Santander (LSE: BNC)

Sector: Europ Banks Price: 910p (EUR 13.56) Mkt Cap £56,914m

CITY INSIGHTS

Robust results continue the pattern…

Santander's half year results demonstrated further progress in retail banking across a broad front. Top down performance – high activity and generally maintained or improved spreads - continued to be very robust. Net operating income was 34% higher than in 2006. After a rise in loan loss provisions, pre-tax income was 27% ahead and attributable income 21%. These results were well ahead of the average of the UK banks – weighted pre-tax profit increase in H1 of 12.7%.

…with gains across all geographic segments

The results from Spain showed little impact from slowing mortgage demand whilst in the UK, Abbey picked up market share and improved its margins. Latin America has continued to be a substantial attraction – growth+stability+bancarisation – and, despite a slower rate of growth than last year, still produced attributable profit gains in excess of 18%. Santander Consumer Finance had a H1 contribution from *Drive*, but underlying profit growth was down on last year due to a weaker car market in Europe. Net attributable income of the segment advanced 25%.

Largely unaffected by sub-prime turbulence

A planned EUR 50bn loan securitisation programme for 2007 was completed in H1. The sale and leaseback of Spanish bank properties and the equity stake disposals have begun. They will be available to supplement a planned EUR 4bn rights issue and EUR 5bn of convertible debt to finance the consortium bid for ABN AMRO.

Strategy on course - not dependent on ABN AMRO outcome

The growth strategy remains on course and is not dependent on the bid succeeding. If it does, Santander would acquire the retail bank networks of *Real* in Brazil, *Antonveneta* in Italy plus *Interbank* and *DMC Consumer Finance* in the Netherlands to expand this segment of the business. Its share of the EUR 71.1bn consideration (based on the earlier RBS share price) would be EUR 19.9bn. Santander's previous success at integration of acquisitions should enable it to achieve EPS gains from Year 1 and ROI above the cost of equity by Year 2.

Y/e 31st Dec	Inc. pre-tax* EUR m	Net Income* EUR m	Tax EUR m	Tax rate %	EPS* EUR	PE X	Gross Div EUR	Gross Yield %
2005	6,837	5,212	1,320	19.3	0.835	16.2	0.42	3.1
2006A	8,776	6,582	1,986	22.6	1.053	12.9	0.52	3.8
2007E#	-	8,000	-	22.8	1.279	10.6	0.62	4.6

** Excluding extraordinary items; # Average of estimates as at 31 July 2007*

Shareholders funds (30/06/07)	EUR 43,956	ROE (30/06/07) w/o cap.gains	19.7%
Ordinary shares in issue (30/06/07)	6254.3m	BIS ratio/risk weighted capital	13.1%
Book value per share	EUR 7.03	Tier 1 capital/risk weighted assets	7.9%

This research may be viewed on **www.cityinsights.co.uk** Tony Cooper Sept 2007

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Introduction

Avoiding the ripples

Santander is the largest bank in the Eurozone and the twelfth largest in the world by market capitalisation. Its primary focus on retail banking means that it has avoided the difficulties associated with exposure on sub-prime loan books and their reduced liquidity. Whilst much attention has been focused on the consortium bid for ABN AMRO in which the Bank is a participant, its strategy does not depend on the bid succeeding. Growth performance in H1 is still in the upper quartile of global banks.

Half year highlights

Growth combined with efficiency …

Continued exceptional performance marked the first half of 2007, based on strong recurrent revenues, further efficiency gains, no deterioration in credit quality and a strong balance sheet. Despite the rise in loan loss provisions these were in line with forecasts and reflect the expansion of lending. There have been no adverse impacts from the sub-prime markets.

Income Statement for six months ended 30 June 2007

			2006	2007	*H1 on H1 (%)*
Figures in EUR million	H1	H2	FY	H1	
Net interest income	**6,041**	**6,447**	**12,488**	**7,417**	***+22.8***
Equity accounted income	241	186	427	160	*-33.7*
Net fee income	3,494	3,729	7,223	4,154	*+18.9*
Insurance activity	148	150	298	189	*+28.1*
Commercial revenue	**9,924**	**10,512**	**20,436**	**11,919**	***+20.1***
Trading gains/(losses)	917	1,263	2,180	1,288	*+40.5*
Gross operating Income	**10,840**	**11,775**	**22,615**	**13,207**	***+21.8***
Net inc. from non fin. services	14	35	49	36	*+157.1*
Other operating income	(40)	(79)	(119)	(70)	-
Administrative expenses	(4,893)	(5,132)	(10,025)	(5,356)	*+9.5*
Depreciation & amortisation	(557)	(594)	(1,151)	(624)	*+12.1*
Net operating income	**5,366**	**6,003**	**11,369**	**7,193**	***+34.1***
Net provision for loan losses	(1,100)	(1,367)	(2,467)	(1,511)	*+37.3*
Impairment loss on assets	(33)	(51)	(84)	(34)	*+6.1*
Other income net	11	(53)	(42)	(254)	-
Income before taxes	**4,244**	**4,532**	**8,776**	**5,395**	***+27.1***
Corporate income tax	(892)	(1,094)	(1,986)	(1,234)	*+38.4*
Tax rate (%)	*21.0*	*24.2*	*22.6*	*22.9*	
Income after tax	3,352	3,438	6,790	4,161	*+24.1*
Discontinued operations	194	160	354	-	-
Net consolidated income	**3,546**	**3,598**	**7,144**	**4,161**	***+17.3***
Minority interests	330	(892)	(562)	268	*-18.7*
Attributable income	**3,216**	**3,366**	**6,582**	**3,892**	***+21.0***
Extraord. gains& write-downs	-	1,014	1,014	566	-
Attrib income	**3,216**	**4,380**	**7,596**	**4,458**	***+38.6***
Ordinary EPS (w/o cap gains)	0.515	0.538	1.053	0.624	*+21.2*
Dividend per share	0.1069	0.4137	0.521	0.1229	*+15.0*

…with retail banking the key driver

The solid operational performance was demonstrated by the expansion in retail lending and management of spreads. Gross loans at the half end totalled EUR 561,296m (2006 H1: EUR 484,442m) a rise of nearly 16%, 14.4% excluding businesses sold over the last 12 months and exchange rate effects. Santander achieved a rise of 27% in pre-tax income of EUR 5,395m (2006 H1: EUR 4,244m).

Attributable income excluding capital gains was 21% higher at EUR 3,892m (2006 H1: EUR 3,216m), all geographic areas producing gains in attributable income of over 20% in their respective local currencies. Whilst retail banking was the growth engine, other business segments – Global Wholesale Banking (GWB) and Asset Management and Insurance (AMI) – also performed well.

Key features of the results were:

Operations

- Growth in interest income (+23%) and fees plus insurance revenues (+19%) combined to produce a strong rise in gross operating income (GOI), reaching EUR 13,207 (+21.8%).

Efficiency

- With the growth in costs constrained to below 10% (+9.7%), further efficiency gains were achieved, the key efficiency ratio improving by 4.9 pps to 44.4%.

Provisions

- Loan loss provisions increased by 37% to EUR 1,511, reflecting a change in mix towards more profitable segments (but higher risk premium), and also the consolidation of *Drive Financial*, the car finance business.

Acquisition

- *Drive's* contribution to these results was 2.9 pps on GOI, 0.9 pps on costs and 1.5 pps on attributable income (or approximately EUR 49m for the latter). Santander acquired *Drive* for US$651m (EUR 494m) last December and it is expected to add 1.5% to Group EPS in 2007.

Quality

- Credit risk quality was maintained with the non performing loans (NPL) ratio remaining at 0.83% (the same as in 2006 H1) with coverage of 169% (186%).

Target

- The 21% rise in the first half attributable profit puts Santander in reach of a full year figure of EUR 8,000m, without inclusion of capital gains. The disposal of the 1.79% stake in Intesa Sanpaolo for a cash consideration of EUR 1,206 m yielded pre-tax gains of EUR 566m.

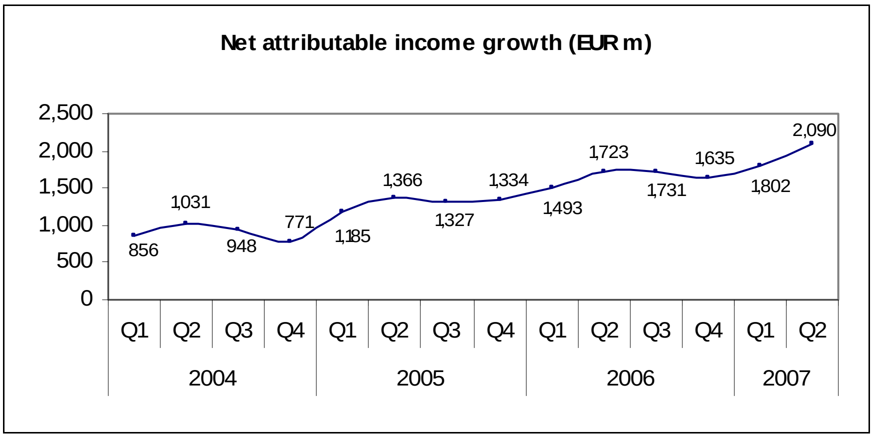
Asset strength

- Capital ratios remained strong - BIS at 13.1% and core capital 6.3%.

Shareholder approval

- EGM 27 July: the Board gained shareholder approval for an increase in equity capital by EUR 4,000m and to issue EUR 5,000m convertible bonds which are likely to be required in the event that the consortium are successful in their acquisition of ABN AMRO.

The chart overleaf shows the steady rise in Santander's net attributable income that has more than doubled in the three years since Q2 2004. The Group is targeting EUR 8,000m in the full year to December.



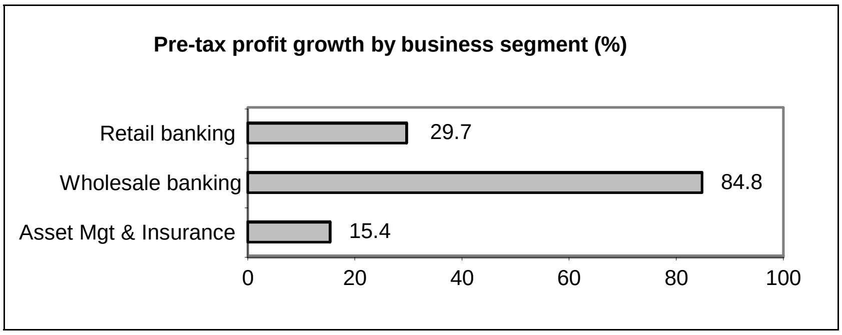
Global conditions remain favourable …

Santander's management are confident that they can continue with the businesses in place and that future growth is not dependent on gaining the Brazilian *Real* retail bank network and *Banca Antonveneta* in Italy from ABN AMRO. Confidence is based on a favourable global economy - GDP growth at c.5% despite a slowdown in the US; a similar rate in Latin America and Eurozone expansion gathering pace. Higher interest rates in some regions have been motivated by an upturn in inflation - a move to 4% by the European Central Bank and to 5.75% by the Bank of England. The average rate set by the G7 central banks has edged up to 3.95% in July 07, and tighter monetary policies have contributed to Santander's efforts to improve spreads and product margins.

Overview of geographic and business segment results

…to assist general progress

Against the back-ground of a stable and generally buoy-ant global economy, all business se-ments produced very good increases. Both Retail and GWB had very strong H1 results. Retail Banking generated 84% of Group GOI,EUR 11,319m, and 73% of Group pre-tax profit, EUR 4,637m.



Geographical segment results by main region

EUR mills	Gross operating income	% ch'ge	Net operating income	% ch'ge	Pre-tax profit	% ch'ge
Cont Eur	6,567	28.6	4,120	40.7	3,499	44.5
Abbey	1,896	9.8	955	24.0	803	42.3
LatAm	5,079	22.4	2,858	34.8	1,993	24.4

Geographic regions overview

- **Continental Europe** - produced a 40.7% rise in net operating income and 45% attributable profit to EUR 2,468m (56% of the Group total). The key factor was a 29% growth in GOI whilst costs only rose by 13%.
- **The UK – Abbey** – measured in Euro, growth in attributable income was 22% to EUR 602m was due to GOI rising by nearly 10% (+7.8% in sterling in line with management targets) while costs fell again by 1.7%.
- **Latin America** - net attributable income in Euro was 18.5% to EUR 1,360m (+nearly 26% excluding the exchange rate impact). With faster expansion in this region, GOI rose by 22.4% whilst costs increased by only 17%. The increase was slightly greater at constant exchange rates.

No fall-out from sub-prime crisis

In all regions, there has been no obvious impact from the spill-over from the adverse developments in the sub-prime lending sector, and the Bank has had no problems to date in securitising assets apart from a slight widening of spreads, e.g. Santander reported 3-4 bps on Triple A grade bonds. Over EUR 90bn of debt securities were issued in H1 against redemptions of EUR 43bn, much larger totals than in H1 2006. The net figure of c.EUR 50bn is in line with the Chairman's earlier statement, 'EUR 50bn is possible in 2007'.

Efficiency

Efficiency gains achieved…

Neither the expansion in Europe (wholesale banking and Spanish and Portuguese retail networks) nor the expansion taking place in Latin America, have affected the efficiency drive. This is reflected in the continued downward trend of the key cost-to-income ratio. Comparing H1 07 with the corresponding period of 06, the Group-wide ratio was at 44.4%, a fall of 4.9 pps. Abbey made continuing progress and has seen further gains to take its ratio down to 50%. Importantly the improvement extends to all business segments and there is a gradual narrowing of the range.

…targeting a sub-40% level

For the Group as a whole, the target remains to achieve a level below 40%, and the top ranking among the peer group. In terms of the nine banks in the UK, their average ratio (based on all their operations both in and outside the UK, was 46% in H1 2007).

…despite continued expansion

Apart from Abbey, the pursuit of efficiency has not been at the expense of curtailing expansion. Excluding amortisation and depreciation, general administration (mainly staff costs) rose by over 9% to EUR 5,356M. On a like-for-like basis, this rise was below the level of local inflation as the branch networks overall were expanded by 6% along with other infrastructure items such as ATMs (+9%).

Credit risk management

Specific provisions increased …

Loan loss provisions were increased to EUR 1,511m of which the greater part (EUR 1,137m) comprised specific provisions to cover real risk. The remainder are generic provisions which include the allowances for country risk.
The key features were:

…mainly for Latin America

- an increase of EUR 371m in specific provisions - from EUR 766m to EUR 1,137m, slightly more than half of which was due to Latin America, specifically Brazil and Mexico;
- This was the result of the growth in retail segments with higher expected NPLs but associated with greater profitability and the incorporation of *Drive* in the US;
- A small increase in generic provisions by EUR 40m, mostly associated with the Santander retail banking network in Spain and Global Wholesale Banking.

…but country risk improved…

The EUR 371m increase in specific provisions was offset by lower country risk in Latin America, notably Brazil. Therefore in the table below, the overall allowance for specific risk has remained virtually constant at EUR 3,136m. Also to note were:

- No increase in the NPL ratio despite lending expansion;

…and NPL was unchanged

- NPL coverage is still an impressive 169%, this being the ratio of the total of loan loss allowances to total non-performing loans.

Lending and credit risk management

EUR million	2006 H1	2007 H1	*Change (%)*
Gross loans and credits	484,442	561,295	*+15.9*
Total credit loss allowance	7,852	8,610	*+9.7*
Net loans and credits	**476,591**	**552,686**	***+16.0***
Non-performing loans	4,489	5,354	*+19.3*
NPL ratio (%)	**0.83**	**0.83**	
Credit loss allowances:			
Specific	3,139	3,136	*-0.1*
Generic (general purpose)	5,197	5,920	*+13.9*
Total	**8,335**	**9,056**	***+8.7***
NPL coverage (%)	185.69	169.16	*-16.53p*

Balance Sheet

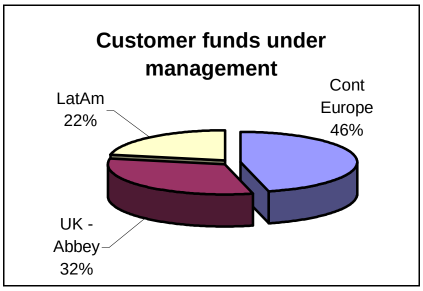
The table below summarises aspects of the increase in Santander business – a 9% rise in customer deposits (current accounts and time deposits) and an overall 17% growth in funds under management. The latter includes the off balance sheet items, mainly mutual funds (+18%), pensions (+14%) and managed portfolios (+22%). The reduction in Savings – Insurance policies is as a result of the sale of the pension fund company in Peru and of Abbey´s insurance business (Q3 06). On a like for like basis, and eliminating the exchange-rate effect, Year-on-year growth was 22% for pension funds and 75% for savings-investment insurance.

Customer funds under management

EUR million	2006 H1	2007 H1	*Ch'ge (%)*
Customer deposits	305,782	333,977	*+9.2*
All on-balance sheet customer funds	**508,344**	**604,954**	***+19.0***
Off-balance sheet customer funds:			
Mutual funds	113,618	133,774	*+17.7*
Pension funds	27,709	31,629	*+14.1*
Managed portfolios	17,088	20,809	*+21.8*
Savings – insurance policies	15,377	8,520	*-44.6*
All off-bal sheet customer funds	**173,791**	**194,731**	***+12.0***
All customer funds under management	**682,135**	**799,685**	***+17.2%***

Funds under management

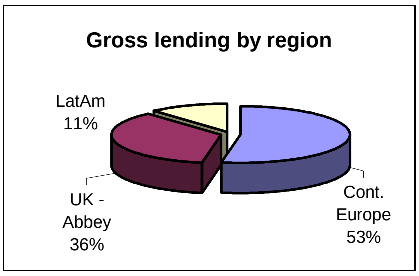
Of funds under management, Continental Europe has nearly half, of which Spain has more than 80% of total balances. Europe's balances rose by 16% year-on–year. In Latin America, managed funds rose by 23% without the exchange rate effect.



Mutual funds have also been increasingly attractive with 43% growth in the region overall, whilst pension fund balances grew 30% year-on-year excluding the sale of the Peruvian pension fund company and the exchange rate effects.

Lending activity…

In gross lending, , Continental Europe accounted for 53% of Group lending, Abbey 36% and Latin America only 11%. The key points about Latin America are that it has substantial other business, e.g. in fund management and, compared with the more sophisticated European markets, is starting from a lower base in general customer lending activity. That is the opportunity and attraction of the whole region.



…was generally strong in all regions

Continental Europe increased its loan book by 21% to over EUR 290bn and its customer deposits by 8%. (The growth in lending is not like-for-like as *Drive* is included within Santander Consumer Finance). European lending enjoyed a rise of 20% - with good loan growth in both the Spanish networks – in the Santander Branch Network 13% and in Banesto 27%. Abbey did not chase volumes at the expense of margin and its loan book expanded by 8% (5% in sterling). It has focused on improving spreads. Latin America continued the strong growth in lending from last year, +25%, and close to 20% in savings deposits, measured in local currencies. The latter included increases of 32% in Brazil, and 34% in Mexico. With bancarisation a LatAm feature, these gains are unsurprising.

Capital ratios

High ratios maintained …

Expansion and capital discipline are paramount to Santander's strategy. Core activities and credit expansion have combined with a strengthening of the key balance sheet ratios which remain among the top quartile of sector peers. Santander has a Tier 1 ratio of 7.9% and BIS (or Total Capital) ratio of 13.1%. The potential impact of acquiring the business units from ABN AMRO, if successful and on the terms published in the offer document, would be expected to have a small impact on the Tier 1 ratio, falling to 5.3% after completion at the end of 2007. (More on ABN AMRO later).

Currently, of the nine listed UK banks, the average Tier 1 is similar to Santander's at 7.3 but their average total capital ratio is lower at 11.3%.

Santander consolidated balance sheet capital ratios			
	2006 H1	2007 H1	*Ch'g (%)*
1 Computable basic capital	32,928	38,411	*+16.7*
2 Computable supplementary capital	22,180	25,256	*+13.9*
3 Computable capital	**55,107**	**63,667**	***+15.5***
4 Risk-weighted assets	444,420	486,391	*+9.4*
BIS ratio (=3 divided by 4)	**12.40**	**13.09**	
Tier 1 ratio (= 1 divided by 4)	**7.41**	**7.90**	
Core capital ratio	**5.75**	**6.27**	

Results details –

Santander Retail Network (SRN), Banesto and Santander Totta (Portugal)

New strategy pulling in new customers

SRN in Spain may be the model for the rest of the Group's retail networks with strong and sustainable performance combined with greatest efficiency (cost-income ratio below 40%). It achieved good top down growth (higher volume, improved spreads) despite expectations of a slowdown due to reduced demand for mortgage loans. In fact, mortgage loans rose 12% (fewer loan advances but higher house prices) and customer funds grew strongly, +9%. The impact of the campaign, *'We want to be your bank'* launched in January 2006 has incurred costs but was more than offset by the achieved growth in customer numbers (up 6%) and 'linkages', i.e. selling customers more than one product. GOI rose by 16.5% against cost growth of just over 7% (despite 151 new branches opened), feeding a rise in net operating income of 23.5%. With reductions in generic provisions, the pre-tax figure advanced 34%.

	Santander Retail Network		**Banesto**		**Totta**	
EUR mill's	**2007 H1**	*Chg'e (%)*	**2007 H1**	*Ch'ge (%)*	**2007 H1**	*Ch'ge (%)*
Net interest	**1,354**	*+20.9*	**704**	*+18.4*	**360**	*+7.2*
Gross op inc	**2,348**	*+16.5*	**1,112**	*+14.3*	**696**	*+26.2*
Net op inc	**1,418**	*+23.5*	**633**	*+26.3*	**425**	*+42.7*
Pre-tax inc	**1,250**	*+33.9*	**539**	*+19.8*	**339**	*+24.8*
Attrib inc	**899**	*+33.7*	**338**	*+11.8*	**276***	*+27.5*

** Totta's net attrib. income excludes EUR 16m of capital gains from BPI*

Banesto also buoyant performer

Also in Spain, Banesto's like-for-like increase in pre-tax profit was nearly 20% to EUR 539m, after adjusting for the discontinued business of *Urbis* (which contributed pre-tax profit of EUR 149m in 2006). As with SRN, top down growth was seen in the target markets of small business, other corporates and the self employed. Volume growth in lending (+29%) was accompanied by improved spreads. Costs rose by only 4% higher with further efficiency gains (ratio down to 42%).

…as was Totta

Totta achieved growth in GOI of 26% and net operating income 43% through higher volumes despite spreads being flat. The costs of adopting the *Conta Connosco* strategy, essentially eliminating fees and commissions to win customers (currently the main focus), was more than offset by other gains including those from the rise in fee-linked funds (mutual and pension plans +7%, insurance plans +20%).

Santander Consumer Finance

Drive's addition adds only 7% to total loan book

As it now incorporates *Drive,* this segment has been split into Santander Consumer Finance Europe and Santander Consumer Finance USA (Drive). Overall the business worldwide increased its total book to nearly EUR 43bn. After stripping out *Drive's* EUR 2,968m loans portfolio, the existing segment's total European loan book increased by 15% to EUR 39,744m. Previously, two thirds of SCF's activity was in car purchase loans and the remainder consumer personal loans, credit cards and other products. Germany (42%) and Spain (30%) accounted for the bulk of the portfolio.

European market trend was weaker…

The figures in the left hand panel overleaf show the increase for the existing European businesses only. Revenues and profits improved despite unfavourable market conditions. Car sales were generally weak especially in Germany (not helped by a VAT increase), competition was tougher and there was pressure on spreads as higher interest rates impacted on funding costs. Car loans were slightly down in line with the market but other products saw better volume growth, including the more profitable direct loans and credit cards. This enabled GOI to increase by nearly 12%, higher than cost growth at 8%, thus pushing up net operating income by 13%. Pre-tax income did not match this rise because of higher provisions required against higher loan volumes with more risky elements.

SCF Europe				Drive*	Total SCF	
EUR mill's	2006 H1	2007 H1	*Ch'e (%)*	**2007 H1**	Total SCF	*Ch'e (%)*
Net interest	658	**709**	*+7.8*	**312**	**1,021**	*+55.2*
Gross op inc	876	**978**	*+11.6*	**317**	**1,295**	*+47.9*
Net op inc	570	**646**	*+13.3*	**275**	**921**	*+61.6*
Pre-tax inc	405				**516**	*+27.6*
Attrib inc	280	**303**	*+8.2*	**49**	**352**	*+25.4*

** Santander has a 90% share interest in Drive*

…but Drive results were above expect-ations…

The middle panel shows that *Drive* delivered EUR 49m attributable income in H1 following a stronger second quarter (EUR 29m). This was above initial expectations as a result of growth in activity and a managed portfolio of loans totalling EUR 2,968m. That total accounts for only 7% of SCF's total loan book of EUR 42.7bn. *Drive* is expected to be earnings enhancing in 2007 despite requiring higher provisions. Nevertheless, *Drive* deals mainly with near-prime customers and exclusively in the car finance sector. For the segment as a whole, the increase in provisions was 120% (but only 20% without *Drive*), which explains why the segment's overall pre-tax income advance of 28% was substantially below the 62% rise in net operating income.

…with further expansion of the perimeter

Santander Consumer Finance has expanded its perimeter with two investments. First, it has acquired Mexico-based *Financiera Alcanza*, for EUR 30m. This is a personal loans company with eight branches and US$5m annual revenues. It has excellent potential for expansion in a developing market. SCF has also invested EUR 15m in a joint venture operation with the *Bergé* car dealership to penetrate the Chile market.

The UK – Abbey

Broader offer gaining recognition

Brand recognition has improved with the more rounded retail bank services now on offer and not primarily mortgages. Abbey has gained customers (over 217,000 new current accounts in H1) although the focus has been on managing and protecting spreads which increased marginally in the period (17 bps) despite the rise in interest rates (+1.25 in five 0.25 steps since August 2006).

Abbey				
	EUR m		£ m	
	2007 H1	*Ch'ge (%)*	**2007 H1**	*Ch'ge (%)*
Net interest	**1,152**	*+11.5*	**777**	*+9.5*
Gross op income	**1,896**	*+9.8*	**1,279**	*+7.8*
Net op income	**955**	*+24.0*	**644**	*+21.7*
Pre-tax income	**803**	*+42.3*	**542**	
Attrib income	**602**	*+22.4*	**406**	*+20.2*
Average exchange rate £1 = EUR 0.674				

Holding the line in mortgage price wars …

With interest income growing at 9.5%, the rise was better than through the whole of 2006 due to both volume growth (customer deposits +4%, loans +7%) plus activity based on the launch of a new Abbey branded credit card. In the mortgage market, Abbey's total stock rose by 7%, gross lending having risen by 5.7%. Its market share is estimated at 9.6% (7.1% in net lending at the end of 2006). Abbey has made gains at the expense of HBOS when, at the start of 2006, the latter attempted to raise the cost of remortgaging at the Halifax. This strategy went wrong and Halifax's share of the new total mortgage market plunged to 8% in H1 (from 21% the previous year). In fact, the mistake was quickly reversed and market share recovered, but other competitors fared less well.

…Outper-forming peer group in the UK…

In a market which has remained fiercely competitive, Abbey has done very well to maintain its position. GOI rose by 8%, a higher rate than for the whole of 2006 (5%), driven by net interest income growth of 9.5% (rising activity, improved spreads). This is well up with competing banks in the UK. The average pre-tax profit growth rate in H1 (weighted by profit) was a creditable 12.7% for the nine FTSE 100 banks, far below Abbey's 42%. This outperformance may not be like-for-like and does not take account of the additional costs of payment to customers for unauthorised overdraft charges which some of the Bank's UK peers have acknowledged.

…weaker UPLs through cahoot

In unsecured personal loans, Abbey's gross lending declined by 53%, a major factor in this being the steep fall in loans through the cahoot online channel with an attendant 22% reduction in loan loss provisions. Nevertheless, over all categories of lending, the total loan book rose by 8% to EUR 197bn (£134bn).

Performance factors of note for Abbey are:

- Greater customer activity through the branches instead of IFAs reducing the churn rate on existing accounts
- Abbey's retail business is growing at about 11% overall and higher interest rates are enabling better spreads, particularly on new business
- Improved efficiency through extension of Partenón, and the

system will be fully operational in 2008. To date, personal accounts and cards are on the system with loans and payments to follow in H2

- Ahead of target on cost reductions (£300m by end 2008 with nearly all of this achieved by end 2006) with further improvement in efficiency ratio – down 6 pps to 50; and also on recurrent revenues – annual growth at 7% to 8%
- Abbey's cost targets will probably be modified with further reductions not at the expense of expansion of the business.
- On course for net attributable income of EUR 1.2bn in 2007, a 20% increase on top of the 24% achieved in 2006.

Latin America

Growth + stability + bancari-sation

The key drivers in this region, as already noted, are robust economic growth, stability and bancarisation. These are exemplified in the principal countries of operation. As the EURO strengthened against all American currencies, the Latin American region's gains are all lower when translated into EUR compared with the operating gains measured in their domestic currencies.

	Brazil		**Mexico**		**Chile**	
EUR mill's	**2007 H1**	*Chg'e (%)*	**2007 H1**	*Ch'ge (%)*	**2007 H1**	*Ch'ge (%)*
Net interest	**1,102**	*+20.2*	**921**	*+34.1*	**483**	*+5.1*
Gross op inc	**2,062**	*+29.5*	**1,234**	*+25.2*	**736**	*+5.6*
Net op inc	**1,211**	*+50.2*	**741**	*+45.5*	**436**	*+6.1*
Pre-tax inc	**706**	*+36.1*	**532**	*+24.4*	**404**	*+23.9*
Attrib inc	**55**	*+27.9*	**322**	***+16.5***	**277**	***+17.0***

Lowest level of country risk

In Brazil, now considered to be close to investment grade because of its stability with country-risk at its lowest level, *Santander Banespa* has increased its customer base by 13% to 7.8m in the past year, and in response to steadily rising consumer demand, increased the number of credit cards issued by 0.74m. *Banespa* now manages the salaries of the employees of the Rio de Janeiro municipal government, gaining it 165,000 new customers. (This gain was offset by loss of a payroll contract in the state of Sao Paulo).

Key features of the progress in Brazil were:

- Fast rise in lending (+27% in local currency, +40% in Euro) with all categories showing high growth, individuals, small business and corporates. The fall in interest rates in Brazil is being viewed favourably as a factor driving activity despite the lower spreads;
- Particularly high lending growth via credit cards and linked to individuals' new payroll arrangements;
- Market share in total lending risen to 5.7%;
- Strong increase in mutual funds (+51% to EUR 19bn) - more attractive to customers than deposits with interest rates declining;

- Higher net loan loss provisions (+62%) but still allowing pre-tax profits to rise by 36% (retail banking +25%, wholesale +51%).

In this buoyant economy, the attractions of adding *Banco Real* should the RBS consortium acquire ABN AMRO are apparent and are commented on more fully later.

New customers with new accounts…

In Mexico, *Santander Serfin* gained 19% more customers in the year to June 2007, and now has 8.1m with 3.1m pension fund accounts. The bancarisation theme has been demonstrable here as elsewhere in the region; The payment of payrolls into new bank accounts and the expansion of *Serfin* credit cards. In the year to June, one million new cards were issued (now 4.9m in total) and 0.4m new payroll bank accounts set up (now 2m in total).

…with market share gains

Within the domestic economy, growth was rapid and ahead of the market: loans via cards +62%, loans to small business +78%. Market share was gained in all main categories – mortgages to 7.9%, bank savings to 16%. Measured in EURO, total loans and credits expanded 15% to nearly EUR 15bn. While costs increased due to business development, net operating income still increased by over 58% in local currency. Higher provisions did not prevent pre-tax profit from retail banking rising by 55%, again in local currency.

…reflecting bancari-sation throughout the region

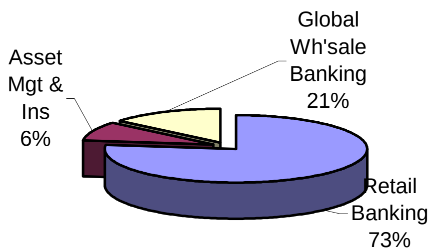
Santander Chile is the largest financial group in a country with high market shares in loans, deposits and mutual funds. In a buoyant economy, it was still possible for customer numbers to increase by 18%, overall lending by 46% (there was strong growth in credit card numbers) and payrolls paid into new accounts by 35%. This is again a reflection of bancarisation benefiting both individuals and small business. Retail banking's profit before tax rose by 50% whilst that of Asset Management and Insurance increased by 42%.

Other segments

Income before taxes by core Business Segment (EUR m)

Retail Banking	4,637
Global Wholesale Banking	1,303
Asset Mgt & Insurance	355
Total	6,295

Income before tax by Business Segment (%)



GWB's pre-tax profit up by 85%...

Whilst Retail Banking performed well in all regions, GWB made good gains in an active market with gross income up by 47% to EUR 1,679m. This was well above the rise in costs (16%) and there was a sharp fall in generic provisions contributing to a rise in pre-tax income of 85% to EUR 1,303m (2006 H1 EUR 705m).

…assisted by a sharpening of activities and new projects

The performance of GWB reflects its successful focus on investment banking products, project finance, debt markets and cash management. The segment is gaining new customers, and has applied specialist business models to a wider range of industries. Particular activities include corporate finance (participation in 139 operations), capital structuring and treasury activities.

…whilst in AM and I pre-tax income rose 15%

Asset Management and Insurance had two main stimuli in the period, first a rise in insurance activity (30% higher) which spurred GOI and, secondly, good increases in the management of all categories of funds, mutual, pension and insurance. The latter produced Group revenues of EUR 2bn (+18%) but a major part of these are included in the results of the banking networks as the distribution agencies. Spain is the largest repository of funds under management, EUR 68bn, Latin America over EUR 35bn and the UK EUR 13bn. The segment generated a rise in pre-tax income of 15% as revenues outstripped the growth in costs.

ABN AMRO – the rationale and prospects

Key parts of ABN AMRO are in Brazil and Italy…

Santander's strategy is not dependent on the RBS consortium gaining ABN AMRO on the current terms, but the parts of ABN AMRO of special interest to the Bank are:

- *Banco Real* which, integrated with Santander *Banespa*, would be a top 3 bank in Brazil behind *Banco do Brasil* and Bradesco;
- *Banca Antonveneta* in Italy;
- *Interbank* and *DMC Consumer Finance*, a consumer credit operation in the Netherlands. These would be fully integrated into Santander Consumer Finance.

Pro forma 2006 results – enlarged Santander with ABN AMRO units

2006 results EURm	ABN LatAm	*Antonveneta* Italy	Santander	Pro forma total*
Total income	**3,738**	**2,182**	**22,615**	**28,789**
Expenses	(2,207)	(1,131)	(11,176)	(14,704)
Provisions	(722)	(336)	(2,467)	(3,554)
Pre-tax profit	**809**	**715**	**8,776**	**10,336**

* Pro forma figures based on full year 2006 results. The combined total includes *Interbank* and *DMC Consumer Finance*

Source: Offer Document of 29 May 2007- Slide 42

…with excellent fits both regionally and in products

In Brazil, *Banco Real* would be an excellent geographical and product fit with Santander *Banespa.* It is strong in areas where *Banespa* is under-represented and also stronger in the mass market and small business. In Italy, *Antonveneta* is sixth placed in the important wealthy northern region but under-represented in some key product areas. It thus has high growth potential and can achieve higher efficiency through adopting the Bank's IT platform. With *DMC*, total pre-tax synergies of over EUR 1bn are expected as shown overleaf.

Deal improves EPS and returns exceed cost of capital by Year3

Figures in EUR m	Allocation of consideration	Cost Synergies	Revenue Synergies	Expected 2010 ROI
Total	19,855	855		
Less: existing stakes in acq'd assets*	1,005			
Adjusted total consideration	**18,850**	**855**	**175**	>12.5%
Allocated to:				
Brazil – *Banco Real*	**12,000**	**700**	**110**	>13.5
Italy – *Antonveneta*	**6,640**	**150**	**60**	>10.5
Interbank and *DMC*	**210**	**5**	**5**	>12.0

EPS impact: +1% in 2008; +4% in 2009; +5% in 2010

Source: Offer Document of 29 May 2007- Slide 51

Share of total consider-ation for ABN AMRO EUR 19.9bn…

Shareholder approval has been gained for participation in the bid. The Bank's share (28%) of the total consideration of EUR 71.1bn will be EUR 19.9bn, approximately 50% financed by a EUR 4bn rights issue and EUR 5bn issue of convertible bonds. Disposals would cover the rest. At the end of last year, the disposal of 4.8% of *Sanpaolo IMI* produced proceeds of EUR 1,585m. After the merger of *Sanpaolo* with *Banca Intesa*, Santander was left with a stake of 1.79% in the new entity, *Intesa Sanpaolo* which, in Q2 2007, it sold for EUR 1,206m. This realised a gross gain of EUR 566m. Other proceeds have come from the sale of the pension fund business in Latin America taking total H1 cash from divestments to EUR 655m.

…will be 50% financed by disposals

A further EUR 1,400m is expected from a sale and leaseback of Bank properties in Spain. In total, disposals will provide c.EUR 2,055m. Santander's half year end (30th June) balance sheet reports 'available for sale' financial equity assets totalling EUR 8,257m. These include minority share interests in the Italian banks, *Capitalia* and *MedioBanca,* and a stake in the oil company *Compania Espanola de Petroleos SA (CEPSA).* Santander also has debt securities totalling EUR 29,327m.

Deal meets the Bank's criteria for acquis-itions…

Santander's usual rule for acquisitions is that the cost of capital of an acquisition is covered in three years and that it must be earnings accretive after year three. ABN AMRO meets these criteria.

- Earnings accretive from Year 1: +1% 2008; +4% 2009; +5% 2010
- ROI expected to exceed cost of equity by Year 2: 10.5% 2009; above 12.5% 2010.

Notwithstanding the pre-occupation with ABN AMRO, Santander's position with respect to *Sovereign* remains unchanged. This is ultimately a strategic investment and, under the terms of the deal, Santander may purchase shares at US$40 per share from July 2008. As it has acquired a 25% share interest already, the remaining 75% might cost in the region of US$7bn at the present US$17 *Sovereign* share price.

In conclusion: Santander is on track for another profitable year and has a strategy in place to continue delivering profitable growth in its core regions without weakening credit quality and balance sheet.

Appendix 1 - The Shares

Santander is quoted on the Stock Exchanges in several countries including Madrid, Frankfurt, Milan, Lisbon, New York, Buenos Aires, Mexico and London (a secondary listing). It is a constituent of both the FTSE Euro Top 100 and Dow Jones Eurotoxx 50.

Private clients have two dealing options:

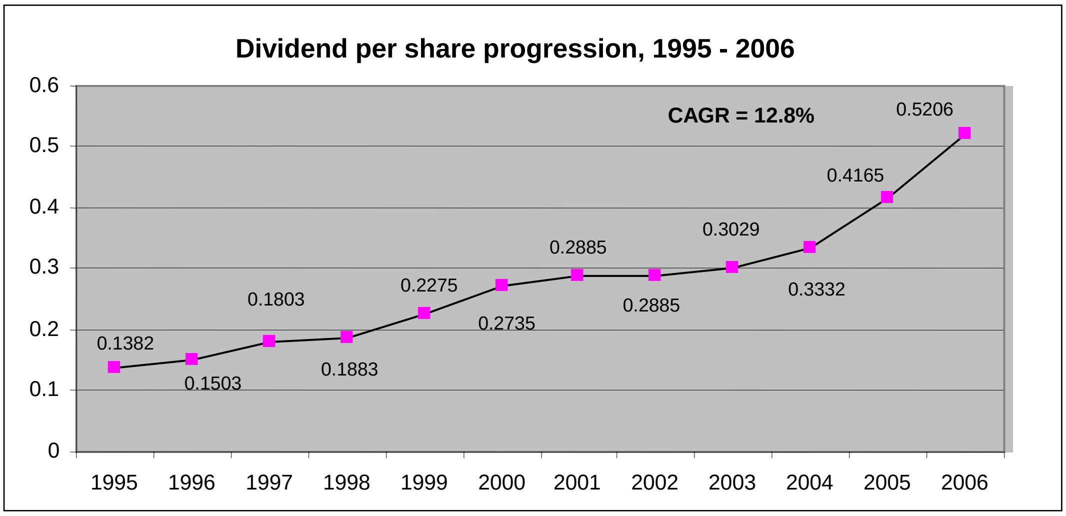
1. Through Lloyds TSB Registrars, and their shares will be held in the Santander Nominee accounts. Dividends will be paid quarterly and in sterling.
2. Directly on the Madrid Stock Exchange. This requires the purchaser to have a Spanish bank account and to complete Spanish tax forms, dividends being paid in Euro.

Dividends

Dividends are a key component of shareholder returns. Santander has a 50% payout ratio and there are three equal quarterly dividend declarations plus a usually larger one at final.

Dividend per share	in EUR	+ %
1st Int 06 (paid Aug)	0.106904	+15.0
2nd Int 06 (paid Nov)	0.106904	+15.0
3rd Int 06 (paid Feb)	0.106904	+15.0
4th Int 06 (paid May)	0.199913	+45.3
Total for 2006	**0.520625**	+25.0
1st Int 07 (paid Aug)	0.122940	+15.0

The dividend progression, adjusted for stock splits and capital increases, over the eleven years, 1995 - 2006 is as shown. The compound annual growth rate for dividends per share is 12.8%. The first interim dividend for 2007 was paid in August, with an increase of 15%.



Group Financial Record

Consolidated Income Statement*

Year ended 31st Dec (EUR million)	2004	2005	2006
Net interest income	**7,576**	**10,669**	**12,488**
Income from co's accounted for by equity method	449	619	427
Net fees	4,769	6,256	7,223
Insurance activity	161	337	298
Basic Revenue	**12,955**	**17,772**	**20,436**
Gains or losses on financial transactions	1,101	1,562	2,180
Gross operating income	**14,055**	**19,333**	**22,615**
Income from non-financial services net	348	65	49
Other operating income	(63)	(90)	(119)
Operating costs net	(7,533)	(10,400	(10,025)
Depreciation & amortisation	(839)	(1,017)	(1,151)
Net operating income	**6,662**	**8,909**	**11,369**
Net provision for loan losses	(1,573)	(1,615)	(2,467)
Other impairment	(270)	(187)	(83)
Other income net	(237)	(270)	(42)
Income before taxes	**4,581**	**6,837**	**8,776**
Tax	(597)	(1,320)	(1,986)
Net income after tax	3,985	5,517	6,790
Net income from discontinued operations	12	225	354
Net consolidated income	**3,996**	**5,742**	**7,144**
Minorities	390	530	562
Net extraordinary gains and writedowns	0	1,008	1,014
Net attributable income	**3,606**	**6,220**	**7,596**
Ordinary EPS	0.73	0.84	1.05
Dividends	0.33	0.42	0.52

Balance sheet – shareholders equity and minority interests

Year ended 31st Dec (EUR million)	2004	2005	2006
Subscribed capital stock	3,127	3,127	3,127
Additional paid-in surplus	20,370	20,370	20,370
Reserves	6,949	8,781	12,352
Treasury stock	(104)	(53)	(127)
On bal sheet sh'hlders funds - primary capital	**30,342**	**32,225**	**35,722**
Net attributable income	3,606	6,220	7,596
Ordinary dividends distributed and pending	(1,838)	(2,605)	(3,256)
Shareholders' equity	**32,111**	**35,841**	**40,062**
Valuation adjustments	1,778	3,077	2,871
Preferred shares	2,124	1,309	668
Preferred securities in subordinated debt	5,498	6,773	6,837
Minority interests	2,085	2,848	2,221
Total assets	**43,596**	**49,848**	**52,658**

Core capital and ratios

	2004	2005	2006
Basic Capital (Tier 1)	24,419	32,532	35,539
Supplemental capital	19,941	20,894	24,237
Eligible capital	**44,360**	**53,426**	**59,776**
Risk weighted assets (BIS definition)	340,946	412,734	478,733
BIS Ratio (%)	**13.01**	**12.94**	**12.49**
Tier 1 ratio (%)	**7.16**	**7.88**	**7.42**

Financial Diary

Q3 results	25 Oct
Prelim results	5 Feb
Public. of Annual Report	March
Q1 "	27 Apr
Q2 and first half results	26 Jul

Share ownership (as at December 2006)

Board of Directors	4.78%
Institutions	61.86%
Individuals	33.36%

This research may be viewed on **www.cityinsights.co.uk** Tony Cooper September 2007