

Interview with the chairman, Pedro Guerrero

'Bankinter ended 2017 more profitable and solvent than it started'



In what kind of macroeconomic environment did the Bank carry out its activity in 2017?

Overall, 2017 was quite a good year from the viewpoint of economic activity. Last year we began to see the global and domestic economic cycle clearly change from contractionary to expansionary. The consolidation of this new and better environment is occurring despite the uncertainties that are affecting geostrategic and political stability.

In Spain, GDP growth was balanced and rose by over 3% for the third consecutive year, thanks to strong performances in consumption, investment and exports.

Central banks began, though tentatively, the slow process of removing monetary stimulus. In the United States the Fed raised interest rates three times in 2017 and the ECB began to reduce the size of its liquidity injections into the eurozone. This is an indication that there is an adequate process of economic stabilisation taking place, as it is clear that monetary stimulus is becoming less needed. In other words, the global economy is beginning to be able to function adequately without external help.

Perhaps the most positive aspect of this growth cycle is its high degree of geographic synchronisation. It is not easy to identify a major economy that is being left out of this process. This fact is especially important for the future performance of Spanish companies abroad and, in particular, it reinforces the long-term sustainability of the growth cycle. These factors taken together offer a hopeful starting point for 2018.

Will it be possible to maintain this growth trend?

I think so. Economies have some strong inertias, both positive (expansion) and negative (contraction), which are not easy to break down in the short term. I think we can trust that, barring unexpected events, the positive inertia that is underway will extend into 2018 and even beyond. It is worth remembering that, in general, expansionary cycles last two or three times longer than contractionary ones. At least this is what economic history since the start of the twentieth century tells us, and there are currently no concrete arguments to cast doubt on this fact. What is more, now that we are in the twenty-first century, the ever faster advance in technology combined with

the more professional management of the economy, both public and private, should further reduce the likelihood of this trend reversing.

How do you see the situation in the banking sector?

The banking industry is a survivor of a set of adverse conditions that occurred over a period of ten years (2007/2017). As a result, there are currently only a dozen banks remaining in Spain, when before the financial crisis there were more than sixty. The survivors among us are stronger and have more solid balance sheets than ever before. This puts us in a good position to take advantage of the improved climate that we believe will gradually be seen over the next few years.

On one side the recovery of activity volumes benefits us, combined with an improvement in credit quality thanks to the upturn in the economic cycle. On the other side, it is very difficult to see interest rates falling and it is most likely they will rise. This is not something we will see short term in the eurozone, at least during 2018, but it will eventually have to happen, as it already has done in the United States. This will also be a positive factor in sector results.

That said, we cannot forget the threats, which are many, mainly resulting from the competition of companies related with the latest technologies; excessive, at times suffocating, regulation; and even the possibility of bubbles forming due to excess liquidity.

What role will digitalisation play in all this?

A very important role, as it is not only increasingly demanded by customers, but it is also vital to give the business scalability without the need to incur the costs that an extensive branch network requires.

Up to now Bankinter's digital channels have been directed towards transactional banking, in other words, to facilitate the self-service banking of our customers. This has enabled Bankinter to have a much smaller physical branch network than would correspond to its market share. However, today's technology allows us to give a new impulse to digital channels so that they support sales and attract new customers, giving them a much greater commercial orientation and not merely a transactional one. In this regard, in 2017 we introduced a new Individual Banking website with a much improved customer experience, and tools to attract customers, such as simulators, comparison tables and search engines, along with selling a bigger product range.

We feel particularly proud of the mass use our customers now make of virtual channels in their relationship with the Bank. 91% of our customers are digital, either pure (31%) or mixed.

From the viewpoint of internal digitalisation we are redesigning our processes and applying new technologies to them, such as facial recognition, OCR (Optical Character Recognition) and BPM (Business Process Management), to reduce the processing times and internal resources dedicated to administrative tasks. All of this will lead to

an improvement in the quality perceived by customers, of the productivity of commercial staff and finally in processes more adapted to the digital world.

Does that mean we should forget the way we have done banking before now? Absolutely not. In the highest segments, human relationships and advice remain a core part of our value proposition, in which the physical branch network will continue to play a central role, but it will dedicate more time to sales, to attracting customers and advisory services, and much less to operational tasks.

What would you highlight about Bankinter in 2017?

The most important factor has been the strength of our commercial activity. In a market which, despite the economic boom, is still decreasing (loans, the Bank's main source of income, continue to decline), Bankinter alone has been able to grow and, therefore, gain market share in all segments, both for individuals and businesses. We have grown in individual retail banking, personal banking, private banking, in SMEs, in medium-sized enterprises and in corporate banking

We have also done so in those businesses which we consider strategic and which we have focussed on over the last few years. This has been the case with consumer finance which performed exceptionally well with growth of 42% in the year. International Business and Investment Banking also did well and made a significant contribution to the Bank's results.

'We can trust that the positive inertia of the economy that is underway will extend into 2018 and even beyond.'

Línea Directa Aseguradora has once again had a brilliant year. It has grown significantly, gaining market share in the car insurance and home insurance categories. It has launched a new line of business, health insurance, through the Vivaz brand. It also beat its record profits, which is a major achievement in a year in which it has invested heavily in growth.

Finally, I must highlight the fine performance of the business in Portugal. In the first full financial year since we acquired the branch network from Barclays in 2016, we have achieved significant in customer funds and loans and receivables and made a profit. The operational integration is also now practically complete.

In my view it is a very notable event, bearing in mind that this is the first significant overseas acquisition that Bankinter has undertaken in its history.

In summary, 2017 was once another record year for Bankinter, and one in which we also laid down solid foundations for our future growth.

The good performance in 2017 has been possible, thanks to the trust of our customers, and the professionalism, dedication and hard work of our employees.

The achievement comes from an exceptional human resources team, which is motivated, committed and has decisive leadership.

To everyone who forms part of that team, I want to congratulate and thank them.

What about the Bank's results?

Although the chief executive officer will refer to the results later, I would like to highlight two things.

The first is the amount. Net profit reached 495 million, our highest ever, meaning that at Bankinter we have now beaten our record profits four years in a row. In addition, this year there were no extraordinary items, unlike last year when we had 145 million euros of EBT resulting from the badwill generated in the Portuguese acquisition, having bought it at a very favourable price. Stripping out this effect, net profit grew by 20.2% in the year.

The second factor I want to highlight is the quality of the results.

As I have said, there were no extraordinary items, but in addition they have come almost exclusively from business with customers.

EFTs (earnings from financial transactions) were 61 million euros, just 3.3% of gross operating income. The Bank's debt portfolio is less than 150% of our own funds, which is considered to be technically correct to cover interest rate risk.

These results have provided a RoE (return on equity) of 12.6%, the highest by some way among Spanish banks and one of the best in commercial retail banking in Europe.

If we add to this our solid capital and liquidity ratios, which our chief executive officer will comment on in more detail, and our low non-

performing loan and foreclosed assets ratio, we can conclude that we are in an enviable position to face the future.

In summary, Bankinter ended 2017 more profitable and solvent than it started.

In what ways will shareholders notice these improvements?

Mainly in two ways.

The first is the share price. It went up by 7.4% in 2017. This increase is significant, if we put it in context. Our share is the bank stock that has increased the most in value in the IBEX 35 in each of the last four years. Also, in the entire five-year period from 2013 to 2017 (both included) our share price increased the most among the 40 banks listed on the STOXX® Europe 600 index.

The good results for the year, which were partially discounted by the market, have seen our share price rise by 17% in the month of January 2018.

The second way is through dividend yield. This year we are proposing to the annual general meeting of shareholders, the payment of a cash dividend totalling 247.6 million euros, an increase of 24%, in both the total dividend and dividend per share, compared with last year. We believe this is a reward to our shareholders that is line with results and at the same time ensures the conservation of capital and the maintenance of an appropriate level of capital adequacy.

'The achievement comes from an exceptional human resources team, which is motivated, committed and has decisive leadership.'

What is new in Bankinter's commitment to sustainability?

It is a clear commitment, that comes from our belief that everyone, from all of our respective areas of activity and as far as is possible, must contribute to a better world. We are delighted that our efforts have been recognised, as was shown last year when Bankinter was included in the Dow Jones Sustainability Index Europe, the stock market index that includes those companies with the best social, environmental and corporate governance performance in Europe.

In 2017 we continued developing the objectives set in the 'Tres en raya' ('Three in a row') plan, which is so named because it aligns the three dimensions of Bankinter's sustainability policy: economic, social, and environmental. What is the aim of it? Basically to establish a balanced, transparent and clear relationship with our stakeholders (shareholders, customers, employees, suppliers and society in general); to assist with the financial integration of people with disabilities; to undertake the responsible management of people, as the Bank's primary asset; contribute to the development of the community; and reduce our impact on the environment to a minimum.

Elsewhere in this report there is a detailed description of the achievements of this plan. However, I will take this opportunity to emphasise the Bank's commitment to sustainability, which increasingly permeates all areas of our business. It is a commitment that has a clear effect on corporate governance, which is subject to the most demanding international practices and the planned requirements of the European Banking Union.

I would also like to express my recognition of the commendable work carried out by the Bankinter Innovation Foundation, which aims to find answers to our concerns, especially in relation to the key role of innovation and entrepreneurship in human progress. It has four programmes focused on achieving this. The Future Trends Forum, which is the top science and technology think tank in Spain and the 27th in the world, according to the University of Pennsylvania. The Akademia programme, which spreads the importance of business innovation in the major university centres and helps students to start-up new self-employment projects. The Entrepreneurs programme, which invests capital in the early stages of these projects. Cre100do which collaborates in the growth

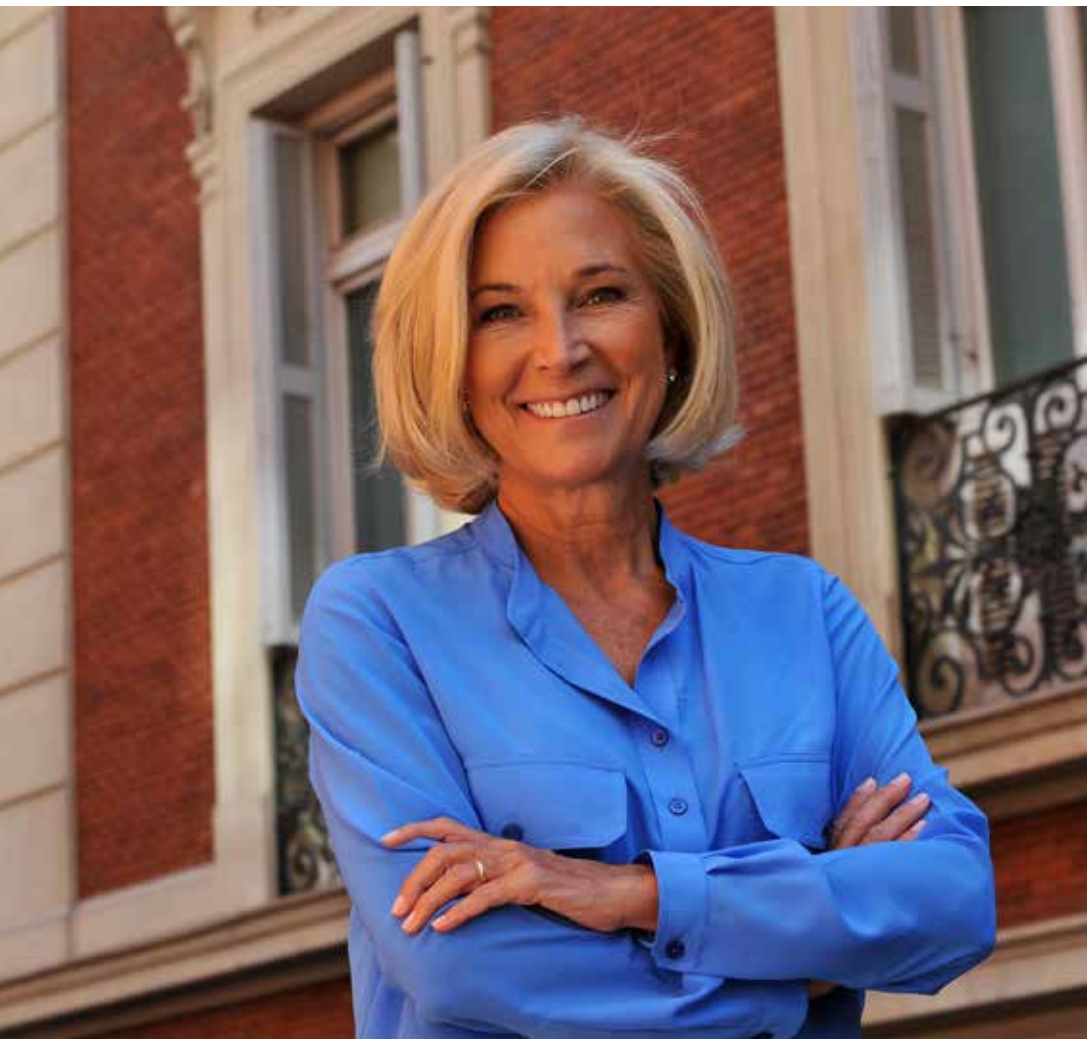
and internationalisation of medium-sized companies, helping to make them bigger.

We believe that the fruits of these four programmes, along with the specific characteristics of our business, will occupy an important place in the Bank's legacy.

'I want to emphasise the Bank's commitment to sustainability, which increasingly permeates all areas of our business.'

Interview with the chief executive officer, María Dolores Dancausa

'2017 was another year of record profits in the history of Bankinter'



How would you assess Bankinter's results for 2017?

I honestly believe that we can be very satisfied. From the viewpoint of the income statement, it was a somewhat unusual year, due to the influence of the inclusion of the Portuguese business in 2016, which put a negative slant on our earnings in 2017. Despite this effect, net profit grew by 1% to 495.2 million euros. The trend in pre-tax profit followed similar lines and increased to 677.1 million euros, around the same figure as last year. In like-for-like terms, in other words stripping out the effect of Portugal, gross and net profit increased by 19.1% and 20.2%, respectively, in line with previous years. This means that in year-on-year terms, the Bank's profits have maintained a double-digit annual growth rate over the last five years, with 2017 setting yet another record year for results in the Group's history.

Apart from profits, what other financial indicators would you highlight this year?

Both asset quality and solvency, profitability and efficiency levels have remained very positive. Non-performing loans fell to 3.45%, which is 56 basis points lower than in 2016, and which compares very favourably with the sector average of over 8%. 'At the same time, we maintained a CET1 capital ratio ('fully loaded', that is assuming in advance the Basel criteria that come into force in 2019) of 11.46%, considerably higher than regulatory requirements. Our profitability, measured in terms of RoE, was 12.6%, the highest among listed banks in Spain. We also improved in terms of the cost-to-income ratio, which closed the year at 46.8%, compared to 48.6% in 2016, and which is a very representative indicator of the sustainability of our results. In summary, we can say that 2017 was a very good year for Bankinter, full of achievements and good projects.

How would you sum up these achievements and projects from the business's point of view?

We have five main business lines, very well oriented and complementing each other. Our main source of generating gross operating income is corporate banking, which is an inherent activity for us, since Bankinter began life as an industrial bank. In 2017, corporate banking maintained its moderate growth rate, with the increase in international business particularly standing out. In retail and commercial banking, the higher wealth segments performed well and we are also very happy with the ability of our new payroll account to attract customers. Bankinter Consumer Finance had yet another dynamic year and we are now one of the major operators in the consumer lending business. Portugal also performed well last year, the first full year with us, and experienced notable increases in retail funds and loans and receivables, partly as a result of the country's improved macroeconomic situation. Finally, our insurance company, Línea Directa, was one of our strongest businesses in 2017, recording growth rates above the market average, both in car and home insurance. In short, I believe that we have a set of very balanced business lines with plenty of room to continue growing.

'There is a solid demand for loans from companies, especially in relation to overseas business activity.'

To what extent can these good results be maintained in 2018 and onwards?

We are working to ensure the growth rate is sustainable over time. As was said before, our cost-to-income ratio has improved. This indicator measures the relationship between costs and income and is very significant in guaranteeing the sustainability of our business model. Certainly, the results obtained in 2017 come from the traditional customer business, and that is the most stable base on which to continue to grow in the future. If we do things right and the economy evolves as forecast, I think we can be ambitious in our growth targets. This does not mean it is going to be easy, because the financial sector faces some major challenges.

What are these challenges?

First of all, regulation. Three new regulations come into force in 2018 that will have a very relevant and direct impact on our activity. On one side is the new IFRS 9 accounting standard, which modifies the treatment of non-performing loan provision and is likely to require us to make more provisions. Two European directives will also come into force, MiFID2, that is changing the way financial products are marketed, and PSD2, that regulates payment services and opens the way for the banks to share information on their customers with third parties, subject to them authorising it. I believe that in general terms the regulation is a good thing, because it requires banks to be disciplined and better organised, but only as long as it is developed within reasonable limits. I think that at the moment it is legitimate to ask if these limits have been exceeded. In any case,

at Bankinter we have worked hard in the last few months and we are adequately prepared to deal with these changes.

Another of our big challenges is interest rates. For over five years now, official interest rates in the eurozone have been below 1%, and are currently 0%, with little expectation of this changing, at least during 2018, despite the price of money starting to rise in the United States. That interest rate scenario narrows our margins extraordinarily and we have to overcome unfavourable monetary conditions with imagination and hard work. Our objective is to make further progress in the process of attracting new customers and offering them higher added value products, so that our business model does not become over-dependent on movements in official interest rates. To do this we must take advantage of the fact that currently, as a result of the recovery, there is a solid demand for loans, especially in relation to overseas business activities, as many companies are investing abroad and need financing.

The third big challenge we face is the impact of technology, both on the processes and services that we offer, and on the consumer behaviour of our customers. This global metamorphosis poses us with major dilemmas as an organisation. On one side we must be capable of combining the service demanded by our traditional customers, who want advisory services, with the needs of our digital customers, who require technology, immediacy and very little dialogue. We are aiming products such as our mortgage that can be arranged 100% online, launched from the Coinc digital platform at the end of 2017, to these digital customers. We must also

'Our profitability, measured by RoE, is the highest among listed banks in Spain.'

be careful when and how we adapt to the technological revolution, because the Bank does not always control the rate of change. At times you can implement a technology very quickly, but the customer may be slow to adapt to the changes and this complicates the process. Similarly, we must ensure we have suitably qualified professionals to cover our future needs, because the introduction of new technologies requires changes in that area too. To handle all the problems resulting from technological change in 2017, we strengthened Bankinter Global Services, which is the area responsible for providing the Bank's technology and operational services, and as such is a key part of our transformation and growth process.

To what extent does the situation in Catalonia affect Bankinter?

It affects us negatively, as it does all of the banking sector and the economy and the whole society in general. It cannot be said that a situation of social, political and economic tension benefits anyone, but it clearly does not benefit the banking sector, which works on the basis of the principles of trust, solidity and stability. Therefore, we cannot speak about banks that have benefited or been harmed by the events in Catalonia. At Bankinter, we always take a long-term view of business and hope that in 2018 common sense will prevail, that social harmony will be restored and that the rate of economic growth recovers so we can continue to increase our market share in Catalonia, as we have done in the last few years.

What are Bankinter's future long-term objectives?

First of all, we want to remain an independent bank. We have been so throughout our history and we aspire to being the same bank as always. Our track record supports this objective of stability, because we have never merged with anyone and we have not bought anyone in Spain. In such a volatile and fast-moving world as we live in today, we want to preserve our essence. This also means that we must be ambitious in our growth targets, but always be selective, remaining prudent in our risk policy and focusing on profitability. We also aim to preserve our commitment to doing things well and putting a seal of quality on all our products and processes. Our backing of innovation and respect for the customer are other characteristics that set us apart as a bank. All these traits, that historically form part of Bankinter's DNA, still exist today and will continue to do so in the future, if we adapt them to meet customer needs and market changes.

What is your view of the current situation in the Spanish banking sector?

I think the Spanish banking sector has overcome a serious crisis and can now work normally. The consolidation process which has reduced the number of banks from 60 to just 12, is practically completed, except for a few minor loose ends, and the capital adequacy level has increased considerably. What is more I believe that the sector has learnt from the mistakes of the past and is not going to repeat certain behaviour or management failures.

Naturally, there is still much to do, because, as we said before, the challenges in terms of regulation and supervision, the acceptance of technological change and the business model are of great importance and could cause problems for less solid banks. However, I think the restructuring of the sector is now complete and the crisis has been left behind. At times in Spain, we tend to undervalue what is our own, but I have no doubt that we have a solvent, dynamic and modern banking system, which is perfectly comparable with that of other European countries, and in which there is also a high degree of competition. This intense competitive pressure, as well as being paradoxical due to the reduction in the number of players, is very beneficial for customers and is also positive for the banks because it makes us improve and move out of our comfort zone. At European level, the Spanish banking sector is also very well placed in terms of efficiency, though this does not mean that we should not continue to try to improve our cost-to-income ratio.

'We are ambitious in our growth targets, but we are always selective, prudent in our risk policy and focused on profitability.'
