1	96
Paragon Group PLC	XS0216276070	GBP	120	7.000	98.54	7.353	0.0429	4/20/2017	5.1727	0.2056	4.5	80.8	1	96
Britannia Building Society	XS0145065602	GBP	150	5.875	70.22	9.068	1.2472	3/28/2033	6.0201	0.0084	13.4	80.3	1	96
Credit Agricole S.A.	FR0010177949	EUR	502	4.000	98.62	4.299	0.0111	4/19/2017	2.1503	0.3584	4.7	78.3	1	96
Credit Agricole S.A.	FR0010317511	EUR	516	4.200	91.16	5.904	0.0203	5/4/2018	3.6287	0.3584	5.6	75.7	1	95
Banco Santander Totta S.A.	PTCPPROE0027	EUR	1,000	2.625	93.92	5.658	0.0574	4/15/2014	4.0075	0.1530	2.1	73.0	1	95
Commerzbank AG	DE000CB891P6	EUR	100	4.745	101.52	3.228	0.0110	2/20/2013	1.8684	0.4727	1.0	66.3	1	93
Banco Pastor, S.A.	ES0413770134	EUR	600	3.625	97.51	7.736	0.0746	9/24/2012	6.5332	0.2633	0.6	64.4	1	92
Commerzbank AG	DE000CB891Q4	EUR	150	4.758	101.08	3.305	0.0134	11/20/2012	2.0549	0.4727	0.8	63.8	1	92
Banesto Banco de Emisiones S.A.	ES0413440167	EUR	1,250	2.625	99.39	3.222	0.0376	2/28/2013	1.8626	0.1530	1.0	63.7	1	92
Banco Espirito Santo S.A.	XS0174467463	EUR	75	3.000	98.58	3.953	0.0297	8/27/2013	2.4770	0.2649	1.5	63.0	1	92
Banco Santander Totta S.A.	PTCPP7OE0020	EUR	1,000	3.250	88.64	8.093	0.1377	10/21/2014	6.2864	0.1530	2.6	61.6	1	92

Analysis as of Feb. 8, 2012. OAS--Option-adjusted spread. PD--Probability of default.

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