Message from Jose Antonio Álvarez

The global economy generally remained dynamic and solid in 2018. The sustained growth in mature economies, particularly the United States, offset the turbulence in some developing countries.

The trade tensions from protectionist threats, despite the agreement reached in the renegotiation of NAFTA, and the tightening of US monetary policy, with interest rate hikes, contributed to the greater uncertainty and triggered varying degrees of tensions, especially in developing markets such as Turkey, Argentina and, to a lesser extent, Brazil, which was also affected by general elections.

Other factors such as the lack of agreement in the Brexit negotiations and the shaping of Italy’s fiscal policy also weighed on the markets.

Therefore, and in my opinion, the instability that characterised the markets’ behaviour this year was “cyclical”, quite apart from the “structural” situation in 2011, when the European economies were in recession.

As well as this macroeconomic context, there are challenges facing the international financial sector. Thanks to the transformation of our Bank over the last few years, we are well placed to manage these challenges proactively and responsibly.

The factors that had the most impact on our business were:

1. In the first place, the sector’s need to digitalise its business in order to improve customer service, adapt to the multi-channel demands, particularly from younger generations, and boost productivity and transactional levels. This implies building a bank aligned with the challenges of the future.

At the moment, the investments in digitalisation and to improve cybersecurity, as well as anti-fraud policies, inevitably entail higher technology costs. This is exerting more pressure on the financial sector’s short-term profitability, particularly in an environment of very low interest rates in some markets.

2. On the other hand, competition is much stiffer as a result of the entry of the so-called fintechs in providing some financial services. These companies enjoy some advantages, particularly in terms of costs (they do not have branches and do not have to renew outdated technology), and in the products and markets where they operate, as they focus on the most profitable ones and do not provide the universal service that we do.

We need to end asymmetric regulations, as banks, on the one hand, and digital platforms and start-ups, on the other,
are not competing on a level playing field, whether in terms of capital requirements, compliance or use of data. We are not an IT company, but it is our duty to use the best technology and look for the best possible solutions for the real financial challenges of our customers, providing them exactly with what they need.

3. While greater regulation over the last years helped to make the financial sector more solvent, especially in terms of capital, liquidity and governance, it should be streamlined in order to avoid excessive bureaucracy and asymmetries with other countries, such as the United States, whose regulation is more flexible.

4. Lastly, we need to progress in building a single banking market in Europe, with a single deposit guarantee fund, that does not restrict the movement of liquidity between countries, harmonises supervisory standards and practices with customers and creates a level playing field for entities throughout the Banking Union. Completing this Banking Union and building a single market would allow the financial sector to develop substantial economies of scale as in the US, improving the quality of service and costs and so profitability.

In addition, we should not forget that the financial sector has to increasingly assume a more committed role with society, fostering the idea of Responsible banking and financial inclusion of the least bankarised sectors. Santander is a pioneer in this matter, as our main purpose is to help people and businesses prosper in the countries where we operate, in a way that we call “Simple, Personal and Fair”.

“The Group is well placed to face the new challenges of the international financial sector”

Growth

Attributable profit
EUR 7,810 Mn
+32%

Revenue
EUR 48,424 Mn
+9%

All changes in the highlights of these pages exclude the exchange rate impact, unless otherwise indicated.
Sharp growth in net interest income and fee income

Flat costs in real terms

Good performance of the credit quality ratios


Fee income (+9%) also grew, reflecting greater activity and customer loyalty, as well as the growth strategy in services and high value-added products and in areas of low consumption of capital. Fee income increased in Retail Banking and particularly in Wealth Management business.

Operating expenses were 7% higher because of inflation in some countries, investments in transformation and digitalisation, greater costs in global projects and the perimeter impact. The synergies and optimisation plans are already beginning to bear fruit in some countries such as Spain, Portugal and the United States and will continue to increase over time. All of this was achieved while maintaining the Bank’s commitment to the quality of customer service.

In risks, credit quality performed well. The NPL ratio and the cost of credit in the last 12 months improved, and coverage remained high. As regards non-credit risks, I would like to point out that unlike other agents entering the financial sector, Santander, as one of the world’s strongest and most solid banks, guarantees data protection and customers’ savings.

Cyberrisks, for example, are increasingly global and can affect both our professional and personal lives. In this sense, the Bank’s experience and investments in systems and in training its employees are our greatest strengths when it comes to protection from cyberthreats.

Balance sheet

Lending continued to be well balanced between individuals (62%, including mortgages and consumer credit), SMEs and companies (27%) and large companies (11%). Eight of the 10 core units increased their lending, notably the developing countries (+14%). Almost all units increased customer funds. The largest rises were in Argentina (+51%), Poland (+32%), Brazil (+15%) and Chile (+8%).

Regarding solvency, we again generated capital and reached our targets (FL CET1 of more than 11%). Our capital position was recognised by the European Banking Authority’s stress test exercise, in which we again achieved excellent results. We are the bank with the least capital destroyed among our peers in an adverse scenario.

In liquidity, the Bank comfortably meets the regulatory ratios. Our strategy reflects prudent management as regards funding sources, wide diversification in terms of wholesale issues and a high proportion of liquid assets.
Profitability

We ended 2018 with one of the best RoTE among our peers, and a RoRWA well above that in 2017, partly due to measures to reduce the consumption of capital of our risk-weighted assets. In terms of creating shareholder value, the growth in TNAV together with the dividend per share in cash increased 8%.

This good performance of the Bank’s main metrics did not feed through completely to the share price, due to external factors that hit the Eurozone and UK stock markets. Nevertheless, I am optimistic about future performance, as reflected in the reports of the main analyst units. We are one of the large international banks with the greatest number of buy recommendations.

Evolution of the Group’s business units in 2018

All of this explains the consistent improvement we made during the year in profit terms and in the main metrics in almost all the countries where we do business.

Before looking in detail at the main trends of the business units, I would like to recall some key aspects of the Group’s strategy.

The first point is our business model through which the Bank’s more than 100,000 professionals are in daily contact with our customers, via an extensive branch network and a unique relationship model, tailored to meet the different needs.

The second is our commitment to geographic diversification, which is balanced between mature and developing markets and has proved to be vital in generating recurring and foreseeable results.

The third is our leadership position in most of the countries where we operate, enabling us to capture economies of scale and be the benchmark in the main markets.

In this environment:

Spain

We completed the legal integration of Banco Popular and began to integrate the branch network. We are taking advantage of Popular’s strong position in SMEs to strengthen our market share in this segment while reducing its portfolio of real estate assets and the cost of deposits that have come from Banco Popular.

In addition, we continued our digitalisation strategy, strengthening our position in mobile payments while showing a good commercial dynamic in insurance, turnover of cards and SME loans. We remained the leader in large companies and private banking.

Profitability

RoTE

11.7%
+129 bps

RoRWA

1.55%
+20 bps

“Our geographic diversification has proved to be vital in generating recurring and foreseeable results”
Evolution of the business units in 2018

**SCF**

Underlying profit  
**EUR 1,296 Mn (+4%)**

**Portugal**

Underlying profit  
**EUR 480 Mn (+10%)**

**Poland**

Underlying profit  
**EUR 298 Mn (-1%)**

**United Kingdom**

Underlying profit  
**EUR 1,362 Mn (-8%)**

These measures were reflected in the good performance of results: profit grew at double-digit rates, driven by customer revenue, gains on financial transactions and enhanced efficiency.

**Santander Consumer Finance**

SCF remained the leader in the European consumer finance market, with a business model based on geographic diversification, efficiency, and risk and recovery systems, enabling us to maintain NPL ratios and cost of credit at historic lows.

We advanced in optimising, transforming and digitalising the area. This enabled us to increase business in almost all countries, maintain a high level of profitability and increase profit for the ninth year running.

**Poland**

In Poland, which is growing at one of the fastest rates in Europe, we completed the acquisition of the retail and SME businesses from Deutsche Bank Polska, strengthening our position as one of the country’s main banks. Also, Bank Zachodni adopted the Santander brand and modernised its branch network.

We maintained our leadership in digital banking, launching new apps and platforms and consolidating business growth at double-digit rates.

Good evolution of profit spurred by customer revenue.

**United Kingdom**

The UK economy saw moderate growth, uncertainty over Brexit and greater competition. In this context, the Bank worked to fully install the new ring-fence infrastructure that separates retail from wholesale banking and with minimal disruption to customers.

Our strategic priorities continued to focus on customer loyalty and digital and operational excellence. We are number one in service quality.

Profit was impacted by competitive pressure on revenue and on costs by regulatory and strategic projects and digital transformation.
United States

The United States is in a phase of the cycle ahead of other mature economies, with strong growth, a historically low unemployment rate and controlled inflation.

In this environment, 2018 was a great year for our franchise, clearly reflecting the efforts made in previous years in transformation, regulatory compliance and optimising the capital structure.

SH USA passed the Federal Reserve’s stress tests and received no objections to its capital plan, enabling it to normalise its dividend payment policy.

We improved the trend in volumes and turned around profits, which increased more than 40% in a favourable environment for banks following the rise in interest rates and the tax reform. I am optimistic we will continue to improve profitability.

Latin America, a region with higher economic growth potential, larger rises in business volumes and high bankarisation opportunities, experienced bouts of instability, due to elections in Mexico and Brazil and the depreciation of some currencies that affected the Group’s results.

In this environment:

Brazil

Brazil enjoyed an excellent year, thanks to the increasing strength of our franchise, a strategy focused on improving the customer experience and satisfaction (we are the leader in service quality) and the good performance of volumes: lending and funds continued to grow at double-digit rates.

In results, the performance was clearly different from that of our competitors. We reduced the gap in profitability due to the good evolution of net interest income and fee income. We reached the best level of efficiency in the last five years and the cost of credit was the lowest in seven.

In less than four years, despite the deep recession of the country, the Bank doubled its profit and increased its return on capital from 12% to 20%. There is still the potential to improve our positioning.

Mexico

In Mexico, a country with strong growth potential, we continued to strengthen our distribution capacity by investing in technological and digital developments and transforming the branch network.

We launched many products and apps in order to meet each segment’s needs. This produced a significant rise in loyal and digital customers and solid growth in business volumes.

Profit grew at double-digit rates, driven by the good evolution of customer revenue and the lower cost of credit.

Evolution of the business units in 2018

<table>
<thead>
<tr>
<th>United States</th>
<th>Underlying profit</th>
<th>EUR 552 Mn</th>
<th>(+42%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brazil</td>
<td>Underlying profit</td>
<td>EUR 2,605 Mn</td>
<td>(+22%)</td>
</tr>
<tr>
<td>Mexico</td>
<td>Underlying profit</td>
<td>EUR 760 Mn</td>
<td>(+14%)</td>
</tr>
</tbody>
</table>

“Our leading position in most countries is enabling us to capture economies of scale and be the benchmark in the main markets”
Evolution of the business units in 2018

Chile
Underlying profit
EUR 614 Mn (+8%)

Argentina
Underlying profit
EUR 84 Mn (-54%)

SCIB
Underlying profit
EUR 1,705 Mn (+8%)

WM
Underlying profit
EUR 528 Mn (+17%)

Chile
Chile remained focused on transforming the commercial network with more openings of Work Cafés (a model we have replicated in other countries) and the launch of a new branch format in the fourth quarter. We also extended the range of our specialised products such as One Pay for companies and Santander Life and Life 2.0, which offers a new kind of relationship between the Bank and our customers.

In a more dynamic economic environment, we accelerated growth in business with large companies and SMEs. Attributable profit was higher, driven by the good performance of customer revenue.

Argentina
Macroeconomic instability led the country to renegotiate its agreement with the IMF, thereby covering the financing needs for 2018-2019. The economic programme was revamped, focusing on correcting the fiscal deficit and inflation in order to stabilise the economy.

In a complicated environment, Santander Rio’s business and customer revenue performed well, and we made progress in the digital transformation. We continued to be the sector’s leader.

But this was not reflected in the Bank’s profit as it was hit by the peso’s sharp depreciation and the adjustment from high inflation.

The units in Uruguay and Peru recorded a strong growth in profits, spurred by the rise in total income and the commercial transformation process.

Global Segments
Santander Corporate & Investment Banking, our wholesale banking business, focused on improving profitability and on the efficient use of capital. We maintained our leadership position in Latin America and Europe, developed the franchises in the UK and the US, and strengthened integration with the retail networks. Profit was 8% higher.

We created the Wealth Management division, which integrates the businesses of private banking and asset management, at the end of 2017. In 2018 we strengthened our offer to customers in both businesses in order for them to be more global, coordinated and based on the specific needs of each client. The total contribution to the Group’s profit was EUR 1,015 million (including the fee income generated by this business), 13% more than in 2017. RoRWA was 12.1%.

In 2019 the insurance business will be included in Santander Wealth Management unit, which will increase the unit’s contribution to the Group and its global synergies.
Our objectives

The focus in 2019 in the Eurozone countries where we operate will be on generating further synergies in the ongoing integration processes and gaining market share, in order to offset the expected low interest rates and slower economic growth.

In the UK, and in an environment with some uncertainties, our aim is to become the best open digital bank, in order to offer operational excellence, maximise efficiency and improve customer satisfaction.

Santander’s management in the United States will focus on continuing to boost profitability, drive growth in customers and business volumes and enhance efficiency.

Lastly, in Latin America we want to take advantage of the greater growth potential to improve our distribution networks, while continuing to develop our growth and customer loyalty strategy.

At the Group level, as the Chairman has explained in her message, we met the targets we set three years ago in customer loyalty and digitalisation, results, profitability, capital and evolution of the dividend. This places us in the best starting point for attaining the new medium term goals, which will be announced at the next Investor Day.

We are now in a position to advance toward our main goals:

1. As regards solvency, we are looking at a FL CET1 ratio of between 11% and 12%, a range we believe is comfortable, not only in order to face unforeseen risks, but also in terms of flexibility so as to take advantage of new growth opportunities. With this in mind, we are working on a capital-light model.

2. In terms of profitability, our aim is a RoTE of more than 13%, although our efforts are focused on reaching 15%. There are two main drivers to achieve this:
   • Foster cooperation via countries and business units, working transversally, sharing initiatives and developing common platforms. This will enable us to give the best value offer for our customers and generate more revenue.
   • Second, improve efficiency. I am convinced that the digitalisation of our traditional banks will help us to cut operating costs associated with launching new products. Moreover, we are building global processes that generate significant savings and centralising, also at the global level, the negotiation of our technological infrastructure and operation of services.

Mid-term targets

<table>
<thead>
<tr>
<th>Metric</th>
<th>Target</th>
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<tbody>
<tr>
<td>RoTE</td>
<td>13% - 15%</td>
</tr>
<tr>
<td>FL CET1</td>
<td>11% - 12%</td>
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“Our employees are the key to our excellent results, and thanks to their engagement, dedication, passion and effort we continue to get better every day.”

The beginning of this phase is a new challenge for all of us, and as with the previous Strategic Plan, we will continue to work to achieve our profitability, efficiency and value creation targets in accordance with the market’s demand and our shareholders, that are sustainable over time, while we build the best open digital financial services platform for our customers, shareholders, society and our employees.

I will end with some words on our employees. All of them are the key to our excellent results, and thanks to their engagement, dedication, passion and effort we continue to get better every day.

José Antonio Álvarez
Vice chairman and Chief executive officer