

Q4 2016 Earnings Call

Company Participants

- Candido Bracher, Deputy CEO
- Marcelo Kopel, IR Officer
- Roberto Setubal, CEO

Other Participants

- Carlos Gomez, Analyst
- Carlos Macedo, Analyst
- Domingos Falavina, Analyst
- Jason Mollin, Analyst
- Jorge Friedmann, Analyst
- Philip Finch, Analyst
- Tito Labarta, Analyst
- Unidentified Participant, Analyst

Presentation

Operator

Good morning, ladies and gentlemen and welcome to Itau Unibanco Holding Conference Call to discuss 2016 Fourth Quarter result. At this time, all participants are in a listen-only mode. Later we will conduct a question-and-answer session and instructions will be given at that time. (Operator Instructions)

As a reminder, this conference is being recorded and broadcasted live on the Investor Relations website at www.itaubank.com.br/investor-relations. The audio webcast works with Internet Explorer 9 or above and Chrome, Firefox and mobile devices, IOS8 or above and Android 3.0 or above. A slide presentation is also available on this site. The replay of this conference call will be available until February 14 by phone on 55-11-3193-1012 or 28204012, access code 4283325#.

Before proceeding, let me mention that forward-looking statements are being made under the safe harbor of the Securities Litigation Reform Act of 1996. Actual performance could differ materially from that anticipated in any forward-looking comments as a result of macroeconomic conditions, market risks and other factors.

With us today in this conference call in Sao Paulo is Mr. Roberto Setubal, CEO; Mr. Candido Bracher, Deputy CEO; Mr. Caio Ibrahim David, Executive Vice President and Mr. Marcelo Kopel, Investor Relations Officer.

First, Mr. Roberto Setubal will comment on 2016 Fourth Quarter results. Afterwards, management will be available for a question-and-answer session. It's now my pleasure to turn the call over to Mr. Roberto Setubal.

Roberto Setubal {BIO 1525746 <GO>}

Good morning and good afternoon for all of you, thank you for being with us at this moment. We are presenting our Fourth Quarter results, closing the year 2016 and may have some general comments on that. I will not go to many details in the pages inside, I believe you have seen already the numbers. So you are aware of the overall results.

I think that we have starting in page three. We had a strong Fourth Quarter, very solid in terms of the results, especially because of the NPLs falling, very clearly solid both 90 days, over 90 days and also the 15 days to 90 days NPLs are coming down. And margins, in general we're okay and I'll comment on margins although the number here shows fall, I believe that we have clear explanation for that. But overall, in this page you can see green numbers in general on the right side that show that we had a strong quarter with ROE of 20.7% which giving the scenario that we are living here and build economy. Recession, very strong 7% accumulated in two years. We believe that this was strong result. And I'd like to discuss with you after 7% reduction in GDP, we could present you as a bank 20%. When we look year-over-year, the year-over-year looks -- we had a lower profit 7% lower than the last year. ROEs falling and the NPLs increasing when we compare December-to-December. But like I mentioned before Fourth Quarter shows a good perspective for the next year and for 2017 seems, it's already much stronger in improving situation compared to previous quarters in 2016.

ROE and ROA both very strong and results on page six also strong. Here margin with clients in the Fourth Quarter although the number shows 3.9% negative, we have -- and also year-over-year negative which was due to impairments that we have done in private and securities that we hold from private companies. But when we clear margin of this impairments. And we can see some growth in the Fourth Quarter and year-over-year small growth. Its show the trend I think that we're coming out of the worst moment of the economy and this clearly can be seen in the numbers. Our market activity trading and banking activities, we are very strong in the year, very good we had a very good year after another good year in 2016 and in the quarter statically work very strong with a growth of 14% in revenues compared to previous quarters. Fees and general commissions for services also increasing year and the quarter again the trend balance the Fourth Quarter. Insurance better as well the trend compared to the year-over-year. So we have seen overall business conditions improving in Brazil. And revenue is coming to some recovery.

I think the best thing about the Fourth Quarter was the delinquency ratio, which is falling and provisions which are coming along, which means they are also falling. And we will talk more about that in the following pages. But this probably is the most important thing that we have in the results. But overall, also the expenses have come down in the quarter under control year-over-year, especially considering the average inflation last year was about 7% to 8%. So I think we are coming okay in terms of expenses below inflation. And net income falling in the year-over-year but increasing Third Quarter through Fourth Quarter.

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One important thing here is -- next page, America, Latin America and Brazil split in terms of the results. We had a difficult year in terms of results in Latin America, especially due to the consolidation of CorpBanca which happened in April this year. We have made mainly provisions to adjust the balance sheet of CorpBanca to our policies, accounting policies and provisions policies. So we had a year of integration and additional expenses leaving the integration of the two banks. But we believe that looking ahead, things will be much better and we believe that after this loss year in CorpBanca. This year we have a turnaround for the positive results in 2017.

In terms of what we forecasted and what we are giving to you here is that we pretty much have, would forecast at the beginning of the year. Actually we have made some changes in the forecast, especially after the consolidation of CorpBanca, we changed some of the numbers. But basically were due to the consolidation of CorpBanca.

So I think the numbers looks okay in general and especially provisions, below the range that we see, which in our view it's a good news and especially the fact that in Brazil, we have not changed the provision range, we basically change for the consolidated using the CorpBanca and we came below the range that we have given for Brazil. I think that at the beginning of the year, we had Brazil under much more stressed scenario, giving the political scene and at the end of the year, especially along the second semester, things improved, economy, the political scenario has reduced the stress and the economic scenario is much better than it was at the beginning of the year. So this has also been an important factor. So that our loan losses, which shape at the end of the year.

Commissions, pretty much inside the range that we gave, expenses also pretty much inside the range that we gave at the beginning of the year. So overall, I think we came along well through the two years of recession in Brazil, it's 7% GDP drop and we are delivering over 20% ROE. And this basically is due, in my view, to the business model that we are making clear on the slide nine, we have a business -- we are a bank for sure. But a bank that more than loans, we have a lot of services, asset management, credit cards, acquiring services. So we consolidate a much more expanded business than the traditional commercial bank and that's why we could come along the crises in such a good returns. But when we go in this pace and this is very clear here, we have the credit business, which is delivering, despite lot of ROE and it's delivering a much below ROE of 9%, which is much below the cost of capital for Brazil. So this was a tough year for credit, giving all those things that I have already mentioned. But on the other side, insurance services and trading, we had good year and we performed quite well.

Especially insurance and services, I think we have a great franchise in Brazil, Asset Management and in general -- payment in general, in Brazil, it's a great franchise that really is not affected by the credit cycle, it's basically a business that is very consistent over time and this is the basis for the level of returns that we can deliver even doing most of years, the level of capital allocation for those business are much lower. And our goal is to perform credit cost of capital and credit and have the other businesses service and insurance as an at on our return above cost of capital because they perform -- I think we have much lower cost capital allocated that they had performed much above cost of capital for them, giving the franchise that we have and this has been very constant over the last 10 years, 20 years that we have built this franchise.

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On the next page, we see how our credit portfolio developed. It was a tough year giving the recession in Brazil again. So we have a net change negative of 6% year-over-year and basically all the segments had a drop in another terms of credit loans and this was basically due to the recession in Brazil. And if you compare third to Fourth Quarter of the year, you'll see the changes are much -- we have -- on the margin things are improving during the economic conditions of the second semester that are better than they were at the beginning of the year. So things are improving, some of the margin you can see some growth even considering the seasonality and things tend to improve in 2017 as we will see on the guidance. The margin with clients is growing, it's still growing.

We had a very good quarter with increasing margins and especially if you do not consider impairment which incomes or accounts we do on the margin. But on a regular recurrent business we would like to make the impairment on a separated basis. So numbers are (technical difficulty) margins with -- which accounts for trading and banking activity was also very positive for the full year and the quarter was a very good year as well with BRL2 billion of margins in the last quarter. Brazil is improving in general conditions and markets are recognizing that (inaudible) are increasing in Brazil, interest rates, reducing risks, reducing general (inaudible) is taking advantage of this situation. In terms of quality, I think this was the most important thing about the quarter, it was important for both in terms of Brazil and the consolidated numbers, we end up the year with 3.4% delinquency ratio over 90 days, is the best in 2016. So we can see much below all the previous quarters and not much above historical levels. The best historical level was at the end of 2014. So we are getting there. So this interesting improvement in the quarter and when we see in the lower area of the page, the different business delinquency, we also can see improvements in all the business lines improving in terms of over 90 days.

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Also, when we look the early delinquency, which is the 15 days to 90 days on page 14, we can see very clear improvements in the trends. There is some positive seasonality in the Fourth Quarter in Brazil especially due to additional salary payments -- we have opened [ph] more salary in December, given labor laws and also (inaudible) a little bit given the Christmas season. But overall it was a very important improvement and we ended 2016 in the same level of early delinquency that we had in 2014. So this is really a very positive news especially considering that after 2014 [ph], we had two years of drop in GDP and that has a cumulative 7% [ph] drop in GDP in two years and we end up with the early delinquency numbers in same condition that we had two years ago, heading for a 2017 year, very positive as well. NPL creation trends have come down, going down clearly, starting 2015, then basically we are getting lower and lower NPL creation numbers. Renegotiated loans also has decreased. So average stock of renegotiated loans has decreased, which shows that overall now we are not seeing things getting worse, we are seeing clearly things getting better and they are getting better because they are really getting better not because we are renegotiating more past due loans and this can be seen exactly in this page.

Provisions, when we look segment by segment on page 17, also the trend is very positive, both wholesale and retail has positive trends compared to previous numbers. Latin America, as I mentioned before, CorpBanca was the major problem that we had this year. We are adjusting CorpBanca numbers to our policies and we believe that over next year, we have a much better year in CorpBanca and in Latin America in general.

On page 18, we can see the coverage ratio, which is very, very strong, 222% is a number that we have never seen here in Itau I believe. It's a very strong level of coverage given even including the renegotiated loans, we still have more than 100%. So in general, things are in very good condition in terms of the level of provisions that we have in our balance sheet and we make it more specific levels of provisions, BRL37.4 billion and BRL11.8 billion [ph] is our provisions that we do according to Brazilian Central Bank requirement.

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Then we have additional provisions for those clients, which we believe needs additional provision than the ones that are requiring by Central Bank, which are divided in those two levels. One is the renegotiated loans, we make additional provisions for renegotiated loans in addition to what is best to do. And even for loans in general that are past due, usually we have more provisions than the ones which are basically required by the Central Bank. Expected losses, we also have provisions for expected losses in retail. This is something that we do usually. In the wholesale business, we also have been doing additional provisions, additional to what Central Bank requires in order to cope with very complex situation that some groups have been involved recently with the strikes in Brazil. So overall, we believe that we have good level of provisions for the level of risk that we have in our balance sheet. We are very comfortable with that.

We have been doing provisions above the level of NPL creation for many quarters now as you can see in the page. And so we are anticipating a lot of provisions in order to make our balance sheet very strong. We are basically trying to mark-to-market the quality of our credit in terms of having provisions in addition to what we believe, in addition to what is necessary by Central Bank but according to what we believe is the right value for that asset.

In terms of securities, we also have done some impairments, connected with the provisions, securities have done impairment [ph] and this is what we show in page 21, the volume of securities of private sector that we hold in our balance sheet, the level of impairment and mark-to-market provisions we have made and in fact shows that we have been positive.

As I mentioned before, we have a very strong business of insurance and services and this is an important part of our business strategy and here you can see where are the main contributors for this service fees and commissions that we have in our revenues, we have very important asset management business and also very important credit card business. These credit cards here doesn't include what is above which is the fees that are collected by the issuer side. The issuer side fees is above here in the page with the credit and trading revenues [ph]. Here is basically the acquiring fees that we collect through our (inaudible). The idea is that fees in general does not involve risk, any kind of credit risk involved in this level of fees that we collect in our business. It has nothing to do with the economic cycle. So when we have a very negative economic cycle, the credit business suffers but the service fee is not affected as I showed you when we discussed the business model we have for Itau.

Non-interest expenses were in good shape for the year below inflation we were able to manage the expenses so that we have a very controlled environment since the revenues are not grown during the recession. We have a strong focus on expenses so that we could

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keep expenses in a lower level of growth and this has made our efficiency ratio basically stable even though the recession was very, very strong.

We have also announced an increase in our payouts to something between 35% and 45% range for the coming years. We believe that given the level of capitalization of the banks after Basel III, already considering all the requirements of Basel III and also considering, as you can see on page 26, considering all Basel III requirement up fronts, considering the Citibank consolidation, the bank operations in Brazil that we have acquired and considering already the (inaudible) we increased the dividends so that at the end of the year after this very much bigger dividend than historical levels, we still have a level of capitalization, a core equity Tier 1 level of 13.2%.

As you know I'm retiring in April after 23 years as Head of the Bank and I'm here just give you one-page to give you my numbers for these 23 years. I have a 23.7% ROE. During the period, our stock price has grown a lot as you can see dividends, everything more than double-digits for the 23 years. I'm very happy, very glad to have the opportunity to talk to many of you who are following this conference call. Thank you, all and now I will turn it to Candido who will talk, as the next long-term CEO [ph], he'll talk about the forecast for 2017.

Candido Bracher {BIO 3158644 <GO>}

Thank you, Roberto. Good morning, everybody. I'm going to speak about our forecast for 2017. We expect our total portfolio, consolidated to grow between 0% and 4%, in Brazil specifically, between minus 2% and 2%. We think that we are in an economic recovery. It is solid. But it will be slow. Therefore, we do not anticipate a significant growth in portfolio. Our financial margin with clients ex-impairment [ph] because impairment now comes together with loan losses, we expect the financial margin to decrease between 4% and 0.5% on the consolidated, between 5% and 1.5% [ph] in Brazil specifically. This is mainly due to three factors. First, the average credit portfolio in 2017, we expect it to be lower than in 2016. We expect the portfolio to grow end of the year, again the end of the year. But the average portfolio will be a little lower in 2017. Also, the drop in the SELIC rate will affect our income with funding projects in general, specifically the overnight rate as you know [ph]. And finally, we may see some margin compression as interest rates come down especially as the general state of the Company as credit conditions improve in Brazil.

The result from loan losses and impairment, here we expect a significant improvement, we expect it to be between BRL14.5 billion and BRL17 billion in the consolidated, BRL12.5 billion and BRL15 billion in Brazil specifically. In commissions and fees and insurance operations, we expect moderate growth from 0.5% to 4.5% in the consolidated, from 0% to 4% in Brazil specifically. Here again, apply our observations about the solid but slow growth in economy. And finally, we intend to keep a firm grip on non-interest expenses, we expect them to grow once again below inflation from 1.5% to 4.5% in the consolidated from 3% to 6% in Brazil. that's basically it.

Marcelo Kopel {BIO 16986304 <GO>}

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Yes. So now -- we're open now to questions. Thank you.

Questions And Answers

Operator

Ladies and gentlemen we will now begin the question-and-answer session. (Operator Instructions)

Domingos Falavina, JPMorgan.

Q - Domingos Falavina {BIO 16313407 <GO>}

Good morning, Roberto, Mr. Bracher and the rest of the participants, i've two questions if I may. First one is actually in addition to a question made on the Portuguese call on the bank's profitability more in the medium term. Specifically on the bank's topline and the reason I ask is, we've seen spreads write in significantly about 25%, 30% I would say in the last year, year-and-a-half based on Central Bank data and loans will be starting the year based on this guidance, very similar to 2017 level. We have a SELIC of significantly lower with the Central Bank sort of pushing for its spreads come down and fees seem like pretty high, pretty extensive already and most of the provision conversion we should see also taking place in 2017 and supporting good earnings growth. So my question is like when you look at 2018 and 2019 sort of not quantitative but at least like the lines that you see most of the earnings growth sort of Itau coming from, if you could explore a little bit on that?

A - Roberto Setubal {BIO 1525746 <GO>}

Well it's not easy -- thank you for your question. It's not easy to talk about what's going to happen in 2018, 2019 since we have still within stable political environment, there are questions about -- especially because in 2019 we'll have a new President, who we don't know, who will be and we've Presidential election next year. But even though, given the scenario I think that it's important to understand that we've some discussions about that in the Portuguese conference call, which is our business model. We -- as I have this in the page, I think nine, we have, we focus a lot on that, the credit business we'll have some growth. We understand and we believe that over the next years. And it might go up as economy improves. But we don't see growth there as much intense as we have in the last decade. Last decade we had years of 30% growth. Nowadays, I can expect as the economy improves, we might have growth of 10%, 15%, this is something that I believe that possible, Brazil still has some potential to increase the level of credit to GDP. But I don't see this growing dramatically.

But what I see when I call your attention on page nine is that our ROE in credit should improve, we had a very tough year this year. We have in 2016, 9.4% ROE and we target for that column, the credit business, there would be at least at the cost of capital level, which we believe for Itau is above 15% today. We are working at 15.5%. So we are much below cost of capital in our view, we are just trying gradual on credit.

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And this is natural thing for a bank in the years of -- after two years of big recession in Brazil, 7% accumulated in terms of drop in GDP, even though when we are doing okay. We, nevertheless the year 2015 was a little bit better. In 2014, we performed cost of capital, it's not here but we performed cost of capital on the credit business. We expected probably in two years to come back to cost of capital.

And this is something that it's important then to understand how we think, because the other part of the business model, which is insurance and services. We will keep growing, especially as the economy grows, I mean payment will grow as the economy grows, asset management depends on economy as well. So it grows as the economy grows, it won't much lower growth if the economy does not grow.

But it's not affected by the credit cycle, this is important to understand. Our service and insurance business is not affected -- especially in terms of insurance, we basically have life insurance. So those are businesses that are not affected by the economic cycle. So if we had a much tougher economic cycle, this business will grow a little bit less. But still be a very profitable business because this was built over 34 years of historical performance of Itau, in terms of really building a franchise in Brazil that has a very strong hold on -- very strong market participation in all those segments of asset management of payment and general credit cards, especially in the acquiring side. I'm talking about real. So those business will be there and we believe that we can really believe that over time as Brazil improves, we will have a very strong business in the side of insurance and services growing. And the credit will improve in order to have a least cost of capital. This is the way we feel.

Q - Domingos Falavina {BIO 16313407 <GO>}

Very clear. So it comes more from credit and the second question is actually a very quick one. Based on the income statement, you provide an under guidance, we're getting to a mid of the range guidance around BRL24.5 billion of earnings for 2017 and the range being BRL21 billion to above BRL27 billion, does that matches your internal analysis?

A - Marcelo Kopel {BIO 16986304 <GO>}

I mean, Domingos, its Marcelo. I mean, you do the math and you know we can't confirm numbers. But we typically work with the midpoint of the guidance. So if you're there it shouldn't deviating much from that.

Operator

Carlos Macedo, Goldman Sachs.

Q - Carlos Macedo {BIO 15158925 <GO>}

Good afternoon, gentlemen, thanks for taking questions, first, Roberto, congratulations on your stewardship of Itau Unibanco overall these years, certainly the numbers leave no room for doubt, it was very successful. And I think all of us here congratulate to you and we're sorry to see you go even though we think that kind of that will be more than able to handle the task going forward.

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Second, first question, you talked lot about Brazil, talking about our Brazil. I mean one of your legacies Roberto was to accelerate the expansion of Itau outside of Brazil, particularly into Chile, what do you see is Itau's role. I mean you talked a lot about acquisitions in Peru, in Mexico, the business in Chile hasn't gone well, you've changed the terms of the partnership of acquisition in Colombia, the Argentina franchise is too small to make a difference in Argentina or to Itau, I mean either buy or sell there, I would say, what you see is the next -- are the next steps as you -- as the Bank becomes more international?

Second question is more related to guidance. The numbers that you gave out for the cost of risk the BRL14.5 billion to BRL17 billion. The coverage is still very high, as you mentioned, Roberto. And even if NPLs do go down, you will see this coverage remaining still very strong, regardless of where this comes out. Do you factor into this number any consumption of excess provisions which are again, that is still a very, very high level for you, particularly given that the cycles are turning the opposite way with asset quality or the positive way, I guess? Thank you.

A - Roberto Setubal {BIO 1525746 <GO>}

Okay. Starting with Latin American and specifically with Chile, where is our modern -- major part by far of our investment in Latin America. The acquisition have done well, I think we are getting well with our partner, a local partner. We have problems integrating the two banks. We have also in Chile, a tough economic cycle, not as tough as Brazil but also tough for the amount of provision that we made this year for CorpBanca to put CorpBanca in the same standards as Itau, was a very big one. We do not expect CorpBanca to require at same level of provisions in the coming years. We expect the year of 2017 and more 2018 to be better than, much better than, kind of numbers. So we are very positive about what we are doing in Chile and the team that we have there and the management that we have put in place is very good management both from local people and also from people of Brazil.

So overall, we are very positive about Chile. Colombia or something that is worse than we expected, has more problems. But again, it's a both time and work and we're going to get there. It's a little bit below and behind Chile, I would say in terms of what needs to be done. Chile is more ahead and we have been working more deeply in Chile. And now we have a new CEO for Columbia and we will also work hard and I'm sure that we will put the Bank in the right standard. And the right operational standard, profitable, making more than cost of capital over the years. So we are very positive. But we understand that we have lot of work to be done in those two franchise in the next two, three years.

At this point in time, we are not really considering any additional provisions. We want to prove ourselves that we are able to acquire something out of Brazil and make it turnarounds in order to make those bad acquisitions, Itau class business with ROEs above cost of capital. We have to ensure that we are able to do it, we believe that we can do, we believe that we have people, culture, management skills to expand ourselves out of Brazil but we are not in a hurry, we are not looking for anything at this point in time and we have pretty much concentrated in something around Colombia and Chile. The other question was?

Q - Carlos Macedo {BIO 15158925 <GO>}

On the guidance for provision expenses if you expect or include and there are any consumption of excess provisions?

A - Roberto Setubal {BIO 1525746 <GO>}

Look excess provisions I don't like the way you mention about excess -- provisions, they may according to the level of risk that it is choosing our asset. So we like to have more provisions for the quality of assets that we have and we have the Central Bank rules, we follow them but we like to have provisions for schemes that are not in the Central Bank requirement. For instance, we have provisions for, we challenge -- you're calling excess level provisions for in the retail business, expected losses. So our book in the retail, we have the provisions that are required but we have additional provisions which in the case as against in the page, page 19 we have BRL6.3 billion of retail expected losses provisions.

In the wholesale, we also have additional provisions and these provisions are made according to what we see and how we analyze and how we think about the quality of assets, especially in these very tough environment that we have been living in Brazil last two years. So we do provisions for specific things, even those provisions in addition to what Central Bank requires, we have provisions with (inaudible). So they are there for something that we believe that needed, if something like that we have a provision for a client, which is not best rule on but we might have provisions given the assessment that we do towards the financial conditions. We made provisions even before client might be best do. If this client -- assume that we made a 50% whatever level provision for that client, when it comes to be test do, we have already the provision, we won't do it again. So in terms and this given the Central Bank rules won't be again, in addition to what Central Bank requires.

But it will be a -- I have made before it was thus do so the provision is already there. I won't make provisions again for that client. But on the other hand, I might do provisions for a new client that I see that I mean -- that client might need some level of provisions. Pretty much we -- for instance we have provisions for guarantees, which Central Bank does not require a guarantee today. But Central Bank is changing the rules to increase -- to put provisions also for guarantees, which to date has been do not require. We have already this in our excess.

So this provision is already there. Okay. So we won't do it again. if the -- so this might in terms of excess to Central Bank requirement. Since I have already the provision, I won't do it again. So overall what I'm trying to say is that is, if the dynamic process every month, every quarter, every year, we have things that we provisioned before Central Bank requires needs to do. And I -- but this is a dynamic part -- I'm always doing that. So I'm always a little bit ahead of the curve, giving our policies of assessing risk.

So this is the idea. So this number we do not have a commitment, with the number that is in excess -- so, we were calling about excess provisions. We have commitment about having the consistent policy of provisioning the bank over time in terms of what we believe that the needed provision and this is -- we do not really committed to numbers, how then if is generic, if specific complementary. Because those are requirements of

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Central Bank. We want to have them -- if you have already the right provisions this is the one is important for us.

So we do not have a commitment on that number of BRL10.4 billion, which is in addition to Central Bank requirements.

Q - Carlos Macedo {BIO 15158925 <GO>}

Perfect, fair enough Roberto. Thank you so much and congratulations again.

Operator

Philip Finch, UBS.

Q - Philip Finch {BIO 3252809 <GO>}

Good afternoon, Mr. Setubal, Mr. Bracher. Thank you very much for your presentations. I've got a couple questions as well, please. First is regarding your 2017 forecast you've guided for financial margins with clients to be minus 5% to minus 1.5% in Brazil. Now given inflation is falling faster than expected and this is paying the way for the SELIC to come down more quickly. What is your SELIC assumptions behind this guidance for financial margin and the second question is regarding your capital position? Clearly you're in an extremely strong position, core capital ratio under Basel III fully loaded basis is at 14% clearly among the highest globally. Give in light of the increased payout ratio guidance and even in taking consideration potentially the impact of Citi on Core Capital assuming you get right for approval. What is the optimal level of capital that you would like to run the Bank going forward? Thank you.

A - Roberto Setubal {BIO 1525746 <GO>}

Okay. In terms of capital, we want to be above 12% in terms of core equity Tier 1. Core equity Tier 1 uphold is a minimum level that our Board requires and this is, we want to be a little bit above that. And currently, as you could see we are at 13.2% based on 6 and we are very comfortable with that level. We believe that we can, in the coming year, I mean the Bank is generating this 20% ROE is something that is generating more capital than we can use to be in the banking conditions of the Brazilian economy and giving also the perspective of growth and we get so -- we are very comfortable to increase the payout for the coming years. And we have through this flexibility between 35 and 45 which can -- if you have a higher growth in Brazil or small acquisition, we can accommodate in that range. So there is -- for the coming years -- all the simulation that we have done make us feel very comfortable with that number. Basel IV which is rule out to be an asset we don't believe given the conversations that we have seen that will have an important fact in our numbers. And probably the idea is that we'll be best placed only the next decade. So we have a lot of time to work on that. About SELIC, we are considering SELIC very pretty much as the market considers falling probably to a level very close to 10% by the year end.

Operator

Tito Labarta, Deutsche Bank.

Q - Tito Labarta {BIO 20837559 <GO>}

Hi. Good morning and thanks for the call and congratulations Roberto and Candido over the years. Couple of questions also, I guess first on asset quality, given the guidance you gave on provisions, which are expected to fall significantly this year. What kind of assumptions you have in terms of the NPL ratio, this year, I expect we saw some good improvement in the quarter, you think that level of improvement kind of continues for the rest of the year. And could there be more further improvements in 2018, I just want to get a little more color on the outlook for asset quality and NPLs.

Then my second question is in terms of expenses, we saw a good job on expenses and the guidance continues to call for slow growth in expenses. But just want to get some background behind that's kind of what are you doing to control expenses, your inflation is coming down. So that helps. But maybe also in terms of the digitization of the bank. And as you move towards a more digital platform, is that helping expenses or where do you see the cost control coming from and what you're doing to get there. Thank you.

A - Roberto Setubal {BIO 1525746 <GO>}

Okay. Starting with delinquency, we expect delinquency to improve, I think the 15 days to 90 days encourage us to believe that levels of over 90 days, we will be lower in next year. So we should probably end up the year lower level than we have today. Not that much. But some additional improvements, we believe that's possible.

Although, probably in the First Quarter, we would see as a seasonality, some increase is ever youth to give back, have some increase in the First Quarter, you can see this in page 14. So all the years, we have, especially in the 15 days to 90 days but also in the over 90 days delinquency ratio. We had been increasing in a questionability quarter which is a seasonality of Brazil and some improvements along the -- especially in the Fourth Quarter is, which is also always very positive.

In terms of expenses, yes, we have worked very hard on the cost side of the Bank and I believe that for the coming years as digital starts to takes place more -- we will see expenses of the bank growing below inflation, I think it's something that's kind of target for us, we are putting the effort on best and it's coming along almost naturally giving, especially the demand of clients are moving to digital. So this makes it much easier towards the reduced costs as clients move to digital. And now we are offering more and more digital products and digital services for our clients. For this year, we are -- I mean, last year, transactions in mobile grew more than 30% of the basic for the final number for the year. This year, we believe that's still growing very high ratios, although the overall level of transaction of the bank pretty much stable, given the economy situation. But more and more transactions, all kinds of transactions are becoming digital. So this gives us the perception that when you look long term, we tend to have our expenses to grow less layer than inflation in a sustainable way for many years.

Q - Tito Labarta {BIO 20837559 <GO>}

Thanks Roberto. It's very helpful. Do you know what percentage of your transactions are digital now?

A - Roberto Setubal {BIO 1525746 <GO>}

The way we measure it, about 36%, of overall -- of the overall bank, not only the retail. But also includes all the business that we have. Including for sale and companies and everything.

Q - Tito Labarta {BIO 20837559 <GO>}

Thanks. That's helpful. And if I may, just one quick follow-up on the asset quality. So given what you said in there are some seasonality in the First Quarter and maybe only modest improvements throughout the year. So is there -- the reduction of provisions, is it safe to assume that provisions will come down faster than NPLs as you maybe reduce the coverage ratio? Is that the right way to think about that?

A - Roberto Setubal {BIO 1525746 <GO>}

That's become record (inaudible) I think I gave you the wrong number, 36% of the growth year-over-year, I think the range, the level of the participation of digital transacts about [ph] 20%, coming from 17% of last year. About provisions, again the thing ancillary to before. We do additional provisions to Central Bank requirements, as we perceive risks on the balance sheet.

So we do not have a commitment with the additional provision that we have survival, additional provision that have to be. We have a commitment with good level provisions, according to the type of risk that we perceived in our balance sheet and remember that in complementary allowance, we have provisions for retail is enough provision for expected loss on retail. So as expected loss on retail falls -- that number might falls.

We have provisions for guarantees which Central Bank does not require. But we will start to require next year. So we have a -- so this -- we went back to justify as additional because it will be driven into a required provision. So it's not an addition. But we already did it, we won't do it again because we have already the right provisions for what we need. So basically, we do not have -- so our clients that gets, we have provision today, which are not -- it's above the level of what would be required during the level of best do that it has -- and we have more than what Central Bank requires.

As the client moves into our full best do, we will not do additional provision than the 100%. So if you have already the provision, I mean, it goes, it will move from provision that is today classified it maybe excess into required. So it's a dynamic process. And when we make -- as things get worst, the trend increases provision ahead of the loans we can best do and this is the cycle, I mean we have a policy here generally that would tend to anticipate the level provisions because we have this policy of being provisions in terms of what we expect to be is not necessarily what Central Bank defines as loses.

In 2008 we'll have IRF 9 coming into place and IRF 9 has been the old, we will require expected provisions to be made. So this, we already do these on our additional provision

level, we have expected provisions basically excess provisions. So this concept of what is in excess depends on what is required. So as requirements change and it's changing over time, this number we all maybe to the PAR, be transcribed in a different way. The same provision we move from excess into required.

Operator

(inaudible).

Q - Unidentified Participant

Hi, everyone. Good morning. Thank you for taking my question. I just would like to understand the Bank's view about the delinquency scenario in the industry for this year. Actually I wanted to know if there is any sector of the economy they can disturb this leads of the credit department, I mean by 2016 we were able to see several sectors causing problems on the Bank's balance sheet. And in this year, several certainties remain in the background and it makes sense to believe that some sectors or some segments already have rope around their neck and cannot stand another poor year? So could you share with us some industry or segment of the economy that is on your radar on their maximum caution?

A - Roberto Setubal {BIO 1525746 <GO>}

Our provision that we have in our balance sheet, taking into account the level of losses and in different industries, we don't have average number, we have specific provisions for specific clients for a specific industry. It's very easy understand that companies that have been involved within some scandal in Brazil, probably have a chance of having higher level of losses and today we have been putting up more provisions for these kind of problems. So we look client by client, segment by segment, industry by industry and we do provisions I mean, we do not expect surprises. And by the way, we have had enough surprises in the last six months -- I mean, all the clients that they have the very big problems. Basically all the ethylic clients, as that they are taking other very, very big client, basically the same that they were six months ago. Some of them have deteriorated since then, some others have been able to sell assets and do important things to reduce the leverage. So things are moving and we are looking very closely the quality and the ability of payment of those companies. But basically the scenario has not changed. I think the good news ahead is, the fall in interest rates will be very helpful for those clients who have more leverage, we can see more interest in Brazil in the last six months and probably in this year in terms of international investors coming into acquire subsidiaries of many companies for sale, there is good opportunity.

We had a very record year in terms of M&A last year. And we are heading for this year, again another M&A record in terms of transactions that we are doing, because many companies selling assets could deleverage. So I things still are moving, I think important thing is that, we are not seeing pricing loops. So no surprises in the last six months.

Operator

Carlos Gomez, HSBC NY.

FINAL

Bloomberg Transcript

Q - Carlos Gomez {BIO 15024854 <GO>}

Thank you. Good morning. Two questions, the first one about the economic assumptions for 2018 and beyond, you mentioned that you expect SELIC around 10%. I would like to know what Itau expects in 2018, where you expect forex to be -- we see that we are assuming that BRL3.5 billion of this year. And finally on credit growth, your expectation is for 0% this year, which is low. What type of recovery, should we expect in 2018-2019.

Second, if I could, for the last 23 years, you have been trying to grow or trying to operate in Argentina. And that has proved a difficult market, the bank has start to do organic, has tried to do acquisitions. How do you see Argentina today, has it changed, is it the market that we would like to address.

And finally. And I think on behalf of all the Investor Community, I want to thank you for the last 23 years for full-year results. And for the opening store investors and to the analyst. Thank you very much, it was an example for all of us. Thank you.

A - Roberto Setubal {BIO 1525746 <GO>}

Thank you. Well in terms of economic scenario for the current years, I think that economy is heading for recovery really, we are expecting this for this year of 2016, growth of around 1% and improving as the economy goes into the year. It's slower in the first semester, faster in the second semester and we believe as reforms are approved in the Congress, the political scenario becomes more clear and if we elect a reasonable at President that -- I think the economy could get back with all these reforms 2% or 3% or 4% growth maybe 19%, 20% I think that pretty much possible. This is what I would expect but there are risks in this new trend plus risks in political scenario with Lava Jato investigations and all these.

Second risk is elections for President. So there is some uncertainty in this trend, although in terms of economic policies I believe that we're heading for a much more stable situation, especially because with the approval amendment to the constitution that public spending and private or public spending has to be keep real terms flat for 10 years and then for my 10 year somewhat 10 years. This would give very ball space for populist government I mean if they have to give which is (inaudible) on the constitution, I don't see how much damage can be done if we had a populist President. So I think this is something that it's very important that was because ahead of those there is always risks in Latin America are much smaller today than they were maybe one year ago.

In terms of Argentina, I think that country has recovered a lot big improvement, I think prices are too high today in general stock market prices. The growth with recovery much lower inflation I think inflation still a very big problem in Argentina, when we adjust for inflation and we have this kind of mind here in Brazil, it seems one of as that returns are very, very low in Argentina in general and prices very, very high. So we are not looking for something in Argentina today.

Operator

Jason Mollin, Scotiabank.

FINAL

Bloomberg Transcript

FINAL

Q - Jason Mollin {BIO 1888181 <GO>}

(technical difficulty) is related to your comments on cost of equity. When you spoke about value creation or disruption in the different business segments, you talked about the cost of equity in the 15.5% range, how does the bank estimate this cost of equity and is there a range you can share with us based on different methodologies and what those methodologies may be? And my second question is on the sensitivity of the bank's earnings to the policy rate you talked about, SELIC falling to 10% perhaps by the end of the year. We see with zero, your forecasts or guidance of 0% to 4% loan growth financial margin with clients will actually is -- would fall minus 4% to minus 0.5%. Can you talk a little bit about how the bank is positioned and if there are strategies to alter the natural sensitivity or exposure to rates. Thanks.

A - Roberto Setubal {BIO 1525746 <GO>}

Cost of equity, there are many, many methodologies and what we try to do, we have four or five of them that we follow. We have four or five methodologies and we make sure that we are close to the average of those methodologies and this is what we have been doing. Basically, the methodology have into consideration, the level of the Brazil's risk, the level of stock market risk, the level of interest rates altogether in different methodology takes into account all those factors in different ways. But basically, the traditional way of measuring the cost of equity and we also talk to the market and ask investors and houses of research what numbers they are using to make sure that our number is pretty much in line with what they expect and what they use internally in terms of cost of equity.

Our margin, I mean there are many things that we have mentioned. We are working pretty much according to the number that we are giving here, it's pretty much in line with assumptions that we have made in our budget. It has to do with following SELIC rates, which impacts deposits, it has to do with mix of products, different products going in different ways, has to do with different segments, mix of segments, has to do with -- probably we believe that as the economy improves, as delinquency reduces, probably we will see a reduction in the premium for risk in Brazil -- a little bit of everything altogether, this is the range that we expect for next year.

Q - Jason Mollin {BIO 1888181 <GO>}

Thank you, Roberto and I would just echo all of the positive comments. It's been a pleasure to work with you and the access to the market that you've provided, it really is an exemplary role model for other CEOs in my view. Thank you.

Operator

Jorge Friedmann, Citibank.

Q - Jorge Friedmann

I have two questions, I would start talking about the Central Banks panel to discuss the spreads that was hosted in Brasilia yesterday. So the panel debated distortions that supposedly prevent a more sustainable any [ph] structural drop of spreads such as cross obesities [ph] with your market or directed credits. So how do you see this debate

progressing and in particular do you see the Brazilian financial system and capital markets especially after this credit cycle ready to assume a chunk from subsidized financing from BNDES [ph] for long-term investments and then I come to my second question. Thank you.

A - Roberto Setubal {BIO 1525746 <GO>}

I think very positive that Central Bank is addressing those discussions. It does not contribute for the development of loan market in Brazil. I think we have managed portions and it's very important that they are addressed by Central Bank and we try to solve many of those points. Spreads are very high in Brazil for many reasons and I think this is open discussion, it's very positive and at the end of the day, I come back to answer your question about, well what about reduction in spreads and margins and so on and so forth.

First of all, we are a very broad diversified financial company. So we do not depend on a specific product or a specific segment. We are very, very diversified. So if we have a broad measure [ph] that might affect one business or another. But overall it's very positive, it will be very positive for the Bank and I believe that the agenda is very positive overall and we can go ahead and (inaudible), it will be very positive for the system and then I come back to my screen of business models where I show the ROE in credit business. Look, if we do not create an environment that make credit business have a return at least on the average of both cost of capital, we won't have credit in Brazil. So it's important to (technical difficulty) to develop credit in Brazil and I believe that it's very clear for authorities (inaudible) and everybody agrees that we need more credit, we need better credit in Brazil and all those changes that we can make the system that improves has to take into account that the capital allocated to that business has to have a return. I mean we have to reduce distortions, avoid distortions and I think this agenda overall is very positive.

BNDES for many years especially in the previous government was trying to push growth in Brazil by offering subsidized loans for investment and this strategy did not work out clearly or not positive for Brazil, it did not really make any contribution to investment in Brazil, the numbers clearly show that and basically what it has managed to put big confusion in the public numbers, the fiscal numbers of Brazil that are still being impacted by the subsidies that were given in those loans. So I think that as long as we bring out, we reduce distortions. And we take distortions out, this will be very, very positive overall for the system, for banks, for investment finance, for everybody and be very positive (inaudible).

Q - Jorge Friedmann

Thank you for the very comprehensive answer, Roberto and my second one is very quick. Could you please provide us with some color about how you believe the line with minorities should evolve this year for us to close our models? Thank you.

A - Marcelo Kopel {BIO 16986304 <GO>}

It's Marcelo speaking. Yes, we can take it offline because it's a combination of multiple businesses we have. But we can take it offline with you.

Operator

No problem, that's perfect, I really appreciate taking my questions and congratulate Roberto Setubal. Thank you.

(inaudible).

Q - Unidentified Participant

Hi. Good morning, thank you, for, for taking my question and congratulations for the results. My question is just one regarding regulatory changes that has been impacting the industry for several months now from tax increases to discussions of reduction of the payment cycle to retailers spreads, lower spreads for credit cards et cetera, just want to know in your view, what's the position of Itau regarding these changes. Some of them are negative but I guess you have a different view on how the credit card for instance should go going forward. Could you share with us your thoughts on that. I appreciate it. Thank you.

A - Roberto Setubal {BIO 1525746 <GO>}

Well I think that our credit card industry in Brazil, which has developed a lot in Brazil is very important for consumption level in Brazil. It represents more than 15% of GDP sales gone through to [ph] the credit card industry. So it's very important and very delicate issue and we have to be very careful in dealing with those things in Brazil.

I think that the Central Bank is pretty much aware that we have to find out solutions that improves the industry, solutions that make the industry more efficient in general and this I think is very clear in the agenda of Central Bank. So it's an agenda to making the industry more efficient and more competitive and we agree on that.

This might affect different points of the exchange [ph]value of payments. In Brazil, we have, I mean the starting with issuer going through the deal of the brands and also the companies' commercial accounts with us associated with some brands of credit card. So there is a lot of people including the acquirer in the value chain of payment in Brazil. And we have some distortions in the point of acquiring value chain, basically distortions that come from the old times of very high inflation in Brazil and these distortions are still in place and the most reasonable one is the fact that we have in Brazil, you can go in a shopping center and buy a shirt in 10 installments with zero interest and on the other hand, through the same instrument, which is a credit card, you can -- you have a very high interest rate on your revolving credit, a lot of distortions. One is clearly subsidizing the other. If we take from our numbers, just to give you an example, our average interest rate among all the receivables that we have on the credit card industry is much below the average rate of personal credit. So on the average, the interim is fine. But there's a lot of refinings [ph] in terms of -- it's not a high level of interest rate compared to other products in the view. But the problem is that the distortion comes from the fact that (inaudible).

So we have to reduce the level of distortions and this is what Central Bank is trying to do without reducing the level of credit that is offered by the industry, without reducing the usage of credit in Brazil in general. So it's very delicate because it's a big industry. I think

at the end some points of the value chain might be affected more than others to reduce those distortions. I think these things have to be done over the time, you cannot do it all of a sudden.

We see things in my view, compensate each other. So at the end, we believe that the business should be a profitable business with different revenues coming from -- in a different way than it is today. Today, a very, very chunk comes from the revolving credit, this will reduce. But we believe that over time we will be able to compensate that through other fees, commissions so that at the end of the day, the total revenue comes from the total industry (inaudible) pretty much in line with the levels of profitability that is required, given the level of capital that is allocated to that business.

Q - Unidentified Participant

Thank you, very comprehensive answer. And so at the end, if all these changes take place, maybe we have a system like very light outside, like in the United States for instance where volumes are higher and maybe you can make more money on the volume side and fees and other lines of business, right? That's more or less the concept.

A - Roberto Setubal {BIO 1525746 <GO>}

That's the idea, exactly, we are discussing with Central Bank, we are trying to make contributions to the discussions exactly bringing examples from what is the business in the US, how important it is and how is the pricing dynamics different from Brazil and I think this will have some influence probably in the way -- the international experience will have influence clearly in reducing the distortions that we have today in Brazil.

We believe that, I mean, by the way in our guidance this year, we simulated some of these changes already taking place this year and our guidance pretty much affords those changes in general. At least, they are in line with what we expect them to be.

Operator

This concludes today's question-and-answer session. Mr. Roberto Setubal, at this time, you may proceed with your closing statements, sir.

A - Roberto Setubal {BIO 1525746 <GO>}

Okay. Thank you very much for the questions. Thank you for being with us through this format [ph] of this presentation. We are very positive about the future of Brazil, cautiously positive [ph] about the future of Brazil since we are improving definitely compared to what we were in the last two years and the Bank is in very good shape, pretty much capitalized and provisioned. So we see a lot of space to grow in the coming years. So we are very positive about what lies ahead. Thank you very much and see you around.

Operator

That does conclude our Itau Unibanco Holding earnings conference call for today. Thank you very much for your participation. You may now disconnect.

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