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Q2 2013 Earnings Call

Company Participants

- Angel Santodomingo, Director of Investor & Analyst Relations
- Javier Marin Romano, CEO
- Jose Antonio Alvarez, CFO

Presentation

Javier Marin Romano {BIO 3961209 <GO>}

Good morning, to everybody. Welcome to the Santander's first half results presentation. Jose Antonio Alvarez, CFO of the Bank. And Angel Santodomingo will be joining me for this presentation.

As usual, I will begin with some key facts and figures for the Group. Later on Jose Antonio will do the same with respect to the individual units. And then we will open -- I will close with a few conclusions. And then we will open some time for Q&A. Let me start with a few highlights on what has been the Second Quarter for the Bank.

Santander continues to develop its business around very complex macroeconomic and regulatory environment. The Group maintained the priorities of previous quarters; strong balance sheet, in terms of liquidity and capital. And reinforcing underlying results offsetting external impacts in several units.

Some key features; business volumes reflected macroeconomic situation of the countries where we operate and the strategy of bolstering the balance sheet. You see this in a sharp negative (feedback) from exit exchange rates. Excluding it, for management purposes, the Group's deposits grew 7% and loans decreased 2%, while deleveraging in some countries.

As a result, there was a further improvement in liquidity with a ratio of loans to deposits already moving into 107%, which is a very comfortable ratio for us.

There was a very strong organic generation of capital in the quarter, 44 basis points, with a BIS II ratio rising to 11.11% and, of course, very comfortably in order to meet the Basel III requirements for the end of the year.

Of note in results was revenue stability, with some countries recovering and still high provisions. But much lower than 2012, where we had the exceptional provisions for the real estate loans in Spain. The first half attributable profit was EUR2.255 billion; the same as for the whole of 2012.

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Let us look a little bit into these points. We have created a little -- a composite here of what has been the growth of GDP in accordance with the footprint of the Bank. We see, basically, the emerging markets were growing slightly better, of course, than the developed world but, of course, at a slower pace than they did last year, at 2.3%, with better prospects for 2014 where the IMF is expecting a 3.3% growth.

For developed countries we would say that they were basically flat, with some countries in recession, like Spain or Portugal. And some others with a flat growth; and, again, with some better prospects for 2014, where the IMF is expecting with this composite index a growth of 1.4% in the economies where we operate.

Interest rates are also impacting business this year. We have flat interest rates and at historic lows in the mature countries where we operate. And we will see this at least until 2014. And we saw a sharp fall in interest rates in emerging markets; around 140 basis points, on average, compared with the first half of 2012, which is more than 20% in relative terms. Especially this taking place in Brazil, although here we've seen already a steep reversal in this trend. And in Poland.

How this translates into our loan and deposit growth. Using some deleveraging in mature markets, due to lower demand for loans, combined with more selected growth and even reduction in some areas and some products, like real estate in Spain or some portfolios in run-off that we have in the USA.

We have a higher and more balanced growth in emerging markets. That has accelerated through the Second Quarter, especially in Brazil, Mexico and Chile. And that we expect, especially in the three of them, to accelerate over the next quarters. This has translated obviously into the liquidity position of the Bank. As a consequence of the evolutions of loans and deposits, the liquidity trend continues to improve.

We've narrowed the credit deposit gap by EUR63 billion in 18 months, which more than covers the maturity of medium and long-term debt for this period.

The liquidity ratios showed improvement. The most basic one, the loan-to-deposit ratio, stands now at 107% within our comfort levels; that will be between 110% and 115%. Worth to mention is our loan-to-deposit ratio for Spain, which Jose Antonio will later on elaborate on, which now stands at 85%.

In terms of capital, the Group has continued to strongly generate capital organically during the Second Quarter. Basel II core capital was 44 basis points higher, absorbing the negative impact of interest rates that impacted 11 basis points in the quarter. This rise was due basically, first of all, for profit retention, favored by a high acceptance of the scrip dividend between 80% and 85%; 86% for the last scrip that we just closed a week ago. And there's also a sharp fall in risk-weighted assets of 7%, stemming from reduced credit risk and the improvement in market and operational risk.

The leverage ratio, equity to total assets, also improved to 6.80% according to IMF criteria.

There's been no substantial changes in the Basel III ratio on what we have already been announced. Basically, during the phase-in we will see a very comfortable position, always over 11%. And in a fully loaded 2019, that will always sit above 9%.

Furthermore, Santander has a few advantages over the mid-term compared to other banks. First, a low capital buffer for systemic risk, where the lowest level, 100 basis points, that compares favorably to the average of our peers in Europe that are 160 basis points. And some of our competitors at the standard 250 basis points; as a consequence, of course, of having a lower risk profile than many of our competitors. And thus requiring smaller capital surplus.

The second advantage that we see is basically the launch of the single supervisor in 2014. Single supervisor will conduct a stress test, basically through an asset quality review over the last part of this year. And then a stress test over the first half of next year, where they will go through a very thorough review of the quality of our assets in the balance sheet. And then a stress testing of the Bank.

It's worth to mention that we already underwent a similar stress test just a year ago. Out of this, we were the only bank generating core Tier 1 capital over the period with a surplus of more than EUR25 billion of capital, even in the most -- even in the toughest situation.

However, I would like to mention that over the last five years, the last five years have been a true -- truly a stress test for the Bank, where we have provisioned EUR60 billion; generated more than EUR20 billion in capital; provided to our investors more than EUR20 billion in dividends; and, of course, well, coming out of the crisis really in a much more -- in a much stronger situation in terms of balance sheet capital and liquidity than before.

Another advantage, we believe, is the new Crisis Management Directive. And if -- the new framework, as you all know, requires a bail-in of 8% of liabilities and shareholders' equity before recourse to external aid, governments, the European funds or whatever, which is limited to 5% of the Bank's liabilities.

This mechanism introduced much -- a much greater market discipline and rewards the soundest and best managed banks, regardless of where the parent bank is based. In other words, investors would rather be in a good bank that is in a less stronger country of residence than a weaker bank that is in a stronger country.

In the case of Santander Spain, our core Tier 1 plus the hybrids exceed 9% of liabilities. So this means that in case of any trouble not only our deposits will be safe. But also our senior bonds.

Another advantage for us with respect to the launch of the single supervisor is the ratio of transform of assets into risk-weighted assets. Relevant studies, like the established from the Basel Committee for Banking Supervision, or a study that we are here in Spain we asked Oliver Wyman to produce, saw very strong local differences, focused on credit risk and loss-giving default levels in the wholesale portfolios.

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Especially in the case of the report from Oliver Wyman, the Spanish banks, should we apply the same rules that are applied in Central Europe, would have -- would increase their capital levels between 100 basis points and 150 basis points.

We believe that Santander is among the banks with the highest ratio of transformation assets, of assets into risk-weighted assets, significantly above the average of our European peers. You see there in the graph that the ratio of transformation is around 44%. That compares to the average of 33% of our peers in Europe. And compares to some of our competitors that are even below 20%.

As a conclusion, I would say, after taking a look into the liquidity and capital, that we are very comfortable with our liquidity and capital ratios. And which both together generate the great foundation for the new future for growth.

In terms of Group profit, the Second Quarter profit was EUR1.050 billion. This excludes, of course, the capital gains, extraordinary capital gains from the agreement with Aegon. That has been offset by some restructuring costs for the integrations in Spain and Poland. And, of course, we have not included the EUR700 million of capital gains from the strategic agreement for Santander Asset Management that should be booked over the Second Quarter -- the second half of this year.

The profit for the first half, that is EUR2.255 billion, is 29% above the results for the same period of 2012. And virtually the same of -- as the one we had over the whole last year, given the impact of the real estate provisions in the second half of year 2012. We believe that this is the first step towards the normalization of the Group's profit.

With respect to the P&L, we would say basically three main aspects, three key features, to point out; year on year, a fall in gross income largely due to exchange rates, which took about 4percentage points of growth and accounts for about one-third of the decline. The liquidity buffer, as you saw, increase in the liquidity position of the Bank, that accounts for one-quarter in the decrease; and the narrowing of the spreads in a few countries that were -- could not offset the growth in volumes in the same, that accounts for another quarter.

Loan-loss provisions was lower than in 2012 with a -- I would say, a broad improvement across the different units. Should we -- and in terms of real estate provisions in the first half of 2012 were higher than the capital gains, while in 2013 gains were neutralized.

Compared to the First Quarter, we see a slight rise in gross income, both in the financial margin and in commissions.

Provisions actually increased 5%. But should we exclude an extraordinary provision of EUR188 million resulting from the merger of Banesto, as customers were recorded on a like-for-like basis under the most conservative criteria, provisions would have actually decreased compared to the First Quarter of this year. This has to do a lot with the standardized loans, of course. And not with the individualized managed ones. This

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extraordinary charge will be compensated over the next semester with some future capital gains.

Other results were higher, because the First Quarter of 2011 were below the normal levels. In the Second Quarter they are back to more normal levels. You know that basically within this item we have the extraordinary charges for (Travailestas) and (Selic) loss within Brazil.

At expense levels, we would say that costs were basically flat, as a result of declines in countries where integrations are taking place, like Spain and Poland. We have also lower costs in Portugal. But higher, in the other hand, in other countries where we are developing or growing our franchises, like Brazil, the US and Mexico.

In Brazil, although Jose Antonio will explain later, our costs grow below inflation. In US they grow due, basically, to the important IT investments in order to prepare our franchise. And in Mexico, as you all know we are extending our branch network; we have opened more than 90 branches over the last year.

We're making a big effort in order to combine business capacity growth with control over spending. We are maintaining a significant advantage in efficiency over our peers. But I am sure that we have still a lot of potential to keep up improving. With the integrations at cruising speed, especially in Spain and in -- at a minor level, in Poland, we will see, still, some more cost reductions.

With respect to credit quality, the trends in the ratios basically continue. Coverage remained stable at around 70%, following the provisions that were made in 2012. Stability -- we have stability in the quarter in most units, except for Poland and Mexico, due to one-off factors. In Poland, basically, to one operation in the developing world. And in the developer's world; and in Mexico, due to the (inaudible) debtors to the developers. And also to the slowing of the economy that we have experienced over this first half of the year, that has affected the numbers for consumption; but we think that will come back during the next few quarters.

We have no surprise on the non-performing loans ratio, 16 basis points more than the First Quarter, coming from 4.76% into 4.92%. The non-performing loans entries were the same as in the First Quarter; and below the quarterly average for the last two years.

We see new non-performing loans in some countries like Spain or Brazil coming down. And, of course, we have the impact of the ratio of the fall of credit that actually accounts for about one-quarter in the rise of the ratio -- of the non-performing loans, excluding the exchange rate impact.

To this evolution we should add the additional impact from reclassification of substandard operations in Spain, which is the dotted line you see in the chart. It represents an increase of 26 basis points at the Group number from in-loan ratio; 1percentage point only we take a look into Spain.

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In our case it affects basically EUR2 billion, which were previously recorded as substandard loans. And are now recorded as non-performing loans. I would like to mention that 93% of these new non-performing loans actually are performing. So the clients are basically paying on these loans. So I would like to mention this as some technical non-performing loans.

This reclassification will not have an impact on provisions, as this portfolio had a provision already of EUR340 million, in accordance with what is a traditional conservative policy of the Bank. We have a portfolio there of EUR3 billion, of the mortgages that have been refinanced, out of which EUR2 billion have been reclassified into non-performing loans, in accordance with the circular from Banco de Spain, that have already this EUR340 million of provisions.

We have an extra EUR200 million provision for the other 1 billion mortgages refinanced. But are still classified as substandard. And for the overall portfolio of (EUR53 billion) that we have in reclassified loans. But which have a real estate warranty of 84%, we have a provision of EUR6.6 billion that we think is more than enough for what we expect from this portfolio.

With respect to the three basic units, they have evolved, of course, differently. Expense ratio continue to rise, mostly due, of course, to this reclassification. There's also a denominator, in terms of the non-performing loans continue to grow in companies, although the entrances are flat with respect to the previous quarter; and we have the decline in lending the reduction in stock. The latter was responsible for 15 basis points of the increase during the Second Quarter.

There's a slight drop in the UK, both in retail as well as in companies; our raises in mortgages and foreclosed the properties continued to be better than our peers.

And the good news come from Brazil where you see a sharp fall of 41 basis points in the Second Quarter, confirming the trend we already announced. And bringing the non-performing loan ratio below to the one we have in June 2012.

We think we have reached the peak for both individuals and companies in Brazil in terms of non-performing loans. The arrears come for the fifth quarter in a row below. So we think that this should produce into the next quarters into a reduction into the non-performing loan ratio for Brazil.

With respect to provisions and cost of credit, the credit quality is basically, of course, reflected in provisions, with two basic ideas. First, for the Second Quarter's provision we're lower than the average for the previous quarters. By unit, we see rises in Spain, basically in companies as we mentioned. And in Mexico, of builders and slightly consumer credit, due to the deceleration of the company -- of the economy, which is offset by significant faults in the rest of the big units, precisely Brazil, the UK or the USA.

Second, after the real estate provision within 2012, the Group's cost of credit has started to decline. It was 2.05%, calculated as the provisions for the last four quarters of the

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average lending. Taking into account only the Second Quarter, on a standalone basis, it would come down to 1.65% annualized. This is still high to -- compared to pre-crisis levels. I remember then in 2008 we had 109 basis points. And in 2007 63 basis points; and towards these levels we should move within the coming years.

Let me hand now the micro to Jose Antonio, that will elaborate a little bit more on the evolution of the different units; and I will come back for some conclusions. Thank you.

Jose Antonio Alvarez {BIO 19692884 <GO>}

Good morning. As Javier said I'm going to elaborate about the business, the different divisions. Let me to start with the chart that shows where we get -- where the profit comes from by geographies. In reality, few changes here. Basically we get 56% of the profits coming from emerging markets, of which 25% is Brazil; Mexico represents 12%; Chile and Poland, 5%/6%. In mature markets we have the US and UK, with a 12%/13%. And Spain represent 8%. And Germany 5%.

Let me to start to analyze the activity of results of the different business areas with Spain. The first thing I should say is in the Second Quarter we completed the legal merger between the two -- the three banks in Spain, the parent company, Banesto and Banif. We are going according to the schedule, a little bit ahead on commercial terms. And while we will -- you will see the results, basically the synergies we announced coming through the P&L in the next quarters.

In relation with the activity in the quarter, let me to highlight that we continue to gain market share, particularly in deposits. And mutual funds; also in loans in this quarter. And probably the most important factor happened this quarter is the inflection point in the net interest income. The net interest grew 4% compared with the First Quarter. And I think that this is a change in the trend on the net interest income that has been falling for several quarters in a row.

While this -- you don't see this better net interest income in the gross income, because the trading days in this quarter were lower due to the Global Banking and Markets; seasonally Global Banking and Markets produce less trading days in the Second Quarters.

So in the provision line, the CEO elaborate on this; more provisions due to companies. But when you compare with 2012, we are running basically at the same level. And we expect to stick this year with the cost of credit of 150 basis points for the entire business in Spain.

In short, what we expect for the business in Spain is lower deposit cost to offset -- more than offset, going forward, the re-pricing of the mortgage book; plus some (co-reduction), plus the provisions start to normalize, probably, at the end of this year, will produce better results in the coming quarters.

Let me to analyze a little bit the activity in Spain; a little to say here. We are pretty much in -- with the same trends. The de-leverage is still going on. You will see the loan book shrinking -- still shrinking. We are making efforts to try to grow in the -- particularly in the

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SME (war). But 'til now the de-leverage is stronger than our efforts -- our efforts are not still reflected in the loan book.

In deposits, as I said before, we continue to gain market share strongly. We want 270 basis points in the last 18 month. We also grow market share in mutual funds 85 basis points during the quarter. So in terms of activity, activity is going well in both loans and deposits.

In terms of credit quality, well, still deteriorating; we've been telling you that we continue to see some deterioration, particularly in the Company's (war) -- in the SME (war). You have the new entries on the right side of the slide. And it compare -- this is a graph that is better it's now we compare the First Quarter 2008 with being days 100, today is 300, still running high.. This stood at the individual, both in mortgages and in consumer, the trend is the opposite. But were still donating significant NPL entries in the SME (war).

It's true that when you look at the ratio, you should look at the denominator that is shrinking. So the ratio, apparently, goes up faster than the new entries reflect on the right side of the chart.

If we go to Portugal, well, three main items here. We are getting significant market share gains, both on loans and deposits; on deposits 80 basis points in 12 months, in loans 20 basis points in 12 months.

For Q1 this is the stronger franchise in the country. So, compared with our peers, both in capital ratio, credit quality efficiency and profitability we're well above our peers. And, well, what we have seen in the country is more stable revenues and provisions. Probably we are reaching a new plateau of -- in which we can build on top of that going forward.

Poland, well, we've been facing a bit quicker macro environment with the interest rates being an historic low in the country. The main task here now is the integration that is on track; the integration between Kredyt Bank and our franchise. And to be able to increase the KB branch activity to be in line with the BZ WBK productivity that we've got in this BZ WBK.

The activity, we are clearly outperforming the peers. We are growing the lending, the loan book. Lending grew 2% in the Second Quarter. The deposits dropped 3%. But if you combine with a growth in mutual funds of 8%, this is part of the re-pricing -- the process of re-pricing the KB deposits -- the cost of KB deposits more in line with the ones coming from BZ WBK.

In terms of results, again we are clearly outperforming peers. This comes basically from a reduction in the deposit costs. And it's true that to match the net interest income in a much lower interest rate, environment is going to become more and more difficult.

Fee income continued to rise, plus 3% in the quarter. The costs fell 8%. This is part of the synergies we are getting from the merger with KB. And provision increased by a particular

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case. But we don't see here any increase -- any permanent increase, we see stability in coming months.

In the second half where the GDP growth outlook is better, our priorities continue to be execute the merger well; to match the revenues in a lower interest rate environment that, for sure, is more challenging than in the past.

Going to Santander Consumer Finance unit, our first idea here, the car sales in Europe, car lending is the main business of this unit, the (structure) of the business. Car sales came significantly lower in Europe. The unit is performing very well, I would say, in this environment, because three -- due to three reasons.

The first one is market share gains. We are gaining market share across the board in almost every country in which the unit operates. Second, the excellent management of the net interest margin; and, third, excellent credit quality, the cost of risk is at the -- a level that is significantly lower than in previous years.

By countries, the business is performing extremely well in all the countries due to volumes. And in Spain due to lower provisions. Germany and Poland are recovering from previous quarters. The outlook is to gradually recover. We expect a gradual recovery of the car market that will help the unit. In the meantime, with respect to gaining market share, some agreements with the car makers to be the providers of the loans to the Santander Consumer Finance, the provider of the loans.

The Spanish business in run-off. So the real estate. So this -- let me to remind you that this division includes foreclosed properties, customer loans with real estate purposes and estates related to the property sector, Metrovacesa and SAREB.

The net balance went down to EUR11.6 billion and the reduction in one year has been EUR7.4 billion from June 2012. The pace of reduction has been EUR400 million/EUR500 million net per quarter, basically, loans with -- are falling 11%. The coverage is in the region of 50% and we plan to keep it there. The loss of this division in the first half has been EUR337 million.

UK, well, the market is slightly better in the UK. So, this is a good starting point. In activity, our activity in volumes, particularly in the loan book, reflect our selective growth policy we've become more -- our lending strategy was more demanding in interest-only mortgages, that as a result of this policy the book fell EUR9.2 billion in 18 months and we are growing well in corporate lending, plus 11%, basically in SMEs where we are growing 12%.

We are, at the same time, focused in the reduction of most expensive deposits and trying to grow in current accounts with the 123 strategy that we -- has allowed us to grow 60% year on year the current accounts with this strategy.

The banking net interest margin on assets improved compared with the previous year.

The results, the net profit was in the quarter EUR224 million, 17% up compared with the previous quarters. The good performance is to reflect of a stable net interest income; and lower cost of deposits; and the cost of funding; and improving the yields in the front book; lower provisions due to excellent credit quality; and a good quarter in trading days that we have set with some provisions. So, the profit in the first half was EUR414 million, up 3% more than in 2012. It's the first time that we grow compared with the previous year.

Let me focus on what we are doing in the business in UK. Let me highlight three points, the selective profit growth that I mentioned before. So the strategy, the 123 strategy, is working very well. The current accounts, we grew the balances 60% in 12 months. And we think that it probably is more important that we are increasing the number of customers and the relationship of those customers with the Bank.

In terms of balance sheet, the mix is changing. It's changing from being almost entirely mortgages to a more diversified balance sheet, while the SME represents 11% of the loan book. And we expect to be growing from here.

And, finally, a solid capital position; as the FSA exercise has shown our capital position is extremely good and is compared in a favorable way with our peers.

So, I would say, just to sum up, this is a good starting point to continue to grow the results in the coming quarters.

Now Brazil, let me elaborate a little bit. Well, in terms of activity, we are very much in line with our competitors. So, the loan book of the peer banks is growing at 5%, ours is growing at 6%. So more or less in line.

We start a significant recovery in the Second Quarter. We grew the lending in the Second Quarter 3%, (inaudible) grew 1%. So we are seeing in the whole year to be around double-digit kind of growth in loan book.

In terms of results, well, when you see the lower figure done in the First Quarter in terms of revenues, was due to trading gains, you see the net interest income was almost the same compared with the previous quarter, that we saw some declines in the net interest income.

First half attributable profit was EUR919 million. Positive points; costs grew significantly less than inflation, used not to be the case in the past. They grew grow 6% in 2012 and 2%, year on year, in the first half.

Lower provisions, as the CEO mentioned, the credit quality came much better in Brazil, associated with a good evolution of NPLs and (regular) arrears. All the indicators in credit quality are heading in the right direction in Brazil. The attributable profit over 2012 was due to lower net interest income, which I will explain now.

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The fall in net interest income is due to the reduction -- the margin compression. Margin compression in our case, 75% compared with the previous year comes from change in mix. You see the lending portfolio -- how the lending portfolio is growing. Compared with the previous year you see the portfolio growing faster in mortgages, large companies and SME companies, well. And less on the consumer side that typically has higher spread, highest costs of risk. So in this case, the effect in net interest income comes from 75%, as I said, from the mix. And 25% from reduction in spread.

We believe that the greater part of the change in mix has already happened. And we expect still some margin compression coming from some of the products, particularly in the consumer side.

Looking at the credit quality, the NPL dropped by 41 basis points in the quarter, with all indicators showed us that the trend is positive in this regard and the arrears are declining for several quarters. Both individuals and companies improved their NPL ratios, provisions are falling. So we are fairly positive on this regard in relation with the future results.

So in short. in Brazil we see an environment of rising interest rates; a pressure on the spreads will continue not due to mix, more due to some pressure in particular products; volumes will rise faster than in the first half in the second half; personal and general costs increasing well below inflation; and definitely improving the cost of credit in coming quarter as you already saw in the last quarter.

Mexico, what we have here is the quarter in Mexico from macroeconomic trends were relative particularly weak, because, well, there was a change in government. When the government changed in Mexico normally the public spending gets reduced for a short period of time, two or three quarters. So this quarter was relatively weak in terms of macro performance in Mexico.

This was reflected in the lower pace of lending the sector as a whole, although we continue to grow very fast in our main segments. In SME we grew 43%, in cards 15%, in mortgages 14%. So on deposits continue to grow in double-digit. So in a bit weaker macro environment, we continue to grow very fast.

In this environment net interest income rose 2% over the First Quarter due to volumes. And it's impacted by the lower rates. So you make money, significant money, in deposits in Mexico. And the revenues come 4.5% to 4%. Year-on-year gross income grows strongly 14%. Costs were flat in the Second Quarter; and higher year on year, because, as you know, we are opening branches in the country to expand our commercial capacity in the country.

Provisions in the quarter were affected by the home builders. In (inaudible) these were charged to equity. But in IFRS were charged to results. And some the duration in the quality of the sector of consumer credit. So, in short, higher provisions affected the quarter result. But there the main thing the business was still good. And growth higher than the marketing target (inaudible).

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Chile, well, this activity, I would say in the quarter, the level of activity improved compared with the previous quarters. In fact, lending grew in the quarter 4%, deposits grew 3%. Particularly focusing SMEs, high-income individuals. And demand deposits where we grew in double-digit. Both loans and deposit were higher than in the First Quarter. So a bit better levels of activity in the unit.

Results, the results in the quarter, basically, are the main explanation of the results is inflation. The net interest income remains unchanged. And this is due to the lower inflation offset the higher volumes, while basically the margins were relatively stable. Reduced fee income, due to the regulatory change in insurance and cards; trading gains because some portfolio disposal. But it was relatively small.

The costs continued to get reduced, the increase in the quarter is purely seasonal. So we expect a better performance in costs going forward. Provisions continue to fall in the Third Quarter. So our view is to continue this trend. So we expect, in the coming quarter, a significant improvement in the activity in the second half, a recovery volumes, higher inflation. And a bit lower provisions.

In other countries in Latin America, generally speaking, all of them are growing in double-digit. Argentina first half profit was EUR166 million, a double-digit growth in all the figures, being net interest income, gross income and net operating income.

Puerto Rico, profit rose for (two) quarters and more than doubled from the first half of 2012. Uruguay went up 14% and Peru 22%. So we don't see no reason to change this trend in the coming quarters.

US, basic ideas here, Sovereign is more focused on companies and retail deposits. Year on year, there is a fall in lending from commercial real estate. We are disposing more mortgages, the mortgages (inaudible) we are disposing all of them and a reduction in the portfolio, some run-off.

Fall in gross income and sharp declining provisions; the fall in gross income in the first half was due to a squeezed spread, the impact of the sale of mortgage and the reduction in non-strategic portfolios. This hit net interest income and trading gains.

The fee income then improved. Reflecting our priorities in the country, we are developing the franchise, we are launching new products and this should be reflected in the future and growth in the fee income; that is probably our weaker line when we compare with our peers in the country. And provisions declined significantly. The credit quality is excellent. So provisions have a very low level.

SCUSA, the Consumer business in the US, new lending grew strongly, partly due to the agreement with Chrysler, where the new production is more than doubled. Yes, it's growing 103%. And the profit we got from here is EUR249 million in the first half, 9% more than year on year.

For coming quarters, we continue to see Consumer US strong, with new lending growing strongly and Sovereign with revenues more diversified due to our bigger range of products. Asset quality, we don't see any issue here.

Finally, Corporate Center, let me to elaborate, the Center made a loss of EUR1.068 billion compared with EUR928 million in the first half 2012 before recording capital gains.

Net interest income was more negative this year. This quarter was a little bit better than the previous quarter due to the repayment of the LTRO that we did in the First Quarter of 2013.

Trading gains reflect the result of centralized management, of interest rate and exchange rate which, as well, that were EUR580 million positive up from EUR325 million in the first half 2012.

The costs increased basically associated with higher indirect taxes and next provisions include, as the CEO management before, a one-off charge to the -- for standardized loans in Spain, in order to align the more conservative practice of the three banks that we merged in Spain.

Now I hand over to Javier to finish, to sum up, this presentation.

Javier Marin Romano {BIO 3961209 <GO>}

Thank you, Jose Antonio. As a conclusion, first thing we are combining, business growth and balance sheet enhancement. We are growing in a balanced way in accordance with the situation of each unit and each country. Liquidity and capital remain very strong and are improving. We are very comfortable within these levels and have the added advantages of Santander's business model.

With respect to Group results, today we are under pressure, because of recession and regulatory issues. We are managing the drivers under our control; spreads, costs, business mix in order to speed up recovery. We are already seeing some progress and also have identified areas of improvement, of course.

Not less important, we are working on our future, strengthening, basically, our high commercial effectiveness, integrations in key countries, new global division for Retail Banking, global business push, such as the asset management or insurance are key elements within this strategy.

In short, we are improving Santander's position to obtain the maximum profitability for the next stage of banking business from strengthening our balance sheet in terms of liquidity and capital into a new phase of strengthening our franchise and growing in clients in the different countries where we operate.

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Lastly but not least, I would like to mention, before we move into the Q&A, about the prize for Santander, the recognition as the most sustainable bank in the world and for Santander, Brazil as the most sustainable bank in America. This is a recognition of the strategic importance that the Bank gives to sustainability and joins the awards that we received already in previous years.

So thank you very much for your attention and for your time. Let me now just open the time for questions.

Questions And Answers

Operator

(Operator Instructions)

A - Angel Santodomingo {BIO 15757370 <GO>}

Q&A part of the presentation, as always, we will try and progress questions received through the web, through the Internet. And, if we have time at the end of them, we will also welcome questions coming through the phone.

As we have done in previous occasions, I will try to organize questions through different themes, our first one being the strategy, regulation and perspectives of the Group.

First question will come from Andrea Filtri, Mediobanca about our opinion on the EU Council proposal on banking supervision and regulation and resolution. Can we expect any impact on funding costs with regards to these potential changes?

A - Javier Marin Romano {BIO 3961209 <GO>}

Okay, thank you, Angel. We are very positive about the European Banking Union. I think this is our first step towards this.

For us, we actually think that at some point, our cost of our financing should come down, as we already mentioned on the presentation that our capital and hybrids cover more than 9% of the liabilities of the Bank. So I believe that it creates a more level playing field for the European banks and thus, we should be benefited from this.

A - Angel Santodomingo {BIO 15757370 <GO>}

Also, linked to the European situation, Britta Schmidt from Autonomous asks about the AQR, the asset quality review. What are management's expectations for this stress, both for Santander and for the European sector more generally speaking?

A - Javier Marin Romano {BIO 3961209 <GO>}

Well, for the European sector, I have no expectations; I don't know exactly what's the individual situation of the rest of the banks.

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In our case, we are very comfortable. We went through a stress test only a year ago. As you have seen, we have strengthened our capital base. We have strengthened our balance and we expect to come out of this new stress test, that should take place over the first half of next year, with very good results.

A - Angel Santodomingo {BIO 15757370 <GO>}

With regards to M&A, Rohit Chandra from Barclays, Carlos Peixoto from BPI and Britta Schmidt also from Autonomous make the following questions, which is what are our views on M&A in Spain specifically or elsewhere?

And also, what are our thoughts or if we are interested in Catalonia Bank or Novacaixagalicia. And which of the two would better strategically fit our strategy in Spain?

A - Javier Marin Romano {BIO 3961209 <GO>}

Well, in general terms, it would depend on the geographies. As I said before, our first objective is organic growth. However, we've been doing quite a number of operations over the last quarters. So we did the Kredyt Bank in Poland in order to strengthen our position in the country with Zachodni. We bought GetNet to create the most important acquiring credit card company in Brazil. We also bought the mortgage portfolio of ING in Mexico. So, actually, we're doing things.

Of course, as I mentioned priority is organic growth. But if we have -- if we find some opportunities we will take a look into them and provided that they fit both strategically and financially within our objectives, we will proceed. We are -- as I said before, we have the capital and the liquidity levels appropriate in order to go -- to do so.

With respect to Caixa Catalunya and Novacaixagalicia, operating in Spain today is to conclude the integration of Santander, Banesto and Banif. The technologic information -- sorry, the technology integration of Banesto and Santander will conclude for individuals and SMEs by the end of the year. But we will go into -- deep into next year in order to do the integration basically for corporates, where we have a lot of tailor made solutions for them and we don't want our clients to suffer.

So that's our first priority, that is going very, very well and we look forward to meet our targets in terms not only of the synergies. But also in terms of timing.

Having said this, definitely we will look into Novacaixagalicia and Catalunya Bank. Of course, it needs to make sense. It needs to fit within the strategy and, of course, in terms of the financial requirements that we ask for any investment, taking into account that our shareholders will be -- we need to take a look into our shareholders and we need to provide the return on the investments that they're all expecting.

At the same time, it's worth to say that we are growing in Spain organically 270 basis points in our market share, in deposits and current accounts, more than 60 million -- more than 60,000 new loyal customers over the last six months, which is a fairly good result.

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We are in terms of satisfaction, due to the enquiries that we -- that are done externally by consultants for all the sector, we are top right now.

So we need to consider all the circumstances in order to decide whether we will definitely be making an offer for either Novacaixagalicia or Catalunya Bank would make sense. But definitely you know it is all -- we will take a look, definitely. We're due to take a look. But we will consider whether this fits our not.

A - Angel Santodomingo {BIO 15757370 <GO>}

There's a lot of questions also with regard to IPOs, Carlos Peixoto from BPI, Britta Schmidt from Autonomous make the following ones which is if we could update timeframe of the different Group IPOs, subsidiaries of IPOs first?

And what is the expected impact from the IPO of Santander Consumer Finance USA. And if we have any timing preference or schedule for that operation?

A - Javier Marin Romano {BIO 3961209 <GO>}

With respect to the IPOs, Santander Consumer USA, as you know, we have filed already the register for the IPO. We have some time to decide whether to do it. Se have not decided yet what we will do in terms either we might not sell any participation that the Bank is holding right now and not dilute our position. So, in general, I would say that it will have no -- at this point, I would say that it will have no capital impact on the Bank.

With respect of the IPO for other units, there's nothing on the table. So we have no plans for IPO in any other unit of the Group.

A - Angel Santodomingo {BIO 15757370 <GO>}

There is a lot of questions around dividends. And the policy, the Group policy and the relation or comments coming from Bank of Spain, I will try to name everybody here. But Francisco Riquel from N+1; Jaime Becerill from JP; David Vaamonde; Carlos Peixoto from BPI; Rohith Chandra from Barclays; Antonio Ramirez from Keefe.

The question -- or the questions are which is our position with regards to dividend, dividend guidelines and with regards to the comments from Bank of Spain, if we plan to change the dividend policy, if we plan to maintain the EUR0.60 which is about -- to me, the same question?

And if we can go into that (guideline) into 2014 also?

A - Javier Marin Romano {BIO 3961209 <GO>}

With respect our dividend policy is perfectly covered by the recommendation of the Bank of Spain and with respect to the 25% limitation on the cash payout. So we will continue with what we advanced over the -- in the shareholders meeting of the Bank, paying EUR0.60 of dividend this year and four scrips of EUR0.50 each.

With respect to 2014 I don't think it's the time to decide this now. So actually what we will do at due time is consider this on the Board and submit this for their approval at the General Shareholders' Meeting.

A - Angel Santodomingo {BIO 15757370 <GO>}

With regard to regulation, there is also several questions about DTAs; Britta Schmidt from Autonomous; Rohith Chandra from Barclays; Daragh Quinn from Nomura; Carlos Peixoto from BPI; Francisco Riquel from N+1; and Antonio Ramirez from Keefe.

The summary of the questions will be if we expect to benefit from any changes in DTA treatment, or the Spanish regulation treatment; if we would consider using the DTA State guarantee. And under what conditions?

What are the changes that we expect to take change here in Spain, to take place here in Spain? And if we can brief what are the DTAs in Spain. And what is the breakdown in between insolvencies, pensions and the rest?

A - Javier Marin Romano {BIO 3961209 <GO>}

Okay first thing what we would love to have in Europe is a level playing field for everything, including the consideration of the DTAs as capital.

Having said this, today out of the DTAs we have EUR6 billion of DTAs that come up basically from provisions and the pensions. We're not in any negotiations, of course. And our only plans today are that over the next five years our recurrent profit in Spain will bite more than 100 basis points into these DTAs due to the generation of profits in the country.

So we're not expecting nothing from this negotiation. And the homework is to generate the profits in Spain in order to bring this litigation into truly a strong capital.

A - Angel Santodomingo {BIO 15757370 <GO>}

I don't know if you want to elaborate a little bit more, it's a question from Andrea Filtri, also related to the first question we made, which is on banking resolution if we are worried about the perpetuation of asymmetrics across countries in national resolution funds, if national resolution funds prevail over a single resolution mechanism for the banking unit?

I don't know you already elaborated a little bit, I don't know if you want to add some comments there?

A - Javier Marin Romano {BIO 3961209 <GO>}

Well, we need to manage what we can manage. And, actually, what we can manage is the situation of the Bank compared to our peers. The actual situation is that as I said before more than 9% of our liabilities are covered by our capital and our hybrids, which I think

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compares very favorably to our other peers in Europe. So this is basically what the -- what we are centering our efforts now and in the future.

A - Angel Santodomingo {BIO 15757370 <GO>}

A little bit in between the regulation and financial management, which is our next theme. It's a question from Britta Schmidt from Autonomous saying which are our thoughts about issuing Tier 1 capital, if we would consider to do something before the stress test. And if we can elaborate a little bit on that possibility of issuance.

A - Javier Marin Romano {BIO 3961209 <GO>}

The quick question -- the quick answer is no. We're not going to issue capital. As I mentioned over the presentation, we are very comfortable with the actual capital levels and we have no plans to issue capital, either at the Group or at the subsidiaries.

A - Angel Santodomingo {BIO 15757370 <GO>}

As I said, going to financial matters, there are several questions around risk-weighted assets coming from Francisco Riquel from N+1; David Vaamonde; Alvaro Serrano from Morgan Stanley; Frederic Teschner from Natixis; Jaime Becerril from JP; Irma Garrido from Ahorro Corporacion; Cerezo from Credit Suisse.

With regards to the evolution of the risk-weighted assets in the quarter, the question is if we could explain the evolution. How much comes from the different concepts of deleverage and models for business, or whatever?

If we can also elaborate on the models, the advanced and non-advanced models, if this is within the 67 basis points we already said in advance of our model impacts on the capital, well, as you can imagine?

If we can explain, in general terms, what is happening around the risk-weighted assets?

A - Javier Marin Romano {BIO 3961209 <GO>}

Should we split the origin of the reduction in risk-weighted assets, 50% would come from, basically, exchange rates and the devolution of the business, being a big part of that the exchange rates. And 50% would come from the internal models for operational risk and market risk, in line with what we have advanced in the previous quarters.

A - Angel Santodomingo {BIO 15757370 <GO>}

There is a question from David Vaamonde about the AFS adjustments, if we could explain them; how much or why they have taken in the quarter.

Basically, here, let me remember there is a difference in between the ForEx evolution and the hedges, not including goodwill in this discussion, basically coming from the Brazilian real. Remember that we tend to hedge the book within ranges. So we do have some initial impact from there on the capital.

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And, of course, it offset on the risk-weighted assets side, which is what Javier was just explaining why the risk-weighted assets have gone down, an important part of them.

Questions around capital, you already said that we don't want to issue. But there are questions coming from Daragh Quinn from Nomura; if we plan to raise capital? And from Rohith Chandra from Barclays and Carlos Peixoto from BPI; if we could elaborate on the evolution of the capital ratio on the fully-loaded Basel III capital ratio? What is our expectation in the evolution of this capital going forward?

A - Javier Marin Romano {BIO 3961209 <GO>}

Yes, capital ratio stands today, Basel II, at 11.11%; should go over 12% at the end of the year. Basel III should close at over 9% at the end of the year.

With respect of issuing capital, we're not going to issue capital.

With respect to Tier 1, in terms of preferred shares, we're not planning either to substitute any of our preferred shares, our first scenario. And I will hand over to mike now to Jose Antonio to elaborate a little bit on this. So that for the next few years, we are very comfortable with our core tier capital and we should not begin to issue preference shares in order to gross up our Tier 1.

Jose Antonio, do you want to elaborate a little bit more on this?

A - Jose Antonio Alvarez {BIO 19692884 <GO>}

Well, as you said in the capital ratio -- the core capital ratio's what you said exactly, we don't see any need.

And I mentioned with the additional Tier 1 and lower Tier 2, the new instruments deciding on the Basel III regulation, well, first thing to say additional Tier 1 is not crystal clear yet. We don't need in this year, neither year nor next year any Tier 1.

But going forward, two years from now, probably, we start to issue according to the new regulations, that is still not known, 100%, what the Tier 2 and additional Tier 1 to cover eventually the 1% and the 1.5% contemplating the regulations. But not now. We are not expecting to issue anything in the next couple of months.

A - Angel Santodomingo {BIO 15757370 <GO>}

To finalize with capital, there another question Mario Lodos coming from Sabadell Bolsa, if we plan any mitigation measures with regards to the potential negative impact on capital, like selling more assets or any kind of de-leverage action? But I understand we don't plan anything.

A - Javier Marin Romano {BIO 3961209 <GO>}

We have no plans.

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A - Angel Santodomingo {BIO 15757370 <GO>}

Liquidity, there are several questions here. If we could update our refinancing schedule, the exposure to the ECB and ECB illegible assets?

And if you want to link to that, what is the current ALCO portfolio, both what is the sovereign exposures and the contribution to NII?

A - Javier Marin Romano {BIO 3961209 <GO>}

Jose Antonio, would you please help me with the question?

A - Jose Antonio Alvarez {BIO 19692884 <GO>}

Yes. Well, you start with liquidity, you show the trends in the presentation. In Spain and Portugal, the leverage is going on. We are growing faster in deposits than in loans. So the pick up -- the loan to deposit is falling all across the Group.

So, the amount of issuance compared with the maturities will be in the region of -- may be in the region of 30%. So, probably to talk about 30% in issuance compared with the maturities is something that probably reflects the issuance of the Group going forward, on average. This naturally depends on Europe, means we're going to be pretty active on securitizationing in Consumer, in the Santander Consumer Finance business, also in Santander Consumer US. And you're going to see some issuance from the UK and the parent company. But, as I said, 30% up, roughly speaking, of the maturities.

In relation with ECB, we will pay, in the First Quarter, LTRO. We have around EUR5 billion/EUR6 billion in Portugal. This is the main funding we have from the ECB.

The ECB illegible assets, I have the number on the parent company. But it should be in the region of EUR100 billion. So, we are not using it. But it should be in this region. I don't have exactly a number here.

ALCO portfolios, you see in the balance sheet, a few changes here. So mainly in Spain, we keep a portfolio in the region of EUR35 billion, the same than in the previous quarter. We reduce our portfolio, ALCO portfolio in the US, we disposed 60% of the mortgage-backed securities. We've had in this portfolio, around EUR6 billion/EUR7 billion in the quarter. We reduce also the portfolio in Brazil, like EUR4 billion/EUR5 billion.

So all the other portfolios remain the same; EUR35 billion in Spain; EUR3 billion or 4 billion Poland; we are in the region of EUR10 billion Brazil; EUR10 billion US compared with the EUR18 billion/EUR19 billion we had before. And those are the performance.

In relation with the sovereign exposure, all the ALCO portfolios but US, basically, what they have sovereign exposure. So they have sovereign exposure, all the local tertiary. So that means in Brazil, Brazilian bonds, in Brazilian reais; in Mexico, Mexican bonds, in Mexican pesos. But sovereign where we have, as I already said, (MBSs), (inaudible) (MBSs) in the ALCO portfolio.

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A - Angel Santodomingo {BIO 15757370 <GO>}

We're going now with different questions on the same items. Frederic Teschner from Natixis; if we could explain the evolution of the core Tier 1 in terms of profit and ForEx? I think Javier has already elaborated on the risk-weighted assets; that basically, they come from exchange impact in business. And the rest is the other half of the variation is models that we already advanced to the market.

Carlos Garcia from Soc Gen asks if it is defined the SIFI buffer of 100 points for Santander. The answer is yes, it is defined as such. As you know, it's renewable. But this is what we have in comparison, as also was mentioned in the presentation, with our peers; that range between 150 to 250 basis points of buffer.

And if we could elaborate on the leverage ratio, how it would look like with all the calculations? We have tried to put IMF criteria, which we think, given the (validity) today of leverage ratios, that was a more neutral one to present to the market.

Ignacio Cerezo from Credit Suisse asks that the continuous downwards trend of the loan-to-deposit ratio in Spain, if it makes the Bank think in a more aggressive way, in terms of lending in Spain, if we could increase aggressively the lending in Spain.

A - Javier Marin Romano {BIO 3961209 <GO>}

What we want to do in Spain is growing clients, right. So if we need to grow deposits at some point, or we need to grow it, great, it's basically what our plans are demanding and what we want to do. We are not going to relax our practices. And our policies with respect to risk, which has been stable over the time.

So once the economy recuperates and we have -- and there's more demand for credit, definitely we will grow. We want to grow our market share? Yes, we want. But this will not be done at the cost of relaxing our risk standards.

A - Angel Santodomingo {BIO 15757370 <GO>}

Going into risks, which is our third group of questions, we have an initial one about restructured and refinanced loans. They come from (inaudible), Francisco Riquel from N+1; Ignacio Cerezo from Credit Suisse; Patrick Lee from RBC; Rohith Chandra from Barclays.

They basically ask around the provisions that we have for both restructured and refinanced loans, the change that we have announced of EUR2 billion from substandard to NPLs, if we expect additional provisions from this change or going forward. And in general terms, if we could explain the movement?

A - Javier Marin Romano {BIO 3961209 <GO>}

Our portfolio of refinanced loans comes to EUR33 billion. It's stable; it's been stable over the year. And we have a general provision of EUR6.6 billion for this portfolio.

The change in accordance with the Executor of Bank of Spain, basically, affects EUR3 billion of the refinanced mortgage loans to individuals. Out of this EUR2 billion have been reclassified from substandard into non-performing loans. Even though, as I mentioned before, the clients are actually paying. So we have 93% of this EUR2 billion that are actually paying and are performing. So we would like to consider this more as more technical non-performing loans.

This portfolio had already a provision of EUR300 million. That covers more than enough the needs for this portfolio, taking into account that more than 80%, we have warranties of real estate assets for more than 80% on the portfolio. So summing up, the provision and the value -- and the actual value of the real estate warranty would cover 100% of the amount of the loans.

Do we expect more provision for this? Well, this is probably the worst portfolio we have, this EUR33 billion. We believe that, up to date, it has adequate provisions in accordance with what we expect, how this portfolio will behave over the next months. And basically, that's it.

A - Angel Santodomingo {BIO 15757370 <GO>}

Okay. There is a question with regards to Spain. There's a question from Alvaro Serrano from Morgan Stanley, saying that, given our current coverage ratio of 43%, if we expect -- what do we expect in terms of provision cost of risk, or the run rate of provisions, if we could extrapolate Q2 numbers to the rest of the year, or if we could elaborate on cost of risk in Spain in general terms?

A - Javier Marin Romano {BIO 3961209 <GO>}

Yes. You saw what -- the rolling average for the last year that has been slightly above 2%. The quarter has been at 1.65% on a standalone annualized basis. And we expect his to come to down to 150 basis points over the next quarters for this year.

Moving on to other years, we look forward over -- between 2014 and '15 to go into more normalized levels that should be between 60 and 80 basis points of cost of credit.

A - Angel Santodomingo {BIO 15757370 <GO>}

That question was also made by Britta Schmidt from Autonomous, if I got it right.

Carlos Peixoto asks for the exposure to renewable energy. I think we already disclosed that we have around EUR1.5 billion/EUR1.6 billion of solar and turbo solar energy exposure. And we do not expect additional impacts coming from that exposure, apart from the cost of risk that was already mentioned for Spain of around 150 basis points this year.

Going into Brazil, there are several questions with regard to NPL and provisions. Alvaro Serrano from Morgan Stanley; Daragh Quinn from Nomura; Ignacio Cerezo from Credit Suisse; and Antonio Ramirez from Keefe; they ask even though the provisions are down q-on-q, what are our expectations for 2013. And specifically 2014.

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Why still low charges -- loan-loss charges are high in Brazil? So cost of risk has been presented in the region of 700 basis points. Why is it so high? If we think that is sustainable, drop in provisions going forward in Brazil. So it's about the same.

And partly linked to this, Antonio Ramirez asks that given the macro perspectives for Brazil, if we have changed our expectations or estimations. And if we can update in general terms credit growth activity and P&L evolution going forward.

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A - Javier Marin Romano {BIO 3961209 <GO>}

Yes. Expectations for non-performing loans in Brazil. Well, our expectation is that they will continue to come down over the next quarters. And we believe this should be also -- this drop should be sustainable also going into next year. The charges are still high. You know that we have -- you have a calendar effect. And we should see cost of grade coming down more steeply over the next quarters.

With respect to the macro perspective and our estimates in terms of growth, our estimates for growth for Brazil for this year will be around 2%. Credit, that has begun to accelerate after the stationary, very quiet First Quarter. We believe that credit at Santander should be growing at high single-digits, around 9%/10% by the end of the year.

We have -- the profile of the growth credit is more biased towards the mortgage loans for individual clients, SMEs. And less pressure in consumption, where we see there, basically, autos coming down slightly. And consumer grades that are slightly (inaudible), a little bit more than flat.

A - Angel Santodomingo {BIO 15757370 <GO>}

With regards to Mexico, there is the same question coming from Ignacio Cerezo, Credit Suisse; from Rohith Chandra from Barclays; Antonio Ramirez from Keefe; and Carlos Garcia from Soc Gen; with regards to provisions in Mexico and NPLs. So within the risk arena. What is coming from home builders, if we can elaborate on the reason on both the increase of provisions and NPLs and the breakdown; why is it increasing; and outlook going forward in the following quarters.

A - Javier Marin Romano {BIO 3961209 <GO>}

The increase, as you said, is basically due to the consumer credit and to home builders, being the big part of that basically consumer credit due to the deceleration of the economy over the first half of this year.

We expect a pickup of the economy, especially over the last quarter of this year. And going through into around 2014. So we expect the number from the launch to come down and cost of credit to remain stable at least for the rest of 2013.

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A - Angel Santodomingo {BIO 15757370 <GO>}

Poland, Frederic Teschner from Natixis asks to what extent results are sustainable, specifically linking them to the NPL rise in coverage decrease in Poland and provisions in

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A - Javier Marin Romano {BIO 3961209 <GO>}

We have two things in Poland. First, the economy is growing and we are growing with the economy, which is good. Second is we are reducing the cost of our deposit base, specifically the deposit screening from Kredyt Bank, which definitely will help. And compensate the reduction in interest rates in the country.

At the same point, we have the integration of Kredyt Bank and Zachodni with the cost synergies that we are expected. And that are very much in line or even above, not only in terms of amount. But in terms of calendar of what we previously anticipated.

In terms of non-performing loans, we have a one off related to a company, a home builder. But it's a one-off. So we don't expect this to move through into the next quarters.

A - Angel Santodomingo {BIO 15757370 <GO>}

Okay, to end the risk part, a couple of questions. One on Spain from Sergio Gamez, Merrill Lynch; if we could explain the charge in the Corporate Center of around EUR200 million due to the Santander Banesto merger, if we could elaborate a little bit there?

The second one would be from Carlos Garcia from Soc Gen asking if we expect from the AQR; that you already elaborate a little bit there, if we expect any change in NPLs, provisions or, in general terms, restructured loan classifications and FAS, additional cost of risk from the asset quality review.

A - Javier Marin Romano {BIO 3961209 <GO>}

Yes. So the first one, with respect to the charge that we have at the Corporate Center, it's EUR188 million. It's basically due to the integration of Banesto and Santander. It relates to standardized loans where we have clients that have different considerations in Santander and in Banesto. And what we have done is, basically, take the most conservative approach, being at Santander or the Banesto approach. So this has resulted in an extraordinary charge of EUR188 million, that this is extraordinary, it's a one-off and this will not continue over the next quarters.

We don't expect -- with respect to the asset quality review, we don't expect any further provisioning from the asset quality review, as we believe that within the traditional conservative policy of Santander, we have quite an early recognition of problems when we think they arise. And thus a good provisioning of the expected risks.

A - Angel Santodomingo {BIO 15757370 <GO>}

Moving to units, we start with Spain. We have different questions around net interest income coming from Alvaro Serrano from Morgan Stanley; Jaime Becerril from JP; Mario Lodos from Sabadell Bolsa. Basically, asking what is our expectation for the evolution of the Spanish NII. We had given a guidance that most of the deposit cost would benefit in the second semester of this year; if we maintain that idea? If we would expect similar

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increases of NII q-on-q going into Q3 and Q4; if we are in the bottom of the NII in Spain, or how far are we from there?

And if the limitation of remuneration of deposits -- I understand this comes from (inaudible) comments on Banco de Spain; if the new pricing of the production of deposits, if it is going to improve and how it can impact on the NII. So as you can see, all around deposits and NII.

A - Javier Marin Romano {BIO 3961209 <GO>}

Very good. Definitely we expect over the next -- for the rest of the year, a good increase in the cost of our deposits. Actually, the cost of deposits is going down -- the cost of the stock is going down monthly between 5 and 7 basis points. So that is basically what we expect for the rest of the year.

We believe that net interest margin -- net interest income has bottomed up in Spain and we expect this to be growing into this year. And especially into next year. We have already -- the reduction in yearly EURIBOR for the mortgages has already been re-priced into our mortgages. And this impact will be more than offset by the reduction in the cost our deposits, especially taking into account that our loan-to-deposit ratio stands today at 85%.

With respect to the decline margin for the asset side, we expect this to remain stable.

A - Angel Santodomingo {BIO 15757370 <GO>}

A couple of questions on Spain remaining; one is with regards to the integration in between Banesto and Santander and costs, that you already elaborated a little bit. But Irma Garrido from Ahorro Corporation; Ignacio Cerezo from Credit Suisse; and Javier Ruiz from Interdin, they all ask about given the evolution of the employees in Spain that has gone down 2% in three months and the branches are more or less stable. What is the expected evolution with regard to this integration that we expect?

If the charges that we have done in the quarter, if they are all that was expected from that integration. We announced around EUR450 million; we have not done all of it. But if you can elaborate how that is growing. And if we can expect additional charges with regards to that integration or we had on both calendar in what we announced. That was the first pending question.

The second one from Daragh Quinn from Nomura is how long do we expect Spain to maintain or to have red numbers going forwards. So if we can elaborate on the P&L, not only on the upper part, in the full P&L for fuller Spain, I guess including all the units.

A - Javier Marin Romano {BIO 3961209 <GO>}

Well, first thing with respect to Banesto and the integration with Santander, the charge. We have, the extraordinary charge of EUR270 million is not only for the integration in Spain. But also for the integration in Poland, even though of course the bulk of it is for the Spanish integration.

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The cost of integration as we advanced were EUR400 million; that is exactly what we expect. The integration is absolutely in plans, not only in terms of savings, in terms of synergies. But also in terms of a calendar.

The other question, Angel, was about ?

A - Angel Santodomingo {BIO 15757370 <GO>}

The second question is about --

A - Javier Marin Romano {BIO 3961209 <GO>}

Sorry, the P&L for Spain. Yes, P&L for Spain. First thing to mention is that our priority in Spain is to continue to grow and in loyal clients, in individuals, especially in the more affluents, where we have a very strong market share. But especially also in SMEs. So this should reflect, first thing, at the level of the financial margin with the re-pricing of the mortgages that we already set, the re-pricing of credit. And moving down the cost of deposits, financial margins should continue to improve. And we will see this much more strongly into next year.

With respect to commissions, I would say that we are having increased operations at the Bank. So we are growing again. We are market leaders in asset management with a market share close to 17%. You are seeing this impacting already this year and more into next year at the commission level and also in insurance, where we are growing very well, especially in non-credit related insurance.

With respect to costs, we will see next year a more dramatic impact of the cost synergies, of the integration with Banesto.

With respect to provisions, as we said before, we will be closing this year with the cost of credit of 150 basis points. That should also continue to be lower through next year.

So I would be quite -- fairly optimistic with respect to our expectations, with respect to the P&L of our Group in Spain.

A - Angel Santodomingo {BIO 15757370 <GO>}

Moving to UK, there is a question from Jaime Becerril from JP, if we expect additional PPI insurance claims for charges. And where are we there. We already said that we made this provision, if you remember, last -- several quarters ago, last year and that we think we are covered there. We don't expect additional hits from that concept.

And Rohith Chandra also asks from Barclays why other income negative is up in certain amount. Basically, that's a generic provision we have done in the P&L. There is nothing special there.

Ronit Ghose from Citi asks about the upper part of the UK P&L how much do we expect in terms of NII and NIM to improve from current levels. And if we could elaborate a little bit

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on both revenues and specifically NII.

A - Javier Marin Romano {BIO 3961209 <GO>}

Very good. Again, the work of the last quarters in the UK has been great in terms of creating franchise. And it's been reflected also, of course, at the P&L level.

So we've grown almost 2 million clients at a one-year to three-year offer, not only in current accounts. But also in credit cards and so on. This definitely has helped to lower the cost of our deposits. And it's a part of the impact you see at the net interest income and net interest margin. At the same time, the margins on credit are remaining thoroughly stable and we are managing quite well to manage the margins for the mortgage book.

So basically, I see this trend moving into the next part of the year, which, together with a strengthening of the economy in the UK, I think that readily will help.

A - Angel Santodomingo {BIO 15757370 <GO>}

Okay. That will make it for the UK. Now, going to Brazil. You already elaborated on Brazil. So I'm going to try to add the new questions because there is Daragh Quinn from Nomura; Carlos Peixoto from BPI; Francisco Riquel from N+1 Equities; and Benjie Creelan from Macquarie; they all ask about the macro. That has already been elaborated.

Probably what could be new is given the evolution of both inflation and interest rates, specifically on the Selic, if we could elaborate on the impact of those movements, if we think that the affordability ratios -- the improvement of affordability ratios for consumer loans could affect positively or negatively that evolution. So that on the side of volumes. And if we see a floor to the re-pricing of the asset in Brazil?

The rest are macro, volume and growth. But I think you already elaborated there.

A - Javier Marin Romano {BIO 3961209 <GO>}

What was the last one?

A - Angel Santodomingo {BIO 15757370 <GO>}

The last one was the re-pricing of the assets side and the floor of potential evolution in terms of that re-pricing on the loan side.

A - Javier Marin Romano {BIO 3961209 <GO>}

Yes. Well, first thing, with respect to inflation, inflation stands today at the 200 basis points over the level of the -- established by the (inaudible).

I don't see especially the increase -- the increase in the interest rates does not translate immediately into our credit portfolio and, as you know, you have the compulsory deposits in Brazil. So it has an initial negative impact on the profitability of our portfolio. But will

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come over the next months when the portfolio is re-priced and to have a much more positive impact over the profitability of this portfolio.

Affordability of credit, I already said that you have a very -- especially a quiet First Quarter. It's been accelerating credit growth over the Second Quarter and we see this, thus, accelerating even more for the next six months, in order to conclude the year with growth close to 10%.

And the question of re-pricing of assets, sorry?

A - Angel Santodomingo {BIO 15757370 <GO>}

Basically, the asset margin compression, if you think it has touched the floor or not, or --

A - Javier Marin Romano {BIO 3961209 <GO>}

Okay, okay. Well, I thought that it was already answered, right. So first, initially, an impact on the -- until our portfolio of credit is re-priced; that will take -- and it's a very short-term re-priced portfolio. So it will happen over the next months.

A - Angel Santodomingo {BIO 15757370 <GO>}

Okay, next unit, which is the run-off real estate unit in Spain, there is one question coming from Mirabaud from (inaudible). Well, if we could share some data regarding this unit activity in terms of sales; how it is evolving; if it's above or below expectations; how much do we expect too, in terms of activity? And if we could also add some flavor to the P&L in terms of potential evolution going forward from the current losses in which we are now.

A - Javier Marin Romano {BIO 3961209 <GO>}

Okay. Just looking at figures on this, we have sold 8,300 units over the first six months. We have reduced the level of credit in almost EUR1.5 billion. In terms of the amount of real estate repossessed that we have sold, this accounts for -- (to EUR500 million), although you see that basically the new foreclosed compared to sales have been flat, because basically the same amount.

We've made a loss of EUR337 million over the first six months and we expect -- we're basically in plan. We think this should accelerate a little bit over the second part of the year. The average discount of sales has been around 45%, slightly below what we were last year. So we're quite in plans with respect to this unit.

A - Angel Santodomingo {BIO 15757370 <GO>}

Last unit is -- we go to Mexico. There a couple of questions there; Carlos Peixoto from BPI and Daragh Quinn from Nomura. First is if we expect any impact from the banking reform, from the structural reforms. And if we think it would impact the outlook of the unit and which is that outlook, which is basically the question from Daragh Quinn.

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The second one; what is the outlook for loan growth for year-end and for 2014 in terms of Santander Mexico?

A - Javier Marin Romano {BIO 3961209 <GO>}

Well, I think these structural reforms are going to be great for the country. And they will add probably a structural 1% to 1.5% more of growth in GDP.

In terms of the loan portfolio, we expect this year to be growing in double-digits for the unit, around 14%.

A - Angel Santodomingo {BIO 15757370 <GO>}

Well, I guess that's all. They say to me that we don't have any questions on the line. So thank you again for your presence. Any questions that have not been addressed, please do direct them to the Investor Relations department and we will try to cover them. Thank you.

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