Q2 2016 Earnings Call

Company Participants

- Bernardo Rothe, Head of Investor Relations

Other Participants

- Carlos Gomez, Analyst
- Carlos Macedo, Analyst
- Marcelo Telles, Analyst
- Mario Pierry, Analyst
- Nicolas Riva, Analyst
- Tito Labarta, Analyst
- Unidentified Participant

Presentation

Operator

Good morning, everyone and thank you for waiting. Welcome to Banco do Brasil Second Quarter of 2016 Earnings Conference Call. This event is being recorded, and all participants will be in a listen-only mode during the company presentation. After this, there will be a question-and-answer session. At that time further instructions will be given. (Operator Instructions)

This event is also being broadcasted live via webcast and through Banco do Brasil website, at www.bb.com.br/ir, where the presentation is also available. Participants may view these slides in any order they wish.

Before proceeding, let me mention that this presentation may include references and statements, planned synergy, estimates, projections and forward-looking strategies concerning Banco do Brasil, its associated and affiliated companies and subsidiaries. These expectations are highly dependent on market conditions and on the performance of domestic and international markets, the Brazilian economy, and banking system. Banco do Brasil is not responsible for updating any estimate in this presentation.

With us today, we have Mr. Jose Mauricio Pereira Coelho, CFO; and Mr. Bernardo Rothe, Head of Investor Relations. Mr. Bernardo, you may now begin.

Bernardo Rothe {BIO 18059993 <GO>}

Good morning. Thank you for participating in the conference call with the earnings release of Banco do Brasil. I'd like to start on page three, where we have the highlights for this quarter. Starting with the pre-tax, pre-provision earnings that increased by 14.9% in comparison to the second quarter of 2015. NII grew by 17.5% on the same comparison. Fee income also grew by 12.8%. Administrative expenses continue under control with a 2.7% growth; and cost to income ratio, as a result improved 39.7%.

On page four, we have the net income and how we got to the adjusted net income of -- in the first half of 3.087 billion. Starting with the last year first half of 6 billion, we have a positive impact of 3.8 billion NII; a negative impact of 3.1 billion in provisions; fee income contributed positively with 824 million; administrative expenses negative 402 million; other items and taxes are negative 2.3 billion, where we get to 4.8 billion in adjusted net income before specific cases of -- increase of provisions. This -- the specific cases net of tax got to 1.8 billion; then we get to 3.087 billion in adjusted net income. One-off items 1.7 billion in this half getting to 4.8 billion in the booking net income.

On this quarter, we also bring to you some other measures of ROE, which is the adjusted ROE that Banco do Brasil calculate is a little bit different from what the analyst calculate. So we have here the booking ROE of 12.3% in the second quarter. The adjusted ROE and the way that we calculate that's 7.7%, the market adjusted ROE that's 9.2%; and we also include here the shareholders ROE of 10.2. These shareholders ROE does not consider the impacts of the -- the instrument that's eligible for capital. Our (inaudible) net profit and also in the (technical difficulty) equity side to really give to everyone what we have -- what the shareholders have, as ROE 10.2%.

In page five, we ring you the pre-tax, pre-provision earnings. As you can see, it grew 14.9% compared to the second quarter '15 to 10.7 billion, a growth of 3.9% in comparison with the first quarter 2016. If we look at the accumulated earnings before provisions, 12 months' comparison between the second quarter '16 and second quarter '15 that growth is 13.5%. This earnings before provisions came in line with the estimates by analysts, all the analysts that cover Banco do Brasil came pretty much in line with what we forecasted.

Markets ratios in page six. Earnings per share, 0.88 and 0.63 for adjusted earnings per share. Dividend yields came at 7.62%, price/earnings 12 months, 4.6; and price/book value, 0.57. All of these indicated at the end of June '16. In page seven, funding. We reached 624 billion at the end of the last quarter. The highlights is the growth in savings of 0.7% nominal against June '15; and for Agribusiness, letter of credit and mortgage bonds of 1.7% growth same period. Funding expenses, as percentage of Selic reached 74.7%, stable in relation to previous quarters. And the adjusted net loan portfolio to commercial funding is also stable at 91.3%.

In page eight, we have other sources of funding, through our subsidiaries, starting with BB DTVM in the left side, which is 668 billion of assets under management, 22% (sic) market share and continued leadership in the market. And Brasilprev, also a leader in the market with 59.1% market share and net inflow reaching 9.5 billion in the quarter.

Page nine, loan portfolio in a broad concept, decreased by 1.2%, reaching 751 billion. The highlight here is the Agribusiness with a growth of 9.6%; and Individuals, 6.3%. Nowadays, Agribusiness and Individuals almost amount to 50% of our total portfolio against 45% that we had 12 months ago.

Page 10, we bring you more information about Individual portfolio and the concentration that we have in lower risk lines of credit. Starting with mortgages in the left side, a growth of 17.1% to 51.6 billion at the end of June 2016, being 5.7% growth in the mortgage with companies; and individuals growing 20.9% over June '15. Delinquency ratio in this portfolio is 1.29%, still very low.

Payroll loans, we are leaders in the market with a market share of 22.6%. We had a growth of 3.1% against June '15, reaching 63 billion. Delinquency ratio for this portfolio is 1.25%. Salary loans grew by 9%, 20 billion; and delinquency ratio in this portfolio is 2.52%. Auto loans had a decrease of 12%, reaching 21.5 billion; and delinquency ratio of 0.95%.

Slide 11, we have loans to companies, where we have the decrease of 5.4% to 327 billion at the end of June '16. By type of company, very small, small companies had a decrease of 13.7%; and the rest of the portfolio, minus 2.4%.

Slide 12, we bring you the Agribusiness portfolio, growth 9.6% reaching BRL184 billion. The growth in the companies portfolio was 11.8%; and Individuals portfolio, 8.7%. We are still number one in the market with 62% market share. We still use a lot of mitigators in our working capital, transactions reaching almost 65% of all the -- these type of transactions. And the last harvest, we had 82.4 billion in disbursements, 12.4% growth compared to the previous harvest.

Slide 13, given that a new resolution by the Central Bank of Brazil was published recently, the 4512, we decided to bring to you some information about our guarantees portfolio. We had -- we had at the end of last quarter, BRL19.3 billion in guarantees provided; and provision for this portfolio of 430 million, represent 2.2% of the total portfolio.

Slide 14, this slide [ph] talk about quality of the portfolio without [ph] delinquency ratios. Given that Banco do Brasil decides to treat as specific case in oil and gas, as delinquent for more than 90 days, different from our peers in the market, we decided to bring you this ratio taking out the impact of these particular case. As you can see, our delinquency ratio without that particular case would be 2.85% at the end of June. Considering this case in oil and gas, the delinquency ratio reached 3.27%.

By segment, Individuals still stable at 2.4%; Companies increased to 4.82%. Here we have also a calculation what would be the delinquency of this portfolio if the portfolio stayed stable in the same level as of March '16. So we have an impact of 20 bps that comes from the decrease in portfolio, the delinquency ratio would be 4.62%. Agribusiness decreased 2.94 -- 0.95%, again below 1% like in the previous quarters before March '16.

In slide 15, asset quality. We have here cover ratios and the balance of provisions. We reached almost 37 billion in provisions at the end of the quarter; and then we have a cover ratio of 109% for delinquency over 15 days; and 163% for delinquency over 90 days. Here also, it's important to consider the impact of this particular case so that you have a number that can be comparable to our -- our peers. So taking out the impact of this particular case, the cover ratio for transactions delinquent more than 15 days will grow to 119%; and for more than 90 days will grow to 187%. And below in the slide, you can see that most of the provisions were made for companies in the quarter.

Slide 16, it has the average risk and the evolution of provisions. We highlight here what came in the flow of provisions for each quarter in the last two quarters, what came from specific case and the increase in risk for some transactions involving certain segments in the corporate portfolio. If you consider the -- only the organic flow of provisions in our portfolio, in this quarter we would have 6.9 billion in provisions instead of 8.3, 6.9 billion is lower than what we had in December '15.

Average risk reached 5.36%, still lower than the market, as a whole and also for -- to make things easier to compare, we bring to you the -- what would be the average risk without this specific case that we have been mentioning. That ratio would be 4.94 and that's more comparable to 6.3% given that this specific case is booked in our offshore branches, so 6.3 does not consider offshore branches across banks of Brazilian banks.

Slide 17, NPL formation, we start on the top with the NPL formation, excluding the specific case that I mentioned. So the index would come at 0.98% below the previous quarter; and the cover ratio for the NPL formation would come at 120% this quarter. Below in this same page, we have the same calculation including this specific case, so with that -- including this specific case, the index would be 1.39.

Slide 18, again more emphasize of NPL formation, now including the portion of the renegotiated loan portfolio past-due more than 90 days. So for some of you that like to make these adjustment in the NPL formation, we have done the calculation for you and then the index would be close to the March '16 at 1.19; and the cover ratio would be 98.84%.

Slide 19, we have the renegotiated overdue loan portfolio details on that particular portfolio. In the last quarter, we have 5 billion in new contracts and we received almost 1 billion in cash as payment of principal and interest plus capitalized interest. Others, a very high volume almost 5% of the previous portfolio; and NPL 90 days for this portfolio reached 22.5%. Cover ratios are 183.8% and this particular portfolio now represents 3.6 of our total portfolio. Below in this slide, we have the formation -- NPL formation rate for renegotiated overdue loan portfolio that stands at 10.78 at the end of the quarter.

Slide 20, we start talking -- showing the net interest income and net interest margin. At the end of the quarter, we have 17.5% growth in the NII, reaching 14.6 billion. Looking at the first half as a whole, 28.9 billion, a growth of 15.6 against the first half of last year. Global spread reached 4.9%. Spread by segments, the highlight here is Individuals that increased by 50 bps to 16.3 The total portfolio also grew by 20 bps to 7.7. Companies portfolio stable at 5.9; and then we have a small increase in the Agribusiness as well to 4.9.

Page 21, fee income. We ended the quarter with 6 billion in fees, a growth of 12.8% against second quarter's '15 and 9.1% against the first quarter of this year. Looking at the first half of 2016, it's 11.6 billion, 7.6 growth against first half of 2015. Highlights here, account fees and asset management fees growing 24% and 11% against the first half of last year.

Page 22, we have some information about our insurance arm, BB Seguridade, adjusted net income reached more than 1 billion, a growth of 9.3. We're still leaders in certain segments, like pension plans, rural, insurance and life insurance.

Slide 23, we have our service network channels, more than 64 million clients and counting on more than 66,000 points of service, present in 99.8% of the Brazilian municipalities. And then we have, as a highlight being even increasingly more digital bank. Our app is the number 5 most present in all smartphones in Brazil losing only to WhatsApp, Facebook, Google and Instagram. Our new type of serving clients through the digital world called Estilo Digital and Exclusivo keep growing. Estilo Digital now has 552,000 clients through 143 digital branches, 240 branches by the end of 2016, that's our goal, to support 1.3 million clients.

Exclusivo, that covers individuals that have earned 4,000 to BRL8,000 per month, now have 52,000 clients through six exclusive offices and the aim is to have 32 offices by the end of 2016 to support 650,000 clients.

Automated service channels still the main way of our clients use to deal with Banco do Brasil, Mobile, is the highlight with 36.8% participation increasing favorable [ph] growth of 51% in 12 months reaching 2.5 billion transactions.

Page 24, we have administrative expenses and cost to income ratio. And cost to income ratio in the quarter reached 39.7% and in the comparing first half this year against first half of last year that indicator would be 39.1%. As you can see, our expenses continue under control. Other expenses are very flat quarter-against-quarter comparing half -- first half of '16 to first half of '15, a very small increase.

Slide 25, we have the Basel BIS ratio, where we reached 16.45%; and the core capital reached 8.42%, growing four quarters in a row. Slide 26, we have the full application of Basel III rules under BIS ratio going from 16.45 to 15.42 fully loaded and considering the use of tax credits, we go back to 16.59. Tier 1, 11.34%, same behavior we've reached 11.42.

Slide 27, we have the guidance of Banco do Brasil and how we performed against the guidance. Adjusted return on equity, 6.6, below the guidance, but we still believe that we are going to be within the guidance until the end of the year, given that we expect a better behavior in the second half of this year. Net interest income came over the guidance at 15.6, given even that now 11% seems to be the base of the guidance, we decided to change to 11 to 15.

Domestic loan portfolio in a broad concept came up with 1.2% growth below the guidance of 3 to 6, impacted by the companies portfolio that grew only 5.4 below the guidance as well. Given what we expect for the rest of the year, impact of the foreign exchange behavior in Brazil recently and the lack of demand, we decided to change the guidance to minus 10 to minus 6%, with that change there is an impact in the domestic loan portfolio as well, as a whole, so we decided to change from minus 2 to 1%.

Individuals portfolio grew within the -- inside the guidance and we expect to be inside the guidance until the end of the year. Agribusiness, a little bit over the guidance and we expect that Agribusiness is going to be -- to move to the guidance until the end of the year. Allowance for loan losses, inside the guidance of 4.3%. Although we had a very high level of provision in the first half, we don't expect to change this guidance. We believe that the second half, we're going to have a better behavior in terms of flow of provisions.

Fee income, 7 to 11, we came at 7.6, inside the guidance. And the administrative expenses, 2.6 below the guidance of 5 to 8, but we expect that until the end of the year, the administrative expense should move to be inside the guidance.

With that we finish the presentation and we would like to open for Q&A. Thank you very much.

Questions And Answers

Operator

Ladies and gentlemen, we will now begin the question-and-answer session. (Operator Instructions) Our first question comes from Mr. Tito Labarta, Deutsche Bank.

Q - Tito Labarta {BIO 20837559 <GO>}

Hi, good morning and thanks for the call. A couple of questions. First with the use of excess reserves, now that you've pretty much depleted your excess reserves, is it safe to assume that you feel comfortable, I guess with the outlook for provisions and asset quality for the rest of the year that you may not need any or see any other specific cases, as we saw in the first half of the year? I just want to get a sense because otherwise it could impact provisioning levels going forward. And just to make sure that the use of excess reserves is not included in your ROE and cost of risk guidance, is that correct?

A - Bernardo Rothe {BIO 18059993 <GO>}

Hi, Tito. Yes, talking about the excess reserve, the additional reserves provisions that we used to have. Just to clarify, make it very clear, when we create the additional provisions and when we use it, it does not flow through the recurring net income. As we create, as an one-off item, when we transform (inaudible) the required provision, it's also an one-off item. So the existence or not of additional provisions makes no difference for you guys when you project our recurring net income.

So it's something that we do when we believe is necessary and when -- and as I mentioned before, we have rules to do that how we are going to use it, when we are going to use it, the triggers for transforming additional in required provision and that's exactly what we did now. We don't see the need of doing additional provision at this point in time. As our guidance indicate, the level of provision in the second half is going to be lower than what we had in the first half of this year. So we are very comfortable with our guidance for allowance for loan losses, for provisions and with the performance during the second half of the year, it's going to be better than what we had in the first half.

But again, excess reserves make no difference in terms of the recurring net income of the bank not -- nor when we create and also when we transform that when required.

Q - Tito Labarta {BIO 20837559 <GO>}

All right. Thanks. That's very helpful. And then just another question in terms of capital. We've seen, you reduced your risk-weighted assets around 10% already so far this year, is there -- is there room to reduce risk-weighted assets further? And do you still feel confident that you won't need to issue equity to reach that 9.5% core Tier 1 by 2019 meaning that you can -- through retained earnings, grow your capital base and through the control of growth in risk-weighted assets?

Also, recently you issued a press release saying that you're looking to sell your stake in Patagonia. Any other asset sales that you think you would need or could happen as well?

A - Bernardo Rothe {BIO 18059993 <GO>}

Okay. Tito, about capital, we're going to still be managing our growth in the RWA that is -- that density should go down in the near future. We are shifting our assets, not only credit, but our assets to assets that consume less capital. We are going to continue doing that.

In the credit side, as you can see, it's been growing through lines that consume less capital and then we have a decrease in some lines that have a high consumption of capital as well. So same -- same quarter behind that. So our RWAs should go down over the time in terms of density. The ROE should go up as we're saying with provisions going down, the pre-provision, pre-tax earnings going up as they've been doing for quite a while now. So both behaviors are going to help us reach the 9.5% by 2019 and that's what we expect. We don't consider selling assets to reach the 9.5%.

Q - Tito Labarta {BIO 20837559 <GO>}

Okay. But does that include the potential sale of Patagonia, what you mentioned and how much do you think that would help?

A - Bernardo Rothe {BIO 18059993 <GO>}

What we have right now is what we inform to the market that we are now eyeing the possibility of doing something with our other shareholders of Patagonia. That's what we have discussed, exactly what we informed to the market last August 5.

Q - Tito Labarta {BIO 20837559 <GO>}

Okay. Great. Thank you.

Operator

Our next question comes from Mr. Carlos Macedo from Goldman Sachs.

Q - Carlos Macedo {BIO 15158925 <GO>}

Good morning, Bernardo, gentlemen. Couple of questions. First, could you give us some color on your NPLs on the SME book? We know that the corporate had the big one-time provision for the large corporate that went bad, but the SME book from what we can see in your vintage lines, it's turning the wrong way, how much of that is just your pull back with your portfolio coming down and how much of that is actually the quality, if you could give us some color there would be great? And then once you're done with that, I'll ask the second question.

A - Bernardo Rothe {BIO 18059993 <GO>}

Okay, Macedo. Thank you for the question. As we don't have the breakdown of the companies portfolio of delinquency by size, it would be very hard to give you the exact figures on that. But what I can tell you is the bulk of the delinquency in the companies portfolio come from the very small, small companies. That's the bulk of the delinquency that's in a segment that suffers more with the economy downturn that we are experiencing.

So the -- the new -- new vintage, it's serving us well with the decrease in the portfolio, that's why you can see in the vintage graphic that we have in the MD&A that for the first time, the new vintages is running over the previous vintages. By the way, that's what our performance that anyone would expect given two years of recession in Brazil. So still we have good things in the portfolio, portfolio suffering with decrease in the denominator, when we calculate the delinquency ratio. But that's the bulk of the delinquency that we have.

Q - Carlos Macedo {BIO 15158925 <GO>}

Okay. So second question is on the guidance. I mean, you've been pretty clear that you're keeping your 9 to 12 guidance on the adjusted capital. Just doing the math here, a lot of it is contingent on your cost of risk coming down from the first half of the year, which shouldn't be too difficult given the one-time provisions that went into those two quarters.

But from what I calculated, maybe the calculation is wrong, it would have to come down to the average of the second half of 2015, around 3.5% cost of risk. Isn't that a little bit challenging given the environment now compared to the second half of 2015? I mean you just mentioned that asset quality in SMEs was weak, probably going to see more weakness in the consumer through the end of the year, beginning of next with unemployment still being high. Wouldn't it be more conservative to guide for a slightly lower ROE, given all these headwinds that you're facing?

A - Bernardo Rothe {BIO 18059993 <GO>}

Well, Macedo, we have several things to consider here, one is the level of -- the flow of provisions over the SME portfolio. As the SME portfolio is going down, the flow of provision will go down, if we keep the same level of risk in the portfolio that's a given idea. So we have in fact of the decrease in the portfolio that goes to provision as well, so we have a much lower level -- much lower balance in the SMEs right now than what we had in the second half of last year.

Second thing, the last year -- the second half of last year is when the problem really started and when we had the pickup in delinquency and so on. So somehow the second half already represent a high level of provisions and to keep that at high level is not that difficult. In fact that as we've shown in the -- in one of the slides in presentation, the level of provisions without the -- some specific cases that we mentioned would be below the fourth quarter of last year already.

And then 6.9 billion that we mentioned, we are not excluding the Chapter 11s that's happened in the second quarter, given the big Chapter 11s that we had in the second quarter are included in the 6.9. Without one specific case, that balance would be 6.3, as you can see, much lower than what we had in the fourth quarter. So we believe that the guidance is correct; and we are moving -- you are going to move to the guidance until the end of the year.

Q - Carlos Macedo {BIO 15158925 <GO>}

But just as a follow-up, I mean, you have 9 to 12, to get to the bottom end of the guidance would imply around BRL5.6 billion in earnings for the second half of the year that's a -- that's a big pick up, I mean, what is the -- is the upper end of the guidance realistic or are we here targeting the bottom end at this point?

A - Bernardo Rothe {BIO 18059993 <GO>}

We believe that the guidance is the one that we have, we are going to be inside the guidance until the end of the year.

Q - Carlos Macedo {BIO 15158925 <GO>}

Okay. Perfect. Thanks, Bernardo.

Operator

Our next question comes from Mr. Nicolas Riva from Citibank.

Q - Nicolas Riva {BIO 16875766 <GO>}

Yeah, thanks Bernardo for taking my questions. So the first one is in loan loss provisions. So your guidance for this year implies about BRL6.6 billion in loan loss provisions for the next two quarters. Are we (Technical Difficulty) goes more to 2017 because assuming that we have some real GDP growth in 2017 and economy gets out of the recession, then if you run at about BRL6.6 billion, even with some growth in that number maybe in line with loan growth, we could see a decline in loan loss provisions in 2017 versus 2016. So my question is, if you're seeing that, if you're seeing a decline in 2017 versus '16 based on what you're seeing already for the second half of this year?

And then my second question on the ROE guidance. So the guidance for this year remains at 9% to 12%, even in the first half, your ROE was 6.6%, what it implies for the second half of this year is about 14% in the ROE, second half of this year. So my question once again, more going to 2017, assuming things get a bit better, if you see that 14% ROE, which you expect to get in the second half at the midpoint of your guidance as maybe the floor for next year, kind of the minimum level maybe being 14% ROE for next year? Thank you.

A - Bernardo Rothe {BIO 18059993 <GO>}

Thank you, Nicolas. Well, I'm not going to give you any indication for 2017, as we don't have the guidance approved. So anything that I say would be speculation on my side. But talking about the loan loss provisions, yes, we are going to reduce the flow of loan loss provisions in the second half; and we are going to be inside the guidance that we have, so we are comfortable with the guidance that we have right now. I'm not going to confirm your figures, depending on how we calculate, it can have very different figures. So what I can say to you that you can expect us to be inside the guidance until the end of the year.

About the ROE time frame, we believe that with the continued improvement in pre-provision results that we're still seeing that flow into the second half and also through next year and the decrease in the flow of provisions, the guidance is going to be achieved by the end of the year. For next year, we are going to see continued improvements in terms of provisions, as the economy should pick up according to what you can see in the (inaudible) report, so provisions should behave better than this year overall and our results should reflect that.

Q - Nicolas Riva {BIO 16875766 <GO>}

Okay. Thanks, Bernardo. Maybe the -- my only follow-up, this is in terms of NPL formation or the NPL cycle. Do you see more the peak been third quarter or fourth quarter of this year and things improving next year?

A - Bernardo Rothe {BIO 18059993 <GO>}

As you can see, if we take out these particular case in oil and gas, the NPL formation already decreased. So we expect that NPL should still go up until the end of the year then we are going to have a big impact because these particular case is going to shift to losses until the end of the year, then only with that NPL ratio should go down. So what we're saying and we're confirming that NPLs should go up until the end of the year and be stable during 2017.

Q - Nicolas Riva {BIO 16875766 <GO>}

Thank you.

Operator

Our next question comes from Mr. Mario Pierry from Bank of America.

Q - Mario Pierry {BIO 1505554 <GO>}

Hi, everybody, good morning. Let me ask you two questions as well, let me go back to the capital ratio. You do have your target of 9.5% common equity Tier 1 ratio by 2019. And the ratio is moving in the right direction now, although it is lower than one year ago. So my question is, if you could provide us with guidance rather than 2019 is where do you expect to be at the end 2017? This would help us or this will make it easier for us to understand your need to sell assets to get to your targets. So if you could provide us more like of a shorter-term target that would be very helpful.

The second question is related to, if I understand your message is that things are improving right, you're feeling more comfortable with asset quality, but at the same time, there was a significant change in the risk rating of your corporate book. So what I wanted to understand is, why now, what happened that made you become a lot more cautious of your corporate book and that you are now classifying your portfolio as much more riskier than you were one quarter ago, what happened in this quarter to make you more cautious? Thank you.

A - Bernardo Rothe {BIO 18059993 <GO>}

Okay. Starting with the capital ratio, the only goal that we -- that we release to the market is the 9.5 by 2019, so that's the figure that we have, sorry. And about the -- what we did this quarter, it's pretty simple. We analyzed the portfolio all the time. We check what we have and what we're expecting for the near future. We don't wait for companies to release their balance sheets or interim balance sheets to take decision in terms of risk and we decided to downgrade some risk that we have in our portfolio that's a nothing judicial recovery Chapter 11 or delinquents that's the decision that we took in this quarter based on our expectations for the portfolio. But we believe that what we have right now is the right level of risk in the portfolio, we present what we really run in terms of risk.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. So if you could be more specific then, which sectors in particular have you become more concerned about?

A - Bernardo Rothe {BIO 18059993 <GO>}

Okay. The sectors are oil and gas, few in mining, sugar and ethanol and a little bit of construction as well.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. Thank you.

Operator

Our next question comes from (inaudible) from Banco Safra.

Q - Unidentified Participant

Hi, everyone. Thank you for taking my question. I would like to raise here a notable dynamic in the second quarter related to the revenue generation. Despite the strong and noteworthy net interest income growth, if you look to the Bank's results, we can notice a significant distinction between the segment of individuals and companies. The individual portfolio is growing in (inaudible) it's growing almost all lines and credit spread is increasing at a strong pace.

For example, at the beginning of the last year, it was 13.5% and in this quarter, it reached 16.3%. And finally, the segment is presenting a significant, but lower impact on the NPL in comparison to the corporate segment. By contrast, the corporate portfolio has shrunk and the credit spread increased only 30 basis points compared to the same period of the last year. And this is the main segment responsible for the peak in defaults. In this sense, my question is, to adjust to the increase of the risk in the corporate segment, is the bank disclosing some increase in credit spreads in the segment and the corporate segment? And was there some specific issue there was -- that has prevented the bank to adjust over that period as the same way it was done with the individual segment?

And finally, can we expect the manners of such strategy for the next quarters? Thank you.

A - Bernardo Rothe {BIO 18059993 <GO>}

Okay. Thank you, Alao [ph]. In terms of credit spreads for the companies portfolio, if you compare, what's been going on in the -- given the size of the companies in the portfolio, the very, small, small companies decreased by 13%, the rest was portfolio minus 2%. Where we have the highest spread in this portfolio is exactly in the very small, small companies. So the change -- there is a big change in mix that everything else the same, will go against the spreads, making the spreads go down or up, right? So this small increase seems small, but it's not that small if you compare the change in the mix of the portfolio. Sorry. So credit spreads in companies are going up as well. But the changing mix is affecting the growth as mentioned [ph] to shoulder the total growth in the spreads in this comparisons that you are making.

If you don't mind, could you repeat the second question, please?

Q - Unidentified Participant

Was there some specific, sorry. Can we expect the maintenance of -- this strategy for the next quarter, growing your loan portfolio in individuals and so is there some room for increasing spreads in the segment and the dynamic of the corporate segment should continue to be the same?

A - Bernardo Rothe {BIO 18059993 <GO>}

Okay. Well, our -- in the individual side, we have repricing loans that we -- we did two years ago. So a big portion of our portfolio can see that these lower types lines of credit represent more than 75% of the portfolio with individuals are loans that have higher duration, but tends to go to five years or even more in case of mortgages. But it's the type of loans then the salary loans and payroll loans that the client usually, they pay and take a new loan every two years. So on average, we reprice the portfolio every two years. So what we are doing now is repricing what we did in 2014, but we still have room to keep repricing this portfolio to be in line with the interest rates that we have in the market right now. So that's the process, it's still going in that direction.

With the rest of the portfolio, we have lines of credit are repriced very quickly, right, like the credit cards and overdraft repriced immediately with pricing was done and we control the growth of these lines because they are the higher risk in our portfolio. So we are not going to increase -- just to make more interest through these lines of credit, we are serving our clients in a controlled way to avoid increasing the risk of the portfolio.

And if you look at the MD&A, just to give an idea how we've performed for example, in credit cards, delinquency ratio that we have is 3.9, it's going down, I would say, stable. So very low delinquency ratio compared to the rest of the market. So it's a good line of credit, but we have to keep it -- them in control to keep the delinquency ratio as good as it is right now.

So growth in individuals are coming through lines of credit with lower risk. So mortgages, we are going to perform better than the average of the rest of the portfolio. Payroll loans and salary loans are going to still be our focus, but you may see some increase in other parts of the portfolio as well given the demand that we have coming from our clients.

The corporate segment, the company segment, we are serving our clients (inaudible) the recent demand that come to us, but there is a decrease in terms of demand as well. Another thing that impacts the companies portfolio is the FX rate. So FX rate is a -- as a portion of the decrease, if you compare quarter-to-quarter, around 40% of the decrease in portfolio came from FX rates. So we are serving our clients, the clients that have the capacity to take loans from Banco do Brasil that reach the guidelines that we have to underwrite loans. So there is no change in strategy, we're still serving our clients.

Q - Unidentified Participant

Okay. Okay. Thank you, Bernardo. That was very helpful.

Operator

Our next question comes from Mr. Marcelo Telles from Credit Suisse.

Q - Marcelo Telles {BIO 3560829 <GO>}

Hi, good morning gentlemen. Thanks for -- thanks for your time. I have two -- two questions. The first question, when I look in terms of your NII performance in the quarter, we see that was very much driven on a quarter-on-quarter basis by higher credit recoveries, right? Once we exclude that your NII actually went down quarter-over-quarter. So what is the expectation for NII going forward, I mean, excluding your credit recoveries now that -- I mean putting it to deleverage optimizing RWA, would you expect the NII environment should be a little bit more difficult I had, in light of what you're doing to optimize RWA and despite let's say, the good performance on spreads?

And the other question is related on the credit recoveries. We saw a big spike in credit recoveries in the quarter. Some of your peers in the past, when had those -- some of these big [spikes] in some cases they had a specific recoveries that were only provision, right, so pretty much there were cash recoveries. So just help us understand the sustainability of that, can you disclose to us if there was anything that was, say, non-cash in this recoveries that was 100% provision? So those are my questions. Thank you.

And -- and the other question is related on the credit recoveries. We saw a big spike in credit recoveries in the quarter. Some of your peers in the past, when they had those like -- some of those big spikes in some cases, they had like specific recoveries that were only provision, right, so pretty much, they were non-cash recoveries. So just trying to understand the sustainability of that. Can you disclose to us if there was anything that was say, non-cash in this recoveries that was 100% provision? So those are my questions. Thank you.

A - Bernardo Rothe {BIO 18059993 <GO>}

Okay. Thank you, Telles for the questions. Well, starting with the credit recoveries, you have all the data in the MD&A, how much we recover in cash and how much we recover in installments. So usually close to 50% in cash, right? The informations there you can compare with the report [ph] performance in the previous quarters as well. So it's a 50% recovery in cash, this is losses. So as they -- they are recovered in installments, they have to go to the renegotiated overdue loan portfolio, a 100% provided at the risk age. So that's exactly what's going on to help -- happens like that, it goes back to the book at 100% provision.

Q - Marcelo Telles {BIO 3560829 <GO>}

So the remaining, what is not cash that -- of course, I need you to look through history, right? But that -- I should assume that was 100% provision, it's a good assumption?

A - Bernardo Rothe {BIO 18059993 <GO>}

It has to be, by the -- and according to the resolutions of the Central Bank, so it has to be.

Q - Marcelo Telles {BIO 3560829 <GO>}

All right.

A - Bernardo Rothe {BIO 18059993 <GO>}

Okay. And the impact, the renegotiated overdue loan portfolio, part of the new contracts that we have there come from recovery, as installments, all the recovery installments to get a portion of the recovery has to be paid in cash in a way, it's not 100% going to the renegotiated overdue loan portfolio without any payment in cash to be considered a recovery. So even though there is instalments on that, a portion of this has to be paid in cash when we do the recovery.

So performance this quarter was higher than the first quarter, because first quarter is usually we have lower recoveries, we have two months that are not very good for recoveries in January and February, also third quarter, we have July vacation. So recoveries in July usually every year is lower than the previous months. So we should have a lower level of recovery in the third quarter, but the fourth quarter is, usually is the highest level of recovery that we have every year. So it should pick up in the fourth quarter again.

In terms of the NII, we are comfortable with our guidance. The guidance represents what we expect for the full year. The level of NII that we have with the credit operations is stable, small reduction, more yield, given the impact of the FX in some of the lines that we have outside of Brazil, foreign branches, they are making the same amount of money, but the impact to NII was lower given the FX. So it's not something that's depending on the FX, should even go up or stay stable, you're going to see a pickup again in the third quarter. So we are not worried about that. We are very comfortable with the guidance that we have provided you guys.

Q - Marcelo Telles {BIO 3560829 <GO>}

Excellent and very helpful. If you -- if one final question, if I may, just on the asset quality side, what it, I mean, we've seen, I mean, you've a -- since you have a more constructive view regarding the provisions outlook for the second half of the year and perhaps for next year as well, so how do you reconcile that with the fact that those are big.

If you look at your NPL formation numbers, there was a big spike on your renegotiated portfolio in the first to the second quarter, right, then if you look at your NPL formations, including your renegotiated portfolio, not only what is 90 days, but that your overall number that would probably be about BRL8.5 billion already excluding this specific oil and gas case, right, which is more -- more or less similar to the level of provisions that you had in the second quarter.

So and given that the formation rates of bad loans within your renegotiated portfolio has actually been quite high for historical levels, you're still too comfortable that you don't see a risk that maybe provisions could be stable or maybe higher in the second half I mean that risk it's just not there?

A - Bernardo Rothe {BIO 18059993 <GO>}

First of all, as I mentioned before in our conversations, we don't agree we -- that we should put back all the renegotiated overdue loan portfolio in the NPL formation that's -- it's totally incorrect. Just one example, we have a big portion of the renegotiated overdue loan portfolio that came from losses. So there is no delinquency there. We are recovering things. So if we put that back -- back you're distorting [ph] the number. To consider that an NPL formation over 90 days, what would be in the NPL that was not because we renegotiated, okay. We agreed that why, we do that calculations to you give me a number that's not close to what would be the NPL formation without that particular case.

But we provide you also the breakdown of the portfolio to give some level of comfort that not everything that we have is bad loans, you can see that we have AA transactions, A, B, C, Ds and so one, the level of risk due age decreased [ph] by 10% if you compare with the previous quarter last year. So the quality of the portfolio is better. Of course it's a stress portfolio and some of the renegotiations that we did before the second half of last year was done given a particular scenario that changed pretty much after that.

So there is things that we have to do, but we recover big portion of the renegotiated overdue loan portfolio. Just to give an example. The historical level of delinquencies increased to 20%, let's say it's 20% and that all the NPL in the renegotiated overdue loan portfolio going to be a lot. So we are recovering 80% of it. Not the right, the number is even higher than that. So to assume that everything that we are renegotiating should be back and it seems -- and it's part of the NPL formation, in our point of view, it's not really the right way of looking at that. Going back to the (inaudible) second half, we are very comfortable with our guidance, so we are going to be inside the guidance.

Q - Marcelo Telles {BIO 3560829 <GO>}

Okay, yeah. No, the point I make on the provision -- on the NPL formation of the renegotiated portfolio that if you look historically, you are above 30% with pull back into [ph] NPLs, right? I mean, when you look today, depending on which base you use because there's definitely a big denominator, in fact will get to something between like 58% and 87% formation rates, using -- of course on an apples-to-apples basis. So -- but we can discuss more of that offline, but appreciate your answers. Thank you very much.

A - Bernardo Rothe {BIO 18059993 <GO>}

Right. Thank you, Telles.

Operator

Our next question comes from (inaudible) from Barclays.

Q - Unidentified Participant

Hi, good morning, Bernardo. I have a similar question to one previously asked. Just trying to assess the apparent stability or recovery of the individuals portfolio pretty much because we saw the spike in early delinquency loans in the first quarter, then it dropped in the second quarter, which I assume it has to be explained by some seasonality, but also we see the increase in the renegotiated loans. So the question is, I'm trying to assess the merits of the apparent stability of the delinquency rates of the retail portfolio.

And just to understand if it's just because -- during the quarter renegotiated loans increased and that kind of explains the reduction in the early delinquency rates for that portfolio, I mean that line, I know everybody seems to be more optimistic about the next quarters, but we continue to see companies to make material adjustments in their in -- their payrolls, for example (inaudible) yesterday, there was a headline that they fired 75,000 people. So it seems like the adjustment cycle for the labor market is likely to continue. So what gives you comfort that the apparent stability of the early delinquency rates or the quality of that portfolio is likely to continue to improve and not get worse later in the cycle.

And then the second question, it's regarding the potential sale of your stake in Banco Patagonia. Have you have -- you run a theoretical scenario, what would be the impact today or after -- of the second quarter, if you were to sell your stake in Banco Patagonia, what will be the impact on the Tier 1 capital ratio? Thank you.

A - Bernardo Rothe {BIO 18059993 <GO>}

Okay, thank you, Amebo [ph]. First, if you look at table 37 in our MD&A, we have the breakdown of the renegotiated portfolio for individuals and you can see what happened in terms of increasing balance in this quarter-against-quarter. So the increase was not that big and it's just a small part of the new contracts in the renegotiated overdue loan portfolio comes from individuals.

I think, I mentioned -- I think, I mentioned this call or on the previous, anyway, 75% companies, 25% comes from Nagro [ph]. So most of (technical difficulty) is not individuals and Nagro is in the companies portfolio. But anyway, you have the balance in the renegotiated credit for individuals in the table 37, you can see the behavior of that portfolio.

The first question, also you're talking about the companies portfolio, right? So going through that, we have a concentration of downgrades for the -- some business that we have in the portfolio that we are not expecting to happen again in the second half. In the Banco Patagonia, the answer to your question is, no. As we mentioned, we are analyzing the possibility of eventually doing something.

Q - Unidentified Participant

All right. Thank you. So -- so this is part of my question -- is it of your view that we might be ahead of the late deteriorating cycle in the asset quality portfolio? What I really need to -- want to understand is that once make sure that after we get off the cycle of the corporate portfolio, we don't enter another one in the individuals portfolio as we, I mean, this concerns come from the fact that we continue to see companies in the corporate side to continue to reduce their payroll, their employees. So what really I mean, if it's not the case tell me why but what really assures that the asset quality in the individuals portfolio is not going to get worse as unemployment continues to rise?

A - Bernardo Rothe {BIO 18059993 <GO>}

Okay. We have very low risk type of portfolio with individuals. Payroll loans are totally concentrated in pension using retirees and civil servants. The overall threat to [ph] individuals end up being like that as we shift to be like that through, as the economic downturn approaching, so and didn't start in 2015, we started with changing the mix way before -- before that.

So our individual loan portfolio is concentrated in people that receive their salaries through the bank, also in the private sector, unemployment I think, I expect a -- the low income portion of the population much more than the middle income and high income portion of the population is affecting everyone, but it's proportional unfortunately. So socially speaking unfortunately that the people that gradually didn't, they are the ones that are suffering the most. But that's such a segment that has no access [ph] to banks, in fact in the end, they don't finance themselves through banks. So that's why delinquency goes towards in other places, where the economy doesn't come to banks as in the same proportion as the unemployment goes up.

But the way we prepare our book in the individuals, it should be a less risk portfolio that reflects in the spreads that we have in our portfolio compared to the other players in the market, it's very different because we run a lower risk type of portfolio. So we don't expect the delinquency ratio in individual should go up, as the economic scenario plays out, okay.

Q - Unidentified Participant

Okay. So very clear. Thank you.

Operator

Our next question comes from Mr. Carlos Gomez from HSBC.

Q - Carlos Gomez {BIO 15024854 <GO>}

Hello, good morning and thank you for taking my questions. I have a question about the payroll lending. As you mentioned on page 37, we can see that it has grown 1.2% year-on-year, you will actually had a slight decline in market share. Now we know that some of the states and municipalities in Brazil are having financial difficulties, has that changed your willingness to lend to some of this entities or have you created any provisions for them or have you had a change in the pricing for these entities?

A - Bernardo Rothe {BIO 18059993 <GO>}

Hi, Carlos, just one clarification, just to let you know. These -- what you have in page 37 considers the overall payroll loans, including not only what we generate through our branches, but also, the transactions we acquire through -- from the market. So there was a big decrease coming from the portfolio that we bought in the market. You can see in table 39 that it went down by 46% against June '15. So take that out, we get to a growth that we have in the presentation that's 3.2%, that's basically what we are doing in our home branches and we are doing. We are still serving our clients and this is important line of credit, very low delinquency ratio, we don't have any problem with any of the employers in the market, so it's very comfortable business for us.

Q - Carlos Gomez {BIO 15024854 <GO>}

However, we know that there are some states that have had to delay the payment of their payroll. Have you had any such cases and have you made any provisions in case some of these entities do have that problem?

A - Bernardo Rothe {BIO 18059993 <GO>}

The level of delays from employers to Banco do Brasil is less than 1 bp.

Q - Carlos Gomez {BIO 15024854 <GO>}

All right. Thank you very much.

A - Bernardo Rothe {BIO 18059993 <GO>}

Okay.

Operator

This concludes today's question-and-answer session. I would like to invite Mr. Bernardo Rothe to proceed with his closing statements. Please go ahead, sir.

A - Bernardo Rothe {BIO 18059993 <GO>}

I just want to thank everyone for participating in our conference call and to say, have a good afternoon. Thank you.

Operator

That does conclude Bank do Brasil conference call for today. As a reminder, the material used in this conference call is available on Banco do Brasil Investor Relations website. Thank you very for your participation and have a nice day. You may now disconnect.