Q4 2018 Earnings Call

Company Participants

- Carlos Wagner Firetti, Market Relations Director – Head of Investor Relations
- Octávio de Lazari, Chief Executive Officer
- Vinicius Tugumi, Private Bank | Head of Credit, Investment Banking and Family Office

Other Participants

- Carlos G Macedo, Analyst
- Carlos Gomez-Lopez, Analyst
- Jason Mollin, Analyst
- Marcelo Telles, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentlemen, and thank you for waiting. We would like to welcome everyone to Banco Bradesco's Fourth Quarter 2018 Earnings Results Conference Call. This call is being broadcasted simultaneously through the Internet in the website, banco.bradesco/ir-en. In that address, you can also find the presentation available for download.

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

Before proceeding, let me mention that forward-looking statements are based on the beliefs and assumptions of Banco Bradesco's management and on information currently available to the company. They involve risks, uncertainties and assumptions because they relate 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 results to differ materially from those expressed in such forward-looking statements.

Now, I will turn the conference over to Mr. Carlos Firetti, Market Relations and Director. Please Mr. Carlos, you may proceed.

Carlos Wagner Firetti {BIO 2489005 <GO>}

Hello, everyone. Welcome to our conference call for discussion of our fourth quarter results. We have today with us participating in the call, Octavio de Lazari, Bradesco's Chief Executive Officer; André Cano, Executive Vice President; Vinicius Albernaz, Chief Executive Officer of Grupo Bradesco Seguros; and (00:02:26), Executive Officer and Investor Relations Officer.

To start the call, I turn the floor to them.

Octávio de Lazari

Thank you very much, Firetti. Hello, everyone. Thank you all for joining our fourth quarter 2018 earnings conference call. 2018, as you know, was marked up by the recent volatility in global markets as well as the Brazilian market. That was led by sort of political and economic disturbances that affected our economy. This combination prevented the economy as a whole from growing faster, repeating the lowest 2013 1% growth and the unemployment rate above 11.5%.

Despite of this challenging scenario, Bradesco remained flexible, focused and feats (00:03:17) to present on healthy and strong and solid operational and financial performance. The Banco's growth is regional (00:03:24) and with the right strategy to grow. This allowed us to expand our own portfolio, increase our services revenues and decrease our risk cost and to keep the overall cost at very decent levels. We can say and generally speaking that we work (00:03:40) with costs below inflation. Operating cost remained uncontrolled, and we partially absorbed the impact from the collective labor agreement, resulting costs growing below inflation as I have mentioned before.

On page 3 of our presentation, we can see that in 2018, we have a record net income of BRL 21.6 billion, up 13.7% year-on-year. Besides that, we had a solid operational profit, up 24.9% year-on-year, in fact incredible year for us.

Turning to page 4, you may see that we had several important initiatives in the past month. Among them, we'd like to highlight the followings. First of all, the renewal of our brands, which allow us to be more flexible in our user communication and reflect our values, as well as our direct level of technology and mobility. We also have experienced the fast evolution of BIA, our unique artificial intelligence platform. And we were able to achieve the important milestone of 500,000 clients for Next. Just to give a flavor, last week, we reached 507,000 plus clients.

On page 5, we can see that the very beginning of this year, our Executive President, Mr. Ricardo (00:05:10) announced the redesigning of our senior management structure as you can see on page 5. We've reduced the number of Executive Vice Presidents down to four from six. This movement aims at speeding up the decision process and boost the cooperation and synergies among our several orders of the organization. Furthermore, we've improved our client segmentation, seeking to provide an even more customized, deeper and comprehensive set of services to our customers. Client is clearly in the organization (00:05:44) is the center of everything that we do.

(00:05:48) now with the following organizational structure. Wholesale Bank that is comprised of Large Corporate, Corporate, Corporate One, fine brokerage, investment bank, global market securities, foreign exchange, and international private bank divisions, it is head by Marcelo Noronha.

High net worth clients in treasury comprised of prime, prime invest, top tier clients syndicated (00:06:16) divisions, Bradesco (00:06:19), wealth management and treasury divisions head by Cassiano. Retail Bank comprised of branches, digital branch platform, Bradesco Expresso, digital channels and cards are led by (00:06:34), and finally control the business support structure that is comprised of Technology, Human Resources, Finance and Risk and other operational areas in these KPIs (00:06:45) led by André Cano.

You can see on page 6 that we are improving our customer experience dramatically. It's a permanent goal of ours and we have a number of important initiatives as we have pointed out at this page. We seek to (00:07:04) our customer needs, will include the include the speed in combination of our services. The products and services portfolio became more and more tailor made for our customers' needs.

As a result, our NPS indexes improved at around 20% in 2018 when compared to 2017. Hence you have to just describe it on page 7, these among our largest efforts in technology and through the idea is to provide a better experience to our customers. We are in the and cutting edge position in the use of our efficient (00:07:41) in the financial markets. 80.3 million customers have already used BIA, with around 73.2 million interactions. BIA is a multiplatform. It comprises Bradesco App, Next, WhatsApp, Google Assistant among others. The evolution have been very, very fast. The accuracy of answers is around 90% today and intends to enhance even more and faster. BIA has a wide range of applications. We use it to assist our managers, clients, anyone to execute transactions.

Just as we did in the previous quarter on page 8, we present some figures from our digital channels. I'll highlight Next. We've achieved 500,000 clients by the end of 2018, but I'll have to just mention we reached 575,000 last week, and we expect to reach 1.5 million clients by the end of 2019. 75% of our clients who'll join Next were not Bradesco's clients. So we're enhancing our base of clients. So, we're achieving our goals there. The numbers of deals in productions, led by our customers to work through WhatsApp keeps growing fast and fast. Only in the fourth quarter of 2018, there were 5.2 million interactions.

The volume of loans released through the mobiles and internet increases steadily. In 2018, this figure expanded 63% for individuals and 76% for companies. The number of digital clients, including mobile and Internet banking were especially more and more mobile reached 15.2 million, which represents an incredible 53% of our checking accounts clients.

Turning to page 9, we point out that we maintain our focus on growth, customization and efficiency of our business model, searching continuously for more profitable business models that fulfill our clients' demands. In the past two years, the number of digital clients grew by 25%.

We have already made important adjustments in our network and we need to achieve it adjust it. We'll continue to close some branches or transform them to points of sale as the KBB. We're just looking for profitable branches and points of sale which allow us to reduce costs without closing transactions with our clients. The size of the branches might be smaller. We expect to achieve 1.5 million clients in the digital platforms by the end of this year.

Due to our increase in tech knowledge and better processes managers, three times more clients profitability to 40%. And as the economy recovers, we have the opportunity to deliver our networks to (00:10:44) throughout the Brazil, as we are the only bank that is (00:10:47) major tariffs of the country.

On page 10, we can see that our insurance operation presented an important decrease in claims as a result of (00:10:59) previous years. We have redesigned several pricing models and focused on portfolios that have higher profitability. The healthcare segment for instance will have ongoing initiatives for cost control such as negotiations with hospitals which makes the business more sustainable in the long run.

We highlight the investments in primary treatments. By the end of the year, we shall have 23 units of new Meu Doutor" e "Novamed. We have been tweaking the Pension Plan segment as part of our wealth management and investment strategy.

Finally, I'd like to highlight that we have several initiatives focused on the experience of our customers. For instance, the expansion in the offering through digital channels.

Turning to page 11, we can see here that the brokerage house environment remains positive and we're gaining momentum there. We concluded the investments in the platforms of our brokerage houses for (00:12:02) towards in order to meet clients' utmost demands. We have just launched Bradesco's new platform, which has been completely redesigned to provide a friendly and comprehensive experience to our clients.

Our brokerage houses have a potential market of 1.3 million clients from our Prime and Private segments, besides the 300,000 clients that we already have. We remain (00:12:31) on our wealth management strategy and bringing further news throughout 2019.

Finally, on page 12, we'd like to (00:12:41) by the great added value we bring the Brazilian society from the total added value of BRL 61 billion generated in 2018, 34% were paid in tax and 30% in compensation to our employees.

This year Banco Bradesco has invested BRL 607 million in student activities benefiting 94,000 students and we have committed to invest up to BRL 650 million in 2019.

Thank you very much. Now I'll turn the call over to Carlos Firetti, who will continue our presentation section on the financial data.

Carlos Wagner Firetti {BIO 2489005 <GO>}

Okay. Thank you, Octávio. So now we'll start the analysis of our numbers in slide 14. We have a summary of our numbers. Main highlights in this slide is the strong increase in our operating income in the fourth quarter compared to the same period last year 33%, and for full year 2018, an expansion of 25% of our operating income. Net income grew around 20% in the quarter, 13.4% for 2018 and our return on assets reached 19.7% in the quarter and return on assets 1.7%, extending from 1.6%.

In slide 16, we have the evolution of our net income since the first quarter 2017, we moved to a new level in the last two quarters, closing the first quarter, as I said at 19.7%. We'll keep the work – working for expanding our level of returns.

On slide 16, we have our loan origination, we have been presenting this chart for more than a year and basically we consistently show expansion of loan origination in the business and companies in the fourth quarter compared to the same period in 2017, origination for individuals grew 23%, while for companies, it's growing at 37.5%.

The quality of this origination has been very good, given all the changes and improvements we had in our models and origination and that's the basis for our post Brazil on credit quality going forward.

In slide 17, we have our loan book basically, it grew 7.8%in 2018. The individuals portfolio was the main highlight, growing at 11% with the mainlines payroll loans, real estate financing, mortgage, car loans and also a highlight for personal loans that accelerated towards this year, reaching 18% basically with improved dimensional process for originating the product and also changing some characteristics in this product.

In the companies segment, the growth was 6.1%, 10.1% for SMEs, 4.5% for large companies. The profile of growth is actually what we have been seeing, higher growth for the sale operations in the SMEs and large growth for large corporates where we continue to focus to be the main bankers for our clients, serve them on their credit needs, but not necessarily doing only launch through our balance sheet. We can use capital markets. We can originate per sale and that is the approach focusing mostly on capital discipline and the returns of our operation.

Slide 18, we have our net interest income. We had a very good performance this quarter, with an increase in net interest income of 6.6%. The asset/liability managements line that increased basically just with the normalization of markets in the fourth quarter, kind of compensating the same movement, but on the negative side we had in the second quarter. The insurance – we also have an improvement more or like normalizing the performance with the inflation index changing with ITCA, the retail inflation coming is higher than the wholesale inflation measured by GPM.

On credit basically we keep benefiting from increasing the origination and increasing the portfolio. We've had some compression in spreads, we think that's part of the environment, but we feel that changing mix and the strong growth in terms of volume should allow us to keep growing our net interest income from credit throughout 2019.

In terms of credit quality, we continue on a good trend. The delinquencies for individuals and SMEs keep going down for now almost seven consecutive quarters the delinquencies for corporates has been still flattish on a relatively high level. We believe (00:19:06) improvements in this line throughout 2019 considering that we believe are at the end of the cycle for corporates and most of these delinquencies caused by a few companies.

On page 20, we had this quarter some increase in the NPL creation this increase comes mostly from the SME operation that has an increase in the fourth quarter, we believe this is explained by a group of companies and also by some seasonal effect if you analyze the SMEs, the (00:19:52) (00:19:49) in the operation actually it had the same increase last year and also we can say the base (00:20:00) for the third quarter was relatively low for the size of the increase is also given by the fact in the third quarter was relatively low. In terms of cost of risk, we remain at a very good level. We believe we still have some room for reducing the cost of risk as a percentage of the portfolio going forward.

In terms of the coverage ratio of 90 days, the levers (00:20:30) increased a little bit more to 245%. We believe this large coverage will be used as we will (00:20:40) continue growing our loan book and also have the NPL ratio stabilize this and growth (00:20:49) actually helps to consume more of this coverage. And also the excess provisions, it should consume this provisions or use this provisions in the transition for IFRS 9. It doesn't change the coverage ratio. It will remain high, but it is part of the transition for the new standard.

Page 22 fees, our fees grew 5.2% in 2018, the main highlights increased confirmed (00:21:31) checking accounts, asset management, the consortiums and from brokerage service. In page 23, our operating expenses is kept at strong (00:21:48) level of discipline throughout 2018 with total cost growing at 1.7% in the year inside the range of our guidance, administrative fees increased 0.8% and personnel 2.5% remembering that the personnel we had increased of salaries for banking workers in September at rate of (00:22:14) 5% and this is responsible for part of the tax we see, especially in the fourth quarter. We should keep discipline in costs and we believe this will remain as a good highlight (00:22:31) for the bank.

We reduced in 2018 132 (00:22:35) branches we could consider the points of service we closed that would make a reduction of 228 points of service plus (00:22:46) branches. So, we should continue adjusting our branch network in the coming years always focusing on the profitability and returns of those branches.

On page 24, our insurance operation that had a very good fourth quarter with earnings growing to 26.7% on a year-on-year basis, 22% in the quarter. The earnings for the insurance company expanded (00:23:27) at 15.4% in 2018. The return of the insurance company was 22.3% in the fourth quarter and 20% for 2018 as a whole.

In the slide 25, you can see the operating numbers for the insurance company. The main driver for this good performance is the improvement in terms of claims, total claims went down again. Again, we've seen this reduction in consecutive quarters reached 7.4%

(00:24:04) reduction of 200 basis points comparing to the third quarter. And as a consequence, the combined ratio also improved in a important way in the fourth quarter.

One of the main drivers in terms of segments, in terms of reduction, in claims it comes (00:24:25) from the Health insurance segment where the managers we have being above (00:24:30) in the company are producing a fast help them to (00:24:35) keep claims under control also benefiting from the improvement in the economic cycle.

In page 26, we have our capital ratios. We increased our total Tier I to 13.7% in the fourth quarter 2018, that's an increase of 150 bps, comparing to the third quarter. We had an increase of 90 bps in the Common Equity Tier I. And also, we issued 81 bps in the fourth quarter. The difference was in the Brazilian market through private placement, it amounted BRL 4.2 billion and this capital was already approved by the Central Bank to compose to be included in our Tier I.

In page 27, we have a slide on the reclassifications of our income statement that is – that are going to be the base for our reporting starting this 1Q 2019. Basically, the main changes are the transfers of the margin from insurance from the margin line to the insurance line. So what you are going to see from now on is the reporting of operating and financial income of insurance in the same line what makes this line represent more the operations of the insurance company and should be less, less volatile.

Also, we reduced the other operating income line transferring part of its (00:26:33) components to the margin that we believe is an appropriate classification. And also transfers of these small amounts to provision expenses and also services. Basically – and in fact, this is the new way of reporting. We produced historic set of data where you are going to be able to use in your models. And the important information here, our guidance applies to this new classification. It's especially for the insurance line and margins.

In the slide 28, we have our guidance. First, the comparison between our revised guidance and the actual performance basically considering the revised guidance the only line we meet for (00:27:39) insurance premiums and meeting all the other lines. For 2019, the new guidance for loan growth is a growth of between 9% and 13%; for the financial margins – for the total NII – from 4% to 8%; for fee and commissions 3% to 7%; operating expenses 0% to 4%; the income from insurance that, as I said, includes the margin, the classification of the margin 5% to 9%; and finally, for provision expense is range growing from BRL 11.5 billion to BRL 14.5 billion (00:28:30).

So with this, I conclude the presentation of the results and now I open for questions.

Q&A

Operator

Ladies and gentlemen, we'll now initiate the question-and-answer session. Our first question came from Mr. Carlos Macedo from Goldman Sachs. Please Mr. Carlos, you may proceed.

Q - Carlos G Macedo {BIO 15158925 <GO>}

Thank you, good afternoon, gentlemen. Thanks for taking questions. I have a couple of questions. First one on your guidance for provisions. I'm just trying to understand I mean that (00:29:32) Firetti you said something you said about the underlying incomplete (00:29:34) loan growth I mean the coverage that you have on the NPLs now more than 45% (00:29:39) is very high. And in this quarter, I mean your required provisions went down. But your generic provisions which are more at the discretion of the bank, they went up. Just trying to understand how and when will happen if it's just going to be fueled by the – like the growth of the portfolio and things like that. And how the IFRS 9 is affected?

Second question on margins. From your guidance, it appears that margins you expect margins to decline sequentially in 2019. Could you talk a little about that? I know that the change in the mix is pretty powerful, but you do forecast that you have a tightening of the margins. Is it going to be just the spreads passing through to your back book from the front book how is that's going to take place? Thanks.

A - Octávio de Lazari

Okay. Carlos. First, question on provisions versus (00:30:40) expenses. Basically, we – the trends for provisions remain positive. We believe we had some one-offs in terms of provisions during 2018 that in our view in terms of the tickets for the – for these one-offs they should and we should repeat in the same levels. We continue to have the impairments, they amounted almost BRL 1 billion. We believe there's room for seeing reductions there.

But I think what gives more confidence for us is that looking through the originations, we see the performance of the vintage (00:31:30) doing very well. We've been considering this performance. We are not normalized in terms of the level of provisions, our portfolio should require. The growth in new demand at some point more – more provisions but we believe that the process of normalization in the absence of one-offs and also the lower impairments should compensate for it.

In terms of margins, we believe in 2018, we'll continue to see some compression in spread. We think that's great – that's the trend, that's a consequence of passing through the improvement in terms of cost of risks in an environment where we believe all factors we'll (00:32:31) be willing to grow. We don't have the final reduction in the present NII that we did (00:32:36), we believe the mix during the year can help us to offset part of that movement.

But when you look through the total margins, it also should be attracted by the reduction in the margins or in the NII from the asset/liability management or in the new classification, the margins from the market considering that in our view the – as of today, the amount of which results to be appropriated in 2019, should be smaller than we have appropriated in 2018. So the our – so the mix is the margins from credit reduces probably not as much and we have, as of today, a perception that there's also some reduction in the margin from the asset/liability management.

Q - Carlos G Macedo {BIO 15158925 <GO>}

Okay. Thank you. And just a follow-up (00:33:52) can you talk a little bit about the IFRS 9 implementation and you expect that to (00:33:57) timing and import for the rest of.

A - Octávio de Lazari

Can you repeat the beginning of your question, I lost it?

Q - Carlos G Macedo {BIO 15158925 <GO>}

The IFRS 9 implementation and...

A - Octávio de Lazari

Okay.

Q - Carlos G Macedo {BIO 15158925 <GO>}

...and how you expect that to (00:34:10)

A - Octávio de Lazari

Okay. As of today, the expectation – this is not totally defined, is expectation at the full implementation should have the – for 2021 – sorry, 2020, and – but basically there's kind of a gradual implementation of some aspect. In our view, the implementation will not require more provisions, basically we have enough, considering the overall provisions, the implementation doesn't change the coverage, but basically the only thing is how especially the additional provision is classified. So we believe we are in a very good position, there is no major impact coming from or there is no impact coming from the provisioning side.

Q - Carlos G Macedo {BIO 15158925 <GO>}

Okay. But still it (00:35:22) increase starting in 2020 when we implemented. But it includes the provisions, given that is expected last – loan to (00:35:26) consumer which has longer duration, it will increase the amount of provision we have to make on a recurrent basis (00:35:36). Or should we expect more of return (00:35:39) in 2019.

A - Octávio de Lazari

We don't basically in terms of the balance, as I said, you with interest 0.5 (00:35:52), in terms of the flow, I think we have right to (00:35:57) do the provisions on our appropriate levels for the flow of new provisions.

Q - Carlos G Macedo {BIO 15158925 <GO>}

Okay, thank you so much.

Operator

Our next question is coming from Mr. Mario Pierry of Bank of America. Please, Mr. Mario (00:36:14), you may proceed.

Good morning, everybody. Congratulations on the results. Couple of questions as well. First on your loan growth guidance of 9% to 13%, can you give us a little bit more color on the breakdown of this growth, which products are you most excited about? Also, if you can share with us how does this compare for your expectations for industry growth, given the public sector bank in Brazil seem to be reducing the size of the balance sheet. So, I was wondering if you're embedding any market share gains here on loan growth.

The second question is related to fees, basically the midpoint of your guidance we're seeing fees growing roughly in line with inflation, even though you do have some room here to change your fee for the old HSBC Brazil clients. So I was wondering also if you can give us a little bit more color on this guidance and why it's only growing in line with inflation. Thank you.

Okay. This is Andrew (00:37:30) speaking. Basically, we do not provide any specific guidance for every line of our corporates price portfolio. But overall, what I can tell you is that regarding to our facilities (00:37:43) is that we shall see a very strong growth from individuals as well as SMEs. We can't see (00:37:52) corporate side, we are about to see a more competitive environment. We expect that the local debt capital markets to provide most of the funds, especially for the high, the high graded companies. And we shall be able to be first to provide solutions, and then to rewrite our portfolio and sell into the markets. That's how we plan to be competitive with this scenario (00:38:26).

Regarding the market share, we share your vision. We're going to state-owned banks. So we guess we still have room to get more market share here.

A - Octávio de Lazari

Also, one thing that is very important in all guided lines, internal guidelines is basically, we should keep a very high level of capital discipline. Our view in terms of credit is really have returns in the operations for that as Alexandre said we can refinance the sale (00:39:03) basically looking for maximization of return even considering that as a banker of companies in Brazil, it's always important to serve our clients.

Q - Operator

Okay. And that's clear and then the question on fees?

A - Carlos Wagner Firetti {BIO 2489005 <GO>}

Oh, sorry. In terms of fees, we – the main pressure we see comes from the payments side. You guys follow what's going on in terms of the competitive environment on the acquiring business and that is impacting our credit card fees. This represents roughly 8.5% of total fees. So this is the main impact also. As you guys know, there's the cap in the interchange for that. That was established last year and was started to be valid in October 2018. That's going to have a full year impact, the impact is not huge, but it contributes to eroding a little bit the overall growth for this line.

We have of course units. We believe this volume of business considering the strong year and stronger economy should help us in cash management, in terms of credit in many lines. But considering the environment, I think it's appropriate to be cautious, I think the 5% in the middle of the range for this guidance. It sounds to us appropriate for the moment.

Q - Operator

Okay. Okay. Thank you very much.

Our next question is coming from Mr. Marcelo Telles of Credit Suisse. Please, Mr. Marcelo you may proceed.

Q - Marcelo Telles {BIO 3560829 <GO>}

Hi. Hello, everyone, and congratulations again on the result and on the strong guidance for 2018. I have two questions. The first one, regarding your insurance performance, I mean you seem to be improving your insurance operation quarter-after-quarter. And we saw a further decline in your claims ratio. So, I'm wondering if you still see room for further improvements in your claims ratio down the road. I mean, could you think a bit more like, like a late cycle situation assuming that your provisions were – you'd still be operating with relatively high numbers? And what do you think that 70% that you had in the quarter, I know there's volatility on a quarterly basis, but what should be our bench – a year that we put as a benchmark for your loss ratio in your insurance operation?

And my second question is, and we've seen it's more – it's kind of a broader question. We've seen like these very significant changes in the management teams throughout different public sector companies, including of course, Caixa Econômica Federal, there has been a lot of talk about new or Caixa Econômica now becoming (00:42:54) their efficiency is becoming like a better bank going for – they are seeking to increase the product penetration with its client base. And I'm wondering if you think there is – this would pose a risk in your view for private sector banks and for you specifically and if there is any overlap between your client base and the client base Caixa Econômica Federal that sort of thing that you think could make the competitive environment tougher down the road. Thank you.

A - Carlos Wagner Firetti {BIO 2489005 <GO>}

Okay. Marcelo, let me start with your last question then I will make some comments on insurance and transfer to Vinicius. So basically regarding the changes in the public sector banks, I think, provided that they operated on rational way and don't provide subsidized loans. A competition is always good. I will think that doesn't pose a major risk, they're already large banks, they're becoming more efficient and basically operation rationally it's good. We don't see that's a problem. What was a problem was subsidized loans or subsidized capital in that somehow fostered a competition that in our view was not necessarily helped.

On the insurance (00:44:40), but I think there were a lot of measures already implemented. They are working in many different fronts, improving the operation in terms of (00:44:54), in terms of brokerage, they have done a lot in terms of health insurance and there's still more to go. But one thing that I'll highlight is, especially in health, we still didn't see growth. I think the economy just reached kind of an inflection point and employment started to stabilize that helped in terms of claims because we have – we don't have the new unemployment and unemployed people that actually have coverage in the health for some time and generate very high levels of claims. So probably we still have room for capturing growth actually in the health insurance segment. Vinicius?

A - Vinicius Tugumi

Just to add to what Firetti mentioned, indeed, I mean we still see room for growth. Actually employment has just stabilized and we are beginning to see room for increase in employment. And I think that should affect positively our health operation. Also it is a combination I mean what we've seen in terms of the decline in the loss ratio, the combination of measures that have been taken in the company for quite some time now and that are maturing and they are working basically on two fronts.

One side is a more competitive, more competitiveness in terms of products. I mean, we have been changing our focus and also are focusing on the regional aspects and creating new products that are more competitive. And also on the efficiency side as Firetti has already mentioned, we have several fronts in terms of negotiation with providers of moving from a traditional fee-for-service model to more value-based type of initiatives with our providers. So we still see room for further efficiency gains there.

So even though, of course, we – I mean, this is risk and volatile environment and we still believe that there are quite structural reasons to believe in this process.

In terms of Ágora (00:47:26) which has also seen a return to double-digit returns in terms of return on equity, we had been focused more and more in better portfolios, with better returns, and focusing on growing in terms of return on good portfolio. So, there is a clear focus on return on equity here. There is clear focus on growing those lines of products that came delivered the right return to the company.

Q - Marcelo Telles {BIO 3560829 <GO>}

Okay. Thanks a lot for answers. I have one extra question if I may. This one is related to margins and to NII. We saw in the quarter a very nice growth with better mix and the NII would – the credit NII didn't really grow in the quarter. Is it possible for you to share with us what are the segments that you saw some declining in credit spreads and pick up in 2019? Now what are the loan segments that you see more pressure on spreads?

A - Carlos Wagner Firetti {BIO 2489005 <GO>}

Okay. Basically we are still feeling a little bit the impact of the changes in the overdraft. And also we have been producing more loans in some lines with lower rates kind of especially (00:49:01) our own clients to take more loans with lower rates. One example also that has produced volumes and of very good quality with lower spreads. For instance, in the personal loans, we have changed the product, we used to treat it as a product for which we granted limit as a percentage of income. Now, we treat it as a product installment, while we can vent for (00:49:33) longer and you sell this product mostly to clients we know, our base of clients. That's driving this growth in personal loans. But the average spread we have generated on it is lower from the original portfolio before we started with this product. But anyway, these products offer very high return.

I think going forward, our expectation is that mix will help and will help to stabilize the average spread, overall spread of the portfolio, the overall margin of the portfolio. And the strong increase in volumes. We believe this will drive NII to the levels we presented in the guidance.

Q - Operator

It's very helpful. And thanks again and congratulations.

Our next question is coming from Mr. Jason Mollin of Scotiabank. Please Mr. Jason, you may proceed.

Q - Jason Mollin {BIO 1888181 <GO>}

Hey, Wagner Frietti. Thank you for the opportunity to ask questions. Some of mine (00:51:07). I wanted to ask first one on your outlook for cash use. You've heard about the proposals that can lead to some capital tax you have to deal with for that capacity as well. But perhaps we could also see some reduction in corporate tax rates and some changes in the tax in the dividends. What is Bradesco's base case scenario today, if you can provide some color?

And my second question is on possible M&A. I saw some impress headlines quoting (00:51:41) Bradesco is looking at possible acquisitions in those privatizations. What kinds – what kind of investments will be interesting for Bradesco? Are there specific companies and would Bradesco consider non-financial companies? Thanks.

A - Carlos Wagner Firetti {BIO 2489005 <GO>}

Okay, Jason. In terms of tax, we believe that considering the – its – the nominal tax rate of 40% that is expected right now. Our expected tax rate for 2019 should be around 30%. There is some debates on taxes, I think. And all of them, you have a lot of information about here on the press. We believe what has been discussed sounds positive making the system more rational, but we don't see in these proposals increasing tax rate. We see a rationalization. But practical purpose, for estimates, we have to focus on what we know, as I said, the nominal tax rate is right now at 40%, what should be the expected tax rate to 30%.

A - Operator

Thank you for your question. Regarding the M&A, we have presented a very strong balance sheet and is giving still a lot of opportunity to country. We do expect that as the economy grow, we shall increase our CUSIP (00:53:31) here and provide more and more services to our clients. Nevertheless, if we find out any specific opportunities that can enhance our platform to provide any thought of specific (00:53:50) that we are not in state-of-the-art. We are not presenting from it, but there is nothing where we're seeing right now.

Then on its component, we don't see anything large at the end of that marginal things that come from demand portfolios. We'll be looking, but nothing that's really looks sizable at this moment. I think the comments made by Octávio was more on general terms, we are free to look considering the rules applied after the acquisition of HSBC. So, in theory, we don't have those restrictions, but nothing in the article.

Q - Jason Mollin {BIO 1888181 <GO>}

Thank you very much.

Operator

Our next question is coming from (00:54:48), you may proceed.

Yeah. Hi, guys. I have just some question about payout ratio. Last year, the bank's debt ratio was around 40% versus 52% in 2017. And all of those payments were through IOC. So, my question is, what is the expected payout ratio that the banking, or what is the expected payout ratio for 2019? How much the bank can pay? And if it'll be – everything through IOC?

Okay, sir. Thanks. As you know, we have been paying mostly interest on capital over the last few years. And I think the base case scenario without any other discussion is we should continue paying interest on capital. I think that's the base case. I think we know we are, we have reached the level of capitalization that is very healthy. We've got already a little bit above the level of capital we have been saying we would be very comfortable with, that is 13.5%. But I think there's some – still some things on the horizon for which we still have to go – to go through the major reforms and the reforms that make the country long-term sustainable. We are getting into a new growth phase that should bring opportunity to expand the loan book. So, we are always, our board is always discussing that what we have on table is we should keep interest on capital for this year.

Okay, sir. Thank you.

Our next question is coming from Mr. Carlos Gomez of HSBC. Please Mr. Carlos, you may proceed.

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

Hello, everybody. Congratulations on the results, better for the group. I have a question regarding your representation of the information that you are not (00:57:21) that increases the contribution of insurance towards mathematical difference 38% of the total. So, officially (00:57:32) the logic for the reclassification, is it internally proven or is it something that creditors or auditors indicated to (00:57:43) better way to do it? Second, going forward, (00:57:47) insurance interest rate and that is positively or negatively related to that? Thank you very much.

A - Octávio de Lazari

Okay, Carlos, basically on your second question, the sales EBIT of one, two interest rates basically short term. As we have been saying, our results are positively impacted by lower rate. Basically that makes a cost of funding to re-price assets. So, lower rates short term, it has produced us positive impact.

So, I think that longer term considering that we would be earning lower interest rates on (00:58:53) assets, our working capital, then the impact of lower rates comparing to higher rates is negative. But shorter term, it depends to be positive. For sure, it depends on the positions of the treasury.

In terms of your first question, if I got this right, is about the reclassifications.

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

That's right, yes. (00:59:25). What is your rationale for the reclassification and who is the driver because you are looking at it basically or you should be additive or related (00:59:41) formation percentage in the information?

A - Octávio de Lazari

Yeah. I think the rationale is basically that kind of closer to the way we move to our numbers internally. Basically, we've had some managerial classifications that we have been carrying for some time, and we always resist to make the changes. But the current changes make the numbers to be more aligned to what we have been looking at to the evolution of our internal managerial numbers. This makes also the numbers easily – more easily compared with other peers. So, basically, this is the main reason for the reclassification.

On the insurance side, there is kind of in terms of size is the most important. Basically, we have a problem in the former classification is that the operational part of the insurance results was in one line, and the margin for insurance in the margin. So, that made especially insurance lines, the operating results volatile. Sometimes the trends were hard to explain, looking to align (01:01:13). Trust me, this new classification makes the understanding of the numbers better.

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

Okay, that's clear. Thank you.

Operator

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

A - Carlos Wagner Firetti {BIO 2489005 <GO>}

Thank you all for participating in our conference call, and we are very glad that we have such numbers and we will remain very positive for 2019. Have a nice day.

Operator

This concludes the Banco Bradesco's conference call for today. Thank you very much for your participation and have a good day.