Q4 2008 Earnings Call

Company Participants

- Jean Phillipe Leroy, Department Director
- Milton Vargas, CFO
- Samuel Monteiro, CFO, Bradesco Seguros Insurance

Other Participants

- Daniel Abut, Analyst
- Ian Smith, Analyst
- Jason Mollin, Analyst
- Mario Pierry, Analyst
- Saul Martinez, Analyst
- Victor Galliano, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. We would like to welcome everyone to Banco Bradesco's 2008 earnings results conference call.

This call will be conducted by Mr. Marcio Artur Laurelli Cypriano, Chief Executive Officer; Mr. Milton Vargas, Executive Vice President and Investor Relations Officer; Mr. Domingos Figueiredo de Abreu, Managing Director; Mr. Samuel Monteiro dos Santos Jr., Chief Financial Officer of Bradesco Seguros Insurance; Mr. Jean Phillipe Leroy, Department Director.

This call is being broadcasted simultaneously through the Internet on 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 a question and answer session. At that time further instructions will be given.

(Operator Instructions)

Before proceeding, let me mention that forward-looking statements are being made under the Safe Harbor of the Securities Litigation Reform Act of 1996. Forward-looking statements are based on the beliefs and assumptions of Banco Bradesco's management and on information currently available to the Company. Forward-looking statements are not guarantees of performance. 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. Jean Leroy, Department Director. Mr. Leroy, you may proceed.

Jean Phillipe Leroy

Thank you. Good morning, and afternoon to everyone. Welcome to our call. Let me now transfer the floor the Mr. Milton Vargas, Banco Bradesco's CFO.

Milton Vargas {BIO 3347541 <GO>}

Good morning, everyone. Welcome to our conference call. 2008 will be remembered for the massive change in the macro economy (inaudible), which again is forced in the second half. As a result, assets lost value, corporate revenue fell, and investors saw their savings shrinking.

The crisis is (based) on an unprecedented scale in terms of (inaudible), it (inaudible) in extensions. Brazil was also affected, although considerably less so, thanks to its solid fundamentals. Nevertheless, we observed a slight increase in delinquency levels. Thanks to this, and in order to maintain our coverage ratio at 155% for loans overdue by more than 92 days, and 130% for loans overdue by more than 60 days, in the Fourth Quarter, we opted to record additional non-recurring provision for loan losses of around BRL600 million. As a result, Bradesco organization recorded a net income of BRL7.62 billion in 2008. In the Fourth Quarter, our results exceeded BRL1.6 billion.

It's worth noting that these additional non-recurring provisions did not affect the calculation basis for dividends, which were declared excluding these provisions, net of sales tax impact.

Similarly, they had no impact on our profit sharing payments, which were calculated in line with maximum value established by the Bank employees collective convention. Grupo Bradesco de Seguras e Previdencia accounted for 35% of the net income of the year, (posting) our result of approximately BRL2.65 billion.

Our assets grew by more than 33% over the last 12 months, led by the expanding loan portfolio, which moved up by 33.4% in the same period, and 9.2% in the Fourth Quarter. The upturn was chiefly due to corporate demand, especially from large corporates, comprising groups with annual revenues exceeding BRL350 million.

On the liability side, the (inaudible) had an (FT) increase of 67.3%. This is the same as 2007, and 18.2% in the Fourth Quarter. As for the main (ratio), the capital adequacy ratio reaches 16%, well above the minimum requirement of 11%. The (inaudible) loans overdue by more than 92 days closed the year at 3.6%.

The combined ratio of the private pension plans segment improved from 86% to 85.8%. And finally, the efficiency ratio came to 42%, very close to last year, even with the solid expansion of our distribution network.

Just to give you an idea, we expanded our network by 27%, adding more than 8,200 proprietary and 30 third-party outlets. (inaudible) 196 new branches, we increased our market share by 0.4%, to the current 17.7%. We also exceeded the 20 million mark in the number of account holders, recording an organic client growth of around 1.7 million in the year.

On the revenue front, in the last 12 months, we were able to expand our net interest income by (19.3%) due to the growth of the loan portfolio, and to increase our fee income mainly due to the performance of credit cards, (consortiums) in asset management, which offset the reduction in fees from checking accounts and loan operations in view of fee adjustments.

We also recorded increased revenue from insurance, private pension plans and savings bonds, especially in the health, life, and private pension plan segments.

Personnel expenses increased due to the collective bargaining agreement, and the addition of more than 3,800 employees, resulting from the expansion of our distribution network, consolidating Bradesco as the largest private sector employer in Brazil.

Administrative expenses move up because of the expansion of activities in high business volumes. I would particularly draw your attention to the solid investments in infrastructure and information technology, that reaches BRL2.7 billion.

2009 will be a year of challenges, and we are projecting GDP growth of around 1.5%, almost five times the estimate for the global economy.

We believe there will be opportunities and we shall continue to invest and expand our activities in 2009. We estimate infrastructure and IT investment of BRL3.6 billion, 35% more than in 2008. We also intend to open another 170 branches and add more than 1.3 million new account holders.

Once again, I would like to close by thanking our employees for their dedication and commitment to our goals.

I will now pass the word to Jean, and I will be at your disposal again during the question and answer session. Thank you very much.

Jean Phillipe Leroy

Our presentation will be accompanied by 34 slides, most of which will already be familiar to you.

Let's begin with our Fourth Quarter net income, which totaled BRL1.6 billion. The highlights were the mark-to-market of the investment in Visa International, of BRL454 million, and the additional provision for loan losses of close to BRL600 million, with BRL429 million being classified as excess provisions, as already mentioned by Milton.

We constituted several provisions for economic plans of BRL68 million above the average for the previous quarters. We also recorded a non-recurring expense of BRL88 million, to bring our financial statement into line with the requirement of the law 11638.

Taking all of these adjustments into consideration, we reported recurring or adjusted net income of BRL1.8 billion for the quarter. Please note that all the comparative analysis on the following slides refer to the adjusted net income, for making a better comparison with previous quarters.

Moving on to slide number four. In slide number four, we show the quarterly evolution of Bradesco's net income. The decline over the previous quarter was largely due to the increase in the claims ratio of the insurance Group, pushed up by the natural disasters in Santa Katarina state by approximately BRL40 million, health claims, and basically seasonal factors and the increase of the dollar because several materials are, of course, in dollars and the effect on the claims, and the increase of the IBNR tail from five to seven years in the life insurance segment which affected by approximately BRL100 million, BRL99.8 million to be more precise. The efficiency ratio remains unchanged at 42% and we believe there is room for improvement in the coming quarters.

We'd also like to reiterate our belief that investments we are making in IT and the overhaul of our internal processes will be crucial in reducing this ratio and improving the quality of our services going forward. The network expansion and the IT improvement usually have a negative impact on the efficiency ratio to begin with, but will definitely result in future advantages.

Slide number five. And we closed the Fourth Quarter with total assets of BRL454 billion and shareholders' equity of BRL34.2 billion. The capital adequacy ratio, in line with the Basel II concept, closed at 16.1% at the end of the year, allowing us to grow in comfort without depending of new additional funding. Bradesco's leverage is exceptionally low especially when compared to international banks. Just to give you an idea, our total credit according to the Brazilian Central Bank concept of BRL173 billion is only five times equivalent to our equity of BRL34 billion. It is also worth noting that Bradesco has sufficient room to double its long term future funding, but subordinated that, (growth) limit is 50% of the Tier 1. If this margin, if this effect were to be adopted the ratio would go up to 18.5%.

Slide number six. The mark-to-market effect on investment in shares was chiefly responsible for the decline in the quarter's unrealized gains. These gains exclude the potential gains from the sale of Visanet and/or Serasa, expected gains from the comparison between the market value of the guaranteeing assets, and the real estate of 4.3% used to calculate the technical reserves of fixed benefit plan, and last but not least the potential gains from the pre-fixed interest rates in loan operations and the expected effective interest rate during the life of the pre-fixed portfolio.

Slide number seven. This slide deals gives the breakdown of Bradesco's net income. The annual reduction of the share of fee income was due to the realignment of fees for individuals and the elimination of the loan operation fee. The annual increase in the share of insurance was basically due to the evolution of operations and the return of provisions in the individual health segments to normal levels. The quarterly reduction in the share of insurance was caused by the seasonal upturn in claims. We expect these percentages to be maintained for the year of 2009.

Slide number eight, giving a summary of our income statement with the main variations which will be discussed in more detail shortly.

Slide number nine. Our net interest income grew by 15% led by the more stable interest earning portion which increased by 19.3%. The volatility impact was chiefly felt in the mark-to-market of the assets resulting in a 16% reduction in the non-interest portion. The growth in loans and funding volume was mainly responsible for the upturn in interest earning operations, offsetting the reduction in spreads both annually and quarterly. The negative impact of the spreads was in turn caused by the higher growth of corporate vis-a-vis individual operations, but spreads are higher.

The BRL63 million rise in the non-interest line in the Fourth Quarter was due to treasury efficiencies despite a negative impact of the mark-to-market of derivatives in the case -- the CDS of the Brazilian foreign debt, sovereign debt.

Slide number 10. On this slide we show our interest earnings in grey and the non-interest earnings in red, result since 2005. It is worth noting that although very important in absolute terms, the non-interest portion is relatively insignificant in comparison to the interest earning portion, underlining the potential stability of Bradesco's results.

Slide number 11. This slide shows the nominal evolution of the net interest margin from interest earning operations, and its ratio in relation to total assets adjusted for the exclusion of fixed assets that are not remunerated and the repos. In the quarter, the reduction in the average rate from 7.8% to 7.3% was due to the higher increase in corporate operations whose spreads are, as mentioned before, lower.

Slide number 12 gives a breakdown of net interest income from interest earning operations in both the annual and quarterly comparison. You can see that the biggest increases came from loans and funding operations, thanks to volume growth.

Slide number 13 gives a summary of loan operations and the blue line refers to gross margin, basically the spreads and the red line to provision for loan losses and recovery. The net margin, the black line, recorded a 19% growth in 2008, underlining the good performance of loan operations. It is worth highlighting the ratio of the provision net of recoveries to the total spreads, which came to 40% in 2008 vis-a-vis 37.5% in 2007. Note that we are not excluding the additional provision in the 2008 data. In fact, as you can see delinquency moved up.

Slide number 14, showing our funding led by demand and savings deposits and CDs, certificates of deposits. Half the increase in time deposits was due to a higher demand for credit especially in the corporate segment. Bradesco's liquidity remained high, even when the crisis was at its worst. The investment fund industry was affected by the decline in the price of the equities, the stock price of the equity. Remembering that the BOVESPA index, the IBOVESPA index fell by 41.2% in the year and by 24.2% just in the Fourth Quarter, nevertheless our fund portfolio managed by brand recorded a 5.4% upturn in the year. Stock market volatility triggered the rerouting of funds to more conservative assets such as savings accounts and CDs, partially explained the substantial 96.8% in time deposits.

Slide number 15. Bradesco's loan portfolio closed 2008 at BRL215 billion, a consistent 9.2% increase in the quarter and 34 points, 33.4% higher on a year-over-year basis, outpacing the private banks and the market as a whole. New borrowers accounted for 20% of the loan portfolio growth in 2008 or by some BRL26.8 billion in absolute terms. The shrinkage of the capital market and viscosity of external credit lines explained a 15% upturn in Fourth Quarter corporate loans. In 2009 we expect our loan portfolio to grow by 15%.

Slide number 16, moving to the analysis of the individual loan portfolio. As you can see the highest annual increases came from leasing, mortgage and rural loans. The strong growth in leasing was due to the increasing focus in this product which is not subject to financial operations tax, the IOF, and is therefore more competitive.

On slide number 17, we are looking at the consumer finance book which totaled BRL57.9 billion by the end of the year; 20.4% up in the year, and 3.1% up in the quarter. In the Fourth Quarter, however, there was a reduction in demand due to a lack of consumer confidence. Auto financing and payroll-deductible loans account for two-thirds of the consumer financing portfolio. Thanks to their particular characteristics and associated guarantees, these operations have a lower credit risk than other consumer financing operations.

Slide number 18, looking at the portfolio of the corporate. The best performance in this segment were working capital for a large corporation and export financing which was impacted by the exchange variation and an increase in demand, reflecting Bradesco's commitment to this country -- to Brazil's foreign trade.

Slide number 19 shows our vehicle portfolio. Bradesco has a 23% market share in this segment in 2008. As I have already mentioned, we began focusing on leasing as a means of financing new vehicles which explained the substantial growth of this fund.

Slide 20, moving to mortgage, the origination during the year reached BRL6 billion, a 47% increase on a year-over-year basis. Our market share in November '08 was 20.5%. We financed more than 49,000 properties during the year, or approximately 17% of the total number of homes financed in Brazil by a bank. This is our information as of November 2008.

Our 2009 origination target is BRL5 billion, slightly below the 2008 figure, although we believe this market will maintain its upward trend, just by the expected economic slowdown. And there will be no shortage of funds due to the savings accounts requirements to be met.

Slide number 21, looking at the provisioning. We basically are showing graph where we can phase the provision vis-a-vis the expected losses. The first line represents total provisions as a percentage of the loan book divided by the book, while the second line corresponds to the Brazilian Central Bank's reserve requirements. Note that we have an excess provision of BRL1.6 billion, the difference between the first two lines. The line in purple, representing the percentage of effective losses or charge offs, and is converging with the green line which represents non-performing loans. Based on this historic trend, we can safely say that we have a provisioning cushion of BRL3.2 billion, allowing us to comfortably overcome any eventual (inaudible).

Slide number 22, moving to the delinquency of more than 90 days. We can see that there was a little bit of an increase in this ratio because of the downturn of the macroeconomic scenario. Thanks to this increase in both individual and corporate segments, we decided to record additional provision of BRL600 million in order to maintain our coverage ratio at close to 165%. And comparing provisions vis-a-vis loans overdue by more than 90 days, and by 130% if we were to compare the provisions vis-a-vis the loans overdue by more than 60 days.

We expect delinquency to increase further in 2009, although the precise magnitude of the upturn will depend on the employment levels in the case of individuals and the payment capacity of certain corporate -- in the corporate sector. Nevertheless, it would remain at reasonable levels since we firmly believe the country, Brazil, can emerge from the expected slowdown in the coming months. In addition companies are already aware of the immediate future trends, and will be careful to make sure they get through the current difficulties without losing competitiveness when growth eventually recovers.

Slide 23, looking at fees. That's increased on a yearly basis by 3.8%. Higher income from credit cards, assets, consortium management, collection and custody are due to the growth in volumes and expansion in the current client base, offset the decline in fees from loan operation and checking accounts arising from the regulatory changes.

On slide 24, looking at the operating expenses, you can see that the structural component of personnel expenses in the Fourth Quarter was impacted by BRL34 million due to the wage increase and vis-a-vis BRL62 million in the Third Quarter of '08 and

BRL96 million in the Fourth Quarter of 2007. Also, in the Fourth Quarter we hired more than 1,000 new employees due to the expansion plan, with the opening of 124 full-sized branches and 130 advanced service branches, which had a BRL31 million impact on our expenses. Clearly, every new outlet is being monitored to confirm compliance with the planned results.

On slide 25, looking at the operational expenses, in 2008 the number of Bradesco's outlets moved up by 27%, or by 8,200 new spots including our own approximately 1,452 and third-party by more than 6,700. New network expansion investment in IT, mainly the IT improvement project, and business expansion were also reflected in these administrative expense. Higher expenses in the quarter can be explained by the seasonal expenses related to advertising and the accumulated opening of new branches and advanced service branches in the period.

Slide number 26, the coverage ratio comparing fees and administrative expenses has been falling due to the impact of organic growth and the regulatory measures that affected fees. However, we believe that higher business volume and the increase in client base will move the ratio back to its previous level as of the Second Quarter of 2009 when the new fee income criteria will have been in place for a year.

Slide 27, it gives a summary of our insurance Group income statement. The 12% increase in the annual results reflect production growth and the return of technical provision in the individual health insurance segment to normal levels. The Fourth Quarter results was affected by the growth in the health claims ratio reflecting the impact of the US dollar appreciation on laboratory processes and medicine costs. In addition, the floods in the south and southeast of the country impacting to the claims ratio in the auto and residential property segments impacting by BRL40 million and the expansion of the IBNR tail in the life insurance segment in the amount of close to BRL100 million, to be more precise BRL99.8 million.

Net income from the insurance group accounted for 37.7% of the Brazilian insurance market's total net income and these are our data as of November 2008.

On slide 28, looking at the revenues from insurance premiums, private pension plans and savings bonds reaching BRL23.1 billion in 2008, a 9.2% increase on an annual basis, equivalent to 24% of the insurance market total sales, and this again our information as of November '08. As a result Bradesco maintains its leadership in the property and life insurance segment as well as private pension plans.

Looking at the slides of number 29 and number 30, basically, we show our own financial assets and technical provisions guarantees which results -- which reached BRL71 billion, equivalent to 34.5% of the market, through November '08. It is worth mentioning that nearly 80% of these assets respond to pension plan and (inaudible) investment portfolios. Total assets grew by 5.3% on the year-over-year comparison. Technical provision reached BRL65 billion, a 34.3% of the insurance market participation, again through November '08 data. The 2008 health segment provision moved up more than BRL200 million in the year, above BRL3.4 billion.

Slide number 31 represents the efficiency ratio of the insurance segment. The highlight was the annual combined ratio that has been improving consistently, indicating operational efficiency of the insurance Group. The Fourth Quarter growth of the index was seasonal, and was impacted by the increase in the claims ratio that we already mentioned before.

On slide 32, looking at the guidance we had given by the middle of last year, looking at 2008, and comparing with what we accomplished during the year. In line with our commitment to accountability, this slide compares our 2008 guidance, and we believe our guidance for individuals and corporate loan segments, operating expenses and mortgages was met; in some cases, even exceeding the forecast figures, despite the adverse conditions. We have not reached the estimated guidance for fees, which was affected by the fee adjustment and loan arrangement fees, the TAC, no longer collected. Also, decline in (Banco) Financing. The net interest income was affected by market volatility and insurance premiums, especially in the private pension plan segment, due to the option of more competitive investment products and conservative, like CDs. However, as you saw in slide nine, the net interest income posted annual growth of 19.3%.

On slide 33, we are looking at the macroeconomic outlook for '09 and 2010 our chief economist has been giving, where basically you can see that we are expecting a 1.5% GDP growth, which should be five times higher than the world's GDP expectation for the year.

In slide number 34, we are looking the guidance for this year of '09, and I would particularly like to draw your attention to our net interest income and fees growth estimated, as well as our new mortgage target.

Slide 35, we are looking at the next APIMEC and INI events we are going to hold in Brazil, and as a matter of conclusion, we would like to just say that the global economy as a whole and the banking sector in particular suffered one of its worst ever years in 2008, reflected in massive write-offs that forced governments to bail out ailing companies and banks, especially in the developed economy. I would just like to emphasize that Bradesco's balance sheet is exceptionally healthy. This will enable us not only to overcome the expected slowdown in the coming months with ease, but will also allow us to continually grow very strongly the expansion of our operations and distribution network in order to be even better positioned to when the growth will return over time.

I am particularly referring to, one, our comfortable level of provision for loan losses, labor, tax and civil provisions, as well as our technical provisions in the insurance and pension plan segment.

Two, the undoubtful recovery of the mark-to-market of CDS, whose position matures in the next 20 months, and other assets as well. Three, the potential gains in our fixed portfolio from the expected fall in interest rates. And four, the improvement in our efficiency and quality ratios over the next two to three years, due to the conclusion of the IT improvement project and the review of internal processes in progress.

Thank you for your attention, and we are now available in the Q&A session for you.

Questions And Answers

Operator

Ladies and gentlemen. we will now begin the question-and-answer session. (Operator Instructions)

Our first question comes from Mr. Jason Mollin with Goldman Sachs.

Q - Jason Mollin {BIO 1888181 <GO>}

Hello, everyone. My question is related to your guidance for 2009, looking at your net interest income, or what we might call net financial income growing 18% to 22%, while you have your loan book growing 13% to 17%. And off the top of my head, I believe your loan book is probably around 40% of your assets, so I'm just curious about what your expectations are for securities in this environment going forward, and how we should think about your net interest income growing so much faster than your loan base. It seems as if you're implying that spreads should go up. And if you look on page, I think it's 82 of your large report for the quarter, we see that 55% of your assets mature in less than 30 days, and another 11% in less than 180 days. So if you can give us a sense of what's driving this guidance. Thank you.

A - Jean Phillipe Leroy

Hi, Jason. Actually, it's always a big discussion that we have, because we have an inflow of new operations, with better spread, and we have a stock of operations that has been, over time, normally moving down. So you see the net interest margin moving down when you look at the stock, but we see, in the new operations, an inflow of higher margins in the operation. We are expecting this process to increase the net interest income on a very sound basis in 2009. You also notice, as a relative participation of operations like large corporations, I believe that half of the loan book growth in 2008 has been originated by large corporations.

So definitely, when you have these effects and you know that the spreads that we charge, even though they are much higher now than before, on large corporations, these affect definitely the margin itself. We have an expectation of the decrease in the cost of our funding, because we have a very important declines in the Selic during the year, and at the end, we have a position in our portfolio which basically says, because of the size of the pre-fixed portfolio that, when we have a decline in the interest rate in the Selic, actually it's more positive for us, because of the size of our pre-fixed book.

So at the end, taking all of this into consideration, thinking also that we were very affected this year, for example, in the effect of the mark-to-market of some securities, like the CDS, which we believe should not be so much affected in 2009. We basically made the calculation that we should be, even though we have a loan book growth of 13% to 17%, we should have a higher growth in the net interest income. So these expectations are relatively the opposite of what we had last year, where the loan book growth was very solid, but we have a net interest income growing by (half).

Q - Jason Mollin {BIO 1888181 <GO>}

Could it also be -- is Bradesco talking about positioning themselves to benefit from interest rates declining, whether it be through derivatives or buying longer-term securities, but I guess we're really looking for short term rates coming down. That's why, I think, with such a large security book, what kind of forecast -- what kind of expectations should we have for the securities portfolio? Should loans continue to represent around 40% of assets?

A - Jean Phillipe Leroy

Yes. I believe that around 40% would be to be expected for 2009. Definitely, we try to be matched between assets and liabilities, but we have a slight component of higher pre-fixed portfolio, which is, actually, a little bit more positive. But we are not taking into account in our analysis a drastic change in our way of positioning the portfolios. The loan book will continue to be growing on a very sound basis, and we marginally could have a gain because of the position of the pre-fixed rate. But we should not change so much the stance of being very conservative and trying to be matched as much as we can between assets and liabilities.

Q - Jason Mollin {BIO 1888181 <GO>}

And lastly, if you could just tell us what your expectation for unemployment is for 2009, as that goes along with these forecasts or guidance?

A - Jean Phillipe Leroy

We are in a number of a little bit less than 8%, looking at 2008, and the expectation for 2009 should be close to 9%. So we have a relative worsening in the employment numbers, but again, the numbers that we have are the best over the last 10 years. So even though GDP growth by 1.5%, one, it's growth, and second, what we have is basically a process of we will have less new job creation than companies firing people.

Q - Jason Mollin {BIO 1888181 <GO>}

Thank you very much.

A - Jean Phillipe Leroy

You're welcome.

Operator

Our next question comes from Mr. Saul Martinez, JP Morgan.

Q - Saul Martinez {BIO 5811266 <GO>}

Hello, everybody. I have two questions. First, on your expectations for asset quality. If I look at page 21, Jean, from the second -- during the last asset quality worsening cycle, more or less the Second Quarter of '05 through the end of 2006, we've seen (inaudible) pass-through loans increase by about 150 basis points, or 140 basis points. It went from

3.2% to 4.6%. We're obviously, as you guys mentioned, entering into another worsening cycle, where you've seen a pretty abrupt downturn in economic activity. Can you give us a sense for whether you think this worsening cycle will be similar, worse, or better than the previous worsening cycle, in terms of the increases in pass-through loans, and if you can give us a sense for why you think that as well?

My second question is a follow-up to Jason's on the spread. Obviously, your 18% to 22% net interest income growth guidance is assuming that lending spreads remain very elevated. Are you worried, though, at all, about political pressure and the discontent out there about lending spreads being as high as they are, and obviously we've seen a lot of talk amongst politicians, and a lot of talk in the press about banks reducing rates on loans, and how do you think about that when you think about your ability to sustain 18% to 22% net interest income growth?

A - Jean Phillipe Leroy

Okay, so, first question about asset quality. I would say, it's very difficult to compare cycles, as it is also very difficult for us to compare our Company with our Company over the last cycles we have (been passing). The fact is that we have been seeing actually a very big change in the portfolio over time. To give you an idea, back in 2003, 27% of the portfolio was with individuals. Now it's 40%. And the credit lines are definitely very different. We have major growth when you look at the operation, in what we consider safe operations like payroll-deductible loans. And also vehicles that are also good in our understanding. So the fact is that as cycles -- I would say that the worst scenario was the worst cycle was in 2001/2002.

The cycle that we are seeing now is very difficult for us to measure, but we don't believe that we would see something very drastic over time. We are always going to see what is going on in terms of the numbers of unemployment, in terms of the numbers of the companies. Basically, we decided to increase a little bit our provisioning, as you noticed in our numbers. But the cycle is different, because Bradesco's different than what it was before.

The credit lines are different, and we have been investing very, very much in improving our credit scores, the training of our employees, and also one thing that is important to mention is that the cycle that we are passing through right now, the companies are less leveraged that they were before. A lot of companies issued capital, they are more professional in the way that they are managing the companies. So on the side of the corporate, we believe that things should not deteriorate so much on the side of the individuals as well.

In terms of the spread, and about the rate, we don't believe that there will be a political issue of the government trying to force or change a thing. Basically, the spread in interest rates, they depend on different variables, but the market is open, and we don't see the government affecting our operation by putting caps or changing the status quo.

Q - Saul Martinez {BIO 5811266 <GO>}

On -- just to follow up, then, Jean, on the first question on asset quality, what segments are you most concerned about, or do you think there's more potential for worsening? Is it credit cards, is it unsecured personal lending, is it SME lending, where obviously we've started to see some uptick, but we're still well below historical levels. But just -- what segments you think are more vulnerable?

A - Jean Phillipe Leroy

Maybe the segments that are more affected by a slowdown in international trade; so, companies that are large exporters or are in the sectors that are in the process of consolidation, although consolidation, on review, is very positive. We don't see particular sectors that we are so much worried about. We should have a consideration basically across the border. Maybe some segments, like companies that are focused on supplying to the auto industry, because the auto industry is expected to sell less. Some companies that are importing goods or some focused on shoes or wood, but nothing so much worried.

You can see also in the footnote that we have of the credit portfolio that we have a very diversified loan book. We are not so concentrated in any particular sector, and this is definitely a safe thing to have in an environment which is very volatile.

Q - Saul Martinez {BIO 5811266 <GO>}

Okay. Great. And congratulations, Jean. Thanks.

A - Jean Phillipe Leroy

Thank you.

Operator

Our next question comes from Mr. Daniel Abut with Citibanks.

Q - Daniel Abut {BIO 1505546 <GO>}

Good morning, Jean. A couple of questions. One, as a follow-up on the asset quality question. You are entering this period of uncertainty, which you correctly describe as very difficult to predict what will happen with delinquencies and therefore provision (inaudible). A lot depends on unemployment and other things that are very difficult to call. But you are entering in quite on purpose with much higher excess reserves. You upped them this quarter, they are now at BRL1.6 billion above the minimum required by the Central Bank.

Should we understand that you're prepared to, then, consume part of that excess cushion as you go along, in case delinquencies (surprise) on the downside scenario, and increase more than expected, or do you indeed want to try to keep the excess reserve of BRL1.6 billion and any negative also pricing increase in delinquencies, and it will all flow through your provisioning needs in the P&L? That will be question one.

And question two will be, if you can elaborate on how we should understand your operating expense guidance, which is 9% to 14% for '09, quite a wide guidance. Should we understand that in case the outlook for revenues and provisioning needs becomes more challenging, that you are going to adjust, and your plans are flexible, so they will end up being closer to the lower end of the range? What does this range depend on?

A - Jean Phillipe Leroy

(inaudible) you are quick in your questions. Let me try to explain. I would say, what we have is a scenario where the data that we receive from the market, and we have a very solid economic team, we have a lot of information that we can capture, much more than the market.

To give an idea, 20% of the collection of the companies in Brazil passes through our system. So we can definitely analyze a little bit better than the market, what is the expectation of losses. We notice that there should be a deterioration in asset quality, and this is the reason why we build some excess provision. We have BRL3.2 billion of excessive provision. They might be used, part or not. This depends on the devolution we have been seeing (actual) numbers of November, and even then December, of the entrepreneurs are becoming a little bit better than what they were in September and October.

So it doesn't mean that we are changing from being relatively cautious to relatively more optimistic. But the fact is that we are going to see what is going on, in terms of the unemployment rate, the health of the corporations. And based on that, we might be doing some more provisions or not.

Definitely, the balance sheet that we have is extremely solid. Extremely solid. So we build some provisions, they might be used or not. This depends, a little bit, of the expectations being -- that we have nowadays being met over time.

In terms of the costs that we have, I would say, we have some costs that are investments, some costs that are linked with IT expansion in the number of distributions. You noticed, I believe, that our distribution market share grew by 0.4% in one year because we have been opening more branches. We believe that the opening of branches is key for us to being larger and better in terms of efficiency.

So if we are going to meet the lower end, or the higher end, of the deals, it's hard to tell. I would say, usually, around the middle is the expectation. And we have a lot of costs that are investments. And at the end, we are going to see what we have.

In the year of 2008, with actually a guidance in expenses that was met. You see that we had 11% to 17%, and we were almost right in the middle. So maybe, considering more right in the middle is more to be expected.

Q - Daniel Abut {BIO 1505546 <GO>}

Just a follow-up, Jean, I understand that the midpoint is probably the base case scenario. What I was trying to get into was that if, let's say as one assumption, as the quality proves to be more under pressure than we think, because you said you're expecting only a mild deterioration, let's say there is worse than that, how flexible are your plans so that you could move to end up closer to a lower end of the range? Or, because it's IT and other things that are already compromised, there's not much flexibility?

A - Jean Phillipe Leroy

Okay, Daniel. I would say, we have a plan. We should be opening 170-plus branches during the year. We have more investment in IT, some BRL3.6 billion, which is a 35% increase vis-a-vis last year. And these are plans that we are, I would say, very comfortable to be following.

We are extremely positive about the long-term of Brazil. So maybe we have a year, or a little bit more than a year, of slowdown in the economy. You see a GDP moving from almost 5.5%, let's say, to 1.5%. But over time, a 4% to 5% GDP growth is the running expectation of the GDP growth. And we are expecting this to happen, and we should be benefitting because we are investing now.

And you see, we have, like, 25, 30 months of return on the investments of the branches that we are opening. We opened a lot of branches. We grew the opening of branches in 2007. So we should be, from next year on, beginning to benefit from that. And this, I believe, should be one of the components of earnings growth over time.

And even the process of IT improvements should be concluded by the beginning of 2010. So these are additional costs that we have of opening branches, of investing more in IT, that we are not going to incur going forward. And this benefits the earnings for our Company.

Q - Daniel Abut {BIO 1505546 <GO>}

Thank you, Jean.

A - Jean Phillipe Leroy

You're welcome.

Operator

Our next question comes from Mr. Mario Pierry with Deutsche Bank.

Q - Mario Pierry {BIO 1505554 <GO>}

Good morning, everybody. I also have two questions. The first one, I don't know how much you're going be able to answer, but I'm going to ask anyway. We have seen a lot of consolidation in the sector recently. There has also been a lot of speculation in the press that there might be some other banks for sale in Brazil. So I would like to hear from management, what is your appetite for consolidation for acquisitions, let's say in the next 12 months?

The second question has to do with your auto insurance business. We saw that auto and real estate had negative net income this quarter. I think it was explained that some of that had to do with the floods in the south of Brazil. But I was wondering, what is the outlook for this segment? How do you see premium growth? How do you see prices going forward? Thank you.

A - Jean Phillipe Leroy

Mario, we are focused on organic growth. And I believe with this plan of opening 500 branches in three years, that we are so firm and committed to continue, it is important to be re-emphasized again.

Consolidation has been very strong in 2008, definitely. And we were, and we are always, a very large player, because we are very focused, and our focus is Brazil. We are always obliged to analyze opportunities, but the numbers of opportunities, they are very limited.

So let's say, focus on organic growth is the number one priority for us. We do have scale, so we don't need to buy anyone. We are a very large one-stop shop company, so we don't need to buy any particular bank in any particular field because we are very well positioned everywhere. But we are obliged to analyze if something comes up. But definitely you should be considering that our focus is organic growth.

Samuel?

A - Samuel Monteiro {BIO 18677825 <GO>}

Mario, talking about insurance business, in terms of Bradesco, in our perspective, no line of business will be (reduced) in our case. We don't talk about the market. Of course, the market would be (affected about the crisis). But in terms of Bradesco, I say to you, you have to put in focus, in the bank-client penetration, because, in terms of, for instance, the P&C, our penetration on a client-by-client basis is lower. And you have to increase so much your (put) kind of penetration.

The same as relates to the health. Because health, we have about 60% or 70% have that penetration in the client, bank-client basis. We have to increase so much about this.

In terms of dental (inaudible), we have today 48% of our clients of health have dental. We have a huge opportunity to increase so much of this kind of business.

As in our perspective, I would say to you, (what in our kind of clients put it that) in between 7% and 9% of the increase of our avenues in insurance, which -- and then maintain our contribution in terms of profit of the organization in total. I think it would be very, very huge opportunity to increase so much our client basis today, in terms of insurance business.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. So (Samuel), if you could also be a little bit more specific on what you expect for the auto segment, specifically. What type of premium growth? How do you see pricing in the segments, going forward?

A - Samuel Monteiro {BIO 18677825 <GO>}

I, according in our view, in terms of order, would be a little bit increased in next months in terms of price. Of course, the competition would be very aggressive, is still continuously aggressive.

I have been in insurance market for 40 years. In 40 years, of very huge competition in terms of auto. Auto is a very competitive business. I think could be, in terms of market, would be a little bit increased in the next months. (The price).

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. Then for premium growth for the segment?

A - Samuel Monteiro {BIO 18677825 <GO>}

Yes. I project an increase in all segments.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. Thank you.

Operator

Our next question comes from Mr. Victor Galliano with HSBC.

Q - Victor Galliano {BIO 1517713 <GO>}

Hi, there. Hi, Jean. Just one question. Coming back to the question about excess reserves, I see that this now counts as part of Tier 1 capital. So obviously, if you do need to dip into that, would you dip into that excess reserve? Or would you increase your provision charges so as to maintain your capital adequacy ratio and not deduct from that? That's my first question.

My second question is can you give us some guidance, in terms of what we can expect in terms of provisioning for loan losses, as a percentage of average loans? What you expect to charge against the P&L in '09?

A - Jean Phillipe Leroy

Victor, look, we have a very solid BIS ratio in Tier 1 and in Tier 2. And we also have a very solid level of provision. One thing is different from the other. The excess of provision is based on maybe the future expectation of losses.

We have more than 16% BIS ratio. And we have a very large possibility to expend the Tier 2 capital. So the idea, if we were to need capital, which is not the case, we, I would say, depending on the conditions of the market, we would be tapping more Tier 2 capital. We are very comfortable with Tier 1, and we are very comfortable with our provisioning level. So the idea is, basically, to expand on this way.

In terms of the provision, the loan-loss provision, it's very difficult to give you a number because it's very difficult for us to forecast, more precisely, what is going to happen in Brazil this year, as in the world. I believe it was never so difficult for anyone.

So the idea, I would say, is to have an increase in the (need) of provisions as a percentage, but difficult for me to be guaranteeing by how much percentage. The idea is, actually, more to expand the loan book. It's more -- it's easier for us to forecast the expansion in the portfolio than to forecast the need of provisions.

In the expectation of the need of provisions, we increased a little bit the provisions because we should be having a little bit higher needs of provisions if the unemployment rate should be increasing a little bit and some companies might be needing operations. But it's difficult for me to provide a percentage.

Q - Victor Galliano {BIO 1517713 <GO>}

Okay. But given that we have seen a big increase in your NPL formation in the Fourth Quarter '08, would you say it's likely to be higher than it was in '08 in '09? Or would you have to satisfy that BRL500 million extraordinary provision that you -- would you have to deduct that from your '08 to get to an increase in '09?

A - Jean Phillipe Leroy

Look, we should be growing the portfolio, and we should be growing more the allowance for loan-losses in 2009 vis-a-vis the loan book, as a percentage. We increased, in the Fourth Quarter, as a precaution for the very difficult expectation for the year. It's difficult for us to forecast.

So the idea is to expand the -- to increase the expenses. And we believe that the level of provisions we did of excess last quarter, in the Fourth Quarter, was in line to the expectation of the asset quality deterioration. More than that, we believe that the BRL3.2 billion are totally comfortable when we compare -- you saw that the level of losses also moved down. So the excess is very solid, and we are very comfortable with that.

Q - Victor Galliano {BIO 1517713 <GO>}

Okay. Thank you.

Operator

Our next question comes from the Mr. Saul Martinez with JP Morgan.

Q - Saul Martinez {BIO 5811266 <GO>}

Hi. Just a follow-up on the insurance question for Samuel. I understand the 7% and 9% guidance for insurance premiums, but can you kind of give us a sense for how the economic conditions impact your underwriting margins for your loss ratios in different businesses?

In other words, should we expect loss ratios in auto insurance to go up or down? Does fraud and crime tend to increase, or does auto usage tend to decrease when the economic activity declines? In the health insurance business, do people use more -- are there more claims activities when the economy's in more difficult conditions, as you see in some countries? Should we expect your loss ratios to be negatively or positively impacted by the economic conditions is, I guess, my basic question?

Hello?

A - Samuel Monteiro {BIO 18677825 <GO>}

Saul?

Q - Saul Martinez {BIO 5811266 <GO>}

Yes.

A - Samuel Monteiro {BIO 18677825 <GO>}

We're talking about this very simply with you, but I would like to repeat again my answer about this. Of course, the crisis would be affected the insurance business in general. But in our case specifically, I would say to you that the crisis is for everybody. It's for insurance companies, it's for stakeholders, for labs, for hospitals, for dealers, for everybody.

In this case, what do I have to do? Of course, there are a lot of movement to reduce the amount of the people would be covered by health in the companies. This relates to the unemployment. In this case, what do I have to do? Do I put pressure about the costs in hospitals, in doctors, in stakeholders, in general, to maintain our margin, maintain our combined ratio?

In terms of health, we have acquired 4 million of insured. It's a very huge portfolio to put pressure on about the costs. The same as in terms of cars. Our portfolio today is around 1.3 million cars insured by us. Of course, that would be reduced in terms of revenues because the price would be affected only in industry.

In this case, what I have to do. The same as in health. And it puts pressure (up on) the costs because the claims which relate the premiums which I sold in the last year are completed provisions. The prices would be calculated in that now.

What happen in terms of fraud? I don't think would be increased the fraud because most of part of our clients are clients of the bank, which have a lot of products with us.

In terms of life -- in terms of life I think would be they increase a little bit lower than in 2008.

I would say to you, in terms of general, of course, the price would be affected, i.e., insurance industry. But this has a huge opportunity to increase the penetration in our client value basis because it's lower today, in terms of (efficiency). In terms of health, we can increase a little bit more.

Q - Saul Martinez {BIO 5811266 <GO>}

So you think that your loss ratios and your combined ratios -- should they be similar over all to what you had in 2008?

A - Samuel Monteiro {BIO 18677825 <GO>}

In terms of total, I would say to you --

Q - Saul Martinez {BIO 5811266 <GO>}

Yes. Total.

A - Samuel Monteiro {BIO 18677825 <GO>}

Not a factor at all.

Q - Saul Martinez {BIO 5811266 <GO>}

Okay. Thanks.

Operator

Our next question comes from Mr. Ian Smith with Nevsky Capital.

Q - Ian Smith {BIO 17539373 <GO>}

Hi. I just wanted to ask for some guidance on three areas where we don't tend to get formal guidance, or at least just a sense of where you think things are going.

Firstly, on tax, whether you think that the underlying tax rate will be similar in 2009 to 2008, i.e., also whether you'll be able to continue to create tax credits for the additional social contributions through the year?

Secondly, on deposit growth, where do you think that could lie, and what kind of mix do you think next year? Is it likely that we'll have lower cost deposits growing faster again as rates come off?

Then finally, just on other operating expenses, through the year, and also through the last quarter, the growth was quite considerable. Is there a likelihood that the growth rate will moderate significantly going forward? And can you give us a sense of what happened in the Fourth Quarter? Why that number was quite high? Thanks.

A - Jean Phillipe Leroy

Could you repeat quickly the question number two and three? I just got the first one. The second was the mix of what, sorry?

Q - Ian Smith {BIO 17539373 <GO>}

The first question on tax. The second question on deposit growth, but also deposit mix. Then the third question was on other operating expenses.

A - Jean Phillipe Leroy

Okay. Look, in terms of the tax rates, probably we should see a tax rate closer to 30% as a guidance that I believe would be correct to pass to you.

In terms of the deposit mix, there was a very huge deposit mix change because the crisis was so strong that it affected the equities and some multi-market funds. A lot of people moved to deposits -- (inaudible) savings deposits. I believe it would be difficult to have further changes so strong in terms of the mix because most of the crisis or at least the expectation of most of the crisis was already affected, so we should not see so much changes in the deposit mix over time.

And in terms of the rates of other operating expenses and revenue, if we look at what happened over these last periods, you can see that the net effect of other operating revenues minus expenses has been over the last four quarters around the BRL1 billion negative mark; a little bit less in the Third Quarter of '08, a little bit more in the Second Quarter of '08. But relatively speaking, this has been close to BRL1 billion. So you can basically continue to have this minus BRL1 billion over the coming quarters as a guidance.

Q - Ian Smith {BIO 17539373 <GO>}

Great. And just on deposits, would you be happy to give us a sense of how deposits might grow? Are they likely to grow in line with loan growth next year?

A - Jean Phillipe Leroy

Yes, definitely more demand for loans will impact on more needs of funding and then -- they are very linked those two things. Just a second.

Although we have a very large liquidity, a very large working capital, but normally what happens is that the more demand for loans, the more funding needs. They should be relatively in line, those two aspects.

Q - Ian Smith {BIO 17539373 <GO>}

Thanks, Jean.

A - Jean Phillipe Leroy

You're welcome.

Operator

Ladies and gentlemen. since there are no further questions I would like to invite Mr. Jean Phillipe Leroy to proceed with his closing statements. Please go ahead, sir.

A - Jean Phillipe Leroy

For finishing, maybe you have an additional question? Someone has an additional question? It might be the last of the call, please?

Okay, since there is no further question, I thank you very much for attending this conference call, and the investor relations area is ready to respond to your additional questions, as the ones that have been sent through e-mail and through the site.

Thank you very much and see you soon. Bye.

Operator

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