

Q4 2011 Earnings Call

Company Participants

- Roberto Egydio Setubal, CEO
- Rogerio Calderon, Corporate Controller and Head of IR
- Unidentified Speaker, Unknown

Other Participants

- Boris Molina, Analyst
- Carlos Macedo, Analyst
- Jorg Friedemann, Analyst
- Jorge Kuri, Analyst
- Marcelo Telles, Analyst
- Mario Pierry, Analyst
- Saul Martinez, Analyst
- Victor Galliano, Analyst

Presentation

Operator

Good afternoon, ladies and gentlemen. Thank you for standing by. This is Itau Unibanco Holding S.A. conference call about the Fourth Quarter and year of 2011 results. At this time, all lines are in a listen-only mode. Later, there will be a question-and-answer session and instructions to participate will be given at that time. (Operator Instructions). As a reminder, this conference is being recorded and broadcast live on www.itaunibanco.com/ir. A slide presentation is also available on this site.

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 those anticipated in any forward-looking comments as a result of macroeconomic conditions, market risks. And other factors.

With us today in this conference call in Sao Paulo are Mr. Roberto Egydio Setubal, CEO; Alfredo Egydio Setubal, Executive Vice President and Investor Relations Officer; Rodolfo Henrique Fischer, Executive Vice President of Itau BBA; Sergio Ribeiro da Costa Werlang, Executive Vice President of Risk Control and Finance; Marcio de Andrade Schettini, Executive Vice President of Consumer Finance; Caio Ibrahim David, Chief Financial Officer; Rogerio Calderon, Corporate Controller and Head of Investor Relations and Marco Antunes, Accounting Director.

First, Mr. Roberto Setubal will comment on the Fourth Quarter and year of 2011 results. Afterwards, management will be available for questions-and-answer session. It is now my pleasure to turn the call over to Mr. Setubal. Please sir, go ahead.

Roberto Egydio Setubal {BIO 1525746 <GO>}

Hello, all of you again. Thank you for being here with us this morning or this afternoon depending on where you are. And we're here to report our next quarter results. And I will also comment on ready cash transactions. And I'll try to be fast enough in this presentation so that we can have more time to -- for questions at the end.

I would make some comments on the highlights. I'll be very short since you have already seen the numbers. We had a recurrent net income of BRL3.7 billion in the last quarter of 2011. This presented a 21.8% ROE. And the total for the year was BRL14.6 billion as a result, an ROE of 22.3%. Loan growth was strong, 19% at the end for the total year, 3.9% at the end of the year. We were more cautious at the end of the year. As you know, we have been talking about that. So loan growth was a little bit lower at the end of the year.

Financial margins with clients grew 14.5%. Net interest margin with clients decreased 70 basis points in the last quarter. Mainly due to two things, one was the reduction in the Selic rate as you know. And the other one that I would like to call your attention is the funding expansions that came from clients that basically had very low margin. And the mix overall has changed and I'll comment additional on this thing. But this when you make the numbers made up a final margin or the percentage is lower than it should. And this had an important influence in the -- this calculation.

Spreads and loans remained almost stable with a decrease of 20 basis points. And this is mainly due to change in mix at the end of the year. Banking services and the insurance business grew 7.4% in the last quarter, totaling BRL5.9 billion and for the year the growth was 13.3%, totaling BRL21.8 billion.

The loan performing loan ratio increased by 20 basis points reaching 4.9%, pretty much inside our expectation for the quarter. And our provisions, net provisions of recoveries was BRL3.9 billion, 6.1%, when compared with the previous quarter. A little bit above the level of growth under the loan portfolio.

Non-interest expenses reached 9.5% in total growth for the year. In the last quarter we were only 1.7% above the Third Quarter level. And this has a lot to do with our program of efficiency our goals. We are announcing a 41% efficiency ratio for the last quarter of 2013. And I believe we are on the way to reach that number. And this last number, Fourth Quarter of 2011 evolution, is in line with the results.

As a result, efficiency ratio that we plan to reach, 41%, has improved more than 400 basis points when you compare last quarter of 2011 with the last quarter of 2010. But for the year it was 100 basis point -- 140 basis points of decrease which was a good result. But we are speeding up in this sense.

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Integration, I think this is a very important point for the Bank because we have basically finalized everything in terms of integration of the operation of the old Itau and the old Unibanco, now we have one bank. All the products, all the services and all the business we do is in one platform. We don't have any more systems running parallel for legacy data. We are basically -- everything is already in the operational system that we have today.

So we have included -- we were able to close down the data center of Unibanco in December. So we are fully operational in one platform. And this is an important achievement basically because we have, in the last three years, allocated more than 30% of our effort in technology. We had allocated it to integration. So we are freeing up more than 30% of our technology capabilities in order to produce improvements for clients, improvements in controls and this is quite important for us as we'll leverage the Bank for - in the future. So we are very happy about this achievement.

Next page, we have the results. I basically would like to call your attention on the market number. The second line financial margin with market, which has decreased in the quarter. This was important explanation for the -- it was part of the explanation for the results in the bottom line. We have -- we believe that our running rate for this line will be something around BRL800 million a quarter so this was above our levels due, although below the Third Quarter.

Banking fees have increased more than 5% in the quarter mainly due to the credit card business that has a seasonality in December given the Christmas periods. And also insurance in terms of revenue has been growing strongly. You can see that the last quarter we grew 5.5% compared to 10.7% for the full year. So we are speeding up also our insurance business.

In terms of losses, when we combine losses for loans and losses for claims, we had a growth of 4%, it was great but not as great when we look only for the loans. But on the other hand, we had good improvement on the recoveries.

I think the great thing that we have done in the quarter in line with our objectives of efficiency is the control on the operating expenses. It was only 1.7% improvement and this is pretty much in line with our objectives of -- for the next year. And I will talk more about that when we give the guidance for the full year of 2012.

In terms of loans, we closed the year with a 19% evolution which was a little bit above the market overall, the last quarter I think that credit card given the seasonality it was very strong. The mortgages have been strong and will keep on being very strong for the coming quarters. We are growing a lot in that business coming from a very low base.

Small companies, we are more careful as I had already commented, given the level of delinquency and that was higher than we would like to have; on the corporate side, the growth is more strong.

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Let me comment a little bit on the net interest margin, we have here the credit net interest margin, which is much more stable and the changes that we see here, most of it is due to the mix. So -- but it's pretty much stable overall.

When you look the full net interest margin clients, we have to make the comment that we have increased at the end of the year our funding from clients. This was very good in terms of creating a larger base of clients on deposits. It's important for the future of the bank.

And this has, on the other hand, decreased our net interest margin when we calculate it as a percentage because of this additional funding, which we have been placing basically in Selic rate.

When we basically make the numbers assuming that we would have no additional funding available in the last quarter compared to the Third Quarter, the number would be more in line with what would you expect.

So this is quite important. Our reduction in the NIM in the last quarter was an important extension because of the lower Selic and the additional funding increasing liquidity for the Bank.

On credit ratios, in general, we -- the NPL over 90 days has increased 20 basis points. But on the other hand, the 15 to 90 days NPLs have been reasonably stable over the quarters with trends to go down. It is more clear when you look individuals, which has clearly improving the rates over time.

We are confident that we have already achieved a good underwriting quality for individuals for the vehicles portfolio. So this trend, we believe, that is a trend that we'll see very solid in terms of improving the NPLs for individuals.

On small companies mainly. And also on corporate, it has been more stable. We believe that was stable both on the 90 days and on the 15 to 90 days. But we would like to see this in a lower level. So we are still working in order to have improvement in this portfolio.

It's important to understand that in the last semester overall, we have a very low economic growth activity. Last semester probably Brazilian economic grew very close to 1%, which is a very low level. And this clearly has affected the quality of credit in general.

But on the other hand, the good news is that we expect the growth to improve in 2012 over the year, especially in the second semester, we believe that the economy will be much more active. So we will probably see an improvement on credit quality conditions overall.

When you see the allowance for the provisions on loan losses, it has been quite stable over the last quarters. And I would like to call your attention on this -- on the right side

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found here the balance of allowance for loan losses, showing you the numbers that we have split here.

We have in blue the additional to the central bank requirements provisions. And on the orange, we have two numbers. The number below is the number that we allocate for the loans. It has already 100% provision.

And you see over time that most of the increase on loan losses that we have seen is on loans that are already 100% provisions. When you look, the amount of provision that we have for other types of loans that is not fully provisioning, we have been increasing also the volume, which means that we are not reducing our -- the quality of coverage that we have over the portfolio.

And this is very clear when you look the credit ratio on the next stage. The line in orange shows very stable level provisions when you compare and you take into consideration only A to G ratios of credits as a percentage of provisions that we have for them.

So we have been keeping a higher level of the same policy for the full period, we have not changed anything, we are not reducing provisions for the future. We are keeping the same level of provision for the same level of delinquency. But we cannot increase provisions over loans that has already 100%.

So this is the number, the volume of loans that have 100% of provisions has been increasing. The total ratio, which is the blue line, has been showing a decrease but overall it's pretty much stable. We are keeping the same level of coverage that we have -- always have.

The next page basically the highlight on the shareholders, equity and assets, the growth that we have enjoyed. The next page, we are talking about funding and assets under management. We have shown a very strong growth in funding with clients of the Bank.

In the last quarter we grew 8.7%. This was the -- the result of this is a great relationship with clients, a solid base of deposit for the future. But on other hand, we had a higher level liquidity that has contributed to the lower level of -- that we are getting on.

Obviously, we have a positive spread on this. But not as positive a spread that we have on other types of relation we find, especially loss. So in the liquidity level of the banks, which is seen in the next page is very strong.

We have much -- and has improved as you can see here from the numbers, which is growth on deposits have improved the liquidity position of the Bank. We are more than -- we are -- currently, we are already complying with the liquidity index that Basel III is indicating as objectives for the future. But we are already complying for those two index of liquidities in a very comfortable way for the Bank.

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Next page, we talk about the evolution on fees and insurance results on the side of fees, the credit card. In the last quarter, credit card was very strong as always in the last quarter of the year given seasonality's. And this has pushed our revenue of total fee income to a growth of 5.5%.

But especially, I would like to show you the number of results coming from insurance and pensions and capitalization that has strong growth in the year, 29%, especially in the last quarter. We are putting more emphasis on insurance business fees when we talk about results fee from insurance, we are meaning premiums less losses on insurance. And also detecting the commercial expenses. So the contribution of insurance is increasing in our business, which is very positive.

On the side of expense, I think we are doing a strong -- a good job. We are very much committed, the full Bank is fully committed with this objective of 41%. And we have already seen fine figure in the last quarter of this commitment. Expenses have evaluated only 1.7%, 9.5% for the year. But the trend is lower than 9.5%, as you can see, in the last quarter.

We are really very much committed to this level of 41%. We have a lot of plans here in sight how to -- we will achieve the numbers. We believe that given the reasonable scenario without a major crises in the year or something like that we will have the conditions to achieve the 41% level at the end of next year, which means the last quarter of next year.

But overall you can see here since we announced the merger of Unibanco the evolution of total expenses in this period. The evolution was very much controlled. We basically grew on the basis of inflation. And you have to remember that during this period assets have been more than 40%. Transactions in volume has gone probably more than that. So we are gaining efficiency and we believe that we can gain even more efficiency in the future -- as we announced for 2012 and 2013.

On the segmentation side, I don't have any special comments for that. All business lines are making money. We believe that including the ones that are suffering a little bit more like small companies and vehicles, we are on the positive side of the equation which is good and we believe that we can improve those businesses for next year.

As a contribution for the net income you can see that we have reduced the contribution in the last quarter of the year coming from market gains and the corporation finally having improved especially insurance have improved Itau EBITDA and consumer credit in the last quarter. I think this is a good thing is improving the quality of gains for the Company.

On the side of capitalization we have a strong capitalization. We are very comfortable with the levels that we are currently enjoying, we believe that we can -- we would not need additional capital for the Bank for -- to face the Basel III requirements. We are already compliant with most of the requirements. And there the timetable that they are announcing for compliance, everything is quite comfortable for us.

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Market capitalization is evaluating -- evolving more like you can see in this screen here. It has reduced a little bit in the last year but is coming back more recently. We are happy about the price level that we have been gaining a bit more recently. And I would like to also to comment that although we are focusing a lot on expense and gains and we are more focused on efficiency which means that we are also looking for the top line.

We are pretty much -- we are not cutting things that would reduce the potential growth for the Bank. We are opening branches; in the last quarter we opened 82 branches overall, branches in cities and medium size cities starting with 50,000 inhabitants, most of it in the capital and big cities of Brazil. So we are keeping our strategy of growing the Bank, growing the branch network. We believe that next year we will open additional 150 branches and this is also considered in the guidance that we are giving you in terms of expense growth. So we are controlling expenses but not cutting growth.

Let me go for this next screen that shows what was the guidance that we gave for the market for 2011. Credit growth, we expected something between 16% and 20%. We delivered 19%. So we are pretty much in line with the guidance. We had a slight increase in the NPL levels. We (inaudible) we had 70 basis points. I believe this was in the higher level of the expectations but still in line with expectations.

Banking services, we were not able to achieve the number that we were announcing. We were behind that number. We are putting emphasis for the next year in order to have a stronger growth in this line. In terms of expenses here we over delivered. We announced something between 10% and 13%. We could deliver 9.5%. So this was a good thing.

On the efficiency ratio side, we are not able to deliver what we had announced. We had some -- revenue did not grow, did not grow as we expected but the main reason was much more a question of timetable because when you compare fourth level against fourth level, we have more than enough above the -- what we were believing. When we compare to those quarters, last quarters of those three years we can see that we have delivered 560 basis points of improvement, which shows that we are still in line with the timetable for the end of next year.

What we are announcing in terms of expectations for 2012. Credit growth will be something between 14% and 17%. It's important to notice that we are announcing that we believe that we announce this number because that's what believe for the market. We think that the market -- we are planning to grow according to the market. We are not planning to gain share but we are not considering losing share. So we are basically announcing something very close to market growth.

In terms of NPLs we believe that we will have some increase in the first semester and some decrease in the second semester. So at the end of the year we will be pretty much at the same level that we are today. So this is what we expect to have for the year. In terms of increase in fees and the result of insurance we are now seeing 10% to 12% growth and most importantly we are now seeing a 4% to 8% growth in expenses.

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I have said that we are very much constant and we can keep growth of expense at those levels, which are pretty much in line with inflation although assets and transactions will be growing like 15% a year. So we are gaining --- again we are gaining efficiency and for the year we believe that we can have an improvement in the efficiency ratio of 200 to 300 basis points for the full year of 2011.

Before we start the questions-and-answers session I would like to make some comments on Redecard. What is the rational of our offer for Redecard. In terms of the Bank I believe that this will and this is a driver, this will give us more flexibility to talk with merchants, will give more flexibility in terms of making our offer more rich and we have today a lot of issues between the Bank and Redecard because issues in terms of what is the price of services and we have different shareholders. So we have to be very careful on that and this reduces our abilities to do things in the speed that we would like to do.

So this would give us more flexibility in terms of timing, in terms of offering of things that we can do, offering more services for clients. I believe that the offer that we are doing, it's a very fair offer. We are offering in the next page you can see looking the numbers of Redecard that is a great gain for shareholders.

We are also analyzing the fact that we are also -- the dividend that BRL1.1 per share that has already been announced in terms of the balance sheet of Redecard is -- our offer is x [ph], these dividends of the shareholders will receive the dividend before the price that we --- the option that we will do for the BRL35 per share for this additional gain for shareholders. And overall gains, quite important, it's much above what (inaudible) in the next stage as you can see. In dollar terms, it's even higher than that.

So I think that it's a fair transaction, I think, for shareholders. We believe that it's pretty much in line with the investment ratios that we see, the return for investment ratio that we see for the Company. So we are very confident that this -- it's a good move for shareholders and for Itau.

Thank you for listening to me and we are here to --- and one more thing about Redecard. We are announcing the withdrawal of the Novo Mercado segment.

So now I would like to open for questions of friends here, the people from Itau BBA, from the accounting side, Macedo, Marcelo [ph], we are all here.

Questions And Answers

Operator

(Operator Instructions). Carlos Macedo, Goldman Sachs.

Q - Carlos Macedo {BIO 15158925 <GO>}

Actually both of them will be related to Redecard but rather the impact that Redecard will have, the tender offer could have on Itau. The first is that we know that this transaction will

generate a substantial amount of goodwill in your books.

I was wondering if you have already done calculations of what the impact that will be for your core tier one capital, the basic capital as per Basel III regulations given that goodwill that is generated after December 31, 2011, isn't deductible or is deductible from your core tier one capital. I was -- I just wanted to see if you know what the impact would be?

The second one, you mentioned that this would be neutral for results. Could you give us some color on that because the math that I do adding the earnings that -- the 50% of earnings for Redecard minus the amortization of goodwill minus the opportunity cost of the cash that you are going to use to buy the shares, I get a significant --- well, I get a BRL500 million to BRL600 million decline, per year decline in earnings. So I just wanted to see how you are coming up with that number? Thank you.

A - Roberto Egydio Setubal {BIO 1525746 <GO>}

Okay. I think we --- I don't have the numbers here and will be very difficult. But Rogerio might have -- down the road you can look up to Rogerio and he might discuss the details of numbers that we are talking about. This has to do also with the issue of amortization of the goodwill. We don't have a clear perfect view about amortization of intangibles. I think the goodwill is not, as you mentioned, is not possible to amortize.

We believe that there will be some intangibles to be amortized; we don't have a clear view on those numbers but we believe that there will be important and probably major part of the total that will not be amortized.

In terms of Basel numbers, Basel --- if we have Basel III today full, we will have to deduct the full -- the full real and intangible from the capital base. But Basel III has a timetable, that has a timetable to phase in from today till the year of 2019. We believe that the peak of Basel III for us in terms of capital allocation will be 2016. And is less than 1% of the ratio. It's about 0.6% of the ratio of the Bank today.

Q - Carlos Macedo {BIO 15158925 <GO>}

Okay. But this --- the tender offer and the goodwill generated would have a negative impact on your basic capital ratio under Basel III?

A - Roberto Egydio Setubal {BIO 1525746 <GO>}

Basel III --- yes. But this, as I mentioned, is a small impact, 60 basis points, which is the peak 2016 or 2017 something like that. Today, it's lower than that.

Q - Carlos Macedo {BIO 15158925 <GO>}

Okay. Thank you.

A - Roberto Egydio Setubal {BIO 1525746 <GO>}

Rogerio also can make up the numbers with you.

Q - Carlos Macedo {BIO 15158925 <GO>}

Okay. Perfect, thanks.

Operator

Jorge Kuri, Morgan Stanley.

Q - Jorge Kuri {BIO 3937764 <GO>}

I have two questions on Itau and one quick on Redecard. On Itau, the first question is on your guidance you mentioned credit growth of 14% to 17%. Can you give us some color on what your expectation is for financial income growth, we are seeing that margins are coming under pressure due to the decline in Selic that may continue throughout the year, Selic heads even further down? Are you expecting financial income to grow less than the 14% to 17% or can you give us more or less a range?

A - Roberto Egydio Setubal {BIO 1525746 <GO>}

Okay. Jorge, hello, how are you? Yes. We are expecting margins to be -- in terms of growth, below loans; this is part of our -- in our plans. I will not get into details but we believe that margins will squeeze a little bit, not as much on the spread side for clients in terms of loans. But something due to the lower Selic and some -- and partially because of NIM.

Q - Jorge Kuri {BIO 3937764 <GO>}

Okay. And is there any guidance that you are providing in terms of financial income growth?

A - Roberto Egydio Setubal {BIO 1525746 <GO>}

No. We are not providing guidance on that as you -- the guidance that we are providing (inaudible) a full slide that we have announced.

Q - Jorge Kuri {BIO 3937764 <GO>}

Great, thank you. The second question on Itau is, on the asset quality, you had guided towards income asset quality in the Third Quarter, then in the Fourth Quarter. And now you are actually saying that you are going to see asset quality still deteriorating in the first semester of 2012. And probably peak, I guess, on June-July of this year. What's happening, I mean, certainly we did see a deceleration of the economy. However, we still have full employment and real wage gain. How is that not translating into an improvement on asset quality and why does the target keep moving ahead? Can you just help us understand a little bit, what is the underlying problem there?

A - Roberto Egydio Setubal {BIO 1525746 <GO>}

There are no new problems first of all. I think that you mentioned, which is very important, let's talk about individuals and talk about companies. In terms of individuals, we believe that the new -- the new advantages [ph] of credit that we are seeing are of great quality,

we are very confident that over time this will improve. But some of the portfolios are longer. It has, for instance vehicles, it's a long portfolio. So it takes some for you to feel it in terms of NPLs over 90 days.

But we are very much confident that this was one of the problems of this year, that the products that we are generating from the second semester on is much, much better than what we were generating in the first semester or before that. And this was in terms of individuals, the portfolio that was hurting more our members in terms of the delinquencies.

In terms of companies, then I think that the issue of the economic growth because although the economic growth has slowed down a lot, the labor level has not changed in Brazil. So there were -- people did not lose their jobs. So this did not affect as much the individual portfolio. But on the companies' portfolio, especially small companies, we had much more difficulties because the economy was much slower, okay, than we expected and much slower than we planned and this is the main reason why we have been moving ahead the improvements of targets. In the two directions, the slowdown in the economy -- in the last quarter it was zero growth; this affected not only the quality, the capacity of companies to pay back the loans but also the growth and demand for loans. So we were affected in that ratio on both sides when it came to that.

So we have put up, yes, we are not -- we see some improvement and some increase in this NPL over 90 days for the next semester. But we believe that a combination of what we have already done in terms of controlling the quality of new loans and the improvement in the economy, we will have an improvement at the end of the year in terms of delinquency. This basically is the story, Jorge.

Q - Jorge Kuri {BIO 3937764 <GO>}

Thank you very much. And just one really quick clarification on Redecard. In the press release where it says that it's neutral in terms of results for the next two years, does that already include an assumption of tax benefits or the tax benefits if they appear they are separate to this view of the deal being neutral or is it already included there?

A - Roberto Egydio Setubal {BIO 1525746 <GO>}

Look, we have not fully analyzed and -- the tax effects of Redecard. It might have some impact but very small, I mean, the impact of tax is basically very, very, very small in the next two years if it had some. It's more in terms of impacts on the Bank. So I will not count too much on that.

Q - Jorge Kuri {BIO 3937764 <GO>}

Thank you very much for the time. Thanks.

Operator

Mario Pierry, Deutsche Bank.

Q - Mario Pierry {BIO 1505554 <GO>}

Let me ask you two questions as well, I only have two, both of them related to Itau. First, on your cost improvements that you are guiding for the efficiency improvements, part of the improvements we have seen in your expense base has been related to headcount reductions since the First Quarter. So I was wondering if you have a specific target of headcount reductions over the next two to three years or where should we expect improvements to come from in the future?

Then the second question is also related to your BIS ratio. You were recently quoted in the Brazilian papers saying that you wanted the Brazilian Central Bank to be more flexible on its interpretation of Basel III with regards to the deferred tax credits that were created from temporary differences. I was wondering when should we expect a final announcement from the Brazilian Central Bank with regards to Basel III and what are your expectations with regards to whether or not you can be allowed to use deferred tax credits from temporary differences as part of tier one capital. Thank you.

A - Roberto Egydio Setubal {BIO 1525746 <GO>}

In terms of efficiency ratio, I think that we are very much confident on the expense side. The expenses will be in the range that we announced. I think that 8% -- it's a number that we believe that only a disaster would cause an increase above this level of 8%. We are very confident that we can be in the range that we announced.

So efficiency ratio in this regard, will depend much more on the growth of revenues, which we have a scenario, there are some certainty in the scenario. But we did use the basic scenario that we have in -- ahead of us. It's a scenario that we will deliver this kind of efficiency ratio.

Although we, in this scenario, we have some problems in Europe, I think, some risks in Europe that might change the overall conditions. But I am pretty much confident that on the expense side we will deliver on the fee service side, we will deliver on insurance, we will deliver. We are not so sure about what would happen if conditions in Europe gets worse than what we have here today. Although it can get much better, which should be even good news, better news for Brazil and for the conditions in our market overall.

The second question relating to Basel III. There is a timetable that phase in the new capital requirements for banks, this goes from next year I think till 2019. We are fully comfortable that the Bank will be able to comply with all the requirements of Basel III in any conditions in the timetable that they have announced.

I think that the Brazilian market has one peculiarity as many other markets have different peculiarities which is the question about the time -- the provisions on loan loss, which is not deductible at the moment that we made them, are only deductible on the road. So this creates a different situation. Italy had a similar problem and they have created a very special thing for that. So I think that we have discussed this issue about credit tax determined and find solution for that so that we don't have in terms of market a major impact.

In our specific case we believe that we on the timetable of a Basel III, we will be able to comply even on the side of on the issue of tax credits. We believe that we will be able to comply on the timetable that they are announcing.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay, let me just follow-up then on your expense guidance. Then you're basically saying that your expenses should be growing roughly in line with inflation even though you are going to be growing your loan book much faster. So what I understood is you don't foresee meaningful space to reduce head count in the future, is that --

A - Roberto Egydio Setubal {BIO 1525746 <GO>}

We don't have an objective of reducing head count. We have objective of reducing expenses; in some cases, it will end up reducing head count. But this is not a guidance, it's not one of the objectives, it's much about reducing expenses.

And on the other hand we are still growing the Bank. We don't want to basically control expenses; we want to control efficiency and we want to keep growing. I mentioned to you we have basically opened 82 branches in the last quarter. We are now seeing that we will be opening another 150 branches during the year of 2012. I mean, we had additional head count for that in some areas but we are increasing business volumes.

In other areas we are putting more efficiencies. So we had some reduction on some other areas. But -- I mean, there's no meaningful program or objective to reduce or to achieve a certain number of people in terms of head counts.

Q - Mario Pierry {BIO 1505554 <GO>}

Very clear. Thank you very much.

Operator

Saul Martinez, JP Morgan.

Q - Saul Martinez {BIO 5811266 <GO>}

I have a couple of follow-ups on Redecard also. And first question is maybe a little bit of a delicate question to be frank. And with Redecard's price trading last time I checked slightly above your offer price even factoring in the dividend of BRL1.1 per share. It's -- the market seems to be indicating that they believe that that there is a decent probability that Itau will up their price from BRL35.

And I wanted to get just get your feedback on how you would think about it if it becomes clear that you won't be able to get the two-thirds approval for the offer. Are you willing to step away from the transaction and how would you think about the possibility of having to increase the bid?

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Then secondly, I wanted to get some clarity on the Basel impact. And just kind of square away what I heard to -- in response to Carlos Macedo's question. And what I heard on the Portuguese call. Is it fair to say that under Basel III fully loaded, which would be 2016, there would be a 60 basis point negative impact? I also heard on the Portuguese call that it could be slightly positive under Basel II, could you just elaborate? Is that -- is my understanding correct? And if you can just elaborate on what the impact -- how the impact would work under the existing capital rules?

A - Roberto Egydio Setubal {BIO 1525746 <GO>}

First on price. We are not considering at all to change the offer. And we believe that we -- we will be able to achieve our objectives.

On the number of Basel III, there's a timetable that phases in the impact. And the peak of the impact will be in 2016 or 2017 I'm not sure. And it will be something around 60, 70 basis points more or less maybe less than that, let's say something between 50 and 70 basis points. This has to do with the timetable of the amortization of the intangibles. So it's not a precise number but something that we have taken into account and is part of the discussion. And we believe that we have room for that in terms of capital in the Bank.

The -- today, we don't have Basel III, we have zero impact coming from Basel III. So basically we are talking about Basel II rules today. We will start having Basel III in fact next year and the year after, which are minor because they are starting to phase in. And as I mentioned, it will phase in as we amortize part of the total price. So this is the reason why we have 60 basis points more or less of expected impact on the BIS ratio.

Q - Saul Martinez {BIO 5811266 <GO>}

Okay. And under the existing capital rules there is virtually no impact on your capital ratio?

A - Roberto Egydio Setubal {BIO 1525746 <GO>}

It's small, it's something between -- I can't remember 15 --

A - Unidentified Speaker

You mean --

A - Roberto Egydio Setubal {BIO 1525746 <GO>}

No. It's very small, it's about 20 bps more or less.

Q - Saul Martinez {BIO 5811266 <GO>}

20 bps reduction under the existing rules, okay. Right, great. Thank you very much.

Operator

Jorg Friedemann, Bank of America.

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Q - Jorg Friedemann {BIO 15405752 <GO>}

And just a follow-up on the potential goodwill amortization. We are aware about all the limitations but I just would like to understand the potential schedule for goodwill amortization. We remember that I know in other occasions like in which when you merged with Unibanco or acquired both BankBoston you usually amortize everything on one shot. So just I would like to understand if you have any goodwill to amortize if you would do it again or if you would amortize over a longer period of time? Okay. Then I do my second question. Thank you.

A - Roberto Egydio Setubal {BIO 1525746 <GO>}

Okay, we are not planning to amortize whole year, that is one. Basically, we have a new accounting rule in Brazil, which is international accounting rules, IFRS rules and in this -- to comply with IFRS we would not be able to amortizing it upfront. So we have to comply with that and this is the -- our consolidated balance sheet we are carrying on IFRS rules so this would not be possible to do.

Q - Jorg Friedemann {BIO 15405752 <GO>}

Perfect, very clear. And the second question about the evolution of your balance sheet. As you mentioned in the presentation the funding evolution is notable. So could you elaborate a little bit more on the strategic decisions that led to the surge on high quality deposits in the quarter? And what do you expect for deposits evolution in 2012. And specifically, should we consider that loan to deposit ratio has further room for improvement during this year? Thank you.

A - Roberto Egydio Setubal {BIO 1525746 <GO>}

Well in terms of results the impact is not -- it's very minor because margins on deposits on the margin is quite small. So the overall impact is more on the results of the Bank. I'm not - I don't have a number here to give you in terms of how this ratio between loans and deposits will evolve. But probably basically we don't think that things will change (inaudible).

Q - Jorg Friedemann {BIO 15405752 <GO>}

Okay. So no specific action that you did in the Fourth Quarter that led to the surge in deposits. Because as long as I can see you improved not only I know on an absolute basis but also comparing to your peers during the quarter. So you gained it seems market share in terms of deposits in the quarter.

A - Roberto Egydio Setubal {BIO 1525746 <GO>}

Yes, pretty much.

Q - Jorg Friedemann {BIO 15405752 <GO>}

Okay. Thank you.

Operator

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Marcelo Telles, Credit Suisse.

Q - Marcelo Telles {BIO 3560829 <GO>}

My question is a follow-up call on the delinquency question. Is it fair to say that there may be a delinquency rate; it's probably going to deteriorate not only in the first but also in the Second Quarter and then stability after that or you think that First Quarter will be the peak?

And my other question is similar to the same one, is regarding provisions, right? Given there is one slide in the presentation where you show that the coverage had to come down because you had loans (inaudible) loans were ready, you could not go above 100% coverage which I understand. But so that means that's maybe in terms of provision expenses in 2012; we should see them basically growing at a lower growth rate than the -- the loan portfolio itself. Thank you.

A - Roberto Egydio Setubal {BIO 1525746 <GO>}

We -- it could be First Quarter, it could be Second Quarter in terms of peak of operations. We don't have it very clear. I think it depends on the market conditions. It depends on also the dollar ratio because, as you know, this impacts the portfolio. So it's not -- I mean we are talking about small differences and small differences might change with the dollar number because it affects 10-20 basis points easily the NPL ratio, the variations that we have seen on the dollar side.

So I'm not so sure about what would be the peak in terms of dollar ratio, okay? As I mentioned, I mean you don't have a month that is real change. It's overall a trend. We believe that the trend is the one that I have described already. It's some increase in the first semester and some decrease at the second semester, with end of the year pretty much on the level that we are seeing today. Basically, this is what we expect. I don't have too much more information to give you at this moment.

Q - Marcelo Telles {BIO 3560829 <GO>}

Okay. Thank you.

Operator

Victor Galliano, HSBC.

Q - Victor Galliano {BIO 1517713 <GO>}

Just on margins, looking at that slide on page six of the presentation, when you look at that NIM on a kind of normalized basis at 11.4%, if you can just go through the kind of rationale of how you arrive at that 11.4%. Is that normalizing for Selic and also for the cost of funding? Is that what you are doing there?

And if Selic is coming down and really you've grown fastest in time deposits, then I don't get why the actual margin has diverted from this normalized one? Can you just clarify

there what the explanation you gave?

A - Rogerio Calderon

Victor, it's Rogerio Calderon speaking. The way we calculated that was to make the loans and funds stable when compared to the Third Quarter. And also the Selic not moving during the quarter. That's the way we came up with this 11.4%.

Q - Victor Galliano {BIO 1517713 <GO>}

Yes. It's keeping the loans to funding ratio the same?

A - Rogerio Calderon

Yes.

Q - Victor Galliano {BIO 1517713 <GO>}

I get it. So would it be fair to say that you kind of front loaded here a little bit in terms of the funding in your growth in deposits and we will see that approach the 100% ratio again heading back into 1Q 2012?

A - Roberto Egydio Setubal {BIO 1525746 <GO>}

I would not say that. I think that we will try to be below that level of 100%.

Q - Victor Galliano {BIO 1517713 <GO>}

Okay, okay. Just a quick follow up, if I may, on renegotiated credits and wheeling back into the credit quality. We saw that increase again as a percentage of the total portfolio in Q4. Would you expect to see that normalized or shall we say stabilized into 1Q and 2Q. And follow the line that you expect in terms of the credit quality cycle that you are talking about?

A - Roberto Egydio Setubal {BIO 1525746 <GO>}

Look, it's -- we are talking about small variations which is very difficult to really precise, make it very precise. Basically, what we have seen is -- I think the best indication that we can give you is what we have in the 15 to 90 days NPLs is what we can expect in terms of impact for the next quarter.

I believe that as the economy improves this will give us some additional gains in terms of quality on the Company's portfolio. And the individuals, I think, the trend is very clear and I think that we probably will keep on going this trend of improving quality.

Q - Victor Galliano {BIO 1517713 <GO>}

Yes, okay. Thank you.

Operator

Boris Molina, Santander.

Q - Boris Molina {BIO 1904979 <GO>}

Just two questions -- a follow-up on Redecard. Have you made an estimation of what is the potential cost savings that you could achieve when integrating Redecard's operations into Itau's infrastructure? We would guess that a substantial amount of the general and admin expenses could be incorporated into the existing infrastructure; we are talking about credit call centers and accounting and operating systems.

And this could have an important impact in terms of how you view this transaction in terms of value creation? Have you provided any analysis in terms of synergies and that you could get out of Redecard?

And I have a follow-up question on capital. But maybe just let's take this out of the way.

A - Roberto Egydio Setubal {BIO 1525746 <GO>}

There are some synergies. They are not that meaningful in this transaction especially because the data center of Redecard is inside Itau already. We already provide them with a lot of services. So this is already in-house. So there will be no gains coming from, for instance, technology mainly because we already done -- we are already doing most of the services which is probably the main line of expenses on Redecard, if you not consider commercial expenses.

In commercial there will be no big synergies given the fact that we will keep the Company alive in terms of the operationalize and so we are not foreseeing that much synergies. Yes. We will integrate the accounting and things like that. But this is not really that much meaningful in terms of making a big difference for the operation.

Q - Boris Molina {BIO 1904979 <GO>}

So in this slide, I think, there was a mention regarding the return on capital employed that was going to be in line with the opportunities that are available elsewhere. What is the type of return on capital input that you would expect to get from this transaction once you take into account these cost savings and potential?

A - Roberto Egydio Setubal {BIO 1525746 <GO>}

Taking everything into account. And the fact that we have Basel II still on today and just that -- the fact that this -- we will phase into Basel III over time. We have a reasonable rate of return, which means that is above our cost of capital. But if we were talking about the return on investment the full value that we are paying for the -- then we will be below the cost of capital of the Bank.

Q - Boris Molina {BIO 1904979 <GO>}

Okay. That's interesting. Now, one final question regarding your -- there's something unique [ph] about this capital impact on Basel III and what not and the phasing in of the

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impact. What is your level of capital on your core tier one under the existing rules that came out of -- like Switzerland some while ago today because we know that this thing needs phasing in. And the way that we perceive they are phasing in is basically intended to allow the weakest link of the world financial system to adapt over time and we're thinking here maybe Japanese banks et cetera.

So when investors and we analysts look at this, they say, well what is our starting point today and what is the amount of input that you'll have to make up over time and how is this going to be achieved in terms of -- is it like slower growth or maybe a cut in the dividend payout et cetera. So it would be very useful for us to know what is the level today in order for us to start making the necessary estimates of how this is going to do over time.

A - Roberto Egydio Setubal {BIO 1525746 <GO>}

Okay. I don't have a number for you today at this moment here but I can assure you that today we already comply with the levels of Basel III in 2019, considering everything, okay? We have already conditioned to comply today with Basel III.

Basically we would be much more close to the minimum levels but we would need no additional capital to comply with Basel III or though I have to say also that there's a lot of things that has to be more detailed as long as we are talking about big numbers and sometimes the barriers are on the details. But as we can -- our interpretation is that we are basically already compliant with Basel III today.

Q - Boris Molina {BIO 1904979 <GO>}

Wonderful. Thank you very much.

A - Roberto Egydio Setubal {BIO 1525746 <GO>}

Thank you.

Operator

Thank you. This concludes today's question-and-answer session. Due to the time, all of the questions and doubts that have not been answered, the IR department will get in contact later on for further clarifications.

Now I would like to invite Mr. Roberto Setubal for his final remarks. Please, sir, go ahead.

A - Roberto Egydio Setubal {BIO 1525746 <GO>}

Well thank you all of you to be with us today. We had a lot of things to discuss. I think that -- I believe that I could make some clarification about guidance for next -- for this year. And some explanation about Redecard. But in addition Rogerio and his team will be available for additional discussion that you might have.

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I know that we still have some questions open. But given the time, we are closing the session at this point.

Thank you, all for being with us. Bye, bye.

Operator

That does conclude our Itau Unibanco Holding S.A. earnings conference call for today. Thank you very much for your participation and have a good day.

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