Global Banking Trends: going cross border…why globalisation helps

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Santander

I. *Building* a Global Financial Group: why we go cross border ….

- I thought banking was a *local* business… How can we justify cross-border acquisitions?
- Economics of cross-border mergers
- Value creation

II. *Managing* a Global Financial Group: "second round" value creation opportunities

Creating value through "globalisation"…

… and making sure local units do not get "lost"

- Global scale vs local flavour
- Are there conflicts between local and parent interests?
- Role of market discipline

III. Conclusions

Why we go cross border?

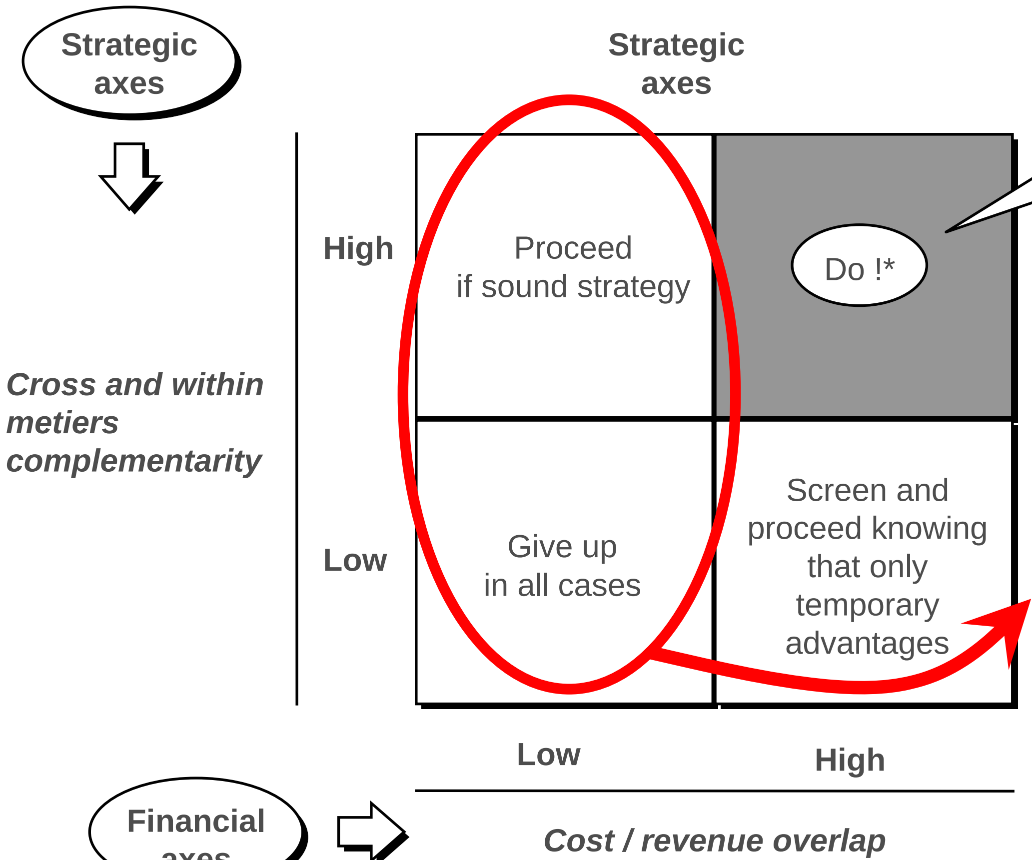
- **One answer explain all other: … because there are value creation opportunities for shareholders**

- **Does cross-border consolidation in the financial sector make sense?....**

…I thought banking was a *local* business

Traditional view on mergers… only in-market mergers create significant value

BANK MERGER SUCCESS GAMEBOARD



Best case for merger as
•Sound strategy and core competency
•Competitive financial advantages

The market view before Abbey´s acquisition:

…cross border M&A does not create value

"Retail banking is about culture and knowing and understanding your customers. It is possible to offer your own retail banking services across a border where the cultures are similar. But **it is much more difficult to put two different banking organisations together especially where one is from north Europe and the other from the south…,**"

We have challenged this view…

… our experience is that acquisitions create value… …under certain circumstances

What **you** need to have		What **the target** needs to have
1. Clear retail business model to export 2. …operating on exportable IT 3. …which industrialises your operations 4. Spare management capacity	+	1. Good old franchise… 2. Commercially underperforming 3. With low operational efficiency… 4. "Pre –industrial" operating systems

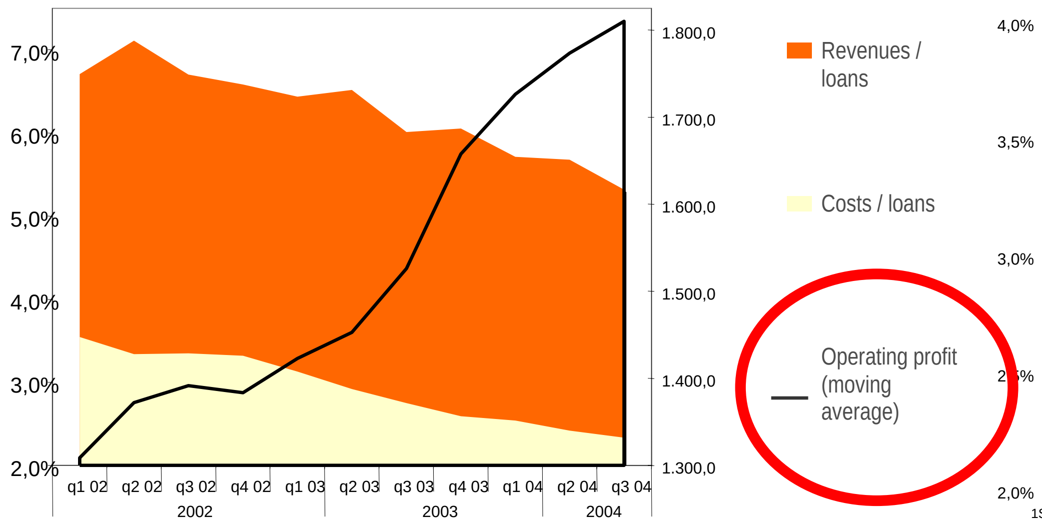
We export our know how in industrialising retail banking

"Darwinism" will keep driving the right acquisitions…

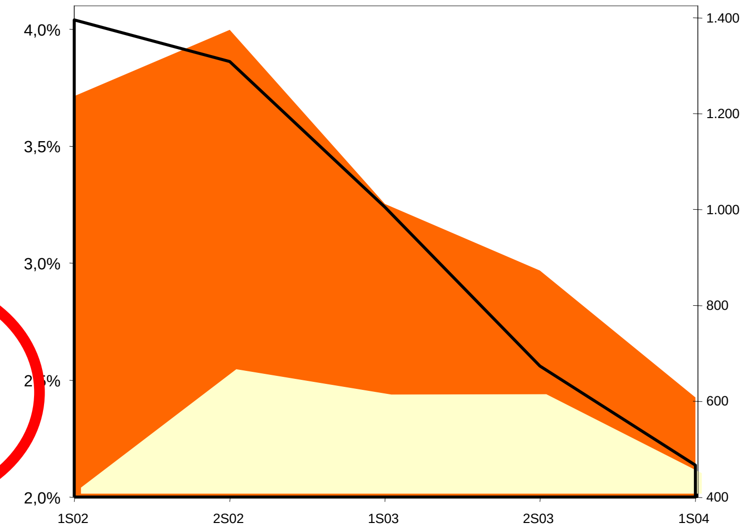
Those not adapting to "the vital necessity" of efficiency are likely to be taken over:

The Abbey example

… SAN opening jaws



… Abbey closing jaws

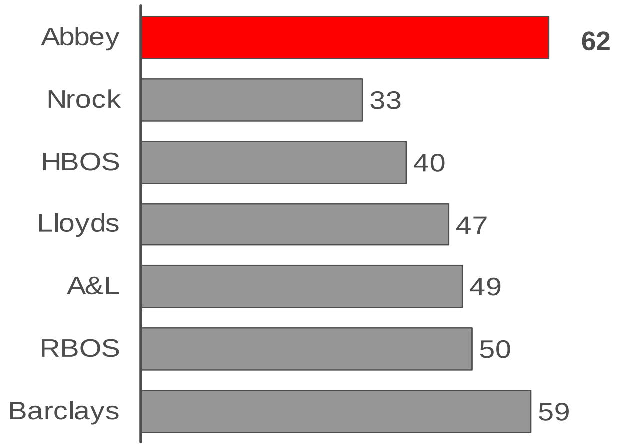


IT is key

Capitalism works: Weaker banks (less efficient) are likely to be taken over by efficient ones in an increasingly integrated European financial services market

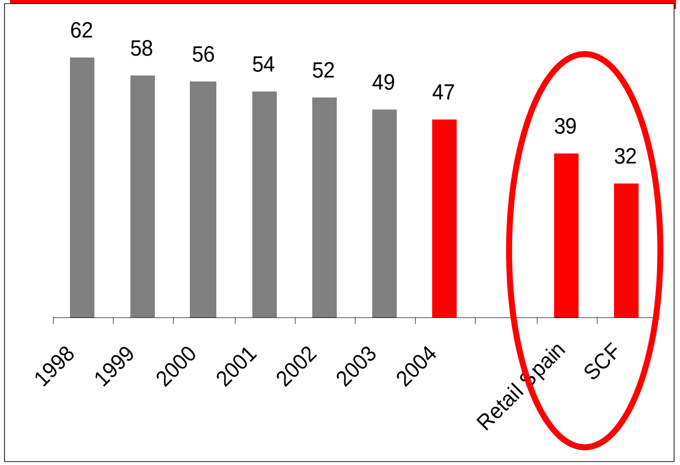
Abbey: the operational “homework”
Significant potential to improve the operational efficiency…

Abbey / UK Banks Cost / Income ratio



Based on most recent results and management estimates of the PFS components of the peer group

Grupo Santander’s proven track record



	Abbey*	SAN Group best practice
Operations staff level as a proportion of total employees	33%	6.5%
% of IT expenses / Net operating revenue	12%	6.9%

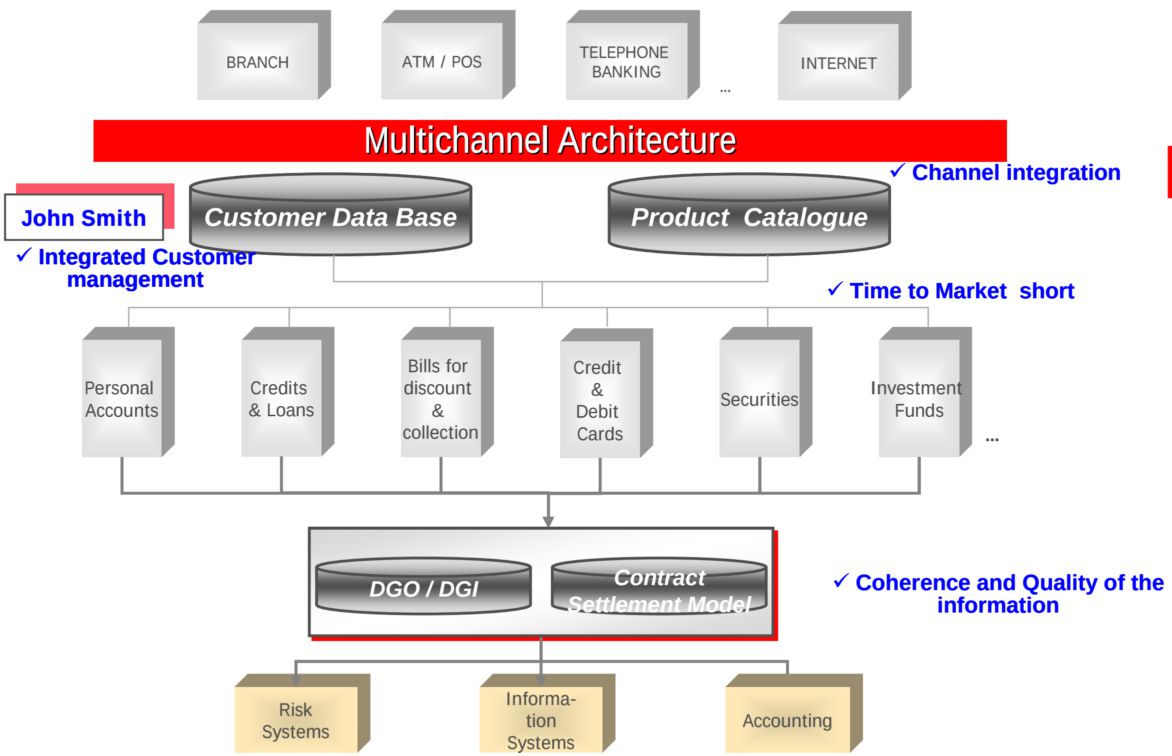
We run “Abbeys” with a third of the people and generate 20% + revenue per front employee

… by industrialising operations
Integrated IT systems gives us a competitive edge…

… most banks have a "legacy" problem

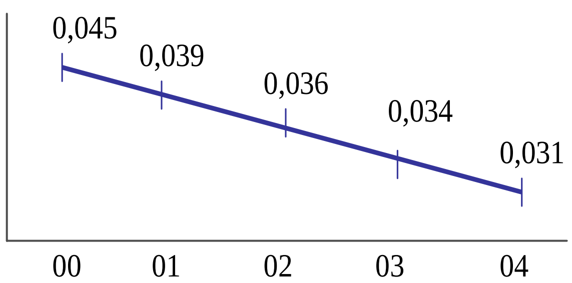
The "architecture" of the factory becomes very relevant - "Silo" style systems are very inefficient

Operating systems like Partenon represent a key competitive advantage…



… which translates into a strong reduction in unit / transaction costs and revenue productivity

Transaction costs- Banesto

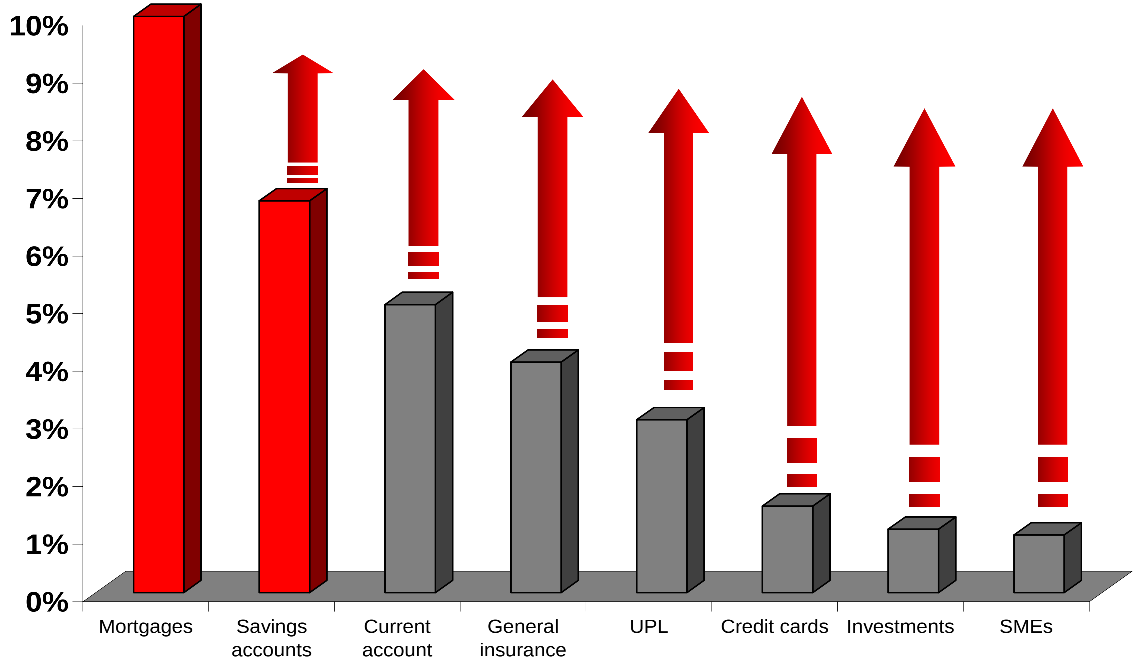


Abbey: the commercial "homework"

Abbey has a strong customer franchise and provides a platform to evolve in the long run from a mortgage bank into a universal bank…

Abbey is still an under-exploited franchise in many key areas

Mortgage bank



Universal bank

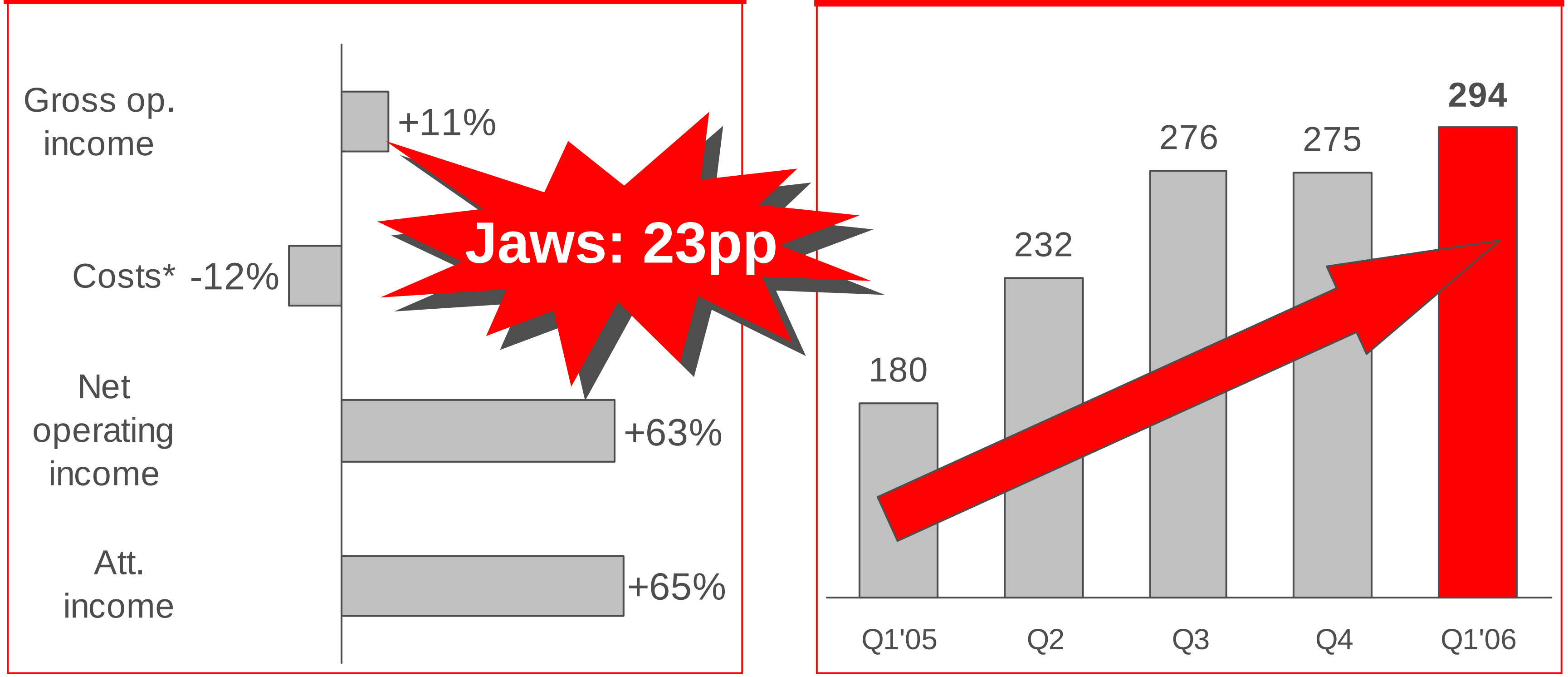
Significant potential to increase share of wallet

… and this strategy is already producing results

Achieving revenues and costs plan.
Attributable income to the Group of £ 167 MM (EUR 244 MM)

Change Q1'06 / Q1'05

Net operating income



(*) Personnel + general costs + depreciation

Therefore: Why we go cross-border?

Opportunity to create value based on:

- Exporting management
- Exporting a banking model
- Exporting IT & infrastructure

(This is the new thing vs 10 years ago)

But this does not work with all targets / buyers…

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Globalisation generates “second round” value creation opportunities that reinforces the cross-border expansion process…

… economies of scale become Global

The IT / telecom revolution… along with the "available talent" in emerging markets… makes the execution of global models possible

Talent / emerging markets

IT / telecom revolution

Service / mature markets

The value chain is broken…

… with each function being placed in the most efficient location

- **In India…**
  - Tax returns are processed for 450,000 US residents
  - … 1m surgeries will be performed on foreigners
- **Cahoot (Abbey's Internet bank) is serviced from Madrid (back office)**

Suddenly we start to create economies of scale in IT and operations…

In the medium and long term, the potential for "true" synergies emerges

Technology

Global operations / back office synergies

- Efficiency leadership / advantage

Joint development (products, businesses)

- Best practice
- Know how transfer

Global units

corporates, cards, insurance, asset management)

- Economies of scale in global businesses

...

The case for global synergies: Global organisations are in a unique position to create value by developing global business units

From:

A MultiLocal model

Whole sale

Cards

Asset Management

Insurance …

To:

Global business unit model

Retail España

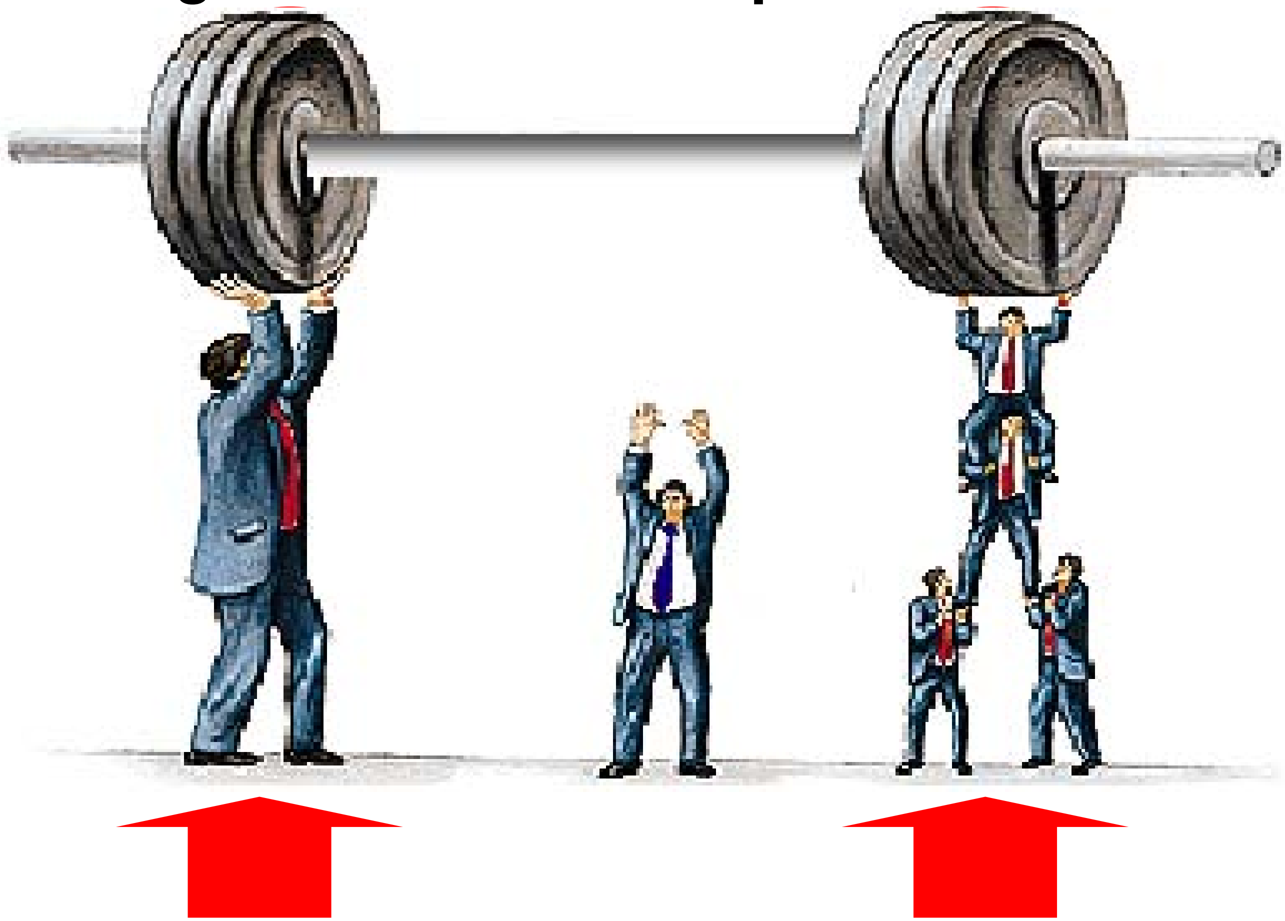
REtail Portugal

Retail UK

Retail Latam

Consume

"Barbell" structures are developing in all industries … and the banking sector is no exception



Global banks leveraging their scale

Specialist / niche players

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Is it possible to combine…

… global skills…

… with a local flavour?

We aim to avoid the pitfalls of globalisation

- Distorted incentives (S-T vs L-T)
- Strategic “straightjackets” (e.g., growth in retail vs SME loans in all markets)
- Capital intensity bias (e.g., dividend payout targets, regardless of investment opportunities)
- …managing business from 10,000 feet up

Local market know = exploit local opportunities = adequate Capital allocation + Capital markets check of local businesses

1. We allocate capital across the Group to those areas that offer the most attractive risk / return profile

- No “capital intensity” bias

2. Different strategies in different markets

- **Chile-** exploit dominant position, focus in retail banking; fine-tune risk / return proposition
- **Brazil-** grow consumer lending / credit cards, focus on SMEs, strengthen installed capacity (scalable platform), develop alternative channels
- **Mexico-** develop mortgage strategy / change loan book mix, grow customer funds, exploit potential of customer base

3. The market has full visibility of our strategy in each area

Our strategy and the evolution of our results in each specific is clearly communicated to the market

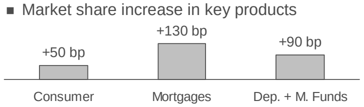
Chile. Key aspects of the quarter

Macro and financial environment

- Favourable environment with notable banking business growth:
  - Loans: +16%; Savings: +18% (*)

Activity

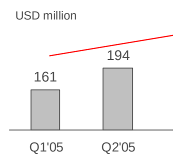
- Retail growth: Increase in linkage and in customers
- Market share increase in key products



- Improvement in efficiency enables expansion plans to be financed
- Active management of arrears. Ratios improve

Results

- Record quarter in revenues due to net interest income (+31%) and fees (+42%)
- Costs growing slightl… efficiency improveme…
- "Leap" in net operatir…



- Loan-loss provisions increase in retail loan… premium

Solid quarter results with a record attributable i… million), underscores the strength of the franchis…

(*) Activity growth in local currency

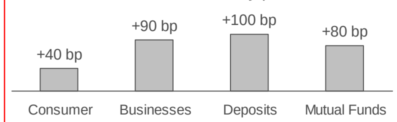
Mexico. Key aspects of the quarter

Macro and financial environment

- Favourable macro environment with strong growth in banking business
  - Loans: +29%; Savings: +17% (*)

Activity

- Increase in linkage and number of customers: payroll and cards: levers of growth
- Market share increase in key products



- Better composition of loan balances

Results

- Record quarter in revenues due to net interest income and fees
- Strong efficiency improvement. Costs lower than expected
- "Leap" in net operating income

Solid and profitable growth of b… increases in net operatin…

(*) Activity growth in local currency

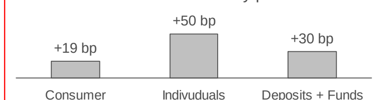
Brazil. Key aspects of the quarter

Macro and financial environment

- Favourable environment: solid fundamentals and strong increase in banking business
  - Loans: +20%; Deposits: +20% (*)

Activity

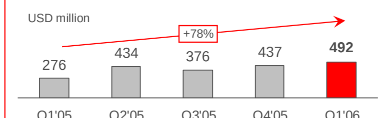
- Increase in customers and linked customers
- Growth in SMEs and businesses
- Stronger increase in volumes than expected: increase in market share in key products



- Technological integration finalised in April: Improvement in future potential

Results

- Record quarter in revenues: in net interest income (+51%) and fees (+57%)
- Lower trading gains: no portfolio sales in Q1'06 (in Q1'05 we sold) and higher unrealised capital gains
- Efficiency improvement. Cost + amortisations are 6% lower in local currency
- "Quality jump" in net operating income



- Loan-loss provision increase: strong loan increase - change of mix
- Increase in taxes (29% to 34%)

Technological integration and faster business growth make us more optimistic than our previous indications

(*) Activity growth in local currency

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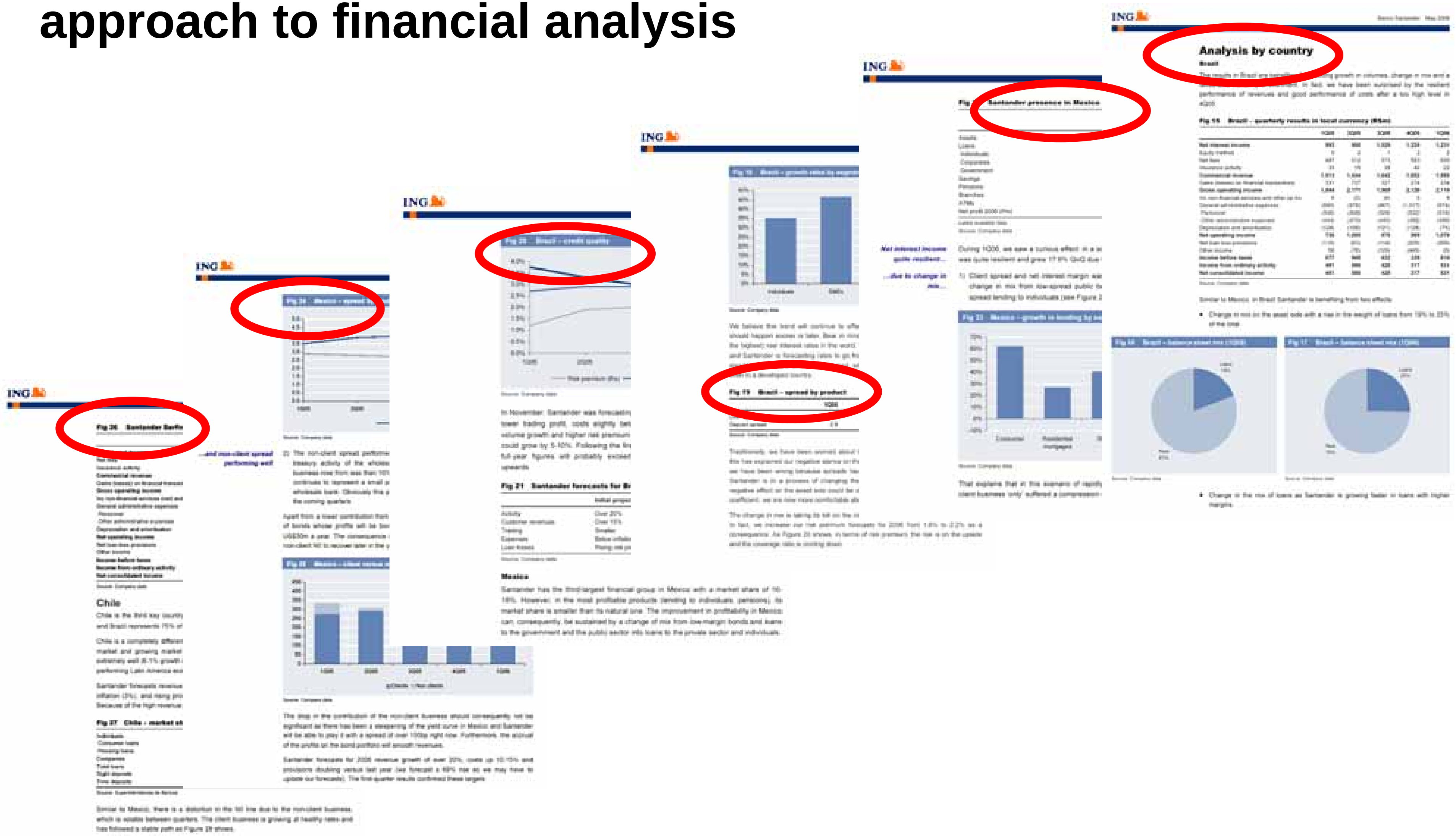
Market discipline: The market does not adopt a "black box" approach to financial analysis



Analysts value each business separately

Table 3: Santander 2007E Sum of the Parts valuation

€m	RWA	Shareholders Capital	Core Tier1 (ex prefs)	Cost of Equity	Net (per SAN)	Earnings (per ML)	ROE Adj	P/E (X)	P/NAV (X)	Implied Valuation	% of Total Group
Continental Europe	273,766	16,353	6.2%	9.4%	4,054	3,726	22.8%	12.4	2.8	46,201	54.4%
SCH Spain	103,664	5,701	5.5%	9.0%	1,777	1,633	28.6%	12.5	3.6	20,412	24.0%
Banesto	64,656	3,427	6.0%	9.2%	685	630	18.4%	12.5	2.3	7,872	9.3%
Santander Consumer	39,646	2,379	6.0%	10.0%	707	650	27.3%	13.4	3.7	8,712	10.3%
Portugal	27,837	1,809	6.5%	9.5%	422	388	21.4%	12.0	2.6	4,655	5.5%
Wholesale and PB&AM	37,962	3,037	8.0%	10.0%	463	425	14.0%	10.7	1.5	4,550	5.4%
Abbey	114,021	5,131	4.5%	9.5%	1,226	1,127	22.0%	11.0	2.4	12,394	14.6%
Latin America	74,019	9,180	13.9%	13.4%	2,415	2,219	24.2%	10.0	2.4	22,223	26.1%
Brazil	20,793	3,119	15.3%	15.0%	853	784	25.1%	9.0	2.3	7,056	8.3%
Mexico	19,004	2,281	16.0%	13.0%	504	463	20.3%	10.0	2.0	4,628	5.4%
Chile	16,325	1,632	11.9%	10.0%	450	413	25.3%	14.0	3.5	5,786	6.8%
Rest of Latam	17,897	2,148	12.2%	14.0%	608	559	26.0%	8.5	2.2	4,753	5.6%
Fin Mgmt & Equity Stakes	44,441	4,175		10.0%	-623	0				4,175	4.9%
Total Santander Group	506,246	34,839		10.5%	7,072	7,072	20.3%	12.0	2.4	84,993	100.0%
Number of shares (million)										6,254	
Implied value, €/sh										13.6	
Acquisition risk discount (5%)										-0.7	
Implied value €/sh, net										12.9	

Source: Merrill Lynch estimates

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Conclusions (I)

1. Cross border consolidation makes sense…

…but only if you can create value

2. Ignore the “globalisation” opportunity at your peril…

… technology makes “intragroup synergies” and global business models possible

3. No “black box” approach…

… and no “tactical bias”…

… to local market operations

Conclusions (II)

	Possible problems	Solution
Sensivity to foreign investment **What are the appropriate goals and behaviour of foreign banks in host markets**	Distant shareholder might underfund local economy… … and distort local market conditions Potential different objectives between local – parent (investment opportunities etc)	Maximise shareholders value brings the right incentives: Ensure rational allocation of capital Ensure efficiency, innovation and competition
What role can market discipline play in ensuring the interests of all stakeholders are considered …?	Markets do not see local operations dynamics	Transparency: Full disclosure of local operations dynamics Valuation of groups as a collection of local markets + global areas
Implication for supervisory policy	Different regulation criteria between home and host regulators Extra cost of double compliance	Better co-ordination / co-operation between authorities

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