Q1 2013 Earnings Call

Company Participants

• Nuno Amado

• Miguel Bragança

• Rui Coimbra

Other Participants

• Jaime Hernández

• Antonio Ramirez

• Carlos Peixoto

• Juan Pablo López

MANAGEMENT DISCUSSION SECTION

Operator

Good day, and welcome to the Millennium bcp First Quarter 2013 Earnings Conference Call. Today's conference is being recorded. At this time, I would like to turn the conference over to Mr. Nuno Amado, Vice-Chairman and CEO.

Please go ahead, sir.

Nuno Amado

Thank you very much. Good afternoon to everybody. We are here today presenting the first quarter results of Millennium bcp. And I can tell you that these results are obviously difficult ones in a difficult year and in a complex and demanding environment as you all know.

The consolidated net income was negative of €152 million, as expected in our plan, and showing a reversal or a slight improvement in the downward trend that we had in the last two quarters. So, first quarter results was as I mentioned negative, but it was better than in the previous two quarters, the third and the fourth quarter of last year. This is more significant if we exclude result from the Greek operations. Without that, the result was negative around €110 million.

And one of the key issues of the last month was the signature of the agreement for the sale of our operation in Greece to Piraeus Bank. This was one of our main concerns as you know, and it seems that is almost sold, because the agreement is the full enforced agreement, but we still require some approval that we don't expect major problems, and I think that's a very positive news for beginning of this year.

In the past for the turnaround of the process in Portugal, the domestic business in Portugal, we would like to – I would like to point out that we were able to reduce our cost base in Portugal by 17% and we believe that this trend in terms of large decrease of costs will be maintained in next quarters, and we expect to save more than €70 million this year, that was the figure that we have planned for 2015, so in this respect we are more or less two years in advance.

Another contribution that I believe we should notice is that in our international operations, we got a contribution of €38 million, an increase of around 10% vis-à-vis last year and – last year first quarter, and I think this is reasonably good because these markets are markets with potential, but they've all suffered from the same trend, decreasing interest rates, and in this environment and in the environment of investments that are doing in some of these markets, we are in the investment phase, I think it's quite reasonable and I would say that there is a larger potential and I expect that could materialize this potential in the future.

Our key difficulty is on the margin, namely the domestic margin that is suffering from three main factors, the CoCo's cost, the impact of the unfavourable interest rates and the stronger deleveraging process in a very demanding environment where good credit is not easy to grant.

In terms of capital and liquidity, our position today is stronger. We have reached a loan-to-deposit ratio of almost 120% according with the criteria that is being applied in Portugal, and 108% if we consider all the balance sheet customer funds. I think this is a remarkable move, and right now we don't want to – we don't expect to decrease this at the pace that we have done in the past, but we expect to stabilize this ratio, which as I mentioned already, reached a level that was to be reached in two to three years' time. So I think that this is very good.

In terms of capital, our Core Tier 1 is for – in local Core Tier 1 Bank of Portugal is 12.1% and for EBA – under EBA criteria is 9.6%, but if you... we adjusted it from the sovereign buffer that is not required anymore because we don't have that capital loss in terms of mark-to-market, it would be 11%. This is a strong base of capital which I think is important.

So, taking into consideration that now we've reached a much stronger position in terms of liquidity and in terms of comfortable capital ratios and that we have clearly mitigated the Greek risk, all our efforts will be focused on the return to the profitability of our domestic market. This is critical for us. That will be in our main focus in the next quarters. As you know all, this is not one day, one month or one quarter job. It will be ongoing process in the next months and quarters. And this is, as I mentioned, in the center of our focus right now.

Last comment for the DG Comp process. We are under negotiation process with DG Comp Brussels together with the Portuguese government because of the state aid that we received last year. And only point that I want to mention to you is basically that we expect by June, end of June, probably to have an agreement. Let's see if that is possible. If that would be possible, that will mean that we'll have a clear path in front of us in terms of what will be the geometry of our business, the measure that we should apply and the markets where we will focus.

So, I think this is my main comments, difficult results but expected results in a difficult environment and demanding environment. We reduced certain areas of risk, liquidity capital in Greece. We are finalizing the discussions with DGComp and we will focus in the return to the profitability of the Portuguese market. That will be a process that will be not done in a couple of quarters, but will be done with smooth and firm steps.

And now I will pass the stage to my colleague, Miguel Bragança, the CFO of the bank.

Miguel Bragança

Okay, very quickly in page 5, the main highlights of the quarter is the risk mitigation in terms of Greece with the sale of the Greek operation, the very strong improvement in terms of the liquidity position where our net loans to balance sheet customer funds already reached 108%, which was due to both to an increase in customer funds, in balance sheet customer funds, and the decrease in our credit portfolio, albeit that this decrease was a little bit higher or somewhat higher than we were expecting with the consequent impact in terms of the net interest income.

The Core Tier 1 ratio is comfortable above the minima, as expected also because in our plan we were envisaging 2013, as we were saying with net losses in order to achieve the breakeven by the end of 2014. And so, that's why we have a core capital in excess of the minima.

Some signs of reversal in terms of the net income trend. Our net income this quarter was already better than the net income of – in the last quarter of last year with an increase in the contribution of international operations and with the costs which are sustainable, which is recurrence impact being reduced in Portugal.

Now, a little bit in more detail. In terms of Greece, we have signed an agreement. This agreement has already the approval of the HFSF, which is as you know a key regulatory agency in Greece. Our RWAs of the Greek operation are around €4 million. We expect or it is in the agreement to have the reimbursement of the funding –of all the funding within six months. There is absolutely no transfer of any asset, of any Greek assets from Millennium bcp to Greece and we will be capitalizing our bank in Greece with €400 million, a part of them was already contributed in December, the €139 million and the remaining will be through the conversion of funding to Greece. So, there will be no additional transfer to Greece.

With this, we will sell then this bank for a nominal amount, and we have as you know a provision for potential losses of around €427 million, so a provision more or less in line with the loss that we have here. As a part of the conditions of the divestment, we will invest in Piraeus Bank €400 million at the same entry price as the HFSF and in practice with the same voting rights as the HFSF. We'll have a six months lock-up period and we will have then in practice to – we have the objective of, in agreement with Piraeus Bank to then progressively sell or divest from the stake.

In terms of accounting, we will not consolidate of course our position in Piraeus Bank. Of course, the final impact of the transaction is only possible to know when we sell the Piraeus shares and it'll be of course dependent also on the value at which we'll sell Piraeus shares, but based on our sensitivity analysis, we think that even assuming a very conservative evolution of the prices of Piraeus shares, that this is a deal that makes sense for Millennium bcp. So we expect even with very conservative evolution of Piraeus shares, this will not be capital destructive, so this will be marginal capital accretive, and we will save so to say in terms of capital the negative net income that we were projecting for the next couple of years.

In terms of liquidity, going to liquidity, I would say a very comfortable position with a healthy evolution in terms of balance sheet customer funds mainly in the international operations where we have grown by 10% but also in Portugal with a growth of 3%.

In terms of loans to customers, as we – we are as we told last time trying to refocus our strategy by – because we can, because we enough capital and we are in a comfortable liquidity position trying to reverse the trend in terms of decrease of loans to customers. We are slightly behind schedule in this objective. However I have to say that when you compare in Portugal the last quarter with this quarter, the loans were already stable, so we see here a decrease in loans, but with already some stability, so we have seized to reduce our loan portfolio.

Of course, this comfortable liquidity position translated itself in a closing of the commercial gap with a reduction in the net usage of ECB and with also a reduction of the loan-to-deposit ratio. In the meantime, in the first quarter of this year, we basically repaid all the long-term debt that matured this year, the €1 billion. And as you see, for the years to come, there is not any material redemption. In 2014, we have €3 billion of which €1 billion is covered bond, so its €2 billion [ph] is senior so this is (14:49) perfectly assumable within the strategy that we have. So, as you are seeing, we have shown that we are able to close the commercial gap at around rate of around €8 billion every 12 months, so €3 billion in 2014 is perfectly comfortable, and we have more than three times eligible assets. We have a liquidity basket that is more than three times this amount.

In terms of capital, evolving more or less according to plan, comfortably above minima, with a ratio of EBA of 9.6%. However, if we were to do the mark to-market of our sovereign portfolio now and adjust EBA ratio for this, the EBA would be 11.2%. So right now in terms of our sovereign debt portfolio, we have a capital gain and not a capital loss.

Profitability, here this is the main issue. In terms of net interest income, the net interest income comparing with last year reduced by €126 million, of which half is explained by the CoCo's. Of the other half, around two-thirds are explained by the level of Euribor, which has come to really very, very, very low level as you know. And the remaining third linked to the evolution of credit losses and the issue around the quality of the portfolio. In terms of net fees and commissions, relatively stable as you see in

spite of a very strong burden in terms of payment of the state guarantee cost. And the operating income as you see relatively stable when you compare it or when you adjust the operating income of last year by the liability management deal that we did in the first quarter of last year, so this is basically in line with last year.
Staff cost, very strong reduction and in other administrative cost also, so – and impairment and provisions with some increase, evolving according – I would say more or less according to plan.

So, in terms of net interest income, as you see here in Portugal, as I just commented, we have here more than half of it explained by the cost of the CoCo's, and of the remaining half, around two-thirds linked to the evolution of the Euribor. In terms of international operations, there is also some reduction in terms of the net interest income mainly due to the reduction of interest rate level in the three core markets in which we are present, as we will comment later on. Fees and commissions, I would say relatively stable. However, I would like to highlight the strong reduction in terms of the fees and commissions of loans and guarantees which came down by 17.4% basically due to less production, less credit acquisition.
Net trading income, the strong reduction basically due to the repurchase of our own debt that we did last year, but that was clearly non-recurrent, as we explained at that time.
The reduction in Portugal is clearly recurrent. So, we have committed within the capital increase deal debt in what depends from us, it was the reduction of cost, that will reach by over the medium term a level of €800 million and we commented that medium term was more or less around 2015. And the good news is that we have achieved this objective two years ahead of the planned schedule.
So, these were – that dependent mainly on management, was achieved two years in advance and was achieved at several levels that we'll see here. I'm sorry, it was achieved both at the staff cost level, but also at the other administrative cost level, as we see here and this is something that is across the board.
So, in terms of staff cost, as you know we probably did the largest concentrated head count reduction that was done in banking and maybe in any Portuguese large corporates in Portugal last December. So, I don't recall such a strong reduction within the legal framework that we have in Portugal in one month in a large Portuguese company as we did last year.
We also changed the governance in terms of cost and the process, in terms of cost that we have renegotiated most of the administrative costs levers, so this is clearly something that was management driven.
In terms of the loan impairments, in spite of a macroeconomic environment that is evolving, I would say less favourably, mainly in terms of unemployment, than what we were expecting when we did the capital increase last year and when we presented the strategic plan. I will say that the cost of risk is evolving more or less according to plan. So, we had as an objective and this is not so dependent from us

as, of course, the administrative costs and the general level cost, part of this is also dependent on the macroeconomic evolution.

So, we've committed to reach a level of around 100 basis points by 2015. We had 180 basis points more or less last year, now we are around 140 basis points, which is more or less the guidance that I would like to give for this year with some slight reduction but not much more. And we are on track, so to say, to achieve the 100 basis points level by 2015, of course, dependent of the macroeconomic evolution.

In terms of the credit quality, as you see here the credit quality deteriorated somewhat, but that's according to plan. As we told at the time of the capital increase, we did our conservative projections assuming that the credit at risk could get to levels of around 20% at the height of the cycle by 2015. We think these are conservative projections, but we are evolving according to the plan that we presented to the market.

The loan portfolio, as you see here, is clearly heavily collateralized with both the mortgage portfolio and the company's portfolio. Now, in terms of the discussion of Portugal and international operations, I will pass to our Investor Relations Head, Mr. Rui Coimbra.

Rui Coimbra

So, on page 27 for Portugal, just to mention what Mr. Bragança just mentioned that this €26.4 billion of loans to companies that we have now in March is the same number that we have in December. So although average volumes will – we will see that will affect negatively net interest income in this quarter, the stock is already stable. So which makes us to forecast different evolution for the next quarter.

Moving to net income in Portugal, the trend for Portugal is the trend that we show before for the consolidated level. So from the first quarter of last year to the first quarter of this year, this deterioration is mainly on the income side, both net interest income that was already explained and as well the trading, the effect of the repurchase of the own debt but when we look to this quarter compared to the previous one, it is already an improvement mainly coming from less cost of risk. In general comparing to quarter-on-quarter is less banking income and less operating costs coming already from the restructuring that is in place.

Now, one slide that I think we should spend some more time is the explanation of the net interest income. When we analyze here together the dynamics of net interest income last quarter, we explained that there was an increase of almost €80 million from the third quarter to the fourth, and out of this €50 million we consider at that time non-recurrent, it was recoveries and some abnormal movements from non-accruals to accruals that we explained at that time, that it was non-recurring.

So, in a way, we were guiding net interest income for numbers from around €75 million to €80 million per quarter, in fact we have less, and I believe this is what requires an explanation. And this is mainly from the volume effect, as you can see on the explanation there, that represents from one quarter to the other, €27 million less, and this is less average loans and this is more than €1 billion as you see, and €2 billion more in terms of deposits.

Actually, this €1.3 billion less in average loans is mainly – out of this €1 billion is from companies. So, although we say that the stock is constant, the average was €1 billion down, in terms of companies. And this, using an average spread of more than 4%, you see that this is an important effect here on the net interest income quarter-on-quarter. The same – if you apply the same exercise for the €2 billion more in average customer deposits.

So what this explains and this – as it was already mentioned, it was not completely according to our plans, this decrease on the average in terms of companies. The fact that the stock is constant already, it makes this negative effect for us at least not to be forecasted for the next quarter. So, let's see what will happen, but we do not expect again this type of negative effect.

Now, just one note here that we've been penalizing very much on the previous quarters the market rates, now we are not seeing yet the increase on Euribor that will make us to have a free ride gain here, but at least we are not being penalized anymore, because it is stable at 20 basis points.

Now in terms of the rates of the time deposit, here what we can see is that the same previous exercise that we did the full-year last year, we continue to do on this first quarter. If you compare quarter-on-quarter, the portfolio of the time deposits rate, it was 4.1% one year ago and now is at 2.9%, so it is an important decrease. Of course, we know that this decrease was at the same time there was a decrease in Euribor so the spread didn't improve very much, although we can see there that compared to the closing of the previous year, there is already an improvement here on the spread of the time deposit. So again converging to what we said that was our target for 2015 in the strategic plan. So the trend is there and we'll continue the same exercise as we were doing up to now.

In terms of companies, the spread is constant both for companies and for mortgage. Now going to commissions, it was already mentioned the main effect here is the commission related to loans and guarantees. Moving to operating costs, it was again mentioning what we can say is that that 2015 target, it will be achieved this year at least in terms of recurrent costs, both on the staff and on admin.

In terms of credit quality, the main numbers that were already mentioned for the – at the consolidated levels, here, I think one note is worth mentioning, that what we have in our strategic plan in terms of this – for credit at risk, it was the 20% at the peak in 2015, but for this very moment of the first quarter of 2013, it was something like around 14.5% and we are less than this. So there is no reason to change anything in the strategic plan related to this, but we can say that it is slightly below what it was expected.

In terms of new entries this quarter, entries minus recoveries, minus collections, obviously it is worse than the previous quarter as we mentioned at that time, but it is better than the correspondent first quarter of previous year, actually entries minus collection is 25% less compared to previous – to the first quarter of the previous year.

Now moving to the international operations, there is a 20% improvement in the contribution of our international operations for the full P&L. From Poland, there is positive news in terms of a 9% increase on net income. Very stable numbers from Mozambique and lower number, lower contribution from Angola to the P&L. From the other operations, small operation, there was a positive contribution as well comparing to the previous year.

Moving to Poland, in terms of customer funds and loans, just one note here on companies because, as you remind, part of the strategic plan was to increase the weight of consumer and companies and less weight in terms of mortgage for the full portfolio. It is happening as you can see already in consumer and even for companies if we consider compared with the previous quarter, quarter-on-quarter. So, this stable number here, if we compare with the previous quarter is an increase of almost 4%. So, following the strategy that was announced last year.

Another topic that again we can write a tick there in terms of KPI on the strategic plan was the fact that the idea of increasing deposits, but to increase more on the savings and current accounts than on the time deposits and it is happening actually. This important increase in deposits here, 39% – there was a 39% increase on current accounts. So which the weight now is much higher than it was before, giving a higher contribution in terms of net interest income.

So, net income in Poland 9% up, coming with an increase of 4.5% in banking income and the decrease on the operating costs.

On the net interest income, as it was mentioned already, there was a decrease on the market rates, which made the income side to decrease, although the adjustments on the side of deposits was very quick, which makes the spread not to deteriorate, on the contrary even a slight improvement of 2 basis points. So, the decrease of net interest income is much more related to even with the decreased rates affecting public debt and the part of public debt that we are having now in our balance sheet.

In terms of commissions, there was an improvement of 6.9% mainly from commissions from mutual funds.

Operating costs decreasing in both in staff alone with the decrease of the number of employees in the bank and for admin, mainly from IT and communication costs. Credit quality, very stable numbers and low numbers with a coverage of more than 100%. In terms of impairment charges, 52 basis points, which is more – which is less than the average of the full year, so it is more than the first quarter of last year, but the average, it was 58 basis points. And so 52 basis points and this 50 basis points should be in a way the guidance for the full year as well.

Now moving to Mozambique, important increase in volumes, both in deposits and loans. Net income very stable and here we have an improvement on the income side and an increase on costs obviously related to the expansion plan, we opened nine branch from the first quarter last year till now. Again, there was an effect here on the decrease of markets rate that affects not the commercial side because in a way we manage to compensate this on the deposits rates. But again on the public debt side, both in volumes and on the rates on the treasury bills as well and this affected negatively the net interest income, although we managed to compensate with commissions and other income. Operating costs up again with expansion plan.

For Angola, stable customer funds and increase in loans. Net income decreased mainly from the increase on impairments and mainly there because what happened again in this country, it was a decrease of markets rate. Again we managed to compensate on the commercial side. So there is no deterioration there, but it affected again the public debt that we have in our balance sheet, which made a slight decrease on the net interest income, compensated again by commissions, slight increase on the operating costs actually with the expansion plan. And then as I mentioned, it's not here, but there was an increase in provisions that made this effect.

Now as a conclusion, as you remember and we are being presented this slide in the last quarter. And on the right side, it is the main KPIs to compare with our plan. So very comfortable position for the three first bullets in terms of balance sheet, capital, liquidity and impairment. And then looking to P&L, important reduction in cost in Portugal. In a way, we show this negative the trend on the net income, some inversion here, let's see next quarter and, of course, the agreement for the sale of the Greek operation.

So we move to Q&A now. Thank you.

Q&A

Operator

Thank you. [Operator Instructions]. We shall take our first question from Jaime Hernández from Nomura. Please go ahead.

<Q - **Jaime Hernández**>: Hi, good afternoon. Thank you for taking my questions. I've got two initial questions. The first one is regarding the domestic business, I would like – I would appreciate if you can please give us some kind of guidance on when are you expecting to reach breakeven in the domestic business, I mean from a net income point of view, and what will be the main drivers to [ph] start doing money (38:07) from the domestic business?

And the second one is related to EBA stress test that alludes that it will updated during this year. I don't know if you've got some kind of information on the timing of that new stress test and the assumptions that it will include, and if you're expecting that new stress test to apply the mark-to-market of the sovereign portfolio that will benefit your EBA Core Tier 1? Thank you very much.

<A - **Miguel Bragança**>: Hi, Jaime, its Miguel Bragança speaking; Commenting on your first of two questions. So our objective is to meet our breakeven by the end of last[1] year as we told during the last capital increase. We maintain this objective. Probably comparing with what we were expecting before. We have probably more cost cuts and probably a lower net interest income line because of the level of the Euribor.

What will be the main drivers of this net – of the breakeven. Costs – the cost of deposits. So as time goes by, there is inertia in terms of direction of the cost of deposits, but we will get there and we are maintaining a very positive trend in terms of the reduction of the cost of deposits. And with the progressive stabilization of the Portuguese economy also, the cost of risk, so we are expecting the cost of risk if as we expect the Portuguese plan works well, to get to levels of 100 basis points by 2015. So, I mean right now we're at 140 basis points, if this is a smooth pattern, we think that with the reduction of the cost of deposits, with the reduction of costs and with the reduction of cost of risk, we will have three very important levers.

An additional lever that will start to bear its fruits, but it's basically more important over the long-term, but will also contribute by next year to some slight improvement in terms of the margin, will be the new credit, the new credit to corporates at front book spreads, if you want mainly – by corporate, I mean mid-sized corporates, will start to bear its fruits and FDA where we are slightly delayed.

With this three – with the first three levers and with this strategic additional initiative, we hope to get to breakeven last[2] year. And with breakeven last[3] year, if you do the numbers, we are comfortably on the track to generate enough capital than to repay the CoCo's, which will be probably the next question.

In terms of the EBA, we actually don't have any reasonable official information in terms of any new official EBA test, so we don't have any – we know from the newspapers more or less, but we don't have any formal data of any new EBA stress test.

Operator

We shall take our next question from Antonio Ramirez from KBW. Analyst, please go ahead.

[1] Meaning next year

[2] Meaning next year

[3] Meaning next year

<Q - **Antonio Ramirez**>: Hello, three or four questions from me. First, can you clarify when you were discussing trends for net interest income in Portugal, I think you suggested that in the second quarter as long as the average volumes in lending should be at least flattish versus down in Q1, you would expect a positive recovery of the minus €27 million you mentioned, is that the correct interpretation, so shall we expect some increase in NII in Portugal in Q2 in the region of €20 million or €30 million? So that would be my first question.

Second question is regarding your comments on the review and negotiations with the DG Comp, the European authorities for competition, what are the key issues? What should be we expecting? Is it about capital, so are you debating for instance if this sovereign buffer that is no longer applicable should be maintained for regulatory capital purposes with EBA or is it about annual review on the asset quality or is it about more restructuring measures, so can you tell us which are the key points that are in discussion and what could be eventually the implications?

And then my third question is on the tax implications of the Greek transaction. My understanding is that the generic provision for Greece that was booked last year, the €450 million was not considered to be tax deductible. However, now these taxes – tax losses will materialize as you sell the subsidiary for €1, so you will materialize the losses that were anticipated with the general provision. What are the implications on taxes in the P&L and also for DTAs. So are you booking a tax gain of 25% or 27% of the €450 million in Q2, and if these are into DTAs, so if you can elaborate on the tax implications of the Greek deal. Thank you.

<A – **Rui Coimbra** >: So Antonio, Rui Coimbra, quickly let me just answering for the first and then Miguel will answer the other two. A kind of a guidance for net interest income in Portugal, you mentioned. I believe that we should start looking to the previous year, having this as a benchmark, and then we know that on top of this, we will have a negative effect of two quarters more of CoCo's. We believe that we will compensate big part of this with this effort of decreasing the cost of deposits. We believe that the negative effect on volumes that we saw in the first quarter, at least this average volumes effect will not continue, and so at least the negative part we will not have and, let's see if there will be an important positive issue there, but at least the negative we're not counting more, which means that it will be probably below the net interest income of last year, but not so much, so part of the CoCo's, it will be compensated.

<Q - **Antonio Ramirez**>: So I understand you want to put it in perspective versus last year, but last year is very far from where we are now, many things have happened. So, I don't think it's very useful to look one year back. And we have had already for two quarters the cost of CoCo's, so now this is no longer explaining a different performance on a quarterly basis. So to make it clear to me because there're many

moving parts, if you're saying last year minus CoCo's is what you think you can achieve is basically flat quarter-on-quarter versus where we are in Q1, is that correct or not?

<A - **Rui Coimbra** >: No, it is not correct.

<Q **- Antonio Ramirez**>: That's why I'm saying it's kind of confusing. So probably it makes more sense to focus where we are today rather than a year ago.

<A - **Rui Coimbra** >: Definitely, but not – but for me not giving [indiscernible] (46:27).

<Q - **Antonio Ramirez**>: Okay.

<A - **Rui Coimbra** >: ... that we do not know. I'm telling you the following, pick the number of last year, we know that on top of this we'll have another negative effect of two quarters of CoCo's more, because last year we just had two, this year we'll have four. And this you should expect a decrease. We will compensate part of this with our effort of cost of deposit decrease, which means that we expect every quarter to be better than this one, but not completely, to compensate the additional cost, okay.

<Q - **Antonio Ramirez**>: Okay.

<A - **Miguel Bragança** >: Okay, going now to the DG Comp issue and to the tax issues regarding the Greek deal. In terms of the DG Comp basically what we are discussing – actually formally it is the Portuguese government that discusses the plan with DG Comp. And formally what we are discussing with DG Comp is our plan, so to say. What are the – what is the long-term plan of the bank, and what are the measures that make sense from their point of view. I would say they have two types of concerns. One type of concern is that our plan is conservative enough. So, they like to, so to say, de-risk our plan by having probably less assets and probably also less cost, which actually, considering the present situation in Portugal and the recent developments that we've had, also make some sense from our point of view.

The second issue that they have is around measures of competitive distortion, so they want to make sure that there is no issue of more hazards, and that somehow we show a reduction in our balance sheet so that we don't profit abnormally or unjustifiably from the CoCo's and so that the competition distortion issues are mitigated. At this point in time exactly because we are negotiating it and we are in the middle of negotiation, that probably will take, I hope, until the end of June, more or less give or take, it will also depend on them, I do not want to say anything more because it's not – it may be counterproductive to discuss in the middle of the negotiation with the markets exactly what's going on, okay?

In terms of the tax implications, obviously, you are right. It's a very intelligent question that there is a positive tax effect from the Greek deal, because there was a possible contingency of €400 million. And now by having, so to say, the capital loss, there is a tax allowance, so to say, or a tax asset, so to say. Whether we will book it or not is something that we will still discuss with our auditors and with the Central Bank. Because as you know in order to book a deferred tax asset, you have to make absolutely sure that you then are able to benefit from it and it also depends on your total volume of deferred tax assets and the way that these tax assets mature over time and whether you have enough taxable income to profit from them.

We tend to be relatively conservative in this issue, but we will discuss both with our auditors and with the Central Bank whether, in a conservative scenario, and that's how we would like to look at it, we will benefit from it or not, okay? So the decision has not been taken as for now, but the benefit will exist, but it may expire if we don't – if we're not able to profit from it, okay?

<Q - **Antonio Ramirez**>: Yes. Sorry to ask again on the same topic, the fact that you are mentioning several times that you will take a conservative view means that it's likely that you don't book this DTA because the level of DTAs you have right now is relatively elevated?

<A - **Miguel Bragança** >: It is not sure, but it is likely. So this is something that we'll discuss with our auditors and with the Central Bank and will also be dependent on the final projection of the discussion with DG Comp. So, because depending on the final projections and depending on the, so to say, our five year plan and on the stress test on the five year plan, we may not book it, at least, immediately. When we feel very comfortable that we will be able to benefit from it, we may book it, okay.

<Q - **Antonio Ramirez**>: Okay. Thank you very much.

<A – **Nuno Amado**>: Sorry, we don't plan to book it at front, but we are [indiscernible] (51:07), we will analyze it, but it will be always a reserve, a reserve, a reserve of value seen on the way that we think they will go (51:21).

<Q - **Antonio Ramirez**>: Okay. Thank you.

Operator

We shall take our next question from Carlos Peixoto. Please go ahead.

<Q - **Carlos Peixoto**>: Hi there. Good afternoon. First question on the risk-weighted assets evolution. This quarter there was an increase in risk-weighted assets. I believe that that has – that might have to do with a review of ratings in certain credit segments, but I was wondering if you could confirm on that? And furthermore, one of the issues that has been debated on this front has been the possibility of the implementation of further IRB models in certain credit segments in Portugal, the SME segments if I'm correct. I was wondering if you could shed some light on when can we expect that to happen, and an upgrade on the potential risk-weighted assets optimization that could arise from that?

Still on this subject, with recent changes to the CRD for namely regarding the weightings to be applied on the SME segments, which basically seems to be measure to improve the credit availability to these companies, I was wondering what could be the impacts for BCP as well, what sort of risk-weighted asset savings could happen from there?

Then on a separate subject, if I may. Regarding the BCP sovereign bonds, I saw that the sovereign buffer that was imposed by EBA has already reverted. I was wondering if there are already some capital gains on the sovereign bond portfolio, and if yes, how much? Thanks.

<A - **Miguel Bragança**>: Okay. In all regards – so starting with last question, because it's easier. So our Portuguese sovereign debt portfolio has a capital gain of around €70 million. In terms of the evolution of the risk-weighted assets, you're right. So basically what happened at the end of the year was with the accounts that we received from the companies, we tend to review the ratings, because as you know the companies typically close year-end accounts, and with the review of the ratings typically in the first quarter you'll see the same last year also, it's always a period where in an economic cycle the ratings get reviewed with an impact then in terms of the conception of (54:03) capital and that's basically what explains the different evolution between the evolution of credit and the evolution of the risk-weighted assets.

In terms of the IRB, we are discussing with the Bank of Portugal advance models for corporates. And as you know we are already in foundation, so we want to go there. They have already approved a part of the advanced IRB, so the part that is related to the credit conversion factor. The part that is related to the LGDs is a very complex part, as you know. We are working together with them. We would like to have it solved by June. However, as you know, we are well in excess of regulatory minimum right now, and as far as we are concerned, so there is no stress in terms of the regulatory ratio.

So, of course, it is important so that we assure a level playing field with other banks. And so that when it comes to the time of us being able to repay the CoCo's, so that we have this additional lever because it's totally fair, but we are on no immediate pressure in this regard. And I have to say they are very complex models, and we have been counting on the cooperation, on the very important and intelligent challenge on the Bank of Portugal in our model so that to make sure that the models are conservative and really are strong enough ensuring also a level playing field. With CRD-IV, there will be an additional benefit, you are right. We expect these benefits to be between, I would say around €1 billion, but we are still doing the numbers. We are still doing the numbers because it depends a lot on the segmentation. So, I would say between €1 billion and €2 billion, but please don't take this [ph] to – it's very recent and these are the first ballpark numbers that we have seen. Okay, I think that's it.

Operator

[**Operator Instructions**]. We shall take our next question from Juan López from Banco Espírito Santo. Please go ahead.

<Q - **Juan Pablo López**>: Yes, hello. Thank you for taking my question. I have actually three questions. First one is regarding the cost reduction that I would say congratulations, it was very impressive, but I don't know if you could provide more color on that. You mentioned on the press conference that there could be more on the table. If I do the run rate of this quarter, I'm getting around 700 million [audio gap] (57:00 – 57:04) below the 800 target that you mentioned for 2014-2015. So, it's well below your target. I don't know if you could confirm again there is no recur – it's all recurrent, and if you could provide more color on that, and if we could expect more cost reduction in the future?

My second question is regarding – it's a follow up regarding your negotiations with DG Comp. While you cannot provide much more detail, but you mentioned that the sale of Romania could be on the table. I don't know if you could also rule out the potential sale of Poland?

And my last question is again regarding net interest income. I saw that your sovereign exposure also increased in the quarter, I don't know if you could share with us what's the impact of the sovereign bonds into the net interest income if you are doing, and what's the impact of the carry trade coming from that? I don't know if that's also the reason why you didn't deduct or reduce more your exposure to [ph] the ECB?

And regarding the sovereign, I don't know if you could comment today's issuance from the Portuguese government, the 10 year bonds, what's your view on that, and if you think that will be a trigger for OMT for the ECB? Thank you.

<A - **Miguel Bragança**>: Okay. In terms of starting here with the most straight forward question in terms of the margins – in terms of our – the evolution of our Portuguese government debt portfolio, it was, I would say, a small evolution comparing with December of last year, around €460 million, as you may see, of which – half of which were treasury bills, which were basically a cash investment because of punctual excess cash where as you know even Portuguese treasury bills don't have a lot of income. So,

comparing with this, EBITDA is not a material territory there. There was around €200 million of short-term Portuguese Government bonds, which is not much. So our net interest income originated from the Portuguese government debt portfolio of this quarter is more or less in line with the one of last quarter. So there was not any material impact from this issue.

In terms of the cost reduction, so we hope actually to close below €800 million this year. You cannot really extrapolate exactly the first quarter in some of the costs to give you an idea, so we have made, for instance, no major TV campaign advertising this quarter to give you an idea. So there are – there is some seasonality in terms of some of the costs that we have. But the guidance that I would like to give you is a number between the €800 million that we had foreseen for 2015 and probably the run rate that would occur from this quarter, because typically the first quarter is also a quarter with less costs due to these issues that I just commented.

In terms of the sales that we may have or we may not have, we are in the middle of a negotiation and there are several dimensions that DG Comp, of course, assesses. One of the dimensions that they want to assess, typically, is balance sheet reduction, so they want to have an objective in terms of balance sheet reduction. Exactly how yet this objective will be an issue that we will negotiate with them. We will try to preserve as much as possible the core assets and we will try to preserve as much as possible value for our shareholders.

However, I have to stress that the DG Comp is not focused on us losing value, so even if they want us to or even if they, I mean, hint that they would like us to sell something, they're concerned that this is done in such a way that does not destroy value, that we are given enough time, that it makes sense and so on. So they want balance sheet reduction but they do not necessarily want to create a value loss, okay? We're negotiating with them and I would say that everything is on the table. Of course, we have our own preferences and our preferences are very much linked to shareholder value creation. So what we will try to defend as much as possible is the situation which, if possible, the measures that are imposed upon us are value accretive and not value destructive, okay?

In terms of the issue of the Portuguese government debt, we see this as very, very positive. We see this as a necessary step towards the OMT or to something similar to the OMT. So we think that even after the present program, we have to count on the goodwill from the European authorities and this goodwill could maybe made more formal through the OMT or maybe more informal and I think that the European authorities will have much more comprehension and our capital of goodwill is much higher if we know that – if we show - that we are both delivering internally the critical reforms that we have to deliver as a country and simultaneously that we are doing our best also to access the markets and that the markets are trusting us. So, this capital of goodwill we think is very important. So, we think that is contributing very clearly to this capital of goodwill, which will be critical to the stabilization of our situation, okay?

Operator

We shall take a follow up question from Carlos Peixoto. Please go ahead.

<Q - **Carlos Peixoto**>: Hi there again. Two additional questions or actually three. I was wondering if you could tell us what was the pension fund performance during the first quarter of this year? Second question on the amount of foreclosed assets by the bank and the current levels of coverage on these assets? And finally, if you could also shed some light on your expectations on cost of risk, particularly cost of risk in Portugal which has been coming down or it came down significantly this quarter. Wondering if you see some stabilization here for the rest of the year, or should we expect some further improvements? Thanks.

<A - **Miguel Bragança**>: Carlos, pension fund, the performance this year was slightly negative mainly due to some equity participation that we had, but very marginally, very close to zero. In terms of foreclosed assets, we maintain this – the gross of the net stock that we added at the end of last year. So just as a reminder, we had a stock of €1.5 billion gross, €1.2 billion net and this has been maintained throughout the quarter.

And in terms of the cost of risk, we think that the level of cost of risk that we have this quarter is a reasonable guidance to the cost of risk that we'll have around the year. Hopefully next year it will be lower, and progressively converging to the 100 basis points that we expect by 2015, okay?

<Q - **Carlos Peixoto**>: Yes. Sorry, just an additional point regarding the expectations for the evolution of net profit in Portugal, what's – what I can deduct from there is that you're expecting to post net profits during the first quarter, but for the year as a whole, you're still expecting net losses from Portugal, is that correct?

<A - **Miguel Bragança**>: You're speaking about – you're speaking about this year?

<Q - Carlos Peixoto>: No, we're already talking about 2014, fourteen, 1-4.

<A **- Miguel Bragança**>: I mean, right not we are not being, so to say, as accurate in terms of this projection right now with the of level of uncertainty that we have right now in the market, so to say. So what we are saying is that we – in terms of recurrent net income by the end of 2014 should be already evident to everybody that we are clearly above breakeven. That's what we want to say at the moment, because it's still – I mean we still have as you know a lot of uncertainties going forward and we would not like to commit to anything further than that.

So, it maybe that it is a full zero by next year, it may be on the second half of last[4] year. Probably as time goes by, we can with more clarity in terms of the evolution of the situation in Portugal, which as you know, is still – I mean you have still some volatility here and we can then be more precise as this volatility disappears, okay?

<Q - **Carlos Peixoto**>: Great. Thank you.
Operator
[Operator Instructions].

Miguel Bragança

Okay, so, is there any question more? I understand not. So just as concluding remarks, I would like to stress that we have sold in this quarter the Greek operation with a very good impact in terms of the de-risking of our balance sheet and in terms of our result. We have also clearly presented a reversal in the downward trend of net income, which was partially linked to a recurrent effort of cost reduction.
Our liquidity position was strengthened and our capital ratios are evolving according to plan and comfortable and consistent with the time that we need to turnaround the bank. And as we said in the beginning, we will focus more and more going forward in terms of profitability and very clearly we are better prepared to face the future challenges and also to support the healthy part of the economy. Okay, that's what I would like say. Thank you very much.

Operator

That will conclude today's conference call. Thank you for your participation ladies and gentlemen. You may now disconnect.

[4] Meaning next year