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Bloomberg Transcript

Q2 2013 Earnings Call

Company Participants

- Alfredo Egydio Setubal, IRO
- Rogerio Calderon, Corporate Controller
- Unidentified Company Representative, Unknown

Other Participants

- Amit Mehta, Analyst
- Carlos Macedo, Analyst
- Daniel Abut, Analyst
- Marcelo Cintra, Analyst
- Philip Finch, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. Thank you for standing by. Welcome to Itau Unibanco Holding conference call to discuss Second Quarter 2013 earnings 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)

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

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

First, Mr. Alfredo Setubal will comment on Second Quarter 2013 earnings results. Afterwards, management will be available for a question-and-answer session. It's now my pleasure to turn the call over to Mr. Alfredo Setubal.

Alfredo Egydio Setubal {BIO 1528623 <GO>}

Hello. Good morning those who are in the US and Brazil and the America zone. Good afternoon, for who are in Europe. Welcome to our conference call for this Second Quarter.

For those who are following through the Internet and through the slides, we're starting on slide number two, highlights of this quarter. The first one is the results, BRL3.6 billion. It means an increase of 3.1% when we compare to the First Quarter of this year, BRL7.1 billion for the whole semester.

The second point is our recurrent ROE. With these results, the ROE was 19.3%, a little bit higher than the First Quarter, 20 basis points, even considering that we had a drop in our results from the financial margin with our clients in total of BRL329 million when we compare to the First Quarter of this year. So this is a good operational banking result for this period, considering this drop that we are going to talk more later.

Another highlight of our performance is the credit portfolio. The growth was 2.5% in the quarter and 8% when we consider 12 months. We continue to reduce our cash [ph] finance portfolio. So we had a reduction in 12 months in this portfolio of 20%. If we just consider these reductions, our portfolio in 12 months would have growth around 12%, more in line with the financial system when we saw the data released by the central bank.

Financial margin [was fine]. We grew 3.4%. The total in reais was BRL11.3 billion, reversing the trend of the last four quarters, which is important. It was the First Quarter that we were able to grow this line.

In our view is the turning point that probably will continue to grow slowly this line. I think most of the adjustment in our credit portfolio is done. And also in terms of spreads, we are not seeing the spreads reduction in the last months and some lines even are growing due to the economic environments in Brazil.

So we believe that financial margin with clients will start to grow quarter by quarter, let's see

Financial margin with credits, net of the loan losses provisions, expenses, we showed growth of 7.6% in the quarter, a total of BRL6.3 billion. What is very important is that the quality of the credit portfolio continued to improve. The 90-day NPL decreased against this quarter and decreased 30 basis points, achieving 4.2%, which is a good level. And a huge reduction. When we compare to the same period of the last year, reduction is 100 basis points.

Also, it's good to see that the NPL between 15 days and 90 days decreased also in a very important pace, as 60 basis points in this quarter and 110 basis points when we consider 12 months. So I think it's good. It's good to see that our policies of reduction of the risk of the credit portfolio that we started almost more than 18 months ago, continued to show a very positive trend in terms of quality and in terms of decreasing the lower -- the provisions for lower loss.

Another point that is important is the banking fee, an increase of 5.4%. And we achieved BRL5.4 billion in the quarter, the result of -- in our insurance operations, including pension plans and capitalization and so on, achieved BRL1.4 billion in the period, a 5.7% increase was good and 11.2% when we consider 12 months. So our insurance operations that we manage are very good and growing also in a very good pace.

Another point is there is point of our strategy in the last two years we control of RA [ph] no interest expenses. The growth in the period was 4.2% when we compare to the First Quarter for the seasonal, the growth in the Second Quarter. And when we compare 12 months, we continue to grow around 4.5% lower than inflation for this period.

If we made an adjustment of the consolidation of the [hedge car] to make it more comfortable with last year. We see that the growth of our expenses is (inaudible) much lower than the growth of the inflation in the same period.

And considering all these in terms of revenues, losses, claims and so on, our efficiency rate risk-adjusted ratio increased 70 basis points, was a good number, in line with our expectations and our guidance.

Going to page three, we see our results in a little bit more detail. We see here the financial margin with the markets (inaudible) decrease of 55% in the quarter. This is more related to the volatility of the markets, especially in our case related to the prefixed [ph] bonds and external bonds that we are going to show you in the coming slides later.

But we continue in a very good pace, in terms of loan [ph] losses and claims. The total in the quarter was BRL4.1 billion, with a reduction compared to the same-- to the First Quarter of this year of 5.8%. So we continue to go in line with the expectation of our expenses for this year, related to the good quality of the new loans that we provide in the last months that are making our credit portfolio even better.

So we finish with the recurrent result of BRL3.6 billion, with a growth of 3% when we compare to the First Quarter. And it's stable when we compare semester of this year with the first semester of last year.

On page four, we show a split between our banking operation and our insurance operations. We can see that from our BRL3.6 billion of net results recurrence, BRL2.9 billion came from our banking operations. This means when we compare the location of capital, our ROE of 20.4%, efficiency rates are 52%. And efficiency ratio adjusted to risk, 75.4.

Insurance, almost BRL600 million in results for the quarter, ROE of 35% -- that's 35.3% -- and efficiency ratio of 33.4%. And risk-adjusted efficiency ratio of 65.3. So I think we were able to show very solid numbers, both for banking operations and insurance.

On page five, we can see the financial margin. The financial margin has been reducing in the last five quarters. The peak in this table we see 13.4%. We finished this quarter with 11%

-- with 11.4%. And we see that the pace of reduction reduced and we expected, due to the increase of the interest rate and more stable spreads and, as I said, in some lines even growing the spreads that is this line we start to grow and stabilize at least in the coming quarters.

We can see then also in the last credit spread is the green line that we have been growing then the net credit spreads in the last three quarters, where we achieved 7.2%. And the risk-adjusted margin with clients that also is growing. So in our view, we are almost done in terms of adjusting our credit portfolio with the new spreads and adjusted and also with the new interest rates, we believe that the financial margins will start to increase again.

On page six, we can see how we finished the First Quarter with BRL10.9 billion in margin with clients. And we finish BRL11.3 billion how these was done.

So BRL219 million was related to the growth of the lowered volumes, BRL121 million is related to more calendar days in this period compared to the First Quarter. Selic already improved BRL150 million in revenues.

And then we see product mix and product mix and spread also reducing -- to reducing the margin. But in a much lower pace and much lower numbers when we compare to other quarters since we began to reduce our risk appetite and also the reduction in spread in the whole financial market.

So that also gives us more confidence that these financial margins with clients will start to grow in the coming quarters and continue this trend in the coming quarters that we saw the Second Quarter. So also, we had a positive of BRL64 million in equity, in earnings with our affiliate companies.

On slide number seven, we see these trends also in the financial margin of credit, achieving BRL6.3 billion. And expenses of -- for allowance for loan losses here net of recoveries of credit and write-offs of BRL3.6 billion. I think the trends are very positive in both lines and also give us confidence for the coming quarters.

And on slide eight, we saw the last quarter's the trend of the financial margin with the markets. We have been in a lower pace here in the -- especially in the last two quarters. And this quarter especially due to volatility in the markets, as I said, especially related in our case to prefix bonds and now debt bonds.

So we finished with the lower results in financial margins with the markets (inaudible) covering the whole history of the bank after the merger. And even lower when we compare just Itau and Unibanco (inaudible)

On page nine, we see the banking fees and results from insurance. As I said, insurance in our case, we are not in the health insurance, as you know. We are more related with our participation with Porto Seguro and directly with what we call the bank assurance products that we sell through our network of branches. But these insurance business has been very good and growing 11% in the last 12 months and almost 6% in this quarter.

So I think it is a good number. And also, the service fees that continues to grow almost 21% -- more than 21% in the last 12 months and more than 5% in this quarter when we compare to First Quarter. Here, we have the impact, of course, of the Redecard that now we have 100% of the Company.

On page 10. And we can see a little more details of our insurance operation. I think it is important to see that also here we saw a reduction in claims. Was it good for us, in terms of reduction of our risk of our assets and our business? And continued to -- the insurance business continued to grow in a better pace than the banking activities of Itau Unibanco.

On page 11, we can see the loan ratios. As I said, we are in 4.2% when we consider the total NPL ratio over 90 days for our credit portfolio, both for individuals and companies are reducing. And this is the lowest level that we released since the merge of Itau and Unibanco at the end of 2008. So I think the policies of reducing the risk are showing happy results.

We can see also in the bottom chart of this page the covered ratio that's continued to increase for the Fourth Quarter in a row. So all the numbers goes well and (inaudible) of our policies.

On page 12, we see here the expenses for provisions for loan losses also reducing due to lower -- lower provision that we are making in the quarters. We continue to have a very good level of provision. We continue with BRL5.1 billion in complementary provision for -- for losses in our expected loss model. We didn't touch these complementary provisions in the last two years.

On page 13, we see the trend of the NPL ratio between 15 days and 90 days. Also here we can see good numbers and good trends that also give us the confidence that the NPL provisions will continue to reduce in the coming quarters. We see here a drop of 60 basis points in our portfolio, in terms of delays of our clients. Both individuals and companies are in the same trend.

We see here in the bottom of the page the NPL creation and write-off, also in the good trend. So everything in line with our policies of reducing the risks.

On page 14, another important part of our strategy that is the control of the non interest expenses. We're continuing a very good trend, 4.6% in the last 12 months, what is a good number below the inflation that in Brazil is running at a pace of 6.5%.

If readjust the total expenses with the full consolidation of Redecard that we bought in the second semester of last year. We saw that the growth of our expenses is only 2.5%. So we continue a good trend in terms of controlling the expenses, as part of our strategy to keep high levels of return for our shareholders.

Considering all this, we saw on slide 15 the trend of our efficiency ratio. Efficiency ratio, traditional measure is increasing because we are not able yet until now to increase the margin with clients. As I said we've best our [ph] quarters in reducing this line. So efficiency ratios deteriorated.

But when we analyze the efficiency ratio adjusted with the provisions for loan losses and the claims in terms of insurance business, we see that we're improving our numbers and I think is very important the trend of this risk-adjusted, say efficiency ratio, because this shows that our strategy is going well.

On slide 16, we saw some the number of assets, we finished with BRL1.057 trillion in rough assets, total assets, with the growth in the quarter of BRL2.8 billion -- 2.8%. And 19% in 12 months. In terms of stockholders' equity, we had a growth of 1.8% in the quarter, the total of BRL75.78 billion, in terms of stockholders' equity.

On slide 17, we see more detail of our loans by type of clients. We finish the total credit risk considering private securities that we held in our portfolio, with BRL467 billion. This is the number of our credit exposure for individuals and companies by the end of the quarter.

We continue to decrease our -- our financing, our vehicles financing portfolio. We finished with BRL45 billion, a decrease of almost 20% in 12 months. And probably we are going to see some reduction yet in the coming quarters.

Payroll loans is increasing in a good pace. We finish with BRL18.4 billion in payroll loans, BRL3.8 billion of this came from our JV already with (inaudible) so the JV is also contributing to the growth of this business, that is a business was important as part of our strategy of reducing the risk of our credit portfolio.

Mortgage also is part of this strategy of growing lower risk portfolios. We finish with BRL21 billion, with individuals in these portfolios, with a growth of 32%. And we continue to be very confident that the profile of clients that we have providing the loans on mortgage is good and we -- in our ratio of loan to value of the houses and the apartments and so on are very low, lower than 80% in the -- in the origination.

If we analyze our total portfolio mortgage, this number is closer to 60%. So we are very confident that is a good business and we continue to take advantage of these but as I said, the profile of our clients is more related to high-income individuals.

Companies, we continue to see a reduction in very small -- in small companies. Middle-market companies we are growing a little bit the portfolio. But anyway, when we saw these three segments together, we continued to see a reduction in the portfolio, both in the quarter and 12 months. So it's part of our strategy of reducing the risk of the portfolio.

By the other hand, corporate is growing. We continue to see a reasonable demand for credit related to large companies in Brazil as the growth in 12 months is almost 16%.

Latin America is the credit [ph] that we have and the countries that we have banks, as we operate in retail and wholesale banking. And the growth here was 11.3% in the quarter. But this is more related to the devaluation of the real. Of course, we had some growth also in the portfolio, in the local currencies. But when we translate that to dollars and to reais, we saw this kind of growth in our portfolio.

On page 18, we see here all the funding and assets under management that we have and working capital of the bank, BRL1.5 trillion with the growth, 3.1% in the quarter.

On slide 19, we see that the -- as we are -- the pace of growth of our portfolio is not very high. The funding is very good -- a very good level to fund the new loans [ph].

On page 20, we see the movement, the changes in our stockholders' equity. We show a growth of 1.8%. We start in the first day of this quarter with BRL74.4 billion. We had a net income in the period of BRL3.6 billion. So this is an increase in our stockholders' equity. We pay dividends and interest [of our capital] of BRL700 million. So is a reduction, BRL1.2 billion also a reduction in the asset valuation adjustment for the available for pay of securities.

And we bought BRL300 million in June in shares. We repurchased our own shares in June. And so that explanation why our portfolio had an increase of BRL1.8 billion and finishing of BRL75.8 billion.

On slide 21, we can see that these adjustments to market value is reduction in our portfolio of BRL1.2 billion, related to our -- as I said, to our bond -- prefixed bond portfolio in Brazil and also related to these external debt bonds that we carry outside to hedge our subordinated debt in dollars that we have, that compose our capital and our BIS numbers.

So if -- so we can see here in this page that -- if we consider assets and the total influence of the liabilities that influence our numbers, the total impact in reality in our portfolio should have been only BRL500 million. So that explains our reduction in the stockholders' equity in the quarter.

On page 22, the BIS ratio of 17.5%, a little bit lower than by the end of the quarter, of the First Quarter. But still very, very comfortable at face the new operations of the bank.

On slide number 21, we can see the ROE, the recurrent ROE. We should consider only the operations of the bank, not considering the treasury operations, just to show the number of our -- of recurrent banking business. We can see that this green line that shows that we have been growing our banking ROE in the last five quarters, without considering, as I said, the treasury operation with the market [ph]. So we finish with operational ROE of 21.3%.

The total number, as I said at the beginning, considering all the operation, was 19.3%. But here we -- we realize that it is important to see that our operations are very good and very current [ph] and growing.

On slide 24, we can see the -- how much we paid comes off dividends. And we continue with the policy of distributing around 30% of the net income.

On slide 25, the market capitalization of the bank by the end of the quarter, BRL122 billion, decreased this year also because of the devaluation of the Bovespa index. And the trading that continuing very good level.

On slide 26, we see the traditional segmentation that we made between -- among the commercial banking, the consumer credit, the wholesale banking and activities with the market. And the excess of capital.

We see that from our net income of BRL3.6 billion, we see here that BRL1.69 billion came from our commercial banking with pay operation with our RAROC of 33%. Consumer credit retail here also impacted by the car financing business, BRL485 million, with a RAROC of 21%.

Wholesale banking, BRL774 million. Here also with loan losses and claims, considering business line. So BRL774 million and a RAROC of 13.6%. And markets and excess of capital -- capital, BRL671 million with a RAROC of 12%. So that's the composition of, in a managerial way, at the see the four big segments that we are used to build.

On page 27 is the IFRS numbers. The net income is a little bit higher, the net income in the regulation [ph] is BRL3.78 billion, above the BRL3.6 that we released in the Brazilian GAAP. This is related to the way we -- the regulation that we need to accrue loan losses and interest rates. So the difference is not very big. But we have some numbers different.

And on slide 28, we saw the year the expectations for the rest of the year. Total credit portfolio, we are changing our expectations from 11% to 14% growth to 8% to 11% growth. I think this is more realistic, considering that we have still some adjustment to make, car financing portfolio and the lower pace that the economy is growing and our expectations around 2%.

All the others we are keeping, the expenses provisions for loan losses, between BRL19 billion and BRL22 billion. We are running in a pace of BRL20 billion. But we decided to keep the expectation in the same level.

Banking fees grow of 15% to 18%, no interest expense at 4% to 6%. And these two we maintained. And also the risk adjustment in efficiency ratio that we expected it to grow -- to improve 200 to 400 basis points. And we are in line with these costs.

And to finalize, on page 29, the new acquisitions and partnerships that we announced in the Second Quarter, the acquisition of Credit card from Citibank for BRL2.7 billion. And we need the approval of the authorities here to go on with this transaction.

Cencosud was a JV in Chile, in line with the strategy that we have also here in Brazil with other retailers, like CPG [ph], Animark [ph]. And Carifu [ph]. And so, is in the same line.

We made this JV for Cencosud in Chile and Argentina.

We bought two branches of Citibank in Uruguay to improve our share of high-income individuals in Uruguay. We announced the acquisition through our JV Itau BMG in payroll business of the BMG Seguradora insurance company and also the new participation that we have, the new reinsurance business here in Brazil that we are -- we have now 15%.

So this finished our presentation. And we are open here, all of us to the questions that you'll probably have.

Questions And Answers

Operator

Ladies and gentlemen, we will now begin the question-and-answer session. (Operator Instructions) Our first question comes from Mr. Daniel Abut with Citibank.

Q - Daniel Abut {BIO 1505546 <GO>}

Good morning, Alfredo. I have a general question on your trends with respect to the ROE. As you correctly explained, we saw already an improvement in this quarter, even though there were some particulars about the quarter, like your lower-than-normal financial margin with the market. And you also said that you expect this trend of improving the contribution from the financial margin with clients that started this quarter to continue going forward.

So if I read between the lines those two statements, it seems to me that the ROE should continue to improve from the 19.3% as we go forward. So where do you think the ROE is getting? Where do you think you can sustain it going forward as these trends continue?

And in particular, if you complement that with the page four that you show us, that the ROE of the insurance operations is 35%, the ROE of banking operations 20.4%. But that's a drag on your overall ROE coming from your excess capital, which is producing only an ROE of 4.2%, is that anything that could be done to address that excess capital over time, either via an increased dividend or via putting it to work in acquisitions that could be (inaudible) going forward and also favor the re-rating of your ROE?

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

Hello, Daniel. Thank you for your question. I think the trend that we are seeing, in terms of margin in our case, as I said, we're almost done in terms of reducing and adjusting the credit portfolio, in terms of risks, especially in the car financing. So this is -- probably this quarter, we are going to see some reduction, also. But it is almost there.

The spreads are stable in some lines, in some products are even higher than in the past. So we see and consider the Selic that is growing up again and lower pace of the economy, probably we're not going to see much more pressure in terms of spreads in the financial system in Brazil.

So altogether, we see that this line will continue to grow. And we'll continue to have good numbers in terms of provisions for loan losses. As I said and I showed in some slides, the delays are very low. So this is a good sign that probably the provision will continue to reduce the coming quarters. The profile of our credit portfolio is much better now than it was in the past.

So everything goes in line. And also the control of expenses, I think will continue to show numbers of growth of expenses below inflation. So when we consider all these together, we see that the ROE of the operation of the bank, as I showed in -- on slide 23, is above 20% already. If we analyze this quarter, standalone, it was 21.3%, not considering the market operations. So I think something around 20% is feasible to achieve.

Of course, it's very difficult to make provisions -- predictions and so on to the treasury operations, especially in this environment that we are here in Brazil and also the international market, also very high volatility.

So -- but we -- if we analyze our operations, I think the ROEs are already in their 20s, low 20s. So I think it is -- seems to us, considering the delays and so on we are seeing in terms of numbers and spreads and so on, that it is sustainable for the coming quarters.

A - Rogerio Calderon

Rogerio Calderon. I'm going to address the second question. The reason we posted these charts regarding the two main operations we have in the bank is that actually to reinforce how important is the banking operations and how profitable and efficient is our business when we consider the banking operations by itself.

And -- but your question, I fully understand your question regarding excess of capital. I think we can -- we can say here is that we permanently look at the capital position, trying to conclude if the capital we are carrying on our balance sheet is enough or not, if it's in excess or not.

You're going to remember that we used more than BRL10 billion less -- last quarter last year to buy minority interest in Redecard. This is a good example of how we can use our [name excess] of capital. It was a reduction of our capital position, balanced by a reduction of cash, a very good example of how we intend to invest our capital.

Also, we had similar transactions in this last quarter, such as credit card and some others, as Alfredo just mentioned. We also have a buyback program that is in full course. We bought 9 million shares during the Second Quarter. We also increased the dividend payouts by 10% in this quarter. So altogether, it's the sort of actions we are taking regarding our capital management.

I'm going also to call your attention for the -- we still have some doubts on the regulations regarding BIS3. So we can do some movements. But we need to be prudent in the way we move, because we don't have the final, final words regarding BIS3. But we are keeping very much attention on this, as well.

Q - Daniel Abut {BIO 1505546 <GO>}

Thank you, Rogerio.

Operator

Excuse me. Our next question comes from Mr. Carlos Macedo with Goldman Sachs.

Q - Carlos Macedo {BIO 15158925 <GO>}

Good morning, gentlemen. Congratulations on the strong results. I have a couple of questions. Both are generally related to credit. First, your new guidance for growth has loan growth accelerating from around 6% year-over-year now to -- and the bottom end of the guidance, 8%. Just -- is that -- does that mean there's a greater appetite for loans at the bank? Or is that just a reflection of much easier [basic comparison] at the end of next year?

And the second question is regarding your provision expense guidance. You did lower your loan growth expense -- loan growth guidance and -- but did not touch your provision expense guidance. Given the level of improvement that you've seen in NPLs, what is the likelihood that that guidance is really a little bit too conservative and that you actually will end up tracking the -- not only the lower end of that guidance. But really below that guidance? Thanks.

A - Unidentified Company Representative

(Inaudible) so, first, regarding our growth expectations, we don't intend to change anything in terms of our credit risk appetite. We see some acceleration in the second half of the year.

This is related to the macro scenario. It's also related to some level of acceleration in the car loan that is -- is still behind what we had at the beginning of the year, in terms of expectation. But marginally improving from the first half of the year.

So altogether, we see some acceleration in the second half of the year. But it's going to be in between 8% to 11%, as we mentioned.

Q - Carlos Macedo {BIO 15158925 <GO>}

Okay. I have just one follow-up question, quickly. Previously, you had mentioned that the target for the BMG partnership was to reach BRL12 billion in loans at the end of 2013. And you're at BRL3.8 billion at the end of the Second Quarter. Does that target still remain?

A - Unidentified Company Representative

Yes. It still remains. And if we are base it (inaudible) right now, eventually we may be over that figure in the periods we were mentioning. It was in the -- by the end of 2014. Remember, it's a two-year period when we mentioned this target. And we are a little bit ahead of the schedule on this implementation.

Q - Carlos Macedo {BIO 15158925 <GO>}

Okay. Thank you.

A - Unidentified Company Representative

Back to your Second Quarter, I think it's fair to say that, if conditions are capped at the current circumstance we have. And you highlighted that most of the -- most or all of the indicators regarding delinquency are behaving very well. So if all the conditions are capped, it's probably -- it's likely that we are going to push our total expenses on loan loss, closer to the low end of the guidance.

Q - Carlos Macedo {BIO 15158925 <GO>}

Okay. Thank you, Rogerio.

Operator

Excuse me. Our next question comes from Mr. Philip Finch with UBS.

Q - Philip Finch {BIO 3252809 <GO>}

Good morning, everyone. Thank you for taking my question. Really, to do with slide six of your presentation, which shows the evolution of your loan portfolio mix. While we've seen in the last 12 months the SME and the auto portfolio shrinking quite a lot, I guess the question really is, from where you are today, how much more -- how much further change could we see in that mix, especially in regards to the SME and the vehicle segments? Thank you.

A - Unidentified Company Representative

So specifically on vehicles, it's a long story, actually. What we have seen now is worse than what we had at the beginning of the year. So we were expecting inflection points in this credit portfolio by the Second Quarter.

Now we don't expect to see the inflection point for the beginning of the restarting growth in the year 2013, probably just in 2014. What means that by the -- by the year end, probably our total portfolio on auto loans is going to be around BRL41 billion, BRL42 billion.

When looking at SMEs, we see marginally an acceleration from one and the figure that we are posing now that shows a negative growth, close to 6%, 5.7%, is probably to be much lower, if not positive by the year end.

So growing from that one. But not growing because of any change in terms of our risk appetite. But related to the fact that we expect some acceleration in the economy, not a huge one. But a positive trend in the second half of the year.

Also -- and back to vehicles loans, we do believe that the performance in the second half tends to be better than the performance in the first half. But not enough to make the [thread portfolio] as a whole to restart to grow. It's balanced.

Q - Philip Finch {BIO 3252809 <GO>}

Okay. Thank you. So just to summarize, can we say that the current mix you have today is close to the optimal mix that you would like to have?

A - Unidentified Company Representative

It's -- it's -- it's closer. But not finished. You know, probably we have -- we have advanced maybe 70%, 80% of the total change of the mix portfolio, because we still have -- and this is not only regarding Itau Unibanco. But the whole market, probably -- we do expect mortgage to outgrow, to outpace the other lines of credit in this country.

Q - Philip Finch {BIO 3252809 <GO>}

Okay, that's very clear. Thank you very much.

Operator

Excuse me. Our next question comes from Amit Mehta with PIMCO.

Q - Amit Mehta {BIO 16442509 <GO>}

Hi, thanks very much for taking the question. I just really wanted to get more color on your margin trends. And...

A - Unidentified Company Representative

Excuse me, Amit. We cannot hear you.

Q - Amit Mehta {BIO 16442509 <GO>}

Can you hear me clearer now?

A - Unidentified Company Representative

Much better. Thank you.

Q - Amit Mehta {BIO 16442509 <GO>}

All right. Thanks. I just wanted to get more color on your net interest margin trends. I know you highlight a lot of the de-risking of the book has occurred. But is there a lag in the margin trend that we might see going forward?

And also, is there anything that you're doing specifically on your financial book where you think you can get a stronger performance going forward, compared to the depressed quarter we've just seen? So if you could just elaborate on those margin trends from here, please.

A - Unidentified Company Representative

Okay. So margin -- our net interest margin with clients, we do believe that the compression tends to decelerate further on. And we expect to see net interest income is likely improving from one and probably search line to interest income (inaudible) in comparison to same periods last year as from the Fourth Quarter. So better thing.

We expect that by the Fourth Quarter this year, our net interest income should be outperforming a year ago. What is not happening now, we said last conference call that we were expecting net interest income to accelerate, to grow, to restart to grow as from the Second Quarter. This is what's happening. It's still timid, in terms of movements.

We expect some acceleration. By the Fourth Quarter, we are going to be in a point that we'll be outperforming last year Fourth Quarter. This is really very important when addressing our net interest income expectations.

Regarding the financial margins or the way we call margin with the markets, we still see some movement in the market, some higher volatility than normal. What makes more difficult the performance in this area, always remembering that we operate in very low level of acceptable value-add risk.

What means that, it's the decision to control or to protect our shareholder total value. But it's -- on the same hand, it does not allow treasury to take higher positions, what could make faster any recovery, if it's -- is a well succeeded decision.

So everything said, we do believe that we can perform better than what we posted in the Second Quarter regarding this line, because the Second Quarter was actually the worst ever in our performance. But we recognize that the conditions [are is still tough] right now to better perform. But keep expecting performance to be better than what we posted in the Second Quarter.

What is the positive outcome of this picture is that, in spite of this, not as good performance in terms of margin with the markets, our bottom line improvement comparing to same quarter last year is a meaningful improvement. What means that in case we were [running at] the normal level our financial margin with the markets, we could be on a higher than 20% ROE [as Fred] just mentioned it.

Q - Amit Mehta {BIO 16442509 <GO>}

Yes, sorry. So just to quickly follow up, just so I understand clearly, on the financial margin, should we anticipate now an 800-plus result would be more exceptional because of where your risk tolerance is, in terms of VAR? Or are we actually at a very depressed period because of the volatility?

Then, also, I mean, your ROE I accept. The ROE is obviously physically -- has shown an improvement ROE. It's 19%. But I mean, a lot of that come from shrinkage of equity, rather than from increasing profitable. So I mean, the positive thing now is at least shareholders' funds aren't going backwards as we've seen in the past.

So can you just elaborate, A, on the quantum of financial margin contribution? And obviously, I'm hoping now that the equity doesn't go backwards much further, as we've seen over the last quarters, or at least not improved -- you know, the pace has decelerated, in terms of decline.

A - Unidentified Company Representative

Yes, not sure I fully understood what you said. The sound was actually -- pretty low here. From the portion that I heard, I could heard, what we can say is that we never supply any guidance in terms of our performance in this line, the margin with the markets.

However, of course, we believe that we can perform better than what we posted in the Second Quarter. The average we posted in our chart is actually a reference based on the path that does not imply any guidance for the future, although, as I said, we expect to perform better in [this line].

In terms of the margin with the clients, definitely this is going to improve. I'm referring to the bottom line to be higher and then the ROE as a consequence.

Q - Amit Mehta {BIO 16442509 <GO>}

Okay. Thanks very much.

A - Unidentified Company Representative

Thank you.

Operator

(Operator Instructions) Our next question comes from Mr. Marcelo Cintra with Deutsche Bank.

Q - Marcelo Cintra {BIO 16463628 <GO>}

Hi. Good morning, everyone. And thank you for taking my question. Look, during the Portuguese conference call, you guys mentioned the focus on the credit card business, which is also in line with the recent transactions that the bank did.

However, when we look at the transaction value growth of the credit cards issued by Itau, we see a deceleration over the past two quarters. And transactions grew only 9% in the Second Quarter, while the industry is growing close to 20%. And your main peer is posting stronger growth sequentially.

So I just would like to better understand if you guys are seeing a stiffer competition on the segment and if this could represent a concern for us and what's your overview for the following quarters for the credit card industry specifically? Thank you.

A - Unidentified Company Representative

This does not represent any concern. The trend in this business is a positive trend. We are fully committed to serving this area. It's very much related to the strategy we have defined that is related to the mix payments industry, more service fees added to our revenues.

So everything that is related to the acquiring business, as well, the movement we made regarding Redecard, the recent movements you mentioned, Marcelo, related to the acquisition of credit card and (inaudible) and also the Uruguayan operations of Citibank. That has an important portion of credit cards in that market. So this is very much related.

But the fluctuations you saw in the balance, I'm much more related to the seasonality of this product by the year end and beginning of the year as a consequence of the movement in the Fourth Quarter. We don't see any measure or any issue regarding any concern on our evolution in this business.

Q - Marcelo Cintra {BIO 16463628 <GO>}

Okay. Thank you. And just to follow up, given that you mentioned credit cards, I just would like to have more color on the integration of credit card business and if the bank is already offering, like, some amount of products of acquiring and also banking products. And if you guys still expect to keep accelerating transactions growth on the acquiring business. Thanks.

A - Unidentified Company Representative

We [are two speeds] in that strategy we have explained it to you, that is posting together the benefits of operating under a single bank business that also has an acquiring business. What means that when Redecard is dealing with the clients, it's not dealing only a product supplier. But also as a channel. What means that the bank business operations are the products could be in our -- actually offering by this channel, as well.

This is -- under full implementation, actually. We are also increasing this strategy, engaging more SMEs in this business. And it's pretty positive. This is a strategy that allow us to keep or even increasing our market share without damages [ph], in terms of margins or prices.

Q - Marcelo Cintra {BIO 16463628 <GO>}

No. That's perfect. Thank you very much.

Operator

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

Q - Daniel Abut {BIO 1505546 <GO>}

Just a quick follow-up, Rogerio. If I recall correctly, in the last quarterly conference call, you did say that although it was early to give any guidance in terms of loan loss provisions for next year, you could see a scenario where 2014 becomes a second consecutive year in which the loan-loss provision on an absolute amount basis declined again, although not as much as in 2013.

You are trending, as Alfredo said, towards a BRL20 billion level for this year, although it could be even lower than that, closer to BRL19 billion (inaudible) guidance. Last year was BRL24 billion. Do you still see a scenario, realistic scenario where 2014 could be below that BRL19 billion to BRL20 billion that you may end up moving in 2013?

A - Rogerio Calderon

We had the same -- we had the same picture, Daniel. That means that we expect loan-loss provisions to be in a lower nominal amount in 2014 than in 2013. Of course, this is related to the growth. And we believe that at the level of growth that we are expecting right now, it's possible to pose a lower figure total amount in loan-loss provisions in 2014 than what we are doing right now. I'm referring, of course, to nominal amount of loan-loss provisions.

Q - Daniel Abut {BIO 1505546 <GO>}

Right. So (inaudible) in BRL20 billion, for the sake of argument, it could be below BRL20 billion?

A - Rogerio Calderon

That's right.

Q - Daniel Abut {BIO 1505546 <GO>}

Okay. Thank you, Rogerio. That's very useful.

Operator

Excuse me. Our next question comes from Mr. Amit Mehta with PIMCO.

Q - Amit Mehta {BIO 16442509 <GO>}

Sorry. I mean, slightly related to that same question asked by Daniel, I'm just curious, how do you account for your loan-loss assumptions given the risk of a rising unemployment situation? We've seen a recent turn in the unemployment data. I'm just wondering, A, what your expectations for that trend, when you kind of give that confidence in guidance, hopefully?

A - Unidentified Company Representative

We consider -- we consider all the movements in the macro data when we make our models to have the final figure on loan-loss provisions. You mentioned the unemployment level.

It's actually pretty stable right now. That is a possibility that we keep -- if we keep with decelerating the economy, it's possible that we have an increasing unemployment. However, this is still pretty slight. And we don't think that it's going to have any major impacts.

Anyway, Amit it's very important to remember that our -- our credit portfolio now, based on seven [ph] whole quarters under a more selective approach, is actually much stronger against any slight movements. So we are less dependent on these small movements, such as -- as this one, the level of collaterals in the operations, et cetera. This brings much more quality to the assets.

Anyway, it's always considered in the model. And keep in mind that our models are based on expected losses. So it's not based on what has occurred in the past. But based on what is expected in the future, what means that every time we have any concern or any movement negative, this is considering our models to come up with the final figure.

Q - Amit Mehta {BIO 16442509 <GO>}

Okay, I appreciate that comment. So then maybe you can just quickly elaborate one more step for me. Given the mix shift in the loan portfolio, how much improvement have you created in the expected loss credit -- credit loss, expected loss charge potentially going forward? So how much enhancement have you done to the risk -- credit risk costs that you may incur going forward?

A - Unidentified Company Representative

Could you elaborate a little bit more? We are not sure we understand your question.

Q - Amit Mehta {BIO 16442509 <GO>}

If I give you an example, let's assume your credit portfolio had a certain make-up two years ago, where you had more auto exposure. And the expected loss under your models was, let's say, 350 basis points.

Now you've changed the mix of your loan portfolio to improve it. And your expected loss may be 300 basis points. You've obviously improved the expected loss outcome by 50 basis points by the mix in the shift of the portfolio, a mix shift in the portfolio.

So I'm trying to understand, given that you de-risked the portfolio, effectively how much do you think you de-risked your credit loss expectations? Because for the margin compression you're accepting to tolerate, you must also get the offset on the credit losses, as well.

A - Unidentified Company Representative

So I -- if I understand your question, I think the expected loss model we had, this is fully impacted by the potential default and to the loss given default. And this is all encompassed in the model.

What means that this is -- you know, as we have, as we had changed the mix of our portfolio, probably around 70%, 80% towards the optimum level, this is probably what we had so far. So what means that we can have probably a marginal additional improvement of maybe 30%, 20%, 30%. But this is a very rough calculation.

We can go into further details and trying to come up with a figure. But just by first idea, we think -- as this is captured by the model. And we have advanced probably 70%, 80% to the optimum level, this means that probably we can go -- we can improve maybe 20%, 30% more out of what we had since now, with, of course, a lot given the full in a lower level than what we had before.

Q - Amit Mehta {BIO 16442509 <GO>}

Okay. Thank you very much.

Operator

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

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

(Inaudible) thank you, everybody, for participating with us. I think it was a very good conference call. And we were able to show you the stronger results that we released and the strategy that we are going. I think we are in a good momentum. I think the strategy is showing results, both in terms of ROEs and in terms of losses, provision losses. So I think we are in a good trend.

Thank you for your time and expect to have you all again for the release of the Third Quarter. Thank you.

Operator

This concludes Itau Unibanco Holding Earnings conference call for today. Thank you very much for your participation. You may now disconnect.