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Q3 2015 Earnings Call

Company Participants

- Angel Santodomingo, Executive Vice President, Chief Financial Officer
- Luiz Felipe Taunay, Head of Investor Relations

Other Participants

- Philip Finch, Analyst
- Unidentified Participant
- Victor Galliano, Analyst

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 Mr. Angel Santodomingo, 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 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, 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.

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

Angel Santodomingo {BIO 15757370 <GO>}

Thank you. Good morning, everyone, and thank you for joining us in the Banco Santander Brazil's Third Quarter 2015 Results. As you can see in the index, in the table of contents, I will try to address our main areas in these result presentation, a short briefing on the macro side, and then I will summarize both results and the final remarks.

Starting on page four, we present there was the consensus, the Central Bank survey shows expecting different dynamics for the main economic variables, maybe share with you some thoughts. The Brazilian economy continues to go through an investment process. In this environment, the amount of measures implemented or announced by the government is considerable. Consequently, the Brazilian inflation has reached the levels of -- clearly over 9% in 2015, well above the 4.5 target. The fiscal measures implemented and/or announced, as I mentioned, indicate a clear change in the course of the macroeconomic policies, which should lead to a better environment in the medium term.

We think that Brazil is addressing the fiscal imbalances and we'll solve them over time. On the other hand, the process will probably be longer than initially anticipated. Since the adjustments are sizable, the economy is being impacted. In 2015, current destinations point to a GDP contraction of 3% with quarter-on-quarter recovery likely starting over the course of 2016. We believe that after these adjustments, the economy would be in a good shape to resume a trend of sustainable growth from 2017 onwards. Consensus expect lower inflation and lower Selic rate for 2016, which is normal. And last but not least, it is suspected that the exchange rate should converge to somewhere around R$4 per dollar, a level that is already improving the Brazilian external account deficit to a more sustainable level. These two large variables, both inflation and current account convergence are always early indicators of a positive change in the cycle.

Moving to slide six, which is where we show our net profit. You can see -- we can see that 2015 third quarter net profit totaled R$1.7 billion, showing an increase of 2% over the second quarter, excluding obviously the extraordinary results we obtained last quarter, and continuing the positive trend of last quarter. Year-to-date in actual basis, results amounted to R$5 billion, growing 16% in relation to the same period of 2014.

It is worth mentioning that (inaudible) to fully amortize the Goodwill related to Banco Real, it has been extended to 2017. As a result, the quarterly amount of Goodwill amortization has been reduced in about R$0.5 billion, which explains Banco's increase of a quarter -- accounting profit that you may see in the slide.

Moving to the next page, page seven, we have the main highlights, I would like to underline in this quarter and the comparison of being compared with previous quarter. I will highlight four main areas. First, the expanded loan portfolio increased by 3% in the quarter, positively impacted obviously by the real depreciation. I remember you that the

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real depreciation was 28% in the quarter. Excluding these impacts, the quarterly evolution would be flat. Funding from clients moved up more than that 3%, it moved up 4%.

Second area, the bank remained at the comfortable position in terms of capital and liquidity reflected in the strength of its balance sheet. BIS ratio stood at 15.8% with a Tier 1 ratio of 14.4%. The loan to deposit ratio decreased to 91%.

Third area, the net profit totaled 1.7 billion in the third quarter of 2015 as I mentioned in the previous slide with a quarterly growth of 2%. I would like to underline here the positive performance of our NII, along with control cost in provisions following obviously the economic part and that we are leaving[ph] in the field[ph]. And finally, the fourth idea asset quality metrics are stable or deteriorating in the limited or controlled way. Even on the phase of our current macro environment over a 90 days delinquency still remained flat in the quarter, while coverage ratio reached 185% maintaining highest level in 2009. At the same time that the cost of risk deteriorated in 12 basis points.

In the next page, page number eight, we sold the main lines or the main parts of our P&L, I will elaborate further on -- on credit revenues, net income increased 2% over the second quarter and 8% in 12 months, while commissions remained flat in the quarter and increased by 7% in 12 months. Second point I will elaborate allowance for loan losses, that the total R$6.9 billion in the first nine months of 2015 with an increase of 5% over the second quarter, and at the same time a reduction of 5% in this year. That the increase in the quarter reflects the economic background.

Third, general expenses remained flat in the quarter and presented a 3% growth in 12 months, well below the annual inflation. The quarterly evolution was negatively impacted by the annual wage bargaining process.

Four, in the quarter, income tax expense of Group profit before tax, which grew 12% as you can see leading to a net fees of the effective tax rate. These reflects the sales in goodwill amortization as well as the fiscal changes that we had during the quarter. And five, as a result, net profit climbed by 2% in the three months and 16% in the year.

And I will start going line by line in next page, we can elaborate on our NII evolution, in the quarterly comparison net interest income totaled R$7.6 billion in the quarter, growing 2% over the previous quarter. NII directly related with client activities, which is credit card recoveries, continue to grow at a rate of 1% in the quarter, showing the effort we're doing with client relating to activities. Market operation maintained a very good performance, and I would like to underline two ideas in this regard. First, client and client NII, which credit continues to grow on a quarter-on-quarter basis 1%, and credit spreads on the loan book that remained flat in the quarter. With the negative impact of a currency mix being offset by higher spreads per product, leading to that 8.5% flattish figure in both quarter.

In the yearly comparison, net interest income increased 8%, 7.7%, mainly explained by the evolution of the credit related NII remained stable. Again, the spread by product evolution as well as volume offset the change or mix that we have been sharing with you during the past quarters, and also happened during this quarter.

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Page 10 shows the loan portfolio. The expanded loan portfolio totaled R$332 billion. The exchange rate in between the real and the dollar variation had a major impact on the portfolio growth metrics. Listening [ph] now to that impact, we see growth deceleration. The yearly evolution of the expanded loan portfolio grew 7%, and the quarterly evolution is flat.

Going by segments, the large corporate segment is more impacted obviously by the exchange rate variation. The annual growth amounted 6%, 26% if we consider the ForEx in the period. In the quarter, this loan portfolio decreased in fact by 3%, excluding the real as -- the depreciation if you consider, it grew 6.9%.

Going to individuals, the individual segment presented a growth of 8% year-on-year, 2% Q-o-Q. The yearly evolution was impacted -- remember by the incorporation of the bond [ph] potential portfolio. Business as usual or like-for-like mortgages and payroll lending continue to be the main growth drivers. Consumer finance, the portfolio decreased 4% in the quarter and 7% in total loans, obviously reflecting a weaker car market.

Finally, SME portfolio, which increased by 1% in the quarter and 2% in 12 months, which also reflect our already commented in previous quarters investments.

On the funding side, the next page, page 11, you can see the evolution that reflects our focus on clients and on the linkage with them. Funding from clients totaled 288 billion, climbing almost 44.5 billion in 12 months and 12 billion in the quarter, remarkable figure. There was an increase on reserve requirements in the quarter, as you can see there, substantially or mainly explained by two factors; first, the decision of the Central Bank of Brazil to remunerate all the reserve requirements by the Selic rate, this could have been the use of both bank and the working capital loan as the reserve requirement reduces. And secondly, there was also an increase of the base of reserve requirement.

(inaudible) continues to grow the loan growth, that 4% I was mentioning, compared with the 3%, I mentioned before on the credit side, leading to an improved liquidity position as we will see in a couple of other slides. Finally total client funds, including assets under management came to R$512 billion with a growth of 18%. 18% in absolute terms is R$76 billion, also a remarkable figure in total and 4% of 18 billion in three months. Assets under management totaled R$187 billion with a 16% increase in total amounts and a healthy 5% in the quarter.

Fees and commission, moving to the next page, the total fee income totaled 8.7 billion in the first nine months, 7% higher than the same period of 2014 and flat quarter-on-quarter. In the quarter, car, asset management and current account fees presented a good momentum, so dynamics in the wholesale business, which is quite understandable in the current environment and insurance influenced by the traditional Q1 seasonality led to a flattish overall fee evolution in the quarter. In terms of fund overall, insurance, current accounts and fees on lending operations explains two-third of the annual growth and fees of almost 600 million or 7.1%.

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General expenses in page 13, in which we give a breakdown on the expenses, excluding depreciation and amortization increased 4% in the quarter and 3% in 12 months, well below annual inflation level, which has been our continuing message with you. The quarterly change was impacted by the annual bargaining process, and the yearly growth was impacted by the non like-for-like incorporation of business and (inaudible). We continue to deliver on the cost margin target.

As we have been commenting during the long series of quarter, cost continued to be controlled well below half the inflation. Including depreciation and amortization, total expenses remained flat in the quarter, and moved up by 3% in 12 months, again well below annual inflation. The drop in depreciation, amortization in the quarter resulted from the impact all time of the intangible assets impairment that we already reported in Q2 of this year.

If we move to quality, on page 14, we may underline that the NPL ratio over 90 days fell by 47 basis points in 12 months with an improvement in both the individual assessment 65 basis points and the company assessment 24 basis points. The 15 to 90 early arrears or early indicator NPL ratio decreased by 23 basis points in the quarter and by 3 basis points in 12 months.

In the quarter, NPL for companies lead the movement, that I mentioned. The real devaluation impacted (inaudible) as well as the traditional also seasonal effect on third quarter, excluding these ForEx effect of 31 [ph] in the quarter, 15 to 90 days NPL for companies and for the total portfolio would have been flat -- flattish.

In the quarter, the NPL ratio over 90 days remained flat within the resource increasing 24 basis points and company decreasing to 10 [ph] basis points. So the behavior of company was again influenced by the devaluation of the real. Excluding again such effects, NPL for company would have been flattish, and the total 90-day NPL ration would have -- or would have increased 15 basis points in the quarter.

We believe that given the economic background, the asset quality metrics showed that they are under control. I would like to underline that we have been sharing -- what we been sharing in recent years -- in the quarter, sorry, we expect (inaudible) and controlled asset quality deterioration reflecting the country's economic reality. Last but not least, from this slide, the coverage ratio reached a remarkable 185% remaining at very comfortable levels.

In the next slide where we move to P&L, in terms of allowance for loan losses, we came to 6.9 billion in the first nine months, resulting a decrease of 5% due to the better behavior of early quarters. While in the quarter the increase 4.7%. Cost of credit drops on a year-on-year basis, again for the same reason, 60 basis points, and increases 12 basis points in the Q-on-Q comparison. This evolution currently reflects my earlier words about quality performance. We see gradual deterioration [ph] on the margin, but limited and controlled.

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Moving to the last part of the presentation, in terms of performance ratios, with evolution and withstanding [ph] on the efficiency ratio that moved 200 basis points -- 215 basis point impacting the quarter down to 48%. The record inflation leads -- recurrence ratio sorry reached 68.1% in the quarter, also increasing 38 basis points. And the profitability ratio (inaudible) equity remained far in the quarter. Remember that we are comparing obviously with the Q2 in which we exclude the -- more than 3 billion of extraordinary results that we presented to the market.

Liquidity and capital ratios on the next slide finally, the banks maintains in a strong position in terms of liquidity and (inaudible) it is stable funding sources in an adequate funding structure. The loans and deposit ratios continues to improve and it stood at 91% in September 2015. BIS ratio decreased 15.8 -- sorry decreased to 15.8%, mostly composed of Tier 1 at very comfortable levels. On the quarter the ratio decreased 223 basis points, mainly to remember that we declared dividend of 8 billion dividend coming from our extraordinary results, that's one of the main reasons. And also, obviously, the increase of the loan portfolio and other assets due to the devaluation of the Brazilian currency in the period.

Finally, in the last slide, as a conclusion, I would like to share with you our main results. Our third quarter 2015 main messages are basically two; first regarding results, revenues continued to present a positive trend with rural expenses that continue to evolve well below inflation. Allowance for loan losses presented a moderate growth reflecting the current economic environment, balances remain strong both in terms of liquidity and solvency. And finally, I would like to remember what I said about dividends, that we declared dividends amounting to R$3 billion coming from the surveillance gains that we have planned in Q2 2015.

The second idea is that we continue to invest in our retail contracts. Results are visible in terms of increased client satisfaction and reduced complains at the rate of 20% for the year. Also we continue to invest in building a state-of-the-art multi-tenant platform improving on digital tenants as recommended in the previous -- in the Investor Day which we did in September.

We're very confident in the customer-centric model we approach in, a model design to provide sustainable and more resilient to long-term results. Thank you and we are now ready to answer any questions you may have.

Questions And Answers

Operator

Thank you. We'll now start the Q&A session for investors and analysts. (Operator Instructions)

Q - Philip Finch {BIO 3252809 <GO>}

The first question we received -- came from Philip Finch from UBS. The question is, in the Q3 did you recognized any gain from tax revaluation arising from the 5% rise in social

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contribution, if so, if not, why not? And question number two is, effective tax rate increase in 3Q 2015 reflecting a higher social contribution -- from Q4 2015 onwards what should we assume as a normalized tax rate?

A - Angel Santodomingo {BIO 15757370 <GO>}

Thank you, Philip. The answer to the first question is, yes. We recognized approximately R$2 billion due to the change you were mentioning, and we offset basically all of it, with and write-off of loss carry forward. So net-net, it was up, it was basically met. The effective, the question on the effective tax rate was, sorry. That it come [ph] and what we should assume the normal evolution of the tax rate, so we have been saying, that has reflected and the change in the CSLL[ph] from 15% to 20%. We should expect that to maintain an adverse trend, and we will optimize that with the evolution of both the amortization of the goodwill and the different part that I already explained on detail, Felipe you want to mention?

A - Luiz Felipe Taunay {BIO 20381786 <GO>}

And that we gauge that going forward, the effective tax rate should move around 13% to 18%. We have ways, you can see that the amount of balance DTAs that we have, amount to about R$2 billion, and also the reduction in goodwill amortization, increase the raw material, increase the payment of interest and capital, so overall, the effective tax rate should grow over in between 13% and 18% going forward in average.

Q - Unidentified Participant

The second question came from Guilherme Costa from (inaudible). Good morning, my question is about the sale of loan portfolio, we observed that was sold to about R$238 million of loans during the 1Q 2015. Could you comment what would be the impact on your NPL ratio, if you have not sold this portfolio, furthermore, was this portfolio 100% provision?

A - Angel Santodomingo {BIO 15757370 <GO>}

Yes. Let me comment to you, and briefly in my thoughts here, and Felipe can give you a little bit more detail. I would say, first, the selling or not selling of portfolios, in general terms, is account of a business as usual activity, okay. So we do obviously optimize, our policy is that, if we have a paid off in between managing it ourselves or obviously selling it to external parts and we measure that, and when we optimize the internal usage, we do it internally and when we see that it makes from the financial point of view, it makes sense to sell to external part, we do sell it externally. When we sell portfolios here, totally with -- there 100% provision, so we have not considered selling portfolios are not 100% provision. On the impact on the quarter, little bit to elaborate, but basically I would say that the impact that we have seen in the quarter is marginal, we're expecting [ph] R$240 billion for portfolio, not a little.

Operator

Mr. Victor Galliano from Barclays would like to make a question.

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Q - Victor Galliano {BIO 1517713 <GO>}

Hi, yes. Can you give us some more -- I hope you can hear me, okay. Can you give us some more detail on the capital situation. Was that primarily really because of the depreciation of the real that we -- that we saw the capital come down, I'm sorry that it was in a very good line once you were giving the discussion.

A - Angel Santodomingo {BIO 15757370 <GO>}

Victor, thank you. I will try to clarify. I mentioned it in my presentation, I will try to clarify. I said that we had 223 basis points of impact of capital. Approx a 100 of -- out of that is the extraordinary gain that we directed to dividend, remember that we presented, we are now at the, I think it was at the end of September, during the month of September we announced our R$3.05 billion dividend and that consumed I'd say around 100 basis points. Then you have business as usual, I mean the invalid assets growth obviously impacted also by the Forex situation, due to our exposure in non-reals loans.

And finally also you have, in the rest of the assets, the impact of the ForEx, but has also meant additional consumption of capital in the month. And please also remember that we have mark-to-market impact due to the different portfolios that we hold in between then the ALCO portfolio for example. So if you add all of that, I think, I'm speaking of 80%, 90% plus, of the variation of the capital in the quarter.

Q - Victor Galliano {BIO 1517713 <GO>}

Okay. So 100 bps from the dividend, the FX depreciation, the FX portfolio, the depreciation impact would have been another 50, 60, and most of the balance in mark-to-market, is that about right.

A - Luiz Felipe Taunay {BIO 20381786 <GO>}

I think we are close to the reality, the ForEx keeps you in different parts, so it's not an issue, want to individualize the ForEx, but more or less is what I'm saying.

Q - Victor Galliano {BIO 1517713 <GO>}

Okay, thank you.

Operator

(Operator Instructions) Thank you. The Q&A session is over. And I wish to hand over to Mr. Angel Santodomingo for his concluding remarks.

A - Angel Santodomingo {BIO 15757370 <GO>}

Thank you, very much for your attendance. It looks like we have had some technical issues, I don't know if we have been able to transmit the message fully. If this is not the case, I will freely invite you to contact us the Investor Relations department in the past that has not been had, in the right way. If this is the case we (inaudible) I'm making this

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comment. Again, thank you for the presence, and we remain at your disposal for any doubts that you may have.

Operator

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

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