Q4 2016 Earnings Call

Company Participants

- Angel Santodomingo Martell, Executive Vice President, Chief Financial Officer & Investors' Relations Officer
- Sergio Agapito Lires Rial, Chief Executive Officer & Vice Chairman
- Unverified Participant

Other Participants

- Carlos G Macedo, Vice President
- Marcelo Telles, Analyst
- Rafael Frade, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, and thank you for waiting. Welcome to the Conference Call to discuss Banco Santander Brasil S.A.'s Results. Present here are Mr. Sergio Rial, Chief Executive Officer; Mr. Angel Santodomingo, Executive Vice President, Chief Financial Officer; and Mr. Andre Farisi (00:21), 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, www.santander.com.br/ir where the presentation is 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 as an 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 they may or may not occur.

Investors may 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.

Unverified Participant

I'm Andre Farisi (02:33), Head of our Investor Relations, and it's my pleasure to welcome you to Santander Brasil's 2016 earnings conference call.

This past year we had several important achievements, which will be presented today by our CEO, Mr. Sergio Rial. Then, our CFO, Mr. Angel Santodomingo, will provide more details on our fourth quarter and full year results.

Now, let me turn it over to Mr. Sergio Rial, who will start our call.

Sergio Agapito Lires Rial {BIO 1925337 <GO>}

Very good morning. Thank you, Andre (03:11). So very good morning, again. Just making sure the mic is working. So apologize for that and the absent time. But delighted to be here with you to talk about the year 2016.

So I would suggest we go to slide 4, and the presentation starts trying to show you three important pillars of what we have accomplished in the last 12 months. One, is to talk about our commercial transformation, what we have done in the different businesses of Santander here in Brazil; the strengthening of businesses, which historically have had important positions, strong hold positions; and the one that is by far the most important one, customer satisfaction.

On slide 4, I think, you see a couple of important words. One is speed. I think one of the things we've done in 2016 is we certainly have accelerated the metabolism of the organization. So I think we certainly delivered and we are today leading an organization faster that is capable to respond in a much more agile and nimble way than I think we've done in the last couple of years.

The second one is innovation. And I think that is somehow, and partially captured in when you see the digital transformation that we have done, not only retail, but also in different parts of the business. And last but not least is the construction of a very client-centric culture around which the whole future strategy of the company really resides. We do believe deeply that there is a space for banks and for a bank in Brazil that actually can delight, it can do, transact and interact with customers in a different way and certainly in a more consistent and better way than I think we've seen in the past.

On the right side of the same slide, very quickly, one of the key highlights of the year has been asset quality. So I think we are pleased to basically deliver what we said we were doing. I think we could see it and you're going to see that more clearly through the words of our CFO, Angel, when you see the evolution of the NPL throughout 2016. Efficiency also moves in the right direction. Here we still have a long way to go. I think we are a lot more ambitious than I think the number we're posting, 48.8%.

Another very important highlight of the year is the growth of commissions, partially explained by the customer activity and the capacity of the organization to have developed different levels of loyal customers, which is reflected on the next item. But, again, we really believe this is the beginning or can still be achieved for the company.

Last but not least, a very important cornerstone of the organization, which has had historically low ROEs, I think we have constantly said and reaffirmed, and I do it again, our commitment to profitability. ROE is an important measure. And we're happy to see that in the last quarter, we're already very close to 14%, having posted 13.9%, pretty much on the right track to deliver the 15.6% that we have articulated in our Investor Day back in 2015 in London.

So moving now to slide 5, let me go a little bit deeper on the commercial transformation, what (06:48) we have done. So on slide 5, we see a couple of things, which are important, and I'll basically touch a few words. One is when we say new work methodologies that we have today around 500 people working inside of the organization, in what we call agile desks, those are multifunctional teams working with the only pursuit of delivering products that are actually potential solutions for gaps that we see in customers' product menu, if you will. Brazilian banks have been historically very much a pool in terms of banks produce and then they basically try to put it in the marketplace. We're trying to really reverse over time to stop bringing the gaps, customer insights inside of the organization, so that we can actually start differentiating ourselves.

Some of that is captured in the ratings the Santander Internet Banking (07:47) and the app mobile has received. So here you see, on the Apple Store, we have received a 4.5 rating out of 5. On the Google Play, 4.2. So this is somehow recognition from consumers of the quality responsiveness, but more importantly, customer friendliness of the devices and apps that we are creating.

Transactions in mobile in Santander in 2016, as you have seen here, have jumped 100%. Sales in e-commerce have tripled in 2016. Biometrics, as you can see it, we have moved the organization to 6.3 million. And this is all signals of a very singular story, which is the digital transformation that we are embarking. And we are not embarking on digital transformation, because it's fashionable or just because it is embedded in sort of a cost culture. Now, we are doing that because it is the right thing from a customer experience point of view, especially in a country as vast and as complex as Brazil, and certainly with limited infrastructure.

On the bottom of that slide, the important piece here is with the digitalization as we're talking from a customer perspective, we have also done a number of things internally to automate processes that were before conducted manually at the branch level. So that's how we explain agility. We have automated a number of processes. Those products, we are talking about 93% of all those products are today done, automated throughout all the branches. We have around 3,431 branches in the country, which has allowed commercial branches, the typical branches, to actually become more spaces to actually sell. So they're becoming less and less factories and they're becoming more and more sales offices. So these are just signals of the commercial transformation.

On slide 6, still on the commercial transformation, here a couple of important things. Still on retail, credit cards. So we have actually gained market share. We ended the year with a market share in credit cards over 13%, and we've done it in the right way. There is still a long way for us to reach the level of profitability that we expect to see out of our credit card portfolio.

So remember that we had historically, and still do, a significant credit card portfolio segment that is called free (10:22), very important, does create the right level of loyalty, but certainly from a profitability point of view, was certainly the segment, that in my view, was historically challenged. And we are doing things so in a way that customers can actually become more engaged and can actually become more profitable even holding a card fee-free as we have.

We have launched Santander Way. This is nothing more than a credit card financial instrument, but important to see the level of downloads. And very important, with the Citibank divestiture of retail, we were able to retain and to gain the commercial agreement with American Airlines on a co-branded card with Santander. So this was a business that it's the global business of Citibank, and this business did not go with the acquirer. So we were able to retain it. And we're talking here somewhere between 300,000 to 400,000 customers, and some of them are, of course, important customers. American Airlines has the largest market share of routes to Florida.

Agro, historically, a 2% market share, 3% (11:28) market share for Santander, a real opportunity. We have been able to really put a strategic intent to at least be able to represent in Agro our natural market share quota. This is a story under construction, I think more to come. But here, you can clearly see that we're able just on the pure liability side, capture an issuance of LCA of more than BRL 7 billion, and of course, those are relatively cost effective liability instruments.

And last but not least is our ambition on the small and medium enterprise. This is a business, which we started about three years ago. We have a very ambitious plan for the next five years. We do see ourselves as one of the natural champions of SMEs in the country. We only see perhaps two other banks competing in that space in sort of a sustainable way. So this is one of the areas that you're probably going to see more growth, more content in the years to come.

Next slide, slide 7. We talk about our acquiring business, Getnet, the business that was started from scratch. And we're pleased to see – and I think the numbers speak for themselves. I think what we have seen here is – what's the reason for this incredible progress? I would say a couple of things.

One, very effective integration with the bank. So we have a well-oiled, integrated commercial franchise between Getnet and the retail franchise and wholesale. Second, what's the part of the reasons for this performance? Second, we are a lot more skewed towards retail in our business than we are towards wholesale. Our competitors are structurally a lot more skewed towards the wholesale segment, around 60%, while for Santander, actually our acquiring business is exposed to roughly 60% in the retail space, which is, of course, profitability significantly higher.

And third, I think it's just part of the commercial transformation that I think we have discussed before. And those numbers, those are numbers primarily related to POS with companies, as we call it, or enterprises.

We have launched our product (13:50) for individuals at the end of last semester, and I think we're going to see a boost potentially in numbers coming from this new device for individuals; taxi drivers, doctors, individuals who are not necessarily enterprises, but are still businesses or conduct important businesses for us to capture. And I will not mention the numbers, but you can see a jump of 30% in revenues.

On slide 8, which is the second pillar about strengthening the leading businesses, GCB, our investment bank in Brazil, we certainly moved, has been a phenomenal year. It was by far the best year of our investment banking business, corporate investment banking in the country. M&A, in terms of volumes, number one house, pretty impressive taking into account that we certainly have tough competitors, both foreign and local.

And on the consumer finance side, our car finance business, I think we have mentioned, and Angel has mentioned that perhaps throughout the year, our disruptive digital platform, which has eliminated most of the paper work in the way people buy cars through dealerships, has allowed us to actually grow market share by 3%. So we basically ended the year with roughly 23%, 24% market share in the consumer finance company.

And more importantly than that, the quality of the sales has actually increased tremendously. As mentioned, asset quality absolutely under control. And as you can see, we are now basically creating an important data base through a number of customers coming for fast simulations through their dealerships. So just on average we're seeing about 1.1 million consumers through our systems asking for simulation. So this is going to be a very fertile ground for cross-sell with our retail franchise. Not yet in any way done. This is the story of the years to come.

On slide 9, customer satisfaction. This is work in progress, far from being an end in itself (16:03). But I think what I'm proud on behalf of the team to see is to see the transformation again of loyal customers to 3.7 million, having an important and direct impact on the group's consolidated goal. Brazil here plays a very important role. See the growth in digital customers, a 45% growth, and in number of digital transactions. So all in all, in the right way. But even for a company that poses itself as part of its core strategy being customer centric, being number two in high income, being number two in middle income is not where we'd like to be. So here there's quite a bit of more work to do on customer satisfaction.

On the employee side for me, as important as any other quadrant, I think what you're going to see more and more is not only a culture to serve, but also a culture that will measure customer satisfaction. So we're going to be introducing in the company net promoter score, as you see in other retail franchises, and the NPSs will start becoming sort of a metric that we will be pursuing. All in all, positive environment and highly engaged organization.

On slide 11, most of you have seen the group's results yesterday. So an important contribution of Brazil, contribution that I think will continue to grow over time as we believe there is plenty of growth for Santander in Brazil to capture. So I think we're proud. I mean, we're proud to be a significant piece, but more important than the number itself is the quality of the earnings that again we were able to generate.

I think Brazil has been an important part of being able to create business models that are indeed capable of generating capital. And I think we did play an important role for the group's capital generation, that's nothing more than an obligation. So whether it's the liability side, paying attention to the liability side of the balance sheet as we have done last year, but also the growth in fees as you have seen, and businesses that are perhaps less capital intensive, have helped Brazil and the group to actually post the numbers you have seen yesterday.

With that I stop. I used 20 minutes. And I'll pass then the word to our CFO, Angel.

Angel Santodomingo Martell

Thank you, Sergio. Good morning, everybody, and thank you again for participating in this results presentation. I will start, as always, by the macro side, that is in the slide 13. Despite the recent climb in GDP growth estimates, we remain confident that we will see a gradual rebound in economic activity. You probably know a lot of these figures, so I'm not going to elaborate a lot around them. But let me underline four main areas, quick areas.

Domestic inflation has been falling steadily, provoking a consensus that there is room for interest rates to continue to decline throughout 2017, reaching single-digit territory.

Second one would be that we are seeing clear progress on the fiscal adjustments agenda, which we believe should help business confidence to continue its upward trend this year, thereby playing a major role in the recovery of the Brazilian industry and investments, albeit at a moderate pace.

The third point is that there has been a continued reduction in industry inventories. And the fourth point I would underline is that we see an utterly positive outlook for agribusiness. All-in-all, we reiterate our expectation that Brazil's GDP will resume growth throughout this year.

So starting with the results, that's slide 15. Let me - I will go into the detail in next slides, but let me underline the main ideas around our results. As we have always said, we are committed to delivering consistent and sustainable earnings growth as we strive to keep improving our bottom line every quarter. This is the 11th out of the last 12 quarters in which we have proven we have improved our profit. In 2016, I think we managed to achieve solid growth and this movement was supported by a host of factors. To name a few of that, as I said, I will go into detail in the next slides.

We note that the Bank continued to enjoy a comfortable capital and liquidity position. Our loan portfolio was affected by Brazil's macroeconomic environment, but the individuals segment remained resilient, helped my payroll loans. Asset quality kept at healthy levels and better than our peers, thanks to proactive risk management. Greater customer loyalty that Sergio was addressing, resulted in increased revenues underpinned by a combination of liability management that I have told to you in the past quarters and good market activity, with fees growing at the promised double-digit pace. And finally, rigorous cost control led once again our annual expenses growth to be below inflation. As a consequence, net income reached BRL 7.3 billion in 2016, a remarkable achievement in our history.

Next slide, that's slide 16, you may see the core evolution of our net profit. As I said, total net profit was BRL 7.3 billion in 2016, 11% higher than the previous year. On top of this performance, last year, we announced BRL 5.3 billion in dividends, of which BRL 3.9 billion were interest on capital. These figures prove we are on the right track to keep delivering sustainable and resilient growth.

On slide 17, we show the main concepts of our quarterly earnings, about which I will go into more detail later on. First, I would like to draw your attention to three events this quarter. As I mentioned, there has been a distribution of interest on capital. We think the dividend payment reaching the total amount of BRL 3.85 billion during the year, BRL 3.35 billion in this quarter, and resulting in a positive impact of around BRL 900 million, BRL 905 million in the tax expense line.

Second point would be that in NII, there was an asset adjustment resulting in an impairment of securities in the amount of BRL 388 million. And the third one is that given the aforementioned downward revision in economic forecasts, we recognized an additional credit provision for loan losses of BRL 517 million attributed to the corporate segment. Thus, excluding these adjustments, let me highlight the following P&L figures that you can see in the slide.

On the revenue front, net interest income decreased by 5.3% relative to the third quarter, due to the weaker market activity. Nevertheless, we present a strong growth in the quarter in both credit and liability NII. In this year, NII increased by 6.3% due to funding and market activities also. Fees advanced by an strong 12% - 12.4% in the quarter and 15.6% in the full year, maintaining the mentioned double-digit growth pace.

On the expenses side, allowance for loan losses fell by 5% - 5.5% in the quarter, totaling BRL 10.5 billion in 2016, an 8.2% increase year-on-year. Finally, general expenses were held under control. In the year-on-year comparison, costs rose 5.7% making the fourth consecutive year of growth below inflation or saving in real terms. Let me elaborate on the details of each of these lines in the following slides.

So, next slide, which is the slide 18 shows the evaluation of our net interest income, the NII, which totaled BRL 31.5 billion in 2016 or 6.3% higher than in 2015, with 5.3% lower level compared on a quarterly basis. Highlights were credit revenues increased 3.7% in the quarter, due to a combination of our raising volumes and the spreads. In this year, credit revenues also posted an improvement despite the decline in volumes. With that, spreads grew by almost 40 basis points last year, as the impact of the portfolio mixed adjustment was offset by the positive price movement during the period. I have elaborated during previous quarters on this change of mix and price.

Revenues from funding also had an stellar 2016, growing by an astounding 31% year-on-year. In fact, the plans that we have been sharing with you over the last five quarters already are now being reflected in the P&L. And finally, market activities, which is as you know included in the others concept, came back to normal levels considering the historical base after two exceptional quarters, the second quarter and the third quarter, as you can see the figures in the slide. And consequently, market activities presented a good result at the year level and a decline in the quarter.

In next slide, we elaborate around asset volumes. Our expanded loan portfolio totaled BRL 322 billion in 2016, which means an increase of 3.8% in the quarter and a decline of 2.5% in the year. Our credit portfolio grew by 3.9% in fourth quarter and decreased 1.6% in the full year. So, this is an important point because, also the Brazilian environment has been weak, reflected obviously in the year-on-year comparison.

We finalized 2016 with a quite positive growth rate in the last quarter, showing again good customer engagement or loyalty. This was the second consecutive quarter of expansion in our loan portfolio, which came in coupled with a wider spread improvement across all client segments, suggesting that the worst is behind us, and that from now on, the loan portfolio could see gradual growth.

The individuals' portfolio continued to deliver a resilient performance, expanding by 3.4% over the previous quarter and 7.8% in the year. Payroll lending and credit cards remain as the primary growth drivers. This quarter, we must also highlight the performance of consumer finance, and Sergio elaborated a little bit on what has happened there, which advanced by 2.7% Q-on-Q and posted a positive growth in 2016, amid an especially difficult year for the car sector.

This recent performance improvement was pulled by the implementation of that disruptive diesel platform that Sergio was addressing, which was spurred significant productivity gains for the business in which I have shared details during past quarters. The reflection of all that is seen on the volume evolution.

Continuing with the good news, the SME and corporate portfolios recorded quarterly growth of 1.9% and 5.5%, respectively. On a full-year comparison, both portfolios are still performing at negative rates, but at a lower space than in previous quarters. If we exclude the forex variation, SME would have posted a decline of 6% year-on-year, and corporate would be negative territory at 2.3% year-on-year.

On next slide, on the slide 20, you can see how our funding has evolved. Funding from clients climbed 2.3% in the quarter and 3.6% in the year. Let me underline, the positive performance of savings and deposits during the second half of 2016, in response to our initiatives to increase – enhance client engagement levels. Total funding reached BRL 552 billion in 4Q 2016, representing an increase of 4% in the quarter and 7% in the year.

Next slide, the slide 21, as we have been saying, since the beginning of 2016, fees revenue growth is the consequence of improvements in our product and services quality, coupled with a continuous effort to foster greater loyalty of our client base, and I think this can be easily seen in this slide. Considering improvements in our loyal customers' client base, I would like to highlight the performance of current accounts, credit cards, and collection services. This situation is an improvement which has led to a positive 12% growth Q-on-Q. In the year, total fee income reached almost BRL 14 billion, presenting an outstanding growth of well into double-digit, almost 16% over 2015 and in line with our goal of delivering double-digit growth in 2016.

Moving to slide 22, let's talk about asset quality. NPL over 90 days dropped 10 basis points in 4Q 2016, reaching 3.4%. Individuals and corporate NPLs decreased at the same pace. It is important to highlight that the early delinquency rate declined 70 basis points in the quarter. That means our asset quality remains under control at comfortable levels, especially considering the usual lag between economic activity and NPLs. This continues to reflect the strength of our risk model and confirms that all actions we have taken and commented in the last two years, three years, such as portfolio risk and diversification were the appropriate measures to protect the quality of our assets. As a consequence of the decline in the over 90 days portfolio, the coverage ratio increased to 212%, which in our view is a healthy level, especially in a moment in which we maybe going out of recession.

Loan loss provisions, in the next slide, totaled BRL 10.5 billion in 2016, implying an 8% rise over the previous year and a 5.5% decrease in the quarter. This has allowed us to maintain the cost of risk also under control at below 4% or 3.7%, a similar level compared to 12 months ago. The full year results reflected a still challenging economic scenario that I have mentioned in Brazil, and at the same time, we reinforced our confidence on our practice risk management.

In slide 24, we may see how expenses have evolved. As I stated in previous conference calls, Santander Brasil's culture is well known by our cost discipline and lean mindset. Staying true to those values, our total expenses amounted to BRL 18.3 billion in 2016, growing 5.7% in 12 months. Excluding non-recurring effects that we had in 4Q, like the lump sum bonus paid to employees in accordance with 2016 collective bargaining agreements, total expenses would have increased by 4.8%, which is also well below inflation in the period.

So, costs rose 8.9% in the quarter, also affected by the seasonal impact from the collective bargaining agreements I have mentioned. All in all, we reaffirm our commitment to a strict cost control discipline. In the last four years, we have achieved expense in savings of 25% in real terms, and going forward, we expect to keep our expenses growing close to inflation.

Next slide, on the slide 25, we present our main performance ratios, which have also shown progress. Efficiency improved in the year-on-year comparison and stood at almost 49%, 48.8% at the end of the year. Our recurrence ratio rose to 75%, 74.9%. Every time that we make strides in this indicator would more predictability and resilience to our results. Thanks to these advances, return on equity keeps increasing at a gradual, but a steady pace, reaching as Sergio mentioned 13.9% in the quarter, in the fourth quarter, which is a good starting point for 2017.

We would remain committed to continuously improving our profitability, in line with our guidance already shared with you in the past Investor Days. Our relentless push to achieve the stronger results is guided by our mission to establish a competitive position against our peers and meet our shareholders' expectations, but always maintaining good solvency levels. Speaking about this in the next slide, you will notice that both our liquidity and capital positions remain solid, with a stable funding sources and adequate funding structure. The loan-to-deposit ratio reached 86% last year, which is quite a comfortable level. The BIS ratio fell to 16.3%, primarily due to a drop in the adjusted regulatory capital in response to the dividends announced.

Remember that we announced in 4Q close to BRL 4.75 billion in dividends. Despite that decline, our capital ratios remain healthy with a Core Equity Tier 1 level of 15.3% and a Tier 1 level of 16.4%. As I said, total dividends paid in 2016 reached BRL 525 billion (sic) [BRL 5.25 billion] (35:56), which is 5.4% of our average market cap in the fourth quarter.

So, those will be the details in the numbers and the results of 4Q. And now, I would like to give the floor to Mr. Sergio Rial again.

Sergio Agapito Lires Rial {BIO 1925337 <GO>}

Thank you, Angel. So, I think on slide 28, which are basically trying to summarize what we have articulated, but I think we're pleased to deliver what we said we would do. So, I think that has to be the baseline. But this is – I think, Santander has shown over the last couple of quarters, a level of consistency and predictability that we work very diligently each and every day in order to consolidate that position.

So, I want to make sure that we reassure our commitment to being a bank that is committed to higher levels of profitability, working on effective commercial transformation. We do see ourselves as a formidable alternative to the existing banking system in the country. We will continue to pay adequate attention to quality of assets, I think this is not going to change, and I think this is probably going to be one of the questions looking at 2017. But I – as we enter 2017, I would like to leave you with the couple of thoughts.

One is, we certainly have a better macro than we had when we entered 2016. I – certainly, it's all my personal opinion that, I think, we're certainly going to have a much more benign commodity cycle than I think we have seen, again, in the last two years. I think we enter Brazil with clear indication, not only lower interest rate which is important from a purchasing power point of view, but also Brazil that is going to be benefiting from, again, a better commodity cycle, highest record level of agro crop, and unemployment probably showing some signs – improving signs towards the second half of this year. And consequently, I think, this may be good news over time for banks in terms of volume. I mean, one of the things we haven't seen in 2016 for sure, has been credit growth. So, hopefully, we're going to see better signals towards the end of second half.

A lower interest rate environment does not mean challenges around profitability in banking, particularly in Brazil. I mean, I speak for myself, in the case of Santander, we still have a long way to actually optimize the thrust, the capacity of our liability. So, we have a pretty strong balance sheet, we have a pretty strong customer base, through which we believe we have plenty of room to do and to generate more value for shareholders, but also for customers through the liability side. So, from a spread point of view, I remain cautiously optimistic in the sense that I don't think we're going to see with the decline of interest rates, a very – a much more difficult environment, much to the contrary.

All in all, good. I would like to thank you all for not only following the stock, but also supporting us in many different occasions and rest assured that the commitment to deliver consistently high ROE pretty much based on organic growth and commercial activity on what we have and gaining market share would make sense will continue to be our motto.

Thank you very much, and I think, we're going to be open for questions now.

Q&A

Operator

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

Moving to our Q&A, the first question comes from Philip Finch, UBS. With NPL trends improving in 4Q, what are your expectations for loan loss provisions in 2017?

A - Angel Santodomingo Martell

Okay. Thank you, Philip. I would say that NPL trends should follow the macroeconomic behavior that we could see throughout the year. Let me go a little bit backwards to put in context things. Now, if you go back, we're speaking of 2016. So, we'll work just 12 months, January 2016, we were speaking of an inflation of around 11%, we are now speaking of inflation below 5%. We had the CVAs around 500 basis points of Brazil. Today, we have the CVAs around 250 basis points. The dollar was up 4% or over 4%. Today, it's below 3.2%. GDP, everybody was speaking of minus 3.54%. Today, we are already speaking of positive territory and gaining momentum, interest rate, et cetera. So, the macro environment – Sergio was also mentioning this in his last words, the macro environment is clearly improving. So, NPL trends, with some delay always that you may discuss, will turn to follow that behavior.

Now, here the question is both – in between segments, how we could see this evolving, first; and secondly, with what intensity we will see this behavior. We tend to be positive, we tend to see the macroeconomic momentum gaining pace throughout this year. And we have an important variable here, which are interest rates. If monetary policy follows what the market is considering today, which is moving to a single-digit interest rate level, the impact that that is going to have across the board, I mean, meaning not only the bargain ratio, but confidence, investment, consumption, I mean the impact that that may have could easily help the economy in a more positive way that we're seeing today.

So, I would say, NPLs would tend to follow that, unemployment is an important variable also, disposable income at the same pace. And we will try, in our case, to continue with the same policies, which means what I mentioned in my presentation, I mean, diversification, de-risking, considering - obtaining a leverage in volume growth as you have seen in past periods.

A - Sergio Agapito Lires Rial {BIO 1925337 <GO>}

Okay. Let me just add two other points on the NPL. So, I think on the wholesale side, a big difference in 2017 is, I do believe companies are going to be able to access the equity markets. So, on the wholesale side, which wasn't absolutely open for Brazilian companies back in 2016, so equity markets are open. And more importantly, fixed income market, international fixed income market is not only opened, but at unprecedented price levels, which wasn't that very clear back in 2016. So, that helps potentially to delever the wholesale side, both in terms of duration, but also in terms of capital structure.

On the second point, if you look at 2016 performance, particularly the fourth quarter, where we have seen the biggest improvement has been on the individual dimension, 100 basis points drop third quarter to fourth quarter. I personally believe that this trend, based on product mix that we have done, but also very close monitoring should not change. So, I think the individual piece, I don't think we would see surprises.

A - Operator

Next question comes from Eduardo Nishio, Plural. Stepping back a bit of the quarter and looking ahead for the next two years, we have seen several downgrades on GDP, interest rates going to one digit, regulators changing rules with some negative implications for banking profits. What's your view in terms of the bank environment regarding to spreads, profitability, loan growth, et cetera, and what's Santander strategy under this scenario? Could you please talk about the regulatory changes that are taking place recently?

A - Sergio Agapito Lires Rial {BIO 1925337 <GO>}

Yeah. No. Thank you, Eduardo. I think, let's start with the regulatory changes. So, I think what we are seeing on the credit card changes, which is basically transforming to a large degree the product into a revolving credit line, it is in itself a good thing. I mean, it's unsustainable for a country to continue to post the level that I think we have seen historically on credit cards. But I also see positive regulatory changes. I think, we have seen interesting discussions around the compulsory, so we may be seeing changes around how much we are basically seeing guided credit in Brazil. I think, I'm going to - I'm more optimistic in seeing a bias towards deregulation that I'm actually going to see regulation. I think where we're going to see regulation is probably on what is structurally excesses in terms of - and I think the banking industry will most likely self-regulate itself than wait for the regulators.

So, I would see banks becoming a lot more proactive in self-regulation. And at the same time, I would see banks pushing to more deregulation. And I think one of the good things that we are seeing is BRL 30 billion of FGTS, the social security funds coming to the economic scheme. So, moving from the state hands back to individuals hands, which are probably going to be allocating it better. So I find environment, if you ask me, I'm positive, really positive relative to 2016. No, it's all relative to 2016. And last but not least, we have formidable competitors, absolutely formidable. But everyone is in a different stage. Everyone is going through a different cycle. Some are integrating businesses, some are reassessing their capital structure, some are looking at businesses that could be or not IPO-ed. So, everyone has a different, we - on the contrary, we are 100% focused on our operations. So, there is no distraction whatsoever in a franchise that still has a lot, a lot of opportunities to be extracted as shown over the last 11 quarters.

A - Angel Santodomingo Martell

And Eduardo, adding to that in terms of the financial system and variables and how we see this evolving going into future. As the microeconomic situation improves, as I was mentioning, the normal situation will be to have some pressure on asset spreads, while the volume starts to offset for the NII in absolute terms analysis starts to compensate, offset our EBITDA trend. So, I would say, on the asset side, mean would be stable under pressure, as economy gets momentum. As you know, today, consensus and general terms estimations are speaking of a positive GDP growth, but not extraordinary positive growth. So, I would say that we will still have a 2017 which is relatively positive or could be relatively positive in terms of NIM.

And do recall that in our case, in Santander Brasil's case, we still are executing these liability and funding plans that I have shared with you in the past. So, that should also give some support, give some help to the total NIM and the total NII compared to the past and compared to the financial system as a whole. Profitability, we also already discussed, we are in the positive trend and we will maintain that. And loan growth, again, saying the same thing, probably will be - we expect a positive year, mid-single-digit or around mid-single-digits will be the normal trend.

A - Operator

Next question is from Nishio, Plural and (48:56) from JPMorgan. Can you please talk a bit more about the non-recurring items, why did you decide to classify a large portion of the interest on capital tax benefit as non-recurring? Also if you could, please talk about the additional allowance for loan losses and secured transactions non-recurring adjustments?

A - Sergio Agapito Lires Rial {BIO 1925337 <GO>}

Okay. Thank you, Eduardo and (49:20) Well, I think, I already gave a little bit of light when I was presenting the general P&L. We have an interest on capital dividend that totaled in the full year BRL 385 billion (sic) [BRL 3.85 billion] (49:36) and that generated a positive impact of BRL 905 million in the tax expense line. On the NII, we made an adjustment of - an impairment of securities that had - by an amount of BRL 388 million. And basically, the other adjustment that we made which was worth BRL 517 million was considering these lower expectations with economic GDP growth and in general terms the economic environment. We thought it's wise to do a corporate loan loss provision of this amount, BRL 517 million. So, that's how it is, there is not too much to be said around these. And these three items were the three items I mentioned in my introductory words.

A - Operator

Next question comes from Jorg Friedemann, Citi. We appreciate the strong progress in ROE, but we still find that convergency to peers lacking stronger contribution from capital-light activities, such as asset management and insurance, but I want to agree not as capital-light as the former. With the recent movement in Spain, with the Bank buying back its asset management division globally, is there any conversation with Santander Spain to transfer asset management and insurance underwriting back to Brazil?

A - Sergio Agapito Lires Rial {BIO 1925337 <GO>}

Thanks for the question. I think when we had articulated the target for 2018, it was really business as usual, right, with the portfolio that we have. I mean, all your questions are absolutely valid. I think we have a number that we have articulated back in the investor conference. Your question is, is our number going to converge with our peers? I mean, there is absolutely a question around portfolio too, as you correctly pointed out. The first task has already been made. I think the fact that we have bought back our asset management business is really, really good. A big piece of this business does reside in Brazil. We do see Brazil becoming more and more of an important, if you will, factory for some of the Latin American firms or funds that are going to be highly multi-market. And I think, the retail franchise and particularly, the affluent market segment that we are building very successfully in Santander Brasil, will benefit it tremendously.

But answering straight, so there are no plans whatsoever at this point in time to do any type of transfer or accounting transfer. I think the insurance piece, from a strategic point of view, is pretty much on our radar, of course, I mean, it is still a country where insurance is an important piece. We have shown that in 2016. A big chunk of the commission growth is actually the distribution effort of Santander. So if the distribution effort of Santander can yield those levels imagine if we would have indeed an insurance company. Just today from a revenue point of view, on peer distribution of insurance products, we would be among the five insurance companies in the country and that's without a real factory. So I think your question is right. And I reassure you that it is very much on our radar screen.

A - Operator

Now we're going to receive questions from analysts by phone.

Mr. Carlos Macedo from Goldman Sachs would like to make a question.

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

Good morning, gentleman. Thanks for taking questions. A couple of questions here if you could indulge me. First, what should we expect for your tax rate going forward? Of course, you have the big interest in capital, but the amortization of the goodwill from the ABN AMRO acquisition in Brazil is running out. Where should we expect this to settle in 2017 and subsequently in 2018?

Second, Angel, you talked a little bit about margin pressure coming from lower rates. How quickly do you think your book repriced this to (53:57) the lower spreads that are going to most likely start coming in as rates go down to 9.5% (54:02) as you have in your forecast?

A - Angel Santodomingo Martell

Okay. Thank you. Tax rate is always a difficult variable to estimate, because as you know, there are different variables affecting on different directions. You are quite correct in terms of the goodwill that is finalizing. But generally speaking, I would say that we should trend towards the 20%, 25%. That's a trend. Remember in Brazil, there is a lot of taxes being paid throughout – in the P&L, that is not only the final tax rate. I mean, we have the PIS, COFINS (54:45). We have different other taxes that we already pay throughout the P&L. But, I would say trending-wise, that would be my best guesstimate.

In terms of NIM, I wouldn't like to leave the sensation that we are already under the spread pressure. I don't think so. If you analyze the quarter, we were able to improve (55:08) and basically half of that was mix – around half mix, half price.

So I would say that we are still in an environment that as the economy is not jumping and boosting, that pressure is not there. I was more elaborating on the medium-term. I mean, clearly, going towards the end of the year, or going into 2018, what could happen with both NII and NIM, but I don't see it full term. We are not seeing that pressure yet. But we have to be realistic and we have to see that it will and may come in the near future.

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

Thank you. Just one follow-up on your 15.6% ROE target for 2018, what tax rate do you have there? I think that might be an easier question to answer.

A - Angel Santodomingo Martell

The 15.6% ROE is our – I didn't hear quite exactly the question. The 15.6% is...

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

So your target ROE, what tax rate?

A - Angel Santodomingo Martell

Repeat your question. Sorry (56:17).

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

What tax rate do you consider on your target ROE?

A - Angel Santodomingo Martell

We are working with the levels I said to you. We are working with levels around 20%, 25%. And as time goes by that will be going up. Sorry, I didn't hear you.

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

Thank you (56:36).

Operator

Mr. Rafael Frade from Bradesco would like to make a question.

Q - Rafael Frade {BIO 16621076 <GO>}

Hi, gentlemen. Good morning, everyone. Just a follow-up, maybe I missed the explanation from previous questions regarding the interest on equity in the quarter. I would like to understand why you classify as non-recurring.

And a second point would be related to the rating of your credit portfolio. We saw a major increase in the AA rating. I would like to understand if there were some changes in rating or this is really that the increase in the portfolio in the quarter was mostly on the AA. So if you could give a little color on this would be great.

A - Angel Santodomingo Martell

Okay. Thank you. Again, I already elaborated on the specific issues of this 4Q. The kind of non-recurring is something that given the economic environment, we thought it's wise to do this on the corporate side, just thinking in 2017. That's about it. And we specified the corporate side, because we wanted to give you some more information more than the typical provision, loan loss provision.

And obviously, we had other positive impacts and one of them was this tax capacity. So as I said, a normalized, I will say, of year-end way of (58:10) optimizing and strengthening the balance sheet.

The second question was – which was the second question? I didn't write down. Frade, are you there?

Q - Rafael Frade {BIO 16621076 <GO>}

(58:31).

A - Angel Santodomingo Martell

Sorry, the AAA classification, you're right. Well, nothing is specific. I mean, if you analyze, we had like – if I remember, well, we had 36% of weight of the AA portfolio, and that moved, I think it's to 37%, 38%. So I wouldn't extrapolate specific issues or things around there. It's just, well, Q-on-Q movements, depending on how clients move, what is the evolution if they go or not into better or worse position, but there is not an issue around a general move that we see in terms of improvement or the other way around. I don't think the issue is to be significant.

Operator

Mr. Lucas Lopes with Credit Suisse would like to make a question.

Q - Marcelo Telles {BIO 3560829 <GO>}

Hi. Marcelo Telles from Credit Suisse. Marcelo Telles for Lucas. I have two questions. One, a more specific one. We saw the decline in NII, also low NII in the quarter mainly hit by lower, let's say, trading revenues. I was wondering if this could be kind of the new levels to expect. I understand there is a lot of volatility on that, but given that the level this quarter was below the average for the first nine months of the year, it would be nice to have some follow-up whether the trend is to have, let's say, a higher number or this should be the recurring level going forward?

And my second question is regarding your capital. I mean, here you have a comfortable capital position. And my question for you is if you would consider doing any sort of capital optimization down the road? I know, you already have a very high payout, right? In the past, you've done a capital reduction and it seems like, of course, (01:00:42) sort of capital optimization strategy there. So how should we think about your capital structure at this point? Thank you.

A - Angel Santodomingo Martell

Thank you, Marcelo. Yeah, the part that is called others (01:01:01) is always a difficult one. I mean, you are right. Compared to third and fourth Q, it's at lower level. If you take the historical average, not only the year (01:01:11) average, we have always been in the region of 1.34% to 1.5%, always minimum. And the majority of the quarter is 1.5%, 1.6%. So we are more or less returning to that historic average, difficult to estimate. If you ask me, for example, starting first Q, if we were going to have our historic quarter in terms of market NII, I would have guessed that. And we had, as I said, a very good quarter, the first (01:01:44) Q.

I will say, for example, we are having or we have had a good January compared to the previous October, November, and December. So, I mean, obviously, we would strive to keep this line improving, but I would say that moving from those historical levels, we probably have to have an explicit explanation. I would clearly concentrate on the credit and funding side of the NII. Those are business (01:02:22) business as usual. This is reflecting our kind of efforts with both clients, products and spreads. In the others, we have to come, the maximum we come, but we have to come with a little bit of volatility.

In terms of capital, I would say that at this point of time, we are not thinking of doing any kind of operation. We have a comfortable level of capital, as I have said with you in the past. You were quite correct saying how we managed that, which is through a high level of payout. As I mentioned, we paid an important amount of dividends last year, BRL 5.25 billion. And our way of looking at this is to use capital both of the stock, but specifically on the margin from a profitable way.

So that was our plan, to keep on using capital in a profitable way, increasing and improving that profitability that we have shared with you. So the Bank is on that kind of mindset from the first employee to the last one and that is being transferred to the commercial arena to the non-commercial arena and that will continue in the near future, right? But at this point of time, as we said, no plans.

Q - Marcelo Telles {BIO 3560829 <GO>}

Very helpful. Thank you so much.

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. So thank you very much everybody. Again, I'm quite happy to represent these good results for the full year. We look forward to 2017 to clearly maintaining this way of delivering and I really hope to share this with you in the near future. Thank you so much, and good day.

Operator

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