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Q4 2014 Earnings Call

Company Participants

- Angel Santodomingo, Executive Vice President and CFO

Other Participants

- Andre Riva, Analyst
- Francisco Kops, Analyst
- Saul Martinez, Analyst
- Timothy Lambert, Analyst

Presentation

Operator

Good morning and thank you for waiting. Welcome to the conference call to discuss Banco Santander Brasil S.A.'s Results for the Fourth Quarter of 201. Present here are; Mr. Angel Santodomingo, Executive Vice President and Chief Financial Officer; and Mr. Luiz Felipe Taunay, Head of Investor Relations.

The live webcast of this call is available at Banco Santander's Investor Relations site at www.santander.com.br/ri, where the presentation is available for download. 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). Each participant is entitled to ask two questions, if any further information is required, please re-enter the line.

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, operating and financial projections, and targets based on the beliefs and assumptions of the Executive Board, as well on information currently available. Such forward-looking statements are not 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 and may cause actual results to substantially differ from those in the forward-looking statements.

I will now pass the word to Mr. Angel Santodomingo, Executive Vice President, and CFO. Mr. Santodomingo, you may proceed.

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Angel Santodomingo {BIO 15757370 <GO>}

Good morning, everyone and thank you for joining us in Santander Brasil's 2014 results conference call. As you may see in the index, in the table of contents, I will try to cover in the next minutes basically an overview on the macro scenario, the highlights of this fourth quarter results, the evolution of the quarter and the commercial activity; and finally, I will try to make final remarks with regards to what we presented today.

In page four, where we speak about the macroeconomic scenario consensus. As you know probably, market expectations have clearly evolved, reflecting the last government measures announced in this January -- in January 2015. Market expects 2015 scenario characterized by low levels of activity and inflation above the targets, which will require probably higher interest rates.

For 2016, it is expected a gradual economic recovery with GDP growth around 1.5. The market consensus points to interest rate around 12.5% in '15 and 11.5% in '16 with an exchange rate that it is as expected to run or to go around R$2.8 per USD and R$2.9 for the next two years.

In this scenario, we continue to believe that Brazil will overcome the short-term economic challenges, specifically with the measures announced by the government. And, obviously, for us, the country continues to be a group opportunity growth in the medium and long-term. We expect '16 and '17 to be quite positive years.

Moving to page six, where you have the highlights of this quarter and the comparison versus the previous quarter. I would like to highlight the main messages of these results. First, expanded loan portfolio increased by 6% in the quarter, with growth in all segments for the first time in the last eight quarters. It is the first time that we saw this positive behavior in all segments. Funding from clients moved up by 4%.

Secondly, the bank remains with a comfortable position in terms of capital and liquidity, as has been the case in the last quarters, reflected in this strength of its balance sheet. Capital ratio, the BIS ratio stood at 17.5 out of which 16.1 is Tier I. The LTD, the loan to deposit ratio reached to 98%.

Thirdly, with regards to results on the right upper side, total revenues grew by 2% in the quarter, chiefly due to the upturn in fees and commissions. As you may see there upclimb nicely. Net interest income remained flat in the quarter. The allowance for loan losses fell by 14% in the quarter, positively impacting net interest income, net of provisions, net of allowance for loan losses, which climbed by 8% in the period.

General expenses remained under control, increasing by 3% in the quarter and continued to grow well below the 12 month inflation, as it has been repeated during the quarters and during the year, being one of our main objectives. Net profit totaled 1.5 billion, 1.521 exactly, in the fourth quarter 2014 growing 4%.

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Finally, it is worth emphasizing that the asset quality on the bottom part of the slide continues to improve. The delinquency ratio for the loans overview by more than 90 days fell by 38 basis points in the quarter, while the coverage ratio reached 180%, its highest level for a long time. These figures were accompanied by the good quality of the leading indicators, the 15 days to 90 days, which I will cover later on.

If we skip to slide or page eight, where you have the quarterly evolution and the yearly evolution of our net profit, as I said, net profit in the quarter totaled 1.521 million, 4% up, 3.9% up in the quarter, while the annual profit stood at 5.8 million[ph], 2% higher than in 2013. The quarterly increase is also the highest out of the last couple of years.

Next page, in page nine, shows the main lines of our results. Revenues, starting by the revenues, as I mentioned, net interest income and NII remained flat in the quarter and fell by 7% in 12 months. The main dragging reasons for this evolution have continued to be what you heard from us during the previous quarters, mix change and the capital optimization plan that we did in January, there is no news there.

Commissions grew by 8% in the quarter and in 12 months. The latter, as you know, adjusted by these specific impacts, in order to make a like-for-like analysis. All-in-all, you have an NII that is flat in the quarter and total revenues that increased by 2% in the same period.

Provisions fell by 14% in the quarter and if you analyze the full year, 2014, the total 9.4 billion, going on 20% versus 2013 and almost 30% if we compare it to 2012, where we reached R$13.2 billion of provisions. This reflects our lower risk production growth. The improvement was also reflected obviously in the cost of risk of credit, which fell by almost 70 basis points, 66 basis points in the quarter and 120 in 12 months.

General expenses as has been the case also during the last quarters, almost eight quarters in fact, where it remained under control, with annual growth of 3%, as I mentioned, well below inflation, reflecting our efforts to improve productivity and efficiency. In the quarter, general expenses moved up also by 3% due to seasonal impacts. As a result of all what I mentioned, net profit climbed 4% in three months.

Going line-by-line, we have in the next slide, the evolution on NII. NII refers the total of the fourth quarter was R$7 billion, remaining is stable over the previous quarter. The decrease in net interest income from credit related activities was offset by deposits and orders. This 1% drop in credit related NII is explained by the spread compression that resulted from the change of mix as you can see on the right side of the slide.

The spread impact per product within the same segment was actually positive. So, the price evolution is positive, the mix is what is explaining the change of NII, or the drop in NII. The change in mix can be made tangible with the following examples. Mortgages, for example, outpaced the growth of other products, and the dropping balances observed in the quarter in what we call revolving credits[ph].

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Another example is that large corps clearly outperformed other segments. In the annual comparison, in the yearly comparison, NII reached 27.6 billion with a reduction of 7%. This is partially explained by the 1.2 billion of credit related NII reduction, which again is related with the mix led spread compression, and partially also explained by the 1.1 billion reduction in the so called line others.

Approx two-third of this reduction in the line others comes from the general capital optimization plan. If we exclude that effect, NII would have fallen around 4.5% in 12 months instead of the 7.3.

We will move to the next slide, where we saw the loan portfolio, we think that we experienced another quarter in which the loan portfolio growth accelerated with growth, as I mentioned in all segments in a positive evolution. The expanded loan portfolio totaled about R$310 billion with an increase of 6% in three months and 11% in 12 months, positively comparing with the private peers sector.

Even excluding the impact of the exchange variation, if you want to adjust by the ForEx, the loan portfolio recorded a healthy growth in both fields. The large corporate segment continues to be one of the main growth engines climbing by 9% in the quarter and an expressive 22% in 12 months. In the individuals segment, mortgages has to be highlighted, moving up by 10% in the quarter and 36% in 12 months.

The individuals' performance continues to be negatively impacted by payroll loans, which also we mentioned in previous quarters. Excluding this product, the segment would have grown by 3% in the quarter and 8% in 12 months.

Consumer finance, another point to be highlighted. This portfolio recorded just 1% up in the quarter and a 3% reduction in 12 months, but it has to be kind of explained because despite the annual decline, Santander has clearly outperformed the market, but as you know, it is in a declining process. And we are in a leading position in vehicle finance market share strongly above our natural market share.

The SME portfolio grew for the first time in many quarters by 2.4% in 4Q; showing a positive trend, thanks to the Bank's efforts to improve over time its platform in this segment. In this year, in 2015, we expect to upgrade even further this platform and the segment we tend to evolve possibly. As you can imagine, this segment is strategic for the bank.

On the funding side, in page 12, you can see the evolution that reflects our focus on clients and on the linkage with them. The liquidity buffer reached its highest level in December 2014.

Funding from clients, as you see there, it is total of 252 billion, climbing almost 30 billion in 12 months and 8.5 billion in the quarter. The 12-month evolution outpaced loan portfolio growth in the same period, which resulted in a loan-to-deposit ratio that I mentioned before, at 98%, reducing almost 5 percentage points in 12 months in a similar figure, flattish figure, compared to the previous quarter.

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If we go to total funding, this means including asset under management, the total came to 450 billion with a growth of 16%, which means R$63 billion in the year, and 4% in three months or 16 billion, both figures that are quite important, as you can see. Assets under management totaled 162 billion [ph] with a 13% increase in 12 months, and 2% in the quarter.

Moving to fees in the next page, you can see that the total fee income totaled 11.1 billion in '14, with an increase of almost 4% in the year. As I have mentioned in the introductory words and also in previous quarters, the annual growth was impacted by the change of the recognition of life insurance policies and by the sale of our asset management activities. Excluding these effects, fees and commissions climbed what we call the normalized total, an 8% in 12 months, a like-for-like comparison.

In between the different lines, I would underline insurance commissions that fell by 1% in 12 months, again heated by these kind of non-like-for-like issues. If we exclude this position, they would have increased 8% in 12 months, this is what reflects the real business as usual evolution. And in asset management, again with the same type of like-for-like analysis, the revenues would have grown 10%. As I mentioned in the quarter, total commissions grew 8%, primarily fueled by higher commissions from insurance, cards and lending operations. The 33% increase in insurance fees reflects the concentration of policy renewals in the quarter.

Moving to general expenses in page 14, we give our breakdown of the total expenses, excluding depreciation and amortization increased by 4% in the quarter and 2% in 12 months. Including depreciation and amortization, total expenses moved up 3% in the year and in the quarter. So it is worth to underline that in 12 months the expenses have continuously evolved well below inflation.

The quarterly upturn was mainly due to the perimeter impact, Getnet, and the collective bargaining agreement. The good performance observed in 12 months with a mentioned evolution well below inflation is a result of our productivity and efficiency programs, which continue and will continue throughout this year. We still expect costs to grow below inflation.

On page 15, next page, you can see the quality indicator for the delinquency indicators, which continue to reflect the quality improvement of our loan portfolio. The NPL ratio over 90 days fell by 37 points, almost 40 basis points in 12 months, with an improvement in both the individual segment, 26 basis points and the corporate segment, another 36 basis points.

In the quarter, delinquency fell by 38 basis points, also with an improvement in both mentioned segments. The leading indicator, the 15 days to 90 days NPL ratio, also fell by almost 20 basis points in the quarter.

And finally, the coverage ratio reached 180%, which is an increase of 10 percentage points in the quarter, remaining at a very comfortable level and as I mentioned before, at a historical level. We expect our portfolio to continue growing, while maintaining its quality.

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In terms of allowance for loan losses in next page, they came to a total of R$9.4 billion in 2014, a decrease of 20% versus 2013 and another 10% versus 2012. As I mentioned before, this amount reached 13.2 billion in '12, which compares quite possibly with the 9.4 billion that we registered in 2014 with a total drop of almost 30%.

Cost of credit reflects this improvement as well as previously mentioned change of mix, representing a decline of 120 basis points in 12 months, which compares positively with the 100 basis points drop that you saw in the credit spread, reflecting what I mentioned, the change of mix.

Performance ratios in next page, you can see that the efficiency ratio stood at almost 54%, with an increase of 300 basis points in the quarter. The recurrence ratio reached 67% with an improvement of another 280 basis points in the same quarter.

Finally, return on equity, on average reached 12%, 12.1% in fourth quarter, increasing 45 basis points over the third quarter and a remarkable 160 basis points in 12 months, if we compare 4Q '14 with 4Q '13. In the accumulated of 2014, the return on average equity improved another 55 basis points. So, as you see, we have a positive trend.

Finally, liquidity and capital ratios, as I mentioned in the introduction, the bank maintains an adequate position in terms of liquidity with a stable fund resources and an adequate funding structure. The loan to deposit ration closed at 98%, declining almost 5 percentage points in 12 months and with a small increase in the quarter.

The 12 month improvement reflects a good funding performance being loans totally funded with deposits from clients. These ratios stood at 17.5%, I mentioned in the introduction, which is as you already know basically composed of Tier I instruments.

The 128 basis points reduction over the previous quarter was essentially due to the increase in credit risk. As a result of the expansion of the loan portfolio, client oriented operations. In any case, we expect an important part of this to reverse in 1Q, due to the end of year operations.

As a conclusion, in the last slide, that I wanted to present to you, the main message is that I would like to share with you are the following. First, the loan portfolio maintains a recovery trend, with growth in all segments, with a change in the risk profile for the better, leading to an improvement in the loan portfolio quality. This improvement has been reflected in the spread net of risk, as mentioned in previous quarters.

Also, as we mentioned in the past in these previous quarters, 2014 has been a year of pressure on our revenue line. In addition to the compression of spread that I have already mentioned, mainly coming from our change of mix, we also have the impact of the capital optimization plan of last January 2014. However, revenues are already showing a positive trend with fee and commissions income recording healthy growth.

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General expenses remain under control, with annual growth well below inflation. The productivity and efficiency plans are generating the expected results, but, once again, the most important point is to continue concentrating on transforming the bank into a client focused organization.

We continue to invest in between 3 billion to 5 billion per year and we aim to maintain these investment levels going forward. In this direction, we are working on our commercial model that you probably have heard about it, focusing on sustainable growth.

At the end of 2014, we launched the new commercial model CERTO, which aims to simplify processes, improving service levels and increasing and devoting more commercial time of our branch network teams to activities with clients. Those are the initiatives that we have shared with you during last year, like our SME individuals segment strategy with commercial model and organic movements, such as the acquisition of Superbank, Bonsucesso, GetNet and others.

We prepared the bank for a stronger performance in 2015, which we'll strive to obtain and to present to you. Management priorities are to continue delivering results while we improve the performance on the upper part of the P&L, as mentioned during the previous quarters.

Thank you. And we are now ready to answer any questions you may have.

Questions And Answers

Operator

Thank you. We'll now start the Q&A session for investors and analysts. If an investor or analysts has any questions they should be primarily sent via webcast through the questions button at the bottom of the platform. Please wait while we get ready with the question.

Q - Saul Martinez {BIO 5811266 <GO>}

Regarding NII, we received one question from Saul Martinez from JPMorgan. The question is, can you discuss why you're lending margins continue falling even as lending spreads have been increasing at the system level? And your competitors who have also had mix shifts towards lower risk margin products have seen stable to rising financial margins since 2Q14.

A - Angel Santodomingo {BIO 15757370 <GO>}

Okay. Thank you Saul for your question. Well, as you mentioned in the question, yes, the lending margins continue to fall, but they are basically, when I speak basically, I am speaking of more than 80%, in between 80% to 90% of the fall explained by the change of mix. For example, if you just analyze the quarter, we had a remarkable drop in what we call revolving in the Rotativos segment with a drop of 9%, which explains a lot of both the spread and the NII evolution.

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That change of mix is also reflected, that I mentioned in the cost of risk, and it will continue to put pressure in the P&L as we move towards less spread and less risky products or as the economy moves into less spread, less risky products. Probably, I always mention this, probably the best way to analyze this evolution is either the NII net of provisions, which climbed 10% or 8%, or the spread net of risk, whatever, it is same concept in terms of the ratio, in absolute terms.

Compared to this 10% that I was speaking a drop on revolving, on rotativos, you have expressive growths, like 36% in real estate, in mortgages, like what we presented in terms of SMEs -- I mean companies, specifically large corporates, they tend to have lower spreads, lower cost of risk. So, we remain comfortable in terms of evolution. We are confident in terms of revenues, and in terms of what we are building of both relationship and the type of growth that we are working going forward. Regarding asset quality we received another question from Saul Martinez from JP Morgan. The question is, can you discuss your exposure and the risks to credit quality related to Lava Jato, car wash, a weakening economy and possible rationing? How should we think about this? Do you see a risk that the improving credit quality you have been showing?

Okay. Thank you, Saul again for the question. I will say here several things, because we tend to having these things a lot of noise around, and probably things have to be more, a little bit more factual. Let me try to address the three points you mentioned, the weakening economy, the impact of the rationing or the water situation and the Lava Jato impact or the Lava Jato exposure. In terms of weakening economy, you saw the consensus; our idea is that the economy, obviously this year will perform clearly in a worse trend compared to 2014, which means that volume growth will not be (inaudible) remarkable.

Volume growth will remain in the single digit, obviously, speaking of private banks, and we are totally conscious of this situation. We believe that it is probably a year that the activity will be focused more on the spreads than in volume. But this does not mean that the capacity of growth disappears at all, no. We have gaps compared to competitors in different segments. And to close, speaking of BNDES, and speaking of rural, we have good performance in segments like the car financing, we have to climb up on the payrolls, both through the internal channel and through the external with Bonsucesso.

GetNet has to be also a successful story and is in the process of being both by itself and as a commercial tool. We are launching this SME initiative I mentioned in the presentation. We are launching this -- it's already launched, we are launching this commercial new model in which we optimize commercial activities and time with the clients. Let me give you a very solid example. We already have told it during the last basically couple of months, because we have started to implement and to announce by early December, and we have seen increase of client contacts more than 50%, increase of sales or activities in different or specific products around 20% to 30%. And this is just because you organize, what I mentioned the time and the way things are being done in your branches or in the different channels.

For us, it is also an opportunity, the launching of the different channels, speaking of the mobile, Internet, ATMs et cetera. So, yes, the economy is weakening. I think the

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government is taking the right measures that are being announced. So, we are moving into a territory, in which probably the economy will digest those measures that are totally needed for a brighter, clearly brighter '16, '17 and onwards.

Second point on your question was the possible rationing, where we have made our estimations, our calculations et cetera, in terms of what the water situation may mean. I would like first to address a couple of points of information and then I will answer your question in terms of impact in the economy.

The first thing is that 82% of the consumption of water in Brazil is done by agriculture activities, which has a weight of 4.5% in GDP. The second thing, the specific idea I would like to say with you is that industries tend not be concentrated in one region. While the water situation that is living today Brazil is clearly concentrated in the Sao Paulo area. For example, you have the beverage sector, that they are present in different areas of the country, and what the analysts say is that they can move production from one side or the other. Or for example, the food sector, which obviously, specifically the protein producers, tend to be affected by water shortages, only 20% of the production is concentrated in the Southeast region.

Last example, I am going to give, because I do not want to give a class of water consumption. For example, 70% of Sao Paulo industries, which represent 30% of GDP, 70% of them use recycled water, and this is 50% of the consumption in the Sao Paulo area.

With all these, well, if we go for a rationing, and this is a pure estimation, but if we go for a rationing of 15% to 25%, 30%, probably you have two impacts, one is inflation obviously around 0.1% or 0.2% per quarter, the rationing pace, and the second one is GDP, and we estimate probably somewhere around 0.4% of GDP as a negative impact. So, all in all, in terms of activity or in terms of growth of the loan portfolio, as you can see, obviously will impact, but probably less than what is being said around.

Finally, the Lava Jato, the car washing question you were mentioning. As you can imagine, we have identified, analyzed in depth and implemented and revisioned all our risk policies, where they were necessary to do. We remain comfortable with our exposure. It is something that the management is following obviously, I could not say another direction, but as I mentioned, we remain fairly comfortable with this exposure.

Probably, the discussion here is more than quality, because obviously, there will be impacts, but we feel and what we have measured that they are totally absorbable. But probably the question is more growth than quality. There will be I do not know, if more than sectors, companies, in which growth will be either limited or low, depending on their risk profile that could not be in other way. So, I had a discussion in this case once, I mean all the media noise et cetera, have also is that.

I made an answer quite longer I guess, but I wanted to clarify.

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Q - Timothy Lambert {BIO 20495180 <GO>}

A question from Timothy Lambert from Loomis. What are Santander's loan exposure to oil and gas and construction sectors?

A - Angel Santodomingo {BIO 15757370 <GO>}

Well I think, we -- the type of public information that we give, is already been put in our website. So, you have the different exposures that we have, organizing the way that we publish them, in terms of sectors and segments. In terms of the different activities that we have covered an exposure to this, what we analyze specifically, more than the full exposure et cetera is within them, name-by-name, obviously, the top x percent, the concentration within them, what is building, what is non-building related, what is services et cetera. And what I said before, we remain comfortable in that segment, in that sector, and I refer to my previous words to Saul's question.

Q - Andre Riva {BIO 17582288 <GO>}

A question from Andre Riva from GBM. A follow-up on the NII question. What would be the target portfolio mix for the bank? I mean, in which level are we supposed to see the mix stabilize, so we could expect spreads to gradually increase or stop falling at least?

A - Angel Santodomingo {BIO 15757370 <GO>}

Okay. Yes. Let me thank you, Andre for your question. Let me elaborate a little bit what we see as evolution and how this business -- if you analyze today the loan portfolio, you have basically one-third in what we call pessoa fisica, the individual, you have a little bit more than one-third in large corporates, and the other one is more or less half-and-half in between consumption, basically car financing and SMEs.

What are the trends that we will probably see? We expect SMEs to continue on a positive trend, so this should gain weight within the portfolio. Within retail, I think that what we have seen will probably be our profile of behavior going forward, specifically, I am speaking of real estate related and mortgage et cetera, or more collateralized lending versus the non-collateralized one. And as I mentioned before, I expect also the payroll loan segment to evolve more possibly compared to 2015. Large corporate is a little bit tricky question, because, as you know, this depends on their eagerness to use the capital markets or the financial system. In any case, we have been delivering good growth in this segment in the past, and I do not see a reason why we should not see this in the future.

Probably we may see more activity in terms of deals et cetera, and that will be reflected more in fees than in NII, but at the end of the day for us which is the main question is revenues or total revenues per client and relationship, linkage et cetera, we will about -- we will reach the same target.

And finally, car financing. Well, you know how the sector looks like here. We clearly are performing, grabbing market share. We have market shares around 18% to 19%, as I mentioned in the presentation, well above our natural markets share. And probably here it is more important environment than the individual relationship.

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So, I would not expect here very good news in terms of total volume, but the profitability of this unit is clearly something that is evolving very positively, and we expect it in the same way.

So, all in all, well, as you know, we do not give a specific guidance, but I will not expect, in terms of volume, that we differ a lot from the private sector here in Brazil, probably focusing more on the spreads and profitability, with a little bit change of mix, being more positive on what I mentioned, on SMEs compared to what we saw in 2014.

Q - Francisco Kops {BIO 17215088 <GO>}

We have a question from Francisco Kops from Safra. Considering the market share increasing in acquiring, as well the increase in costs that you show in credit cards, why the card revenues growing slower? Is there a pressure in MDRs?

A - Angel Santodomingo {BIO 15757370 <GO>}

No. Here we have a little bit of mixture of differences. You have first the kind of the behavior of the market and probably you have heard that Christmas time was not the best over the last years, but at the same time, in our case, we have the kind of the first steps of an already established Company, which is GetNet, and all the acquiring activity and the commercial activity that goes around.

As you mentioned, we are a strongly gaining market share there, but we are speaking of a company that if you analyze the full kind of business cycle of this Company, it is clearly in early stages, in which you tend to invest, you tend to increase markets strongly, as we are, we are a clear gainer of market share there. But you have to make it more profitable, you have to improve efficiency, you have to improve revenues and you have to go in the right direction.

So I will say, today -- what I acquiring, I think I have mentioned this in previous quarters, our acquiring offer is a leading one, leading meaning at least 12 months ahead of the next competitor. And this is a strong commercial tool for our different areas, I'm speaking obviously of SMEs, I am speaking of companies. So I would say that it is more a question of how this is being developed and is being integrated in our commercial activity.

In any case, in the quarter, as you probably saw, card commissions grew 4.8%, almost 5%, if I remember correctly, which I would say that it is a nice growth just for a quarter.

Operator

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

A - Angel Santodomingo {BIO 15757370 <GO>}

So, thank you very much for your presence again with us. We hope we answered all your questions. Obviously, our Investor Relations team remains totally open for your questions.

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And we look forward to presenting you in three months' time our 1Q results. Thank you very much.

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