Q3 2015 Earnings Call

Company Participants

- Alexandre da Silva Glüher, Executive Vice President
- Carlos Wagner Firetti, Market Relations Department Director
- Luiz Carlos Angelotti, Managing Director & Head-Investor Relations

Other Participants

- Boris D. Molina, Analyst
- Jorge Kuri, Analyst
- Mario Pierry, Analyst
- Pedro Fonseca, Analyst
- Saul Martínez, Analyst
- Thiago Bovolenta Batista, Analyst
- Victor A. Galliano, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentlemen and thank you for waiting. We are glad to welcome everyone to Banco Bradesco's Third Quarter 2015 Earnings Results Conference Call. This call is being broadcasted simultaneously through the Internet in the website www.bradesco.com.br/ir. In that address, you can also find the presentation available for download.

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

Before proceeding, let me mention that forward-looking statements are based on the beliefs and assumptions of Banco Bradesco's management and on information currently available to the company. They involve risks, uncertainties and assumptions because they relate to future events, and therefore depend on circumstance that may or may not occur in the future.

Investors should understand that general economic conditions, industry conditions and other operating factors could also affect the future results of Banco Bradesco and could cause results to differ materially from those expressed in such forward-looking statements.

Now, I will turn the conference over to Mr. Carlos Firetti, Market Relations Department Director.

Carlos Wagner Firetti {BIO 2489005 <GO>}

Good morning, everybody and welcome to our conference call for discussing our results for the 3Q 2015. We have today with us, Mr. Alexandre da Silva Glüher, the Executive Vice President of Banco Bradesco; Luiz Carlos Angelotti, Executive Director and Investor Relations Officer of Banco Bradesco.

I now turn the presentation to Luiz Angelotti to start with the main highlights.

Luiz Carlos Angelotti {BIO 4820535 <GO>}

Good morning, everybody. Thank you for participating in this conference call about the Bradesco's results for the third quarter. In the slide two, we have the highlights. Our adjusted net income reached R$13.3 billion in the nine months of 2015, increasing 18.6%. In the third quarter, our adjusted net income reached R$4.5 billion. Our ROE reached 21.2%. The NII earning portion increased 16% in the nine months, mainly because the increase in the average spreads related to the corporate portfolio. We started to have this year, some increase in the rates, and probably will continue during this year and probably the first half of next year. Then we expect to have some new benefits in this increasing. Another thing that helped the NII grow is the funding and management (03:48), and the gains with asset liability management.

Our efficiency ratio remained at 37.9%. This shows our higher commitment with the control of cost and efficiency, and our operating coverage ratio. The relation between fees and the fixed cost reached at 79.1%, the best level that we have in our ratio.

The fees and commissions income increased 12.3% in the nine months. They are growing at the double-digit. The main effect came from the segmentation progress that we are creating new segments in the retail base of clients. These new segments (04:50) 2014, then this year, we started to get the benefits. Probably this growing in the revenues, mainly from the accounting revenues, will continue during 2015 and 2016. (05:17) that are growing around 15%. (05:26) of transactions, and the growth in the client base. Our operating expense grew 7.8%, below the inflation in the last 12 months, and this shows the commitment with the costs. The total assets amounted in the end of the quarter at R$1.051 trillion. Our extended loan portfolio reached at R$474 billion. And something that we need to highlight that the allowance for loan loss reached at R$28.6 billion in this quarter, and our coverage ratio for 90 days reached at around 206%, one of the highest levels in the quarter. (06:33) insurance business, the net income for insurance amounted R$3.9 billion in the nine months and the premiums grew at 18.6%.

Now, Carlos Firetti will continue with the next slide.

Carlos Wagner Firetti {BIO 2489005 <GO>}

Okay. Thank you, Luiz. Now we will go with more details in our numbers. In slide three, basically the comparison between our book net income and adjusted net income. We have some important events this quarter.

Basically, we had an accounting gain of R$2.341 billion related to the revaluation of tax credits due to the increase now in the social contribution tax rate from 15% to 20%. We offseted this gains with some provisions R$2.222 billion in credit-related provisions. Part of it additional provisions and part of it related to the generic provisions related to the revision of ratings in some specific credits that clearly do not belong to this quarter. Additionally, we had expenses with contingent liabilities, basically related to provisions for lawsuits that are in our view, one-off effects. With this adjustment, the adjusted net income was R$4.533 billion, with ROE for the quarter of 22.1%.

In slide four, adjusted net income growth. For the quarter, our net income increased 0.6%; for the nine months, 18.6%. For the quarter, the main drivers for these performance came from the NII, the interest earning portion of NII, that was R$294 million higher. Fee and commissions, that contributed with R$262 million, and others at R$228 million, mostly related to our lower tax rate in the quarter. On the negative side, we had a lower contribution from NII from non-interest, a negative contribution from higher provision expenses, and also from operating expenses which we will detail in the next slide.

In the slide five, we have a breakdown of our net income. Basically, insurance represents 29% of our earnings; the banking business 71%, credit contributes with 34% and fees 29%. Non-credit related revenue sources represent 66% of our total earnings.

In the slide five (sic) [six] (10:29), we have our efficiency ratio. Our efficiency ratio in the quarter was 38.4%. But focusing on the accumulated for 12 months, 37.9%, that is still one of the best levels or the best level we ever had. The operating coverage ratios that are fees and commissions compared to administrative and personnel expenses reached 79.1%, that is also our best level ever.

In slide seven, we have some details of our NII, the interest earnings portion and non-interest earning portion. Basically, the non-interest NII was lower this quarter, R$26 million compared to R$126 million in the second Q, mostly related to the market volatility. Our NII in the quarter continued increasing and reached 7.5% in the 12 months accumulated, growing 10 bps compared to the second Q. And the net income coming from interest increased 2.2% Q-on-Q.

In slide eight, we analyzed specifically the interest earning portion of our NII. NII grew 16% year-on-year, 2.2% in the quarter, credit intermediation margin grew 11.2% in the quarter, basically driven by a good performance on the funding sides where we have been able to improve our market funding, and also in the credit side where we have been benefiting from the improvement in spreads.

Insurance grew 32.3% in the year, still driven by a good performance in volume. And securities and others in the quarter specifically came a little bit lower mostly due to the lower IPCA inflation in the quarter that is an indication (13:21) factor for part of the bonds we have in our portfolio.

In slide nine, we have details on our credit intermediation margin. Basically our credit intermediation margin was flat in the quarter at 11.5%. This performance was impacted by the mix effect, basically the effect depreciation (13:53) increased the size of dollar inflows that has proportionally lower spreads.

We still see the credit intermediation margin going up in the next quarter and throughout next year. Basically there is still room for repricing of our portfolio, as you can see 48% of our loans have an average turnover 30 days-60 days, the average portfolio has an average terms of 1.5 years. So the repricing effects will remain since spreads are actually higher. Basically our net credit margins after provisions increased 1.1% in the quarter and is growing 8.1% in the nine months.

In slide 10 we have our numbers for our BIS ratio, our BIS ratio in the quarter was 11.4%, a reduction compared to the second quarter. The main reason for this reduction is related to the market-to-market in the securities portfolio, but mostly to the accumulation of tax credits, first, related to the revaluation of our DPAs (15:38) and also to tax credits related to our – to the head of our assets abroad. This tax credits should be consumed over the next two years-three years, basically alleviating the capital position also the prices, the price of assets have already improved in the quarter compared to the end of the third quarter, what also contributes to an improvement in this position.

But additionally, we see our capital position evolving organically over the next few years. We believe our capital growth more than a 100 bps per year just by the accumulated profits which we'll have in the next few years while risky weighted assets that grew this quarter mostly due to the impact of tax credit and also the FX depreciation will not grow that much. So that basically give us a lot of comfort related regarding our capital position. Considering the acquisition of HSBC, our BIS ratio is calculated in the 9.1% for the third quarter.

In slide 11, we have our total assets, total assets grew 6.4% in the last 12 months with return on assets reaching 1.7%, our equity grew 8.8% in the last 12 months with ROE for the nine months reaching 21.2%.

In slide 12, we have our expanded loan portfolio. Our expanded loan portfolio grew 6.8% in the last 12 months, 2.4% in the quarter. This was impacted by FX. Without FX, it would have grown 1.7%. The highlights comes from the corporate portfolio that grew 4.5% Q-on-Q and 12.8% year-on-year. The impacts on FX – from FX is larger in this specific portfolio. SMEs remain at almost flat year-on-year and individuals basically have been driven by payroll loans with growth of 17.9% year-on-year and real estate financing growing 26.6% year-on-year.

In the slide 13, we have our credit quality indicators. Basically our 90 days delinquency ratio increased this quarter 9 bps for the total portfolio well behaved as we have been saying it would remain. In the SME portfolio, we have an increase of 39 bps. Basically this portfolio is more sensitive to the economic activity, but its – the increase in NPL is also related to the fact that this portfolio is not growing. Only, as an example, if this portfolio were growing by 5%, actually this increase in the delinquency would be almost half of what it was.

In the Individuals portfolio, we have an increase 22 bps. We have a good comfort – level of comfort with this portfolio given the change in mix, we will go a little bit deeper on that later. We believe that for the fourth quarter, we should have a better performance for seasonal reasons. And for the future, delinquents there should grow, but in our view gradually.

In the corporates portfolio, we have a reduction in NPL by 14 bps, mostly due to higher write-offs in this portfolio, and a little bit due to the FX depreciation. We believe that in this portfolio, we should delinquents ratio at least flat going forward in the absence of specific cases. Short-term delinquents ratio, 50 days to 90 days for the total portfolio went down 3 bps, driven by large corporates, and we've had some pressure coming from the individuals portfolio.

In the bottom of this slide, we have numbers for our NPL formation and the gross provisions excluding what we considered to not recur, the additional provisions in generic non-recurrent provisions. Basically, we show here that first, the NPL duration went down in the quarter from R$4.4 billion in the second quarter to R$4 billion this quarter, and basically that our gross provisions reached 111% of the NPL creation, and very consistent to the pattern of provisioning we have been presenting over the last few years. That clearly shows that what we consider non-recurring, really does not belong to this quarter.

If you turn to 14, we have our changing mix, basically, what is in your view, the main driver for the relatively benign performance in terms of credit quality, we are seeing, we believe, we will continue to see that in the future, basically compare for instance 2008 with now, the participation of SMEs reduced from 27% to 23.6%.

And more importantly, in the individuals portfolio, looking to the breakdown, you can see that the participation of less risky credits, like mortgage and payrolls reached 37.9% in September compared to only 12.7% in 2008, while the participation of car loans went down from 43.5% to 16.5%. In 2008 the portfolio was growing above 30% year-on-year with a much higher level of down payments in the portfolio.

Today, this portfolio is still shrinking, and the down payment is around 47% what really makes it a much more secure portfolio than it was at any other moments in the past.

Just basically why we say, we expect this gradual increase in delinquents for the coming quarters. On page 15, you have our coverage ratio our coverage ratio in the quarter reached 205.7%, the highest level we saw since 2007. The 60-days coverage reached 168.4%, also one of highest levels. This give us a lot of comfort for the current environment, and we see this provision as a conservative position for going through the current economic scenario. Our total provisions represent 7.8% of our total portfolio compared to net charge-offs of only 3%, the coverage ratio of charge-offs is 260%.

In slide 16, we have details from our fees and commissions. Basically, fees are growing at 12.3% for the nine months of the year, the main driver is coming from cards, growing at 18.7%, and checking account fees growing at 21.4%, and consortium management growing at 19.5%.

In the case of checking accounting fees, the driver is our segmentation, we created new classes of services in the retail segment, which we call exclusive in plastic (26:27). We are migrating our clients to this class of service, we have already migrated a large amount, and we provide higher value-added services in this for this segment, and they pay fees for it.

We believe the driver in checking accounts will remain for the coming quarters, and should continue to be a driver for fees. We believe – we want to remain at the top of our guidance, obviously, that goes from 8% to 12%, and we expect this performance to continue next year, this good performance continue.

In cost, slide 17, our costs are growing 7.8% year-on-year with personnel growing 5.5%, and G&A expenses growing at 10.1%. Basically, this quarter we had higher administrative expenses, mostly related to marketing that was an anticipation of expenses that otherwise would be reflecting in the fourth quarter as for instance happened in 2014. Therefore, we believe that we will remain inside of our guidance that goes from 5% to 7% for the full year. We are relatively comfortable with this guidance.

In slide 18, we have details on our insurance operations. We remain with our very strong performance in the insurance business with net income growing 22.5% for the nine months, with ROE of 26.8% for the third quarter specifically. Total premiums growing at 18.7% with main highlights coming from Life and Pension, growing at 26%; and Health growing at 20.7%.

In slide 19, we have some highlights from our insurance business with our coverage ratio at 6.9% in the third quarter, and with our technical reserves and financial assets in the insurance business still growing.

Now, I turn the presentation to Luiz Angelotti to the further comments.

Luiz Carlos Angelotti {BIO 4820535 <GO>}

In closing, we want to say that, we had a good performance even with the scenario we faced in this first nine months of 2015; we managed to keep solid ratios, such as the efficiency ratio remaining at 37.9%, and the ROAE of 21.2%. We increased the provisioning level for the loan loss, and we have now R$28.6 billion in provisions.

The coverage ratio reached around the 260% (30:02), our main sources of income have posted double-digit growth, and our cost keep running below the inflation, then we have to say that, we have also maintained a good remuneration for our shareholders.

Thank you for your time, and we would now be glad to take your questions.

Q&A

Operator

Ladies and gentlemen we will now initiate the question-and-answer section. Our first question from Mr. Jorge Kuri from Morgan Stanley, you may proceed.

Q - Jorge Kuri {BIO 3937764 <GO>}

Hi, good morning, everyone. I have two questions, if I may. The first one is on HSBC. Can you explain to us how you hedged the $5.2 billion that you're supposed to pay at the close of the transaction? Exactly how is that hedged? What percentage of the transaction is hedged? What is the carry cost of that hedge? And what does that imply in terms of your expectation for accretion of the transaction or impact on your capital, given that the currency has moved a lot from where you set the deal (31:43)?

And then, my second question is on asset quality. I mean, certainly things have gone worse than you discussed earlier this year, in between renegotiated loans and NPLs. We've seen a bigger jump that you were expecting early on this year. The amount of provisions that you've created, obviously make very clear what your concerns are, or I get the level of your concerns are. What lies ahead? At what point do you think the NPL cycle will peak? Your GDP expectation of 1.5% negative for next year looks optimistic at this point, I guess; consensus is now moving closer to 2% and beyond. To what extent a repeat of 2015 when the currently contracted fee percent around that changes your view on asset quality? What is the sensitivity around that? Thank you.

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

Thank you. Thank you Jorge for the questions. About the hedge of HSBC, we did in (33:00) the market a normal operation that we do, the amount is well below – higher, but with the total hedge and the price that we finally – the R$17.6 billion (33:16) we'll maintain with this hedge.

And now we are protected (33:24) above the volatility of the currency, and those affected the final price. About the – when we – we probably expect to have the approvals of the regulators probably could happen in the end of this year or in the beginning of 2016. Then, when we do the payment, after the payment, we expect to (34:00) probably our ratio there, we did a simulation in – about the basel ratios. We understand that we have – how to assume the bank in a normal way, we have the margins runoff (34:16) in the ratio (34:18) can be our profitability in the next few years. There will be an offer to maintain the ratios along with the levels of (34:31) that we need to have.

But we have the another way that – same we show in the simulation that we have the option to issue subordinated debt Tier 1, and we will maintain our dividend spent in (34:56), something that we can do, (35:01) in the meantime, in the past years to pay dividends and to offer new shares for our shareholders to use this to subscribe with the dividends payment.

This is something that's possibility, we have also maintained, the ratios are on the level, that we understand, that's a one-off (35:21) to maintain the bank. About the asset's quality, I think you talked about the renegotiated portfolio that is – that you grow little more, but the normal growth that we expect for this period of the year, is the correlation between the growth of our loan portfolio and the renegotiated portfolio, very similar, and here I think the goal is a little above what is normal for the period. I think we did many investments in – to be very faster enough about how to deal with these operations, and how to control the guarantees, and that if we could reduce the loss with the operations, the quite operation in this portfolio, I think the delinquency ratio, we could maintain running on more lower level.

But the normal rule, we understand that we had that we had the – because (36:34) growth of the portfolio. And today, about the increase in the provisions, we believe increasing the additional provisions R$2.4 billion (36:48) and they are another part of the – the reason will be the – when we revise the ratios or the ratings of our clients, some good corporate clients, specific clients, we understood that it was a moment (37:09) to do this review. We have on the other side, the gain or the accounting gain, which is the social contribution.

This is why we did the adjustments in the provisioning levels. But, we understand that we don't need to use these provisions now, is a more conservative procedure that we did. The additional provision is probably – is only in a stress situation that we probably will need to use. We have now R$6.4 billion, whether you do the provisions, when you are in a better time, not, when you are in a stress time, it is not possible to do provision, then we are anticipating any potential problem, we don't see any problem in the market, we see only because the economic environment is a little more – we have now the GDP growth in the countries, negative growth then we understand that we are in adjustments in the economy, but we don't see any higher potential goal in the quality, to have a problem with the quality of the asset.

We understand that, the growth that we have now is according to our expectations, and if the adjustments in the provisions is more, because we are adopting more conservative procedures, and we don't expect to use this provision, but the additional provisions are the rating downgrade that we did for some clients is only one adjustment for our correct policy.

This year – well, we started the year with the (39:19) GDP growth that – our expectations at the beginning of the year, for the GDP growth was that we will be in a better scenario, but we finish the year much closer, 3% of negative growth, for the next year we'll be closer 1.5% of the negative growth, the GDP.

We have (39:48) the asset quality that we have now as we told you during the conferences that (39:56) told about the – our portfolio now, we understood that we had a better quality, the mix is better with less risk. We did investments in our instruments (40:11) to do the analysis, systems to approve (40:15) then we did the main investments. We – inside of the company, we changed the procedures to recover operations and the guarantees. We have now better procedures to have a better guidance.

Then we could reduce the risk, and we'd expect to have an increase in the – higher increase in the provisions or in the expense-linked provisions. What we see probably, that we are now with around 15% this year, growth 17% and probably, finish the year, maintain this level 15% to 18% probably.

And next year, probably we expect to have something close of this level. But you need to consider that the revenues from the margins of interest earnings, the increase in the NII, the increase in the – spreads are increasing in the corporate portfolio. And I think we had more space to re-price our portfolio, only 6% I think of our portfolio had been re-priced. Then we expect that with the contribution from the revenues, from spreads we'll continue. We will maintain the margins after delinquency ratio growing up positively. We do need to consider that we had other revenues that came from insurance and fees that we are growing in a double with more stability. We expect to maintain the profitability running around the level that we are having now.

Q - Jorge Kuri {BIO 3937764 <GO>}

All right. Thank you.

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

Thank you.

Operator

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

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. Good morning, everybody. Let me ask you two questions. The first one, sorry, I'm going to stay on the asset quality topic. We're seeing the NPLs, they have been rising about 10 basis points per quarter for three consecutive quarters now, but we're seeing, when we look at the SME portfolio and the individuals portfolio, the deterioration is starting to increase, right? Individuals are growing close to 20 basis points, and SMEs just increased 40 basis points this quarter.

So my question then is related, what do you only expect a gradual deterioration? It almost seems to us, listening to you is that, you expect the deterioration next year to be similar to this year, but we're starting to see an acceleration. So, just wanting to understand why would things start to decelerate, going forward, in terms of NPLs?

And my second question is related to what you just said about your – you're still re-pricing your loan portfolio, especially your corporate loan book. What I wanted to hear from you is about your ability to continue to increase rates, because looking at the Central Bank (43:36) data, most recently we saw that spreads, at least in the last month, they had come down. So, just wanted to hear, rather than just the re-pricing of the loan book, is about your ability to continue to raise spreads going into next year. Thank you.

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

Mario, related to the first question, the deterioration, SMEs and in individuals, basically our feel in terms of the gradual deterioration we expect is related to the – is like a mix we presented. We believe our portfolio now is much less riskier than it was at any time in the past. There is a large number or there are credit lines that are doing very well, and are sizeable in the total portfolio. We had in the case of individuals, an acceleration, but actually into this fourth quarter we may see some better performance. There is this seasonal impact coming from the 13th salary (44:57) and other things that helps.

Going forward, we are growing zero in this portfolio, basically part of this because demand is low, but also because we have been cautious for some time, and there are material improves in five (45:21) of the credit lines, it's not that only the mix improved, but each line is now better. We have the economy under pressure, but our individuals portfolio is better.

The SME portfolio, as I said, did this calculation, with 5% growth, we see the NPL evolution would be lower, we have a portfolio that is not growing actually year-on-year, it's shrinking a little bit. We see the portfolio, we see the indicators of (46:08) of clients and we believe that the most likely outcome, knowing deeply the companies is a gradual evolution.

In terms of repricing, the repricing comes – it's more market driven and basically our point here – we don't want to make any point that trends will continue, increase (46:37), et cetera. But just by repricing, what has already happened, it still has a sizeable impact in our credit margins. So, basically, the positive driver only from the repricing is already enough to offset most of the pressure or a big portion of the pressure that comes from (47:10).

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

(47:14-47:19) they decreased this quarter. They're not – could be that the next quarter, this next quarter – we don't have an increase in the delinquency ratio. They're not – (47:33) some stabilization could happen, but this is something that you need to consider into your formation.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. Let me ask you then on – specifically then on the individuals portfolio. What concerns you the most about potentially leading to the higher NPLs? Is it inflation? Is it unemployment? What do you think has the biggest impact on individuals NPLs?

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

Normally, I mean (48:04) is the main thing that affect the delinquency ratio. But as we told you, we – a good part of this portfolio we have now is this payroll loans and the mortgages, that where we had a very small delinquency ratio. Normally, where we had some increase is more in personal loans and in cards. But as we told you, we are or what we – we did investment in our systems, in our models to reduce the risk or to have better control the risk could reduce frauds, and we are more effective into charging the clients or to recover the credits (49:02). We are working hard to reduce the risks and this is why (49:04) expect some increase, but it's not something that (49:10) higher risk (49:12-49:17) we expect that in 2017, the economy will recover the growth. And probably the second half of 2016, I think the environment will be a little better and we expect to have some stabilization in the delinquency ratio (49:39).

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. Thank you very much.

Operator

Our next question comes from Mr. Saul Martínez from JPMorgan, you may proceed.

Q - Saul Martínez

Hi – Thank you very much operator. Hi, guys, two questions. First, on your capital position, and I want to gauge whether your comfort level depend on your ability to sustain pretty high levels of profitability. And by definition, you hold capital for unexpected losses, but you're talking about capital and capital generation based on the expectation that you don't have unexpected losses, that your profitability remains very high. So, I want to ask you, does your view on capital really depend on sustaining close to a 20% ROE? And if you are wrong, is there a level of profitability and your profitability comes in from which you might expect given the macro backdrop, how do you feel about your core tier 1 at that lower level of profitability and a lower level of capital generation?

My second question is on renegotiation of credits. You guys give less disclosures than some of your peers. You've renegotiated credit only for delinquent loans as opposed to renegotiations for performing loans. And obviously that could mask some strain if you're renegotiating loans that haven't fallen into delinquent status. Is there a big difference in terms of the trend, if we were to look at the whole performing loan portfolio? And I ask that because you obviously have a very sizable SME book, and I would guess there, like at some of your peers, you would be seeing more renegotiations. So, my question is, if we were to have a more expansive view on renegotiations, would that number change? And if you actually do have that number, it'd be great to have to disclose that.

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

Saul, I'm going to answer the first question. Basically on capital, our view on capital doesn't depend on our view on our profitability, basically, first we would be generating still a lot of capital even at lower level of total profitability and there is also the scenario that the risk-weighted assets are not going to grow materially for some time, maybe 2016 and 2017. The increase in risk-weighted assets this quarter came a lot due to tax credits and FX. But tax credits are going to be recovered over the next two years, three years. We absorb that relatively fast.

Our comfort comes from basically the fact that, remember, the level we have, it is still enough. Basically we have options, as Luiz has, we could issue subordinated debt. If you want, we can do what we have done in the past like offering a subscription at a lower price when we pay the dividends. But basically this, all the options we have, together with the fact that we will accumulate more capital is what gives us comfort. Luiz?

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

Yeah. (53:45) firstly one thing is that, we don't expect to have a small or (52:53) the profitability. Then, it is only our opinion, but we (54:00).

And about the assets quality, about the assets growth, probably the next two years, you'll have a very small growth in the assets. Then there's something that you need to consider that the consumer (54:17) next two years probably.

About the renegotiated portfolio, we shows (54:26) according to the Central Bank rules, our portfolio, we had R$12 billion. This year, it grew a little more than the total portfolio. It's more related because the environment that we have nowadays (54:43-54:51) probably, normally what we lose is only one-third percent of the delinquency ratio of this portfolio (55:00). The rest of the portfolio, we're maintaining according to Central Bank rules, (55:11) risk evaluation that we maintain in a normal way and we follow all the Central Bank rules (55:24).

Q - Saul Martínez

Okay. That's helpful. And just for what it's worth, I am not -my base case is not that your probability gets impaired dramatically, but capital by definition is for scenarios that are worse than what the base case is. And I guess my question is more along the lines, is if you are wrong and I don't have a crystal ball and you don't have a crystal ball, but if you are wrong and your ROEs are 15% for example or 16%, it's a pretty good ROE, given the environment. Is it fair to say you'll still be – you'll still generate capital? You'll still consume your tax credit with that level of profitability?

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

You need to understand actually we consider to maintain some margin to support any stress movement that happens in our models, in our analysis, when we talk about capital, the tier 1 ratios internally, and tier 2 ratio, the total ratios for Basel III, we consider to maintain some margins on buffers – internal buffer, (56:38) any surprises. But we don't expect to have surprise, but the margins that I told you today is 25% to 30% that we expect to maintain, an additional above the minimum requirements.

During the revision at GSPC, could be (57:01) that we will be running very close of the minimum margins around, but we don't expect to have any surprise and the margins that we maintain during this period will be enough to support any volatility.

Q - Saul Martínez

Okay. Great. Thank you very much.

Operator

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

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

Yeah. Hi, guys. Thanks for the opportunity. I have two simple questions. The first one regarding NPL coverage ratio. The coverage ratio is now at a very high level. Do you expect to see some contraction there in NPL coverage ratio going forward for the coming quarters? Whether we should expect an increase in the delinquency ratio? And second one, what you believe will be your normalized utilizes level of taxes for 2016, for instance?

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

Normalized level of what?

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

Of tax rate.

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

Tax rate. Okay. I will answer the first one. Basically, in terms of NPL coverage, we don't expect to consume this coverage. Basically in normal situation, we should basically continue provisioning the formation. The coverage may go down because we have a fixed portion that is the excess provision and that essentially will be diluted on the total coverage. But unless we have a specific event that we don't foresee, we don't intend to consume this coverage provisioning (59:01).

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

On the tax ratio, what we expect for the next two years, three years, (59:08) that we will have the social contribution in the – 5% more with the total ratio of 20%. Probably we will have an increase in the normal ratio around the 4%, 5% (59:24) what we expect the normal level was around 34%. Probably you will running next year 38%, 37%. Probably you'll start more in the second – in the last in the last quarter, now until the end of 2018.

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

Okay. Thanks for the answers.

Operator

Our next question comes from Mr. Victor Galliano of Barclays. You may proceed.

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

Hello. Yes, my main questions have been answered. Just to follow up on capital here. When you first announced the HSBC acquisition, you gave some fully loaded estimates there of 9.9%. And in this third quarter, now you're down to 9.1%. So is that 80 basis points of consumption? I just want to confirm here that there is nothing that's changed here in terms of the risk-weighted assets that you're expecting from HSBC. Is that down to what you've said about the higher tax credits and also the depreciation of the real?

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

The HSBC, basically we are now using the second quarter financial statements. We did the first analysis in the fourth quarter 2014.

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

So you're using the lower base of Q3?

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

Yes.

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

Okay. All right, thank you.

Operator

Our next question comes from Mr. Pedro Fonseca of Haitong. You may proceed.

Q - Pedro Fonseca {BIO 7271227 <GO>}

Hello, everybody. I have a follow-up question on capital. Your capital ratios are now going down, particularly with this HSBC acquisition. What is your comfort level of capital? You have said it's 25% above minimum requirements, but I'm not so sure which one you're talking about. If we just focus on core capital, which is beyond the type of capital a lot of us care about, and if you focus on Basel III fully loaded, is this the minimum requirement right now, you want to focus on the 25% above? Is that the requirement in 2019 that you want to be 25% above? What is it?

And also, when you answer, can you kindly let us know why you guys insist on this unorthodox way of presenting Basel III fully loaded? Because it's not standard. And while different countries have – may have different versions of Basel III, the concept of fully loaded is fairly universal, which is you pick all the adjustments, all the deductions that you have to make by 2019. It has nothing to do with what the balances will be in 2019, such as goodwill. It's all about removing them all now, because if you did that, obviously, you're core tier one is most definitely not 9.1 fully loaded. So, if you could just enlighten us a little bit, I think we'll all be very grateful. Thank you.

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

Thank you. This is the way that we show (01:03:03) the normal way. (01:03:05-01:03:11) in the fully loaded basis when we reach in the area of 2018. What we show here is that simulation of this fully load and we understand that we have held a capital opportunity to do the acquisition, to do the – to maintain (01:03:30) in the higher level. And I think you need to consider that for the next periods, we'll have the profitability of the Bank that we will add capital, normally 100 bps per year of NIM that we expect for each year that we have until 2018, then we are comfortable with these ratios.

Q - Pedro Fonseca {BIO 7271227 <GO>}

I'm sure you have answered the questions, so the 25% above minimum requirements, is this – I mean if you just think about core tier one, is it the ratio that's required right now? Is it the ratio required in 2019? Because the ratios are different. How should we think about these capital ratios, please?

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

Today with the acquisition we have the Tier 1 and the additional margin that we expected to have 25%, we are comfortable to do the acquisition to-date and to maintain the margins. And these margins will be maintained probably until the end 2018, then we will have the simulation. We have now today margins and also to finish the acquisition – conclude the acquisition and maintain around 25%-30% as we told that our internal limits for sure that we expect to maintain.

Q - Pedro Fonseca {BIO 7271227 <GO>}

So, what you're saying is, basically with the capital in terms of what the regulations are right now and not how they're going to be in the future? Is that correct?

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

We have it today and we will have in 2018, this capital, the simulation that we have here shows that we have the capital on all part to do the acquisition.

Q - Pedro Fonseca {BIO 7271227 <GO>}

Okay, but – no, I'm not disputing that. I'm (01:05:30) point of view. I'm just trying to understand how you think about the capital on a rolling basis. From what you're telling me, you concentrate on what the regulation is right now, and you demand a 25%, 30% extra buffer. Is that correct or am I mistaken?

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

We have the – (01:05:51) have the requirements that the level that we have today to have now and then we have the margins that we consider internally that this 10%, 12%, 13% (01:06:05) and this margins we will maintain after the acquisition on future dates 2018 as we expect to have them.

Q - Pedro Fonseca {BIO 7271227 <GO>}

Okay. I think what you're saying is that you look at the regulations as they are now, and you want to make sure that you keep the 25% margin all the way through to the future. Is that correct?

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

Yeah, our internal regulation that we have (01:06:41) 25% is, 25%-30%. And we'll maintain this buffer, the minimum buffer, all time.

Q - Pedro Fonseca {BIO 7271227 <GO>}

Okay. Well, thank you very much, but – yes, thank you. You realize most banks think several years ahead in terms of 2019, what the requirements will be then, and then try to get a buffer, but all right. Well, thank you very much for your answers. Thank you.

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

Thank you.

Operator

Our next question comes from Mr. Boris Molina of Santander, you may proceed.

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

Yeah, thank you. I'm going back to the situation of capital again. When we look at your slide on page number 10, it's fully loaded Basel III evaluation. (01:07:31) on the basis – can you hear me?

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

We can't. Please speak slowly and a little bit louder, we cannot hear you.

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

Is this better?

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

Yeah.

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

Okay, wonderful. I want to go back to the situation of the capital position of the bank. If you look at your slide on page number 10, we see a fully loaded Basel III common equity of 9.7 before the consumption of tax credits. I mean, this is kind of like the number we used because we felt that process has been growing for the last couple of years, and the situation is going to be pretty concerning? If you do a – it's just a calculation just to see what would be the impact to this capital ratio if you didn't include the government guarantee, which is a very, I would say, toxic option to get government support in case of a crisis? We would have to come somewhere between 200 basis points and 300 basis points. And then, maybe like the 200 basis points from the HSBC acquisition, and we are at somewhat closer to 5%, 6%.

Now, (01:08:38) has a history of allowing banks to operate, if I look at the low capital ratios at dispensing the public sector banks, right? However, (01:08:48), you have to stand on your own two feet. They're a no-private bank. They don't make (01:08:54). And so, what I mentioned before, this capital is to take care of unforeseen situations.

Now, my question for you is – and obviously the Central Bank is not going to stop your acquisition. It's going to go ahead, and you're going to end up in the first quarter of a fully loaded true capital ratio of around 5%. Do you think that this is a comfortable level to take care of the financial tail risk that we think (01:09:21) expected two years ago that we're going to be in the situation in we're in today? What happens if, two years from now, we are in a situation that is relatively weak? Now, I'm starting from that base, you say that you can make the 100 basis point. By the time that you reach this 12%, 13% level that you should have, being in a country like Brazil and the type of risk you have, it's going to take maybe eight years.

So, my question to you is do you have any plan to accelerate improving your capital ratios over the next 12 months? And I guess there's obviously a big problem, because (01:09:54) tax assets – for tax assets for non-performing loan provisions are twice the level they should be when you calculate it in the provisions times the tax rate. Obviously, you cannot collect annual (01:10:04) tax assets as you write off the loans. And if the situation is going to continue to grow, as the economy weakens and you write off more loans. So, if we (01:10:12) non-performing loans, is it something that you think we should – I think you should accelerate, because (01:10:20) tax assets are losing net present value every month. So, is it something that – is there a plan that you have apart from those (01:10:28) issues? (01:10:30) cutting your cash pay as well. Is there something that you can do that you want to do (01:10:35) capital increase? And then my second question is regarding asset quality. And we've seen (01:10:41)...

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

Sorry, to be very honest, we got very little of what you said because we can't hear you very well, (01:10:52) a little bit, but if you're going to do the second question, speak slowly please.

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

Okay, I'm sorry. The second question is related to asset quality. And if we look at your individual non-performing loans, stripping out that would be a nonperforming asset for the mortgage and payer loans (01:11:11). Do you view those – like it's called consumer (01:11:16) and nonperforming loans (01:11:17) couple of quarters and they are heading to the levels we saw on the previous cycle. Do you have any expectation of how or when (01:11:31) asset quality is going to peak in relation to a moment when unemployment (01:11:37) in June 2016 but in the real non-performing loans continue to increase three quarters, two quarters, four quarters after that. Is there something like a rule of thumb that you have in your models? Thank you.

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

Thank you. About the capital, we are comfortable with the acquisition – with the level of acquisitions, okay, we are not – we will looking what we can – how we can improve the internal capital ratio. Then our possibilities we can use if we understand that it will be necessary, then subordinated debt tier 1 is something that we can do to internally to use some reorganization for to improve the – or to have some gains with is the capital, then we are normalizing how to improve or how to have the debt, use our capital.

Then we are not stopped or we are thinking and planning how to use the capital, how to maintain our internal requirements to have the margins as we require. Then we are not stopping. We are managing the capital of the bank and considering our risks and potential FX with acquisitions and others FX, then we are (01:13:27). We will continuously de-risk normally, but we can have times to pay dividend and to use the (01:13:44) business to issue new shares. That is one option of our shareholders if they want to buy or not, they can do, but only using the dividend payment. We will maintain this advantage normally. We are comfortable with the capital levels and we are managing the capital ratios to maintain the banking running and to buy GSSE after the approvals of the regulator.

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

I am sorry. If I can follow-on. Do you have any plan to address the deferred tax assets from loan loss provisions? Because you have been growing pretty (01:14:29), there is an issue about collecting your tax benefit from the government and these numbers are hanging on the balance sheet. We would like to see bank disposing these non-performing loans that I have been looking for in order to collect the 44% tax benefit on the face value that you lost. This is a huge amount, it's R$23 billion 34% (01:14:58). So is there something that in the plan to deliver this?

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

We don't have a non-performing loans hanging on the balance sheet, basically we have (01:15:10) and we have loans that follow the normal evolution. You know the rules here. We do the provisioning after the (01:15:24), six months later we do the write off. It's plain, it's simple. And that's what happened in Brazil, I think it's straight forward and very conservative. Basically, we have provisions and we have additional provisions. And one thing even after we have the write-off, it still takes one year, one year-and-a-half to have the tax credit tax deductible. That's kind of the unique thing we have in Brazil and that's why Brazilian banks carry so much tax credit.

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

Okay, okay. Wonderful. And on the consumer peak related to the internal rate, you have any yardsticks that we could use?

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

We have been saying, we believe NPLs will peak for the second half, that's our view on this as long they keep together and the long road starts to pick up a little bit. So that's our view on the NPLs provisions actually.

Yes, NPL provision actually you see, NPL provision has already pointing down this quarter.

A - Alexandre da Silva Glüher

They both decreased this quarter. I think the increase (01:16:56) we expected. We actually see some – could be some stabilization this quarter.

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

Okay, wonderful. Thank you so much.

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

Thank you.

Operator

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

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

Hi, okay. Thank you. Okay, thank you, everybody, for participating in our conference call. The investor relations department is available for any other questions you may have. Thank you all.

Operator

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