Q1 2014 Earnings Call

Company Participants

- Luiz Carlos Angelotti, Managing Director
- Paulo Faustino da Costa, Market Relations Department Director

Other Participants

- Anibal Valdes, Analyst
- Jorge Chirino, Analyst
- Regina Sanchez, Analyst
- Tito Labarta, Analyst
- Unidentified Participant, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. And welcome everyone to Banco Bradesco First Quarter 2014 earnings results conference call.

This call is being broadcast internally through the Internet in the website, www.bradesco.com.br/ir. In that address, you can also find the banner for which the presentation will be available for download. (operator instructions)

Before proceeding, let me mention that forward-looking statements are being made under the safe harbor of the Securities Litigation Reform Act of 1996. Forward-looking statements are based on beliefs and assumptions of the Banco Bradesco management and on information currently available to the Company.

Forward-looking statements are not guarantees of performance. They involve risk, uncertainty 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 that general economic conditions, industry conditions and other operating factors could also affect the future results of Banco Bradesco and could results to different materially from those expressed in such forward-looking statements.

Now, I will turn the conference over to Mr. Paulo Faustino da Costa, Market Relations Department Director.

Paulo Faustino da Costa {BIO 6436050 <GO>}

Good morning, everyone. And thank you, all, for participating in our conference call in the First Quarter 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 always increasing the transparency of information disclosed to the market.

We have here today Mr. Luiz Carlos Angelotti, Executive Managing Director and Investor Relations Officer; Mr. Moacir Nachbar Junior, Deputy Officer.

I will now turn to our Managing Director and Investor Relations Officer, Mr. Luiz Carlos Angelotti, who will lead our conference call; and 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 on Bradesco's First Quarter 2014 conference call. Now, let's look at slide 2.

Slide two shows the highlights for the period beginning with the adjusted net income, which amounted to BRL3,473 million in the First Quarter, 8.6% quarter over quarter and 18% year over year.

Our ROAE reached 20.5%, the best performance in the last seven quarters.

Our insurance operation, which is one of the pillars of our business, has also performed well, with a net income of BRL1,040 million, 11.8% up year over year, due to the premium growth across auto and a reduced plan ratio, further reinforcing the excellent prospects for this business.

Our net credit margin went up by 12.7% year over year, mainly driven by a lower delinquency cost, underlining the improved quality of our loan portfolio.

The delinquency ratio over 90 days continued to decline falling by an additional 10 basis point quarter over quarter and 6 basis points year over year, reaching 3.4%, the lowest level in the last five years.

The fee and commission income went up 14.9% and the operating cash flow remained below inflation for the period. This mix of constant [ph] investment and the strict cost controls [ph] contributes to an improved efficient and operating coverage ratios.

I'd like to call your attention to our quarterly efficiency ratio which reached its highest -- the lowest [ph] level of the last five years, 40.1%.

Our total assets amounted to over BRL922 billion and our expanded loan portfolio amounted to BRL432 billion.

Slide three shows the reconciliation between our book net income and the adjusted net income. In this quarter, the only non-recurring item was the provision for civil contingence totaling BRL50 million to us. Adjusted by this event, our book net income rose from BRL3,443 million to an adjusted net income of BRL3,473 million.

As previously mentioned, our return on adjusted average equity came to 20.5%.

On slide 4, you can see that the income growth in the First Quarter of 2014 was mainly driven by, first, the lower professional and the administrative expense; and second, the lower provisions for loan loss; and is partially offset by the lower net interest income.

Year over year, the adjusted net income recorded a significant increase of BRL530 million, or 18%, basically due to the first higher fee and commission income, as a result of an increased (inaudible) of operations, mainly fueled by our expansion of the client base and the customer services channel; second, the reduced delinquency [ph] costs; third, the higher interest earning portion of net interest income and partially offset by the increase of personnel and administrative expense below inflation; and as a result of the continued cost-cutting efforts led by our Efficiency Committee and the lower non-interest portion of the net interest income.

Our 12-months' earnings per share went from BRL2.8 to BRL3 in the last quarter.

In slide 5, you can see the breakdown of our net income, which remains practically stable in the quarter. Year over year, it's important to note the expense share of loans due to the higher business volumes and the lower delinquency costs, first, driven by the extended credit card and client base, as well as customer service channels and the funding, due to the increase is 33% [ph].

Moving on to slide 6, our 12-months' efficiency ratio came to 41.9% in the First Quarter of 2014, a big improvement quarter over quarter.

The quarterly efficiency ratio shows the best performance of the past five years, 4.1% sic; see slide 6, "40.1%" [ph]. We believe that the trend is that in the next quarters, we will be running around this 40% and moving to 30% into the end of the year. That is our target: to have an efficiency ratio around 39% in the end of 2014.

The blue line shows the risk-adjusted efficiency ratio, which stood at 51.4%, showing an improvement to -- of 70 bps and it be 170 bps quarter over quarter and year over year, mainly reflected the drop in delinquency in addition to aforementioned factors.

Please also note that our operating coverage ratio, fee and commission and [ph] to administrative and personnel expenses, on the top line came to 73.6%. This ratio is a measure of our ability to cover operating expense with the fee and commission income. Operating coverage ratio rose to the highest point in the last six years.

In slide 7, we can see that our unrealized gains amounted to BRL15 billion this quarter, BRL1.1 billion quarter over quarter. Such increase was basically driven by the appreciation of our investments, especially our shares of Cielo, which went up by 12.2% in the quarter.

These figures do not include the BRL5.3 billion related to our -- the potential surplus value of our property.

In slide 8, we show the performance of our net interest income from both non-interest and the interest-earning operations. This quarter, we saw a decrease in the total interest income, mainly due to the lower non-interest earning portion, basically related to our insurance activity. Year over year, the increase was mainly caused by the growth in the interest-earnings portion, mainly loans and funding.

The non-interest earnings portion drop reflects the lower arbitrage gain.

Annualized net interest margin reached 7.1% in the First Quarter of 2014, remaining stable quarter over quarter. Our expectation is that probably the NIM will be stable during this year between -- around 7.1%/7% is our expectations for 2014.

On slide 9, you can see that in the First Quarter the interest-earning portion of net interest income was impacted by a lower margin, mainly due to our lower average spread. And a quarter with less working days, which was partially offset by the higher securities margin.

On an annual basis, as I have highlighted, loans and funding which grew due to higher business volumes, whereas funding was also impacted by the increase in interest rate in the year.

On slide 10, this quarter the net credit margin, the blue band of the chart decreased by 0.8% quarter over quarter, basically due to the lower average spread. Year over year, the margin increased by 12.7% was still affected by higher business volumes and the reduced delinquency costs.

For 2014, we expect the delinquency ratio will stabilize at the current lower level and the credit margin will increase due to the great business volume. And this includes our average spread.

On slide 11, we show out capital adequacy ratios. The total ratio stood at 15.7% in March 2014, while the common equity Tier 1 ratio came to 11.9%, remaining at very comfortable levels. A portion of such quarterly decrease in these ratios related to the increased sales [ph] reduction established for the implementation schedule of reviewable [ph] adjustment, partially offset by the higher results in the quarter.

For simulation purposes, if we apply 6% [ph] of this prudential adjustment to our December 2013 figures, our common equity Tier 1 ratio would be 10 basis points higher end of March 2014.

It is also worth noting the impact of our subordinate activities in the quarter, which affected the total ratio by 50 basis points, you can all see a simulation of our BIS III ratios on a fully phased-in [ph] base, which results in higher ratios of 10.9% for the Tier 1, driven mainly due to our consistent growing results, totaled [ph] with the sound quality of our assets. Therefore, we think the [ph] implementation of the rules will not impede our ability to finance our fund [ph].

On slide 12, we show that total assets amount to BRL922.2 billion, 3.1% up year over year. The return on average assets stood at 1.5%, 10 basis points up quarter over quarter, while the adjusted return on average equity was 20.5% for the year; as mentioned before, the best performance in the last five -- the last seven quarters.

On slide 13, we show that our expanded loan portfolio amounted to BRL432 billion as of March 2014, 1.2% up quarter over quarter and 10.4% up year over year. This performance was mainly driven by the increased loans to large corporations, the corporations, 1.6%. And in the last quarter built [ph]. And 12% year over year; and the loans to individuals 1.5% in the last quarter and 11.5% year over year.

In the corporate segment, the product that posted the strongest growth in the last 12 months was real estate financing, corporate plan. In the individual portfolio, the highlights were the real estate financing that grew 36% and the payroll-deductible loans, our own origination, 37%.

It's important to emphasize that as from January 2014, as a result of our corporate client migration, we have reclassified information for prior period. We had some -- during this period, some clients that was classified in SMEs, that they have now revenues over, then, BRL200 million per year and we did the migration of these clients. So the clients of the corporate segment.

Slide 14 shows our delinquency ratio. Our total delinquency ratio, which is based on transactions due over 90 days, showed an increased quarter over quarter and the -- showed a decrease quarter over quarter to -- we finished the quarter with 3.4%; the least that we had in the last five years.

The decrease is as a consequence of changing the portfolio mix, mainly the increase of payroll-deductible loans and the real estate financing, mortgage operations; continuously improving the non-rating [ph] procedures; and the improved credit risk [ph] on non-performing models.

In addition, most (inaudible) there has been a continuous drop in the individuals ratio. The main effect is because of the mix of operations, payroll loans and the mortgage operation that is increasing very steadily in this segment.

The slight increase in the 61 to 90 days' delinquency ratio, quarter over quarter, reflected seasonal amount [ph] of effect in the -- relates to debt [ph] and contribution penalty [ph], concentration [ph] effect, contribution payments in the beginning of the year, which tend to [ph] negatively impact our clients' credit worthiness and it's not indicative trend [ph].

We expect that our delinquency ratio, it will increase in the next year. We expect that the total delinquency ratio that is 3.4% in the last quarter will stabilize at this level for the next quarter. And this -- we emphasize that it's the lowest level since December 2003.

On slide 15 shows that our provisioning ratios remain robust. Assuming the maintenance of the 12 months' net-loss ratios, as of March 2013, we had BRL12.2 billion of excess provision. It's the reduced [ph] portion of the total line.

I would point out on this slide, the increase in the coverage ratio for loans overdue by 90 days, reflecting the drop in delinquency. The drop in the coverage ratio for loans overdue by 60 days, is related to seasonal effects. And is not indicative of a rising trend in impact.

Therefore, we believe that our level of provisions, in accordance with the Central Bank regulation, is in line with our provisions and risk assessment policy ensures our corporate role and margin to handle the effect of any potential downturn.

Moving onto slide 16, the First Quarter fee and commission income went up by 1.1% quarter over quarter. And amounted to BRL5,283 million. Mainly because of this quarter, performance in underwriting financial advisor fees that influence our investment gain, the DTI.

On an annual basis, fee and commission income increased by 14.9%, led by operations such as card, checking accounts and consortium. It is important to mention that our continuous investment in technology, extension of customer services channels and the organic growth [ph] had led to an increase in our customer and credit card fees, compared generally to a continuous upturn in transaction volume and subsequently in fee and commission income.

Slide 17 shows that operating expense were down 7.5% quarter over quarter. The reduction was mainly due to lower personal expense impacted by the higher concentration of vacation leaves [ph], which did go up First Quarter. And it is seasonal effect in administrative expense, which mainly affected underwriting expense in the biggest quarter.

Year over year OpEx was up 3.9%. The increase in personal expenses was mainly driven by payroll -- the expense [ph] arising from collective bargaining agreement.

The 0.9% increase in administrative expense reflects our continuous effort [ph] to reduce cost, resulting from the active engagement of our internal Efficiency Committee.

It is important to emphasize that the overall impact of month's [ph] inflation rate was around 6%, respective rate [ph]. And we had an increase in our OpEx only around 3.9%.

Considering our ongoing pursuit of improved efficiency and investment in technology, we believe that we will continue to deliver OpEx well below the inflation level in 2014.

On slide 18, it shows the insurance written premiums, pension plan contributions. And capitalization bond income, which went down by 21% quarter over quarter, mainly due to the strong growth in the pension plan segment, which was boosted by a higher concentration of pension plan contributions in the Fourth Quarter of 2013.

On an annual basis, we have seen 4.5% increase, led by health insurance, capitalization bonds. And auto, which shows double-digit growth. Please note that the life and pension plan decreased, reflecting the fact -- the overall market behavior.

The net income for the quarter posted [ph] in our insurance business moved up by 3.9%, exceeding BRL1 billion, mainly due to 100 basis point reduction in the claims' ratio, improved financial results. And the lower administrative expense, despite the collective bargaining agreement signed in January 2014.

On an annual basis, the 11.8% increase in net income is basically explained by an increase in revenues, improved financial results. And the stability of claims' ratio.

Slide 19 shows some of the main themes of our insurance activity. Our financial assets amounted to BRL180 billion sic; see slide 19, "BRL147.7 billion" [ph], while the technical reserves stood at BRL138 billion, BRL108 billion sic; see slide 19, "BRL119.9 billion" [ph] of which fall under life and pension plan business.

Finally, I would like to emphasize our outstanding performance in the First Quarter of 2014, which allowed us to reach a 20.5% ROE. This is due to our (inaudible) actions aimed at promoting sustainable results, while we constantly (inaudible) to obtain the best risk and returning ratio.

The current scenario is certainly challenging. But we are confident that we are on the right track to reach the goals outlined for 2014, (inaudible) to maximize the return for our shareholders.

Thank you for taking part in our conference call and we are now able to answer any question you may have.

Questions And Answers

Operator

(operator instructions) Jorge Chirino, Morgan Stanley.

Q - Jorge Chirino {BIO 17127041 <GO>}

(technical difficulties) pension mix. I think it would be very helpful if you could provide us more color on what happened to spreads during the quarter. Did they increase significantly, or how do you see the outlook for spreads going forward? Thank you.

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

Please, Jorge, can you repeat the question on (inaudible); we had some cut off in the call.

Q - Jorge Chirino {BIO 17127041 <GO>}

Sorry. Is it better now?

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

Yes, now we're okay.

Q - Jorge Chirino {BIO 17127041 <GO>}

It's a question about the spreads. Your margin on loans contracted on a sequential basis in the First Quarter. I know there's the impact of the change in mix. So I think it would be very useful if you can provide more color on what happened to spreads during the quarter. Did they increase significantly. And how do you see the outlook for the spreads going forward? Thank you.

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

We had some effects in this quarter in our gross margin. Definitely [ph], in this quarter we had less business days, three business days less than the previous quarter. Then this is the one effect that we had in dispute that we reduced a little bit revenues.

But we understand that during the year, we will have some improvements in the spread in some lines, because we can see that we have some growing [ph], some operational, for example, credit card, loan portfolio, which it translates that our clients is using more, because it breaks some new products that (inaudible), that is our clients has the potential pay the due in installments. Then they use [ph] more this part of them helps us to improve the revenue.

Then, this will help us during this year to improve more our revenues with the credit. And we will gain here some compensation, because of the mix effect that came from mortgage and the payroll loans.

And the real estate [ph] during the year, this revenue will increase a little more than this focus that we're having when we compare year over year, the growth that we have. Then this is the effect that we expect for this year.

We expect that some more stabilization in the spreads, the final spread, that we have in our portfolio [ph] that is 9.9%, because the growth that we have in some products.

Q - Jorge Chirino {BIO 17127041 <GO>}

Okay. Thank you very much.

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

Thank you.

Operator

Regina Sanchez, Itau BBA.

Q - Regina Sanchez {BIO 16404038 <GO>}

Congratulations on the results. I have two questions; the first one is on slide 11 that is showing the common equity Tier 1 ratio, already full loaded under Basel III, increasing to 10.9% in First Quarter, from 10.2% in December, 2013.

This shows that there was a tangible equity generation quarter over quarter. And probably as a consequence of -- with earnings and returns. And still smaller in growth.

Considering the scenario of a more moderate loan growth, maybe around 10% to 15% in coming years, do you see room to increase the payout ratio and/or increase the buyback of shares? This is my first question.

Then I ask my second question later, thank you.

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

Thank you, Regina. Our expectation for the next year is that probably the loan growth will be around 10% to 15%. And we expect to maintain our ROE around the 18%/20%.

Probably in the future, the growth of the stability [ph] will compensate the growth of the capital allocation. And probably we will have some additional capital in the future.

But to change our dividend policy probably we will wait for the total implementation of Basel III, until the end of 2018/2019. Our Central Bank probably will adopt an additional requirement for the institutions -- the most important institutions, regional institutions. And we don't know if it will be something around 1% or 1.5%. But we expect the final implementation of Basel III to change or not our dividend policy.

We will not pay our dividend policy. We continue staying according to our bylaw; that is 30% that we pay after the tax effect.

Q - Regina Sanchez {BIO 16404038 <GO>}

Okay, perfect. Just to follow up on this question, is the 100 basis points or 150 basis points regarding this domestic, systemically important institutions? This is already what we have seen in terms of conversations with the Central Bank?

And do you have any date in terms of expectation of the release of this requirement, in terms of a Central Bank revolution?

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

We don't have the final numbers. But it probably will become clear around this level. We need to wait the final implementation for -- to decide if we change, or not, our dividend policy.

Q - Regina Sanchez {BIO 16404038 <GO>}

Okay, perfect. Thank you. So my second question is regarding the administrative expenses; that we really like to see this reduction of 7.5% in the quarter; that it's more than usually happens in the First Quarter. So it's even better than the seasonality.

Do you think through this cost control, the efficiency program, you can even achieve better efficiency ratio. And maybe grow this expense line more towards the bottom, or the low end, the guidance for 2014? I appreciate that, thank you.

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

Regina, we expect to finish the year around the center of the target, that is around 4%/4.5%, probably it will be the level that we expect to finish the year.

We have many activities that we have impairment for to --- that we will give us some economies and reduced costs. And we have the effect of the IT revitalization [ph] plan that is some new systems that we do have running -- do have helping us in the internal process in this year. And in 2015. Then the divestments do help us to maintain the costs growing probably (inaudible).

Then, for this year, we have guided 3% to 6%. And probably our expectation for now is finish the year around the center of the guidance. 4%/4.5% is what is expected.

Q - Regina Sanchez {BIO 16404038 <GO>}

Okay, Paulo [ph], thank you so much. I appreciate.

Operator

Tito Labarta, Deutsche Bank.

Q - Tito Labarta {BIO 20837559 <GO>}

I have a couple of questions. Just firstly in terms of asset quality and provisions, as you mentioned, NPLs that are around 5-year low, provisions also at historically low levels. And you mentioned the asset quality should stabilize around these levels in the next few quarters. But just want to think maybe a little bit longer term.

When do you think the cycle will begin to turn. And maybe start to see a pickup in NPLs and maybe provisions begin to rise again? I just want to get a sense of where you think you are in the cycle, maybe beyond the next couple of quarters. That's my first question.

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

Our expectation for the delinquency ratio is that they will be stable for this year. They're now only 3.4%.

For the expenses, in the last quarter we had a decrease in the expense. Probably we will have some stability during the Second Quarter. And on the second half, probably we will have some increases because the effect of the growth of the portfolio.

This is what we expect. And when you compare 2014 with 2013, in nominal terms, we expect that probably the total expense, which is P&L provisions and hedge of the recovers probably will be in a similar level around the BRL12 billion, is what we're expecting for this year.

Q - Tito Labarta {BIO 20837559 <GO>}

Great, thank you. Just a follow up on that, you said NPLs should be stable for this year. But I was thinking maybe a little longer term. I see you're forecasting GDP growth of 2.5% for 2015.

But do you have any concerns about that being able to happen with perhaps some fiscal adjustment needed. Do you think NPLs could begin to rise in 2015?

And do you think that the 2.5% growth, there's any risk to that for next year? I know it's a little long dated. But I just want to get your thoughts a little bit longer out.

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

Possibly the scenario that we have now, our economic department, they expect for 2014 a little better growth in GDP. We have something around 3%. I think the market consensus is around the 2%.

But in both scenarios I think if we consider that the unemployment rate will be -- will grow only at a small level, around 0.6%, it would not be enough to change the increased risk for individuals.

We understand that, probably 2015, we will have a similar stability and the effect that we will have, in 2014, probably will be the effect of the nominal growth, the Fourth Quarter. Then we expect some -- the growth in the extent in the NPL origination will be a similar of the grow of the portfolio.

And we expect stability in the delinquency ratio around this level, 3.4% is what we expect for 2015.

Q - Tito Labarta {BIO 20837559 <GO>}

Great, thank you. That's very helpful. Then just one follow-up question on expenses; somewhat similar in IT, you've grown expenses below inflation this year.

But given some of the projects you have, in terms of improving efficiency with IT and things, do you think that you can continue to improve efficiency further out and continue to grow expenses below inflation, say in 2015 and in the year beyond that?

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

Yes. We understand that it's possible to maintain the expenses this year, growing under the inflation. For 2015, probably we'll be in a similar situation.

If you look at expenses we have this year, some expenses that will -- that we had, year over year, a negative growth.

I think in communications and (inaudible) probably be in this line, first part -- in this line that there are things that explains that we have some projects that will help us to maintain a cost reduction.

We have -- on other projects there are some of -- an effect of the IT revitalization [ph] and the new systems that we will be running during this year and the next year will help us improve some internal process and we will have some cost reduction that will help us maintain the -- our expense growing less than inflation this year and probably in 2015.

Q - Tito Labarta {BIO 20837559 <GO>}

Great. Thank you very much. That's very helpful. Thank you.

Operator

(inaudible), UBS [ph].

Q - Unidentified Participant

I have a follow-up on Tito's question actually on the cost to income. We saw that there was a small reduction in the headcount in the quarter and I have seen this in the past few quarters. So just wanted to check if this is through natural attrition.

Then the second question going with the cost to income as well, you mentioned that mobile banking represented 14% of total transactions if I can remember right.

I just wanted to get your feeling on when you look at the Internet banking and mobile banking, do you think you can still continue to increase a lot the percentage of transactions that use this channel; and is that going to be a key driver of efficiency gains? Thank you.

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

Okay. Thank you. About the headcount, we had a decrease in the number of employees this year, only 2,800 employees. This reduction is accordingly normal turnover of the Company, the internal improvement of the process in some areas. This effect probably will continue during 2014 and in 2015.

It was because, as I was mentioning, the new system that will help to improve the quality of internal -- of information, the internal services and with these systems, we will need less personnel intervention. It will probably help us to continue in this movement.

But these are normal movements, because we did improve, with the technology, our internal process and year over year, we do many different amount of investments in technology. Last year was massive, BRL5 billion. Probably this year, we will do something similar; probably it will be a little more than BRL5 billion.

Then we need to, year after year, invest in more technology to support the growth, that grow we have in the volume of transactions.

This is related in the same way with the second question that you did. We are investing in our technology channels; that is Internet and in mobile. The mobile transactions reached in this quarter, net, 15% of the total number of transactions that we have in the Bank; and the Internet, now is around the 45% of the number of transactions.

The Internet, I think, is -- the smallest cost that we have, represents around 10% of the costs in the similar transactions that we have in the branches.

Then investing in our technological channels, in Internet, in mobile, that we -- probably by [ph] value in the next year, we will be running in a volume of transactions very close of Internet. And these channels, the costs of transaction is cheaper than the normal transactions in the branch.

Then Internet is around 10%. I think in mobile, it's a little more, 15% -- very close to the 10%.

Then these investments and this movement toward more technological channels will help us continue reducing costs and maintain the growth, the scale in our transaction.

Q - Unidentified Participant

Thank you, that's very clear. If I may just ask you for a quick follow-up then. If you look at the Bank maybe five years from now, in the long term, where should we think the cost to income can grow?

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

We feel would like to reaching 39%, is not staying off [ph] the line. Then probably you can choose for doing efforts for -- to have a better efficiency ratio.

But how more you -- this is [ph] more difficulty you have for continuously increasing the budget, probably I think we have to probably decrease [ph] more 2% in five years, considering that the economy will continue growing and we have opportunity to build our scale, then we will have some good effect of our investment in technology.

And probably, at the minimum, I think it's 2%. But we will work for to -- our timing to this to have a better efficiency ratio. I think it's at the minimum of 2%. But probably we will have a little more -- a little better efficiency ratio in the future.

Q - Unidentified Participant

That's great. Thank you very much on this.

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

Thank you.

Operator

Anibal Valdes, Barclays.

Q - Anibal Valdes {BIO 17745509 <GO>}

I have two questions. The first one is regarding your capital ratio. On slide 11, you show the fully-loaded core Tier 1 capital for the Bank at 11.9%. But I was having trouble to reconcile the deductions that you made on the First Quarter, because really, it's at [ph] BRL3.4 billion for the prudential adjustment, which represent 20% of the adjustments that you had to make towards the full implementation of Basel III.

So if I use that information I get to a number that is total deductions should be around BRL17 billion. And I would -- if you apply that deduction to the capital ratio, to the capital numbers that you have for the First Quarter, you would get to a core Tier 1 capital ratio of 9.6%, which is lower than you're -- the number that you guys are showing of 10.9%.

So I wanted to know a little bit more what's behind that number that you guys are calculating, or if I'm making a mistake or I'm missing some information here.

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

No, no, it isn't a mistake. We had some additional adjustment.

We had -- we consider -- the additional provision that we had is BRL4 billion; is same [ph] and (inaudible) to cover the (inaudible). Our Central Bank does not accept that clearly we can pass this additional provision; probably in the future we will do a reverse.

Then in our full application we consider that we have this additional provision as capital [ph].

Another adjustment we have in our insurance business nowadays some excess capital that we deducted in the calculation that we have now.

In the future we will do some internal distribution. We will do an internal allocation of the capital for the insurance business (inaudible) and the same with total capital in the Group. But with this allocation, internal allocation, we will reduce the deduction that we do now in the calculation.

Then we have this additional adjustment for the future that we were reaching this number that we had; we gave it, 10.9%.

Q - Anibal Valdes {BIO 17745509 <GO>}

All right. Thank you very much; understood.

In this same sense, I would like to know your expectations or intentions to issue more capital in the form of subordinated debt under Basel III rules. Is that something that is -- that you guys are considering for this year or maybe something that you will consider next year? Is that on the carpet or you haven't really looked at that possibility?

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

We consider that in the future to issue a Tier 1 subordinated debt and a Tier 2 subordinated debt. We don't expect to issue this year. Probably the next year we will -- probably we will do something. But only 2015.

This year particularly we have a marginal -- we don't need to issue subordinated debt. But probably in 2015. And maximum 2016, we will issue both; we plan to issue Tier 2 and Tier 1.

Q - Anibal Valdes {BIO 17745509 <GO>}

Great, excellent. Thank you for the color. And just a final question on the margin.

You're (inaudible) business [ph] for the Selic rate this year are at 11%. But you have a hike of 100 basis points for next year to 12%. So given that the loan mix of the Bank has been changing. And I will assume that you will continue to grow on mortgage lending or real estate financing and zero deductible loans. And so that will increase the percentage of your portfolio.

How will the margins behave in this new portfolio, because in the past you see that the financial system in Brazil it's is hyper-sensitive? So is it fair to say that given that the mix of the portfolio has changed, at the end a hike in the Selic rate of 100 basis points more in next year will hurt margins?

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

You need to consider that this probably has a lower spread, a lower margin. But it has a lower delinquency ratio. Then normally both, they have -- take [ph] less than 1% of the delinquency ratio. Then the final effect in the margin, net of delinquency ratio, normally is posted.

Then I think if you look for the future, this causes the new -- perhaps the margins are reduced. But the delinquency ratio will have a similar effect; it will reduce the delinquency ratio for the future.

Then we have a compensation and the final contribution of these products -- or the net for the product is posted, then I think you need to consider this effect.

But we have other products that we are growing and we expect to pay some compensation during some time for this mix effect that the credit card operations with the interest rate bears on our loans that we expect to maintain and grow. We are trying to improve the average spread in the portfolio to maintain the final spread of the portfolio at nearly stable.

Then I think the mix, to look for the long term, the final effect is posted. What we are working on the products to maintain the spread stable. Then with everything will help us to improve the final posting [ph] or the final results of the Bank.

Q - Anibal Valdes {BIO 17745509 <GO>}

Right, thank you. Yes, I understand the lower provision expenses. But once -- when you're in a steady state how will -- I want to understand how will margins react. And how will margins move with the movements in the Selic rate? The Bank, will it be asset sensitive? Or it's going to be -- turn liability sensitive?

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

We have the -- the total effect, each 1% of increase in the Selic in a full year is around BRL400 million revenues. If it improves the Selic, it is additional revenue. If the Selic decreases, we have a liquidity need for BRL400 million. This is the effect of 1% Selic in a full-year basis in our balance.

We expect this year that Selic will be stable, then our effect of Selic that we had. This year, we're expecting Selic more this higher level, around 11%.

Q - Anibal Valdes {BIO 17745509 <GO>}

Okay. Thank you very much. Thank you for taking the time to answer my questions. I appreciate that.

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

Thank you.

Operator

(inaudible), Credit Suisse.

Q - Unidentified Participant

Would you please provide more color on the operation of that caused underwriting and financial advisor, please, to go up this quarter? Thank you.

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

Operation underwriting, our investment bank is improving the operation in the Brazilian financial system; year after year they are reaching a better position in the rankings. We expect this year that they gave us probably some additional fees considering the last few years. But this is an activity that you have some effect from the environment, of the economy.

Then in a normal way we start the year with a very good fee generation and if we have a stable situation during this year, I think we have a lot of potential to maintain the fees in a very good level. But normally, it's an activity you have more volatility, because of the economy and the environment.

Then our expectation is that we will have a good year for our investment banking fees. But it's something that we cannot -- it is something that is -- very rarely -- has a (inaudible) because the environment. This is what we understand.

Q - Unidentified Participant

Thanks, I appreciate that.

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

Thank you for the questions.

Operator

Excuse me, ladies and gentlemen. since there are no further questions I would like to invite Mr. Paulo Faustino da Costa to proceed.

A - Paulo Faustino da Costa {BIO 6436050 <GO>}

Well 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 IR team are at your disposal. And that all the content of our First Quarter 2014 and all the information concerning Bradesco is on our website.

I also would like to invite you to join our Bradesco issuance day that will be held in Rio de Janeiro on May 6 at 8.30 am. Thank you very much.

Operator

That does conclude the Banco Bradesco half-year [ph] conference for today. Thank you very much for your participation and have a good day.