Q2 2012 Earnings Call

Company Participants

- Alfredo Egydio Setubal, EVP and IRO
- Rogerio Calderon, Corporate Controller and Head of IR
- Sergio Ribeiro da Costa Werlang, EVP of Risk Control and Finance

Other Participants

- Carlos Macedo, Analyst
- Daniel Abut, Analyst
- Mac Pina, Analyst
- Marcelo Henriques, Analyst
- Marcelo Telles, Analyst
- Mario Pierry, Analyst
- Saul Martinez, Analyst
- Victor Galliano, Analyst

Presentation

Operator

Ladies and gentlemen thank you for standing by. We inform you that this conference call aims exclusively to discuss the earnings results of Itau Unibanco Holding regarding the Second Quarter of 2012. Queries related to Redecard's public offering shall be addressed to the investor relations division of Itau Unibanco Holding. 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.itau-unibanco.com/ir. A slide presentation is also available on the 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. Alfredo Egydio Setubal, Executive Vice President and Investor Relations Officer; Sergio Ribeiro da Costa Werlang, Executive Vice President of Risk Control and Finance, Caio Ibrahim David, Chief Financial Officer and Rogerio Calderon, Corporate Controller and Head of Investor Relations.

First, Mr. Alfredo Setubal will comment on the Second Quarter of 2012 results. Afterwards management will be available for a question-and-answer session. It is now my pleasure to turn the call over to Mr. Setubal.

Alfredo Egydio Setubal {BIO 1528623 <GO>}

Hello. Good morning for those in US and good afternoon for those who are in Europe. It's a pleasure for us to be here again to speak about our Second Quarter results of 2012.

For those who are following through the Internet we are starting on page two on the slide number 2, highlights. The first highlight is the result. The result -- recurring result -- recurring income BRL3.6 billion in the Second Quarter, what means ROE analysis of 19.4%, this means an increase of 8.1% when we compare the Second Quarter of 2011. For the whole year of 2012 the net income achieved BRL7.1 billion with ROE of 19.7%. This result means an increase of 2.5% when we compare to 2011.

The second highlight is the loan portfolio that we are going to speak more deeply in the coming slides. But anyway, we achieved BRL432 billion in credits here including endorsements, sureties and private securities that we held in treasury of large companies. This means a growth including all these, 3.6% growth when we compare to March '12 -- 2012. And 15.2% when we compare to June 2011.

The third highlight is related to our financial margin with clients. The financial margin with clients achieved BRL12.3 billion in this quarter. The net interest margin with the clients decreased at 30 basis points achieving 10.9%, especially because of the impact of the reduction of the SELIC rate that the Central Bank is doing in the last Copom meetings during the year since last August, when they started to reduce the SELIC rate.

The credit spread remained almost flat with a small reduction of 10 basis points achieving 13.4%. And when we look at the risk adjusted credit spread, the net spread also a decrease -- an increase of 10 basis points achieving 7.5% in this quarter.

The fourth highlight is related to our banking fees and result from the insurance, pension plans and capitalization business. These operations grew 0.6% in the Second Quarter when we compared to the First Quarter of 2012, achieving BRL5.8 billion in the period. When we compare to last year, we see an increase in this revenues and results from 11.5%.

Fifth highlight is related to our non-performing loan ratio and our loan losses. Our expenses net of credit recovery achieved BRL4.9 billion in the Second Quarter. The 90 day -- the total provisions created in this quarter achieved BRL6 billion. The 90 days NPL achieved 5.2% in the Second Quarter with a 10 basis point growth quarter-on-quarter and 70 basis points when we compare to June 2011. And we are going to talk more about this in the coming slides also.

The sixth highlight is related to our non-expense -- interest expenses. The growth in the quarter 3.2% and when we compare 12 months, 5.8%, in line what we expected. And there is a reduction in the pace of growth of expenses during the year.

Seventh highlight is related to efficiency ratio. Efficiency ratio in this quarter increased 50 basis points. This ratio reached 44.8%, what means that 280% increase compared to the first half of 2011. In the last 12 months our efficiency ratio reached 45.9%, which means an improvement of 330 basis points also in line with the expectations that we have for this year.

And the last highlight is related to our unrealized gains. We have BRL5.8 billion in unrealized gains. And from this BRL1.5 billion is related from our available for sale portfolio of securities.

Going to the slide number 4. We have here the -- our results. The total recurrent net income BRL3.6 billion, net income BRL3.3 billion, the difference is related essentially to the sale of our position our stake on BPI in Portugal to la Caixa of Barcelona.

More details. Here we can see the operating revenues of BRL20.2 billion, an increase of 1.8% in the quarter and 12.2% when we compare to June of last year. We can see here the financial margin with clients that we already talked during the highlights, an increase -- a decrease in the quarter of 0.1%. Margin with the market, an increase of 18.4% in the quarter achieving BRL1.1 billion. And an increase of 28.3% in the -- in 12 months here, more related to our structural positions and also for a better quarter for the market especially for fixed income.

We can see also banking fees of BRL5 billion, an increase of 1.5% in the quarter. Results from insurance, BRL1.4 billion, an increase of 0.3% and when we compare 12 months, almost 17%.

Good news came from loan losses and retained claims -- our expenses of loan -- for loan losses was a little bit lower than in the First Quarter. We have a decrease of 0.7% achieving almost BRL6 billion, what was good because it was in the lower range of the bands that we provided at the end of the second -- of the First Quarter, when we announced the expectation for losses for the second and Third Quarter. So here it was a better number, better -- for us was good news also.

Recovery, a little bit lower also when we compare to last quarter, 5.6% lower in terms of recovery of credits. Operating expenses, as I said, we continue to be very focused on controlling the non-interest expenses and the growth of this line when we see 12 months was -- 5.8% was a good number for this line.

On slide number 5, we can see here more visual, some highlights, operating revenues, total of BRL40.2 billion, an increase of 12.2% year-over-year. Loan losses provisions expenses, the total for this first semester is BRL12 billion, an increase of 26.7% when we compare to the First Quarter -- for the first semester of 2011. Non-interest expenses 5.8%, as I mentioned and recurrent net income BRL7.1 billion, an increase of 2.5% when we compare to the first semester of 2011.

Slide 6, we can see here the net interest margin with the clients, with a decrease as I mentioned of 50 basis points, achieving 11% when we compare 12 months and 30 basis points when we compare to the First Quarter of 2012.

Banking fees, an increase of 11.5% in the quarter, we -- including here the results from the insurance business. And our ROE, 19.4% in the quarter, a little bit lower than the 20% of the First Quarter of 2012. And when we compare 12 months, 19.7% lower than the almost 22% that we showed in the First Quarter -- in the first semester of 2011.

On page 7, we can see the financial margin. As I mentioned in the highlights, a small reduction of 10 basis points in the gross credit spread, achieving 13.4%. When we see the dotted line, when we consider risk adjusted NIM with the clients, also a reduction, achieving 6.6% of reduction. So we continue to see a trend of some reduction here related to the reduction of the SELIC rate and also the spreads.

On slide number 8, we see some other highlights related to our balance sheets. Assets, we have a decrease in this quarter, a decrease of 0.9%; especially related this decrease of the reduction of the portfolio of vehicle financing. So we had this reduction and a lower pace of credit growth in this period. Stockholders equity, only by capitalization of profit, increased 4.3%, achieving 75.6% (sic; see slide eight "BRL75.6 billion"). The loan portfolio here only -- not including the securities of large cost that we hold on our treasury books. So the number is BRL413 billion, an increase of 3.2% in this quarter compared to the First Quarter. And funding, total deposits and events with clients, BRL942 billion, an increase of 1.8%.

On page 9, we can see more details about our loan portfolio, when we see by the type of line and product that we have. So the total of BRL413 billion, BRL147 billion is related to individuals. We see that during this quarter we had a decrease of 0.2% on the credit related to individuals mainly because of the reduction that we are doing in our car financing business. During this quarter we reduced the portfolio of car financing by 4.2%. And also a reduction when we see the 12 months, almost 6%. So it is part of our strategy to reduce a little our exposure in the car finance in the local Brazilian market.

But when we see the other lines, credit cards and personal loans, we see good growth when we compare to the First Quarter. And mortgage, that continues to be strong, almost 8% growth in this quarter and 43% when we compare to last year. So individuals, the main issue here is related to car finance that we are going to give you more details in the coming slides.

When we see the numbers related to companies, we can see that we show the growth of 4.3% here, we achieved BRL241 billion, corporate increased 5.8% in the quarter and here we have an impact of the devaluation of the real against the dollar in our credit portfolio denominated in dollar currency. When we see this very small, small and middle market, we continue to be selective here since the beginning of last year. So we continue to have a small pace of growth when we see this portfolio. So in 12 months the growth was only 6.3%. And in the quarter 1.9%.

We had some growth in the Mercosur Countries that we have corporate and retail operations, the growth of the credit portfolio was 14.8% in the quarter, here because of having more activity of corporate business in Chile and also because of the devaluation of the real related to the dollar.

On slide number 10, we can see more details about our credit ratios. The credit ratio for the total portfolio increase by 10 basis points, achieving 5.2%. We can see here a decrease in the NPL over 90 days for companies. We reduced these from 3.7% to 3.5% and we see an increase also in the portfolio of individuals, that increased from 6.7% to 7.3%. Here we have also impact of the increase of the delinquency in car vehicles, at the same time that this portfolio is reducing. So we think have -- this reduction of the portfolio of course have an impact in the credit ratio for individuals in the total ratio for individuals in terms of credit.

It's a good news on this chart design. When we see 15 to 90 days NPL ratio, we can see that both for individuals and for companies these numbers are much better. What we can expect a lower NPL creation for the coming quarters if this trend continues to -- in the coming quarters. The total balance of provisions is BRL27.1 billion at the end of this first semester.

On slide 11 we can see our delinquency for the vehicle -- car finance portfolio. We can see from long periods of time, of monthly granting of credits. We can see Itau Unibanco line in red and the markets without Itau Unibanco in dark, in black. We can see that we had some periods at the beginning -- or at the end of 2010 and beginning of 2011, that our numbers were worse than the industry and this is what we are making provisions now and the last quarter, the first and the Second Quarter of 2012 more specifically. But with the measures that we took at the beginning of last year when we saw this trend, we have now much better ratios when we compare to the market.

So also this gives us much confidence that we took the correct measures to avoid worse problems related to this credit portfolio. And what we are seeing in these quarters. And we will continue to see in the coming quarters, is more related to the credits granted in the past. When we see this -- the credit granted to the end of last year we can see much better numbers and position.

On slide 12, we can see other numbers related to the measures that we took, related to this vehicle portfolio, the reduction in the number of payments that we did -- we have now 42 months in terms of payment. And also in the orange line, the average down payment that increased from 28% to 35%. So the value of the collateral is much better now in this situation.

We see in the charts below that we reduced very deeply the 60-month term of no down payment. And on the chart at the right side we see what we expected in terms of trend because of these measures and because of these much better numbers that we have in terms of delinquency. What we expect in the coming two quarters for the second semester in terms of loan loss provision for this credit line. So we can see a much better trend in terms of provisions for car financing.

On slide 13, you can see all the funding and all the proprietary capital and subordinated debt and AuA that we have. The total is BRL1.2 trillion.

On page 14, no problems in terms of funding for the growth of the credit portfolio, we have room to continue to grow. Deposit is not an issue here in Brazil for funding the credit portfolio.

Slide 15, banking fees and insurance result -- 12-month growth, 11.5%, in line with the numbers that we provided. And here we can see also that we have the impact of Orbitall that we sold. So we don't have more revenues from Orbitall in terms of processing service that this company was providing.

On slide 16, non-interest expenses. As I said we continue to be very focused on these and we are very optimistic that we continue to reduce the pace of the growth of these non-interest expenses. In 12 months, the growth was 5.8%, in the quarter 3.2%. We continue (to be) very optimistic that we are going to reduce even more, these.

On slide 17, our managerial composition of net income. We can see in the Second Quarter that the commercial bank was responsible for 32% of our net income, Itau BBA 17%, insurance 14%, consumer credit 8%. And our market activities and corporation in our -- means the use of the excessive capital that we have, 29%.

In terms of BIS ratio, we have 16.9%. We can see in the chart besides these -- the composition of the reasons of the growth, where did this growth come. And also we had the approval of the Central Bank today that our Tier II ratio of BRL1.7 billion subordinated debt. So our number today is higher than this; it's 17.2% because of this approval that was pending in the Central Bank.

In terms of -- on slide 19, our market capitalization has decreased during last year and this year because of the financial credit crisis in Europe, in Brazil, in the U.S. So the Bank's shares suffered a lot in all these markets and our market capitalization also achieving BRL127 billion by the end of the semester. And our shares continue to have more liquidity in the New York Stock Exchange. The total liquidity is BRL751 billion per day, which is a good number.

On side 20, here we have some new expectations for 2012. The first conference call of the year when we released the results for 2011 we said that our expectation for credit growth was 14% to 17%. Now, with the revision that we did and because of the measures that we took and are taking on our credit portfolio, we expected our credit portfolio to grow at 10% this year especially because we are decreasing our credit portfolio in car financing from BRL60 billion by the end of 2011 to BRL50 billion to BRL52 billion in this segment. So this impacts the growth of our total portfolio. If we don't consider vehicles, we expect a growth of 13% to 15% for the whole year of 2012. So we are reducing our expectation in terms of credit growth.

In terms of NPL, we -- at the beginning of the year, we expected the NPL to be stable. In the conference call of the First Quarter, we changed to show the loan loss expenses instead of NPL. And this also we are reducing our expectations of loan loss provisions expenses that we'll be creating in the third and Fourth Quarter. So Third Quarter, now we expect the loan loss provisions to be between BRL6 billion and BRL6.5 billion for the Third Quarter. And BRL5.7 billion and BRL6.2 billion for the Fourth Quarter of this year.

In terms of fees and result from insurance, we are keeping our 10% to 12% growth for the year.

Non-interest expenses also we are reducing. We expect now the growth to expenses to be between 3.5% and 6.5% for the whole year

And even with these difficulties to increase the revenues line because -- especially because we are going to grow less than expected in terms of credit. But anyway, because of the good numbers in terms of expenses we are maintaining our 200 basis points to 300 basis points reduction -- improvement in the efficiency ratio.

The final slide is related to our new JV that we announced with Banco BMG. We are creating a new bank where Itau Unibanco will keep 70% of the shares and Banco BMG, that will continue to make its operations, will have 30%. The total capital --- initial capital for this new venture is BRL1 billion and we --- this new venture we will have 70% of the creation of payroll credits that Banco BMG will sell to this new venture.

We expected this venture to achieve BRL12 billion in terms of payroll credits in two years. So this is in line with the strategy of changing a little the mix of credits of Itau Unibanco, especially related to the credit of individuals.

We expected now this payroll business to grow and help us to reduce the dependency in car finance and credit card business. They are very good, we will continue to be good but of course is more risky and we want to reduce the risk of our credit portfolio in the coming years. So this BMG deal was in line with the strategy that we announced some quarters ago that we are going to grow in this direction of changing the mix of our individual credit portfolio.

So this finishes the first part of our conference call. And now we are all here open to answer your questions about this quarter and the trend for the coming quarter. Thank you.

Questions And Answers

Operator

Excuse me ladies and gentlemen. we will now begin the question and answer session. (Operator Instructions) Daniel Abut, Citigroup.

Q - Daniel Abut {BIO 1505546 <GO>}

Alfredo, in the prior conference call you did say that even though this year was going to be subpar in terms of earnings growth, even the significant increase in provisions that you have seen particularly in the first half but to some extent into the second half as well. But you still expected some low single digit earnings growth for the (year of the call) and so fine the first half you are delivering that. You explained in page five that if we look at the net income --- recurrent net income for the first half of the year is showing 2.5% growth compared to the first half of the 2011.

So you still feel comfortable that this kind of low single digit earnings growth for (the year of the call) remains a realistic assumption particularly given the more encouraging trend that you are starting to see on the asset quality side?

And the second question on expense, well, given that --- that you have lower the guidance for expense growth this year and given the promise you are making on your efficiency improvement program, given that that program lasts at least through the end of last year, is this the level of cost growth that we should expect for this year as well --- for next year as well, or there is something more concentrated in this year in terms of your cost effort that doesn't necessarily translate into the way your expenses are going to behave next year?

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

Hello Daniel, yes we expected some low single digit growth for the year, that is the number -- that is the expectation that we have. Of course, due to the conditions especially also because we are -- continue to have some growth, some good --- some big numbers in terms of NPL and expenses creation for loan losses. Of course, we cannot expect big increase in terms of result but we still expected -- expect some growth for the results. We continue to work well in terms of expenses. We continue to see some growth in terms of credit portfolio.

So one by the other we --- our budgeting should see some growth in terms of results. But we have to see especially the trends related to our provision for loan loss. I think the biggest driver for this is these line of provisions that we have; how much we will have to make in this second semester; but we don't see big changes in the scenario related to the economy, which we expect the economy to be in a better shape by the end of the year and next year.

So we don't see unemployment growing. So the scenario that we are seeing is a better scenario. Of course we have some uncertainty stemming from, especially from Europe; of course it is unpredictable what can happen in Europe and what -- if something bad happens and what will be the real impact in the Brazilian economy. But anyway, what we can see we are confident that the results will be in a good line and probably with small growth when we compare to last year.

A - Rogerio Calderon

I can take the second one, Alfredo. Rogerio speaking, Daniel. You asked about the pace for expense growth next year is -- that the pace we are posting now is sustainable for next year. We have a long term view in terms expenses growth. We drive the bank in order to keep expenses grow in line with inflation in order to have all the productivity benefits we have in order to fund the organic growth of the bank. So we do believe that we are --- we will be able to keep the same pace of growth in terms of expenses for next year and we do reaffirm that we have conditions to reach the expectance -- the expectation we have in terms of efficiency ratio. Of course it is important to remember that the level of top line growth is an additional challenge here but the bank is going to the right type of direction in terms of gaining efficiency. So we are going to be -- if not at 41% we are going to be very close to 41% as we had established before.

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

For this year, 3.5% to 6.5% is not the outlier. That is kind of the pace you think not only next year but longer than you would like to keep as inflation is likely to fall somewhere in between that range and that you still feel comfortable getting close, if not hitting, the 41% cost-income ratio by the end of next year.

Q - Daniel Abut {BIO 1505546 <GO>}

Absolutely.

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

Thank you, Daniel.

Operator

Carlos Macedo, Goldman Sachs.

Q - Carlos Macedo {BIO 15158925 <GO>}

I have a couple of questions. They are kind --- they are little bit of a follow up to Daniel's question on efficiency. So I will go first with the --- with the more difficult part of the equation, which is margins. Margins dropped again in the quarter. Of course the base rates the SELIC going down has an impact on your margins.

The question is, Rogerio. And I think in the previous call you mentioned that you still expect margins to increase by something like 12% this year versus last year because of the hedges that you have against lower rates. Is that something -- is that expectation something that you still have, a 12% increase in net interest income in 2012? What if not -- given the results of the quarter, I think now, year to date, you're going at 10%. Should we expect that to improve going forward despite rates being lower?

And the second question is again regarding expenses. And particularly head count. The head count dropped below 100,000 for the first time since the merger. Is there more cutting to be done? Will you lower head count further or will additional gains in efficiency from the -- from that perspective come from for instance, shifting back office away from Sao Paulo which is a very expensive location or other things like that?

A - Rogerio Calderon

Okay, Carlos, we have reviewed the expectation for credit growth. We have now an estimate of credit growing around 10% when you include auto loans insight, its 13% to 15% (ex-auto) loans as you know. So we believe that the contraction in terms of spreads is still in a slow movement. But we do see some contraction in the origination particularly because of the mix, particularly because we are driving the bank to a lower risk type of credit. And because of that we have an expectation that the top line should grow below 10% and slightly below 10%.

Regarding your question on expenses. We had an important impact in the Second Quarter 2012 because of the selling of Orbitall. So a portion of the head count reduction is due to the selling of Orbitall, as well as the cumulative figure includes some reductions on partnerships, et cetera, that reduced our head counts. Looking forward, we do have some perspectives of keeping, gaining efficiency, taking into consideration the opportunities we have in terms of normal turnover of the Bank.

It's pretty important to highlight this point, particularly at this point of the year, because what we are doing is actually capturing benefits out of the normal turnover of the Bank. Every time we can keep doing the same level of business without replacing people we take this advantage and we capture this benefit. We should keep doing the same.

Q - Carlos Macedo {BIO 15158925 <GO>}

So this -- you would take advantage of attrition in order to not hire but just hire selectively, I guess, to replace. Are there other things that you can do -- if you could give us some color in order to achieve this very low inflation, rate of pace of growth given that volumes will be growing faster than inflation? What is in the pipeline to be done so that we can at least have some comfort that you will be able to achieve this?

A - Rogerio Calderon

So lots of initiatives, (even though the project efficient). So we have lots of synergies capturing. We have a base effect. Remember that we have, as you mentioned, we have a lower head count now so we have some -- we had -- on one hand we have the new labor agreement to come. But on the other hand we have a lower level of head count due to the normal attrition as you mentioned. So we do have in our budget all the conditions (to post) inside the range we just supplied to you. And we are pretty confident that we are going to do so.

Q - Carlos Macedo {BIO 15158925 <GO>}

Including next year, as you said, around inflation next year, right?

A - Rogerio Calderon

Yes. Long-term view is the expense is growing in line with the expenses. So every -- inflation. And every additional improvement or increasing in our activity should be funded by the gains we have in efficiency.

Q - Carlos Macedo {BIO 15158925 <GO>}

Okay. Thank you, Rogerio.

A - Rogerio Calderon

Thank you, Carlos.

Operator

Saul Martinez, JP Morgan.

Q - Saul Martinez {BIO 5811266 <GO>}

Hi good morning, guys. I have to say I am a little bit surprised by the response on -- to the cost question. My understanding was that you -- that the target was really to improve the efficiency ratio as opposed to targeting a certain number of -- a certain percentage cost growth i.e. inflation. Has something changed because it seems if volumes pick up at some point and you do start to see a bit better top line, wouldn't it be more -- wouldn't it be better to invest in your business and try to capture that growth even if cost growth is a little bit higher in an environment where revenue growth starts to pick up and hence you can -- and hence you can invest in your business and still grow your cost base a little bit as long it's grown below inflation you get the operating leverage.

But it seems to target inflation in an environment or perhaps the economic environment improves and top line improves, I don't know, on surface it seems to be a little bit short sighted. Has something changed in terms of how you are thinking about the cost? I always thought it was 200 to 300 basis points, the improvement that you are targeting, as opposed to a select percentage growth figure?

A - Rogerio Calderon

Well nothing changed, Saul, Rogerio speaking. Sorry if I gave you a different perspective or a different conclusion out of what I just said. Our long-term perspective is of course taking into consideration the normal business. But our preference is -- of course is investing, is growing. And of all what we have behind the targets of the Bank remain on efficiency, not in cost cutting definitely.

Q - Saul Martinez {BIO 5811266 <GO>}

Okay. So that the inflation figure you gave assumes a certain growth in your top line in the coming years; that similar to what you're growing today?

A - Rogerio Calderon

Yes. Actually it's expected that the country or the environment should improve. And we expect that next year, a strong next year, we could be growing in a higher level. And the mention I made in terms of inflation is a sort of an overall perspective we have in long-term. But what we are going to do is taking all the opportunity to keep growing. Of course, it's not a barrier to keep or to prevent from growing because of the targets on costs. What is driving the Bank is definitely efficiency.

Q - Saul Martinez {BIO 5811266 <GO>}

Okay. So -- okay, fair enough. Follow-up question on your expectations for financial margins. I think you addressed it. But your NIM from spread sensitive transactions has been very resilient. And we have seen a pretty sharp reduction in lending spreads according to Central Bank data. Can you talk a little bit more in detail about what your expectations are there? You mentioned you expect a little bit of a decline. But why -- and part of that's a mix. But why shouldn't we see a broader decline that really compresses your margin if new origination is being done at much lower spreads?

A - Sergio Ribeiro da Costa Werlang {BIO 2384657 <GO>}

Saul, this is Sergio. I will comment a little bit on the Central Bank data and then I'll pass on to Rogerio.

Q - Saul Martinez {BIO 5811266 <GO>}

Great.

A - Sergio Ribeiro da Costa Werlang {BIO 2384657 <GO>}

The Central Bank has two measures of spreads. One is not very well known and it's published in the financial stability report. And it's quite comparable to our net interest margins. And it has a much smoother behavior than the other one which is more, let's say, famous. And is monthly released.

The other spreads have been created. This other measure, which as you mentioned has shown sharp reductions. They have been -- it has been created in 1999. Now, it turns out that the mix of products that the market now has is -- is quite different from the mix of products which is considered under this basis of the Central Bank.

Let me give you two examples just to illustrate the point. By then, in 1999, real estate loans for individuals were actually quite -- at the quite low level in the economy. And so it was decided not to be included. Another portfolio, which was not very large, was some BNDES loans that are given through the financial sector and which became quite important.

And Saul, these two they have very, very small spreads and which oscillate quite -- they have quite small oscillations. What I mean is the following with this introduction. You should not use the big number that is released monthly by the Central Bank in terms of fall of spreads to imagine that this will have an immediate one-to-one impact on the balance sheet of the financial sector as a whole.

A - Rogerio Calderon

Saul, just complementing a little bit, Sergio has mentioned a lot in terms of the average of these spreads, particularly, I just want to add, if you look particularly on specific segments, auto loans for instance, what we have is a reduction. First of all, what you see in the data from Central Bank is origination. Remember that we are more selective. So we are originating lower level of risk in our portfolio. And as a consequence of course the spreads are lower, does not mean that the final contribution is going to be lower. But it does mean that the net or the gross spread is lower at the origination.

It takes some more time because of the replacements of the portfolio as you know. So the NIM we show in our statements of income, is actually a consequence of our stock and not of our origination, that is, it does reduces. But reduces because of mix, because of some specific things like in auto loans again, the commissions to the car dealers has been reduced.

So at the end of the day it does not impact the profitability of the bank. But it represents a reduction in the spread for the final (cost). I also want to remind you that we have made a very important shift in terms of the mix of our personal loans. We are now originating much more payroll discounted type of credit, what drives this spread down. But does not remove any profitability, much on the contrary.

Q - Saul Martinez {BIO 5811266 <GO>}

Okay. So I guess, if I look at the spread on credit transaction, down from like 12percentage points in the end of 2010 to 11 -- 10.9percentage points now, is that the kind of compression that you see a gradual compression of about a percentage point a year, would that be a reasonable assumption to kind of use for the rate of compression in your lending spreads?

A - Rogerio Calderon

Yes. It's a similar pace. Of course when we have some acceleration in the credit origination, it could accelerate a little bit. But we don't think it is going to be a major change. We do believe that it will take some years and this, from our perspective, will give us enough time to reduce the level of provisions we have in relation to the top line. Remember that at now we have the worse picture because we are moving from higher risk to lower risk. But (issue) posting the consequence of the higher risk portfolio originated some time ago. So with this time change, we could be benefiting out of this change.

Q - Saul Martinez {BIO 5811266 <GO>}

Okay, got it, thanks a lot

A - Rogerio Calderon

Thank you.

Operator

Mario Pierry, Deutsche Bank.

Q - Mario Pierry {BIO 1505554 <GO>}

Let me ask you two questions. The first one on your NPL ratio. You did do a good job showing to us that the increase in NPLs in the individual segments was primarily related to the auto portfolio and primarily related to the slowdown in the loan book. But I was wondering if you can provide us any color on how your other portfolios are performing, in particular credit cards.

And also how comfortable do you feel with the health of your corporate portfolio, I know that you showed an improvement on your overall corporate portfolio. But some of your peers are having some problems. So I was just wondering if you think that the problems that we are seeing with the other banks is specific or do you think this could become a concern for the industry as a whole? Then I will you my second question later.

A - Rogerio Calderon

We have -- this NPL increasing over 90 days is the consequence of mainly two factors, or almost everything coming from this work. We have some increase in the level contributed by personal loans because of the acceleration we did in the past. So this is a mix change. And we do have this increase of auto loans, as you mentioned, I just remember that all of these movements are included in our expectation, just released positively on a lower level of expenses for -- but that's in the coming quarter.

When looking at the companies, we have a decrease of 20 basis points in the portfolio of companies, this decrease was observed in the both lines, is more companies and corporates, both at the same level. Just as you mentioned the peer, of course I am not going to comment on this. But I just want to reaffirm that we look at the SME with a different perspective. We name SMEs here at Itau Unibanco, companies with revenues limited to BRL150 million, what is different from some of the other competitors. But in both case we don't have any negative movements, both are improving at the same level, 20 basis points.

Two additional data are important to analyze the future of this NPL, particularly (inaudible). We see two very positive indicators, the early delinquency, 15-90 days, is actually in a lower level, decelerating from over 90; this is a consequence of the decisions we took before. So more selective, of course, we are originating better quality of creditors. And as time goes on we have a better performance of delinquency in our portfolio.

The other important indicator showing improvements is the NPL creation. So the level of NPL creation has reduced from First Quarter to the Second Quarter and we do believe that this new level reached is a stable level. So we should see a more resilient level of NPL creating in the coming quarters at a lower level than what we showed in the First Quarter.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. That's clear. My second question then is related to the negotiations, your annual negotiations with the labor union. I read here in the local press that the union is asking for 10% increase in wages this year. Is this is a type of increase that you have baked into your forecast when you gave your expense growth of 3.5% to 6.5%?

A - Rogerio Calderon

Mario, yes, this is all included in our expectation for efficiency ratio and expenses. We do have some expectation that's contemplated in our budgets. Let's wait and see.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. So but like -- I would imagine that normally the union asks for a big number and then you eventually are able to reduce this more in line with inflation plus --

A - Rogerio Calderon

Yes. In our budgets we have a lower level than what they had initially asked for. And normally, if you look at the history of all the negotiations, normally the first initiative from the unions came in a higher level than the final agreements that we have at the end.

Q - Mario Pierry {BIO 1505554 <GO>}

Great, thank you.

Operator

Marcelo Telles, Credit Suisse.

Q - Marcelo Telles {BIO 3560829 <GO>}

I have one question regarding your fee guidance. You basically maintain the same 10% to 12% guidance that you had provided at the end of last year. But I remember when all the discussions about lower credit spreads started, one of the arguments is that banks and yourselves would be able to increase fees in order to compensate for -- for lower credit spreads. And you maintain this 10% to 12%. I want to know what is the reason for that and if you think that maybe next year we can expect some acceleration in fee growth and then after that.

Then my second question would be still on the margins because if you look at the agreement you guys had with BMG and so on -- I believe that your mix might change in a meaningful way, right, very high growth in mortgages high growth in payroll lending. And my assessment is that even if you look in terms of your credit spreads after provisions, I would imagine that those segments would still have lower risk adjusted spreads than other segments. Therefore, we should expect a decline in your margins aside from the impact of lower rates, which is easier to predict but how do you respond to that and why are you so confident that the spreads or the margin after provisions will not go down? Thank you.

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

Marcelo, we agree with your points on fees and that's exactly why we are not reducing any expectation in terms of fee income despite we have a lower contribution from the auto loans segment. And also the selling of Orbitall, that reduces our fees on this specific business. So despite we have those reductions, since the first moment we launched the guidance on fee income we are keeping what -- if you consider everything the same, it would imply actually an increase in expectation in fee income. We are keeping the same despite of these reductions in terms of growth. Remember that auto loans represent a very important contribution in terms of fee income and also the investment bank has had a lower level of activities than what we had forecasted at the beginning when we launched (the guide).

And I think, if you add everything in a more negative or lower dynamics in terms of growth, beginning from the growth of the Brazilian economy. So all included, just by keeping the fee income perspective we think we have a positive re-approach of this perspective. In terms of margins, as you mentioned, we are moving, we are changing the mix of the portfolio towards lower risk. And the margins, the gross margins, the gross -- or the margin before bad debt, that should be impacted over time. It takes some time as I mentioned in the prior question but this trend is what we also believe is going to happen.

When looking at the margin after bad debt, then it's different because the level of bad debts that we have now is pretty high. So it tends to reduce as a proportion of the margin; so offsetting part of this pressure. So we don't think that we are going to be pressured down. We don't share the view of this major compression in the margin after bad debts.

Q - Marcelo Telles {BIO 3560829 <GO>}

Thank you.

Operator

Marcelo Henriques, BTG Pactual.

Q - Marcelo Henriques {BIO 17385475 <GO>}

Hello, guys. I have two questions. One, I want to stress a little bit the discussion on the NII and margins, in trying to separate 2012 and 2013. Looking at your numbers, at least from my perspective, when you are looking at whole NII, even if you (close) with the market, it seems very reasonable to assume that you are going to have very -- difficulties in increasing this number in absolute terms until the end of the year.

If you assume that, as you always say, that the margins from the market should go -- should be between BRL800 million and BRL900 million. And the fact that on the client side the interest rates will be lower on average in the next two quarters if you compare to the Second Quarter 2012. And then even continue to have a very low loan growth. So it seems unlikely that you can improve this number. So on 2012 specifically I am just wondering how confident you are of reaching a number which is pretty much around 10%.

And moving forward to 2013. And it's difficult to see but maybe you have a pickup in volumes as this growth is still very low. But on the margin side -- that's my question, the margin side. And I understand from your comments that it's very hard to compare the Central Bank data with the numbers that the banks report but the reduction was very pronounced; and even if you consider, like, half of what happened and the Central Bank, what should be expect from margin reduction in 2013 from a client perspective? Would a 40 bps, 50 bps decline would be something that should be reasonable?

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

Marcelo, looking firstly to the coming quarters as you mentioned, we just released our expectation for the credit growth encompassing auto loans. It means that our final portfolio growth at the end of the year is going to reach around 10%. We believe that the less of contraction that we see in the margins are going to be moving at the same pace in the coming quarters. So we do believe that the NII growth should be lower than 10%, close to 10%.

When mentioning our margins with the market, that includes the contribution from trading but it also includes the assets and liability management of the Bank. We believe that we are going to be posting the same perspective that we -- you just mentioned. And that we normally announce to the market. So around BRL900 million every quarter. So we believe that at the end of the year we are going to be close to 10% but lower than 10% in terms of NII.

When looking at the next periods, 2013 onwards, we believe that we are going to have a contribution from bad debts. So despite of this reduction in the margins we do believe we are going to retain the benefits of these shares because mainly when you look at the data from Central Bank what we have is the change of the mix.

So we know that the spreads measured by Central Bank is actually now based on the type of portfolio that is not what we have majorly in our portfolio, is not -- as a consequence is mostly impacting the spreads and the losses on credits. So we believe that we are going to post better figures in terms of the amounts of losses on credit. This is pretty important when you forecast our expectation for margins.

Q - Marcelo Henriques {BIO 17385475 <GO>}

Would you agree that it is easier or let's say less difficult to keep your margins a little bit more resilient in a way -- in a sense that you are not growing; you're actually decelerating your loan book. And so as you move toward to 2013 and if you want to re-accelerate that, your margin should compress much further than what happened this year.

And not to mention that the interest rates on average in 2013 at least should be much lower than this year as (inaudible) curve is saying? So I am just wondering -- I know you are not providing guidance for 2013 but what should -- should we expect a much larger compression of margin in 2013 than what you are seeing now?

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

We -- it's important. You made a good point. Volumes should increase. Remember that we are -- this movement on spreads moving the credit growth towards lower risk is actually what we have decided to do, what we have announced a year ago. So we are moving on that direction. We just announced this BTG agreement, the new bank on the payroll BMG agreements, the new origination on this payroll linked loans. So this is all related to increasing the volumes of the Bank. It's probably another benefit on our margins as well.

Q - Marcelo Henriques {BIO 17385475 <GO>}

Okay.

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

Remember, that SELIC is reducing this year but, the SELIC expected for next year is different. Some guys in the market are actually pointing SELIC up.

Q - Marcelo Henriques {BIO 17385475 <GO>}

And sorry, just one last question. On loan loss provision, if I am looking right, when you report by segment. And if I look at the numbers specifically on Itau BBA, your loan loss provision, the expenses increased almost three times quarter-over-quarter, I mean, from BRL79 million or BRL80 million, something like this to BRL230 million or BRL220 million. And one of your competitor, actually two of them is saying that this quarter specifically they have to increase provisions on a large corporate site. So I am just wondering if this related as well because I know that only -- Itau BBA specifically that's where you handle the large corporate. So I am just wondering if this is related and if you see this continue?

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

Marcelo, this is all contained in the our expectation of the debt expense for the rest of the year. The movements you saw in the Second Quarter, 40% is related to ForEx impact and all of the other movements are related to the mix of the portfolio and maturity, not special case, not specifically anything, the NPL actual improved 20 basis points for large corporates and this is all included in the bad debt expectation.

Q - Marcelo Henriques {BIO 17385475 <GO>}

Okay, got it, thank you, thank you very much.

Operator

Victor Galliano, HSBC.

Q - Victor Galliano {BIO 1517713 <GO>}

Yes, just a couple of questions here. One on the NPLs. And looking in particular the vehicle and what you put there on page 12, which is very interesting. So are you saying that 2011 quarterly average of provision of BRL607 million, is that kind of a normalized level that you would expect to be kind of heading back to or is there any effect of contamination there, say, in Q3 or Q4 in that provision number? In other words, could this actually -- could a normalized provision for vehicle loan portfolio be lower than the BRL607 million? That's my first question.

The second one is do you disclose what percentage of your total loan portfolio is fixed rate and of this what percentage would mature in the next 180 days; those are my questions?

A - Rogerio Calderon

I am trying to take the figures here to address the second question. Regarding your first question, actually the proportional levels of bad debt expenses, back to this level we announced here is a good proxy. But as the portfolio is now at a lower level, the nominal amount should be even lower than BRL600 million. And also currency is actually mentioning here, also there is a mix change in terms of the quality of the origination. So we are originating the credit now at a lower risk.

If you look at the -- your left hand side, you will see the terms are shorter and the level of down payments are higher. So the quality of the portfolio is actually better. So it should improve as well as a consequence of the mix. Fixed rates, it's around 80% and I think maturity, a good guess, with not a very fine, the final calculation here is around two years.

Q - Victor Galliano {BIO 1517713 <GO>}

Two years is the average and 80% of your portfolio is fixed rate? 8-0, wow.

A - Rogerio Calderon

Yes. So just remember that although fixed rate, it has a short duration.

Q - Victor Galliano {BIO 1517713 <GO>}

Yes, sure.

A - Rogerio Calderon

So it's actually some lines despite of this fixed rate, they have a behavior that is similar to a floating rate behavior.

Q - Victor Galliano {BIO 1517713 <GO>}

Yes, right. So really fixed rates, would it be half of that, would it be 40% do you think in terms of that would really have a sort of average maturity of two years?

A - Rogerio Calderon

I don't have this figure here. We are going to study if we can to provide this information to the markets in the future.

Q - Victor Galliano {BIO 1517713 <GO>}

Fair enough, thank you Rogerio.

A - Rogerio Calderon

It's a good quality of information, thank you for the suggestion, we are keeping note of this Victor.

Q - Victor Galliano {BIO 1517713 <GO>}

Okay. Thanks Rogerio.

A - Rogerio Calderon

Thank you very much.

Operator

Mac Pina, Morningstar Equity Research.

Q - Mac Pina

I have a question about -- I really appreciate your information on vehicle loans. And I was wondering if you can provide some more similar color on your mortgages. And in particular, with the credit quality of your newest mortgages, your latest vintages. Then a follow-up on that also on your mortgages, what's the average rate of new mortgages that you are bringing in the pipeline?

A - Rogerio Calderon

The level of, well, maybe Mac I could start by saying that the mortgage business in Brazil is low, almost zero risk because the loan to funds -- the value of the collateral is actually pretty high. The average loan to value is around 65%-70%. So the value of the collateral is pretty high. The interest rate base is the lowest one in the country. The level of over 90 days is close to zero to give you a good figure on this.

And we keep originating at a very, very high level. And we -- another good example is that we offer terms up to 20-25 years and the average origination is around 15 years, much lower than what we offer. And at the end of the day we have around eight years in terms of down payments because we have lots of pre-payments in this portfolio as well.

Q - Mac Pina

Okay. So just to recap, you said loan to value between 65% and 70%, right? And your NPLs of 90 plus are close to zero, is that what I heard?

A - Rogerio Calderon

Close to 65% and close to zero as you mentioned.

Q - Mac Pina

Yes. In NPLs, okay, (multiple speakers). So --

A - Rogerio Calderon

I think it's also interesting to highlight to you Mac that we have a constant amortization scheme in Brazil, what gives benefit to the banks as well because the amortization keeps (earlier) than what normally you see in other parts of the world.

Q - Mac Pina

Okay, understood, that's why you're so -- thank you very much, everyone.

A - Rogerio Calderon

Thank you.

Operator

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

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

Okay. Thank you, all for participating with us at this conference call. We continue to be very comfortable with the direction and the policy and strategy that we have. Thank you. And waiting for you for the next conference call.

Operator

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