Q4 2012 Earnings Call

Company Participants

- Caio Ibrahim David, CFO
- Roberto Egydio Setubal, President & CEO

Other Participants

- Carlos Macedo, Analyst
- Daniel Abut, Analyst
- Eduardo Nishio, Analyst
- Jorg Friedemann, Analyst
- Jorge Kuri, Analyst
- Maclovio Pina, Analyst
- Marcelo Henriques, Analyst
- Marcelo Telles, Analyst
- Mario Pierry, Analyst
- Natalia Corfield, Analyst
- Saul Martinez, Analyst
- Unidentified Participant, 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 Fourth Quarter and year 2012. 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 website.

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 Roberto Egydio Setubal, CEO, Alfredo Egydio Setubal, Executive Vice President and Investor Relations Officer, Caio

Ibrahim David, Chief Financial Officer, and Rogerio Calderon, Corporate Controller and Head of Investor Relations.

First, Mr. Roberto Setubal will comment on the Fourth Quarter and year 2012 results. Afterwards, management will be available for a question-and-answer session. It is now my pleasure to turn the call over to Mr. Setubal.

Roberto Egydio Setubal {BIO 1525746 <GO>}

Hello. Good afternoon. Good morning for all of you. It's a pleasure to be here to speak about our results. I would like to start, screen number 2, with our highlights for the year. We had a recurring net income for the quarter of BRL3.5 billion and, for the year, BRL14 billion. ROE was 19.3% for the quarter. And 19.4% for the year. And I will comment this down the road. Assets exceed BRL1 trillion, overall.

But overall, I'd say that we had a very challenging year. 2012 was not an easy. We had reduction in rates, pressure on margins, delinquency increasing. But I believe that we end up the year in good shape, because we were able to control delinquencies, as we will show you down the road in this presentation. We finished the year below the levels of December 2011. And I think this was a great achievement for the year.

Margins are reducing. And we have been managing the P&L of the Bank in order to adapt to this new environment. I think we are very successful in controlling expenses. And this made it possible to deliver these results that we have.

Provisions for loan losses are now on the way down in accordance with the NPL trends. So I think that we are ending the year in a much better shape than we started the year when NPLs and provisions were increasing.

We announced over the year also a big investment in technology, BRL10.4 billion [ph]. This will be invested over a three-year period. This has to do with the new datacenter that we already started to build, 100 kilometers from Sao Paulo. We are also investing in new technologies and new systems, new architectures in order to be able to do what we plan to do in terms of quality of services, in terms of agility to serve clients. So on and so forth.

We also announced a partnership with BMG. I think we are pretty much in line with the schedule in order to make it operational. It will start in March, fully operational. It's already in piloting terms but, anyway, we are supporting BMG, acquiring the loans so that they could expense the distribution for it. And we probably will start in high levels of production for the JV, in higher levels than we expected when we planned the acquisition.

We also finalized in the year the tender offer for the minority stake of Redecard (inaudible). We spent -- we invested BRL11.8 billion, that we show in the next screen, in page 3. We accounted this transaction as a capital transaction, aligned with the international standards and with our consolidated financial statements in IFRS. The important thing, I believe, in the way we accounted here is the fact that this will not impact our results in the future. So the full impact of the premium that we paid for Redecard is already on our balance sheet in our consolidated statements. So there will be no impact down the road for that.

Even though we have this equity reduction, we believe we are in good shape in terms of capital levels. We ended the year with 16.7%, which is very comfortable. And considering the adequate treatment for deferred tax assets that we have here in Brazil, our core capital ratio according to Basel III concepts will be above 10%, after this impact because of Redecard. So we are in good shape in terms of capital. And we believe that the acquisition will pay off down the road.

On page 4, we have our P&L. I believe that I won't comment the numbers. But I will more spend time commenting with you that our strategy, as the way we have been describing with many of you, it's already paying off. We can show clear results of what we have planned for the year. At the beginning of last year, we decided that we should change our risk appetite. And as a matter of fact, this started in 2010. But in 2011, was fully implemented, completely change in our risk appetite so that we moved out of some subprime, high risk kind of segments and assets and, nowadays, we have be seeing that this already paying off at the end of the year.

In fact, although our margins are still declining as we expected because we moved out of both segments with high margins, our services revenue and insurance revenue have been increasing sharply in the end of the year. Although we have some seasonality there, I believe that the numbers are above the seasonality issue.

So the things that we're expecting are already coming down the road as facts. And although margins have been reducing, the expenses for loan losses also have been reducing. So things are coming to the right place as we have been describing as a plan. But now, it's not a plan. It's already on the numbers.

Also, we have been very focused in terms of getting more efficiencies. So we have been controlling our expenses, non-interest expenses, in a very tough way for the year. We had a 1.8% growth in non-interest expenses. So that this was below inflation, was much below asset growth and revenues. So we have been gaining efficiency. And this is something that we plan to keep close eyes on this part of the business.

Next page, page 5, we show what we classified as non-recurring events. Non-recurring events, which is defined by the fact that in those issues here, we have changed the criteria that we were using to account for that. For instance, in terms of economic plans, we have done a very (inaudible) analysis, case-by-case analysis. So that we had more precise provisions for the commitments that we have ahead, much more precise than we had before when we used to use a more simplified model to make the provisions.

That's the same case for the labor claims. We went for a much more detailed analysis of large case of labor claims and not using the average as we used to use [ph] before. So this represents a change in terms of criteria that we use [ph]. Also, in terms of loan losses, we have changed some of the models in order to have a more gross [ph], precise rating for clients. But it changed. So this is not -- if we were using the same criteria that we were using in previous quarters, we would not have this level of additional provisions. But since we have changed, because we believe that this is more precise, now we have this additional provision that we are putting on non-recurring expense.

In the next page, page 6, we make an interesting calculation, showing that -- and, it's very important, because some of you have questioned if this would not be recurring. I would like to say this is related with much more on exclusivity with a change in criteria and does not have to do to any specific asset or loan that is past due. There's no any provision pertaining to the quarter related to past-due loans we had done on the recurring statements here. We have only done revision in our criteria so that we classified it as non-recurring.

And this is very clear here in page six when we applied the idea, the concept of, Okay, let's assume that we would have kept the level of coverage of past-due loans and provisions at the same level that we had the quarter before. When you see the numbers, you can see that we have improved our coverage by a large extent, bigger than what we had classified as non-recurring. So what we are doing is really making this, our provisions, stronger and not having to do anything about loans that are already past due. So this was the concept that we used for that classification.

Next page, we have this ROE of 19.4%, which was benefitted by the fact that we had reduced the equity of the Bank because of the Redecard transaction. If you had not done that, the Fourth Quarter would be 17.7% in terms of ROE. So this new level where we -- has to do also in part with the way we accounted for Redecard.

Loans have been -- it was a slow growth year, in terms of loans. We have grown 9% and, here, we had clear impacts that can be seen in the vehicles and the very small, and medium-market companies loans. Those two segments, we have a very, as a matter of fact, negative growth in both segments that impacted the overall growth of our portfolio. In those two segments, we are the most impacted by the new risk appetite policy that we have in place. So this was a reduction. And we expect that by the Second Quarter of next year those two portfolios will be already growing.

On this next screen, let's see, 9, we have the evolution of our net credit spreads, which is the strong green line, net of interest and net of provisions. So we can see that, although we still have a -- our margins are still falling, when we look at net of provisions it's already stabilizing. And we expect it to grow next year.

But overall, NIM has reduced more sharply this quarter for many reasons. And I will explain this in the next page, page 10, the very different impacts here. First, we had an increase in volume that put some [ph] additional revenue on our margins. But given the new risk appetite, the new risk appetite has impacted the volume that we are booking in different products of the Bank. So higher (inaudible), for instance, overdrafts, which are higher risk products and higher margins, have been reduced in our portfolio. So this is an example of the mix of spread [ph] has been impacted, because of this new underwriting policy.

Also, the acquisition of Redecard reduces our cash position in BRL12 billion, almost. And this also reduces the margin. Although we do not have any more, the minority shareholding (inaudible), in terms of bottom line, it was a positive impact.

We also have the SELIC rate reduction, which also impacted the numbers.

And finally, we have, which was a minor part, the margins and other effects that were compressed for different reasons here.

So this was an important understanding of how our business is evolving, (inaudible) in margins. But pretty much explained by the fact that in many ways we already expected an impact and was the (inaudible) which was a result of the new risk appetite.

Those are the bad news. But the good news, we start to see in the page 11 which accounts for delinquencies. The delinquency ratio has been consistently reduced. And we have been during the whole year reducing our level of short-term delinquency ratio. And NPL creation has already came down by a large factor and, on the next page, page 12, you can see that over-90 days NPL ratio is also already showing good results here, both in companies and also in consumers. I have to mention that on the consumer side we have sold assets for affiliated companies in an amount about BRL480 million. This had a 10-bps impact in our overall profitability ratio. So even if we did not have sold those assets, we still would have dropped to 4.9%. And that's still a good drop coming from 5.1%.

The assets that we have sold were auto loans which were delinquent for more than one year. So we are adopting this as a new policy. This won't have the same level impact in the coming quarters, because this was the total stock of loans over one year that we had. Now on, we will see much smaller numbers, because it will be the new things that we have below one year that will go on this process.

Our coverage as a result of all those things, all those improvements. And the additional provisions that we have made, has improved in a good amount. We have come from 149% to 158%, in terms of coverage ratio. So above last quarter and above December last year.

Let me move to page 15 just to show that our franchise of capturing deposits from clients is very strong. We have gained some market share this year. The growth we had was 16.5% (sic-slide 15). So very strong level of [ph] client franchise. We achieved more than BRL1 billion and quite strong impact from clients [ph].

As a result of that, loans have not shown as much. We have improved the ratio of loans to funding in the Bank, as you see in page 16 [ph].

Page 17 is just a picture of our new strategy that we have implemented during the year in the Bank, putting more emphasis on insurance and services revenue given the fact that we have had a reduction in margins. So this has offset somehow [ph] the (inaudible) margins and we have, as a matter of fact, grown the last quarter. The total revenue has grown mainly given this new trend. We have some seasonality in those numbers, clearly.

But even though, the improvement was above the seasonality level as we can see when we compare to last year's 2011 levels, three and Fourth Quarter.

Our efficiency ratio has improved this year, mainly because of our cost [ph] control on expenses, as we show in the page 18. We have grown only 1.8% expenses. So much below the level of inflation, much below asset growth and deposits. And so on. So forth. So the Bank is clearly gaining more efficiency. And this appears in our efficiency ratio, as we can see in page 19. Our efficiency ratio and risk-adjusted efficiency ratio has basically [ph] improved.

On page 21, we can see our progress that we have seen in our BIS ratio, which has finished the year at a level 16.7%, below the last quarter, September, mainly because (inaudible) Redecard, as we show here on the side. But above last year's number. So we are very comfortable with the overall capacity of the Bank.

The volume of our trading has kept in high levels. So I think it's very high, which is very good.

And on page 23, we can check the guidance that we gave you for the year. So what has been achieved and what has not been achieved. At the beginning of the year, we announced the change in our risk appetite. So this affects our portfolio growth, actually (inaudible) vehicles and small companies. We are not able to achieve the regional expectation, although we were able to achieve the number, revised, which would not include vehicles.

In terms of fees [ph], I think the main impact -- the negative impact here was also coming from the vehicles, which was accounting for the level of service revenue coming from the vehicle origination was much, much lower. So this affected the overall results.

In terms of non-interest expenses (inaudible), we were above the target. We give you a target of 4% to 8% at the beginning of the year. Then, 3.5% to 6.5%. And we end up growing only 1.8%.

Efficiency ratio was very close to the final levels that we originally had expected. We did not achieve for the full number basically because of revenues. But expenses were very much under control.

For next year, we believe that we will have a growth. We base these projections in a 3.2% growth in our GDP. So we expect more or less this level of growth. And credit portfolio will grow around 11% and 14%, under this circumstance.

We believe that provisions for loan losses will reduce. We are putting here a number of BRL19 billion to BRL22 billion. And we are very comfortable with those numbers, given the very different trends that we have seen in loan losses and delinquencies.

And service fees and insurance, we plan to grow more fast trends for the year. And we keep our stronghold on expenses. We believe that we will be able again to grow below inflation levels. So we are very comfortable with those three numbers.

I have to mention that we also plan to improve the risk-adjusted ratio. And we believe that there is some -- the margins will grow low one-digit, low levels. They are depending on how markets develop and some thresholds and margins and the rate and [ph] growth of the economy. This might be a factor [ph]. So I would say basically that there is more uncertainty around the lean [ph] growth and most certainty about the guidance that we are giving you in this chart here.

Having said that, I open up for questions. Thank you.

Questions And Answers

Operator

Ladies and gentlemen. we will now begin the question-and-answer session. (Operator Instructions) Carlos Macedo, Goldman Sachs.

Q - Carlos Macedo {BIO 15158925 <GO>}

Good morning, Roberto. Good morning, gentlemen. Congratulations on the strong results, strong trends. A couple of questions. First, if you could give us some color on the loan growth expectations you set out for 2013, particularly in between the lines for what specific areas you expect more growth for? Of course, you had weak growth on the auto line and stronger growth on the mortgage line. Are those trends expected to continue into 2013, for a specific line? And how does that affect your mix and your margins as a result?

The second question is with respect to expenses. The guidance you give of 4% to 6%, I was wondering how conservative you are? Because, just looking at some of the trends, for instance, in personnel, average number employees will be down. The severance expenses that you had in 2012 presumably will be down as well. Those were almost doubled in 2012, related to 2011. Could there be a positive surprise in expenses with expenses growing or being flat year over year? Is that a possibility? Or, are you conservatively guiding 4% to 6%? Thanks.

A - Roberto Egydio Setubal {BIO 1525746 <GO>}

In terms of expenses, remember that we are guiding you are the numbers that we believe that we have plans for achieving them. And we are very confident that we can achieve.

Having said that, I have to tell you that we still are working in order to reduce expenses, although I cannot give you any guidance today, because I don't have a clear plan (inaudible). But if we are able to find out new things and I believe that we can do a lot of hard working for that, because we have to prepare the Bank not only for the next year. But also for 2015 and 2016. So we are still working in new things that we have to improve productivity.

So it is possible that we achieve this number in the lower band, clearly, maybe a little bit below. It may be possible, though we don't have any plans for that, I have to say. On the other hand, we don't know exactly how the inflation, how the exchange rate, how the readjustment of salaries, the official readjustment. Just to give you an example, last year it was 2% above inflation. So if this is something that happens again this year, this will have a negative impact as well.

The other question was about mix. We believe that on the Second Quarter of the year, we will have the vehicles portfolio and the small company portfolio back to growth. So we still have some (inaudible) of this reduction in risk appetite. For the year, we believe that lower-margin products will outgrow higher-margin products. I'm talking about consiginardo [ph]. I'm talking about credit to mortgages. I'm talking about big companies, big corporations. So those portfolios in my view will outgrow other portfolios that have large margins.

Q - Carlos Macedo {BIO 15158925 <GO>}

Okay. Thank you, Roberto.

Operator

Mario Pierry, Deutsche Bank.

Q - Mario Pierry {BIO 1505554 <GO>}

Hi. Thank you for taking my questions. Let me ask you two questions, Roberto. One is we have seen significant improvements, or reduction, in your headcounts at the Bank over the last roughly 12 months. We saw headcount fall by 7%. I was wondering if you could give us any guidance in terms, should we expect this trend to continue? Should we see an acceleration in headcount reductions? If you could, just give us some more color specific to headcounts?

Then, second question is related to Redecard, or your acquiring business. We saw a significant pickup in volumes this quarter. So I was just wondering if you could remind us of your strategy for Redecard? What are you expecting for volume growth NPRs [ph]? That'd be great. Thank you.

A - Roberto Egydio Setubal {BIO 1525746 <GO>}

In terms of headcount, we don't have a goal to achieve in terms of reduction. We believe that we have more opportunity in terms of getting efficient in other things, not necessarily in people reduction. And we do not have a specific goal on that.

In terms of Redecard, we had a good quarter, good development. I have to tell you that although we recovered some of the market share that we had lost in previous quarter for the year, this was a result much more of fees [ph] and decisions that were taken [ph] even before the (inaudible) position of the Bank. So I do not really would think this improvement to the fact that we are already fully owning Redecard. Those decisions are taking before that.

We have a new CO there. We have plans for Redecard. We are very excited with the opportunities of integrating more with the Bank, synergies in terms of what we have in terms of opportunities with small companies. This is an important relation with small clients. We believe that Redecard is an important part of this strategy, because it creates opportunity to extend credit in a very solid way. So this is important.

We also believe that, in addition, on the other side in terms of payments opportunities, Redecard is an important asset, give us a lot of flexibility, give us a lot of power to negotiate with VISA and MasterCard and other brands that are in the road. So if we can, we are stronger today to negotiate with those guys.

So I think we are very happy about the acquisition, the way things are developing. And the kinds of things that by integrating with the Bank we can have.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. That's very good. Just if I could go back then to your answer, you're not specifically looking for headcount reduction, or you don't have a target. But you're looking to improve productivity. Can you just give us some examples of what type of plans you have in place? I think it has been long mentioned in Brazil that the banks would eventually share ATMs and things like that. Could you just give us an update on how can you achieve productivity improvements?

A - Roberto Egydio Setubal {BIO 1525746 <GO>}

We don't have and we are not announcing specific things. But I can tell you that. And at the point that we are, we do not have one single silver bullet. It's a lot of small things. Everybody in the Bank is working very hard in all the areas of the Bank, improving productivity. Everybody has this in their own goals, achievable [ph] goals. So it's a lot of things. Some are more relevant, some others not as much relevant. But there are no single important thing. We are integrating. The cost is changing. Process. A lot of small things.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. Great. Thank you very much.

Operator

Daniel Abut, Citi.

Q - Daniel Abut {BIO 1505546 <GO>}

I just have a couple of [ph] questions. One, on the capital situation, now that you explained that after the integration of Redecard and the new level of capital that that implies, you did say in your disclosure that if you apply the general new Basel III rules, given what you understand will be the treatment of deferred tax assets, you'd still be about 10%. But what I wonder is within that about 10%, what will be your situation for [ph] the core capital? Because it appears to me that maybe on the core capital, basically, it will be too tight depending on your growth plans. And I'm trying to get a sense to where this is a sustainable situation? Or, sooner or later, you may need capital?

And depending on your answer to that question, then I wanted to ask you about the sustainability of your ROE now that you've reached this low 19%'s level in the portfolio. But it seems to me that from now on, particularly given the effective decline in provisions that you are guiding, your earnings generation should start to improve. How do you feel about your ROE, going forward? But again, that's tied to whether you feel your current capital situation is sustainable, or not.

A - Roberto Egydio Setubal {BIO 1525746 <GO>}

Hello, Daniel. Thank you for the questions. I think we are not clear. I'm sorry for that. So we are 10%. The level that we are talking about is the core capital. We are in terms of core capital, above 10%. I think I was not clear when I mentioned that number. So this is really something very comfortable.

In terms of ROE, clearly, the fact that we have reduced the equity will have an impact in the ROE. Just to give you the idea there, the ROE of last quarter would have been 17.7%, instead of 19.4%. So this was a clear improvement.

But coming to the P&L itself, I'd say that margins will be a very important driver of this. How much ROE and how much final net income we can get will be much more depending on the margin, the net interest income development. I think there's some uncertainty today. We will have to see how the year develops.

Q - Daniel Abut {BIO 1505546 <GO>}

Okay. Thank you, Roberto.

Operator

Guillermo Mueller [ph], Credit Suisse.

Q - Marcelo Telles {BIO 3560829 <GO>}

Hi. Hello, everyone. Marcelo Telles, Credit Suisse. I have two questions. The first one regarding your extraordinary provisions for loan losses. I was wondering if you could tell us, what was the amount of the loan portfolio that was reclassified with the different risk ratings? And how much of that portfolio is actually related to the restructured portfolio?

And my second question is a more broad question. We saw a very -- a big guidance on provisions for 2013, which makes sense considering the improvement you clearly have been showing. But on the other hand, it seems that a very good chunk of that improvement is being offset by an expectation of NII decline because, if we play with your guidance and we try to derive what sort of earnings you would be expecting, NII evolution, it looks like you'd be expecting the NII to go down 5%, more or less 5%, in 2013. But then, you have a decline, maybe 13%, in provisions which would lead to a low single-digit increase in NII after provisions. Right? But the net effect of that is that your earnings growth would still be around high single digits. So what --? Do you think this trend can revert, thinking about 2014? Do you think you can resume growth in your NII from that point? Or, you think that 2014 you would still see a relatively slow resumption of NII growth after provisions? Thank you.

A - Roberto Egydio Setubal {BIO 1525746 <GO>}

Okay. Starting with the last question. I recognize that we have some uncertainty in the margin development. We have been sharing this very clear with you. I would say that our -- we do expect it to be slightly positive, in general, although we see risks of going down depending on market conditions, growth of the economy, demand of loans. But also, we can have also a positive impact coming from less pressure in the marketplace. So there are some uncertainties. And this we have to see over the year. We believe that this is really [ph] about free provisions levels.

Part of the provisions we reduce. And we expect that net interest income will be very close to a low level, positive number in terms of overall growth for the year. But (inaudible) strategy there. I positively agree that it can be slightly positive. It's going to be more positive or slightly, very slightly, maybe negative. But probably more on the positive side.

In terms of provisions that we -- the non-recurring numbers, again, the provisions that we classified as non-recurring were non-specific provisions for any specific clients. It was much more a review of models that showed us that from many clients -- basically, retail, mostly small companies -- we would be more precise in terms of expected loss for giving the current situation of loans in the portfolio. We have more provisions there.

Q - Marcelo Telles {BIO 3560829 <GO>}

Thank you, Roberto. And just a follow-up on that question. Do you expect more of this type of provisions, going forward? Or, this is as much as we're going to see in terms of this extraordinary provisions? Thank you.

A - Roberto Egydio Setubal {BIO 1525746 <GO>}

We do not expect any new revision in models. I think we have learned a lot on models this year, as we all know here. We have made a few mistakes. But now I think that things are pretty much in good shape. And we do not expect any review in terms of our provisions.

Just taking the opportunity to mention that, on page 3, although we have stated there -- I'm coming back basically to the question of Daniel Abut about the total capital ratio above 10%. It's wrong there. We are talking really about core capital above 5%. I'm really sorry to have this here in our presentation. We will correct it on the site.

Thank you.

Q - Marcelo Telles {BIO 3560829 <GO>}

Thanks, Roberto.

Operator

Jorge Kuri, Morgan Stanley.

Q - Jorge Kuri {BIO 3937764 <GO>}

Hi. Good morning, everyone. Thanks for the opportunity. I have two questions. The first one is on your margins. Just wanted to clarify, you said net interest income growth of low single digits? I know it's not an official guidance. It's not here on the last page of your presentation. But you are providing a little bit of color. So I just wanted to make sure I understood. So what is your expectation for net interest income growth for 2013?

A - Roberto Egydio Setubal {BIO 1525746 <GO>}

We are not really giving you a guidance. We are basically recognizing that there are some uncertainty there. Numbers could be slightly positive, slightly negative, maybe more positive. But this is basically -- and, this is clearly because we did not give you a clear guidance. There is no -- we accept that there are some uncertainties there. Basically, this is what we can really provide you, Jorge.

Q - Jorge Kuri {BIO 3937764 <GO>}

Thanks. So just to understand, the uncertainties on margins, you have a loan portfolio guidance. So I'm assuming you know where you're going to grow. You have a provision guidance, which I'm assuming then you know what the mix of the business is going to be. And you have a SELIC forecast which is, I think, flat for the year. I'm just --. You understand the duration of your loan book and when the SELICs [ph] expire and the front book, back issue. You know what your duration of your assets are and liabilities. So just wanted to understand where the uncertainty is? What part of the margin story is the one that you don't know today that drives you not to have a specific guidance, because it seems to me that all of the pieces you know? I guess I just want to know which part you don't?

A - Roberto Egydio Setubal {BIO 1525746 <GO>}

I don't know two things. One is the volume. We have some uncertainty about the volume, some uncertainty about the growth of the economy. And this is an important uncertainty. The other comes from uncertainty about pressures on margins in the market. If we assume that we reduce, we are more on the positive side. If we assume that there will be more pressure on margins, we might be on the negative side. But basically, this is what we have. But so now, the difference in my view what's going to happen.

Q - Jorge Kuri {BIO 3937764 <GO>}

All right. Thanks. And the second question is just also clarification. Your guidance of provisions of BRL19 billion to BRL22 billion, that assumes that your coverage ratio remains stable throughout the year? And I ask this because we did see a big depletion [ph] of your coverage ratio in 2011/2012, from almost 180% down to 150%. So you can do BRL19 billion or BRL22 billion in provisions without taking out of the coverage? Is that the thinking? Or, it includes maybe taking the coverage ratio down to closer to 120%, 130%?

A - Roberto Egydio Setubal {BIO 1525746 <GO>}

No. Our guidance assumes that we will keep the same policy that we have today for making the provisions. And we would say that the trends of delinquency, positive as it is, will lead to increase in the coverage ratio, because we will have lower level of delinquent assets with the same policy of provisions. So I would assume that -- I don't have the numbers here. But my math would imply an improvement in the coverage ratio.

Q - Jorge Kuri {BIO 3937764 <GO>}

All right. Thank you very much.

Operator

Jorg Friedemann, Merrill Lynch.

Q - Jorg Friedemann {BIO 15405752 <GO>}

(technical difficulty) for the opportunity. First, on the expectations that you have for 2013. I note that in the non-recurring events screen that you had in the beginning of the presentation, that you realized the remaining of the tax benefits on increasing the social contribution rate. And just wondering where do you expect the effective tax rate to go, over 2013? Thank you.

A - Roberto Egydio Setubal {BIO 1525746 <GO>}

Could you please repeat the question, Jorg?

Q - Jorg Friedemann {BIO 15405752 <GO>}

Sure. Just that you realized the positive tax benefits on increasing the social contribution rate over the Fourth Quarter. And I'd just like to understand how you expect the effective tax rate to evolve during 2013?

A - Caio Ibrahim David {BIO 16553443 <GO>}

Hi, Jorg. This is Caio. How are you?

Q - Jorg Friedemann {BIO 15405752 <GO>}

Hello.

A - Caio Ibrahim David {BIO 16553443 <GO>}

So that's pretty much our effective rate would be around 32% to 34%, if you consider that we have the benefits coming from payments of the dividends and the EPTs [ph]. So that's pretty much what we are considering right now, in terms of forecast for 2013.

Q - Jorg Friedemann {BIO 15405752 <GO>}

Okay. I ask that because this implies an increase of about 4% to 6% compared to what you posted in 2012. Is this correct?

A - Caio Ibrahim David {BIO 16553443 <GO>}

Yes, something like this, especially because we consider the social contribution benefits all in 2012, as you know, as a non-recurring event. So that's why we believe that we are going to increase a little bit the effective tax rate in 2013, based on that.

A - Roberto Egydio Setubal {BIO 1525746 <GO>}

But for the full 6%, Jorg, because we have companies that are already 34%. Okay? Just remember that. So don't have yet a clear number here to give you. But remember that Redecard, for instance, is 4% and it will stay 4% with no difference. So we have things in other situations that won't change. So the full effect will not be the 6%.

Q - Jorg Friedemann {BIO 15405752 <GO>}

Sure. Perfect, Roberto. And taking the opportunity to ask a more broad question, I know that the relevance for the countries in Itau's balance sheet continues to increase over time. So just wondering how much you believe those other countries could contribute to the Bank's total loans in the next couple of years. And whether this could be an additional source of net income generation in your view? You bought, for instance, HSBC retail operations in Chile, I think about 15 to 18 months ago. And HSBC continues to be vocal about potentially divesting from non-core regions. So would you consider opportunities in the Caribbean and in Mexico, should those become available? Thank you.

A - Roberto Egydio Setubal {BIO 1525746 <GO>}

Well I think that we have to basically -- I think your question is much more related to the local loans that we do in local markets -- Argentina, Chile, Uruguay. And Paraguay -- and not necessarily loans that are booked out of Brazil which we do with Brazilian clients, for instance.

Q - Jorg Friedemann {BIO 15405752 <GO>}

Yes.

A - Roberto Egydio Setubal {BIO 1525746 <GO>}

Well today, as we can see in our balance sheet, we have, like, BRL29 billion in that number. It has grown. I'm not sure how much this year, adjusting for the exchange rate. But it has been growing much more than the local number. I think that those numbers would be closer to 15% to 20%. And not like the local numbers were 9%. We had much higher levels of growth in those markets.

And I believe it will continue given the fact that those markets we did not have to adjust any kind of risk appetite. So we are stable in terms of growing. We have been growing in all those markets. And those economies in general are outgrowing the Brazilian economy.

So we expect them to outgrow the Brazilian portfolio by a larger amount, although they still represent a small amount in our balance sheet.

I believe that any major change in terms of really becoming a meaningful aspect of our revenue would come only after a major acquisition. The current numbers are still below 10% of our loan portfolio. So we should not expect a major, meaningful impact on our balance sheet in the short term. And we do not have any plan to date to do any major acquisition. I don't think there's any possibility of this currently. There's no important asset being offered or being negotiated in the marketplace. So for the time being, I don't think this would be a relevant thing. But I have to say that we are in the position of interest of investing in other Latin American countries.

Q - Jorg Friedemann {BIO 15405752 <GO>}

Perfect. Thank you, Roberto.

Operator

Saul Martinez, J.P. Morgan.

Q - Saul Martinez {BIO 5811266 <GO>}

Hi, guys. Good afternoon. My question is really just, it's a follow-on on a lot of the earlier questions. But it's a more broad question, I suppose, about risk appetite. Roberto, you mentioned that you believe that SMEs and auto loans should start to grow in the second half. You've also mentioned a lot of uncertainty in your expectations for net interest income. And you've clearly been in a risk-off mode for a while. And perhaps that's the right strategy. It's been good for asset quality. It's been bad, obviously, for your net interest income evolution. But what needs to happen either in the macro environment for you to start to grow your higher-margin products at a more elevated rate? Is it --? Do you need to see better macroeconomic growth conditions? Do you still feel uncomfortable with the leverage levels of consumers? What is it that would cause you to start to take a more risk-on type of mindset since, obviously, that is really a big part of what will get net interest income growing again?

A - Roberto Egydio Setubal {BIO 1525746 <GO>}

I don't think that -- I believe that the opportunity in that segment is not the same as it was ten years ago. Ten years ago, Brazil was basically starting to develop the consumer credit markets. And we had high, very high level growth during this period. Clients have increased the level of indebtedness of them. So I think that today the opportunity in this market is pretty much reduced, in terms of growth. It will stay growing. But much more slowly than it used to do in the past. So we don't foresee this as a major opportunity for growth for us. We believe that opportunities will be larger for growth in other markets, like mortgages and payroll loans and things like that, with lower level margins although much, much lower levels than (inaudible).

Q - Saul Martinez {BIO 5811266 <GO>}

Do you see SMEs as a growth opportunity anymore?

A - Roberto Egydio Setubal {BIO 1525746 <GO>}

I see SMEs as a growth opportunity. Yes, I do, although I think that margins in that segment also will be much more controlled. I think we have to use much more collateralized types of loans, like Redecard loans for instance. We can use collaterals of Redecard for loans for the small companies. So I think that that segment, we have probably more opportunities than in the consumer segment. But have to adjust the risk profile.

Q - Saul Martinez {BIO 5811266 <GO>}

Okay. Great. Thank you very much.

Operator

Maclovio Pina, Morningstar Equity Research.

Q - Maclovio Pina {BIO 16236843 <GO>}

Hi. Good morning. And thank you for taking my call. And also, thank you for slide 10. I think it's pretty useful. And also, following up a little bit on the net interest margin questions before, I'm just curious if you can give us a little bit of color in what you've seen in the development of client NIMs for loans so far this year? Can you give us a little bit of a taste of, have they been better or worse than the average 4Q12?

A - Roberto Egydio Setubal {BIO 1525746 <GO>}

The trend is the same. We probably will lose some margins in terms of -- we will gain volume, when compared to the chart that you just mentioned. We're still going to gain more volumes. If you do this at the end of next year, the same chart, I would say that we will see growth in volume, some loss because of spread mix. We won't have Redecard. I believe SELIC will stay pretty much stable. And there's some uncertainty around the last thing, which would be the margin. If we assume stable margins of what we are doing today, what we are underwriting today, then probably we will have a positive evolution of net interest income.

Q - Maclovio Pina {BIO 16236843 <GO>}

Okay. But essentially, the trend remains as in 4Q. Great. Thank you very much.

Operator

Marcelo Henriques, BTG Pactual.

Q - Marcelo Henriques {BIO 17385475 <GO>}

Hi. Thank you for taking my questions. I have two questions. One is just to clarify the background scenario for the credit growth this year, which the guidance is between 11% and 14%. Some of your competitors, private ones, are saying that they do foresee that the public banks will decelerate their aggressiveness during 2013. I'm just wondering if -- and, sorry if I missed that during the presentation -- but I'm wondering if you'll consider that as part of your assumption for credit growth for 2013?

A - Roberto Egydio Setubal {BIO 1525746 <GO>}

Well last year, we grew 9%. So we are accelerating our growth to a higher level. And this level will depend only if [ph] the growth of the economy and the situation around the market. But we will have growth, definitely.

Q - Marcelo Henriques {BIO 17385475 <GO>}

Okay. Because I was just wondering how this would play out. As I'm looking how the economy is going, it's still in a ramp-up phase. And the fact that the new credit being originated in the system depends too much on public banks for, I don't know, 70%. So from a top-down perspective, it seems hard. At least when the economy is in a ramp-up state, it was all down. And effect that if the economy improves, why would they stop anyway, because it's just a better economic environment? So they don't have a purpose to stop. And from a bottom-up perspective, for the public banks, since they seem to decrease very much the interest spreads and tariffs, if they do not compensate in volumes, they will really suffer even more probably that we are going to see. So I was just wondering that at least if this could compromise your ability to reaccelerate growth in 2013. And to such an extent that you do not choose to take more risks again as you have been more in a risk-off mode recently?

A - Roberto Egydio Setubal {BIO 1525746 <GO>}

Yes. We won't change our risk appetite. We are very confident that it will pay off at the end of the day. It will bring the right returns for the capital that we are using to make the loans.

I believe that this year, 2013, we will see a much smaller difference between public and private banks.

Q - Marcelo Henriques {BIO 17385475 <GO>}

Okay. And also on the credit growth. And just for me to understand. And actually related to the provisions, of course, there has been an improvement in Q4, although if you consider the credit sale that you did and the write-offs, despite improvement, maybe it is not as significant as it appears in the numbers. But it did improve. And you're being pretty bullish on 2013 guidance from loan loss provisions. But I'm just wondering if this decline in loan loss provisions is just more related to the fact that you were in a risk-off mode in the past, let's say, 18 months? Or, if you're really seeing an improvement in credit quality out there? And if that's so, -- and, again, I wonder why you cannot grow more if the public banks are less aggressive? If the environment, it is better and if they didn't do, let's say, didn't take too much risk, why shouldn't you increase your credit growth even more this year, especially on the individual side? The scenario, I'm not sure it's perhaps changed as much in 2013. People are still employed. They're still making real wage increases. And the fact that they're still leveraged, despite the fact that it's low or high. But they're still leveraged, at least above historical average. So why would --? I'm trying to understand if this decrease in loan loss provision is a rebound from the fact that you have been basically not lending? Or, you see actually structural improvement in asset quality in the system in Brazil, that's why you see that?

A - Roberto Egydio Setubal {BIO 1525746 <GO>}

Well first of all, we are talking about our numbers. I'm not talking about Brazil's numbers, the system's numbers. We are talking about our numbers and, talking about our numbers, we are very confident that. We have shown all the numbers here. And we can look from many sides and all of them lead to one conclusion -- the improvement in the asset quality is very clear. I don't think that there is any question.

I'm not sure about the numbers in the system, because I don't know what the banks have in their assets. But public numbers they do not show the same kind of improvement that we have seen here in Itau. And basically, the reason is because we have been much more careful the last quarter. I think this is a result of our policy. Something very, very clear. So at this point in time, I think that we are very confident that quality of assets is improving.

I can explain to you why our volume will not grow maybe as much as you would expect, basically, for one single reason. If you divide our current portfolio in two types of clients, assume that one type of client is the clients that I am according to my current risk appetite. And the other one is the remaining book of clients, of type of loans that I would not renovate any more, as long as I can have the loan fully paid. So I have still today a portion of assets of loans that, under the current level of risk appetite, we would not have booked. So I have to finish that level.

When you take into account basically the level of loans that I have in my book today that have the risk appetite that I'm talking about, the one I have been booking. And we see the growth that we are expecting for the future, this growth is above 15%.

Did I make myself clear?

Q - Marcelo Henriques {BIO 17385475 <GO>}

Yes. It's very clear. I can of course follow up with you guys off line. But I think the question, the main question, I have for 2013 improvement in your numbers, which I know that's your numbers, is that maybe it is more related to the fact that you've been on a risk-off mode and then you have seen improve in your asset quality. But once you start growing again. And if that is the case. And if the credit quality of the system has not changed. So you basically have a choice to take marginal risks again. So I'm basically talking much more about 2014, maybe end of 2013. So making more -- taking more risk again, because really the environment of the system has not changed dramatically. So that's why I was trying to relate the loan loss provision and the ability for you actually to grow more on a structural basis, not meaning only 2013. But I don't want to dominate the call. And I can follow up on that.

A - Roberto Egydio Setubal {BIO 1525746 <GO>}

Just a comment. Rogerio can give you more details on that. But again, we have numbers from vintage [ph]. The recent vintage that we have been booking the last six months are much, much better, in terms of delinquencies, much, much better than the ones that we were booking before. So all signs that we have in any angle that you can see shows the same kind of trend and conclusion.

Q - Marcelo Henriques {BIO 17385475 <GO>}

Okay. Thank you. Thank you very much.

Operator

Eduardo Nishio, Brasil Plural.

Q - Eduardo Nishio {BIO 15333200 <GO>}

Hi. Thank you for taking my question. My question relates to delinquency and competition. Delinquency in Brazil as nicely depicted in your institutional presentation is much higher than other countries. And all banks seems to be moving to lower risk, lower return products to decrease risk in their balance sheets. My first question relates to this changing mix. It's only the mix that will decrease the risk profile? Is any other initiative you are trying to implement, not only you. But industry, to decrease the risk profile? But not only that, probably to try to improve profitability of the next (inaudible)?

And my second question is related to that. Since all banks are moving towards the same products, basically payrolls and mortgage [ph] loans, it's already impacting prices. How can we avoid the same mistakes that happened in 2010 when all banks were trying to get into SMEs and other [ph] segments? Any risks you see in the short term in margins for those segments? Thank you.

A - Roberto Egydio Setubal {BIO 1525746 <GO>}

Okay. Starting with your last question, currently, I don't see any risk of any problem in the things that we are booking. By the way, as I mentioned before, the (inaudible) that we have been seeing recently are the best probably in more than four or five years. So we don't see any major problem coming from that side.

How can we assure you that we can keep this for a longer time, in terms of system? I think it's a matter of discipline. I think banks when they rub their hands, say -- it's a good lesson. Let's go back home. We do all our homework. We go back in a more disciplined (inaudible) way. I think that in 2010 the boom of the economy, the boom of the market made the banks a little bit relaxed [ph]. Now, we are much more back to the basics. And we think that are the right things to do for banking.

What was your other question, Eduardo?

Q - Eduardo Nishio {BIO 15333200 <GO>}

It's related to the mix. Is there any other way to improve profitability or to decrease risk, aside from changing mix?

A - Roberto Egydio Setubal {BIO 1525746 <GO>}

I think the right question here is risk assessment. I think as long as we have the right risk assessment and we are able to price the risk, we can make a lot of money out of very low risk assets or high risk assets, as long as you price correctly and you assess correctly the risk. So there's not really -- I don't think the idea that high-risk assets are more profitable than lower-risk assets, I don't think that this is true. It's a matter of really understanding exactly the kind of risk that you are talking about and how to price it.

Q - Eduardo Nishio {BIO 15333200 <GO>}

Okay. Thank you.

Operator

Emmet Meta [ph], PIMCO.

Q - Unidentified Participant

Hi. Yes. Sorry, I might be reiterating a question asked earlier. But can you just give us some color on the net interest margin? What scenario are you assuming for your guidance, which I understand to be kind of flat to slightly up, pre-provision? And also then, what dynamics concern you that could obviously derail that?

A - Roberto Egydio Setubal {BIO 1525746 <GO>}

Basically, we assume that we will have the same risk appetite throughout the year, which is what we plan to do. And there's some uncertainty given the fact that volumes might float [ph] a little bit and, also, what would be the kind of pressure coming from the marketplace that we might have. So these might bring me some uncertainty in terms of what would be the net interest income for 2013.

Q - Unidentified Participant

And just coming back to the point made by some other analysts, in terms of every bank moving into the same segments, does that make you maybe a bit more sanguine about certain high-risk segments, that they may be getting priced better?

A - Roberto Egydio Setubal {BIO 1525746 <GO>}

Again, it's a matter of knowing what you're doing. It's a matter of doing the right risk assessment for the assets that you are underwriting. Again, we are tracking this very closely. And we are very comfortable with the levels that we consider to be booking (inaudible) today.

Q - Unidentified Participant

Okay. And sorry, can I just follow up with one last question? Can you just give me an update on your payout ratio in light of this slower loan growth and where your capital position is? Your payout ratio has been around 25% to 30%. And what do you expect going forward from here?

A - Roberto Egydio Setubal {BIO 1525746 <GO>}

Usually, we (inaudible), or net dividends that we have to pay. We have basically floating our payout ratio between 30% and 35% of the (inaudible), the net dividends to the returns, net income. And we do not plan to change that.

Q - Unidentified Participant

So despite the slower rate of growth, you don't think you have capacity to raise your payout ratio?

A - Roberto Egydio Setubal {BIO 1525746 <GO>}

We believe that we will be able to use the capital in a profitable way.

Q - Unidentified Participant

Thank you very much.

Operator

Victor Galliano, HSBC.

Q - Victor Galliano {BIO 1517713 <GO>}

Hi. Yes. My main questions have been asked. But just a couple of follow-ups here. Just clarification on the guidance you've given for provisions for loan losses. This I assume is gross provisions. So before recoveries? Am I right in thinking that?

A - Roberto Egydio Setubal {BIO 1525746 <GO>}

Yes. You are right. It is gross.

Q - Victor Galliano {BIO 1517713 <GO>}

Okay. Okay. And also, one other thing on the CapEx you're talking about IT, the BRL10.3 billion over the next three years. Is this all going to be capitalized? Is any of this going to be expensed through the P&L? And is that factored into your non-interest expense guidance of 4% to 6%?

A - Roberto Egydio Setubal {BIO 1525746 <GO>}

It's CapEx. Long-term investments CapEx.

Q - Victor Galliano {BIO 1517713 <GO>}

Okay. So none of it is going to be expensed.

A - Roberto Egydio Setubal {BIO 1525746 <GO>}

No.

Q - Victor Galliano {BIO 1517713 <GO>}

Okay. Thank you.

Operator

Natalia Corfield, Deutsche Bank.

Q - Natalia Corfield {BIO 6421991 <GO>}

Good morning, all. Thanks for the questions. It's about your JV with BMG. If you could give us some more color on how it's evolving? You had an initial guidance of BRL12 billion at the end of the first two years. I would like to know if that's still current? And also, how you expect your payroll lending portfolio to grow in 2013? Thank you.

A - Roberto Egydio Setubal {BIO 1525746 <GO>}

The partnership is going very well. We are already piloting contracts now in January. Have been booking and formalizing all the agreements with all the payrolls that BMG used to have. We are also formalizing all the agreements with the processing [ph] of the (multiple speakers). So things are pretty much in line to have the full operation in the Second Quarter of this year, probably March already we'll be almost fully operational. And probably fully operational in the Second Quarter.

Volumes today that we are originating in BMG which would be basically the distribution forces [ph] for the new enterprise are about [ph] the level that we expected when we announced the deal.

Q - Natalia Corfield {BIO 6421991 <GO>}

Okay. And are you expecting the JV to be profitable in 2013? Or, is the JV going to have a loss?

A - Roberto Egydio Setubal {BIO 1525746 <GO>}

Probably, a small loss or a small -- pretty much close to breakeven, not meaningful at all.

Q - Natalia Corfield {BIO 6421991 <GO>}

Okay. Thank you.

Operator

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

A - Roberto Egydio Setubal {BIO 1525746 <GO>}

Okay. Thank you for all of you that's still there. Long hours here. It was a pleasure to be with you and try to clarify some of your doubts. And I would like to finish by saying that we believe that we have a strong year, this year, although also challenging for us.

Thank you, all. And see you next time.

Operator

This concludes our Itau Unibanco Holding earnings conference for today. Thank you very much for your participation. You may now disconnect.