Q2 2016 Earnings Call

Company Participants

- Angel Santodomingo Martell, Executive Vice President, Chief Financial Officer & Investors' Relations Officer
- Guilherme Domingues Costa, Analyst

Other Participants

- Eduardo Nishio, Analyst
- Marcelo Cintra, Analyst
- Mario Pierry, Analyst
- Rafael Frade, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning and thank you for waiting. Welcome to the Conference Call to discuss Banco Santander Brazil SA's Results. Present here are Mr. Angel Santodomingo, Executive Vice President, Chief Financial Officer; and Mr. Andre Parisi, Head of Investor Relations.

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

Before proceeding, we wish to clarify that forward-looking statements may be made during the conference call, relating to the business outlook of Banco Santander Brazil, operating and financial projections and targets based on the beliefs and assumptions of the executive board, as well as on information currently available. Such forward-looking statements are not a guarantee of performance. They involve risks, uncertainties and assumptions as they refer to future events and hence depend on circumstances that may or may not occur.

Investors must be aware that general economic conditions, industry conditions and other operational factors may affect the future performance of Banco Santander Brazil and may cause actual results to substantially differ from those in the forward-looking statements.

I will now pass the word to Mr. Angel Santodomingo. Please, Mr. Santodomingo, you may proceed.

Angel Santodomingo Martell

Thank you. Good morning, everyone, and thank you for joining us in Banco Santander Brasil's results conference call for the second quarter of 2016.

Before starting, I would like to initiate asking for apologies to all of you given the change in the schedule time of this call. As you know, we never do this type of things and we will try to avoid them, any changes in the future, but this time, due to unavoidable issues, we couldn't maintain the announced schedule time.

Starting with the results, as you can see from the table of contents, I will basically try to cover the following: firstly, I will remind you of main figures of Santander Brasil followed by the results of the Santander Group, an overview of the macro scenario, the quarterly results highlights, evolution of the quarter in commercial activity, and finally some concluding remarks regarding what has been presented today.

Firstly, I would like to address the four main strategic pillars of the bank that are the reflection of the structural changes that we are trying to carry out within our Group - here in Brasil.

Our commercial strategy is to support customers in their business and so we'll continue investing in our retail franchise, building our multichannel platform and improving our digital channels. As a highlight, 73% of all transactions are through our digital channels already. In fact, we reached 5.5 million digital customers in second Q 2016, an increase of 36% in one year. On top of that, we have 100% of our branches covered with biometric technology already, to serve more than 2.4 million customers already registered in this tool. In fact, as of today, this 2.4 million clients have already grown to 3 million clients. Still regarding digital transformation, during the last two months, we have launched more than 10 new features on our mobile app. All these actions have been reflected in more transactionality, customer satisfaction and less complains. Indeed, as you probably have seen, in June, we've reached seventh place in the Central Bank Complaints monthly ranking, our best historical position.

The second pillar is our focus on business. Our loyal client base continues to evolve positively, reaching 3.4 million customers as of June 2016, an increase of 13% over June 2015 boosting retail results. We launched simultaneously in 12 countries, the Select International global services, a global offer of products and services, which reinforces our position as the only international bank with a scale in this country, in Brazil.

Additionally, we remain strengthening our credit cards and payroll loan businesses. The total loans of these segments grew 1.6% and 7.2% in the quarter respectively and we are also having a greater role in the agri business.

Moving to our leadership position, I must say that we are widely positioned from an integrated offer including wholesale and retail services and products to our clients through a strong and already existing platforms.

Let me underline some of them. Global Corporate Banking, GCB, which is already the leader in project finance and forex operations. Taking advantage of our leadership in consumer finance, we are launching a new digital platform and new partnerships. Getnet was the first to accept all credit cards brands reflected in a continued gain of market share. Finally, we are investing and gaining market share in the asset management business. In fact, we gained 62 basis points of market share in the retail segment in the year, growing more than any of our competitors.

Finally, with regards to the fourth point, efficient management, I will underline the following points. Execution of our liabilities, business plan delivers initial results as you will see in the following slides. Efficient and new initiatives maintain expenses growth much lower than inflation. The gap between costs growth and inflation was 370 basis points, almost 4 percentage points in the first semester of 2016. NPL ratio has decreased 10 basis points due to our state-of-the-art risk management tool, our knowledge of our clients, models, et cetera. Finally, capital structure and liquidity position remain quite solid.

So, moving to slide 8, today, Santander Group, as you probably already know, already presented second Q results, generating a net profit of more than €1.6 billion. The Brazilian unit results are very important for the group. In fact, Brazil represented 19% of the group's results in the first semester of 2016.

Returning to our country and moving to the macro slide, regarding the macro scenario, it is clear that the country continues to undergo an adjustment process. But also it is clear that we already have several economic variables pointing to the start of at least a stabilization period.

On the monetary policy front, it is worth mentioning the clear communication from the central bank to bring the annual inflation to the center of official target as soon as the end of 2017. Having said that, inflation is expected to finish this year at around 7%, falling further throughout 2017, providing plenty of room for a less-restricted monetary policy.

On the foreign exchange side, commercial and financial flows have been large. Rolling 12-month trade surplus at $40 billion, whereas foreign direct investment in the same period amounted to as much as $79 billion. Such inflows and momentum should lead Brazil to remain relatively strong in the short term. In fact, when you guesstimate the current account numbers and the gain, we maintain a lower than 2% in fact 1.7% current account deficit in the country, which are levels as you may imagine quite comfortable.

Lastly, we believe that a combination of improved confidence and the government capability to put in place the structural reforms coupled with fiscal consolidation will lead to an increase in public and private investments focused in improving productivity and consequently resuming growth.

Moving on now to our performance on slide 12. We believe that we have presented a sound set of results. Starting by the balance sheet issues on the gray boxes. The bank's capital and liquidity position remains comfortable. The loan portfolio, obviously, is reflecting the economic scenario while asset quality metrics remain stable with our coverage ratio increase and our cost of credit that reflects the current environment.

With regards to P&L, revenues performing positively due to more customer transactionality and efficient management of expenditures are reflected in evolution of costs. Finally, all these issues result in a net profit that climbed almost 9% in the quarter reaching BRL 1.8 billion. The best result of the last five years.

Moving to the specific performance. As mentioned before, you may see in the slide that we totaled BRL 1.8 billion net profit in the second quarter of this year with the 8.8% growth I was just mentioning.

In the first half of this year or compared to the same period of 2015, net profit increased 4.8% which underlines that we are on the right path for a sustainable and more resilient results. Resiliency is one of the main issues of Santander Brazil as we have been delivering results during the last years in a continuous way quarter-over-quarter.

On slide 15, we show the main lines of our results, about which I will go into more detail later on in the next slides but when we give you the main issues around the P&L.

Regarding revenues, net interest income increased by 2.8% over the first quarter of 2016 and 5.4% over the first half of 2015. Even with volumes, as I already said reflecting the current macroeconomic scenario.

Fees increased 7.7% in the quarter and posted a strong year-over-year upturn of 11.9% already a double-digit growth.

On the expenditure side, the allowance for loan losses increased in a controlled manner by 3.7% in the quarter and presented a growth of 11% year-on-year in the first semester.

General expenses were stable in the quarter and grew by 5.1% in the first semester of 2016 over first semester of 2015, which is still and well below inflation as I mentioned before. As a result, net profit totaled BRL 3.5 billion in the first half of this year. This set of result as you probably know had been well above the market consensus in all lines of the P&L.

Slide 16 shows the evolution of our net interest income, which totaled BRL 7.8 billion in second quarter of this year, 2.8% higher than the previous quarter and a 4.4% in year-over-year comparison. This increase - and this is an important point about the NII, was wider spread among the sub segments. The NII from clients, which is both on the asset and the liability side, increased despite the weaker volumes boosted especially by spreads, as you can see at the right of the chart with both the credit and the funding spread increasing substantially during the last quarter or two quarters.

So, credit and NII improve the spreads coming from a change of mix and higher prices. And with respect to the client's deposits, NII and the spreads already reflect the first signs of our efforts on liability management that I have commented to you in past quarters. Additionally, we had another quarter of good performance in market activities. So, the three concepts that are there in depth (15:31) in the NII have had good performance.

Moving to volumes, in the next slide. The expanded loan portfolio totaled BRL 308 billion, which represents a decrease of 1.2% in the quarter and 4% in the last 12 months. Obviously, it is a natural tendency given the still poor macroeconomic scenario. In any case, if we adjust by the Forex valuation, the portfolio would have been stable in the quarter.

By type of client, it is worth noting the performance of the individual portfolio which increased by 1.4% of the previous quarter and 6.5% in the last 12 months. Payroll lending and mortgages continued to be the main growth drivers.

Consumer finance increased by 2.3% Q-on-Q reflecting the weak vehicle market. In any case, our model is extremely efficient. And we were consequently able to gain 30 basis points on markets in the year in the current rate scenario, maintaining our leadership in the car financing industry. Both the SME and the large corporate portfolios obviously, again, reflected – mentioned weakening derived (16:55) from the macro scenario.

On slide 18, you can see our funding evolution. Total funding including off balance reached BRL 518 billion, an increase of 1.1% in the quarter and 5% in 12 months. Funding from clients increased 1.7% in the quarter and 4.5% in 12 months. Then, the underlying – the positive performance of the non-deposits growing both in 12 and in 3 months reflecting the greater customer linkage.

Additionally, this increase in customer penetration is also reflected in our assets under management evolution which increased and is climbing (17:39) 5% in three months and almost 26% in one year. 6% in one year gaining 62 basis points of the markets are in the retail segment.

Moving to commissions, as we have been saying, fee revenues growth is a consequence of our improvements in product and services portfolio couple with great linkage of our customer base. As a result of these improvements fees posted an outstand evolution in second Q 2016. On the quarter fees increased almost 8%, 7.7% with an almost widespread growth among concepts especially those that referred to transactionality such as current account in cards.

Total fee income came to BRL 6.4 billion in the first semester almost 12% higher than the same period last year. So, it is particularly worth nothing that fee revenues already reached the expected double digit growth for the full year.

Moving to asset quality on slide 20. I have to underline several points. The 15 to 90 days overdue portfolio showed an increase of 70 basis points in second Q 2016 basically explained by specific corporate case and consequently it does not suggest a widespread worsening in the second. In fact, excluding this effect, the overview portfolio would have an increased only 20 basis points again continuing a marginal deterioration that reflects a macroeconomic scenario.

NPL over 90 days remains controlled and at comfortable levels especially considering the mentioned again (19:32) macroeconomic situation. On the quarter, it decreased 10 basis points, with an improvement of 30 basis points in individuals and an increase of 10 basis points in corporate. This continues to reflect that our regional (19:46) is strong and solid. And that all measures taken and commented to you during the last two to three years are proving to be right. The coverage ratio reached a comfortable and historic level of 209% in the quarter.

On next slide, the allowance for loan losses reached BRL 2.5 billion in the second Q of 2016, an increase of 3.7% in three months and 7.6% year-over-year. (20:19) the credit cost increased by 30 basis points, in return to four Q 2015 levels. We continue to see evolution under control and in line with the economic reality of the country.

Moving to slide 22. We reinforce one of our main pillars, given that cost control is a cornerstone for Santander to grow in a sustainable way. In fact, in second Q 2016, total expenses were stable due to the strong and efficient internal (20:53) Q2 culture implemented already for some time now. Expenses totaled BRL 4.4 billion with an increase of just 0.3% so almost flat in the quarter and 5.1% in the first semester. If we compare this with inflation levels, the almost flattish numbers in the quarter compared with a 1.75% inflation, so we saved almost 2 percentage points in real terms, and year-over-year the 5% compares to almost 9% of inflation, so again, saving close to 400 basis points, exactly 370 basis points in real terms.

Going forward, we remain committed to maintain these cost control disciplines. And as we have mentioned in several occasions, we expect to deliver expense growth below inflation for the fourth consecutive year in 2016.

The next slide presents our performance ratios, which have also a general and specific improvement. Efficiency improved both quarterly and yearly and reached 48.5%. Recurrence in the same way moved and increased from 72% to 75% or to over 75%.

Every time that we improve this indicator, as you know, we bring more predictability and resilience to our results. Thanks to these advances, return on equity increased again to 13%. We remain committed to continuously improve our profitability. And all these have been done with an improvement in both liquidity and capital ratios.

On the slide 24, you may see that our liquidity and at both of the ratios, liquidity in capital, as I mentioned, remained solid with a stable funding sources and an adequate funding structure. The loan-to-deposit ratio reached or was below 85%, which is quite comfortable. This ratio stood at 17.7% with an increase of 120 basis points over the previous quarter.

Our capital ratios remain, as I mentioned, solid with our core equity Tier I level, embed in the ratio I mentioned, of 15.3%. And our Tier I ratio, capital ratio as you may see there of

16.5%.

So, finally, in the last slide, from our second Q results, I would like to highlight the following points. First, that the results with improvement in performance indicators. I think they are solid and, as I mentioned, shown recurrence here. Second, customer experience that is positively impacted by new services and digital channels.

Third, fee growth reflects our strategy of increasing clients linkage and transactionality. Fourth, efficient management expenses or efficiency in management of expenses continues to be one of our cornerstones. Fifth, the excellence in our risk models and risk control continues the positive evolution that we have seen in the last two years even with an uncomfortable scenario.

Finally, as I mentioned in the previous slide, comfortable levels of liquidity and capital. Additionally, we have an engaged team, enough infrastructure of capital and an integrated commercial model with important competitive advantage in the local market. All in all, it ensures that we are well-positioned to deliver higher profitability and sustainable growth, executing the structural changes that I have mentioned within the bank.

Thank you. And we are now available to answer your questions.

Q&A

Operator

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

Q - Mario Pierry {BIO 1505554 <GO>}

Addressing asset quality. First question is from Mario Pierry, Bank of America Merrill Lynch. Has the bank made any provisions related to the one specific, large corporate case that had an impact toward NPL (26:06) in the second quarter 2016 or will the bank use its excess reserves? Can you comment in what segment has this large corporate operate?

A - Angel Santodomingo Martell

Thank you, Mario. Well, I don't know it is a traditional issue and way of presenting results in Santander Brazil, we do not comment on specific names. Obviously, what I can mention is that we already had provisioned an important chunk of this corporate that we are absolutely comfortable with the levels of coverage that we have.

And probably also linking with this what we also did was we moved – provisioning that we had done in the past from what it is called additional, which is a kind of a non-specific provision to request it given the change of status that these name had. And you can see that in the information we have presented.

But the specific equation I must say that the levels of coverage that we have – and I would say not only that name, obviously bring attention because of the change of 15 to 90 days. But I would say in general terms, as we have been proving quarter-over-quarter continuously the levels of both coverage and provision that we have today with specific names and general names, we feel absolutely comfortable. We haven't given a single surprise in that sense.

A - Guilherme Domingues Costa {BIO 17950499 <GO>}

Second question from Guilherme Costa, Itaú BBA. We know that yearly (28:06) delinquency rate increased materially, as well as the NPL ratio overdue by 60 days. You have commented that increase in the year end NPL ratio is due to one specific corporate line.

My question is do you expect a deterioration to occur in the portfolio overdue by 90 days or this will be normalized in the next quarter? Moreover, could you comment on how much you have a (28:33) provision for this client or if you expect to book additional provisions?

A - Angel Santodomingo Martell

Well, I think I already mentioned and answered the last part of the question. We expected to go through nonetheless. Well, obviously, it will depend on the situation of the client. What we do is we reflect the reality of the clients. We do not change that reality. So, if the client continues to be in the same situation, it will naturally flow to the over 90. And if something change during the close of the quarter, then it will not move. I cannot anticipate anything now because I really do not know. But again the same comment, this is one case that brings attention but the policy, the provisioning and the way of covering this type of cases is general across the board and does not change depending on individual names.

Q - Operator

Next question is from (29:58) of Deutsche Bank. How did consumer NPLs improve? Can this continue or else these are one-time improvement? Why did provisions increase if asset quality improved? Can this be a pick (30:11) for the cost of risk?

A - Angel Santodomingo Martell

Well, in general terms, what are we seeing on credit quality, obviously, we are seeing the NPL ratio improved a little bit in the quarter due to the retail individual's evolution. This has several things to do. I mean, has to do with the mix. Remember that we are growing in what is called (30:42) in payrolls. We are growing significantly in both payrolls and real estate and that gives – should trend to give you lower pressure on both NPL ratios and cost of risk. This is one question. One issue.

There is another issue which is, as you know in car financing, the book is going down. So, naturally, in a sector that is suffering significantly, the book is going down and that also should be reflected in an activity that if you analyze – I don't know, in the last five years or seven years, at least we (31:23) – I think this is something applicable near terms to the sector. But we have clearly moved to, for example, asking more equity to our clients when they finance their cars, et cetera, which at the end of the day improves in credit profile of your clients.

The relation in between NPL ratios and credit quality has a lot to do with how you move into – from NPL clients or early NPL clients to final provision. It is not directly linked on a quarterly basis as you can imagine. And then you have a lot also to comment in terms of recoveries and in terms of how you prevent clients from going into NPLs.

We are doing a strong job and this is something that the group has a know-how already that has been shown to the market, I would say, during the last at least seven, eight years in which we know how to deal in these low cycle moments, we know how to deal with clients and we know how to treat early delinquencies and we know how to prevent delinquencies.

Maintaining the levels of renegotiation, maintaining the levels of restructuration, so I'm not saying that we are changing at all criteria, in fact, criteria has restricted us, it has been in the past. But it is true that we have some knowhow there and we are showing it and I think that the numbers are quite clear in a sense.

Q - Eduardo Nishio {BIO 15333200 <GO>}

Next question is from Eduardo Nishio, Plural. The evolution of your results were relatively good compared with the economic conditions and perhaps your peers. How do you see the environment for asset quality in the next few quarters? When do you think the peak of delinquency will be?

A - Angel Santodomingo Martell

Okay. Yes. I do agree that the macroeconomic scenario continues to be negative. Obviously, we continue to have an environment in which activity levels, GDP, et cetera, are in the clearer negative territory. But I have to say that during the last two, three months, we are starting to see clearly variables that show us that at least an stabilization process is starting; if not, the initiation. And then, we mark initiation phase, the initiation of small recovery.

And speaking of industrial production or GDP, I am speaking of sales through credit cards, I am speaking of confidence, I am speaking of different variables which tend to be leading indicators that the lower part of the cycle has been passed (34:46). Does that mean that we are going to start seeing strong positive rebounds in the very, very short term? No. But I wouldn't be surprised if third Q shows, I don't know, a flattish behavior or around flattish behavior compared to second Q. Or we start to see positive evolution in four Q. If that is the case, and then we underline, if that is the case, what we would normally have is going into 2017 two things: we should start to see some volume pick-up. Obviously, it would be different by type of products and segments, but some volume recap. And obviously at some point also linked to unemployment, but at some point, the peak of NPLs.

The peak of NPLs to be quite honest, I tend to be quite skeptic (35:44) about giving up a point of time because it tends to lack and tends to move around the peak of unemployment to move around the low part of the cycle, and it is difficult to estimate. But with that macro scenario, I would tend to see that going into 2017 we should go into the year with a more positive view about those values.

A - Operator

Changing subject now to NII. Next question is from Flavio Yoshida of Votorantim and Mario Pierry from Bank of America Merrill Lynch. We observed another round of spreads improvement but we would like to know the management expectation towards spreads going forward given the fact that Selic rate will likely start to trend down around this year.

A - Angel Santodomingo Martell

Well, yes, you are right, Flavio and Mario that we have been able to increase the spreads on both sides of the balance sheet. I will probably tend to differentiate a little bit in between assets and liabilities.

On the asset side, we have done an effort there trying to bring some of our spreads to higher levels given both the general situation and specifically the financial sector situation. In some cases, we have to increase them because we were below the market practices. In other, they were due to the specific way that we have here in Brazil in terms of the linkage of directed loans, the linkaging with, how we are funded on the liability side and I'm speaking specifically of real estate and things linked to that.

On the liability side, I had mentioned in previous quarters that we already started, I would say, two quarters to three quarters ago, a liability trend by which we started to analyze and to remodel our way of looking to liabilities and that has to do with prices but it has to do with mix also and it has to do with where we put the focus.

So, in both sides of the balance sheet, you have management of prices. I have to underline the mix effect; please do not forget the mix effect on both of the issues.

In going forward, what we will try to do is maintain the positive impact coming from the spreads until we start to see some help from the volume side. I would say that probably this is the natural trend not only of Santander Brazil but in general sense in the sector because, when you start to see some help from the volume side, normally the pressure on the spreads also trend downwards. That this would be the strategy now going forward.

A - Operator

Moving forward to effective tax rate and a question from (39:09). We saw that you shown an increase in effective tax rate due to a lower depletion (39:15) of tax credits. Can you comment on your expectation for the effective tax rate going forward? Will the benefit of the depleting (39:22) tax credit or will it continue to decline?

A - Angel Santodomingo Martell

Well, this is – thank you, (39:29). This is a question I always answer every quarter. And I continue to see the same trend. I think that the normal trend is marginal but upwards in that that should happen and continue to happen in the next quarters going into 2017 and going into 2018. So, I would say that the natural trend is upwards. I wouldn't expect big jumps, but a trend in that way.

A - Operator

A question from loan portfolio, (40:11). Do you expect to see a pick up in the loan expansion in second half 2016? Which segments are expected to lead the portfolio expansion in the second half and in 2017?

A - Angel Santodomingo Martell

Well, I elaborated a little bit already on the portfolio side, but I will say that here you have a different analysis. You have by sectors that, obviously, you have sectors in the economy that are directly linked to domestic consumption which are suffering more and those, up to now given the real movement because in the last month or two months, the real has moved the other way around, but up to that moment, the export sectors that were doing pretty well and were kind of the leading the volume evolution.

In terms of retail, I will say that payrolls will continue to grow nicely, probably real estate also because demand is there. We do not have any kind of Basel (41:17) or similar things on the real estate sector here. So, there is a need of growth there. And I will also underline probably lending linked to infrastructure. We have a lot of interest from outside the country in the potential plans of infrastructure. That will pop in money from outside, and I'm sure that also domestic clients and domestic investors will clearly be interested in that type of loan evolution.

A - Operator

Regarding fees, question from Domingos Falavina, JPMorgan. How much did the Santander Select contributed to 26% increase in current account fees? How much was price increase? What is the fee growth expecting for the year?

A - Angel Santodomingo Martell

Okay. Thank you, Domingos. Let me elaborate a little here on fees. What are we doing here? First, as usual in the presentation what we are doing is reflecting that increase in linkage, increase in transactionality, and that has to do with current account, has to do with cards, has to do with general movement of fees and tariffs of our clients. Santander Select which is an important part of our commissions are widely spread through the different commissions.

Another set of measures that we have taken, we have been trying to adopt the usage of things like credit cards to our clients. For example, we used to have a credit card that was for free and we had times that did not use it. Now, we have changed the way of charging and the way of fees linked to those credit cards, by which if you use it, you continue to have it for free. So, we have a lot of clients on that specific credit card that are starting to use that credit card, which was no use before. They are still not paying those fees, but they are generating and we are and the like.

So, I will say, those type of decisions or measures that are being taken, in which you have a win-win situation between the client and the bank, will continue to be reflected on the P&L and specifically in commissions. We are totally convinced that we have an specific space there, to continue improving and as I said, with a win-win situation with our clients.

A - Operator

Other subjects. Question from Alessandro Arlant, Bank of America. Can you please remind us of your dividend payout policy? Has it increased over the last couple of years? Is there any restriction from the Central Bank of Brazil for Santander Brazil to make extraordinary dividend payments to its parent?

A - Angel Santodomingo Martell

Okay. With regards to the – as I mentioned in past quarters and the way – how do we manage capital and capital back to our shareholders, we manage it through payout. As we have been during this year. We made in a specific operation as you know, two-years-and-a-half ago. But in general sense, what we're trying to do is manage it through payout. This is up to the board, but as you know in the past, we had been optimizing the payout in local terms, in (45:09) by which it has been close to 90%. This will have to be decided and talked at the board level. But I would say that the payout policy going forward, we'll try to maintain a kind of way of doing similar to the past. I cannot anticipate obviously levels of payout because as I said it's up to board but, I think we have been remunerating the shareholders nicely during the last two years. If I remember well in 2015, yield was close to 4%, which was probably the largest within the financial sector and we will continue to try to remunerate our shareholders in the way we have planned.

A - Operator

Next question is from Mario Pierry, Merrill Lynch. What impact do the uncertainties in Europe relate to the Brexit and (46:07) capital ratio of the group have to Santander Brazil? Does it mean that Brazil might be required to preserve capital? Does this diminish the appetite for acquisitions?

A - Angel Santodomingo Martell

Well, I will – thank you, Mario. I will speak or try to answer the questions related to Santander Brasil more than to Santander Group. In terms of Brexit, the reality – this is a reality both for Santander Brasil and for the Brazilian economy is that the impact for this country is low. It's low because the dependence to UK both in financial terms and in structural terms, in trade terms, et cetera, is low. Obviously, if it affects the general growth at the world level, it will affect the demand to this country and that will also mean obviously lower activity. But that is a little bit, I think long in terms of time. Negotiations are starting to take place in Europe and I don't see a short-term impact happening in the next quarters or even in the next year.

In terms of capital and in terms of acquisitions and how do we manage this, I have spoken about this in the past. I mean, we think – I think that we have the fiduciary duty to analyze any opportunities, organic and inorganic, that may arise within our financial sector or country. So, in this situation, if in Brazil, we have opportunities, we will obviously analyze them. We will analyze them from a strategic point of view. We will analyze it from a financial point of view and if we hit our goal on both of them, we will try to go.

This happened in the past, and we have been quite open about this. For example, HSBC in which we – it did have an strategic sense and we analyzed it to a maximum in financial terms and this is what we did and we stick – and at that time, we stopped at a certain level, sticking to that financial strategy basically.

So, I would say that yes, we will analyze potential inorganic movements and with that analysis, if we come to a positive end, we will try to execute them. There are times our position or strategic situation here is that we feel the bank is well-positioned and as we had done in the past probably what it makes sense is in very specific, small gaps that may add value to products or to segments, we may think of movements, but again, following the fiduciary duty that we have to do.

And in terms of capital management, I think I already addressed the issue. We plan to manage this situation through payout for the time being, but this is up to the Board.

A - Operator

Andre Parisi here, the Head of Investor Relations, is saying to me that I think we open now for Q&A. Yes. Okay. So, we are open for direct Q&A, if any.

Thank you. We will now start the Q&A session for investors and analysts by telephone. Our first question comes from Mr. Rafael Frade from Bradesco.

Q - Rafael Frade {BIO 16621076 <GO>}

Hi. Good morning, everyone. It's just a follow-up on the NII question. If you could give a rough (50:00) this spread basically flat and we saw a good improvement this quarter, I would like to understand if this is on the level that – from the level probably we should see, hear some improvement for the coming quarters or not. If you could elaborate a little better on this.

And also on the liability side, also if you believe that already been, let's say, in the best point in terms of the improvement or do you believe that you can have more improvement in the spreads for the liability side?

A - Angel Santodomingo Martell

Okay. Thank you. Well, if I were on your side, I think that extrapolating 40 basis points per quarter on the asset side is, I think, is a little bit optimistic in terms of thinking an extra one, two, three years. I would say that the efforts on the asset side will try to continue to be there, but only – it obviously depends a lot on the mix effect, on the general situation and on the demand that we have in the different segments. I wouldn't extrapolate it exactly those 40 basis points going forward.

On the liability side, it's another story; as I already mentioned, this way of looking to liabilities both in terms of mix and in terms of prices, in terms of what should we have from the different segments and from the different process, and how we should manage the funding of our assets. I mentioned the plan, I already gave you some details, so on that side I would say that we should expect a continuous improvement both in NII terms – in NIN terms and in a spread terms.

Obviously, this is an execution that is not an issue of a quarter revolution, this is a trendy situation and we will continue to execute it within the following quarters. I'm speaking of several quarters, not any specific one. So, I would be more positive on the liability side, around the asset side and specifically as we had a question before, you speak about the – obviously there's a (52:34) et cetera that as some point may have impact, offsetting or not by the (52:41) issue.

Q - Rafael Frade {BIO 16621076 <GO>}

Okay. Perfect. Thank you.

Operator

Our next question comes from Mr. Marcelo Cintra from Goldman Sachs.

Q - Marcelo Cintra {BIO 16463628 <GO>}

Hi. Good morning, everyone. My first question is actually a follow-up on the NPLs and coverage levels. Looking at your additional provisions, we know that there was – like it lowered by roughly BRL 400 million and when the bank constituted increased the excess provisions in first quarter last year, it was considerd a non-recurring event. I just would like to better understand, if you continue to use this additional provision, this will still be considered as a recurring event as well as this quarter, and what's the level of additional provisions that you would like to extrapolate if it could drop to, I don't know maybe BRL 1 billion and then I will follow up for my second question. Thank you.

A - Angel Santodomingo Martell

Well, as you said, I mean, what we had there was an additional provision of around this BRL 400 million that you are mentioning if I understood all the questions because it was a little bit fluffy, the sound. In that, what happened is that it moved to a requested provision which is the G, I think it's in the G area or the G level of classification.

With that provision being specifically allocated, I mean, being specifically allocated, as I said to you before, I'm not going to give specific levels of coverage, but we are more – now, the underlying more than comfortable in this case. And as I said to you before, I mean, this kind of brings attention because we're speaking of one name, because 15 to 19 days, but this is conservative in general way that we have of dealing, you don't see here obviously smaller names, but this does not change at all the way we function. I remember fourth Q results, I came that day saying to you guys, today, we have an specific name that has not been signed and we have 15 to 90 days picking – I don't remember how much, but it was picking strongly up and well, this is how live it is. I mean, part of our cost is obviously cost of credit and we have to treat it in a homogenous, coherent and recurring way and this is what is happening exactly here.

Q - Marcelo Cintra {BIO 16463628 <GO>}

Okay. Thank you and if you on asset quality, we also noted that there was roughly BRL 220 million of portfolio sale, apparently, you mentioned that it was (55:37) in this level. I just would like to understand if there was any impact on your NII regarding this asset savings as immaterial?

A - Angel Santodomingo Martell

Firstly was immaterial and secondly this is totally (55:53) business as usual issue that we try to optimize. I think we have addressed this in past times. What we do is we analyze the portfolio and we try to determine if it makes more sense to maintain the portfolios inside or outside. We analyze them and you have every single quarter a small amount depending on the quarter of portfolio being sold. So, the reality, the total business as usual in total margin.

Q - Marcelo Cintra {BIO 16463628 <GO>}

Okay. Perfect. If I may ask a third question, today, we saw the Santender Group, basically the (56:38) in order to do a partnership on the (56:41) management side. I just would like to understand from you, if this movement could change the strategy for Santander Brasil, (56:51) have its own asset management as the other local banks does or even acquire back the Brazilian operations or if it doesn't change the strategy for the local business that you have.

A - Angel Santodomingo Martell

For the local business, it does not change anything because remember we are speaking of a factory here. So, what the local business does through branches is specifically sell those funds that you saw was we're growing 25% on an annual basis and that commercially and strategically speaking does not change a single point.

Obviously – and I don't know and I don't want to speak in Santander Group's name, but obviously, if Santander Group makes some movement, we will analyze it, but it will always be in the arena of the factory, not on the arena of what we sell and how the branches are remunerated. Remember that – I don't remember, I know it was 75%, 70% or 80% of the fees remain in the branch and the rest are allocated to the factories. So, we are speaking of that part of the factory, okay.

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

First of all, I didn't do it in introduction, but I want to do it now which is we have to welcome Andre Parisi, which is being incorporated to the Group as Head of Investor Relations, and in Santander Brasil and he's been the person who has been kindly introducing the questions that you send through the website written.

And secondly, my final remarks are that I hope you found these results as solid and recurrent as we feel they are, which reflects our continuous trend of what we have been doing during the last years and quarters. We expect to continue delivering in the same direction, and we look forward to seeing you in next results. Thank you for attending, and let's look forward for next quarter.

Operator

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