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HEADLINE: Brazil - Bradesco Lags Behind In Value And Efficiency - Banco Bradesco, Brazil's Largest Non-government Bank In Asset Terms, Is Enjoying Impressive Income Growth. But It Cannot Afford To Rest On Its Laurels If It Wants To Keep Up With The Competitors.

BODY:

Marcio Cypriano, president and CEO of Banco Bradesco SA, appears confident yet relaxed as he talks to The Banker at the bank's headquarters in Osasco, Sao Paulo. His contentment may be due to the bank's announcement a few days earlier that its third-quarter net income has soared to R\$752m (\$263m) from R\$564m a year ago - growth of 33%.

Yet Bradesco has some way to go to catch up with its rival Banco Ita, a fact that Mr Cypriano appears to shrug off. "This (larger market capitalisation for Ita) is a function of its higher profitability in the last four years, higher than that of Bradesco," he says. "This doesn't bother us because we aren't going to sell Bradesco."

At the end of the first half, Bradesco had a market value of R21.2bn, about \$7.5bn, compared with \$9.8bn for Banco Ita - a condemnatory judgment from the market, considering Bradesco's much larger assets: R179.7bn compared with Ita's R122.76bn.

This could affect Bradesco's ability to buy other institutions. After the wave of bank mergers in recent years, there are few institutions left to buy, says Mr Cypriano. But there are some state banks to be sold, he adds, mentioning Banco do Estado de Ceara, Banco do Estado de Espirito Santo, Banco do Estado de Santa Catarina and Banco do Estado do Piaui.

"When there is a state bank for sale, we always look at it because it has the accounts of the government and the accounts of the state government functionaries also. This is important to us," he says.

Efficiency gains

Overall, Bradesco - Brazil's largest non-government bank in terms of assets - is benefiting from a growing economy and raising revenue from fees. Operating efficiency was 58.3% in the Q3 2004, an improvement on 55.9% a year earlier, and a reflection of Bradesco's control of expenses, albeit much higher than Ita's 47.3%.

Brazil's economy, which is expected to grow by about 4% this year, is helping consumer lending to grow by 23% even though larger companies reduced their straightforward bank borrowings. "We had a problem with large companies. They paid or prepaid their loans or arranged other ways to finance their businesses through the capital markets or structured finance," Mr Cypriano says.

The strengthening of Brazil's currency, the real, by 7.8% against the US dollar in the quarter caused the value of Bradesco's dollarised loans, about a fifth of its portfolio, to fall in value, he says.

But the bank predicts loan growth for the whole of 2004 of between 20% and 22%. Return on net equity rose to 18.6% from 16.7% a year earlier. Bradesco is improving. "It is doing a lot better," says Tomas Awad, banking analyst at Ita Corretora Equity Research in Sao Paulo, who rates Bradesco shares as "hold".

Acquisitions to digest

Bradesco has bought 20 banks since 1997 and 41 banks since it was founded in 1943. It will now start to benefit from completing the digestion of its acquisitions of recent years, such as Banco Mercantil de Sao Paulo and the Brazilian unit of Banco Bilbao Vizcaya Argentaria (BBVA).

"When we bought BBVA and Banco Mercantil, we had 3500 branches. There was great overlap," says Mr Cypriano. "We closed more or less 450 branches. Now we have about 3050 branches."

Bradesco does not plan to expand into retail banking outside of Brazil, says Mr Cypriano. "Bradesco will never have retail banking outside of Brazil. We could have the same difficulties that foreign banks encountered in retail banking here if we entered the market outside of Brazil. We will stay in the domestic market, which has a lot of space to grow." Only 40 million people in Brazil have bank accounts "though there are 80 million people economically active", he says. "Therefore, we still have space to grow."

Domestic expansion

Bradesco is starting to attract the 40 million unbanked Brazilians through its Banco Postal, which was established two years ago with the Correios, the Brazilian post office. "We are already generating operating profit from Banco Postal though we have not recovered our investment," Mr Cypriano says.

He calls Banco do Brasil SA, Latin America's largest commercial bank, "our big competitor" because it is present in all states of the country. Banco Ita is more competitive in the states of Rio de Janeiro, Sao Paulo and Minas Gerais, he says.

Banco do Brasil is a state-controlled bank, which gives it advantages over Bradesco and

Ita£, such as the use of workers' funds for financing. But as far as analysts and investors are concerned, Bradesco's main rival is Ita£. Its 18.6% return on net equity is far below that of Ita£, whose figure was 33.1% at the end of the first half of 2004.

Closed system

"Ita£ is more of an open system, which can adapt better to changes in the environment such as a different exchange rate policy," says Carlos Coradi, bank analyst at Engenheiros Financeiros & Consultores in Sao Paulo. "Bradesco is a closed system. It is rare for anyone there at the top levels to speak English." Bradesco is known for employing most of its management from inside the organisation, people who joined the bank straight from school.

Ita£ stands head and shoulders above other large Brazilian banks in the percentage of personnel costs covered by service fees, according to a study by Coradi. Its service fees cover almost 183% of personnel costs, followed by Unibanco with a figure of 165%. Bradesco comes in at 112% of its personnel costs paid for by service fees.

Efficiency lag

The difference in efficiency at the largest and second-largest non-state banks may be seen in outlays for computer technology, says Mauricio Ghetler, a consultant at MG Systems Consultoria e Sistemas Ltda. in Sao Paulo. Bradesco spent \$510m and Ita £ had outlays of \$320m, he says. "There's a lot less of expenditure at Ita£ for the same level of efficiency," he says.

Overall, Bradesco needs to learn some lessons from its rival. Otherwise it risks being left even further behind as the Brazilian economy powers forward.

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