# Q4 2017 Earnings Call

## Company Participants

- Candido Botelho Bracher, Executive President and Chief Executive Officer

## Other Participants

- Carlos G. Macedo, Analyst
- Carlos Gomez-Lopez, Analyst
- Eduardo Nishio, Analyst
- Jason Mollin, Analyst
- Jorge Kuri, Analyst
- Philip Finch, Strategist
- Rafael Frade, Analyst
- Tito LaBarta, Analyst

## MANAGEMENT DISCUSSION SECTION

### Operator

Good morning, ladies and gentlemen. Welcome to Itaú Unibanco Holding Conference Call to discuss 2017 Fourth Quarter Results. 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. As a reminder, this conference is being recorded and broadcasted live on the Investor Relations website at www.itau.com.br/investor-relations. The audio webcast works with Internet Explorer 9 or above and Chrome, Firefox, and mobile devices iOS 8 or above and Android 3.0 or above. A slide presentation is also available on the site.

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 São Paulo are Mr. Candido Bracher, Executive President and CEO; Mr. Caio Ibrahim David, Executive Vice President, CFO, and CRO; Mr. Alexsandro Broedel Lopes, Group Finance Director and Investor Relations Officer. First, Mr. Candido Bracher will comment on 2017 fourth quarter results. Afterwards, management will be available for a question-and-answer session.

It is now my pleasure to turn the call over to Mr. Candido Bracher.

## Candido Botelho Bracher {BIO 3158644 <GO>}

Good morning and thank you for listening to our 2017 earnings conference call. Before we go into our key financial figures and performance; I'd like to spend a few minutes on slide 3 to talk about our medium and long-term strategic agendas. As you may remember, in previous quarters we outlined six objectives in order to increase the value creation to stakeholders. In this quarter, we have segregated those objectives into two groups, the transformation group and the continuous improvement group. When we talk about transformation, we refer to client centricity, digitalization, and people management. These are aspects that we believe we need to truly transform within the organization. When we talk about continuous improvement, we are referring to risk management, internationalization, and sustainable profitability. These are aspects that are broadly embraced by the organization but that we should continuously strive to improve.

And permeating and enabling all those objectives are our corporate governance and sustainability. Corporate governance as you know plays a vital role in enforcing stakeholders' interests and is key to achieve long-term sustainable growth. It is embedded not only on the objectives we disclosed here but also in each part of our daily business activities, from remuneration practices to risk management. Our view on sustainability is that it needs to be fully integrated with our business in the operational aspects and also in the commercial ones, making environmental and social issues part of our everyday activities. Its variable need to be incorporated and measured into each of our diverse processes such as credit ranking, investments, insurance activities, contracting of suppliers, and wealth management.

We will repeat this agenda annually and update you on recent developments since this is a multi-year agenda. Nevertheless, we are always available to discuss it in our interactions during the year since we see this agenda as a fundamental test of the management team. I'll be happy to answer questions on this agenda as well at the end of this call.

So if we move to slide 4 now, here we highlight the key performance figures from our fourth quarter results and also for the full year 2017. We have posted BRL 6.3 billion of recurring net income in the quarter. For the full year, our recurring net income of BRL 24.9 billion, which resulted in an increase of 160 basis points in our recurring ROE which reached 21.8% in the year. Although we could deliver earnings and returns expansion in the year, 2017 was a very challenging period with declining rates, credit growth still lagging, and lower overall volumes and transactions in the economy than we had originally expected. You all remember, I mean, the political events in May which somehow frustrated the recovery which we were seeing then. Nevertheless, we ended the period on a good note, with unemployment rate already going down, inflation under control, and overall activity in the economy slowly but steadily improving.

And when we take a more detailed look at our results, they are a direct reflection of this environment and also of successful implementation of our strategy. Therefore, we have presented lower financial margin with clients mainly due to the impact of the lower Selic in our liabilities margin and remuneration of our capital and also due to lower credit swaps. These lower financial margins were more than compensated by lower delinquency ratio, which in turn led to a substantial decline in the cost of spread and also by the increase in commission and fees and strict cost control which led our non-interest expenses to grow way below inflation. I'd also like to remark that our Brazilian operation continues to be the main driver behind our earnings growth, with an increase of 13.5% of its recurring net income in 2017.

Finally, I'd like to make some comments about our Latin American operations. The results for 2017 showed a contraction of 13.6%. This is mainly due to the performance of the Itaú CorpBanca. As I mentioned in the previous quarter, we saw a more difficult than expected market economic scenario and the natural challenges of a merger of this size impacting the profitability of this operation. Nevertheless, I'd like to highlight that we see operational improvements, with a good evolution on the integration of our clients, branches, systems, and teams. We are working to bring gradually the profitability operations through the levels we believe it can deliver sustainably.

Moving to page 5 now, we show here the evolution of our net income and ROE over the past eight quarters. When we focus on our recurring figures, you can see the sustainable evolution of our net income and ROE over the last two years.

On slide 6, we present our business model chart. In this chart, as you remember, we break down the consolidated income statement between income in operations that bear credit risk, including its related fees, income from trading operations, income from insurance and services, and excess capital. Also, the insurance and services business lines continues to be the main driver behind our value creation, and this is in line with our objectives. This income represents 54.1% of the total recurring net income.

I'd like to highlight with pleasure that the credit business created value for the first time since 2014. You can see here on the second column, I mean, the credit business with an ROE of 14.3%, which is above the cost of capital. We now estimate our cost of capital to be at 14%, and it has created in the past year BRL 100 million of value for the first time in a long period. We expect this trend to be a sustainable one for the coming periods.

On page 7, we look at our credit portfolio, and here we notice satisfaction that the total credit portfolio resumed growth this quarter, with a 3.2% increase in the period. And this growth was mainly driven by our individuals portfolio and also by our very small, small and middle market loans. For individuals, the credit card portfolio grew 10.3% in the quarter, helped by seasonal effects but also by higher economic activity and increase in our client base. Also notable is our car financing book, which posted a 1.4% increase in the quarter. This was the first increase in the car financing book since December 2011. The increasing demand for credit and retail and also in the small and medium companies allows for positive expectations regarding portfolio growth in 2018.

On slide 8, we present our net interest margin and also the impact in our fourth quarter financial margin with clients when compared to the previous quarter. Our gross net interest margin contracted 20 basis points as a result of the lower Selic rate and its impact in our liabilities margin and our own working capital. These effects were partially compensated by structure operations in our wholesale bank and by a change in our credit mix by our higher using products (11:01).

On slide 9, let's talk about our margin with the market. We had a positive quarter, with an increase of 5.3% when compared to the third quarter. And we reached in the year BRL 6.3 billion, a decrease of around 10% on a year-over-year comparison. As we had anticipated in previous conference calls, this decrease is related to the lower Selic rate impact in our assets and liabilities management, and we expect this trend to continue in 2018.

Moving to slide 10, credit quality. Here we see an improvement in our delinquency ratios both in the non-performing loans 90 days and in the non-performing loans 15 to 90 days. The improvement in our total NPL 90 days continues to be driven by better credit quality ratios in our individuals and SMEs portfolios in Brazil. On the 15 to 90 days NPL, we also see improvements in the quarter led by individuals and SMEs portfolios in Brazil, which reduction was more than enough to compensate the usual volatility in the corporate segment which, in this case, is due to a single name (12:28) for which we have already have provisions. The NPL 90 days of our Latin America operations presented a 10 basis point increase mainly in the individuals portfolio, both in Chile and in Colombia.

On slide 11, we present the evolution of our NPL creation. Our total NPL creation decreased for the fifth consecutive quarter and reached its lowest level since March 2014. This improvement was led by a significant reduction in the NPL creation for the retail banking portfolio in Brazil.

Now on slide 12, we present evolution of our provisions for loan losses and cost of credit. We had a small increase this quarter from 3.6% to 3.7%, and it's mainly related to two different events. The first one relates to a few corporate clients in Chile that we do not expect to be repeated in the next quarters. And the second relates to January provisions resulting from the growth in the individuals portfolio in the quarter in Brazil.

On page 13, we show our total allowance by type of risk remaining quite stable at a level of BRL 36.7 billion.

Now we come to page 14, coverage ratio. And here once again, I am bound to explain why it is so high and why it is not reducing fast. Although, we are convinced that it will go down over time, this movement may take a while. As I have explained in previous quarters, the current high level of our coverage is a result of the growth of the renegotiated portfolio which occurred during the years of the economic recession. These renegotiations, they provoke a lengthening of the recovery period, and therefore they require to carry provisions for this exposures for a longer period.

As mentioned in the past, what will cause this rate to drop is one of two things. Either the companies, for which we have made precautionary provisions, actually default and these provisions are moved to the regulatory provisions so the non-performing loan rate increases and the coverage ratio decreases with no impact in our results because the provisions are already there. Or on the contrary, these companies for which we have precautionary provisions, they improve and we are able to revert the provisions. In this case, also the coverage ratio decreases and with a positive impact on our results. However, in the short-term, it may happen that none of these two things materialize. Neither the companies default nor they improve to a point in which we can reverse the provisions. And if we couple these with the continuous decrease in the 90-day NPL, we could even have a temporary increase in the coverage ratio. This is what's been happening in the past quarters.

On slide 15, we see that commission and fees increased 5.2% in 2017 when compared to the previous year. This growth was mainly led by the good performance of our asset management fees in line with the solid growth of our assets under management in the period and also by the advisory services and brokerage fees, investment bank, where we saw a 38% growth mainly related to our M&A performance, debt, and equity capital markets which were quite active throughout 2017. Page 16, we look at our non-interest expenses. And comparing with the year ended in December 2016, non-interest expenses increased only 0.3%, way below the accumulated inflation for the period. This we think is a reflection of our digital strategy and our efficiency approach.

Now on page 17, we talk a bit about payout, and I'd like to remind you of what we divulged in September concerning our payout practice. So in September 2017, we announced changes in our capital management practices aligned with our value creation strategy.

First, we excluded the maximum payout limits that used to be 45% and maintain the practice of paying dividends and interest on capital of at least 35% of net income.

Second, and this is more important, at the beginning of each cycle we will make an analysis taking into consideration the forecasted – our results in the period, the minimum level of Tier 1 Capital, which must be at 13.5%, and also the expectations of capital usage based on business growth, share buyback programs, mergers and acquisitions, and regulatory changes that may change capital requirements. Therefore, the percentage to be distributed may change every year based on profitability and capital demands. So the percentage of capital distributed, just to make it clear, will be the necessary distribution to keep the core equity Tier 1 level at 13.5%. It is important to highlight that, first, we do not intend to have capital surplus in excess of this level of 13.5% without the prospect of using it, and any possible surplus will be returned to our stockholders.

Consistent with that, we move now to page 18 where we see that that we finished 2017 with a Common Equity Tier 1 capital ratio of 15.5%, already on a fully loaded basis; that means anticipating all of Basel III effects. Now if we consider the additional of our – if we consider the approval of the additional Tier 1 we have just issued and the capital needed for the acquisition of a minority interest in XP Investimentos, our Tier 1 capital is 15.3%. So in order to bring our Tier 1 capital to the ratio desired of 13.5%, which is the minimum level set by the board, we will pay on March 17 an additional dividend of BRL 13.7 billion.

On page 19, we see how the payout practice and our capital management impacted our shareholders' remuneration. So in 2017 we will have distributed to our shareholders BRL 17.6 billion as dividends and interest on owned capital, and BRL 3.1 billion through the acquisition of our own shares. These all added together represent a payout ratio of 83%. This payout ratio translates into a dividend yield of 8% in average in 2017.

On page 20, I will compare our 2017 forecast to what we actually delivered, and I will focus the analysis on the consolidated figures on the left. So starting with our credit portfolio, we ended the year below the quarter since the growth in the fourth quarter was good but was still insufficient to reach the bottom of the guidance, so we were 0.8% below the bottom of the guidance which was given. Our financial margin with clients was also below the forecast range as a result of the lower credit growth in the year, besides the fact that Selic rates were even lower than we had anticipated. So here, I mean, we had a reduction of 4.7% when the bottom of the range of 4.2%.

For cost of credit, as mentioned last quarter we ended the year around the top of the range, slightly below the top of the range at BRL 17.9 billion. And then there are two items here where we missed our guidance but we missed for the better, so this is why it's painted with blue here instead of with red. For commission and fees and result from insurance operation, we grew 5.2% and finished the year above the top of the range mainly due to the strong fourth quarter in fees which, in turn, was a result of the increased economic activity seen in the period. And to finalize, non-interest expenses, we had an increase of 0.3% in the year, which was a performance better than expected and below the bottom of the range, which was at 1.5%.

Now coming to page 21 to our forecast for this year. So I will also focus on the consolidated figures here. For the credit portfolio, we expect a growth between 4% and 7%, which should translate in a range between minus 0.5% and plus 3% of our financial margin with clients. We expect the financial margin with the market to finish 2018 between BRL 4.3 billion and BRL 5.3 billion. Our cost of credit should continue to decline and we expect it to ramp 2018 between BRL 12 billion and BRL 16 billion. For our commissions fees, and results from insurance operations, our forecast is a growth of between 5.5% and 8.5%. We expect to continue delivering our non-interest expenses growing below inflation, with a range between 0.5% and 3.5%. Lastly, we expect our effective tax rate to be between 33.5% and 35.5%.

So with this, I conclude the presentation and we can go now to the questions you may have.



# Q&A

## Operator

Ladies and gentlemen, we'll now begin the question-and-answer session Our first question comes from Tito LaBarta, Deutsche Bank.

## Q - Tito LaBarta {BIO 20837559 <GO>}

Hi. Good morning. Thank you for the call. A couple of questions I guess particularly on your guidance. First on your margins. It does indicate a slight margin compression this year, but trying just to understand what do you think the margin compression will be or when will you have realized the impact of lower interest rates completely? In other words, like when do you think the margin stops declining? Then second question in your guidance for provisions. Further improvements this year, does indicate the cost of risk could likely fall below 3%. How sustainable do you think that level is? I mean, does that include or does that factor in maybe some working out some of the renegotiating loans which you mentioned which could improve the coverage or does that not factor that in? So just trying to get a sense of the sustainability of the cost of risk at these levels beyond this year. Thank you.

## A - Candido Botelho Bracher {BIO 3158644 <GO>}

Thank you for the question Tito. So first on margins. So we believe we may still have one or two reductions in the Selic rate this year. One this week, another 0.25%, and maybe one next month. Not so sure about the second one. Though the one this week looks a bit more probable of happening. So when this process is over, I think it will still be maybe a quarter until the full impact of the interest rate reduction is felt on the margin. Of course, I mean, as I said in the guidance, we expect this effect, which is mainly on our liabilities margins than in the credit margins as effect of the lower Selic, we expect this to be compensated by our growth in assets, which will increase the margins.

Now your second question on provisions and how sustainable this is. I mean, the reduction and the cost of credit below 3%, I think it is sustainable. Of course, I mean, this year we may have some help in a moment or other of clients for which we have already provisions in which companies may recuperate, but we also have still negative effects this year from the large renegotiated portfolio during the crisis. I mean, when I remember the normal years, I mean, before the crisis of 2015 and 2016, I think, I mean, we had a cost of credit of around this level which we are forecasting. So I expect this to be a sustainable trend in normal years.

## Q - Tito LaBarta {BIO 20837559 <GO>}

Thank you, [Foreign Language] (27:51). Thank you.

## A - Candido Botelho Bracher {BIO 3158644 <GO>}

Thank you.

## Operator

The next question comes from Jorge Kuri, Morgan Stanley. Mr. Jorge Kuri?

## Q - Jorge Kuri {BIO 3937764 <GO>}

Yes. Hi. Good morning, everyone. Let me do a follow-up on the question on provisions. The range on the guidance is quite wide. There is like a 33% gap between the low and the high-end, which is almost 2x the range that you had in 2017. So I'm trying to understand what is it that you're thinking on both sides? What macro conditions and operating conditions would lead you to that BRL 12 billion and the same goes for the BRL 16 billion? That's my first question.

## A - Candido Botelho Bracher {BIO 3158644 <GO>}

Okay. Thanks for your question, Jorge. I mean, as a matter of fact, I mean, it appears a bit more difficult to forecast the provisions this year than it was last year. Of course, it's always easier to speak, I mean, after the fact. This year, I mean, the main effects which provokes volatility in the provisions beyond the normal effects of economic activity and how does it may affect the individuals portfolio is still related to the corporate portfolio.

We have a large renegotiated portfolio on the corporates and there are companies which can improve and provoke a reversion in their provisions and there are others which have renegotiated credits and are still in a difficult situation that may be coming in every year and so on and thus even requiring more provisions. So I mean this is what causes the volatility and have indicated to us this interval which you correctly point out that is larger than it was last year.

There's another effect also which is just as important as this large credit portfolio which is how much our portfolio will grow. And in between 4% and 7% growth, it will mean a very different need to make new provisions for the growing portfolio. This also impacts our forecast.

## Q - Jorge Kuri {BIO 3937764 <GO>}

Thank you, Candido. And then my second question is on spreads. There was a relatively good ability of the banking system to defend spreads last year in the face of falling Selic rates, and that probably had to do with the lack of competition and then just your desire to try to offset some of the negative pressure on your securities portfolio as rates came down. As we move now a year into having low rates and you start to get a little bit more competition, the credit markets starts to pick up, the customers start to ask for lower spreads given that rates are now low for long, what is your expectation on the credit spreads throughout this year?

## A - Candido Botelho Bracher {BIO 3158644 <GO>}

Okay. Thanks, Jorge. As you see in our chart on page – business model on page 6, we have last year, I mean, barely meet our cost of equity in the credit. So, I mean, despite the facts that we are defending our cost spreads, only now the credit activity has been able to generate to create value. So I think this is a natural factor in resisting through a pressure to lowering spreads. I think what's true for us is true also for our competitors. I don't think no one is making a return much above cost of capital in credit. And what we have seen is relative stability in credit spreads. We believe that there will be some increase in demand, and that this will also help to support the spreads around the level they are today.

## Q - Jorge Kuri {BIO 3937764 <GO>}

Sorry, Candido. The connection is not great. So you said you expect credit spreads to be flat this year?

## A - Candido Botelho Bracher {BIO 3158644 <GO>}

Yes, I expect them to be flat this year.

## Q - Jorge Kuri {BIO 3937764 <GO>}

All right, great. Thank you.

## A - Candido Botelho Bracher {BIO 3158644 <GO>}

Thank you.

## Operator

The next question comes from Philip Finch, UBS.

## Q - Philip Finch {BIO 3252809 <GO>}

Good morning, everyone, and thank you for the presentation, Mr. Bracher. Two questions from me, please. The first is regarding the competitive landscape, if you could just give us an update on that. And would you say the outlook still looks benign or are you seeing signs of rising competitive pressures, and if so in what segments? And possibly linked to this, are you seeing any signs of disruption with increasing technological advancements in Brazil at the moment? And the second question is slightly related to this. Can you give us an update of your digital offerings? What percentage of your customer base are now using digital mobile banking and does this pave the way for more branch closures? Thank you.

## A - Candido Botelho Bracher {BIO 3158644 <GO>}

Thanks for your questions, Philip; they are broad. Let me first talk about competitive landscape. I mean, we have never seen much ease on the competitive landscape. I think we have always lived in an intense competition in Brazil with the banking systems. In some areas more competition than in others, but in general I think it's quite a competitive market. We expect it to remain this way in 2018 and we are not seeing this becoming neither tougher nor easier for this (35:12).

And in times of disruption, you asked, I mean, there are always news here and there and we see new companies appearing with new products every day in many parts of the market. I mean, this is the case of XP, a discount broker in which we – where we acquired, we are in the process of acquiring a 49% stake. This is the question; it is also the case with some companies in the acquiring business. You just see this in the IPO of Banco Seguro (35:57) in this segment, but I don't think these are disruptive companies. I mean, this is more competition in markets where we already operate with different strategies. But of course, I mean, we are seeing here in the market every day, I mean, news of new products and more use of digital products.

In our case, I mean, there are many numbers you can use to talk about digital. Even if you refer to our own bank, a number which is simple to memorize, and as we always say, that, I mean, 80% of the transactions that customers do with the bank are through mobile or Internet. Of course, when we look at this figure, it indicates a better picture than the one we actually have because not all of the transactions which the clients do digitally with the bank, they go digitally end-to-end in all the processing. So our efforts now are very much geared towards digitizing more and more our operations area, our back office.

If I can quote to you some other important figures here, we have over 2 million clients in our digital branches. And this digital branch, over 2 million of account holders in a total of 18 million account holders. And these branches have a 20 to 30 percentage points, they are more efficient than the normal, the regular brick-and-mortar branches. And there are many other figures I could go through here. I mean, 9.5 million users using mobile bank line and SMS and things like these. But, I mean, the picture is the same in with all the figures I gave you. So intense effort to digitize. In the first page of the presentation, I mentioned our strategic goals and the transformational ones. And one of the transformational one is exactly, I mean, our digital strategy which has been, I mean, the object of intense attention of the executive committee.

## Q - Philip Finch {BIO 3252809 <GO>}

Great, thank you Mr. Bracher. So with the impressive improvements in digital, do you expect to see more branch closures going forward?

## A - Candido Botelho Bracher {BIO 3158644 <GO>}

Not immediately. We have closed 280 branches in the past two years. When we analyze now looking forward, we didn't find many branches below the line in which we consider a branch economic, and this mainly because branches are still very important in opening new accounts. So what we are studying very intensely here is the new uses of branches, is how to transform our branches to adapt them to the new times. This is taking more our attention than the push to close down branches.

## Q - Philip Finch {BIO 3252809 <GO>}

Okay. Thank you very much indeed, Mr. Bracher.

## A - Candido Botelho Bracher {BIO 3158644 <GO>}

Thank you.

## Operator

The next question comes from Jason Mollin, Scotia Bank.

## Q - Jason Mollin {BIO 1888181 <GO>}

Hi. Thank you for the opportunity. I have two questions. My first question is on your business model breakdown and looking at the returns by business segment. And yes, you mentioned the first time we've seen value creation in the credit portion of the business. Looking at how you analyze that in this slide again, it looks like you're calculating the cost of equity very close to that return because the value creation is slightly positive, therefore my calculation about 14.1%. And then overall in the consolidated basis for the year, if you just take the regulatory capital of the value creation, it looks like you're calculating a cost of equity close to 14.9%, 15%, and that is a little higher. It's interesting if we take the nine months mid-year that you gave us after the last quarter, that's up a little bit from 14.6%. I'm just wondering what that reflects. Does that reflect a higher cost? It looks like it's coming from a higher cost of equity in the trading side to the end of the year. So I'm just trying to understand that I would have thought with lower rates that might not be the case; it might actually be lower. That's my first question.

## A - Candido Botelho Bracher {BIO 3158644 <GO>}

Jason, your question is correct. You are very observant. I mean, as a matter of fact, we have internally three costs of capital. We have a main cost of capital which we use for everything, and is the one we use for credit. Then we have a cost of credit which we use specifically for operations bearing market risk for trading, which is higher than the cost of credit. And we have a cost of credit we use for service operations, for operations we have no credit, no market risk, and this is a cost of credit slightly below the average which is now 14%.

## Q - Jason Mollin {BIO 1888181 <GO>}

And would you consider the cost of credit in the current environment given where Selic is and given where the 10-year government bond, you think is this on the low end? Have we reached – looking out for the next year or so, is this kind of where you think it will remain?

## A - Candido Botelho Bracher {BIO 3158644 <GO>}

Listen, the 14% I refer is the cost of credit at the end of the day. Today, it's already 13.5%. We have reduced it in our last board meeting last week. We think it is coming close to the best point in the curve. I mean, when we compare the cost of credit in Brazil to the cost of credit we see you analysts using in developed markets, we think it's not likely that the spread will narrow much further than it already is.

## Q - Jason Mollin {BIO 1888181 <GO>}

That's helpful. And my second question would be on the regulatory outlook or potential changes. We saw a shift from credit card loans, revolving credit cards, a push to move those into installment credit. Are you anticipating any other changes that could materially impact your results?

## A - Candido Botelho Bracher {BIO 3158644 <GO>}

Listen, Jason. These changes on credit cards, they effectively impacted our results, and the effect on 2018 will be a bit bigger than in 2017 because they were not there for the full year of 2017. Some of them have started in April, some of them have started in August 2017. So in 2018, we will have them for the full year. There are some discussions ongoing with the Central Bank concerning overdraft, and there is a self-regulation in this, by the banks. And this self-regulation, I mean, it may lead to some reduced usage of overdraft, but it's too soon to tell.

## Q - Jason Mollin {BIO 1888181 <GO>}

Thank you very much, Candido.

## A - Candido Botelho Bracher {BIO 3158644 <GO>}

You're welcome.

## Operator

Our next question comes from Rafael Frade, Bradesco.

## Q - Rafael Frade {BIO 16621076 <GO>}

Hi. Good morning, everyone. I have a follow-up question on the provisions for guidance. So just to be more clear, so it's reasonable to expect given all that you mentioned that eventually we will have provision expense below the NPL ratio for the year given that you have or had some cases that were provisioning even in 2017 or even 2016. So how we should expect this evolving throughout the year? Another question would be related to fees. I'd say I was a little surprised. It seems a little strong to me. If you could give a little more visibility about the year, is there any specific line that maybe will lead for this growth? Would be very happy.

## A - Candido Botelho Bracher {BIO 3158644 <GO>}

Okay, thanks for the questions, Rafael. If I understood well your first question regarding provisions, you asked me, I mean, is it possible that your total provision will be below NPL creation this year because some credits are already provisioned for.

## Q - Rafael Frade {BIO 16621076 <GO>}

That's right.

## A - Candido Botelho Bracher {BIO 3158644 <GO>}

I think, yes, it is possible. I don't think it's certain if a reflection on that will be our coverage ratio. What I can tell is that we do not expect significant changes in our coverage ratio this year. So if you go down a little bit the coverage ratio of course, as I said in the slide, but it is not a significant change. So I think you asked, so you're right. I mean, it's possible that we have the provisions this year below NPL creation.

Your second question on fees, let me just go here to our fees forecast. So we are forecasting a growth from 5.5% to 8.5% in 2018 after having shown 5.2% in 2017. I don't think this is such a difficult increase since during the year 2017, we saw a constant improvement in this trend, which we expect to continue during 2018. Of course, 2018 is an election year. So specifically for the investment banking fees, I think that the second semester may lag a bit. But as for all geographies, I mean, asset management, cash management and so, we are seeing, I mean, the increase in demand which are consistent with this forecast.

## Q - Rafael Frade {BIO 16621076 <GO>}

Okay. That's perfect. Thank you, Candido.

## A - Candido Botelho Bracher {BIO 3158644 <GO>}

Thank you, Rafael.

## Operator

The next question comes from Eduardo Nishio, Banco Plural (sic) [Brasil Plural].

## Q - Eduardo Nishio {BIO 15333200 <GO>}

Hi. Thank you. Thanks for the presentation. My first question, I have two, is related to your financial margins with clients. If you can give more color on how do you want to achieve? Basically you have a positive range, and we see some peers with negative guidance for 2018. Obviously your credit growth will help. But looking to your peers also, they have the same range, positive range for the year. So if you can break down a little bit and give us a little more color on how you can achieve that positive range, I'd appreciate. Then I have my second question. Thank you.

## A - Candido Botelho Bracher {BIO 3158644 <GO>}

Okay, Eduardo. I think I don't have much to add to what you already mentioned. I mean, the improvement in financial margin with clients is a direct consequence of the improvements in total credit portfolio. Seeing that, I mean, we expect credit portfolio to grow more in individuals and SMEs than in large corporations. And as you know, individuals and SMEs carry a better spread than large corporations.

## Q - Eduardo Nishio {BIO 15333200 <GO>}

Okay. And the Citibank also helps that? I mean, the growth?

## A - Candido Botelho Bracher {BIO 3158644 <GO>}

Yes, the Citibank also helps the growth but it's very small.



## Q - Eduardo Nishio {BIO 15333200 <GO>}

Okay. Then my second question relates, and sorry to go back to the cost of credit and your provisions outlook, you're reaching a historical low now with provisions over your loan portfolio of 3.7%, historical low. Also, cost of credit also historical low. Just give a ballpark number of how much you think it can normalize, it's far beyond this 2.9% or it's around that number? More color here I think it will be greatly appreciated. Thank you.

## A - Candido Botelho Bracher {BIO 3158644 <GO>}

Okay, Eduardo. I don't have the full series of our NPL here with me, but I don't think this is a historical low. If I come back to the years before the crisis of 2008, I think we had much lower, way lower figures than 2003, 2004, and 2005. But I can't affirm just because I don't have the figures here with me. Having said that, I think, I mean, it's a different environment today, it's a different Bank. We see this level of 2009, 2008 a level around which we can stabilize the cost of credit.

## Q - Eduardo Nishio {BIO 15333200 <GO>}

Okay. Thank you.

## A - Candido Botelho Bracher {BIO 3158644 <GO>}

Thank you.

## Operator

Our next question comes from Carlos Macedo, Goldman Sachs.

## Q - Carlos G. Macedo {BIO 15158925 <GO>}

Good morning, Candido. Thanks for taking the questions. First question, I just wanted to get an idea. You said that you expect spreads to remain steady through the year. If you could talk a little bit qualitatively about the spreads on your front book and your back book, so the spreads at which you're originating loans now compared to the spreads that were in your book, say a year or two years ago. How does that relate? Are they lower now? I mean, can you help us to get an idea of what could that be (51:36) going forward as you originate more loans in an environment with a lower benchmark rate?

The second, again I'm sorry, much like Nishio before, to go back to this question. I'm looking at the historical loan loss provision to average loans here and the cost of credit, and it's never dipped below 3% going back to 2004. So the question is, again, how sustainable this is? Is this a factor of you using part of your X reserves to offset some of your clients demanding more coverage? How should we think? And you talked about the coverage ratio not going down, so does that really just means that your asset quality is going to stay very solid the whole year, improves throughout the year, as expected? I mean, how should we think about this overall given the big picture of Itaú and the mix of the portfolio now?

## A - Candido Botelho Bracher {BIO 3158644 <GO>}

Thanks for your questions, Carlos. Let me first go to spreads. If I compare the spreads we are using today with the spreads of two years ago, which were during the crisis, for the same types of credits the spreads are positively a bit lower today than they were two years ago. Having said that, we must see that we are changing the mix of our portfolio, we have been changing the mix of our portfolio. And in this sense, I mean, we have been reducing the portfolio in the large corporations where the spreads are lower and increasing in individuals and SMEs where they are higher. I mean this movement in the mix, I think that may more than compensate the reduction in the same line of cost spread. When we talk about loan loss, we'll also come back to the mix a little bit to explain how this can be different now. And, I mean, since then, that's many years, (53:46) I mean we have, I think, had a very consistent evolution in our risk appetite and in our risk tools and in our credit models, more recently now, especially for retail. So I would, I mean, I think this allows us to expect a lower cost of credit than the average before.

## Q - Carlos G. Macedo {BIO 15158925 <GO>}

But just – sorry, to follow-up. Wouldn't it make sense if you're shifting the mix to improve your margins that they will have an impact on your cost of risk as well?

## A - Candido Botelho Bracher {BIO 3158644 <GO>}

Yes, that's true. But I think that the move in the – that improvement in the quality of the credit instruments more than compensates for that.

## Q - Carlos G. Macedo {BIO 15158925 <GO>}

Okay. Okay, thank you, Candido.

## A - Candido Botelho Bracher {BIO 3158644 <GO>}

Thank you.

## Operator

The next question comes from Carlos Gomez, HSBC.

## Q - Carlos Gomez-Lopez {BIO 18107094 <GO>}

Hello and good morning. Three very brief questions, the first one is what is your appetite for auto loans? And I look at your portfolio here, you have BRL 14 billion, used to have as much as BRL 60 billion seven years ago. How large can it go in this line of business to build your portfolio going forward? The second is whether you intend to do any changes at credit card given the increased competition. And the third, I would like to get your opinions on Argentina? Thank you.

## A - Candido Botelho Bracher {BIO 3158644 <GO>}

Sorry, Carlos. Could I ask you please to repeat your second question? I didn't understand it.

## Q - Carlos Gomez-Lopez {BIO 18107094 <GO>}

Yes. At credit card, I mean, when we look over the last few years credit card has lost market share versus its competitors. We have an environment in which we have new offers in the market. Is your strategy going to remain the same? Change? Will you have a low-cost offer? Are you going to be doing anything different in credit card compared to (55:50)?

## A - Candido Botelho Bracher {BIO 3158644 <GO>}

Okay, thank you. So first on auto loans. As I mentioned in auto loans, I mean, after 21 quarters of a decreasing portfolio we have reverted this. We expect this portfolio to grow now strongly. I don't think we will come back to the levels of portfolio we had in the past, but I think we will be significantly higher than it is today. On credit card, yes, you're right. I mean, on credit cards, I mean, there has been this pressure, competitive pressure in the market which has caused us to lose market share and also there were some margin pressures in this market. We are reacting to these trends in various ways, I mean, by making a more combined offer of products for our account holders. The companies that are our account holders, we see improving a lot. We have hired new people as one of the few exceptions here in the bank, that we hired 500 new people to deal more with smaller companies in this portfolio which paid higher margins. We still expect to lose some return in credit cards this year, but we expect it to level and to grow from there.

## Q - Carlos Gomez-Lopez {BIO 18107094 <GO>}

Thank you. And Argentina?

## A - Candido Botelho Bracher {BIO 3158644 <GO>}

And Argentina? I mean, in Argentina the strategy is the same as we had. I mean, we had a good year in Argentina but we have a bank which makes money in wholesale activity, and this year even made money on the retail activity. But this was the first time in many years and it was a very, a very small amount. So we think we are subscale in the retail in Argentina. We do not see many possibilities of increasing this participation in the market in Argentina by acquisitions now; this is not what we are looking at. What we are looking at is at using more digital tools in Argentina in order to increase our participation.

## Q - Carlos Gomez-Lopez {BIO 18107094 <GO>}

Thank you. Very clear.

## Operator

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

## A - Candido Botelho Bracher {BIO 3158644 <GO>}

Just to thank you all for having participated in the call and thanking those for who made questions. I mean, these questions always help us to try to make more clear statements and presentations in the future.

## Operator

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