Q3 2014 Earnings Call

Company Participants

- Angel Santodomingo Martell, CFO, EVP & Investor Relations Officer
- Luiz Felipe Taunay Ferreira, Head-Investor Relations

MANAGEMENT DISCUSSION SECTION

Operator

Good afternoon and thank you for waiting. Welcome to the conference call to discuss Banco Santander Brasil S.A.'s Results of the Third Quarter of 2014. Present here are Mr. Angel Santodomingo, Executive Vice President, Chief Financial Officer and Control 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, www.santander.com.br/ri, where the presentation is available for download. All the participants will be on a listen-only mode during the presentation, after which we will begin the question-and-answer session with further instructions will be provided. We would like to inform that questions received via webcast will have answering priority.

Before proceeding, we wish to clarify that forward-looking statements may be made during the conference call related to 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 to 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 floor to Mr. Angel Santodomingo, Executive Vice President, CFO. Mr. Santodomingo, you may begin.

Luiz Felipe Taunay Ferreira {BIO 16259322 <GO>}

Good morning. Luiz Felipe Taunay Ferreira. I would just like to reinforce the idea that we give priority to the questions that are posed through the webcast. I will put together all the questions related to the same subject, and afterwards, if needed we will also answer questions that comes from the phone. So, Angel, if you could proceed please.

Angel Santodomingo Martell

Thank you, Felipe. Good morning, and thank you for attending Santander Brasil's Third Q results conference. Before going specifically into the results, I would like to share with you some ideas about the voluntary public offer - tender offer that was just finalized some days ago. As you probably have seen, the addition of minority shareholders of Santander Brasil, combined with the ADR holders represented approximately 13.7% of a total capital. Even then that did not exceed the two-thirds of existing free flows and the exchange offer is closed. So there will there be no additional periods provided.

So in this way Banco Santander Groups are holding a stake that rises to 88.3% of the capital; and sales and units of Santander Brasil needs to be listed as you know on Level 2 of the BOVESPA and began trading on the traditional segment. As mentioned during the offer, we will continue to strive to deliver increasing profitability to all our shareholders, current shareholders, and we will continue our Investor Relations activities with the market as we have done in the past.

So now changing or moving to the specific results presentation, I would like to go through the different concepts, the macro scenario, highlights from the results, and some final remarks. On Slide 4, we start with the macro scenario, which is the consensus macroeconomic outlook. The markets forecast shows the macroeconomic scenario improving to a still low level of activity of around 1% which was, as you know, adjusted during the last weeks with inflation hovering around the target ceiling in the next two years. In general terms, the economy is expected to recover gradually.

Market expects 2015 GDP growth to be gradually and positively impacted by the economic policy adjustments. After the last two weeks, interest rate rise by BACEN of 25 basis points. Consensus stays at 11% for 2014 and climbs to 12% for 2015, probably to be adjusted during the next weeks. On the foreign exchange market, expectations are stable. We continue to believe that Brazil will overcome the short-term economic challenges, and the country continues to be a growth opportunity in the medium run.

Moving to Page 6, I would like to underline the main highlights of third Q results. Let me remind you that we speak here of comparisons in between quarters in 3Q compared to 2Q. I would like to mention that as of this quarter, our results already reflect the consolidation of GetNet, means starting in August 2014 us having a two-month impact on our results. Bottom line, there is no almost - there is almost no impact. So the GetNet consolidation shows almost zero bottom line. Also different lines of the P&L obviously are impacted.

Let me share with you my view in these results. First, the bank continues with a comfortable position in terms of capital and liquidity, reflected in the strength of its balance sheet. The BIS ratio, the capital stood at 18.8%, almost 19%, with a strong generation in the quarter and with a Tier 1 capital of 17.3%. The loan-to-deposit ratio decreased a couple of percentage points to 96%.

Secondly, the expanded loan portfolio grew 5% in the quarter - I would to like underline that 5% - mainly driven by large corporation mortgages, which recorded both an increase of 9%. If we exclude the exchange rate variation, which also affected positively, the growth would have been, instead of 5%, 4%. At the same time on the liability side, funding from clients continues also to be strong with a 5% rise in three months. Thirdly, regarding results, total revenues moved up by 4% in the same period, reflecting the increase in the net interest income and commissions.

On the other hand, general expenses, including depreciation and amortization posted an upturn of 6.7% in three months, reflecting the perimeter impact and the contractual adjustments or the wage agreements in the period. All in all, net profit totaled BRL1.4 billion in 1Q, posting an increase of 2% in the quarter. Of course, I will elaborate in the different lines on the P&L and specifically on the receipts lines in the structure of that part of the P&L.

Lastly, I would like to point out the improvement in credit quality of our portfolio, and delinquency ratio over 90 days dropped 40 basis points in the quarter, and the coverage ratio reached 170 basis points, also increasing from last quarter. And this was accompanied by a good quality leading indicator that we think to 90 days, from which I will elaborate in the next slides.

In Slide 8, basically what we have here is the net profit evolution. As I mentioned, net profit amounts to BRL1.464 billion with a 2% rise in the quarter. And Gyear-to-date, that's the nine months results amounting to BRL4.328 billion, remaining flat in relation to last year.

Let's move to the P&L, which you can find in Slide 9. Starting with revenues, net interest income moved up 4% in the quarter, falling 9% in 12 months. The evolution in 12 months, as I already mentioned in other quarters, was impacted among other factors by the capital optimization plan that we executed last January.

In the quarter, we had an expansion of NII, driven by higher gains from market activities. In the next slides, you will see a breakdown of these concepts. Commissions climbed 3% in three months and it is important to note here that evolution, both in the three months and the nine months was affected full by non-recurring impacts that we always explain in the quarters and I would also try to indicate in the next slides. In any case, excluding these effects, commission we have drawn a like-for-like or a business-like-oriented ratio, 5% in the quarter and 8% in 12 months.

Moving to quality, allowance for loan losses remained stable in the quarter. In the first nine months, those allowances amounted to BRL7.3 billion with a reduction of 24% in the year. We continue to maintain that strong reduction that was shown in an accumulated basis in the past quarters. In terms of credit, also the cost of credit was reduced by 10 basis points in the quarter and 133 basis points on annual terms.

Billing and expenses, another important line in the P&L. We think they remain under control with an annual growth of around 3%, again, well below inflation, reflecting our efforts in these increased productivity and efficiency. In the quarter, as you can see, expenses grow close to 7%, 6.8% impacted by, what I mentioned before, the wage agreement that was signed in this quarter and the perimeter effect that I also mentioned a couple of slides ago. In any case, our view with regards to cost is that they will maintain a growth well below inflation. As a result of all these dynamics, as I mentioned, net profit increased 2% in the quarter.

In the next page with regards to net interest income, I would like to comment the main points. Net interest income totaled BRL7 billion in the third quarter of this year with an increase of almost BRL300 million, BRL294 million compared to the previous year. Such performance was driven by what we call older margins, which is basically return to historical normal levels of market activities as you can see in the previous columns, exception made of the second Q.

Credit-related NII presents a decline as a result of good growth in lower spread products as is reflected in the spread chart. The reduction of the spread was due to a fall in revolving loans, offset by growth in mortgages. So what you have is an decrease of around 9% in this type of revolving loans, which is basically offset or tends to be offset with lower spread loans like mortgages. So the full drop on the spread is totally explained by the change of mix.

In the nine-months accumulated 2014, NII came to BRL20.7 billion with a reduction both in the margin related to businesses, change of mix and other margins, specifically due to the second quarter I mentioned before. This reduction in the others line is a result of basically two factors, lower accumulated results from our market activities, including the impact of a higher selling rate as we have commented in previous quarters and the known impact from our capitalization optimization plan that I also mentioned done in January. This explains approx half of the variation of others. If we do not count this impact, the capital optimization, the NII would have declined around 6% in the 12 months. So the impact is around 3 percentage points.

On Page 11, we can move to the loan portfolio. As you can see, credit growth in general terms has clearly accelerated in this quarter in all segments. The expanded loan portfolio totaled BRL293 billion, posting a growth for the second consecutive quarter with an increase of 5% in the quarter and 7% in 12 months, mainly driven by the segment large corporates, which give 9% in the quarter and 17% in 12 months. Even if we exclude the effect of the foreign exchange variation, this segment posted quite an expressive evolution.

In the Individuals segment, mortgage was a highlight, with - I mentioned 9% growth in the quarter and 35% in 12 months. The Individuals' performance was impacted by payroll lending as also happened in previous quarters. Again, excluding this product, individual loans would have grown 2%, 1.9% exactly in the quarter, and 9% in 12 months, 9.2%.

The consumer finance portfolio, which is another important line, remained relatively stable in the quarter. I remind you that this line is basically car financing. And you know also, the vehicle financing market is slowing down. We continue to gain share here. We have become leaders in credit origination with a market share over 20%. This is the first time we ranked first in the market for a long time.

In terms of SMEs, we can see that the evolution is improving in the quarter as a result of the banks strengthening in this segment, aiming to begin in 2013, basically in the first quarter of next year with a stronger proposal, which we also mentioned in the past, which is Santander Advance. The performance of the quarter has gone from – has improved and has gained acceleration as the quarter moved on. As we have said in the past, this segment is strategic for the bank, both locally and globally.

On the funding side on the next page, the evolution is also quite positive. This reflects the evolution on deposit activities, our focus on our clients and the linkage. Liquidity buffer currently is at its highest level with very comfortable levels of liquidity ratios, both the LCR and the NSFR, well above the already known minimum levels.

Funding from clients amounted to BRL243 billion, an increase of almost BRL34 billion in 12 months and BRL12 billion in the quarter. In both periods, growth was higher than the increase in the total credit portfolio, and as a result, the loan-to-deposit ratio, as I mentioned went down to 96%. This is almost 9 points drop in 12 months and almost 2 points drop in the quarter. Total funding plus assets under management amounted to BRL436 billion with an increase of 9% in the quarter, that is BRL35 billion and 17% in 12 months or almost BRL63 billion. As you can see, assets under management amount to BRL161 billion. It's also rise significantly both 12% and 5% year-on-year and Q-on-Q.

Moving to fees on the next page, as we mentioned before, we have different impacts, basically non-like-for-like impacts and perimeter impacts. In the first nine months of this year, fees totaled BRL8 billion, BRL 8.1 billion increasing 3% when compared to last quarter and in the same period in 2013. As already mentioned, this annual growth is impacted by the way the life insurance policies was renewed, as well as by the sale of the asset management operation. Both things have been commenced extensively in the last quarters.

Insurance fees dropped three months in 12 months. Excluding this mentioned effect, they would have grown 10%. So the business like-for-like activity of this line is growing 10%. In the same direction, in relation with asset management, the revenues from this unit would have grown 8% or are growing in a like-for-like basis, 8%, instead of the drop of 18% that you see there.

In the quarterly evolution, we have another quarterly impact from the accounting reclassification between cards and tax expenses as you can see on the cards line. Again, the business like-for-like evolution is 5%. But this reclassification between lines makes that drop to 0% in the quarter or flat in the quarter. In any case, fees are reflecting the evolution of the business in a like-for-like comparison showing quite a positive trend.

Moving to general expenses or to expenses on Page 14, we have the following things. Total expenses, excluding depreciation and amortization, so basically administrative and personnel, have increased 6% in these three months and 2% in the 12 months. If we include everything, as you can see there, they have increased 3% year-on-year.

The increase in expenses reflects mainly the wage agreement that was signed by the sector and, again, the perimeter effect that I mentioned. I would underline the 12 months effect, which is still a good performance in terms of expenses that we expect to continue, of course, in following quarters, as a result of the productivity and efficiency programs that we plan to continue in next year. In any case, costs will grow well below, and I underline well below inflation.

On Page 15, we go into the quality part of the portfolio. And we have the quality ratios, the delinquency ratios. I would like to underline and to highlight the improvement – the general improvement on the quality of the portfolio, both in the current quality or in the leading indicators part of it, as well as the coverage ratio.

There were 90-days delinquency, fell 79 basis points in 12 months with an improvement both in Individuals, 87 basis points, and the Corporate segments, 66 basis points. In the quarter, the delinquency ratio declined 40 basis points with a more expressive improvement in the Individuals segment. So we run at a 3.7% NPL ratio over 90 days, which is, as you can see, the lowest in the last five to six – at least in the last five to six quarters that you see in the slide, or at least even more. The 15 to 90 day, the leading indicator that we normally publish, also presents a strong improvement of 72 basis points in the quarter, continuing as the second quarter improvement, and also in a year-on-year comparison to 4.3%.

Finally, the coverage ratio reaches 170 basis points, again, increasing 12 percentage points in the quarter and almost 20%, 19% in comparison to September 2013. We remain quite comfortable with this ratio, even as you can see in an increasing trend. All in all, quite comfortable and positive quality ratios that should lead to no surprises in the future.

Going in to the P&L in the next slide, we can analyze how both expenses and ratios, in terms of quality have evolved. Allowance for loan losses totaled BRL7.3 billion as you can see in the first nine months, with what I mentioned in interaction, almost a 22% decrease compared to last year.

In the quarter, the allowance losses or the provision cost remained flat. For the fourth consecutive quarter, we remained at similar volumes. If we speak of cost of credit, as you may see in the red lines, it declined more than 130 basis points in the last 12 months and 10 basis points in the quarter. Even the trends mentioned in our credit portfolio, we should expect also positive trends, going forward, as a reflection of lower spread and better quality evolution on the cost of credit.

Finally, performance ratios in the next page as – let me underline the main points here as you already have all the data there. Efficiency ratio came up to 50.6%, increasing again 113 basis points in the quarter reflecting mainly the pressure on expenses that I mentioned. Recurrence ratio 64.3% in the quarter, reducing 227 basis points in three months; and return on equity maintains the 11.6%, which is the same level as in the past quarter.

Finally, with liquidity and capital ratios on the last page, again, let me underline that we are at very comfortable levels in terms of liquidity with stable funding sources and quite strong and adequate funding structure. The loan to deposit ratio, as I mentioned, reached 96% in September, with a fall of almost 2 percentage points in the quarter and 9 percentage points in 12 months, reflecting what I already mentioned several times, a good funding performance with a positive asset growth in 3Q 2014.

On the BIS ratio that stands at 18.8%, so almost 19%. Probably - well it is the highest among Brazilian banks as you know. It rises 87 basis points above the previous quarter and being mainly composed of our Q1. The main reason of the improvement as you can easily imagine is the new measures that were approved by the BACEN, the Central Bank in Brazil in August with regards to lower capital consumption of different loan portfolios. That explains, basically, the increase of around 100 basis points of core capital.

Let me finalize with my main final remarks. As you have seen, third quarter results indicate that, first, our balance sheet remains quite solid with strong and comfortable levels of capital liquidity and coverage ratios. Total revenues increased in the quarter, reflecting the favorable evolutions in the net interest income and commissions. We had a good recovery of the loan portfolio growth, which was followed by an improvement in the quality of our assets, with a delinquency over 90 days improving almost 80 basis points just in a quarter. In terms of expenses, allowance for loan losses remained basically stable while general expenses posted some growth - significant growth, due to the wage agreement and the non-like-for-like events that I already elaborated in.

As we have said in the past, 2014 remains a year with top line pressure. This is not a surprise because we have been underlining that situation. Besides this compression relate basically to the change of the mix. We also have the impact from the capital optimization plan. In any case, trends tend to be positive as I have elaborated, both in the credit portfolio and in general terms in the P&L.

Finally, our productivity and efficiency plans are delivering the expected results, but the most important point is to maintain our focus on transforming the bank into a client-led bank that will have its reflect on the upper of the P&L. Our management priorities have to continue delivering results while we work on that part of the profit and loss account.

Thank you very much. We open the floor now for questions if there are any.

Q&A

Operator

Thank you. We will now start the Q&A session for investors and analysts. Please wait while we gather for query requests.

A - Luiz Felipe Taunay Ferreira {BIO 16259322 <GO>}

I think two questions in the webcast. The first one regarding the loan portfolio is Santander is accelerating credit growth while the overall growth in the system is decelerating. What explains such behavior by Santander and what are the risks involved?

A - Angel Santodomingo Martell

Sorry. I was in mute. Thank you very much. I would like to underline first thing that with regards to the portfolio, as you know, both SMEs and payroll financing have been kind of a drag in the past. In SMEs, we are remodeling the offer. That offer which I mentioned briefly in the presentation is called Santander Advance, which is basically a full package service that is going to be offered to our SMEs. And that will come into force probably around 1Q next year.

In any case, what we start to see is that that dragging effect of SMEs in the past is kind of shading away. We have seen that in this quarter. SME lending growth has gone from being negative to almost being non-negative at the end of the quarter. So we see kind of an improvement on a marginal way in terms of SMEs. In terms of payroll, you already know the story. It's basically we reached an agreement with Bonsucesso. We are in the process of setting that up, trying to make it work and start to be active in the way we design, and we present it to the market probably starting of next year. So these two things that were kind of negative in the past are, let me call it, less negative now compared to other quarters.

At the same time, we are growing in kind of lower spread, higher quality loans. The portfolio, I already mentioned the dynamics, good growth in corporates, in large corporates, in real estate and drops in revolving that generate interest rates. A 9% drop in the quarter in revolving that generate interest rate, which means that we have pressure, of course, both on the NII and on the spread. But I also mentioned that that should be reflected in the cost of credit in the next quarter. Obviously, we are quite busy in terms of asset quality issues. That is something that has always been underlined. And as you may see, the credit quality is clearly under control. Thank you.

A - Luiz Felipe Taunay Ferreira {BIO 16259322 <GO>}

We have two questions on the NII topic. One regarding spread and the other one regarding the line Others. The one regarding spread is; the decreasing spread in the quarter was quite strong. You have mentioned that the mix explains the decrease. Could you provide more details, what should one expect in terms of spread evolution going forward? And the question regarding the line Others is the following; this line has improved substantially in the quarter. How sustainable is that improvement?

A - Angel Santodomingo Martell

Okay. Thank you for both questions. Let me elaborate a little bit more in the NII. And as I mentioned just in the previous question, the change of mix is strong. I mentioned the 9% drop in those revolving loans. That is a part of revolving loans that generate interest rates. A 9% drop on the Q is quite strong. This is obviously something that we have been executing within the last quarters. And now in this quarter, it was more intense. Obviously, we don't expect these to be extrapolated to other quarters.

I would say that a general comment is that probably that kind of change of mix or normalization of spreads is something that structurally – and I'm speaking here more medium and long term, probably, we will see on the Brazilian financial system going forward. Obviously, a discussion period phase (35:18), the acceleration or not, the moments where this happens, and here, the visibility is lower. But I would say that the trend is there to stay.

With regards to others, well, I think, I already elaborate a lot on this, but basically, the idea is that we are kind of returning to – in a volatile line, because we have quite a volatility in the P&L. We are returning to what we can call, if we can call this an average of the history; we'll be returning to that average. Remember that we have the impact of the accounting of the Tier 1 instruments in the 2Q. It was one of the reasons why we showed an extraordinary low level of August. And basically, we are returning to what you have seen as an average in the previous quarters. I don't think there is nothing more or less extraordinary there.

A - Luiz Felipe Taunay Ferreira {BIO 16259322 <GO>}

We received one question regarding the fee issue. The question is, the credit card fee growth seems to be weak for a Company that is still an entrant on the acquiring business, and has integrated GetNet in the quarter. What explains this? How GetNet integration is behaving? Was there any major accretion related to the integration?

A - Angel Santodomingo Martell

Okay. With regards to fees, we have several things there. I already pinpointed the different issues in the year-on-year and on the quarter. The year-on-year were over the norm. On the quarter, we have these kind of readjustments in-between lines. So, I would underline that the business is growing, what I mentioned, the 5% Q-on-Q.

So I will say it has more to do with accounting things and nothing more than this type of reclassifications that you have to do. We thought of doing restatements, but we thought we would make it more kind of less clear. So we prefer to explain it as it happened. In any case, obviously, in between GetNet, our (37:56) business being one of our main products, credit cards, obviously the growth in these lines should continue to be important.

A - Luiz Felipe Taunay Ferreira {BIO 16259322 <GO>}

We have one question regarding asset quality. And the question is asset quality has improved in the quarter, what is the perception for 2015?

A - Angel Santodomingo Martell

Well, I also think I mentioned a lot about the credit quality issues. The general trend is quite positive. Either you take balance sheet ratios, you take P&L ratios or whatever. So I think that both current and leading indicators are positive and pointing in the right direction. We expect the change of mix of course to be reflected on that evolution, and we continue to have a strong focus on credit quality and credit standard.

I will also invite you to see – I think it's on the annexes, no, Felipe? We have the Vintages, the Safras. We have the Vintages there and if you see, all of them are also pointing in a kind of quite a positive direction. I think – I'm trying to find. It is here, Slide 34, if you want to look in the presentation in the annex. And you can see that Individuals, Corporate, and even car finance, they had really bit of a peak in the previous quarter, they are all pointing down. So the trend is positive. We don't have any kind of concerns or anything that could mean a concern for us. So, that's it. Thank you.

A - Luiz Felipe Taunay Ferreira {BIO 16259322 <GO>}

We have no more questions coming through the webcast. If anybody wants to pose a question through the phone. Please

Operator

I show no questions, audio questions at this time. So I'd like to thank you and the Q&A session is over, and I wish to hand the call back over to Mr. Angel Santodomingo for closing remarks.

A - Angel Santodomingo Martell

Okay. Thank you very much to all of you for being there in this 3Q results. I see that we have answered basically all the questions posted. Any additional things, please do come to us and we will try to respond. Thank you for being there.

Operator

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