Q2 2019 Earnings Call

Company Participants

- AndrÃ© Parisi, Head of IR
- Angel Santodomingo Martell, CFO, Executive VP, IR Officer & Member of the Board of Executive Officers

Other Participants

- Carlos Gomez-Lopez, Senior Analyst, Latin America Financials

Presentation

Operator

Good morning. And thank you for waiting. Welcome to the conference call to discuss Banco Santander (Brasil) S.A.'s results. Present here are Mr. Angel Santodomingo, Executive Vice President, Chief Financial Officer; and Mr. AndrÃ© Parisi, Head of Investor Relations. (Operator Instructions) The live webcast of this call is available at Banco Santander's Investor Relations website at santander.com.br/ir, where the presentation is also available for download. We would like to inform that questions received via webcast will have answering priority. (Operator Instructions)

Before proceeding, we wish to clarify that forward-looking statements may be made during the conference call relating to the business outlook of Banco Santander (Brasil), operating and financial projections and targets based on the beliefs and assumptions of the Executive Board as well as on information currently available. Such forward-looking statements are not a guarantee of performance. They involve risks, uncertainties and assumptions as they refer to future events and, hence, depend on circumstances that may or may not occur. Investors must be aware that general economic conditions, industry conditions and other operational factors may affect the future performance of Banco Santander (Brasil) and may cause actual results to substantially differ from those in the forward-looking statements.

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

AndrÃ© Parisi

Good morning, everyone. It's my pleasure to welcome you to Santander Brasil's earnings conference call. Once again, we delivered another set of solid figure -- figures, which will be presented with more details by our CFO, Mr. Angel Santodomingo.

Before moving onto the quarter's highlights, I would like to remind you that Santander Brasil will host its first Investor Day on October 8, when we celebrate 10 years as a listed company. So it will be a great opportunity to discuss with the top management about our strategy, threats and opportunities. So please confirm your participation. And for more information, please reach our IR team and also our website.

Now I turn it over to Mr. Angel Santodomingo.

Angel Santodomingo Martell

Thank you, AndrÃ©. Good morning, everyone. It's a pleasure being again with you this morning on a new set of results.

Starting with the agenda. Key messages will be the first part followed by a small slide on Santander Group results because they have already been published, macroeconomic scenario and, obviously, we will focus on the result highlights and final remarks.

So starting in Slide 6. I would say that our return on equity remained above the 21% level, reaching another historic maximum, improving in the quarter. We keep on generating more value to our shareholders, with profitability materially higher than our cost of equity.

In the next slide, you will have a better understanding of how we manage to deliver such performance, being our operational leverage and tightly controlled provisioning expenses, 2 key elements to deliver those results.

Last quarter, we presented the best efficiency and recurrence ratios in the financial Brazilian sector, key contributors to our profitability. We have further improved first Q levels in this quarter on both ratios. So we will see if we maintain this best or top place within the sector.

According to 2019 Euromoney awards for excellence, you have it in the slide on the right side of it, we were named the Best Bank in Brazil and in Latin America. We believe that this reflects current positioning of the bank.

Finally, I call your attention to the BRL 2 billion distributed in dividends, interest on capital, in fact, during the first semester of this year, which compares with BRL 1.2 billion that we distributed last year or BRL 1 billion in 2017 for the same period. So doubling versus 2017 and something like 70%, 80% higher compared to last year.

One of the bank's -- so next slide, sorry, one of the bank's main pillars in our customer -- is our customer base, which kept expanding at a strong pace. This sound evolution for an extended period, almost 50 months in a row, as you can see in the slide, comes as a result of our focus on client service. The Net Promoter Score is the metric, as you know. And I have been sharing with you, that we have been using as a tool to materialize continuous improvements in client service. We have increased it by 8 points compared to second Q '18 and almost being flat at 59 points, similar to first Q '19. We believe that levels above 60 are sound and strong for a bank.

In Slide 8, we see the results of the client base continuous growth, a profitable market share gain.

While we reached a 9.5% market share on loans, in deposits, we are now above 11%. Based on this, I would like to underline the performance on the following products.

Cards. Reflects our offering on products for all niches, from the low-income segment with a credit card offering to high-income clients, with, for example, the American Airlines Advantage card. These, combined with the best credit card app in the industry, Santander Way, compounds a strong offer that we think will be stronger in the near future.

SMEs. Our success is the result of integration in between financial and nonfinancial solutions, such as the AvanÃ§ar program that helps in their entrepreneur businesses. We have also recently launched the Santander Duo, where we combine individual and corporates accounts into only 1 service, turning the life of microentrepreneurs much easier.

Vehicles. Our digital platform, combined with risk-based pricing that we have been sharing with you lately, remains the backbone of our success.

Payroll loans. We reached a market share slightly higher than 10%, coming from close to 0% just 4, five years ago. Our digital platform has definitely contributed to this achievement, along with our strategy of increasing the number of companies (in most) municipalities that we process payrolls for.

And last. But not least, agribusiness. Our expansion process continues on track as part of our plan to expand into Brazil's countryside. In line with this, we have already opened 24 agro stores. And we have plans to keep on expanding this number.

Slide nine shows our approach to ESG management fully integrated with our business. We have established several commitments that I wanted to share with you, which includes eliminate single-use plastics in our offices by 2020 and have our operations running on 100% renewable energy by 2025. With all these objectives, we have been opening our branches on weekends to promote financial education and guidance. So by first semester of '19, we have already achieved a few important milestones that you can see on the right side of the slide. Energy consumption from renewable resources already reached 21%. Women in leadership already represents 25%. And more than 360,000 clients that are active in our microcredit platform, Prospera.

Moving to Slide 11. You can see the already announced first semester '19 Santander Group net profit and results. In the semester, Santander Brasil represented 29% of the group's earnings, showing the relevance of the Brazilian subsidiary results for the group.

So let's turn our attention now to the macroeconomic scenario. On the back of well-behaved inflation dynamics in tandem with the maintenance of sound performance of the balance of payments, Brazilian economic fundamentals remain positive. Economic activity has registered as lower-than-anticipated recovery trend. But market participants have witnessed some concrete progress as far as the structural reforms agenda is concerned, which should lead confidence indicators to improve ahead.

Moving to Slide 15. You can see Santander Brasil's net income in the quarter that it reached BRL 3.6 billion, which is 4% higher than the previous quarter and 20% above second Q '18 levels. The results for the first half of the year is 21% above the same period of last year. We basically are generating in 1 semester what we achieved, for example, in full 2016 just 2 or three years ago. Customer base growth, volume, cost and provisions control are the main supporters of our evolution.

On Slide 16, we present main lines of our quarter results. On the revenue front, NII grew 5.3% on a quarterly comparison and above 7% versus the first semester of 2018. Fees expanded high single digit relative to first semester last year and almost 3% compared to last quarter. Looking on the expenses side, an 8.8% quarterly increase on provisioning expenses, reflecting the already mentioned low levels of first Q '19. And general expenses with an above-inflation increase, reflecting new businesses launches. I will elaborate on the main concepts in the following slides.

NII totaled BRL 11.3 billion in the quarter, a 5% increase compared to first Q '19 and 8% better than second Q '18, with the following highlights.

Credit NII expanded 5% in the quarter and 7% year-on-year, reflecting a solid loan portfolio. Remember that this 7% year-on-year credit NII expansion still reflects or has inside itself the regulatory impacts that we announced in second Q -- first Q last year, okay? So adjusting for that, it will be almost 9%.

Funding NII grew 4% Q-on-Q, explained by higher average volumes. And the Others (concept) for a quarter is slightly above average.

On Slide 18, our loan portfolio presented a 9% year-on-year increase, reaching almost BRL 320 billion by the end of June. Individuals segment continued to deliver a good performance, increasing 18% in the year and almost 4% in the quarter. Payroll, credit cards, personal loans were the main growth drivers.

Consumer finance once again delivered a strong performance year-on-year, expanding 17%, reflecting our successful model mentioned -- that I mentioned before.

Our SME portfolio accelerated in the quarter, expanding by 10% year-on-year and reflecting a better NPS in the segment, which has been gaining strength during the last 6 quarters gradually.

Lastly, the corporate portfolio, which is still lagging due to both the capital markets activity and our profitability-oriented (study.)

Moving to the next slide. We present our funding progress that in the quarter grew more than our assets side.

Funding from clients increased 4.5% Q-on-Q and 8% year-on-year, highlighting demand and time deposits, with a strong growth in comparison to last quarter. Saving deposits also presented a less intense increase. But gaining market share (thus) above the financial sector -- system growth, while financial bills declined 4% compared to first Q this year.

On the commission side, performance is a direct consequence of the customer base and transactionality growth. In first semester, with a more competitive environment, we grew 9% year-on-year, with positive performance in cards, current account and insurance. And remembering that also we have a regulatory impact coming from the first Q '18, which could lead that 9% to almost -- or around 10%. In the quarter, we had a strong performance in all lines, except in cards, where we had an above-average revenue fee in first Q '19.

In the next slide, we see Santander's asset quality. In general terms, we do not see any worsening sign for our loan portfolio. Short arrears and 90 days ratio present an almost flattish performance in the quarter. All in all, we keep quite comfortable levels based in our risk model's accuracy, granting us confidence to keep on growing our operations. Coverage ratio decreased to 191%. But perfectly in line with our risk exposure.

In the following slide, you will notice that loan loss provisions net of recoveries increased 8.8% in the quarter. Here, it is important to highlight the fact that the provisioning level for first Q '19 was lower compared to both quarters before and after, thus provoking this increase. On the cost of credit, it reached 3.2% for second Q '19, perfectly in line with previous quarters.

On Slide 23, we see costs growing 2% in the quarter and 7% in the year. We are growing above inflation provoked by the different new investment in new platforms that we have been announcing to you during the last quarters. I'm speaking of Pi, of Ben, Santander Auto, Loop, et cetera. And you may see these reflected in the administrative expenses line. On the other hand, as you can see, personnel costs are absolutely controlled, being flat both over the year and the quarter, defending that cost control mindset that I have referred to in previous occasions.

Moving to next slide, to indicators. They show good evolution. And I would say that except for return on assets, the other 3 ratios, efficiency, recurrence and return on equity, present best levels ever. So historic levels -- historical levels. The efficiency ratio improved 70 basis points below 39%, while the recurrence ratio totaled 80 -- above 89%. And as a result of all that, we presented to you this morning our return on equity that rose 20 bps compared to last quarter, reaching the mentioned 21.3%, the highest level ever.

Moving to the capital and liquidity front. We continued to deliver solid recent numbers. Our funding stood at a comfortable level, with a loan-to-deposit ratio of 90% and with good liquidity ratios and levels. By the end of June, our BIS ratio is at 16%, with our core equity Tier 1 of 14%. As mentioned before, we distributed BRL 1 billion in dividends, interest on capital in second Q, totaling BRL 2 billion year-to-date, which is close to 70% more compared to the BRL 1.2 billion that we distributed last year in the same period.

So moving to final remarks and to conclude the presentation, I would like to highlight the following. Revenues increased 8% year-on-year, strengthening our position as a growth company. Asset quality remains controlled. Productivity consistently enhanced, leading to a more efficient company and a 21% year-on-year net profit growth, yielding 21.3% return on equity.

Overall, we believe that this dynamic is a clear indicator that we are on the right track to keep on delivering solid and sustainable results to our shareholders.

I would like to thank you -- to thank everyone for the attention. And we are now open to answer Q&A.

Questions And Answers

Operator

(Operator Instructions)

A - AndrÃ© Parisi

Okay. First question is from Mario Pierry with Bank of America.

Congratulations on the quarter. I'd like to hear your views about the sustainability of ROE, considering a scenario where interest rates stayed low for a longer period of time. And as we are seeing the increase of FinTechs, which one concerns you the most, low rates or competition?

A - Angel Santodomingo Martell

Thank you, Mario. I agree with you that we may be entering lower for longer period here in Brazil. I think I have commented this for several quarters now. But it is true that we have a more stabilized Brazil. I feel optimistic in that sense, meaning that we have a controlled inflation now. We have controlled fundamentals, having very good balance of payments or very good external reserves, et cetera. And fiscal policy being kind of tackled by the government. So we may see that scenario in which we have lower for longer. I think in those scenarios, to your question of sustainability of return on equities, et cetera, what you normally have is 2 things. One is lower cost of equity. And that may lead to lower profitability levels that may happen or not, depending on the evolution of the strong wave of the economic. Normally, you tend also to have more competition because volume is available.

If you see what has happened here in Brazil. And I have also shared with you this idea with you several times, market share of public and private-owned banks have behaved differently. I mean in the good, very growth intense years, public banks reached a high market share, gaining it against private banks, which, back before that positive economic cycle, were the leaders with close to 60%. And now that is reverting. I mean now approx market shares are 50-50. And I would bet that, that kind of behavior will continue, seeing a majority of the market share gain by private banks and probably public banks going below 50%. So that gives also a valuable volume at the right prices and at the right profitability to the system. So you have both a positive economy and volume available from some competitors. So both things should lead to growth on the NII side.

Now to finalize my answer on the competition, FinTech side, well, what I would say is that we have -- as you know, we have more than 500 FinTechs now in Brazil in different areas in terms of -- in the financial sector in terms of services. I have shared this with you in several occasions. I mean this is competition that wakes you and that keeps you on the -- awake on the competition side in terms of how we deliver both services and products to the clients. To some point, some of these competitors will have to go into positive numbers at some point. And what Santander Brasil will certainly not do is, we'll go into a strange or competition affecting prices just for the sake of volume or for the sake of market share. So I will say that, to wrap it up, we are in a good -- a positive scenario that we should kind of take advantage of with spreads probably under pressure. So volume will tend to compensate the spreads. Thank you.

A - AndrÃ© Parisi

Next question is from Yuri Fernandes, JPMorgan.

Interest rate and NII. Can you share your sensitivity to reference rates or perhaps 1-year interest rate curve, specifically how 100 bps reduction in rates could impact your NII in the short-term and in the long term?

A - Angel Santodomingo Martell

Yes. Yuri, thank you. Yes, I think we have shared with you this number. We have a sensitivity of around 300 -- 250, 300, depending on the quarter -- million reals -- to 100 bps move in the curve.

A - AndrÃ© Parisi

Next question is from Gabriel NÃ³brega, Citi.

We see that your loan book decelerated in the quarter. And we acknowledge that is due to the fact that you implemented an aggressive credit strategy over two years ago. What -- if and when the pension reform is approved during the third Q, do you expect to change your appetite for loan concession in any of your loan book segments?

A - Angel Santodomingo Martell

Well I think that our book -- our loan book performance reflects a little bit what is happening in the country. I mean you -- we keep on seeing good growth or positive growth on the individual part of the portfolio. SMEs have been gaining momentum as we speak during the last 4, 5 quarters or 6 quarters, while corporates and large corporates still are either flattish or negative due to several facts, I would say, due to, first, you have the capital markets alternative; second, spreads are under pressure. And we will not enter into operations that we think, at least, under our numbers, do not have a certain level of profitability; and probably still investment plans coming from manufacturing companies are not there, waiting for the economy to pick up and also using the spare capacity that you have available in the economy today, both through unemployment and through industrial capacity, not being used. So that is how we see the performance of our portfolio.

If you see, we have seen a strong change of mix during the last two years in our balance sheet. What used to be retail close to 60 today is above 70 of the total loan book, reflecting what I just said. Going forward, I already elaborated in my first answer. But what I would say is that the normal trend should be to see those 2 parts of the book to stabilize in similar trends of growth and not have such a difference between retail and wholesale. That should be the trend looking forward.

A - AndrÃ© Parisi

Next question from OtÃ¡vio Tanganelli, Credit Suisse.

Congratulations on the results. I want to have a little more color on the spreads. We saw that credit spreads continue to edge higher in the quarter. But most likely as a mix effect. Do you see any pressure on a product-by-product basis? Any segment that competition has been more aggressive, driving spreads down?

A - Angel Santodomingo Martell

Yes, OtÃ¡vio. What I would say -- I briefly mentioned this in my previous answer. Spreads are under pressure and are under more pressure as you move from retail to corporate and large corporates, okay? So I would say that there is more pressure on corporates and large corporates. On the retail side, I would say, a little bit less, depends a lot on the products, depends a lot of the moment, depends a lot of the certain campaign from competitors or from ourselves, et cetera. You have all the acquiring world that I think is well known by everybody that has been under pressure for some time. But I would say that spreads in that cycle that I was mentioning and describing before will tend to be under pressure. So what I would wait -- or, I'm sorry, what I would expect is NIM probably on the asset side with some pressure given that volume will grow when spreads will tend to be flattish or with some pressure, while NIM on the liability side and fees will tend to offset the profitability formula on that side. But I would say that in general terms, what you see as a flat spread or even improving in our -- say, in our case, for the whole bank in the quarter, you are totally right, is because of the mix effect I mentioned before.

A - AndrÃ© Parisi

Next question is from Tiago Binsfeld, Itau BBA.

A question on asset quality. Can you provide more details on the increase in early NPLs? Do you see any risk of systemic deterioration? Or is this a normal behavior of the portfolio?

A - Angel Santodomingo Martell

I mentioned it in my speech, I don't see any -- we don't see any worrying trends if we speak of segment by segment in terms of credit quality behavior. As you know, the early arrears is a ratio that tends to be volatile. If you see in the quarter, I think it raised, if I remember well, 10 basis points, reaching the same level that we had one year ago or the same level that we had by year-end 2018. It's been ranging in between 4, 4.2 continuously. You have some seasonality, sometimes in the end of the year or first Q. But I wouldn't say that there is a trend. And early indicators will not show that.

Again, 2 comments -- 2 important comments here. First one is the change of mix I mentioned to you, okay? So remember that considering that retail has been growing in the 20s and corporate companies in general, (trends) have been growing closer to 0 or low single digit, that change of mix during the last two years has -- could have enhanced its impact on the provision level. That's one point. The second point, which is a little bit more structural one, is that in the Brazilian world that we just mentioned before, cost of risk in a positive economy, in a positive cycle with all the caveats that I mentioned before should not be a point where we should have a negative evolution. So I would say, flattish or even positive. But again, with the caveat and the hypothesis that we have a positive country looking forward.

A - AndrÃ© Parisi

Okay. Next question from Tito Labarta, Goldman Sachs.

You mentioned on release of one-off effect in cards, acquiring fees in the first Q. What was that related to? Do you expect this fees to continue declining?

A - Angel Santodomingo Martell

Tito, Yes. No. I wouldn't say -- I don't know if I use the word one-off. But I would say that what we -- you have this typical effects depending on your volume, depending on your commercial activity on some quarters that even -- I mean if you exclude it, we will be on positive growth. So it's not an extraordinary, it's not these type of things. It's purely commercial driven than we had on the first Q. Given some volumes and some activity, you do have that kind of volatility in between quarters. Excluding that, as I mentioned, we are on the positive -- in positive territory. So I wouldn't at all think that credit cards or card business will have to -- will present a negative evolution in the future. It's just a punctual issue that I wanted to underline in my speech so that you all knew about it.

A - AndrÃ© Parisi

Regarding Getnet -- the next question is from Yuri Fernandes, JPMorgan.

Competition is getting tougher in payments industry, which is one of Santander Brasil (impairing) key areas. Getnet volumes decelerated from 30% in '18 to 16% in the first Q and only 6% now. This is below industry growth for the period, implying market share loss for the first time in years. How to address it? Would Getnet get more aggressive in pricing? Or is it about better service?

A - Angel Santodomingo Martell

Thank you, Yuri. It is about better service. That's the kind of policy and strategy that we have been using, not only with Getnet. But specifically with all the products and services of the bank. As you know, for the long tail, we launched an offer a couple of months ago, a profitable offer. And being profitable because we have been working strongly in cost of -- in unit cost of each operation in Getnet for some years now. And being profitable, it's also the lowest in terms of discount of receivables for retail clients. So you can achieve profitable, again, underlying profitable, profitable offers with being competitive, if you do your work at home in terms of unit cost, et cetera.

In terms of Getnet, you mentioned a little bit percentages. Again, with the same argument, speaking of volumes may be tricky sometimes, okay? And we will not go -- and I have repeated this for several times, both again in Getnet and outside Getnet, we will not go for volume for the sake of volume or for the sake of market share. If you see number of transactions just in this quarter and you analyze those number of transactions that we are dealing with, we are in double digit, I think, somewhere in the 12% or 13% growth. So we keep on with good activity, obviously, selecting or avoiding volume that is unprofitable. And to your answer also, the bank will not follow the idea of trying to be bigger or larger for the sake of having a larger market share. We will grow in markets. We think we will grow. But through a profitable scheme.

A - AndrÃ© Parisi

The next question on asset quality from Gabriel NÃ³brega, Citi.

Can you comment with us why you increased provisions in the quarter if your NPL has reduced and NPL formation grew below the growth rate of your book and coverage remains high? Is there something that you are seeing in your loan book, which could be to worry you -- to begin to worry you, sorry?

A - Angel Santodomingo Martell

I don't know if I understood it. Could you comment with us why you increased provisions in the quarter if your NPLs -- well, I mean, one thing is the balance sheet ratio, the 90 days over ratio and the other thing is the provision. With the provisioning, you have both a calendar, a criteria, a ranking of the different both companies and parts of the portfolio. So one thing, obviously, talks with the other. But they are not immediate in the same quarter both because of what I said and because of the different policies. I look at both from the regulatory point of view and from our own criteria, which sometimes is more conservative than the regulatory levels.

The coverage remains high, as you said. NPL formation is still on the low 1%, 1.1%, 1.2%, depending on the quarter. So as I said before, we don't see an issue on the credit quality front as we continuously present to you.

Operator

Our next question comes from Eduardo Altamirano from HSBC.

Q - Carlos Gomez-Lopez {BIO 18107094 <GO>}

This is Carlos Gomez from HSBC. I had a question regarding the tax rate, which was 29% this quarter. Any particular reason why it's a bit lower than in other quarters? And do you expect the increasing 5% proposals in the social security reform to go through?

A - Angel Santodomingo Martell

Thank you, Carlos. Well you're right, the tax rate was 29%. We normally -- this is a little bit volatile, as you can perfectly understand. We expect the tax rate to be in the 30%, 30% plus, okay? But with that kind of -- I understand that you analysts want the exact number. But it does have these kind of small variations throughout quarters.

What -- on the 5% increase that was included on the pension reform, well, we are waiting to see how this evolves. If it goes through, you will have a positive impact on the short term and a negative impact on the medium and long term. Probably in 3, four years, you tend to offset one with the other. But I cannot say to you much more. I mean it's under the political process or the government and Congress process. We will see how it goes finally out when it is approved. As you know, parallel to that, you also have the tax reform. So we have a lot of things on the table to consider. And the best now is wait and see and see how it evolves.

Q - Carlos Gomez-Lopez {BIO 18107094 <GO>}

Okay. And for the quarter. So the 29% was also related to your -- you made a big payment of interest on capital. Do you expect to pay less in the second half of the year?

A - Angel Santodomingo Martell

No, less interest on capital or less tax rate?

Q - Carlos Gomez-Lopez {BIO 18107094 <GO>}

Interest on capital.

A - Angel Santodomingo Martell

No. I mean you know that there is a regulation with regards to interest on capital. We paid (1 billion) in the first Q interest on capital. And we have paid another 1 billion in the second Q also interest on capital. So this is up to the Board. But the normal estimation will be that 1 billion is repeated in the (third) Q. And we will adjust numbers in fourth Q. That will also lead to a little bit less volatility and an easier stance for you because if you remember what happened in previous years was that we had some volatility on the tax rate in the fourth Q, given that lump sum or increasing value in interest on capital. So the idea is to stabilize a little bit more in between the range of impact that you normally have on the tax rate. But to try to stabilize a little bit more the tax rate across quarters. So I would expect a stability in both interest on capital and tax rate.

Operator

(Operator Instructions) I'm sorry?

A - Angel Santodomingo Martell

Go on. I was going to ask you if there was anything else.

Operator

(Operator Instructions)

A - Angel Santodomingo Martell

Okay, not having any additional questions, I thank you for being there and hearing to us. And I look forward to following quarters. Thank you.

Operator

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