Q4 2016 Earnings Call

Company Participants

- Alexandre Gluher, CFO & IR Officer
- Carlos Firetti, Market Relations Department Director

Other Participants

- Carlos Gomez, Analyst
- Carlos Macedo, Analyst
- Henrique Navarro, Analyst
- Jorg Friedman, Analyst
- Mario Pierry, Analyst
- Philip Finch, Analyst
- Thiago Batista, Analyst
- Tito Labarta, Analyst
- Yuri Fernandes, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. And thank you for waiting. We would like to welcome everyone to Banco Bradesco's Fourth Quarter 2016 Earnings Results Conference Call. This call is being broadcasted simultaneously through the Internet in the website www.bradesco.com.br/ir. In that address, you can also find the presentation available for download.

We inform you that all participants will only be able to listen to the conference call during the Company's presentation. After the presentation, there will be a question-and-answer session, when further instructions will be given (Operator Instructions)

Before proceeding, let me mention that forward-looking statements are based on the belief and assumptions of Banco Bradesco's management and on information currently available to the Company. They involve risk, uncertainties and assumptions because they relates to future events. And therefore, depend on circumstances that may or may not occur in the future.

Investors should understand that general economic conditions, industry conditions and other operating factors could also affect the future results of Banco Bradesco and could cause the results to differ materially from those expressed in such forward-looking statements.

Now, I'll turn the conference over to Mr. Carlos Firetti, Market Relations Department Director. You may proceed.

Carlos Firetti {BIO 2489005 <GO>}

Good morning, everyone. Welcome to our conference call for discussing our 4Q 2016 results. We have today with us, Alexandre da Silva Gluher, our CFO and Investor Relations officer and Mr. Randal Luiz Zanetti, Chief Executive Officer for Bradesco Seguros Group. Now I turn the presentation to Alexandre Gluher.

Alexandre Gluher {BIO 4820551 <GO>}

Good morning, everyone. Thank you for participating in our conference call today. For us, 2016 was marked by our focus on three main priorities. The full integration of HSBC Brasil, which we completed in October, last October; to keep our credit quality under control; and to maintain our discipline in cost control.

We understand we reached our goal in these three fronts, (inaudible) considering the complexity of the scenario. We believe we are now ready to explore the opportunities of a new cycle of flow and capture the synergies in our operation. I'll explain now the main highlights of our results and Firetti will go later into details in the rest of the presentation.

In the Slide 1, we observe that our net earnings reached BRL17.1 billion in 2016, a reduction of 4.2% year-on-year. Considering only the Fourth Quarter, our net revenues reached BRL4.4 billion, (lower) 3.9%. Our earnings for the year and the quarter reflected complex environmental change.

The loan book is up 8.6% year-on-year both on the acquired book and dropped 9.2% on a pro forma basis, impacting our revenues. We were also impacted by the increase in NPLs and the consequent impact in loan loss provisions expansion, which also on a pro forma comparison increased 25.9% year-on-year. We were able to compensate part of these negative factors with good results from fees, controlling operational costs and with higher average (strength) in our portfolio.

Our results were solid, following resilience in higher currency on our sources of revenue. The main reason for this is our high level of (investigation) in our results, especially in (inaudible). We expect a reduction in credit provision expenses already in 2017 (inaudible) 2018, while we have (inaudible) capturing synergies from the acquired book. These factors should allow us to drive returns in the range of 18% to 20% in the coming years. Our assets reached BRL1.2 trillion in 2016, an increase of 19.8% year-on-year, reflecting most of incorporation of the acquisition. Our shareholders equity reached BRL100.4 billion, growing 13%, even considering that our recent payout ratio reached 48.7%.

Comparing our main operating numbers with the guidance, we delivered almost all. We only did not meet our guidance for operating expenses, which were impacted by extraordinary items that we maintained as (liquidity). They have enabled with the integration of the HSBC and some of the (inaudible) payments. These results show our capacity of delivering our objectives in all kinds of environments.

In terms of NPL, we had an increase in the Fourth Quarter. However, we already seen signs of improvement in the short-term delinquency and the new (inaudible) have been behaving better. We included this quarter new information about NPL creation by segment. This data shows that even in the SME segment, which presented an important increase in NPL this quarter, the creation was almost stable, showing that most of the increase was due to lower loan volume. To save the delinquency, we have in our balance sheet, a strong level of provisions representing 207% of our expected loss for the next 12 months.

In terms of (quarterly) provision expenses, we believe we have already reached the peak in 2016 and they (inaudible) for a reduction in 2017 and much larger reduction in 2018 onwards. In insurance, we have a good performance in 2016 with our premiums growing 10.5% year-on-year, within our guidance.

Bradesco Seguros net revenues reached BRL5.6 billion, an increase of 5% year-on-year. This performance shows the strength of our operation which comes with stable (sources) of result. In terms of capital, we closed 2015 with a Tier 1 Basel III ratio of 12%, level we consider (inaudible) it should continue to expand the next (inaudible).

We concluded the integration of HSBC Brasil in October (inaudible) operation considering the dimensions and the results we achieved. We have all new clients and branches already integrated in our platform and now we are able to offer the client the same product and quality of services we offer to our regional client base, capturing (software) synergies from revenues and cost. We've followed without distraction since we had to let complete the integration. We are focused on growing our business and exploring the opportunities of synergy.

We continue to evolve in our strategies for saving our clients, increasing their options to digital channel with differentiated services and expanded business hours. Our traditional banking model base based on branch remains strategic for business origination in servicing our clients, that we will continue innovating and launching new platform to serve all kinds of clients and profiles, in the line with our traditional (open-branch) strategy.

Now, I turn the presentation to Mr. Firetti.

Carlos Firetti {BIO 2489005 <GO>}

Thank you very much Alexandre. So now we will follow with the analysis of the results. And go into details. In slide 3, we have the adjustments in our net income from book net income to the adjusted. The book net income was BRL3,592 million, while the adjusted BRL4,385 million. We had three main adjustments.

One, impairment of assets, we considered non-recurring, basically BRL20 million after tax in impairment of shares. And BRL137 million of systems from HSBC. We have another impairment recorded in our net interest income, which I will go into details later, that one we consider recurring. Also, we have contingent liabilities, the biggest portion of it, are provisions for something called (FCDS), that is related to mortgage loans in the 1980s and early 1990s for which there was a securitization process.

We made the provision of BRL235 million, we had already made some provisions in the past. With new provisions, we believe we have completed the provisioning for this. Also, goodwill amortization, this quarter, we started to adjust our net earnings considering the gross with real origination leaving the tax benefit as a recurrent element in our P&L.

In the previous quarter, we had basically discounted the goodwill (mass) of the tax benefited instead of the gross. We didn't just with 3Q numbers. Only the strong of goodwill basically for 2017, you can consider, we will be amortizing BRL2.4 billion in goodwill; in 2018, BRL2 billion and going forward, a reduction of about RBL400 million per year until we complete the amortization.

Going to Slide 4, you have there our P&L. We can go in some comments on the main items. Our net income, as I said, was BRL4.385 billion, a reduction of 1.7% Q-on-Q and a reduction of 3.9% year-on-year. For the quarter, considering 12 months, there was a reduction of 4.2%. Our ROE for the year reached 17.6%. Our return-on-assets,1.5% with our equity growing 13% basically through accumulated earnings and assets grew 19.8%, reflecting mostly the incorporation of HSBC.

In terms of net interest income, we had a drop of 7.5% in the quarter, mostly related to the impairment of assets, we will comment a little bit more on that. And looking to the pro forma; our net interest income dropped 3.5%. We have some slides that detail our net interest income.

On the impairment, basically this impairments is related to loans in Brazil, for which we run the impairment test at the end of 2016. We used to run this impairment test on an annual basis. This is related to our test of recovery -- the ability for this asset . We considered it as a recurrent impact on our numbers.

Going forward, we are evolving with our governance for impairments and we should start to do this impairment test on a quarterly basis. We believe we did the necessary impairment for the portfolio as of year-end 2016. Going forward, we cannot forecast if we will have or not more impairment. But we believe that if we have something, it's going to be much lower than what we had for full-year 2016.

On insurance, we had important growth in the quarter, 31.3% for premiums and variation of technical provisions. Basically, this is mostly related to (gained premiums -- increase in gaining premiums) in insurance and also lower loss ratio for the health insurance segment. Fees, we (had a very abrupt) increase of 1.3% in the quarter. Operating expenses, our growth was 2.1%. We have further details on that in the coming slides.

In terms of income tax, we have lower income tax this quarter and this reflects the payment of interest on capital, the change in the goodwill adjustment now considering the (gross), we give the tax benefit on the tax line. So that helps to reduce it and also the use of some tax credit that was realized since we had the incorporation of HSBC.

So going to slide five. We have the evolution of our net earnings and earnings per share. Our earnings per share reached BRL3.09 per share in 2016. Our net earnings for the year dropped 4.2%. This slide also shows the strong level of diversification of our net income with 31% coming from credit intermediation, 29% coming from fees. And 22% from insurance (with grants stability, resilience) for our earnings given this strong diversification of sources.

In slide six, you have our net interest margin. Our net interest margin for the year was 7.5%, remaining roughly flat for the year. In slide six, we have the details of our net interest income, the interest earning portion. Basically, it decreased in the quarter 0.3% with credit intermediation margin dropping 1.4% mostly due to lower number of business days and most also lower volumes that it's playing a big part (of) this effect. Insurance, we had also a reduction due to lower interest rates and inflation rate; inflation tax has been (the decision) factor for some of our bonds in the local market. In securities and other, we had an increase of 12% due to gains in our asset liability management. There was this quarter no revenues coming from dividends from our investment bank portfolio.

Going to slide nine, we have our expanded loan book. The expanded loan book in the quarter dropped 1.3%. For companies, a reduction of 2.2% with the biggest reductions still coming from SMEs, which reduced 7.3%. Individuals increased 0.6% with payroll loans growing 1.8%, credit card, 6.4%. And the real estate portfolio, 1.8%. For the year-on-year analysis, we had an increase of 8.6% due basically to the incorporation of the HSBC loan book. In our pro forma comparison including HSBC, in the end of -- for 2016, basically our portfolio shrunk 9.2% with the companies segment dropping 13.6% and individuals portfolio growing 1.3%.

In the slide 10, which show the diversification of our loan book with (substantial reduction in the) participation in the SMEs mostly because this portfolio is shrinking in this environment where demand is very low. The increase in the participation of corporates and individuals. Individuals (inaudible) migration of loan operations to lower risk with payroll loans and mortgage reaching 41.4% of our loan book (inaudible) a reduction on the risk in this portfolio.

Going to slide 11, we have here the information on our delinquency ratio. This quarter, you're going to see in the following slides, we brought a new information on the NPL creation by segments. That, in our view, is important in the analysis. We had this quarter total NPL growing to (5.1%) of our loan book (inaudible) to 8.6% driven a lot by fact that the loan book is shrinking. I think you can do a better analysis looking to the NPL creation. Individuals, we had an increase to 6.94%.

In corporate, the total ratio dropped to 1.24% mostly due to the write-off of a specific case in the Fourth Quarter that (reduced the index). If we analyze the NPL already without that effect in the Third Quarter, we see actually an increase that was due to some cases that turned into late payment. We already have a big level of provisions in this case. So this didn't impact that much our provision expenses.

In the case of shorter-term delinquency ratio, we see a very good level of improvement for individuals going to 5.78% from for 6.47%. But it is still an (increase) in corporate and this corporate is mostly due to new case that (hit) our delinquency ratio this quarter. It is still in the 15, 90 days late payment. It should migrate to 90 days in the First Quarter. But we already have this case with 100% provisions. The fact it is turning to late payment only now is due to some specific contract characteristics. But as I said, it is already provisioned and we should write-off it in the Second Quarter.

In the slide 12, we have the chart for NPL creation excluding the effects of the specific case in the Third Quarter. We had an increase in the NPL creation. The fact that we had provisions representing (inaudible) 94% is mostly due to the fact I mentioned, the part of the creation comes from corporates and for the specific companies we already have that very high level of provisions.

In terms of provisions expenses evolution and as a percentage of the loan book, our provisions represented in the Fourth Quarter 5.5% of our loan book. We believe going forward, especially in 2018 and for full-year 2019, we can go back to levels similar to the low levels we see in this chart after we start to see the improvements in the credit cycle and we have already written off the -- we have already started to see improvements in credit quality.

In the slide 13, we have the new charts on NPL creation. Total NPL creation already showed in the previous slides. For corporates, NPL creation in the Fourth Quarter was BRL500 million. Actually, if we adjust the creation for the Third Quarter by the specific case that went into NPL that quarter, actually, you can see -- and was written off this quarter, actually the NPL creation for corporates would have increased this quarter and this explains actually a big portion of the increase in the NPLs we saw in the Fourth Quarter in the corporate segment.

For (inaudible), we have very interesting information that the NPL creation actually stabilized in the Fourth Quarter despite the deterioration we see in the NPL ratio. That deterioration in the ratio as I said is mostly due to the reduction in the portfolio and also because we have lower write-offs in the Fourth Quarter. And finally individuals, we had some increase in the NPL creation that is mostly stems with the increase in NPLs. But as I said we already see short-term delinquencies improving and also, this improvement is consistent with improvements in shorter-term vintages that are already showing a much better performance than (older vintages).

Going to slide 14, we have our provisions -- provisioning. Our provisions represent 10.4% of our loan book. We have total excess provisions of BRL7.5 billion. That is in our -- part of our total provisions. Considering coverage, we have 188% of our NPL ratio in terms of provisions and if you compare to our expected losses for the next 12 months, our provisions represent 207% of this number.

In slide 15, we have our renegotiated portfolio. This portfolio represented an increase this quarter, it represents 4.5% of our loan book. We have 68.4% of this book in provisions and the NPL ratio in this portfolio is 28.1% meaning loans that redefaulted after renegotiated. One important point in this portfolio is that part of the loans that go to this portfolio are loans that were renegotiated after written-off when we recovered those loans or renegotiated them, they go to the renegotiated portfolio with 100% provisions.

So this is an important portion of this renegotiated portfolio and this portfolio is also (led by courts recover) process that are approved and when that happens, it goes to the renegotiated portfolio. On top of that, we have our normal day-to-day renegotiations that happens mostly for loans after they get late and especially late after 90-days.

In the Slide 16, we have our fees and commissions. In the quarter, our fees grew 1.3%. Looking to the pro forma analysis, our fees grew in the last 12 months 4.5%. The main highlight in this fees are checking accounts that grew 12.9%, mostly due to the segmentation of our client base; asset management with a growth 10.3%; consortiums 13.2%; and 27% in our underwriting and financial advisory service, that is our investment bank.

In terms of expenses, we had an increase this quarter of 2.1% and looking pro forma 12 months, expenses grew 0.9%, showing a very good performance, remembering that the pro forma includes HSBC for full-year (2016), a period where we were not actually managing the bank. We don't have that information. But looking to the -- bank has relatively, we also keep a strong level of (inaudible) and we also have very good performance.

In the slide 18, we have our efficiency ratios, they got worse with the incorporation of HSBC that are included in the efficiency ratios. We do a 12-month accumulated efficiency ratio. We believe, we will go back to the levels of efficiency we had prior to the incorporation of the bank in 2019 after we compete most of the adjustments in the operation.

Finally, in the slide 19, we have information on -- for our insurance operation. We believe we had a very good performance insurance in 2016, especially considering the environment we faced, we saw segments where we believe there is still a lot of room for growth, especially deepening the penetration on insurance problems. In the Fourth Quarter, specifically the results and ratios for the insurance operation improved with better loss ratios for the Health Insurance segment and also increase in gained premiums for insurance.

Focusing on the quarter, we had a Q-on-Q growth in our premiums for insurance of 20% in the Fourth Quarter, due to seasonal factors and also efforts in the distribution of, especially the pension plans, pension and life plans that had a very strong performance in the quarter.

Looking to premiums year-on-year, we focus on the pro forma analysis for which we had a growth of 7.8% in 2016. Financial assets focusing on the pro forma grew 17% year-on-year in 2016; technical provision 16% and the equity of our -- the shareholders equity of our insurance company, 25.6%.

Net earnings in the quarter for (inaudible) was BRL1.505 billion, that's 24.9% return-on-equity. And for 2016 as a whole BRL5.551 billion that represents an ROE of 23%. Reminding that actually the insurance company was hit by the increase in the income tax with the social contribution tax rate. They are more directly affected by that increase and even with that, there was an increase of 5% in earnings.

Going to Slide 20, you see our capital ratios. We have a very comfortable level with BIS ratio following the phase-in schedule at 12% considering Tier 1 ratio, 11.2% considering common equity. Looking to fully loaded ratios, without any adjustments, our fully loaded ratio would be 10.4% for Tier 1; 9.6% for common equity; and considering the estimates of consumption of tax credits and goodwill amortization, our capital ratio goes to 12.2% for Tier 1 that compared with the expected requirements for 2019 of 9.5%; 11.4% for common equity that compares to 8%. And on top of that we believe we will keep increasing the capital base with repayment earnings over the next coming year what brings us a very strong level of capital origination.

Finally, in terms of guidance; first, I'll comment on 2016, the only line for which we were out of the range in our former guidance, as already mentioned, was for operating expenses, for which we had the impact of some expenses that we can somehow call extraordinary. But given adjustment, known as non-recurrent. This business is related to anticipated payments in some contracts for which we had some advantage prepaying and also expenses related to the incorporation of HSBC.

For our 2017 guidance, we present it in two ways, comparing the pro forma that is including HSBC for full year 2016. And as disclosed, where we're comparing with the reported numbers that include HSBC only in the second half. We will discuss only the pro forma. For the pro forma, we had the expanded loan book. We expect to expand that loan book to grow between 1% and 5%. Only for this guidance we believe, it's more likely to grow in the bottom of -- the mid-lower portion of the guidance and this is what is increased in our guidance for net interest income.

For net interest income, we expect a drop on a range between minus 4% and zero. Basically the main impact for this guidance comes from lower volumes, average volumes actually will shrink if you compare 2016 to 2017. But I'm sure we will have questions on this.

Fees and commissions; 7% to 11% reflecting already part of the benefits from synergies is what drives this guidance to this ratios -- to this levels. Operating expense is minus 1% to 3%, what also reflects the benefits from synergies considering total inflation should be around 4.5%; insurance premiums 4% to 8%; and provisions for loan losses -- expenses between BRL21 billion and BRL24 billion, reminding you that we closed pro forma 2016 at 24.1% -- BRL21 billion. So the middle of this guidance implies, as we have been saying, reduction comparing to 2016.

So now, we are opened to questions.

Questions And Answers

Operator

(Operator Instructions) (Marcelo Macedo), Goldman Sachs.

Q - Carlos Macedo {BIO 15158925 <GO>}

Good morning. Thanks. Carlos Macedo here from Goldman Sachs. I have a couple of questions. First question is on margins. Your guidance calls for, on the published basis, 3% to 7% growth and on a recurring basis or on the pro forma basis 0% to 4%. Now this don't really leave much room for margin compression, as a result of rates. I think, you have rates going down to 9.5%, averaged rates will be down 300 basis points.

Give us some color on how your margins react to rates and more importantly than rates, spreads because you have to assume that spreads will (inaudible) rates, as it really has started to happen in the data that comes out from the Central Bank in November and December.

Second question, the additional provision that you have right, the excess provisions that you have of BRL6 billion, half of them now are basically earmarked for your guarantees. If -- I know you say that you're not going to use them. But if in any situation arose that you had to use them, how much do you actually have available? Is it really the BRL6 billion or at this point, are we talking only about BRL3 billion. Thanks.

A - Carlos Firetti {BIO 2489005 <GO>}

Okay. Carlos, first the guidance on margins. As we have been saying, the structure of our balance sheet makes us to actually have a positive impact from rates in the first moment, if you compare our loan book to the rate structure of the fund. So basically, we have a big portion of fixed rate loans with more than one year duration that are backed by one day duration funding.

So from the rate and specifically of this portion of the book, we have a positive impact and we have (inaudible). We have other impacts that somehow compensate this positive impact for the negative, like the impacts on interest rates in other items of our balance sheet. Also, the lower inflation rates that is indexation factor for part of our bond portfolio.

So for rates, it's the (fixed) business the main factor. There is, I'm talking about the bank. On the Insurance company, the impact for rates is more negative and the fact that they have a big portion of their results or their margins are based on their financial assets and that moves the index either by inflation or by rate. So if you look to the breakdown of our margin, the insurance actually you have a negative impacts from rates.

In terms of spreads, we can say that, the spreads in some cases have started to go down. We think they are in a process of normalization. But we are still repricing our portfolio. In terms of credit spreads on the portfolio we can say, we should see the margins relatively flat. The main negative impact we have comes from volumes, if you do the calculation on average volumes, it dropped. And you have consider that the growth we expect actually comes also a lot in the second half. So if you look to the average portfolio, it could be even lower than if you just do the average taking year-end 2016 and year-end 2017. That's on margin. On the guarantees --

Q - Carlos Macedo {BIO 15158925 <GO>}

Just one follow-up there. So what you're saying basically is that we shouldn't see that dramatic of an impact this quarter because of the way that your balance sheet is set up. But it then flows that in 2018 when the benefit from lower rate doesn't really show up anymore because rates are going to be lower for the full-year, that's when see a bigger hit in margins and spreads, is that -- will that be an accurate statement?

A - Carlos Firetti {BIO 2489005 <GO>}

Yes, basically the (reprice in 2018), we should see a little bit more of the impact of the price and also the impact from lower interest rates and we believe that can be more than compensated by the reduction on credit cost in terms of our results.

In terms of guarantees, basically we have set aside (BRL3 billion) for guarantees, basically and the Central Bank requires us to make this provision, there was no rules defined and we used the most conservative rule that was just applying the (26(h)(2)) that is the provisioning regulation in Brazil for guarantees and you know guarantees are contingent liability, meaning you will lose if the company goes into default and if it loses the lawsuit to which the guarantee is related.

So we decided to be conservative and set aside part of our additional provisions. In January, we start with the final provisioning for this that (fall in the rules of regulation 45 PL), basically we have defined the new model for provisions of guarantees and the actual provisions we should make are more related to what we call the (specific) that is something around BRL600 million in the Fourth Quarter and not the (BRL3 billion).

Q - Carlos Macedo {BIO 15158925 <GO>}

But if you had -- just follow-up again, if you had to use the excess provisions now, for whatever reason, I know it's extraordinarily unlikely, you would only be able to use (inaudible), is that right?

A - Carlos Firetti {BIO 2489005 <GO>}

No, no, basically that BRL3 billion will be normal provisions part of the additional provisions, what we will have as now the (official business) in provisions for guarantees following the regulation will be a lower number and then we will make provisions for guarantees (inaudible).

Q - Carlos Macedo {BIO 15158925 <GO>}

So basically if this rule -- just to get it right, if this rule would have been in place in 2016, the full year, I think your provisions that are allocated, the guarantee provisions that are allocated to this additional line (was up BRL2 billion, those BRL2 billion would have) to go through your income statement as regular provisions, right?

A - Carlos Firetti {BIO 2489005 <GO>}

There was no rules, (it was for banks, partners).

Q - Carlos Macedo {BIO 15158925 <GO>}

I understand. But had it been in place. (multiple speakers).

A - Carlos Firetti {BIO 2489005 <GO>}

Basically we sacrifice what we believe was an (exact) amount of provision and now doing the provisions for the past, we will be functioning, we will use something like (BRL600 million). Our system was doing the same, maybe we were even a little bit more conservative using the (inaudible). So the BRL3 billion will not be the provisions for this inventory (but perhaps as it goes to the new rule). We go through a more rational way of calculating and defining what is necessary for provisions.

Operator

Mario Pierry.

Q - Mario Pierry {BIO 1505554 <GO>}

I have two questions as well. First question is on your guidance for provisions, if I take your Fourth Quarter provisions and I annualize them, you are annualizing at BRL22.1 billion while the midpoint of your guidance is BRL22.5 billion. So basically you're saying that on a quarterly basis, provisions are likely to be higher than where they are now. Just wanted to understand that or if your guidance is too conservative and you are more likely to reach the BRL21 billion rather than the BRL22.5 billion (high) guidance. Second question has to do with your guidance for fees and operating expenses. On fees as you've shown on your slides, you've been growing well above loan growth given all the changes you made in the systems and the cross-selling, however, you continue to expect very strong growth in fees in 2017. I wanted to understand on this guidance, how much synergies are you expecting from HSBC and how is HSBC impacting your guidance then for fees and as well for operating expenses, if there is any number you can give to us in terms of cost savings from HSBC that is embedded on your guidance for operating expenses. Thank you.

A - Alexandre Gluher {BIO 4820551 <GO>}

Thank you, Mario. You can say our guidance for provisions is conservative. To contemplate the fact that we are in an economy that is improving and the credit conditions that are improving. But it includes a process of improvement from a situation that was relatively fragile. So we think our guidance is conservative and it kind of contemplates kind of (something for) that is considered in the scenario. In terms of (another thing), we can say eventually the Fourth Quarter is a quarter where you have some, also some seasonality.

In terms of fees, we can say that this guidance (inaudible) can also contemplate synergies from HSBC. We have been growing our fees in Bradesco standalone considering our segmentation and we have doing better offers for our clients. But we believe there is a lot of room for cross-selling in HSBC or to penetrate more the client base. That is something we have been saying since the beginning. On a pro forma basis, (in 2016 we grew 4.5%), the midpoint of our guidance is 9%. So it clearly considers benefit from synergies.

Q - Mario Pierry {BIO 1505554 <GO>}

Any way you can quantify these synergies, any products specifically or anything like that?

A - Alexandre Gluher {BIO 4820551 <GO>}

I think it's harder to do that especially considering now we have I think (greater bank in a) single platform and everything, it's only Bradesco. But as you said, in many products, we see penetration in the acquired bank client base (below of ours).

Q - Mario Pierry {BIO 1505554 <GO>}

Sorry, do you have some statistics that show how many good products each client has at HSBC versus what you have at Bradesco or something like that?

A - Alexandre Gluher {BIO 4820551 <GO>}

(Not to share, that's all).

Q - Mario Pierry {BIO 1505554 <GO>}

Okay and then on the costs, what type of synergies or cost savings are you anticipating from the HSBC transaction?

A - Alexandre Gluher {BIO 4820551 <GO>}

Look, our guidance implies evaluation of expenses between minus 1% and 3%, basically inflation this year, (4%, 4.5%). So it already implies a capturing of synergies. We have been saying since the beginning that we can capture at least 30% synergies on the (region of hot space of) HSBC. We maintain that. There is kind of a ramp up, the synergies or the levels of synergies will be growing throughout this year. We have been doing already most of the work to capture synergies. (inaudible) and that should materialize very soon and the adjustment of the structure, it is kind of stable now with turnover and (drag over) the next three years.

Operator

Tito Labarta, Deutsche Bank.

Q - Tito Labarta {BIO 20837559 <GO>}

Couple of questions also. First I guess on asset quality. I understand you saw NPL creation this quarter a little bit better. But just looking at 2017, you still expect very modest recovery (inaudible) down side. So just want to -- where do you, how do you feel comfortable that there are no other risks out there that couldn't exactly call them worse (and expect it). As you mentioned, you saw early NPLs in corporates go up this quarter. I understand your 100% provision for that but can there be more cases that you're not fully provisioned for and stir some surprises (technical difficulty). Could there be some risk there that are not quantified yet in terms of asset quality and then my second question in terms of the tax rate, you see the lower tax rate this quarter, the interest on capital and goodwill amortization, what kind of tax rate should we expect for the full year in 2017? Thank you.

A - Carlos Firetti {BIO 2489005 <GO>}

Okay. Thank you. Starting with the second question in terms of tax rate, first as I said, we changed the way we adjust for the goodwill. Now we adjust for the (gross goodwill and that keeps) the tax benefit in the tax rate difference of what happened into the Third Quarter. So you can work with the tax rate for 2017 between 26% and 28% already including the impact of the goodwill amortization. In terms of NPL evolution, in that question particularly, I'm not sure I got everything because the quality of the sound was not very good but you correct if I didn't answer something, we see the economy in a point where it is starting to recover, we may already see high stabilization of the economy maybe even this quarter.

We have been cleaning up our portfolio over the last two years and NPLs increased through the normal write-off cycle. Basically that has been (leading our portfolio) the origination has been improving in quality. If you compare the recent vintage to vintage originated a year ago, for instance, you see a meaningful improvement. So we believe that together with short-term delinquencies, for instance, the 15, 90-day delinquencies, that already shows an improvement for individuals. I think with all of the data on NPL creation et cetera, all of that points to this perception that the peak of this NPL cycle is really around us.

Q - Tito Labarta {BIO 20837559 <GO>}

Thanks Firetti, that was very helpful. So is it fair to assume that maybe NPLs stay relatively stable next couple of quarters as the economy stabilizes and then maybe by year-end, you can start to see some improvements as the economy pick up more?

A - Carlos Firetti {BIO 2489005 <GO>}

Yes. We mentioned that there is a (case) in that 15, 90-days that should go into 90-days late payment in the First Quarter. If you -- and this is a 100% provision, if you adjust for this, it is fair to say that we don't expect actually an improvement in that first-half. We believe that will start to happen more in the second half.

Q - Tito Labarta {BIO 20837559 <GO>}

Okay. Great. Thank you.

Operator

Philip Finch, UBS.

Q - Philip Finch {BIO 3252809 <GO>}

Good afternoon, everyone. Thank you for the opportunity. So I have a couple of questions. I was cut-off during the presentation. So apologies if you've addressed this issue. Can you talk about --

A - Carlos Firetti {BIO 2489005 <GO>}

Philip, I cannot hear you well. Can you repeat and try maybe to speak closer to the speaker, something like that.

Q - Philip Finch {BIO 3252809 <GO>}

Yes, of course, is it better.

A - Carlos Firetti {BIO 2489005 <GO>}

Yes.

Q - Philip Finch {BIO 3252809 <GO>}

Okay, I will speak slowly as well. Can you tell us how you see the new rules on revolving credit impacting your operations, both from a revenue and a risk perspective. And the second question is, can you discuss more about your new digital bank that you plan to launch this year. What are the key features and how could they enhance revenues and all other costs? Thank you.

A - Carlos Firetti {BIO 2489005 <GO>}

All right. First, on the revolving, basically this was a discussion that what made with the Central Bank. We will -- the regulation for the new revolving was already released. It states that the revolver we have, it remains that for the first 30 days, then clients go into payment in installments they usually choose from the possibilities available. They choose up to a certain limit the number of installments. Basically in our view, the interest rates on that will be lower; as well will be lower the credit cost of this operation. What we'll compensate over time the impact of lower interest rates.

It makes the product more sustainable. We should be forming a portfolio over the months after we start with the product. And as we form this portfolio, that we'll have a higher duration with the need to really compensate the losses in interest, since the original revolving credit line. We have already incorporated some estimates on that impact in our net interest income guidance. It's okay on this, (inaudible) Philip.

Q - Philip Finch {BIO 3252809 <GO>}

Yes. That's very good color. Thank you.

A - Carlos Firetti {BIO 2489005 <GO>}

Okay. On the digital bank strategy, basically, let me run you through our strategy here in the bank. Today, we have our traditional bank model that should serve most of our clients and it is still responsible for generating most of our business and we believe will remain relevant as a source of generation of the business still for many years. There is a big portion of the clients that -- who still prefer it and continue doing their business through branches.

On top of that, we have digital banks strategy where we have been inviting clients that are clients of the traditional bank model to be served by a digital branch. These digital branches are centralized structures where you have managers that serve the clients through digital channels; it can be a chat , it can be online or a video chat. They have larger portfolios of clients, since there are some gains of scale, in the way they can serve this clients, they have in many cases broader portfolio of products and it has been a very successful strategy in the and that fact that clients that accept to migrate to the digital branch model actually have higher average revenue than before they migrated to the new model. And on top of that, we are launching a new digital bank in a couple of months that will focus mostly or basically in new clients. Clients more in the average range of age between 25 years and 35 years, the so-called millennial, that have a totally different behave in how they do their relationship with financial problems in branches.

This, in our view will be kind of a disruptive model in the sense that the basis, the relationship of clients with products in their journey, in the bank, in their lives and trying to capture to algorithms they have today to do the right offer of products. We should be launching this. So it's still -- don't share our expectations in terms of goals or how much we have impacted on this.

Operator

Henrique Navarro, Santander.

Q - Henrique Navarro {BIO 16188960 <GO>}

Hi. Good morning everyone. My question is on HSBC, the level of client detention from HSBC, I know it's natural, what we have seen in the Fourth Quarter after a decision like that to see the loan growth coming down and also a reduction in number of branches and a reduction in the number of active checking accounts.

But specifically in the case of checking account holders, there was a reduction of nearly half a million clients. So my question is, if this number of checking account holders that were lost, what Bradesco first estimate that it was natural. If we're going to see further reduction on this drop in account holders for -- over the next quarters. And also, the reason for that? If it was because of overlap or any other reason?

A - Carlos Firetti {BIO 2489005 <GO>}

Okay, Henrique, first, reduction number of account holders, if you look also in December 2015, before we incorporated HSBC, the number of account holders dropped in the Third Quarter 2015 from 26.4% to (20%) in December and it dropped from September from 27.2% to 26.8%. All end of the year, we do some sort of tune up in the account base, look to what are actually active clients and we move this base from the client rate.

So it's related to Bradesco also. And as you saw, actually we had a similar reduction last year when we still didn't considered HSBC in the numbers. In terms of branches, we are constantly evaluating the branch network, the model of its (inaudible) as we prefer is the evolution of branches. Basically, we are converting our -- some of our full branches and point of services and sometimes reducing the size of some larger branches.

So we keep monitoring the branch network. We don't keep branches that are not viable open. We need our branch network now -- it's composed of branches that is basically what is necessary and what we have to have to serve our client base. But our main focus will be really on our first approach at that performance of the branches.

Q - Henrique Navarro {BIO 16188960 <GO>}

Okay. Thank you. And if you allow me a second question, on your coverage ratio, it is near to 100%. We know that it is not a normal level, if the scenario starts to getting better. So I would like to know what you consider a normalized level of coverage ratio for the next couple of years. I know that by considering your guidance for provision, we more or less can guess how much is going to be the coverage ratio for 2017. But looking forward for the next couple of years, let's say 2018 and go on, what you believe is going to be the sustainable and normalized level of coverage ratio for Bradesco?

A - Carlos Firetti {BIO 2489005 <GO>}

Henrique, if you look historically, we haven't worked at additional provisions until there is something that could change additional coverage ratio immediately if we do. So we don't have any expectations on using additional provisions unless in the future we go to levels that we believe we should discuss that.

But on a, let's say, normal basis, what's going to happen is as we start to grow again, basically, the coverage ratio should adjust. In the past, when we were growing our loan book, we reached lower levels of coverage. We believe that can happen again. But we don't have specific targets for coverage and actually we will have an expectation also to rework additional provisions that would eventually reduce that coverage in the short term.

Operator

Thiago Batista, Itau BBA.

Q - Thiago Batista {BIO 15398695 <GO>}

Yes, hi guys, thanks for the opportunity. I had one question Firetti. On the level of credit recoveries, we saw a big expansion in the credit recovery in the 4Q. If I'm not wrong it went up 20% Q-over-Q and 50% year-over-year. So could you give us a little bit -- some color on the material expansion in the levels of recoveries?

A - Carlos Firetti {BIO 2489005 <GO>}

Yes, I think there is a couple of things. First, we believe our operation, our models are working on credit recoveries (inaudible) we've been improving the way we work over time and it has produced pretty good results. Another thing, we don't sell on a regular basis, loans after write off, We did something this quarter. But it was something specific and for us it's actually that were older loans. But we have a base for working on credit recover that is the bigger. So have more to recover. Also on that front, we did the merger with HSBC in the October. We incorporated our -- in July actually, we started to incorporate HSBC and do the (pre operation) in the October and we had a new base for loans to work. They started to apply our way of dealing with loans through HSBC portfolio that helped. And I think, this explains most. We had also some loans, we call -- from the writes-off that originated new loans, we mentioned that when we discussed our recovered loan book, that also helped, I think. All these things together probably explain this performance.

Operator

Jorg Friedman, Citibank.

Q - Jorg Friedman

Thank you very much. I have two questions that were not approached in the Portuguese call. So first, I know there is an important increase of your renegotiation credit portfolio to 4.5% in this quarter, in terms of total loans versus 4% in the previous quarter. So is still Bradesco is running below on this metric versus private controlled peers, which show that number above 5%.

So my question is, what this increase related to a change in your renegotiation policy in order to become more productive in that line going forward or was this related to any specific event? Then, I go for my second question, thank you.

A - Carlos Firetti {BIO 2489005 <GO>}

I think, I discussed a little bit of that on the previous answer. Basically as part of the recovery of loans, when I recover something, that recover is based on the new loan. I record that on my renegotiated portfolio. This is part of it and you know my recoveries have been growing. So that leads also to an increase in the renegotiated portfolio, loans that are recovered after the write-offs. So part of the renegotiated portfolio is composed by loans that came from the write-offs. Also, when you have a court recovery approved, also that credit remains in my portfolio and its goes to the renegotiated portfolio. And on top of that, I'm doing very well on the process of recovering loss.

Q - Jorg Friedman

Okay. But not necessarily you are going to continue fostering this renegotiation. It's a natural process that happen to imply an increase this quarter.

A - Carlos Firetti {BIO 2489005 <GO>}

No, nothing changes. If you look to the consistency of the portfolio, the level of delinquency of this portfolio has been varying a little bit. But relatively stable. You see that the increase in provisions, in the renegotiated portfolio also brought relatively large increase in provisions, meaning the loans that we brought to this portfolio have a high level of provisions and it's exactly -- because of I said, part of this are loans that came from the write-offs, already these are around 100% provisions.

Q - Jorg Friedman

Okay, perfect. Then my second question is with regards to the insurance platform. You did a significant improvement in terms of the (current) ratio, as you mentioned in the health segment. But on the Auto and P&C segment, you actually reported a loss. Basically, you mentioned in the press release that it was due to the business plan revision on the P&C segment.

So my question here is, is it done? You've booked like a lot of -- approximately BRL100 million, if I'm not mistaken or you have any further negative recognitions to the reserve in the beginning of this year.

A - Carlos Firetti {BIO 2489005 <GO>}

P&C is exactly that. It is the revision of the business plan of one agreement we had on the extended guarantee business. That revision led to expense or a loss of BRL101 million. We booked this in the commercial expense lines for the P&C business and this (one), we treated that as a recurrent item, it's there and it's kind of a one-off thing and that's the reason for the loss in this P&C business.

Q - Jorg Friedman

That's perfect. And do you believe also that the claim ratio observed in the health segment is something sustainable going forward or anything that might imply a deterioration in the beginning of year, of course, taking into consideration the normal seasonality of the business?

A - Carlos Firetti {BIO 2489005 <GO>}

Basically, this decrease in the loss ratio in health insurance in the Fourth Quarter is related to some seasonal impacts, basically. And especially at the end of the year, there is a reduction in claims. Also, there was less business dates this quarter that impact claims. So part of it is due to the fact that the perception is, there is also a real improvement due to the measure we, our health insurance company has been adopting.

So even if the seasonal effects go away, the perception is, we will not go back to the levels we saw in the second and Third Quarter last year in 2017. And on employment sub-license, other factors that have been contributing to the high loss ratio go away, like the fact that (inaudible) increases and people is afraid of losing their jobs or people has some standard coverage, when they lose their job, they lose more. So in the second half, which we have the benefits of the stabilization on employment, we can have even bigger benefits.

Operator

Carlos Gomez, HSBC.

Q - Carlos Gomez {BIO 15024854 <GO>}

I'm wondering about (BRL2 billion) adjustment to net interest income and we talked about it the Portuguese conference call. But just wondering. So it's BRL1.26 billion, it's an impairment in terms of (inaudible)of debentures. It is a per month loss or it is an impairment because it will not be (simple) or because of the change in the financial conditions. Because you're keeping a lot of liability part of provisions. And what should we expect going forward. Is it going to be a recurrent future in the quarter and will you distribute out separately the (detailed) information about it. And second, I would like to ask about your amortization of goodwill. And if I could please consider as number currently then, then I wonder what (inaudible) we should expect going forward. Thank you.

A - Carlos Firetti {BIO 2489005 <GO>}

Carlos, the quality of the call was not very good. I'm not sure I understood everything. But if I don't answer something, please correct me. Related to the impairment first, impairments related to (inaudible) I record as provisions, what I have in the loan book that follows the (26/89) resolution. So it's a separated thing. The impairment is related to the protection of a recognition of a loss related to credit events. So most likely, it's not recoverable, unless for some reason our company for which we have downgraded our view, improves dramatically. It can happen, let us say, it is very likely. But it can happen.

So most definitely, it is a permanent loss. We used to have -- we have our annual governance for doing this impairment test, considering the level of problems we had until now, it was enough. And we decided to revise to make it more quarterly. One thing is most of the problems are evolution in credit events that lags to the impairment. That really happens in the Fourth Quarter.

So it's not something -- there was some concentration. From now on, we do it on a quarterly basis. We believe, if we have something and we cannot say we have actually, we believe at the end of 2016, we did the right level of impairment for the current credit conditions. But we still have -- we believe it would be much lower for the year than the (BRL1.26 billion) we made in 2016. The second question, can you repeat it? Sorry.

Q - Carlos Gomez {BIO 15024854 <GO>}

Yes. So, the amortization of goodwill (multiple speakers).

A - Carlos Firetti {BIO 2489005 <GO>}

Okay.

Q - Carlos Gomez {BIO 15024854 <GO>}

A non-recurrent event.

A - Carlos Firetti {BIO 2489005 <GO>}

Yes. So basically we were treating it as a recurrent event in the sense that we were divesting the goodwill, net of the tax benefit. We were adjusting. So either way we were adjusting, it neutralize totally the tax benefit. Technically, the (new) amortization becomes deductible after the incorporation of HSBC. In the previous quarter, it was not deductible at that point.

So considering that -- and considering that basically we see our peers adjusting -- deducting the gross, we thought it was actually more appropriate to do in line with what our peers do. But from now on, basically it's going to be done this way. In terms of the (real), you saw we amortized something like (BRL245 million) in the quarter. You can consider a amortization schedule considering we will amortize BRL2.4 billion in goodwill in 2017, BRL2 billion in 2018 and kind of reducing it around BRL400 million each year until we amortize everything going forward.

Q - Carlos Gomez {BIO 15024854 <GO>}

And all these amounts will be considered as non-recurrent every year?

A - Alexandre Gluher {BIO 4820551 <GO>}

Yes. We (move) that expense as non-recurrent, the full BRL2.4 billion as non-recurrent, leaving the goodwill (inaudible) is what I said in line with what other banks do.

Operator

Yuri Fernandes, JPMorgan.

Q - Yuri Fernandes

So I just had one question relating to the credit card change on the revolving credit card. Can you comment please on potential NII impact you may see there and do you see potential (inaudible) reduction will offset the lower NII you may have. And finally, is this included on your NII guidance?

A - Carlos Firetti {BIO 2489005 <GO>}

Yuri, the answer is yes. We included the impacts from the changes in credit card in our guidance. We believe they have initial negative impact followed by a compensation coming from portfolio with longer duration and that should (cover them) and also lower risk. So both things together compensate the loss coming from lower interest rates.

Q - Yuri Fernandes

Do you see (inaudible).

A - Carlos Firetti {BIO 2489005 <GO>}

We don't see this discussion at this moment.

Operator

Excuse me, ladies and gentlemen, since there are no further questions, I would like to invite the speakers for the closing remarks.

A - Carlos Firetti {BIO 2489005 <GO>}

Thank you very much for the questions and interest in our call. We are available for further (inquiries) if you have, just contact Bradesco's investor relations department. Thank you.

Operator

That does conclude the Banco Bradesco's audio conference for today. Thank you very much for your participation. Have a good day.