

Q1 2012 Earnings Call

Company Participants

- Alfredo Egydio Setubal, EVP and IRO
- Rogerio Calderon, Corporate Controller and Head of IR

Other Participants

- Alex Thumblert, Analyst
- Boris Molina, Analyst
- Carlos Macedo, Analyst
- Daniel Abut, Analyst
- Jorge Kuri, Analyst
- Marcelo Henriques, Analyst
- Marcelo Telles, Analyst
- Mario Pierry, Analyst
- Saul Martinez, Analyst
- Victor Galliano, Analyst

Presentation

Operator

Ladies and gentlemen. thank you for standing by. We inform you that this conference call aims exclusively to discuss the earnings results of Itau Unibanco Holding regarding the First Quarter of 2012. Queries related to Redecard's public offering shall be addressed to the Investor Relations division of Itau Unibanco Holding.

At this time, all lines are in a listen-only mode. Later there will be a question-and-answer session and instructions to participate will be given at that time. (Operator Instructions) As a reminder, this conference is being recorded and broadcast live on www.itau-unibanco.com/ir. A slide presentation is also available on this 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 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 Egydio Setubal, Executive Vice President and Investor Relations Officer; Mr. Sergio Ribeiro da Costa Werlang, Executive Vice President of Risk Control and Finance; Caio Ibrahim David, Chief Financial Officer; Mr. Rogerio Calderon, Corporate Controller and Head of Investor

Relations; Mr. Marco Antunes, Accounting Director; and Mr. Gustavo Henrique Penha Tavares, Itau BBA, Director.

First, Mr. Alfredo Setubal will comment on the First Quarter of 2012 results. Afterwards, management will be available for question-and-answer session. It is now my pleasure to turn the call over to Mr. Setubal. Sir, you may now begin.

Alfredo Egydio Setubal {BIO 1528623 <GO>}

Hello. Good morning, for those here in the US, in America. Good afternoon for those who are in Europe. We are starting our conference call through the page 2, the highlights for the quarter. The first one is recurrent results, BRL3.5 billion, with a average ROE annualized of 20%. The second one is our loan portfolio growth. The total portfolio exceeds a little bit BRL400 billion at the end of the quarter, with a 9% -- 0.9% growth when we compare to the end of 2011 and 16.1% when we compare to March last year.

Additionally, to that number we have private securities in a total amount of BRL17 billion. So our total risk considering these securities in terms of credit is BRL417 billion. We are going to go more deep in credit in the coming slides.

The third highlight is the financial margin with our clients. The growth was 3.2% in the quarter and reaching BRL12.4 billion. And a growth of 14.6% when you compare to the First Quarter 2011.

Net interest margin with our clients increased 20 basis points in this First Quarter. The credit spread increased 50 basis points in the quarter, reaching 14.5%. While the risk adjusted credit spreads, net spreads, presented a 60 basis point decrease in the First Quarter of 2012. And we're going to show this trend in the coming slide also.

Fourth highlight is the banking fees and result from insurance business. The banking fees and all these revenues from insurance pension plans and capitalization, the growth was 14.1% in this quarter, achieving BRL5.8 billion. It was a decrease of 2.6% when we compare to the last quarter of 2011, especially related to credit and seasonality.

The fifth is the non-performing loans ratio and loan losses. Expense for allowance for loan and lease losses, a net of recovery of credit, the total was BRL4.8 billion in this quarter. The expense for allowance for loan and lease increased 10.6% when we compare to the last quarter of 2011 and achieved a total of BRL6 billion.

The 90 days NPL reached 5.1%, about 20 days increase when we compare to the 4.9% of - the end of last year, in line what we said that we are expecting an increase in this First Quarter. And it continues to show this increase.

The sixth is the non-interest expenses, that was a decrease of 4.5 -- 4.6% when we compare to the end of the year and an increase of just 6.1% when we compare to the March of 2011. These all together, the revenues and the expenses, we achieved in this

quarter 44.5% in the efficiency ratio, a decrease of 250 basis points compared to previous quarter and almost 300 basis points when we compare to the same periods of 2011. During this past 12 months the efficiency ratio achieved 46.6% and we continue to target 41% for 2013.

(inaudible) this week we received the approval of the Central Bank of Brazil about the acquisition of 49% of Banco Carrefour that was pending since last year. And also we announced that we sold our stake in the BPI in Portugal to the La Caixa Barcelona Group.

Going to the next slide, on page 4, our result, a recurrent result of BRL3.5 billion. The highlights here, I would comment on the financial margin with our clients, an increase of 3.2% in the quarter and an increase of 14.6% in 12 months. Also another highlight here is related to the results from insurance pension plans and capital operations. It had achieved BRL1.4 billion, an increase of 5% almost in the quarter and almost 20% in the last 12 months.

All these good performance in terms of revenues was offsetted by an increase of expenses for loan losses. The total, as I mentioned, achieved BRL6 billion in the quarter, an increase of 10.6% in the quarter and so it's almost 38% when we compare it to the First Quarter of 2011. And other expenses that we continue to focus a lot in controlling and reducing expenses. The growth was -- a reduction in the quarter when we compare to the last quarter of 2011 of 4.6% and an increase of 6.1% in 12 months. That is a little bit higher than inflation.

Going -- I will jump the page five and 6 that we already said, it's more a graphical pages. And we can go to page seven on the financial margin that increased from 13% to 13.5% with the gross credit spread. And net credit spread reduced from 8% to 7.4% and 7.4% to 6.8% when we adjust the (inaudible) decline. So it shows a decrease, as I mentioned in the first parts of the presentation.

Total assets achieved almost BRL900 billion. The stockholders equity BRL72.4 billion by the end of the quarter. Loan portfolio, as I said, BRL400 billion and total funding with clients here including the mutual funds, BRL926 billion.

On page nine we can see loans by type of clients, a breakdown of our loan portfolio. As I mentioned, the total including endorsements and sureties achieved BRL400 billion by the end of the quarter, a split of BRL147 billion with individuals and BRL231 billion with companies. In the case of individuals, we can see a seasonal reduction in credit cards portfolios because of the huge use usually in December in the last quarter because of Christmas and New Year's Eve.

We can see a growth on personal loans of 6.5% in the quarter and almost 40% when we compare 12 months. That equals a reduction of 1.7%. Here it's not only seasonal reduction, it's a more strategic and a lower demand also for car financing in the whole industry -- you reduce it, the portfolio is 1.7% in the quarter and also almost flat also when we compare 12 months.

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What continues to be with a good demand is mortgage, an increase of 8.5% in the quarter, 57% in 12 months. The total with individuals is 14.5%. And we have to add almost BRL7 billion related to companies that is inside the companies numbers. So the total related to real estate is almost BRL22 billion, what is a little bit more than 5% of our portfolio.

Moving to the Company's business, corporate continues to have a better demand, 1.8% growth in the quarter. And we continue to be very selective when we are talking about small and very small and middle market companies. The portfolio were almost flat, a decrease of 0.1% and 9% growth in the last 12 months.

On Page 10 we can see in more detail about our ratios related to credit. 90 days NPL ratio increased from 4.9% to 5.1%. We can see the same trend in this graphic in the total of the financial system in Brazil using the numbers released by the Central Bank. We can see that the total of the industry increased from 5.5% to 5.8%. So we are in the same trends.

This was pushed more with individuals, an increase of up to 6.7% and companies increased from 3.5% to 3.7%, what makes this average of 5.1%.

What we can see on the graphic on the right side of this 90 day NPL ratio is the 15 to 90 day is the first delinquency, the first sign that we can have a delinquency. We can see that in the case of individuals the jump in this ratio was from 6.9% to 7.8%, what is potentially a bad sign for the trends in terms of NPLs over 90 days. And in terms of companies these numbers were almost flat. And we have a total of BRL26 billion in provisions for loan loss.

On slide 11, we can see the credit ratios, the coverage. The coverage continues to be good, although it has been reducing in the last one year and half. It finished up at 148. If we don't consider the E to G companies' rating, this number is 132. So that is a small decrease of 1%.

On page 12 we are putting here some perspectives that we see in terms of credit. The first one that is loan losses provision, the expense. We showed and we said and you know BRL6 billion in the First Quarter and we expected that the expenses in the Second Quarter to go in a range that's BRL6 billion to BRL6.4 billion. And in the Third Quarter BRL6.5 billion to BRL7.1 billion.

This is related to these early delinquency numbers that I talked to two slides before, that is increasing the numbers the first time. And also to this environment -- economic environment of low growth that Brazil is expecting these quarters, that we expected, that the reason that we expected these numbers for expenses in the coming quarters.

The most impacted are of course are vehicles and personal loans, the two lines of credit as we expected to continue to have more impact in terms of creation of these expenses. We continue to (stimulate) our campaign of responsible use of credit. We have been more selective in terms of clients. We are getting more collateral, especially in the small and small companies. We increased the collateral for these segments.

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And we had problems and we remember in the beginning of last year. But this segment in our view is totally under control in terms of expenses and in terms of credit quality. Our problems are more related to the vehicles and personal loans, especially the vehicles that we have. We are market leaders with more than 30% of market share. And in this environment really we are facing problems, especially with the creditors that were originated in the second semester of 2010. So that's the (inaudible).

On page 13 we can see the total funds, including here our working capital and funds and deposits and mutual funds. We have a total of BRL1.2 trillion. On page 14 the ratio between loan portfolio and funding continues to be very good. We don't see deposits as a issue to continue to grow the credit (technical difficulty).

Banking fees, we can see here that the reduction in the quarter was more related to loan operations and credit card. The other services and fees and tariffs was in a good shape. And these two is more related to seasonal issues.

On page 15 we can see the expenses, non-interest expenses and efficiency ratio. We continue to focus a lot in these numbers. We expect to continue to reduce and to achieve, as I mentioned, the 41% efficiency ratio next -- by the end of next year.

In terms of division of the recurrent results among the five business lines that we usually show, you can see these in the First Quarter that we had a small reduction in our commercial bank more related to the delinquency, an increase in participation in the recurrent net income of Itau BBA that jumped from 19% to 21%.

Our insurance was almost flat, a reduction in 1%. And stable in terms of the consumer credit. And our treasury operations and remuneration of the excess of capital has increased from 21% to 23%. The numbers were not much different from the last quarter. But some differences especially related to delinquency.

BIS ratio of 16.1%, on page 18, also is not an issue in terms of funding the growth of credit and the growth of the bank in the coming years. Market capitalization by the end of the quarter were BRL158 billion and the liquidity -- total liquidity considering New York Stock Exchange and Bovespa of BRL743 billion.

And to finalize, on page 20, the operation that we made selling our stake on BPI, we had 18.87% of the capital of the bank. We sold that to La Caixa Barcelona, that has a good presence in Spain and also we increased and controlled the bank -- this bank in Portugal. We sold the stake for EUR93 million. And this will impact our stockholders' equity in BRL100 million and a non-recurring effect of -- negative effect of BRL200 million in the Second Quarter of 2012.

That's what we wanted to talk to you in this presentation. And now we are open for the questions.

Questions And Answers

Operator

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

Carlos Macedo, Goldman Sachs.

Q - Carlos Macedo {BIO 15158925 <GO>}

I have two questions, first one is referring to your guidance for provision expenses. This is a significant increase from what we saw last year and again an increase from what you reported in the First Quarter. And it seems to go against a little bit what other -- your peers are saying and the data that's been come out from the Central Bank, including today, where there seems to be an improvement in asset quality already in March.

Is there anything that you are seeing in your portfolio, is there anything that you originated that was -- that might be different from what the market is seeing that should lead you to make these significantly higher provisions in the upcoming quarters? And is there something -- if it is, should we expect the level of provisioning going forward to remain high or should we get a normalization maybe towards the end of the year, beginning of next year?

And the second question is related to expenses. The headcount for the bank continues to go down as you further deploy your efficiency program. However, in the First Quarter we did see personnel expenses go up quarterly in a quarter that typically you see personnel expenses going down. Was there anything in the quarter that led these expenses to go up or are there any expenses related to labor expenses or something like that. And is there a level that should be more recurring going forward? Thank you.

A - Rogerio Calderon

Good morning, everyone. Rogerio Calderon speaking. Hi, Carlos. Your first question is regarding our guidance on expenses. But that expenses in comparison with the other peers. What we are guiding is the impacts of our portfolio. I think it's important to highlight what makes a difference when comparing to the others' portfolio is the fact that we have a different mix of risk. And we have a much higher presence of vehicles in our portfolio. And vehicles is the one -- is the type of credit that is presenting the worst performance in terms of delinquency. I think this is mainly -- is probably what is leading this difference.

In terms of the shape of the curve of delinquency if you compare our delinquency with the system, it is pretty much in line. And in some cases of course we have different timings. Sometimes we are pioneers in one product or not. Then the consequences of this behavior sometimes is different in the line of time. But the trend is not different, except for the different proportions of the credit portfolio, different risks taken.

Regarding expenses, I think the only figure that we have that is abnormal not recurring in the first part of the year is that we had some additional level of layoffs amounting to

around BRL60 million or BRL70 million in the quarter.

Q - Carlos Macedo {BIO 15158925 <GO>}

Okay. So we should -- so looking at that number maybe the recurring number will be BRL60 million or BRL70 million lower?

A - Rogerio Calderon

That's right.

Q - Carlos Macedo {BIO 15158925 <GO>}

Okay. And now going back to the first question. So this vehicle, this auto loan, the mix, is it something that you are resolving? When should we expect to see your provision expenses normalize? I mean, I have to assume that you are addressing those issues and that in the future they will normalize? And to what level should we expect them to normalize, maybe looking as a percentage of average loans?

If you do increase the provision expenses to the levels that you have guided, you will be roughly operating at 7% of average loans being your provision expense. That's about as high as it's been with the exception of during the 2008 crisis when a lot of the provision expenses were made preemptively for the corporate book. Is there a level that we should -- that you believe this will normalize to maybe next year?

A - Rogerio Calderon

We believe the level is going to normalize towards the end of the year. And you are right when you say that. Of course, we took some measures on controlling this increasing delinquency.

And as I mentioned in the first question, Carlos, the main issue is in our auto loans portfolio. And when we look deeply in the auto loans portfolio, we figure out that we are still seeing the consequences of the origination (than) during the end of 2010 and mainly during 2010. You remember that we had some macro prudential measures. By that time interest rates went up. The quality originated by that time was not good. We tightened up by April-May. And as from that time we start to build up a different portfolio, lower risk.

And what we see now is the first payment before, for instance, much better than before. We have now 50% of the first payment before that we are presenting -- we were presenting a year ago. But it's a long duration portfolio. So it takes some time to reach the turning point, that we believe is going to be reached by the Third Quarter. This is the main factor why we are postponing this consequence of delinquency increase.

Q - Carlos Macedo {BIO 15158925 <GO>}

Okay. So now just in terms of the provision expenses as a percentage of average loans, 7% or higher given the provision expenses you are expecting for the next two quarters. Historically, it's been around 5%. Should we expect it to go back to 5%, obviously

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respecting the difference in mix? Or is that -- are we at a higher baseline permanently, given that conditions for auto loans in Brazil have declined?

A - Rogerio Calderon

It should decline. But it's not going to be back to the same level we presented in 2001. If I am not wrong it was 6.2% or something. And we don't expect to reach the same level in 2012, definitely. And 2013 onwards, yes, it goes down. I cannot say anything on the quantitative right now.

Q - Carlos Macedo {BIO 15158925 <GO>}

Okay. Thank you, Rogerio.

A - Rogerio Calderon

Thank you.

Operator

Daniel Abut, Citi.

Q - Daniel Abut {BIO 1505546 <GO>}

Alfredo and Rogerio two questions from me. One a follow-up from the prior one. And then one on your performance of the financial (with) decline, financial margin decline.

On the asset quality side as a follow-up, if you are now saying or suggesting that this NPL cycle will not peak until the Third Quarter it will have lasted overall about 21 months or so. Because it started early last year. So if it doesn't pick until September or October it's close to two years, 21 months or so, which is much longer than normal.

I mean, in the past the cycles in Brazil have tended to be much shorter partly because the duration of your other portfolio is short. What makes a difference other than your client concentration in the market is not long, what makes this cycle so much longer than normal, given that the employment rate has remained very low in Brazil? And it seems that it has surprised you, because in the past you have guided for a shorter cycle.

I think if I go back to a few conference calls ago, initially you were expecting it to end towards the end of last year, then you prolonged that to the first half and now we are saying some quarters. So it seems that even your models were surprised by this lasting much longer. What's underpinning this cycle that will likely now last close to two years or 21 months or so?

And on the financial margin, which clearly was a very good performance in the quarter, Rogerio, as you explained, it grew year-on-year close to 15%. So only a touch below the long growth that we saw year-on-year for the quarter. Do you think that's sustainable for the rest of the year or at some point we're going to see more margin pressure affecting this top line income performance, given not only the ongoing decline in the interest rates

but the recent launch of programs at lower rates following the lead of the public sector banks.

A - Rogerio Calderon

Okay, Daniel. In terms of asset quality, I think -- I think now definitely what made the difference between what we were forecasting and the actual figures is the fact that every time we make an estimation this is linked to a scenario. And the scenario that we had in mind by the time that we announced our estimate actually was not confirmed. And we are talking particularly on the speed of the GDP growth.

Nobody -- we were not expecting -- and I assume nobody was expecting the level of GDP growth or the zero level of GDP growth by the Third Quarter last year and very modest growth in the Fourth Quarter and beginning of the year as well. So because of that we are -- actually we made our new calculations in our models and we concluded that this increase in delinquency is going to continue up to the Third Quarter. No -- at the time we know that, we have that information, we decided that would be for the benefit of you to make it clear for you as soon as possible.

Regarding spreads, we believe that if you take the year as a whole as we had in the beginning of last year at a higher level, probably we are going to post a slight decrease year-on-year. But it's really a slight decrease. So we are not really forecasting any stronger compression in margins for the year.

Q - Daniel Abut {BIO 1505546 <GO>}

And just to clarify, Rogerio, because sometimes when you mention margin in your presentation, you talk about the absolute amount of reais you make in your business with client and sometimes the percentage. When you're saying that you expect the small contraction, are you talking about the percentage?

A - Rogerio Calderon

I am talking on net interest margin, the percentage, yes.

Q - Daniel Abut {BIO 1505546 <GO>}

Okay, okay. Because the amount of reais you make in this line actually increase almost 15% year-on-year. You're not calling for decline of that line. It's still going to be growth.

A - Rogerio Calderon

Could you repeat, please? The sound was very low.

Q - Daniel Abut {BIO 1505546 <GO>}

I just wanted to make sure you don't confuse people, because sometimes when you use the word margin in your presentations you're referring to the absolute amount of reais that you're making in this intermediation with clients, which sure was 14.6% increase year-on-year -- .

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A - Rogerio Calderon

That's right, that's right. The net interest income increases, the net interest margin presents a slight compression. Is this clear?

Q - Daniel Abut {BIO 1505546 <GO>}

That's clear now. Thank you, Rogerio.

A - Rogerio Calderon

Thank you.

Operator

Jorge Kuri, Morgan Stanley.

Q - Jorge Kuri {BIO 3937764 <GO>}

I have a question on -- I have a couple of questions, sorry. The first one is on your margins. I am not sure I understand the expectation for a slight or modest -- very modest, as you mentioned Rosario, decrease in net interest margins. If I look at the composition of your margins, your rate sensitive margin actually fell a lot on a quarterly basis. And given that Selic rates continued to come down and your balance sheet is asset sensitive the negative re-pricing will continue throughout the year as you saw in the First Quarter.

And where your margins did better was on the spread sensitive part. Now if I just follow the other things you're saying, which is your NPLs will continue to go up, you're going to change your mix towards less risky products. If I look at your new pricing given the government clampdown on spreads, it just does not seem to me that you're going to be able to produce an increase in the spread sensitive part of the margin. So can you be a bit more specific exactly why you think you're going to have just a slight decrease when we're seeing this underlying trends play out?

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

Let me try to do it, Jorge. We are saying that the expected growth for our credit portfolio is between 14% and 17%. And we are saying that the net interest income is going to grow somehow lower than this. What means there is a slight compression not too much lower than this, a slight compression net interest margin. That's what I said. This is all before bad debt.

In terms of bad debt I think better than saying anything what we did was to present the figures. So our expectation for the bad debt expenses in the second and Third Quarter was just showed to you. So if you -- I think if you get all together you are going to realize that there is no such important reduction in our net interest margin. And if you want me to summarize why, this is because of the mix of our portfolio.

We are now replacing to -- the vintage originated in 2010, except for those with longer duration like vehicles that I said before regarding delinquency. We are replacing the

portfolio originated in 2010 by a portfolio that was originated, built up during 2011 at a marginal higher level of margins. That's what causes the margin to be resilient or just posting as a slight decrease.

Q - Jorge Kuri {BIO 3937764 <GO>}

So just maybe the best way for us to understand exactly what you mean is, what does a slight decrease mean to you? I mean, are we talking about 10 basis points, 50 basis points? What do you think relative to the margin of 2011 the 2012 margin is going to have?

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

The credit portfolio is going to grow between 14% and 17%. And we are forecasting the net interest income to grow low two digits.

Q - Jorge Kuri {BIO 3937764 <GO>}

I'm sorry. So in terms of net interest margin is that a 10 basis point contraction, is that a 50 basis points or 100 basis points?

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

We didn't announce any guidance on this. If you take the calculation on the efficiency ratio, Jorge, it implies around 12%, 13% growth in net interest income. What reflects in the net interest margin? I don't have the figure here. But I think you can make the easy calculation on this.

Q - Jorge Kuri {BIO 3937764 <GO>}

All right.

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

So net -- the credit growth is going to be 14% to 17%, net interest income somehow 12%, 13%.

Q - Jorge Kuri {BIO 3937764 <GO>}

All right. Thank you. The second question is on returns on equity. In the Portuguese conference call you mentioned that you expect return on equity to be 22% to 23% in 2012. And look, I was not at the conference call. I just heard that from someone else. I just want to make sure that was correct. Is that right, you said 22% to 23% for 2012?

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

No. I didn't. What I said is that we -- when question was about the sustainable level of ROE, I said that we believe the -- under the current scenario, the current way of doing business in Brazil our sustainable return on equity is around 22%, 23% and that we -- we probably will not post this year because of this increase in delinquency. I said actually --

Q - Jorge Kuri {BIO 3937764 <GO>}

All right.

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

-- other way around. But I said that is a sustainable level for some years, while the cost of capital is at the current level. Of course, when the cost of capital brings down to a different level probably we'll be able to keep the same value creation. But not being able to post the current level of return on equity. So just to make it clear I didn't say that is sustainable, it's possible to deliver 22%, 23% this year.

Q - Jorge Kuri {BIO 3937764 <GO>}

All right. And so what is your estimate for ROE this year?

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

We don't announce any guidance on ROE, Jorge.

Q - Jorge Kuri {BIO 3937764 <GO>}

All right. Thanks.

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

Thank you.

Operator

Saul Martinez, JP Morgan.

Q - Saul Martinez {BIO 5811266 <GO>}

I have two questions as well on asset quality/loan growth. And Rogerio, I hope this question doesn't come across as too confrontational. But your guidance has been continually pushed back on when we see the peak of the NPL cycle. And I think your investors have gone somewhat frustrated by that sort of continual pushing back to 1Q, 2Q and what not. What gives us -- why should they be confident that this time around it's going to be different, that the Third Quarter is really when we see the peak? And are you relying too much on an expectation that the economy is going to really reaccelerate and bail you out on this?

And my second question is related to this in the sense that your loan -- and it's -- your loan growth target is 14% to 17%. And given how you've started the year that implies a pretty substantial reacceleration, about close to 5% sort of sequential growth, which is -- which you haven't reached really since 2010, especially the second half of 2010, which got you into the problems in the first place. So my question is, is this type of mid-teen loan growth especially given the issues you're facing an important part of your loan book? Is -- and recognizing that you are more conservative than your peers. Is that the right strategy in this environment?

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A - Rogerio Calderon

Well how confident we are in terms of guidance for the year? I think it's fair to say that we are 100% confident on the measures we took. But there is an implied expectation for growth in our guidance, in any guidance any time. And what we had last year was frustration on the GDP growth for Brazil in the second half of the year and also the beginning of the year at a very low level.

We are now forecasting a different scenario. But this scenario, yes, it takes into consideration some acceleration, important acceleration in the second half of the year. We are confident that this is going to happen. You know the level of inventories in Brazil are reducing, what should trigger the industries probably to grow. Demand is accelerating. We have the interest rates going down. We don't have an increasing unemployment levels. So the conditions are positive to believe this is -- this growth is going to come. But all the scenarios are related to us -- all the forecasts are related to a scenario.

14% to 17% is a level that we believe is possible. We talked on discussing this level of growth during this First Quarter. We don't have reasons to believe this is not deliverable. But we are going to come back every quarter to talk on this. We have a pretty good opportunity to grow in some portfolios; some others are not going to push growth.

And you are right when you said that this implies an acceleration in the second half of the year, an important acceleration. This is also true. And this is related to the Brazilian GDP that is expected to push 1% or close to 1% in the first half of the year and going up to 4% or 5% during the second half of the year.

So altogether this should create an environment that is feasible for us to deliver what we guided. The guidance was always very conservative in a big range exactly because of this level of uncertainties. But we believe that it's possible. Also remember that the second half of last year the growth was low. So what makes easier the acceleration in our growth in the second half of the year, while the first half is on the other way around.

Q - Saul Martinez {BIO 5811266 <GO>}

Okay. What is your underlying economic assumption that you are using currently, if you can remind us, in establishing your guidance? The GDP growth, for example.

A - Rogerio Calderon

I'm just checking it.

Q - Saul Martinez {BIO 5811266 <GO>}

Sure.

A - Rogerio Calderon

So First Quarter is 1.5% and the whole year -- I think I have the figures by quarter here.

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Q - Saul Martinez {BIO 5811266 <GO>}

Okay. That would be even more helpful actually.

A - Rogerio Calderon

So I can give you in details if you want. But I remember -- what I have in mind is that we have 1.5% for the First Quarter similar to the first half of the year. And then in the second half of the year around 4% or 5% in order to bring us annualized growth of between 3%, 3.5%. That's the figures I have in mind. I can look --

Q - Saul Martinez {BIO 5811266 <GO>}

Okay.

A - Rogerio Calderon

-- into details and send you our scenario. We use the scenario -- our macro scenario that is posted by (Elian) in our securities business.

Q - Saul Martinez {BIO 5811266 <GO>}

Okay. Just one final quick question on charge-off, they are extremely elevated in the quarter. Should we expect them to remain more or less at these levels in the coming quarters?

A - Rogerio Calderon

No. The level of charge-off is increasing because of the peak of delinquency over 90 about a year ago. Had this impacts of SMEs peaking in the second, Third Quarter last year. You -- of course you know, Saul, that there's a 270 days difference between the peaking over 90 and the peaking in the charge-offs.

Q - Saul Martinez {BIO 5811266 <GO>}

Yes.

A - Rogerio Calderon

And as we had this peak a year ago, we don't expect the same level to be maintained. It is -- it's going to go down in the coming quarters.

Q - Saul Martinez {BIO 5811266 <GO>}

Okay. Great. Thank you very much.

A - Rogerio Calderon

Thank you.

Operator

Mario Pierry, Deutsche Bank.

Q - Mario Pierry {BIO 1505554 <GO>}

Let me ask two questions also. Specifically, if you can give us more color on the deterioration that you're seeing in your vehicle portfolio? Can you give us any order of magnitude how much NPLs have increased? Because it seems to me and from hearing what you're saying is that the bulk of the problem is with vehicles. Are you actually seeing an improvement in NPLs in other lines?

Also, staying over this topic of vehicle NPLs increasing, I was wondering why the Bank followed the public sector banks and announced reduction on spreads for auto loans. This to me seems counter-intuitive that you should be actually tightening your credit standards, not easing your credit standard for vehicle loans.

Then, finally, I have a question here with regards to your provision expenses. You're guiding for loan loss provisions prior to recoveries. If you are right and this economy starts to improve in the second half of the year, should we see a meaningful improvement in recoveries? Thank you.

A - Rogerio Calderon

Okay, Mario, let me start from the end. Yes. We are guiding the bad debt expenses and we expect some increasing in the recovery. "Meaningful", I don't know what you mean by meaningful. But it's expected to grow in between 5% to 10% every quarter.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay.

A - Rogerio Calderon

Okay. So in terms of our auto loans, I think what is important to highlight is that this is a longer duration portfolio. So it's right, it's true that we took decisions in the past. But it's also true that it takes some time to reflect in our NPLs the consequence of this changing strategy.

I think I made this comment before. But it's -- we have in 2010 the worst quality portfolio built up in auto loans. And after that, the quality was increasing. We made the selectivity more tighter. We -- more tight. We had some changes in the quality, meaningful changes, I mean, since then. And we still have the consequences of the 2010 portfolio. I think there's another indicator that is very important to remember, that is the first payment (default). This is actually right now in a much, much better level than what we had a year ago. But we still need to run-off the portfolio originated in 2010. This is the main reason why the quality of origination was deteriorated by that time. And I think it's also important to highlight that the quality of our portfolio originated right now is at the same level of the best vintage we had in 2009.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. So let me rephrase then the question. So do you expect then to accelerate origination of auto loans going forward from this levels on or is that how we should read into this?

A - Rogerio Calderon

No. In terms of balance we don't expect an acceleration of the growth. I just want to make sure it's well understood that it does not mean that we are not doing business in these auto loans area. We actually originated around BRL2 billion in new contracts every month. But this does not represent a growth because we are more selective and at the same time we have a very important base effect. So it's -- even if we have exactly the same strategy growing on such a big and matured portfolio is a difficult task. And now with a different perspective in terms of delinquencies this is actually not possible. So we probably will see the same level of the portfolio by the end of the year or even lower.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. And if you can give us an idea of -- I know you don't disclose your NPLs by product. But if we look at your auto loan NPL today, compare it to crisis in 2008-2009, are you higher than those levels? Or, can you give us an idea if we're seeing an acceleration in NPLs? But from what you are saying, it seems like the NPL formation in auto loans should actually be improving?

A - Rogerio Calderon

It's higher. It's higher than a year ago. It's higher than two years ago. If you take the 2009 level that was the best level we had, is 150 basis points higher. If you take by 2011 then we are talking on around 60 basis points higher.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. Thank you.

Operator

Marcelo Telles, Credit Suisse.

Q - Marcelo Telles {BIO 3560829 <GO>}

I have two questions, the first one of course regarding asset quality. If you look at the provisioning guidance that you provided for the second and then the Third Quarter, basically what you're implying is that provisions for the first nine months of the year will probably be up about 28% to 35%, right? And if I look to earnings and the consensus numbers for you guys, which is at around like BRL16 billion, it looks like it could be talking about a potential for like 12% to 15% earnings downside, which basically place your earnings numbers for the year at about BRL14 billion. Does that calculation make sense and do you think that in 2013 you can actually have a sort of reversal of that provisioning trend?

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And the other question in the same subject, I saw that you only provided guidance for up to the Third Quarter for provisions. And I must say, I definitely -- I think it was very good of you guys to provide more color on the provisioning front. But what was the reason for you not to provide the guidance for the Fourth Quarter given that you think that your delinquency is going to peak in the Third Quarter? Is that that you probably don't enough visibility to expect, let's say, an improvement in provisions in the Fourth Quarter of the year?

Then I have my other questions.

A - Rogerio Calderon

Okay. So we don't think the BRL14 billion figure you mentioned is -- it's price is okay. We expect earnings growth, we expect single-digit earnings growth for the year. So what brings to an upper level. BRL14.6 billion was our result for last year. So BRL14 billion would imply a reduction, what is by far what's -- it's not what we are expecting, by far not.

The other question you made is why -- if I correctly understood is why we are not presenting our guidance for the Fourth Quarter in bad debt expenses. And the reason is actually positive. We are going to do it in the next quarter. This is a figure that is pretty much accurate, the one we released and this is based on our current portfolio of credit. So we have the impacts of the rolling of our portfolio. And Fourth Quarter is a little bit different because it would represent some origination that is done right now. So I think we are going to be in a more -- in a more adequate, in a more precise condition to make any forecast within a quarter regarding the Fourth Quarter. But we believe that the peak is going to happen in the Third Quarter, yes.

Q - Marcelo Telles {BIO 3560829 <GO>}

Thank you, Rogerio. And just one final question, regarding your NII growth, the guidance that you mentioned like low double-digit growth in NII. I mean, I remember when you provided that guidance. I believe that the interest rate implied in the U-curve was probably about 10%, 10.5% if I am not mistaken. And currently you have the U-curve --

A - Rogerio Calderon

I was 9%. It was actually 9%, Marcelo.

Q - Marcelo Telles {BIO 3560829 <GO>}

It's now at 8.5%?

A - Rogerio Calderon

Yes. That's right.

Q - Marcelo Telles {BIO 3560829 <GO>}

Yes. And so -- okay. So at least you have, let's say, another half a percentage point decline in the NIM. So are you accounting for that in that number? And given that -- I mean, we

saw Central Bank's data today we saw spreads coming down months and months. Of course, there could be some seasonality factor there. But I mean, do you think -- do you -- how confident are you that you're going to actually meet that NII growth, because you guys are very confident on asset quality and the deterioration ended up being higher than expected? So are you confident that, I mean, you are not going to have to revise downwards your expectation for NII growth for this year?

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A - Rogerio Calderon

At the current scenario including this 8.5%, you know that we have an impact -- a direct impacts of the (inaudible) reduction. 50 basis points is impacting around BRL70 billion in our net asset position. So this is included in our guidance just mentioned.

Q - Marcelo Telles {BIO 3560829 <GO>}

Okay. Thank you very much.

A - Rogerio Calderon

Thank you.

Operator

Marcelo Henriques, BTG Pactual.

Q - Marcelo Henriques {BIO 17385475 <GO>}

Just a couple of questions on the -- actually on the cycle of the asset quality deterioration. I'm swinging a little bit. So if you could help me please. I mean, if you get the -- the credit was originated after 2011, according to your numbers is roughly 70% of the total. And if I understood correctly, I mean you have been saying that you are more cautiously lending since the Second Quarter 2011.

So -- and you keep saying about the 2010 origination portfolio, which is roughly only now 18% of the total. So how come this can continue creating so much trouble for you in the coming quarters. And -- or does that mean that maybe you are not as cautious as you should be in 2011 and even at beginning of this year, 2012?

So I'm trying to understand how much long this cycle can continue if you have like 70% of your book already originated in 2011 -- so in '12. And you keep pushing forward the delinquency ratios up?

A - Rogerio Calderon

Okay. So just to make sure it's clear that most of the delinquency increasing that we are observing right now is auto loans originated in 2010, what is actually out of the 70% you mentioned. But the 70% you mentioned we model it with an implied expectation that was actually worse than the one modeled. And this selectivity that we applied before was able to keep the same level to offset this increasing deterioration. But not enough to improve out of the prior position.

Q - Marcelo Henriques {BIO 17385475 <GO>}

Okay. So if I understand -- if I understood you correctly like this 18% 2010 although it's small compared to other, of course you can create this amount of trouble I mean in the next coming quarters still?

A - Rogerio Calderon

This is in the guidance we gave. This is the -- the running off of this portfolio is included in the figures we presented on these growths in bad debt expenses.

Q - Marcelo Henriques {BIO 17385475 <GO>}

Okay. All right. And the second question is on the -- how confident of the economy -- economic recovery in the second half. And you keep saying that this would be like crucial for the asset quality begins to improve in the Fourth Quarter. Also, I'm swinging a little bit, how this -- help me understand how this could help especially when it comes to individual portfolio, because clearly the environment for individuals in Brazil has been -- maybe I'm wrong. But it has been terrific.

Actually, you have the -- unemployment rates all-time low, real wages has been increasing quite substantially. So how the economic recovery could help the individual side of your portfolio even more if you already have like a very good, let's say, scenario for consumer, let's say, behavior?

So how does -- is there any kind of other indicators that you're seeing more like income commitment coming down already in the First Quarter, or -- help me understand a little bit how the economic recovery could improve the asset quality on the individual portfolio?

A - Rogerio Calderon

Sure. I think it's important to highlight that we took measures, we became more selective and we took other measures in terms of improving our portfolio. Other than this, the growth of the economy of course helps. Both helps because it irrigates the portfolio. But also because it creates a better environment for building up a better portfolio. What makes in association with the decisions we took before, brings a higher quality in our portfolio. The more growth we have, the faster is this replacement in our portfolio. That's what I tried to explain.

Q - Marcelo Henriques {BIO 17385475 <GO>}

Okay. The final question I promise. It's like a similar question that I asked on (inaudible). You have been running. And especially this quarter, a very low ROE to a bank like Itau's standards. Even looking historically probably it's not this is the lowest one. But it's very close to the lowest level ever. And part of the ROE recovery it's kind of linked to the economic recovery in the second-half. And I know that's a -- it's a bank cycle. So you do depend on macroeconomic environment. But I mean if it doesn't come, what you can do? I mean, how can you still be able to deliver -- or if it doesn't come as much as you are

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expecting, actually every economist is expecting, what you could do besides of what you are already doing on the cost-side?

Maybe you could do something more. But what you could do to really improve and what are you willing to do to really improve the ROE of the bank going forward, kind of not regardless of the macroeconomic condition because of course it affects. But let's say a little bit more less dependent on this, "This huge economic recovery that's supposed to happen in the second-half."

A - Rogerio Calderon

So then -- the way we look at our interest -- income statements formation, Marcelo, is the credit growth is expected to be between 14%, 17%. We expect a slight deterioration in our margin, what brings the net interest income to grow around 12%, 13% that I mentioned before. If you add -- and this has to do a lot with the type of growth that we are going to see in the second-half of the year, as you just mentioned.

The other lines that accounts for our results and our return are fee income, insurance results and also our ability to control our costs and to improve our efficiency. Those three are the ones that we could present better results in case we need to catch up in any case.

Q - Marcelo Henriques {BIO 17385475 <GO>}

Okay. Thank you.

Operator

Victor Galliano, HSBC.

Q - Victor Galliano {BIO 1517713 <GO>}

I mean, most of my questions have been answered. But just on, if I can say, unfortunately with the issue of credit charge and provisions. So what we saw last year was I think the provisions were about 4.9%, just under 5% of average loans. So for this full year would it be reasonable to assume we'd be looking for something like 6% provision of average loans. And then we could expect it to come down from there as a percentage of average loans into 2013?

And one other question --

A - Rogerio Calderon

Victor, just one point. I think you are referring to the bad debt expenses net of recovery, right?

Q - Victor Galliano {BIO 1517713 <GO>}

Yes. Net of recoveries, absolutely.

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A - Rogerio Calderon

Okay. So your figures are okay. It's the same way we look at them.

Q - Victor Galliano {BIO 1517713 <GO>}

Okay. So 6% is a reasonable one for this full year?

A - Rogerio Calderon

That's right.

Q - Victor Galliano {BIO 1517713 <GO>}

Would you -- having mentioned earlier that recoveries should be picking up by about 5% to 10% going forward from the --

A - Rogerio Calderon

Going forward quarter-on-quarter, that's right.

Q - Victor Galliano {BIO 1517713 <GO>}

Yes, yes. So just looking at the divisional business, I mean obviously what you see there -- and I think this kind of wheels back into the overall ROE of the bank. It's clearly -- it's clear that the problem is with auto loans and other personal credits and probably not with people who are core clients of the bank. It seems like the ROE of the commercial bank remains pretty resilient. But the problem is with the consumer division.

Do you see an opportunity here going forward and maybe with Basel III coming in for you to reallocate capital into better return businesses and thereby helping your ROE over the medium run?

A - Rogerio Calderon

This is what we do all the time, Victor.

Q - Victor Galliano {BIO 1517713 <GO>}

Right.

A - Rogerio Calderon

Allocating capital here or there, depending on the best opportunities and return opportunities we have. It's exactly the way we do.

Q - Victor Galliano {BIO 1517713 <GO>}

But looking in reference right now in particular to the consumer division, given that that isn't going to be a growth area any time soon and that houses most of the auto portfolio and some other personal credits, do you think there's more scope here on a, shall we say, on not just a cyclical or quarterly basis but on a secular basis to reallocate capital?

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A - Rogerio Calderon

Yes. But also remember that we have all these initiatives in terms of the use, the conscious use of credits and we pay attention and we want to avoid over-indebtedness in the consumer area. So we have some room to reallocate capital here or there, yes. But also have some other limitations to do so.

Q - Victor Galliano {BIO 1517713 <GO>}

Regulatory, yes, sure.

A - Rogerio Calderon

Thank you.

Q - Victor Galliano {BIO 1517713 <GO>}

Okay. Thanks.

Operator

Boris Molina, Santander.

Q - Boris Molina {BIO 1904979 <GO>}

Just one final question, you have this substantial stock of excess number for loan provisions, do you plan to meet your target of single digit earnings growth in the year? Do you see some of these provisions probably in the Fourth Quarter or is this something that you don't have any intention of using?

A - Rogerio Calderon

No. The -- our provisions are built up and are used based on the expected loss criteria. We -- they move based on the expectation improving or not. We don't take decision on releasing provisions or not. This is actually the result of our criteria. We don't have any plan to do anything other than respect the criteria.

Q - Boris Molina {BIO 1904979 <GO>}

So do you have (inaudible) for the level of coverage of 90 days capacity loans that you might be achieving towards the end of the year, lower than current levels?

A - Rogerio Calderon

You're referring to the coverage over 90 days, right?

Q - Boris Molina {BIO 1904979 <GO>}

Yes.

A - Rogerio Calderon

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Okay. So it's possible that it goes up or down based on the expected loss criteria. But I just highlighted that the provision on each H to G, what means all the over 90 days except for those fully provided is exactly at the same level that we presented a quarter ago -- E to G, I am sorry. So it's really very important that you understand that the coverage is actually flat, stable.

Q - Boris Molina {BIO 1904979 <GO>}

Okay. Thank you.

A - Rogerio Calderon

We don't need to keep any extra coverage on what is fully provided.

Q - Boris Molina {BIO 1904979 <GO>}

Sure. Okay. Thank you.

Operator

(Alex Thumblert), UBS.

Q - Alex Thumblert

Two quick questions. In terms of the auto loans just going back to what you discussed earlier, it seems to us that Brazil is running at almost full employment and I just wonder if you could kind of elaborate a little bit more on why you see such a huge pickup on non-performing loans on the vehicles financing?

And a second question that I had, given the successful -- apparently successful deal of one of your competitors on the IBD business, I was wondering whether or not you consider actually spinning off your IB business with Itau BBA and actually listing their operation given that probably the -- but probably not. But for sure the value of that business is not being reflected on your valuation today?

A - Rogerio Calderon

So we're not going to answer the second question. The first question, we have the consequence of some vintage that were originated in a negative scenario. Those vintage particularly in auto loans are presenting this increasing delinquency. That's -- I don't have anything else to talk on this. This is the reason why we are presenting this increasing delinquencies. And also we have some increasing delinquency comparing to the models in some other areas like personal loans. But at a much lower level. Auto loans -- particularly auto loans that originated in 2010 are those more impacted. The other question, I think we don't -- we are not going to address. What I -- I think what we should say is the very obvious fact that we pay attention to any strategic movements all the time.

Q - Alex Thumblert

Thank you.

Operator

Excuse me, ladies and gentleman, this concludes today's question-and-answer session. Mr. Setubal, at this time you may proceed with your closing statement, sir.

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

Okay. Thank you, all for participating in our conference call. It was a good and long one. I think we could explain and clarify all the issues. But if you have some, you can contact our team in IR. They will be able to give you more information. Thank you. And goodbye.

Operator

Thank you. That does conclude our Itau Unibanco Holding earnings conference call for today. Thank you very much for your participation and have a good day.

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