Q2 2014 Earnings Call

Company Participants

- Luiz Carlos Angelotti, Managing Director & Head-Investor Relations
- Maurício Machado de Minas, Executive Vice President
- Paulo Faustino da Costa, Market Relations Officer

Other Participants

- Boris D. Molina, Analyst
- Mario Pierry, Analyst
- Philip J. Finch, Strategist
- Saul Martinez, Analyst
- Thiago Bovolenta Batista, Analyst
- Tito Labarta, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentlemen. We would like to welcome everyone to Banco Bradesco's First Half 2014 Earnings Results Conference Call. This call is being broadcasted simultaneously through the Internet in the website bradesco.com.br/ir. In that address, you can also find the banner through which the presentation will be available for download.

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

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're related to future events, and therefore depend on circumstances that may or may not occur in the future. Investors should understand the 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. Paulo Faustino da Costa, Market Relations Department Director.

Paulo Faustino da Costa {BIO 17286050 <GO>}

Good morning, everyone, and thank you all for participating in our conference call about the results of Bradesco in the first half of 2014. We are here to provide you with all the information you may need about our numbers and this is in line with our goal of always increasing the transparency of information disclosed to the market.

We have here today Mr. Julio de Siqueira Carvalho de Araujo, Executive Vice President; Mr. Marco Antonio Rossi, Chief Executive Officer of Bradesco Group and Bradesco's Executive Vice President; Mr. Maurício Minas, Executive Vice President; Mr. Luiz Carlos Angelotti, Executive Managing Director and Investor Relations Officer; and Mr. Moacir Nachbar Jr., Deputy Officer.

I will now turn to our Managing Director and Investor Relations Officer, Mr. Luiz Carlos Angelotti, who will lead our conference call. After his presentation, we will be open to answer your questions. Mr. Angelotti, please go ahead.

Luiz Carlos Angelotti {BIO 4820535 <GO>}

Good morning, everyone, and thank you for taking part in Bradesco's Second Quarter of 2014 Conference Call. Let's now look at slide 2. Slide 2 shows the highlights for the period, beginning with the adjusted net income, which is amounted in the second quarter 2014 to R$7.277 billion, 22.9% increase year-over-year.

Our ROAE reached at 20.7%, the best performance for the last eight quarters. Our insurance operation, which is one the pillars of our business, has also performed well, with a net income of R$2.112 billion, 13.5% up year-over-year, mainly due to premium growth, cost control, and the maintenance of the cancellation, further reinforcing great prospects for this business.

The net – the interest earning portion of our NII went up by 8.2% in the last 12 months, due to the increase of business volume, especially on the loans and the funding sides. Please pay special attention to our efficiency ratio, which reached its – the best level since December 2009. Our number is 4.9% (sic) [40.9%] in this quarter.

Our operating expenses increased 3.8% year-over-year, 270 basis points below the inflation, the IPCA. Total assets amounted to over R$931 billion, and our expanded loan portfolio amounted to R$435 billion.

Slide 3 shows the reconciliation between our booked net income and adjusted net income. In this quarter, the only non-recurring item was the provision for civil contingencies, totaling R$43 million gross. Adjusted by this event, our booked net income rose from R$3.778 billion, to an adjusted net income of R$3.804 billion. As previously mentioned, our return on adjusted average equity changed to 20.7%.

On slide 4, you can see that income growth in the second quarter of 2014 was mainly driven by higher net interest income, both interest and non-interest earning portion, which was offset by the increase of provisions for loan loss in part, due to a modest increase in overdue loans, as well as a review on clients, specific clients' credit ratings, and an increase in personnel and administrative expense.

Year-over-year, we've seen that the adjusted net income recorded an increase of R$1.356 billion, or 22.9%, basically due to a higher interest earning portion of the NII, and the increase in fee and commission income, reflecting the increased business volume and the larger offer of products, as well as a growth in our checking accounts and the credit card client base. These events were offset by a higher personnel and administrative expense, but still below inflation level. Our 12 months earnings per share increased from R$2.79 to R$3.23.

On slide 5, we present the breakdown of our net income, which remained practically stable in the quarter. Year-over-year, the highlight is the funding share in net income, due to the higher SELIC rate and an improvement in the funding cost structure, better management.

Moving to slide 6, our 12 months efficiency ratio remains at 40.9% in the second quarter of 2014, 100 basis points up quarter-over-quarter, and the best level since December 2009. We had reported the best quarterly efficiency ratio in the past five years, 38.6%. Please note that such performance came as a result of increased business volume, along with the behavior of operating expense, helped by the strict cost control. We target a 12-month efficiency ratio of 39% for the remainder of the year, and our efforts will remain in place in the following periods, so that we can push down the target to have a better improvement for the next period.

The blue line shows the risk-adjusted efficiency ratio, which stood at 50%, an improvement of 140 and 206 basis points quarter-over-quarter and year over year, mainly reflecting the drop in delinquency in addition to the aspects I just mentioned. It is also worth noting on the top of the line, our operating coverage ratio. That is the relation and we see ending commission income to administrative and personnel expenses, which came to 74.1%. This ratio is a measure of our ability to cover operating expenses with the fees and commission income, and it rose to its highest point since 2008.

Slide 7 shows that unrealized gains amounted to R$21.7 billion this quarter, R$6.7 billion up quarter-over-quarter. Such increase was basically driven the appreciation of our investments, especially our shares of Cielo, which went up by 25.8% in the quarter and the fixed income securities. These figures do not include the R$5.3 billion related to the potential surplus value of our properties.

On slide 8, you can see our net interest income from both non-interest and interest-earning operations. The R$1.1 billion growth experienced in the quarter was mainly due to the increase in the interest earning portion, particularly securities and others, loans and funding and the increase in the non-interest earning portion, reflecting the higher market arbitrage gains. Year-over-year, the increase was mainly caused by the growth in the interest earning portion, mainly loans and funding. Annualized net interest margin reached 7.7 in the second quarter of 2014, mainly due to an improvement in all business lines that make up the interest-earning portion of the net interest income.

We had some additional effects because this quarter we had less business days than when you do the calculation of the margin, you have some effects in the calculation that will improve the margin. But we expect the NIM for the next quarters, only talk about the NIM for the quarter, something around 7.5%. But for the full year of 2014, we expect the NIM in the level around this 7.3%.

Now looking at slide 9, our interest earning portion of the net interest income, reached R$11.9 billion this quarter, an increase of R$903 million, particularly securities and others, loans and funding lines, which presented an improved average in spreads. Year-over-year, we highlight loans and the funding whose growth rates were due to the increased volume of operations, whereas for loans such growth was a good to offset the reduction of average spreads, mainly as a result of changes in the portfolio mix.

For the funding line, there was also a contribution of our improvement – of our improved funding cost structure focused on retail, associated with the higher SELIC rate in the period. And we are giving priority for the retail funding, and the line is with less cost and then this is helping us to improve it again with the funding, help us improve the funding margin.

Slide 10 shows that in this quarter the net credit margin, the blue band on the chart remained virtually stable quarter-over-quarter. Year-over-year, we experienced a 9.4 growth as a result of the increased business volume and the reduced delinquency costs. For the next periods, we expect delinquency ratios to stabilize at current levels. As to the provision for loan loss, the red band on the chart which was slightly impacted this quarter to some extent by a small increase in the overdue loans, and the review on the specific client's credit rating. We also expect H2 to remain stable, delivering a PLL-to-gross credit margin ratio of 37% or 38% in the next quarters.

In slide 11 we show our Basel ratios, on slide 11. This total ratio stood at 15.8% in June of 2014, while the Common Equity Tier 1 ratio came to 12.1%, remaining at very comfortable levels. On the right-hand side, you can also see a simulation of our Basel III ratios on a fully phased-in basis, with our Common Equity Tier 1 ratio reaching 11.1%. The ratio shows on the simulation are consistent with the stable progress of our results, and remain coupled with the soundness of our assets and strong capital levels. Therefore, the phase-in implementation of the rules will not limit our ability to finance our clients.

On slide 12, we can see that our total assets amounted to R$931 billion, 3.8% up year-over-year. The return on average assets reached 1.6% per year, while the adjusted return on average equity was 20.7% per year. As I mentioned before, the best performance in the past two years. A similar ROAE level is expected for the following quarters. Then we expect to maintain this level of ROAE for the next quarters and the next year.

Slide 13 shows that our expanded loan portfolio amounted to R$435 billion in June 2014, 0.7% up in the quarter, and 8.1% up on the annual basis. The quarterly performance was mainly driven by the increase of 1.8% in loans for individuals, and in the annual comparison there was an increase of 9.9% in loans to large corporates, as well as 9.6% for individuals.

In the corporate segment, products that posted the strongest growth in the last 12 months were real estate financing and foreign transactions. And in the individual portfolio, the highest growth were in the real estate financing, 35%; and the own payroll-deductible loans, 26.9%.

Also, the drop in the SME's share of the total portfolio, as can be seen in the graph, was mainly due to our faster pace of growth. More conservative loan products such as payroll-deductible loans and the real estate financing, as well as loans in large corporates. By the end of this year, we anticipate the loan growth – our expectation is to have something around 10%, at the bottom of our guidance range.

Slide 14 shows that year-over-year our 90-days delinquency ratio decreased from 3.7% to 3.5%. This was mainly the consequence of changes in the portfolio mix, the continuous improving of loan ranking procedures and systems, and the improved credit risk monetary models.

Quarter-over-quarter there was a slight increase, mainly – 0.1%, mainly due to the lower loan growth. In the fourth quarter we had a deceleration in the loan portfolio growth and this affected this 0.1%, probably 50% of the effect is because of the deceleration in the growth of the portfolio.

And another event that we had is some specific provision for specific clients in the corporate segment. It's important to mention that the easing with lower loan growth, the short-term delinquency, the graph that is at the bottom right-hand side, that is 15 to 90 days delinquency ratio, is the short delinquency ratio, has remained stable year-over-year, and it experienced a slight reduction quarter-over-quarter, indicating that there is no growth trend in the delinquency. Then we expect now that our delinquency ratio will – to continually stable, same with the track happened that we have, with minor changes in a few case, therefore not represent a trend. Then we can have some movements, small movements in the future, but it will not represent changes to have the delinquency ratio to grow. We expect the stability for this year and the next year.

Slide 15 shows that our provisioning ratios remain robust. Assuming that the maintenance of the 12 months net loss ratios as of June 2013, that is around 3%. We have R$11.9 billion of excess provision, when we compare with the total provision that we have in the balance sheet. In June of 2014, the coverage ratios for loans overdue by 60 and 90 days have remained at comfortable levels, reaching to 149.9% and 186.9% respectively.

Slide 16 in the second quarter of 2014, fees and commissions income amounted to R$5.3 billion, 0.9% up over the previous quarter, mainly as a result of an increase in business volume. On an annual basis, fee and commission income increased by 10.7%, led mainly by the increase of our customer base and transaction volumes, as a result of continuous investments in service channels and technology. The types of income that contributed most to this result came from a good performance of credit cards, checking accounts, loan operations and consortium management.

Fee and commission income is expected to continue growing even more, mainly in the asset management and card segments. And we expect to finish this year around the higher level of the guidance. Our guidance is 9 to 15. Then we will probably finish the year more in the higher level of the guidance.

In slide 17, we see OpEx increasing 3.8% quarter-over-quarter, and also when compared to the first half of 2013. This increase is in line with our goal of keeping expense growth below inflation, this year it's around 6.5%. Quarter-over-quarter, this increase is mainly due to the higher personnel expense impacted by a lower concentration of vacation leaves during the period, and the increase of administrative expense, primarily due to the increase in business volumes in the quarter, resulting in greater expense, with the maintenance of (24:01) assets and the backup processing and the third-party sales.

OpEx on the first half of 2013, administrative expense went up by only 0.4% as a result of continuous strive to reduce cost, considering the organic growth recorded in the period. The increase in personnel expenses refers mainly to the payroll adjustments arising from the 2013 collective bargaining agreement.

Taking into consideration our ongoing pursuit of improved efficiency through our efficiency committee and the investments in technology, we believe that we will continue to deliver OpEx growth below the inflation level in 2014. And our target for this year, the guidance is between 3% and 6%, and probably we expect to finish the year around the center of the guidance.

In slide 18, we have some information about the insurance business. We show the insurance written premiums, pension plan contributions and capitalization bond income, which increased 22.2% quarter-over-quarter, mainly due to the strong growth in segments such as life and pension plans 46%, auto and P&C 10%, and capitalization bonds 7%.

On the annual basis, we have seen an increase of 5.2%, mainly in segments such as auto, health and the capitalization bonds. Please note that the valuations observed in life and pension plan segments reflected the overall behavior in the pension plan market.

The net income in the quarter increased 3.1%, mainly due to 22.2% increase in the revenues, the improved financial results, a stabilization (26:18) of the claims ratio, and the improved administrative efficiency ratio.

Year-over-year, the 13.5% increase in the net income is a result a 5.2% increase in the revenues, improved financial results, reduced expenses and claims ratios, and the maintenance of administrative efficiency ratio.

On slide 19 some of the main figures of our insurance activities are on slide 19. Our financial assets amounted to R$154 billion, while technical reserves stood at R$143 billion, R$124 billion of which from life and pension plans.

Finally, I would like to emphasize that our results in the second quarter of 2014 which allowed us to maintain a little more than 20% ROE, are due to actions associated to our strategic planning, and to promoting a consistent and sustainable results.

As you can see in our financial statements, we have improvements in all main lines in our NII. We could have improvements in our fees. We are having double-digit growth. We are having strong cost controls. And our insurance business has maintained the ROE around the 25% a year, and we see a lot of opportunities for the insurance business in the country. And we had success here in the (28:23) of our asset portfolio.

Then the combination of these movements is helping us to maintain our consistent results, and we expect to maintain this ROE at the 20% level or more. Then we are confident that we are in the right track to reach the goals that we outlined for 2014. We established to maximize our return for our shareholders.

Thank you for your participation in our conference call, and now we would like to invite you to our Q&A session.

Q&A

Operator

[Operator Instruction] Our first question comes from Philip Finch with UBS.

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

Good morning, Mr. Angelotti, and thank you for your presentation. I have really two questions. One is regarding your loan growth guidance, which you kept intact. Now obviously in the first half we saw weaker growth coming through. Can you just explain in a little bit more depth and color what gives you confidence that we should see stronger growth coming through in the second half, and maybe in fourth quarter in particular, if there's only seasonality that should give us confidence that you'll achieve your guidance range?

And the second question is regarding asset quality. Obviously, we saw deterioration in terms of the NPL ratio, although the early lead indicator suggests that things are improving. Again, can you tell us – give us reassurance why you think second half we should see further improvements in terms of asset quality. What are the indicators that give you that confidence going forward? Thank you very much.

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

Okay. Hi, Philip. Thank you for the questions. About the loan growth, we understand that we – it's possible to reach the 10% growth. That is the lower base of our guidance because normally in the second half, we have some movements from the companies that today start to improve their investments or to have products to offer for the pricing at the end of the year.

Normally in the last part of the year, we have an increase in the consumption, and the companies need to start to be prepared before. Then probably in this third quarter, we expect that the companies will do more investments, and we will have more great demands.

From the individuals, we have products that is growing in the high level, namely payroll moves and we are stating loan. Then this product is growing around 35%. And probably they will maintain this level to grow. It could have some improvements. But we had other products, namely credit cards, that in the first half of the year we – they didn't grow as we expected, and now in the second half, we expect that the credit cards probably will have some increase, and the other operations for individuals will have this similar movement.

Then we understand that's possible to reaching the base of our guidance that is at the 10%, and this movement we understand that probably will be – we will reach the 10% or a little less, not to affect our expectation for the margin growth for this year, because our spread margin, the new operation that we have this year, the new originations is getting better spreads and probably for the next quarter, we will have some additional contribution for this new portfolio that we have at this better spread.

Then the loan growth, we understand that it's possible to reach this 10%, and our margins, our expectations for the margins growth NII not should be affected too much. The asset quality, this quarter, we had a small increase in our expectation, the delinquency ratio for a 90-day was 3.4% and the increase were 3.5%, a 0.1% increase.

One effect that we have here is, because here we had a deceleration in the loan portfolio growth. We was growing actually 10%, and now we are growing 8%. Then on this movement, we had mathematical affect that is around a negative 50% (34:22) of this 0.1%.

Then one effect is a mathematical effect. And another effect is a small increase in the overdue operations that we needed to do a little more provision expense. And in specific clients, corporate clients, bigger clients in some cases, we did some adjustments in rates specific clients. Then this combination in the quarter, we had an increase in the expense around R$280 million.

But this movement doesn't represent an expectation of increase in the delinquency ratio, because when you look for the short delinquency ratio, our delinquency ratio between 15 and 90 days in this quarter, we had a decrease. Then this shows that the effect in the third quarter, we expect stabilization or a decrease in our delinquency ratio, and this movement will continue for the next quarter.

Then our expectation is for delinquency ratio is a stabilization between 3.5% and 3.4%. We could have some movement, a little movement, increase and decrease, but we don't see any changes or much increase in the changes (36:00) of the stabilization. For the expenses, probably the level that we had in this quarter, we expect that we will maintain for the next two quarters in 2014. Then probably this will be the maximum level expense for the next few periods.

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

Thank you, Mr. Angelotti. That was very reassuring to hear.

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

Okay. Thank you, Philip.

Operator

Our next question comes from the Mr. Saul Martinez with JPMorgan.

Q - Saul Martinez {BIO 5811266 <GO>}

Hi. Good morning, all. I hope you can hear me. I guess I'm struggling with the explanation for why you're comfortable with asset quality. If I look at the numbers, it was a pretty broad based increase in delinquencies. I understand it was only 10 basis points in 90. It was 20 basis points in 60. If I look at the formation adjusting for charge-offs of NPLs, it increased pretty substantially this quarter. The 15 to 90 days, is that really an adequate indicator of what your asset quality will do considering that there's a high degree of seasonality to that number? When I look historically second quarter's generally show early stage delinquencies improving even when things are worsening on the 90 days and provisions.

So I guess why – can you give us a little bit more color as to why you feel comfortable with the provisions and asset quality guidance for the full year and what economic assumptions are embedded in that guidance as well? And I have a follow-up question as well.

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

Okay. Hi, Saul. About the asset quality, why we are comfortable, when we analyze our portfolio, if you look in, we are having a consistent improvement in the quality of our portfolio. During the last two years, our delinquency ratio is decreasing, and we are investing a lot in the course of our models to analyze and approve the credit. And we did investments in the quality of the models and in technology. Then we understand that we developed good models and the quality of our portfolio is very consistent. And the – another movement that we have is because the mix of the portfolio, we had some operations that is increasing – the participation our portfolio that is reducing the risk.

An example of operation that SME payroll loans and the real estate financing, they are growing at the level 30% a year, 35% a year. Then one effect in our portfolio is the mix that is improving with the operations with less risk. But when we analyze now our portfolio, example our short-term delinquency ratio, as you can see, show a decrease in – for individuals and for companies. Then this movement shows that the portfolio, or the movement that we have in the second quarter, is only a specific movement, the effect that we did in the increase in the expenses is because we had some specific clients, more corporate clients, that we need to do some adjustment in the rate as well as some additional provisions that affected a little our expense.

But when we analyze our other operations, individuals for our products, we see now in our portfolio that the delinquency ratio we have stability. For SMEs and the other clients, corporate clients, we've seen our portfolio that the tendency now is actually to return for stability. We don't see for the future the risk, for example, individuals increase the delinquency ratio.

Our expectation for unemployment rate that is something that could affect the delinquency ratio for individuals is that it will increase a little the unemployment rate. That is probably this year it will increase 0.3% only for 2015, a little more than 0.3%. Then this small increase in the unemployment rate, we understand that it will not really affect our individual's portfolio.

And for the other portfolio, corporates and the SMEs, we don't see risk here in the quality, because when we select better our clients, we have – for SMEs, we had – we maintain our clients with a very closer margins there. We maintain a specific platforms in our structure with the segmentation for corporates and the medium companies where we can – to be very close to our clients, and we can anticipate any risks in our portfolio.

Then this administration, that this management that we do in the risk, and we are comfortable that our delinquency ratio for the next quarters probably will maintain stability. Then this is our view about our portfolio and our situation.

Q - Saul Martinez {BIO 5811266 <GO>}

Okay. Thank you for that. If I can ask one other question on the NII, on page nine, the securities and others obviously increased substantially, R$1,236 million versus R$861 million in 1Q is up 44% Q-on-Q. You mentioned in your release that in part it has to do with re-pricing and the impact of inflation, IGP-M and IPCA indices. Can you give a little bit more color as to what exactly happened in that line item?

And I believe, correct me if I'm wrong, your expectations for this year for that line item to grow, I believe, roughly 10%, if you can confirm that, that would be great.

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

Okay. The way that we show our NII, we be dividing in the correct margin, the funding margin. This is normally operation with price. And we have the insurance margin and in our operations we have with insurance is in this line. Then this effect that you talk about, the IPCA and the IGP-M effect, we have only in the insurance portfolio. And this quarter was something like R$80 million. Then this is only in the insurance business.

In the bank we don't have this effect between IPCA and the IGP-M, only in the insurance business, because we have the liability in IGP-M. And we don't have the – an offer to cover this, to do the hedge budgeting, then we do the hedging partially with the secured with IPCA ratio. One thing secured in others that is the last line that we have in the NII.

We have here our other effect in the balance sheet about margin, excluding credit, excluding funding from clients and excluding insurance. Then here we have the one big thing. The asset liability management that we have here. We have the one effect that is improving the revenues in the last three quarters, and in this quarter is our predicted loan portfolio that normally when we do a loan operation, or to have the NII to the correct margin, we mark the operation in the day with the rates that we have in the market.

And the operation that we have long-term, we transfer the risk for the treasurer department to do the hedge or not. In this decision of to do the hedge or not, sometimes they don't – so they decide not to do the hedge. And the effects of this pre-fixed loan portfolio, we had flat, is affecting this line.

Last year, with this – in 2013, with the fast increase of Selic rate, our prefix portfolio, loan portfolio, lose some revenues compared with the Selic group. But now this portfolio is renewing, and the new operation is reflecting the rates that we have in the market. Then the effect of fast growth of Selic that we had 2013, in 2014 we have Selic with stabilization, and the – our portfolio, loan portfolio of prefix portfolio, is renewing and in turn our age of this portfolio now is better.

And the one factor in this line is that this additional revenues is growing quarter-by-quarter. Then this one part of the effect, one another effect that we have in this quarter is because we have last business days, and the operation that we had costs are related to Selic, then we had some additional positive effects. Then the combination of these effects is that we helped us to add R$1.2 billion in revenues.

For this line, we expect that probably these revenues will continue improving for the next quarters, because this combination of the effects that we have in this line, and probably we will finish the year in this line, we see a growth, when you compare 2014 with 2013, between 5% and 10%.

And the effects of this line, they are sustainable, because they are related with our asset liability management, and the effects that we have in our other line is in the balance sheet, some securities that we have, example debentures that we – some of these debentures that we maintain in this line that has some (48:57). This combination that's reflecting this line.

Then the revenues in this line, they will continue growing this year. And they will – are sustainable. Then this is why we understand that the guidance that we gave for the NII that is 6% to 10%, and now we have a growth of 8% probably. We will maintain this 8% for the end of the year.

It could be that we will finish a little more than this 8%. But we are thinking 8% is very possible to reach, because in the other lines, we have the credit margin that now we have at 4.2% growth.

Probably we expect to finish the year with the next 5% or more, because the new loan operations, the new origination is having – is growing with better spreads than this. Better spreads will help us to improve a little more the revenues for the next quarters.

The funding margin that we have here, we are working to give priority for the funding from the retail clients or the two – we are getting priority for lines where we have the less cost. Then this management that we are doing for the funding costs is helping us to improving the revenues.

And probably we will finish the year with something – with a growth 2014 compared with 2013 around 30%. Insurance probably we will grow between 10% and 15%. That is the historical record that we have. Then this combination, I think, is possible reaching the center of the guidance here around the 8% or probably to have a little better performance through the end of the year.

Q - Saul Martinez {BIO 5811266 <GO>}

Okay. That's very helpful. Thank you for that very detailed response. Appreciate it.

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

Thank you, Saul.

Operator

Our next question comes from Mr. Mario Pierry with Merrill Lynch.

Q - Mario Pierry {BIO 1505554 <GO>}

Hi. Good morning, everybody. Let me ask you two questions as well. At the beginning of your presentation, you've talked a lot about the efficiency ratio and how it has improved so much.

Looking forward, I wanted to hear from you. What else can you do to improve the efficiency ratio? Because the bank recently announced an agreement with IBM? You also – the banks here in Brazil announced that they will start sharing their ATMs. So my question is more, it seems to me there's room for you to maintain expenses growing well below inflation, at least, for the next couple of years. So I wanted to hear from you. What is your opinion on that?

And then related to your fee income growth guidance, if I'm not mistaken, you guided for fee income to grow at the upper end of the range this year. I think you mentioned 15%, but when I look at the evolution of your fees, the growth rate that we saw this quarter decelerated to 7%. So I'm just wondering why do you expect to see an acceleration in fee income growth going forward. Thank you.

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

Okay. About the efficiency ratio, we are working hard in the last year or two to improve our efficiency. In Q2 2011 we had the fastest growth in our operations. We had internal growth and we did many investments. And since 2011, when we opened 1,000 branches, now our investments are to cover our accounts. Now we are improving process, internal process. Then we have the efficiency committee, and we improve all areas in the bank and everyone is looking inside of their departments to see opportunities for reduced costs, revising process, or revising contracts.

And in the last two years we could maintain costs growing less than inflation. This year our expectation is to continue this movement. Our guidance is 3% to 6%, and probably we expect to finish in the center of the guidance. Many implementations that we did during these two years, we have more new process to improving for 2015 that will help us to improve the efficiency.

But another thing that will help us to maintain our efficiency and improve the efficiency and will help us to maintain costs probably growing less than inflation in the next quarter is our IT recalibration plan, that is we start the implementation in 2005, and now we are finishing the process of to rewrite our systems and now we start the implementation of the systems to put these new systems running and to turn off the old. And Maurício Minas, that is the Vice President of the IT department, will give you better color about these investments and the effects for the next quarters.

A - Maurício Machado de Minas

Hi. Good morning. This is Maurício. As you probably know, IT is a major cost center for us and most of the retail banks operate with that. And any gain of efficiencies that we might have, we are always pursuing that. The two examples that you just gave us, which is the Scopus transferring to IBM is a good case. What we're aiming in that movement is basically to operate under the activity that IBM has through its scale of its operation and build on that, have gains of productivity, as well as having better tools for providing very same services that we used to do at Scopus with higher efficiency. That means using different software tools, using business analytics for forecasting whatever might happen in the future and base it on that to have these gains for us.

The other good example is what we've just did, and that's valid for all the banks in Brazil regarding transferring our off-premises ATMs into Tecnologia Bancária or Bank 24 hours. That's again a movement where we keep or even improve the quality of services to clients. And at the same time, we have some cost reduction.

On the other hand, as Angelotti just mentioned, we started a major program years ago for revitalizing our IT. Everything, which is related to infrastructure, is already accomplished, and we've been capturing these efficiencies in the last years. But the major initiative is a total new applications architecture that instead of being only an IT project, it's also a transformation program for the bank. As we used this opportunity for changing dramatically the processes, the way we do business, the products and the services that we provide to the marketplace.

And regarding that, about 90% of the development of this program is already done. But one thing is to develop and to test; the other thing is to go through change management. That means the rollout of all those products and new processes into the field. This takes time, because we are very cautious for not bringing any operational risk to the bank. And at the same time we have to start slowly to see how it reacts in a very complex environment.

What I mean, is we started capturing those gains by the end of last year. We're going to capture part of that during this year. At the end of this year, we will be probably close, something between 30% and 40%. By the end of next year, we are going to capture more than 50% of the gains. And our expectation is really to accomplish 100%, about the end of 2016.

That's why Angelotti says IT is contributing for that to have a better efficiency ratio as a whole. It's an incremental effort. It's not a big bang. And as soon as we are able to capture it, it's reflected into our figures.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. That's very clear. Just let me ask you two questions on that then. If you're able to quantify the benefits of the ATM sharing that the banks just announced, and also if you are willing to give a target for your efficiency ratio for 2016, because clearly, it seems like there's plenty of room here to improve. And your efficiency ratio is already, as you mentioned I think at the beginning of the presentation, at the lowest level in five years. So, just wondering if you can quantify the cost savings and if you can give a target efficiency ratio?

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

About this movement that we are doing, which is Tecban, we don't share the number. We don't have the numbers in our bookkeeping, because this is a movement that we are doing. We are transferring the points in a gradual way, because our points is along the country, in many – a lot of cities.

Then this movement that we will do during this year, we started our efforts, but probably this year and next year, we will bring this movement up to translated points. Normally we don't show or offer these numbers.

And about the efficiency ratio, our targets for this year, is to finish the year with 39%. This quarter our quarter efficiency ratio is 38.6%. Then out of this (1:00:20) we maintain for the next quarter, we will be reaching our target of 39% this year. We don't have a specific target now for 2016, but we will continue working hard in improving the efficiency. We don't have a number, but in the past years, our better level was around the 36%. Then we are working our time to have a better performance. Then probably, we expect a better situation in 2015-2016, but we don't have now a number. Probably, it will be a little better than 39%, is what we expect to have.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. And then just on the question that I had asked about fees as well.

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

Fees? Okay, we finished this quarter with a growth of 10.7%. Our guidance is 9% to 13%. Why do we expect that, probably we'll have some improvements in this growth, probably this number 10.7% could be a little better, 11% or 12%. We are improving our channels to offer more products. We are doing inside of the bank the segmentation. This with this segmentation, we will have better structure to work more closer with our clients. Then with this movement, we offer better service for our clients, and we have also to improve the profitability with the relationship with the client.

Then we expect some additional movements that will help us continue improving the fees. The level the fees have to have for cards that now in this quarter, the growth is 11.6%. The normal growth for cards normally is around at 13% or 15%. Then probably cards until the end of the year, we will have a little better growth.

And in the other line the checking accounts probably consortium, we expect a better evolution. Then this is why we expect probably to finish the year with the growth a little better than what we have now, the annual growth. This 10.7% probably could be a little something between 11%, 12%, probably a little more closer to the higher level of the guidance.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. So just to be clear then, the improvements you're seeing is from improved penetration rather than increase in tariffs, right?

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

Yes. A good part of this improvement will come from this segmentation process. But e-cards (1:03:32), we expect a little better contribution this second quarter, the second half year here. So cards have more space to grow, and the other lines similar – checking account and the consortium is something that we probably will maintain a very good growth.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. Thank you very much.

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

Thank you.

Operator

Our next question comes from Mr. Tito Labarta with Deutsche Bank.

Q - Tito Labarta {BIO 20837559 <GO>}

Hi, good morning. Thanks for the call. I've had a couple questions. Just first a follow-up on your net interest income, more related to net interest margin. You mentioned before, you expected to be around 7.5% for the rest of the year. It was 7.7% this quarter, and then for the full year around 7.3%.

But in your answer to Saul's question you mentioned that spreads are rising, you had some benefits from funding, which you think is sustainable. So just I'm not sure I understood. Why would the margin then you expect that to sort of decline a little bit in the second half of the year? I just wanted to get a little bit more explanation on that.

And then just a second question in terms of your provisioning levels. You mentioned you expect the asset quality to be stable, and you had some additional provisions this quarter related to a specific client. So do you think the provisioning levels should come down? Should they be more in line with what we saw in the first quarter? If you can just give a little color on that as well? Thank you.

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

Okay. Thank you, Tito. About the NII, what – we expect this number that we have now, the mean 7.7%, probably for the next quarter we will have something around this in the quarter and the quarter number will be probably something 7.5% – around 7.5%. But for our full year 2014 mean, we expect that the number is around this 7.3%. This is for the full year, 7.3%.

In our lines, we expect that that we will continue a nominal grow in the revenues. They will continue growing in nominal numbers. The quagmire is because the spreads of new origination, the funding because the better management of the cost ensures that we will maintain the growth around that we have now, 10% or 15%, in the securities and others.

We have this movement of, as I explained, our pre-fixed loan portfolio that is recovering the better rates, the better remuneration and is helping us to improve a little more the revenues. And with this combination of Selic and the rates in the system, in the markets, we will have in the future the stabilization of this process of the revenues from this pre-fixed loan portfolio.

Then we expect until the end of the year that these revenues will continue growing, but in a little less faster growth. Then what we expect for this line until the end of the year is growth in securities and other, finish the year with 5% to 10% growth when you compare 2014 with 2013.

And the other lines, as I told you is, credit margin growing around 5%, and the funding we expect that probably will finish with 30%. Insurance is 10% to 15%. And this will help us to maintain the guidance at 8% that is the end of the guidance. And probably we could have a little better performance for this combination of effects, and we could have something like it goes up 9%. But the 8%, we understand that's very possible to reach, and we understand that we according to our capital structure, or according to our asset liability management, we don't expect any effect that will change this direction that we see the revenues and our portfolio that is going.

And about provisions, sorry?

Q - Tito Labarta {BIO 20837559 <GO>}

Yeah, sorry. Just one follow-up question, because I'm still not completely clear, because you mentioned the spreads are rising, yet you still expect your margin to fall a little bit compared to the second quarter. So I just wasn't clear. Is that because you mentioned the pre-fixed loan portfolio, the benefit from that are kind of slowing down because Selic is stabilizing? I just want to get a sense, why did the margin fall, even though most of the line items you said are improving in the function of the loan mix, that I just wasn't completely clear about.

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

Okay. One thing is the way that you do the 7.7% is the quarter mean. When you do the calculation, you have the exponentialization. Then this quarter, the second quarter, we had the less business days, when you compare with other quarters in the Sustena (1:09:42). When you do the calculation, the mathematical calculation and you have the exponentialization of this effect, then we added this improvement of mean, 7.7%.

And considering for the next quarter, the same calculation, we expect probably to have the numbers around the 7.5%. These are reasonable levels. But when you do the calculation in a full year, our revenue is up 2014 compared with the average assets that we have. We expect for the full year calculation 7.3%. Then our revenues with the margins, with continuous growing, according to our expectation, then probably will finish the year according to the guidance that we have and the expectation of the center of the guidance, 8%.

Then one thing in the quarter mean, that we do this exponentialization. And the full year mean, we don't have this effect. We will have the revenues and the average assets. Then the number that we have, this number is 7.7% is the quarter mean, with the exponentialization effect here that we had this quarter, because less business days that we had. But in a full year, the growth of margins according to our expectation is sustainable in all lines, and we expect to finish it with this growth of 8% or it could be a little better, until the end of the year.

Q - Tito Labarta {BIO 20837559 <GO>}

Okay. So just this quarter benefit from less days, so the margin was a little bit higher, and then that all kind of normalized through the next few quarters?

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

The small effect or some effect because these less business days in the quarter.

Q - Tito Labarta {BIO 20837559 <GO>}

Okay.

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

But it is something that when you look for revenues, where the level of revenues, we expect that to be able to continue growing. And it is effect, specially effect on that we had in the second quarter.

When we talk about the provisioning level, we expect stability, because as I mentioned, our delinquency ratio had a small increase, but because this specific effect, one part is some additional rate that we did – we increased the ratings of some clients, and we did some additional provisions for specific clients, our corporate clients, we had a small increase in our overdue operations, this in the second quarter.

We don't always (1:12:39), because normally in the first quarter we have that seasonal – the increased ratio this year, we didn't have in the first quarter. Probably it could be some transfer that we had, a movement that could transfer one part of these effects for the second quarter.

But when we look for the short delinquency ratio, we feel that we will have a decrease in the delinquency ratio. We see that is our – we will have a normalization in our delinquency ratio. Then we don't see reason for to have an improvement or changes of improvement for the delinquency ratio for the future.

Our expectation is stabilization, and then talking about the expense that we had in the quarter, we had an additional expense that around R$280 million. If you look at our total expenses that we had in the first half is negative R$6 billion. We expect a similar level of expense that we had in the second quarter for the next two quarters this year.

Then at this level, probably our total expense in the year match up recovered, probably we'll finish the year between in excess R$12.3 billion. That is according to our expectation. We don't see any risk of the delinquency ratio increasing, because of the quality of our portfolio and when we analyzed the short delinquency ratio, in our products, in our segments, in our lines, we see that we are having a decrease of the delinquency and the overdue operation – the level for overdue operations will reduce.

Q - Tito Labarta {BIO 20837559 <GO>}

All right, thank you. That's very helpful.

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

Thank you.

Operator

Our next question comes from Mr. Thiago Batista with Itaú BBA.

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

Yeah. Hi, guys. Thanks for the opportunity. I have just one question. Actually I wanted to talk a lot about the margins. But could you comment on your expectation for the margins, not in 2014, but in 2015? It's fair to assume that the margins can improve in 2015, as we probably will see a positive trend in the margins during the second half of the year. So it's fair to see a better margin in 2015 when compared with 2014.

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

So going to 2015 here, what we expect is that Selic rates probably will have a similar level that we have now this year, or could be a little more, the Selic. Then considering this expectation, when we talk about the credit margin, we expect to finish the year with better spreads in the portfolio. Then probably the contribution for 2015 will be – probably will be similar. That's the level that we have this year. Funding could be better next year, probably the total revenues probably will be – could be better because we expect that the total effect that the management that we are doing will continue reflecting next year.

Insurance normally they maintain – they grow around 10% to 15%. And the interest line, securities and others, probably will have some stabilization.

But we have other effects on the asset liability management that we will maintain revenues, probably growing. Then I think the level – we don't have the guidance now. We'll probably give the new guidance at the end of the year. But the level could be, I think, very similar, or the level, I think, this number that we have for this year 8% probably, we'll have something very close to this level. But the guidance we'll probably have only at the end of the year when we will finish our budget and we will announce the numbers for 2014, in January.

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

Okay. Thank you very much.

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

Thank you.

Operator

Our next question comes from Mr. Boris Molina with Santander.

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

Yes, good morning. I have a question regarding the operating trends in your Insurance business line, specifically in Life and Pensions. You're noticing a slowdown in the volumes in the number of participants and the rate of growth. And are you sustaining your guidance for premium growth this year? We understand that earned premiums are sustaining closer to 15% growth. But written premium seems to be slowing down in this lower provisioning effort. So could you just explain to us, what is going on in the market in terms of number of participants in the insurance business and what you expect in terms of growth of individual life and group life or life and pension funds, et cetera? Thank you.

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

We will maintain our guidance. Our guidance is 9% to 12%, according to the growth that we are having. We expect that to – the product that is responsible around this 60% of the total premiums that is pension plans and the life. So we will continue recovering the growth this year in the second half. We had last year one effect in the second half here, which is some modification in the rules about the investments of these funds that affected a little the growth, but this modification in the rules that we had last year, during the end of 2013, we had new adjustments that we solved these problems. And now the product is recovering with similar growth that we had in the past.

Then the premiums from pension plans and the life group continues growing and probably expects to grow at the level of next 15% in the next quarters. And we expect to finish the year around the guidance of 9% to 12%, probably (1:19:53) net returns.

Normally our insurance company, they maintain a double-digit growth, probably it will be close to 10% until the end of the year, because we expect to have some additional improvements in the growth of pension plan premiums. The other products, they are maintaining growth next year, 30% in the semi-auto and the health next year 20%, 22%.

Then these are the products we expect that to maintain at this level until the end of the year. Then the recovery that we expect is more related to pension plans. That is the biggest part of the premiums, 60%. And we understand that's possible to maintain, one grow next year 15% for – to reaching around the 10%, that is the premium supporting our guidance for this year.

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

Okay, wonderful. Thank you.

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

Thank you.

Operator

Excuse me, ladies and gentlemen, if there are no further questions, I'd like to invite Mr. Paulo Faustino da Costa to proceed with the closing statement. Please go ahead, sir.

A - Paulo Faustino da Costa {BIO 17286050 <GO>}

Thank you all for participating in this conference call. I would like to take the opportunity to remind you that our market relations department and our teams are at your disposal, and that's all the contents of our first half 2014. And all information concerned for this will be in our website. Thank you very much.

Operator

This concludes Banco Bradesco's audio conference for today. Thank you very much for your participation. Have a good day.