

Q3 2016 Earnings Call

Company Participants

- Carlos Firetti, Market Relations Departmental Officer
- Luiz Carlos Angelotti, Executive Managing Officer and Investor Relations Officer

Other Participants

- Domingos Falavina, Analyst
- Henrique Navarro, Analyst
- Jason Mollin, Analyst
- Jorge Kuri, Analyst
- Thiago Bovolenta Batista, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good afternoon, ladies and gentlemen, and thank you for waiting. We would like to welcome everyone to Banco Bradesco's Third Quarter 2016 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 company's presentation. After the presentation, there will be a question-and-answer session where 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 the 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, Markets Relationship Department Director.

Carlos Firetti {BIO 2489005 <GO>}

Hi, everybody. Welcome to our third quarter 2016 earnings conference call. We have today with us participating in the call our Executive Vice President, Alexandre da Silva Glüher; our Executive Managing Director and Investor Relations Officer, Luiz Carlos Angelotti; the COO of our Insurance Company, Bradesco Seguros, Randal Zanetti.

I will turn the presentation now to Luiz Angelotti to start.

Luiz Carlos Angelotti {BIO 4820535 <GO>}

Welcome, everybody. Thank you for staying with us in our conference call about the third quarter of 2016. This quarter, we had the effects of acquisition with HSBC. Then we try to give you a prepared information about the effects of the - incorporation of the numbers of HSBC in our balance sheet. Then, I always try - we try to do in details our movements.

We have been in October the set of the - after that division, the immigration of our operations to Bradesco platform. Then we are very optimistic with the benefits of synergies and opportunities that we will get in the next years. With the acquisition, that will give us some additional profitability that is our objective with these investments.

Then, I will start with the - in slide 2 with the highlights. Our adjusted net income in the quarter is BRL 4.462 billion compared with the second quarter; we had an increase of 7.2%, one decrease when you compare with the same period of 2015. These decrease is related to our - the increase of the delinquency ratio during dispute. Our annualized return on average equity is 17.6%. We have one in total assets this quarter, BRL 1,270 trillion; BRL 161 billion came from the HSBC acquisition. Our expanded loan portfolio is BRL 521 billion, a Tier 1 increase of 10% considering acquisition of HSBC. But excluding HSBC effects, we had a decrease in our loan portfolio, around 6.8%, because of the lower demand in the operations.

Our operating efficiency ratio, we have now 38.2%. The increase is that we had compared with the period before is related to HSBC effects. Our expectation that this number will be running after one year of acquisition, HSBC probably will be running next to 41%, and our objective is in two or three years to return for the same level that we had, that is around 37%. That is getting the objective - the benefits of the synergies and improving the opportunities to offer more products for the HSBC clients. Our Basel ratio had a decrease because the effect of the HSBC acquisition. We will have (06:10) with more details in the next pages.

Then, now, I transfer to Carlos Firetti that will explain the next slides about the presentation.

Carlos Firetti {BIO 2489005 <GO>}

Okay. Thank you, Luiz. So now we're going to more details on the results. In slide number 3, we have the main adjustments we had in our net earnings this quarter. There was a

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series of adjustments related to the incorporation of HSBC. Basically, these adjustments are the ones that were made in - that went through the P&L. Besides that, before incorporating HSBC, we made some adjustments in HSBC related to the adjustments of ratings of their credit portfolio aligning with ours. Also, additional provisions, about BRL 1 billion, a little bit more than that in HSBC and also some contingency provisions. All these didn't go through the P&L. This is reflected in the reduction of the book value of HSBC and is incorporated in the goodwill we will amortize going forward.

In Bradesco, basically, we have the following adjustments: the impact of the alignment of ratings in the Bradesco site, basically downgrading ratings of loans in the Bradesco portfolio to the level of clients that have lower ratings in HSBC, the impact of that net of taxes was BRL 716 million. Also, we made this quarter an increase in technical provisions in our insurance company, mostly related to provisions for individual health insurance plans that impacted our results in BRL 592 million net of taxes, we returned that as non-recurring.

We also have this quarter the definitive decision on a case in the courts related to the contributions of Social Security on self-employed service providers; this is a discussion that has been going on for a few years and we have posted a decision on that. And we referred to the provisions and that impacted positively our results to BRL 575 million. We also removed that as non-recurring.

We adjusted as non-recurring the goodwill amortization expense and net of the tax benefit. The gross goodwill amortization expense was BRL 427 million. Our decision was to adjust only the portion net of the tax benefit. And also we adjusted as non-recurring expenses related to a lump sum bonus payment related to the collective bargain that was closed in the third quarter. That was BRL 191 million. With that, the adjusted net income for Bradesco consolidated was BRL 4.462 million.

In page 4, basically we have the evolution of our adjusted net income, incorporating HSBC. Basically, incorporating HSBC, earnings grew 7.2% Q-on-Q. Without HSBC, earnings grew 3.7% Q-on-Q. The contribution of HSBC on our earnings was BRL 148 million this quarter. In nine months, earnings incorporating HSBC dropped 4.3%; and without HSBC, dropped 5.4%.

You have there the impacts in net earnings. Only to call attention that this is the last quarter you will be able to see the numbers of Bradesco stand-alone and HSBC isolatedly. Starting in the fourth quarter, we will be able to show only consolidated numbers since after the integration we completed in early October. Actually, we have already disconnected the IT and all systems related to HSBC, so we only have the accounting on consolidated terms.

In page 5, we have the breakdown of our net earnings. We always highlight the diversification of our results. Insurance represented, in the third quarter, 34% of our earnings. The banking operations represented 66% of our earnings, with fees representing 28%.

In page 6, we have information related to our total assets return. Basically, our total assets grew year-on-year 20.9%, including HSBC. HSBC added BRL 161 million to our total assets. That amounted BRL 1.27 trillion. HSBC assets represent roughly 13% of total assets. Our equity grew year-on-year 14.3%; and the return on equity, including HSBC, 17.6%; only Bradesco, 17.4%.

In the chart below, we have our operational coverage ratio and efficiency ratio. The coverage ratio, that is fees divided by costs, dropped to 78% when we consider the consolidated number. Without HSBC, it would be at 80%. The efficiency ratio in the quarter, already considering the incorporation of HSBC, reached 41%. We believe we will be able to return the efficiency ratio to past levels over the adjustments we will be able to do in the next three years.

In page 7, we have details on our net interest income. Basically, total net interest income with HSBC was BRL 16.9 billion; and without HSBC BRL 14.5 billion. Total NII grew, without HSBC, 5.4% year-on-year in the quarter isolatedly; and with HSBC 23.3%. Our treasury results dropped a little bit from BRL 179 million in the second Q or BRL 101 million in the third Q without HSBC.

In page 8, we have the breakdown of our net interest income, the interest-earning portion. Basically, we have some comments on this. Basically, focusing on Bradesco stand-alone, credit intermediation grew 8.5% year-on-year, but dropped 1.3% Q-on-Q, mostly due to the impact of volumes. The insurance NII grew 7.8% year-on-year, 3% Q-on-Q.

In Securities and Others, there was a drop of 15.6% Q-on-Q, growing 10.2% year-on-year. In this line specifically, this drop Q-on-Q is related to the fact that we had, this quarter, lower interest revenues from the IPCA inflation. We have bonds that are indexed to IPCA. This IPCA inflation dropped in the quarter, something like 7 bps. And this leads to lower financial revenues due to that and also dividends from some operations on the portfolio of our investment bank.

In page 9, we have the credit intermediation information. Basically here, we can see that the spreads in our portfolio continue to increase, reaching 12.5%. This is basically due to the repricing of the portfolio considering the increase of spreads we have seen in the past months. We basically - it is still growing nicely. We believe there's still some room for seeing this repricing impacting the credit Intermediation marketing a little bit ahead.

In page 10, we have the information in our - for our capitalization ratios. Basically, considering the phasing, our Tier 1 ratio reached 11.9% in September, dropping from 13.7%. The core capital dropped to 11.1%. We had at this quarter 0.8% from the approval by the Central Bank of a subordinated debt that was Tier 1 capital-compliant.

In terms of fully loaded, basically, we have a ratio of 11.3% considering core capital plus 0.8% in terms of Tier 1, amounting to the 12.1% total Tier 1 capital; we see this as very comfortable. We should be adding more capital organically in the coming quarters coming from the accumulation retention of earnings. We believe we can add easily more than 100 bps per year through earnings retention.

So, going to page 11, our expanded loan portfolio, basically focusing here in the portfolio without HSBC. Without HSBC our loan book dropped 6.8% year-on-year. This is also impacted by the FX depreciation. In the quarter, the drop was 1.2%.

The SME book, the company's portfolio is dropping 10.8% with large corporate dropping 7.6%, and SMEs dropping 17.1%. Individuals is doing better, growing 2.1%, the vast growth comes from the real estate financing portfolio that is growing 20.2% year-on-year. There were loans growing 8.1% and the credit cards 12.3%. HSBC added BRL 80 billion to our expanded loan book that amounted BRL 522 billion including HSBC.

In page 12, we have our delinquency ratios. Basically, we have marked the information we believe we should focus on the analysis. In terms of total NPL, basically it grew from 4.64% to 5.35% also impacted by the fact the portfolio as a whole is shrinking considering adjusted number excluding HSBC and the impact of a specific client that impacted our 90 days' NPL this quarter, the NPL would be 4.87%. So, basically, this big increase in NPL is mostly related to this specific case that we just want to be written-off already in the fourth quarter and is already fully provisioned.

We believe that the trends of asset quality are under control. We believe that the peak of NPL can be in the fourth quarter, as we have been saying, and it's - and probably we should see more meaningful drops in NPL ratio at the end of 2017.

In terms of short-term delinquency ratios, we have a pretty good performance in Companies and we had some increase in Individuals. We believe this might be related to the strike that kept many of our branches closed at the end of the quarter. But anyway, even considering there's a small increase in Individuals, short-term delinquents we don't see any different trend and think we are also close to the peak of NPLs for Individuals.

In page 13, we have the NPL creation and allowance for loan losses. Basically, we think there's good news here on at the NPL creation that dropped from BRL 5.4 billion in the second quarter to BRL 5.2 billion, excluding HSBC and the specific client. Basically we have been making provisions covering the formation consistently over our history, you can see, since fourth quarter 2014, actually, we have been covering around 100% or more every quarter. So, we believe our provisions that make us with some very good levels of provisions and very consistent provisioning methodology.

In terms of provisions, we had this quarter, excluding the impact of HSBC, BRL \$4.553 billion that was a reduction comparing to the number excluding the specific client in the second q. We believe the peak of provisions this year might be already in the past, probably first q 2016.

We are still running at a high level of provision, the quarterly ratio last quarter at 1.44%. The best level in the chart, as you can see, was 0.87%. We believe we can go back to that at some point, maybe if they think.

Going to page 14, we have the composition of our portfolio. Basically, the breakdown between Corporates, SMEs and Individuals; SMEs representing 21% of our loan book, a

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decreasing stake over the last few years; Corporates representing 46% and Individuals are close to 33%. And Individuals, basically, a big migration from higher risk credit lines to lower risk. Today, payroll loans and mortgage represent around 41% of our total loan book. We believe this is behind the very - our capacity despite the severity of the crisis keeping our NPL ratios, especially Individuals actually doing relatively well.

In terms of - in page 15, we have our provisioning ratios. Basically, total provisions represent 10.1% of our loan book. We have an excess provision over the minimum requirements by the Central Bank of BRL 7.5 billion, and an excess of provisions over the net charge-offs of BRL 22 million. In the chart below, you can see this coverage ratio. Basically, excluding HSBC and the specific case, our coverage ratio remained at close to 200%, 198.1% for 90 days and 162% for 60 days' NPLs.

On the renegotiated portfolio, we added this quarter the renegotiations from HSBC that pushed up the renegotiations - total renegotiations to BRL 15.8 billion, but excluding HSBC the number would be BRL 14.4 billion. We keep the very high levels of provisions on this portfolio, 65% provisions to the renegotiated portfolio and the NPL ratio has been consistently around 27% - 26%. Only remembering this renegotiated portfolio are renegotiations for loans that got into past due loans, at least one day late, and this is already part of our total loan book and NPL ratios.

We have in page 16 fees. Basically, fees are growing for Bradesco standalone, 8.4% year-on-year. Cards growing 5.6%, checking accounts 18.2%. We believe we are doing quite well considering the environment and we think we should keep the good performance going forward.

In expenses, we have our total expenses in page 17 growing 8.1% year-on-year for comparing the nine months; 3.5% Q-on-Q. Only in the third quarter expenses grew 5.6%; that shows already a marginal deceleration comparing to the level we are still growing in the year, the 8%. Considering our guidance for Bradesco stand-alone that we are reviewing this quarter, we think we would be consistent with the middle of it, the 6% growth.

Basically, HSBC added this quarter BRL 1.8 billion in expenses; with HSBC, expenses grew 25.9% Q-on-Q. We believe we can capture at least 30% synergies on HSBC regional expenses, with synergies on the administrative expenses coming faster and basically on the staff, on the personnel expenses taking up to three years, and it should be captured mostly based on the turnover.

Page 18, we have numbers for our insurance company. Basically, with HSBC, the results for Bradesco Seguros was BRL 1.502 billion, an ROE of 25.6%. But focusing specifically on Bradesco stand-alone, the earnings for Bradesco Seguros was BRL 1.429 billion, 24.7% ROE. Premiums grew 8.8% year-on-year.

Looking to the quarter isolatedly, premiums grew 12.5%. So with these recovery results for Bradesco Seguros is related to the fact that we didn't have, as last quarter, expenses related to the liability tax. We have to do on the insurance company each half year. We

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have an impact of BRL 166 million expenses due to this in the second quarter. We didn't have this quarter. Also, we had some recovery in the loss ratios in the health insurance business, mostly due to some reduction in frequents. Despite that, the claims and the health insurance are still relatively high, but bought some improvement.

Going to page 19, we have the technical provisions and financial assets for the insurance company. With HSBC, they amounted BRL 198 million. Only comparing Bradesco stand-alone technical provisions, grew 17.6% year-on-year. Financial assets basically for Bradesco stand-alone grew 17.7% year-on-year and amounted, with HSBC, BRL 231 million.

We have here in page 20 our guidance for 2016. We have to revise it. Considering we added HSBC in, we will not be able to provide Bradesco stand-alone anymore. Basically, the only revision in Bradesco guidance stand-alone would be in the loan growth. Basically, our portfolio is dropping 6.8% year-on-year. And when we revised the guidance, we also changed the number for loan growth adding an expectation for HSBC.

For the other numbers, we basically maintained the guidance for Bradesco. We think we are mostly in line with those numbers, adding expectations for HSBC in the second half. Basically, considering this we can give some positioning in the guidance, how we see things progressing in terms of NII, the interest earning portion, that the growth including HSBC in the second half is 13% to 17%. Probably, we'll be in the mid-high portion of this guidance.

And in terms of costs, 12% to 16%. Probably, we're going to be in the middle of this guidance. And in terms of loan loss provisions expenses, the BRL 20 billion to BRL 22 billion. We would be in the middle. We also provide this guidance in the format of a pro forma, but basically it's the same thing.

Here, so basically to finalize, we completed in October the integration of HSBC in the weekend of October 8 and October 9. We believe the integration was a success. We have integrated all systems. All operations of HSBC are ready, running on Bradesco systems. We have already turned off HSBC's previous systems. It was a huge operation, involved a lot of logistics and people; and we believe it was a big success.

So now, I turn the presentation to Luiz to his final consideration.

Luiz Carlos Angelotti {BIO 4820535 <GO>}

Well, in our opinion, I think we had very good growth (37:01) in the quarter considering the environment. One important thing is that we start to see the deceleration of the delinquency ratio, and we are very close up to the peak.

With the incorporation of HSBC, I think we have now a lot of opportunities with the synergy and with the sales. Our expectations is improving the offer of products for HSBC clients. Then we understand that probably HSBC will start to add value. It will be accretive in our results, but not this (37:48) next quarter, but after in 2017. We understand that we look at more faster the benefits of the acquisition. And the synergies probably in two

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years, three years it will be at the minimum 30%. Our expectation is that we'll be more than this number because we see a lot of benefits with the acquisition.

And with the migration that Firetti explained, now our operations are in the same platform as Bradesco. Then, we will be much more efficient to get the synergies and the opportunities.

Thank you for participating in our conference call. And now, we are open for questions about our numbers and sets of the quarter. We may start the Q&A.

Q&A

Operator

Ladies and gentlemen, we will now initiate the questions-and-answer section. Our first question is coming from Jorge Kuri of Morgan Stanley.

Q - Jorge Kuri {BIO 3937764 <GO>}

Hi. Good morning, everyone. I have two questions please. The first one is on HSBC. If I look at the disclosure that you provided on page 34 of your presentation, the book value that you recognized after all of the different adjustments for HSBC was BRL 7.7 billion. On top of that, you took a charge of BRL 1.2 billion in Bradesco's numbers. So that puts the acquisition price or - not necessarily the acquisition price, but I guess the top of the money you invested to get that asset around BRL 18.8 billion. Over the shareholders' equity you got - you're looking about 2.4 times booked. You obviously need to add some benefits from the goodwill amortization. So, if you do that in present value you're roughly like a 2.1 times booked.

I'm just wondering how you make this acquisition accretive when you guys are trading at 1.6 times booked. Itaú was trading at 2 times booked. So, sort of like best-in-class banks are trading at well below what you paid for HSBC, which again as you provided on page 35, it doesn't really make any money. So, how do you make this accretive? Can you just help us go through the map on how this make sense and what exactly are those returns that you're expecting? And just as specific as possible so we can understand what the rationale is because the marketers doesn't really help.

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

Okay. Thank you, Kuri, for your question. And we are very comfortable with the acquisition as the goodwill that we have now is around BRL 10 billion. That's probably with the amortization we will be in five years. This is one we will cover on part of the price in the - with the stability of the goodwill. But with our mix - actually, we'll cover the majority of the price. We were very comfortable with the valuation.

With the synergies and the opportunities that we have in other products, we did the analysis of the client's bases, very good client base and the network of branches for us

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that we have the complementation. Now, we have a better position in the Brazilian market.

Let me talk about multiples, I think we understand that the price that we have now in the market does not reflect the correct multiples, probably with the recovery of the Brazilian market, the multiples will return probably at better levels. Our expectation is that probably in 2018 and 2019, we will have much better numbers.

Then, the acquisition that we did is looking for the future, was the last opportunity in the Brazilian market. And that's a quarter we probably will have some benefits with the acquisition recovering more, one part of synergies that you start to benefit to the props with the - after the migration that we had. But the higher benefits will come in 2017. We're working in a unified platform. Administrative cost will reduce more faster in the first time. And the personal cost probably with the turnover that we have in the banking mostly only using the turnover, we cannot use the structure of employees in two years or maximum three years.

Then, we are very comfortable with the acquisition and that the ROE probably we will have start to have a benefit or the improvements with the additional profitability that will come from this HSBC benefits from the synergies and the improving of sales. Then, we are very comfortable with the numbers and the acquisition. What we have announced are more the full activity in the markets. Then sometimes the multiple doesn't reflect the proactive benefits that we see with the acquisitions.

I am only complementing, we had provided when we announced the deal, a map saying that in the first year the deal would be neutral. Second year, it will be accretive.

Basically - in a very simple way, basically, we lose the interbank rate on the BRL 18 billion. And considering the earnings from HSBC plus synergies, we'll be able to match what we lose in terms obsolete (45:45) probably during the first year. And that makes in a simple way, I know, the deal in terms of EPS neutral in the first year. And considering the amortization of goodwill and considering the path on absorption of synergies that we believe or even if we believe three years is the full period, for synergies probably two years, already bought a big chunk of it. We believe it's going to be already at least in terms of EPS accretive for us.

Q - Jorge Kuri {BIO 3937764 <GO>}

All right. Thank you. My second question is on your outlook. I know you have not provided 2017 guidance, but just on a qualitative basis, your view on NII for next year in the context of a weaker - still overall weak volume environment, falling rate and loan loss provisions, how much can they fall when you continue to see unemployment go up and overall economic activity is being revised down across the board. So, how do you think demand adds off in terms of particularly NII and provisions for next year?

A - Carlos Firetti {BIO 2489005 <GO>}

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Okay. About provisions and expenses with the allowance for loan loss, our expectation is that probably next year this is also the final guidance is our expectations considering what we can hear about the economic expectations for 2017. So, probably, we will have the stability in expense for loan loss, the allowance for loan loss. But probably, we can have some decrease in the end of the year.

We don't affect any increase. It's most probable that we can have some decrease in the expenses in the end of the year because the environment and the economy we expect a 1% growth in GDP. Probably, delinquency ratio will start to be stable. We see in 2018 further decreasing in the expense is what we expect.

In the margins, NII, we don't have that guidance now. What we can see what will help the margins next year is that probably we will cover some volumes in the loan portfolio. We expect some increase at the total market. Probably we'll grow something closer 5%, and our expectation is to grow in a similar way. We have this Selic effect that the expectation that probably will decrease this. Our Central Bank is actually to decrease in a more faster way Selic in the next few years. Then we probably will get some benefit in our decrease portfolio, then some additional profitability we will gain in our NII from this portfolio.

When we talk about HSBC some benefit that we will have is the funding of the GA CDC have a higher cost when you compare with previous one. Then we are starting now to manage it better the cost of funding HSBC clients that we start to reduce, then this another effect that we will improve our NII next year. Then we don't have now a number there, but we expect some growth probably something closer around loan portfolio growth, closer of the loan portfolio growth. This is the main benefit that we expect for next year in the NII.

Q - Jorge Kuri {BIO 3937764 <GO>}

All right. Thank you very much.

A - Carlos Firetti {BIO 2489005 <GO>}

Thank you.

Operator

Our next question is coming from Jason Mollin of Scotia Bank. You may proceed.

Q - Jason Mollin {BIO 1888181 <GO>}

Thank you very much. My question is related to lending in the individual segment, the consumer segment. Bradesco reported an increase in NPLs both early delinquency, 15 to 90 days and for the 90 days, some of the statements mentioned said that this may be partially attributed to the strike. But maybe you could provide some color there, maybe some details looking at, let's say, credit cards. What portion of the usage of cards in the quarter actually became revolving loans or credit? And how has that been evolving? Are the usage - or more people utilizing the cards as a source of credit or are more people actually paying their bills in full every month?

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A - Carlos Firetti {BIO 2489005 <GO>}

All right. Thank you, Jason, for your question. When we talked about specifically about the credit card portfolio, the volume is up operations. We start to have a deal acceleration increase. We had a reduction in one part of the credit card numbers, individual clients. But we can see a little higher delinquency ratio when we talk about non-clients. And for our Bradesco clients, we see a little better behavior in our delinquency ratio.

Our expectations are probably this portfolio of credit cards will stabilize the delinquency ratio in the next quarter probably. In our portfolio of credit cards in the loan portfolio, it's normally more close of the end of the year. You have, yeah, (53:22) in the utilization of credit cards. We see a normal movement with probably this movement will continue until the end of the year. I think, it is normal in our portfolio, the clients pay their operations in installments.

What we have is we are trying to reducing the revolving operations or for us we don't have interests. If he declines, staying in the revolving operations for too much time, then we try to offer them some, a better way to offset another operation too that they will have less or better capacity to pay. But, normally we could see our limits when we cross again to reduce new portfolio.

This then is a normal management that we do in the portfolio. Then, the increase we see is a normal movement when we are more closer for the end of the year. I think in a short period the delinquency ratio 15 to 90 days. One part of the delinquency ratio related to credit cards or auto loan is more related, because it's some non-clients or clients that the - through - don't have the automatic payment. They pay using tickets or cashiers. Because of the strikes here in September, we believe that one part of the delinquency ratio in the short period is related. They did strike. But we don't see any additional risk in the portfolio or in the movement.

Our new operations or our new clients that when we renew the limits, we are selecting better the clients and they're using our systems and models to have a better new origination in the operations. Only for you have an idea, 25 of our branches were closed during the strikes and, normally, in big parts of the day. Then, the movement caused some effect in delinquency ratio and in fees - and I think in growth of fees is one part of the product. But now everything is normal and they're returning for their normal levels.

Q - Jason Mollin {BIO 1888181 <GO>}

Okay. Okay. That's helpful. Thank you very much for that color.

A - Carlos Firetti {BIO 2489005 <GO>}

Thank you, Jason.

Operator

Our next question is coming from Domingos Falavina from JPMorgan. You may proceed.

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Q - Domingos Falavina {BIO 16313407 <GO>}

Hi. Good morning. Thank you for taking the question. My question is - I have two questions. The first one is regarding the hedge used to have for floating versus fixed. I understand you used to have historically a hedge of about BRL 20 billion. You have lowered that to BRL 1 billion and it seems you went back to BRL 20 billion. And my question is sort of the impact on the NII for the fourth Q, given the recent steepen (57:39) on the Selic curve.

So basically should we expect some kind of a negative impact of equity? If you could provide any details as the magnitude of that to every 50 bps or 100 bps increase in either your one-year curve or the three-year curve? What can we expect? Because it seems that your outlook for the reference rate decrease into the next year seems a bit more aggressive than maybe unwinding as a result of the electoral outlook here in the U.S.? Then I have a second.

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

Okay. Thank you, Domingos. This is Luiz speaking. Probably with the volatility of the dollar and the rates could have some impact in the capital ratios. But we don't expect a huge impact. After the HSBC acquisition, the ratio we understand that we have a very comfortable number. We had the additional improvement in the ratio with the new subordinate debt level 1. That is addition - we had an additional 0.8% in our index. Then probably we will have some impact I think less than we had in the third quarter of 2016. But we are very comfortable with the ratio that we have. We don't expect too much in fact before this movement.

Q - Domingos Falavina {BIO 16313407 <GO>}

Remind me again. I think that quarter you mentioned was the quarter you had about BRL 6 billion, right, of negative effect that the bank reclassify in available for sale, most of the securities?

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

No, no. I think the only the effect that we had last year with the volatility was the mark-to-market effects in the equity. This is a one-off effect because the rate variation was the market-to-market in the equity. Another effect is with the dollar increases here in Brazil, we had some increase in the tax credit, that when you do the calculation for the Basel ratio, we had an improvement in deduction of tax credits. But the total movement last year was 1.1% or 1.2% and the valuation of dollar was 35%, I think. Then we don't expect a similar leg of variation. What we see that one impact we have, but less than we had last year.

Q - Domingos Falavina {BIO 16313407 <GO>}

Okay. Perfect. And my second question is more on the SME side. We see a lot of filings for bankruptcy, actually, very resilient, even growing up the margin. But the NPLs for you, if you adjust for the shrinkage of the loan book you're starting to stabilize. I mean you are deteriorating at a lower base. And my question is, in your view, when should we see the

peak in the NPLs for the SME? When should we start to see, actually, even that maybe coming down?

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

Okay. The SMEs, I think, the (01:01:36) that has a little more higher than loss ratio - little more higher delinquency ratio. Probably because the small companies had more affected with the small consumption in the Brazilian market. Then, we understand that it's probably we are very close up the peak. If it don't being the next quarter, it will be in the first part of 2017.

We are working hard in trying to improve the quality of our models. We are working to move our portfolio for a lower-risk portfolio. Then, now all new origination of loans have less delinquency ratio and probably, we are very close of the peak when we talk of the SMEs. And the old portfolio that has, as you know, more higher delinquency ratio, probably the worse operation that have problem we will continuously have migration to the write-offs. And the rest of the portfolio has the best quality. Our expectation is that continuous to be reaching the peak probably at the end of the year or beginning of the year in this when you talk only about SMEs. When we talk about total ratio, probably, we have to set up until the end of the year. We are very close out the piece.

We are also very comfortable. Our expectation is that we do not have our guidance before the allowance loss extends probably now considering the HSBC numbers. Probably, we'll finish it the year, around the need of the guidance. We're a little closer at the middle of the guidance. We don't see too much risks, new risks in our portfolio.

Q - Domingos Falavina {BIO 16313407 <GO>}

Understood. Thank you very much.

Operator

Our next question is coming from Henrique Navarro of Santander. You may proceed.

Q - Henrique Navarro {BIO 16188960 <GO>}

Hi. Thank you for taking my question. My question is actually on your acquiring company, the company you have on stake, which is Cielo. Cielo has been losing market share in point of sale. So, we're talking about, basically you're talking about last merchants and SMEs where Bradesco could be selling its banking products. So, my question is how uncomfortable Bradesco is with this situation, and if there is any strategy trying to revert to this situation? Thank you.

A - Carlos Firetti {BIO 2489005 <GO>}

Yes. Thank you, Navarro. I think Cielo is one independent company. Okay? We have participation in the company, but we compete in the market with Cielo.

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I think in our case, strategy is the relationship with the clients. We are more close to the clients, then we have developed the other operations with the clients. Then we try to offer packages and the attractive with clients. We see our total relationship in financial terms. And this is the way that we are working our clients. I think we are having success. But we compete in a normal way with Cielo.

I think for Cielo, it's our one important market. But I think we are more close of the clients. Then it's not only a relation about a (01:06:02) pricing. Then we try for clients far, try and tell this is the total benefits of the relation that the banking benefiting our operations. Then I think we are having success in this process.

Q - Henrique Navarro {BIO 16188960 <GO>}

Okay. I understood. So, so far, there is no, let's say, acquiring initiative from Bradesco other than Cielo. Cielo is the only and sole vehicle for Bradesco?

A - Carlos Firetti {BIO 2489005 <GO>}

Yeah. Cielo continues doing the movement. We work for Cielo to improving their participation in the margin, in the acquiring operations and then in improving. But we compete with Cielo in other operations. But we don't have any strategy to create a new company to compete with Cielo. Cielo is our main investment. When we talk acquiring, it is the most important thing. And we are working for Cielo continuous growing. But in some situations, we are competitor of Cielo. This, I think - these are normal situation when you have opening company's asking in the market. Both companies are investing here.

Q - Henrique Navarro {BIO 16188960 <GO>}

Okay. Crystal clear. Thank you.

A - Carlos Firetti {BIO 2489005 <GO>}

Thank you.

Operator

Our next question is coming from Thiago Batista of Itaú Corretora. You may proceed.

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

Hi, guys. Thanks for the opportunity. I have just one question on the capital side. In your calculation of the core capital Tier 1, after a fully loaded and after divestments of the tax effects and the goodwill amortization, you calculate an increase in the capital of 0.9%. This is mainly the goodwill of HSBC and also the synergies. So, I have two questions on this. The first one, the goodwill is the amount of goodwill that you believe you'll be able to amortize until the end of 2018? And how much is or what is the synergies of HSBC that you mentioned in this chart?

A - Carlos Firetti {BIO 2489005 <GO>}

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This is, I think the synergies is only, it's not benefits of synergies. It's only goodwill amortization. I thinks it's a wrong to interpret synergies. It's a - the effect on the goodwill and in principle assets amortization until the final implementation of Basel 3.

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

Okay. Okay. Thank you very much. Thanks for the clarification.

A - Carlos Firetti {BIO 2489005 <GO>}

Thank you.

Operator

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

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

Thank you, everybody for participating in our call. The Market Relations Department is open to receive further questions you may have. Thank you very much.

Operator

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

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