# Q3 2013 Earnings Call

## Company Participants

- Angel Santodomingo, Director of Investor & Analyst Relations
- Javier Marin Romano, CEO
- Jose Antonio Alvarez, CFO

## Presentation

### Javier Marin Romano {BIO 3961209 <GO>}

Good morning, ladies and gentlemen. Thank you, very much for joining us for this Third Quarter results presentation for Group Santander.

Jose Antonio Alvarez, Chief Financial Officer of the Group, is joining me for this presentation. I will basically go through the main figures for what has been the Third Quarter; then Jose Antonio will comment on the results for each geography and each area. I will come back with a summary of conclusions and for the priorities for the Group for the next quarters.

In an environment that shows signs of improvement. But which remains complex, the Group focused on two aspects. On the one hand. And in line with previous quarters, maintain a strong balance sheet in terms of liquidity and capital; and continue to reinforce the capacity to generate results.

On the other hand, we are laying the foundations for a more efficient management in allocating capital and investments; generating more revenues by taking advantage of the Group economies of scale, thus, integrating more the Group; better segmentation with a great focus on customers.

Some key figures and messages for this quarter; firstly, with respect to volumes that continue to reflect the different macroeconomic situation of the countries where we operate, we see a larger growth in deposit -- a larger rise in deposits than in loans, that they shrink by 2%, because of the deleveraging of certain of the economies where we operate.

As a result, we maintain a very comfortable liquidity ratio. The loan-to-deposit ratio stands at 108%, that is -- and especially backed by Spain, where the loan-to-deposit ratio sits at 85%. Just let me remind you that we have grown more than EUR230 billion in deposits over the last five years.

With respect to capital, we produced again a strong organic capital generation in the quarter, increasing the core capital by -- to 11.56% by 45 basis points, in line to comfortably meet Basel III; or we expect to be always above 11% for the phase-in ratio and above 9% for the fully-loaded one.

We have a very strong profit for the first nine months, 77% year on year; of course, affected because of the lowering of provisionings that were extraordinary last year for the two Royal Decrees that affect the real estate's assets.

The Third Quarter, we have flat profit, taking into account exchange rates. Exchange rates have had, definitely, a big impact over this quarter. If we eliminate this impact, the profit for the quarter increased 8.5% with respect to the previous one, thanks to stable revenues and declining provisions.

Let's look to each of these points. This slide shows the evolution of GDPs in Santander footprint, helping us to better understand the context in which we are conducting our business, which is basically a context of low growth and low interest rates.

The macro picture this year is still unfavorable. You see there basically that only three countries grew above last year for the first half, while the rest of them are basically decreasing; three economies improving; Brazil, UK and Argentina; the rest reducing, like Poland or Mexico; or still in recession like Spain or Portugal.

The good news is that the forecast for 2014 from the IMF points to a general improvement. And a significant one. This will be probably the first year, since 2007, where the 10 economies where we operate will have positive growth.

We have positive news for Spain and Portugal where they get out of recession. We have heard the expectations from the IMF, 0.2% of growth for Spain. And 0.8% for Portugal. Our forecast for Spain is that we'll be -- is well above this. We expect that the Spanish economy should be growing at a pace close to 1%. And still with room for some even more positive surprises.

We will see faster growth in Germany, in Poland, the UK and the US. And in Latin America we will see a recovery in Mexico, that has been affected because of the change of government that occurred this year; and basically unchanged, the growth, in Brazil and Chile.

Meanwhile, of course, we'll have low interest rates that will continue to exert pressure on revenues in some countries.

In this context. And taking into account the strategy of the Group of strengthening our retail franchises in the last years, we have thus reflected in the balance sheet where, basically, we see a deleverage in mature markets, because of low demand for loans, together with more selective growth, a reduction in higher-risk products, basically real estate in Spain portfolios, or portfolios in run-off in the US.

We have a stronger and more balanced growth in emerging countries, with acceleration in the Third Quarter in Brazil, Mexico and Chile, although below our forecasts. Just in Spain we'll basically create strength -- although Jose Antonio will come in later, in Spain we'll create strength with this first nine months by about 6%.

Net new amounts to SMEs -- sorry, gross new loans to SMEs accounted for EUR31 billion, plus EUR11 billion of bond issues for SMEs that were lead managed by the Bank. Even though we are still -- as I said before, the credit stock is diminishing by between 5% and 6%. But we are gaining market share by 0.4 points.

As a result of this decrease in loans and increase in deposits, the loan deposit gap has been reduced by EUR62 billion since the beginning of 2012. This figure covers the maturities of medium and long-term debt in this period. So, this year we have sharply reduced the volumes of issues by the Group.

The loan-to-deposit ratio, as I said before, stands within our comfort zone, at 108%. Just let me remember that the comfort zone where we would like to be is between 110% and 115%.

With respect to capital, the Group maintains its strong capital generation in the Third Quarter. Basel II core capital grew by 45 basis points in the quarter and 123 basis points since the end of 2012, accelerating the growth of the last few years.

This was due basically to a profit generation, favored, of course, by the high acceptance of the scrip dividends between 80% and 85%; and a reduction in risk-weighted assets due, because of the shrinking of the balance sheet by the reduction of credits; and the positive impact of the new SMEs' definition that was applied in Spain, in accordance with the European definition of SMEs.

We also continue to improve our leverage ratio, shareholders' equity to total assets in the quarter. According to the IMF criteria we grew to 7%. This is the same criteria we used in the last presentation. So now you can all make your own calculations with respect to what will this represent in accordance with CRD IV.

In short, we are very comfortable with our capital and liquidity levels. And with our capacity to grow and strengthen our balance sheet.

We just received the letters from the European Central Bank with respect to the risk assessment, the asset quality review and the stress test. We don't expect any surprises from these exercises. We hope that they will definitely recognize our low-risk model. And the low-risk profile of the retail bank that we are.

We are very comfortable towards a meeting with the criteria of Basel III; we will always be above 9% on a fully-loaded basis. And 11% on a phase-in. And it is very important to show the great capacity of the Group to generate, organically, capital.

With respect to profit, the attributable profit in the quarter was EUR1,055 million, in line with the Second Quarter. If you exclude exchange rate impact, it was 8.5% higher. The profit for the nine months stood at EUR3.31 billion, 77% more than in the same period of 2012, given the big impact of real-estate provisions in the second half of 2012. This is the first step towards the normalization of the Group profit.

Let me just remember that these results do not include the EUR700 million of net profit that we will generate from the strategic alliance for the asset management unit, which are expected to materialize on the last quarter of this year.

If we take a look to the P&L account. The first thing to note is the big impact of exchange rates, as I mentioned before. So I will comment basically on the gray line that is basically excluding the exchange rates, where we will see, basically, the efforts of management and the results of the management of the Bank over this quarter.

In relation to the first nine months of 2012, exchange rates explain two-thirds of the fall in gross income. And close to half of the decline in operating income. If we eliminate their impact, gross income declined by 2.9%, due to the liquidity buffer; the narrowing of the spreads, due to the change in the mix towards lower risk products in some countries, like Brazil; and lower lending volumes.

Costs were slightly below, up -- or the average inflation of the Group. And loan provisions were lower year on year. Lastly, the higher attributable profit reflects the impact of large real estate provisions in 2012.

We have a better evolution on our quarter, if we take a look to the quarter on quarter. Attributable profit was 8.5% higher after correcting the impact of exchange rates. The lower provision this quarter, particularly in Brazil, explains the rise in attributable profit. Gross income was unchanged and costs reflected some revision of collective agreements, basically in Brazil, where we will comment later. And one-off factors, basically, in Mexico.

With respect to the gross income, you have here basically two lines, the line that is excluding the impact of exchange rates. And the bars that are including the impact of exchange rates. At constant exchange rates, gross income showed a stabilization trend in the last few quarters and reflecting some seasonal factors in the Third Quarter, mainly for Spain.

Important to say, on a quarter-on-quarter basis, that 7 out of our 10 countries had better income in the Third Quarter than in the Second Quarter. In (current euros), the evolution is conditioned by the large depreciation of Latin American currencies, which reduced growth in gross income by 5percentage points.

Another point is the composition of gross income, which shows a significant degree of recurrence. We have -- roughly 90% of the income of the Group comes from net interest income and fee income, which, if we take into account only the operating areas, this percentage would grow to 93%.

We have a reduced proportion of trading gains, 9%. A lot of that related to client activity, even though this is half of our peers that stand -- this level's at 17% in the first half of 2013. The rest of the revenue is basically dividends, equity accounting methods and so on, accounted for barely 2% of the income of the Group.

In terms of costs, we have a difference performance by units, countries depending on their momentum. On the one hand, the clients in those units going through an integration process like Spain or Poland, or adjusting their structures for lower growth, like Portugal.

On the other hand, some higher costs in franchises under development or growth, like Mexico, the US or Brazil. An effort is made in the latter to combine growth in the business capacity with a control of spending. For example, the pace of growth in Brazil, costs continue to decline, 3% so far this year compared to 6% inflation.

For the Group as a whole. And at constant exchange rates, costs rose slightly below the average inflation rates of the countries where we operate. The average inflation for these countries stands at 3.7%.

At the same time and compared to our peers, we maintain a significant advantage in efficiency and we have the potential to keep up improving. I believe that in the coming quarters with integrations at cruising speeds, plus additional efficiency measures that we will comment later, we will see further cost cuts. This is key to adapt to a new environment of lower growth and lower interest rates. And to enhance the value proposition to our customers, becoming a more attractive Bank for them.

With respect to integrations in Spain and Poland, both are ahead of schedule, which is reflected in the upward revision in the forecast for synergies. In Spain we have the first wave of branches, 130, that was already rebranded. We have brought forward the exercise of rebranding. The whole Banesto branch will be rebranded to Santander before yearend.

We will bring forward the initial branch integration plan. You remember we had -- the plan was to close 750 branches, 250 this year and the rest next year. We will bring this forward to close 450 this year. We have already achieved almost 40 by September and now that everything has been tested and works well, it will be accelerated over this last quarter.

In technology, branches already in four regions in the Center North have been successfully migrated in September with no incidences. We plan that 100% of the branch migration will take place before the end of the year.

In Poland the Kredyt Bank branches are already operating with the same brand and technology as the Bank Zachodni. Now that the rebranding of Zachodni has been fully completed, we are working on the transition to the Santander brand. The optimization of branches and headcount is also proceeding at -- ahead of schedule and surpassing the (intermediate) goals in synergies.

Technology integration is enabling us to launch common products in the unified branch network. This will help and is already helping to improve the productivity of the former Kredyt Bank branches.

Let me remind that Zachodni is notable for its innovation and leadership in cards, in electronic banking and in mobile banking.

Even though it's not an integration, there's something important occurred recently, that has been the rebranding of our Bank in the US, from Sovereign to Santander. This shows a commitment to the country, to our employees and to our clients.

It places more pressure on us to improve the quality of service at the Bank. We are working hard to simplify the Bank, to streamline the processes, incorporating new tools, like the new mobile app that has been successfully implemented and with very good comments from our clients. So, step by step, definitely, we are working to improve the retail franchise that we have in the US.

With respect to credit quality, we -- it is basically maintaining the trends. The non-performing loan ratio stood at 5.43%, up 25 basis points in the quarter, in line in terms of growth with previous quarter, except for the second one, where we had a reclassification of sub-standard loans in Spain, as that was incorporated. The rise in the ratio was basically due to Spain. And because -- half of it because of the fall of the credit, let's say the fall of denominator.

On the other hand we had units that account for two-thirds of the Group's loans that show a stability or an improved non-performing loan ratio. Jose Antonio will comment later with more detail for each unit.

Coverage remains at 65% (sic; see slide 14 "64%"), high level in relation to the mix of our credit portfolio. More than half of our credit portfolio are secured loans that require lower coverage. And in other -- in certain countries where we have the proportion of secured loans is lower due to the consumer business in countries like Brazil and Mexico, this coverage level is then, well, close or above 100%.

The evolution of the non-performing loan in the large units, we see Brazil where we have a new decline in the non-performing loan ratio, 37 basis points in the quarter, which confirms the trend we announced and return us to the levels we had in the first half of 2012.

The reduction was due both to individuals and corporates. And the declines were anticipated in previous quarters, because of the evolution of the early non-performing loans; let's say, maturities of less than 90% that are materializing.

In the UK the ratio remained stable at around 2%, like the previous quarters.

Spain's ratio continued on a rising trend, basically for three reasons. As I said before, the denominator explained half of the rise, around 30 basis points. We continue to see a rise in the -- in companies; that the new entrants in non-performing loans continue at high levels, although stabilizing.

And we have the impact of unifying Santander and Banesto loan portfolios to the most conservative criteria. We already mentioned this in the last quarter, because we did a provision of EUR188 million. But now it's -- we have the recognition of these non-performing loans into the -- due to the more conservative criteria in the figures for this quarter.

My view is that we will continue to see an increase on the non-performing loan ratio. We should be close, in Spain, to 7% by yearend, although by next year we should already begin to see a reduction of the cost of credit on a trend towards normalization.

With respect to provisions (inaudible), first, is the trend of decline in total provisions in 2012 -- with respect to 2012, sorry. Second, the provisions made in the Third Quarter are the lowest since the beginning of 2012. We have low levels in Brazil, the UK, Santander Consumer Finance, Portugal and the US; in contrast to the still high levels that we have in Spain, as mentioned. And in Mexico because of the home builders; and the regulatory change to provision with respect to expected loss that Jose Antonio will comment later.

Lastly, these trends mean -- are reflected in a new and significant reduction in the Group cost of credit in the Third Quarter. It is true that 1.77% calculated on the basis of the provisions for the last 12 months as a percentage of the average credit risk, if we take the quarter on a standalone basis, this ratio would be -- the cost of credit would stand at 1.47%, which compares favorably to the 1.65% that we had on the Second Quarter.

It is the best figures of the last two years; still higher than the pre-crisis levels. Let me remember that in 2008 we had 1% cost of credit and in 2007, 0.63%. These are the levels towards we should return in the coming years.

I now hand over the micro to Jose Antonio that will comment on the different business areas.

## Jose Antonio Alvarez {BIO 19692884 <GO>}

Good morning. As Javier mentioned, I'm going to go through the different business areas, making the highlights of each of them.

First we start the chart that shows basically that the profit is well diversified by countries and, basically, is virtually unchanged in the quarter compared with the previous quarter. 55% of the profits come from what is so-called emerging market, being the main one Brazil as usual. And mature markets, UK, generated 15% of the profit and the US 11%; and Spain, at this point of the cycle, only 7%.

Let's start with Spain. In Spain on the activity side we continue to see a significant deleveraging. We are gaining market share, both in loans and deposits. But even though the volumes in the loan book are falling and this explains, in some sense, the trends in revenues.

In the revenues in the quarter we have some major effects; the deleveraging that is going on, as I mentioned. The second effect that is very well-known for you is the re-pricing of mortgages that is coming to an end. The bulk has been done already.

There is some pay-off between net interest income and trading gains in wholesale business. But, as you know, the Spanish wholesale business is supported here in Spain.

And still, the improvement coming from the cost of deposits is not yet at full speed. Still the next two quarters we will see significant drop in the deposit cost, that basically we are renewing the deposits 160 basis points the time deposits, lower than the back book.

The costs are relatively flat. Still too early to see the effects of integration that Javier mentioned before. And finally, still a very high effort on provisions, as you can see in the numbers.

Well, in the coming quarters, I will elaborate later on on -- specifically on activity and asset quality. What we see is a -- as we mentioned before, positive trends in the P&L here, due to the improvement in revenues to recover after the end of the re-pricing of the mortgage book; lower deposit costs; and largely efficiency gains, the ones we have announced in integration plus others that -- additional efficiency measures that we're going to take and normalization of provisions.

Banking activity in Spain, the trends in business were virtually unchanged. Lending reflect deleveraging, the deleveraging is more intense in companies, in corporates, than individuals. Individuals is fairly flat; companies still significant deleverage there. Even -- we are doing intense efforts to try to grow the book. But the demand is still really weak at the moment.

In deposits, well, our priority here is the cost. It's not that much the volume; the loans to deposits is running at 95%. So the priority is the cost and we will see in this quarter and the next quarter significant drop in deposit costs that will go in the total cost in the region more with 120 basis points/130 basis points.

In terms of volumes in deposits, the quarter retail deposits went up by 0.2% in the Second Quarter and 22% in the year. The volume in deposits, you see in the quarter, is largely institutional deposits and is the result of more demanding pricing from those.

The strategy going forward is to grow in affluent -- market share in affluent and SMEs. And to grow in -- a little bit customers that we already grew in the year 19,000.

Going to the asset quality, well the NPL ratio continued to go up as the CEO mentioned, largely due to the nominatories half of the increase. Mortgage NPL remain unchanged. And the corporates, the NPLs -- the companies NPLs are the ones who are going up.

We see a cost of credit for this year around 150 basis points for the Spanish business, including real estate business in run-off. And what we see going forward is a reduction, significant reduction, in the cost of credit in 2014 and onwards.

If we look at the trends in the NPLs we see what I said before, basically individuals are -- mortgages and consumer loans are flat down, the new entries. And is the companies, the corporate loans, that reflect the current macro environment in Spain and are still going up when you compare with the previous quarters.

Going now to Portugal, well, the terms are pretty much the same; a strong deleverage in the country. Loans and deposit are falling, even we are gaining market share. More in deposits, we are gaining 40 basis points in market share in deposits in the last 12 months and 20 basis points in loans.

Where we -- in Portugal now revenues are more stable, I would say fairly stable. The lower deposit costs are offsetting the deleverage that is happening on the asset side. We will see relatively stable revenues going forward and lower provisions; the new entries are falling across the board. And you will see in this quarters, the quarter was relatively good or very good and did revert where the provisions fell 11%.

In the coming quarters we see a more positive evolution of the net interest margin with a stable spread in loans, improved cost of deposits and expenses flat to down, provisions (inaudible) to normalize. This is the outlook for Portugal.

In Poland a different story; on the activity side where we are focusing very much in the reduction of the deposit cost, both in BZ WBK and more intensively in KB, where deposit were really, really expensive. And in this regard we are growing the long book 3%; deposits are falling 3%; but mutual funds are growing 23%.

So we've been able to translate some of the expensive deposits into mutual funds as a policy. The policy is reflecting a significant improvement, as you can see in the slide, of the cost of deposits that are falling dramatically in every quarter.

In terms of P&L, we are (addressing) and with management of the net interest income in the context of lower interest rates, some generation of fee income. Overall, net interest income and fee income were 5% higher in the quarter.

Costs 3% down, 8% on year, these reflect the integration process that the CEO refers to before. And provisions went down dramatically this quarter (3%). But is due to run-off in a company that we recover. So the NPL ratio and coverage improved.

Year on year growth in gross income and net operating income in profit of more than 3% because the integration of KB; on a like-for-like basis double-digit growth.

The outlook, we expect a slightly better macroeconomic scenario. We see stronger growth in the future. We maintain as a priority here to complete the merger process. Margin and spreads improving the productivity going forward, particularly in the KB operation.

Consumer finance, well, another good quarter I would say; the performance continue to very good. Particularly good in an environment where the consumption is relatively weak, all across Europe, as you know. We are gaining market share. The car sales -- the new car sales are falling 6%; our production is falling, the new lending, only 1%. So this means that we are gaining significant market share.

And in results, I would say, good management of the spreads and still a good credit quality. The profit was 4% higher than in the first nine months of 2012. And it's particularly important, this, because they had this in -- with self-funding.

This unit, that used to be -- have a significant line from the parent company, now is self-funded 50-plus-% the deposits. They are (50%) with AON Insurance and the securitizations.

The outlook for this unit, well, we continue to see -- or we expect to see a recovery in the consumption in the Eurozone that will effect positively the levels of production in the Santander consumer finance business; that, as I said before, the performance continues to be excellent.

Going to the Spanish real estate run-off portfolio; first, the portfolio fell 26% in the last 12 month. The level of -- the size of the portfolio now represents 3% of the total assets in Spain and less than 1% of the Group assets. So it is relatively small.

And what we expect here is to continue the pace of reduction that we see in the last 12 months. We are very good at running at (20%) reduction per year, more or less. This is what we expect to continue to see in this run-off portfolio.

We sold 2,800 units in the Third Quarter in Spain. In the First Quarter we sold 9,000 units. So the Third Quarter normalization is seasonally low. The coverage remains above 50% and losses in this remain relatively stable.

UK, well, in activity I would like to say we are focusing in two -- I qualify the activity with two features. The first, we are doing a selective growth; and second, we try to strengthen the franchise. Those are the two main elements of our activity in the UK.

In loans, we are growing 11%; in corporate banking, mainly in SMEs, we are growing sustainable variable rate mortgages. At the same time, we are -- we have a significant drop in interest-only mortgages. As you know, our policy -- we introduced a new policy one year -- 18 months ago in interest-only mortgages.

In deposits, again, we are -- there is a significant reduction in the most expensive ones. And we are focusing in (remunerated) current accounts. I will elaborate later on on this.

The results, very good quarter results overall. Third quarter the profit was GBP261 million, 17% more than the previous quarter. This was, basically, higher spreads and loans; lower cost of deposits -- because there was significant maturities of expensive deposits, probably this is not -- cannot be repeated quarter after quarter, cannot be extrapolated.

The costs remained flat, (due) so in the quarter relatively flat. We expect relatively flat deposits. And the rise in provisions over the Second Quarter that were very low. Overall, very good quarter and we remain positive on the outlook for the United Kingdom businesses.

Let's focus on what we are doing on the commercial side. We have a strategy that is, basically, in four pillars. The 1,2,3 strategy that, well, that has already more than 2 million customers. We are growing a lot in current accounts, as you can see in the slide.

Second pillar of this is -- that is the segmentation of the customer base, individual customer base. The third is to provide our mortgage offer to the customers. And the fourth is to focus on corporate. Those are the four pillars of our strategy there.

And we are -- the (first) result we have from this is that you can see in the slide. We are gaining market share in SMEs. We are gaining market share in current accounts. And we are happy with what -- how the business is performing in the ground.

Additionally, today, the balance sheet is still in a very good position . And the capital strength is -- well, has been recognized by the British regulator in (last June's) stress test.

In short, high solvency, good dynamics in volumes and net interest income, provisions under control. And costs rising below inflation rate. So I would say overall, it's a pretty good picture for the business, going forward.

Brazil, well, a little bit impact (inaudible) in the quarter, with a growth of more than 2%; inflation relatively high and the central bank rising interest rates.

In loans growth accelerated, we are growing 7% year on year, largely in line -- slightly above than private sector bank. But largely in line with those.

Well, we are changing the profile of our -- we will see later on, our loan book, with lower risk products, that naturally has some effect in the net interest income. And we are making an effort to capture deposits, particularly the cheapest one is not a -- is more the result of trying to improve the relationship with the customers, with more transactional banking with them.

And as a result of this, we are growing the low cost deposits, that, as you know, we reserve the majority of those in the central bank.

Looking at the results, we see in the quarter, (8%) rise in profit before taxes. But the growth did not feed through the attributable profit, because higher taxes and minority interest.

Brazil can change, because there is a trade-off between lower net interest income and higher trading gains. I will elaborate on this.

Costs grew in the quarter, because there was -- normally in September, it's the wage agreement; the wages grew 8% in the sector, the agreement with the unions. And costs related with contracts and (inaudible).

So finally, there was a sharp fall in provisions, because -- thanks to the better evolution in non-performing loans.

I will we look into more detail into the two main drivers of the P&L in the quarter. The first driver was the interest income. The reduction -- there has been a significant reduction in the credit spread, 10.5% to 9.9%. This is due to three elements.

One for each one, basically. The first was due to a change in mix, that I mentioned before; we are growing faster in large companies in mortgages, than in consumer lending. And this produced a reduction in the average credit spread.

The second one is a change of mix of products inside the same customers. And third, one-third is due to a reduction in the spreads product by product.

Second was a lower contribution from the ALCO portfolio. We have reduced our (bid). And you will see in the numbers in the balance sheet, the duration of the balance sheet before (technical difficulty) went up. And this is reflected, on the other side, with higher trading gains.

Credit quality continued to (improve) in the quarter significantly. NPL ratio went down 37 basis points. Provisions went down in line with this, were the lowest in the last two years. The cost of credit continued to fall. In the quarter, the provision cost was 5.9%, the lowest of (CDs).

In short, in Brazil we see a country with a significant underlying strength, with the still some pressure on the spreads, from the change in mix that we have not yet finished.

(Technical difficulty) we expect to increase well below inflation, half of the inflation, somehow like that. And improving cost of credit that we continue -- is a process that continues to go on.

Our target here is to increase significantly the (transactionality) with our customers and lead the way towards efficiency improvements. And it's not the cost income ratio; it's more than that. It is the cost to business that Javier mentioned several times to you, that is what matters most in Brazil.

In Mexico, well, as you know, a slowdown in the economy, more than expected or where the economy is growing significantly less than consensus. And this -- in reality this is not -- this is affecting the business somehow. But the results in activity are quite good.

We are growing almost 10% both in loans and deposits. And we're growing faster than that -- significantly faster than that in target segments, like SMEs we are growing 29% and mortgages 13%. (A single-digit growth) in deposits, with demand deposits growing at 20%.

So in the results I will say two (elements) here. The first one is the top lines of the P&L, that very good trends. Net interest income 4% up in the quarter, fee income 9% up in the quarter so very good trends on the fee income generation, in -- sorry, (inaudible) remuneration in Mexico.

We have two exceptional impacts in the quarter. We made a charge of (EUR180 million) for homebuilders. This we have now a coverage of 40% that is in line with our respective loss coming from this specific situation.

The rise in NPLs in the quarter was due to the incorporation of the NPL portfolio of the homebuilders. Excluding them, NPLs were almost flat in the quarter.

The second, I will say, exceptional item in the quarter was a change in the (inaudible) way of provisions are made in SME loans. The new formula incorporates the expected loss -- the average expected loss in the system -- in the Mexican system. Our portfolio is significantly better. And we have much more warranties coming from the government bodies than the average. And this increases the provisions in the quarter for this specific (inaudible).

(Family) cost went up also significantly in the quarter. There was a regulation change in the employee statutory profit sharing. And we are opening branches, in the last 12 months, we're opening 106 branches, 9% of them are (inaudible) and we also increased the number of ATMs in 400.

So, overall the business is performing well. We have some one-offs this quarter, some of them will stay like the employee statutory profit sharing. But the other two, the SMEs and the homebuilders, is a one-off that we don't have in the next quarter. So, overall, recurring profit and expectations for the business are good.

Chile, well the macro in Chile is good; our activity is picking up. The loan book is growing faster and deposits are growing faster. We are having a selective growth, SMEs growing at 16%; affluent customers 12%; demand deposits 12% year on year.

Profit was significantly up in the quarter, 26%. Net interest income rose 16% partially due to the inflation portfolio, the so-called UF portfolio. You have in the slide the inflation UF rate in the quarter was 1% compared with minus 0.1% the previous quarter. And this is playing part of the increase in net interest.

Fee income, still this year affected by regulatory changes in insurance and in car businesses. And trading gains were lower than the previous quarter. Costs remaining flat. And provisions increase is not something that we expect to stay there. But continue to grow more slowly year on year.

In short, the dynamics -- the business dynamics of the Bank are improving. In the quarter -- Fourth Quarter, high inflation is suspected will push the net interest income. We see stable costs and risk premium.

In other Latin American countries, overall, they are performing well. All countries increase their profit with double-digit growth over 2012. And is driven by pure commercial business, net interest income and fee income.

You have Argentina, the profit EUR254 million, plus 31%; Puerto Rico rose 70% in the first nine months; Uruguay 16%. And we do not expect significant changes in the coming quarters in this area.

In US, well, the economy continued to grow around 2%. Interest rates -- ultra-low interest rates; as you know, our expectation remaining in this the same probably for -- 'til 2015.

Well, we are taking significant steps here in the direction of consolidating our business there. We change the Sovereign brand to Santander brand. And we are reorganizing -- we reorganized the commercial areas. We have focused the Bank more in commercial areas.

On the other front, in consumer business the agreement with car leases has stellar performance and will allow ourselves to benefit from the Bank with better penetration on some areas.

On activity, Santander Bank growth was focused on companies. Total lending declined, because we sold more mortgages and the reduction on the portfolios on run-off.

In deposits we are pushing demand deposits that are growing 7%.

At Santander Bank the results, the fall in revenues was due to lower spread, some reduction on the duration of the balance sheet, which impacted the net interest income and trading gains.

The quarter costs rose because the rebranding and costs from the development of the franchise, among others; recovery of provisions; and this -- in the quarter, a significant year-on-year fall thanks to excellent credit quality.

On the consumer side, on SCUSA, a strong rise in lending partly due to the agreement with Chrysler, which is not fully reflected in the P&L, because the first -- when you start to grow you should make, as you know, provision -- upfront provisions to the expected, to the new growth that, at the beginning, produced lower profits. The contribution of SCUSA was $346 million, 4% more than in 2002 (sic; see slide 33 "2012").

We continue to see SCUSA very strong in the coming quarters, while Santander Bank we are building the franchise. We target more diversified revenues with larger range of products and reducing the funding costs, while we expect to keep the good credit quality.

The corporate center, well the results are pretty much in line with those of the previous year. Overall, the profit is negative EUR1.49 billion compared with EUR1.50 billion in the same period of 2012, before the recording of capital gains.

Net interest income slightly, compared with the nine months, less negative, while what plays here is the liquidity buffer that we have been keeping during this period.

And the second, trading gains very significantly up; this year EUR920 million compared with EUR512 million (sic; see press release "EUR515 million") the previous year. It's the centralized management of interest rate risk and exchange risk, who is recorded here and who produced this change from last year to this year.

General costs increased, mainly due to indirect taxes. Provisions are higher incorporating the charge that we comment in the previous quarter; that was due to the unification of the lending portfolios in Spain to the most conservative criteria of the two -- of the three banks we merged at the time.

And now I'll give the floor to Javier to elaborate on the conclusions and the priorities for the coming quarters.

## Javier Marin Romano {BIO 3961209 <GO>}

Thank you, Jose Antonio.

(A summary) -- just to sum up the quarter. Santander has adjusted to the macroeconomic and competitive conditions in each market to increase volumes and customers in a differentiated way.

In general terms, as you've seen, there's more focus -- there's greater focus on lending in emerging economies and developing the franchises. And on deposits on mature markets.

We continue strengthening the balance sheet, backed by our business, high capacity to generate capital and liquidity. We are comfortable with the current levels and have no restrictions to keep on growing.

Furthermore, we see improvements in our underlying business which we expect will continue in the coming quarters. Group revenues stabilized in recent quarters, 7 out of 10 core markets with quarterly increases in net interest income and fee income.

In costs, we are absorbing the investments in building franchises in several countries, even though we have very clearly room for improvement.

And lastly, still high provisions tending to go back to normal; the Group cost of credit dropped in the year with its six core markets, with reductions since the beginning of the year. And two are stable.

In short, in 2013, we are managing the business to lay the foundations for growth.

Let me finish reviewing the priorities for the coming quarters, when we will focus on recovering profits and profitability, focusing on customers. We have three global priorities to attain this.

First, improve the profitability of capital through a more efficient allocation. We are already mapping the Group, revising each of the business segments to adjust the levels of capital to the strategies and growth prospective.

As you know, we have split each bank in the different segments, reviewing the return on risk-weighted assets by segment, the potential for growth. And then preparing the plans for each segment, for each country, in order to see how we can increase the returns and definitely take profit from the high-growth pools.

In some cases, we will increase the investments. In others, we will adjust it to be more profitable. In any case, Santander will maintain its presence in its core markets and businesses.

Second, we will improve our cost efficiency. Our objective is to redesign the Bank. So we can do the same with lower costs. Although our efficiency is higher than that of our peers, we can improve it. We are identifying cost inefficiencies across the Group that enable us to keep on enhancing efficiency.

We have been measuring margin and sales; we've not been measuring cost of production. So now, aside from efficiency, we will focus much more on our cost to do business in the different geographies. Our objective over the three years is to achieve cost savings of EUR1.5 billion, including the EUR500 million of synergies announced out of the integrations underway in Poland and Spain.

The third priority is to increase the integration of the units across the Group. In other words, to obtain the global advantages in revenues, costs, provisions and quality while keeping a very strong local focus. And give us benefits in our core markets.

We need to benefit more from our global footprint, identifying the best practices and sharing them across the Group. This is why we have created the retail banking division, the recuperations division and so on.

If we take a look into countries. And we see what are the trends to follow, we see Spain and Portugal where we have a good evolution of the basic lines of income backed by economic recovery and some efficient growth. We need to gain market share in more attractive segments, SMEs, affluent.

We need to speed up the synergies from the merger, as we are already doing. And take advantage of the increasing revenues and the lower cost of deposits, together with the decline in the cost of credit. You will see very clearly cost of credit is declining to more normalized levels in the next years, probably going down to 70 basis points by 2015.

In the UK, we are already seeing improvements in recent quarters and we will remain focused on improving segmentation, linkage and service quality as the main drivers to grow in target segments.

We are already growing in SMEs, we will continue with our (inaudible) to see how we can speed up growth. We will focus on the affluent segment; that is a huge opportunity for us. We're doing well with the growth. But we believe we can still accelerate that. And we will continue to reduce the cost of funding for our Bank.

In Brazil, our objective is to develop the commercial franchise, particularly in mid corps and high income individuals. It will be key to improve efficiency. Inflation at 6%. And with a payroll increase of 8.5% you see how important it is to drive our cost to business as low as possible.

We need to adjust the spreads to the risk. So that the net interest margin, net of the cost of credit, can increase in a sustainable way. This has been the case over this quarter where, for the first time, the net interest margin minus the cost of credit for individuals has gone down in Brazil.

In consumer business in Europe, we are maintaining the guideline of the last few years that are producing very good results. We will increase market share organically, as well as by taking advantage of opportunities, like the one we had with profit here in Spain, that hopefully will be closed -- should be closed by the end of the year, early beginning of next year, with the biggest and the best retailer in Spain, El Cortes Ingles.

We should maintain efficiency and credit quality at the actual levels that compares very, very well with respect to our peers.

In Mexico, we should manage the priorities and firmly set on growth. We will continue to invest in our commercial networks; we've opened almost 40 branches over this nine months. We will open still another 40 branches over the next quarter and still more than 100 branches for next year.

We need to do this efficiently in order to keep growing in volumes and revenues, taking advantage of the economic recovery, focusing on key segments, like SMEs where we already the bank of reference. And in affluent. We still have room, in certain products, like mortgages, insurance and deposits, to grow.

Very similar in Chile focusing on companies and the affluent clients, in order to take advantage of the economic growth differential with other countries in the region.

In the rest of Latin American countries, the Group should be spurred by the economy and the banking penetration potential. So we should develop our franchises in the mid-corporate and the high-income clients that will produce strong rises in volumes and revenues.

In the US, Santander has begun the last phase of its transformation, developing a full franchise bank for clients, boosting companies, global banking and markets, transactions to generate fee income. And focus on high-income clients; as you see, a lot to do, a lot of opportunities.

We shall develop some niche business, some of which are already underway, like auto finance through the agreement with Chrysler. We shall improve our credit quality to our customers. We already begun with the re-branding, I already elaborated on that. And it's vital to reduce the cost of funding, which even though it has declined, it still has room to go further down.

Lastly, in Poland, we will continue to center on completing the merger and extracting the maximum value, anticipating synergies and boosting the productivity of our branches.

In short, a series of priorities for the Group and its units, which I believe should enable us to attain a more normal level of profits and profitability and reflecting Santander's potential.

Thank you, very much. We will now open the time for the Q&A, Angel.

## Questions And Answers

### A - Angel Santodomingo {BIO 15757370 <GO>}

Good morning, as Javier said, we are open now the session now for Q&A. For all the questions we have received through the Internet. Of course, at the end if there are questions through the phone, we will try to address them, if time is available.

I will organize question, as always, by themes, starting by (inaudible) relation perspectives for the Group and for the sector.

The first question will be about yesterday's announcement from the ECB on the AQR and the stress test. There are several questions here posted by Britta Schmidt, Autonomous; Axel Finsterbusch, JP; Alexander Pelteshki, ING; and Daragh Quinn, Nomura.

Basically the questions would be what is our reaction and opinion on this announcement; if it will change or not the strategies of the Group? Do we think we can meet the 8% buffer that was announced by January 1, 2014? And if we expect changes on our books, on the sovereign book, measures, etc.? So, in general, comments to what was announced yesterday and impacts both on us and on the sector.

## A - Javier Marin Romano {BIO 3961209 <GO>}

Our first reaction to this is positive. First thing, we believe it's a good exercise of transparency, which is key in order to recover trust on the financial sector.

We will see, for the first time, a more level playing field. So applying homogenous criteria to all the banks. And basically, with respect to non-performing loans and refinance loans, the criteria that are being applied are basically the same criteria as are being applied in Spain by the Bank of Spain. So we feel very comfortable with that.

It will cover a broader spectrum, not only balance. But also off balance sheet assets, with all kind of risks. And the European Central Bank will guard that the consistency on the criteria of information is enough.

We feel very comfortable with this. Santander has a very low risk profile. We've gone already through a number of stress tests, always with very good results.

With respect to capital, the European Central Bank is placing the bar, the phase-in -- 8% Basel III phase-in. As we have been stating, we are already 3percentage points above this figure. So we feel very, very comfortable; so no surprises and we expect good results out of that.

You also asked me whether this will change the way we do business. Well, if we are comfortable with the results. And as we are quite confident that this will be good, definitely, there will be no change with respect to the way we do business.

We are very retail bank, very well diversified, with a very unique model in terms of our affiliates in core markets and with a very granular, in terms of income and in terms of risk, business. So we don't expect to make any changes because of the outcome of the asset quality review and the stress test.

## A - Angel Santodomingo {BIO 15757370 <GO>}

The second group of questions apply to dividends and dividend policy. Rohith Chandra from Barclays; Stanislas (inaudible) from BNP; Victor Rodriguez from (inaudible); and Britta Schmidt from Autonomous all circle around our dividend policy with regards to 2014.

Basically, do we think that the dividend payout rules from Bank of Spain will be maintained on the 25% payout ratio? What is our idea with regards remuneration of shareholders; if we think we can sustain the dividend that we have paid or what are our thoughts around this?

## A - Javier Marin Romano {BIO 3961209 <GO>}

Let me see; the dividend policy of the Bank sits perfectly within the recommendations of the Bank of Spain. So, we don't expect to do any changes.

We have already announced the dividend for this year; that will be EUR0.60 in form of scrips.

For the next year, as you know, every year we bring to the General Shareholders' Meeting what should be the policy for 2014. So this is a decision that is up to the General Shareholders' Meeting.

I can only speak for 2013, where basically we will keep the dividend on the same way we already -- for the amount and the way we announced that sits perfectly within the new policy set out by the Bank of Spain.

## A - Angel Santodomingo {BIO 15757370 <GO>}

There are M&A questions coming from Rohith Chandra, Barclays and Carlos Peixoto, BPI with regards to our interest in M&A basically in Spain; in fact, they specifically about Catalunya Caixa and Nova Caixa Galicia, if we are interested or what our ideas with regards to making inorganic movements in Spain.

## A - Javier Marin Romano {BIO 3961209 <GO>}

Our first task in Spain is to integrate Banesto and Santander. We are on the process. We are trying to accelerate it as quick as possible. It is very important that we don't lose foot during this process from a commercial side.

We are growing well in deposits. We have on-boarded more than 90,000 loyal clients into the Bank over this nine months. And that is very important. I think we still have a lot of room to do things better with our actual footprint in Spain.

However, of course, definitely, we will take a look to both Nova Caixa Galicia and Caixa Catalunya. We always -- I think it's our duty to analyze any opportunities that might arise in the markets where we operate.

Of course, as you all know the Group has very rigid returns expectancies on all the investments that we look at. So they need to meet them. We will look at them as we are already looking at Nova Caixa Galicia. And we will see balancing the risk and the opportunities what should be the decision of the Bank.

## A - Angel Santodomingo {BIO 15757370 <GO>}

With regards to potential IPOs, there are a couple of questions coming from Carlos Peixoto from BPI; Mario Lodos from Sabadell; Rohith Chandra from Barclays; basically, focused on both UK and US. On UK, given the recent (inaudible) from the Chairman, if we are thinking of the IPO in 2015 or 2016 in UK, if we can give a clarification here? If we could be thinking of doing a private placement like with Consumer Finance USA and what are our ideas with the IPO of SCUSA, of Santander Consumer Finance USA?

## A - Javier Marin Romano {BIO 3961209 <GO>}

Well, as you know, the Group policy is to have our affiliates independent in capital, independent in financing. And quoted in the markets where they operate. So this will come. When? At the appropriate moment.

Now, we are hands free in the US after the sale, the registration for the IPO. So now we can do it whenever we want.

In the UK we need to wait for the appropriate moment. The appropriate moment means both the markets and the internal situation of our franchise. I don't think this will happen definitely next year. So later next year we will see.

## A - Angel Santodomingo {BIO 15757370 <GO>}

With regards to regulation there's several questions on DTAs; Britta Schmidt from Autonomous, Rohith Chandra from Barclays. And Patrick Lee from RBC.

Basically, what do you expect from the new potential regulation on DTAs if we include them on our fully-loaded calculations. If there is any update on availability of DTAs? What could be the conversion of inner Spain? If we can elaborate on the different types of DTAs? And if they're fully loaded 9% includes them or not?

## A - Javier Marin Romano {BIO 3961209 <GO>}

With respect to DTAs, our attitude with respect to this is that we should leverage only on our capabilities; that is the potential to grow the business and to generate organic capital. We cannot wait for any kind of negotiations that we are not part of.

Of course, we would love to have a level playing field in Europe. So the similar situation that we have in Italy, in Germany, or in France, we have it in Spain. But we are not counting on that for anything within our numbers. If it comes it will come as a bonus.

Our objective is to generate positive results in Spain, in order to bite into these DTAs.

## A - Angel Santodomingo {BIO 15757370 <GO>}

Okay, leave DTAs and going into capital, there are several questions both with regards to our level of capital in the fully loaded. You already elaborated here. But if you want to address something additional.

Rohith Chandra from Barclay;, Stanislas from BNP; Ignacio Cerezo from Credit Suisse; Benjie Creelan from Macquarie; Carlos Digrandi from HSBC; they basically ask about if we see more capital optimization exercises, like in Brazil recently, that's on one side. The other side is if we are thinking of raising capital or whether the levels of capital that we feel comfortable with. As I said you already elaborated there a little bit.

Then the third group of questions would be on the fully-loaded basis, if we can add data there on our position, what is the fully loaded. And what is still to come, elaborating around the 9% that we have said that we think would be above that (first loaded).

## A - Javier Marin Romano {BIO 3961209 <GO>}

With respect to optimization exercises, definitely some -- we've done the operation in Brazil, which definitely will increase ROE for all the shareholders, which I think is good. We have an active policy of reviewing the capital as I mentioned before, not only by geographies. But also by segments. So you should not exclude that we also -- that we actively review and take action where we see some opportunities for optimization.

With respect to raising capital, the answer is no, we're not going to raise capital. We are very comfortable with the actual levels of capital. And with our capacity to organically generate capital. So, we're not planning any capital raising, even though the price to tangible book is high. And whatever. But we are not planning anything, because you do this when you need it. And we don't need it. We're very comfortable with our actual levels.

With respect to the fully loaded, we already said that Santander will always stand above 9% on a fully-loaded basis. And we are on track to be there.

## A - Angel Santodomingo {BIO 15757370 <GO>}

Formalizing relation, we have specific questions from Antonio Ramirez from KBW. How does the NPL and refinance structured loans definition by EBA compare with those that we are already applying with regards to the AQR exercise?

Let me remember here that basically that exercise is converging to what we could call a Spanish criteria, they include above 90 days, they include subjective NPLs on the definition of NPLs. On the restructured, they comply or they move towards that definition of forbearance that is highly conservative following Spanish standard. I would say basically we are already there.

Moving into financial arena linked to capital, there is a question -- we still have questions around risk-weighted assets. Britta Schmidt, Andrea -- from Autonomous; Andrea Filtri from Mediobanca; Ignacio Cerezo from Credit Suisse; and Ignacio Ulargui from BBVA; they ask for explanations on the drop of risk-weighted assets, on the total amount, specifically in Spain, if we have reduced risk-weighted on SMEs. And if there is additional potential optimizations in the pipeline?

Well, as we said during the presentation, the reduction in risk-weighted assets came, firstly, because of the reduction of the stock of credit; and second, most because of the new definition of an SME that made it homogenous with what we have in Europe. Half of the generation of capital came from organic generation, from the P&L and the other half came from the other effects.

You probably also have to add the ForEx impact, that is like about one-third on that movements.

About issuance, linked to the regulation into our ideas of what we could issue, Britta Schmidt from Autonomous and Axel Finsterbusch from JP ask about what are our ideas of issue.

In addition, Tier 1, with the requirements about CRD IV, what are our plans there; if we are going to start issuing these type of securities, whether we foresee additional Tier 1 to be issued.

## A - Javier Marin Romano {BIO 3961209 <GO>}

Basically, our idea is to replace our additional Tier 1 and our additional Tier 2 that will go under the grandfathering. So we have basically EUR18 billion that will be replaced over the next 10 years, both at a corporate level and at the affiliate level.

I don't know, Jose Antonio, do you want to elaborate more on this?

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

No, basically when I issue both from the parent and from the affiliates, in some affiliated we may start soon, at the parent company level, maybe next year when we start to replace, as Javier said, some issuance that mature, or we can call or loose (complete-ability) in the coming years.

## A - Angel Santodomingo {BIO 15757370 <GO>}

With regards to (inaudible) and ALCO portfolios, there are also several questions from Britta Schmidt from Autonomous; Mario Ropero from Fidentiis; Antonio Ramirez from KB. Basically, they all ask about the ALCO structure, if we can speak about what are our exposure to sovereign debt? What is the reason of the drop on debt securities in the balance sheet? If we can speak about duration and volumes and NII contribution?

## A - Javier Marin Romano {BIO 3961209 <GO>}

I will let Jose Antonio go with this as Chief Financial Officer.

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

The policy in the ALCO portfolios, well, in the main trend has been to reduce, as I mentioned in the presentation, to reduce the duration in the balance sheet. This was particularly strong in Brazil, US and (somehow) in Spain. So our duration in the balance sheet is, in general, shorter than in the previous quarters.

As a result of this, the instruments we use to change, to hedge or to change the duration of the balance sheet normally is sovereign debt -- the majority is sovereign debt or almost only sovereign debt. As a result of this, we reduced the holdings in Brazil, in US. Usually, in the US, in one year, the number has been 30%, in Brazil significantly and in Spain, we reduced 15% or something like that the sovereign debt.

The durations now are really, really short; in some balance sheets negative. So -- because still we run significant amount of demand deposits, current accounts not paying interest. And, in general, our position in all the balance sheets, all the ones I mentioned, is more towards higher rates. And our position is to higher rates, generally speaking.

The holdings of sovereign debt is around EUR60 billion; in Spain around EUR30 billion; Brazil EUR7 billion, I'm speaking in euros. And the other are minor, Poland EUR4 billion; US EUR3 billion; Mexico EUR2 billion. So those are the main holdings; overall, EUR58 billion.

## A - Angel Santodomingo {BIO 15757370 <GO>}

On the liquidity side, there is a couple of questions from Carlos Peixoto from BPI and Carlos Garcia from SG, with regards to our financing exposure to ECB, mentioning the LTROs.

If we -- what are we using, what do we expect to use, if we expect a LTRO or not? And that would be, basically, the two or three main issues around liquidity.

## A - Javier Marin Romano {BIO 3961209 <GO>}

Basically, what -- when we (tell) the LTRO in Spain, most of that has already been paid back in the First Quarter of this year. We have still an exposure of EUR10 billion; EUR7 billion our bank in Portugal, that should come down to EUR5 billion soon; and the rest to Santander customer financing, in order to finance their business.

With respect to our new LTRO, well, for us, basically, we don't need it. So it should be good for some operators in the industry in Europe. And to avoid tail risks. But, for us, we are in a very comfortable position in terms of liquidity.

## A - Angel Santodomingo {BIO 15757370 <GO>}

There is a question on our announcement of cost synergies that we made around one month ago. The question is coming from Carlos Garcia from Soc. Gen., Irma Garrido from Ahorro Corporation. And Rohith Chandra from Barclays; they are asking if we could elaborate on this EUR1 billion additional cost savings that we announced. If we plan to have additional charges -- restructuring charges; if they are included or not? If that is the

EUR1.5 billion is the total drop that we will see by 2016? Well. And the breakdown through geography. So -- basically.

## A - Javier Marin Romano {BIO 3961209 <GO>}

Out of the EUR1 billion, the split will be between around 35% in Spain; around (40%) in Brazil; and the rest will be a split between the different countries.

Will they have restructuring charges? Definitely they will. In order to restructure we will need to apply some costs, right. We will come back with this figure. We are already working on each exact plan in each country, in order to figure exactly what the restructuring costs are going to be. So the next quarter we will come back, in order to -- with much more detailed information, in terms of what we can expect in terms of the restructuring charges.

With respect to 2016, yes, you can expect EUR1.5 billion of less costs by 2016.

## A - Angel Santodomingo {BIO 15757370 <GO>}

To end up on this area, we have a question with regards to the Tarullo US rules. What do we expect if we expect them to affect or move into Europe. And what are our thoughts on those rules?

## A - Javier Marin Romano {BIO 3961209 <GO>}

Basically, we're not -- as you know the Tarullo rules apply, basically, to foreign banks that they have operations in the US. We have already complied with this. We have an affiliate -- due to our strategy and our policy of having affiliates that are independent in capital; independent in financing; work on an affiliate base and not on a branch base, we already comply with the Tarullo rules. So we are already okay.

## A - Angel Santodomingo {BIO 15757370 <GO>}

Moving to the next area which is risk, the risk arena. There is a general question around the coverage ratio for the Group, made by Andrea Filtri from Mediobanca, asking why do we let the coverage ratio go down a couple of percentage points. What are our thoughts there? And what is the evolution we expect from there?

## A - Javier Marin Romano {BIO 3961209 <GO>}

Well, as you know, the coverage has never been our objective for us; it's a consequence of the evolution of the non-performing loan ratio and the need of provisioning, in order to cover the expected losses of this.

So the portfolio, of course, has different collaterals. We have, as we said before, more than half of our book is collateralized. So at the end the coverage is the result of the non-performing loans, minus the collaterals that we have. And with the expected loss that we have for each portfolio in each country. So it's not a question for us; it's a fact. It's not an objective.

## A - Angel Santodomingo {BIO 15757370 <GO>}

With regards to criteria and specific data there are a couple of questions. One from Santiago Lopez from Exane, if a company that has been restructured or refinanced more than once, if we are including those on the restructuring and refinanced loans. The answer is yes.

With regards to Spain there are several questions, as you can imagine. One first is the exposure to renewable energy, this comes from Carlos Peixoto from BPI. We already gave that exposure in the previous quarter. I think it's around EUR1.5 billion/EUR1.6 billion in the specific renewable exposure that could be affected. And it's already provisioned with no additional expected problems there.

Generally speaking, not in Spain, from Rohith Chandra from Barclays and Ignacio Cerezo from Credit Suisse, there are several questions. How do we see the quality evolving? What is our provision charge expectations for 2014, if we keep on seeing a gradual reduction in both loan charges, provisional charges in the P&L? When do we expect an improvement? And if we can update on the refinances in other areas; basically, quality in Spain, cost of risk, how do we see that evolving?

## A - Javier Marin Romano {BIO 3961209 <GO>}

With respect to quality we're seeing some improvement in quality from credit to individuals, both consumer credit and mortgages are performing better, in terms of new non-performing better.

Arrears also are performing better. We still see high levels of entrants of new non-performing loans in SMEs at a high level and at a sustained level. So we don't see still an improvement there.

With respect to cost of credit, we already see an improvement for next year. We already saw an improvement from the Second Quarter coming to this quarter and we will see this going further down through next year.



## A - Angel Santodomingo {BIO 15757370 <GO>}

Patrick Lee from RBC was also asking this point, plus if there is any specific one-off or anything to -- anything that we should extract from the 6.4% of NPL ratio in Spain? The answer is -- as Javier said, there is nothing really especial to underline.

On the refinance and restructured side there are several questions. Antonio Ramirez from KBW, Ignacio Cerezo from Credit Suisse and Andrea Filtri from Mediobanca, they ask if we -- what do we expect in terms of additional or potential new reclassification on restructured and refinanced loans by Bank of Spain, potential additional definitions. If we feel reasonably positioned on that area?

And if we can give, basically, an update on how we are aware what are our coverages, etc.?

## A - Javier Marin Romano {BIO 3961209 <GO>}

Okay, in terms do we expect any additional reclassification, no. The answer basically is no.

Within this, the portfolio is adequately provisioned with respect to the expected loss that should -- for this portfolio. We have roughly around the 42% of this portfolio that is already a non-performing and around 25% to 30% of this portfolio that is sub-standard.

The rest is basically performing and the portfolio is provisioned in accordance with how we expect that this -- the portfolio should perform the next years.

## A - Angel Santodomingo {BIO 15757370 <GO>}

There are two questions from Andrea Filtri from Mediobanca and Frederic Teschner from Natixis asking what would be the NPL ratio according to EBA? If we expect more NPLs through the structural launch and if we would include that in the business as usual cost of risk?

And the answer, as has been stated, is, yes, that is in the guidance we have given. In terms of cost of risk, we should include or we are including in this type of movements and potential impacts that we would have from this type of launch.

Two areas specifically mentioned on the risk side, Mexico and Brazil on the first one. Several questions from Rohith -- from Daragh Quinn from Nomura, Patrick Lee from RBC, Rohith Chandra from Barclays, Alvaro Serrano from Morgan Stanley and Mario Lodos from Sabadell Bolsa with regards to the jump in provisions in Mexico. If we could update on the homebuilding exposure coverage, reasons of the pickup, how do we see the trends in asset quality in Mexico; and if we expect additional hits coming from there?

## A - Javier Marin Romano {BIO 3961209 <GO>}

With expect to the homebuilders in Mexico our portfolio sits at EUR300 million. The provision already charged is -- made is at 43%. But this is what we expect could be the potential loss of this exposure. As you know, this provision was made against capital at local level, in local accounting. It has made again results at the Group level.

In terms of the general portfolio, we've seen deterioration because of the sluggish growth that we've seen in Mexico over the last quarters. But we don't see a big trend of the deterioration. We hope that this should come back when the economy begins to grow at a more normalized level.

## A - Angel Santodomingo {BIO 15757370 <GO>}

And going to the second division in Brazil mentioned, well there are questions from Ignacio Cerezo from Credit Suisse; Mario Ropero from Fidentiis; and Rohith Chandra from Barclays. Stating that we have seen that decrease of both NPLs and provision charges in the P&L.

How do we see that evolution? If we can explain how sustainable it is and if we are already in the bottom of those charges whether we could see additional good news coming from that part of the business?

## A - Javier Marin Romano {BIO 3961209 <GO>}

Our view is that this reduction in non-performing loans and provisioning should continue over the last -- over the next quarters.

If you compare our Bank to our peers in Brazil you see that the peak of our NPLs took place nine months later than it did for them. So we are nine months behind.

In addition to this and, of course, it's hurting the financial margin, as Jose Antonio explained, we are growing in certain areas of lower margin and lower risk and this should be, of course, reflected on the behavior of our overall portfolio.

In addition, early arrears, especially over 60 show good decreases. So we believe that this should be a trend to be seen over the next quarters.

## A - Angel Santodomingo {BIO 15757370 <GO>}

Going into specifically the units, we start with Spain, there is probably the same question made in three different ways or linked in between them, let me try to summarize them.

The first part would be the general thoughts about business in Spain; that we expect positive prices in 2014, if we could elaborate there? If we expect to return to profit in Spain early or not, that would be a general one?

And then specifically there are two areas, volumes and NII, that you probably want to address jointly?

On the volume side questions around deleveraging in Spain; loans have gone down. If we see them still going down or not? How much additional leverage we could see? Given the strong activity in new loans in companies in Spain, if we can expect the loan book to increase? So, all around the loan book and volumes, if they are affected by integration of Banesto. But you probably want to (inaudible).

And the third part of this question that is linked is the NII margin. What is the reasons of the decline of that margin in the Q? If we can give some kind of guidance, if we expect it to be positive etc.?

Those questions come from (inaudible), Carlo Digrandi from HSBC; Daragh Quinn from Nomura; Ignacio Cerezo from Credit Suisse; Mario Ropero from Fidentiis; Frederic Teschner from Natixis; Alvaro Serrano from Morgan Stanley; Rohith Chandra from Barclays; Francisco Riquel from N+1; and Ignacio Ulargui from BBVA. I think I included all of them.

## A - Javier Marin Romano {BIO 3961209 <GO>}

Okay. First question, volumes deleveraging; as you know, the economy has gone through a very strong deleveraging. The size of credit for households and companies has gone down to almost 30%, which is quite a lot. We believe that this is -- we should be close to the bottom. Our expectation for next year is that our loan book should be stable; so no more decreases.

Is it affected by the integration with Banesto? Definitely no; we haven't reduced the lines to any credit, because of the concentration of Santander and Banesto.

With respect to deposits, we've seen a growth in deposits over the last months, over the last quarters. We expect to continue to see this trend, especially with respect to current accounts. We have a very strong focus in transactional business. So we expect to see this growing.

Assets under management funds are growing very, very well. And we still see this trend, especially with this very low interest rate scenario. Insurance is working well. So we see some good news in terms of the overall income.

Margins; margins should move up. As Jose Antonio explained, our average cost of deposit at -- we began the year at around 180 basis points. We'll close the year at around 125 basis points. So this will mean a huge reduction in the cost of deposits for next year.

The (re-appreciation) of mortgages is already close to its end. So it will -- we will have no more impact, especially next year. We don't see a huge -- we don't see any price compression with respect to credit. So we are quite positive with respect to what we can expect, not only in terms of the net interest income. But in terms of the net income for Spain next year.

Costs; you already know. We will see, next year, the acceleration of the synergies in terms of their impact on the P&L. We will see already some near effects of the efficiency measures that we will take. So costs, definitely, next year will be lower than 2012.

And provisions; we already said, the cost of credit is going down, should continue to go down. And we expect, next year, to have some positive news in this side.



## A - Angel Santodomingo {BIO 15757370 <GO>}

You address it a little bit. But there is another group of questions with regards to specifically deposits and pricing. And cost of deposits and spreads.

The questions are if we can say what are the cost of deposits that you mention? How they are evolving? How is the new production? Why the spread has gone down in the quarter? That we have seen volume of deposits shrinking, if you can explain that movement, that you mentioned in the presentation. But I don't know if you want to elaborate a little bit?

These questions come from Benjie Creelan from Macquarie; Patrick Lee from RBC; and Rohith Chandra from Barclays.

And there is an additional one from (John Blanch) from RCM, from (Raiffeisen) Capital Management, speaking about the general situation in market, (so I would guess) specifically in deposits of savings banks; that given that they gained a lot of market share before the crisis, if we are not afraid that Spain could go through difficult times, given that now it's the other way round, if you can elaborate a little bit there.

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

No, I elaborate in the presentation. Basically, on deposit costs, the front book/back book dynamics is very good. So, in fact, in time deposits we are seeing reductions in the costs of 160 basis points, when we compare the back book time deposits with the front book time deposits.

What remains to be done, some, as Javier mentioned, we started the year 180 basis points cost of deposits; (we'll end) at 125 basis points. Well, we expect to do -- what needs to be done is around EUR30 billion deposits are going to replace timed deposits in the next six months, or something like that. We expect to get from this a reduction of (150) basis points, more or less. I'm speaking more or less on this. And this is the process of repricing down the deposits.

In volumes, we already elaborate. The volumes are coming in the good side. Particularly in the last quarter, was more in mutual funds than in deposits, because the focus in deposits, as we mentioned, is more the cost than the volume, given the liquidity position of the Bank.

## A - Angel Santodomingo {BIO 15757370 <GO>}

To end with Spain, we have a question from Mario Lodos from Sabadell Bolsa. When do we think the mortgage repricing will end? Remember that this is linked to the Euribor. Euribor went down in 2012 until around October/November, which is approx. when we should see the end of that repricing process, with a little delay of one month/one month and a half.

Then, the last question on Spain would be on the run-off real estate portfolio, made by Benjie Creelan from Macquarie. He asks about the proportion of land within our portfolio that is growing. It's 57% now, with a 62% coverage ratio; if we feel that, that is enough. And how do we think that we'll evolve in the future?

## A - Javier Marin Romano {BIO 3961209 <GO>}

With respect to the first one, (re-appreciation) of mortgages, the bulk of it has already occurred. We still have a tail, a small part over the next quarter and, by year-end, it should be finished.

With respect to the land -- the question about the land, of course, the weight of the land on our real estate portfolio increases, because we are selling the flats. So definitely, it increases.

What we are doing is, today, we have more than -- we are promoting more than 100 of this product. Basically, in big cities, we see there is demand for this. We only begin the promotion when we have more than 35% of the flats sold.

So we see a very good trend here that will help us to recover out of the price -- out of the accounting figure for this plot more than we have permission. So we expect some good news over there.

## A - Angel Santodomingo {BIO 15757370 <GO>}

Going into Brazil, two big group of questions, one is around business volumes; the second one around costs.

The first one, there are questions like how do we see, generally speaking, volume growing in the country, stating the difference in between public banks and private banks; if we think that the government will keep on forcing or increasing through public banks volume growth? How do we see our growth going on this year and next year?

And linked to that, margins and spreads, how do we see the NII evolving in Brazil? How do we see the spreads, if we think they have bottomed or that they will continue? So basically, volume at the macro sector -- at the sector level; volume for us; and NII evolution, that's on the business.

And on the costs, Mario Lodos specifically asks how are the negotiations with the unions, if we can give an update of the cost situation and the impacts in terms of cost evolution going forward.

## A - Javier Marin Romano {BIO 3961209 <GO>}

Okay, with respect to volumes, we stated at the last quarter that we expected our Bank to be growing at the credit portfolio close to 10%. The credit is growing at 7% right now. So we expect to be close to that figure.

It is true that the growth for public banks has been huge compared to the private banks. We see the public banks are already slowing down the pace of growth in credit. And probably next year, we will see again, for the whole industry, double-digit growth -- low-double digit growth in terms of credit.

With respect to the net interest income, with respect to our Bank, the most important thing is that our net interest income minus provisions, how this figure evolves. So our view is that this net interest income minus provisions, minus the cost of credit, should continue to behave better.

We will still see some margin compression in the country, basically because of competition, because of regulation.

On costs, as we did this quarter, we are focusing more in growing in segments, in affluents, in SMEs. We have a lower -- and in products that have a lower cost of credit and definitely a lower margin. But the margin net of provisions should begin to improve.

Costs, the collective agreement has come up with an 8.24% increase in salaries. That is why it is so important to implement all the measures we have in plan, in order to bring Brazil to a cost to business that is similar to other countries where we operate, like Mexico.

## A - Angel Santodomingo {BIO 15757370 <GO>}

Speaking of Mexico, we have a question from -- by the way, I didn't mention the questions from Brazil; Benjie Creelan from Macquarie Research, Mario Ropero from Fidentiis, Daragh Quinn from Nomura and Alvaro Serrano from Morgan Stanley.

As I said, Carlo Digrandi from HSBC is asking about Mexico, about the NIM, if we think it has reached an inflection point, if we can elaborate on the drivers for next year in Mexico, specially speaking of the upper part of the P&L?

## A - Javier Marin Romano {BIO 3961209 <GO>}

Now let me see, we've seen an introduction in Mexico that definitely has hurt our net interest income.

The trends we see, basically, we see interests where they are picking up slightly. Volumes are working well. We think that they should accelerate, both in credit and deposits over the next quarters, with the economy getting more -- well, speeding up.

## A - Angel Santodomingo {BIO 15757370 <GO>}

There are two questions on the Anglo-Saxon markets. On UK, (Alex Potter) from Miraubaud Securities, he asks about the UK results mix. NII was good and positive, with re-pricing comments; if we can talk about Q3 fees -- evolution of fees and loan losses. So part of the revenue side and specifically on the quality side on UK. That would be UK.

Then US, there is a question by Mario Lodos from Sabadell asking about our guidance given by the Chairman, as he spoke about $2 billion net profit for 2016, how do we plan to meet that target? And if we consider the (current) interest levels or if we are considering any inorganic growth strategy?

## A - Javier Marin Romano {BIO 3961209 <GO>}

Okay. With respect to the UK, commissions were hit in the quarter, basically, because of the lower volume in terms of the distributed funds through the network and a less intense activity in global banking and markets; that they, definitely, at the end brought down our commissions in the quarter.

And with respect to provisions, we see the UK at a very good level. As you saw, the non-performing loans is still 3 basis points below what we had the previous quarter. So we don't see any special item here.

With respect to the US and the $2 billion that were stated by the Chairman, definitely, we don't have the presence in the US that we would like to have. We have -- we are in the northeast. We would like to be, as in any other country, top three player in the region.

We need to do this basically right now organically. We have still lots of things to do. And, at some point, we will take a look to any opportunities we have in the country in the area, in order to accomplish this objective of being a top three player in the region.

However, today, what we need to focus is in improving our franchise; improving the quality of service; growing our franchise; connecting more with Santander consumer, which is also a very good operation that will give us very good surprises over the next quarters. And altogether, I am sure we'll be on top of this $2 billion.

## A - Angel Santodomingo {BIO 15757370 <GO>}

Okay. We do not have questions through the phone. So we are set. If there is -- I hope we have covered all questions received. If this is not the case, please contact us on the Investor Relations department.

Thank you for being here and thank you for receiving the results of Santander.

## A - Javier Marin Romano {BIO 3961209 <GO>}

Thank you, very much.