Q3 2014 Earnings Call

Company Participants

- Alfredo Egydio Setubal
- Marcelo Kopel

Other Participants

- Boris D. Molina
- Carlos Macedo
- Marcelo Telles
- Mario Pierry
- Philip J. Finch
- Saul Martinez
- Tito LaBarta

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentlemen. Welcome to Itaú Unibanco Holding Conference Call to discuss 2014 Third Quarter Results. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session and instructions will be given at that time. As a reminder, this conference is being recorded and broadcasted 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 November 11 by phone on 5511-3193-1012 or 2820-4012, access code 1599139#. 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 comment as a result of macroeconomic conditions, market risks and other factors.

With us today in this conference call in São Paulo are Mr. Alfredo Egydio Setubal, Executive Vice President and Investor Relations Officer; Mr. Caio Ibrahim David, Executive Vice President & CFO; and Mr. Marcelo Kopel, Corporate Controller Director and Head of Investor Relations. First, Mr. Alfredo Setubal will comment on 2014 third quarter results. Afterwards, management will be available for a question-and-answer session.

It's now my pleasure to turn the call over to Mr. Alfredo Setubal.

Alfredo Egydio Setubal {BIO 1528623 <GO>}

Thank you. Good morning for those who are in the US. Good afternoon for those who are in Europe. It's a pleasure for us to be here to comment about our third quarter results. For those who are following through the Internet, we are starting on slide number two, the highlights for the quarter.

First one, of course, is the results, the net income. The recurring net income of BRL5.5 billion, which is a solid growth from the second quarter of almost 10% and 34% when we compare to nine months of last year. These solid results provide a recurring ROE of 24.7%. That is the highest ROE in the last years when we compare the quarters, with an increase of 100 basis points from the second quarter and 380 basis points when we compare to last year.

The better credit quality of our credit portfolio, we are also in the lowest level in the history of the bank, 3.2%, when we consider the NPL over 90 days. We were able to improve 20 basis points this quarter and 70 basis points when we compare to last year.

Margin with clients was also again a solid quarter in terms of revenues from the operations from our clients, both in terms of credit, in terms of services, BRL13.3 billion in the quarter. Financial margin with the market was the best quarter when we compare to the last two years. The conditions of the market and the positions that we're taking and the hedge and everything worked very well this quarter, even though the volatility of the local market and international market. But, anyway, it was a quarter above the historical average. It was a very good performance for us.

Loan loss provisions, BRL4.7 billion, which is an increase of 6.2% when we compare to the second quarter. This increase in provisions were more related to the reclassification that were made in some large companies related to some sectors that are not performing very well in the economy. It was more related to these points in these companies and it is not a trend in our view. It was more a point that in our analysis required a little bit more provisions due to the reduction of our internal rating.

Fees and result from insurance also was a good quarter. We continued to focus a lot in terms of fees and insurance products, the growth in the last 12 months of almost of 15%. This quarter, 4%. If we not consider the Credicard acquisition that was made last December, the growth in nine months, to make things more comparable, would be 11.5%. So I think the strategy of growing fees is correct and we are delivering a good growth in this line.

In terms of expenses, BRL9.8 billion in the quarter. We increased 10.8% in the year, in line with the guidance that we provided to the market at the beginning of the year. Because of the acquisition of the Credicard bank from Citibank in December last year, we are having more expenses, especially in technology. As we announced, we built a huge and very modern new data center and we are running the bank with three data centers at this point because we are just starting to transfer the systems slowly to the new data centers in a process that will take more than one year.

So in terms of expenses related to technology and to these data centers, we are going to have again next year yet with some extra expenses. And probably we are going to shut down one of these three data centers only in 2016, 2017. So we are going to carry some extra expenses in the coming quarters related to this. If we do not consider the Credicard, to make things comparable again, we can see that the growth of expenses were 7.6% in nine months, but it's a little bit above the inflation index, 1%. But it is good number when we consider all these extra expenses related to technology that we are incurring.

In terms of efficiency, we reached 45.5%. I think we continue to improve in line with the guidance. The loan portfolio, due to the lower pace of the economy this year in Brazil in last quarter, the growth of the portfolio is not so good. We have 3.2% in the quarter and 10.2% in 12 months. If we include the private securities that we carry, this growth would be 11.5% in 12 months. But the economy is not performing very well. So the credit portfolio and our policies to reduce the risk appetite of the bank in terms of credit expansion I think is in line with this strategy, the results, the growth of the credit portfolio.

On slide number three, the results are more open. I think we had a very solid operation revenues, BRL23.3 billion in this quarter with a growth of 5.4%. As I said, margin with clients was very good. The growth would mean that our core business, that is the business of the client is very solid and growing in a good pace.

Margin with market was, as I said, a very good quarter. It's difficult to forecast new quarters – coming quarters in terms of results from our hedge and our operations with the market proprietary desk and so on. But anyway, this quarter was very good. The second quarter was a good one also, but this was much better. It's difficult to forecast, as I said, in the coming quarters, but the volatility of the market and our position provided the result this quarter.

Commission and fees, as I said, was a very good quarter. I think the strategy of the bank in the last years to increase fees in terms of the acquisitions that we made in terms of (11:17) in terms of Credicard, I think is paying-off in terms of revenues and is also helping to reduce the dependence of our revenues from credits exclusively. So, I think the strategy is good. The results from insurance also is a good one, before claims, BRL2.4 billion, also in line with the strategy of growing in terms of Bancassurance with products that we can sell through our branches, through our managers and through the internet. So I think we are concentrating more and more in these product lines and I think also the results (12:05).

In terms of provisions, we have increase in provisions from loan losses, more related to the reclassification of some clients from large companies in some specific sectors. So, this is not a trend in our view in terms of increasing the loan loss provisions but more related to these companies. Recovery of credit also was higher this quarter. Also, because we cover specially a one client – one large company also made influence in these numbers, but the trend is quite stable for the coming quarters in terms of recovery of credit in the average that we have in the last quarters.

Expenses – non-interest expenses, 9.7%, as I said, a little in line with the expectations of the guidance that we provided at the beginning of the year. And we will continue to be very focused in the coming years in terms of controlling and getting more efficiency, especially with the huge investments that we are taking in terms of technology, new systems, new data center. I think this will help to get more efficiency and reduce and control more the level of expenses that we have.

At the end, we have this recurring (13:50) results of BRL5.4 billion, was a very good quarter with a very good ROE. We can see the ROE trends in the next page. Two years ago, before we changed the strategy of the bank, we reduced the risk of the credit portfolio and increased our revenue strategy in terms of services, in terms of fees, a 19.3% and this quarter, getting the benefits from this strategy, we achieved the 24.7%

In terms of loan portfolio on slide number five, we continue to grow payroll loans and mortgage in the in line of this strategy of reducing the risk. In terms of payroll loans, we bought this quarter again BRL4 billion from Banco BMG that was included in our JV with them. So, part of the growth of this portfolio that achieved BRL36 billion with a growth of 21.9% in this quarter was related to this BRL4 billion in terms of acquisition.

We continue to reduce the vehicle financing 8% this quarter. At the end, it was BRL31 billion portfolio. Just to remember that two years ago, or a little bit more, this portfolio was BRL61 billion. So, we reduced by half the car financing for individuals in these last years, in line with the strategy of reducing the credit risk.

In terms of companies, corporate continue to be our main driver. In terms of growth, BRL203 billion is our credit portfolio for large companies at the end of the quarter with a growth of 3.7%, even though the strength are not so good here but we continue to be believe that in this environment of low-growth of the economy, it's better to provide credit to large companies than to a small and very small, this segment of very small (16:38) are much more leveraged, and they suffer much more the results of delinquency with a very low pace of the economy.

In Latin America, we continue to grow. Here, it has also influence of the dollar, the real devaluation. But, anyway, we continue to increase, especially in Chile, our presence in the large companies segment. Private securities, BRL33 billion. So, at the end, we have a total credit exposure, BRL536 billion with a growth of 11.5% when we compare to last year.

On page six, we can see a more visual way the change in the credit portfolio that we made in the last year. At the bottom of this page, we can see what's made the influence in terms of financial margin with the clients. That jumped from BRL12.7 billion to BRL13.3 billion. We can see here that the more calendar days provide more revenues, accruals. Selic rates product operations also improved to BRL228 billion. It helped to improve this margin with the client and the increase of the loan operations of BRL144 billion. So, this is a breakdown of how we and why we increased the margin with the client.

On page seven, we can see the net interest margin. We see that the Selic rate has been growing in the last quarters and we have an increase last week also. But in terms of gross credit spreads, we are quite stable. The spread is stable. What is changing is that we are renewing our credit portfolio in higher rates than in the past. So, that's why we believe that the net interest margin will remain in these levels for the coming quarters.

On page eight, financial margin with the market. We can see here the volatility of this result. It's difficult or impossible to forecast what will come in the coming quarters. But anyway, this quarter specifically was the highest in the last two years. It wasn't a very good performance from our structural and from our proprietary desk in terms of market.

On page nine, we can see the trend of our NPL over 90 days. When we compare two years ago, the number was 5.2%. We reduced 200 basis points in this period with this policy of reducing the risk of the credit portfolio. In both individuals and companies, we were able to reduce the lowest level ever in the history of the bank and maintaining a very good coverage ratio of 181%.

On page 10, also in terms of credit quality, we can see the loan loss provisions expenses is 4.5% when we annualize to our total loan portfolio. A little bit of both in the last quarter in relation to this reclassification of credits in the large segment – large company segment. In terms of allowance for loan losses, we continue with a very solid level of provisions and we maintain BRL5.2 billion in terms of extraordinary provision.

On page 11, good sign also in terms of credit quality that the index of 15 days to 90 days NPL ratio continuing reducing the level. We finished with 2.6%, 10 basis points improvement when we compare to last quarter. What is a good trend for our next quarters in terms of provisions? We are not expecting provisions to increase much in the coming quarters.

On page 12, we can see here the commissions and fees in more detail. We continue to be very focused on products and services and insurance products to grow our revenues in these segments to reduce the dependency on credit revenues. So we can see here that the improvement was in the last 12 months, 14.7%. If we would not consider the Credicard acquisition that was made last December, this growth would be 11.5%. But it's continued to be a very good number. So I think the strategy continues to be correct.

On slide 13, we can see the breakdown between banking results and insurance results. We had BRL5.4 billion result of the bank. From this, BRL4.3 billion came from the banking operations and BRL880 million came from the insurance business. And related to the allocation of capital, we can see at the ROI of the bank operation was 25% and the ROI to insurance business, 78%.

On page 14, insurance operations in more detail. I think we continue to increase the results for the four quarters in a row. I think the strategy here also is to concentrate more and more in Bancassurance products that we can sell through our branches, through the internet to our client.

In terms of slide 15, our non-interest expenses, as I said, we continue to be very focused. This year we have more expenses. But anyway, if we exclude Credicard to make things more comparable, the growth was 7.6%, a little bit above the inflation, but in line with the extra costs that we have, especially in terms of technology investment.

On page 16, we can see here the capital ratios. We are generating capital. And here was an exercise to see how we would be in terms of capital (25:09) of Basel III. I think here it's not an issue. We are generating capital enough in this moment, of course more than we need because the credit portfolio is not growing much. But anyway, we have to keep this generation of capital to face the future when the credit portfolio will have a better performance and also to be open to new investment opportunities that can appear for us.

On page 17, we can see the liquidity of our shares, BRL830 billion per day, half and half between New York Exchange and BOVESPA. And our market cap close at BRL200 billion.

In terms of outlook, we are on page 18. We can see the outlook that we provided at the beginning of the year. We changed the growth of the loan portfolio, that was 10% to 13% at the beginning of the year. As the economy didn't perform very well, we will not reach these levels. And we announced to the market 15 days ago that our expectation now is below 10%, something around 8% in terms of the total growth of the portfolio for the full year of 2014.

The other one, we didn't change, the loan loss provision, net of recovery of credits between BRL13 billion and BRL15 billion. We've maintained this. Service fees and results of insurance, 12% to 14%. We also maintained this range. Non-interest expenses, 10.5% to 12.5%. Also, we maintained this level of the expenses. And efficiency ratio improvement from 50 basis points to 175 basis points. And also we keep this for the full year of this 2014.

On slide 19 we can see the strategic agenda. Bancassurance concentration, as I said, in terms of insurance. And we sold to the large risk business to ACE and it was approved last month by the regulators and this was finalized by the end of last month. And also, we announced the termination of the agreement that we have with Via Varejo to offer extended warranty in the retail network of Ponto Frio and Casa Bahia and we recovered part of the investment that we made upfront with them.

In terms of CorpBanca business in Chile, the merge between Itaú Chile and CorpBanca, we have the approval of the Central Bank of Brazil and now we are waiting for the next step in terms of approval from Banco Central de Chile and Colombia. (28:47) And we expect this to be finished the first quarter of next year.

In terms of mortgage and payroll business, we keep our leadership among the private bank, for us is important because of these two lines of credits that we are growing more in this strategy of reducing the risk of the credit portfolio. And to finalize for those who will be in Brazil in the coming weeks, we have a power presentation of Itaú Unibanco in Brazil on November 12. And also our main event with investors and shareholders that is our public presentation of São Paulo on December the 16. And everybody who can be here in Brazil, it'll be a pleasure to receive you there in both of these presentations.

This finalizes our first part of the conference call and now we are open to the questions.

Q&A

Operator

Ladies and gentlemen, we will now begin the question-and-answer session. Our first question comes from Philip Finch with UBS.

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

Yes. Good afternoon, gentlemen. Thank you for the presentation and the opportunity to ask some questions. First of all, can we just start macro-wise? What are your forecasts internally for GDP growth next year and the Selic? And related to that, what should we assume in terms of loan growth for you next year? Clearly, it's slowing down. Should we assume that trend continues next year?

And secondly, just in terms of the cost expenses, which you very helpfully explained, there were some distortions from the Credicard acquisition. But given the IT expenses and the data centers, you're still going to have three for the next year, or so, and it won't come down to two. Should we assume that cost growth should remain above inflation next year? Thank you very much.

A - Marcelo Kopel {BIO 16986304 <GO>}

Hi, Philip. It's Marcelo. Good afternoon. Regarding our view on the macro, what we have for GDP next year is 1.3% real growth. Selic, we envision finishing this year at 11.5% and next year at 12%. In terms of loan growth, we are still wrapping-up our budget process. But, as of now, it should be close to nominal GDP-plus-something, so that's where we are at the moment. We're going to be finalizing that and give you more transparency over the fourth quarter earnings call. Regarding IT expenses, you mentioned the data center which was mentioned by Alfredo. Our aim is to grow at inflation or inflation-plus. So, you may consider a small plus over inflation, given the data center investments but that shouldn't be a meaningful number, that plus that I mentioned to you.

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

Thanks very much, Marcelo. That was helpful.

Operator

Our next question comes from Tito LaBarta with Deutsche Bank.

Q - Tito LaBarta {BIO 20837559 <GO>}

Hi. Good morning or good afternoon in Brazil. A couple of questions. First, in terms of your net interest margin, you mentioned you expect it to remain relatively stable as you've been able to increase your spreads in some of your loans. But with the recent increase in rates and you had mentioned you expect the Selic to continue rising into next year, do you think there could be an upside to that or what will it be the sensitivity to the rising Selic? And then the second question in terms of asset quality. You continue to deliver pretty good results there with asset quality still improving. But at what point do you think that could start to shift and you could see some deterioration? I mean, is that maybe end of 2015, or do you think you could still see even further improvement? I just wanted to get a little more color on how you see asset quality continuing to evolve. Thank you.

A - Marcelo Kopel {BIO 16986304 <GO>}

Thank you, Tito. On NIM, our view is that it should remain relatively stable, given the different moving parts we have on that by, let's say, renewals coming at a higher rate than the previous rates but the mix shift still play a very important role, given the growth differential that you have between the different portfolios. So, that's something that should keep it relatively stable.

You mentioned the Selic rate. The market now is very competitive. The price dispersion that you see between banks has reduced. So, (34:26) much room for having – you could see increase in rates, but not necessarily an increase in spreads, given the competitiveness of the market. So, that's where we are regarding the Selic rates. And last, we see, let's say, a meaningful deterioration, where we basically were going to be risk-adjusting the price to reflect that. But that doesn't change our risk appetite. So, for that end, we should – don't see much change on the rates other than our own cash, which obviously benefits for the Selic rate.

Regarding asset quality, you asked at what point we could see a shift. I mean, the shift on the economy, we are – let's say, we are, let's say, less correlated to the economic environment now because of the mix shift. That should probably continue towards the next year, unless you see a major disruption, which is not our base case scenario. But you could see that changing towards the end of 2015 and starting in 2016. Meaning that, we're going to be more pegged – our, let's say, credit performance will be more pegged to the economy than it is now, because of the mix shift that we have.

Q - Tito LaBarta {BIO 20837559 <GO>}

Great. Thank you. That's very helpful.

Operator

Our next question comes from Carlos Macedo with Goldman Sachs.

Q - Carlos Macedo {BIO 15158925 <GO>}

Thank you. Good afternoon, gentlemen. Alfredo, Marcelo, I have a couple – one question, actually. I mean, looking at your ROE, almost 25% – it's about as high as it's been in the last several years – and the outlook that you've laid out with a weak GDP growth higher rates, your margins looking as they were going to be flat throughout the year, maybe you don't get the tailwinds from provision expenses that you had in the last few – in the last several quarters.

When you put all that together, it does look like earnings growth is going to be weaker next year than it was this year. Maybe 10% to 15%, something like that, which probably leads your margins to – or your ROE to contract from where it is now, given it is at a very high level. Is there anything the bank can do? I mean, on the expense side, on the fee side, or generally, to sustain the, kind of, growth that we've seen from earnings. I mean, potentially, if you do get some pressure in NPLs, it could be even lower than that. But is there the bank – any leverage the bank can pull outside of the – of what's pushed by the economy to sustain the level of growth in earnings?

A - Marcelo Kopel {BIO 16986304 <GO>}

Hi, Carlos. Thank you for your question. I mean, if you think that the – if we say that ROE let's say, just for argument's sake, is 24%, okay? And we pay a third of that as dividend. So, we are left with – we'd be 8% of this the 24% ROE. So, we are left with 16%. So, anything on earnings growth below 16% will be, let's say, a reduction in our ROE just to work the math.

So, basically, we are focusing on all the levers that you mentioned. On costs, we are focusing on increasing service to our clients. We are – the quality of the asset portfolio is helping us. The credit portfolio is helping us, but net-net what we could see – another avenue that we can see of growth is insurance. We're underpenetrated on insurance. But given the participation of insurance in the overall results, it's hard just to say that we're going to sustain the entire ROE or even grow the ROE based on that. And you correctly mention about the tailwinds we have on credit this year, which is something that is unusual for you to grow the portfolio, increase revenues, take less risk and reduce your credit cost.

So, it's, let's say, it's something that we would focus to do on the different levers. But it's hard to expect the ROE to be kept at nearly 25% next year.

Q - Carlos Macedo {BIO 15158925 <GO>}

So, I mean – so, it would be reasonable to say that we're at the peak of the cycle here. And I'm not talking specifically about Itaú necessarily, because several of your peers have had the same kind of behavior in terms of NPLs and – you're probably better but NPLs and margins.

A - Marcelo Kopel {BIO 16986304 <GO>}

Yeah. You could say that, let's say, a high point of our, let's say, historical path. I hope I'm wrong. But that's the alignment of several, let's say, positive factors that we have in this quarter. But net-net, we still are confident we're going to be delivering ROEs over the course of the next quarters over 20%, 20% plus.

Q - Carlos Macedo {BIO 15158925 <GO>}

Perfect. Thank you. A follow up to that is the scenario that you outlined is generally aligned with the market consensus for next year. You were talking about being a little bit less cyclical than in the past. How does that relationship evolve over time? If GDP growth slows to less than 1%, say, 0.5% next year and if we do see unemployment climbing up from 4.5%, 5% to 6%, 6.5%, is Itaú really that protected from a negative environment or a more negative environment than is currently expected?

A - Marcelo Kopel {BIO 16986304 <GO>}

Carlos, all the preparations, everything we started two-and-a-half years ago in terms of the derisking, the less dependency on credit revenue by means of increasing fees, everything was done to make the bank more resilient to, let's say, a downturn scenario. You could see upticks on, let's say, on certain credit lines like credit cards, overdrafts line which is basically what we spoke, I think, in the second quarter.

But the overall portfolio, to some extent, and I'll give you the auto financing portfolio as an example, our NPLs in this portfolio are going down even though the portfolio is reducing. So it's hard for you to reduce the NPLs when you're reducing a portfolio and our NPLs are going down there. So to some point or to some extent we believe we can shelter the pressure, but we will only know when we get there. Unfortunately, that's as much as we can give you in terms of clarity. So there are, let's say, lots of moving parts and, to some extent, we believe we are sheltered. But we'll see.

Q - Carlos Macedo {BIO 15158925 <GO>}

Okay. Thank you, Marcelo. Thank you for answering.

Operator

Our next question comes from Mario Pierry with Merrill Lynch.

Q - Mario Pierry {BIO 1505554 <GO>}

Hi. Good morning, everybody. And congratulations on a very strong quarter. Let me ask you two questions. The first one is related to the fee income growth. Excluding the acquisitions that you made, when we look at current account fees and loan operations, they're still growing close to double-digits. So I wanted to understand from you is your ability to increase prices to sustain fee income growing at a double-digit pace in the future? And if you could also comment on credit card. It seems like Rede finally was able to gain market share from competitors for the first time in almost two years. If you could tell us more about your strategy on credit card going forward. And then I'll ask a second question later.

A - Marcelo Kopel {BIO 16986304 <GO>}

So thank you, Mario. In terms of fee income growth, the big growth in this year hasn't really come from increase in prices, but basically the increase of services offered to clients and a large number of the clients buying into the new services that we are providing. We have differentiated services (42:46). We have MaxiConta with credit on your prepaid cell phones. We have a number of new packages and offers and clients did sign up for that. So basically that's where the increases are coming in current accounts. Insurance also is an avenue of growth for the following year. We mentioned Bancassurance, and that's a very promising area for us.

So part of the strategy is to continue to focus on that. Obviously, the credit card market is something that is probably going to be growing mid-teens next year. And a third of our fee line comes from credit cards, and that doesn't include the interest on credit cards, but also only includes the NVR from the acquirer (43:34) and the interchange that we – and the annual fees we have on the issuing side. So payment is an avenue that we will continue to grow. And the economy is still going to be moving and we are benefiting from that end. So if the fee growth next year is not something at mid-double-digits, it could be at least very low-double digit or high-single digits.

Regarding your question on Rede that we may have gained share, the strategy has been, since the delisting of the company, to have the bank working closer to Rede. Now we can see this crystallizing by the bank being closer. The new segmentation that we have on small companies, where these companies are being serviced in our branch network. So that brings the bank closer to the acquirer. That means the number of affiliations of the bank nearly doubled in the last 18 months to 12 months.

So Rede has been gaining ground and traction with the bank and that is reflecting in, let's say, more activation and more volume. So this is something that should continue and that was the primary objective of having Rede as part of the group or fully owned by the group, which is to be able to have a holistic approach to the clients.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. That was very thorough. Let me ask you then my second question is with regards to costs. Here, my concern is more like we'll continue to see a very weak economic environment. We're seeing your loan growth decelerating. And it seems like you're not too excited about loan growth next year either. So just wanted to get from you, how comfortable are you with your current head count or is there room for you to be reducing head count in the coming years if the economy doesn't improve?

A - Marcelo Kopel {BIO 16986304 <GO>}

Mario, we don't have targets for head count. I mean, we manage the bank based on being able to produce more and gain efficiency. So based on the churn we naturally have out of the bank, we're able to manage the head count. And if we have to manage the head count down, it's not going to be by a major restructuring, by proactively managing the turnover. And the people who can be retrained, we retrain them. We have a high rate of people who are retrained and relocated within the bank. But that gives us a buffer to manage, let's say, the banking more difficult times if we have to manage down the head count. But there is no restructuring program in place that we'll need to do it.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. Thank you very much.

Operator

Our next question comes from Marcelo Telles with Credit Suisse.

Q - Marcelo Telles {BIO 3560829 <GO>}

Hi. Good afternoon. Hello, everyone. Thanks for your time and congrats on the results. I have two questions. The first one, was there any impact in your result resulting from the depreciation of the real, or you were like pretty much hedged and there was no impact at all?

And the other question is regarding your provision expenses for the quarter. We saw there was quite a bit of an increase in provisions in the wholesale division of the bank, which would indicate something in line with what you said about some specific corporate loans that had to be provisioned for. So, do you think we can see, let's say, an improvement in provisions in the wholesale division in the coming quarters? Or do you expect those provisions to remain more or less at the same levels? Thank you.

A - Marcelo Kopel {BIO 16986304 <GO>}

Telles, thank you for your questions. We have no impact of the real depreciation. I mean, we were fully hedged on that. So, it's – no material changes in our number regarding that. Regarding the loan loss increase in wholesale, as Alfredo mentioned, we did change the rating of certain corporate names, no concentration on any specific economic sectors. And I mean, given the circumstances and what we see in the economy, this could happen in some names, but nothing that you could see as a trend.

So net-net, we will be managing the portfolio and keeping an eye on if there's specific loan loss increases that we need to do punctually or specifically, we will do. But in our radar screen, that was something that was done specifically in this quarter. But we are, let's say, vigilant regarding any specific change that needs to be done.

Q - Marcelo Telles {BIO 3560829 <GO>}

Perfect. Thanks a lot.

Operator

Our next question comes from Saul Martinez with JPMorgan.

Q - Saul Martinez {BIO 5811266 <GO>}

Hi. I just have a couple of – well, one follow-up question and one other question. First, Marcelo, you mentioned in your earlier remarks that your asset quality has become less correlated to the economic environment due to mix shift. And obviously that's – it's obvious that that seems to have occurred. But that it could change at the end of 2015 or 2016 and start to become more pegged for the economic cycle. Can you elaborate on that? I'm – it's not clear to me why that would be the case, especially since the mix shift process should continue as we head into next year. If you can just give us a little bit more color there.

And secondly, the payroll loan book has grown tremendously. It's bigger than your mortgage book. It's bigger than your order book now. Obviously, the BMG partnership has helped. But is there any difference at all in terms of the economics, the profitability of acquired loans from that partnership relative to payroll loans, for example, that you may originate yourself? Can you just give us a sense of whether the economics are also attractive, especially considering this is a product with very high-risk-adjusted margins?

A - Marcelo Kopel {BIO 16986304 <GO>}

Right. Thank you, Saul. Let's start – let's answer it backwards in terms of the payroll. Payroll is, as you mentioned, is key to our strategy. The difference in economics is basically if you consider that we have, let's say, two types of originating channels, one, through our branch network and the other one through the joint venture. And throughout our branch network, basically, we have the branch cost and basically we dilute the cost by originating the credits there.

So, the profitability of a loan even if you do the proper cost allocation, which we do for our own origination is better than originating to third parties. The risk is quite similar because the credit approval process is the same. So on a net basis, when you originate through our own network you're better off. So, that's the comment regarding payroll growth.

Regarding the asset quality and the being less correlated, the fact that I mentioned that is because when we are outgrowing on portfolio like payroll, and let's use that as an example, and even mortgages, payroll now is around 85% of that is related to the public sector, be it retirees or be it public servants. So, that is where I say it's less correlated because those segments are not affected by unemployment.

And when you look at the mix shift and you see that portfolio that are more prone to be affected by the economy like unsecured lending and SMEs and so on and so forth, the difference between the speed of growth between those two portfolios end up being as less correlated to the economy. That's where my comment came from.

So, as we go deeper on that, eventually, we will become more correlated to the GDP. But obviously, our best case scenario is there is no disruption in the economy. If we were to have a disruption, then the correlation will obviously will come into play. But we don't have a disruption scenario for next year.

Q - Saul Martinez {BIO 5811266 <GO>}

In other words, it becomes more pegged if we see a disruption or if we see a real, sort of, stress scenario for economic conditions.

A - Marcelo Kopel {BIO 16986304 <GO>}

Yes.

Q - Saul Martinez {BIO 5811266 <GO>}

Okay. Fair enough. And then the four – so, just to elaborate on the first answer, on the own origination versus the BRL4 billion, the BRL4 billion that you acquired, can you give us a sense of how different the economics are between those of the acquired portfolio and other – are these still very profitable types of loans that you are acquiring, because you are obviously growing that book very, very quickly?

A - Marcelo Kopel {BIO 16986304 <GO>}

So, what I can give in terms of color is the average commission that you probably see over the term of a loan acquired to a third-party is around 15%, okay? So, to the extent, I find a way of doing these acquisitions through our network, under that number, we are becoming more – we are more efficient. So, this is just to put you in perspective. And remember, the branches there as our window to be distributing and offering multiple services to our clients. So, it's really the more efficient we get in terms of targeting our clients, the less we're going to spend on this, let's say, theoretical 15% that we have to spend to make economics equal.

Q - Saul Martinez {BIO 5811266 <GO>}

Okay. Great. Thanks. That's helpful.

A - Marcelo Kopel {BIO 16986304 <GO>}

Thanks.

Operator

Our next question comes from Boris Molina with Santander.

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

Yes. Good morning. Thanks for taking my questions. I have two questions. The first one regarding the progress in your acquisition of CorpBanca. Could you confirm if you are currently in negotiations with the IFC to amend the shareholders' agreement? Or if the only authorizations for you to close the merger are related to Central Bank and regulatory approvals?

A - Marcelo Kopel {BIO 16986304 <GO>}

Boris, IFC is doing its homework now. I mean, they have an agreement on the existing shareholders' agreement with the current shareholder. And they are doing their homework in terms of doing valuations. And we are basically if there is information that they ask us, we provided that. So, they're (55:17) there. And we are confident that the deal will provide the benefits to all shareholders, including obviously themselves. So, I think we're going to get to closure on that.

Our scenario in terms of approvals, we just got the approval from the Brazilian Central Bank for the – to be participating on the merger, have a stake in the merger control stake in the merger. And we are seeing, we still need to go through the approvals of the Chilean regulator and Colombian and Panama and obviously come to the shareholders meeting where the shareholders of both entities need to approve that. So, our estimated closure for this transaction is first quarter 2015.

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

Okay. Wonderful. Thank you. And I had a second question regarding the slide on your presentation about the evolution of the capital ratios on the Basel III. You show a 100-basis-point improvement from the use of tax loss carryforwards. Is there any change in the regulation of taxation that would allow you to avoid having tax loss carryforwards in the future? I mean, over the last years, your tax loss carryforwards have been around 6% and 7% of your shareholders' equity and this is like a nature of life. So, are these going to disappear completely?

A - Marcelo Kopel {BIO 16986304 <GO>}

No. it's not that it's going to disappear. The assumption there is if we are to consume everything we have – and just keep in mind that at the same time, we are consuming that we're also having the benefits of some goodwill amortization for tax purposes. So, over time, as we don't have all the goodwill amortization tax benefits to be consumed, the ability to consume the tax loss carryforward makes it becomes easier than having to eat into the tax loss – the tax shelter we have from goodwill and the tax loss carryforward.

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

Okay. Wonderful. Thank you.

Operator

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

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

Thank you, everybody, for participating with us. I think we had a very good and solid result. Marcelo answered all the questions that you had. We were able to attend everybody. So, thank you for your participation and we hope to see you again in the fourth quarter results at the beginning of next year. Thank you.

Operator

This concludes Itaú Unibanco Holding Earnings Conference Call for today. Thank you very much for your participation. You may now disconnect.