Q3 2011 Earnings Call

Company Participants

- Alfredo Saenz, CEO
- Jose Antonio Alvarez, CFO
- Unidentified Speaker, Unknown

Presentation

Alfredo Saenz {BIO 1422535 <GO>}

Good morning. We are going to begin the results presentation for Q3. As usual, I will present the quarter's fundamentals. And the Group's results. Then Jose Antonio Alvarez will review the different business units in more detail. And finally, I'll close with some conclusions.

The quarter has taken place in a very unfavorable global context, falling volumes in US and Europe, together with the uncertainty of the European sovereign debt crisis, have increased risk premiums and affected consumer and business confidence. At the same time, there have been strong corrections in assets and currencies. And growing tensions in wholesale funding. And all of it has meant that the global economy has grown a lot less than expected, as seen in the latest IMF estimates.

The key to our results, overall, our underlying operating income has continued to perform well and has become our main profit driver. In our balance sheet we have focused on liquidity and capital management. In liquidity we have a very good structural position. And at the end of the quarter we had already comfortably covered the medium and long-term maturities for the whole year.

In capital our ratios are still very solid. And match to our business model. We ended the quarter with core capital at 9.42%; that's 62 basis points higher than at the end of 2010. Moreover, we will comply with the new capital requirements established by the EBA for June 2012 without requiring any capital increases.

Finally. And in line with our Group's policy of prudent (solvency) management, we will use the capital gains of around EUR1.5 billion which will be reported in the Fourth Quarter to strengthen the balance sheet even further. We'll now look at each of these points in more detail.

In the Third Quarter, attributable profit was EUR1.803 billion, which demonstrates the Group's ability to generate earnings in complex environments; should note the strength of basic revenues, the impact of markets on non-commercial revenues. And continued high provisions.

With this profit for the first nine months was EUR5.3 billion; and I remind you that this profit was hit in the Second Quarter by a one-off charge of EUR620 million net of taxes related to payment protection insurance remediation in the UK.

Finally, these results do not include the approximately EUR750 million in capital gains from the agreement obtained by the divesting of our insurance with factories in Latin America to Zurich, nor do they include the EUR750 million from the transaction of Santander Consumer US, which we have recently signed, allowing the entry of new partners in order to enhance our future growth potential.

Going into basic revenues, net interest income, plus commission, plus insurance, we see a very solid trend in the last quarter. And there recurrence is the main drive of our results. Thus, we see that Q3 was again a record quarter with a number slightly above that of the Second Quarter when, seasonally, it tends to be in the Third Quarter a lot weaker.

Inter-annually the growth was 6%, that is over EUR1.6 billion in absolute terms in the following breakdown; great dynamic growth in Latin America, up for the sixth quarter running with an inter-annual growth of 12% local currency, acceleration of volumes since mid-2010. And the gradual impact on revenues is the reason behind this evolution.

The strong growth of Santander Consumer Finance, that's both organic growth as well as the entry of SEB in Germany and the AIG in Poland; positive impact of the six-month contribution of the Polish banks accordingly. And all of this growth will comfortably offset the falling revenues in more mature markets, patricianly the cost of funding in the UK and in corporate activities.

If we look at total income in the Group we see a slight drop in the Third Quarter due to smaller ROS income in our corporate center, because of a very unfavorable context for this activity. And also, the dividends because of a seasonal effect. Growth for the first nine months, however, has continued to rise up to 5.8%. This growth distinguishes us from our peers, whose gross income is either flat or declining in the case of our European peers. Moreover, it is not just that our income has grown more. But also the profitability of our balance sheet has grown, particularly if we compare it with our European peers.

As for costs, costs have grown high single digit rate versus last year, as a result of a highly diversified policy depending on markets and businesses. Over 70% of cost increases came from emerging countries where we are investing in order to capture future growth.

In Latin America growth was connected to increased installed capacity. We have 200 more branches and 1,300 more employees than a year ago. We've also been launching new sales projects, have been remodeling our point of sale, deploying new technology, etc. And to this we must add some pressure in the signing of wage agreements and costs related to inflation in countries such as Brazil and Argentina.

Also, in emerging countries we have a perimeter effect, mostly because of the integration of the Zachodni Bank. Most of the rest of the increase came from countries and units where we are improving our franchises by investing either in technology, or in our commercial structures, or in service improvements.

Finally, in our retail units in Spain and Portugal, costs are declining at nominal rates between 1% and 2%.

Overall, our cost income ratio has enabled us to continue to carry out the investments planned. And to continue to be the best in class in cost income ratio. We are second amongst our peers, ahead of all our European competitors. And as a result our cost income ratio is 14percentage points better than the average.

Loan loss provisions, as far as provisions the last two quarters show the declining consumption of generic provisions; specifically, an average EUR35 million in comparison with an average of EUR500 million in the previous five quarters. As a result, in the first nine months we have released EUR800 million less in general provisions than in 2010, which offset the drop in specific provisions for the whole of the Group.

The net result of both effects was that total net provisions in the year were at a similar level to last year's, still high due to the cycle in some units. Specifically, there have been increases in our Retail businesses in Spain, Portugal and Brazil, offset by the decline in Santander Consumer Finance, Sovereign, the UK and Latin America, except for Brazil.

In line with these trends the Group's NPL ratio inched up slightly, 8 basis points in the quarter, up to 3.86%. This was largely due to Spain and Portugal, where NPLs have continued to rise. On the contrary, Santander Consumer Finance and Sovereign have continued to improve. And for the last four quarters, there -- for SCF, NPLs have dropped significantly. And for the last seven for Sovereign.

Remaining units have remained basically stable, with some small quarterly fluctuations.

As for coverage, the rate for the Group was 66%. In the Third Quarter there's been a slight decline in Spain. But it has continued to rise strongly in Sovereign for the seventh quarter running, up to 93% and at SCF, where our successful recovery (so far), has brought it up to 132%. In Latin America coverage ratios are over 100%, both in Brazil and in the rest of the region, in line with provisioning efforts made.

As for these trends they mean, although the cost of credit, that is specific provisions as a percentage of total risk, have already begun to improve in the Group, in line with what we announced at the Investor Day. The improvement in net provisions as a percentage of credit is not yet reflected in the income statement, because of the reduced use of generic provisions.

As you can see in this slide, Santander is not yet taking full advantage of the fall in provisions, as our peers are doing. And, moreover, at this point in the cycle, our cost is higher than that of our peers. Naturally, as provisions returned to a normal level, we will have more leeway to improve our results.

Trends in costs, income and provision have meant that our net operating income after provisions was EUR10.75 billion, that's almost 7% higher, than in the first nine months of 2010, or 5% if we exclude the perimeter and exchange rate effect. It's growth that was based on solid and consistent revenues, net interest income and fee income rising in spite of the current scenario and with provisions almost flat.

This positive growth in our net operating income is not seen in net profits, due, on the one hand, to higher provisions in 2011, especially that one-off PPI charge in the Second Quarter, I'll remind you, that it was EUR842 million before taxes, EUR620 million net of tax; and also, to the increased tax rate for the whole Group, which has meant an increased tax payment. The combination of both effects PPI and taxes, dented profit growth by 14percentage points.

Move on to point two in my presentation, liquidity. Santander has a very solid and sustainable liquidity structure. Our liquidity ratios have improved significantly in the last few years. For instance, our loan to deposit ratio has dropped from 150% at the end of 2008 to the current 118%, where we feel very comfortable. And this improvement in our liquidity position has not just been quantitative. But also qualitative, because the Group has greater medium and long-term wholesale issuance capacity, even in high stress periods, of which 2011 is a good example.

At the end of September we had covered 117% of the maturities for the whole year, after issuing EUR36 billion to which we have to add EUR20 in securitizations placed in the market. Even in a Third Quarter in which markets have been almost entirely closed, we have placed over EUR9 billion debt, plus securitizations; again, comfortably exceeding maturities.

Meanwhile, our recourse to short-term wholesale funding has been very limited in the specific case of our positions in the US market. The recourse to the parent bank is of less than EUR1 billion. And furthermore, we maintain a high discounting capacity with Central Banks of approximately EUR100 billion.

So in summary, we have a very solid starting point and deleveraging envisaged in the mature markets where we operate will be the drivers that will enable the Group. And its subsidiaries, to continue to maintain a very comfortable liquidity position.

As for our solvency ratios, we ended September with core capital at 9.42%, which demonstrates the Group's excellent ability to generate capital, even in this difficult environment. Specifically, we've increased our core capital by 22 basis points in the quarter and by 62 basis points since December. And this after absorbing, in the Second Quarter, the integration of the Zachodni Bank, the Polish bank we recently acquired.

Capital generation is boosted by high retained profits and also by optimized management of risk-weighted assets. So in summary, our core capital ratio is above 9% under Basel II, which is our target. It is a very solid ratio, matching our business model, our balance sheet structure and our risk profile.

And I'd like to share with you at this point, our initial view on the potential impact on Santander of the hypothesis about new capital requirements of the recapitalization plan envisaged by the European Union for its major banks. As you know, minimum core capital requirement will be 9% by June 2012, within the framework established by the EBA. This framework will introduce Basel 2.5. And the application of some criteria anticipating Basel III, such as the mark-to-market of Sovereign debt, reduction of intangibles and impacts on financial stakes and securitization.

In the case of the Santander. And starting with core capital of 9.2% by June, the application of the new framework would mean that core capital adjusted to June 2011 would be 7.9%, including convertible capital instruments. On this basis and considering the increased core capital registered in Q3, which I mentioned in the previous slide that is those 22 basis points I mentioned, our adjusted core capital in September would be 8.12%.

On the screen you can see our forecast for core capital growth in the next quarter within the EBA framework. The Santander will remain in a comfortable position, well above 9% by June 2012. And this thanks to our ability to generate free capital organically, three-quarters generating between 12 and 15 basis points each. The roll-out of our internal model is based on the schedule fixed up to 2014. And the optimization of risk-weighted assets. With these two drivers our core capital will reach 9.2% by June 2012.

But, furthermore, the Group has other financial drivers to generate additional core capital in an amount of a further 80 basis points, bringing us up to our objective of 10% core Tier 1 under EBA criteria. In short, our solid starting point, coupled with our high capacity to generate capital will enable us to comfortably surpass the new solvency requirements without needing to do any capital increases or modify our payout policy.

Finally, we will be obtaining around EUR1.5 billion net capital gains from the sale of our Latin American insurance to Zurich, plus the new agreement to bring in partners into Santander Consumer USA. These capital gains will be fully recorded in the Fourth Quarter. And will be used at the end of the year to strengthen our balance sheet.

As is customary in the Fourth Quarter's presentation, once allocation has been decided, we will give you full details. But it will include the write down of assets in Spain.

And now I'm going to give the floor to our CFO, Jose Antonio Alvarez. So he can give you more detail about the different business areas.

Jose Antonio Alvarez {BIO 19692884 <GO>}

Good morning. Continuing with our results presentation, I will review the different business units. I'll remind you as usual, I'm sure you all know, that on the website we post even more detailed information about the different business units.

Starting with profit and its evolution, you can see the contribution of each of the different geographies. Starting on the right with Latin America; Brazil, profit dropped 6% local currency. Because of the bottom part of the income statement, net margin is growing, or net operating income has been rising at 13% year on year and there have been taxes and minority interests that have dragged down our profit.

The rest of the Latin American countries, overall profit grew 17%, partly in this case due to the decline in minority interests in Mexico.

The UK plus Sovereign, well Sovereign, starting with Sovereign, continued to register strong year-on-year growth, in line with -- clearly with our targets at the time of the acquisition of EUR750 million profit in the year. The UK is affected in the year-on-year comparison by regulatory changes, the PPI charge. And a difficult low growth environment. We explained in detail during our Investor Day rising liquidity costs in the UK which have affected our profit line.

In Continental Europe, without including the Polish business, drop 17%, largely due to Spain and Portugal, where you know the macroeconomic context is very difficult. And Spain mostly due to the reduced availability of generic provisions.

Finally, the Polish bank, the Zachodni Bank, has performed very well, wonderful results, EUR172 million, in the six months since it joined our Group.

Moving down to the different units. And starting with Continental Europe. And before incorporating the Zachodni business, the income statement reflected the difficult business environment with a significant deleveraging in the main economies in this area, with low interest rates and, therefore, smaller volumes plus low interest rates.

And in the Third Quarter also our ROS has been strongly impacted by market conditions. In the last quarter ROS was almost zero when the running rate is between EUR100 million and EUR200 million quarterly profit.

In the year-on-year comparisons there are some elements which make us feel reasonably optimistic about the future. Basic revenues are already rising 4%.

In the slide on the top right-hand side you can see the trend on the upper part of the income statement, with a strong recovery of the Santander Branch Network. And Banesto. And the excellent performance of Santander Consumer Finance, costs down 1%.

Our retail networks increased overall due to the perimeter effect and also investments in global businesses, to bolster positions reached in previous years. And to launch new initiatives. Provisions dropped slightly, offsetting the drop in specific provisions by a lower release of generic provisions. The net result of all of this was a profit of EUR2.269 billion.

If we look at the breakdown by unit, starting with the Santander Retail Network, again we're seeing a widespread deleveraging in Spain with falling volumes. But a significant improvement in spreads.

And the combination of both is what has shown a slight upward trend in basic revenues, up 9% versus the same period last year. This again because of rising spreads on lending and also a drop in the cost of deposits, after renewing the deposits we attracted in the Second Quarter of 2010. Therefore, revenues growing 9% versus the same quarter last year and up 2% versus the previous quarter.

Provisions are still high as a result of economic context. Specific provisions have remained at a quarterly level of EUR350 million/EUR450 million, well below the average of EUR600 million in 2010. So in short, the underlying context is improving, both in terms of revenues and falling provisions. And we believe that in the next quarters keeping costs flat and as revenues -- and spreads continue to rise, profits should improve.

As for Banesto, I'm not going to go into too much detail; they present their own results. The underlying fundamentals are the same; falling volumes but improving spreads, recovery in revenues, good cost control. And the same impact of generic provisions as in the Santander Network. So I don't think I need to go into further detail, because it's the same thing we've just heard from our CO.

And as for Spain, as in previous quarters, let me just show you the evolution of our portfolio in Spain; still falling, EUR3 billion in the quarter for -- from EUR229 billion to EUR EUR226 billion in the quarter; 4% reduction in the year to date. And almost three times more in balances with real estate purpose falling 11%; same trend as in previous years.

NPL ratio rising from 4.8% to 5.1%. And that is 100% from our real estate purpose loans. As you see in this slide, the rest of our portfolio home mortgages, individual loans at the same level as in 2009. And the rest of the portfolio is at 3.4%. And it's only the real estate development portfolio which has remained weak and with a rising NPL ratio.

NPLs and substandard loans with a real estate purpose remained stable in the quarter. And are slightly lower than at the end of 2010. Although, of course, when we look at NPL ratio, as the overall size of the portfolio drops, that also makes the NPL ratio look larger. But if we look at the loans with real estate purpose, again a drop in the overall volume of a third, the size of the portfolio down EUR13 billion.

Foreclosed assets in this period, EUR3.8 billion gross, net EUR1.5 billion; as for foreclosed properties, I'll add just about the quarter that net entries were very -- or additions were very small, the smallest in the last few years, only EUR100 million coverages remained at 32% like in the previous quarter, with coverage between 42% for land, to 25% for finished building, with an average of 32%, which I mentioned earlier.

Moving on to Portugal; since our last results presentation, the new Portuguese Government has continued to implement measures to guarantee compliance with the adjustment program agreed with the EU and the IMF. The financial sector has continued to deleverage, focused on boosting deposits, which have been growing 7% in the system, in an environment which is, of course, extremely price competitive. And has been cutting lending by 1.5%, particularly consumer lending.

In this context Santander Totta has reduced the size of its balance sheet in the period December to September by EUR5 billion, that's slightly over 10%. We've reduced lending by 13% year on year. And deposits have risen at 15%. As a result, the commercial gap has improved significantly. We said at the Investor Day where we gave lots of detail about the different maturities of our wholesale funding, that the Bank is in a very comfortable liquidity position with these current maturity rates.

If we look at the rest of our income statement, volume in lending has dropped; deposits rising; strong competition for deposits which is affecting our net operating income and basic revenues, even though costs are falling. Rising NPLs in this context; we had anticipated some time ago our NPLs would double in this scenario in Portugal and we are seeing trends as expected. And higher provisions are having a significant impact on our profit line; net margin after provisions or net operating income after provisions down 44% year on year.

The fourth unit that we have in Continental Europe, Santander Consumer Finance, has performed completely differently, much more positive, supported by an anticipated position in the cycle and by the business diversification. It has four elements that supported very good performance, a growth in production and volume. The volume is growing in lending, 10%. And deposits 34%.

There is a change in the perimeter. But also the businesses are doing very well. Germany and Nordic countries are also doing very well this year with spreads that remain at very high levels. And the costs are -- remain the same ex-perimeter.

And in this business the fact that less loan-loss provisions are required, are in line with the reduction in the risk premium and a better credit, the quality of our coverage for NPLs is 132%. All of this produced profit growth, particularly in Germany, Spain. And Nordic countries and the US. And pushed up attributable profit to EUR990 million for the first nine months; and a very good Third Quarter where profit was EUR325 million, 6% more than in the Second Quarter.

In Poland, I said this when we were talking about Continental Europe, the situation is quite positive. Lending and deposits are growing; lending 10%, deposits 6% up. So revenue is growing at 10% and the costs are growing at 4%, which is slightly more than the inflation.

There is a fall in provisions of 11%, although in the past quarter they grew a little bit because of higher volume, basically because the business mix meant that they have to grow a little bit.

As a summary, profits increased 40%. And the -- what we expect for the next few quarters in a context of slowdown in Poland. So we think that we can grow a little bit more than the system, which will grow by 5%. And therefore, we think that we can continue to generate favorable results in line with what we had expected in our business plan when we acquired the franchise.

In the UK the income statement is still very affected by lower activity and very low interest rates with one-off impacts like the PPI charge that we talked about earlier.

But if we didn't take into account the impact of the PPI, then revenue would fall 8% for three reasons; flat volumes in mortgages and deposits, which are the two main items. Of course, we are gaining significant market share in SMEs, where we are growing very well. In SMEs we're growing at very high rates, more than 20%. And in the core business with other companies it's also growing strong by 20%.

And now there are higher regulatory costs with higher funding costs, wholesale funding, it's much more expensive. The funding mix is going from shorter term to longer term and, therefore, the cost of funding is more expensive. Interest rates continue to be very low. And so that has an effect on the spread.

There is a strong reduction in provisions. The NPL rate is doing better than what we expected in mortgages, which was where have the best NPL ratios, as well as in consumer loans. All in all, the net operating income after provisions declined 4% and profit before the PPI charge fell 9% in the first three quarters of the year.

Brazil kept up its good trend in business volumes in the quarter and in their transfer to the top part of the income statement. In the nine months attributable profit was $2,773 million with strong activity. Lending is growing at 20% with a stronger growth in loans to individuals 25%. And SMEs growing 14%. Deposits are also a double-digit growth.

The results, basic revenues rose for the sixth quarter running, 13% year on year; this is very good; for the sixth quarter in a row they continue to rise. Costs also increased 11% but this is for two reasons. First of all, the increased distribution capacity; we've opened 167 branch offices, 8% in the branch network. And the pressure on costs from inflation now 7.3%. And also from a high employment rate.

The efficiency ratio cost to income is still improving, 36.8%. And this allows us to absorb larger provisions due to greater lending and a slight rise in NPLs in the sector in the first half.

Santander Brazil's NPL ratio was unchanged and provisions declined a little.

Business growth is not reflected in the bottom line, because of high provisions, partly due to labor disputes. And a negative impact of 5percentage points from the higher tax rate and larger minority interest.

In short, the Bank continues to gain business drive and improve its market position and meet the targets announced at Investor Day where we -- although we've had the impacts that I just mentioned.

And in the rest of the region, Latin America, the trend remains, strong growth in loans and savings which increased at double-digit rate favored by the macroeconomic environment.

Attributable profit rose 17% due to the good evolution of basic revenues fuelled by Retail Banking. The net interest income reflects a larger business volume. Three or four quarters ago we -- the situation was quite different; it's been improving since then.

Fee income is increasing 11% and improved cost of credit as a result of lower provisions. There is also a favorable effect from lower minority interests in Mexico.

By countries, I will say a few words about Mexico and Chile separately. Argentina, Columbia, Porto Rico registered high double-digit or double-digit growth in attributable profit.

If we look at Mexico in more detail, we see that the business is growing strong, 22% lending if we exclude the perimeter of the acquisition of Mortgage portfolio from the GE portfolio, it would grow ex-perimeter at 24%. Therefore, a strong growth in the business with an improvement in our shares in cards, deposits, mortgages, etc.. So very well there.

Basically revenue is already showing the change of the trend that started at the beginning of the year and returned to notable growth in the Third Quarter. Good performance of net interest income from larger volumes, particularly in consumer credit mortgages and cards. And also a good performance of fee income, basically from insurance.

The costs are increasing. There is a commercial strategic plan with a significant investment in IT and that is reflected in the cost. Provisions fall and we've been talking about this for some quarters now, because it's linked to the strong fall of the risk premium in the world of credit cards. And that means that the net margin is increasing at 12% of net operating income after provisions.

Profit before minority interest at a new quarterly record and were 25% more than in the first nine months of 2010. And attributable profit was 59% higher.

Chile, the business is growing well, volumes -- well, because it is more than 20%, lending 14%. A significant compression of the margins, of the spread, this is because inflation was particularly low in this first half of the year, part of the portfolio is indexed to inflation and that had an impact. And there's been an increase in rates which also asserted pressure on the spread.

There's an impact of the effort in capturing deposits. And the market situation also affected fee income and gains on financial transactions. Provisions rose in the Third Quarter, because of the more conservative stance in the risk policies. As a result, the Third Quarter result interrupted the favorable trend of previous quarters. But did not change the underlying performance for the coming quarters.

I think there is use of impact here for an amount of $100 million, which is not going to affect the future quarters where it would go back to normal.

If we look at Sovereign now, I would say the delivery is very good in Sovereign, good growth in lending and deposits. The market is not growing. So there is a clear improvement in our commercial activities, in activity deposits rose 15%, increasing in the (most) core lines and at good prices, lending rose 5%. If we eliminate the portfolio effect, because when we acquired the Bank there was a 20% of the portfolio was in run-off. But the rest of the lending increased at rates of 8%.

In results, the main points are net interest income at a quarterly high and a gross income 9% more than in the first nine months of 2010. Operating expenses rose 8%, because we are investing in IT; we're changing the technological platform and we are also hiring people to improve commercial activity.

The NPL has an excellent performance. A few quarters ago we had a higher NPL rate than the rest of the industry, now it is lower than the average of the industry. So we're performing very well in this regard. And although this means that the net operating income after provisions rose 58%. And profit 44%.

Finally, in Corporate Activities this is what we present, this is a different -- well, there is losses of EUR89 million less than 2010 due to the following factors. The first was the higher cost of wholesale funding, which made net interest income more negative than in 2010. And the liquidity position maintained by the Group which is conservative also entails a certain cost.

And the second factor is the lower recovery of taxes, here we recover part of the taxes that the units, that are part of the parent company pay. In the parent company we have Wholesale Banking, the Corporate Center, etc., therefore the other units pay less taxes here. Here we recover less taxes and that is offset by better trading gains through the year.

And this change in trading gains is due to the hedging of exchange rate. We have an improvement in revenues of close to EUR500 million over the first nine months of 2010, as in 2010 this hedging recorded losses compared to profits this year.

The euro depreciated 1% against sterling and against Latin American currencies; Brazilian reals 7%; the Mexican peso 8%; Chilean peso 6%; and Argentinian peso 5%. So this year we have EUR300 million in this trading line -- trading gain line and this is what explains this change in the trading gains.

And now I'd like to hand over to the CEO. So that he can finish with the conclusions.

Alfredo Saenz {BIO 1422535 <GO>}

Right, we have reviewed the Group's performance and that of its main business groups. And I'd like to finish with some points that summarize today's business trends and those for the coming quarters.

The first is that Santander has a great capacity to generate solid profits, even in an environment like that in the Third Quarter. And this is because the Group's underlying business continues to improve, as compared to last year, strongly backed by sustained growth in basic revenues.

I would like to emphasize that this is something that is a part in the current banking scene, where revenues are scant and few of us -- our competitors that offer growth higher than inflation. This trend is not fully reflected in profit, because of the larger provisions made, particularly the one-off charge for PPI and the higher tax pressure at Group level.

The second point is the advantage for the Group of its diversification and capacity to adapt to the environment of its various units. On the one hand we have our commercial units in Europe and the UK, which are tackling the difficult challenge of recovering revenues and growing in an environment of reduced activity, with low interest rates and much more demanding regulations.

Other units, such as Santander Consumer Finance, Poland and Sovereign are enjoying a brisk growth. Their main task is to construct the future income statement in the countries and businesses where the Group has a great potential.

Lastly, the Latin American units are busy transferring to profit the revenue strengths emanating from economies growing strongly and benefitting from greater bankerization or banking penetration rate. And all of this without halting investment to capture a larger share of future growth.

And the third idea is the strength of our balance sheet. And I'd like to insist on this. Santander is one of the banks with the strongest balance sheet, with strong liquidity and capital positions which we continue to boost every quarter.

We're very strong in liquidity, thanks to our great capacity to capture medium and long-term wholesale funds, combined with the power of our 14 -- almost 15,000 branches to capture savings on our low recourse to short-term wholesale funding, coupled with our high discounts and capacity in central banks. And all of this in an environment in which mature market units generate liquidity due to the deleveraging processes of the economies.

We are also strong in capital, backed by two structural features; on the one hand the high quality of our balance sheet, the result of our business model and low risk profile. And on the other, the strong capacity to generate profit and so free capital within a prudent and sustained pay out policy. These features combined with active management of risk-weighted assets will enable us to comfortably meet the new capital requirements of the European Banking Authority, the EBA.

Lastly I remind you that in the Fourth Quarter Santander intends to further bolster its balance sheet by applying its recent capital gains.

In short, the trends in results of the balance sheet of Grupo Santander are in line with what we announced at the Investor Day for the coming quarters.

Questions And Answers

A - Unidentified Speaker

Good morning, as always, we're going to answer the questions that we received over the web and, if there is time, then we will take the questions that we have received over the telephone.

The presentations are already available in Spanish and English for those of you who would like to follow them. But all of the slides presented by the CEO and the CFO are available to you.

First of all, let us begin with questions on strategy and regulations, or questions on the European Banking Authority. I'm going to group the questions.

Sergio Gamez from Merrill Lynch and (Marcel Fraser) from Bernstein asked whether we can say something about the latest news from the EBA. What are the consequences of that for the Group, particularly in future acquisitions or divestments? And if you think the European Union will somehow limit or impose parameters for the reductions that banks can do on the side of assets and assets risk.

Well, I think we give lots of details in the presentation that we just made on the requirements of the EBA on the one hand. And the -- and it's also very clear in the different activities that the Bank is going to carry out, some of them are already underway. But we're going to do other things as well to meet the requirement.

We have an internal objective of reaching 10% by June 2012. More specifically in the chart that I presented a moment ago, we indicate three levels that we will be reaching and then in the future organic generation of capital, which is very expensive. But we have been achieving this; a reduction in the risk-weighted assets basically due to the progressive roll-out that comes from the past of the rolling out of models for our assets to convert them into risk assets; and then continuous optimizations of our operations, which will lead to reductions of risk-weighted assets.

So, all of this will allow us to meet the limit set by the EBA. So I wanted to insist that we don't need to do a capital increase to achieve this and nor will we change our dividend payout policy. I think I've answered the question.

Yes. What about the assets?

No, we don't have any need to adopt any other measures than the ones I just mentioned.

Francisco Riquel from (inaudible) is asking that in order to reach the guidance of repeated recurrent benefits in 2011, you would need a net profit of EUR2.3 billion in the Fourth Quarter. Are you still going to keep that guidance for 2011?

And do you think that the agreements that were reached last night in Europe will allow markets -- debt markets, to open for Santander and Spanish banks at viable prices?

With regards to the first question, in effect, arithmetically speaking, we are lacking that amount to reach the same level of profits that we had last year. But there's still a quarter left. The Third Quarter is always worse than the others. So we still have the idea that we expressed in the Investor Day; that we would like to repeat last year's profits or slightly less than that. But basically, yes, we would like to equal last year's profit.

And with regards to your second question, I would say that we hope that these measures that were decided on last night will open markets; will put markets at ease. But taking into account the recent history, I dare not do any forecast yet.

There's a question from Carlos Berastain from Deutsche Bank. The organic generation of capital, he thinks it's low, taking into account the profit that we are obtaining in the traditional generation of capital.

And those 40 basis points for three quarters, we have been conservative because, as you know, we have been generating quite more than that. So that's just because we wanted to give out a conservative message when we talked about the future capital figures.

(Neil Smith for) -- is asking the EBA says that those banks that don't reach 9%, they expect not to pay out any dividends or bonuses. So can we, therefore, draw the conclusion that Santander will not pay out dividends until it reaches that 9%?

I don't think we apply to this because, as I said, we are going to have more than that 9%. Even in December of this year, it is possible that we might reach that figure, that 9%. Therefore, we are not in that situation.

There are several questions on the capital gains generated by the selling of the business in the US. Sergio Gamez from Merrill Lynch and Raoul Leonard from RBS ask, first of all, why did those capital gains -- why are they used to reinforce provisions and are not included in the capital? And can you shed some more light on how provisions are going to be dealt with?

And there's another technical question on what could be the impact in the capital, the minority interests for cap -- the impact of capital?

I can answer that. It's very small and it affects the risk assets, the goodwill and minority interests. And that netting is a very small impact.

So basically, the question is can you shed some more light on the provisions? And why do you put the money into provisions and not capital?

Well, these EUR1.5 billion in capital gains can be used as we wish and, right now, we -- there are different alternatives, of course, total or partial, to make use of that EUR1.5 billion. And we want to have a chance at the end of the year to decide with flexibility.

So our idea right now. But that's just a first thought, is that we don't need it to reinforce our capital. Nevertheless, we do think it is a very good signal to the market if we reinforce our provisions, particularly in Spain and particularly in Spain for real estate assets.

And therefore, I repeat, it's just a first thought. But we haven't reached a binding decision yet, is to go along those lines. And most probably a significant part of these EUR1.5 billion will be used for provisions, for Spain for real estate assets. But so far, we haven't yet made the final decision on how much we would dedicate to that. So we prefer not to say anything more. But, as I said, that's what we're thinking of right now.

There's a question from Marco Troiano about the impact of risk-weighted assets and the agreed bonds and so on. We specified that in the EBA stress test already. So if you want, we can give you the technical detail of the weight of each of the assets at risk.

More questions about the EBA. Andrea Filtri from Mediobanca is asking what do we think will be impact of all the measures adopted on the Spanish banking sector overall, not just us.

Jaime Becerril is asking about the dividend payment, which we've already answered. And whether this includes scrip dividend or not, the EUR15 billion that we mentioned. Yes, it is.

(Antonio Ramirez) from Keefe is asking whether we could give more detail about the additional buffer of 70 basis points we mentioned.

And Frederic Teschner from Natixis is asking about the evolution of core Tier 1 capital in Q3, which we've already answered too.

So that's just two questions really; detail about that extra -- our additional buffer of 70 basis points and the overall impact on the Spanish financial sector.

Question is more details about that additional 70 basis points buffer, well, there's a whole range of measures, whole series of things --

(Technical difficulty).

So the additional 80 basis points, I mentioned, are part of a really long list of small measures that bring in three, five, eight basis points each. I suppose that the person asking the question knows quite well that the things that can be done to optimize and to make, I should say, risk as efficient as possible, is really long.

In fact, our plans which we've been working on for months now are -- it's a huge, long list of things. And all of them together will bring in those additional 80 basis points; plus, of course, our own sale of assets, mostly in Spain. But also in other countries. And all of these things will add up to 80, or approximately 80, or maybe more. But it doesn't really make a lot of sense for me to go into each and every one of these things, because what matters is 9%. And we've shown clearly that we'll be comfortably above that level.

Okay. And to finish this part on strategy, regulatory framework and capital ratios, there is a question from Santiago Lopez and from Benjie Creelan, about why core capital drops in absolute terms in the quarter; and same thing about negative adjustments and there is a series of questions about this.

You have to think about exchange rate adjustments. They impact both capital and assets at risk, especially in Latin America.

I answer this because there are several questions about assets at risk and then about)capital. And these are the factors that offset them, mostly. And also, you have to consider the impact the exchange rate this quarter was significant.

And a final question about capital ratios, it says that the price of convertible bonds that we issued some time ago is substantially below listed price. What do we plan to do with these convertible bonds? Are we going to compensate our holders in any way?

Well, this is question that has come up several times already. It did come up several times at the Investor Day. And also, I think, in the last result presentation, last quarter. And the Bank will convert, based on the terms of the issue, bondholders in the same position as our shareholders. So there will be no chance of any kind of compensation.

Okay. Moving on to financial management. There's a question about -- from Santiago Lopez, about the loan to deposit ratio, which according to him is at 139% considering (deposits).

Well, we don't know how you come up with that number. Our number is a loan to deposit ratio of 118%. So we can go through your figures later, if you like; and you can tell -- explain how you come up with that number.

Andrea Filtri is asking whether, given the regulation that has just been approved in terms of liquidity and financial management, do we plan to use other kinds of liquid assets other than sovereign debt or bonds? I suppose she means in general, (our) hedge.

I don't really get the question. But -- well, we use state bonds, as we've mentioned, to hedge our interest rate risk in those units where loans are predominantly at variable rate, like Spain, Portugal, Mexico are very typical examples. So we use state bonds to hedge our core deposits since we don't have any fixed-rate assets. So I suppose the question is that since -- if we -- we'll consider these instruments in the future.

Well, there are, of course, other alternative methods, like interest rate swaps, although, of course, those would require some kind of macro hedge. But the hedges (won't) work, not just from the economic point of view. But also from the accounting point of view; if that was your question.

(Marta Sanchez) from Keefe and Raoul Leonard from RBS are asking about the evolution of our ROS, particularly in Spain and the comparison with the ROS of the Corporate Center. Can we talk about the trends for both in Spain and in the Corporate Center? And what -- how do we expect these two variables to evolve?

And then there's a question about spreads for the whole Group, from Raoul Leonard, who's saying that spreads in general are suffering. And whether we're worried about this trend. And what kind of Management measures are we considering for asset spreads in general, in the Group?

Right, as for our net interest income; in Spain, I think, the quarter has been basically flat, the Santander Retail network. In any case, this was the low season. But we still see a positive trend on spreads on loans. And we had a significant drop of the cost of deposit, when we renewed those expensive deposits. But volumes are in -- are not helping in this, nor do we expect them to help.

As we said in the Investor Day, we expect the loan portfolio in Spain to keep shrinking by about 3%; so volumes won't help. But I do think lending spreads will continue to rise. And in deposits there could be some additional negative impact, if, as the market believes, the ECB lowers interest rates.

And we reported in the Investor Day the impact which 100 basis points would represent in the Eurozone and in the different areas. I'm speaking off the top of my head. But I think it was EUR140 million in the Eurozone; and I think it was (180 million) in the pound sterling zone. So that's basically the variables. Volumes, lending spreads which are improving. And possible changes, which would be basically interest rates.

And as for the Corporate Center, there are two basic functions there. And one is to fund the different units. And that is done with market spreads. And that changes month on month. And then it has another function, which is to fund the holdings. And, of course, with rising rates in absolute terms versus last year and with higher funding costs, in terms of lending spreads, the Corporate Center has more negative than interest income.

And a general question about whether spreads are suffering throughout the Group. The idea -- and it's always hard to speak in general terms; but I'd say, in general, lending spreads are rising in almost all our units. I think the only unit that I can think of in which they're not is Chile. And that's because, as I showed you in the presentation, lending is fixed rate. And there's been a significant hike in interest rates; and that's meant a pressure on our spreads.

In the other countries spreads are either stable or rising, although, of course, because of the mix the greater growth in corporate activity and low-end cards may give that impression. But segment by segment, in general lending spreads are rising.

Where spreads are suffering is on deposits, particularly in those countries where interest rates are very low, almost zero; US; Europe, not as low. But also low; and the UK. And the Latin American countries, where rates have tended to drop slightly, like Mexico; and now, in the last 20 days or in the last month, Brazil. But in general the idea is that lending spreads tending to rise. And spreads on deposits are under pressure from low interest rates.

A question from Ignacio Cerezo asking whether we can we say something about the guidance we issued of about 80 basis points of EBA impact.

Well, I think the slide showed all the detail; the impact is 90 basis points without the mark to market of the (ACS's). So that's basically what we mentioned.

A question from Marcello Zanardo about sensitivities to 50 basis points variation in interest rates.

A - Alfredo Saenz {BIO 1422535 <GO>}

Jose Antonio Alvarez has already explained that.

A - Unidentified Speaker

A question from Raoul Leonard asking whether we can we say anything about the fall in the (ACS's) in the quarter. And also the change in derivatives mark to market.

And then there are several questions from Antonio Ramirez and some other analysts about our sovereign debt portfolio, our exposure held to maturity.

There's a slide from the Investor Day with each of our exposures. We have no held to maturity, it's only (FS) in the Group. And in the presentation for the Investor Day, you have specified for each country exactly what we have.

Okay. And the drop in assets available for sale in the quarter is basically Brazil. In Brazil we have a public debt portfolio. And I think the data from the Investor Day that (Angel) was just referring to, I think it was about EUR18 billion/EUR19 billion. I'm not sure if it was euro or dollar. But it was specified very clearly there.

And this in part was bought; when we did the capital increase, there was a surplus liquidity in Brazil which we invested in sovereign debt. The loan portfolio is growing strongly, as we showed in the presentation. And we sold some bonds in Brazil. And that's the main effect of the drop in available for sale.

And as for the mark to market derivatives (inaudible) market trends, it's all mark to market by definition. So that's it. In general, our exposure to the derivatives are (ERS's) with customers from fixed rate to variable rates. So the evolution of interest rates, up or down, is what changes the figure. But there's nothing really on top of that, as far as I can remember.

Moving to Spain, it's a question about M&A, about whether we are planning anything. A question from Daiwa Asset Management -- are we planning to buy some banks, or Caixa's savings banks in Spain?

And Britta Schmidt and Raoul Leonard from Autonomous and RBS have a similar question about the possible sale of our EUR3 billion portfolio of real estate assets in Spain. Are we selling? Are we not? What is our position? Do we plan to sell these assets off aggressively?

Well, the first part I think we've repeated many times. We are, of course, looking at each opportunity in the market; it's our responsibility. And professionally, we do have to analyze each of these opportunities. And that's all I have to say to that.

And as for the second point, it's true that our recovery unit are having talks of all types with lots of intermediaries to study possible transactions of this type. But in any case the transaction you just mentioned is not really very advanced at all, just some preliminary contacts and talks. So I can't really be more explicit.

And moving onto risks in Spain, there are several questions from Benjie Creelan from Macquarie and Francisco Riquel from N+1 about the evolution of the NPLs in Spain.

And Matteo Ramenghi from UBS; are there any segments that are specifically deteriorating. How do we expect a rise in interest rates this quarter? And do we believe that the peak NPL -- or have we reached the peak NPL in Spain yet? When do we think we will reach that peak; that's another question? And do we plan to create a bad bank and transfer all those NPLs there and sell them off?

Well, there's a chart which I think Matias Rodriguez Inciarte showed the Investor Day showing a breakdown of the NPLs in Spain by segment; individual mortgages, businesses, others. And then the real estate developer business mostly. And there you could very clearly see that the trend for NPLs, other than real estate developers, were pretty flat, or growing only very slightly. However while we still saw significant NPL rises is in developer loans, I think it's a big percentage too.

So that's the first part of my answer. We don't see real change of trends in NPLs in segments other than the real estate developers; this is my first point.

And the second point is that we were thinking a year ago that towards the end of the year NPLs in Spain would have peaked. But now we no longer think so. We think that they could still rise potentially, especially -- well, real estate developers mostly.

So it went up in Q3 over 5% in Spain, which we did not expect to happen a year ago. And we think that in 2012 it will continue to rise, perhaps not very significantly, though we don't think that it has yet peaked. And probably won't in the next quarter either. We'll have to wait and see what happens next year. We expect some rises. But it's always going to be in that same segment, real estate developers.

And, Jose Antonio is right, about the bad bank thing. Well, I don't know what that means, nor do I understand what you mean by that question. Of course, a lot of people are talking out there about dividing up the Bank and creating a bad bank. But we certainly have not thought anything about that. And if you have some ideas about it, go ahead and tell us. But we're certainly not considering any such thing.

The next question is about what do we expect to happen with the quality of loans to developers and so on. And I suppose you've just answered that.

And Matteo Ramenghi is asking whether we're comfortable with the current coverage levels in Spain.

And to finish with risk, there is another question also from (Kiti Fuji) from Brazil -- about Brazil -- if we can explain the situation with loans and risk quality in Brazil. Do we think -- or how do we think NPLs will evolve; have they peaked in Brazil?

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

Well, in Brazil, what has happened in Q3 we already anticipated last month. We said that in Q3 there was going to be a rise in NPLs; it was going to be rising but then it would normalize in the following quarter. And after than we didn't expect to see anything particularly unusual. So the cost of lending would remain more or less constant. And loan growth would be the driver for rising NPLs. But ratios would remain the same, because there's no change foreseeable.

And as for coverage in Spain are we comfortable? Yes, we are comfortable. Maybe, as I said earlier, we may reconsider the coverage of some of the real estate assets towards the end of the year as a possible way to allocate the capital gains we're generating. That might be the only area where we might allocate some of our capital gains to improve those coverage levels, for some specific real estate assets.

But in general, we are comfortable with the coverage that we have. Plus, if you compare it with our peers of Spanish and elsewhere, it is also very good; it's above average.

And as for the NPL ratio in Brazil, remember that in the Investor Day we said that it could worsen by an additional 30 basis points. And it's actually been quite flat. And early defaults are reasonably flat too. The evolution has been, as our CEO has pointed out, in line with our target or better.

A - Unidentified Speaker

And finally, Spain, the top part of the income statement, a couple of questions from Benjie Creelan from Macquarie. You're saying that we're growing deposits. But it seems that with higher costs. Are we seeing any deposit wars in Spain, or how do we expect this to evolve in Spain? And can we shed some light on net interest income over mean assets on that ratio, medium term or in the next quarters?

Well, I think there was a question about that already, where we basically explained what we thought. We saw widening spreads on loans. And for deposits I think the main impact would be interest rates, because if the Central European Bank were to lower rates, that would have an impact on our spreads for deposits.

As for deposit wars, well, there is intense competition for deposits. But I wouldn't call it a war. There are different strategies at different times. But I wouldn't say there's an all-out deposit war.

Similar question from Jaime Becerril from JP about covered bonds in Spain. Do we think that this could be a product that might be used more? In our particular case, how are sales going and can we give some idea about volumes or amounts?

Well, the main reason for those -- or selling them -- or maturities are significantly longer than for deposits. So that gives you more stability than time deposits, particularly when liquidity -- when there's so much competition for liquidity. And the wholesale markets are so limited. I don't have the figures here. But generally we will place what was scheduled.

Okay. And finally for other unit, Andrea Filtri in the UK is asking whether we can remind them of the regulatory impact. And other impacts for '12 and '13.

We also specified this during the Investor Day. We spoke about total impacts; combining regulation and other things of between GBP500 million and GBP600 million, annual.

(Alexander Postetski) from ING is asking about the drop in lending in Latin America. I suppose that's an exchange rate impact, because actually lending is growing in Latin America. And he's also asking about the tax rate in Brazil, which explains, as Jose Antonio said in his presentation, the negative impact on our profit.

(Interpreted) Well, that is the end of all the questions we've received over the Internet. I don't think we have any time left for questions over the phone. But there aren't any it seems. So we'll leave it there.

Thank you, very much. If you have any other questions, or if you think of anything else, do get in touch with Investor Relations. Thank you.