Q2 2017 Earnings Call

Company Participants

- Alexandre da Silva Glüher, Investor Relations Officer & Executive Vice President
- Carlos Firetti, Market Relations Departmental Officer
- Octávio de Lazari, Deputy Officer

Other Participants

- Aníbal Valdés, Director
- Jason Mollin, Analyst
- Jorge Kuri, Analyst
- Jörg Friedemann, Analyst
- Philip J. Finch, Analyst
- Thiago Bovolenta Batista, Analyst
- Tito LaBarta, 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 2017 Earnings Results Conference Call. This call is being broadcasted simultaneously through the Internet in the website, banco.bradesco/ir. 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 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 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'll turn the conference over to Mr. Carlos Firetti, Market Relations Department Director.

Carlos Firetti {BIO 2489005 <GO>}

Good morning, everybody. Welcome to our conference call for discussing our second quarter 2017. We have today with us our CFO and Investor Relations Officer, Alexandre Glüher; the CEO of Bradesco Seguros and Executive Vice President for Banco Bradesco, Octavio de Lazari; and also our Executive Director responsible for accounting and budget, Luiz Carlos Angelotti.

Now for beginning the presentation, I turn the floor to Alexandre.

Alexandre da Silva Glüher

Thank you, Firetti. Good morning, everyone. Thanks for joining our conference call today. I'll walk you through the main highlights of our results, and later Firetti will discuss the numbers in more detail.

As you can see in page 2, we posted a net profit of BRL 4.7 billion, a growth of 1.2% quarter-on-quarter. Considering the first half of the year, the net profit was BRL 9.4 billion, an expansion of 13% year-on-year, with ROE reaching 18.2%. In our view, these results are consistent and align with our projections, despite the market scenario we are facing.

The positive trend in delinquency was maintained, keeping a favorable environment for quarter three. In addition, we continue to present a very good performance in cost control. A major challenge remains the weak loan demand, which pressures our NII. Our loan book reduced 7.2% in the last 12 months on a pro-forma basis, which includes the numbers from our acquisition.

Volumes contraction is the main cause for our modest performance in NII, which reduced 5.5% in the first half year-on-year. NII guidance was revised and now indicates a contraction of 3% in the midpoint. The good news is that we already see signs of growth in credit origination, for both individuals and companies. If the current levels of origination are maintained, the individual's portfolio will soon start to grow again, and the company's portfolio will stop shrinking.

As I mentioned, cost of risk continues to present a good performance, driven by the improvement in delinquency. In the first half, cost of risk reached BRL 9.8 billion, leading us to reduce our guidance, which now has a midpoint of BRL 19.5 billion. We understand that this positive trend will continue in the rest of this year and in 2018.

Fees grew 2.5% year-on-year, and operational expenses dropped by 2.7%, both on a pro-forma basis. The performance in fees is somewhat dependent on the market scenario, which is the main effect of our actions to capture revenue synergies.

In cost reduction, our initiatives have been very successful. We held in (05:11) the adjustments of our expenses and recently announced a Special Voluntary Severance Program. That will help its dividend. (05:18) We understand that this adjustment will be concluded by the end of 2018.

The optimization of our distribution network continues. This year, we had already reduced 246 branches, part of which converted into point of service. This optimization keeps in course. Regarding capital, this quarter, we had an event increasing our Tier I ratio up 50 basis points, with the fully loaded Tier I ratio reaching 12.5%.

In summary, I can say that we keep investing in technology and product development, credit quality is meaningfully improving. We are ahead of scaling cost synergies, and we will soon start to see the effects of revenue synergies. Additionally, we already see positive signs in loans origination. Finally, I would like to emphasize that in our view, we are consistently establishing ground for growing our business.

Now I'll turn the presentation to Firetti, who will present you the numbers in more detail.

Carlos Firetti {BIO 2489005 <GO>}

Thank you, Alexandre. So now we go to slide 3, where we show the adjustments in our net income. Only one important adjustment that's worth some explanation, the impact of the changes in accounting practice for Cielo, these changes led to a one-off impact in our numbers of BRL 210 million after tax. There's no major impact to our numbers on a recurring basis going forward.

On slide 4, we have our income statement. Only the highlight on net earnings that increased 1.2% in the quarter, 13% in the comparison of the semester for an ROE of 18%. I will go in more details on the other lines in the following slides.

In slide 5, also the evolution of our earnings per share and net income, only emphasizing here the participation of each segment in our net earnings, Insurance contributing with 28%, Credit Intermediation contributing with 33%.

Going to slide 6, we have our total NII. Our total NII dropped 0.8% in the quarter, with no interest revenues basically almost flat Q-on-Q, only a small negative variation. And we had BRL 414 million in impairments. Basically, we can say that impairments for 2017 could be somehow higher than in 2016.

I will go in more details in the interest NII in the following slide. So page 7, we have a breakdown of our interest NII. Basically, Credit Intermediation presented a reduction Q-on-Q of 2%, 7.5% pro-forma year-on-year. Basically, Credit Intermediation mostly suffered with weaker volumes. This is the main driver, actually, for the interest margin as a whole.

Also, there's the impact of the new rules for credit cards. We have a negative impact in this quarter. That probably is the biggest in the year, considering our expectations, we think the negative impact is within our expectations. We expect for 2017 a reduction in our NII of BRL 500 million pre-tax. It could be lower, considering what we are seeing, which we prefer kind of to wait, more definitive numbers or more quarters, but the trends look good.

The spreads overall are relatively stable. In insurance, we had important reduction in margin, basically a reduction of BRL 288 million, mostly due to lower inflation, lower EBITDA inflation. That impacts the bonds that the insurance group carries. Probably, this quarter presents the lowest number for margins in the year.

And finally, in the securities and others, basically, we have there already the impact of gains from our asset liability management. From the past, we have a fixed rate exposure in the balance sheet and also dividend (11:16) revenues.

In slide 8, we have more details on our credit intermediation margin. For the year, the credit margin was flat at 13.2%, reflecting the fact that stable – trends (11:41) are relatively stable. If you look only to the quarter, there was a small reduction and that's mostly explained by the negative impact of the new credit card rules. After cost of risk, the margin presents a positive evolution.

In slide 9, we show details of our loan book. The loan book on a pro forma basis year-on-year reduced 7.2%. For companies, a reduction of 10.9%. In individuals, already we've had a small of their business, 0.3%. Basically, the main highlights in terms of performance in the quarter was the payroll segment and mortgage, with the negative driver coming from SME loans.

In slide 10, we have the composition of our loan book, with individuals representing 34.9%; companies 46.4%; SMEs, 18.7%, with a reduction in SMEs, increase in individuals and in corporates.

In the individuals loan book, we have over the last two years, our portfolio migrating to lower risk. Today, mortgage and payroll loans represents 43%. Considering payroll loans, credit originated in our branch network represents 64.8%. These payroll loans are more profitable, we don't pay commissions and that, in our view, is a very, very good trend in our loan book.

In slide 11, we have data on our loan origination per business day. We think we have good news on that. Basically, we're seeing the origination for individuals and companies growing meaningfully on a Q-on-Q basis. And also looking – comparing to the third quarter last year, also in the case of individuals, fourth quarter, we didn't include the second quarter, because we only had data for Bradesco. We thought the comparison was not fair, but the number would be very strong if we included it here.

We believe with this number, the individuals portfolio will continue growing in the second half. And we are going to unstabilization of (14:52) the company's portfolio, probably going back to some growth in the fourth quarter.

In slide 12, we have delinquency ratio numbers, very good trends in all lines: individuals, SMEs and large companies. We think this positive trend will continue in the coming quarters. This quarter, we sold BRL 1.3 billion in bad loans that were already written off many years ago. There is no major impact in our results. The main benefit is that we can turn off some legacy systems, what actually help us to save some costs.

In slide 13, we have our 15-90-day delinquency ratio. We think there are good trends there, that in our view, supports the improvement in 90-day NPLs going forward.

In slide 14, we have our NPL creation and provisioning. Very good trends also for NPL creation. Provisions, also very consistent. In terms of provision for loan losses, this quarter, we have a small increase in provisions. We think that overall, the trend is that provisions will continue going down in the coming quarters, also continue throughout 2018. We think we may go back to the bottom of provisioning at some point in 2018.

In slide 15, we have the breakdown of our NPL creation, also very good trend for all segments. In the case of corporates, it was flattish this quarter, but very consistent improvement in the other categories.

In slide 16, we have our provisioning ratios. Highlighted here for the increase in our coverage ratio, for 90 days NPL, it reached 202.5%. We think this coverage ratio should remain high. We don't intend to use excess provisions to improve our provision expenses, which should expand throughout 2017 and very likely 2018, as they are right now.

In slide 17, we have the renegotiated portfolios. We had a small increase this quarter. This increase can be explained mostly by renegotiated loans that come through the recovery of loans, loans that were off-balance. Basically, if you look to loans that are still on our book, these renegotiations would be already going down.

In fees, we have a more soft performance. Growth pro forma of 2.1% Q-on-Q, 2.5% year-on-year, mostly impacted by the economic environment.

In slide 19, we think we have – it's very good news. We show our total expenses going down 2.5% year-on-year in the quarter, 2.7% year-on-year for the half year. Personnel expenses, it still grew 3.1%, mostly because of the salary adjustments of last year.

Administrative expense are going down 7.9% for the half year, year-on-year. We are doing the adjustment, a reduction this quarter of 1,500 employees. And we also have a 54 – a reduction of 54 branches in the quarter. Comparing to July 2016, when we merged with HSBC, we had 111,000 people, we are already at 105,000 people. As you guys know, we announced recently a voluntary severance program. We still don't have numbers to share for this program, but we believe it will have – it can be a relevant adjustment, kind of speeding up the adjustment in our staff.

In slide 20, we have our efficiency ratio, basically reached on a 12 months basis, 41.5%. We think we will soon start to show improvement in terms of efficiency, in line with the good performance of our costs.

In slide 21, we have the numbers for the Insurance Group. Basically, total premiums pro forma increased 7.5% for the half year, year-on-year, with technical provisions growing at 13.6%. And our net income for the half year growing 3.9%.

For comments on the operation of the insurance company, I will turn now the presentation to Octávio de Lazari, Bradesco Seguros, CEO.

Octávio de Lazari

Thank you, Firetti. Good morning, everyone. It's a pleasure to have this opportunity to talk to you about Bradesco Insurance. Firetti already went through our main numbers, so I am going to talk about the key topic of our operations before making some additional comments on our results.

The Brazilian insurance market faces one of its most challenging moments in decades, mainly due to the slowdown in the economic activity, very high unemployment and a contraction in consumption. These impacts to the private sector, but in special segments as health insurance. Despite this, our (22:21) has continued, presenting a very good performance, growing 12.6% in the first half 2017, mainly due to pension plans, which grew 16% year-on-year and life and personal accident insurance, which grew 23% in the period.

The main reasons for our good performance, even in this challenging moment we not only executed strategies, but also some other drivers that contribute, too. For instance, insurance penetration in Brazil is still low. What is evidenced by the fact that our market is (23:06) with strong potential long-term growth.

In the pension plans segment, our growth was positively influenced by the recent legislations by the Brazilian social security reform, which made Brazilians more aware about this subject. In our view, the pension plan segment should present strong sustainable growth for many, many years.

Additionally, we recently implemented a change in the way we sell pension policy today. Instead of using brokers, as we traditionally used to do, the distribution is now done by our own account officers in the branches, which allow us to make a more complete analysis of customers' investment needs, increasing the efficiency of the sales process and also the satisfaction of our customers.

We started to prepare for the change about two years, three years ago, when we decided to (24:18) our sales strategy, change its focus from products to customers and also to convert the brokers that worked with us from product express to much products (24:32).

In the health plan segment, we faced especially challenging moments, the lower economic activity and high unemployment results in a reduction in the amount of customers and are increasing of (24:51) which leads to higher costs with claims. Additionally, we have a pressure for high medical inflation.

Despite this scenario, we are in a solid position in the market. And we clearly have one of the best products in the market today. In a recent study made by IESS, an institute which focuses on the development of healthcare plans. Health insurance held in the third position after (25:27) in Brazil with customers satisfactions reaching 95%.

We believe (25:35) growth in this segment, as we see the claims ratios improving, as the employment goes down and our process efficiency (25:46). Even with this adverse scenario, the net profit in the Insurance Group grew 5% in the first half of the year when compared to previous year, with an ROE of 19.1%. The drop in ROE this year is mainly due to the increase of 22.3% in the last 12 months due to high level retained earnings.

Our net profit was impacted in the first half by the gross inflation, which affects our NII since we've used inflation-linked bonds in our asset liability management. This effect was partially compensated by an increase of more than 23% in our operational results. It is important to highlight that the negative impact from lower bonds yields due to lower inflation should be smaller in the next quarters.

In summary, we will continue growing our business since our market still offers great potential expansions. Our focus remains on product development and enhancing our distribution capacity, and most importantly, offering better service to our customers.

The Insurance Group delivers recurring and cost-effective results, which are a key for Banco Bradesco's strategy and we understand that we will keep contributing to this. Thank you for your attention, and we are available for any questions. And now I will give the floor back to Mr. Firetti.

Carlos Firetti {BIO 2489005 <GO>}

Thank you, Octávio. So let's go to the last two slides of our presentation. In slide 22, we have our BIS ratio indicators. Basically, the current BIS Tier 1, 12.5% Common equity ratio, 11.6%.

Considering a fully loaded basis, Tier 1 is 12.8%, while common equity, 11.9%. Important to highlight that we should continue growing our capital base in the coming quarters through organic capital accumulation, and we feel we are in a very comfortable position, and as I said, still accumulating capital.

And finally, in page 23, we have our guidance. We revised our guidance this quarter. We revised in most lines, except insurance premiums, focusing in the pro forma, basically a reduction in the extended loan book from 1% to 5% positive to minus 1% to minus 5%.

The other lines, also we changed the guidance. We believe that guidance is realistic. It reflects what happened in the first quarter. Probably, in all lines we target the midpoint of the guidance, with some chance that in the provision expenses line, we could be in the mid, low portion of the guidance.

So now with that, we conclude our presentation, and we are available for questions.

Q&A

Operator

Thank you. Ladies and gentlemen, we will now initiate the questions-and-answer section. Our first question comes from Philip Finch of UBS. Your may proceed.

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

Good morning, Alexandre and Carlos. Thank you for the presentation. A couple of questions from me, please. First one, can you elaborate more on what is happening in terms of loan originations? This seems to be picking up for individuals, as you highlighted. But are we seeing any early signs of it spreading to other lending products?

And secondly, on slide 14 in your presentation, you showed the allowance for loan losses as a percentage of loans, which troughs at 3.5% in Q1 2014. Looking forward, do you think we could potentially fall back to these levels? And if so, what sort of timeframe are we talking about here? Thank you.

A - Carlos Firetti {BIO 2489005 <GO>}

Thank you, Philip. Basically, loan originations, we see in – with individuals, improvements in different lines. I would highlight improvements in payroll loans, mortgage, that were already growing and continue to do very well. Also, we are seeing some improvement in the origination in car loans. Our loan book has been growing now for a few years now, and we believe it's high – it's now adjusted for the current origination and is still growing. But I would say in most lines, we have some positive indication.

As I said, (31:57) origination, probably, we should be growing in the second half, probably expanding the growth we are already showing in the first half. That is still very small.

For companies, basically, it's also kind of widespread. The main product is working capital for companies. The increase in new origination is enough probably to stabilize the portfolio that has been going down for many quarters. And if we grow a little bit more, maybe we can show a positive growth Q-on-Q in the last quarter that is also seasonally stronger.

In terms of provision expenses, as I said, we believe we are in a positive trend, as indicated by our guidance. We think the provisions can continue reducing on a quarterly basis going forward. We think that we can go back to levels closer to this bottom in provisions I showed in the chart on page 14. Probably, that could happen at the second half 2018.

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

Perfect. That's very clear. Thanks, Carlos.

Operator

Our next question comes from Jorge Kuri of Morgan Stanley. You may proceed.

Q - Jorge Kuri {BIO 3937764 <GO>}

Hi. Good morning, everyone. I wanted to ask you about net interest margins. We've seen very big contraction in margins in the first and second quarter, average interest rates are going to fall more in the second half of the year, given the direction of rates so far. What's your expectation for margin contraction the rest of the year?

A - Carlos Firetti {BIO 2489005 <GO>}

Jorge, basically, the NII, when we look this first half year, if there is a single thing that answers for most of the reduction in NII, its credit volumes, basically. Its spreads are relatively flattish considering the growth size. You have some mix effect, but I would say this is the main impact. We also had in the second quarter, the negative impact of the new credit card rules. Basically, as we said, we expect BRL 500 million for the full year. The worst quarter is the second quarter, the numbers kind of goes down for this following quarter.

There was a very weak margin for the Insurance company because the EBITDA inflation was only 0.22% compared to 0.96% in the first quarter. Probably it's going to – considering expectations from economist, this inflation goes down in the second half, and this impacts our inflation (35:47). Putting all together and there is also the positive impact of the asset liability management, the fact we are, in the short term, liability sensitive. So as interest rates go down, we're seeing a positive impact from the fixed rate gap in the second half.

So that said, margins should be relatively flattish for the remaining – or maybe increasing a little bit at the end of the year, but flattish from a small increase for the rest of the year. But looking forward, for sure, given that next year the impact of lower interest rates will affect more. And probably, net interest margin remains under pressure. What has to be compensated by volumes, we think we can grow a little bit more next year, hard to say how much right now. So, that's more or less our view on this.

Q - Jorge Kuri {BIO 3937764 <GO>}

Thanks, Firetti.

Operator

Our next question comes from Tito LaBarta of Deutsche Bank. You may proceed.

Q - Tito LaBarta {BIO 20837559 <GO>}

Hi, good morning. Thanks for the call. My question is on loan growth. I just want to understand a little bit more, I understand, you expect to maybe pick up growth, specifically on corporate side by the end of the year and consumer is already growing. So why haven't you get more aggressive, or be more positive in terms of this loan growth?

I understand the macros will be difficult, but already showing signs of improvement. You're seeing asset quality improve, spreads are still high. What do you need to see to get more comfortable in terms of loan growth? Is it just really the macro and the political environment or is there anything else that you're looking, because you are seeing some good trends in terms of asset quality and margins, as I mentioned?

So I just want to get a better sense of when you can get more aggressive and do you see competition still being limited but (38:14) seems to be growing (38:17) thoughts a little bit more on loan growth (38:20)? Thank you.

A - Carlos Firetti {BIO 2489005 <GO>}

Okay, great Tito. Thank you for the question. Your line was not very good, but I think I got most of the question. If I forget something, please complete your question. Basically, we believe that in terms of loan growth, we depend more on the improvement in demand than actually seeing, becoming more confident and kind of relaxing credit quality to originate more. We think demand was overall weak, and we think the improvement in the origination is mostly due to improvement in demand.

For sure, the origination has been lower for some quarters. Our portfolio reduced. And now with this pickup in demand and origination, this makes easy to start to grow a little bit more. So basically, we think it depends on more demand; on companies more confident investing, producing; individuals really demanding more loans.

Q - Tito LaBarta {BIO 20837559 <GO>}

Okay, that's helpful. And then maybe another question somewhat related to that. In your capital ratio, you mentioned you have capital has been – (39:59) you have been generating capital for several quarters now, and given loan growth where it stays likely to continue to (40:08) generate capital. So that demand doesn't come back, what do you think about your capital levels or where will you be maybe in a year? I mean, maybe you're kind of comfortable today, but as you generate more capital, you could eventually have excess capital. What's the right level of capital that you think about? And if you don't have (40:28) the loan demand, what would you do with some of the potential capital that you've been generating?

A - Carlos Firetti {BIO 2489005 <GO>}

Basically, in terms of minimum capital plan, in our governance, the governance, we have a minimum target of a supplement of 25% on top of the requirement. Basically, considering our current fully loaded BIS of 12.8%, we are there, so we are already covering our minimum requirement. We – as I said, we should continue accumulating capital organically in (41:15) relation, even with some risk-weighted starting to grow a little bit more. We always (41:22) accumulate something like 100 bps in capital in 12 months.

So basically, we should continue adding capital. We don't intend to take any actions to proactively deploy capital until to the end of 2018 or 2019, considering there is a good implementation of BIS. After that, we do believe the environment for loan growth and the economy will be better, probably, we'll have more opportunity. If not, at that time, probably, we will analyze the scenario, and if necessary, take other sides (42:08).

Q - Tito LaBarta {BIO 20837559 <GO>}

Okay. Thank you. That's helpful. Thank you.

Operator

Our next question comes from Jörg Friedemann of Citibank. You may proceed.

Q - Jörg Friedemann

Thank you very much. Good morning, everyone. So I have two questions, please. I know – and the first one, I know you do not have numbers to share on the voluntary dismissal program. But could you at least inform us how many employees are eligible towards this year for this program? And to stay on the efficient side, could you elaborate a bit more on the recent closure of branches. Were those already related to HSBC branches? And could you have, I know, more potential to close – to shut down branches throughout the year? And so I'll come back to another point. Thank you very much.

A - Carlos Firetti {BIO 2489005 <GO>}

Regarding the voluntary severance program, unfortunately, we cannot share numbers or we don't want to share numbers at this point, because actually, we prefer to see what is the actual results and then eventually communicate them.

I'm going to tell you what (43:37) who are eligible for this program. Basically, here in Brazil, when people can retire and continue working, basically, those people are eligible. Or people that is already eligible for retiring or close for retiring, they're improving that condition, they can participate in that program. And also, people that work with us for more than 10 years and are not part of the work in the branches, account officers in the branches are not eligible, so those people working with us for more than 10 years are eligible. So this is what I can share on this severance program.

Regarding branches, everything we have been doing so far are based – is based on the Bradesco branch network. We are constantly adjusting and revising our network. Some of the branches we closed were actually transformed in point of sale (45:05) in Portugal. Basically, this is a smaller branch with one, two people, only ATMs. And there's a very important reduction of costs when we do this movement.

Especially in the second quarter, we've closed, actually 54 branches and 50 point of sale. And we should start to look at the HSBC branch network in the second half. Basically, there is strategy (45:42) that was to give HSBC branches some time to see how they perform, what are their trends? And now, we're going to analyze what (45:55) for our branches? We will analyze viability (46;01) of some branches and potentially, we will close more branches in the second half.

Q - Jörg Friedemann

That's perfect. Actually, thank you. And another question on fees. By the time of the merger with HSBC, I remind that the bank was excited about the potential to capture some revenue synergies with the recent incorporation of the bank, especially on checking account fees that could be better structured to serve legacy clients from – I know that bank. However, given this progression of fees, I ask if – is this still a reality for you and also if you are seeing a higher-than-expected churn in HSBC clients that could be just fine, what you labeled as soft performance on some fee lines (46:52)? Thank you.

A - Carlos Firetti {BIO 2489005 <GO>}

Yes, basically, the main reason for the soft performance so far (47:01) is related, there are some one-offs, some lines that are kind of, they impact negatively a little bit this growth, but this is not the explanation. The explanation is more related to the economic environment. That makes our life more difficult to sell products, to basically the unemployment also, to basically be able to expand fees.

Basically, you have to improve the relationship with clients and you have to convince the clients to migrate to new package of services. You cannot just charge them upfront. So this what really impacts. Look at credit cards, this is not really related too much to HSBC, (48:01) of total fees, it's one line that is growing something like 2% pro forma. This is economic activity. So I would say the churn is not a big contributor or a relevant explanation honestly for the fee performance, the churns we have is normally related to unemployment, and there are frequently clients that were not consuming products or generating that much in fees already.

So it's not what explains. It's more the economy. Our initiatives (48:46) revenue synergies takes longer. We knew that. We always said that, and we think we are progressing in this initiative, and some of them will mature in the coming quarters, allowing us to pick up growth, in our view.

Q - Jörg Friedemann

Got it (49:09). Thank you very much for the explanation.

Operator

Our next question comes from Mr. Jason Mollin of Scotiabank. You may proceed.

Q - Jason Mollin {BIO 1888181 <GO>}

Hello, everyone. Thanks for the opportunity to ask the question. My question is a follow-up on the outlook for net interest margin pressure, which in particular, after you talked about the short-term period that the bank could benefit from declining rates. But any – more (49:41) medium-term, clearly, there's going to be pressure on NIMs, and you talked about the need to offset the NIM decline with volumes. I want to understand this volume question. I mean, clearly, loan volumes would help, but loans are only about 50% of assets. So is this also indicating that we would need to see a material increase in securities? Or are there other factors that need to take place to offset this margin compression to maintain profitability?

And you did talk about a return, potentially, at the end of next year to loan loss provision as a percentage of loans going back to the trough in 2014. That could be a very important offsetting factor, maybe even more important than volumes, no?

A - Carlos Firetti {BIO 2489005 <GO>}

Yeah – no (50:41). Jason, I totally agree with you. When I talk about volumes only and not talk about cost of risk operating expenses, only (50:52) to isolate the explanation in NII. Our view is precisely what you stated.

We believe, first, in NII only. It's illogical to think that with lower interest rates this rate will stick and remain low. It means that probably the economy will be in a situation of starting recovery, and we do believe that in this scenario volumes will pick up again. So it's logical to think that we will have that benefit.

We may even see in some moments of the recovery, recovery lies where the margins are very good, like if it is compressed (51:44) too much, we can recover, start to have a little bit more of that, this kind of thing. But really, what we think that will help us in terms of overall profitability and overall margin after provision is really provision expenses. We have provisions in a level that is very high. We are far from a level that we can say provisions are normalized. So this normalization will happen through this year and next year. And when we look to total provision in the year, maybe, we may have even a further impact in 2019.

After this normalization, actually, the improvement in NII, et cetera, is more important. Also, remembering that Insurance is also a high-growth product, we should continue accumulating reserves. The Insurance company is suffering right now with lower inflation, but they are – due to their asset liability management, loans and bonds (53:07), and with reserves growing and without its adjustment inflation, that impact their margin this year, growing. They are also a (53:18) good contributor to margin going forward. So that's more or less how we see this playing out.

Q - Jason Mollin {BIO 1888181 <GO>}

Very helpful. Thank you, Firetti.

Operator

Our next question comes from Thiago Batista of Itaú BBA. You may proceed.

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

Yeah. Thanks, everyone. Thanks, Firetti. I have two questions. The first one is about the level of provisions the bank did in the quarter. When I compare the loss provisions into the transformation, you have a slight comparison. The bank did 125% of the new transformation. There's (53:54) an explanation for this higher level of provision? Or it was only actually a conservative approach? The second one – oh, go ahead.

A - Carlos Firetti {BIO 2489005 <GO>}

Yeah, let me answer this first. Basically, we had some revisions in rates and guarantees. Also, as we have a strong level of recovery and part of the recoveries come as new loans. And these loans, when we win (54:36), basically, come with 100% provision. So basically, when you look (54:42) the growth provision, it impacts that. That's why when you look to net provision, the growth in provision is smaller, because we deduct the recoveries from provisioning.

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

Okay. And you already answered part of my second question. My second question was about credit recovery. Could you comment on how much do you expect of credit recovery in coming quarters? This quarter, you said we saw – been (55:16) increasing the level of recoveries. We could imagine that this will continue, grow to this BRL 2 billion or tend to return to historical average?

A - Carlos Firetti {BIO 2489005 <GO>}

It could be around that or even growing more.

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

Okay. Okay. Thanks so much.

Operator

Our next question comes from Aníbal Valdés of Barclays. You may proceed.

Q - Aníbal Valdés

Hi, good morning, guys. Thank you. So you noted that the Tier II part of your capital increased due to the recent financial growth, recognition of financial numbers (56:00) during the quarter. I just want to have a better sense of your need and actual strategy to issue Basel III-compliant debt going forward? Are you completely out of (56:18) the dollar market? Thank you.

A - Carlos Firetti {BIO 2489005 <GO>}

I would say that makes more sense for us for issuing in Brazil. Basel III, when you compare the rates and conditions with that (56:36) in Brazil with especially the rates we get in (56:39) international markets, it doesn't really make much sense for us issuing in international markets.

In addition, we also don't have much demand for dollar-linked loans at this point. So that further adds to this lack of appetite right now for issuing in international markets.

Q - Aníbal Valdés

Very well. Thank you. And could that change in the future, if conditions were to change and you needed that or this is something that structurally you can solve you think in the local market going forward?

A - Carlos Firetti {BIO 2489005 <GO>}

We are always looking at the market conditions. Our treasury (57:27) is always looking at that. It depends also on loan demand. If we have loan demand in dollars from Brazilian companies, that could be a trigger for changing that. But we don't see that happening that far. But anyway, things can change.

Q - Aníbal Valdés

All right. Thank you so much.

A - Carlos Firetti {BIO 2489005 <GO>}

Operator? (57:55)

Operator

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

A - Carlos Firetti {BIO 2489005 <GO>}

Thank you, all, for participating in our conference call. We are always available for answering any other questions you may have. Thank you, all.

Operator

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