Q2 2018 Earnings Call

Company Participants

- Angel Santodomingo Martell, Executive Vice President & Chief Financial Officer
- Unverified Participant

Other Participants

- Carlos G Macedo, Analyst
- Domingos Falavina, Analyst
- Marcelo Telles, Analyst
- Neha Agarwala, Analyst
- Rafael Frade, Analyst
- Thiago Bovolenta Batista, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, and thank you for waiting. Welcome to the conference call to discuss Banco Santander Brasil SA's Results. Present here are Mr. Angel Santodomingo, Executive Vice President, Chief Financial Officer; and Mr. André Parize (00:00:13), Head of Investor Relations.

All the participants will be on listen-only mode during the presentation. After which, we will begin the question-and-answer session when further instructions will be provided. The live webcast of this call is available at Banco Santander's Investor Relations website at www.santander.com.br/ir where the presentation is also available for download. We would like to inform that questions received via webcast will have answering priority.

Before proceeding, we wish to clarify that forward-looking statements may be made during the conference call relating to the business outlook of Banco Santander Brasil, operating and financial projections, and targets based on the beliefs and assumptions of the executive board, as well on information currently available. Such forward-looking statements are not a guarantee of performance. They involve risks, uncertainties and assumptions as they refer to future events and hence, depend on circumstances that may or may not occur. Investors must be aware that general economic conditions, industry conditions and other operational factors may affect the future performance of Banco Santander Brasil and may cause actual results to substantially differ from those in the forward-looking statements.

I will now pass the word to Mr. André Parize (00:02:01). Please, Mr. Parize (00:02:03), you may proceed.

Unverified Participant

Good morning, everyone. My name is André (00:02:08), and it's a pleasure to greet you to Santander Brasil's second Q 2018 earnings conference call. We had another quarter with great results, which will be presented by our CFO, Mr. Angel Santodomingo.

So, let me turn you over to Santodomingo.

Angel Santodomingo Martell

Good morning, everybody. Thank you for being here with us another quarter, in our second Q Santander Brasil results. The agenda, as you may see, will be basically five points: key messages; Santander Group results; macroeconomic scenario, specifically the results highlights; and I will wrap it up with my final comments or remarks.

So – well, we are glad to show that our ROE kept its improvement trend and reached 19.5%, the highest level since the IPO was done. So, that's almost nine years. I will elaborate through the presentation the reasons why we keep on improving, but as a financial summary, I may say that taking advantage of our operational leverage has been key. This is, revenues have been growing 3 times what expenses have done, also leading to our best efficiency ratio ever as you will see going forward.

Moving on to the next slide, profitable growth comes in between other initiatives through profitable market share increase on both loans and deposits. While we reached a 9.2% market share on loans; in deposits, we are now above 10%. We have been gaining market share consistently across products, as you may see, but let me underline just some key lines.

Vehicles, we kept being leaders on auto financing. As mentioned during the last two years, our digital platform has disrupted the auto loans market dynamic.

Cards, we continue to present a very good performance, with differentiated products and an outstanding credit card app in the industry, Santander Way, as you may probably know. Both volume and credit card sales, 1.2 million credit cards sold in the quarter, continue to outperform.

Getnet, which remains one of the main pillars of our commercial strategy, its revenues continue to grow and we keep on grabbing market share while keeping profitability at healthy levels. It is worth bearing in mind that Getnet's importance going beyond its acquiring services. We consider here a crucial component of our plan to leverage the bank's revenues and relationship with clients.

Payroll loans, a couple of years after we redesigned in this product plus starting almost from scratch, we are producing above 12% of the market.

SME, what strengthens our position in this segment goes beyond our financial offerings. We provide a unique non-financial platform, Avançar program, that helps entrepreneurs in their businesses. We have already reached 1 million clients in this segment.

And last but not the least, Agro business. As I have mentioned already for some quarters, we are making strong efforts in this area. The market share gain is a clear indication that we have adopted the right strategy to expand our base of agribusiness clients. We have opened 16 Agro branches and we will continue expanding.

On the next slide, you can see that we remain focused on delivering user experience improvements for our client base, since we see customer satisfaction as the cornerstone of our strategy to keep growing in a consistent and sustainable manner.

The NPS, Net Promoter Score, is a clear methodology to measure how we are evolving here. I presented to you this number for the first time last quarter after talking about its implementations since the beginning of 2017. So, it's already one year and a half we have been speaking about this. We keep our focus to improve customers' experience and satisfaction by measuring this NPS on a daily basis in all our branches and channels. And in the quarter, this number increased to 51, as you may see. We know how difficult it is to move this indicator up, but we are achieving good results here.

I would also like to commend some of the innovative solutions launched in the past quarter. Meus Compromissos, a tool available in our app that easily shows the customer financial obligations in a consolidated view, making it easier to manage its monthly commitments. It enhances our transparency with our clients.

SuperGet, our acquiring business arm focused on individuals and micro merchants (00:07:26) providing services designed to support its public main issues at competitive prices and with superior agility.

Select Direct, a platform to provide a better experience to our select customers that mid and mid-up (00:07:44) in our segmentation and at the same time, boosting our capillarity on this segment.

In the Itinerant mini-branch, for example, improving our new payroll customers' onboarding experience.

Moving on to Santander Group results, net profit for the first semester reached, as you probably have already seen, above €4 billion equivalent to BRL 18 billion. This quarter, Santander Brasil represented 26% of the group's earnings, showing the relevance of the Brazilian subsidiary results for the group.

So moving forward, the economic recovery in Brazil hit a bump in the second quarter given the known impact of the truckers' strike. Considering direct and indirect impacts, the strike alone cut our growth estimates by 70 basis points this year versus our previous expectation, impacting negatively also some market variables. We believe such deterioration to be somehow temporary with some decompression expected in the near term. Obviously, elections next October will be key to understand market and economic variables evolution.

So, let's now talk about Santander Brasil performance in the quarter. Net income amounted to BRL 3 billion, a little bit more than BRL 3 billion, BRL 3.02 billion, 6% higher than the previous quarter and 30%, 3-0, above second Q 2017. The result of the first half of the year is 27% above the same period of last year.

We have been growing consistently our net profit on a Q-on-Q basis for more than four years now and I have been sharing with you these results. This dynamic shows our capacity of delivering sustainable and resilient results.

On slide 13, we present the main lines of our results. On the revenue front, net interest income increased by almost 15% relative to first semester of last year and almost 3% on a quarterly comparison, reflecting higher transactionality. Fees grew 12% year-on-year and more than 3% compared to last quarter.

And on the expenses side, provisions grew almost 14% on a year-on-year basis, while they decreased close to 2% in the quarter. The loan portfolio growth dynamic is key to understand the year-on-year evolution.

General expenses increased 5% on the year in the semester and 1% Q-on-Q, but still at lower pace than revenues. I will elaborate on this further on and on the remaining concepts.

Slide 14 shows net interest income evolution, which amounted to BRL 10.5 billion in the second Q, 15% higher than the second Q of last year and 3% better compared to the previous first Q 2018. The highlights of the quarter are: loan NII went up 7% over the last quarter. I repeat, 7% over the last quarter, reflecting the strong loan portfolio growth as well as the mix shift effect.

Revenues from funding resumed its expansion process and grew 12% Q-on-Q even considering the maintenance of the Selic rate at its lowest level.

Others concept lost some strength compared to the figure presented in first Q, but still delivered good results, reflecting favorable results from the four components: the prepayment of receivable businesses, capital remuneration, treasury and ALM (00:11:41) portfolio.

Underlying both NII and spreads evolution, it is important to mention that the retail segment now represents 69% of our loan book compared to 65% one year ago or close to 60% before that.

Looking at the loan book in the next slide, we expanded our portfolio by 13% over the last year and 4% in the quarter, which we're considering a strong performance. We keep on growing our market share from a profitable perspective.

Compared to the first Q 2018, we observed a better performance in all segments on a yearly basis. Individuals' book at accelerating and expanded by 23% in 12 months. Payroll, credit card and mortgages were the main growth drivers.

Consumer finance performance continues outstanding, growing 4% Q-on-Q and almost 23% year-on-year, reaping the benefits of our strategy of our digital platform and individual pricing model.

Our SME portfolio keeps accelerating, increasing more than 8% over one year and almost 3% in the quarter.

And lastly, the corporate book, which would have printed a negative (00:13:01) evolution when adjusted by the forex impact in the quarter, but still with a better performance than the one presented in the previous quarter.

On slide 16, we can see how our funding has evolved. Funding from clients increased 2.5% on the Q and 8% year-on-year, a clear result from our intense effort to enhance customer engagement levels. Except from the most expensive instrument, financial bills, letras financeiras, all concepts presented a positive performance, reflecting client activity and loyalty.

The highlights in the quarter are time and savings deposits, which grew well above the system over the last year. Total loan balance funding grew 13% year-on-year, similar to the 13% that the asset side achieved.

We have a clear view that the fee revenue performance is directly related to NPS, as you may see in the next slide. It comes as a result of a greater number of engaged and active customers, adequate pricing, and improvements in the quality of our products and services, all together culminating into increased transactionality.

Comparing in the first half of 2018 to the same period of the previous year, total fee income increased double digit, as we have said, 12%, reflecting good performances on current accounts and credit cards in between others.

Now, let's turn our attention to asset quality in the next slide. Total figures improved for both short-term and over 90 days overview. The over 90 days NPL improved 10 basis points and reached its lowest ratio or its lowest level since the IPO. This performance was influenced by a good evolution of the corporate and SME segments. The short-term NPL also improved 10 basis points, reflecting 30 bps improvement in the individuals segment.

In our view, again, as we have been saying with you in the previous quarter, this is an undisputable evidence that our risk models continue to be highly trustable (00:15:19), giving us confidence to keep on growing our business. For further corroborate this statement, the coverage ratio reached 219%, which in our opinion is a comfortable level.

In the next slide, you will notice that loan loss provisions net of recovery decreased 2% Q-on-Q and totaled BRL 2.6 billion. Let me remember that our loan book, at the same thing occurring in a Q-on-Q basis, grew almost 4%. This has allowed us to improve the cost of credit to 3.2%, which we consider a healthy level.

On slide 20, we analyze how expenses have evolved. Santander Brasil continues to focus cost discipline and lean mindset as it couldn't be another direction. We keep industrializing our processes, as I have commented in the past here.

In line with this, total expenses grew only 1% Q-on-Q, with a special good performance in personnel expenses. In the first half of 2018, expenses grew more than 5%. This is one-third of the rate at which revenues are growing, as I mentioned before. Again, our operating leverage is key to understanding obviously the weight variable expenses and here, explains part of the evolution.

Looking ahead, we expect cost to be somewhere around inflation. Also, the level of commercial intensity on the bank will continue to put pressure here, specifically on the variable costs as I mentioned.

The next slide summarizes our performance ratios. All in all, these metrics have shown a positive evolution. As a result of what I just mentioned in the previous slide, our efficiency ratio is at a historic best level, reaching a lower level of 40%, 39.6%. The recurrence ratio rose to almost 88% in second Q 2018 versus 83% one year ago, again bringing more predictability and resilience to our results. As I mentioned before, thanks to all these advances, return on equity achieved 19.5%, the highest level ever.

Moving to capital and liquidity side, we continue to present solid numbers. On funding sources, the funding sources stayed stable with a loan-to-deposit ratio of 89% at the end of the semester. Santander Brasil BIS ratio is almost at 15%, 14.8%, while our core equity Tier 1 fully loaded stayed at 12.4%, a healthy level.

During this quarter, we declared a dividend payment of €600 million (sic) [BRL 600 million] (00:18:19), aligned with our policy of quarterly payments. This is the second quarterly payment for us this year. We already declared BRL 1.2 billion in dividends and interest on capital.

So going through my final remarks, I will conclude the presentation with the main highlights. Net profit growing 27% year-on-year compared to first semester last year, representing the solid and sustainable value added for our shareholders. Revenues growing 14% versus last year first semester, echoing our customer-oriented strategy. Asset quality control, controlled costs leading to our best efficiency ratio ever presented, first time below 40%. And lastly, but importantly, our return on equity reaching the highest level ever, 19.5%.

We remain well positioned to deliver sustainable results as have been proved during the last 18 quarters, powered by a well-defined business, strategy, organic growth, and disciplined capital employed. Let me remember (00:19:40) you that we have offered a continuous growth Q-on-Q in net profit for 2018 quarters with the exception of one.

I would like to thank everyone for the attention on this presentation. And before we move to the Q&A, I'm passing the word to our Head of Investor Relations, Mr. André Parize (00:19:59). Please, André (00:20:00).

Unverified Participant

Before we start our Q&A session, I'd like to inform you that we have postponed the date of our Investor Day. The event will no longer take place on October 31 and was moved to first Q 2019. This is a consequence of the announcement made by Santander Group today of postponing its Investor Day for early 2019. So, as soon as we have the new date, we will inform you.

Now, we can start the Q&A session.

Q&A

Operator

Thank you. We will now start the Q&A session for investors and analysts.

Okay. First question is from Lucas Lopes, Credit Suisse. Could you please elaborate on your strategy for SuperGet? Are you considering to introduce mass marketing efforts and alternative cash-out solutions such as prepaid cards?

A - Angel Santodomingo Martell

I'm sorry. I was speaking on/off. I assume I'm being heard now. What I was saying is that I have been sharing with you in previous quarters, I mean, that we have the – what we call the Vermelhinha, the little POS, already being offered through our agencies, et cetera. So, SuperGet is we are going to dedicate in specific business line within Getnet to these small POS machines with different formats and different ways of both acquiring or obtaining the usage of the POS, trying to increase our presence on that market.

We already started this. I think I firstly commented that this is like one year ago. And what we are doing is we are enforcing that presence on that segment of the market with this specific allocated business line within Getnet.

That's about it. We will have a strong presence on the digital side, et cetera, but that is part of the execution that you will be able to see as we move forward.

A - Operator

Okay. Next question's from Mario Pierry, Bank of America Merrill Lynch. Your CET 1 ratio has been declining steadily and has reached 12.4%, down from 14.3% one year ago. Can you comment on how this could impact your loan growth or dividend payment going forward?

A - Angel Santodomingo Martell

Mario, thank you. I think this is a question that comes from Mario, Jörg and Thiago. Okay. I have always said that we wanted to have comfortable levels in terms of capital, okay. Let me remember the history here. This is a bank that comes from a position with excess capital from the IPO long time ago, and that excess capital existed or cohabited with – during a certain amount of years.

We started a strategy of adjusting that level of capital obviously during the last, I mean, probably five years ago, four years ago, and our idea was to be always in a fully loaded ratio terms in the region of 12%, 12.5%, even 13%. And this is where we are moving.

If you look at the previous quarter, we were at 13%. The previous one, I think, if I remember where we were at 12.6% or 12.7%, somewhere around there. So, we are moving always in that arena. We think that range of fully loaded – I insist fully loaded – that range of fully loaded is where a bank like us in a country like Brazil should be fully loaded.

When I mean fully loaded, it's fully loaded. I mean with all the reductions, no compensations, no things being added that we are going offset during next years, et cetera. This is the fully loaded capital ratio.

So, answering your question. No. I mean, we announced and the board approved – has announced BRL 600 million of dividend, which is 20% more than what was paid in the same quarter last year. The same amount was paid in first Q. So, I think we are giving a message to the market that we should be able to keep on offering a good dividend yield that as has been the case during the last years.

A - Operator

Next question from Mario Pierry, Bank of America. Can you comment on how the market volatility and the movement of the yield curve, in particular, impacted other interest income this quarter?

A - Angel Santodomingo Martell

Okay. Thank you, Mario. As always, remember that in this part of the P&L in NII others, we have four components: the capital remuneration, we have the receivables discount activities from Getnet, we have ALM (00:25:39), and we have the treasury.

Now, how the volatility has impacted? It has impacted for the good or for the bad on the treasury part, which is a minor part. The movement of the yield curve – let me remember to all of you that this is a mark-to-market impact on capital, okay? So whatever happens to the Q.

Another thing is that the approval of the ALM (00:26:08) obviously goes through this line of the P&L, but we do not trade. I have said this for several times. We do not do trading on the ALM (00:26:20). The ALM (00:26:20) is for another thing. The ALM (00:26:22) is to match and to hedge the balance sheet in a safe way.

So, answering to your question, treasury is a minor part of it, but it has its volatility, even the volatility of the market. And the other goes, if it has to go, through capital.

A - Operator

Next question is from Thiago Kapulskis of BTG Pactual. Good morning. Top line remains doing very well and beating expectations. Do you see room to keep growing the loan book at this pace for the rest of the year? Which lines show the best opportunities particularly in the individual segment?

And number two – the second is asset quality remains under control despite the very good loan growth in the past few quarters. Do you believe that provisions will remain at the current levels going forward or is there room for a decrease, particularly if the economy posts some recovery, helping corporate or SMEs?

A - Angel Santodomingo Martell

Okay. Thank you, Thiago. On the loan discussion, obviously, this goes – this has two sides of – or two points to underline. The first one is how the economy and how, in general terms, the financial system is able to grow. I keep on believing that we are in a country in which growth of high-single digits should be easily achievable, okay?

Another discussion is how private and public banks perform, et cetera. But I mean, as a financial sector, I would say that considering a nominal GDP in the region of, I don't know, 6%, 7% being conservative, I mean, thinking over the next three to five years, okay, somewhere in that region, 1, 2, 3 including 4 percentage points above that nominal GDP growth for – considering the loan growth should be achievable.

In our case, I always have shared with you my intention or our intention is to keep on growing market share always in a profitable way. So, it is not that we want to be larger or the largest, we do not have an objective in terms of size. We will always capture market share if that profitability is there.

So, as it is today, that is happening. That profitability is available given our costs and our capacity of execution, and that is why we are grabbing market share across products and segments, as you saw when I presented.

I will tend to maintain the same message in terms of loan growth going forward. So, probably growing a little bit above the county level, and maintaining capital market share gains if they continue to be profitable.

And we do have areas. I mean, I have spoken on the Agro business. I have spoken about the SME business. I have spoken about credit cards. I have spoken about mortgages or the real estate side. So they're products in which we feel our profitability could clearly evolve positively.

On your second question on asset quality and how we could evolve. I fully agree with you. I mean, we are about to see what happens on elections and the political situation, et cetera. But I mean, we – if Brazil goes in the right direction in terms of evolution macroeconomically speaking, et cetera, I do believe that structurally, there is a potential decrease in cost of risk.

And that is, I mean, structurally. I'm not meaning one player or another. I mean, the country should lead to lower cost of risks. But that is a hypothesis today because we have still to see how that economic evolution evolves.

If we eliminate that from the discussion, I will say that I would expect kind of similar levels going forward. I mean, we are growing strongly, as you have seen, in the loan book. I mean, the risk department is doing a tremendous good job in terms of – they're up to date, obviously, because of the job that they have done during the last four years. But I mean, the evolution and the consequence of that job is what you see today, that we are being able to maintain total provisions and fast lower cost of risk. But I would expect it to be somehow in – around the levels you are seeing today.

And I'm sorry, too, in my answer. The mix effect also has an impact and could have an impact going forward. If we continue moving more on the pure retail side from large corporates or midsized corporates in terms of relative growth, okay, obviously that will impact the cost of risk.

A - Operator

Next question is from Eduardo Nishio of Brasil Plural. Congratulations for the results, in particular congrats for the strong recovery and profitability reaching 19.5% ROE this quarter. Any estimate on how much ROE can go?

A - Angel Santodomingo Martell

Thank you for the congratulations, Eduardo. As André (00:32:06) said, as you know, we had an Investor Day scheduled for next October that has been postponed due to the Santander Group's also postponing the – its Investor Day from October to somewhere in February. So that's where we expected to give clear guidances or to give some guidances looking forward.

Now, having said that and given that we are postponing two or three months the Investor Day, what I would say is that what I have said before. I mean, we do want to maintain current profitability. Obviously, past experiences cannot be extrapolated, so I wouldn't count on hundreds of basis points increase in return on equity as we have done in the last two, three years or quarters.

But we keep on – we had total focus on capital, capital usage on every single product, on every single segment. We follow economic profit, the difference between return on equity and cost of equity on a continuous basis for every segment, for every unit, et cetera. And that's the way to manage this.

So, I mean, this is not going to change. I wouldn't be surprised if we see some volatility on this ratio going forward obviously because, as I said continuously every single quarter at some point, we made both on the ratio or on other variables because we are hitting record highs on a lot of them. And at some point, you may have one quarter better, one quarter low (00:33:50). But I would say that the intention of profitability and the capital management – a way that we have been doing this in the last four years is a clear must and I will continue putting focus on that.

A - Operator

Next question's from Carlos Macedo of Goldman Sachs. Asset quality for consumer loans weakened sequentially despite much of the growth being driven by payroll loans. Can you comment on the trends for asset quality in the consumer portfolio? Should we be concerned given the above-market growth the bank has been delivering?

A - Angel Santodomingo Martell

Carlos, I do not see that deterioration that you were mentioning. I don't know exactly what you mean by consumer loans. When you see our – for example our car financing unit, we don't see – because we – obviously, you do see volatility and we fine-tune the decisions both from the risk side and from the commercial side continuously, but that is both totally business as usual.

This is not something that – I don't see kind of leading indicators or vintages or over – whatever, over 30, over 60 the different analyses that we make. I don't see a red sign out there. So, you do have some behavior in terms of the different segments. But I wouldn't – I mean, we are not – as I say, we keep a continuous eye on this. But moving that continuous eye to a worrisome position, we are not in that position today.

A - Operator

Next question is from Jörg Friedemann, Citibank. The bank had been positioned to benefit from lower interest rates in Brazil. What actions were taken in the quarter during the significant market volatility and what is the new sensitivity of NII to interest rates?

A - Angel Santodomingo Martell

The actions that we – as I mentioned before, I mean, the strategy. If you are referring to the ALM (00:36:11) portfolio because as well – I mean, we had a little bit of misunderstanding here. I mean, the ALM (00:36:18) portfolio is stable. It does not trade in - on a continuous basis. It doesn't generate results continually.

As I said, by accrual, it goes into the NII. So it's a position that is there to hedge the risk of the balance sheet. And again, it is something that has a low relative weight.

So, our sensitivity today is a little bit above BRL 200 million and about BRL 210 million, I think it is, to 100 basis points decrease, which is around where have been in the last quarter. So, again, my main concern with this portfolio is to have the balance sheet fixed, to be on a P&L-orientated mood.

A - Operator

Next question's from Thiago Batista, Itaú BBA. The credit margin showed a strong performance expanding another 20 bps quarter-on-quarter. In our view, this expansion was only caused by the mix change, or do you have an explanation for the expansion in the credit margins? Do you expect further improvement going forward?

A - Angel Santodomingo Martell

Thank you, Thiago. I mentioned in my presentation on the NII evolution, you do have the impact of the mix change. That is clear. On top of that, obviously, you have the volume impact. You have two variables here, volume and price.

In price, if you realize by segments, the spreads remain stable or with some pressure depending on the segment, depending on the case. If you analyze the volume, volume is - you saw it. It's clearly stronger on the retail side, less strong on the SME, and still a little bit negative without the forex impact on large corps.

So, I will say volume and mix, which is explaining what you have seen. The good thing here is that if you analyze that net of risk, we are evolving positively. And I would recommend also to analyze that. Okay.

A - Operator

Okay. Now, we are going to open the session for questions from phone calls.

Mr. Marcelo Telles from Credit Suisse would like to post a question.

Q - Marcelo Telles {BIO 3560829 <GO>}

Hi. Good morning, Angel and André (00:39:23). Congrats on the result. I mean, a lot of my questions have been answered, but I want to follow up on the big improvement in your efficiency ratio in the quarter, which was quite remarkable, below 40%. How should we think about the efficiency ratio down the road?

I mean, on one hand, I mean you mentioned you seem optimistic about the evolution of NII, net interest income going forward, and you've also been - have been doing a very good job on cost. I mean, do you think it's – is it possible to think that your efficiency ratio can actually improve further down the road and – because we've seen you're growing your loan portfolio well above your level of corporate expenses and that also explains quite a bit of your efficiency ratio improvement. So, is that sustainable?

Thank you.

A - Angel Santodomingo Martell

Okay. Thank you, Marcelo. Well, yes, I mentioned this that we are at a historical minimum in terms of cost income ratio, below 40%. Why is this happening? I mean, because at the end of the day, what it means is that we are growing 3 times in revenues compared to costs. So we have to analyze a little bit both things: revenues and costs.

In revenues, I think I wouldn't really lose too much time in NII, in NII credit, in NII loss, in fees. The bank is growing 25% in linked clients. The bank has grown 1.2 million digital clients in the last 12 months. The bank is opening an important amount of current account in the digital world.

The bank is selling more than 100,000 credit cards in the digital world per month, 400,000 total credit cards. So the bank is expanding in terms of clients. The NPL is improving, et cetera, and that means that the revenue capacity of the bank remains at where you are saying.

So, here, the issue with revenues is to continue being able to doing that, that we continually keep on its 37 months that we have grown our client base, 37, one after the other. So, if the bank continues to position itself where we are and we keep having a very good app on credit cards, a very good service on the auto loans, payrolls, growing market share, Agro business going strongly because we have put the good team on that and we are opening shops, et cetera, et cetera, et cetera, we should be able to continue growing revenue. It will depend on us obviously on the environment, et cetera, but it will depend on us.

And then on the cost discussion, what you have is both fixed and variable. On the variable side, variable cost, we tend to grow them less than the business, but obviously you have a linkage there. And then what we put is a lot of effort on the fixed part.

And on the cost discussion, I shared with you in the past, what we define our new structure on operations that was done over the three quarters now. It was announced, I think was like September last year, more or less. And that is analyzing all processes end-to-end, analyzing the unit cost of each single thing. So, an industrialized way of analyzing operations, analyzing processes, analyzing the old concept of the back office, which doesn't exist anymore. A player today that continues to think and speak about back office and front office is out of trend that we should see going forward. So, understanding operations as a key part of the commercial way of doing business is key.

So analyzing the two things, I would say, well, we should be able to deliver good performance here. Now, if the ratio is going to improve or not, you can understand, we are at a historical best level ever. So, I have to be a little bit more conservative here in my comments, okay?

Operator

Our next question comes from Domingos Falavina from JPMorgan.

Q - Domingos Falavina {BIO 16313407 <GO>}

Thank you very much for taking the question and again, congratulations on the surprisingly strong quarter.

Two quick questions. First one is if you could shed a little bit of light on the effective tax rate. I think it's again at 35%, but we're working with 30%. And the second question is on the payroll. I was very surprised by the 40% growth in payroll. If you could explain that, have you bought portfolio on there or what exactly are you doing? How you're boosting the growth of this portfolio so much?

A - Angel Santodomingo Martell

Okay. Thank you, Domingos. Thank you for the congratulations. I will pass on the tax rate question to André (00:44:46) that can elaborate a little bit more, but on the payrolls, let me position a little bit what we have been doing.

If you go back four years – that's three years, four years I think it is – we had unprofitable. And what I mean unprofitable, it's not from the economic profit point of view. It's that we were in losses on the payroll business. We were distributed through what we call correspondent bankers. So, it's a kind of a third-party network in which we were – we didn't know how to do it basically, okay? So in – through branches was the same case.

Now, couple of years ago or three years and a half ago, we set up this joint venture with Bonsucesso only, which is an industrial partner, and we started to do all this external correspondent banker distribution in the right way. This has been extremely successful, with total risk control criteria. We are growing there significantly. And taking advantage of that, our internal meaning in our branches, okay? Our internal distribution network has started to perform in the right direction with our clients through branches.

So you have to have both things. Today, we are producing our BRL 2 billion per month of (00:46:17) of payroll loans, which is what you saw there, 12% markets in production probably on the back book on the stock. Fundamentally, we have like – not close to 9% of market share. But the alignment of both things working by themselves and starting also to play on the digital, all that happening together is why the payrolls are performing so, so well.

A - Operator

Hi, Domingos. Regarding the tax rates, we have three components here. First, the net profit being higher. We have a capital efficiency from the goodwill amortization, which is much, much smaller than our past. And the second point is that during the quarter, we declared dividends. And in the first quarter, we declared interest on capital. So, this is the main difference between the quarters regarding the tax rate, okay?

Our next question comes from Carlos Macedo from Goldman Sachs.

Q - Carlos G Macedo {BIO 15158925 <GO>}

Hi, Angel, André (00:47:34). Congrats on the strong quarter. A question going back to Jörg's question on the webcast part on margins. So, in the past, we had spoke about – we talked about the impact that ALM (00:47:45) was having on your NII and you mentioned BRL 210 million now. Obviously, there's an accumulated effect. And we talked about how part of that ALM (00:47:52) would run until the third quarter this year and then that effect would change.

Is that still the case now that we're closer? Are you still going to continue to benefit from the ALM (00:48:02) after the third quarter or is that still going weigh down on your NII? And if it does, what do you expect the impact to be?

A - Angel Santodomingo Martell

Thank you, Carlos. Well, I think is, as you said, I have been elaborating this during the last quarters continuously. It's always something to come from part of the market that – and it doesn't happen.

I mean, at the end of the day, as I mentioned, the others is not, by far, only ALM (00:48:37). I wouldn't concentrate the message there at all. The ALM (00:48:43) depends on the monetary policy, obviously, and I already mentioned the sensibility that we have toward decreasing 100 basis points. It goes through all the time. I wouldn't put it in the third Q because it continually – what happens is that it continuously re-hedges the balance sheet, obviously, at different levels and at different prices. And it depends how you hedge that balance sheet, the impact in terms of time.

But again, in terms of NII others, the volatility comes more from the treasury activity, which is in the wholesale banking part of the business. It is not – nothing to do with the ALM (00:49:30). And so, that volatility will come from there.

And the lasting effect of the ALM (00:49:38), it will depend again on how we see interest rates moving, how we produce on the asset side and the type of rates that we take. But I wouldn't point in terms of third Q or fourth Q and that you are going to see in a strong surprise upward or downward, eliminating what I said the volatility on the treasury activities.

Operator

Our next question comes from Rafael Frade from Bradesco.

Q - Rafael Frade {BIO 16621076 <GO>}

Hi. Good morning, all. So just a follow-up on this point that you mentioned about the ALM (00:50:21), or how we should read these other results. I would like just to clarify is the other operation. We already talked about this in the past, but I would like to reconfirm that the other credit operations like FDIC, CRI and other lines, they are in this other line and not in the NII for credit (00:50:45). So this is explain a book of this result. So I just would like to clarify this.

And the second question related to – you mentioned about the growth in clients that you had. I would like to understand that looking for your intangible, I see that in the – I believe that you spent a little more than BRL 1 billion in exclusive agreements in the last 12 months. So I would like to understand a little bit this strategy, especially in a moment that it's becoming easier to transfer payroll account from one bank to another. So I would like to understand a little bit how do you see this strategy to pay for exclusive agreements going forward? Thank you.

A - Angel Santodomingo Martell

Rafael, thank you. I'm going to try to answer both questions. We didn't understand it very well, to be quite honest. If I do not do it, please refer to the Investor Relations to be more clear on the question.

Let me clarify again what is included ALM others (00:51:56). It is capital remuneration, receivables, discounts from our acquiring business, third – and not by order of importance. Third, treasury; fourth ALM (00:52:11). That is what is included in others. The rest from the credit activities in credit and the rest from the liability activity is in the liability of funding margin.

On the intangibles, I didn't get – we because we are here, but didn't get very well the question. The only thing I can think about on intangibles is that when we are acquire things, for example, like payrolls because you can acquire payrolls paying or non-paying. You arrive to an agreement with a company. You don't pay, you go to an official institution like a state government and they auction the payroll. When we do that, that goes into intangibles and we depreciate it throughout the time.

But I don't know if I'm answering exactly the question. If not, please address the Investor Relations department that they will clarify exactly what you want to know about the numbers.

Operator

Our next question comes from Neha Agarwala from HSBC.

Q - Neha Agarwala {BIO 17722501 <GO>}

Hi, Angel and André (00:53:24). Thank you for taking my question. This is Neha Agarwala from HSBC. I understand about the ALM (00:53:31). One quick question on the loan spreads. We see that over the year, the loan spreads have increased, as you mentioned, from 9.4% to 10.2% and this is about rates (00:53:41) going down. I understand that a part of this is because your loan mix has changed from low to more profitable segments now, but has that change in loan mix already been reflected in the higher spreads or do you see more benefit of the change in loan mix coming in the spreads? And where do you see the loan spreads in the coming quarters? Thank you so much.

A - Angel Santodomingo Martell

Okay. Thank you, Neha. And you're right. I mean the main impact on the loan evolution you saw, I mean we increased loan spreads like 20 basis points on the quarter. I think was from 10% to 10.20%, and that's the average obviously. It has to do with the mix, okay?

So, going forward, if the mix continues to go in the direction we see today, and this depends a lot on how large corporates and corporates evolve, I mentioned that large corporates are still in the negative territory here. Obviously, they have had in the past capital markets as an alternative funding source and there has been, at some time, some pressure in the spreads.

So, if large corporates and corporates come back, that will equilibrate or that will eliminate that mix change we have seen in the past, and I would say spreads will tend to be stable or even with some pressure, also depending on the economic momentum that we see. If we go into a strong positive cycle, obviously I would assume that there will be some spread pressure. If that is not the case, the pressure will be lower. But it has to do with the mix.

And going forward, I would totally link it to that mix in a situation of the Brazil that we know today, which is basically growth, but not in a heating mode, if I may say it like that.

Operator

Our last question comes from Thiago Batista from Itaú BBA.

Q - Thiago Bovolenta Batista {BIO 15398695 <GO>}

Yeah. Hi, guys. Thanks for the opportunity and congratulations for the results.

I have just one question about additional provisions. If I'm not wrong, you increased your additional provision by about BRL 200 million this quarter. So, I want to confirm if this expense, they passed through the bank's recurring earnings. I believe, yes, but I want to confirm. And why the bank reinforced its additional provisions? Is there any specific corporate case? Do you see some deterioration (00:56:13) ahead? Why did Santander increase its additional provision this quarter?

A - Angel Santodomingo Martell

Thiago, yes, it does go through the P&L, answering your question. This doesn't answer – I already elaborated on the risk side, on the quality side, so I'm not going to say again that we do not see any worries going forward in this type of actual response. I mean, we do not a unique answer here. I mean, they respond to our risk department way of doing things in which we have our inside analysis in all segments and that ends up with different movements.

I would underline also that it is not in BR GAAP (00:57:01), but in the Spanish criteria, we are developing a good knowledge on IFRS 9 and that also obviously leads to outstanding performance in terms of expected losses.

So, that has nothing to do – we see better or worse scenario going forward. It's pure one-by-one, segment-by-segment, product-by-segment, product-by-product. You can imagine to the detail that this goes down, and that moves in between quarters and in between years. But I mean, the outcome is what you saw. I mean lowest ratio in terms of NPLs, good performance and maintenance of the provisions levels, okay? Thank you.

Operator

Thank you. The Q&A session is over, and I wish to hand over to Mr. Angel Santodomingo for his closing remarks.

A - Angel Santodomingo Martell

Okay. Thank you, all, for being in this results call. Again, a pleasure presenting to you second Q results of Santander Brasil, and looking forward to seeing you in the following quarters. Thank you.

Operator

Banco Santander Brasil's conference call has come to an end. We thank you for your participation. Have a nice day.