Q2 2015 Earnings Call

Company Participants

- Carlos Wagner Firetti, Market Relations Department Director
- Luiz Carlos Angelotti, Managing Director & Head-Investor Relations

Other Participants

- Boris D. Molina, Analyst
- Eduardo Nishio, Analyst
- Mario Pierry, Analyst
- Philip J. Finch, Analyst
- Thiago Bovolenta Batista, Analyst
- Tito LaBarta, Analyst
- Victor A. Galliano, 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 Second Quarter 2015 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 a banner through which the presentation will be 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 will 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 circumstance 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 will turn the conference over to Mr. Carlos Firetti, Market Relations Department Director. Mr. Carlos, you may proceed.

Carlos Wagner Firetti {BIO 2489005 <GO>}

Okay. Good morning, everybody. Welcome to our conference for discussing our Q2 fiscal results. We have today with us Luiz Carlos Angelotti, Executive Managing Director and Investor Relations Officer of Banco Bradesco, and Roberto Chamberlain, Director of Bradesco Seguros.

I will turn now the presentation to Mr. Angelotti.

Luiz Carlos Angelotti {BIO 4820535 <GO>}

Good morning, everyone. It's our pleasure to stay with you now our – Bradesco's second quarter conference. We'll start in the slide two, with the highlights of the periods. Our adjusted net income in the first half reached at R$8.778 billion, increasing 20.6% when compared to the same period the year before, and R$4.5 billion in the quarter – in the second quarter.

Our ROE reached at 21.9%. Our NII earnings portions increased 17.8% in this quarter – in this half, in first half. Our efficiency ratio reached at 37.9%. It's the best level ever in our organization.

And our operating coverage ratio reached at 78.7%. This index represents how our fees – how much our fees covered our fixed costs – our operational costs.

Our fees and commissions increased 11.8% in this first half, just by the cards evolution and our client segmentation improvements that we are implementing in this segment now starts to have the benefit. And within that in the digital channel certainly has helped us to improve the number of products per client.

Our bank operating expenses grew 6.1%, below the inflation; I would be say, in the periods. Our total assets reached at the R$1.030 trillion and our expanded loan portfolio reached at the R$463 billion. And our net income from the insurance business that is around 1/3 of our profit and at the risk diversification that we have in our portfolio, this is net income in this first half reached at R$2.566 billion. And the total insurance in written premiums grew 19.4% above the year ago.

And now, Carlos Firetti continues with the details on our presentation.

Carlos Wagner Firetti {BIO 2489005 <GO>}

Okay. Going on the slide three, we have the adjustments in our net income. Basically, we had a thin quarter with no major adjustments. Our adjusted net income in the quarter grew 18.4% year-on-year, reaching an ROE in the quarter of 22.7%. In the first half, our net income grew 20.6% year-on-year, with ROE reaching 21.9%.

In slide four, the adjusted net income growth, focusing specifically on the Q-on-Q variation, earnings grew 5.4%. In terms of the major drivers, we still had a good performance in terms of NII from interest, benefited by our strat and also strats in the funding side, where we have been able to get improvements.

Banking fees benefiting from our segmentation and good performance in the cards segment, where we also had impact of the consolidation of Cateno to Cielo, and good performance in insurance, and lower net operating expenses, since we didn't have the same level of provisions as in the first Q.

This was partially compensated by lower non-interest NII and higher operating expenses Q-on-Q, despite we are still having a very good performance in terms of expenses.

Going to the slide five; our net income breakdown that shows our diversification in terms of sources of income. Our insurance business represents 29% of our total earnings, while banking operations 71%. On that credit intermediation, 34%; fees, 28%; and securities and others, 9%. Interesting to note that the non-credit-related activities represent 66% of our net income.

Going to slide six, our efficiency and operating coverage ratios, we reached this quarter, again, our best efficiency ratio ever, with 37.9%, with strong control of expenses, the maturity of our investments in technology positively impacting our efficiency; and also, good performance in terms of revenue. Our operating coverage ratio that is reached at 78.7%, also our best level ever.

In slide seven, we show some numbers related to our NII. Basically, our total NII grew 12.2% year-on-year, while our NII from interest grew 13.9%. These numbers are above our guidance for this line, which we have revised, as we will show at the end of this presentation. Our NIM increased in the 12 months, accumulated 10 bps Q-on-Q.

NII from the interest, basically we had in the first half compared to the first half 2014, an increase of 17.8%. Credit intermediation grew 11.7%, as I said, benefited by good performance in terms of funding and also expressed on the corporate loans.

In terms of insurance, we have a year-on-year growth of 31.3%, benefited by the tax in the first half of the IPCA inflation, but also benefited by the strong performance in terms of premiums that increase our reserves, and also a good performance in securities and others growing 58.9% in the comparison of the first half; that benefits from our liability management and the investment of our equities.

In slide nine, basically our net credit intermediation margin, basically, the gross margin grew 10 bps, and after provision also 10 bps Q-on-Q. The total margin from credit grew 10.2% year-on-year in the second Q, and net of provisions 8.8%.

In slide 10, our BIS ratio, basically, considering the schedule of implementation of BIS in Brazil, our common equity ratio increased from 12.1% to 12.8%. That is due basically to the reduction in our risk-weighted assets by the relatively slow growth in terms of credit, and also reduction in the market risk component. The index was also benefited by our accumulated profits in the quarter.

In terms of our fully-loaded BIS ratio, we have 12.6%, which we consider very comfortable for the moment. And, as we have been saying, this number should be growing over the coming years as frankly we should be accumulated more capital than the necessary for the pace of growth of our loan book.

In slide 11, the evolution of our total assets and shareholders' equity. Our total assets grew 10.6% year-on-year with our return on assets at 1.7%. Our shareholders' equity grew 13.2% year-on-year, with our ROE reaching 21.9%.

In slide 12, we have an analysis of our expanded loan portfolio. Basically, we grew our total loans 6.5% year-on-year, without the impact of the fact that appeared for the year it would be 3.3%. In terms of drivers for growth in the year-on-year comparison, we have the corporate portfolio, with an increase of 10.7%, benefited by the impact of FX.

We have been growing less in our SME portfolio as in the previous quarters, considering the economic moment we are facing. And in the individuals portfolio, we continue to have as the main drivers for growth, the payroll loan portfolio, with an increase of 17.2% year-on-year, and the real estate financing portfolio increasing 26.4% year-on-year.

In slide 13, we have a slide with our delinquency ratio numbers. The 90 days delinquency increased 14 bps in the quarter with individuals increasing 13 bps, SMEs 15 bps, and corporates 23 bps.

We have this quarter the impact of some specific cases in the corporate portfolio impacting this NPL for corporate. Clearly, these numbers are slightly worse than we expected, but we believe our portfolio is very sound, and we don't expect any major trend of increasing NPLs in the coming quarters.

Our 15 days to 90 days delinquency ratio didn't return to the levels we expected, since we have been saying we believe it was mostly seasonal. We still have some growth in these ratios this quarter. But we have seen some improvements in shorter-term delinquency, and we expect we could still see improvements going forward. Let's see how that behaves going forward.

In slide 14, we have our provisioning and coverage ratios. We still have a very comfortable level of NPLs coverage, with 90 days coverage reaching 180.4%, and 60 days NPLs coverage reaching 146.5%. We are always very consistent in terms of our provisioning, and you don't expect this to change. We will continue with our provisioning policy going forward.

In terms of effective coverage ratio, it reached 223.3%, very comfortable level. This coverage ratio is basically how provisions cover effective losses. We like to focus on this index, and it shows also the consistency of our provisioning.

In slide 15, we have our fees and commissions income. Basically, in the first half comparison, we had an increase of 11.8%, going to the top of our guidance, as we have promised we had said in the first Q, we expected. This good performance is driven by a good performance in cards. That was partially benefited by the consolidation of Cateno in Cielo that we capture in our fees for our cards, but also, I can tell you that the performance in the cards segment is by itself doing very well in all lines.

Checking accounts, we benefit from the segmentation we have been implementing. We mentioned we expected this line to show improvement throughout the year, and it started to show it in the second Q. The year-on-year growth in checking account fees is 18.8%.

As we said, we have created new classes of services for our clients, (18:10). We have been incorporating them in this class of services, and this results in the new level of service, and the fees on that. Also, the fees highlight for the consortium management; that is an operation that is showing very sound growth, 20.8% year-on-year.

In slide 16, our operating expenses, we keep our focus in controlling expenses. Our investments in technology are maturing and benefiting our efficiency. Our total expenses year-on-year in the first half grew 6.1%. Personnel grew 5%; administrative expense, 7.1%.

We believe it's better to focus on the half year comparisons, as we can have some variations, comparing quarter-to-quarter. But we have, at this moment, a lot of confidence in the control of expenses. This is something the banks is totally focused, and we have confidence in this guidance between 5% and 7%, which should fit close to the middle of it for the year, as we expected.

In terms of insurance premiums, pension contributions and capitalization bonds in slide 17, basically, our total premiums grew 19.4% year-on-year, driven by a very strong performance in the first half, of life and pension plans contributions which grew 26.1%, and health insurance growing 21.5%. The ROE in the second Q in the insurance business expanded to 26.7%, and in the first half we had an ROE of 25.8%.

In slide 17 (sic) [18] (20:30), we have our combined ratios and other indexes for the insurance business. Basically, our combined ratio showed a slight improvement, going to 86.5% compared to 86.8% in the first Q. And you can see our technical reserves continued to grow for all segments and as well as our financial assets, which are the base of our future results.

Now, I turn the presentation to Luiz Angelotti, which will comment on the guidance and conclusions.

Luiz Carlos Angelotti {BIO 4820535 <GO>}

In slide 19, we have the guidance for the full year of 2015. This quarter, we decide to move to change our guidance for the NIIs. We move from 6% to 10% for the new guidance is 10% to 14% growth, is our expectation.

This movement, we did because the benefits that we had from the cost – the funding cost reduction that we've had this year in expectation as we have for the next half. The expense increased, but we have, at the moment, the contribution for the future, and the results of our asset liability management that we have in our total portfolio.

For the other guidance that we have, the loan portfolio growth, our expectations in the guidance is 5% to 9%. Probably we will finish the year remaining a bit more in the lower level of the guidance.

For fees and commission, with the benefits of the segmentation that we start now, improves this year through each segments and this quarter, you can see the benefits that we start to receive.

And probably this benefit will continue during the year, and the growth that we have, the contribution from cards and the investments in digital channels that we expect to finish the year in the multiples of the top of the level of the guidance, multiples of 12% is for the remainder of the year.

Operating expense, despite the higher level of inflation that we grow that probably we'll finish the year around 9%; we decide to maintain our guidance between 5% to 7%. Probably we will finish more in around the center of the guidance.

And for insurance premiums, we have a new sales structure in the insurance, with more efficiency, and probably we will finish the year close up to the top of the guidance, closer 15% growth in premiums.

Closing the presentation, we actually had a good performance, even with the challenging scenario that we faced. We managed to reach very solid ratios, such as the efficiency ratio, which reached at the best level ever in our organization, and the ROE that finished the quarter with 21.9%.

Our main structure (24:15) posted double digit growth, and our costs are running below the inflation. Our performances reflect (24:24), which provides for consistent and sustainable results, aiming at maximizing shareholder value.

Thank you for your timing, and we would now be glad to take your questions in the next part of our presentation.

Q&A

Operator

Ladies and gentlemen, we will now initiate the question-and-answer session. And our first question is coming from Thiago Batista of Itaú BBA. Mr. Thiago, you may proceed.

Q - Thiago Bovolenta Batista {BIO 15398695 <GO>}

Yes, hi, guys and thanks for the (25:16). I have two questions; one, about asset quality; and another one about Cateno and Cielo. The first one on asset quality; (25:25) comfortable with the evolution of asset quality going forward. But recently, we are receiving many questions from analysts comparing the spike in provisions we saw in 2008, 2009, when the cost of loans achieved something close to 6%, to the new cycle where the provisions is still around 4% of your loan book.

In your opinion, what changed in your book and across the variable that will prevent really, a big increase in the provisions going forward, as we saw in the last crisis?

The second one, I think a much easier question, is about Cateno and Cielo. In our calculation, how much of the increasing in your share in Cielo and also the consolidation of Cateno, has impacted in your fees and also your expenses? So, how much of the expenses you posted in the fees and also in the expenses came from Cielo and Cateno?

A - Luiz Carlos Angelotti {BIO 4820535 <GO>}

Thiago, first part of your question; basically, I think we shouldn't really compare the cycles. 2008, 2009, it was a totally different moment. Basically, we had a sudden stop in terms of credit growth in 2008 and 2009, and we were growing very strongly. The system was growing very strongly at that moment.

And this time, we have been growing more moderately over the last few years. Also, when you compare the portfolios, we had a major change in mix in terms of the types of loans that have migrated to lower-risk. Also, we have had improvements in terms of credit scoring and our systems, incorporating actually how the evolution in the perception of credit in Brazil, and also having systemic improvements. And also, there are major improvements in size of each line.

Actually, when you look our loans today, it's better than it was in the past. When you look each line, you can see a sounder portfolio. So, in our view, as we had said in the presentation, credit card came a little bit worse than we expected. We have been slightly more positive. There were some specific cases in the corporate portfolio.

The seasonality expected to be the fact of increasing the short-term NPLs, didn't materialize as we expected; but, as I said, we are seeing improvements in the short-term credit card ratios, that maybe we'll revert that in the future.

So, with this scenario, it's a portfolio that is different from past cycles, that has been formed in a much more cautious way, and with more moderate growth, that gives some comfort even considering the economic conditions that we see as very tough.

One important thing, I think, with this quarter about the asset quality, is that our NPL duration for 90 days that we were over 90 days increased; but when we look for other 60 days, (29:17) so the thing is that with the short-term this ratio starts to decrease, then we believe that the effect of the seasonality that we had in the first quarter continues a little more during the second quarter.

But now, that shows that the new decreases, the shortened BIS ratio because of the NPL duration for 60 days will start to decrease.

And then about Cateno and Cielo, this quarter, the current number that the effect of Cateno (29:55) because the net increase that we have – that came in the first quarter and the second quarter, is around R$120 million. The majority of this increase came from the Cateno. Cateno services increased the participation that we improved during the quarter. It has very small effect, when you talk about these revenues.

Q - Thiago Bovolenta Batista {BIO 15398695 <GO>}

Okay. Thank you. Thanks for the answer. Just one follow-up, in the (30:25) expenses, are you comfortable that expenses will be in the guidance (30:30) looking to confirm?

A - Luiz Carlos Angelotti {BIO 4820535 <GO>}

Our expectation with soft guidance that we have in the P&L with these extensive provisions.

Q - Thiago Bovolenta Batista {BIO 15398695 <GO>}

No, I'm talking about operating expenses.

A - Luiz Carlos Angelotti {BIO 4820535 <GO>}

Operating expenses. We are comfortable with the guidance of 5% to 7%, we probably will finish the year closer to the center of the guidance.

Q - Thiago Bovolenta Batista {BIO 15398695 <GO>}

Okay.

A - Luiz Carlos Angelotti {BIO 4820535 <GO>}

(30:55) this quarter, we have some increase in some expenses. As more (31:01) we are doing investment in our branches, and the maintenance costs increased but the (31:10) costs we are considering in the – our expectations for the full year, then we probably will finish the year, with this guidance that we have, more closer to the center of the guidance.

Q - Thiago Bovolenta Batista {BIO 15398695 <GO>}

Okay. Perfect. Thank you very much for the answers, Angelotti (31:27).

Operator

Our next question is coming from Mario Pierry of Bank of America. Mr. Mario, you may proceed.

Q - Mario Pierry {BIO 1505554 <GO>}

Good morning, everybody, and congratulations on solid results. Let me ask you two questions; first one is related to your outlook for the economy. I was looking at your slide from the first quarter presentation. Your GDP forecasts have declined quite a bit, you were originally expecting GDP to expand 0.5% this year, now you have a contraction of 2.1%.

However, at the same time, you have maintained your asset quality guidance for modest deterioration. So, what I was trying to understand here is, why isn't the economy having a bigger impact on your asset quality? And how long can this last? I think, right, this has been the biggest surprise for the market, is how well you have managed your deterioration in asset quality.

So, just wanted to understand behind the disconnect between weak economy and asset quality trends for the bank. And then I'll ask the second question as well. Thank you.

A - Luiz Carlos Angelotti {BIO 4820535 <GO>}

Mario, basically, as you know, we basically increased our soft guidance on provision expenses. We were even more confident in terms of credit cards. What we had been saying in the past is given the quality of our origination and the performance of our portfolios, if everything was okay, actually NPLs should be trending down. All comes from the change in mix, and the change in quality deep inside of each credit line. So, I think that's what probably the market is missing.

We have a quite change – a big change in the profile of the portfolio. If we were actually in a better environment, probably our ratios would be better. And actually, this worsening comes out of the (33:49). We are kind of – we know our portfolio and we are seeing the trends. As we admitted, the NPLs came a little bit worse than expected, but we see some indications that we're not going to see NPLs moving up so strongly for the rest of the year.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. Let me rephrase then. When I look at page 13, the delinquency for large corporates, it has more than doubled, right, since the beginning of 2014. It went from 0.4% to about 1% now. When I look at the delinquency for individuals, it has pretty much stayed stable. It's up about 30 basis points in the same period.

Part of this, I do understand. It reflects a change in the mix of your portfolio. But eventually it seems like unemployment figures are going up. How concerned are you that we could see significant deterioration in the individual portfolio specifically?

A - Luiz Carlos Angelotti {BIO 4820535 <GO>}

There are some lines in the individuals portfolio that are more directed, are more sensitive to the economy; the lines that are more clean. And we may have some impact there. But that's the reason we are saying that actually credit quality is coming slightly worse than our expectations.

In the corporate portfolio, actually we had a few cases in 2014 that led the NPL corporates to this level, that are actually higher than the average NPL in this portfolio. We also had a few cases this quarter that led to this increase. But overall, this portfolio is totally mapped out. We have basically this knowledge of the groups, and we believe we are in a position that is relatively comfortable, considering the environment.

We need to consider now that in the individuals portfolio we have the effect of the mix then for the future, the product that we are increasing the participation in the portfolio the loan and the mortgages. (36:31) we have another product that they have – they have more – they are more sensitive for the environment, the economy.

We have another set that actually some other thoughts we haven't (36:48) we have the stability between these (36:57) full year.

And about this corporate portfolio, to that project, we have a very high knowledge of our guys, having distinct relation that as our expectations for the future, analyzing our total portfolio, we understand that (37:17) close the year with a reasonable stability in the total delinquency ratio probably could grow a little more – 0.1% more. But this is what we expected, analyzing the total portfolio.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. Now, that's very clear. My second question, then, is related also to your ability to continue to grow your operating expenses below inflation. I do understand, right, you're seeing the benefits of all the investments you have made in technology over the last few years; but also, we've seen a head count reduction. I think your head count is down roughly 5% in the last 12 months. Is this something we should expect more going forward?

Also, we know that you have the salary negotiations with the union starting now. If you can give us some type of expectations, what is being demanded by the union, and how do you see, then, your ability to continue to grow your inflation? Thank you.

A - Luiz Carlos Angelotti {BIO 4820535 <GO>}

Okay. When we talk about all this guidance, you will consider for the future all of near effect, including the negotiation with the union, considering the new level of the inflation and the – we are now – have many benefits of the investment that we did in technology.

With IT utilization, this is something that is helping us induce movements through some of (38:59) and the demonstration. But another thing is about the (39:06) huge immigration for digital channels in the operations. Now they 92% of the total transaction, transactions in number, by doing through this digital channel, then have the costs in these channels compared with the branches (39:29 – 39:35) most important channel.

(39:38), we are improving the volume of transactions with last quarters, then this helping us with expenses. And we have internally a market niche active with our efficiency committee, that we see what the our areas in the banks, then we are doing and actually, that we – how much we are going to move next in quarter, more things contributed to (40:08) we'll probably have to continue the present cost. Probably in the next two years, we'll continue having new benefits for the new systems that will be implemented in our movements in the IT utilization.

We changed our Q2 2014, 6% of the systems, and now, in 2015, 2016 and during 2017 probably we will finalize the implementation of another 50% of the total system generated. We expect could continue collecting benefits of these implementations, because we are changing internally process that will help us to reduce costs.

We are improving the quality of the information, I think. We are improving the quality of the service, because many of these systems are advance to offer better service in our branches, it's helping our managers in the branches constantly to do efforts in sales, and not only in the cost.

This movement is helping us in this efficient in the costs, and it helps us sometimes in the sales, improving sales. This is why we are, when they connect continuously business probably continue growing expense, operational expense under the inflation for the next years.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. Now, that's very clear. Thank you very much, and congratulations again on the results.

Operator

Our next question is coming from Philip Finch from UBS. Mr. Philip, you may proceed.

Q - Philip J. Finch {BIO 3252809 <GO>}

Thank you, Mr. Angelotti; thank you, Carlos, for the presentation. So, I also have two questions, please. The first is, in regard to slide seven of your presentation, we saw margins improve, I think, 50 basis points over the last 12 months to 7.4%, which is a great achievement. Given that the SELIC has continued to rise over this period, and we have loan re-pricing ongoing, how much higher do you think this could go, say, in one year's time? Could we see another 50 basis points improvement in margins over the next 12 months?

And my second question is regarding taxes. So, back in May, we saw the social contribution rise by five percentage points to 20%. What is your analysis on the implications this will have, going forward, on your profitability? Thank you.

A - Luiz Carlos Angelotti {BIO 4820535 <GO>}

Okay, Philip. Our expectations for the – probably we finish this quarter with 7.4%. Probably until the end of the year, we'll continue increasing a little more, probably with the benefits of the contribution in the growth, the better spreads in the (43:32) probably we'll finish the year closer to 7.5% and 7.6%, is probably what we expect, considering that this new guidance that we gave.

And about the social contribution of the increase in the ratio, we need to wait for the approval of the law. It probably will happen until the finish of the third quarter. Then, according to the new law, you see we have the new ratio for (44:13) probably we will (44:19 – 44:24) if you really have the ratio and (44:28) without the time limit probably the effect register. We will do some accounting procedures internally; don't expect any relevant effect in the final results in our, probably with the future quarters.

Q - Philip J. Finch {BIO 3252809 <GO>}

Thank you very much. That's very helpful.

Operator

Our next question comes from Tito LaBarta of Deutsche Bank. Mr. Tito, you may proceed.

Q - Tito LaBarta {BIO 20837559 <GO>}

Hi. Good morning. Thanks for the call. A couple of questions also; first, on the asset quality, more on the provisioning side, you mentioned, if I remember correctly, in the first quarter, that provisions could possibly grow around 8% to 12% for the year. And given that the asset quality was a little bit worse than expected this quarter, do you think that's still reasonable to assume? I guess that would imply provisioning levels remain around 4%, or maybe even a little bit lower.

But given that, asset quality is a little bit weaker, do you think maybe there's some risk to that provisioning levels being a bit higher this year? And if you could give some more color on that?

And then second question, just following up on net interest margins. I understand you expect it to increase a little bit more through the end of the year. But, for 2016, you do expect rates to come down. So, do you think maybe in 2016 you could see a trend where your margin contracts somewhat, as SELIC comes down? If you can maybe give some color on, kind of, the longer-term outlook for net interest margin as rates come down. Thank you.

A - Luiz Carlos Angelotti {BIO 4820535 <GO>}

Tito, first, in terms of credit provisions, basically we still think the top of our guidance, 12%, is a good reference. It could be around that level. But looking to the dynamics of provisioning, we don't think this level is not achievable.

Regarding your second questions, in terms of margins, remember that even if SELIC rate goes up – goes down next year, the average SELIC rate will be still relatively high. So, we still have the benefit on that. Also, we also talk about our fixed rate exposures that in our view should be something defending, a little bit, the performance of our margins in an environment of interest rates trending down. So, this is our the main views on this item.

Q - Tito LaBarta {BIO 20837559 <GO>}

Great. Thank you very much.

Operator

Our next question is coming from Boris of Santander. Mr. Boris, you may proceed.

Q - Boris D. Molina {BIO 1904979 <GO>}

Yes. Thank you so much. I just have a question regarding the evolution of spreads in the corporates segment. The Central Bank data is telling us that already delinquency for the system for corporates in the free market is reaching record levels, and continues to increase.

And, however, we've seen that the expansion in spreads for corporates in the free market has basically stalled over the last month.

So, what are the dynamics that we are seeing in spreads and the behavior in the system, and what could we expect (48:13) because, if we look at the level of spread that we saw in Brazil in the aftermath of the (48:21) after they bottomed out in late 2013, (48:28) 23% or less of the ground that they lost.

So, it appears to me that there is a significant room for corporate spreads to increase, given that the deterioration that we've seen, both in Bradesco's SME non-performing loans and corporate non-performing loans, is very close to the levels of peak that we saw in the aftermath of the (48:50).

So, it appears to me that there is something here that – a dynamic, maybe it's the public sector banks, or you don't see this system-wide deterioration in asset quality that is apparent, and it's pretty obvious in the Central Bank data for company loans, early delinquency in the free market. So, (49:12) in terms of spreads?

A - Luiz Carlos Angelotti {BIO 4820535 <GO>}

Okay. I think in terms of spreads, basically, you shouldn't compare with 2008 and 2009. That was kind of a totally different condition, where the spreads basically went up so strongly because demand for credit was quite high at that point, the liquidity basically dried out. So, we had a situation where demand was high and liquidity lower and the perception of risk in the system, remember the derivative crisis ever since. This time, we have an environment where there is some perception of risk, but the demand for credit has also reduced. So, this is kind of the environment now comparing to 2009. I think this kind of increase in 2009 was driven by, kind of, a special condition.

Q - Boris D. Molina {BIO 1904979 <GO>}

Okay, great. Thanks. My second question is related to efficiency in your insurance operations. And we were expecting the insurance results, at least net income, to improve, and in the second quarter we saw a jump in operating expenses. Initially expenses actually led to indication in your combined ratio.

So, what can you tell us about the evolution of efficiency and profitability in insurance? This year in particular seemed to be a very good year; and second quarter was also kind of strong.

A - Luiz Carlos Angelotti {BIO 4820535 <GO>}

In the insurance business, it will give you some best and somewhat strategic I think (51:14) we restructure our sales structure, then we have now less costs with the structure, and the other efficiencies in sales but then we could reduce our commercial costs. We decreased the costs with smaller structure.

We have in the insurance business, another – the semi structure that we have in the bank – the efficiency committee. They are committed with the cause of costs internally in the company. Then the benefits that we are having now, is because these investments that we are doing, could improving in the efficiency and in business of insurance.

Operator

Our next question is coming from Victor of Barclays. Mr. Victor, you may proceed.

Q - Victor A. Galliano {BIO 1517713 <GO>}

Thank you. Yes, just a quick follow-up. My main questions have been answered. But just looking at the renegotiated credit portfolio, we did see quite a big increase and it's run well ahead of loan growth, both year-on-year and quarter-on-quarter. I don't know if you could give us a little bit of color here in terms of what you're seeing there. Is this primarily driven by consumers and individuals renegotiating? Is the jump more driven by big corporates in the renegotiation space?

It would be good to get some color. Or is it a spread of SMEs, or is it all three? Just to get a better sense, really, of where that credit quality deterioration is coming from. Thank you.

A - Luiz Carlos Angelotti {BIO 4820535 <GO>}

About the renegotiation portfolio, normally the growth of this portfolio is very similar to the growth of the loan portfolio. Now, because of the environment of the economy does this year (53:24) more growth – a better growth in this portfolio compared with the loan portfolio. We understand that's very normal. This renegotiate portfolio – we do our renegotiations only when we understand that it is possible to recover something.

The early negotiation can have success in the future, and we won't think provisions for this portfolio that we did. The normal delinquency ratio – the provisions for this portfolio is running around the 60%, 62%. So that's a very normal growth, because of the environment that we have now. But it is not too much than our loan portfolio growth is having now – we are having now.

Q - Victor A. Galliano {BIO 1517713 <GO>}

So – sorry, if I could just follow-up there. Did you say that you would only do a renegotiation when you get some of the principal back of the original loan? Is that right?

A - Luiz Carlos Angelotti {BIO 4820535 <GO>}

Normally, no. Our renegotiation that we do normally, we try to recover the principal with the additional interest rates. (54:49) the situation – the debtor, then probably we try to use the best internal structure to have success in the renegotiation. But we only do renegotiation when we understand that's possible to recover something. And in our accounting policy, our operation that we do renegotiation, we maintain in the same rating, when we take the renegotiation.

If the corporation was overdue, (55:26 – 55:33) we maintain in this level until we recover – until the talk meet the credit. If we recover the operation that was run by cost, we maintain the pace until the total – company after the recover the debt then the credit. This is our accounting policy, and we are having, I understand some improvements in our policy that we could improve our revenues for the quarter. We have been more successful because we did the (56:16) and I think we have now more efficiency in our process of recovery of debt.

Q - Victor A. Galliano {BIO 1517713 <GO>}

Okay. Thanks for that color, Mr. Angelotti. Appreciate it.

A - Luiz Carlos Angelotti {BIO 4820535 <GO>}

Thank you.

Operator

Our next question is coming from Eduardo of Banco Plural. Mr. Eduardo, you may proceed.

Q - Eduardo Nishio {BIO 15333200 <GO>}

Good morning. Thank you for taking my question. I think just a follow-up. One, on delinquency, page 13 of your presentation; I just would like to know your outlook for the SME portfolio and the large corps.

If I remember correctly, previously you indicated that in second half of the year you would see improvement on the large corp book; and on the SME, if I remember correctly, you were looking for stability. But this quarter you had a 20 bps – almost 20 bps increase in that specific loan book. So, I was wondering if you could give us an update. Environment, I understand, has deteriorated faster than most expected. So, if you could give us an outlook on those specific loan books, I appreciate it. Thank you.

A - Luiz Carlos Angelotti {BIO 4820535 <GO>}

Okay. First of all, the segment – the expectations of the delinquency. Our expectations for the quarter's portfolio is more probably that we consider the level that we have now. Probably we will finish the year with more average of – could decrease into the end of the year, is our expectations.

When we talk about SMEs, okay, we had a decent, a little more pressure in corporate environment. Probably could increase a little more but we don't expect that we will have a huge increase in this segment. During the year, we had an increase around 0.3% on this segment.

Then probably we will finish the year with a little more increase, but not something that is probably in the total ratio of the portfolio. What we expect with the compensation between the large segments that we'll probably finish the year with a little more increase in this ratio, probably 0.1% more until the end of the year, is something that we expect reasonable stability until the end of the year in this ratio – the total delinquency ratio.

Q - Eduardo Nishio {BIO 15333200 <GO>}

All right. Thank you.

Operator

Excuse me, ladies and gentlemen, since there are no further questions, I'd like to invite Mr. Carlos for the closing remarks.

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

Okay. In the name of Bradesco's management, I want to thank you for participating in the call, and the Investor Relations department is available for any other doubts you may know. So, thank you, everybody.

Operator

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