

Q4 2015 Earnings Call

Company Participants

- Eduardo Mazzilli de Vassimon
- Marcelo Kopel
- Roberto Egydio Setúbal

Other Participants

- Carlos Macedo
- Jason Mollin
- Jorge Kuri
- Lucas Lopes
- Mario Pierry
- Saul Martinez
- Tito LaBarta
- Victor A. Galliano

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentlemen. Welcome to Itaú Unibanco Holding Conference Call to discuss 2015 fourth quarter results. At this time, all participants are in a listen-only mode. Later, we will conduct the question-and-answer session and instructions will be given at that time.

As a reminder, this conference is being recorded and broadcast live on the Investor Relations website at www.itaunet.com.br/investor-relations. A slide presentation is also available on this site. The replay of this conference call will be available until February 9 by phone on 55-11-31-93-1012 or 28-20-4012, access code 1628627#.

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 São Paulo are Mr. Roberto Egydio Setúbal, Executive President and CEO, Chief Executive Officer; Mr. Eduardo Vassimon, Executive Vice President, CFO (Chief Financial Officer) and CRO (Chief Risk Officer); and Mr. Marcelo Kopel, IRO (Investor Relations Officer).

First, Mr. Roberto Setúbal will comment on 2015 fourth quarter results. Afterwards, management will be available for a question-and-answer-session.

It's now my pleasure to turn the call over to Mr. Roberto Setúbal.

Roberto Egydio Setúbal

Good morning and good afternoon for all of you. Thank you for being with us and giving us the opportunity to clarify some doubts and things about our results, and especially about the guidance

you've seen yesterday. I will start talking about the quarter and then we will - I'll go quite fast on that, so that we have more time to discuss (02:27) the coming year.

Our results in the quarter were BRL 5.8 billion, down from last quarter 5% and 15% above last year's 2014 last quarter. The ROE was down given (02:52) very high level of 22% in the quarter, closing the year almost 24% of ROE for the year. Credit quality was down, as we have seen some deterioration on NPLs over 90 days and some improvement in the short-term NPLs as we look down the road.

Second page, you can see the trend of the past year of ROEs, we have been very strong in terms of our ROE and coming down in the last two quarters. And the main reason for coming down in the last quarter, as we can see on page 4, was the financial margin with markets that we have a very high level margin in the third quarter, BRL 2.2 billion, which is much above the traditional level that we have, and down to BRL 1.2 billion, so a reduction of BRL 1 billion in the revenue in the quarter.

I would say that you should have expected this reduction given the fact that we had already announced that we - this number can fluctuate during the quarters. But for one year, we expect it to be close to BRL 5 billion, so the level that we have in the fourth quarter was pretty much in line with what would be an average, kind of an average that we could expect coming from this kind of revenue.

In the quarter, we also had civil provision going up with seasonality given the card expansion in the Christmas time, and some other revenues had increased in the last quarter of the year given more intense activity.

But everything else, in terms of revenue, was pretty much in line with the expectations that we have coming from the third quarter.

Provisions and recoveries net, we're pretty much in line. And if you look, the provisions and recoveries in the quarter was in line, but we had one strategic case of above BRL 300 million that was written off that we recovered, so we had a negotiation - a renegotiation on that credit. But we have full provision - we have made full provision under the same recovery. So, net-net, it was very close to what we had last quarter. Claims were pretty much in line. Operating (05:53) expenses also a small increase, especially given the fact that we have - doing a salary increase deal in September, which affects much more in the fourth quarter. So, basically, these were the main different results, not putting more seasonality effect, we're pretty much in line with the third quarter.

We have opened in the fifth page a new chart, which opens our consolidated team P&L in Brazil - Brazil P&L and Latin America P&L. This is something that will be important in the future given the fact that we will be consolidating along with CorpBanca in Chile. CorpBanca will be a number that will affect the Latin America column, but you will - might be able to keep track of what's going on in Brazil given the fact that we will be opening these numbers, which I think will be more and more important in the future (07:07).

Our two main groups of activity, credit and trading in services and insurance. We opened the results here in 2015. The results in services went up 22%. This was good news. This is a very strong source of revenue for the bank. This keeps our business very stable. And in 2015, which I believe was one of the most difficult years in our credit business, we do have a stable recurring net income, and this gave us below what would be cost of capital for us today. But the return is still 15%, although like I mentioned below the cost of capital, but still given this very bad year in terms of delinquency, still good result.

Going ahead, this scenario that we are leaving Brazil is this big GDP reduction. Our credit portfolio basically stayed stable during the year. Few lines have increases, and many others have declined.

Automobiles, for instance, have declined. Payroll loans have increased. Mortgage has increased. But overall, small reduction and some stability overall. We have put here down the table how this - down the chart the CorpBanca number which I think is interesting for you to give an idea of what CorpBanca - how CorpBanca will impact our numbers.

But it's very clear that going up to something around (09:08) of loan. Latin America will represent very close to a little bit above 20% of that exposure in our balance sheet. The change here, the evolution of CorpBanca at 30% is pretty much due to exchange rate fluctuation, which was very close to what we have overall in Latin America, including all the countries of Latin America of 34% (09:43).

Moving ahead, financial margins were pretty much stable. We have some stabilization in margins with a small trend of spreads but the fact that we are more risk-averse today. Our mix is coming to a low, so - and ending with a - resulting in a margin that is quite stable even when we consider the level of reserves that we are putting on against, the margin still have - we have them up from last quarter from 7.4% to 7.5% but was pretty much stable. We have been able to keep margins in line with provisions. So in this kind of environment, maybe this is a good job.

Financial market - margins with Markets have come down and you can see in page 9, I have already comment on that. And the number of the best quarter was pretty much in line with what we can expect for coming quarters; it can go up and down around December, but the number was quite okay in this fourth quarter.

When - if we look into the year, we see that the number for the year was strong. We have been quarters above that level and specifically last quarter was a record gain in Margins with Market which is something that made our results stronger in that quarter.

Credit quality in page 10 is in good moments for the short-term NPLs of 15 day to 90 days and it came down this last quarter. For - the NPL, 15 day to 90 days for consumers in general have come down. We have some seasonality here. We have additional salary at the end of the year in Brazil. So this gives some more revenue for people, so they can pay dues more in line with what was expected.

And also the fact that credit card number in the last quarter is always a little bit higher, given the use - the higher use of credit card in the last quarter. So all this combined made the numbers come down. If we do not consider the seasonality effects, it would be pretty much stable with the previous quarters.

Next quarter, we expect it to go up like we have seen already in 2015, 2014, 2013, all the years that we have this first quarter impact and over the year it's come down a little bit. Small companies fluctuating pretty much in line with previous quarters, and corporations have come down. This is good news, looking ahead for corporations. As we can see in NPLs of over 90 days, corporations are coming down, the NPLs. It's good news.

It has been affected by the assets that we have sold, and we will talk more about that in this presentation. Consumers and more companies with trend of deterioration which we believe will be going forward along the year. We expect the economy to - the GDP to reduce again in 2016, so we expect that in line with that we have some deterioration in NPLs. So the scenario that we see ahead will be definitely what will mainly impact NPL in the year.

Our coverage ratio is strong. We have not touched the coverage ratio in this last quarter. We have BRL 11 billion (14:38) in coverage. And when we see the kind of NPL that we have, considering only those credits that are not fully provisioned, it has been pretty much stable, which is also a good indication that we have provisions in good shape in line with the duration.

In the next page, we have some more information about renegotiated loan operations. I think this is something new, and we have never shown the way we are opening here. We have opened the days overdue at the moment of renegotiations, so it was clear, work has been done in the bank. The book is growing because delinquency has been growing and (15:39) pretty much in line with delinquency, which is consequence of the GDP reduction. Below here, the good news is that NPLs of debt book, it's pretty much lower at this moment compared to other moments in the past. So, the book is probably reasonably well.

Here is a more detailed information about the assets that we have sold. We have three main portions that we have sold and I will start on the right side. We have sold middle market segment loans which were written off, so (16:30) on our balance sheet. This was a sale of BRL 2 billion, that we made BRL 44 million of revenue. But it did not impact NPL because it was already written off.

In Chile, we have this every year - we have a sale of student loan portfolio, this is - every year we do this in Chile. And also it's not impacting the NPL ratios because it was pretty much in - we do not have any major personal loans in this book. In Chile (17:11) sold pretty much for the value that we have making profit in Chile on that sale because it was a good portfolio.

Here in Brazil, we also (17:29) loans with very low probability of recoveries in the short-term. We made the sale to keep our books clean. We had already a lot of provisions on debt (17:46) 75% of the asset was already with provisions. We had at that moment that we saw that more provisions in our book than those that would be required by Central Bank rules. So we're selling (18:03) credit that was overdue on our assets, assets of companies, loans of companies that have other loans in the markets. So we had a negative impact of giving provisions that we have.

Some of those were already fully provisioned, 100% provisioned. So we made some revenue on that, but we made additional provision on this revenue of BRL 17 million in order keep this with low effect - very low effect in terms of profits. This has the impact that we show here in (18:51)

Provisions - the next page, we can see how much provisions we have been making every quarter in the retail banking and the wholesale banking. Retail banking, delinquency in consumers has been increasing, have been going up as well. The delinquency in the wholesale bank, as I've mentioned to you, has been coming down. So the provisions has also been coming down.

In this last quarter, as I mentioned before, we had recover of write-off of BRL 300 million that impacted because we recovered, but we've made 100% provisioning against this renegotiation, and if BRL 300 million this year (19:48) So if we do not have this recovery, we would have a number pretty much close to BRL 1.2 billion compared to BRL 1.4 billion before the quarter before, BRL 1.7 billion and BRL 2 billion in previous other quarters.

So this is pretty much in line with what we have done before. We mentioned to you that we were making provisions - anticipating provisions in previous quarters. We made this communication that we were anticipating (20:21) given the fact that we are not seeing any major additional big number coming up. In coming quarters, we expect that we won't have that much provisions on the wholesale assets.

On page 15, we open the insurance and services P&L of each one of the lines that we have. I think this is an important source of revenue for the bank. It's pretty much stable. It's a very strong business for us. It gives us a lot of stability in our earnings. We have good returns on this business. It's very diversified. It's not - it's something that complement quite well our loan business because it has no volatility in terms of bad moment of the economy. It does not suffer. As you can see, this year, we still have some growth here, although lower growth than other years, but still growth and good revenue, sound results. And so this balanced quite well with the loan book. And this represents more than 60% of - almost 60% of our results in the year.

And next page we open - details the fee and commission revenue that we have. Overall, we have grown the business in the year 10%, I think it's pretty much in line with inflation, although we have this GDP reduction in the year.

In terms of expenses on page 17, we have strong expenses, non-interest expenses below inflation (22:29) around 10% in Brazil, 10.5%. So we were focused on below inflation in terms of excessive expansion which is quite good. We believe that we will keep a very strong focus on - of reducing expenses going forward. So for the next years and the years ahead, we expect non-interest expense to grow below inflation.

And on our capital position, as we can see on the page 18 quite strong, quite comfortable. We have at this moment 18.8% of the core equity tier 1, fully - right, fully loaded Basel rules, so it's very comfortable. And we have ahead of us, just to make the point, the fact that we have reduced our CET 1 by almost 1% at the moment that we made the consolidation of CorpBanca and especially because we will make a capital increase in CorpBanca of \$600 million more or less, probably in this first semester this year. So this will reduce a little bit their position during the - at that moment.

In 2017, we have our guidance, and we believe that we have made a good job, especially because we started the year - at the end of 2014, everybody was expecting GDP to be positive in 2015, so a more stable exchange rate, so on and so forth. But at the beginning of the year, with the new perspective for the year, we have changed the guidance.

But even though the result at the end of the year was much worse, much more difficult, GDP reduction was much worse than the one expected at the beginning of the year, we basically could follow the guidance pretty much well, only the provision for loan losses net of recoveries were a little bit above the guidance that we gave. But we believe that is, given the scenario, a very good number. For 2016 we see again a scenario more negative. We believe the activity will be negative this year of 2016, of the economies. And for the other numbers, the IMF, negative number for 3.5%, negative for Brazil, (25:58) Brazil with numbers negative at 4%.

So, those numbers here that we see in our guidance are based in something between 2.5% in the best case, and the worst case, which we don't believe that will be the case, but we gave some space for that of 5% negative of GDP.

Especially, provision number which is high, and I believe that it has (26:33) are based in this very negative scenario of 2.5% negative of GDP to 5 also negative. So, we are trying to be very realistic about the economic scenario in Brazil. We believe that even in this scenario of delinquencies, we will be increasing consumers, especially given the higher level unemployment with delinquency in consumers will be higher. And also expect that in small and medium market, we believe that as the economy keeps on this same pace of deterioration, reduction in activity, we believe that we will report provisions for the year.

On those same lines, we believe that we won't be able to re-price margins and grow margins for the client. The same things that we did this year. So, we are more conservative here in terms of margin compared to what we have in 2015. And the same applies to commissions and fees. I think we are trying to give numbers that we think are more realistic with this kind of scenario. Obviously, we have a better scenario than this one, numbers might be better, but we are trying to be more realistic and based on numbers in this scenario that we are considering for the year.

In terms of expenses, we are working hard like I mentioned before to have expenses below inflation, so this is what we are looking for the year. We have opened here what would be the consolidated balance sheet guidance and the revenue guidance. It is important because we don't know exactly what could happen with the exchange rate last year, exchange rate quarter-to-quarter fluctuated a lot and this may be much more complex to understand where we were. But now, we will be opening the - this very clearly so that you can have a more clear observation of

how the Brazilian deals are doing. And we gave the guidance for the Brazilian group of business as well.

Okay. You should consider also effective tax rate, 33%. This is what we have in our projections for the year of 2016

Thank you. Now, we open for questions.

Q&A

Operator

Ladies and gentlemen, we will now begin the question-and-answer session. Our first question comes from Mr. Tito LaBarta with Deutsche Bank.

Q - Tito LaBarta {BIO 20837559 <GO>}

Hi. Good morning. Thanks for the call. A couple of questions. I guess, obvious question in terms of asset quality and your provisioning guidance. You seem to be a bit more conservative than some of your peers. So I just want to get just maybe some more color on that. Are you just being more conservative than your peers, or are you seeing some more asset quality issues? Obviously, we've had some deterioration this year. But I guess, how much deterioration do you think you could see? I know it's early in the year, maybe hard to tell, but would it be similar to what we saw in 2015, around 60 basis points, 70 basis points deterioration for the year? Do you think it can be worse than that? If you can maybe give some more color on that.

And then the second question, I guess, in terms of profitability. Clearly, you had very strong ROE last year, probably not sustainable this year. But do you think it's - in terms of longer term, what would be a sustainable level of ROE? Is it something that kind of drops this year maybe to 18% or 19% and then can recover back to the 20% level or so? If you can maybe just give some thoughts in terms of what you think for bottom line profitability, given the guidance that you've given? Thank you.

A - Roberto Egydio Setúbal

Okay. Very good point. First question about the expectations for provisions, basically our provisions with models that are showing correlation for the year. Looking back with GDP, and especially the retail business, we have a good correlation and we have model that show good correlation on what can you expect in terms of delinquency and what kind of provisions we would need as a result of that with the GDP. So basically, our numbers are working with the scenario. We have no specific issue that we have specifically condition other than the scenario macro in Brazil.

Like I mentioned, we are in those numbers, been very open in terms of the possibility of having something much better than what the last numbers (32:29) showing Brazil between 3.5% and 4% negative number. We have now positive numbers closer to 2.5% reduction in GDP. And our worst case scenarios show in terms of provisions and delinquencies go as high as negative 5%. So, we believe that we are recovering what would be something that we can see today with good margin in both sides compared to what market expects today.

Delinquency will go up like we mentioned. In the worst case, it can go even up than the number you gave. If you have a 5% GDP fall, which we do not believe but we are putting a scenario, we could see higher numbers than 60 basis points to 70 basis points increasing (33:31).

And generally, for the coming years, it will depend a lot on the scenario that we see for Brazil. If we do, if we see some recovery, some, at least, improvements in GDP conditions, I think ROE will

improve because we are keeping the books very clean and we are doing all the provisions that we can do.

And especially, it's a good opportunity to mention the fact that we have - how - we believe that as the economy improves, ROE will improve and the cost of capital will be reduced. But this gives me an opportunity to mention something about the additional provisions that we have in our balance sheet, provisions above the Central Bank level that we have today. We have BRL 11 billion for loan losses which are above the Central Bank, which is almost one-third of the full provision (34:53) that we have.

This number, I mean, how do we work with those provisions. We have been deeply (35:02) trying to keep the expected loss, fully provision it. So in retail this is quite easy because we have a models that shows the expected loss at each moment for our books. So we apply the model in our portfolio, we came out with a big number of provisions. And then we reduced what is required by Central Bank and this is part of what we call additional provisions.

For the corporate side, it's more complex because we don't have models that can really apply to cost base (35:44), very specific things and very big numbers. But we also do in a more - especially given the economy and especially looking at specific segments and specific situations, we try to make provisions ahead of Central Bank requirement as we have assets that we believe that will not perform. So we do provisions to put additional, trying to mark-to-market what will be the asset value for - that we believe would be the case at each moment. So we keep doing provisions as we increase expected losses for retail and corporations.

But looking to the future, the moment that economy starts to recover, we will see a scenario that probably the new expected losses will not come up and the old ones that might be in our books at that moment, we will be already covering the losses that will come up. So, we see a much better scenario in terms of provisioning quite fast as we improve the scenario overall.

We believe that 2017 should be a better year than 2016. Although it's not clear, but we believe that 2017 can be a better year than 2016.

Q - Tito LaBarta {BIO 20837559 <GO>}

Great. Thank you very much. Just a quick follow-up question then. In terms of - maybe trying to get a more specific number on ROE, I mean just given the range that you've given on the provisioning levels, would you think this year would be closer to the 17%, 18% level, or can you stay closer to 19% to 20%.

And I guess, following up on the excess reserves that you have, I mean could you use some of that to keep it profitable maybe at the higher end in terms of like what you're thinking in terms of what the ROE could be this year? I know it's difficult to say but just want to get what you're thinking about that in terms of what you're comfortable with given the excess reserves that you do have.

A - Roberto Egydio Setúbal

Tito, I believe that the guidance that we are giving to you, including the 33% tax rate, make it very easy for you to make up the numbers and come up with the kind of ROE that you can work in that range. With the guidance, you find, I mean, the midrange, the positive range, the negative range. I think we believe that ROE will be pretty much in that range. So you can just make up the numbers you come up with these results.

Q - Tito LaBarta {BIO 20837559 <GO>}

Okay. Fair enough. Thank you very much.

Operator

Our next question comes from Jorge Kuri with Morgan Stanley.

Q - Jorge Kuri {BIO 3937764 <GO>}

Hi. Good morning, everyone. I have two questions. The first one, and bear with me, I'm really not trying to be difficult, but I do want to understand what gives you confidence that your current more negative guidance is fair? You were rather optimistic about delinquency over the last 12 months, particularly 12 months ago despite a good level of skepticism from the market. I think you talked about de-risking and how you've changed the balance sheet and seeing how you thought was going to be enough to contain any asset quality problems. On the consumer side, you seemed not very worried. And obviously things didn't played out that well. As such, your bad debt formation was up 40% last year. Your consumers NPLs went up 100 basis points only in the last six months.

Look, I get it, that the macro environment was tough and it's easy to say that asset quality was worse because the macro was worse. But in reality, the risks were clearly that that was going to be the case. So prudence in the expectations, you knew it was probably called for. So now, you come with a much more negative message. So the question is, look what gives you and also I guess confidence that the current guidance is not again too optimistic, that you're not underestimating the macro and banking risks? You're expecting 2.5% contraction in GDP but consensus is already above 3%. So how do we get confidence on what you're saying? And I'll ask my second question later. Thank you.

A - Eduardo Mazzilli de Vassimon {BIO 5349410 <GO>}

I think you're absolutely right, we started the year with much lower level of expectations on delinquency. As we started the year, also the beginning of 2015, the kind of macro environment was much better expected at that moment than the one that played down the year. So I think that we should have made more clear the kind of expectation that we have for the year in terms of macro growth or recession.

At that point, we did not made it that much clear.

Now, we are making it very clear. Like I mentioned to you, this provision were made based on the positive number that most - the smaller number would be something that would be pretty much in line with a 2.5% negative growth for the year in Brazil. The top number would be more in line with 5% negative, okay. So the mid range that we are talking about here in this space is something around 3.75%. So we believe that this number will be as we expect, if Brazil's development for the year -- the economy stay in that range, provisions will stay in that range as well.

Q - Jorge Kuri {BIO 3937764 <GO>}

All right. Thank you, Eduardo. And my second question is what's happening on your credit card book. You obviously have more credit cards than anyone else. I think it's roughly 30% of your consumer loans, about two times more than the average of your peers. Given the unemployment and consumer recession because it's exactly that that we're seeing in Brazil, how is that book performing? What is the NPL ratio on credit cards today? What was it a year ago? How much do you think it's going to increase and to what extent the provisions that you have included in your guidance are specifically directed to credit cards?

A - Roberto Egydio Setúbal

Okay. Fair question, Jorge. I think that credit cards are at a higher risk than other consumer risks like mortgage and payroll loans. We have been very careful in that book. We have been declining the book for the last two years. So we have been doing controlled risk management in that book. I don't have the numbers of NPLs here. We do not release that number but definitely it is included in the NPLs of individuals that we show here, okay. It's higher, a little bit higher than the average for

sure because payroll loans and mortgage are much lower than credit card. But in our case, at least we can compare with the markets according to Central Bank numbers. And we are below market delinquency in credit card.

Q - Jorge Kuri {BIO 3937764 <GO>}

All right. Thank you, Roberto.

Operator

Our next question comes from Carlos Macedo with Goldman Sachs.

Q - Carlos Macedo {BIO 15158925 <GO>}

Good afternoon, Roberto. Good afternoon, gentlemen. Thanks for taking questions. A couple of questions, one on the margin. We saw margin - the margin with clients kind of basically held serve this quarter. And now looking into next year, the guidance doesn't really say much of an expansion in margins and basically saying that margins will stay flat. Could you give us a little bit of view on what you expect for the SELIC, and you always talked in the past about how the reprising of the book would still provide some support to margins going forward and whether you think that's still the case or we're at a point now where that's not really going to happen given the outlook for SELIC? And then, I have a second question.

A - Roberto Egydio Setúbal

Okay. Our guidance provision (45:17) reflect that we expect SELIC to be stable for the year. But we expect in terms of financial management indiscernible (45:26) decline. Because of that and because of the overall situation, we are not expecting spread increase along the year for this (45:38) spread that we will practicing (45:41) at the end of the year.

So re-pricing will take place. It was still at the end of the year -- was a moment that spreads were higher than most moments before, so some re-pricing will take place. And this is the reason why margins reflects our going ahead of growing more than the credit portfolio -- because of the pace that you re-price them. But we are not considering here that additional increase in spreads will take place in the market. Along this year of 2016, we have a lot of price increases, spreads increases, as SELIC was increasing, spreads were increasing.

But since we are not expecting SELIC to increase, we do not expect major movement in the spreads. So, we expect spreads to be (46:47) pretty much stable compared to what we have...

Q - Carlos Macedo {BIO 15158925 <GO>}

Okay. So - okay. Thank you. So, no increase in SELIC but no cuts in SELIC either. Is that the assumptions you're using for this (47:02)?

A - Roberto Egydio Setúbal

Yes. And we are basically using spreads that we are doing - we're practicing at the end of the year of 2015 (47:11) stable in 2016.

Q - Carlos Macedo {BIO 15158925 <GO>}

Okay. Thank you. Second question, on capital. Your capital levels are really strong, common equity tier 1 above 13%. We know that CorpBanca will dilute that a little bit, but still loan growth in Brazil - which, for the purposes of capital ratio is important - you could be in negative territory and you still, based on your guidance, middle of the range, will do 18% ROE or so with a 30% payout.

You'll accumulate a significant amount of capital assuming that things don't completely unravel. When do you start thinking about increasing the dividend payout? I mean it's 13.5 going to 12, but soon coming back to the 13. When do you start considering that kind of possibility?

A - Roberto Egydio Setúbal

We have a long tradition of keeping our dividend payout between 30% and 35%. Maybe 20 years, maybe even more than that. Our payout was in that range. In many years, we have used surplus of capital that we were generating to buy things, that to invest and do other things. In other years that we do not have that much of (48:31), we bought back shares and we kept the dividend pretty much in that range.

Buying back shares is something that we do often. If you look back over the years, we buy back over the years a lot of shares and this last year, for instance, we bought almost 2% of the capital of the bank back. So at the end of the day, the earnings per share are increasing in addition to the 15%, 16% number, nominal number of the earnings of the bank with additional 2% which may take that total to 18%.

So we might buy back shares as long as we see that this is a good investment for the bank. And I believe that at this moment, shares are in the very low price for all the reasons that we know. But in the long term, we believe that our ROE will go up in 2017, 2018, especially given the (49:41) Brazil will improve a little bit. Not that much, but this will be – just some small improvement in Brazil will be enough to make it possible for the bank to increase ROE, especially because we are keeping very close track on delinquency and doing all the provisions that are needed.

We are – like I tried to explain on the expected loss, we believe that we are ahead of the curve and so our books are very clean. So by the time that the economy starts to improve, we won't have (50:16) coming from the test that would be necessary to pay (50:20). So we'll be open to enjoy the full new scenario in the future.

Q - Carlos Macedo {BIO 15158925 <GO>}

Thanks, Roberto. So just following up, you mentioned that levels now are attractive for buybacks. The program you have now is roughly a little bit less than half of what you did in 2015. How – is it easy to increase the size of this program? Is there something that depending on the situation, the generation of capital that you were able to put together is something you consider? I mean, could we have another year like 2015 in buybacks if opportunity presents itself?

A - Roberto Egydio Setúbal

We don't have (50:58) guidance, but this is a possibility. We have been announcing numbers of buybacks, and once we reach the level that we have been authorized by the board, we go through another (51:15). It still depends on the situation, the conditions, the perspective. So, these numbers from (51:23) that we believe is a small number. For the bank, we can cope quite well with this kind of acquisition buybacks, given the scenario that we are seeing. So for the moment, we believe that this a good start and along the year we can see how it develops.

Q - Carlos Macedo {BIO 15158925 <GO>}

Okay. Just one final question and wrapping this up. Is there a maximum number for core tier 1 that you consider that you wouldn't want to go above and you would have to reconsider maybe the historical dividend policy?

A - Roberto Egydio Setúbal

We believe that between core tier 1 fully loaded, we would not go above 12% on a stable basis.

Q - Carlos Macedo {BIO 15158925 <GO>}

Okay. All right. Okay. Thank you, Roberto.

A - Roberto Egydio Setúbal

Thank you.

Operator

Our next question comes from Mario Pierry with Bank of America.

Q - Mario Pierry {BIO 1505554 <GO>}

Good morning, everybody again. Let me ask you two questions. One question, more specific and then one general question. Let me start with the specific one. Your guidance for provisions is net of recoveries. However, (52:41) we have seen the recoveries perhaps totaled close to BRL 5 billion in 2014 and 2015. You're making a significant investment right now with the acquisition of Recovery. I was wondering, what kind of recoveries, what is the nominal amounts or nominal level do you expect in terms of recoveries in 2016? Could we see a number much higher than the BRL 5 billion that you have been delivering?

And then the more general question is you're guiding - basically you're guiding for negative REO loan growth in 2016. Your peer is also guiding for negative REO growth. My question then is related - if there are any concerns that we could see the government trying to interfere in the system again, if we could see public sector banks becoming more aggressive in lending spreads.

Also, how do you think is the relationship with the government now? Clearly, last year the system was targeted by the government. Your tax rates increased by 5 percentage points. Right, you still grew your earnings 15% in 2015. Your ROE was still 22%, 23%. So, are there any concerns that the government could try and interfere in the system again in 2016? Thank you.

A - Roberto Egydio Setúbal

Well, talking about recoveries, we are not putting any influence on the Recovery acquisition (54:24). So there's no impact in the guidance, given the fact that we are in this process of acquiring Recovery. Although we plan to use Recovery which probably might increase our performance in recoveries in general. But we believe that in this scenario, recoveries are much more useful. Recoveries is something that improves a lot when the economy improves. So this, we do not plan - we are not putting any numbers - any improvement. So we are basically keeping recoveries in low levels between BRL 4 billion and BRL 5 billion, more towards BRL 4 billion in this guidance. We do not believe that in the year of 2016, we would have a major improvement in the growth. It's possible that down the road, when the economy is much better, another thing that has been written off - has been written off currently, we will recover. So I expect recoveries to improve at the end of this cycle, not now.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. And the question...

A - Roberto Egydio Setúbal

Yeah. The second question about the - we do not - look, we have never been influenced by the government. I think that the interference from the government in the situation has been always done through the public bank, which accounts for more than 50% of the market share. So - but they have never influenced our actions. So this will never happen in their view. So I do not believe that this will happen in the future.

Q - Mario Pierry {BIO 1505554 <GO>}

I know exactly, so that's my question. Do you think that the government could use the public sector banks again, in order to try to stimulate the economy and how do you think that the government looks at your profitability right now if you could be - if they could come up of new taxes in the banking system?

A - Roberto Egydio Setúbal

I think the - look, the good thing about having federal banks in Brazil is the fact that government understands the dynamic of banks. They know the problems, they know about the delinquencies, they know about the capital need, so it makes the conversation much more rationale, because they have on their side also people that will be influenced and will impact that. So I don't - and obviously tax increase and additional budgets in the system will make credit even more beautiful, which I don't think at the moment is the interest of the government. I think they would like to see banks to be more easy and to increase more the credit offer than try to collect some more taxes. So I do not expect this to have any influence in all this.

The banking - the public banks, I have to say, I think they have announced - I know what's in the newspaper. They have announced some lines, additional lines which are much smaller than lines that we - the amount of lines that we put in the market in previous years. So for the year, they are not - this BRL 83 billion of additional loans and programs with no subsidy. I'm not sure about the demand for those lines without subsidies, maybe some of them like agricultural loans which have very strong demand in Brazil given the exchange rates. You might have additional demand but not necessarily for all that number. So I don't think that this will be a major impact in the banking market.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. Thank you very much.

Operator

Our next question comes from Jason Mollin with Scotiabank.

Q - Jason Mollin {BIO 1888181 <GO>}

Hello, everyone. As always, thank you for the detailed presentation and call. Roberto, can you provide an update on the strategy for the Latin American region? Specifically, where do you see the greatest opportunities outside of Chile where Itaú will have a 12% loan market share post merger?

You mentioned Argentina, in the Portuguese call, is a small investment for Itaú currently, but there are good prospects with President Macri. And also, what is your view on Mexico and the opportunities there? Thanks.

A - Roberto Egydio Setúbal

Okay. We see Latin America as a good opportunity for Itaú. Our experience is that we have performed quite well in this market. So we believe that we should increase our presence in other countries in Latin America. Currently, we have presence in Argentina, Chile, Uruguay, Paraguay and Colombia. We believe that we can increase our presence in Chile, Colombia and Argentina. We have a good position in Paraguay and Uruguay. Those are leading franchises in both countries with very good level of profitability.

In Chile, we are acquiring CorpBanca, and in Colombia, basically we are entering with CorpBanca's subsidiary. In those two markets we will become fourth and fifth biggest bank in terms of assets in those markets. But we believe that we can go up and do additional acquisitions in those markets in the future.

In the moment, in those two markets, we believe that we have to make the integration of the bank that we have acquired with our bank in Chile. And in Colombia, CorpBanca had acquired two banks which are already in the process of integration. So I think that for the next three years, at least, we probably will not acquire anything in those countries, or we must look forward to acquire anything because integration will take a lot of effort and this will be our strategies to put those banks integrated and to make all of them a good franchise.

Then comes up Argentina, which, I mentioned to you that we have a small position. I think the market expectations are very high in Argentina. Let's see how it develops. It's a great opportunity for us with the presence that we have today already (01:01:50) lot in the region, see if the conditions shows the right ones in the future.

Then, we have Mexico. I think, it's a market that we are not in. Mexico and Peru, the next two markets for us that we would see as a potential for Itaú to be present through an acquisition. But today, we don't - we are not seeing anything in those markets that would be of our interest.

Q - Jason Mollin {BIO 1888181 <GO>}

Thank you very much.

Operator

Our next question comes from Saul Martinez with JPMorgan.

Q - Saul Martinez {BIO 5811266 <GO>}

Thank you. Hi. Hi. Good morning, everybody. I have two questions. I hope you can hear me. I'm actually outside the office. But, first, a very specific question and then I have a broader question. On NII, I'm still a little bit perplexed by the guidance. And if I take your fourth quarter run rate for NII from client activity. And I carry that through just the fourth quarter level, through 2016, I get to the high end of your guidance range. I get to something around 4% or 4%-plus. So effectively, your guidance implies that at the midpoint below that the run rate in 2016 for NII is actually going to be lower than what it is currently.

And I understand directionally the guidance in terms of mix shift and less pressure from spreads, maybe FX, but can you give a little bit more granularity around and quantify a little bit (1:03:35) the impact of these effects? In the fourth quarter alone, you had a re-pricing benefit net of mix shift of BRL 400 million. So it's hard for me to see that that essentially goes away from one quarter to the next that quickly. So if you can just give a little bit more color and that's especially in light of your competitors being a bit more optimistic about NII.

Secondly and this is a broad question, forgive me, it's not meant - the spirit of it is not meant to be confrontational. But the question is why should anybody buy your stocks right now? And if you can make the equity case for Itaú because I think a lot of the investment story for - a part of the investment story has been that you - the competitive backdrop has gotten better. You have some benefit from re-pricing. That buffer is the negative impact on asset quality and allows you to maintain high profitability. You've certainly done that. Your profitability has been impressive in the tough environment.

But your ROE, according to your guidance, it is around 18%. Long-term rates are not much lower than that. So, clearly, right now, you're not generating value. The outlook for 2017, 2018, and 2019 is highly uncertain and any cost of equity reduction really depends - is really outside of your control. You are more buying back stock, so you certainly feel like there's value. But I'd like to hear in a little bit more detail how management, how the company views the investment in Itaú and what you think the investment story is for Itaú for investors?

A - Roberto Egydio Setúbal

Okay. Let me start with the margin. I think we have a lot of seasonality in the fourth quarter. So I don't think that the (01:05:18). We have some seasonality in terms of use of products that changes over the year. So there's no full compliance with the idea that the fourth quarter is going to replay every quarter because of this seasonality effects. This is one thing.

Second thing is the fact that from third quarter to fourth quarter, part of the increase was due to the exchange rate, the average exchange rate between the two quarters. Although the final exchange rate was stable, the average one was we have some devaluation along the third quarter that was for fully - became fully revenue in the fourth quarter as the loan book in other premises was bigger throughout the quarter. So this had some impact in the fourth quarter increase in terms of margins.

And like I mentioned before, we are not putting in our guidance spread increases along the - it's only re-pricing, okay? So if we have additional spread increases, we would be able maybe to increase more spreads. But really we are not seeing spread increases basically for two reasons. One is because we expect SELIC rate to be stable; second, because we believe that the current market conditions, we do not believe that we could be able to increase rates at present. We have increased along the 2015 year.

So, in that sense, we might - we were assuming those conditions as true. We believe that this number reflects what we could expect. If you believe that we can have a higher level of spreads, which could be the case, then our margins will be higher than that.

Okay. And on the business case of Itaú, I think that Itaú has most of its business in Brazil. So Brazil is going through a - maybe worst moment ever in terms of economic growth, but I believe that Brazil, at some point, will be better than it is today. We'll improve our GDP, at least - might improve somehow, not that much in the short-term, but we believe that it will be better than it is today.

So, as Brazil improves, we believe that capital ratios in Brazil - cost of capital in Brazil will reduce and the performance of the Bank will improve. ROEs will be higher in the future, we believe. We always have kept a difference between cost of capital and our level of ROE, which we believe, will be the case in the future. Maybe today, we have not had this opportunity given the fact that the year was much worse than we expect by the end of 2014. Just remember, at the end of 2014, everybody was considering growth for 2015 and we end up having a negative GDP of almost 4% in the year. So we are not really foreseeing this.

Looking this year, we believe also, like I mentioned in our guidance, our guidance are made based on negative growth of 2.5% to 5%. So (1:09:42) something in between that range. So this is something that we do not believe that this - you can expect that this will be going on and on. We believe that we probably are in the bottom moments and things tend to improve in Brazil, (01:10:09)

But Brazil, in terms of current accounts (01:10:17) probably, I mean give the plan and (01:10:17) projections, somehow, they're already projecting neutral, so zero (01:10:25) And we are closing (01:10:27) this year and next year. So, these things change a lot, the perspective for the country. And I believe that under better conditions, Itaú will perform with ROEs much above cost of capital and above my peers. Another important point is that we are really making the effort to keep the books very clean, provisions very updated so that by that time that the economy starts to recover, we'll not be carrying over fees (01:11:04) from the past. So we believe that as we keep books very clean, we will be able to very quickly to improve ROE.

We also have business models that's very resilient especially in a condition like the one we are living, given the very strong amount of revenue that comes from services and this makes up more than - almost 50% of our - more than 50% of our profit last year.

And this is not affected by this GDP issue and higher risk in our loan book. So it complements quite well on our loan book and make our profitability very resilient. So if we keep the books clean, light I'm trying to explain, I believe that once we do recover, we will be able to grow all our books quite fast as well and profitability will improve quite fast. And in addition to that, I believe that we are working very high - very hard in terms of improving the efficiency of the bank and the quality of the bank.

Since we do not have space for growth, we are investing a lot in improving the bank, investing especially in technology in order to make the bank more efficient and also preparing the bank for the digital world which we believe will be coming very soon and we have to be well prepared for that.

So, I think that the franchise of Itaú overall in terms of business model, in terms of diversity of business, it's quite good. It's a great franchise. Clearly, I think we have conditions to outperform the peers, the average market at least. So, assuming over the years that Brazil will have some kind of improvement, I think that the current price of Itaú somehow low, I would say.

Q - Saul Martinez {BIO 5811266 <GO>}

Thank you very much for the thorough answer. I really appreciate it.

Operator

Our next question comes from Lucas Lopes with Credit Suisse.

Q - Lucas Lopes {BIO 18956724 <GO>}

Hi. Good afternoon. Thanks for taking my questions. It's my understanding that the large corporate segment has driven the material increase in cost of risk (01:13:45) in the past year. How does the bank expect the composition of loan loss provision expenses should be in 2016 or is this expected to be - and does it need to deteriorate the most this time. Any color on that would be very helpful.

Also, if I may ask a second question, follow-up on the NII one. Has Itau taken into account any repercussion from higher NPLs or margins in the guidance (01:14:12) because the provisioning guidance and there's a sharp increase in NPL and after six days they do, the bank cannot accrue interest in a loan which will bear negatively on NII? That's it. Thank you.

A - Roberto Egydio Setúbal

We believe that the - I mean, we're talking about the delinquency for next year. We are very clear that retail segment, we will have increases in NPLs. Most of the provision increase is related to retail. Most of the provision increase is related to retail, much smaller increase in middle market and corporations. Most of the provision increase comes from the retail segment. This is what we expect for the coming year.

A - Marcelo Kopel {BIO 16986304 <GO>}

And, Lucas, for the impact...

A - Roberto Egydio Setúbal

Marcelo is answering the other part of your question.

A - Marcelo Kopel {BIO 16986304 <GO>}

Yeah. And for the NII growth and the impact of non-accruing loans, yeah, it's embedded in the equation, that as well. It's one of the components that is as part of the equation on how we project NII going forward.

Q - Lucas Lopes {BIO 18956724 <GO>}

Great. Thank you.

Operator

Our next question comes from Victor Galliano with Barclays.

Q - Victor A. Galliano {BIO 1517713 <GO>}

Hi, there. Thank you for the opportunity. Just a couple of quick questions for me. On CorpBanca in the past, you said that this would absorb - I think I heard in the past more like 80 basis points on the acquisition. I hear you're now saying more, 100 basis points. Has there been any material change there? Is it an exchange rate thing? Can you give us some clarity on why that's moved?

The second question is about the RWAs came down in the fourth quarter. Is that a recalibration of credit risk along the book on the back of the new regulation that Central Bank came at? And lastly - sorry, third question on insurance, I just want to get a sense of why you think that there was - why you can tell us there was no earnings growth year-on-year in the insurance segment? Thank you.

A - Roberto Egydio Setúbal

Okay. Let me start with insurance earnings. Basically, we are moving out of some lines, as we have already announced, and concentrating on other few lines. So, this movement, we have some adjustments in the business, which has made it more difficult to grow revenues and profitability. We also have, at the moment, the crisis (01:17:35) is taking place today. We don't have that much space to grow the insurance business. So we expect the insurance business to grow pretty much in line for the coming year. And this year specifically, we have this adjustment coming from the sales of some business lines and some reduction in some lines that we are moving out, closing out the business.

About the 80 basis points that we mentioned of CorpBanca impact in our capital ratio, now we are moving up to something more closer to 100 basis points. Basically, one reason is the exchange rates. It became a much bigger book, given the current exchange rates. And I think this is the major influence. And second one is the more fine adjustment that now we know - we have more information on the balance sheet, so we can have a much better calibration on that.

And Marcelo will answer about the RWA.

A - Marcelo Kopel {BIO 16986304 <GO>}

Yeah. On your specific point on RWA, the change from the Central Bank affected the sureties, the risk weighting for sureties. Okay. And then, I also mentioned the dollar movement and also the consumption of tax asset.

Q - Victor A. Galliano {BIO 1517713 <GO>}

Okay. Thank you. Just a quick follow-up on the CorpBanca, if I could. So, there is no - as you said, there's - if the FX rate - is there any sort of hedge in place with regard to this, because I know that it's a dollar-based field for any of the price? And obviously, the agreement has been in place for a long time.

A - Roberto Egydio Setúbal

About the hedge product, commitment of capital increase, you're talking about?

Q - Victor A. Galliano {BIO 1517713 <GO>}

Yeah. Well, just the price of the deal, because I know it was struck in dollars back in 2014.

A - Roberto Egydio Setúbal

Yeah. The 80 basis point, 80 bps relates much more to the size of the asset that was impacted by the capital - the size of the asset, when we translate it into reais, it became bigger than it was previously. That's why we have this additional - around 20 bps impact in the capital ratio. It's not because of the...

Q - Victor A. Galiano {BIO 1517713 <GO>}

Okay. Thank you.

Operator

Our next question comes from (01:20:34) with NM Investments.

Hi. Hello. This is (01:20:40). Just a quick question on your guidance for provision, and you mentioned that the range of GDP that you're working with is between 2.5 - minus 2.5% and minus 5%, and the range of provision is BRL 22 billion to BRL 25 billion. But for a 2.5% change in GDP, do you expect the provision to increase by BRL 3 billion? That sounds a little bit too optimistic. Would you agree with that?

A - Roberto Egydio Setúbal

Yeah, pretty much, given the level that we are already, this is what we expect, because this would mean an acceleration in price this year. The impact in 2016 would be basically on the margin of what we have seen today, okay? This will give more impact in 2016 and 2017, if we have this kind of environment. We have additional impact in 2016 - in 2017, I mean. Do you understand?

Q - Operator

Yeah.

A - Roberto Egydio Setúbal

Because what you are seeing today is...

Q - Operator

Also just to understand in terms of how you, sorry.

A - Roberto Egydio Setúbal

Basically, what we are seeing is that...

Q - Operator

Go ahead, please.

A - Roberto Egydio Setúbal

Basically, what we have seen, we have a base case, and as this deteriorate or improve, the impact was not going to be in the full year. The full-year impact of that will be down the road in the year ahead. So, we have a best middle case.

Q - Operator

In 2017?

A - Roberto Egydio Setúbal

Yes. In 2017...

Q - Operator

Okay, fine.

(1:22:14)

A - Roberto Egydio Setúbal

...better environment in 2016 will be much better in 2017, or the worst case in 2017. This will have a 5 negative in 2016.

Q - Operator

Okay. That's clear. And just also trying to understand about how you factor in corporate delinquencies in your guidance, because for retail you can use your models to project what sort of provisional requirements you would require. But to corporates, they can be pretty lumpy, and it's hard to kind of project which corporates are going to go bankrupt and how much provision you will require. So how do you work on the corporate provision?

A - Roberto Egydio Setúbal

It's much harder. As you mentioned, we have to keep very close track on corporations in order to understand that. But mainly, we'll keep a good track on sectors that are suffering more. We keep a much closer track than other sectors that are doing fine. So, we can basically look to sectors and see how this would affect our book, how our exposure is to that sector and how this could impact the provision. But you're right, it's much imprecise kind of expectation that we can have in the provisions for wholesale.

Q - Operator

Just quickly and finally, do you think there's also - in what circumstances would provisioning guidance - provision would be higher than the BRL 25 billion that you're guiding for?

A - Roberto Egydio Setúbal

Basically, from today, I just would say that only if GDP would be even more negative than the range I gave you some, so it would be less than 5 or...

Q - Operator

Okay, thank you very much.

A - Roberto Egydio Setúbal

...major impact is coming from something that we won't do. But today, we do not see that.

Q - Operator

Okay. Thanks.

This concludes today's question-and-answer session. Mr. Roberto Setúbal, at this time, you may proceed with your closing statement, sir.

A - Roberto Egydio Setúbal

Okay. I just want to thank you for being with us all in this call. I think it was an important opportunity to us to clarify how we are basing our guidance for 2016 and ahead. And I think I believe that we will have - we have answered all of your questions, and please feel free to look for Marcelo if you

have additional points (01:25:11) that were not clear enough during the call. And thank you very much for being with us at this time. See you next time.

Operator

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

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