Q4 2014 Earnings Call

Company Participants

- Roberto Egydio Setúbal

Other Participants

- Boris D. Molina
- Carlos Macedo
- Jorge Kuri
- Mario Pierry
- Nada Oulidi
- Philip J. Finch
- 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 Fourth Quarter 2014 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.

As a reminder, this conference is being recorded and broadcast live on the Investor Relations website at www.itau.com.br/investor-relations. A slide presentation is also available on this site. The replay of this conference call will be available until February 10 by phone on 55-11-3193-1012 or 2820-4012, access code 2225864#.

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 Chief Executive Officer; Mr. Alfredo Egydio Setubal, Executive Vice President and Investor Relations Officer; Mr. Caio Ibrahim David, Executive Vice President and Chief Financial Officer; and Mr. Marcelo Kopel, Corporate Controller Director and Head of Investor Relations.

First, Mr. Roberto Setúbal will comment on fourth quarter 2014 earnings results. Afterwards, management will be available for a question-and-answer session.

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

Roberto Egydio Setúbal

Good morning and good afternoon for all of you. It's my pleasure to be here with you to comment on our results for the fourth quarter and the year of 2014.

On this presentation, I'll take the opportunity also to comment on our business model and the implications of the current macroeconomic situation of Brazil. Let me start commenting on the fourth quarter results.

I think it was a great quarter, closing a great year. We had BRL 5.7 billion recurring profits and a recurring ROE of 24.7%. I think that the result was very good, but not only the results were good, but the quality of the results were very strong. Financial margins are increasing. Provisions are declining, fees, service and insurance revenue increasing, of the revenues are developing and growing above the level of non-interest expenses. So, all of these together brings this level result. It's important to note that even though we have a difficult macroeconomic situation in Brazil, our credit quality has been improving recently, and I will comment more on that during the presentation.

ROEs have stabilized in a very high level during the course of the year or during the second semester of 2014. And I think that is and it's very – the quality of the results makes me believe that we have a good moment for the bank and a good sustainability for the results we are enjoying at this moment.

Commenting on our P&L on screen 4, I think that again here, we have – commenting on the year, I think we had a very strong year. Revenues in general grew 14.5% comparing to expenses growing to 10.4%. This was very positive for the result, obviously. And on the top of that, our loan losses and claims declined during the year, so this combination allowed our results to grow more than 30%.

It's important to note this also that all the lines have been moving in the right direction. So, all the lines of margins with clients is growing. So, we're recovering from two years ago and very strongly. Commissions, fees, services in general are growing, so this was very positive.

The quarter itself was pretty much compared to the third quarter, which was a very positive quarter. So, we kept basically the same trend of the previous quarter with good growth in margins and very much controlled (5:54) loan losses and expenses. So, all of this allowed us to have also a strong quarter for last year.

As nonrecurring events on screen 5, we can see that we have a gain that we announced previously on the sale of our large risk insurance operation. And also, we – looking on the current macroeconomic situation and what we envision for the future, we thought that would be a sound policy for the bank to increase our provisions, our allowance for loan losses, which we did during this quarter above the regulatory level in more than BRL 1.1 billion on provisions. And the net effect is here, as you can see on page 5. Those were the main events, nonrecurring events for the quarter.

Let me talk a little bit about our business model as we move to page 6. We are a bank, obviously, but we are a bank that has much more business than loan itself. Loan is part of our business. It's an important part, obviously, but we have a strong presence in services, financial services and insurance.

And as we show here in this screen 6, we have more net income coming from insurance and service than we have coming from credit itself. When you look at the credit business, we can see here that our return on regulatory capital is getting to the level of 15% in 2015 compared to 12.4% the previous year, so it was an important improvement and basically, this improvement was due to our current risk appetite policy that is pretty much aligned with return above cost of capital, which we believe that is at the level of 16% for the bank.

Our insurance business has also been developing strongly and we have looking on the right side of this page, a 16% growth in our revenues in our insurance and services business. Since this is outgrowing the expenses, we end up having a 25% growth in our net income for that business. That business as I mentioned, was - is bigger than our credit business which had an important improvement in terms of quality, delivering a growth in terms of net income of 35%. This was due mainly to the improvement in the losses that we had in that business, so the business is moving today into a very sound situation, performing above cost of capital and with a very strong and good quality of assets.

So, this is the current situation that we have. In our mind, a business model we target to have a return of - on the credit business, of cost of capital at least, and the insurance and services that we cross sell for our clients basically comes on the top of that, giving us strong ROE and pretty much sustainable as we are able to deliver this cost of capital return on loans, because the service business is a business that does not take into that much lower capital-driven business, so we can deliver the final and a sustainable strong ROE at the end of the day.

And this current level of return on credit is something that we believe is pretty much sustainable and this is what we have been targeting since we changed our risk appetite two years ago, and we have been having our loan portfolio moving into this direction more recently.

So, on page 7, we can see this loan business here that we have in the bank is a strong improvement, as I mentioned, with much better returns than we had last year and much better than the ones we had in 2012, where we were below 10% at that year. So the improvement is really very important to observe. This was the result.

One of the reasons for that, we can see on page 8, was the change in our business, in our loan portfolio with a much more safe and lower risk kind of portfolio. So we drill (11:26) this last year a lot in payroll loans and mortgages much stronger than areas that were more riskier in our view, like vehicles where we have been declining.

Also, the small company portfolio has declined during the year. But things we have already cleaned that book, we started to grow in the last quarter. And we believe that the year of 2014, we probably will have a small growth in that segment, even though we know that the current level of - the current macroeconomic situation is not one that's favorable for that business. But even though we believe that we can grow the book, although in a small, low speed, but we can grow that book under the current level of risk appetite.

On page nine, you can see the change of mix of portfolio, which was really very important coming from 2012.

On screen 10, we can check the margins, how our margin has improved and how it has been especially sustainable when we look at the net credit spread, which is the gross margin - the gross spread after credit cost. So we have been having a stable spread, net spread, which has been very positive in terms of results. Our financial margin with - our market revenue has come back to high levels, and it has been very, very stable in the last quarters.

The credit quality as a result of that change in the risk appetite is still improving, as we can check in the page 12. In terms of consumers, our rate of decline is very impressive. Year-to-year and quarter-to-quarter, we still keep on going this trend. We believe that we might observe additional improvements in the consumer portfolio during the year of 2015, even though we have this challenging macroeconomic impairment.

And I can already mention to you that we are very positive on that trend, given the quality of the origination that we have today. The vintage that we are originating today are much better quality than they were in the past. They are very consistent, and they have a lower level of risk than is to have, and not every - we don't have the numbers of the NPLs over 90 days. It does not reflect the current quality of origination that we are booking in the bank.

So, we probably will see additional - in the lower speed, but additional improvements in the quality of the consumer portfolio. Companies in general are more stable situation today. As I mentioned to you, the small company portfolio has already been cleaned, so we have today a more stable credit quality at a level that we are seeing today. So, at the end, the total NPL might have some additional improvements in the year of 2015.

This is combined as we can check below here in page 12 with a bigger coverage that we have today. So, we have been - we have increased the level of provisions in this last quarter as I mentioned before. So today, we are more comfortable, more better covered in this scenario.

Obviously, today what the major concern is the corporate portfolio, but we believe that we have strong provisions for that scenario. And even though we know clearly the problems that will result from the problems at Petrobras and Lava Jato case, but we believe that the level of provisions are very good enough for the - more than enough for the moment and we are facing very confident targets for next year.

As we know, we gave you a guidance for next year of BRL 13 billion to BRL 15 billion of net provisions. We believe that this number is pretty much achievable, giving everything that I have been describing to you at this moment. Both the improvements in the consumer portfolio, the level of provisions, the quality of the origination that we have today for both the small companies, consumers and also the corporate.

Corporate might have problems here and there, but overall, our exposure to the Petrobras chain is a small one. We are very comfortable with all the provisions and the situation and the quality of credit that we have today. Having said that, we move on to page 13. The level of provisions compared to our book has been stable in this first quarter. The level of allowances that we have in our balance sheet has grown. So as I mentioned, we are quite comfortable with the position that the bank has today.

In page 14, we can check the short term delinquency, which is still improving in consumer. We know that for the next quarter, probably we will see some increase in the short term delinquency as we have had in all the years before in this series here since 2009. This is a seasonality that we have in Brazil. So we expect this to improve a little bit, to increase a little bit, and but we believe that overall trend over the year is a positive one in terms of improvements.

Small companies, as I mentioned, it slowed a little bit more given sometimes you have companies specific case of those in delinquency. So it slowed a little bit. But overall, we believe that the level of delinquencies will stay stable.

Okay. This is what I had for the loan business. Let me talk now about the insurance and service business that we have, which is an important part of our franchise. As I mentioned to you, the biggest part of our profit stems from that business and I'd like to share with you the way we see that business and how strong is that business, which by the way, and it's important to note, is a business that is not related to the economic cycle in terms of - it's much more sustainable over time. It might grow more or less, depending on GDP. But it's a sustainable business with growing net income over time. Returns here are very high, given the fact that we have the clients already in the way. It's a strong franchise. We attract a lot of clients.

We break down this column here on page 16 showing you of the major service business that we have to take, starting with the insurance business, then we have REDE, which is the old credit card business, cash management, asset management, deposits and asset liability management. We can see improvements in all these lines compared to the previous years.

Hedge particularly had a great year, a great improvement since we acquired REDE two years ago. We have been improving the quality of services, the efficiency, the expenses, which were stable, by the way, during this year. So we kept flat expenses and this resulted in a huge improvement in our recurring results.

Cash management is also an important business for us, also growing. Asset management as well. Deposits is an important part of our banking franchise. It's a strong source of revenue for our commercial bank. It's important not only from the perspective of a stable funding source but also in terms of revenue, which also helps to pay the high cost of the distribution on branches. So, on page 17, we have all these revenues here split, service revenues split by business lines, but I would like to move on to page 18, where we have our insurance business, which is improving.

Gross revenues has grown 10.6%, but we have to be careful here given the fact that we are selling some of the business, like I mentioned, we sold the big risk business, so we lost revenue in the last quarter. We are disactivating some business lines and concentrating in the more profitable business.

The characteristic of our insurance business is very particular in many ways, especially when you look at the level of claims that we have. It's a very low claim business, 27%, 28% claim level. It's very strong because it's a life business, basically. We have more here the low-risk levels of insurance, so this is quite sustainable.

It's a business that is quite profitable and the level of profitability has been growing above the level of revenues, specifically because we are restructuring the business, concentrating on more profitable business, and more low-risk kind of insurance deals. And we believe that over time, this will be the trends, high growth here in terms of profitability and profits in general.

REDE has had a good year as we can see in the screen 19. The volume of transactions grew 11%. The revenues grew 12%, so we had a good MDR, basically stable MDR compared to last year. Expenses were pretty much under control, although we had a great increase in our presence in clients and points of sale in general. So, it was a good improvement. So, the level of revenue coming from equipment had an important growth here.

And also, the financial revenues has 60% almost increase, very strong increase. So, altogether, we were able to increase the growth here in net income by 27%. So, it was a very strong year, very good year. We are very happy about the acquisition, the improvements that we have made in this business, and the perspective that we, looking ahead, we have in that business.

Other services in page 20 are very strong business for us. We look at them as a long-term business. We have a strong business in asset management. We manage almost BRL 669 billion out of our balance sheet. It's an important business for us, and we like that business and it give us a strong revenue of BRL 2.1 billion, so it's important source of revenue for the bank as a business. Funds from clients, basically deposits, we have BRL 447 billion of deposits which brings us margins savings (25:45) and it's a good business for our retail operation, and also as a source of funding for the bank itself.

Consortium is also another important and fast-growing business that we have with revenues growing very rapidly. Other business we like, that low risk, associated risk with those business. So, this is important source of revenue and very stable and sustainable over time.

Cash management, which accounts basically for current accounts, revenue, together with payments in general and receivables that we, service that we do for clients is also growing and important source of business and revenues for us. So, altogether, the business of services and insurance, it's an important business and it's important source of revenue, very stable, very sustainable over time. So, this is part of the business model that we have today, important part of the business model.

On the other side of our balance sheet of our P&L, we have expenses which we have been keeping under strict control this year. As we can see on screen 21, we had a 7% growth, just a little bit above inflation in a comparable basis, not including credit card here. So, the expenses growing in a much lower speed than revenues in general, which is something that we keep – we have in mind to keep this way for the years ahead.

Efficiency ratio has been improving as a result of that and particularly, the efficiency ratio adjusted to risk, also it's improving, reaching the level that we have never had in the past for the bank. We are very comfortable with the capital position of the bank today, as we can see on page 22. We have already under the current rules of Basel III, fully applied today, so phasing in right now. We will have above 10%, almost 11% level of core equity Tier 1. So, it's a very comfortable position and we still have improvements as we offset the tax loss that we are carrying today in our balance sheet, and we optimize some investments, we might reach 12%.

So the bank today is in a very strong of capital. We do not see any need for capital in the future, so that's to Basel III. In terms of guidance for 2014, I think we had a great year in terms of loan portfolio. We are not there, but we were very close. 10% was a low range guidance. We have 9.8%, especially given the situation, the macroeconomic situation that deteriorated during the year, I think it was a good number to achieve.

Our loan-loss provisions were in the low end of our expectation. The revenues coming from services and insurance was in the higher end of our guidance. Expenses, also in the lower end. Efficiency ratio was even above the best guess that we had at that moment.

For 2015, we expect a little bit lower growth in general in terms of margins and services and loan portfolio, as we can observe on screen 24 compared to 2014. Growth on revenues will be lower but still growing, outgrowing expenses. And we believe that we can keep provisions pretty much under control, between BRL 13 billion and BRL 15 billion, which by the way was the same range that we gave you for 2014.

So we believe that provisions, even though the scenario is more difficult, even though we have a perspective of much lower growth this year than last year, even though we have Petrobras and Lava Jato and all the problems that will arise from that, even though all those things, we expect to be in that range.

Thank you. And now, we are open to answer questions.

Q&A

Operator

Ladies and gentlemen, we will now begin the question-and-answer session. Our first question comes from Jorge Kuri, Morgan Stanley.

Q - Jorge Kuri {BIO 3937764 <GO>}

Hi. Sorry. Good morning, everyone. Thanks for the call. A couple of questions. You're obviously very positive on the outlook for delinquency in 2015. I guess it would help to understand what sort of macro and industry backdrop are you basing those assumptions? Meaning, how much do you expect unemployment to go up? Are you expecting electricity rationing? What sort of GDP growth assumptions you have? To what extent you are assuming or not that there is a bigger problem with the oil and gas companies?

So just a little bit of that background, so we can understand at what point you would change that view, say, if you think delinquency is going to be flat, because you don't think unemployment is going to go up, well, then, if we see unemployment go up, then we can think about another scenario? So that would be my first question.

And then, the second question is regarding credit cards. I think you've correctly pointed out that you've changed the structure of your loan book moving out of car loans and more into payroll loans which - and mortgages, which do have lower risk. But we do see that the portion that is on credit cards has actually increased a lot, I think it's like 32% of your total loan - consumer loans and it's actually the biggest portion of your consumer loans. That number compares to 10% to 15% of your peers. So you're significantly more exposed to that.

So thinking about a difficult year, thinking about a year with recession, a year in which unemployment may go up for the first time in a long time, which we're already seeing now and knowing by looking at every single credit cycle in emerging markets and developed markets over the last 50 years. Credit cards are normally the product that does the worst in a scenario where unemployment goes up, as the first thing people stop paying.

So, just curious to understand, what is it that gives you confidence that even though you are by far the largest exposed to credit cards and if credit cards do the worst in a difficult employment macro scenario, what gives you comfort that that's not going to play out against you? And obviously, in the understanding that you have like around 40% to 50% market share of credit cards in Brazil, so they cannot all be to A and B clients. You probably have a lot of exposure to lower tier clients. Those are my two questions. Thank you.

A - Roberto Egydio Setúbal

Thank you, Jorge, for the questions. I think they are very important points to clarify. I think the points are very important, especially given the macro scenario that everybody including us are seeing for Brazil this year of 2015.

Starting with the scenario, we - I believe that and we believe in those numbers are based on a scenario that growth will be close to zero, maybe negative, maybe a very small portion of positive, but very low growth. we do not expect this year unemployment rate to grow up more than 1%. It might go up, somehow we consider that it might, probably. And the year, maybe 1% above the current level, but not more than that. And I have to mention that today, we have a good portion of our consumer business is not related to people that - employed persons.

We have a business that also make loans to people that are self-employed, which is important portion of the Brazilian macroeconomic situation - design. I mean, Brazil have - we have 20 million people that are officially employed and more than 40 million people that are part of the population economically (35:47). So this is one portion of the problem.

I think - so we believe that there will be some additional influx, but what makes us to feel much more confident is the quality of the origination that we have today and the amount of data that we have today.

Today, we have access to the level of indebtedness of any client in Brazil through the Central Bank database. We have a lot of data, given our presence in the market, about the clients' payments customs, level of income. So we have a lot of data to figure out the quality and the level of indebtedness of and the level of income of all the clients. And the quality of the origination that we have today in our portfolio, it's a very good one. So this makes me feel very, very comfortable about the outlook for the level - the quality of delinquency.

It's clear that as the economic - macroeconomic situation, if it deteriorates, probably we might have some deterioration also in delinquency, but we really do not see this having a major impact this year. We believe that if we have an impact, might be down the road because this year, probably it won't have the time to have the effect in P&L, given the quality that we have today in our books, given the quality of origination that we are doing, and given all the monitoring that we have been doing in our portfolios. We have been – every month, we look very carefully through all the leading indicators, the quality of the portfolio that has been originated, and we have been correcting any kind of deviation that we see.

So, for the time being, there's no sign at all of any problems especially in the consumer portfolio. And in the credit card portfolio, you are right, we have a strong presence in that market. We take it a lot of – when I say monitoring, we monitor everything in that business, especially because of our big exposure there. Again, we have seen already in the last month some changes, some deterioration here and there. But we were able to correct them most on line (38:24), okay?

So, it has not been affecting the overall performance of that portfolio, because there are minor things here and there and regions of Brazil that are suffering a little bit more some segments of clients and we have been tightening in, so that we correct all those effects. So far, we don't see again any kind of deterioration there. And we have been keeping a very strong control on that portfolio.

We have a portfolio, as we mentioned that are in segments A and B. Clearly, we have a huge concentration there, because the bank is very strong in those markets. But as you mentioned, we also have some exposure to C clients, although, much smaller in terms of portfolio compared to what we have in A and B.

Did I answer all of your questions? I think so. If you have anything else, please ask me.

Q - Jorge Kuri {BIO 3937764 <GO>}

No. Thanks, Roberto, for the detailed explanation and congrats on 2014.

A - Roberto Egydio Setúbal

Thank you.

Operator

Our next question comes from Philip Finch, UBS.

Q - Philip J. Finch {BIO 3252809 <GO>}

Good afternoon, Mr. Setúbal. Thank you very much for the conference's presentation. I've got a couple of questions as well, please. First, it's to do with your capital position which clearly has improved dramatically and impressively in recent quarters. My question is two-fold here. One is going forward, given that your balance sheet growth is going to be pretty limited given the macro environment and giving you very high levels of ROEs and retained earnings, this capital position is going to clearly rise quite dramatically going forward. So, the question here, two-fold. One is, what sort of optimal level of capital are you targeting? And secondly, with excess capital, how do you – how are you considering deploying that going forward in terms of paying more interest on capital or is this part of building up some sort of war chest to make acquisitions?

And secondly, my question is to do with your ROE, which again has impressed in terms of the improvement we've seen in recent quarters. Again, what is the sustainable level here? Are we at the optimal level? And again, working against you here is your capital position, the equity's getting larger and larger and that's obviously putting pressure on that ROE? Thank you.

A - Roberto Egydio Setúbal

Start with the capital position, I think that we recently – we have all those changes in the regulatory capital requirements, so we have been – having to accumulate more capital in order to comply with

Basel III statistically. It's not totally clear all the requirements that might come ahead. I think we probably have gotten 80% of the regulatory requirements. But there's still some questions, some things open that might made us need some additional regulatory capital looking from today.

But assuming that we achieve those levels and we are comfortable, basically today, we believe that being at the level of 11.5% or something like that in terms of core equity Tier 1. For the current level of capital requirements, we believe that we would be in a good position. So assuming that we at some point in time in the short future, we achieve that position which we are not there today, we at this level of ROE and distributing basically one-third of our profit as we have been doing, we will be accumulating capital, because growth will not be like 15%, at least this year and next year. So we'll be generating more capital than we probably will need.

I think that there will be two ways of using that we today would consider to do to use the capital. One is future acquisitions, which we don't see today. I mean, they might happen. We don't see anything in Brazil and not anything in Latin America, which are areas that we could be looking for additional opportunities. We don't envision anything today in the U.S. or Europe or Africa or Asia. We don't see anything that we might be interested in. We are focusing basically in Latin America. So those are the markets that we are busy.

I think that in Latin America in general, assets are still expensive compared to Brazil. I think, as the economic cycle takes place, I mean, with the fall of price and commodities, I think all these will probably affect more positivity relativity Brazil to other markets in Latin America, making maybe things more attractive in the future. But for the time being, we don't see anything to use the cap.

So – and the additional – the alternative use for capital would be the acquisitions of shares. I think that as we feel comfortable with the level of capital that the bank has, as we have done in the past, and given the current level of price of our share, we believe that we might have an opportunity to acquire buyback shares to the bank.

Q - Philip J. Finch {BIO 3252809 <GO>}

Right. Thank you very much, indeed.

Operator

Our next question comes from Carlos Macedo, Goldman Sachs.

Q - Carlos Macedo {BIO 15158925 <GO>}

Hi. Good afternoon, Roberto. Congratulations on the strong results in the fourth quarter. A couple of questions. Really, the first one, it's two questions on the same theme and it's your guidance for margins. It's fairly robust, even though you did expand quite significantly in 2014 on the back of it. Just trying to give – set up the stage a bit. The average SELIC in 2014 was up 260 basis points from the average SELIC in 2013. We're looking at 2015 being up half of that, 130 basis points. We know from prior calls that you're exposed around BRL 600 million in your financial margin for every 100 basis points. So, all those equal, that's what we expect. We know that there's still the repricing of the back book even though over 30% of your books originated in the current quarter. So, a part of that's already done. And we also know that there is a very significant shift in your loan mix.

Also, on top of that, from what we could see here, the big impact of the change in financial margin 2014 was in insurance and services as opposed to credit. Could you give us some color on what's behind that guidance, what you see for SELIC at the end of the year, what exactly will drive the margins to essentially increase year-on-year, since you're guiding for stronger growth in NII than you're guiding for loan growth? And then, I'll follow-up with another question.

A - Roberto Egydio Setúbal

Yes. Okay. The guidance for SELIC, we're not having a different view from the market. It's something between 12.5% and maybe on the top, maybe 13%. But I'm more towards 12.5%, and this was basically the number that we based the guidance. We are supposing a 12.5% SELIC rate during this year.

In terms of margins, yeah, one of the reasons is the SELIC – why the gross margins that we are guiding from – we are announcing the guidance for margin – financial margin of between 10% and 14%. One of the reasons for this that has been growing – outgrowing the loan portfolio is SELIC rate which has, on the average, in 2015 compared to 2014 will be higher. Second portion is the fact that we have been declining delinquency, this also adds to the margin additional revenue compared to the level of assets. Also, the fact that we are reducing growth, so when we take the average revenue that we have on loans compared to the previous year, given the deceleration of growth, this brings more revenue than loan growth.

So, there's a lot of small things that you add up and at the end, you come back to this level. Another thing which is important is the fact that we are re-pricing the stock of loans in higher spreads. We are not expecting any growth in spreads compared to what we have today. We based our views and our guidance on the current level of spreads. But the current level that we are practicing today of spreads is a little bit higher, especially in some segments, than it was one, two years ago. So the re-pricing of the portfolio is a favorable one. That's why altogether, all these we have margins outgrowing the loan book.

Q - Carlos Macedo {BIO 15158925 <GO>}

And surely, there's the mix effect that will work against that a bit. But also, you probably had that in 2014 as well, right, over 2013. My question is most of the increase in 2014 came from insurance and other services. Is that something that we can expect to happen again in 2015?

A - Roberto Egydio Setúbal

Well, insurance is not an important factor in the financial margin. I'm not sure if this is what you are talking about.

Q - Carlos Macedo {BIO 15158925 <GO>}

It's just that the breakdown that you provided us this quarter, it went from BRL 10 billion to BRL 14 billion so, a 35% growth there.

A - Roberto Egydio Setúbal

Let me check what are you referring to.

Q - Carlos Macedo {BIO 15158925 <GO>}

Page 16 on your presentation.

A - Roberto Egydio Setúbal

Okay, on there.

Q - Carlos Macedo {BIO 15158925 <GO>}

Just most of the increase came from there. I'm just wondering if we're going to see – and the asset liability line is where it went from BRL 1.3 billion to BRL 3.2 billion, which was the biggest increase in that specific segment. I'm just wondering if we're going to see the similar thing in 2015?

A - Roberto Egydio Setúbal

There's some fees in 2015, and this is also is part of this process that I described it to you of repricing and things. But this is also already taken into account in the financial market, yes.

Q - Carlos Macedo {BIO 15158925 <GO>}

Okay. Just a follow-up question on that. Over the last couple of quarters, your trading business, treasury business has done much better than in prior quarters. And we also saw the VAR, at least under the new methodology that you're using to calculate it, increase. Should we expect both things to stay higher going forward? Is that a new strategy for the bank or is it just something that happened as you were taking opportunities in the last couple of quarters?

A - Roberto Egydio Setúbal

Okay. If you are referring to page 11, page 11, we have the financial margins with market that we mentioned here. It has been stronger than the last year, I mean sustainable, but this is not really trading business. A good portion of this ALM revenue is in here, okay? So, the portion of trading revenue coming here, it's very small. It's the smallest part here. So, what we have really is much more ALM kind of revenue. So the trading, we do not expect any major difference of trading compared to what we have this year, the year 2014, or even the – the year of 2014, as a matter of fact, was not a great year in terms of trading. It was below 2013. And we do not expect that to really increase. The banking book is the one who is really making more difference.

Q - Carlos Macedo {BIO 15158925 <GO>}

Okay. Thank you. Thank you, Roberto.

A - Roberto Egydio Setúbal

Thank you.

Operator

Our next question comes from Tito LaBarta, Deutsche Bank.

Q - Tito LaBarta {BIO 20837559 <GO>}

Hi. Good morning or good afternoon for you and thanks for the call. A couple of questions, just following up on the asset quality a little bit, you did book some additional provisions in the quarter. I just want to understand a little bit more the rationale behind that. Was it specifically related to Petrobras or just what kind of drove that and what could drive that in the future? What are you concerned about there that had you do those additional provisions? And then a second question, just saw some headlines talking about succession plans could be starting on April. Maybe if you could give some more color on that in terms of the timing, potential candidates for CEO? If you could give any color on that or just how you see that evolving? Thank you.

A - Roberto Egydio Setúbal

Okay. Starting with succession plans. I still have two years to go, so it's something that is down the road. It's not something that we are really discussing today. What we'll be announcing is the Head of Wholesale and Head of Retail Business as an additional step to that. This will take place till the first – till April of this year, so it was not something – the process is going on, and it will be a natural process inside the bank. I have been more recently delegating more and more, so this will be a natural process that will go ahead this year.

In terms of provisions that we have made last quarter, additional provisions, I think that we had – looking ahead, we see a year that will be a tough year. There's a lot of uncertainty around all those issues on Petrobras, on Lava Jato, on the corporate side, how this will impact constructors. So we're observing this and the level of growth that we foresee. We thought that it'd be a good idea to make additional provisions for all this expectation.

Q - Tito LaBarta {BIO 20837559 <GO>}

So were you just taking advantage, say, of the gain you had from the large risk insurance operations, maybe offset that with the additional provisions, being more just kind of precautionary than anything?

A - Roberto Egydio Setúbal

No. I think that we would say that this was much more given the recent deterioration of the scenario in Brazil.

Q - Tito LaBarta {BIO 20837559 <GO>}

Great, all right. Thank you very much.

Operator

Our next question comes from Mario Pierry, Merrill Lynch.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. Good morning. Congratulations on the very strong results. I have two questions, Roberto. The first one is related to your guidance for provisions of BRL 13 billion to 15 billion. If you could help us understand or give us a breakdown on how do you see this provisions between corporate and consumer? And also related to this, as you showed in your presentation, your coverage ratio now is at 193%, where do you think that this ratio is going to get to by the end of the year?

And then my second question is related to Redecard or REDE. We appreciate the improved disclosure that you are giving to us, and we noticed that REDE has gained market share now for two consecutive quarters after losing market share for about a year and a half.

However, your market share still is well below historic level. So, if you can give us more color specifically on REDE, what kind of growth rates do you think we could see out of the business and where do you think your market share can evolve to? Thank you.

A - Roberto Egydio Setúbal

Okay. Starting with the coverage ratio on those guidance of provisions, BRL 13 billion to BRL 15 billion, we do not foresee any reduction in the coverage ratio, okay. We are keeping the level of coverage ratio to reach this level of guidance.

In terms of how much provisions we think that we will have of this BRL 13 billion to BRL 15 billion on consumers and how much to companies and coverage, the only thing that I can tell you is the fact that compared to this year, we will have less provisions on consumers and more provisions on companies. I think this is what I can tell you.

In terms of REDE, you're right. REDE has been recovering market share. I think that's the beginning when we started operating REDE after the acquisition, we put a lot of effort in terms of integrating needs with the bank, reducing costs and expenses in general, improving the level of quality for clients, and this effort is paying off. I think that - and also, the alignment of the interest of REDE with the interest of the bank itself for the small business segment has been very strong. So, I think we are in a good moment. I think we implemented the right strategies. And we definitely have been doing a good job in terms of recovering market share during these last two quarters.

Q - Mario Pierry {BIO 1505554 <GO>}

All right. Thank you.

Operator

Our next question comes from Saul Martinez, JPMorgan.

Q - Saul Martinez {BIO 5811266 <GO>}

Hi. Good afternoon. I know this question is going to come across as a little bit repetitive, so I apologize in light of all the questions and the discussion, the Portuguese call and your prepared remarks, earlier question on this call, but I there is a bit of a disconnect between investors and the market participants and what we're hearing about Lava Jato, rationing, the economy, very, very negative headlines and views on Brazil, and your guidance and Bradesco's guidance on loan-loss provisions where you're expressing confidence that things will be – things are fine.

So, my question is more on corporate credit specifically and if you can elaborate more specifically on why you feel okay, in light of Lava Jato, in light of rationalizing risk? And is there anything you can share with us in terms of perhaps structure of the loans, type of borrowers, collateral cash flows of borrowers, anything that can make us feel more comfortable and help us bridge the gap as to why you feel comfortable with corporate credit in light of what seems like a pretty difficult environment?

And secondly, I believe in the Portuguese call, you actually said that the economics plan issue is something that worries you or that is a bigger risk factor for you and for the banking system than Lava Jato. Is there anything new there, anything you would be willing to share in terms of what your expectations are with the economics plan issue and what your thoughts are on the potential for that to come before the Supreme Court?

A - Roberto Egydio Setúbal

Starting with the economic plan and going into Lava Jato, I was asked what would be my worries looking ahead. And among the alternatives that was given to me was mentioned the plan economico (59:49). So, I think that plan economico (59:51) is not something that is worrying me. As a matter of fact, I'm much less worried today on plan economico (59:58) than I was one year ago. I think things have been moving into the right direction and I think the understanding of the issue itself is much more clear today. The fact that the banks have not gained anything on the economic plans and they basically have implemented what the law required us to do, is becoming much more clear to everybody. So, I think the outcome would be positive.

For sure, I worry about that issue because we don't have a final outcome and the numbers might be big. But I'm very optimistic about a good outcome on that section. But given the fact that the number is a big number, I worry about it. I do not worry about that much on Lava Jato in terms of direct exposure that we have there. That's why I say the exposure that we have, the companies that are involved in Lava Jato are relatively small, assuming that Petrobras – I'm not including Petrobras on that. Although we don't have a big exposure on Petrobras. I'm very confident Petrobras is not under risk of default.

And the companies that we have exposure in terms of – that has been involved in Lava Jato, first of all, the exposures are relatively small. Second, most of the companies that we are talking about in terms of our exposure are groups and not companies exactly, but are groups that have much more assets out of that kind of activity. So – and we believe that if they have problems in some – in the construction business, they have other business and assets that they might sell in a strategy (1:01:54) that makes us to feel very comfortable about the numbers that we have exposed.

It's important also to understand that there's a number rolling out the press about BRL 130 billion exposure of the Brazilian banking system to companies that are involved within Lava Jato. In reality, this is a misleading number, because when we talk about BRL 130 billion, this includes our companies of those groups. So if you look at some of the groups that were mentioned in Lava

Jato, many of them have - the biggest ones have a lot of other business and business that has nothing to do with the construction company.

And the number of BRL 130 billion includes all the exposure of all other companies that has nothing to do with Lava Jato. It's basically companies that have partially the same shareholder, but not necessarily all the shareholders, because many of those companies are even listed companies.

So, all the exposure that we have there are included in that number of BRL 130 billion. When you takes the number of companies itself that are really involved in Lava Jato, it is a much, much smaller number. And a good portion of this number is - our numbers - a good portion of this number has collaterals and things.

In our case, we feel very comfortable with the level of exposure that we have. It's really not meaningful for us, even if something goes wrong directly there, we do not expect that this BRL 13 billion to BRL 15 billion number will be affected. We are very comfortable with the exposure in Lava Jato and all those things.

Q - Saul Martinez {BIO 5811266 <GO>}

Okay. That's great. So, just a follow-up. I know you say you don't see any risk at all with Petrobras going into default. But with Petrobras having had their ratings downgraded by the rating agencies, is there any risk? And I know your exposure is small. But is there any risk that you have to downward classify them into a higher risk bucket and that it could - that could trigger an additional amount of provisioning back at your bottom line?

A - Roberto Egydio Setúbal

Assuming that we keep in line with the international raters, the classification that we have in our balance sheet, this will not affect at all the level of provisions that we'll have to do for Petrobras. Even this downgrade, we had already downgraded before. We are a little bit even more conservative. We have more granularity in terms of ratings than the agencies. But we are pretty much comfortable with the level of rating that the agencies are giving to Petrobras. We are even more conservative than they are.

Q - Saul Martinez {BIO 5811266 <GO>}

Great. Thank you very much and congratulations on a very strong 2014.

A - Roberto Egydio Setúbal

Thank you.

Operator

Our next question comes from Boris Molina, Santander.

Q - Boris D. Molina {BIO 1904979 <GO>}

Yes. Good morning. Thank you for taking my question. I have a question regarding your presentation, and the new slides on the breakdown between credit and services. You mentioned that this is a business model, and we're going to review the business model. But I had the impression that the old business model was still valid, meaning a weaker bank and insurance, the car and consumer credit and wholesale banking.

So, my question is, did you entail a change in the way you measure and manage the business, or is this just an interesting set of slides so that we can see that Itaú does have, like other banks, fee-based businesses like Bradesco and Banco Brasil? However, you know - does it mean that you try to expand this to apply higher valuation, given this (01:06:11) percentage?

And the question comes because we know that Banco Brasil has been doing this asset revenue stripping in order to realize capital gains and support their capital ratios and help the treasury under a constrained fiscal position. But this breakdown of businesses doesn't make sense from the point of view at least, some of these businesses cannot exist without the other, no.

So, you can't really realistically expect us to assume a separation, because in the instances where these assets are being stripped, there's a huge degree of cost utilization that depresses the profitability of one segment versus the other and to a larger degree, is kind of like self-defeating or a zero-sum game.

So, what is your thinking regarding this? Is this a real change in the way you see or expect us to see the business? Are you going to continue to present the results under this format and not on the other format? What can we expect on this? Thank you.

A - Roberto Egydio Setúbal

I think this is a excellent question and give us more opportunity to discuss the business model. I think one very important change that we have made since two years ago, and now we are showing more results, more detail of that was the risk appetite. The risk appetite that we are implementing in our loan portfolio and the kind of pricing and everything is totally in accord with the capital requirement for that activity.

So, what we are trying to – which we did not really did before as strictly as we are doing now is the fact that we are pricing risk much more according to the risk itself in the capital needs that that business have, that clients have, that the loan have. So, the big difference that we are putting much more emphasis internally since 2012 to the fact that loans have to be – the use of capital has to be paid by itself.

So, the loan price and the loan activity today is much better priced than it used to be. This is a very important change because probably, looking back, if you go back many years, probably, we were operating loans below cost of cap, if you look only at loans.

Now, we are going in the direction of having loans, much better priced in terms of loan, especially in the low segment. And we are – and the corporate segment is more complex, but we do not consider reciprocity on services for medium and long-term loans. This has to be priced according to the capital that it uses. We do some calculation on reciprocity as – in a short-term loan but not in a long-term loan, okay. So, this is an important thing to see.

Another important issue is the fact that a good portion, very important portion of that business of services and loans – of services and insurance is not related to clients that has loans in the bank. So, I'm not saying that are independent business, but there's many, many clients, a good portion, as I mentioned, of that segment, does not take loans on the bank. Okay? And this is important to understand that. The bank is a bank, is one company, we are not considering to split it or to float any of those businesses.

But not necessarily the client of loans is the client of services. We have many – probably, we have more clients in number that do not take loan and have services with us as compared to clients that has loans and services. Because also in the loan business, we have clients and we are reducing it, but we do have clients that only take loans. So, the way we are looking at that is, okay, we have to adapt the bank to this situation. But loans have to pay for itself. That's the first idea. Second, it's not necessarily, this is important for you to understand, clients that are bringing me revenue on the services and insurance, not necessarily they have loans in the bank. Okay. So, this is very important also to understand.

So, when we look the business internally this way and we have all the internal targets and things and we have been increasing as we announced two years ago the importance of services in our business and all these happenings, technology everything. This is also consistent with this idea of increasing the level and the level of services and number of clients on services and also revenue on service. So, we are really trying to give more weight internally in our business to non-loan business.

Even though we believe that the bank will be always a bank, even though we like the loan business and – but we are – today, the vision is to manage the loan book in a much lower level of volatility with much lower risk. And we can do that without jeopardizing the service business, the insurance business. As you can see, we reduced in many segments our loan process and we reduced especially in the higher risk segment, without suffering on the revenue of services and without reducing our presence in service in general. So that's a very important point. The fact that clients are clients of the bank and we have a supermarket of service to offer, not necessarily clients that we – not necessarily clients that have credit with the bank, have loans on the bank are the ones who also – who really service from our service business. Is that okay?

Q - Boris D. Molina {BIO 1904979 <GO>}

Thank you. Yes. It's wonderful. And I had an additional question regarding your – the prior question of capital and the outlook going forward. Do you expect that when you expand across Latin America that local regulators will demand from Itaú subsidiaries capital levels consistent with what will eventually be a domestically significant financial institution for Brazilian regulation, meaning that you will probably see 100 basis points to 200 basis points capital surcharge? In the financial stability board recommendations, there is this caveat implying that, potentially in Chile, (01:13:44) which, after the merger, is going to be better capitalized but still short of the levels that we think the bank should have, would potentially face an additional capital surcharge. Is this something that you foresee either in Chile or in Mexico going forward?

A - Roberto Egydio Setúbal

That's a very important question, especially given the fact that we plan to increase our presence in other markets. Yes. There are differences between the capital requirements of Brazil, where we have our balance sheet consolidated and capital requirements in other jurisdictions.

In Brazil, we have higher capital requirements than compared to any other jurisdiction in Latin America, much higher. So when we do an acquisition, we plan to do something, any kind of M&A transaction in Latin America, we basically consider the current level and the future levels of capital requirements that Brazil requires.

So, this makes me less competitive compared to local investors, because I need more capital than local investors, who have only to comply with their own jurisdictions. So if other countries like Chile, Colombia, they come closer to Basel III, I'll be more competitive because the gap between the capital requirements here and there will reduce. Is that okay?

Q - Boris D. Molina {BIO 1904979 <GO>}

Yes, yes. Thank you so much.

Operator

Our next question comes from Victor Galliano, Barclays.

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

Hello. Yeah. Most of my questions have been answered. But hate to beat – flog a dead horse here, but if we can go back to the credit quality question. And one of the things that you did mention was about how much better your credit quality assessment was now and using, in part, the Central Bank's database. Is there anything that has changed in terms of your sourcing of credit and how you assess credit risk, in particular with regard to consumers that is independent of the database, in other words, internally? And you can give us any color on how that's changed over the last year, year and a half, two years since you made the strategic decision to move away from revolving credit, ex-credit cards, of course. Thank you.

A - Roberto Egydio Setúbal

Yes. There are many changes in the way we manage the risk of our loan, the consumer loan portfolio. In addition to check for all the clients the level of indebtedness, we also are much more conservative today on the collateral portion that we want for our loans, especially in the vehicle loans, we are requiring today much more collateral. So, the client basically have to have an equity in that loan so that we feel comfortable. That's one of the reasons why we have been reducing our presence in that segment. The level of collateral that we are requiring is much higher.

The level of income also is higher than we used to ask. So, we basically move it out a little bit of the subprime segments. We are today much more concentrated in A and B segments compared to what we were two years ago.

There are many other specific details, but basically, the whole policy for credit has changed. It's much more detailed and carefully monitored, so that we monitor region by region. We monitor a lot of things that we do not used to do. But basically a lot of small things like those that I mentioned have changed.

Operator

Our next question comes from Nada Oulidi, Loomis, Sayles.

Q - Nada Oulidi {BIO 18241914 <GO>}

Hi. Good afternoon. Congratulations again on a very – yet another solid set of results. I had a couple of questions if – which I'd really be grateful if you could clarify. The first one is – and, again, sorry to go back to the question that kept being asked throughout the call. But could we please go back to slide 24 and your 2015 outlook for the provisions?

Could you please provide a bit more clarifications on your key assumptions for why the provisions forecast would be in line with last year's, especially that this year will be clearly a more challenging year from a macroeconomic perspective and also, we have the overhang of the car wash exposure? That's my first question.

My second question is related to CorpBanca. Could you please provide a bit more color on when you expect the transaction to be completed? And also, do you have any other expansion plans in Latin America for next year – for this year or next? Thank you.

A - Roberto Egydio Setúbal

Okay. Thank you. First, we do not envision any transaction in Latin America for this year, anything relevant. We envision that probably before end of this first semester, beginning of second semester, we should have all the approvals and we should start consolidating CorpBanca in our balance sheet. Things are moving a little bit slower than we would expect, but that's the way things happen with regulators and things.

On that guidance on loan loss provisions, I can understand that you guys feel surprised with the level of provisions, giving the fact that the macroeconomic situation, it's getting worse. And basically, why I do feel comfortable with the guidance that we gave you, basically because we started two years ago moving into a more conservative model two years ago. It was in 2012, moving to a more conservative kind of risk appetite.

So all the loans that we have been originating since then have been under a different level of risk, much lower risk. That's why since then, if you look our numbers on credit policy and delinquency, we have been improving, basically because we - at the beginning, very first moment when we start to put up this kind of policy, we had a mix of much more loans that we have underwritten in the old, let's put this way, in the old previous risk appetite and a small portion of the ones that were underwritten in this new risk appetite.

Since then, I mean, we are moving out of the loans that were underwritten in the old risk appetite and moving into this new quality of loans, much better quality of loans under the new risk appetite. So that's why we have been improving the risk quality of our total portfolio.

We have not gone through all these processes. We still have in our books loans that were underwritten under the old risk appetite, and that's why we are still, even this year, which was a very bad year in terms of economic development, growth was close to zero. And by the way, we have - these last two years, we have had very low level of growth in Brazil. So, the next year growth won't be that much different from what we have had these last two years.

So, even though we have been improving our risk - our delinquency ratio exactly because of this mix of new risk appetite underwritten loans and old ones, so we are more and more moving towards - to get to a point probably along this year of having probably 95% of our loans under the new risk appetite model. So that's why we believe that we are still in a mood of improving things. I'm not saying if we had stable risk appetite, even the new one, probably we would see a situation that we would show some deterioration.

But the situation that we expect today is much smaller than the benefits that are still coming from cleaning up the books and improving the mix that we are still under way. Okay?

Q - Nada Oulidi {BIO 18241914 <GO>}

Sure. So, essentially the €13 billion to €15 billion incorporate both the benefits from this derisking which has taken place a few years back.

A - Roberto Egydio Setúbal

Yes.

Q - Nada Oulidi {BIO 18241914 <GO>}

Plus the cost from the Lava Jato exposures.

A - Roberto Egydio Setúbal

Yes. You are right. And by the way, one important comment is that if we had a more earning, if you look only the consumer portfolio, probably 2015 compared to 2014 would have a lower level provisions. And on the company's side, we would see an increase in provisions year-to-year. So at the end, that's why at the end, more or less, they balance each other, they offset each other.

Q - Nada Oulidi {BIO 18241914 <GO>}

Thank you very much.

Operator

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

A - Roberto Egydio Setúbal

Okay. Thank you very much for having the opportunity to talk to you and showing why we are positive about the 2015 year. And I was very glad also to share the views about our business model, which we'll get in more details in future presentations.

Thank you, all, for being with us and for the questions. Thank you. Bye bye.

Operator

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