Q1 2013 Earnings Call

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Company Participants

- Alfredo Egydio Setubal, VP & IRO
- Caio Ibrahim David, CFO
- Rogerio Calderon, Corporate Controller and Head of IR

Other Participants

- Boris Molina, Analyst
- Carlos Macedo, Analyst
- Daniel Abut, Analyst
- Daniel Fasa, Analyst
- Ian Smith, Analyst
- Jorge Kuri, Analyst
- Marcelo Henriques, Analyst
- Mario Pierry, Analyst
- Philip Finch, Analyst
- Saul Martinez, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. Thank you for standing by and welcome to Itau Unibanco Holding conference call to discuss First Quarter 2013 earnings result. 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. (Operator Instructions) As a reminder, this conference is being recorded and broadcast live on the Investor Relations website at www.itau-unibanco.com/ir. A slide presentation is also available on this site. The replay of this conference call will be available by phone on 55-11-4688-6312, access code 0600682 pound key.

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 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 Sao Paulo are Mr. Alfredo Egydio Setubal, Executive Vice President and Investor Relations Officer; Mr. Caio Ibrahim David, Chief Financial Officer; and Mr. Rogerio Calderon, Corporate Controller and Head of Investor Relations.

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First, Mr. Alfredo Setubal will comment on First Quarter 2013 earnings results. 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>}

Hello. Good morning, for everybody. Good afternoon, for those who are in Europe. We will start on page -- slide number 2, highlights for the First Quarter. First one is the result, BRL3.5 billion, with a little increase of 0.3% when we compare to last quarter of 2012. And a recurring ROE of 19.9% (sic; see slide two "19.1%"). The second point is related to managerial financial margin that in total achieved BRL11.5 billion in this First Quarter.

When we analyze, we see a decrease of this margin of BRL1.1 billion when we compare to the last quarter of 2012. This due to the decrease of BRL278 million in margin with the market in our treasury operation; BRL800 million in margin with the clients. And inside this BRL800 million, we have a reduction of BRL255 million due to the few calendar days in this quarter. So anyway, we had a decrease in this line in this quarter, the First Quarter.

Also related to the margin, when we compare these numbers to 12 months ago, the First Quarter of '12, we see a reduction of BRL1.7 billion. This BRL1.7 billion is splitted in BRL361 million reduction in margin with the market. We have reduction of the Selic rates that actually decreased this margin in BRL507 million. A reduction of our working capital related to the acquisition of Redecard minority shareholders. This impacted almost BRL290 million. And of course the change in the mix of our credit portfolio that is part of our strategy that we have been doing in the last one-year-and-a-half. This change in the mix of products impact BRL365 million.

By the other hand, we have -- because of the strategy of reducing the risk of our credit portfolio, we have been able to show another quarter of reduction in nominal NPL ratio. We increased -- improved 30 basis points, achieving 4.5%. When we compare to the 12 months ago, the improvement was even better, 60 basis points in this period, even considering that the First Quarter is not the best one because of seasonality in the credit portfolio.

With this, the allowance for loan losses decreased 14% in this quarter and 20.5% when we compare to March of last year.

Financial margin of credit, the net expenses show some stability in this quarter, achieving BRL5.8 billion, with an increase of 1.6% when we compare to last year. Banking fee continues to grow, BRL5.1 billion in this quarter. When we compare to last year, 18.8%, this includes also the results of BRL1.4 billion for our insurance business in '12.

Another good point is the non-interest expenses, with a reduction -- a nominal reduction in BRL211 million. And we was able to increase only 4.1% in total expenses when we compare to March 2012, below the inflation rate for this period. We did our best in terms of revenues, expenses and NPLs. Our efficiency ratio adjusted -- to risk-adjusted decreased 60 basis points when we compare to previous quarter.

On slide three we can see the results. As I said, we have this more difficult period again with financial margin with the client, with a decrease of 6.8% in the quarter and 10.8% when we compare 12 months, achieving almost BRL11 billion. It is our challenge that we can talk more for the next quarters. Expenses for loan losses 4.9%, in line with the expectations that we finalized when we released the results for the last year.

Another point of importance is expenses that we continue in the trend of reduction and we will continue to work hard this year and next year to reduce to get the Bank more efficient, considering that we want to keep good ROEs for our shareholders. So the efficiency ratio is important and especially working to reduce the nominal expenses as part of our strategy and we'll continue in the coming quarters.

Another point that I wanted you to pay attention is the income tax and social distribution. And in this quarter we had a reduction due to the operation of Redecard. And this level of provisions for income tax will remain in the coming six years in our expectation. So in your model, you can consider this as recurrent at least for six years in terms of income tax.

At the end, we have a recurrent net income of BRL3.5 billion. It is a little increase of 0.3% in the quarter and a reduction when we see the numbers of last year of almost 1%.

On slide 4, we can see the banking operations and the insurance operations. As we stated, in the MD&A you have much more information and much more analysis of these two operations. But anyway, we can see that from our recurring net income of BRL3.5 billion, banking operations was responsible for BRL2.8 billion and the insurance of BRL546 million.

Continuing all these, we see that the banking operation has had a ROE of 20% and a risk-adjusted efficiency ratio of 75.3% and the insurance operations with a ROE of 36.6% and a risk-adjusted efficiency ratio of 70.1%. So it's another way to look at our consolidated numbers. And as I said, you have much more details in the MD&A.

On slide number 5, we can see the financial margins. We can see the gross credit spreads reducing again this quarter. The peak was last year 13.4%. Now we achieved 11.6%. And we can see because of this better numbers of provisions for loan losses that the net credit spread achieved 7%, almost flat -- a little increase when we compare to the 6.9% of the last two quarters.

On slide number 6, we can see how was the variation of the financial margin within the last 12 months. We had last year, March of last year, BRL11.7 million and we achieved BRL10.9 million this quarter, BRL210 million positive in terms of margin because of the increase of the volume of the credit. BRL255 million in this quarter related to the reduction in the quarter, in this First Quarter when we compare to last quarter of last year, the numbers of calendar days because of holidays in February -- the number of days. So we had less days this quarter. Product mix from (Q12) was a reduction of BRL73 million. BRL322 million because of mix of clients and spreads. BRL286 million related to Selic and BRL78 million related to equity.

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If we look down on this chart, the evolution of the mix of the portfolio, the credit portfolio, we see that we were changing the mix to a lower credit risk in the last quarters. For almost one-and-a-half year we have been changing that. We are increasing our corporate portfolio related to large companies. We have been reducing our credit portfolio related to car financing, auto loans. And we continue to decrease a little our small and micro companies. In terms of mid-sized companies, we are able to keep the level. And we continue to grow the mortgage business and also we are increasing our business in the South America in the countries that we are present, especially related to large companies, in these companies. So we are increasing our credit portfolio in those countries.

Now on slide number 7, financial margin of credit and allowance for loan losses. We continue to see the trend -- good trend in terms of reduction of expenses, net expenses, net of recovery in terms of loan losses. We continue in the trend of reducing the provisions due to the strategy of reducing the risks of the credit portfolio.

On slide number 8, we see that this -- the result of this quarter we had lower gains in the financial margin with the market. We achieved BRL600 million, when in average our numbers are BRL830 million; some quarters better, some quarters lower. But anyway, in this quarter due to the market conditions we released a lower result.

On slide number 9 we can see the banking fees and results from insurance. I would like you to pay attention on current account services. We continue to increase these numbers especially because of the segmentation that we operate in the Bank in the retail especially when we can see the growth of the fully class services for our clients that have been able to increase the offer of products in this segmentation that we have. So we continue to grow in this line. But anyway, we are in a good position here in terms of the growth, also in terms of credit cards operations.

On slide number 10 we have more numbers of the insurance operations that I said have much more detail in the MD&A. But anyway, it is the operation that is growing, is gaining importance in terms of results, in the consolidated numbers of Itau Unibanco Holding. Remembering that we sold auto insurance and residential insurance to Porto Seguro and we now have 30% of capital of the Group for Porto Seguro and we don't operate more in cars and the residential. So we continue in pension plans, we continue in the capitalization market, we continue in life insurance and extended guaranteed life risk and so on; doing business regularly with our client basis here at the Bank.

So we have claims ratio of 38.4%. That's a good number. The results of the insurance business, the 15.5% of the so called results of the Bank. And you can see on the left side -- lower left side of this chart how we started from BRL2.38 billion in premiums and how with this reduced recurring net income of BRL546 million. And on the right side, the combined ratio that is 82.4%. That is a good number.

But as I said, this is a market that is growing and in general, a market that we continue to invest, especially in the pension plans -- funds. And you have more detail in the MD&A.

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On page 11, loan ratios, we continue to see the result of our strategy of reducing the risk of the portfolio under the new scenario of lower spreads and lower Selic. So the expenses of loan losses when we compare to our credit portfolio continues to reduce. The peak was exactly one year ago of 1.79% and we finished this quarter in 1.34%. So it's a good increase. We continue to have good provisions for loan losses and we continue to keep BRL4.1 billion in complementary provisions for credit in our expected loss model that we use for many quarters already.

On page 12, we see the NPL ratio over 90-days. We continue to see, as I said, the trend of getting better, much better numbers here. The peak was 5.2% in June last year. Now we reduce to 4.5%, both segment of individuals and companies showing improvement.

With this strategy and this lower level of provisions, we have been able to increase for the Third Quarter in a row the coverage ratio of 90-day coverage ratio that achieved 161% at this quarter.

When we see on slide 13, we see the 15 to 90-day NPL ratio. We see a deterioration in this quarter. But if you go back and look all the First Quarters of every year, it is a natural trend that in the First Quarter we see some deterioration because of people use more credit and they have difficultly to pay at the beginning of the year. So we -- because it's normal it doesn't pay -- you don't pay much attention, much relevance in the small deterioration in this quarter.

On page 14, non-interest expenses, we continue to focus and to reduce nominal expenses. We expect it to continue to grow lower than inflation this year again. So it's part of our strategy to keep good ROE in the more difficult scenario of market.

On page 15, efficiency ratio and risk-adjusted efficiency ratio, we show a little better number this quarter when we analyze the risk-adjusted and a positive relation when we compare the efficiency traditional ratio. But much related the efficiency -- traditional efficiency ratio to the seasonality and the margin contraction in this quarter not related to expense.

On slide 16, we can see a growth of our assets that continue above BRL1 trillion in this quarter, a growth of almost 15% in 12 months and 1.4% in this quarter. Stockholders' equity increased 0.3% this quarter, achieving BRL74 billion.

On slide 17, we see the loans by type of clients. We finished with total loans including endorsements and sureties of BRL434 billion. We had also almost BRL22 billion in corporate bonds, in private securities. So for this bond -- this bonds of credit. So the total credit exposure that we have is BRL456 billion.

Using this number, we saw a growth of 9.2% in the last 12 months and 1.5% in this quarter. The growth has been below the market average because we continue to reduce the risk of -- in the total amount of our card financing business, remembering that we achieved more than BRL60 billion and now we have BRL48.2 billion. And we do have some contraction to happen here in this quarter.

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We also continue to reduce the small and very small companies. So this segment continues to contract in terms of portfolio. The others we continue to grow mortgage in a good pace. We continue to increase our payroll loans that achieved BRL16.2 billion in this quarter. And the JV, Itau and BMG, is working well in this quarter.

On page 18 we can see that we have no problem in terms of funding and repo funds and so on, with almost BRL1.5 trillion in total funds.

On page 19 we see that the ratios between funding and loan portfolio is very comfortable in terms of funding, in terms -- and of course because we are not growing so fast in the private portfolio.

On page 20, we have the BIS ratio, 17.7%, with a little -- with an increase this quarter. And 11.7% in the Tier I category in the quarter. On page 21, we can see if Basel III was implemented today, we estimate that our BIS ratio Tier I would be almost 10% what is above the requirement. So we don't see issues related to Basel III. We continue to consider that we will be able to generate enough capital to face the growth of the Bank in the coming year.

On page 22, the recurring ROE, 19.1%, a little below the last quarter. But still a good number in terms of return for our shareholders. Market capitalization on slide 23, BRL161 billion. We continue with a very good liquidity of our shares both in New York Stock Exchange and Bovespa.

And to finalize, on slide 24, the expectations for 2013, we keep the same level of expectation that we released when we announced the results from last year. We continue to believe in credit portfolio growth of 11% to 14%. We believe in the second semester the growth will be higher because the adjustment in the portfolio, especially in the car, probably will be finished. So we will start to grow more in line with the market the total credit portfolio of the Bank.

Internal expenses for provision for loan losses, we keep the expectation to BRL19 billion to BRL22 billion for this total year. And banking fees, we are showing a growth of 15% to 18%. If you compare to the last expectation that we released was 11% to 14%. But here it's just adjustment because of the reclassification of the numbers of Redecard that we released last week before the release of the results.

So here, it is not revision of the expectation; more adjustments with the new numbers including this reclassification of Redecard. So the new number is 15% to 18% and we are in line with that up to now.

Non-interest expenses growth of 4% to 6%. This year we will also continue to be below inflation. And risk-adjusted efficiency ratio improved 200 basis to 400 basis points indeed. So we keep the same level of expectation for the coming quarters until now.

With this, I finish the presentation and we are open to your question.

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Questions And Answers

Operator

(Operator Instructions)

Jorge Kuri, Morgan Stanley.

Q - Jorge Kuri {BIO 3937764 <GO>}

I wanted to ask a question about margins. It seems to me that you feel more comfortable that margins are probably going to behave better going forward than what we have seen over the last couple of quarters. And I am just trying to get to that. As per your disclosure the asset sensitivity of your balance sheet is such that the maximum re-pricing gap is roughly 12 months out and Selic rates fell a lot in the second and Third Quarter of last year. Actually, that was -- the biggest decline in Selic in that cycle happened in those quarters, I think the two combined were more than 200 basis points.

So all else equal, we really haven't seen the full negative impact on margin from falling Selic and in addition your loan book continues to have lower profitability as long as the front book is not improving. We've seen that the back book is -- sorry, that the front book is only growing in corporate lending and government on lending. So by definition, as your back book continues to amortize and your front book is not really growing, spreads will continue to come down, probably more so going forward. So can you help us understand the assumptions behind your view on margins? Maybe if you can share the math behind your assumptions that will be fantastic? Thank you.

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

Jorge, Alfredo speaking. Yes. We expected the margin to continue to be challenging for the Bank, for the system as a whole. We are very confident in our strategy related to confirm -- to change in the mix of the portfolio. We have been able to show a much better provisions for loan losses and we continue to believe that these numbers will continue to reduce in the coming quarters due to the new mix of the credit portfolio and also we continue to be confident in the strategy of being more -- controlling more the expenses.

So the challenge that remains really is the margin with the client because margin with the market is -- the volatility of the market some quarters you go better, some quarters you don't do so well. And we are not changing the limits of the treasury, these (inaudible) and so and so. It is difficult to forecast.

In terms of margin with the clients, we believe that because we changed this mix and of course we too had some impact to absorb in the coming quarters, especially in the Second Quarter, that we will continue to reduce a little bit car financing and in small and very small companies. But anyway, we continue to see the trend of a better margin with the clients in the coming quarters, because we already changed the loss and turned over the loss in the credit portfolio. And most of the credit portfolios is already in the new spreads. So when we renew these credits, the impact will be much lower than in the past.

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And we believe the economy continue to -- the pace of growing and we expect it to grow something along 3% this year. That, the worst in terms of margin with the clients, probably will be this First Quarter of 2013. We believe that we -- from here to now -- to the coming quarters, we are going to see some increase already in the margin with the clients. We don't see much pressure in terms of price in the market.

The change in our mix of the credit portfolio of course will continue but in a slower pace. So all this together make us much more confident that in the coming quarters we are going to see some recovery in the margin with the clients. And we expect it to remain flat this year when we compare to last year.

Of course it is not easy. I am not minimizing the difficulty. But the numbers, the simulation that we have, the expectations and what we see in the market, the expectations also of our directors that are dealing with the clients, the channels, give us confidence that we need to believe that the trends will change in the coming quarters when we analyze the margin with the clients.

Of course not easy. We have the competition. We have the conditions of the economy. We'll have to see what will happen with this increase in the Selic. How much this will impact the economy and so on. But anyway, our feeling the best numbers we have today is that probably the worst in terms of margins occurred in this First Quarter of 2013.

Q - Jorge Kuri {BIO 3937764 <GO>}

And I guess the part I don't understand is your disclosure (inaudible) is different. It is clear from the disclosure that when you look at your gap, your asset sensitivity gap, the worst part of it is 12 months out and, as I said before, rates fell a lot in the second and Third Quarter. So I mean, I am -- that's I guess what I am trying -- having a hard time reconciliating, it just doesn't seem that that's going to be the case. And so has the gap changed? Are you hedging the gap? I mean, can you just give us a little more details why the disclosure says different than what your expectation is?

A - Rogerio Calderon

Yes. Rogerio speaking. We are not sure that we are understanding your question. But if you are referring to the average price of the portfolio, we think that the major compression was actually finishing its impact to the First Quarter. What means -- and Alfredo was just mentioning that, that from the perspective of the margin with the clients, we think that we have touched the bottom level in the First Quarter and from now on we expect this line to grow. It's not going to be a big growth quarter on quarter. It's going to be a gradual movement upwards. Why? Because we have less stress in terms of the spreads right now. We have volumes accelerating. So the pressure on the remaining impact of the average re-price of the portfolio is going to be lower than the growth in volumes. At what point? The margin with the clients to go up.

When you look at the margin -- not only the margin with the clients. But the margin with credits as a whole, what also includes some of the impacts in the floating and the Selic impact that you announced when you addressed the question, the pressure on the

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average Selic from now on is going to be reduced from the pressure we saw in the First Quarter. If you remember last year, the Selic drop was in the beginning of the year. So removing the difference when the year went on.

So all said, we believe based on our simulation, on our budget efforts, et cetera, that margin with clients are going to -- is going to go up. Questions remain on how difficult it's going to be to reach the flattish level, as Alfredo mentioned. We recognize that it's not an easy task. But we think it is still possible and that's what we are doing here to deliver to you. We are pretty confident that this is going to happen as from now on.

Q - Jorge Kuri {BIO 3937764 <GO>}

All right. Great. Thank you.

Operator

Carlos Macedo, Goldman Sachs.

Q - Carlos Macedo {BIO 15158925 <GO>}

Actually, I have a couple. The first is a little bit of a follow-up on Jorge's question on -- but not on margins. But rather NII growth. I mean, margins apart, NII growth -- NII actually contracted almost -- margin with clients, as you like to put it, contracted 11% year over year. And part of that is because of the weak loan growth or the -- not weak. But very low loan growth that you have been able to put forth over the last few quarters, of course taking into consideration the general level of risk in the economy and all that.

I would like you to give us some color on the Bank's appetite for credit. And how much could we expect an acceleration on this credit to help NII growth achieve your objectives for the year and maybe be flat or something like that?

The second question will be on expenses. 4% year-over-year growth in expenses, that's in line with your guidance even though it does look like there's still a large amount of severance in there. And I'm just wondering, is there room for that to come below guidance throughout the year? What kind of confidence do you have in that sense? Thank you.

A - Rogerio Calderon

So in terms of our risk appetite, Carlos, we are happy with the bigger selectivity we have been applying which very well succeeded results in terms of our asset quality improvement. We don't plan to change anything on this. But we should recognize that the First Quarter has a lower level of activity. So we expect some acceleration in the coming quarters. We think that by applying the same level of selectivity, we are going to keep protecting our asset quality. Growth is going to accelerate towards our guidance. So we believe that 11% to 14% is feasible to -- and we are going to reach that level on a non-annualized basis probably between the second and Third Quarter.

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We have been growing very, very well in the most important lines on our current status. I am referring to the personal loans, particularly those based on the restructuring payroll loans. This is growing at a very fast level, fast speed. Also happening the same with mortgage. And when looking at the Company's loans to large companies, we also expect the major projects on infrastructure, et cetera, to speed up as time goes on during the year. And this should happen -- should help the loans to large companies to keep at this high level that we had been posting.

So in summary, we believe the credit growth is going to accelerate from now on and we don't expect to change anything in terms of our risk appetites to deliver this high level.

Q - Carlos Macedo {BIO 15158925 <GO>}

Just a question on that.

A - Rogerio Calderon

Please.

Q - Carlos Macedo {BIO 15158925 <GO>}

Obviously, the auto loan book has been the one that's been dragging down the growth for a while. Is the turnover in that book done? I mean, it's still --

A - Rogerio Calderon

Not yet. But pretty close -- not yet. But pretty close to the turning point. We expect the turning points to happen by May, eventually by June. Some origination volumes have reduced in the -- I mean I am referring to the system, reduced in the beginning of the Third Quarter, now accelerating again. So we expect the origination to become positive, marginally positive, as from the mid-year, balance probably to start to recover as from the Third Quarter. Still is expecting some reductions, some contraction in the balance of auto loans by the Second Quarter.

But the point is very relevant actually because this is going to reduce the burden we have in terms of delivering the full growth for the portfolio. Of course when we stop shrinking the portfolio on auto loans, it's going to be easier to go towards the double-digit growth.

Second question was regarding expenses we had. When we look at the analyzed figures in terms of expenses, we are still below inflation. We have announced some reclassifications in our figures. Those are impacting -- actually impacting higher the expenses growth. Without these adjustments we did, the expenses growth would have been 2.504. And this is the trend that we expect. So pretty close to the low end of the range.

You referred to the severance and this too impacted the expenses last year. But impacted not in the First Quarter, in the following quarters. So we should expect this benefit, if I could say, in the coming quarters.

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Q - Carlos Macedo {BIO 15158925 <GO>}

Okay. So you are still maintaining your guidance 4% to 8%. But would you say that the likelihood of it being towards the low end of the guidance is stronger?

A - Rogerio Calderon

Yes. We keep the same guidance, 4% to 6%, in spite of additional difficulties due to this -- by bringing this difference of consolidation in our figures. If we had to restate the guidance, it would have reached probably -- I mean the bottom level would have reached 4.5% to 5%. We have not restated because we are pretty confident that we are going to deliver better than this figure; that we don't need to revise the guidance because we are going to deliver better than expected.

Q - Carlos Macedo {BIO 15158925 <GO>}

Okay. Do you have -- just a wrap up, do you have any views yet on the level of collective bargaining for this year and how that can impact your guidance?

A - Rogerio Calderon

We have -- of course we have included this in our budget that is behind our guidance. We expect some increasing salaries, a little bit higher than inflation in line with previous years.

Q - Carlos Macedo {BIO 15158925 <GO>}

Okay. Thank you, Rogerio. Thank you, Alfredo.

Operator

Philip Finch, UBS.

Q - Philip Finch {BIO 3252809 <GO>}

A few questions, please; first, a more general one. And really asking whether you're seeing signs that the economy is picking up. And if so, can you give us some examples of that?

Second, on slide six you gave a very useful loan mix evolution chart. Do you have a target for where you want your loan mix to be going forward? Are we there yet or could we see the evolution continue?

And lastly, in one of your slides you showed clear improvements in terms of the NPL ratio, a 60 basis points improvement in recent quarters. You are now at 4.2% -- sorry, 4.5%. Do you have a normalized level that you are targeting as well? Thank you.

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

In terms of economic growth in terms of the environment, we believe that the economy will grow around 3%. Probably the Selic rate will be higher and the central bank will

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continue to increase probably more 100 basis points if Selic rate is becoming (18) of the coupon. We think it is a reasonable scenario. Of course it's not exciting. Of course this brings some risk in terms of credit, credit portfolio, because increased interest rate always brings more risk. But anyway, we believe that the scenario is reasonable to continue the growth of the credit that Rogerio mentioned in the last question, especially in the second semester.

In terms of ideal credit portfolio, I think we are much closer now than we were when we started this movement one year-and-a-half ago. We have some growth to come in the payroll business because we just started the JV with BMG. So we have room here to increase and to reduce the average of risks for the individual portfolio. Some reduction yet to come in this quarter related to car financing. And in terms of small and very small companies, I think we are going to grow probably from the third or Fourth Quarter because these operations, as we announced, is now integrated with the retail operation of the Bank.

So we believe in this model we can be -- again be able to get more control of these two segments of Company. So I think we are closer to the portfolio that we wanted to make. We still see in the coming quarters these growth in payrolls, continued growth in mortgage, emphasis in large companies. So we have some changes to happen. But I think that most of them are already done.

A - Rogerio Calderon

And your third question regarding NPL is obviously related to this optimum portfolio breakdown that Alfredo was mentioning. Although we are closer to this optimum picture, we still have the portfolio running that is going to keep delivering improvements in NPL. We are not guiding the market in terms of NPL evolution. But we think that the level that we have reached by the First Quarter end at 4.5% is not the lowest. We expect NPL to go lower, probably at a lower pace than what we posted in the First Quarter. But still driving down. Not difficult to believe that is going to keep closer to the 4.4% -- shut 4% by the year end. What we have the most confidence on is the guidance on the loan loss provision expenses and basically we have reiterated the guidance. And from the current level it's not -- is changing. It's probably to be closer to the lower end of the BRL19 billion to BRL22 billion total.

Q - Philip Finch {BIO 3252809 <GO>}

Great. Thank you very much. That's very reassuring.

Operator

Mario Pierry, Deutsche Bank.

Q - Mario Pierry {BIO 1505554 <GO>}

Let me ask you two quick questions; first is on your tax rate. You seem to suggest that your effective tax rate for the next six years should remain around the 27% level. But in the last quarter's conference call, I recall that you were guiding for a 32% to 34% effective tax rate.

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So can you just tell us what has changed? In your view why now are you guiding for the benefits of Redecard to be running through your income statements?

And the second question is related to your credit card loyalty program. Earlier this year you changed the conversion ratio of points. I was wondering if you're feeling any impact from this changes on the growth of your credit card balances? Thank you.

A - Rogerio Calderon

Thank you, Mario. Good question, the first one. Yes. We have -- we were actually finishing all the expenses regarding Redecard when we announced that expectation. It was actually our expectation without the impacts or the rental impact that we are going to post due to the credit card capital transaction done in December.

So from now on, we expect the range of our effective tax rate to be between 27% and 29%. I just draw the attention that it's a fixed number that is going to reduce our tax burden every year. So when the net income increases -- the net income before tax increases, of course the benefits of this credit from the Redecard transaction reduces proportionally. So right now, it's around 27%. It's going to be between 27% and 29% the next six years.

In terms of our credit card loyalty program, in spite of the adjustments we made, the change we announced, we had kept our market share. We have not noticed any impact in our market share so far.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. Thanks, Rogerio. Just can you share with us what is this fixed number that's going to reduce your tax burden every year?

A - Rogerio Calderon

It's around BRL150 million, BRL160 million per quarter. If you remember, we announced I think was BRL3.7 billion in tax benefits and this is spread out six years around BRL630 million per year. What means BRL150 million, BRL165 million per quarter.

Q - Mario Pierry {BIO 1505554 <GO>}

Perfect. Great. Thank you.

A - Rogerio Calderon

Thank you.

Operator

Daniel Abut, Citi.

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Q - Daniel Abut {BIO 1505546 <GO>}

A quick question; given that you are disclosing now -- although we have all the information of the final rules for Basel III and you did a very good job in one of the slides of explaining how comfortable your capital situation is. And all the scenarios up to 2019. And given that in another slide you actually when you disclosed -- when you composed the ROE, you're showing that the excess capital is a drag on the ROE.

Wouldn't it make sense to consider an increase in your dividend payout ratio, again, given that you now know that you're very comfortable related to Basel III, asset growth is likely to remain much lower than in the past and it's unlikely you're going to be doing any acquisitions outside Brazil and Latin American, even the big differential in valuations that Roberto refers to. Wouldn't that be a way to support your ROE given such a comfortable capital situation?

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

Daniel, it's Alfredo. Of course, we -- all the numbers show some good prospective considering Basel III. But on the other hand we are still in a condition of the market pressure, competition, uncertainty that equals more conservative in terms of keeping the same level of dividend that we used to pay; that is around 30, 30-something of the net income. We're not planning any changes in that until we have a more clear vision of what will happen in the financial system in the country with the delinquency and everything together. But at the moment we are not considering any changes in the -- in this level of capital. We understand that we are -- that seems to be a comfortable position. But anyway, we work to keep this capital to see really what is happening in Brazil, outside Brazil. And all the uncertainties that is around the global economy. And also specifically in Brazil.

Q - Daniel Abut {BIO 1505546 <GO>}

Thank you, Alfredo.

Operator

(Daniel Fasa), Credit Suisse.

Q - Daniel Fasa {BIO 2092381 <GO>}

The first one is on asset quality. I understand that even with the 30 bps improvement in NPL you posted this quarter, you still see room for further improvements in NPL ratios throughout 2013 and on the back of that you think you are on track to deliver a provision expenses closer to the low end of the BRL19 million to BRL22 billion guidance. But thinking forward, however, I know it's still too early for official guidances or estimates for 2013. But I am curious if next year when you probably have a loan book mix closer to what you consider to be ideal with more payroll, mortgage and large corps, if you see the possibilities of provision expenses falling or being flat in absolute terms versus 2013? And I'll ask my second question later.

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A - Rogerio Calderon

Yes, Daniel, Rogerio. We believe that most of the benefit out of our mix change is going to be finished during 2013. We think that the quality -- the asset quality is going to improve. And we still see some potential reduction in our nominal amount for loan loss provisions in 2014. Of course this is very much dependent upon the acceleration of the economy.

If we have the credit portfolio growing faster than the current speed, then eventually we don't have the same delivered to give you -- to give to the shareholders. But of course it's going to be on the upside circumstance. Considering everything the same level that is being posted right now, we -- yes, we see some marginal reduction in our total amount of loan loss provisions for next year. But it's going to be closer to BRL19 billion, lower than that. But closer to. And now second?

Q - Daniel Fasa {BIO 2092381 <GO>}

Yes. Thanks a lot for that. My second question is on the evolution of NII, especially regarding margins with clients. I'd like to know if you decrease your spreads and margins in revolving credit lines, for instance, by expanding your hold of credit card based lower rates for the revolving portion of credit cards. The reason I am asking that is to see if you're already aligned if your main private competitor that announced these kinds of changes for their whole customer base. But you're implementing that in a more gradual manner with the Itaucard 2.0?

A - Rogerio Calderon

In our case, it's a gradual change. We don't have any major impact. Of course there's the seasonality in the First Quarter, when some of the lines have been reduced more than others during last year. And of course as they account for a bigger portion in the First Quarter, sometimes they increase the impacts when you look -- when you compare different quarters. We don't see any major impacts. And particularly when we look from the current level onwards, then we see the positive. Why? Because we have lower spread contraction, as we mentioned at the beginning of this conference call. And we had the volumes accelerating. So we see NII, at least on each portion regarding margin with the clients, to grow from the level presented in the First Quarter.

Q - Daniel Fasa {BIO 2092381 <GO>}

Okay. Thank you, Rogerio.

Operator

Saul Martinez, JPMorgan.

Q - Saul Martinez {BIO 5811266 <GO>}

I hate to beat a dead horse because it seems like everybody has asked about NII. But I'm going to do it as well. It's more of a broad question and that's just can you just -- what's your level of confidence that NII has hit the bottom in nominal terms in 1Q?

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And you've always said -- or you've consistently said in recent quarters that the hardest thing in terms of your projections, in terms of your guidance and expectations is to talk about NII because of all the moving parts. And some of the things that -- and I also ask because some of the things you've said on the surface to me do seem a little inconsistent. You mentioned NII being flat in '13 versus '12. That's -- I mean, you just mathematically given 1Q. That's very difficult to reach and you have also said that you don't see a big quarter-on-quarter increases in NII. If you don't see very big quarter-on-quarter increases, you are not going to get anywhere near flat '13 versus '12.

So if you can just comment on your level of comfort that all the things you mentioned about re-pricing and mostly being over, how comfortable you are that and what your level of confidence is that the First Quarter was the floor in terms of net interest income? And I have a follow-up question as well.

A - Rogerio Calderon

We fully agree. We recognize that it's going to be challenging to reach this level. It will require something like 5% or 6% net interest income growth every quarter. We are counting on growing volumes and we are counting on reduced pressure on spreads from now on. And we think it's possible. As we've said before, we recognize how difficult it is. But we haven't given up. So we think it's possible and we are doing for that. If it does not happen, it's going to be closer to that anyway.

Q - Saul Martinez {BIO 5811266 <GO>}

You think that 5% to 6% Q on Q growth on average 2Q to 4Q is a realistic possibility?

A - Rogerio Calderon

Depending on the volume, yes.

Q - Saul Martinez {BIO 5811266 <GO>}

Okay. Second question is on your -- I mean, obviously you can't talk about individual client exposures and there have been some concerns around individual specific exposures to (Batista) Group. But is there any risk that -- I will ask the question in a broader fashion, is there a risk that exposure to select large corporate clients poses a risk to the very positive outlook for loan loss provisioning this year?

A - Rogerio Calderon

Thank you for your question. You know, we are limited to answer on specific clients due to the Brazilian law, et cetera. But we must recognize that we are a leading bank in Brazil. We, of course, have a large exposure to all the large corporate segments and regardless of not being able to give you more details about client exposure, it's only natural that large companies which had large exposure in financial system will also have large exposures on our balance sheet.

So after having said that, we are reiterating that our guidance of BRL19 billion to BRL22 billion. Of course in comparison to all the risks we have, all the stresses, et cetera,

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scenarios we do. And we are reiterating that under any of those circumstance we are going to deliver our loan loss provisions inside the guidance.

Q - Saul Martinez {BIO 5811266 <GO>}

Okay. All right. Thank you very much, Rogerio.

Operator

Ian Smith, AXA Investment Managers.

Q - Ian Smith {BIO 17539373 <GO>}

Just a couple of questions on asset quality if okay. The first one is on just the shorter term NPL ratio, the 15 to 90-day and the one day ratios. Those just in the quarter, is that just completely a seasonal factor or are you seeing anything there that might give you some room for caution on your guidance for this 90-day and 60-day ratios falling through the year a bit further?

Then just finally on the re-negotiated loan portfolio. I think it came down slightly. But it's still above 5% of your overall loan portfolio. How do you see that moving going forward I suppose. And it kind of plays into Saul's question on certain large corporate accounts? Do you anticipate that that restructured loan portfolio will continue to trend or do you see possible room for that to grow through the year?

A - Rogerio Calderon

Okay, Ian, thank you. In terms of our early delinquency, it's all related to the seasonality of the First Quarter. The average NPL early delinquency measured from 15 overdue to 90 days increased 40 basis points. It happened the same last year. If you look from December 2010 to March 2011, it went up actually 80 basis points. If you look backwards to December 2009 to December '10, it was 40 basis points. If you go further in the past, you are going to see that this is very much the same trend.

We actually don't see any reason for major attention on this. Remember that we also look at our portfolio vintage by vintage and we see the trend very much in line with our expectation. Normally in the Second Quarter -- and I think this gives me a very good opportunity to highlight this point. Normally the recovery happening in the Second Quarter is not stronger than the Third Quarter because we have the impacts of this increasing early delinquency in the First Quarter. So normally the Second Quarter tends more towards the stability and then we improve from the Third Quarter when we are under a positive cycle in asset quality as we see in our books.

You also mentioned the renegotiation. We have actually changed the way we present this figure. It's all explained in the MD&A. We have not changed anything in terms of our strategy on renegotiation. This is actually reducing now. The reduction is a function of the volumes of overdue from last year and from now on we expect this amount to reduce. Remember that we are focusing towards lower risks. So renegotiations tend to decline permanently actually. It's now representing 3.8% of the total portfolio, coming from 4%. And this trend down is expected.

Q - Ian Smith {BIO 17539373 <GO>}

Fantastic. Thanks very much.

Operator

Marcelo Henriques, BTG Pactual.

Q - Marcelo Henriques {BIO 17385475 <GO>}

I also have more like a broader question and it's a discussion between margins and NPLs. In my opinion, of course, they go hand by hand, right? I mean if you have more risk, you should charge more. If you have lower risk, you should charge less. So no wonder the NPL failed because you are -- definitely when risks cost more, then the margins also collapsed.

But I am wondering the dynamics of the NIM versus NPL. I mean if the risk-adjusted NIM going forward you see lower or higher than what we are seeing today, in my opinion just to give a background of what I think here. I mean, if it was like some years ago when you had still a very high demand for credit because the credit was even less penetrated, the public banks were not that aggressive. You did have very, let's say, good room Q2 to have more bargaining power with your spread pricing given the environment. The population was less leveraged. So on and so forth.

But going forward the scenario seems to have changed quite a bit and there certain credit segments that are really fatigued. No wonder you are not growing there. Actually, you are declining. When you talk to the banks including public, I mean everyone wants to grow in payroll and mortgage and large corporate, I mean, no exception. So everybody is like pointing their guns to the same direction.

And it seems like, the demand, it's not as heated as it was a while ago because the credit is kind of already penetrating some segments -- and not to mention the over leverage of the middle class. What I am trying to get at, how confident are you that the NIM adjusted to risk going forward even if we are going to a lower risk environment this could be beneficial to the profitability of the Bank in a way that if this scenario persist longer, it means that your ability to price better or to have a better spread or to keep the spread adjusted to risk in a better -- higher than in the past, it seems pretty hard in my opinion. So it's a broader discussion. It's more like a theme. It's not about the next quarter or whatever. But it does compromise the profitability of the Bank. So I am just wondering what are your thoughts on this.

A - Rogerio Calderon

Well in terms of our net interest margin, if you look on page 5, the net credit spreads, it's actually showing stability and now showing first signs of re-increasing. When, of course, we look at the risk-adjusted net interest margin, not only on credit, there is an impact here of the other floating activities I mean Selic is impacting a little bit this other line. But if you

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just look at the green line in this chart here that is pointing to the trends on credits, the risk-adjusted credit spread is actually stable or now marginally going up. We expect the same trend to keep happening in the coming quarters.

Then, why it is possible for us to believe that we are going to keep the leading this movement towards lower risk? This is based on the strategy. So we definitely believe that we are going to have to show better conditions than the others on growing on those segments. We should look at the segments one each time. If you look at the payroll loans, you should consider the fact that we are growing on the previous base built up by BMG sales force. So it's actually easier to grow because we are not stealing from the markets, we are replacing one of the previous agents in the market. We are building up a new portfolio here and this is showing a growth. If you compare our growth, it's higher than 20% in the quarter, closer to 50% year on year. And this is going to keep being delivered at a very fast speed. So 50%, 70% year on year on payroll loans.

If you look at the mortgage, then we should highlight our partnerships with home brokers that give us a solid base for keeping growing. This is not based on the markets every day. So it's actually a very solid relationship with the originators of this type of transaction.

The third line that's become some attention is the large corporations. And then we have our franchise. Our market share is very important among the largest banks in Brazil. And the more the economy grows on this, we are going to keep delivering a very good and attractive growth on those lines. So this is going to help us to keep this movement towards lower risk, what should lead to net interest margin and credit to go upside wards.

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Q - Marcelo Henriques {BIO 17385475 <GO>}

No. I understand the green line in the next quarter. And so I was just -- that why I was asking going forward if the trend continues to be declining risk-adjusted margins or actually if you're not seeing this at all? I mean it's a reverse. The trend is still continue to go up, if it was the case or slightly up if it was that case in the First Quarter.

So that's why I asked more in a long -- mid to long-term perspective and not the Second Quarter, Third Quarter, if the trend is -- I mean given the environment that we have if you're seeing the trend in the coming years in a declining trend or upward trend or stable. Because when I had the discussion about the spread in Brazil, it would go down, down blah, blah, blah. But you had the argument that the NPL should also go down. And then you're not going to see a contraction in the NIM or in the risk-adjusted NIM. I am just wondering if that changed given the circumstances that are taking place in the mid; to long-term view, not in the Second Quarter or Third Quarter?

A - Rogerio Calderon

You know, Marcelo, when analyzing our behavior right now, I think it's very important to look at the risk-adjusted net interest margin because we are changing from higher risk to lower risk. Of course, this is causing the figures, the gross figures, the spreads to go down and this should be offset. If our strategy is right and we are confident it's right, it should be offset by this lower level of loan loss provisions. So driving net interest margin up.

One day, of course when everything is finished, this trend on net interest margin adjusted by risk is going to finish and then the growth when looking at future the growth should be based on volumes with a more stable risk-adjusted net interest margin. But in the short-term we expect net interest margin -- risk-adjusted net interest margin to keep improving slightly, gradually, as I said before.

Q - Marcelo Henriques {BIO 17385475 <GO>}

Thank you, Calderon. Thank you.

Operator

Boris Molina, Santander.

Q - Boris Molina {BIO 1904979 <GO>}

I have a question related to your appetite for market risk. If we look at your MD&A -- I think it was the slide on page 24, you showed the maximum bar on your balance sheet and it has gone up dramatically over the last 12 months related to recent history. And also when we look at the volatility of your mark-to-market of available for sale securities versus equity, excluding your hedges, it has been a standard deviation of this mark-to-market around BRL131 million over the last decade. Over the last couple of -- actually, the last four, five quarters it has risen to around BRL600 million and you had very positive returns at the end of that year coinciding with this increase in your max bar.

However, this performance reversed dramatically in the First Quarter with a BRL900 million loss after taxes. So I was wondering what explains the change in this appetite for market risk? Should we expect this level of volatility in terms of gains and losses in available-for-sale securities to continue going forward and was this change in risk appetite driven by the need to have the treasury operations try to offset weak performance in your -- in the retail banking operations?

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

Hi, Boris. This is Caio. Thanks for your question. And there is no change in the risk appetite for market risk at all. As Alfredo mentioned before, we are maintaining the (inaudible) limits for the trading book. So what -- pretty much of this First Quarter was related to the volatility of the yield curve. So fixed rates in Brazil changed a lot in terms of this year, the volatility. And that's pretty much the impact on this.

So there is no change in the trading to risk appetites and risk frameworks. And of course what we are seeing in terms of available for sale, which is also part of your question, is related to this volatility that I just mentioned. And when you are talking about the available-for-sale security, we are talking about the structural part of the portfolio. So we are not talking any more about the trading. But now about the banking book. So when you see this volatility through the shareholders' equity it's related to the banking book. It's structural. So it doesn't mean that we are assuming additional risk. It's just our asset and liability management question here that is based on this analysis.

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Q - Boris Molina {BIO 1904979 <GO>}

I would like to assume that the mark-to-market in your (PVDEL) and (BVDEL) portfolios does not affect this figure. I think it's all in the trading, in the trading that has mark-to-market risk --

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

Excuse me, Boris, could you repeat? It was a little bit --

Q - Boris Molina {BIO 1904979 <GO>}

Yes. Looking through your disclosures in the accounts the PVDEL and BVDEL portfolios are the units that back the technical results are in the trading book, not in the -- not the available for sales. This volatility that we are seeing in that I just mentioned is not related to -- it's not (inaudible) but this is -- you have to filter out the activity on PVDEL available-for-sale securities. I just want to know if --?

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

No. That's not our case.

Q - Boris Molina {BIO 1904979 <GO>}

Okay. Thank you.

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

Sure. Absolutely. Thank you.

Operator

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

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

Thank you, everybody for participating with us in this conference call. We keep very confident in the strategy and reducing the risk and the expenses, knowing that it's challenging for growing the revenues. It's not easy. But we are confident that we are going to do that. And we expect to be back again for the next conference call for the Second Quarter. And good day to all as well.

Operator

That does conclude our Itau Unibanco Holding earnings conference for today. Thank you very much for your participation.

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