

Q3 2009 Earnings Call

Company Participants

- Alfredo Egydio Setubal, IRO
- Daniela Ueda, Financial IR
- Rodolfo Fischer, EVP
- Sergio Werlang, EVP
- Silvio de Carvalho, CFO
- Unidentified Speaker, Company Representative

Other Participants

- Boris Molina, Analyst
- Daniel Abut, Analyst
- Ian Smith, Analyst
- Jason Mollin, Analyst
- Jorge Kuri, Analyst
- Maclovio Pina, Analyst
- Marcelo Telles, Analyst
- Saul Martinez, Analyst
- Victor Galliano, Analyst

Presentation

Operator

Ladies and gentlemen, thank you for standing by. This is Itau Unibanco Holding Conference Call.

(Operator Instructions)

At this time, I would like to turn the conference over to Ms. Daniela Ueda of Financial Investor Relations Brazil. Please go ahead.

Daniela Ueda

Good morning. And welcome to Itau Unibanco Holding conference call about the Third Quarter 2009 earnings. I would like to remind you that this conference call is being broadcast live on www.itau-unibanco.com/ir. A slide presentation is also available on this site.

Before proceeding, let me mention that forward-looking statements are being made under the safe harbor of the Securities Litigation Reform Act of 1996. Actual performance could differ materially from those anticipated in any forward-looking comments as a result of macroeconomic conditions, market risks, and other factors.

With us today in this conference call in Sao Paulo are Alfredo Egydio Setubal, Investor Relations Officer; Sergio Werlang, Executive Vice President of Risk Control and Finance, Silvio de Carvalho, Chief Financial Officer, Rodolfo Fischer, Itau BBA's Executive Vice President, and Marco Antunes, Accounting Director.

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Bloomberg Transcript

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

Alfredo Egydio Setubal {BIO 1528623 <GO>}

-- who are in Europe. It's a pleasure for us to be here today to comment about our Third Quarter results. And I think our vision was a very good one, both in terms of growth, in terms of synergies after the merge, and also in terms of results.

For those who are following through the internet, we are going to start on slide number two, highlights for the results. The first one is the earnings. We showed recurrent results, net income of BRL2,687 million. That means an increase of 10.6% when we compare to the Second Quarter and means annualized ROE of 22.4%; in terms of results that were released, published, BRL2.2 billion and ROE of 18.9%.

The difference is the second highlight, is the extraordinary items. We had a negative impact in the net earnings of BRL419 million because of the amendment of the Itau Unibanco contract that we have with CBD that if we renewed in the Second Quarter. And most of these extraordinary items are related to these rearrangement with CBD.

The third highlight is the additional provision. As we did in the first and Second Quarters of this year, we used part of the additional provision to compensate the deterioration in terms of some factors, some of the segment that we have in our credit portfolio. In this quarter, we used BRL373 million from this additional provision that was made by the end of 2008. So the balance at the end of the quarter for this additional provision is BRL6,104 million in total.

The fourth highlight is the NPL ratio over 90 days and the NPL ratio. The NPL ratio over 90 days achieved 5.9%, and the NPL ratio for 60 days 7%. These were numbers that we have been talking during the -- throughout the year. And we always said since the end of 2008 that our expectation was that these levels -- this level 7% should be reached by the Third Quarter. And this, what happened, it was under our expectation and the guidance that we gave to the market through these quarters, through these months. And we expected these to be the peak for the NPL in the year of 2009. And we expect lower numbers when we compare -- lower ratios when we compare to 2010.

The fifth highlight is the BIS ratio that reduced to 16.3% because of the growth of the credit portfolio and also because of the new regulation of the Central Bank of Brazil related to operational risks.

On page three, we see that the stockholders' equity ended BRL48.8 billion with a growth of 3.4% in the quarter, and total assets of BRL612 billion with a growth of 2.7% and when we compare to the Second Quarter; market capitalization of Itau Unibanco at the end of the quarter BRL161 billion.

On page four, we can see a little bit more details of the non-recurrent effect. As I said, we had BRL419 million in negative impact after tax. And these numbers were BRL56 million related to economic plans provisions and also BRL363 million related to the new contract between Itau Unibanco and CBD. So because of that, the net income that we released, BRL2.2 billion, and the recurrent result of BRL2,687 million.

On page five, we can see more details of the -- our results. We can see that the managerial financial margin and banking fees and services achieved by the end of the Third Quarter BRL6,136 million with a growth of 2.4% in the quarter and 12.4% in the 12 months when we compare to September '08.

This number was splitted in margin, financial margin with our customers of BRL9.3 billion with a growth of 1.8% in the quarter and 12.7% in 12 months; financial margin with the market BRL1.4 billion with a growth of 8% compared to the Second Quarter; banking fees a growth of 6.5% in the quarter. But we can see when we compare in 12 months that we have a decrease of 3.4%, both related to the new regulations of the Central Bank and also in a more competitive environment. In terms of results from insurance, pension plans, and capitalization, we have an increase of almost 3% in the quarter, achieving almost BRL1.4 billion.

In terms of loan losses, we made provisions total of BRL4.69 billion with a decrease when we compare to the total provisions made in the Second Quarter of 7.1%. But of course, due to the environment in this year related to the crisis, we have a huge increase when we compare to the 2008, September 2008.

We used less additional provision, as I said. We used in this quarter BRL373 million compared to BRL775 million in the Second Quarter, showing some improvement in terms of delinquency in our credit portfolio. Recover of credit written off, BRL569 million this quarter when we compare to BRL461 million in the Second Quarter; retained claims BRL791 million against BRL732 million in the Second Quarter.

Good news came from expenses. Non-interest expenses reduced when we compare to the Second Quarter of this year in 1.3%. And when we see 12 months, we can see 7.2%. That is a good number, a little bit above inflation. We are going to talk more details some slides ahead. Tax almost in the same level of the Second Quarter, that means this recurrent result of BRL2.6 billion.

On the slide number six, net interest margin, we see that improved in the quarter from 10.1% to 10.7% basically because of the spread that continues to be high when we compare to other quarters and also because of the mix of the credit portfolio that improved, as we can see in the next slide, in terms of middle-market companies that improved in the quarter.

And we can see on slide number seven loans by type of customers that our credit continues to be very focused on individuals and small; and micro; and middle-market companies. In terms of individuals, the growth in the quarter was 1.1%. And we can see when we go to companies that the small; and middle-market companies improved only in the quarter 4.4% and 18.1% when we compare from one year ago. That continues to be our market. We expect it to continue to grow in this segment. And it's one of the segments that we are making new investments through the year.

So another important point to talk here is mortgage loans that continues to be active, a growth of 10.2% in the quarter and 36.4% when we compare 12 months. This is a seven -- the total is too small, BRL7.8 billion when we compare to total retail credit. But anyway, that is BRL167 million only from retail. Anyway, it's a segment that is growing at a pace of 30% to 40% a year and probably will continue in the coming year.

On slide number eight, we can see that NPL for 90 days, the ratio for individuals continues to be stable when we compare to the Second Quarter, as we expected and some improvement in terms of ratio. The delinquency for companies improves from 3.1% to 4.1%, as we talked in the end of the Second Quarter. So on average, compounding the two segments, 5.9% in NPL ratios for 90 days.

When we compare to 60 days, we can see that individuals improved a little bit. Companies continues to decrease. And the total achieved 7%. That is the ratio that we talked throughout this year that was the number that we were expecting to achieve. And this level probably remains flat. Or we'll reduce next quarter and probably reduce throughout 2010 to lower levels.

In terms of coverage ratio for 60 days, we finished almost in the same level of the Second Quarter in 145%. What it means, a very comfortable position in terms of provisions.

On slide number nine, we can see that we made provisions of BRL4.3 billion in the quarter. And we used BRL373 million, as I said, from our additional provision book. And the total was BRL4,669 million with a decrease from the BRL5 billion of the Second Quarter. And we have total provisions over the credit portfolio of 10.2%. It means also a very comfortable position.

On slide ten, we can see the total funding, the total deposit and investment funds and portfolio under management of BRL648 billion with an increase of 1.6% in the quarter.

The ratio -- on slide 11, the ratio between loan portfolio and funding -- that is a slide that we have been showing the last quarters -- at the end of the year was 85%, improved to 87.4% in the Second Quarter, ending this quarter 89.9%. We are growing our credit portfolio and using part of cash that we have from the deposits from our customers.

Banking fees and income from banking charge, we can see in the quarter some improvement in the asset management, more investors are going to mutual funds. We are not paying much in terms of time deposits for customers. So in our case, we can see this improvement in terms of fund deposits.

In terms of current account services, we can see when we compare 12 months that due to the Central Bank regulation and competition that the market is more difficult here in terms of fees and that we can charge from our clients. But anyway, in the quarter, we have an improvement of 2%. The total fees and charges achieved BRL3.8 billion in the quarter, compared to BRL3.6 billion in the Second Quarter, also because of the fees from loan operations and guarantee provided in this quarter that improved.

On slide number 13, we can see non-interest expenses. As I said, it is good news here. We can see some improvement and some synergies already appeared from our merge -- the merge between Itau and Unibanco. The total non-interest expenses in the quarter reduced 1.3%. And we expect it to continue to achieve better levels of efficiency, as we can see on slide 14, that we achieved in the quarter, 41.1%, and in 12 months reduced to 43.4%.

On slide 15, our traditional segmentation that we split in four managerial blocks -- commercial bank, more related to retail and middle market; Itau BBA, corporate and investment banking; consumer credit; and corporation, as we allocate our excess of capital and treasury gains.

On slide 16, we can see in terms of managerial results the total recurrent results for Itau Unibanco, BRL2,687 million. And we can split that number in these four segments. So we can see that the commercial bank earned BRL1,041 million. We have allocation of capital for this segment of BRL14.2 billion. That means a RAROC or ROE of 28.8%, what was a very good quarter, better than in the Second Quarter that we can see in the lines below.

In terms of Itau BBA, recurrent net income of BRL446 million, capital allocation of BRL13 billion, RAROC ROE of almost 16%, a little bit better than in the Second Quarter. Consumer credit, BRL465 million, BRL7 billion in terms of capital allocated, RAROC of 24.9%, a little lower when we compare to the Second Quarter. And the excess of capital and treasury gains, BRL735 million, capital allocated BRL14.4 billion means a RAROC of almost 20%, in line with the number that we showed in the Second Quarter. So all these four segments in terms of recurrent results, BRL2.6 billion and ROE of 22.4%.

To finalize on slide 17, insurance, pension plans, and capitalization, we have some numbers here only of the operation of Itau Unibanco, not including anything from Porto Seguro. We can see the combined ratio of 91%, a little worse than in the Second Quarter but better than most of the quarters, the previous quarters, and also our selling expenses over earned premiums of 22.7% in average in the same level of the previous quarters.

And in terms of technical provisions and the GBLs and the GBLs that are our pension plans, individual pension plans, we achieved almost BRL50 billion in total of technical provisions in these segments. Now we are open for questions that you probably have about our results.

Questions And Answers

Operator

Ladies and gentlemen, we will now begin the question and answer session. (Operator Instructions) Our first question comes from Mr. Jason Mollin with Goldman Sachs.

Q - Jason Mollin {BIO 1888181 <GO>}

Hello, everyone. I have two questions. My first question is on loan growth. We saw for the individual segment loans grow 1.9% quarter on quarter with credit cards and auto loans growing. Yet we saw personal loans decline about 1% quarter on quarter. Can you explain what you saw in the personal loan segment and what you expect in this area going forward?

And my second question is related to your interest rate outlook. Can you tell us about Itau Unibanco's outlook for interest rates going forward? The current (inaudible) rate is 8.75%. Yet if we look at the two-year forward rate, we're already about 11%, if you could give us your outlook there. Then assuming all else equal, how would 100 basis point change in the benchmark interest rate impact Itau Unibanco's net interest income? Thank you.

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

Silvio speaking. We are expecting for our loan growth this year will be around 12% December '09 in relation with '08. This forecast must include big corporations. What happened in the figures that we provide to the market in the Third Quarter is related big corporations was negative because of the impact of the currency and because of the demand in credit for big corporations.

For next year, we expect that the loan growth will be around 20%, 25%, again, not including big corporates. If you breakdown by segment, we are expecting that SME will be much more present in this market and this year will probably grow around 12%, 18%, December '09 in relation to December '08, next year around 25%. The other important presence will be in the mortgage mark that probably will be around 30% next year, around 35% in '09.

In relation to the second question, I will transfer to Mr. Sergio Werlang.

A - Sergio Werlang {BIO 2384657 <GO>}

Okay. So as for the expectations for the select rates, we expect the select rate to increase by 150 basis points, starting on the beginning of the same April next year. And that will be enough. I mean, it will depend a lot on what is the wisdom and how fast the Central Bank wants to start.

If the Central Bank starts early, we believe 150 basis points is enough. And we are expecting to keep inflation of 2011 within the target because the inflation of 2010 will be within the target, even according to our estimates, even if the interest rate remains at 8.75%.

However, the result if interest rates stated at 8.75% for the inflation of 2011 would hit above the target. So we expect the interest rate to go up next year. The earlier it goes, the less it has to go up. And even with this increase in the interest rate, we expect next year's growth between 5.5% and 6%.

Now for the impact in the net interest margin of 100 basis points increase in the interest rate, I'll pass back to Silvio again.

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

The increases that we have in the net interest margin in the Third Quarter that correlates with the mid of the loans that we are much more present in the SME market. That is basically the reason because it's increased. But we are not expecting a big difference in relation to the net interest margin, including this year and next year.

Q - Jason Mollin {BIO 1888181 <GO>}

Okay. Just a follow up on the loan growth question -- I was really referring to what you refer on slide seven, personal loans under what you call individual, which we saw them decline 1% from BRL22.7 billion to BRL22.5 billion in the quarter, while we saw credit cards and vehicles increasing quarter on quarter. What's going on in that segment? Is there -- I mean, they were basically flat to down. But is this an area that you expect to grow going forward? Or was there something specific this quarter why that book was shrinking?

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

The reason because you know that we were selective, more selective, in 2009. And you know that the Fourth Quarter, the economy here in Brazil is much more active. That's behind our guidance when we talk that the individuals will grow in the Fourth Quarter now and for next year. We are expecting improvement in employment rate, like (inaudible). We expect that the GDP will grow much more when compared with 2009. And the next year, we expect that in general the loan growth will grow around 20%, 25%.

Q - Jason Mollin {BIO 1888181 <GO>}

Thank you very much.

Operator

Excuse me. Our next question comes from Mr. Jorge Kuri with Morgan Stanley.

Q - Jorge Kuri {BIO 3937764 <GO>}

Hi, everyone. Good morning. Congrats on the results. I have two questions. The first one is on expenses. On page 13 of your presentation, you have the first nine months expenses. Personnel plus admin expenses increased roughly like 8.5% relative to the first nine months of 2008. And if I can see here from the note, these are already adjusted for the merger. They're pro forma numbers.

So the question is -- your expenses are up 8.5%, just the personnel and admin expenses this year versus last year. What -- I'm trying to understand what have been the merger synergies so far to date. In other words, if you exclude the merger, what do you think expenses would have grown organically? I'm just trying to see how far low are you in achieving some of the merger expenses that are expected.

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

Jorge, we are not giving guidance in terms of cost synergy. We are just talking in terms of qualification of the synergy. Last year, these figures that we compare '09 with '08 is a pro forma figure. We put the two banks together. At that time, you know that we are increasing the number of branches Itau and Unibanco alone. And this is consequence of this investment that happened during 2008.

And another point -- in September, normally, we have a unoagreement[ph]. And this unoagreement that happened in September '08, when you compare with the figures of '09 with '08, you have the total -- the nine months of the solid increase and compared with '08 that we didn't have this increase. It relates with the unoagreement that the last year it was around 6%.

In September of '09, we had the unaudited agreement again. It was a closed rate. This decrease is 6%. But we got this opportunity to stabilize the personnel expenses in the Third Quarter. This figure that we are providing in the Third Quarter in personnel expenses, we consider all the agreements within the (inaudible). This is the explanation of the figures.

It's difficult to take out the impact of the synergy just to compare. What we are mentioning is in terms of efficiency ratio that today is around 42%. I think you have opportunities to improve the productivity of the bank. And next year, we have two events. The first event is related with the integration of the Unibanco branch that we are converting the Itau system. These branches that we are forecast to implement 154 months initiate in February. We'll create opportunities in terms of the cost. This is -- will be 150 branch per month. And we are forecasting that until the end of the year, all the branches will be converted to Itau. And we appear opportunist[ph].

For the other hand, we are not closing any branches. We'll keep all the two branch networks open. And we intend to open more branches. We are forecast to open 150 branches next year, which means that the expenses will increase in consequence of the investment, and the other hand, a reduction because of the merger of the two banks. In other words, we are not supposed that we will have a big difference in terms of number of employees next year.

Q - Jorge Kuri {BIO 3937764 <GO>}

All right. Well let me ask the question another way, Silvio. Thanks for what you mentioned right now. Out of 100% cost synergies, where do you think you are now so far in the first nine months of the year? Are you 20% along, 30%, 10%? I mean, where are you in respect to what you think are the 100% cost synergies that can be achieved from this merger?

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

We are supposing that in the end of 2010 we'll have 80% of the total synergy implemented. And it means that in the First Quarter of 2011, we have 100%. These synergies will appear totally in 2011, Jorge.

Q - Jorge Kuri {BIO 3937764 <GO>}

So it's fair to say that today we are at the early stages, 10%, 20%?

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

We are just initiated the process.

Q - Jorge Kuri {BIO 3937764 <GO>}

All right, all right. Great. Thanks. Then my second question is on fees. There was a nice jump quarter on quarter on fees. And even if I exclude the investment banking fees, your fees grew around 6% quarter over quarter. That's a big difference relative to the levels that I guess we've seen for almost 18 months now. Have fees turned a corner? Should we expect to see a better number going forward? Or was this kind of like a one-time event?

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

We are expecting that the fees will increase organically, not considering investment bank, around 5% year by year.

Q - Jorge Kuri {BIO 3937764 <GO>}

All right.

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

Just a moment, Mr. Rodolfo Fischer will talk about the IBCs.

A - Rodolfo Fischer

Hi, Jorge. It's Rudi. The investment banking market has been improving in the second -- in the Third Quarter. And we expect this improvement to keep on going in the Fourth Quarter next year. So this is not a one-shot event. So Itau will continue to grow as the economy recovers next year.

Q - Jorge Kuri {BIO 3937764 <GO>}

All right. So can you just -- so full-year fee growth 5% next year, excluding investment bank.

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

Yes.

Q - Jorge Kuri {BIO 3937764 <GO>}

Okay. Thank you.

Operator

Excuse me. Our next question comes from Mr. Daniel Abut with Citi.

Q - Daniel Abut {BIO 1505546 <GO>}

Good morning, gentlemen. Two things -- one, if you would complement a bit more the prior discussion on the merger synergies and efficiency ratio. Silvio, if I'm not mistaken, if you look at page 14, where you show the efficiency ratio community figure over the last 12 months, on a pro forma basis throughout 2008 and the first half of this year, you were ballpark in the 45% figure.

And last conference call, I think Alfredo said that towards the end of last year you could be in the low 40s. If I'm not mistaken, you said 42%. But you have achieved 43.4% already this quarter because merger synergies, which were not expected to start this year -- at least you have no guidance for it -- have started earlier. Should that mean that over the end of next year, we could be at a cost-income ratio cumulative for 12 months lower than the 42% that Alfredo had talked about in the last quarter conference call? That's question one.

And question two, if you could give us more color on the NPL ratio side on the information you have on page eight, I think Alfredo said that you continue to be comfortable that the 7% on a 60-day basis that we saw this quarter should be the peak and should start to come down. But we still see a quite significant increase on the Company, on the commercial NPL side, which increased again another 90 basis points this quarter. What have you seen in terms of numbers after September, October, for example, and give you comfort that even in commercial, in company NPLs, we have seen the biggest one?

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

Let me talk about fee and for efficiency ratio. This quarter, we report 41.1%. We expect for next year that we'll be around 40% in the Fourth Quarter of 2010. That's what we are seeking this morning, Daniel. We didn't finish the budget yet.

In terms of NPLs, we mentioned that we are expecting an improvement in the economy. This improvement in the economy will create the conditions for us to upgrade some companies. And because of the economy, you'll be much more active. We are expecting that the SME will prove here as well. And in this condition, if you look in the slide number eight, you'll see that the NPL ratio over 61.90% today improvement in the both markets, individuals that in this part of the segment of

the curve reduced from 2% to 1.7% and for companies that's reduced from 0.8% to 0.7%. This -- and we are expecting that the situation will prove much more in 2010.

Q - Daniel Abut {BIO 1505546 <GO>}

Silvio, just to make sure I understand the numbers you gave us already, you said that the cost-income ratio to get to 40% by the Fourth Quarter of 2010. Is that correct?

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

Yes.

Q - Daniel Abut {BIO 1505546 <GO>}

And second, you said that the Company's NPL, 4.8% on a 60-day basis should have been the peak.

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

We are supposed that this figure will be reduced. How much will be slowly. I am not expecting that this happen in the Fourth Quarter. But we expect that happen in 2010.

Q - Daniel Abut {BIO 1505546 <GO>}

Thank you, Silvio. That was very helpful.

Operator

Excuse me. Our next question comes from Mr. Saul Martinez with JPMorgan.

Q - Saul Martinez {BIO 5811266 <GO>}

Hello, everybody. I also have a couple of questions. First, I want to understand the financial margin with market line a little bit better. That line was BRL1.456 billion in the Third Quarter. And I know that line not only includes proprietary trading and realized gains and more volatile results. But it also includes other things within the treasury.

And I wanted to ask you guys how we should think about that line going forward if you guys could talk about what a more sustainable basis might be but also if you could also talk about whether there is a portion of the market or the treasury results that are recurring and what portion of it is more volatile in nature and if you can kind of quantify or try to quantify in broad terms what portion of that line item is more recurring in nature and what portion of that line item is more volatile in nature. And I also have a follow up as well.

A - Rodolfo Fischer

Hi, Saul. This is Rudi. You're right. The results that we show in the treasury lines refer both to trading activities and to banking activities. I would say that most part of it comes from banking activities in the institutional part, the structural part of market risk that we manage. There is a part of it which relates to trading activities, which is not the largest part of it. How sustainable these results are -- these results in the first three quarters of the year were excellent, much above what we were expecting and much above the recurrent level is.

What happened was that most risk factors followed a very clear trend. And we were able to capitalize on both the trading and banking activities and market risk. And we did not expect these numbers to repeat themselves. Starting from Fourth Quarter, it might be an intermediate level. But next year, we expect lower levels of treasury results. It's difficult to give you numbers. But I would say that recurrent number for a quarter would be instead of BRL1.5 billion well maybe BRL500

million level. But it's, again, this is very difficult to see. And it will depend on the evolution of the market, the existence of new prices or new market conditions.

Q - Saul Martinez {BIO 5811266 <GO>}

Yes, I guess as just a -- I mean, I guess just to follow up on that, Rudi, if I look back historically on your number, in the first and Second Quarter of '08, the numbers were something like BRL500 million to BRL600 million per quarter, which kind of thought of as sort of a difficult result. It's been much higher than that since then. I mean, BRL1 billion drop off, I mean, is that -- I mean, is the BRL500 million something that you think is something that is a more normalized level?

Or is that sort of the base upon which -- or is that something that is sort of the base upon which you would have a higher number from? In other words, is that kind of the floor on a number? Or that's the kind of the sustainable part. Then you'd have trading results that would aggregate to that BRL500 million because it seems like that's a pretty low or a conservative figure at least at first blush.

A - Rodolfo Fischer

It's always very difficult to talk about future in treasury results. You have to understand that. And it will depend on market conditions. You're right when you say that BRL500 million tends to be the base number. We obviously want to go over that number. But again, you asked me for a recurrent level. I would say this is a recurrent level. Again, it's very difficult to promise a number higher than this, especially in a country, in countries we work basically on, which is in the Southern American market, which is always very volatile, very difficult to forecast. So I would tell you that the base number, yes, it's BRL500 million. Of course, we'll make under all the limits that we have, try to get better numbers.

Q - Saul Martinez {BIO 5811266 <GO>}

Okay. Fair enough. Follow-up question on your tax rate -- you guys are using tax credits to offset the increase in the social contribution rate from 9% to 15% because you believe that the increase was unconstitutional. And that will change. Assuming that it does not change and the courts withhold the increase in the social contribution, how much -- how longer can you use tax credits to offset the hike in your tax rate? And should we expect at some point -- and would -- should we expect that your tax rate would go up by six percentage points once those tax credits are utilized?

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

Consider not change or no judgment of this matter, we suppose that we have tax credit for next two years to neutralize this social contribution increase.

Q - Saul Martinez {BIO 5811266 <GO>}

Okay. And after that, we would expect your tax rate to go up by about six percentage points. Is that fair? Is that a conservative -- ?

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

No. We are supposed that we win. If you win, we'll be 34%.

Q - Saul Martinez {BIO 5811266 <GO>}

Okay. How confident -- are you guys very confident that you actually will win on that matter?

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

Yes. If we (inaudible) that if you'll not have confidence, we are utilizing 40%, not 34%.

Q - Saul Martinez {BIO 5811266 <GO>}

Okay. All right, fair enough. Thank you very much.

Operator

Our next question comes from Mr. Marcelo Telles with Credit Suisse.

Q - Marcelo Telles {BIO 3560829 <GO>}

Hi. Hello, everyone. I have two questions. The first one -- can you detail a little bit more your branch expansion strategy? I mean, over the past 12 months, you increased your branch network by roughly 3%. Given that the outlook for the economy seems to look pretty good for next year, do you expect that to accelerate?

And the second question is regarding the -- if you go back to your number five, the slide number five, if you look at the other operating income line, there was a significant reduction from BRL225 million to BRL57 million in the Third Quarter. If I look in previous quarters, I mean, that number was for many quarters above BRL200 million. Do you think that that number could go back to the BRL200 million level? Or you think this BRL57 million should be seen as more sustainable? Thank you.

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

Marcelo, we are expecting that we will implement this strategy that I mentioned before in relation to the conversion of the Unibanco branch to Itau. This means that we have the opportunity and synergy with this strategy when you compare to just one system. With the cost of the people that we have in the both banks, Itau utilizes the centralized (inaudible) process.

Unibanco utilizes the decentralized process. It means that Unibanco had many people in the branches working the back office. And Itau had other process. And we are adopting Itau model. This means that these synergy opportunities will appear during the year. And we intend to implement this conversion until the end of 2010 or even in the beginning of 2011.

In terms of other operating income, I think the figures that we release in next couple of quarters will be closer to BRL57 million, not BRL225 million. And we made some reclassification in this quarter. This is spread out on other lines. And BRL57 million is more recurrent.

Q - Marcelo Telles {BIO 3560829 <GO>}

Perfect. Just a follow up on the first question, I assume you -- I mean, over the past 12 months, I think you increased by roughly 130, 124 branches, new branches. Do you think that number could double in 2010 in terms of new branches opening?

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

We are supposed -- first, Marcelo, we are not closing any branch for the two banks. Okay? We are keeping all the branches that we -- the both banks, the new bank. And we intended to open 150 branches next year.

Q - Marcelo Telles {BIO 3560829 <GO>}

Okay. Excellent. Thank you very much.

Operator

Excuse me. Our next question comes from Mr. Maclovio Pina with Morningstar Equity Research.

Q - Maclovio Pina {BIO 16236843 <GO>}

Hi. Good morning. Thank you. I was just wondering if you could give us a little bit more color on the NPLs. For instance, the corporate NPLs rose for 100 basis points. And I'm wondering if you can give us a little bit more granularity and what specific sector drove that. And likely in the early delinquencies from 61 to 90 days, there was also a nice fall in that. But -- and also, what was behind the decline in those early delinquencies, please?

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

This is consequence before the quiet[ph]. When you have LP relations[ph] last year to September, we (inaudible) the operations with some credit risk. And it is a situation -- we had to increase the provisions around this year. And this delinquency -- we announced that we are expecting an increase in delinquency in the beginning of 2009. We mentioned it to the market. This increase in delinquency happened. But we are considered that this factor of the crisis is done.

And we are not expecting that we'll have this situation again. We are considered that the new laws that we are consider of the crisis and after the improvement in the economy is -- has much more low probability to happen again in left that you had[ph]. If you look at slide number eight under the right side of the slide, you see that appear some improvement in the delinquency already.

Q - Maclovio Pina {BIO 16236843 <GO>}

Yes. That's precisely my point. I was just wondering if you can give us a little bit more granularity in the sense of what types of businesses are behind the decline or if it's just --

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

It's across the board.

Q - Maclovio Pina {BIO 16236843 <GO>}

Okay.

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

And we are expecting -- give some upgrade in many segments of our portfolio.

Q - Maclovio Pina {BIO 16236843 <GO>}

Okay. So in general, there's no one particular business line or business type of loan that's driving either of those -- well, first the increase in nonperforming and then the decrease in early delinquencies.

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

Yes.

Q - Maclovio Pina {BIO 16236843 <GO>}

Okay. Okay. Understood. Thank you very much.

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

Okay.

Operator

(Operator Instructions) Our next question comes from Mr. Victor Galliano with HSBC.

Q - Victor Galliano {BIO 1517713 <GO>}

Hi there. Just -- my main question's been asked. But just on provisioning and charges for provisions going forward, you show there on slide nine that the quarterly is -- provision for loan loss -- is 1.8% of your credit portfolio. How do you expect this to change going forward?

Can you give us some guidance on what we might expect for, say, full year 2010 and if we'll see any big change in Q4 of this year, given that the asset quality outlook is more positive? And what sort of -- would you target a level of coverage, 130, 140, just some kind of idea or at least a range of where you'd like to be there? Thank you.

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

With the situation improving, Victor, we are expecting that this 1.8% will be reduced next year for 1.5% per quarter. And we are not expecting that the coverage ratio will be reduced much lower than 140. This means that under this, the write off is not affected the provision. It's affected this quarterly ratios. That's the scenario that we are seeing for 2010.

Q - Victor Galliano {BIO 1517713 <GO>}

Do you expect charge offs to come down in 2010?

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

We are expecting the first movement that the charge off will increase.

Q - Victor Galliano {BIO 1517713 <GO>}

Okay.

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

Because the maturity of the operation is that we are 100% provisioned. But this will, according to the Central Bank holes[ph], we have to wait in letter 180 days to make the charge off.

Q - Victor Galliano {BIO 1517713 <GO>}

Okay. Okay. So maybe we'll see that coming down towards the end of the year, end of 2010.

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

Yes. In the second semester of 2010 in the Fourth Quarter probably will happen.

Q - Victor Galliano {BIO 1517713 <GO>}

Great. Thank you.

Operator

Our next question comes from Mr. Ian Smith with Nevsky Capital.

Q - Ian Smith {BIO 17539373 <GO>}

Hi. Thanks. Just two questions, the first one on operating provisions -- I think around the time of the merger there was certain merger and restructuring and labor provisions that were created. Can you give us a sense of what the level of provisions currently stands at and what level of reversals were done in the Third Quarter?

And just a second question on the cost-income ratio guidance of 40%, I think by the Fourth Quarter of 2010, what's the assumption around the market related financial margin in that? Is that assuming

that that goes down to a level of around BRL500 million per quarter or assuming that it stays at sort of higher levels than that?

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

Yes. We made the provision for structurally in the end of '08 about BRL1,331 million. And this quarter, we consumed BRL151 million. And now we have a total balance about BRL797 million. This we are supposed to continue to utilize according the implementation of the measure. Just a moment, please.

A - Unidentified Speaker

Just to be sure, you asked about the margin, which the (inaudible) margin, right, in the 40% assumption that we gave you?

Q - Ian Smith {BIO 17539373 <GO>}

Yes. Absolutely.

A - Unidentified Speaker

Okay. Yes. We used a little higher number, around BRL600 million a quarter for that number.

Q - Ian Smith {BIO 17539373 <GO>}

Thank you very much.

Operator

Our next question comes from Mr. Boris Molina with Santander.

Q - Boris Molina {BIO 1904979 <GO>}

Yes. Good morning. I had one question regarding capital ratios. Could you give some guidance in the impact of operating capital consumption how much further you think this could impact capital ratios and whether you've heard from the Central Bank that they have any intention of adjusting capital ratios for intangible assets anytime soon.

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

This quarter, we made implementation of our new rules from Central Bank for operational risk. We had to allocate 50% for operational risk. And this quarter, we implement 80%. That's basically the reason because the RBIS ratio reduced from 16.5% to 16.3%. But we are considered that the generation of the results of the bank and with the retained earnings, it's sufficient to provide the conditions for the bank to grow in the next couple of years. And we don't need to raise capital or other capital instruments.

Q - Boris Molina {BIO 1904979 <GO>}

And regarding the deductibility of intangible assets from tier I capital, do you expect that this could change anytime soon?

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

I think intangible assets will be keeping this level about it.

Q - Boris Molina {BIO 1904979 <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 - Alfredo Egydio Setubal {BIO 1528623 <GO>}

Thank you, all for the participation with us this morning here in Brazil. I think we had a good quarter. I think the synergies are appearing in the performance in terms of loan, in terms of growth, and the direction that we are expecting to continue through this quarter. Of course, this Fourth Quarter is more heated for the Brazilian economy in general.

But we are very confident about 2010 that the economy will grow, as Sergio Werlang said, something between 5% and 6%. So this will give us a much better environment to grow the business and catch the synergies from the merger with Itau and Unibanco. Thank you, all. And hope to see you and be with you in the next conference call. Thank you.

Operator

This ends our Itau Unibanco Holding earnings results conference call for today. Thank you very much for your participation. And have a good day.

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