Q2 2015 Earnings Call

Company Participants

- Unidentified Speaker

Other Participants

- Unidentified Participant

Presentation

Operator

Good morning and thank you for waiting. Welcome to the conference call to discuss Banco Santander Brasil SA's Results. Present here are (inaudible), Executive Vice President, Chief Financial Officer and Mr. Luiz Felipe Taunay, Head of Investor Relations.

The live webcast of this call is available at Banco Santander's Investor Relations website www.santander.com.br/ri, where the presentation is available for download. All the participants will be in listen-only mode during the presentation, after which we will begin the question-and-answer session, when further instructions will be provided. (Operator Instructions) We would like to inform the 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, operating and financial projections and targets based on the beliefs and assumptions of the Executive Board, as well as an 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, and may cause actual results to substantially differ from those in the forward-looking statements.

I will now pass the word to (inaudible), Executive Vice President, CFO. Mr. Santa Berlingo [ph], you may proceed.

Unidentified Speaker

Thank you. Thank you everybody for being on the webcast on the call for the second Q results of Santander Brasil. As you may see in the index and I will list out by the index we will cover five items. We're starting as well as by the macro-scenario review and we had divided results, given the extraordinary items that we already commented and communicated to the market last June [ph]. We have divided the results in between those that include extraordinary events and those that are kind of business as usual, to which I will live out [ph] the majority of the presentation, finalizing, as always with my final remarks.

Moving on page four, we present there the Central Bank service. So the expected dynamics for some of the most important economic variables, maybe share some thoughts with you. The Brazilian economy is well known, is going through an adjustment process. In this environment, the amount of measures implemented announced by the government is considerable and in the right direction. There has been a pronounced adjustment in prices in the Brazilian economy.

Actually, there have been two important relative price adjustment processes in the economy; the realignment of regulated prices and market prices, and the realignment of non-tradable and tradable prices. Consequently, the Brazilian inflation has reached levels around 9% in the current months, well above the non-target of 4.5. The fiscal measures implemented and announced, indicate a clear change in the course of macroeconomic policies. To that extent we believe that bulk of the measures will (inaudible) impact the economy in a positive way. Since the adjustments are sizable, the economy is being impacted.

In 2015, this year, current estimations point to a GDP contraction, close to 2%, probably setting the grounds for a better medium term starting in 2016. Consensus is positioned with a hike in interest rates up around the current levels, as you know yesterday night coupon announced another 50 basis points in sign out, that it could be the last or the end of the hike in the cycle. They're starting to lease [ph] probably next year once the 12 months expected inflation falls or gets near the target. Last but not least, it is expected that the Brazilian real should convert to the R$3.25 per dollar, a level that's over time should reduce a current account deficit to a more sustainable level.

Let me move to the next slide, in which we summarize total results are including extraordinary items. Are we moving the presentation? Okay. Total results amounted to R$4.832 billion in the second quarter and 6.465 million in the first half of 2015, with ultimately substantial growth compared to the same period last year, due to these extraordinary results that we announced.

As announced last June, these result and as I'm commenting was possibly impacted by the reversal of tax provisions, what we communicated as the coffin's [ph] recovery. Additionally, complimentary provisions had been recorded to strengthen our balance sheet. The net after-tax impact of these two events amounts to R$3.2 billion.

Excluding the extraordinary events, which is the line of profit that they will focus in my presentation. The managerial net profit totaled R$1.675 million in the quarter, 3% higher than the previous quarter, and 3.3 billion in the first half of 2015, with an increase of 16% in 12 months.

Next page. On page seven, we breakdown these extraordinary results of the PU [ph]. The reversal of tax provisions amounted as mentioned to R$4.77 billion. Additionally, we have done complementary provisions to reinforce from the balance sheet amounting the mentioned 1.6 billion that were divided in three main blocks. Almost 800, R$799 million for amortization of intangible and other assets. (Technical Difficulty) for civil and physical contingencies, and finally, 331 million for credit provisions.

As a result, and as I already mentioned, the net after-tax impact of these two events amounted to R$3.2 billion. Once explained the results including extraordinary items, then we moved to the business as usual. Net profit, its main characteristics and the main lines that confirmed it.

On page eight, you can see this second quarter 2015 net profit totaling R$1.68 billion. As I mentioned almost a 3% or 2.6% increase in the quarter, which continues the positive trend, we have seen in the last quarter. The same thing apply to the year-to-date results in first semester, came out to be R$3.3 billion with a growth close to 16%, compared to the same period of last year.

Moving to page 10, we highlight the main ideas that are summarized coming from both balance sheet, P&L and quality. From now and as I mentioned, I will just discuss these managerial results, excluding the extraordinary events in the period. As we will see the quarter sales positive revenues, dynamics in various metrics, which result from the implementation of their strategy that we have been sharing with you for some time and quarters already.

I will highlight four main points. First, the expanded loan portfolio decreased by 1% in the quarter, negatively impacted by the real appreciation was around 3% in the quarter. Excluding these impacts the quarterly evolution would be or would have been -0.6%. And finally from clients -- client are moved down by 6%.

Second, the Bank remains with a comfortable position in terms of capital and liquidity reflected in the strength of its balance sheet, at the same time that we continue to increase our profitability. In this sense, that this ratio stood at 18.1% with a Tier I ratio of 16.6%.

Obviously, possibly impacted by the extraordinary events of the period and even without them also moving up very strongly. The loan to deposit ratio reached 92% as a reflection of what I commented in terms of what the asset and the liability moved -- how the assets and liability moved in the quarter.

Third, net profit totaled R$1.67 billion in the second quarter with a quarterly growth already mentioned 30% [ph]. If it's basically explained by a better evolution of revenues in the quarter, which presented a robust growth after various quarters under pressure. And finally, we see a slight deterioration of quality, probably reflecting the current environment. Delinquency over 90 days increased 19, almost 20 basis points in the quarter, while at the same time; the recovery ratio reached 185%, also positively impacted by these extraordinary events of the period. This coverage level is the highest for a long time in Santander Brasil.

In next page, in page 11, we show the main lines of our results. With regards to revenues, there was an acceleration of the net interest income that increased 5% over the first quarter and 7% in 12 months. This is the highest quarterly increase, since 2012. Commissions also improved growing 3% in the quarter and 8% in 12 months.

Second important point is allowance for loan losses. The total 4.4 billion in the first half with an increase of 11% over the first quarter and a reduction of 7% in the year, reflecting our low-risk credit [ph] growth in this year. The yearly improvement was also reflected in our cost of credit, which fell by 69 basis points in 12 months. I will elaborate about these two points later on the presentation.

General expenses grew 5% both in three and 12 months, with these last case well below the annual inflation. The quarterly evolution was negatively impacted by perimeter and the traditional seasonality of each quarter. As a result of what I'm saying, net profit climbed by 3% in three months and 16% end of the year.

Let's go line by line, so that I can show you our main thoughts. In the next page, we have the evolution of the net interest income. Net interest income totaled 7.5 billion in the first half of 2015, growing 5% over the previous quarter. The credit related net interest income has continued its improvement, as I mentioned increasing 5% in the quarter, which is the first relevant growth, since 2012.

Market activities also maintain the odd [ph] level of performance in similar positive numbers compared with previous quarters. In the yearly comparison, net interest income increased 7%. The decrease in credit related NII was more than offset by the increase in deposits related NII, and by the increase of the line of this due to what I mentioned gains in market activities.

Again the decrease in credit related NII is fully explained by the change in mix, in the overall banking book spread that we have already also mentioned in previous quarters. The change of mix both from our credit or segment perspective can be made tangible with the following examples. The balances of rescale deposits [ph] for individuals, and mentioned what we call here with our dealers, credit cards, overdrafts and personal credit, decreased 1.7 billion year-on-year or 4%, while for example mortgages increased 35%, 6.3 billion. And on the second level or example, for example, large corporate's loan portfolio growth clearly outperformed their segments growth. So these are the main reasons and effects why we see this performance in experts [ph].

Moving to page 13, to the next page, and where we have the loan portfolio. As you see the loan portfolio, the expanded loan portfolio totaled R$321 billion. Evaluation of the real, the exchange rates had an impact on the portfolio annual growth, which is significant. Excluding the impact of these ForEx evaluation, the yearly and quarterly evolution of the expanded loan portfolio amounted to a growth of 11% and decrease [ph] of 0.6%

respectively. As you can see, well below --especially in the annual side, well below the numbers that are the total variation numbers.

The Large Corporate segment continues to be one of the main yearly growth engines, growing 16%, again we include the ForEx valuation [ph] is 29, so almost a double, in the period, after filtering out these exchange rate devaluation.

In the quarter, these loan portfolio decreased by 4%, 2.8 [ph] if we exclude the real appreciation. These type of portfolios as you probably know the volatility in the quarters given the large amounts, we are speaking that.

In the (inaudible) segment presented a growth of 8% year-on-year and 2% quarter-on-quarter. Both metrics have been impacted by the incorporation of Bonsucesso, remember our payroll joint venture portfolio. Like-for-like growth was 4.7% and 1.5 respectively. Mortgages and Agro [ph] continue to be our main drivers.

Consumer finance portfolio decreased 2% in the quarter and 4% in 12 months. We are absolutely comfortable with the profitability and performance of this segment, especially taking into account how the overall growth, current market dynamics are taking place here in Brazil in this year.

Finally, the SME portfolio decreased by 1% in the quarter and presented a slight increase in 12 months, probably reflecting also the mainstream macroeconomic environment. In any case, we continue to invest in our franchise in this segment.

In the next page, page 14, we can see evolution on the funding side, but it had clear reflection of our focus on clients and on the linkage with them. Funding from clients totaled 276 billion, climbing almost 45 billion in 12 months and 15 billion in the quarter. (inaudible) financial system with good evolution in demand and saving deposits was reflected also in our performance in this quarter, but even with this on balance funding grew 4.5% in the quarter.

Finally, total clients funds including assets under management came to almost 500 billion, 494, growing 23% in 12 months, 93 billion or 5% in the quarter, 25 billion. Do you remember clearly that the assets under management totaled 178 billion, increasing 16% in 12 months and 7% in the quarter.

Going back to P&L in the next page, we have the fees and commission income. The total amount, we are speaking of almost 5.8 billion, which has an 8% variation on the year, but probably there is no important, a 3% increase in three months. These specialties quarter evolution compared with previous one's that we have been presented to you to the market in the previous quarters, is a gain, a reflection of our effort on client linkage in our commercial (inaudible). In the quarter, they highlight the current account and lending operation, which grew 8% and in 12 months the growth was boosted from insurance and lending operations.

Moving to page 16, we have breakdown of general expenses. If we exclude depreciation and amortization, it decreased by 5% in the quarter and 3% in 12 months, where we already mentioned approximately 9% annual inflation, in which will lead to the investment [ph]. It is worth mentioning and remembering that the incorporation of GetNet, our acquiring company impacts the daily evolution and (inaudible) corporation, which took place in the first Q in February, impacts both periods of comparison.

Traditional seasonality that I mentioned and were actually worse in the second quarter and personal expenses also impact in the Q-o-Q comparison. We continue to have the same target, we do not bury these target in terms of expenses growth, when we continue to stay that they will grow well below inflation in 2015.

As you can see including depreciation and amortization total expenses moved up by 5%, both in three and 12 months, in this last case well below inflation.

Moving to quality on page 17, we can see the delinquency ratios. The NPL ratio over 90 days fell by almost 90 basis points, 88 basis points in 12 months with an improvement in both GBM [ph] 124 basis points and the Corporate 40 basis points segments.

In the quarter, delinquency increased by 19 basis points impacted mainly by the Large Corporate segment. The legal indicator were 15 to 19 days NPL ratio increased 16 basis points in the quarter, maintaining a fall of 51 basis points in 12 months, again with the main impact coming from the Corporate segment.

In the (inaudible) segment is around the same level as the previous quarter, both involve indicators in the over 50 to 90 days NPL ratios. Despite the general economic pressures, but we are all aware of.

Finally, in this slide the coverage ratio grows to 185%, which is a highly comfortable level in a historical also level for us. In that ratio, the extraordinary items have an impact, which if we exclude them it will be a 178%, which is also a comfortable level in quite similar to the previous quarter.

In terms of allowance for loan losses in the next page, as you may see they came out 4.4 billion in the first half presenting a decrease of 7% year-on-year. In the quarter, the allowance, the provisions for loan losses increased 11%. The cost of credit from the first half of 2015 is 50 basis points lower than the cost of credit of the whole year 2014, which was around 3.5%. We maintain our expectation with reduced regards with a cost of credit in 2015, in similar levels compared to 2014, and this applies in general terms for the quality discussion in Brazil.

Moving to performance ratios in the next page, I would underline the efficiency ratio at 50% in the second quarter with an increase of 32 basis points in the quarter and the recurrence ratio that has reached 60, almost 68% reducing 123 basis points in the quarter.

And the third item I would underline is the return on equity, but it stood at 12.8%, the same level as the previous quarter and all these -- we include extraordinary items, it goes up to 18.2%. In terms of liquidity and capital ratios in the next slide, the reflection of the stable funding sources in an inadequate funding structure leads to a loan to deposit ratio of 92%.

On the other hand, on the Solvency side that these ratios stood at 18%, 19.1% mostly composed of Tier 1, at very comfortable levels. On the quarter, the ratio improved 210 basis points, out of which 130 are due to the extraordinary's, we already mentioned. So your guidance generation is around 80 basis points.

The main factors that explain the evolution in the 12 months are the growth of credit portfolio, the impact of the Basel III faced in an increase of operational reason due to the implementation of the provincial conglomerate balance sheet, in January 2015, that we've commented in the previous quarter.

Finally, in the last slide, then we go through my final remarks. As a conclusion of what I already presented, our second quarter 2015 main messages are the following. First, the performance evolution is directly linked to transformation that we are trying to do in the bank and that we are executing and that our client's organization is experiences, which has been shared with you in previous quarters.

(inaudible) is based on three main drivers. First driver, are investments in our commercial mortgages. There has been a significant simplification of the processes around the client like opening a current account, (inaudible)transaction account easier and there was a launch of the new mobile app for example, we have implemented our new commercial mobile and a new customer relationship management focus called (inaudible) as we have mentioned previously, which has simplified processors improved service levels and devoted more time of our branch network teams to commercial activities with clients. We have also improved the strategic businesses in partnership with (inaudible) for example that is already being fixed.

In SMEs, we have recently launched some Santander (inaudible), which is the most of banks in SME platform in Brazil and we'll make the difference in our results in the following quarters and years. Management we have improved -- in terms of management, we have improved our credit quality management and we have maintained our costs discipline (inaudible) evolution, always running well below inflation.

My second main point, in terms of final remarks, underlying the acceleration of revenues in the pace of growth, continuing to show a positive trend.

The third point as I already mentioned favorable expenses remaining with annual growth well below inflation. The fourth point that I would also underline is, a slight deterioration that we are seeing in asset quality also the environment as we already commented performance will remain comfortable thanks to our coverage levels, maintaining management priorities to continue delivering results while we keep improving the performance of the active path of the P&L.

And fifth, finally, there was an improvement of the liquidity in solvency positions of the bank. Thank you. And now we are ready to answer any questions that you may have.

Questions And Answers

Operator

Thank you. We will now start a Q&A session for investors and analysts. (Operator Instructions)

Q - Unidentified Participant

We have two questions about the asset quality, one coming from (inaudible) from Itau BBA. And one coming from Philip Finch from UBS. And both of them they mentioned that the NPL ratios increased the 15 to 19 increased 20 basis points, if 16 [ph] increase 40 basis points, and then 19 [ph] increased 20 basis points.

And the questions regards, if you could comment on the expectations for asset quality going forward. If you expect further deterioration as a consequence of the economic slowdown and deterioration in the early delinquency rate.

A - Unidentified Speaker

Okay. Thank you, (inaudible). What I would say around credit quality is that first (Technical Difficulty). Sorry, they tell me that I was speaking already with no impact. I was saying that in terms of the quality what are seeing, but we are seeing this is slight deterioration that I already mentioned basically on the Corporate side, and depending we speak of the NPL ratio or the cost of credit.

And what I would call this is a normal reflection or a normal impact of the current macroeconomic environment. And then we remember to you, that the GDP will probably a standing recession with minus 2% or around minus 2% grow this year with unemployment wise. And so this has to have an impact on the quality.

Now another discussion is how this impact may be and what are our views. What we see and I mentioned also in my presentation is probably the 2015, and average terms will be seeing that in 2014. This means during the slight, it's now probably concentrating on the corporate sites, but both the 15 to non-delivering indicators.

The kind of messages, behavior and relationship that we see coming from our clients do not lead us to a message in terms of (inaudible) what may be coming forward in terms of asset quality. We see this slight deterioration that may continue, but I would underline a slide because at this point we do not see we're in silence either in the leading indicator side or on the actual NPL formulation and ratios.

Q - Unidentified Participant

We have one more question about costs. What is the outlook of the banks for the cost base growth in 2015 and 2016?

A - Unidentified Speaker

Well, in the cost evolution, we also mentioned in my presentation. The cost evolution of this quarter was impacted first from some seasonality that we always have on personnel expenses in the 1Q, or 2Q compared to 1Q.

Secondly, perimeter and thirdly by some kind of impacts that we tend to have like the launching of Santander(inaudible) in what way that they mention of this type of impact tend to very big volatility between quarters. The annual evolution of the year continues to be well below inflation and we continue to maintain that message. However we see the future, the future we see are converging towards inflation, but in that case, we will keep our focused management vary in costs. And this means that Santander Basel will keep the discipline on the lower part of the P&L, we felt kind of increasing the impact on the net profit. So the message going forward is that discipline will continue in cost.

Operator

Thank you. The Q&A session is over, and I wish to hand over to (inaudible) for his concludes remarks.

A - Unidentified Speaker

Okay. Thank you all for being there, in this again Santander 2Q, 2015 results. I hope that you're agreeing us with good set of results, both in relative terms and absolute terms. And we will continue to probably next quarters to deliver these type of sound results.

Let me remember you that we will be in Santander Group Investor Day taking place on the 23 and 24 of September in London, and there, if you are there, we will more than happy to meet and to discuss with you any points that you may have about our bank. Thank you very much.

Operator

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