Q1 2017 Earnings Call

Company Participants

- Andre Parisi, Head of Investor Relations
- Angel Santodomingo, Chief Financial Officer

Other Participants

- Carlos GomezLopez, Analyst
- Carlos Macedo, Analyst
- Guilherme Costa, Analyst
- Marcelo Telles, Analyst
- Mario Pierry, Analyst
- Rafael Frade, Analyst
- Unidentified Participant

Presentation

Operator

Good morning, and thank you for waiting. Welcome to the conference call to discuss Banco Santander Brasil SA's Results. Present here are Mr. Angel Santodomingo, Executive Vice President, Chief Financial Officer; and Mr. 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. (Operator Instructions) 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. (Operator Instructions)

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

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

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

Andre Parisi {BIO 21511610 <GO>}

Good morning, everyone. I'm Andre Parisi, and it's my pleasure to welcome you to Santander Brasil's first quarter '17 earnings conference call.

This past quarter, we had several important achievements, which will be presented by our CFO, Mr. Angel Santodomingo. So let me turn it over to Mr. Santodomingo.

Angel Santodomingo {BIO 15757370 <GO>}

Thank you, Andre. Good morning, everyone, and thank you for being there. Before getting to the results, let me quickly outline the topics I will cover during this presentation.

I will firstly remind you of some of our key messages, then I will discuss the results of the Group -- of Santander Group, which will be followed by an overview of Brazil's macro scenario in just one slide, the highlights of the quarter and to wrap it all up, I will provide some concluding remarks on what has been presented today.

Starting with our key messages, I would like to highlight the fact that we have achieved a significant improvement in ROE, in return on equity this quarter, reaching 15.9%, meaning, that we were able to meet our profitability guidance objective, seven quarters ahead of a schedule. Let me remind you that this objective was done and revised during the last couple of years for December '18. And as I said, we have achieved that almost two years in advance or seven quarters in advance. The Group has announced an Investor Day next October 10th, in which obviously we will probably revisit these targets and specifically the return on equity target.

All the metrics also show, Santander Brasil remains on track to deliver the goals that we set out to accomplish. Our NPL ratio is the best among our peers, considering public information up to now. The efficiency ratio improved by 540 basis points year-on-year and is now very close to our December '18 target also. Our fees continue to display strongest -- strong growth and the number of loyal customer has increased to 3.7 million, indicating that we are on the right path to also keep our guidance.

Moving on to the slide five, I will now start to address five key slides in which we try to summarize through commercial highlights and customer satisfaction, what we are trying to do and we are achieving in Santander Brasil. So as I said in the slide five, on the commercial front -- on the retail commercial front, we closed the quarter with positive achievements and trends to be added to our continuous digital transformation process.

As such, I would like to underscore the following. Cards, we had a very good performance in both credit and debit cards. In credit cards, we reached a market share of almost 14% in credit revenues, while in debit, we were one of the MasterCard issue that experienced the highest growth in debit revenues worldwide.

Looking to the near future, we remain optimistic as Santander Brasil is now the sole issuer of American AAdvantage and American Airlines cards in the country allowing our customers to accrue mileage points -- mileage points in one of the top loyalty programs in the world. We should also point out the fact that the credit card Santander Way app continues to show remarkable success with almost 3 million downloads thus far.

In payroll loans, we maintained upward trends in markets share and portfolio growth, with a significant contribution from the Ole Consignado brand.

For ContaSuper, the number of users climbed 14% in the quarter, meaning that we now have almost 1 million customers who are 100% digital. Regarding the savings account consortium and a specific Brazilian product -- saving product, also this product was only recently launched. I remember to you that 12 months ago, we had almost zero market share. We have already achieved 7.5 market share in new sales, in production.

In the private segment, we saw good growth across the board in the certain of the ultra-high segment, thanks to a more compelling offer, which helped us to attain considerable growth in asset under management in France. Lastly, in the agribusiness, I had commented during the last quarters that we have been investing in this business for some time now. Now it is starting to be reflected in numbers. As for example, we grabbed close to 100 basis points in market share in the last 12 months.

The next slide is still on commercial highlights or in the commercial area, brings some of the positive results achieved by GetNet, our acquiring firm which stands out as one of the main pillars of our commercial setting. Its revenues are growing at a faster pace and we keep gaining market share without losing profitability, which is key to our strategy. In fact, GetNet's revenues increased by 38% year-on-year and it has already grabbed a market share of 11% in the first Q, 2017.

Our acquirer [ph] allows for an integrated offering with the bank, reaching different segments and resulting in an expansion of our base of loyal customers, not to mention benefit of greater synergies. It is key to bear in mind that GetNet's importance goes beyond its acquiring services. It is a major product to leverage the bank's revenues.

Still in the commercial highlights in slide seven, it shows that our leading businesses continue to run at full steam, not only maintaining leadership but very importantly expanding it. We have maintained our leadership in wholesale banking, while also holding on to the top positions in project finance and ForEx transactions. We were also at the helm of M&A deals last year, and this year, in 2017, we are leaders in equity capital markets this year for both Brazil and LatAm for the first time, as well as in fixed income in Brazil, according or following the ANBIMA ranking.

I would like to call your attention to also our digital channel in the commercial finance segment. With our unique platform for car dealers, Santander Brazil innovated and is completely changing the dynamics of the car financing industry in the country. We had more than 1.5 million potential clients doing car finance and simulations in March. These represent 45% growth from December -- just three months ago from December 2016.

Now moving to customer satisfaction, the second concept I wanted to describe to you in my introductory words, that's the next slide. Our customer satisfaction is our cornerstone to keep growing in a consistent and sustainable manner. That's why everything we do aims to create a better experience for our client base. Our strategy to achieve that goal is grounded on EPS Squared [ph] that's excellent performance and satisfaction also reflecting in earnings per share.

What that -- what does this mean? Establishing a culture of customer service excellence through improving our approach to client relationship, upon which we are constantly striving to increasing our knowledge of their needs, providing with high customization. Net promoter score, as an indicator of customer experience is starting to be implemented in real (inaudible) and we will be following it in following quarters. Industrializing Santander's processes with the purpose of becoming faster while also enhancing the overall quality of our operations, which is why we are implementing the Lean Six Sigma in the following year [ph].

Second, clear incentives to push your competitive advantages such as cost reductions through a new mindset, bringing the P&L at the branch level. It is not an easy task, I know, but I'm certain that this strategy will strengthen our position within the country and I expect that through my summary, I was able to transmit to you what we are doing on the cost and excellence in service front.

Moving on to slide nine, as we just mentioned, our growth is based on better customer experience, which is why we are continuously focused on creating value for our customers. While we still have a lot of work to do on this front, I would like to highlight some of our achievements so far.

The number of loyal customers increased by almost 14% -- 13.8%; while digital customers rose 36% year-on-year. Digital transactions jumped 26% year-on-year and reached 76% of the bank's total transactions, boosted by an increase in mobile transactions of more than 90% year-on-year.

Sales of digital channels have doubled in comparison with the previous year. We are confident that we are now on the right track to keep expanding our base of loyal and digital customers.

So moving on to the Santander Group results, earlier today, as you probably may have seen, the Santander Group also announced its earnings for this first Q 2017, reporting a net profit of 1 -- almost EUR1.9 billion or BRL6.3 billion. The results of the Brazilian unit are important for the Group as a whole.

In fact, Santander Brazil accounted for 26% of the Group's earnings in the quarter. With regards to the macro scenario, after more than two consecutive years of GDP contraction, we are finally observing some recovery.

It is true that Brazil's economic rebound will likely be gradual, but important message here is that the country is moving in the right direction. I have already mentioned this for some quarters in the past. When [ph] we add to this situation, the productivity gains that will come with the structural reforms, that are being announced, approved and executed, I think we will enter in a long structural growth period in the country. Domestic inflation has been falling steadily, creating room for aggressive interest rate cuts as we are seeing. Market consensus indicates that the Selic rate should reach single-digit recovery [ph] still in 2017, contributing to the delivery chain process of both individuals and corporates.

We are seeing progress on the fiscal adjustment arena, which we believe should help the business confidence to continue its upward trend in 2017, thereby playing a major role in the recovery of the Brazilian industry and investments. First, we believe that the worst is behind us and that the macro scenario tends to improve in the months ahead.

So now let's move to -- begin examining Santander Brazil's first Q 2017 results on the slide 15. First, and again, I must highlight our exceptional gains in profitability as I have been announcing to you in the last quarter. Our final objective is to continuously improve profitability, and we are starting to show that process. It is in line with our commitment to delivering consistent and sustainable earnings growth.

During our 2015 Investors Day in September 15th and also in September 16th, we established our return on equity guidance of 15.6% for 2018. Obviously, much has changed since then both on the positive and on the negative side. But especially in our case, the speed of our commercial innovations, which enabled us to achieve and surpass that goal almost two years earlier than expected, despite the still challenging macro scenario facing the country.

As I have mentioned in the past, our profitability gains have come and will come from improvements in our P&L operating leverage. This is maintaining costs under control and growing revenues.

Moving on to further details on the next slide, on the slide 16 of our quarterly performance. As we have always said, we strive to keeping improving our bottom line every quarter. This is the twelfth, the number twelve out of the last thirteen quarters in which we delivered an earnings growth. So recurrency [ph] is an important value here to consider.

In first Q, '17, we managed to deliver another solid quarter. This movement are supported -- was supported by a host of factors. To name a few, we note that, in spite of once again loan portfolio being affected by the still timid and regular [ph] rebound of the Brazilian economy, our loan portfolio to individuals and consumer finance segments remained resilient.

The Bank continued to enjoy a comfortable capital liquidity position. Asset quality stayed at healthy levels, greater customer loyalty resulted in increased revenues, underpinned by a combination of liability management and good market activity, with fees growing well above the premised double-digit pace.

And finally, the efficiency ratio rose to the best level in the past five years. As a consequence, net income amounted to 2.3 billion in first Q, '17, 15% and 37% higher than the previous and one year ago quarters respectively.

And in the next slide as I stated before, net profit totaled 2.3 billion in this Q, 14.7% higher than previous quarter and 37% above first Q, '16 again providing the number 12 out of the last 13 quarters with profit growth. These figures provide undisputable evidence that we are on the right track to keep delivering sustainable and resilient results in the quarters ahead.

On slide 18, we show the main lines of our quarterly earnings about which I will go into more detail later on. On the revenue front, net interest income increased 13% relative to the fourth quarter 2016 highlighting market activity, liability [ph] NII. On an annual comparison NII rose 16.7%. Fees decreased in this quarter owing to insurance and credit cards seasonality, but advanced by a strong 24% against first Q of '16 further accelerating our double-digit growth phase.

On the expense side, allowance for loan losses fell by 15% Q-on-Q and 6.6% year-on-year. And general expenses declined by 4.2% versus the previous quarter and climbed 7% year-on-year. I will elaborate on the details of each line in the following slides.

Slide 19 shows the evolution of our net interest income, which came to 8.9 billion in first Q'17 or '16 -- almost 17% higher than first Q last year and 13% better than 4Q16. Let me highlight the main points.

Market activities, which is what we call Others line, played a key role also in the quarter on top of market general evolution. In this item, we include the ALM results and this important to understand as we had been sharing with you that we are positively positioned to lower interest rates. So that position from the ALCO from the ALM [ph] strategies is reflected here. In fact, as we always say, part of the -- red part of the column is also embedded on the grey side.

We are offsetting or helping the asset NII part of the total NII with the ALM positioning activities. Revenues from the funding side had another very good quarter, growing by an outstanding 54% year-on-year and 12% Q-on-Q. This figure demonstrate that the plans that we started approximately 1.5 years ago and that I shared with you by then and during the last almost 6, 7 quarters, are starting and are being reflected in the P&L.

Finally, as I mention on the red part of the column, credit revenues went up 0.5% in the quarter due to a combination of higher volumes and the stable spreads.

In the year, trading revenues also posted an annual improvement of 5.6%, with the CD [ph] volumes and wider spreads. On the spread side, on the right side, you can see both asset and liabilities spreads and specifically on the liability side, what I mentioned about our liability management in terms of improving the spreads during the last 1.5 years.

Next slide we look into asset volumes. Our expanded loan portfolio totaled 325 billion in first Q, '17 which means an increase of over 1% in the quarter and 4% in the year. Our credit portfolio was stable at the margin, but saw this 4% rise year-on-year, making the first year-on-year growth since the first quarter '16. Hence, also Brasil's economy environment experience -- is experiencing a gradual recovery we start this year with a positive growth rate, again showing good customer loyalty.

In addition to that, I would like to draw your attention to the individual portfolio, which continued to deliver a resilient performance expanding by 2.8% over the previous quarter and almost 10% from first Q last year. Payroll lending was the main growth driver there. Once more this quarter we must highlight the performance of consumer finance, which advanced by 2.9% Q-on-Q and 9% year-on-year, notable figures, considering the still poor conditions in the car sector because remind -- I remind you that this is basically car financing.

This improvement has been fueled by the implementation of our disruptive digital platform, which took place in September 16th and has spurred significant productivity gains for the business, and which I have shared details over the past quarters. On the other hand, the SME and corporate portfolio decreased in the quarter. This decline of [ph] SMEs is -- despite the weak quarter we understand that our combination of commercial focus and more compelling offers amid a better macro scenario will help [ph] the way for portfolio expansion in the following -- in the coming quarters.

On the corporate side, excluding the ForEx change, the portfolio was at cost -- minus 2% Q-on-Q and our positive almost 3%, 2.7% year-on-year.

On slide 21, you can see how our fundings has evolved. Funding from clients increased by 0.8% Q-on-Q and 6% year-on-year in this quarter. Let me underline the positive and above market performance of savings and deposits in this quarter, in response to our initiatives to enhance client engagement levels. Additionally, we have been reducing the amount of financial bills, what we call treasury notes or Letra Financiera, which suggests a better cost of funding. This trend will continue.

Finally total funding reached 553 billion in first Q '17, remained stable in the quarter, but increased almost 8% year-on-year.

Next slide. As we have been saying since the beginning of 2016, fee revenue growth is a consequence of adequate pricing improvements in the quality of our products and service and engage clients. Also fee revenues had a mild decrease of almost 1% in the quarter. It is worth noting that this performance was impacted by the traditional seasonality in insurance in this Q, and credit cards. Excluding the effect of the former, fee revenues would have grown by 3.5% Q-on-Q.

On the other hand, the annual comparison that eliminates these Q-on-Q seasonality, total fee income had 24% growth. Regarding the gains in our base of loyal customers, I would like to highlight the performance of current accounts, credit cards and collection services, showing this trans-nationality concept, I just mentioned.

Moving to asset quality, the yearly [ph] -- the delinquency rate increased by 120 basis points in the quarter, reflecting the seasonality in the individual segment and also a few corporate cases that were already known and some had already been partially provisioned. Still we note that some of those cases have already normalized as we will speak. So we don't -- we do not see these movements as an alert for an asset quality deterioration process in following quarters.

NPL over 90 days, dropped by 50 basis points in first Q to 2.9%, basically explained by the write-off of an specific case in the corporate segment, that we mentioned back in first Q '16.

Additionally, individuals NPL fell by 10 basis points, which is the fourth consecutive quarterly improvement, reflecting the efficacy and efficiency of our risk model. In our view these numbers are an empirical evidence that our asset quality remains sound and at comfortable levels, especially considering the usual lag between economic activity and NPL.

These favorable trends continue to reflect the strength of our risk model and confirm that all actions we have taken and commented on in recent years.

The appropriate measures to protect the quality of our assets includes a more collateralized portfolio, which reached 63% of the total individual portfolio in the first Q '17 versus 58% three years ago and diversification. As a consequence of the decline in the over 90 days portfolio, recovery ratio increased to 229%, which is in our view, a healthy level.

In the next slide, loan loss provisions totaled 2.3 billion, in this quarter implying a 15% decline from the previous quarter and a 6% decrease relative to first Q last year. This has allowed us to maintain the cost of credit at 3.1%, the lowest level in six quarters.

On the slide 25, we see how expenses have evolved, as we have been stating in previous quarters, Santander Brasil continues to focus on cost discipline and lean mindset, even after four consecutive years of real savings in these areas. Our total expenses dropped by 4.2% in the quarter attributed to seasonality in both personnel and administrative expenses.

In the last 12 months, total expenses increased by 7% year-on-year, which has -- which was above inflation in the period. This is explained by an obvious rise in administration expenses, reflecting the renewal of contracts and services, which usually lag inflation. I remind to you that we come from a double digit inflation and we are now in 4% or a little bit more than 4%.

Looking ahead, we expect costs to grow in line with inflation, as we are still reaping the benefits of a number of initiatives such as tighter control of operating expenses, the digitalization process and measures aimed at enhancing productivity, I commented these in my introductory words.

The next slide presents our performance ratio, which have also shown progress. Efficiency improved both year-on-year and in Q-on-Q terms and stood at 14 -- sorry 44.9% almost 45% in this quarter, the best level in the past five years. Our recurrency ratio rose to 80% versus 69% in the first Q last year. Every time that we make strides in this indicator, we bring more predictability and resilience to our results. Thanks to these advances, return on equity keeps increasing, and as mentioned earlier, we were able to meet our 2018 guidance almost two years in advance, despite the challenging macro scenario in this country, -- in our country.

We will remain committed to continuously improve our profitability. Our relentless push to a stronger result is guided by our mission to establish a competitive position against our peers and meet our shareholders' expectations while always maintaining good solvency ratios.

And on next slide, you will notice that our liquidity and the solvency positions remained solid, with stable funding sources and a rather good [ph] funding structure. The loan-to-deposit ratio -- the loan-to-deposit ratio reached 85%, which is quite an affordable level. This ratio decreased to 15.8%. Despite that decline, our capital ratios remain healthy with our core equity Tier 1 level of 13.7% and a Tier 1 level of 14.7%.

We also announced yesterday that the Board approved our dividend payment, a quarterly dividend payment of BRL500 million. So this is the first time we move into this territory of quarterly payment in terms of dividends.

So, I will wrap up things in the next slide. I would like to bring your attention to the highlights of our first Q earnings. Profitability achieving almost two years in advance objectives. A stronger and increased -- and increasingly solid results in every quarter, commercial initiatives and digital innovation continued to contribute to boost in customer loyalty and transactionality, which allowed us to offer a more compelling value proposition, as well as to it's [ph] growth in net income increase.

Also, our liability management, that has been announced continuingly during the last quarters proved to be effective and resourcable. Greater productivity remains at the top of our priority list as our efficiency ratio reached the lowest level in recent years. Excellence in risk management provided resilience to our asset quality, comfortable liquidity and capital levels and our employees are and continue to be committed to Santander's unique culture.

So lastly, we are set to deliver -- and this is our main messages -- our main message, a consistent and upward trend in return on equity powered by a well-defined business strategy [ph] fueled by organic growth and disciplined capital deployment. As a consequence, we are confident that we will keep advancing to provide a strong and positive customer experience, which is key from the (inaudible) our strategy and profitable return to our shareholders.

Thank you for your attention and we are now able to go into the Q&A session.

Questions And Answers

Operator

Thank you. The floor is now open for questions. (Operator Instructions). Mr. Guilherme Costa from Itau BBA would like to pose a question.

Q - Guilherme Costa {BIO 17950499 <GO>}

Hi, good morning guys. Congratulations on the results. My first question is about the NPL ratio. We saw you showed a material improvement in the NPL ratio for loans overdue by 90 days, which is partially linked with the credit was [ph] written off from the corporate portfolio. But my concern is the increase in the early [ph] NPL ratio, the loans overdue between 15 and 90 days, could you comment on the deterioration seen in the commercial portfolio of the early NPL ratio of this segment, do you expect these to increase the NPL ratio for due [ph] by 90 days going forward, and what are your expectations for the cost of risk as a consequence of this increase in the early NPL ratio? And then I have my second question.

A - Angel Santodomingo {BIO 15757370 <GO>}

Okay, thank you, Guilherme, thank you for your good words and congratulations. Okay, let me elaborate on the 15 to 90, I tried to elaborate a little bit on my speech, but there are two things here to understand. Well, first, let me give you the headline. The headline is that we do not expect these to translate into a kind of a trend, or strong deterioration in the NPL ratio, but let me try to explain this movement. In the retail side, in individual side, our first Q is always -- you always have seasonality there.

So you always have a deterioration. As you know in 4Q you have the thirteen [ph] salary here, which provides liquidity. You have all these expenses. And then you go into the first Q in which you tend to see the typical delays in payment et cetera. So I would put aside kind of the individual's retail segment. And now concentrating on the other side, on the corporate or the non-retail individual's side we had an specific series of 10, 12 cases that as we speak today, they have come back.

Okay, so these both operations or individual names that for end reasons, you end up in the quarter with again these type of delays. So if I add all that, I mean I don't know, more than half or close to two third or somewhere around there, is an non-event issue. So I would totally try to normalize these 15 to 90 days evolution. We will see obviously, we are following as we have been in the last almost three years, during the crisis, the evolution of the quality of risk, et cetera.

But again as I have been sharing with you, as of today, we don't see any warnings or any point that I could address to you or say to you, where we have these to look after or to follow in the following Qs.

On the cost of risk, looking forward, as I always mention to you, I mean this has to be totally linked to what we think on the economic side. It looks like the economic, the macroeconomic picture is going to improve. We should have a positive GDP growth rate this first Q already, above 1.5% probably.

So if that continues Q-on-Q and we continue to see that trend, which is what we all are probably hoping or -- sorry expecting -- not hoping, expecting today, we probably have seen the worst, okay. But I want to link these message to the macro evolution. So we know we are at a very good level in terms of credit quality, but this is my view in terms of evolution.

Q - Guilherme Costa {BIO 17950499 <GO>}

Okay. Perfect. Very clear, Angel. And my second question is related to margins. First on the funding spreads, you have delivered a material improvement in the funding spread over the last quarters. How much more potential do you see for improving this funding spread going forward?

And about the credit spreads, they seem to have stabilized now. Are you expecting the credit spreads to contract going forward or we are going probably to see stabilization over 2017?

A - Angel Santodomingo {BIO 15757370 <GO>}

On the funding side, I mean, I announced to you, as I said 1.5 year ago, something like that, that we were starting to put focus on the liability side, which is something the bank had not done for a long time. That plan was initiated. And as you say, it's delivering results. I do not see that we have ended that capacity. So we should be able to continue that movement. It's both a financial movement in terms of the impact in P&L and it's also our view of service on the commercial front. So I do not see that ending for now.

On the credit -- and obviously, remember also my words in terms of the type of funding that we have, the Letra Financiera, the Treasury bills by which we are starting to decrease and that's an expensive funding.

On the credit spread, well again, this goes with the market. I mean if we are going to -- I don't see it now, okay? I'm not seeing it now, but I (inaudible) to the positive cycle and then speaking of the next two, three years we'll obviously have pressure on the spread side. I mean we'll have to probably offset that with volume. But my view is on a two year -- two year, three year that the NIM on the asset cycle could have some pressure. We already have the NIM from the liability side, and the ALM and the Asset Liability Management activities to offset that.

So my view on the total NII and NIM tends to be positive.

Operator

Now we have questions via webcast.

A - Andre Parisi {BIO 21511610 <GO>}

As you know we have preference to written questions, so we are moving on. Next question comes from Philip Finch of UBS. NIM improved strongly in the first Q '17 partially driven by lower funding costs and loan mix shift. Were there any other drivers for the margin expansion and how sustainable is the current level of NIM?

A - Angel Santodomingo {BIO 15757370 <GO>}

Okay Philip, I think I briefly mentioned, or I just mentioned the ideals [ph] for NIM. The answer is we do have potential and we have been showing these in the past quarters on the liability side. You're right on the -- on how you see the NIM expansion. I already elaborated on my views on NIM going forward.

A - Andre Parisi {BIO 21511610 <GO>}

Next question comes from the Eduardo Mitchell [ph]. Your NII had a good evolution growing much faster than your loan growth, can you please give a bit more color on the ALM strategy, credit and funding spread? Do you still have space to improve funding and credit spread in light of lower Selic rate environment?

A - Angel Santodomingo {BIO 15757370 <GO>}

Okay, Eduardo. Let me try to elaborate on total NII -- NII. How do I see this? I see three kind of areas, okay, the NII and NIM on the assets on the liability and on the Alco [ph] or ALM activity. I already mentioned NIM on the asset side, not in this quarter probably not in second Q, I'm trying to give you a kind of medium-term view. One, two, three years from now. I tend to see some pressure on the NIM asset side. I mean it's obvious that if volume starts to grow and spreads, at --- and remain even flat, you'll have that pressure.

Now in our case, we have two things to consider. The NIM on the liability side. I already mentioned, we have been improving that part and we are trying and we'll continue to try to improve that side. So yes, I do see expansion there. And then we have the ALM activity [ph], how are we positioned in ALM? We have already shared with you this in the past. We are positively positioned to interest rate decreases, 100 basis points -- 100 basis points decrease (inaudible) move in the Q. We have a positive sensitivity of BRL300 million.

So that is why in the presentation I was saying, okay, you do see a credit, an asset NII, because we do leave to you this breakdown. I mean if I would give you everything together, let me say like that, you will not notice it, but as I'm giving it to you, breaking down, you can see how the asset spread is fairly stable while we are growing the others. In the others, it is steady [ph] I mean -- we are positioned, the bank is positioned to offset that decrease.

So as I said in my presentation part of the order [ph] that you have in the NII, really belong to the asset side. So you should see both together and that position lasts for 12 months to 18 months. So that's how we are positioned in the ALM side.

So all-in-all, sorry to wrap it up, NII, NIM, obviously, we have -- we may have in the future again, please underline my words, that is in the medium term view, we may have this NIM pressure offset by liabilities in ALM.

A - Andre Parisi {BIO 21511610 <GO>}

The next question regarding to ROE comes from Carlos Daltozo, Banco Brazil and Yuri Fernandes, JPMorgan. Is there more room for asset quality improvement? Is the ROE sub-guidance [ph] of 15.6% by the end of '18, announced in 4Q'15 conference call maintained or I mean, 4Q'15 was the Investor Day, and the last quarter was conference call maintained [ph]?

A - Angel Santodomingo {BIO 15757370 <GO>}

Okay Carlos, Yuri. Let me remind to you on the ROE side. We have shared with the market our ROE objectives, both in September '15 and September '16 in the Investor Day, in the Group's Investor Day. We are having another Investor Day this October, the 10th of October. I mentioned that in my words. We will revisiting obviously, our guidance given that we have already made that almost two years in advance.

So if your question is if we are going to do something with -- yes, obviously we have done these seven quarters in our advance. We will revisit, we see our profitability. We will try that our profitability continues to improve.

In terms of asset quality I think I already elaborated.

A - Andre Parisi {BIO 21511610 <GO>}

Next question regarding the tax rate comes from Yuri Fernandes, JPMorgan. Can you please provide more color on your effective tax rate in addition to no payment of IOC, what else drove higher rates? How should we expect your effective tax rate for the full year '17?

A - Angel Santodomingo {BIO 15757370 <GO>}

Yeah. Yuri, tax rate I agree with you. I mean the numbers we have presented numbers. We had a strong numbers and on top of that -- of those strong numbers the tax rate has increased substantially.

On the Q numbers, the tax rate is always kind of -- we have to be careful. What we have been commenting with you is that we should head to the 20%-25% tax rate. But I mean this depends on what you said in (inaudible) capital, depends on a lot of deductions and non-deductions that are applicable or not applicable. And this Q, we presented the numbers with a 30% tax rate, if I'm right, 29% tax rate.

So the only think I can say is that, we think we are presenting a strong numbers with a high tax rate. Obviously this will evolve during the year. The tax rate is kind of something that depends on a series of variables.

A - Andre Parisi {BIO 21511610 <GO>}

Next question now we are going to other expenses. Yuri Fernandes from JPMorgan and also (inaudible) from Citi. Can you please comment on provision for contingencies in your other income expense, income - expense line. It accelerates this quarter. Any specific reason for that? How should we think this line will evolve in the next quarters? And you had also comment about the expenses on credit cards, if it is anyhow linked to the American AAdvantage program.

A - Angel Santodomingo {BIO 15757370 <GO>}

Well, you probably have seen that we have some increase in these contingencies and provisions for these contingencies. Again, I mean this has to do again on a Q-on-Q you have a lot of -- you have some volatility. And so it's a difficult one to estimate. It is true that other expenses increased in the -- in the quarter but as I said, this is coupled with not only contingencies but with our expenses linked to several things. There is nothing special here. It's just that you have to cover [ph] it in each quarter, with the volatility.

In terms of operating expenses, I mean the American, we have already started to commercialize the American Airlines credit card. I would not link these to the evolution of expenses, to these initiation of commercialization. Both expectation and the initial answers and demand and interest for these credit cards has been amazing. As you know we have an exclusivity agreement with American Airlines, that used to be with Citibank and now is with us for a long time.

So we are very happy to offer this. We have been quite active commercially speaking, linked to conservative marketing campaigns, but I wouldn't link it to the other expenses line.

A - Andre Parisi {BIO 21511610 <GO>}

Okay, now you open the mic for a few questions.

Operator

(Operator Instructions). We have a question from Mario Pierry of Bank of America Merrill Lynch.

Q - Mario Pierry {BIO 1505554 <GO>}

Good morning everybody. Congratulations on the quarter. Thank you for a very detailed presentation, as well. Just a question related to loan growth. Like you mentioned right, this is the first time that we see year-on-year growth in lending, but primarily driven by individuals in the consumer finance segment. When do you expect the corporates and the SME segments -- when do you expect to start lending against the corporates and SME segments, as from your remarks, it seems like you're fairly comfortable with the asset quality trends. So I just wondering if it is a matter of time or what do you need to see before you start lending again? Thank you.

A - Angel Santodomingo {BIO 15757370 <GO>}

Okay, Mario. Thank you. Yeah, a good question. I would say that, as you said, we are comfortable on the credit quality side, on the individual side. I will say that probably the loan growth looking forward will first -- will come from these SME and corporate side. Probably gain -- with macro going forward, probably gaining momentum as the year goes by. On top of everything, we have specific programs for these SME and corporate world. That should also give some result. I would expect it to gain momentum as the year goes by and is probably one -- going to be one of our arguments to end up. We have always said to you 3%, 4%, 5% loan growth.

It has to come obviously, and again the macroeconomic discussion here is a key one, but we have got -- we have a feeling that we will gain momentum as the year goes by, and clearly going in to 2018 and I have no doubt it's going to be -- I mean the deliveries [ph] there has been significant and we will probably see good positive growth there.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. And when you look within the corporate segment today, any sectors in particular that you still are very concerned about or in which you're still uncomfortable lending or -- just trying to get an idea here which sectors could be leading this recovery?

A - Angel Santodomingo {BIO 15757370 <GO>}

No. The sectors that we are not -- I mean obviously, you have the strong ones, the agro, the exporters, et cetera. But sectors in which we have a concern, no. Remember that we have -- I mean, for example, I have been -- I have received questions lately about our asset building, for example, okay.

We are project-oriented, okay. So we do finance in general terms projects. We are very active in project financing in general not only in building. So our strategy in terms of quality obviously goes through sectors, but it doesn't go through a general sector view, we will go deeper than that, and that's probably one of the key successes of our credit quality line.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay, thank you very much.

Operator

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

Q - Rafael Frade {BIO 16621076 <GO>}

Hi, good morning all. So I have three questions. First one is related to -- sorry to come back to the other lines on your NII, but just to confirm, so I understand that probably with the mark-to-market of the figures that you have in the quarter, and the results that do not flow through the income statement, but only in the balance sheet, probably, we should see these other lines still strong, let's say for the less, in the next 9, 12 months, is that correct?

The second one would be related to your -- you saw the portfolio of BRL200 million more or less that you disclose that it was in the age ladder [ph]. And just to quantify, if it was in the NPL or not.

And the third one is related to GetNet, so this quarter, you didn't disclose the number that you have been disclosing in previous quarters. So is it your intention not to disclose any more the numbers, just the volumes, specifically for GetNet?

A - Angel Santodomingo {BIO 15757370 <GO>}

Okay. Other NII, yes, you do have a point in terms of obviously, as we have this ALM activities there that are trying to offset this decrease in interest rates. You will have that impact on the orders.

Again, I have always said to you these, and I am not going not change my speech now. This is -- this is not something that is affecting [ph] the rest of the -- because you also have market activities and other activities that tend to get some volatality back. I agree with you that on the ALM side, it should give us some recurrency.

In terms of selling [ph] portfolio no, answer is linked to NPL, I say [ph] no. This is business as usual. We do have this as a normal, it is lower amount in fact, activity, but and in GetNet, well, I did share some numbers, I don't know exactly, which one you remember, but you referred to, what we are growing 38% in, how you say that, in selling in the turnover -- sorry I didn't the other income, in the turnover, we are growing nicely both in debit and credit.

We have already 11% market share. So whatever number you need, please do ask Investor Relations, because we haven't changed any policy there.

Operator

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

Q - Carlos Macedo {BIO 15158925 <GO>}

Hi, good morning, Angel. Just -- I'm sorry to go back to this others line, just trying to understand what the dynamics here are. So you were saying that last quarter, the average Selic was down 100 basis points quarter-on-quarter, which means you made around 300 million just on the ALM position. Could you break down what was actually trading, because trading as you've suggested is a lot less volatile, a lot more volatile and maybe not totally recurring, whereas ALM is. And so just sort of we understand where we can use as a base for that others line, that was very relevant in the quarter.

Second question, still on this, the Selic rate is expected to go down all the way to 8.5, you have 8.5, market's running 8.5 or 9, maybe even by the third quarter. So does this mean that after the third quarter, when you get to the fourth quarter and then first quarter next year, this ALM position will not provide support to your margins.

And as a result, the BRL300 -- BRL300 plus million you can get every quarter this year, will go away and that could have a negative impact in your quarter next year in addition to the pressure that spreads on the asset side could cause?

A - Angel Santodomingo {BIO 15757370 <GO>}

Okay. Thank you. In terms of NII, what I said was our sensitivity. I gave these 100 basis points BRL300 million sensitivity, not because of the quarters, because that's the sensitivity we have commented with you. Trading revenues in these others, they tend to be low, okay?

Low means, I don't know, 10%, 15% in that region, depending on the quarter. So is not an amount that really drives. Will it last for long or not, I already mentioned these. I mean the ALM activities give some help in the 12 to 18 months. How are we going to offset that, I already mentioned the liabilities et cetera.

And obviously in total NII, no, in terms of NIM, volumes should come up at some point. So that would be, again, repeating myself in some of concepts, that will be the main points.

Operator

Mr. Carlos Gomez Lopez from HSBC, New York would like to pose a question.

Q - Carlos GomezLopez {BIO 18107094 <GO>}

Yes, thank you very much. I wanted to ask about fees on page 22, and you show us a very strong increase especially on current account, 33%, on collection 25%, on securities 25%. First, I would like to know if that increase in current account is still sustainable, have you changed the pricing in that product?

Also in insurance, in which you're growing 21%, have you changed the terms of your relationship with the insurance company? And again, did you think this rates of growth are sustainable? Thank you.

A - Angel Santodomingo {BIO 15757370 <GO>}

Thank you, Carlos. The answer to this is, what we have been commenting in the last few quarters is both usage of the banks transactionality, linking clients and new clients. So we did have pricing improvements obviously, but the main issue here is that, in terms of current account et cetera, we have client using more the bank.

And this is the main driver. In terms of insurance, we haven't changed anything. It's -- we keep on the same direction. I mentioned there is seasonality in this quarter, but there is no change. The reality is that we are selling a lot of insurance and I also mentioned to you that we keep a big chunk of the revenues of the fees generated by insurance in our commercial network.

So when we sell an insurance product, it depends, what it goes along, 70% of the fees remain with us. So that's why it is growing. So I would say, fees is a clear reflection of the transactionality that I have been trying to comment to you.

Operator

Mr. Marcelo Teles from Credit Suisse would like to pose a question.

Q - Marcelo Telles {BIO 3560829 <GO>}

Hi. Good morning, everyone and congratulations on the very strong quarter. I have two questions. The first one, I mean you clearly -- you have been gaining some market share versus your peers.

You know, if you like the -- SME business is somewhat -- of course, in the individual segment as well. So my question to you is, I mean, how comfortable can we be that -- there is no sort of like adverse selection in that portfolio. If we -- how comfortable are you that you can maintain a good asset quality levels there?

And my second question is regarding the abnormal course loans balance we saw an increase in the quarter. Let say, despite the effect that one of the -- specific corporate exposure that was charged off. So if you could -- can you comment a little bit on that as well. Thank you.

A - Angel Santodomingo {BIO 15757370 <GO>}

Okay. Thank you, Marcelo. You're right. I mean we do have to be quite careful or over careful [ph] in terms of adverse selection on the corporate and SME side, especially when you have -- when you have different strategy within the financial sector in which you have different players with different appetite in terms of lending, et cetera.

Totally agreeing with you, we are absolutely concentrated in growing our client base in the SME side but with maintaining our credit standards. We are not changing that at all. So that means that we expect to remain comfortable in terms of credit quality.

In terms of an impact in this Q, of this written off, I will remember to you that I have to remember to you that in first Q we explained to you. We are putting into an NPL on specific case in the corporate segment, which if I remember well was something like 0.5 percentage points of NPL but now six months afterwards following the (inaudible) is being written off.

That means that if we do a like-for-like analysis, NPL ratio this quarter would have been fairly stable. I think it's a little bit down, but fairly stable. NPL information, I don't know if you were also referring to that. My -- our calculation is that they remain quite stable. So around 1% or something like that or a little bit down. So no issue there.

Operator

Mr. (inaudible) would like to pose a question.

Q - Unidentified Participant

Yeah. Thanks for the opportunity, just an additional question from my side. You are just sitting on a lot of capital. So just like to have some color on your upcoming plans for that. I hear you when you comment about a very conservative capital deployment.

But I'm not sure if there is any news that you could share with us maybe with relation to buying back some of the activities that were set to the parent company, years ago, such as the asset management unit. Thank you very much.

A - Angel Santodomingo {BIO 15757370 <GO>}

Thank you. On the capital, I mean, we did make a change but we have announced quarterly payment of dividend payments.

We continue to see capital in the same way we have seen which is we will manage through pay out. We don't have any plans further than that as we speak today. So no news, we are comfortable. Obviously, we will manage the level of comfortability going forward.

But I mean we do not have a huge -- we do not see a huge excess of capital nor that we are short of it. So I mean, as I have always said to you, this is our kind of medium-term view, we cannot manage capital based on the quarter. So if we do think that Brasil is going to start growing structurally going into '18, '19, I do not want to have to start it with capital. So I will keep on reasonable levels, which is around where we are or lower, but I mean consuming part of feed as growth comes in, but trying to -- I mean putting the focus both on the usage and on the profitability of it as you have seen.

Now in terms of asset management the Group has announced that it is buying. It will execute the operation during the year. So we'll have to wait to that execution. I remember to you that as in insurance we do have a big chunk of the commissions generated by the asset management unit within our retail network. Okay, so thank you so much.

Operator

As there are no more questions, I would like to turn the floor over to Mr. Angel for final considerations. Please Mr. Angel, you may proceed.

A - Angel Santodomingo {BIO 15757370 <GO>}

Hi, yes, Andrea, thank you very much for your time. And if you have any further questions the IR team is 100% available. Expect to see or to meet you all in the next quarter. Thank you very much.

Operator

Thank you. Santander's conference call is finished. Have a nice day.