

Q4 2004 Earnings Call

Company Participants

- Roberto Setubal, CEO
- Thomas Karsten, Unknown

Other Participants

- Jason Mollin, Analyst
- Jorge Kuri, Analyst
- Paul Tucker, Analyst
- Rusty Johnson, Analyst
- Yolanda Cortine, Analyst
- Yulenta Cortine, Analyst

Presentation

Operator

(Operator Instructions). At this time, I would like to turn the conference over to Mr. Thomas Karsten, of Financial Investor Relations, Brazil, which, as a reminder, is the successor of Thomson Financial Investor Relations, Brazil. Please go ahead.

Thomas Karsten

Good morning, ladies and gentlemen. Welcome to Banco Itau Holding Financeira's conference call to discuss the Fourth Quarter 2004 results.

I would like to mention that a slide presentation has also been made available on the company's investor website at www.itauir.com, during this call. And that a new full screen feature for viewing the presentation has also been added.

Before proceeding, let me mention that forward-looking statements are being made under the safe harbor of the Private Securities Litigation Reform Act of 1995. Actual performance could differ from that anticipated in any forward-looking comments, due to macroeconomic conditions, market risks and other factors.

With us today in Sao Paulo are Mr. Roberto Setubal, the Chief Executive Officer, Mr. Alfredo Setubal, the Investor Relations Director, Mr. Henri Penchas, the Senior Vice-President and CFO, Mr. Silvio de Carvalho, the Executive Director, Mr. Candido Bracher, the Superintendent Vice-President of Banco Itau-BBA. And Mr. Marco Antunes, the Director of Accounting.

First, Mr. Roberto Setubal will be commenting on the Fourth Quarter 2004 results and, afterwards, management will be available for a question and answer session. It is now my pleasure to turn the call over to you, Mr. Setubal. You may now begin.

Roberto Setubal {BIO 1525746 <GO>}

Okay. Thank you. Good morning, for you in the U.S.. Good afternoon for you in Europe, other areas of the world. I will comment the Fourth Quarter, together with the whole year of 2004.

I will start on screen one in internet with the highlights of the--well, the results were 3.7 billion, with an ROE of 27%. The Fourth Quarter results were at the level of 1.03 billion, with ROE of 33%.

I think that the most important thing that happened last year was the development of the credit portfolio, especially for medium and small companies and individuals. In the case of medium and small companies, we had a growth of 71% almost and, in the case of individuals, 43%. This was the main reason for the growth of the result for the year.

Going to the screen two, we can also see that the nonperforming loans ratio has declined to 2.9% last year. And this also had a very positive impact in the results, together with the growth in the portfolio.

We also, as we have always done in the past, we keep our quality of amortizing the whole goodwill up front of our acquisitions. In the last year, we had a main acquisitions and we decided to fully amortize those again. And it had a very important impact in our results. Mainly in the Fourth Quarter. But all together it accounted for almost 1.3 billion realized.

Going to the next page, we can see the main numbers of the bank. I think most of them I have already comment. But I would comment basically the ROE, that we are keeping a very high level of ROE for 2004. And especially for the Fourth Quarter, which I will comment later on in this presentation. Also the efficiency ratio, which are improving. And I will comment also this down the road. And the capitalization, the BIS ratio, that we have been kept at a very high level, although the very strong growth in our loan portfolio.

On page four, we tried to clear the numbers for you in terms of what was recurring and non-recurrent earnings in last quarter. So, we start with a net income that we put together for the Fourth Quarter, \$130 billion realized. We add to this number the extraordinary results for the Fourth Quarter. And then we come to a net income of 1.8 billion realized.

Then we show that we have the trading area, we have results on the securities side. And we sold securities with profits that added 400 million realized. And also, we have a non-recurrent item, which was the service fee that we recovered from the official pension sector of Brazil that paid back what was not paid in the past. And now, we have recognized this as income. So, in the end, we have non-recurrent earnings of 1.3 billion for the Fourth Quarter.

The next page is page five. I think a very important one when we break down the earning assets, how it developed, how it grew last year.

In the case of individuals, like I mentioned already, we grew 43%. A very important number and had a major impact on the results.

On the company side, we had, especially in the small and medium-sized companies, a very, very strong growth, 71%. And this was very important for Itau, which was behind in the market and now we are recovering market share. We're growing both market growth. And we believe that we can keep growing faster than market in 2005. This is also true for individuals. We believe that we will grow faster than market growth in 2005.

Although we believe that the growth for 2005 will not--although it will be very strong, it will be not as big as we had in 2004. So, we expect a reduction in growth, although still a very strong growth, probably around 30% in those two combining numbers.

In the case of corporate, we had a--not a growth. But a decline in our portfolio. And this was mainly due to the valuation of Real against Dollar. And all the trade finance portfolio had a decline in Reals. We have reduced our security portfolio in order to make the funds available for other loans.

Going ahead, we can see on page five that this made a huge difference in the mix of our portfolio, which we believe we have today a portfolio with a lower level of risk, due to the spread over many more clients than we had in 2003. So, our portfolio, we believe is becoming less risky.

On page seven we can see the evolution of the credit portfolio. On page eight, we can see the currency evolution--I mean the credit portfolio by currency, where we can see the impact of the dollar portfolio.

Page nine, we can see that the nonperforming loans is reducing. And the coverage ratio is increasing. We believe that from now on, probably, we will see a small increase in the nonperforming portfolio and nonperforming ratio. Mainly, because of the mix of the portfolio that's changing, is becoming more retail. And although we have a much bigger margin, we also will face a bigger non-performing ratio.

On the balance of the (inaudible) and the impact on the results of the higher spread of the portfolio, in higher non-performing, we believe that will be extremely positive for the results, this movement of the mix.

In terms of services, service fees, we are keeping our growth very steady. Every year we are growing. And we believe that we'll keep on growing for next few years. As the economy grows, services will grow naturally.

Page 11. I would like to spend some more time here. The expenses that we are showing here, the growth of expenses. We had last year a special focus on cost control, as we had

in 2003. And I think we were very successful in controlling the expenses of the bank, which (inaudible) are much below inflation. Adjusting for the year, the number will show 1%, as you can see on page 11. And this is--considering that we have inflation of 7%, was a major growth in productivity for the bank.

As a result, the efficiency ratio, as you can see on the next page, has declined, which is very good. So now we are at the level of 52%.

So, we are growing, we are improving our efficiency ratio. And we believe that for the next year, or 2005, we will have additional improvement in the efficiency ratio.

On page 13, we can see the unrealized gains that we keep in our balance sheet, which are in the same level that we were in December, 2003. Although we have sold and realized some gains in our security portfolio, we could keep the same level of 2003, although a reduction from September because of this realization of profits in our securities portfolio.

Page 14. We can see the breakdown of our main numbers between Itau and Itau-BBA. Both companies are performing quite well. They have a very positive evolution when compared to 2003.

When we see on page 15 only Banco Itau, we can see a major growth in the numbers, mainly due to the growth of our present portfolio. And also this effect that we mentioned on the securities portfolio.

Net income on page--net income breakdown on page 16 is shown here. And as you can see, we had a major evolution of the banking activity due to the same things that I just mentioned before.

On page 17, it's very interesting to see the impact that the acquisition of Credicard had on our credit card portfolio. We are growing our--we grew our portfolio 33% last year. Our revenues were grown 26%. So, we are very happy about the position of Credicard. And as we have already announced, we will split the portfolio of Credicard between Itau and CitiBank.

This number that we are showing here, are just the number that Itau will incorporate to our own portfolio. And based on this split, we will be able to cross-sell to those new clients for us, because most of those 3.6 million cardholders are not Itau clients. Less than 10% are Itau clients. So we are going ahead with our plans on the credit cards.

On page 18, we have a picture of what was the year for the pensions and insurance sector and capitalization. We had a small decline as a result, mainly due to the fact that we had a smaller financial income last year, mainly due to the fact that the interest rates were lower last year compared to 2003. But the business itself is growing, as we can see on the operating margin is very healthy and improving.

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Page 19. We can see the growth of assets under management and technical provisions for the insurance business, the insurance and pension. Overall, the growth are still very strong in both areas.

Page 20. We have the numbers of Itau-BBA itself alone. The results had a very good impact last year of the recovery of loan losses that were provisioned the year before. On the other hand, we have a much lower gain in trading last year. So, both (inaudible) on the opposite side so, in the end, we had a net income that grew almost 30%. ROE has improved.

And page 21, we can see the growth the last 11 years for earnings per share, 26%. And this is our main commitment, creating value for the shareholders. And we believe that we are doing so by growing the earnings per share at a very high level rate that we are keeping throughout the years. Dividends also are increasing faster than earnings.

On page 22, we can see that also, which we believe is very positive for the shareholders, the average daily volume that was traded is increasing. So the liquidity of our stock is improving, which is very good news I think. Every year it's improving, increasing. So, this is also positive for the share price.

The year 2004, as we can see on page 23, we have a year that we took many actions on the consumer credit factor. And we believe that those actions which are outlined here will have a major and very positive impact down the road. They were a very important movement, I think, of Itau.

The partnership with (inaudible) and the acquisition of Credicard, the start of Taii, all were very important. And will be very important down the road for (inaudible).

The year of 2005, Taii and (inaudible) activities will not have a--will have a negative, small negative impact on our numbers. But very negative, which I believe in 2005 might turn into positive numbers as the business start to mature.

For the year of 2005, we will have three main focus for the year. Number one, I think that we believe that we still have a lot of opportunities in the individuals and small and medium-sized company credit market. We believe that we can outgrow the market. And we believe that we will do that for the year of 2005.

As I mentioned, I think that the growth here will be strong. Although, not as strong as we have in 2004. Margins probably will reduce a little. But overall I think will be very positive result for the bank. Losses will be controlled. So, this focus will be the main driver for the growth in our results for the year.

Second priority will be to consolidate all those actions that we took in 2004 in terms of credit consumer factor. It will be very important to us to consolidate those initiatives.

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The third priority, although third but very important for us, will be the cost control actions that we are taking. And we believe that, although we will be growing very fast in the year in terms of loans and other activities, we believe that we will be able to keep the costs in real terms on the same basis. This basically means that we will all together keep improving our efficiency ratio for the year of 2005. This is what we do expect. So, revenues will be growing faster than costs.

As a result, we believe that we can keep the same level for 2005, the same kind of ROE that we are showing this year and the last three or four years, which means that we are probably going to stay at the level between 25% and 30% for the whole year of 2005.

In the year of 2005, we will disclose for you the new consumer credit segment, as a segment side-by-side with Banco Itau and Banco Itau-BBA. This is due to the fact that we are investing a lot in this segment. So we want to make sure that you understand clearly what we are doing and how this is developing.

At the same time, that we can keep the (inaudible) of Banco Itau and Itau-BBA very clear under the (inaudible) development. So, separating the new segment and the traditional business that we are carrying on. We believe that this will have a very fast development in the coming year. So we think that will be important to have these numbers disclosed to you.

This is what I have. And we are open here together with Henri, Alfredo, Candido and Silvio for any questions that you might have. Thank you.

Questions And Answers

Operator

(Operator Instructions) Jason Mollin, Bear Stearns.

Q - Jason Mollin {BIO 1888181 <GO>}

Good morning, to--or afternoon to everyone, depending on your time zone. My first question is related to the profitability levels that you just discussed for the outlook for 2005, with an ROE between the 25% to 30% range, which is a little bit below where you have been reporting on an annualized basis.

And I would highlight the presentation in your--and in your press release, you show the earnings kind of excluding extraordinary or nonrecurring charges, which would represent the return on equity more in the 39% range, well above what you're highlight for the outlook for 2005.

My question is related to that, to this level of let's say recurring ROE that we saw in the Fourth Quarter. And perhaps I could just say one of the drivers from what I see is that loan provisions net of recoveries were only 2.3% of total loans in the Fourth Quarter. Where, if

we look at it for the whole year, it was about 3.4%. Is that a main driver for what could bring down recurring profitability in '05 versus the Fourth Quarter of '04?

A - Roberto Setubal {BIO 1525746 <GO>}

Jason I would say that the Fourth Quarter, 39% is correct. But, we don't believe that we can keep 39% every quarter. We believe that we can keep it at the level of 30% every quarter. Which at the end of the year, we will have on the final average a 27% return on equity. So, you take the average, you'll be at the level of 30%.

We believe that this is quite possible. Maybe, depending on how things develop in Brazil in a more favorable scenario than we are forecasting, in terms of growth of the loan portfolio, we might deliver a higher level of ROE. But, we are not sure about that.

We think that, based on our budgets, we can deliver the 30% ROE for 2005 on average equity compilation. And we have to remember that, also as I mentioned, probably we will see increase, small increases in the loan provisions. This is true because of the change of the mix. We are facing now higher level margins, higher level of provisions will be coming down the road. At the end, as I mentioned, positive impact. But, we are not--we will see increased.

And also, the fact that we are developing, investing a lot on this credit consuming business. Which also has a small negative impact in the numbers of 2005.

Q - Jason Mollin {BIO 1888181 <GO>}

Maybe a follow up question would be on the regulatory environment or perhaps the tax environment. We've been hearing some discussions about perhaps the possibility that the income tax might be raised on service companies. I don't know if you have any comment there.

And secondly, if you see anything on the regulatory front, specifically reserve requirement. Some people have been speculating that perhaps the Central Bank could increase reserve requirements to tighten monetary policy.

A - Roberto Setubal {BIO 1525746 <GO>}

Well, everything that the authorities have mentioned so far, I've been discussing. In terms of taxes, will not affect Banco Itau. We are not being affected in that front.

In terms of the reserves requirements, we are not sure if they will do that. They have never mentioned that. They have declared in the past that they would like to reduce reserves requirements. So, we are not sure.

What I can say is that our budget was done based on--I would say not necessarily conservative. But we are doing numbers that we believe that we can perform.

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Operator

Paul Tucker, Merrill Lynch.

Q - Paul Tucker {BIO 2367847 <GO>}

Congratulations on the results. I just wonder if you could clarify a little the margin outlook for 2005. We're looking at an interest rate environment that, if anything, looks more attractive than 2004. And a mix in the loan book which seems to be moving in the direction of the higher margin areas.

Now, did I hear you correctly, Mr. Setubal, in suggesting that margins would be a little bit lower in '05? And I wonder if you could just clarify that.

And secondly, a related question. Just maybe if you could say something about the competitive environment into the second year of a strong credit recovery. Are you seeing any pressures on spreads at all?

A - Roberto Setubal {BIO 1525746 <GO>}

Okay, Paul. First, I think that as I mentioned, in 2004 we had a very--Banco Itau itself, not considering the corporate segment which is taken by Banco Itau-BBA. So, when we look only at Banco Itau, we had a very, very strong growth in the portfolio. This is a very strong number. Let me try to find out here the numbers for Banco Itau itself, was about 30%, I think, 35%, when we look at Itau itself.

So, we believe that growth will be very strong again in 2005, although not as big as in 2003. And for 2005, strong growth is not as big as 2004.

And this is--although we will have, as mentioned, an increase in interest rates, we are living in this environment at this moment, we believe that the growth will be there for two reasons. Number one, we are living--although the interest rates are increasing, we expect 3% to 4%, probably closer to 4%, growth in (inaudible) of Brazil.

The growth in (inaudible) will by itself have an increase in the demand for credit. What the government's trying by increasing interest rates is just like controlling the growth at this level. So the 4% growth will deliver a strong growth in the credit segment.

So, we won't have, as I mentioned, a growth of 70% in our small company portfolio and 43% in our consumers portfolio. But probably we will see numbers like 30%, 35%, is something that we could expect for 2005. What was your other question?

Q - Paul Tucker {BIO 2367847 <GO>}

And I guess just to follow on from that. Would it therefore be reasonable to expect, with that improvement in the mix in the loan portfolio, the balance sheet generally. And the high interest rate environment, in the absence of any tightening in reserve requirements,

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would it be reasonable to expect an improvement in your margin over the course of 2005?

A - Roberto Setubal {BIO 1525746 <GO>}

Marginal--could you come again, please?

Q - Paul Tucker {BIO 2367847 <GO>}

Yes. I guess your net interest margin--net financial margin in 2005, would it be reasonable to expect an improvement, given the outlook that you've put forward?

A - Roberto Setubal {BIO 1525746 <GO>}

I'm not sure about the final balances we are looking for with Banco Itau. We will--I think you should probably work with Silvio indeed in those numbers. But what are we expecting is that we will have revenues growing after provisions are factored and then costs. This will lead to improvement in our efficiency ratio. And we believe that it will be enough to keep our ROE at those levels that I mentioned.

Operator

Rusty Johnson, Hardin Loevner Management.

Q - Rusty Johnson {BIO 3426780 <GO>}

My question really relates to the real price of money that your customers are paying now. And in the future, to what degree management may be expecting effectively your loan spreads to come down from very high levels.

And presumably, that's going to have to happen as lending really drills deeper into the overall Brazilian economy. And is this predicated on effectively government bond rates or would you be able to allow your real returns to come down to expand your lending? And what would be your strategy there?

A - Roberto Setubal {BIO 1525746 <GO>}

Spreads will--we believe that spreads will reduce in Brazil. That's correct. We have to remember that they are already reducing. They are at very high levels. It's reducing slowly. And we believe that it will be a slow reduction. We don't believe that this will happen very fast. We will reduce slowly. And this will be out--it will be balanced by the growth in the portfolio.

So, we are very comfortable that although we will have a reduction in the spreads, an increase that we are facing in the growth will be more than enough to compensate the reduction in spreads.

Operator

Yolanda Cortine, of JP Morgan.

Q - Yolanda Cortine

Two general questions and a small specific question.

On the general front, if you could address the strong expansion that we saw in deposits in the quarter, how much of that you think you can retain on your balance sheet and how much of it was quite seasonal.

And with regards to the strong consumer loan growth that we saw in the period, which was again quite impressive, is there a portion of that which is essentially you know, from a classification standpoint, sort of lines of credit that are very low spread, do get lumped in there with consumer, consumer lending. Is there a portion of that that contributed to the growth we saw in the period?

And just on a very specific front, the additional fee income that you're calling extraordinary--.

Operator

--Pardon me. This is the operator. If you could please just hold your question for a moment, ma'am, their line has disconnected.

Q - Yulenta Cortine

Okay.

Operator

Please hold on. Thank you for your patience. Mr. Setubal, you have been rejoined to the conference.

A - Roberto Setubal {BIO 1525746 <GO>}

Okay. Thank you. Sorry for the interruption. Okay. Yolanda, you were just--could you repeat the question? We were not able to listen to it.

Q - Yulenta Cortine

Of course. Sorry. I'll try to be less long winded this time. One was on deposit expansion and how much of what you secured and the jump up in deposits in 4Q you think you can retain on balance sheet and how much was seasonal. And if there's any particular driver for that jump.

Secondly, was on consumer loan growth. If there was a portion of that consumer loan growth in the Fourth Quarter, which is these lines of credit that are not actually at consumer spreads.

And then just with regards to the INSS fee income that you're calling extraordinary, what period is this lump summary payment for and do you expect an annualized return that some portion of this going forward?

A - Roberto Setubal {BIO 1525746 <GO>}

Okay. Yulenta, I'll try to answer your questions one by one.

First, in the credit portfolio that we had in the Fourth Quarter, we acquired about 350 million Als from Banco America to BMG in the Fourth Quarter. This was 350 million, more or less. And we also had the impact of the increase in our share in Credicard, which amounted for 850 million Als.

So all together, in the case of Credicard, is the consumer spreads. In the case of America to BMG acquisition, the portfolio is not, as you mentioned, is not a consumer spread.

The second question was about the extraordinary fees that we accounted in last quarter. This was fees that we were not recognizing for I think 18 months more or less all together. And we recognize them at one shot this last quarter. And the third question was about did security portfolio--.

Q - Yolanda Cortine

--So the demand deposits.

A - Roberto Setubal {BIO 1525746 <GO>}

And demand deposits. What was your question again, please?

Q - Yolanda Cortine

Just the (inaudible) demand deposits in the quarter and whether--if there was any particular driver for that and if you think you can retain much of that on your balance sheet.

A - Roberto Setubal {BIO 1525746 <GO>}

Demand deposits varies a lot every day. So we are taking here the last day position, which you cannot take as a basis for evolution. It can vary. It depends on the day of the week that we are finishing the year and closing the balance sheet and things like that. There's (inaudible) here. So, I would not take this as a number that we can project any kind of number for the future.

Q - Yolanda Cortine

And just going back to the fee income, fee specific income though, that was 18 months worth. But you should be accruing that on a monthly or quarterly basis going forward now?

A - Roberto Setubal {BIO 1525746 <GO>}

Yes. We are going now to be recognizing this monthly. (Operator Instructions)

Operator

Jorge Kuri, Morgan Stanley.

Q - Jorge Kuri {BIO 3937764 <GO>}

Congrats on the quarter results. I have one question regarding capitalization. I see that you ended the year with a higher BIS ratio than in 2003. In fact, the current 20% BIS ratio, you're at the highest level over the last five years. And even though you grew your loan book quite aggressively, the return earnings were more than enough to support growth. You know, 20% BIS ratio seems quite high, particularly with the improvement in the risk outlook in Brazil.

Can you tell us--share with us any plans on what to do with the excess capital that is sitting in your balance sheet? Either higher buy-backs, higher dividends. You know, it seems like your returns on investment capital will clearly benefit from a rationalization of the use. Thanks.

A - Roberto Setubal {BIO 1525746 <GO>}

Okay, Jorge. One thing that I would mention is that, although we have the increase in the credit portfolio, we had a major reduction in our market positions. So, we released a lot of capital by reducing market positions in terms of exchange and interest rates. So, our balance sheet now is requiring much less--a much smaller amount of capital for balance sheet positions. There's a very low level of risk at this moment. So, this is not requiring any capital, compared to 2003. We've reduced some capital because of this. And this is one of the explanations, together with the internal regeneration of capital for the improvement in our BIS ratio.

What we are going to do with this level? We still believe that we will have, for the coming years, very strong growth in the credit portfolio. We believe that we can do some acquisitions down the road. We believe that we can buy back some shares, as we have been doing recently. And we will keep on growing dividends in the coming years.

So, we won't change basically, at least in the short period of time, any of those policies that we've been (inaudible) in the past.

Q - Jorge Kuri {BIO 3937764 <GO>}

Thank you. And just let me see if I understood something. Apparently, what has been declining is your holdings of public securities which, if I understand correctly, they don't really require you to create a lot of capital reserves, right?

A - Roberto Setubal {BIO 1525746 <GO>}

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Right. When I mentioned market positions is much more on the exchange, we are basically neutral at this moment. We have already had a much bigger position in terms of exchange. This requires capital by Central Bank regulation. We used to have a much higher level of fiscal credits. We have been reducing--fiscal credits have much higher weight in terms of capital position and capital requirements.

Our interest positions also have been reduced. So, we are releasing capital from market and also from fiscal credits. We have been--two years ago, I think two or three years ago, we had fiscal credits of almost 50% of our equity. And now we are on the base of 30%. So, this has been reducing our capital requirements for these kind of assets. (Operator Instructions)

Operator

At this time we show no further questions. This concludes today's question and answer session. Mr. Setubal, at this time you may proceed with your closing statements.

A - Roberto Setubal {BIO 1525746 <GO>}

Okay. Thank you, all for being here with us. And thank you for your attention. As a final statement, I would like to mention that we are very positive the macroeconomic scenario in Brazil for banking is a scenario with a steady growth; 3%, 4%, 5%, that range. Next year probably more close to 4%. This is a very good scenario for banking.

We believe that Banco Itau can outgrow the market at this moment. And especially in terms of credit. We believe that our investments in the credit consumer business will be very important for keeping the profits growing in the future. So, we are very positive about the outlook for Banco Itau in the coming years.

Thank you, all very much and see you next time. Bye.

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