Q1 2014 Earnings Call

Company Participants

- Alfredo Setubal, EVP & IRO
- Caio Ibrahim David, CFO
- Marcelo Kopel, Head IR
- Unidentified Speaker, Unknown

Other Participants

- Anibal Valdes, Analyst
- Carlos Macedo, Analyst
- Daniel Abut, Analyst
- Jorge Kuri, Analyst
- Marcelo Telles, Analyst
- Natalia Corfield, Analyst
- Nita O'Leary, Analyst
- Tito Labarta, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. Thank you for standing by. And welcome to Itau Unibanco Holdings conference call to discuss 2014 First Quarter results. At this time all participants are in a listen-only mode. Later, we will conduct a question and answer session and instructions will be given at that time. (Operator Instructions)

As a reminder, this conference is being recorded and broadcast live on the Investor Relations website at www.itau.com.br/investor-relations. A slide presentation is also available on the site. And the replay of this conference call will be available by phone on 5511-3193-1012 or 2820-4012, access code 1259686#.

Before proceeding let me mention that forward-looking statements are being made under the safe harbor of Securities Litigation Reform Act of 1996. Actual performance could differ materially from that anticipated through any forward-looking comments as a result of macroeconomic conditions, market risk 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. Marcelo Kopel and Mr. Rogerio Calderon, Corporate Controller and Investor Relations.

First, Mr. Alfredo Setubal will comment on the 2014 First Quarter results. Afterwards, management will be available for a question and answer session. It is now my pleasure to turn the call over to Mr. Alfredo Setubal.

Alfredo Setubal {BIO 1528623 <GO>}

Good morning, everyone. Thank you for being with us for this conference call. And for those who are following through the Internet through the slides we start on slide number 2, the highlights for the quarter.

The first one is the result, the recurrent net income BRL4.5 billion with a growth of 29% when we compare to the First Quarter of 2013.

The second highlight is the ROE at 22.6%, also a good improvement when we compare to the First Quarter of 2013, 350 basis points.

And also the quality of the credit portfolio with the NPL of 90 days, over 90 days at 3.5% with an increase of 100 basis points compared to last year First Quarter.

The financial margin with clients achieves BRL11.9 billion in this quarter with a growth of 8.6% when we compare to First Quarter 2013. And a reduction, a seasonal reduction of 0.8% in the fourth -- when we compare to the last quarter of 2013.

Financial margin with the market BRL614 million is under the volatility of the market and difficult to forecast and to see the numbers that have been very volatile in the last quarters. But anyway it is a good number; when we compare to the last five/six quarters, it's a good result in this line.

Loan loss expenses provisions BRL4.3 billion in the quarter with a decrease of 13.9% when we compare to the First Quarter of 2014 (sic; see presentation slide two "2013"). And an increase of 1.4% here, when we compare to the last quarter of 2013, more related to the Credicard business that we assume the acquisition last December. So now the lines, of course not only this one, they will have the impact of this acquisition.

Commissions and fees both grow -- grow both in the -- when we compared to the Fourth Quarter and First Quarter 2013, a big increase in these lines. And we achieved this quarter BRL6.1b, what is a very good number this quarter.

Non-interest expenses a growth of 9.2% in 12 months. Of course these, with the impact of the Credicard operation, when we compare to the last quarter, 3.4% reduction. If we took out the Credicard numbers just to make things more comparable with last year, the growth of non-interest expenses should have been 6% (sic; see presentation slide two "6.2%) (inaudible) quarter, what is a number below the current inflation that we have in Brazil for this period. So we continue very tough in terms of controlling the non-interest expense.

Efficiency ratio was a better number 47.7%. And risk-adjusted efficiency ratio achieved 66.4%.

The loan portfolio is in a lower pace due especially for the pace of the economy that is not very excited and very heated this year, continuing the trend of last year. So the loan portfolio decreased 0.3% this quarter because mainly of the exchange variation for this period. If the real shouldn't appreciate, the growth of the portfolio should be 0.8%. Still low but a better -- should be better. The growth in 12 moths 11.4%.

On page three we see the growth of the ROE. This growth, when we compare to last year, we have been growing above -- showing ROEs above 20% since the Third Quarter of 2013 because of the strategy. I think it's the result of this strategy that we make in the last year's to increase commissions and fees, decrease the risk of the credit portfolio and, of course, improve that we had in the control of costs. So this is a good return, 22.6% for this quarter.

NPL above 90 days continued to drop since the Second Quarter of 2012. And it's the best number, this 3.5%, that we have since the merger of Itau and Unibanco and is a good number even considering that this First Quarter usually is unfavorable in terms of seasonality for the period.

Efficiency ratio this quarter 47.7% also an increase when we compare to 2013. And we will continue in the efforts of growing revenues and controlling costs to achieve even better numbers throughout this year.

And the risk adjusted efficiency ratio 66.4%, also a very good number and the better -- the best number ever that we showed in this line.

On page four are more detailed results of our results. We see the financial margin with clients growing 8.6% in 12 months. And reducing -- with a reduction of 80 basis points in this chart. This is more related to the First Quarter that usually is the weakest quarter for the bank and for credit portfolio. But also related to the low pace of the economy that we have seen here in Brazil.

We continue to see the economy performing very low in terms of growth. We have 1.4% GDP forecast for this year. So this growth of our credit portfolio will be limited during this year due to this pace. That will reflect of course in the pace of the growth of this financial margin with clients.,

What is good to compensate is as I mentioned at the beginning that commissions and fees are growing very -- in a very good pace, 18.3% in 12 months and 0.3% in this quarter, what will help to compensate the lower pace that we will see in the growth of the credit portfolio with our clients

Loan losses continue to reduce, BRL4.2 billion in this quarter, what is a good number in line with the expectations that we have that this line will continue to reduce during this year of 2014. The reduction, when we analyzed 12 months, is almost 14%.

Recovery of credit in this quarter was lower than last quarter also of last year. And we will continue to keep the expectations that we have for loan losses, net of recover, that we announced at the beginning of this year, actually the first conference -- during the first conference call of the results of 2013.

Expenses BRL9b, I think we continue to focus a lot here and we will continue to do that to be able to compensate lower revenues due to the pace of the economy, especially related to credit.

So at the end our net recurrent result, BRL4.5b, I think is a very good number with a growth of 29% in 12 months.

Margin with market on page 5, as I said it's very volatile. But anyway the second best number that we released when we compare the five last quarters of the bank.

Recurrent ROE, I think we have a good number. When we did -- this chart shows, as we have been showing in the last quarters the numbers, with the treasury gains or the results with the market, considering this 23.2%. I think it also shows that we have a good result and a solid and sustainable result for the bank when we look specifically at the operational side of our operations.

On page seven the loan portfolio, we achieved a total risk in terms of credit of BRL508 billion with a growth of 10.3% if we compare to 12 months and 0.8% in the quarter. Here, including all the endorsements, sureties, private securities and the traditional credit portfolio.

When we analyze closely the credit portfolio, you see that we continue to reduce our car finance business, the vehicle finance with a reduction of 8% in this quarter achieving BRL37b. We continue to expect this portfolio to reduce these coming quarters because the demand for cars and the pace of the economy continue to be very low.

By the other hand we see growth of payrolls, payroll loans. We expect this segment to continue to grow in terms of volumes, especially after the announcement that we made yesterday of the new structure of the JV with Bank BMG that we are going to talk later. And also we expect the mortgage loan to continue the pace of growth that in this quarter was 4.3% -- 4.2%.

So mortgage and payrolls will continue to lead the growth in terms of credit for individuals. And of course, with the acquisition of Credicard, this business of credit cards will also contribute for the growth of the portfolio.

In terms of companies we don't see much demand for credit for corporate, for large companies. In this quarter the growth was 0.6%. And we don't see a good environment for companies to really making huge investments this year due to the uncertainties that always comes together with elections.

We continue to reduce the portfolio, especially of small and very small companies. This reflects in the size of the portfolio. Considering all very small and middle market companies we reduced the portfolio in this quarter of 1.9%. So this trend, I think, will continue in the coming quarters of reducing these portfolio (dues), especially to the pace of the economy that we have seen in the year.

On page eight a breakdown of the financial margin with clients, we start -- we finished last year, Fourth Quarter BRL11.9 billion and this year in this quarter we finish with BRL11.8b. So a small reduction. It was seasonal also because the First Quarter usually is the weakest quarter for the bank in terms of business.

But anyway the compositions from where we were and for the -- and where we achieve this quarter was related to BRL251 million with Credicard new business that started with us this quarter.

Loan operations revenue is BRL247m. We had two calendar days left this quarter BRL206 million (sic -- see presentation slide eight "BRL260m") so in terms of reduction of less revenues.

Mix of product, clients and spreads also a reduction, still related to the adjustment of the credit portfolio and spreads that we are finishing in terms of adjusting the risk appetite, at BRL255m. And Selic and others also a reduction of BRL74m. So that's the composition, the breakdown of the differences of the margin with clients.

On page 9, net interest margin, quite stable the gross credit spread in this quarter and also compared to the last two quarters of 2013. So we are not seeing much pressure in terms of spread this period. And the net credit spread we have had a small reduction more related to the recoveries, lower recoveries in this period.

On page 10, credit quality. As I mentioned at the beginning the NPL ratio continued to reduce to record levels. We finished with 3.5% this quarter. And the peak of this ratio was in June 2012 when this number was 5.2%. So with the adjustment of the risk appetite in the credit portfolio, we were able to reduce substantially and achieve 3.5%. And both segments have been contributing to this; both individuals that achieved 5.4% in the period and companies, large and middle and small companies 1.9%. So we continue to decrease and we expect some improvement in the coming quarters yet.

The coverage ratio improved a little from 174% to 176% what is very comfortable for the credit portfolio that we have.

On slide 11, credit quality. Loan loss provisions expenses also improving and we expected these numbers to be -- to continue to improve even considering the numbers that also are (inaudible) for the credit card operations. The total provisions finished this quarter with BRL25b, a reduction of BRL26.4 billion from the end of 2014 (sic; see presentation slide 11 "2013").

On slide 12 we can see the 15 to 90 days NPL ratio that is usually seasonal in this First Quarter. It was quite stable when we compare to last -- to the last two quarters with some deterioration, seasonal deterioration related to individuals. You can see that all these quarters since June 2009 that the First Quarter always had some deterioration, seasonal deterioration. But if we analyze, this year was the lower pace of the deterioration when we compare to the last two or three years First Quarter that we see that this -- where we can see the seasonality of these numbers.

Commissions and fees, on page 13, continue to improve. We have very good numbers -- they are increased in this quarter -- of 0.3%. And 18.3% when we analyze and compare to the First Quarter 2013, achieving more than BRL6 billion in this line.

Considering the result of the insurance business we can see (inaudible) of BRL7.4 billion in total result and fees for this period.

And also we have revenues that came from Credicard (inaudible). To make things more comparable, excluding the Credicard business, to compare to the last quarter 2013 you can see BRL7.2 billion in this line.

On page 14 we can see the split of our results between banking operations, insurance and excess of capital. You can see that from the results of BRL4.5 billion BRL3.7 billion came from the banking operations with an ROE of 22.6% and efficiency ratio of our banking operations of 50.3%. The insurance operations contributed with BRL600m, BRL608 million with an ROE of 58% (sic -- see presentation slide 14 "58.9%") and efficiency ratio of 35.3%. And the excess of capital with an ROE of only 6.3% reduced at the end the composition of our ROE, consolidated ROE.

The insurance operation in more detail on page 15 is something that we continue to focus. We concentrate our business on the bancassurance operations. The revenues net of claims of BRL1.1 billion in this quarter. And we open here that from these revenues 58% came from the bancassurance 31% came from the pension business, that is an insurance in Brazil as you know. And capitalization 11%.

So we continue to focus on bancassurance, remembering that we don't operate in the health insurance that is very good in terms of revenues but also brings a lot of claims. So we are focusing in our business with Porto Seguro where we have 30% and bancassurance. In this line, as you know, we announced that we are selling the big-risk company that we have, related to big companies, large companies in terms of insurance.

On page 16 non-interest expenses we finished the quarter with BRL9b, an increase of 9.2% considering First Quarter 2013. But here we include, of course, the consolidation of Credicard that we bought from Citibank by the end of the year. If we exclude the Credicard expenses, just to make things more comparable with last year, we can see that the growth in 12 months was 6%. But is below inflation, just as a matter of to make things more comparable.

Stockholders equity evolution on page 17, we started the quarter with BRL81b. We have a net income of BRL4.4 billion in this period. We paid dividends and -- of BRL3.5 billion in the period related mostly to the results of last year of course. Asset valuation BRL300m, equity transactions BRL200 million negative and stock options and others increased the stockholders equity in BRL100m. So that's why we are starting with BRL81 billion and finish with BRL82.2 billion in the quarter.

This next (one) shows BIS ratio of 15.6% with a reduction related to new (regimentations) -- regulations of the Central Bank. 11.1% in Tier 1 and if you adjust for Basel III, our Tier 1 would be 9.6%

in this quarter.

Market capitalization BRL167b, (with a) daily liquidity of BRL718 million per day split almost equally between New York ADRs and BOVESPA here in Brazil.

On page 20 the IFRS numbers,. The number -- the recurring net income increased a little to BRL4.66 billion especially related to the difference in provisions for loan losses. The ROAE remained mostly the same, 22.6%, both in Brazilian GAAP and IFRS.

On page 21 just to remember the outlook expectation that we have for 2014, that we are not changing at this moment. We will keep these. So the expectation to loan portfolio is to grow between 10% and 13%; Loan loss provision expenses, net of recoveries, between BRL13 billion and BRL15b; commissions and fees and results for our insurance business a growth of 12% to 14%; non-interest expenses a growth of 10.5% to 12.5%. And, excluding the Credicard just to make things more comparable, 5.5% to 7.5% is the growth of (non-interest) expenses; the efficiency ratio an improvement of 50 to 175 basis points.

On page 22 what we announced yesterday, in line with the growth of the portfolio especially related to loan payrolls, we are, with Banco BMG, to concentrate all the operations of payroll business in the JV that we have together with them, Itau BMG. And so Itau Unibanco will reduce the participation (inaudible) to JV to 60% coming from 70% and Banco BMG will increase from 30% to 40%.

But by the other hand all the business we bring under the JV, what we expected that our loan portfolio in this JV alone will be over BRL20 billion by the end of the year, what is a number that today is around BRL12b. And of course we will continue to grow our own business of payroll through the branches, in this case more related to the private sector employees business.

To finalize, on page 23, we made different -- a very important improvement. We consolidate our annual report including GRI sustainability ratios, the 20-F and the Debt Report into one so it makes things easier for investors and analysts of equity and credit to make analysis of the Bank.

And we also for the first time and the first bank in Brazil to release the Integrated Report. That is a new approach to show the numbers and the strategy of the Bank in a easier way for investors and for shareholders and so on, what shows in more detail and easier way, as I said, our strategy and the numbers of the Bank. So everything is on our website. So if you want to release and download this. I think it's important; it's a new approach in line with the transparency of the Bank to our shareholders, stakeholders and everybody.

So this ends the presentation. And we are open for questions from you.

Questions And Answers

Operator

(Operator Instructions) Daniel Abut, Citi.

Q - Daniel Abut {BIO 1505546 <GO>}

Good morning, everyone. I normally ask it once and then I will try again, I suspect what the answer will be. But let me try again. If I look at page 6, when you look at the evolution of the ROE, you correctly explain there that now for three consecutive quarters you've been posting ROEs significantly above 20%; 21% to 24%. On a trailing basis for four consecutive quarters you're actually now significantly above 20%.

When you have indicated where you think you can sustain your ROE, you normally say at least 20%. It continues to seem to me that that is too conservative, that your track record over the last three, four quarters clearly show that you can sustain -- at least as far as we can see, long-term, long-term who knows -- but at least in the foreseeable future well above 20%. What do you see in terms of ROE in the foreseeable future, let's say 2014 to 2015? What's a more realistic level than just 20%?

And my second question, if I look at page eight when you look at the -- you show the evolution of your loan portfolio mix which is a clear reflection of your strategy. When you started this de-risking strategy about two and half years ago, the composition of what could be considered relatively higher risk and relatively lower risk -- if I consider relatively lower risk corporate loans, mortgage loans, payroll loans in Latin America --was about, if I'm not mistaken, about two thirds relatively high risk, one-third relatively low risk.

Now fast forward to First Quarter 2014 that's about 50/50. You continue to grow faster in the relatively low risk, i.e. corporate, mortgages, payroll, Latin America. If I look ahead over the next (few) years, where do you think that mix can evolve in terms of relatively low risk, relatively high risk from the current roughly 50/50 that you are right now?

A - Marcelo Kopel {BIO 16986304 <GO>}

Morning Daniel, Marcelo speaking. I'll start with your second question since the first one is a recurring one. But I'll start with the second one then. The loan portfolio mix, as a matter of fact, as you correctly pointed, we've been shifting it towards less riskier portfolio. We rebalanced that in my -- over the course of the next years you may see it skewing to 60% or even 70% of less risky assets in favor of the risky assets. So you could, in the longer term 70%/30% could be something.

Regarding the other question, we do think that for short-term you may see higher ROEs in our case because of favorable market, or interest rate environment, or the benefit, the early benefits of the de-risking strategy where we have significant benefits from a reduction in NPLs and gains of efficiencies. So short term, I will confirm that you will see, as you already seeing, high ROEs. But longer term, a sustainable level, we still believe 20% is the number.

And I'll make a caveat here that we constantly look at the benchmark rate in our cost of capital. So if you have a higher cost of capital, the way we look at it is the spread over the cost of capital. So depending on how the cost of capital behaves, you could see that number going up or going down.

Q - Daniel Abut {BIO 1505546 <GO>}

Let me just a quick follow up, Marcelo. When you say short term and long term, how do you define short term?

A - Marcelo Kopel {BIO 16986304 <GO>}

I'd say two to three years. And longer term, I'd say three years onwards. But Daniel, it's very important for us to keep an eye on the cost of capital. This is really key for our -- in our equation.

Q - Daniel Abut {BIO 1505546 <GO>}

(No doubt). But it's fair to say, then, that over the next two to three years, it wouldn't be a surprise if you keep posting ROEs above 20% and then longer term, beyond three years, 20% is a realistic target?

A - Marcelo Kopel {BIO 16986304 <GO>}

That, in the current environment, Daniel. And needless to say that things are in a changing phase here in Brazil. So to the extent the current environment or slightly better happens, this is what we believe.

Q - Daniel Abut {BIO 1505546 <GO>}

Fair enough, Marcelo. Thank you very much.

A - Marcelo Kopel {BIO 16986304 <GO>}

Thank you.

Operator

Jorge Kuri, Morgan Stanley.

Q - Jorge Kuri {BIO 3937764 <GO>}

Hi. Good morning. Jorge Kuri here. I have two questions, if I may.

On asset quality, you've been moving towards lower-riskier products. And that has had an impact on your reported NPLs. And we've seen NPLs come down over the last six quarters, basically. I guess my question is, at what point the normal aging of the portfolio -- because even though your overall loan book hasn't expanded when you look at it on a consolidated basis, there are products that have been growing a lot, like payroll, for example. And credit cards. And those will age and will start to show NPLs.

So at what point do you think it's fair to expect to see the trend in NPLs and turn around and move higher, just from a normal part of the cycle and obviously overlaid with the fact that you are also de-risking. It's probably not an easy question. But to the extent that you can help us understand how those two factors that affect your NPLs are going to play out on a consolidated basis. That's question one.

Question two refers to payroll loans. It does seem that every bank -- and again, I guess this is also part of the de-risking process. Most of the banks are focusing exactly on the same thing. They're moving away from risk, focusing on safer products, payroll loans particularly. Everyone's focusing on payroll loans.

And we are seeing, at least from the numbers that the central bank reports on spreads on origination. But the spreads on origination on payroll loans are coming down basically every quarter. And that's really the product that's growing in Brazil.

So wanted to get your -- now that you're putting even more emphasis on payroll loans with the announcement you made, how do you see that playing out? Are we going to continue to see spreads come down? How much more can spreads come down? How do you think this is going to affect your overall financial margins?

You did present on page eight the impact of the mix of product, clients and spreads continues to negatively affect growth. So that NII is growing lower than loans. So how does that play out? Thank you.

A - Marcelo Kopel {BIO 16986304 <GO>}

Jorge, thank you for your question. I'll start with the second question, then we'll move back to the first one.

Yes. As a matter of fact, everybody is really focusing on less risker products and it's important for us. The JV we announced re-emphasizes our commitment to this market and our ability to distribute this product. We have our own distribution throughout our branches and the way we sign up with companies as well to have their payroll signed up with us for this type of loan. But we also -- it's important, the JV we have, because that expands our distribution capacity.

Spreads, yes, spreads are coming down. But in a way that still, when you look at it on a risk-adjusted basis, it's still a very interesting return for us. And therefore, we will continue to work on that.

But one important thing here, Jorge, is we are not doing only this. We are looking to do more corporates. We are looking to do other types of lending.

The reality is that, as we saw, the vehicle finance portfolio is at a lower pace than anyone in the market had expected. So if we didn't have that slowdown, the mix of the portfolio, where you have higher returns blended with slightly lower returns, will help mitigate the pressure on NII and the net interest margin. So because we are seeing that strong slowdown in some of the portfolios, that is, at this point in time putting more pressure, if anything.

One thing that we see going forward is, with the JV we gain more scale. So if we don't see the returns coming from the NII line, we may see it going from -- coming from the cost line and other efficiencies that we may capture. So that's one of the things that we look on specifically on payroll.

Regarding asset quality and the fact that NPLs are going down and the mix is pushing it down, when you look at the speed we renew our portfolios, Credicard has a very -- is a very short-term duration. So the products that have longer duration are basically mortgages and vehicles.

So in those two cases, the new vintages we are bringing, they are coming with a better quality, much better quality than the vintages we had before that, specifically in the case of vehicles. And this will help at least keep NPLs at a healthy level or the level we are seeing now.

If things improve even more, or if the economy improves even more, we may see some slight improvement on that. But the way we see it is, it's in a way that we are comfortable and we are managing our risk. We are not changing our risk appetite.

So I don't know if that addresses your question.

Q - Jorge Kuri {BIO 3937764 <GO>}

Well partly, yes. Thank you, Marcelo. But I guess that we all know that credit quality goes in cycles; it goes up, goes down. And if you look at the past many years of cycles, cycles normally last six, seven quarters and then they turn around.

And I guess my question is, you are already seeing six consecutive quarters of NPL improvement, which is in line with previous cycles. The question is more specific, when do you think that turns? When do you think that, from a normal aging of books, you will start to see NPLs go up? Again, I'm not asking you to tell me when we're going to see a massive NPL problem. It's just, in the normal cycle, when do you expect this trend to turn?

A - Marcelo Kopel {BIO 16986304 <GO>}

Jorge, I appreciate your point. But had we done the same thing we've done in the past, I couldn't agree more with you that a cycle could come. But we changed -- since we changed the -- materially changed. And we continue to change and foster the strategy of less-risky products, when you look at our portfolio of mortgages, the loan to value of the portfolio is around 40%.

New originations are coming between 60% and 80%. When you look at our vehicle finance, the way we are doing it now, loan to value is around 60%. When you look at corporates and when you look at small enterprises, small enterprises we are doing -- emphasizing collateralized loans backed up on receivables.

So I would agree with you that a cycle could come hadn't we changed our strategy and focused on the de-risking. So I could agree with you had we done the same thing. But we are not doing it the same way we have done in the past.

Q - Jorge Kuri {BIO 3937764 <GO>}

So that means you expect NPLs to continue to improve for how long, then?

A - Marcelo Kopel {BIO 16986304 <GO>}

I'd say if they level at the stage we are, then I think we would be okay. But if the -- let's say payroll becomes even more relevant and if the -- like in the previous question I was saying that we could reach between 60% and 70% of our assets skewed to more less-risky assets, then you could see some improvement in NPLs. But that basically will come with the execution of our strategy.

Q - Jorge Kuri {BIO 3937764 <GO>}

All right, thank you.

A - Marcelo Kopel {BIO 16986304 <GO>}

Thank you.

Operator

Carlos Macedo, Goldman Sachs.

Q - Carlos Macedo {BIO 15158925 <GO>}

Good morning, gentlemen. Thanks for answering questions. Congratulations on the results.

A couple of questions. First on expenses, you did report a fairly subdued level of growth in expenses in the quarter and also year on year. The difference between the expense growth with and without Credicard, the Credicard acquisition, was around 3%. Your guidance for the year says around a 5% difference between the two.

Assuming that as the year goes by, you'll be able to crystallize or to make -- or to find more synergies within the operations, which I think is a reasonable assumption, do you still hold that 5% difference? Or should we expect that we're going to see better cost -- or lower cost growth, given that the integration is proceeding and that the starting point is that much lower?

The second question that I have is related to loan growth. Of course, loan growth has been weak. The economy isn't really forthcoming for further loan growth. The outlook that you have is still -- you're maintaining your guidance of growth for the year, which implies an acceleration through the end of the year.

What would actually make that happen? Would it take more credit appetite from Itau? Would it take a bigger amount of demand for loans from the general public? Would it be on the consumer side? Would it be at the corporate side? What exactly are you seeing for the next, say, 12 months that would allow you to meet your guidance in loans and loan growth? Thanks.

A - Marcelo Kopel {BIO 16986304 <GO>}

Carlos, thank you for your questions. I'll start with the last one. When we talk about loan growth, there's lots of moving parts. As the economy is in a slow phase, too many moving parts we saw about auto financing. But at the same time, we just announced the BMG -- the next step on the BMG joint venture. So given the moving parts we have, at this stage, we don't see a need to change our guidance.

We are comfortable with the guidance. It's a 10% to 13% range for the year. So we would stick to that for the moment. If things materially change and we have a feel that we need to change it, we'll definitely address that in one of our conference calls.

Regarding expenses --

Q - Carlos Macedo {BIO 15158925 <GO>}

Marcelo, just if I can interrupt, just a quick follow up, then. If that's the case. And if you exclude the Credicard acquisition from your loan book, then your growth is below 10%, what would actually take you to 10% to get to the bottom of the guidance? Would it be greater demand or just greater appetite from Itau for risk?

A - Marcelo Kopel {BIO 16986304 <GO>}

No. We are not changing -- that's a good point, Carlos. We are not changing the risk appetite. And regarding the Credicard acquisition, that was embedded in our guidance. So we already have Credicard embedded in our guidance. What we didn't have was the next step on the joint venture with BMG. So as I said, there are many moving parts at this stage. But we don't feel the need to revise our guidance.

Regarding expenses, there's seasonality throughout the year. As you know, we are one of the biggest -- we are one of the major sponsors of the World Cup. And associated with that, there is seasonality on the expenses for the year. So again, we don't see a need to revise the guidance now.

As a matter of fact, you correctly pointed that we have room for the integration on Credicard. There could be opportunities and synergies that could be captured. But we will probably address that in the follow-up quarters.

Q - Carlos Macedo {BIO 15158925 <GO>}

Okay. So but the difference, the 3% difference in growth in expenses, both year over year and quarter over quarter that comes from the integration of Credicard, the guidance is 5%. There could be upside potential from that guidance, right? In other words, it could be 3%, it could be even less.

A - Marcelo Kopel {BIO 16986304 <GO>}

Yes. There could be. But as I said, we need to -- it's the First Quarter; the operations aren't really with us. We're in the process of migrating systems and portfolios and so at this stage we are holding ourselves to the previous guidance.

Q - Carlos Macedo {BIO 15158925 <GO>}

Okay. Thank you, Marcelo. Thank you, gentlemen.

A - Marcelo Kopel {BIO 16986304 <GO>}

Thank you.

Operator

Tito Labarta, Deutsche Bank.

Q - Tito Labarta {BIO 20837559 <GO>}

Hi. Good morning, everyone. Thanks for the call. My question, a bit of a follow up on the asset quality question but looking at it more from the provisioning level. We did see provisions rise a bit on the quarter. Even before recoveries, gross provisions did show a small increase.

But if you do think asset quality can potentially improve further, do you think that provisioning levels can also come down along with that? You're somewhat on track to deliver on your guidance of the BRL13 billion to BRL15 billion in provisions. But just want to get a sense, if you do think asset quality can potentially improve, does that mean provisioning levels can come down? Or what we saw in the quarter is an indication that it should grow roughly in line with loans or maybe begin to grow faster than loans going forward, since we did see a pickup compared to last quarter? Thank you.

A - Marcelo Kopel {BIO 16986304 <GO>}

Tito, thank you for your question. At this stage, the way we are seeing our cost of credit is within the range or slightly better than the range we guided earlier in the year and we continue to see that for the rest of the year.

You may see a reduction on our cost of credit expense. This quarter in particular, we had the seasonality on the recoveries. But that was expected. So we are within the trend.

One may argue that we are in the lower range of our guidance. But that will -- as we move on throughout the year we will see how close we are to the low end or to the midpoint of our guidance. So as of now, we are comfortable with the guidance and should expect expenses to behave within that.

Q - Tito Labarta {BIO 20837559 <GO>}

Okay. Thanks. So just, the small pickup we saw was mainly due to seasonality. But you're saying if asset quality improves, you could revisit this number in the future if you do see some changes with your expectations to asset quality, given your loan mix?

A - Marcelo Kopel {BIO 16986304 <GO>}

Yes. The pickup was really for Credicard, BRL200 million plus on that line. So as we see eventually slight improvements in the quality, you may see a pickup on the expense, as you correctly pointed.

Q - Tito Labarta {BIO 20837559 <GO>}

Yes. All right, thank you very much.

Operator

(Nita O'Leary, Morningsales).

Q - Nita O'Leary

Hi. Good morning. Thank you very much for the presentation. I have a couple of questions, if I may. The first one is related to the merger with CorpBanca. Could you please provide an update on the status of the merger and when we should expect a completion of the transaction?

And the second question is related to BMG. If you could please elaborate a little bit more on the recent announcement and the rationale for the decrease of Itau's participation or stake at the JV? Thank you.

A - Marcelo Kopel {BIO 16986304 <GO>}

Starting with CorpBanca, the timetable for that, we expect that to be a Fourth Quarter event, given all the necessary approvals we need to go through. We need to have the Brazilian regulators, Chilean, Colombian and also in the US and Panama. We just got a note that the Colombian regulators did approve the transaction, which is in line with our expectations. So it becomes -- it will probably become a Fourth Quarter event.

Regarding the JV, the way it's going to work is, we will -- via capitalization, BMG will increase its share on the JV, whereby we're going to be issuing shares and BMG will be the only one subscribing those shares. So basically it will be diluted and reach a 60% level.

And the way it's going to work is, 100% of the loans originated by the JV compared to the 70% that was previously originated through the JV. So therefore, the funding of all the originated loans will stay within the JV.

Q - Nita O'Leary

And what is the rationale for this change?

A - Marcelo Kopel {BIO 16986304 <GO>}

The rationale for this change is --

A - Unidentified Speaker

(inaudible).

A - Marcelo Kopel {BIO 16986304 <GO>}

The market, from our perspective, it's a market that we -- one of the priority markets for us; want to continue to increase our distribution. And that was a second step.

When we announced the JV two years -- at the end of 2012, one of our goals was to achieve BRL12 billion by the end of two years. We are now at BRL12 billion before that and we believe that the success of that made us do the second step, which was already part of the original transaction. So it's a market that we want to be and we want to have the JV being a key part of our distribution.

Q - Nita O'Leary

Okay. Thank you.

A - Marcelo Kopel {BIO 16986304 <GO>}

Thank you.

Operator

(Daniel Magalhaes), Credit Suisse.

Q - Marcelo Telles {BIO 3560829 <GO>}

Hello, everyone. Marcelo Telles, Credit Suisse. Thanks for your time.

I have two questions, actually. One, the first one on credit spreads, how do you see credit spreads evolving in your main business lines going forward? We've seen based on the central bank data that credit spreads have been on a rising trend. And (inaudible) saw public banks increasing spreads materially on working capital loans now, for the first time, matching pretty much the levels of the private sector banks. So I was wondering if you see more room in general. But particularly on the commercial side if there is room for further increases.

And the other question, just if you can remind me, what was the -- would be your Core Tier 1 ratio under Basel III, including CorpBanca. I know in your presentation you have 9.6%. But I'm just not sure whether this includes CorpBanca or not. Thank you.

A - Marcelo Kopel {BIO 16986304 <GO>}

Talking about the CorpBanca, when we did a first calculation, the initial impact of CorpBanca would be something around 15 bps. And when we do it looking on a prospective basis, with the full implementation of Basel, it would be around 50 basis points.

Regarding credit spreads, we are seeing, as you said, slight adjustment, the market adjusting spreads. In our case, we are doing slight adjustment in certain products. But we have to remember that there is a difference between what private banks were doing and public banks were doing.

So as a matter of fact, you're seeing the change in the spread as a whole for the market. But there are (existing) adjustments between the banks. In our case, there are slight adjustments in certain products and it is just a reflection of the increasing Selic and adjusting for the risk as well.

Q - Marcelo Telles {BIO 3560829 <GO>}

Kopel, if you allow me -- thanks for your answers. If you allow me just one more question, in the event of a much bigger, let's say, pullback of public banks, particularly on the SME side, going forward, how do you think that would impact your asset quality? Do you think that would have any impact at all, or maybe (for) very different segments? How much overlap do you think there is in that segment, at least for you?

A - Marcelo Kopel {BIO 16986304 <GO>}

We have very little overlap on that, Telles. And one of the things that we say -- and just to link that to the previous question about spreads -- the way the market was pricing certain risks, there is a group of clients that we like the risk. But the pricing of that risk wasn't adequate to what we saw. We still like the risk. But at the right price. So if the market is adjusting that, that could be an opportunity for us in that particular segment.

In terms of a pullback from the banks, there is little overlap. So we are not seeing any, let's say, spillover effect over our portfolio, or nothing material that could bring say -- that could bring us to a jump in our delinquency.

Q - Marcelo Telles {BIO 3560829 <GO>}

Thanks, Kopel. Very straightforward answers. I appreciate it.

A - Marcelo Kopel {BIO 16986304 <GO>}

Thank you.

Operator

Anibal Valdes, Barclays.

Q - Anibal Valdes {BIO 17745509 <GO>}

Good morning, everyone. Thank you for the opportunity to ask a few questions. The first question is as regarded to the number that you show for fully-loaded Basel III Core Tier 1 capital ratio of

9.6%. In your press release, you mentioned that that number, the 9.6%, is after the application of some mitigation measures.

I just wanted to understand better what those mitigation measures are and also is it fair to say that the deductions that you show in the First Quarter from Core Tier 1 capital for the prudential adjustments, it's equivalent to 20% of the total adjustments that you would have to make towards Basel III full implementation? That's the first question. Thank you.

A - Marcelo Kopel {BIO 16986304 <GO>}

Okay. What we see as the mitigating measures is basically regarding diversification on insurance and some risk-mitigating -- some other risk-mitigating factors. Regarding your question on -- the second question, the reduction in capital is basically the reductions that were already mandated by the central bank, they were already scheduled as the next-year reductions are. So it was basically following the regulations that were released and that impacted the whole system.

Q - Anibal Valdes {BIO 17745509 <GO>}

Yes, I'm sorry. I think maybe I was not clear enough. On the mitigation measures, is that related to the reversal of excess provisions, or liberation of excess capital in the insurance company or the spin-off (of) certain businesses to raise capital?

How should I understand what are the sources of those mitigation measures and how much money would that be? Just to have a better idea of that fully loaded 9.6%, how much you're accounting in terms of reals, billions of reals, for mitigation measures and what are the sources of those mitigation measures?

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

Hi, Anibal. This is Caio speaking and, just to follow up on Kopel's answer, that's pretty much related to the optimization of the insurance company's capital. So we still have some room for moving towards that direction. And that's why we are mentioning here that we are considering some mitigations to show exactly the figure that we expect to have in the coming quarters regarding this, after this optimization that I just mentioned to you. And in this figure there is no reversal of any provisions at the balance sheet of the bank.

Q - Anibal Valdes {BIO 17745509 <GO>}

Thank you, Caio. And in terms of money, how much are you accounting for those mitigation measures?

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

Well we are talking about a couple billion reals here of optimization in the whole structure of insurance companies, (inaudible) financial companies in our structure here at the bank and relating to those companies. But it's something that is planned already. So there is no further, say, difficulties to get there. It's just a matter of timing to do that kind of optimization here.

Q - Anibal Valdes {BIO 17745509 <GO>}

Thank you, Caio. And is it also fair to say that the deductions that you show for prudential adjustments in the First Quarter this year are equivalent to 20% of the total deduction, or that's more than that or less?

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

Well that's pretty much the whole impact of the Basel III schedule, which is implemented by the Brazilian Central Bank, in line with the BIS schedule. So that's pretty much what we see as a reduction in the tier-one capital in the First Quarter, especially because we did not grow the risk-weighted assets this quarter. So that's pretty much the result of this.

Q - Anibal Valdes {BIO 17745509 <GO>}

Oh, yes, I'm sorry. But the schedule is 20% each year, right, beginning this year, for the deductions --

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

Exactly.

Q - Anibal Valdes {BIO 17745509 <GO>}

Of the (market) prudential deductions --

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

Exactly so. It's not a (market) prudential it's just a (schedule). And you're going to see the same effect in the First Quarter of the coming years. That's why -- which is important. We are looking at the Common Equity Tier 1 as the capital ratio to be followed by the bank as forecast to manage our balance sheet risk exposure.

Q - Anibal Valdes {BIO 17745509 <GO>}

All right. So Caio. So that the six -- I'm sorry about this. But is it fair to say that BRL6 billion or the BRL5.9 billion of deductions that you applied on the First Quarter is 20% of the total deductions? Is that correct?

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

I would say, yes. But the team here will confirm to you exactly the breakdown of this, okay?

Q - Anibal Valdes {BIO 17745509 <GO>}

Okay. Thank you, Caio.

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

Sure, absolutely. Thank you.

Q - Anibal Valdes {BIO 17745509 <GO>}

And quickly, the second question is regarding write-off of loans. You have been talking a lot about asset quality improvement. And the truth is that, well, the asset quality improvement has been very significant over the past year, year and a half. But when you look at the write-offs as a percentage of the total portfolio, I calculate that currently they're at 5.5%.

So the question is that, given that NPLs are currently at 3.5% and you mentioned that you might see even a further improvement in terms of asset quality, what are you expecting in terms of write-offs as a percentage of the loan portfolio? Will we see also an improvement in that metric, or you think that it will stabilize around 5.5% or maybe 5% going forward? Just to have more color in terms of write-offs.

A - Marcelo Kopel {BIO 16986304 <GO>}

When you look at this quarter in particular, there was an item. Regardless of -- if we segregate the specific seasonality, there was an additional write-off regarding to vehicle financing.

So when you look at the trend, the trend, as the charge-offs, should be reduced. So then, depending on how the portfolio behaves overall, that will give you the answer on the percentage of the charge-offs over the portfolio. But it's important to emphasize that this event in this quarter, the number of this quarter, had that particular two impacts of seasonality and the vehicle finance additional charge-offs.

Q - Anibal Valdes {BIO 17745509 <GO>}

All right. Thank you. In terms of annual charge-offs, what are you expecting? If the level of NPLs stays at 3.5%, going forward, what would you expect in terms of charge-offs as a percentage of the loan portfolio for the next years. Is that materially lower?

A - Marcelo Kopel {BIO 16986304 <GO>}

We don't guide that. I'm sorry. We don't guide looking forward for the percentage we expect.

Q - Anibal Valdes {BIO 17745509 <GO>}

All right. Thank you. Thank you very much.

A - Marcelo Kopel {BIO 16986304 <GO>}

Thank you.

Operator

Natalia Corfield, JPMorgan.

Q - Natalia Corfield {BIO 6421991 <GO>}

Good morning, all. Thank you for the question. It's a follow up on your Common Equity Tier 1. How much would this ratio be if we disregard this mitigant that you are considering? And I'm talking about the fully loaded of 9.6%. That's the question.

A - Marcelo Kopel {BIO 16986304 <GO>}

It would be around --

A - Unidentified Speaker

(inaudible).

A - Marcelo Kopel {BIO 16986304 <GO>}

8.5% and 9%.

Q - Natalia Corfield {BIO 6421991 <GO>}

So it would be lower, 9%.

A - Marcelo Kopel {BIO 16986304 <GO>}

Yes.

Q - Natalia Corfield {BIO 6421991 <GO>}

Okay.

A - Marcelo Kopel {BIO 16986304 <GO>}

Yes.

Q - Natalia Corfield {BIO 6421991 <GO>}

All right. Another question, in terms of asset quality you've been guiding for a continued reduction. But I would like to know, given what you are expecting for 2015, what can we see in terms of asset quality?

A - Marcelo Kopel {BIO 16986304 <GO>}

We continue, again -- the strategy won't change. So to the extent there is no material change in the economic environment and nothing that will deteriorate the overall environment, the asset quality should remain relatively stable to what we are seeing now. And remember, there is the economy that rules everything that happens and there is our strategy that is being executed, consistently executed over the last quarters. And we continue to execute that moving forward.

Q - Natalia Corfield {BIO 6421991 <GO>}

All right. But your -- for instance, you have a GDP growth expectation for 2014 of 1.4%, which is low. If we have something similar for 2015, do you think you will have a stable asset quality, or do you think you can have some deterioration?

A - Marcelo Kopel {BIO 16986304 <GO>}

Our view is that we're going to have it stable. And by the way, our forecast for next year GDP growth is 2%. So it's not materially different than what we have for this year.

Q - Natalia Corfield {BIO 6421991 <GO>}

Okay. Thank you.

Operator

(Operator Instructions) This concludes today's question and answer session. Mr. Alfredo Setubal, at this time, you may proceed with your closing statements.

A - Alfredo Setubal {BIO 1528623 <GO>}

I would like to thank you, everybody, for participating with us in this conference call. I think we have very solid results, very good numbers and, more importantly, very sustainable numbers for the coming quarters. Thank you, everybody. And wait to see you again on the next conference call (inaudible) for the Second Quarter results. Thank you.

Operator

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