Q3 2012 Earnings Call

Company Participants

• Miguel de Campos Pereira de Bragança (CFO)
• Rui Pedro da Conceição Coimbra Fernandes (IRO)

Other Participants

• Juan Pablo López (Espirito Santo Investment Bank)
•Jaime Hernandez (Nomura)

MANAGEMENT DISCUSSION SECTION

Operator

Good day and welcome to the Millennium BCP Third Quarter 2012 Earnings Conference Call. Today's conference is being recorded. At this time, I would like to turn the conference over to Miguel Bragança. Please go ahead, sir.

Miguel de Campos Pereira de Bragança

Okay. Thank you, thank you very much. It's Miguel Bragança speaking, the CFO of Millenium BCP. Our CEO asked me to tell you that he is sorry not being able to join us in this conference, but he is in our African operations right now, so it was not logistically possible.

So, starting here with the presentation that we have, I would say that the main message that we wanted to pass to you is that in spite of the negative results, everything is evolving according to plan despite the more demanding macroeconomic context. So, what we are seeing is in line with what we were expecting, okay. We have three levers right now, so lever of capital, liquidity, and profitability.

Our main priorities were liquidity and capital up until now. These were largely solved so to say. In terms of liquidity, we are continuing to have a very strong commercial gap improvement with a ratio of net loan to balance sheet customer funds at 121%, and considering the Bank of Portugal ratio that does not include retail bonds 138%. So, we are very comfortable that these are good ratios for a commercial bank.

Our balance sheet customer funds continue to grow soundly and we are still with a positive trend in terms of liquidity with something like around €7 billion of eligible assets, additional of actually eligible assets for the ECB, so liquidity is, I would say, a tick, okay?

The second issue that we wanted to solve is capital. As you know, we had the capital increase and we had the negotiation of the recapitalization plan with the Portuguese Government. We think that the negotiation considering the condition analysis that we have was a reasonable renegotiation for both parties.

I would highlight here the fact that we have a cost, an equity cost that is tax deductible, that I think is important, on one hand, and I would also like to highlight the extreme flexibility that these instruments have that allow us either to prepay when we can or to defer the payment until mid 2017 which we think are very interesting conditions.

What we also think was a major achievement, was in such a difficult market to be able to execute these equity transaction, these rights issue assuring that the State did not enter our equity structure. We think that from a symbolical point of view and from a governance point of view, it's very important that we really continue as a private mindset – as a bank with clear private mindsets and with clear focus on shareholder value, without any type of government intervention, we think is very important.

In terms of profitability, the profitability is suffering from our starting point from the situation in Portugal, but is evolving according to plan. As we are expecting, of course, the situation in Greece in accumulated terms, in terms of the – is paying its toll. Our operations in Poland, Mozambique and Angola are showing a positive performance and, as we should, because it's our duty as management to do it we are launching a restructuring program as we commented in the rights issue and as we are commenting and as we have already commented to the market at the time of the equity issue. We are still reinforcing the impairment charges in Portugal, mainly due to the legacy book that we have and to the situation in Portugal that we are living. Going to page five, what we see is a graphical highlight of what – I just commented. So, core tier 1, an increase of almost 400 basis points in one year. Commercial gap, a closing of around €7.3 billion which is very relevant, albeit as you'll see, at a slower pace according to plan and a very strong closing of the loan-to-deposit ratio, okay.

In page six, you see very clearly that most of the impact in terms of net income came from Greece, but not only Greece. So, also a part of it is coming from Portugal. The net income from operations in Poland, Mozambique and Angola are being very resilient. Going now to the – to page eight, in terms of the capital increase, we were able to increase the number of shareholders. So we are really a popular, so to say, capitalistic institution, so to say, so we're basically a real PLC in Portugal with more than 190,000 small shareholders. As you see, we had a demand in excess of 160% of the subscription, which made the demand for the proratation was only – I'm sorry, we had a demand of €331 million for only €15 million of available shares that were not subscribed, €15 million of rump, if you want, before the proratation. So, we had the ratio of more than 20 times between one and the other.

The shareholder structure remains more or less the same, I would say, with a small increase of retail and a very minor decrease of qualified shareholders that we think is important. After the capital increase and already, so to say, a price that reflected the success of the capital increase, and this was publicly announced, Sonangol increased its participation materially to around 15%. Okay?

In page nine, what you see is that our core capital really have increased 35% to €7 billion, so we have a core capital ratio of €7 billion which for our type of book means a core tier 1 ratio of almost 13%, which allows us obviously to cope with this transitional period that we commented during the rights issue where over the next quarters, we will consume capital with an objective of achieving breakeven in 2014 in Portugal as I commented to many of you. Okay?

Another issue that's not clear here from the graph is that in terms of the EBA ratio, we are also achieving the numbers of EBA ratio and somehow that the banks in the peripheral markets are being penalized by the fact that the EBA buffer is being calculated at the September 11 number, so to say. If we were to do the mark-to-market right now, we would, I mean, generate a capital higher than the capital increase than we have just done. So, somehow by stabilizing these at September 2011, this is clearly, I would say, almost a discrimination for the institutions that for some particular reason in September 2011 were in peripheral markets and had a portfolio of peripheral markets debt. Okay?

Going now to liquidity. Liquidity, what we are seeing is that the total customer funds are increasing with balance sheet customer funds, increasing 4.8%. And in terms of Portugal, so to say, the balance sheet customer funds of Portugal around 2.1% and with a very solid growth in terms of international operations of around 11.5%. Some of you asked me what would we be doing with some of the money from the CoCos and whether we would be buying Portuguese government debt at that time. And I commented that our main purpose was basically to let go some of our very expensive deposit that somehow were contaminating our commercial systematic and our customer base. So it is – we are letting some of these very expensive deposits of large corporates and of institutions go but, in spite of it, the very franchise driven, franchise-linked deposits are growing in a relevant way.

But, you see, of course, this acceleration exactly due to this factor. In terms of loans to customers, you see here a reduction and I would like to highlight the strong reduction in loans to construction and real estate promotions. So, clearly, we are seeing this business of loans to construction companies and real estate promoters as a business where we don't want to be in. It's not the most relevant part of our book as you see here, but it came down from €9.3 billion to €7.5 billion.

Progressively what we will be doing, as I commented during the capital increase, is to close the commercial gap at a slower pace with a progressive higher focus on growth of deposits and less in terms of the acceleration of credit, which we expect to become reasonably constant over the next two years. Okay? In page 13, you see basically what we have done with the commercial gap, so the €7.3 billion of closing of the commercial gap were, on one hand, used to, over this period, to repay the accumulated long-term debt that we repaid around almost €6 billion, as you see here, so the long-term debt net repayments went up from €12.8 to €18.4 billion and in terms of some decrease comparing with September 2011 of the usage of ECB.

As you see in page 14, we have a very healthy maturity profile in terms of wholesale funding. So, nothing this year, one billion in 2013, three billion in 2014 when you compare the number of 2014 is perfectly aligned with what we are doing in the last couple of years. So it's clearly a challenge that is being met. In terms of our funding structure as you see, we came down from a wholesale funding below one year of 26% to around 5% in September of this year, okay, in page 14.

Profitability. So, as time goes by, so this becomes our next challenge as we have commented. So in terms of net interest income, we have here two – a couple of impacts, so to say. One of the important impacts were the liability management operations of last year that provided some upfront gains on last year. If I am not mistaken, last year the upfront gains were around €180 million up to September of the last year. But these liability management operations then as the securities that were bought were substituted by securities at more expensive rate; of course, is bearing its consequences in terms of the financial margin of this year.

On top of it, the fact that BCP is a bank that is very much retail based and the fact that it is decoupling in terms of the rate of the deposit, of retail deposit and Euribor, whereas the assets are still Euribor-linked, what you see is that we are suffering from the very low level of Euribor that we are seeing right now because it's being very difficult to translate them to the retail deposits. And of course, with our de-franchise in terms of current accounts, of non-remunerated accounts is almost impossible to translate at least over the long-term to the customers. This impact of the Euribor explains more or less €190 million of the decrease of liability management.

Other banks that are less, so to say, retail based; they don't have such a large franchise of non-remunerated current accounts or that have, so to say, less retail in terms of mortgage and so on, of course, have a different impact than the one that we have.

Net fees and commissions I would say is still very healthy because here we have to consider that we are paying as an insurance to the Government. Guarantee costs for eligible assets that we have, that are bonds issued by ourselves with state guarantee that can be used for the ECB. This is an insurance that we are paying, but this insurance goes in this line, so this explains most of the reduction of the commission. Okay? In terms of the other operating income, what we see here is a large gain. This – comparing with last year - this gain is basically composed of two effects, so to say. One effect is the liability management operation of this year compared with the one of last year, and I would say that the impact in terms of the P&L of every year are similar, okay?

And the other effect is basically the mark-to-market of Portuguese Government debt where we have suffered. So to say last year, a big negative mark-to-market of

Portuguese Government debt. And we have a slight positive mark-to-market of Portuguese Government debt this year. So, this is basically what explains the difference between this year and last year. It's basically the big negative of around €120 million that we have last year compared with the positive around €40 million that we have this year. So this is what the difference is. In terms of staff cost, still very healthy staff costs. But most of the impact that we'll be expecting in terms of the reduction of staff cost, will occur as a consequence of our restructuring effort that is starting right now. And in terms of other administrative cost and depreciation, you see here also a strong reduction, it's already a part of the effort that we are doing right now. Okay?

So, this explains that our net income – our income before income tax, so to say, this year reduced around €170 million.

And as you see, this is more or less the impact of the liability management operation and slower or smaller than the impact of the margin – of the evolution of the margin. Then another impact that we have was we had a big one-off gain in terms of deferred tax assets last year, so we had an activation of deferred tax assets last year, following the restructuring of the group, overall €30 million and this impact was a one-off, so we don't have it this year. Okay?

So before the Greek operation and CoCos, so we are having a negative income of €217 million. Then the net income of the Greek operation is basically the €450 plus some net income that we are still having, and that we still have before the funds, €150 million. And then we have here clearly segregated the impact of these – of our new stakeholder, the government with CoCos, we show it here as a last line, just to separate very clearly what the operational management of ourselves and what is the remuneration of this new stakeholder? Okay? Then in page 17, you see a little bit more in detail what I have just commented in terms of the margin. So the two big impacts of the Euribor or the net interest margin evolution linked to the market evolution of the decoupling of the interest rate of deposits and interest rate of retail credit, the liability of management operation of last year, the cost of the CoCos before taxes here, in the previous pages the number is after taxes; the past due effects impact on margin, so the fact that some loans become past due and its impact on margin; and then you see a positive, it's our commercial effort in terms of the re-pricing of the credits, increasing of the spread of deposits.

In page 18, what you see is that our banking fees and commissions that the real recurrent banking linked fees and commission are quite resilient. So, basically, constant, coming down from around €500 million to €491 million and with a negative of market related fees, so you see, as you would expect in a country in a bail-out situation and with the impact of the state guarantee that we have this year. The international operations is still growing very very solidly, as you see here, growing around 5.7%.

Page 19, you see here what we are doing in terms of cost even before this restructuring program that we're launching right now, I just commented. And in terms of credit quality what you see is in line with the evolution of the situation and with our portfolio where we are particularly exposed to the SME sectors and to some sectors like leverage finance and that are more exposed to the economic cycle. We see here some degradation of the credit quality, but I would highlight the point that it is totally in line what we were expecting and that with the provisions that we are doing, we are keeping the coverage ratios exactly as were expecting.

Page 21, you see here the loan impairment charges growing as we were expecting and what you see here is that most of our cost is linked to company's loans. So our mortgage, I would highlight that mortgage is around 50% of our portfolio, slightly below 50%, is intrinsically a healthy portfolio, is performing very well according to our models and even considering the situation of the country with a high unemployment rate and so on is performing well. Where we are having challenges is in the companies, mainly in the companies that are in the non-tradable sector, in commerce, small and medium sized companies tends to the domestic market, small real estate promotions and so on. And of course is the domestic consumption is going down, are suffering particularly.

In page 22, you see also very clearly the type of LTV that we have in our mortgage portfolio. You see that even after the new revaluations of the houses and even with the present price and so on, we only have 14% of our book with an LTV above 90%.

In terms of our exposure to public debt, it came down in terms of the Portuguese Government debt, it came down and we had – the interest generated by our – by these assets is relatively constant when you compare this year with the previous year. I would also like to highlight that most of our portfolio is short-term maturity. You see that between one year and two years we have here around 60%.

Now, I would pass you to our Investor Relations key officer, Rui Coimbra.

Rui Pedro da Conceição Coimbra Fernandes

So, some more detail now for Portugal and international operations. On page 24, the increase on customer funds and the decrease of loan to customers that was referred already. And just a note that the increase on deposits that we see here is September, against September. If we compare with June there was a decrease in Portugal of €1.6 billion, which is more on the wholesale deposits that it was referred already and because the retail is increase ng still, so then, and this was, as it was mentioned, one of the utilizations of the €3 billion of CoCos. It was here and not to buy, as other alternatives, to buy public debt.

On page 25, the net income for Portugal, so here, as it was referred after taking the effect not only of Greece on the P&L that we showed before, but the positive from the other international operations. So for Portugal, the result was a negative of €378 million, which compares with a positive of €24. So this decrease of €400 million is mainly coming from banking income and in particular, as we saw already, on the net interest income almost €400 million and that, although there was this decrease on the operating cost, than the other part was the tax effect that was referred already when we compared the nine months against the nine months last year.

Net interest income, the main reasons were already explained and this obviously makes the net interest margin to go to below 1%, although if we consider out of this number, if we take the liability management transaction and even the CoCos effect, margin will go to 1.23%. So the 23 basis points compared to previous year is really the market, the markets rates effect, that is important for us. Even though, when we go for spreads for credit and deposits we see that it continues the effort on the credit, increasing credit spread. Third quarter last year, against third quarter this year there is an increase of more than 70 basis points. But even though the major effect on our P&L now is the continuity duration of the deposit spread.

We can see, even though, that the last quarter the decrease the duration is smaller than previous quarters and this has to do with our effort of decreasing the tax rates that we will see. But even though, Euribor is not helping for the calculation of the spread here. So for – on the credit side, it is mainly companies as it is obvious, very difficult to re-price mortgage but the effort on the company side maintains and on the deposit side on page 28 is what we were referring.

So, new production, one year ago, we were offering rates of around 5%, 4.9% to be exact and now it's 2.5%, and for the full portfolio September last year it was 4.1%, it increased up to the peak of November at around 4.4% and now it is 3.5%. So, in a way what we are doing, especially since the beginning of the year, is to decrease the rates of deposits of around 8 to 10 basis points per month. But if Euribor decreases more than this, then it's difficult to show the effort on our P&L, but assuming that Euribor will not decrease so much more and this effort will continue, we expect to see something in some month.

Now, commissions, we saw this already. The €20 million decrease on our banking commission is mainly on credit and banking guarantees and as well on cards and transfers. Market related commissions as expected as well, given to market conditions and of course the €51 million of the state guarantee effect as well. Operating costs, here we show the decrease of the operating costs excluding the specific items that we mentioned and we discussed this in previous quarters' presentations. Without the excess, the decrease is even more but this one is the one that is relevant and it is through all the lines, so it is on staff, on admin and on depreciation.

What it was discussed by Mr. Miguel Bragança is that and we present exactly these numbers and the next two slides are exactly the numbers that we show for doing the capital increase in the process of the road show.
We said, in a way, that the operating cost in Portugal starting from 2011, it was around €900 million and it will go to less than €800 million. So €100 million program of

reduction. And this will be from staff, from admin and from depreciation, in a way the number is €30 million, from staff €10 million, or €12 million from depreciation and the other part from admin costs.

On the staff, we say here that the €30 million savings immediately for next year is recurrent, obviously we will have costs on doing this program of course that will affect the accounting number let's say this year and the next, but if we take this one-offs it will be a savings of more than €30 million. For the main guidelines, is really to reduce the staff and to reorganizing the way the bank by networks and adjusting even [ph] send-off (30:32) services to the new model.

For the admin, of course, I am on page 33, a part of what have been done, we have a full program of reducing including the depreciation €70 million. It will not – everything will not appear on the first year, but on the medium-term and if you remember from the capital increase and the road show presentation, medium-term means 2015, so it will go. This will have effect €50 million on 2013 and then going to €70 million savings. So all together it will be €100 and here for the admin cost it will be through all the lines of admin from consulting, advertising, insurance, and rental. So it will be everywhere and it is a program. We know exactly where these numbers will come from, so it will happen. On the credit quality, we saw already the numbers for the group. For Portugal if – so the overdue loans increased from 4.4% to 6.6%, this is just the overdue part. When we take in consideration the full exposure and all the capital it goes to 13.5% and 13.9% as credit at risk. So it is increasing still, but we maintain the effort in terms of impairment. The 6.6% is mainly on companies, it's 9.18% companies and 2.7% for individuals.

This is a number that we present on page 35 and we see it from the, let's say, beginning of 2010, the dynamics from slightly above 2% to 6.6% and this is mainly given the companies, given the fact that the bank is leader on the loans to SMEs. And of course because not only leader but it's 20% market share obviously a big part of this is related to its non-tradable sectors. So it's really related to the domestic demand that are being particularly effective now on this crisis period that we are passing by.

Even though this dynamics of the overdue loans we thought that the full credit management model should be revisited on the three main parts of granting, monitoring, and recovery where especially on the monitoring side, improving the early warning system and improving as well this capacity of the network with the help of some regional centers in Lisbon, but especially outside Lisbon, to help in monitoring the customers. On the recovery side, a part of lot of changes inside, there is an important factor of the transfer of 180 staff FTEs for the recovery area.
On the international side, now I am on page 37. Here we see, in general, increase on Poland, Mozambique and Angola and the effect on the net income of Greece that is penalizing the global number for the international operations.

Starting by Poland, an amazing result in terms of growing customer funds and the number is quite similar is 12.6% increase if we take just the deposits, which is a €2 billion increase in deposits, which makes actually the loan to deposits to be again below 100%, is 96%. In terms of credit, a slight decrease, although it goes exactly on the trend that we want for the future, which is more companies, slightly more consumer, but the weight of the mortgage in the full portfolio to decrease through time and which we see already here in these numbers.

Net income, an increase of €1 million comparing to previous year, but an important increase on banking income and in particular on the net interest income, costs, a small decrease. Net interest income is a 3% increase, is €7 million, is mainly through volume effect, actually on the deposit side, as we mentioned, even though with the decrease on the spread of deposits, if we compare last year with this year. Although, since the spread is positive, increasing the volumes makes an increase on the net interest income. In terms of the spread of loans, a slight increase as well. Net commissions, a decrease mainly related to markets, in particular all the business related to securities. Costs, there is an overall decrease in costs mainly due to admin. Admin in particular in for marketing and IT expenses that in a way compensate the increase of 4% on the staff costs. This increase has nothing to do with or salaries or number of employees, as we can see the employees decreased 192, but is mainly related to the increase of social security tax that moved from 4.5% to 6.5% affecting here these numbers.

Related to the employees, the 192 that – if you remember last year we discussed this, there was as peak in the third quarter of last year related to an agreement with Makro Cash & Carry. It was a business that we were doing last year. So the peak – the reason of the peak was this and then when we compare there is this decrease of 192 FTEs.

Credit quality, still very soundable, 3% with the coverage more than 100 and impairment charge is slightly higher than last year and this is related to construction sector, although I would like to stress that the exposure to construction is really low compared on our full portfolio, which is less than 3% and it is nothing when we compare to the average weight of the construction for the banking sector in Poland.

And, this is known, it was presented last week by our Polish subsidiary to the market there and is a revision more aggressive on the targets for 2015, but mainly a part of lot of things inside of organization. In essence, the main contributions to the P&L will come from the decrease of the weight of the mortgage and the increase of the companies and even consumer lending. Companies now is around 26% and the target is to be from 30% to 35%. This will contribute to a return on equity from 14% to 15% and through – and this will come mainly from the cost to income to be at 50% maintaining the comfortable capital ratio around 10% core Tier 1 and generating liquidity to the group. In a way, the bank does not need support from the mother company, in both capital or liquidity, so self funded, self sustained.

If we move to Mozambique, an increase on customer funds and if we take just the deposit, which is a big part of this, this is a 17% increase. The loan to deposits is 68%, which makes actually the excess liquidity to be mainly used for Mozambique and public debt and which actually now is having effects on not making the margin to grow so much since the rates are lower than last year. The overdue loan is still very low and the coverage high of more than 300%. Net income increased 4.5%, which is €3 million mainly from banking income and of course operating costs as well to finance the expansion plan, where we have 22 more branches than last year and more than 200 employees comparing to last year. In net interest income, the increase is a low increase of 1% and this is the comment that I made before. It goes up as more from the volume effect of the deposits, but this excess liquidity being allocated to treasury bills and the rate of treasury bill last year were 15% and now is 11%, which definitely makes a negative effect on the net interest income that was well compensated by the volume effect on the deposit side.

Commissions up by 30%, mainly related to transfers, cards and banking guarantees. In Angola, customer funds 5% up, here customer funds and deposits are the same, everything is deposit. Loan to deposit, 58%, so again generating liquidity, but on the loans side an increase with still overdue loans ratios increasing, but still numbers completely different from the ones we have in other geographies and well covered of more than 150%.

Net income increased by 8% around €2 million coming from again banking income increasing €14 million and operating cost increasing €12. Again operating cost from the expansion plan, we opened 16 branches since last year. We have 141 employees more than last year and so the reason for the cost is well understood I suppose.

On the net interest income, an increase of 13% coming again more from the volume than from the net interest margin that is, remained stable at around 6%. Fees and commissions, again, an increase more on the related to transfers, to cards and to banking guarantees. Moving to conclusions, Miguel?

Miguel de Campos Pereira de Bragança

Concluding, so we have here a set of benchmarks that are critical for us to deliver on what we are promising the market as you see here in page 51 and we will follow up exactly on how we are evolving according to these metrics. In terms of the core tier 1 ratio, we are already with a level of almost 13%, which allows us exactly to cope with the difficult quarter that we will have ahead. The net loans to balance sheet customer funds is also evolving according to plan and of course, the time deposits spread is also suffering, but what you see is that the interest rate that we are paying to customers and actually the interest rate is more relevant now than the spread because effectively there is a total decoupling of the price of deposits from Euribor, is coming down in a sustained way, which is a major breakthrough in terms of our commercial systematic.

Our operating costs are also showing a very positive pattern and the cost of risk is also showing a positive revolution, exactly according with plan. So, I would say that the main conclusion here is that the numbers are what they are, so they don't look good, but they are exactly according to plan and that we will present to you exactly how we are evolving according to our plan. Okay?

So as a summary, we have presented to you the different phases in which we are. In this year, next year, we are basically focusing on capital liquidity but progressively, so as a priority that is coming high in the ranks, we will be looking more and more towards profitability and later on towards the sustained profitability. There are a set of the initiatives that are already implemented. The initiatives regarding the recap plan, the initiatives regarding to a new systematic in terms of competing for deposits at more reasonable price, initiatives in terms of impairment charges, initiatives in terms of the risk mitigation of our weak exposure as I commented to you during the rights issue.

We are also now launching a restructuring plan that will allow us to become much more lean in terms of our cost to income and in terms of our cost structure. We have implemented a new model in terms of credit management, in terms of governance of credit, in terms of the power, so to say, that the dependent credit departments have within the institution, in terms of the number of areas that report directly to the board that have to do with risk and credit that we expect will bear fruits over the short to medium term. And we are reviewing the strategic objectives of our main subsidiaries. We have presented here the one of Poland, but we are doing the same in Mozambique and Angola and I hope to be able to highlight it to you in our next presentation.

And that's it, so the main conclusion is that in spite of, so to say, the challenges of the country, we are evolving according to plan. This is the main message that I would like to highlight. And now, I think we are open to questions.
Q&A

Operator

Thank you. [Operator Instructions] We will take our first question from Jaime Hernandez (47:20) from Nomura. Please go ahead.

<Q>: Hey, hello, good afternoon. I am Jaime Hernandez from Nomura. I got a few questions. The first one is related to the €22 million that we saw in the quarterly P&L [indiscernible] (47:37) related to the estimated losses of the Greek business. If you can elaborate a bit more on those €22 million. Afterward, I have got another question regarding the repayment of CoCos. It looks like you are thinking about selling the Greek business. If – I would like to know if there is a specific threshold or there is a specific level of core tier 1 above which you will start seeking approval to repay the one part of the CoCos. I mean, if the – for example, the Greek deal goes on, if you will anticipate one part of the repayment of the CoCos.

And the third one is related to the NII, if you can please provide some kind of the trends expected in the coming months, I think if there is going to be some kind of changes in the outcome strategy or the debt portfolio strategy trying to compensate the efforts that you mentioned during the presentation. Thank you very much.

<A - Miguel de Campos Pereira de Bragança>: It's Miguel Bragança, thank you. Just in terms of most – the €450 million that we have of provision is processed to be seen together with the business in Greece so to say. What we have done is from this €450 million, we have a part of the decrease in the equity linked to the negative net income that the equity had. As the equity also already came down, so we have, so to say, reversed €22 million of this €450 million because this is already reflected on our P&L and in our equity. So, if we did not do it, this would be a double dip so to say.

Okay, in terms of selling off the Greek business, so I would like to manage the expectations here in such a way that we will do what we think is in the best interest of the shareholders. So, we won't be driven by image or by just headline announcements. We will do what it takes in the protection of shareholder value, okay, this is important. So, if we are not able to come up with a deal that is in the best interest of the shareholders, we won't do it, okay. I think it's very important, just to say it. So – because we don't feel pressure to do it, we think that, right now, after the provision, the situation is manageable and that we have alternatives.

So in terms of whether there is a specific level of core tier 1 for the anticipation of the CoCos, as Mr. Claude Trichet said, I would here quote him, we do never pre-commit, no? So I don't want to pre-commit on an eventual level, because I do think that this is a part of the analysis that we have to do. So, we would like to pay off the CoCos as soon as possible, but on one hand, but… on the other hand, they are a security because they have a lot of – for our stakeholders and inclusive for our shareholders because we can postpone the payment. I think the fact that we have here something with an equity treatment that we can pay up until 2017 is a very powerful option and if we prepay, we lose this option. So, depending on our views of core capital and depending on how we are seeing the situation evolving in Portugal and depending on regulatory risks also because we can certainly have a new EBA or different changes and so on, we can take the decisions that based on the different set of information better protect shareholder value.

In terms of NII trend, as you know, we have here two issues. There is – when the Euribor comes down, there is something of a lagging effect in terms of the interest generated by our assets because not our assets is really price the same months so to say. I would say if you take the monthly figure of September, I would – and if the Euribor does not come further down and I feel here, of course your guess here are as good as mine, but this is not a scenario in which we are working that the Euribor will go further down. I would say we are close to the bottom of it, but these are to be used, okay? Next question?

Operator

We'll take our next question from Juan Pablo from BES. Please go ahead.

<Q - Juan Pablo López>: Hello. Thank you for taking my call. I have two questions. First one is regarding asset quality, probably one of the, okay – well I consider one of the

good news of these results. I don't know if you could elaborate a bit because asset quality is relatively flattish compared to previous quarter, something that is anti-intuitive given the macro situation in Portugal. Could we assume that in the second quarter you anticipate some tuning-up of asset quality? What will be the trend for the next quarter? Related to this, could you provide us some detail regarding the foreclose – the repossessed assets, mainly the gross exposure, impairments and coverage basically?

Another follow-up question regarding Greece, with this negative result I guess core tier 1 will be below 6% probably, I don't know 5.6% or something like that, could you remind us what's the target for the end of the year, how do you plan to reach the target for this unit?

And one last question, sorry, is regarding the ECB dependency. It increased this quarter. There has been some wholesale maturities of around €600 million. Could you elaborate a bit on this increase in ECB funding this quarter?
Thank you.

<A - Miguel de Campos Pereira de Bragança>: Okay. Just taking on numbers, the core tier 1 number that we have, that we are showing already reflect the negative income. So, we are at 12.8% after this negative income, okay. So – and we are perfectly according to plan, as you may see in the presentation that we have on the net, that we have presented during the rights issue. We are evolving according to plan here, so no news in this respect.

In terms of the repossessed assets, I would say that the flow is evolving according to last year also and according to plan. What we see is that we have a number of repossessed assets more in the vicinity of €1.3 billion with around €300 million of impairment charges and this is reasonably constant, so what is coming – what we are repossessing as being sold with the stock reasonably constant both in terms of the gross number and in terms of the impairment charges, okay.

In terms of the asset quality, so we have here, I'd say, two big – I'd say, it is normal in banking, two big volumes, so to say, or two big explanations. One is the mortgage portfolio and I would say that the mortgage portfolio is performing relatively well and even better than our expectations and the part of it has to do with the resilience of the Portuguese families and also a part of it is due to the Euribor, to the low levels of the Euribor because most of it is indexed to the Euribor and with the book of Euribor plus 115, I mean for the clients that have a mortgage, this is a huge benefit, so this is a big part and then another part of it is linked to the corporate loans.

Then in the corporate loans I would also segregate in two parts. There is a statistical part that is performing slightly worse than we were expecting and then there is the part of the large loans that is a little bit bumpy, so to say, it's a little bit digital. So I would say that in this quarter things have evolved in a reasonable way. It's difficult to foresee, mainly when we go through what will happen in any one quarter, because there the statistical error is more difficult to see. What we have said is that, during our capital increase and which we maintain, is that we are in spite of the difficult situation that the country is living, so to say, is that we are progressively, so is that we want – let me go a little backward. Over the medium term in a sustained way, we are expecting to converge over the medium term to cost of risk of around 100 basis points and in terms of asset quality, what we would expect, that's what we have shown to the market as you may see in our presentation of the rights issue, is that the credit at risk ratio would go up to levels of almost 20%. And even considering these assumptions that is you may add is conservative or not, but this is your judgment, we are able to repay the CoCos. So this is the issue in terms of asset quality. ECB dependency, I would not call it dependency because dependency, it's like addiction or like drug addict and so on, dependency, it's a negative way of looking at it. I would say the ECB source of funding because that's whether it's dependency or not, it depends on how the market is looking at it. And I have seen here different perspectives. So, when I speak with some of you, they ask me, why aren't you buying more bonds and making credit trade with ECB? And when I speak with others of you, they say, look, you are being addicted to ECB so please come down.

So, one-year-and-a-half to two years ago, there was some convergence I would say of perspectives where this was seen as a bad thing. Today, at least for me and mainly after the LTRO and to the Draghi announcements and so on, it's not so clear whether it is in the best interest of shareholders to reduce a lot the ECB. But going to the numbers, our – we are reasonably constant in terms of ECB and the variation that we have in terms of ECB since last quarter has mainly to do with the fact that in June we have just received the CoCos, the CoCos money, and as I told you we used some of this CoCos money to allow some very expensive deposits of institutions to let go, basically. And we also had around slightly less than 1 billion of long-term maturities and this also had its impact. But I would say that it's reasonably constant, but we are not obsessed by ECB unless either our shareholders or the regulators make us obsessed there. And right now, we are not seeing this obsession, okay.

<Q - Juan Pablo López>: Thank you. If I may regarding Greece, and regarding the core tier 1, I was referring to the Greek core tier 1, to the Greek business unit, not to the …?

<A - Miguel de Campos Pereira de Bragança>: Okay. In terms of the Greek business unit, I am sorry, okay, it's good that you clarify. Okay, in terms of the Greek business unit what we have, as you know, is that we have a funding to the Greek business unit and we have the provision in excess of €400 million that we have created. What we may do at some point in time is to converge or convert a part of this funding in equity instrument, but maintaining the guarantee of this funding so that our total guarantee and our total exposure is the same. So, we think that in any situation that we are envisaging, it's very difficult to see a situation in which over the following months any operation on any outcome of the Greek situation would be capital destructive, I would say or, okay?

<Q - Juan Pablo López>: Yes, thank you.

Operator

[Operator Instructions] We have a follow-up question from Juan Pablo from BES. Please go ahead.

<Q - Juan Pablo López>: Thank you for taking my question again. Regarding funding, I have another follow-up question. I was wondering if you are considering in the short term or medium term to tap into the wholesale funding market and if you plan to issue any medium or long term instrument? And just for curiosity, I don't know if you could elaborate a bit more or give us some color regarding the cost of this expensive deposit you were mentioning during the call that you left – that you let to leave this quarter? Thank you.

<A - Miguel de Campos Pereira de Bragança>: Taking the second one, so it is a cost above the threshold of the Bank of Portugal. So, as you know the Bank of Portugal has a negative threshold depending on the maturities, but that goes up to 300 basis points. So, in terms of the medium and long-term, as you see right now in terms of our funding structure and because we have some old securitizations and because, I mean, the way we are – and because of the diversity of our funding bank because we are a retail bank, so most of our deposits are from retail customers. So our current accounts are from retail customers and most of our time deposits are from retail customers. So we have a very diversified funding base, okay. There are other banks that are more corporate-based, and when they are more corporate-based, of course, the stability of the deposit rate is not that high. So, in terms of the type of funding structure that we have, we think that right now our liquidity risk is very low, so it does not make sense for us to sacrifice capital and to sacrifice margin to improve our liquidity position because we think we are in a very comfortable situation. Okay? So, we don't think it would make sense for us right now to do it because, I mean, we feel comfortable with it. I think, of course, I mean, we are not fundamentalistic about it. If suddenly the situation evolves in such a way as the long-term funding becomes very, very cheap, which is not our best case scenario, of course, we would review the position.

<Q - Juan Pablo López>: Okay.

Operator

We have another follow-up question from [ph] Jaime Hernandez (01:04:21) from Nomura. Please go ahead.

<Q>: Hi, hello. Two more questions, one is regarding the – if there are some drivers or some asset disposals or some other alternatives that you are studying that in the same case that in Greece that you could take or you're going to study to increase or accelerate the capital increase. I mean, the sale of portfolio or other type of business or for the liability management trying to have some additional capital gains. And

related with this question is that, I think just to confirm that you will have €30 million of one-off related to the restructuring program in the fourth quarter, if that will be compensated with some kind of this one-off positive efforts that I mentioned. And on the other hand, is related to questions that Juan Pablo made before, related to the foreclosed assets. You mentioned that you are selling it, if you can elaborate a little bit more regarding the level of sales, the prices. I am a Spaniard. I know that the situation of Portuguese, it has nothing to do with the one of Spain. But just if you can provide us some color regarding how things are performing with those assets in terms of the speed of the sale and the prices. Thank you very much.

<A - Miguel de Campos Pereira de Bragança>: Okay. So in terms of drivers of equity and capital guidance. So, as you know the situation in Portugal is being difficult already for some time. And most of these sources have already been exploited and it's normal because, I mean, we are under a bail-out already under some time and we don't have really a lot of capital sources and a lot of assets that we may sell with a positive impact in terms of P&L.

Second issue, in terms of possibilities of generating capital, so as to accelerate the repayment of CoCos, we are continuously analyzing alternatives for capital and you know, there are some – I am not speaking about the tier capital, but of capital transactions into securitizations and to capital relief transactions, so we're continuously analyzing this type of situation, but they are very expensive. So these are situations which we have to see very clearly whether the cost of the situations is better or worse than the after-tax cost of the CoCos. So, I would say that there are some transactions that we're analyzing. Our threshold is whether the cost of these transactions is better or worse than the after-tax cost of the CoCos. We're continually analyzing. So this is part of the normal course of business. I would not – I mean, right now I would not manage our expectation in such a way as to say we have something that will be implemented in the next couple of weeks, but, I mean, the market evolves very quickly, as you know.

So in terms of the restructuring program of around – the cost of around €30 million this quarter where we have some extraordinaries or not, I mean, we don't – I mean, typically we don't manage our economic decisions based on accounting criteria. So, it's not because suddenly we have an extraordinary cost of €30 million that we feel compelled to generate an extraordinary gain of €30 million. So we tend to base our decisions on economic criteria on what makes sense and whether the timing of the transaction makes sense or not to sell. So, there is no connection between one thing and the other. If there is a good moment to sell something, let's say a part of our government debt, for instance, that we have, a part of it has capital gains, we may do it. But we will not be compelled to do it because we have an extraordinary cost of €30 million, but whether we think that the price will go up or go down afterwards.

Okay. In terms of the repossessed assets, I would say that this quarter was very much in line with the other quarter. So, the situation, as you know, in Portugal is different from Spain. In Portugal, the real estate practices in the decade of the 2000 have evolved in line with European average with a cumulative annual growth rate of around 0.7% whereas in Spain it was different. So there was not an issue of bubble. But we do have an issue of domestic demand. So people are not buying houses, they are not investing, not because the prices are up a lot and then they are coming down, everything has domestic demand. For instance, the car sales went down by around 40%. So if the car sales go down by 40%, of course the house sales also go down materially, but not because of an asset price bubble, it's because of domestic demand, so based on other factor.

But I'd say that this issue around domestic demand is the same issue that we had before and the type of dynamics, in terms of P&L, and the type of provisions that we have, I mean, are having more or less the same impact as we had before. So I would say we're in an adverse scenario, but I would say that no news when we compare this quarter with previous quarters. Okay.

Operator

[Operator Instructions]. As there are no further questions in the queue, I would now like to turn the call back over to your host for any additional or closing remarks.

Miguel de Campos Pereira de Bragança

I would really thank you for this interest. The situation is difficult, but we're implementing a plan, we do have a plan. We are pursuing all the initiatives that we ought to, both in terms of risks, in terms of costs and in terms of income also.
And I hope to every quarter to have this conversation with you to really show what we are doing and how we are delivering on our commitment. Thank you very much on all of you. Bye-bye.