Message from José Antonio Álvarez

Our results, for yet another year, underscore the soundness of Grupo Santander and its capacity to provide sustained, quality growth. They are the consequence of positive performance of the main income statement components: revenues, costs and provisions.
Grupo Santander carried out its activity in 2016 in a challenging environment. Global economic growth slowed down slightly, as markets were hit by volatility stemming from concerns about growth in China and the uncertain international political panorama.

However, there are some positive aspects that invite optimism about the near future:

- Financial markets are increasingly resilient, quickly recovering from bouts of volatility.
- Developing economies in general grew at a faster pace, and the worst performers, such as Brazil and Argentina, adopted economic policies that should enable them to emerge from recession in the coming quarters.
- Lastly, mature economies began to recover in the second half of the year. The UK’s referendum, in particular, had a limited impact on growth, and the Spanish economy again grew by more than 3%.

Another factor in this environment are the pressures on banks since the onset of the financial crisis, mainly because of new regulatory requirements and low interest rates in mature economies, limiting a more intense recovery in profitability.

I will now set out the Group’s performance during 2016, the priorities and main steps taken in each of our markets, and the financial objectives for 2017.

The Group’s performance in 2016

We posted an attributable profit of €6,204 million, 4% more than in 2015 and 15% higher in constant euros (the exchange rate effect was again negative).

This figure includes some positive and negative one-off results which had a net negative effect of €417 million (€600 million negative in 2015).

Profit before extraordinary items, taxes and excluding the exchange rate effect, which is a more appropriate way of assessing our management, rose 12% to €11,288 million.

These results, for yet another year, underscore the soundness of Santander Group, its capacity to provide sustained quality growth. They are the consequence of the positive performance of the main P&L lines: revenues, costs and provisions.

The first thing to emphasise in revenues is their considerable recurrence in an environment of high volatility. This was made possible by the high relative share (94%) of commercial revenues:

- In an environment of very low interest rates in mature markets, net interest income increased 2% in constant euros thanks to management of spreads and our significant exposure to developing countries and to consumer credit business.
- Fee income increased 8%, double that in 2015, reflecting the greater loyalty and satisfaction of our customers.

* Excluding exchange rate.
Costs were 2% lower in real terms and on a like-for-like basis. Seven of our core units registered a rise in costs that was below the inflation rate.

This good performance was the result of efficiency plans and the active management of our business, differentiated in each market, where we adapted the cost base to the business reality. The measures taken to streamline and simplify structures, both in the corporate centre as well as in some units, are enabling us to continue investing in our commercial transformation while remaining one of the international financial system’s most efficient banks.

More revenues and control of costs were accompanied by a 2% fall in loan-loss provisions in constant euros. As a result, the cost of credit dropped from 1.25% in 2015 to 1.18% in 2016. The improvement in credit quality is closely related to the strengthening of the risk culture across the Group through several initiatives.

Turning to the balance sheet, there are two noteworthy aspects:

• We delivered balanced growth in both lending and funds (+2% and +5% respectively) and our liquidity ratios were well above the minimum required levels.

• The Group continued to generate capital quarter after quarter. In fully loaded terms, we attained a capital ratio of 10.55% (+50 basis points), putting us in line with our target of 11% in 2018, while comfortably meeting all regulatory requirements.

Consequently, we combined a sustained generation of capital, which underscored the Group’s capital adequacy, with a high level of profitability compared to the sector’s average: a RoTE (Return on Tangible equity) of around 11% and a RoRWA (Return on Risk Weighted Assets) that increased to 1.36%.

Priorities and performance of the business areas in 2016

The units’ strategy in mature markets focused on boosting the number of loyal customers, gaining market share, controlling costs and improving the credit quality.

Spain
Santander Spain is building deeper and long-lasting relationship with its customers, underpinned by the 1|2|3 strategy. The number of loyal individual customers rose 27% and companies 48%. Santander remained among the Top 3 in customer satisfaction surveys and increased business activity.

In a sector in which activity is slowing down, the higher profit was supported by an improved risk profile, lower provisions, the efficiency plan and higher fee income.

United Kingdom
Profit was impacted by the new tax on banks. Pre-tax profit, which better reflects the business performance, increased 8% thanks to higher volumes, good management of spreads and control of costs. In addition, lower provisions due to the excellent improvement in the quality of credit risk.

In a demanding environment characterised by greater uncertainty in the second half of the year the solid evolution of our business is worth noting. The number of 1|2|3 customers increased to 5.1 million while lending to companies also saw further growth. We continued to focus on operational excellence: the sustained improvement in our mobile and online channels produced a 25% rise in the number of our digital customers.
We combined a sustained generation of capital, which underscored the Group’s solvency, with high profitability compared to the sector’s average.

Santander Consumer Finance
SCF remains the consumer finance leader in Europe. In 2016 it continued to gain market share and the agreement with Banque PSA Finance (BPF) was completed successfully, expanding activity to 11 countries, strengthening our diversification.

Profit rose for the seventh straight year, demonstrating the robustness of our business model throughout the cycle.

United States
We completed building the holding company, thereby consolidating the management of all operations in the country, and we made progress in meeting regulatory requirements. We continued working on the transformation programme to improve risk management and our technological and operational capacities.

Santander Bank is focusing on driving commercial activity and Santander Consumer USA changed the composition of its portfolio toward a lower risk profile.

All these changes and measures are aimed at building a more profitable business in the medium term. Meanwhile they are temporarily impacting results and are the main reason behind the lower profit.

Portugal
We own the country’s strongest bank. Our strategy is centered, on the one hand, on improving the bank’s profitability and, on the other, on the technological and operational integration of Banif’s business acquired at the end of 2015. We are well positioned in the country, with market shares of around 14% both in loans and deposits.

Developing markets are in a different stage due to structural reasons. They register stronger growth than that of mature economies in volumes, higher interest rates, a substantial potential for banking penetration and RoTEs between 15% and 20%. Santander has local critical mass, a strong business model and an effective risk management of the credit cycle, which produced very good results in all the units of the Group’s developing countries.

Brazil
Santander generated excellent results in an environment of recession, thanks to the improvements achieved in the last few years in the franchise, the good commercial dynamics and progress in the digital strategy, which enabled the number of digital customers to surpass six million (+45%).

In 2016, for the first time, Santander became one of the best companies to work for and launched several commercial offers, such as Olé Consignado, in payrolls business. We also announced a commercial agreement with American Airlines so that our customers can accumulate air miles, and created a joint venture between Santander Financiamentos and Hyundai.

All these measures were reflected in our financial variables. We increased deposits, improved the trend in lending in the second half of the year, and profit was 15% higher thanks to the good performance of commercial revenues, improved efficiency and a cost of credit below that of our competitors.

<table>
<thead>
<tr>
<th>Country</th>
<th>Profit</th>
<th>Change</th>
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</thead>
<tbody>
<tr>
<td>España</td>
<td>€1,093*</td>
<td>+18%</td>
</tr>
<tr>
<td>Portugal</td>
<td>€399 million</td>
<td>+33%*</td>
</tr>
<tr>
<td>United States</td>
<td>€1,786 million</td>
<td>+15%*</td>
</tr>
<tr>
<td>Brazil</td>
<td>€395 million</td>
<td>-42%*</td>
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* Excluding exchange rate.
The outlook for 2017 points to a modest upturn in global growth, which could be close to 3.5%. This would be supported by both mature as well as developing economies.

Mexico
The strategy was very focused on improving customer retention, commercial transformation and innovation. The year was very active as we launched products and commercial agreements produced a gain in market share in lending, growth in deposits and a sharp increase in loyal and digital customers. Profit rose, spurred by the good performance of revenues, particularly net interest income.

In order to continue improving the franchise and the IT systems, we announced a 15,000 million mexican pesos three-year investment plan, over and above our recurring investments and initiatives.

Chile
Management focused on growing those segments that contribute the most, such as companies, high-income customers and deposits. We also concentrated on improving the quality of customer care, reaching the Top 3 in customer satisfaction.

Santander Chile continues to gain market share in loans and deposits, ranking first in loans and second in deposits. Profit rose thanks to higher net interest income, control of costs and lower provisions.

Argentina
Santander Río wants to exploit the high growth potential of the financial system (which is very transactional), and the improved environment for developing banking business. As a result we decided to strengthen our position in the country by acquiring Citi’s retail business, as well as continuing to modernise the network and open new branches.

Poland
We continue to be the leading bank in innovation and digital channels. We increased the number of loyal customers, notably so among companies, and our growth in loans is well above that of the sector.

Excluding the impact of the new tax on assets, profit rose 14% due to the good performance of net interest income and a very significant improvement in credit quality.

Lastly, the units in Uruguay and Peru increased their profit by 32% and 21% respectively. In Uruguay profit was underpinned by the sharp growth in revenues and in Peru by the decline in provisions.

Financial objectives for 2017
As you can see, in 2016 we achieved our main goals and our financial variables for the Group and for the main units performed well.

The outlook for 2017 points to a modest upturn in global growth, which could be close to 3.5%. This would be supported by both mature and developing economies, which are expected to grow faster in 2017 for the first time in five years, largely thanks to expansive policies in the US and a significant improvement in some large developing countries. US interest rates can be expected to increase again, and could produce a steeper yield curve in Europe.

The risks are primarily of a political nature, such as the impact that the policies in the US could have in some developing countries, the Brexit negotiations and the outcome of elections in France and Germany.

* Excluding exchange rate.
** Excluding the impact of the new tax on assets and exchange rate +14%.
We will continue to make progress in 2017 toward achieving the goals we announced at the Global Strategic Update. In order to do this, we have set the following priorities:

- **Accelerate revenue growth**, particularly in developing markets, where we see high one-digit or double-digit growth in all units and where interest rates enable good spreads to be obtained.

- In **mature markets**, where revenues are under pressure, we must increase our market share, mainly in companies, and continue to grow in fee income, mainly in cards, insurance and funds. The recent agreement to acquire 50% of Santander Asset Management should be seen in this context.

- **Continue to keep costs under control**, keeping their total increase below the average inflation of the countries, and maintain revenue growth above that of costs.

- **Keep on improving the cost of credit**, with the Group's provisions falling as the cycle improves in some core markets such as Brazil and Spain.

- **Grow risk-weighted assets (RWAs)** below the increase in the Group's loans and profit in order to improve our RoRWA ratio.

- **All these measures should improve our profitability**, moving us toward the RoTE goal of 11% in 2018, and strengthening our capital ratio.

Lastly, I would like to thank all the Group’s professionals for their efforts in transforming and improving our bank. The achievements in 2016 and attaining the goals in 2017 would not be possible without the contribution of each and every one of them.

We will continue to work every day to help people and businesses prosper, and to turn Santander into the best retail and commercial bank by earning the lasting loyalty of our people, customers, communities and shareholders.

José Antonio Alvarez
Chief executive officer

**FINANCIAL OBJECTIVES 2017:**
- Accelerate revenue growth
- Gain market share in mature markets
- Costs under control
- Improve the cost of credit
- Grow RWAs below the increase in the Group’s loans and profit
- Improve our profitability