

Q3 2005 Earnings Call

Company Participants

- Alfredo Egydio Setubal, Investor Relations Director
- Henri Penchas, CFO
- Lidia Borus, Investor Relations Contact
- Silvio De Carvalho, Executive Director

Other Participants

- Jason Mollin, Analyst
- Jorge Kuri, Analyst
- Mario Pierry, Analyst
- Paolo Rivero, Analyst

Presentation

Operator

Ladies and gentlemen thank you for standing by. (Operator Instructions) At this time, I would like to turn the conference over to Ms. Lidia Borus of Financial Investor Relations Brazil, which as a reminder is a successor of Thompson Financial Investor Relations Brazil. Please go ahead.

Lidia Borus {BIO 21620257 <GO>}

Good afternoon, ladies and gentlemen. And welcome to Banco Itau Holding Financeira SA Conference Call to discuss Third Quarter 2005 results. I would like to mention that a slide presentation has also been made available on the Company's Investor Relations website at www.itaubr.com during this call. Before proceeding let me mention that forward-looking statements are being made under the safe harbor of the Security Litigation Reform Act of 1996. Actual performance could differ materially from those 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 are Mr. Alfredo Setubal, Investor Relations Director, Mr. Henri Penchas, Senior Vice President and CFO. Mr. Silvio de Carvalho, Executive Director of Controllershship. Mr. Eduardo Vassimon, Executive Vice President of Itau BBA. And Mr. Marco Antunes, Director of Accounting.

First Mr. Alfredo Setubal will comment on Third Quarter 2005 results. Afterwards, management will be available for a question and answer session. It is now my pleasure to turn the call over to Mr. Alfredo Setubal. Mr. Setubal, you may now begin.

Alfredo Egydio Setubal {BIO 1528623 <GO>}

Good afternoon. The plan at first to be back the conference call this time for the Third Quarter. First I would like to explain for those who are with us today, that we are doing this conference call today, the same day that we release the results, because tomorrow in Brazil is a national holiday. That's the reason this quarter we are making the conference call the same day. We understand that you didn't have much time to analyze the numbers and the MD&A and so on.

The first, for those who are following through the internet, on the slide number one is highlights. The first highlight is the net income, BRL1.3 billion with an increase over the Second Quarter 1.4%. ROE annualized for the quarter 40.5%. The nine months of 2005 BRL3.8b, with an increase of 39.4% and an ROE annualized of almost 35%. The second highlight is the growth of the credit portfolio 5.1% in this quarter, with the highlight for this growth in terms of Personal Loans 10.1% in the quarter. And Vehicles 15.3% also in the quarter. We are going to give more details in the next slide.

The third highlight is related to additional provisions. We increased by BRL50 million the excess provisions that we have in terms of credit. The total at the end of the Third Quarter is BRL1.2b. The excess provisions are both the minimum required by the Central bank of Brazil. We maintain the additional provisions for Securities portfolio in BRL400m. We haven't touched this number during the quarter.

The fourth highlight is delinquency, the non-performance loans in the quarter finished 3.3% above the 3% that we finished in the Second Quarter. In line with the expectation that we announced it that probably the delinquency would increase. And this happened in this quarter.

The fifth highlight is solvency ratio. We maintain a high ratio at 17.6% even considering the buyback of preference shares, that we did in the quarter they have achieved BRL522m.

Slide number two highlights in terms of more numbers. Earnings per share increased 2.4% in the quarter, due to the growth of the net income. And the reduction in terms of shares, because we cancelled some shares during this period. Market capitalization achieved BRL60 billion in the period.

On slide number three we see a devolution of managerial net margin. We show here quarter by quarter since the First Quarter 2004. We see that this period of First Quarter 2004 the net margin was 11.6%. And this quarter, in line with the Second Quarter, is 13.5%. The increase in terms of managerial net margin is due to the mix of products, of credit products mainly that we did in the period, when we started to be more active in terms of lending to personal -- to personal credit. And middle market and small companies. So this shows how we are increasing the mix, changing the mix from big companies to this new -- to the segments with more margin and, of course, more risks, we increased that much.

Slide number four is the Itau Holding pro forma net income finishing BRL1.3b, as I said. We started giving more transparency in the last quarter, in terms of disclosing the net

margin. So in this quarter we open in three parts like we did in the Second Quarter. Banking operations BRL3.1 billion in a total of BRL3.3 billion with an increase of 5% in the quarter, was a good result.

Treasury operations decreased 74% in the quarter. We finished treasury gains with BRL48 million in Itau Holding against BRL182 million in the Second Quarter.

And the management of foreign exchange risk we finished up with an increase of 7% net of tax. The results for the exchange -- the management of exchange rate for the investment that we have abroad in our subsidiaries and branches. This numbering is quoted BRL178 million against BRL166 million in the Second Quarter. So the big difference here is the reduction in the gains in terms of treasury in this quarter.

Another point that is important is non-interest expenses. We finish with a increase quarter to quarter of 1.3%. We finish BRL2.6 billion in terms of non-interest expenses. This increase is due to the finish of the annual negotiation of the Union that increased salaries. And here we already made the provisions for vocations and for the whole year in terms of increasing, in terms of salaries. And, of course, includes in this total number the investment that we are doing in opening new branches of Banco Itau. And also, of the investment that we are doing in the consumer credit through Taii our consumer finance company opening own stores. And also, with the JV that we have with CBD and Lojas Americanas. So the number in terms of controlling of costs in our opinion continues to be good.

On slide number five we can see a breakdown of loans and securities portfolio. Here we can see that the individuals increase in the quarter 12.1% mainly because of Vehicles that increased 15.3% in the quarter. Personal Loans increased 10% and Credit Cards increased 10.6%. This is in line with the strategy of the bank, to increase in these segments that have more margin. Another segment that we are increasing. And putting more focus in the last quarters, as we have been saying in the last conference calls, is small business and middle market. This during this quarter increased 3%. We can see here that Corporate continues to decrease due to the valuation of the Reais against the Dollar. And because the companies are using more capital markets, local capital markets to finance part of their needs.

In terms of the Securities portfolio we decreased the public securities a little and increased a little the private securities. So the total increase is 1.8% but the mix will change a little bit during this quarter, putting more investment in private securities.

In slide number six we can see through a different view the composition of the credit portfolio and how it changes the mix during the last three years. We can see here September 2002 to September 2003, September 2004 and September 2005.

In September 2002 individuals represented on 24.5% of the total credit portfolio. And by the end of this quarter the individuals represent 41.5%. You see that we increase a lot the individuals through consumer credit during these years. Another big change, it is important to notice, is in terms of corporate that it was 56% of the total credit portfolio.

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And now it is only 33% because of the explanation that I give. Companies are using more the local capital market and because of the valuation of the Reais against the Dollar. So this mix was important in terms of contribution for the net margin.

In slide number seven we can see the contribution of credit portfolio. To show you that the strategy, of increasing volumes in these segments, that offer more margins are correct, in terms of providing more revenues for the bank. Even considering that we have more expenses in terms of provisions for loan losses. We see here in these segments, in this slide sorry, that we have an increase in the quarter, in terms of lower losses from BRL500m, almost BRL500 million in the Second Quarter, to BRL784m. This increase was compensated by the margins of the product that we are increasing in terms of individuals. And this is middle market so the balance is very positive, in terms of contribution, because of the margins and because of the increase in terms of (inaudible).

On slide number eight we can see nonperforming loans that increased, as I said at the beginning. We finished 3.3% in the consolidated basis for Itau Holdings this because the increase in 1.3% from 1.1% in terms of companies. And a small increase also in terms of individuals. We finished with 5.3% in terms of delinquency for individuals. So we expect these numbers not to decrease much more. But we are confident in this strategy. In terms of coverage ratio we maintained the number in 200% because of this increase that we did in BRL50m, in terms of excess provision, above the minimum required by the Central Bank.

And Service fees that continues to be important, slide number nine, we increased in the quarter 6.4% in total, mainly because more revenues from asset management. Also fees provided by the increase in terms of credit operation and collection of services in this line, also we have an extraordinary revenues because at Banco Itau it was paid some debit that was due.

In terms -- slide number 10, non-interest expenses, we would like to show you that we continue to be focused, in terms of controlling the expenses of the Bank. Here we can see that the total expenses adjusted, total expenses adjusted by the investment that we are still doing in terms of Itaured, in terms of opening new stores for Taii, opening these stores in CBD and Lojas Americanas, hiring people. We increased a lot the number of personnel in these product lines during the year. We -- and also adjusting the Orbitall, that is the company that now we have 100%, that was a subsidiary of Credit Card that we bought last year. So doing these adjustments we can see that the total expenses was less than the Second Quarter. We finish with a reduction adjusting the expenses in terms in 1.9% for the Bank. So in our view we continue to be in line with what we have been saying, in terms of controlling expenses for the business that we used (to) have.

Efficiency ratio, slide 11, we can see a 50.5% a little bit -- a little reduction when we compare the Second Quarter. And we expect to achieve a number consistently below 50% in the coming quarters.

Slide 12 market value, we still have a good number in terms of unrealized gains in our assets that is the total effect in the shareholders, stockholders equity would be BRL1.8

billion if we realize all these assets.

Slide 13 is the segmentation, is a pro forma presentation for Itau Holding. We used -- show this slide with four segments. Itaubanco that is retail operation, Itau BBA corporate and investment banking, Itaured, personal credit and Corporation where we are located the excess of capital.

Looking on page 14 the ROE is just -- if we consider the capital allocated for each of these segments we see that the ROE are very high for the retail banks 46%, Itau BBA 35%, Itaured almost 46%. And Corporation where the excess of capital is allocated turns 29.4% in the quarter.

We can go to slide 15 and see the number for Banco Itau the retail part of the business in managerial result of BRL738 million in the period. I would point out the treasury reduction in terms of gain -- gain in terms of treasury for the Banco Itau in this quarter. And the control in terms of non-interest expenses in the quarter also. Going deeper in the result of Banco Itau we can see that the banking operation was responsible for BRL488 million of the BRL738 million for this segment. The Credit Card BRL96m, Insurance, Pension Plans and capitalization BRL114 million and asset management BRL40m.

Going deeper in these numbers you can see that Credit Cards, on slide 17, show a reduction in terms of net income, a reduction in the quarter from BRL114 million in the Second Quarter to BRL96m, especially because the result of provisions for loan losses. But by the other hand we increase 3.6% the number of cards, we finished with 8.2 million cards for Itau cards, not considering here the Credit Card that we are going to receive from this (inaudible) Credit Card with Citibank. And revenues increased 6.3% in the quarter.

In terms of the Insurance, Pension Plans and capitalization on slide 18, we can see also here a reduction in terms of net income. The number reduced almost 19% especially because the increase in claim ratio that achieved 56% in the quarter. And selling expenses for products especially pension plan, increasing to BRL132m. So these -- all these result in these reduction in terms of results for this segment.

Certainly for Banco Itau retail operation is to continue to cross-sell products. We see room to continue to cross-sell products among the clients. We intend to continue to take the benefit of this good credit cycle. We continue to see the economy growing and good conditions for the growth of credit, especially for middle market and the segment of consumer credit. We are expecting to continue to grow in terms of extension plans. We continue to see good forecasts for this business. So we finish with more than BRL13 billion in terms of technical reserves.

We continue to be focused in terms of controlling expenses. We continue to see these as an important issues to maintain the profitability in the coming quarters. And, of course, to continue to provide good and quality products to our clients.

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Going to Itau BBA pro forma we can see that the pro forma show us a result of BRL304 million in the quarter, down from BRL322 million in the Second Quarter. This is mainly because of a reduction in terms of gains that, in the Second Quarter was very high in terms of treasury gains. In the Second Quarter the gain was BRL214 million and this quarter BRL47m. So the result is BRL204 million for Itau BBA in the quarter.

In terms of the strategies and priorities for Itau BBA, cross-sell products like we said in the last conference call, improving banking, our services continues to be an important target, because we don't see much growth in terms of credit portfolio for big companies in the coming quarters. In terms of the investment banking I think we made this -- invest money in these areas this year. We continue to be delivering in terms of local offerings in fixed and income for that. And we intend and we are increasing this doing this year, our participation in terms of offers of equity for investors. And we are extending and growing in terms of M&A.

In terms of international area we see Itau BBA using more the network of Itau to serve more clients outside Brazil.

In terms of Itau credit, where we allocate all the non-account holder business, here we can see that we finish with a net income of BRL150 million with a decrease from BRL226 million in the Second Quarter. Also because increase in terms of lower -- provision for lower losses. And because also we can see here that Taii, that is the brand that's been used to consumer credit. And for the JV that we have with CBD and Lojas Americanas so those are BRL40 million due to the high investment, in terms of new stores and own stores and investments in the JV stores that, we are doing in this period. By the other hand we continue to have a good return in terms of vehicles. That is a business that continues to grow and we expect that we will continue to grow in the coming quarters.

In terms of priorities for this segment, of course, this continues to get the good credit cycles. And continues to grow in terms of Personal Loans and Vehicles. We are cross-selling more products and we are using different segments to achieve new client's cross-selling. And using more these non-account holders segment to cross-sell more products, including the checking account.

Vehicles as I said, we expect the growth to continue. And Taii we will continue to open new branches and we expect next year to show better. And increase the results from Taii own stores. And the JV's that we announced with CBD and Lojas Americanas.

To finish, to show you that we have been growing earnings, net income and earnings per shares quarter by quarter. And it is not different this quarter, we increase the earnings per share in 2.4% by the end of this period.

That's what we would like to say. And we are here open to questions that you may have. Thank you.

Questions And Answers

Operator

Thank you. Ladies and gentlemen we will now begin the question and answer session. (Operator Instructions) Our first question comes from Jason Mollin of Bear Stearns. Please go ahead.

Q - Jason Mollin {BIO 1888181 <GO>}

Hello everyone. My question is related to asset quality. And the growth in non-performing loans that, we saw in this quarter. And particularly the provisions for loan losses that, were created in the quarter. And how that relates to the profitability of the banking segment. You did mention previously I believe, very explicitly after the First Quarter results were posted, that you expected asset quality deterioration, or a growth in non-performing loans. And we definitely saw that this quarter.

If I could relate that to slide 15 where you show the result for loan losses for Itau Banco pro forma? And if we look at that for the quarter and for the nine month period, the relationship between loan losses and financial margin has changed dramatically quarter over quarter. But also year over year. We saw you in this quarter provision almost 35% of your financial margin compared to almost 25% in the Second Quarter. And for the nine months this year almost 28% versus about 14% last year.

What kind of relationship, is this a good way to consider this, or what kind of relationship should we expect going forward? And maybe in the context of your outlook for non-performing loans you stated that this level, I wasn't actually sure if you said that you don't expect it to increase or decrease much from this, I believe its 3.3% as you classify non-performing loans, the total loans?

Operator

Thank you. Our next question comes from Mario Pierry of Deutsche Bank.

Q - Mario Pierry {BIO 1505554 <GO>}

Yes hello. If you want to have a chance to answer Jason's questions first.

A - Silvio De Carvalho {BIO 20450971 <GO>}

Yes Silvio speaking, Jason a (inaudible) we mention during the last periods when you report the results, we -- before I go out our targeting the product with the higher margins, we are expecting that we needed to make more provisions. But then our expectation is that the contribution for the results will be positive.

If you look the slide, the slide in number seven, you will see that the contribution for the results from the credit it's positive. In our vision probably we will have to increase this -- continue to increase this provision. There's probably there's non-performing loan where we show you what is different size. Basically these provisions can mean some to some segments that is basically need is more risk, needs more provision. Basically personal loans and Credit Cards.

Operator

Thank you. Our next question comes from Mario Pierry at Deutsche Bank. Please go ahead.

Q - Mario Pierry {BIO 1505554 <GO>}

Hi. Good morning everybody. Congratulations on a solid quarter. My question has to do with the net financial margin. You showed here that some credit operations, the net financial margin improved 5%, which was in line with the loan growth that we saw in the quarter. So I was wondering if you are seeing pressure on pricing?

Because as you highlighted throughout the presentation, you have been making significant improvements to your loan mix. So I would have expected a contribution from some of the credit operations to be a little bit stronger than just loan growth. So if you could comment a little bit on how you are seeing the competitive environment in Brazil, in terms of pricing?

A - Henri Pechas {BIO 1525748 <GO>}

Mario, Henri speaking. The competitive -- the market is very competitive. But we believe that with all the partnerships, with all the positions of payrolls that, the problem is that exactly just what we want. And the best mix between growth and margin and provisions. When you increase your loan book in the beginning you see the (repay) in the beginning you have -- in the first months you have higher losses. And after that you have higher margin. So it's a question just of balancing growth and margins.

Q - Mario Pierry {BIO 1505554 <GO>}

If I can just follow up then, if you can just tell us, for example, your Credit Card rate, where they are today compared to a year ago? And also in your other loans, what are your rates today compared to one year ago?

A - Henri Pechas {BIO 1525748 <GO>}

I don't have the numbers now with me. But we can provide that for you later. If you just call us in one day we can provide that for you.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay great. Thank you.

Operator

Thank you for your question Mr. Pierry. Our next question comes from Jorge Kuri of Morgan Stanley. Please go ahead.

Q - Jorge Kuri {BIO 3937764 <GO>}

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Hi good morning. This question is on asset quality as well. Provisions for individual loans were BRL825 million during this quarter versus BRL343 million in the Third Quarter of last year, relative to the size of your consumer loans this quarter would imply provisions over average loans of around 14% on an annualized basis versus 10% last year. That increase seems quite significant. Can you help us understand what do you think is a normal level of provisions, for consumer loans you need to take, on the average size of the portfolio? That will probably help us out figuring out where your provisions should be going forward, assuming specific loan growth. Thank you.

A - Silvio De Carvalho {BIO 20450971 <GO>}

I think it is ratio tendency around the 15% on an annualized basis.

Q - Jorge Kuri {BIO 3937764 <GO>}

You said one five Silvio?

A - Silvio De Carvalho {BIO 20450971 <GO>}

Yes.

Q - Jorge Kuri {BIO 3937764 <GO>}

Okay. So we are almost there?

A - Silvio De Carvalho {BIO 20450971 <GO>}

Yes.

Q - Jorge Kuri {BIO 3937764 <GO>}

Thank you.

Operator

Thank you for your question Mr. Kuri. Our next question comes from Jason Mollin of Bear Stearns. Please go ahead.

Q - Jason Mollin {BIO 1888181 <GO>}

Maybe a follow up to the last -- to your answer Silvio to the question I was asking. And talking about your consumer business and how you show the contribution of the credit portfolio on page seven. Are you suggesting that the pricing of service fees, related to credit should be considered, when we consider credit costs? Is -- should we be amortizing? I am just trying to think of this, the fees that you are -- are you pricing the fees for these credit products, in addition we should consider that in addition to the rate when we consider expected losses? Because clearly as a percentage of financial income if we exclude the fee component then, the contribution has declined substantially.

A - Silvio De Carvalho {BIO 20450971 <GO>}

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I think it will decline no doubt Jason, because there are these provision related to (inaudible) mark. But no doubt that you have to include the calculations the services fees that related with credit.

Q - Jason Mollin {BIO 1888181 <GO>}

Okay. Thank you.

Operator

Thank you, Mr. Mollin for your question. The next question comes from Paolo Rivero of Citigroup. Please go ahead.

Q - Paolo Rivero

Good morning. I want to follow up on Mario's question about the margin. Do you have an idea of the sensitivity of your margin to interest rates, given all the talk of cuts? It was right that we are going to see some cuts. And I know that -- or is there a way to quantify what impact of the change in the mix of the portfolio. And domestic rate environment in Brazil? Thanks.

A - Silvio De Carvalho {BIO 20450971 <GO>}

Please you can repeat your question?

Q - Paolo Rivero

Yes, for example, if there is a 100 basis points cut in interest rates, do you know how that would impact the margin? Or how do you see that playing out in terms of your margin, the scenario where interest rates in Brazil are dropping? Or do you think that is counter balanced by the mix, the change in the mix?

A - Silvio De Carvalho {BIO 20450971 <GO>}

Paolo our vision our (inaudible) model when you measure this impact you have to consider other impacting scenario. In our vision the provision for loan losses is decreased when you consider the increase in interest rates. The other point that the volume really clears us well. The third point is related to the improvement in the mix or the (depreciation) because the consumer market creates more confidence to assume the rate (inaudible).

Q - Paolo Rivero

I see. And -- but is there a number that you could --?

A - Silvio De Carvalho {BIO 20450971 <GO>}

(inaudible) in our (less) the simulation is not the very necessity of being this moment, to decrease interest rates in terms of the net interest margin.

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Q - Paolo Rivero

Right. Perfect, thank you very much.

Operator

Thank you for your question sir. (Operator Instructions) Our next question comes from Jason Mollin of Bear Stearns. Please go ahead.

Q - Jason Mollin {BIO 1888181 <GO>}

A very specific question on the small and medium sized company segment. You were growing there at about a 6% quarter over -- sequential quarter over quarter basis in the Second Quarter, we saw that slow in the Third Quarter. Is there anything that you could do about 3%, is there anything you can highlight in that segment? In the presentation that was mentioned as an area of focus for growth. And we did see that growth slow down.

A - Silvio De Carvalho {BIO 20450971 <GO>}

Nothing special to comment Jason. Basically I believe it's not a huge demand. And in the Third Quarter for middle markets. But nothing special to comment.

Q - Jason Mollin {BIO 1888181 <GO>}

Okay. Thank you.

Operator

Thank you for your question Mr. Mollin. Our next question comes from Jorge Kuri of Morgan Stanley. Please go ahead.

Q - Jorge Kuri {BIO 3937764 <GO>}

Hi, another question if I may? Can you give us some guidance for 2006, in terms of your expectation for the main drivers of the business, interest rates, GDP growth, growth in loans by each segment, growth in fees, expenses, any help would be appreciated?
Thanks.

A - Silvio De Carvalho {BIO 20450971 <GO>}

Well basically the guidance that we are giving to the market is related to interest rates. But we expect that it will finish in this year with a 18% interest rate. And basically it will finish in 2006 so it's a 15%. In terms of a low (growth) suspect to grow again around the 20%, 25%. In terms of GDP growth that will be around 3.5%.

Operator

Thank you for your question Mr. Kuri. (Operator Instructions) This concludes today's question and answer. Mr. Alfredo Setubal at this time you may now proceed with your closing statement.

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A - Alfredo Egydio Setubal {BIO 1528623 <GO>}

Thank you, all of you that followed the presentation. Thank you for your time, we consider it a very good quarter, very consistent in terms of recurring results. We continue to expect good quarters ahead we don't see much changes in terms of the environment here. And the view that could affect the banking -- the bank operations. So we continue to be very confident that, we are going to have good numbers in the coming quarters.

Thank you for time. Sorry again for the small time to study our balance sheet. But as I explained tomorrow is a holiday here. And we prefer this time to make the conference call in the same day that we release the results. Thank you. And expect you again in the next conference call, for the close for the 2005 and the beginning of next year. Thank you.

Operator

That does conclude our Banco Itau Holding Financeira Conference Call for today. Thank you, very much for your participation. You may now disconnect.

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