Q1 2018 Earnings Call

Company Participants

- Candido Botelho Bracher, Executive President & Chief Executive Officer

Other Participants

- Carlos G. Macedo, Analyst
- Jason Mollin, Analyst
- Jorge Kuri, Analyst
- Jörg Friedemann, Analyst
- Marcelo Telles, Analyst
- Mario Pierry, Analyst
- Philip Finch, Analyst
- Rafael Frade, Analyst

MANAGEMENT DISCUSSION SECTION

[Abrupt Start]

...gentlemen, welcome to Itaú Unibanco Holding Conference Call to discuss 2018 First Quarter Results. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session, and instructions will be given at that time. As a reminder, this conference is being recorded and broadcasted live on the Investor Relations website at www.itau.com.br/investor-relations. The audio webcast works with Internet Explorer 9 or above, and Chrome, Firefox, and mobile devices, iOS 8 or above, and Android 3.0 or above. A slide presentation is also available on this site.

Before proceeding, let me mention that forward-looking statements are being made under the Safe Harbor of the Security (sic) [Securities] (00:01:00) Litigation Reform Act of 1996. Actual performance could differ materially from that anticipated in any forward-looking comments as a result of macroeconomic conditions, market risks, and other factors.

With us today in this conference call in São Paulo are Mr. Candido Bracher, Executive President and CEO; Mr. Caio Ibrahim David, Executive Vice President, CFO and CRO; Mr. Alexsandro Broedel, Group Financial (sic) [Finance] (00:01:32) Director and Investor Relations Officer. First, Mr. Candido Bracher will comment on 2018 first quarter results. Afterwards, management will be available for a question-and-answer session.

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

Candido Botelho Bracher {BIO 3158644 <GO>}

Good morning. Thanks for joining us in this first quarter of 2018 earnings conference call. Before we go into key financial figures and performance, I'd like to briefly talk about of economics in there, the regulatory framework and changes in the competitive environment in this first quarter.

During this period, we observed the continuity of the trend started in the second half of 2017. It's a more favorable moment in the Brazilian economy and of steady and gradual recovery of economic activity. This improvement (00:02:32) result of the Brazilian Central Bank's ability to control inflation, which enabled a further decrease in the Selic rate.

The more benign economic environment led to an increase in the confidence levels of individuals and companies, notably in the SME segment, that continued to improve credit demand in the period. Besides that, the Brazilian Central Bank has acted following its BC plus agenda (00:02:59) aiming at the reduction of the inefficiencies of the financial system, as demonstrated by the recent measure related to the reserve requirements.

The combination of all these factors, coupled with better asset quality indicators, allows gradual and sustainable spreads reduction. Now, on the competitive arena, we continue to see increasing competition mainly from newcomers in fintechs. We like competition, because it stimulates us to permanently seek the improvement of our products and services, all these aiming at our client satisfaction.

Turning now to slide 3. Here we highlight the key performance figures from our first quarter results. The recurring net income reached BRL 6.4 billion in the quarter, which resulted in a recurring ROE of 22.2%, an increase of 30 basis points when compared to the fourth quarter. In the same period, the recurring ROE for our Brazilian operations was 20 bps higher and reached 23.7%.

As you know, the first quarter is usually the weakest quarter in the year for the loan book, mainly due to the credit card portfolio. I'm glad to say that the seasonal impact in our credit card portfolio was less pronounced than in previous years, and (00:04:26) for this portfolio and large companies, all the other portfolios presented growth in the quarter, leading to a 0.2% growth in the total loan book in period. This positive development is the result of the increased credit demand from our clients.

Now, taking a more detailed look at our results we presented. First, lower financial margin with clients mainly due to the lower number of calendar days this quarter. Commission, fees and results from insurance operations declined 3.4% in the quarter, mainly due to seasonal effects. It's important though to highlight that year-over-year, fees increased 7.3%. The margin and fees contraction was more than compensated by the decline in cost of credit, as a result of the lower delinquency ratio in Brazil, both in individuals and in the SMEs portfolio. I also highlight the decrease of 7.9% in non-interest expense.

Now, on slide 4, we present our first quarter income statement. This quarter, the decrease in financial margin with clients and in commissions was more than compensated by the reduction in cost of credit and in non-interest expenses as I mentioned in the previous slide. These movements in the quarter led to an increase of 12.7% in our income before tax and minority interests, and 2% in our recurring net income when compared to the fourth quarter. So the income before tax and minority interests increased by 12.7%. The income – 2.2% was our recurring net income, because as you see, the tax rate increased. Let me just highlight here that we are calculating income taxes at a 45% rate, while valuing our deferred tax assets at a 40% tax rate in line with the current legislation.

On slide 5 now, we show the evolution of our net income and ROE over the last seven quarters. The figures show the positive evolution of our profitability, especially when compared to our cost of equity.

On slide 6, our business model chart, in which we break down the consolidated income statement in income earned in operations that bear credit risk, including its related fees, income from trading operations, income from insurance and services, and excess capital over regulatory requirements. I point out that the capital allocated in these activities corresponds to the target capital of our risk appetite, which as you know, indicates a Tier 1 of at least 13.5%. The insurance and services business lines continues to be the main driver behind our value creation, and this quarter, the credit business created value, mostly as a result of the lower credit for us, where you can see there under credit column, first quarter 2018 value creation of BRL 0.2 billion.

On slide 7, we present you our credit portfolio breakdown. On the last three months, the portfolio grew 0.2%. On the individuals portfolio, as previously mentioned, the only portfolio that showed contraction was the credit card, due to seasonality (00:08:22) the first quarter. All the other credit lines showed positive evolution in the quarter. This trend is related to the resumption of consumer confidence that resulted in increased demand for credit. I highlighted the increase of 3.9% in personal loans and of 0.7% in mortgage loans. I also want to emphasize another quarterly growth of our vehicle portfolio this time of 1.7%. The stronger demand was also a key driver for the growth in the very small, small, and medium companies portfolio, which increased 1.9% in the period.

Looking at the past 12 months, the portfolio grew 2.4%. Here, we have the positive impact of the acquisition of Citi's retail portfolio in Brazil. The portfolio would have grown 1.3% if it were not for this effect. This was mainly due to the retail portfolio, especially on consumer product line, and also to our SMEs portfolio.

Now, on the negative side, we continued to see a subdued demand on large corporates as expected, leading to a decrease of 1.9% in the quarter. The main reason for this movement is related to a very healthy demand for corporate debt from the capital markets, which has enabled companies to access cheaper sources of funding with longer maturity.

Now on slide 8, we are presenting for the first time our credit origination and private securities issuance in Brazil. So it's an account of our credit origination. We do not intend to show this every quarter because there are not that significant changes every quarter. So here, we make an yearly evolution update, and so that you can have a long-term view of how was the growth in our credit origination.

So you see that in the years before the crisis in 2014 and 2015, we had a stable credit origination in these two years. Then we dropped 35% in 2016, started recuperating 7% in the first quarter of 2017, and now we are growing 17% in the first quarter of 2018, this in (00:10:50) total credits. And we can see that this increase in credit origination is led mainly by individuals, you see that we are back to 99%, almost to the same level we had in the first quarter of 2014, we're still below the level of origination we had in the first quarter of 2015.

And it's also led by very small, small and middle market companies, where we see an increase, we are now at 92% of the origination that we used to have in the first quarter of 2014. And looking at the trend, we have the reasons to believe that the trend is too positive, that we'll keep on growing credit origination (00:11:41).

On the other hand, we see that on the corporate sector, credit origination continues to lag. A significant part of the explanation comes on the left chart in the bottom right, where this show a very hefty increase in private securities issuance, which are now in the first quarter of 2016, almost twice as much as what they were before the crisis in the first quarter of 2014. Having decreased after that (00:12:15) to a level which was 34% of that of the first quarter of 2014, and now we are more than 5 times more than what we had in the first quarter of 2016 in capital markets. So, I think that this may be a permanent factor now, and that the corporate portfolio is not expected to grow as we are seeing the growth in the individuals and SMEs portfolios.

Turning now to page 9. The net interest margin and financial margin with clients. We present here our net interest margin and also the impacts in our first quarter financial margin decline when compared to the previous quarter. Our gross net interest margin remained stable, and once again, was negatively affected by the lower Selic rate, not only in our liabilities margin and in our own working capital, but also in the reduction of spread. However, this effect was compensated by a change in our credit mix (00:13:29) products. Despite the stability, the reduction in cost of credit caused the risk-adjusted net interest margin to grow 30 bps in the quarter.

Going to slide 10 now, we present the evolution of our margin with the market. We had a positive quarter, with an increase of 20.9% when compared with the previous quarter, reaching BRL 1.7 billion. The better than expected performance was related to the trading book, which benefited from the volatility in Brazil (00:14:05) and by the gain of BRL 19 million from the sale of B3 shares.

Moving to slide 11, we present our delinquency ratios, and both the 90 days and the 15 to 90 days NPLs were stable in the quarter. Despite the stability of the 90-day NPL, we highlight the important decrease (00:14:29) of 30 basis points in the individuals, and of 20 basis points in the very small, small and medium-sized companies in Brazil. These decreases were compensated by the increase of 80 points in the coverage ratio, which is related to the exposure of our clients that in the previous quarter was in the 15 to 90-day NPL. This exposure was already adequately positioned.

Our 15 to 90 days NPL of the individuals portfolio increased 20 points in the quarter. This deterioration is related to the seasonal concentration of bills and expenses for individuals, such as annual taxes on cars and housing, education costs, and end of the year credit card bills, among others. Nevertheless, it is important to highlight that the seasonal deterioration was smaller than it has been in the previous three years.

On slide 12, we present the evolution of our NPL creation. Our total NPL creation increased in the quarter and reached BRL 5 billion. The increase is mainly related to the exposure of a large corporate client that migrated from the 15 to 90-day NPL as mentioned, which was already provisioned and as I mentioned in the previous slide. The dotted line indicates that NPL excluding the mentioned case would be BRL 4.5 billion. Now on the positive side, the NPL creation of our receivables further continues to improve nominally, decreasing for the third quarter in a row and has reached the lowest level since 2002.

On slide 13, we present the evolution of provisions for loan losses and cost of credit. The decrease in our provision for loan losses in this quarter is mainly related to the improvement in asset quality of the retail portfolio in Brazil. In the wholesale portfolio in Brazil, despite the slight increase, it continues to perform as expected. And as I mentioned before, the increase in the 90 days NPL did not affect our results. I'm glad to mention that the ratio of cost of credit to the total risk reached 2.5% this quarter, the lowest level since 2014.

On slide 14, we present our coverage ratio that reached 236% this quarter. As I have explained in previous conference calls, the coverage ratio goes down if a company to which we have made precautionary provision defaults, and the NPL increases without affecting our profit and loss. And that was the case this quarter. The dotted lines indicate the NPL excluding the case I mentioned previously in this presentation.

In the long term, the coverage ratio will go down not only due to events similar to what we had this quarter in which our company defaults, but it will also go down if the companies improve, and we are able to revert (00:17:43) the provisions. In this case, there's a positive impact in our P&L. However, in the short term, coverage ratio may even increase if none of these events materialize, and we have a reduction of the 90-day NPL balance.

On slide 15, we see that commissions and fees and result from insurance operations decreased 3.4% when compared to the previous quarter. This performance was mainly a result of the decrease of 6.2% in credit card fees, which is seasonally impacted, and by the reduction of 19.8% in advisory and brokerage fees related to our investment bank (00:18:29), which, despite a good volume of operations in the first quarter, was below the record level verified in the previous quarter.

These reductions were partially offset by the increase of 6.5% in asset management fees, associated with the growth of the assets under management and the higher performance fees, and also by the increase of 3.1% in current account services, due to increase in volume of transactions and client fees.

Turning now to slide 16, we show here the decrease of 7.9% of our non-interest expenses in the period, mainly related to the typical seasonality of the first quarter. But I want to highlight our annual performance in this line. Excluding the impact of the consolidation of the Citibank operation and the expenses of our Latin American operations, the annual growth of the non-interest expenses was 1%, 170 basis points below the inflation on the same period, once again, demonstrating our (00:19:35).

Now we move to slide 17, here, I'll comment on our capital ratios. So after having reduced our fully loaded Tier 1 capital according to our stated policy, the 13.5% after the payment of dividends, we finished the quarter with a level of 14.5% due to the first quarter profit and our additional Tier 1 issued on March 2018, which is pending approval by the Brazilian Central Bank. Lastly, it's important to state that our additional Tier 1 capital issued in December 2017 was approved by the Central Bank.

Now, on page 18, in addition to the disclosure of our financial results, I'd like to present the distribution of added value in the quarter. During this period, we added BRL 17.4 billion to society, that helped to boost the economy and to stimulate the transformational power of thousands of people. Of that value, 14% was designated to our more than 120,000 direct shareholders, and more than 1 million indirect shareholders in Brazil through investment funds, 32% was designated to taxes, fees and contributions, 28% to our employees, and 24% to reinvestment in our operations.

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

Q&A

Ladies and gentlemen, we will now begin the question-and-answer session. Our first question comes from Philip Finch, UBS.

Q - Philip Finch {BIO 3252809 <GO>}

Thank you, Mr. Bracher, for the presentation. I have two questions, please. The first is regarding your asset quality or provisions specifically, you mentioned that there is seasonality as we saw with the pickup in the 15 to 90-day NPL ratio. Now, with that in mind, your provisions net of recoveries came in at BRL 3.3 billion in the first quarter. Now if we annualize that, that suggests that we're running at probably the low end of your BRL 12 billion to BRL 16 billion guidance for the full year. So, what I'm (00:22:26) trying to gauge here the possibility that provisions actually do end up at the low end of your guidance or even below, given that Q1 is seasonally adjusted or impacted?

And the second question is regarding your dividend policy. Can you give us an update on this given expectations of loan growth, your latest ROE performance of 22%? And in light of the issuance of the second tranche of additional Tier 1 capital of BRL 750 million that you did back in March? Thank you.

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

Thank you, Philip, for your questions. So the first one concerning asset quality, I did (00:23:11) think we had a good quarter in terms of provisions. And I mean, this reinforces our belief that our guidance is correct. At this moment in time though, I think it's too soon to say, to state whether we will stay in the middle of the target or below or in the bottom or in the top for our profit (00:23:35). We just think, I mean, it was a good quarter in terms of provisions, and we are comfortable with the guidance we have given (00:23:44).

As to the dividend policy, once again, so I'll give them, policy is to at the beginning of the year, evaluate what we have as investment plans, those prospectives profit percent (00:24:03), distribute the capital so that we will have Tier 1 of 13.5%. This continues to be our policy, as I said this year, we went back to the 13.5% the beginning of the year, and also (00:24:27) we have grown to 14.5% because of the results (00:24:31). We don't intend to make changes (00:24:38).

So as we approach the end of the year, we will review all these perspectives here, and we'll distribute the dividend so that it come back to the 13.5% of additional Tier 1, taking into consideration, as I said, possibilities of investments and also (00:25:05) possibility of change in the regulation and the capital regulation, and our growth prospects for the year.

Q - Philip Finch {BIO 3252809 <GO>}

Thank you, Mr. Bracher. Just a quick follow-up, the 13.5% figure you just mentioned, does that include or exclude the additional Tier 1 capital?

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

It includes the additional Tier 1 that – which, as you know, it cannot be more than 1.5%. So it would be at least 12% of our core equity Tier 1 and complemented by additional Tier 1 and to (00:25:45) the level of 13.5%.

Q - Philip Finch {BIO 3252809 <GO>}

Excellent. Thank you very much indeed.

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

You're welcome.

The next question comes from Jorge Kuri, Morgan Stanley.

Q - Jorge Kuri {BIO 3937764 <GO>}

Hi. Good morning, everyone. I have two questions if I may. The first one is, can you help us understand what you are seeing on the credit demand side? Those charts that you have on your presentation about credit origination are useful, but I wanted to understand if those are the numbers that you were expecting at the beginning of the year, or if credit is actually slower than expected. Certainly, the macro environment has proven a bit tougher than people expected, the consensus numbers for GDP have been coming down throughout the year.

So wanted to see if what you're seeing is below what you expected, what do you think is holding you back, and at what point do you think we're going to start to really see an acceleration of credit towards numbers that can really drive your balance sheet and your P&L of course?

And then the second question is on net interest margins. Where are we in the process of the contraction of margins? Selic rates have fallen more than, I guess, what people expected, certainly more than what you had originally in your guidance for the year. So wanted to see if how many more quarters do you think of NIM compression we'll see? And if you can quantify that, where do you think NIMs are going to bottom out? Thank you.

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

Thank you, Jorge, for your questions. So first, on the credit demand, credit demand for individuals and SMEs is in line, even a bit better than what we had anticipated the growth in demand for these two groups. For corporates, it's still a bit frustrated, I think. And we don't expect really much improvement in the corporate credit demand this year, especially being an election year, and due to the uncertainties in the economy, we believe that corporates, I mean, will wait to have a marked year scenario (00:28:30) before deciding on their investments and borrow (00:28:34). So, to answer, I agree (00:28:39) with overall credit demand is, as you expect, it may be a bit below, better in individuals and SMEs, a little worse in corporate.

Your question concerning the net interest margin, let me just – you asked me how many more quarters of contraction of the net interest margin, let me just emphasize that. There was no contraction of the net interest margin in this quarter. I mean, we have a stable net interest margin in this quarter. You were right, when you point out that the Selic dropped, it dropped below our initial (00:29:21) below our initial expectations, but it is expected to drop below our initial expectations now in the next

(00:29:32).

On the other hand, the mix in portfolio is coming better than we expected because of the fact that I just mentioned, that individuals and SMEs portfolio are outgrowing the corporate portfolio. So, despite we are seeing a reduction in spreads for the same type of loans, the mix provides for the growth in the net interest margin, offsetting partially the effect of the (00:30:10).

Q - Jorge Kuri {BIO 3937764 <GO>}

So – thank you for that. So, just to clarify – so, do you – so, I mean, do you expect net interest margins to remain flat the rest of the year? Is that the right way to think about it?

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

I expect them to be within our guidance that we provided in the beginning of the year.

Q - Jorge Kuri {BIO 3937764 <GO>}

Thank you.

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

You're welcome.

The next question comes from Mario Pierry, Bank of America Merrill Lynch.

Q - Mario Pierry {BIO 1505554 <GO>}

Good morning, everybody. Let me ask two questions as well. The first one is related to your head count. We continue to see your head count, especially in Brazil, increasing. We do understand that you have the incorporation of (00:31:01) employees here in the fourth quarter. But even if we go back and we look throughout last year, your headcounts was increasing on every quarter. While I think most – for your peers, we're seeing a declining trend. So, I just like to understand, like, what is your view in terms of a head count going forward, especially given all the investments in technology that the bank is making?

Second question is related to the Redecard or Rede operations. We saw POS terminals again down 20% year-on-year. Seems there's significant pressure there. Can you just tell us about your strategy in this segment and how you plan on protecting market share? Thank you.

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

Thank you, Mario, for the questions. Actually, the two of them are somehow linked. When you ask about the number of employees, (00:32:04) grown last year, not only because of the acquisition of the operations of Citibank, but also because we have invested in hiring people for hedging, especially to cater the loan account holders with the bank. And we also hired some people for the branches in order to get a better balance and a better performance in fulfilling labor legislation. These investments are made, and so I don't expect the number of employees to keep on increasing. And there's, I mean, maybe a couple of hundred employees that we needed to hire, but maybe around this level, I think, broadly. Now, (00:33:02) as you correctly point out, the number of POS reduced in this quarter, and I think – I mean, this is a trend which we are trying to resist, but it's definitely a very difficult market in which we are and with new entrants, peers competition, including products competition and so on.

Our strategy here has been to invest in making packages to the accountholders, I mean – making a compound offer of services to the accountholders who have our hedge and to increase the sales force to the non-accountholders, to the open (00:33:55). We are also working with other products which we are beginning to offer, and machines will begin soon, with new machines and with lower rates also.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. So, just to be clear then on hedging, we saw, right, one of the main players recently announcing significant price reductions. Is that something also that you're contemplating, that you're doing? And if you want to penetrate this lower – I guess, lower income segment that we have seen a new entrants there gaining a lot of market share, is that what you meant when you said you have new machines and is that what you meant that you're trying to penetrate this market?

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

Yes, that's precisely. I mean, we are preparing ourselves to penetrate this market as well.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. Thank you.

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

You're welcome.

The next question comes from Carlos Macedo, Goldman Sachs.

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

Hi. Good morning, gentlemen. Thanks for taking questions. So, first question – both on asset quality. First question. Could you give us some color – your NPL ratio for consumer lending individuals is about as low as it's ever been, or at least certainly in the last several years, but there's been a big change in mix that's helped that. Could you give us some color how the lines are behaving individually, so payroll, auto, credit cards and other lines, so personal loan, so that we get an idea of maybe how much more it could improve beyond just the mix effect?

Second, it's quite clear that the main reason why you have the NPL coverage that you have is because of the corporate book where the coverage is excluding this latest effect over 800%. And obviously, there's a lot of discretion that you have that you can use to basically assess the creditworthiness of the borrowers in that segment. How is that process moving ahead, given that you've had the economy not thrive but at least bounced back? Are you seeing more upgrades in credit scores that could possibly lead to more reversals in these provisions? I mean, I think of the excess provisions as defined by the Central Bank, you already reversed something like BRL 800 million in the last two quarters. Is that something that we could see more of if the ratings for the companies that you lend to go up? How should we think about that?

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

Carlos, thanks for your questions. Concerning the first one, the asset quality. You're right, it's improving considerably because we have a better mix with higher growth on lines with better credit quality. But the fact that we can say that credit quality is improving also individually in every single line of the portfolio, (00:37:27), individuals, credit cards, everything. We are very satisfied with the evolution of our credit models and the use we had been making of artificial intelligence (00:37:43). We think this may be one of the reasons behind this improvement in every line of the individuals portfolio.

Your second question on NPL coverage. Here, as mentioned, I mean, this quarter we had one company which entered in default, went above 90 days, and was already provisioned for, so we lose that provision to cover this company. This is something which may happen in other cases; and in other cases, what will happen with the excess provisions we have is that they will prove to be excessive (00:38:35) because the companies will improve and we will be able to reverse them.

Right now, I mean, we are making some improvements in ratings, and the economy is improving. These companies are generally improving, and we feel very comfortable with the level of coverage we have and it has been a comfortable level for some time, and it's showing to be more comfortable as the economy improves.

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

Thank you, Candido. Just going back to the first question. As you said, the NPL ratios as well it's been a long time audit as a whole. Just trying to get a little bit more -is there more room, based on historical levels, to improve individual NPL ratios so that you could see even better quality in your consumer loans going forward? Individual, I mean, by individual lines, sorry.

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

Let me tell you – let me answer you this way, Carlos. I mean, they had been improving for some time, and we are not seeing – nothing that indicate a reversal of this trend. But they are coming to a level so low that can – we imagine that somewhere in the near future we will have them leveling at a given level.

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

Perfect. Thank you.

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

You're welcome.

Our next question comes from Rafael Frade, Bradesco.

Q - Rafael Frade {BIO 16621076 <GO>}

Hi. Good morning all. I have two questions. The first one, going back to the slide that you showed the origination for retail and for SME. Could you give us a sense of how the tenor of those origination has been improving? My perception is that we – for example, in SMEs, we are seeing increasing demand moves by shorter length. So, it's hard to grow the portfolio with this. So, we would like to get a sense of how the tenor of the origination has been evolving. And second question would be related to the fees. When I tried to remove the – what would be the impact of (00:40:57) on the year-on-year comparison, the impression is that fees could be running a little below the guidance. So, just to confirm if that's the case, and where do you think that maybe it's the weakest part on it? Thank you.

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

Thank you for your questions, Rafael. On the first one, concerning SMEs, yes, you're right, we are also witnessing this reduction in the average maturity of loans to SMEs. Despite that, the combination of the two effects, I mean, the higher origination and the shorter maturities, they still account for an increase in the total balance of these loans.

Concerning fees, I'm not sure I understood your question because Citibank is already considered in our guidance and, as I said, I mean, we are comfortable with the guidance we have supplied on these loans.

Q - Rafael Frade {BIO 16621076 <GO>}

Okay. Good. Just on fees. I understand when we look for the year-on-year comparison, your fees grew – fees and insurance grew about 7%, but here we are comparing the first quarter of 2017 that there was no CD with the first quarter of 2018 with CD. So, I think that in same days, your guidance is between 5.5% to 8.5%, but the 7% that it grew, it's adding CD on this number. So, in fact, maybe – I don't know how much was CD in the first quarter, but maybe if I'm comparing only Itaú with Itaú, it's growing, let's say, 4%. I don't know the figure. So, just if I'm missing something on this?

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

On the fourth quarter, we already had Citibank in our commission and fees results. So, I mean, anyway, what I can tell is that we think that the forecast and the guidance we supplied for this line of opportunities, we'll still abide by it and then we think it confirm our guidance here.

Q - Rafael Frade {BIO 16621076 <GO>}

Okay. Thank you.

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

You're welcome.

The next question comes from Marcelo Telles, Credit Suisse.

Q - Marcelo Telles {BIO 3560829 <GO>}

Hi. Good morning, Candido. Good morning, everyone. I have two questions. The first one is a more specific question. Could you please tell us in what segment that BRL 500 million of the – of new NPLs in the corporate side was related to? Just to get a little more color on that. I know you cannot mention the name of the company, but knowing the sector would be helpful.

And the second question is in relation to your performance on the retail portfolio. When we look in terms of your growth for this quarter, which was actually a slight decline, it seems that you are underperforming the sector on the retail side. And if you look at your private sector peers or if you compare your performance to the Central Bank, the market was up, you were slightly down. And when you look on a product-by-product basis, it seems that you lost market share in every single product line within the individual segment. So, I was wondering what is driving that underperformance. Is it that – is there a risk that you might be overly conservative and/or maybe you are having more competitive pressure from other players that is making it a little bit more difficult for you to grow? Thank you.

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

Thank you, Marcelo, for your questions. The first answer, the company is in the infrastructure sector, the corporate company. Your second question, I don't – I'm not certain we have the same data here. I mean, we show a growth in market share in vehicles, we show a growth in market share in mortgages. And so, I mean, we are not seeing here this loss in market share in every single line in the individual portfolio.

Q - Marcelo Telles {BIO 3560829 <GO>}

Yeah. Yeah, I see that all individuals, I think, was down – your portfolio was down 0.1% quarter-over-quarter according to the Central Bank data. There were 1% up, 1%, 1.2% up quarter to-date. You look at Bradesco, it was up 1.3%. Santander, I believe, was much higher than that as well. You know what? When you look in aggregate and then when you look in on individual, on a product-by-product segments, I think most of the segments, you'd seem to have grown below.

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

Marcelo, we'll have to come back to you on that. I think we have a different figure to you. We will reconciliate, and our team will come back to you.

Q - Marcelo Telles {BIO 3560829 <GO>}

I appreciate that. But just as a follow-up on that, in effect and perhaps rephrase my question. So, regarding the NPL on retail side, it has been performing extremely well, right? We are as very close to historical lows. So, do you think that you may be too conservative on your (00:47:18) origination policies? I mean, there is room for you to maybe loosen up a little bit, and then accelerate your retail book further.

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

Marcelo, we have not changed our credit appetite or risk appetite, and we are not looking at doing this. I mean, we believe a lot of the origin – a lot of the improvement comes not only from the improvement in the economy, but also from an improvement in our credit models. And at least for the short-term future, I mean, we are not considering reviewing our risk appetite.

Q - Marcelo Telles {BIO 3560829 <GO>}

Okay. Appreciate your answers, Candido. Thank you.

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

Thank you.

The next question comes from Jörg Friedemann, Citibank.

Q - Jörg Friedemann

Thank you for allowing me to make questions. I have two questions. First, looking into your strong performance and the first quarter margin with the market, you would be running well above the range for the year in your guidance. First quarter represented 32% of the upper end of the range. So, just wondering if you believe that I know you are becoming conservative with this guidance here?

And my second question is, where will you see the bulk of the improvement throughout the year in expenses coming from? Your guidance implies overall non-interest expenses growing between 0.5% to 3.5%. I understand that the 6% growth observed in expenses, I know – was distorted given that you still did not have Citibank included. But just wondering, where are the bulk of the improvements expected throughout the year maybe via, I don't know, branch reduction or where are the synergies to be captured? Thank you.

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

Hi, Jörg. Thanks for your questions. Concerning the financial margin in the market, as you well know, this is the – individually, this is the line more difficult to forecast because many of the results are made on the quarter and derived from some positions, not all of them but a part of them. So, what we had was one good quarter, we keep – which does not alter our perspectives for the three remaining quarters of the year, which should be according to guidance.

Concerning the non-interest expenses, a significant part of the gains come exactly from the synergies with Citibank, which will kick in during the year.

Q - Jörg Friedemann

Okay. Thank you very much for the verification. If I could just follow up. The other banks are providing a better breakdown of these lines of margin in the market. Do we have any, I know, maybe color, additional color, to where the asset liability management or the structural part of this line, I know, holds on so we can have a better assessment of how much volatile these line can be. Thank you.

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

Jörg , we – I think we supply more information about the clients than at least the other banks in the local market. Actually, I think we have been supplying this for a long time now, and we divide this between (00:52:02). What you can see is that (00:52:09) is more stable. (00:52:12) is more volatile. This is what I can tell you.

Q - Jörg Friedemann

Okay. Thank you very much.

The next question comes from Jason Mollin, Scotiabank.

Q - Jason Mollin {BIO 1888181 <GO>}

Hello, everyone. Candido, my question is looking at the business model breakdown that you provide, looking at the value creation by different segments of Itaú Unibanco's business, we saw on our calculation a slight improvement in the recurring earnings from credit, you show it year-on-year for the quarter. We tried to back into the fourth quarter numbers. We saw, obviously, just a very slight improvement there, but it is encouraging. And year-on-year, clearly you're showing the improvement and you are showing a lower cost of equity for that business on your assumption. Really, where can we go?

And on the credit side, trading was a very good quarter. And it looked like for us, the insurance and services segment trying to calculate it on the sequential basis was very stable. Year-on-year, it looks quite good. Clearly, there's a seasonal factor probably in the first quarter versus the fourth, but can we – where can we see, I mean, this quarter you're – we're starting to see and last quarter we saw it as well, a positive contribution from credit. Where can this go? We've talked about this in the past with you about some portions of the lending business, it's hard to make more than your cost of equity. How do you feel about that in the upcoming year or so given the trends, particularly if you're growing faster in consumer?

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

Thanks for the question, Jason. Yes we have actually, I mean, been talking about this; I mean, how difficult it is to create value in the credit market. We lost – we destroyed value in 2015 and 2016. We were fairly positive last year. This year, we think we can be a bit more positive year, especially because of the breakdown between corporates, individuals and SMEs. So, we are growing more of the portfolios in SMEs, with better delinquency rates. And the cost of capital has also reduced into 13.5% (00:55:00) than it was last year. I think last year was an average 14.5%. So, all these makes us expect a positive value creation in credit this year. But I mean, as the banks are – the banking sector is under severe pressure to reduce spreads so in individual lines we are reducing spreads. The total is growing because of the mix in the credit portfolio, and we think this is a trend for the year.

Q - Jason Mollin {BIO 1888181 <GO>}

Maybe a follow-up on that. I mean, on the regulatory side, we saw the banking association, FEBRABAN, approved overdraft guidelines. I understand they'll be effective in July – on July 1 of this year. If you can talk about how that could impact – obviously, it's not the largest size of your business, but if you can talk about the implications for profitability. And also on the regulatory side, we see the Central Bank rule on debit cards that I guess there'll be a maximum of 0.5% for the interchange fee and a maximum, I believe, at 0.8% for any transaction. Any implications there, and if these changes are material and if we should expect more?

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

Okay, Jason. Yes, I mean, this change, of course, I mean, in the overdraft within the regulation also in the debit card and the failure last year in the credit card, all these changes, I mean, do affect our income. And we think we are dealing with them, trying to be as efficient as we can. I think, at the same time that the Central Bank is making these changes; I mean, they are trying to create conditions for the lowering of the spreads and in the lowering of the reserve requirements. There is this approval pending now in Congress after positive result, and the credit policies also improved. So I think is a trend. There's no resisting to this trend. It's also in our interest, I mean, to increase the number of clients and to increase demand for credit and this also happens as the rates go down.

So, I mean, if we compile it all, we come to our guidance. I mean, we believe – I mean, we can have a growth in results at the same time as we lower the cost of our lines to our clients.

Q - Jason Mollin {BIO 1888181 <GO>}

Thank you very much.

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

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

Well, thank you all for attending the call and thank you for the very good questions. Bye-bye.

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