Q2 2011 Earnings Call

Company Participants

- Alfredo Egydio Setubal, IR Officer
- Rogerio Calderon, Corporate Controller & Head of IR
- Unidentified Speaker, Unknown

Other Participants

- Carlos Macedo, Analyst
- Federico Rey, Analyst
- Jorge Kuri, Analyst
- Krim Delko, Analyst
- Maclovio Pina, Analyst
- Marcelo Telles, Analyst
- Mario Pierry, Analyst
- Saul Martinez, Analyst
- Victor Galliano, Analyst

Presentation

Operator

Ladies and gentlemen. Thank you for standing by. This is Itau Unibanco Holding conference call about the Second Quarter of 2011 earnings. At this time, all lines are in 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 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. Alfredo Egydio Setubal, Investor Relations Officer; Sergio Ribeiro da Costa Werlang, Executive Vice President of Risk Control and Finance; Caio Ibrahim David, Chief Financial Officer; Rogerio Calderon, Corporate Controller and Head of Investor Relations; Marco Antunes, Accounting Director; and Rodolfo Henrique Fischer, Itau BBA Vice President.

First, Mr. Alfredo Setubal will comment on the Second Quarter 2011 earnings. Afterwards management will be available for a question-and-answer session.

It is now my pleasure to turn the call over to Mr. Setubal. Please sir, go ahead.

Alfredo Egydio Setubal {BIO 1528623 <GO>}

Okay. Thank you. Good morning, to all for those who are in Brazil and the US and good afternoon for those who are in Europe.

For those who are also following through the presentation, we are starting on slide number 2, highlights. The first one is the net income BRL3.6 billion in Second Quarter with a 22.2% ROE.

The recurring net income was BRL3.3 billion with a decrease of 8.8% when we compare to the First Quarter and below the consensus estimated to meet [ph] the market for this quarter.

The total recurring net income achieved in this first semester was BRL7 billion. That means an ROE of 22% and an increase of 7.6 when we compare to the first semester of 2010.

The second highlight is the loan portfolio. The growth of the total portfolio was BRL360 billion with an increase -- a total increase of 4.4%. Individuals, the growth was 5.6%, companies 3.6%. Just to remember that we have a very big dollar linked credit portfolio with devaluation of the real. This portfolio reduced with the real remained -- had remained stable, the portfolio of companies, the increase should be 4.2% and the total instead of 4.4% should be 5%. So the growth of the portfolio, the origination of new credits in this quarter was very strong when we see the total number and we compensate the dollar devaluation.

The third highlight is the financial margin with clients; our managerial financial margin grew 4.3% in this quarter. This number is in line with the 4.4% for the credit portfolio growth.

The NIM with clients declined slightly, 10 basis points. But grew in performance credits in 30 basis points. We are going to give more details about the margin in the coming slides.

Other effects, we showed stability in the mix during this semester. And we're going also to show the decrease and importance in credits that we provided one year, two years ago and now the origination of these credits are in larger spreads.

Financial margin with markets, BRL700 million, 26.2% lower. This is mainly our proprietary trading desks. And of course due to this more -- much more difficult environment only -- not only Brazil. But also the markets offshore.

The fourth highlight is the NPL and loan losses. There is the balance of provision increase for loan and lease losses by 6.9%. Our expenses for loan and lease losses increased 16.6%, much more than the growth of the portfolio and achieved a BRL5.1 billion.

This growth in provision and these expenses mainly because of regulatory provisions, when we change the classification of the clients and this according to the resolution 2682, especially when we analyze our small and very small segment of company that we provide credits.

The 90 days delinquency increased 30 basis points, achieved 4.5% by the end of the semester. This is in line what we said that our delinquency ratio would increase during the year. We said that in the first semester conference call.

Our expectation was that this increase of 30 basis point would be around that for the year. We achieved that in this quarter. But we don't see much deterioration in the coming quarters as I will show you in the coming slides.

This 4.6% is below the -- this 4.5% is below the 4.6% level that we were in the first semester of 2010. Short-term delinquency rates measured by this 31 to 90 days ratio declined 20 basis points, that is good. And in the quarter reached 2.7% of the total the loan portfolio. And our complementary provision for losses, remained at BRL5.1 billion and the growth of the portfolio was 4.4%. So we didn't touch the complementary provision level.

Banking fees is the fifth highlight. The growth was 4.6% and the 12 months is 11.1%. I think it's in line with the expectation.

The sixth highlight is the non-interest expenses. The non-interest expenses, the growth was 3.7% in this quarter achieving BRL$8 billion and confirming the trend of the deceleration. Remember that when we compare the First Quarter of this year with the First Quarter of the last year, this rate was 19%. And now we finished with 14.7%. So we continue to decelerate the pace of the growth of non-interest expense.

The efficiency ratio achieved at 48.3% in this quarter, mainly because of the decrease in net interest income with the market.

On slide number 7, we are going to see the expectations that we provided in the beginning of the year for 2011. So at the beginning of the year, we said that our expectations of credit growth was 16% to 20%. We reiterate this growth for this -- the whole year of 2011. We are not changing this. We see the Brazilian economy growing. We are not seeing any problems in terms of so-called the credit bubble in Brazil.

We don't see this happening. We are very confident that is a sustainable growth due to the environment and due to the formal jobs and the expansion of companies and so on that is happening in Brazil.

So -- and especially the creation of formal jobs when we analyzed the growth of portfolio of credits for individuals business. So we reiterate our growth of 16% to 20%.

The second expectation that we said was a slight increase in NPL levels. We were expecting some growth of around 30 basis points for the year. Now we achieved this level already and we do see some increase in the NPL levels for this -- for the rest of this year.

Due to the problems that we do have related to very small -- in the small company. Our expectations here is this slight increase. So we are seeing something between 20 and 30 basis points more for the year in line with the growth of our credit portfolio.

The third expectation that we said was banking fees growth 14% to 16%. We reiterate these levels for 14% to 16% growth for the year.

Non-interest expenses, our expectation at the beginning was 10% to 13%. We are now in a pace that is lower than that. So we are changing our expectations of non-interest expenses growth from this levels then to -- for change to 8% to 10% considering all these expenses and also the union [ph] negotiation.

And the fifth was 250 basis points improvement in the efficiency ratio. We reiterate that we are going to achieve and these are grow and we are going to be in this level of efficiency ratio by the end of the year, because of the growth of the credit portfolio and because of the more controls in the acceleration of the expansion of our non-interest expense.

So we can go to slide number 5 for those who are following through the presentation. Managerial financial margin, the growth was 2.5% in the quarter, 11% in 12 months. The loan loss figure, as I said we made much more provisions than we were expecting in this quarter, in this small and very small companies especially. So the growth when we compare the two quarters of 2008 [ph], the 2011 17.1%.

Non-interest expenses, as I said we are in the trend of deceleration, 14.7% in the Second Quarter compared to 19% in the First Quarter and our new expectation is something between 8% and 10% by the end of the year.

On the slide number 6, net interest margins with the clients, almost stable at 10 bps reductions to 11.6% in the Second Quarter. Banking fees growth of 4.6% achieving BRL$4.6 billion in the quarter.

On -- change to slide number 7, we see the trend of net interest margin that is stable and we are going to the next three slides, talk more about these. We can change to the slide 8, we have more detailed analysis of our financial margin.

The first thing is that our performance credits, the NIM of performance credits achieved 11.3%. That means a 30 bps increase when we compare this to the First Quarter of this year.

The second is the portfolio credit mix that we have this two tables here to talk. The portfolio credit mix -- the contribution was positive for the financial margin in the quarter. But it was neutral when we analyzed the year, the first semester.

So the difference between one quarter and one of in the Second Quarter was neutralized, as we can see on the right side of the slide in the simulation of constant mix in the loan portfolio. What was good in the First Quarter was compensated in the second. So it was neutral when we analyzed the first semester.

On slide 9, is a very interesting to see what was our position in terms of credit origination in June 2010 and June 2011. We can see that one year ago, 25% of our credit portfolio was originated in 2009. As an example, we can see in June that this origination of 2009 was less than 10%. So this reduction in this participation of this 2009 vintage.

It's interesting to see that we already renovate 47.8% of our credit portfolio in the first semester of this year because maturity -- short maturity of many of the -- of our credit drawback. And if you have 31.7% originated in 2010.

This is important to analyze, because 2010 the spreads were lower than the spreads that we are using today in the new originations and renovations of credit because of the entitlements of this year is worse than it was in 2010.

And the spreads also in 2009 because of the crisis of 2008 was higher. So we are generating new spreads and new operation that's why the NIM and the performance credits achieved 11.3%, an increase of 30 basis points when we compare to the First Quarter.

On page 10, we can see that the total assets achieved BRL792 billion, an increase of 1.8% in the quarter. Stockholders' equity is BRL66 billion, an increase of 3.7%. Loan portfolio total for the year includes endorsements and sureties at 4.4%, BRL360 billion. And funding with clients including here the short the money market funds and assets under management of BRL822 billion.

On slide 11, we can see a more detailed of our results. I think we talked about this in the previous explanation. So I think we can change to the page 12, talking about loans and NPLs for -- I think it's more important at this moment. We continue to grow personal loans to individuals. As I said also more of it is continued to be important 18.4.

We don't see any problems, we don't see any risk or deterioration in this individuals' credit portfolio. I think we have been more conservative in our vehicles financing. We have been more -- also in terms of credit cards. And companies, they grow for 3.6% due to the high % when we -- if we take off the dollar devaluation impact against the real in our dollar linked portfolio.

And as I said, the growth of 4.3% in the very small and small and medium market continues to be strong and we reduced the base, especially in very small and small because of the problems that we have in the portfolio originated in 2010.

On the slide 13, we can see the trends of NPL ratios for 90 days. 4.5% in this quarter by the end of the quarter from 4.2% that we were in the First Quarter.

We can see the NPL ratios for individuals, very slight, the duration of 10 bps from 6.7% to 5.5% -- 5.7% to 5.8% that as I said and we don't see problems here. And companies, they increased from 2.9% by year-end of 2010 to 3.5% year -- the end of the first semester, especially related to the problems that we have with very small and small companies portfolio.

The NPL ratio in 31 to 90 days is okay and we don't see -- definitely the trend are very positive. That the balance of provisions of BRL23.7 billion, increased BRL1.5 billion in the period and with altogether the covered ratio reduced from 173% to 166%.

On page 14, you can see the evolution of expense for loan losses and the increase when we compare this quarter, when we meet BRL5.1 billion against BRL4.4 billion almost in the First Quarter of this year.

Moving to slide 15, the breakdown of our deposit and asset under management and the debt of the bank. The total funds that we managed s BRL1,067 billion [ph].

On Page 16, banking fees revenues, I think we don't have much to say here, 4.6% in the quarter, 11% in the year. We reiterate our expectations to achieve something between 14% and 16% due to the volumes that we manage and also because we increased some prices of tariffs and services in the first semester.

Now on page 17, non-interest expenses, I think it's a good number. We -- especially when we analyzed 12 months we see this much better the number that we are achieving and we continue to reiterate our expectations of growth of 8% to 10% in the expenses for the whole year of 2011.

We also reduced the number of employees, especially related to credit card operations and some of the retail branches. And also in the JV that we have -- people that we had here that we are transferring part of them through the JVs that we have with the retail companies. So we expected to have 1,000 back in the JVs from people that we reduced directly from the bank. So part of this costs, we'll come back through the JVs numbers.

On page 18, efficiency ratio, as I -- we said, we expected to reduce to 250 basis points by the end of the year. With this numbers and expectations of credit and tariff growth and our numbers for new guidance for expenses growth of between 8% and 10%.

The BIS ratio continues to be very comfortable to phase the growth of the bank, 16.1%. And we need to consider pending approvals in the Central Bank for Tier II. This number should achieve 16.6%.

That's our presentation. And now we are all here open to the questions that you'll probably have.

Questions And Answers

Operator

Thank you. Ladies and gentlemen we will now begin the question-and-answer session. (Operator Instructions) Our first question comes from Mr. Carlos Macedo from Goldman Sachs.

Q - Carlos Macedo {BIO 15158925 <GO>}

Good morning, gentlemen. Actually, I have a couple of questions. The first one is related to I think obviously to the provision expenses you reported in the quarter. We saw a slight deterioration in the NPL ratio and we saw various large increase in provision expenses. If you could give us some more color about your expected loss model? And mostly, how should we look at provision expenses going forward? What exactly should we expect given that for such a small deterioration, you have such a big jump in provision expenses?

The second question is related to the margins. Thank you for the very good graph on the -- on seasoning of your portfolio. I think it's impressive that from the 100 bid [ph] you originated in the First Quarter, only 30 bid are left in the second. What does that say to us about margin? Should we continue to expect margins to go up on the loan side. And then borrowing another weak quarter in trading that we should see overall margins for the bank going up through the end of the year? If you give us some color on that would be great. Thanks.

A - Rogerio Calderon

Hey Macedo. This is Rogerio Calderon. Looking for in terms of the bad debt expenses, we believe that this -- the movement should be very much in line with the margin movement. So we don't expect to have a similar circumstance that we post this quarter on which we had expenses, transaction expenses growing much faster than the margin.

Thank you for your comments on the margins chart and that the margins chapter actually in the MD&A, I draw your attention to page 9, I think on this chart it's -- this chart is particularly very important because it shows our flexibility to re-price the portfolio. So after six months, almost 50% of the portfolio now is -- was created, originated after doing this year or by the time we have anticipated this -- this quotation of deterioration in the credit scenario. So what means that, there are favorable condition that margin could re-cap, could re-bounce some, after now. So I'm not saying that is going to happen. But the conditions are very favorable.

It's also very, very -- I think it's very important to highlight that the more we have in this portion of new origination created this year, the trend is to have an overall that are quality in our portfolio since -- as it was mentioned, since the beginning of the year, we became more selective. So in overall terms, the quality of the portfolio tends to be a bit better. But also benefits the movement, there is still some movements in the vintage and NPL.

Q - Carlos Macedo {BIO 15158925 <GO>}

Okay. Thank you. Just going back to the first question then, what you are saying is that we should expect the provision expenses to go up in line with loan growth, is that it?

A - Rogerio Calderon

That is it.

Q - Carlos Macedo {BIO 15158925 <GO>}

So start from the level which they start -- which are in the Second Quarter and go up with loan growth through the end of the year.

A - Rogerio Calderon

That’s it. That's it.

Q - Carlos Macedo {BIO 15158925 <GO>}

Okay. Thank you.

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

I just want to complement -- just Carlos, just want to -- this is Alfredo. I just want to complement what Rogerio said. I think it's important that we -- as we were expecting this increase in the NPL, as I -- we said, especially in the First Quarter conference call. We took measures since the end of that year, especially in the small and very small segment to be more conservative and to have more collaterals from the companies and so on.

So what we are seeing is that with the end of this vintage that we had problems of the acceleration that we made during the year of 2010. So as I said before, we are not seeing any issues related to large companies or to middle market companies.

We are very confident in the portfolio and so on. And the same for individuals. So the problem is very concentrated in the small companies more than the very small because the portfolio of the small companies around BRL20 million to BRL25 million -- BRL22 to BRL25 billion that don't have really good number exactly.

And much higher than the very small that is around BRL7 billion to BRL8 billion. So is the concentration in this segment and all the rest in our view is showing no problem, no deterioration.

Q - Carlos Macedo {BIO 15158925 <GO>}

Thank you, Alfredo. Thank you, Rogerio.

Operator

Mr. Saul Martinez from JP Morgan.

Q - Saul Martinez {BIO 5811266 <GO>}

Hi everybody. Thanks for taking the call. I want to follow-up on the questions that were made previously. First, as you mentioned a lot of the problems were concentrated amongst, or seemed to have been concentrated amongst small and very small companies. Can you give us a bit more color on what drove this deterioration? Because it's still unclear to me whether this is an issue of Itau growing too rapidly in this segment, where you did grow very rapid in last year and hence, essentially riding that business? Or is this a broader issue that's more industry-driven because we really haven't seen obviously these issues with some of your competitors. Obviously there is a mix issue, you get more focused on the smaller and then some of your competitors. But is this an issue that is more Itau specific? Or is it a broader industry type of problem?

And secondly, just a follow-up on that question, I wasn't clear by your response to Carlos' question about the vintages with small companies and the -- there the problems being done there. Are you saying that you don't expect additional deterioration amongst small companies that these are -- that these vintages in this deterioration has mostly run its course in the Second Quarter?

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

Saul, it's Alfredo. I think in our case, we don't have the breakdown of cost for our competitors and for the industry because the Central Bank release corporate numbers and they don't segment the Tier groups.

In our case, just to give you more information what we consider to be a very small company is companies that have revenues up to BRL500,000 a year. So is a very, very small company. What we consider to be a small company is a company that has revenues between this BRL500,000 level to something around BRL6 million. So that's our segmentation, okay.

We have a very strong position compared to other banks in the middle market. So probably we were the first bank to grow more down in this segmentation last year. So we accelerate more, this small company credit portfolio before the others.

I don't know exactly how are the others to-date. Our figure is that we have this BRL22 million, 25 billion portfolios, this portfolio shows problems for us, the way we operate.

That the main reasons for the provisions that we are making -- we made in this quarter. The guidance that we provided in the First Quarter of the increase in our NPL was related to what we were seeing in this segment, mainly because as I said we don't see problems in the other portfolios.

So that's the picture for our case. I don't know the others. How are they operating or if they are operating in this segment or not? But in our case we did and -- we -- sincerely we were not very well succeeded and we took measures since the end of the year. We have been much more restricted in providing credit for this segment, for these companies or these small companies.

And that's why our NPL increased. And in relative terms also increased because we reduced the pace of growth of this portfolio. So the old vintage has -- been way higher than it was when we started to increase. So I think it --

Q - Saul Martinez {BIO 5811266 <GO>}

That’s helpful. If I could just ask a quick follow-up as well and I don't want to take all the other analysts' time either. The guidance that you gave for loan loss provisions, that is to check if that -- the loan loss provision should remain stable with the percentage of loans or should it continue to increase as NPLs increase in the coming quarters as a percentage of your loan book?

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

Our expectations and what we said and Rogerio and I said is the level will be in line with the growth of the credit portfolio.

Q - Saul Martinez {BIO 5811266 <GO>}

The credit losses should grow at the same rate as your loan portfolio?

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

Yes. That's it.

Q - Saul Martinez {BIO 5811266 <GO>}

Okay. Got it. Thank you for that.

Operator

Mr. Marcelo Telles from Credit Suisse.

Q - Marcelo Telles {BIO 3560829 <GO>}

Hi. Good morning, gentleman. Thanks for the opportunity. I have a couple of questions and the first one is still on asset quality and actually the impact on your loan growth expectations. I mean given that you are pulling back from the SME segment or at least part of the SME segment, are you still comfortable with your 16% to 20% guidance? I know, you reiterated the guidance. But do you see any downside risk regarding that guidance and how do you expect to compensate for the lower growth in SME, which segment you think can grow more to be able to fall within that guidance?

And my second question is also regarding the -- your restructured portfolio. If you -- if I look at your restructured portfolio, as a percentage of your loan portfolio was actually up, 60 basis points quarter-over-quarter and compared to a 20 basis point increase if you look at the same period of last year. So there was a big jump there compared to last year levels. I know there is some seasonality there. But here it seems it's a little bit higher. Can you please explain, I mean which segments, explain that increase in your restructured portfolio, was it like individuals or SMEs, if you could clarify that, I would appreciate. Thank you.

Marcelo, this is Sergio Ribeiro. Just answering our guidance of growth of the loan portfolio, still we'll be in between 16% and 20%. We think that the ranches [ph] is much more than enough to accommodate further loss of speed of growth of the small and very small enterprises segment. As for the restructure, that I'll pass on to Calderon.

A - Rogerio Calderon

Marcelo, I suppose you referred to the bank negotiation footnotes we have in the financial statements, right?

Q - Marcelo Telles {BIO 3560829 <GO>}

Yes.

A - Rogerio Calderon

It did accelerate to 22% this quarter. That's from -- why I -- I want just to re-emphasize that we didn't change anything on negotiations, anything any rule was changed. It didn't -- it does not impact anything in terms of the provision.

It does impact and change the NPL, whenever we have cash, we receive. Of course when we receive that money, the credit is not non-performing anymore, is a performing credit.

Q - Marcelo Telles {BIO 3560829 <GO>}

Okay. Yes. But -- I understand all your points, I'm just asking, I mean that is -- so the increase in the restructured portfolio does not concern you whatsoever, in terms of future delinquencies, that's the point you are making.

A - Rogerio Calderon

No. This is business as usual and this -- and the portfolio that grow more or less in the total negotiation is totally related to the vintage. We grow more or less in the best.

Q - Marcelo Telles {BIO 3560829 <GO>}

So one more, one follow-up question, when I look in terms of performance of your delinquency rate by segment. I was -- it was interesting to see that on the retail side, you actually did better than your competitors. You had an increase of 10 basis points quarter-over-quarter and compared to some of other peers, they are like between 20 to 50 basis points.

Why do you think you performed better on the retail side? And in that regard, I mean, talk about your expectation for additional 20 to 30 basis points increase in overall in the NPL ratio in the second half of the year. What are the segments that you think will drive that deterioration in NPL ratio for the second part of the year? Thank you.

Well this is Sergio again. I think that several factors contribute to the smaller increase of our NPL. And basically, I would say that the main thing is that we have a mix of individuals that are -- of credits with guarantees.

For example, we have a lot of real estate credit. We have a lot of -- we have been growing quite a bit in the (inaudible) the payroll link. And furthermore, we have been growing personal credits in only the very best classifications.

So it is natural. And as Alfredo pointed out, what we see the increase is in the small and very small enterprise and that's what we see for the second semester as well.

Thank you. Sorry to bother you guys again. But just one final question on the restructure portfolio, is it possible to -- can you share with us, what percentage of your restructure portfolio is related to loans to individuals in this quarter versus First Quarter, 2011? Thank you.

A - Unidentified Speaker

No. We don't -- normally we don't -- we don't share this information. So we take your suggestion and we're going to considerate it and include in our financial statements or make overall publicly known to everyone.

Q - Marcelo Telles {BIO 3560829 <GO>}

Appreciate. Thank you.

Operator

Mr. Mario Pierry from Deutsche Bank.

Q - Mario Pierry {BIO 1505554 <GO>}

Good morning, everybody. Let me ask two questions as well. First, I'll stay on the topic of asset quality. About three months ago, the Bank guided for a 30 basis points increase in NPLs for their full year. Now you are guiding for another 20 to 30 basis point increase. So I just wanted to understand exactly what has changed in three months for you to double your expectations for pickup in delinquency?

And also on asset quality, if you can give us just a breakdown, what percentage of this small and medium-sized companies, what percentage of them or these loans have a collateral attached to them?

Then, the second question will be on expenses. You showed that your expenses are growing 15% year-on-year in the first half of this year. And you have reduced the guidance -- or your growth guidance to 8% to 10%, can you be more specific, why are you reducing your guidance? What measures are you implementing in order to see a slowdown in the growth? Thank you.

A - Rogerio Calderon

Mario, Rogerio. The first (technical difficulty) yes. So your question on our expectation on NPL. Actually what we put in out in the other call is that we have an expectation of 30 bps up by the end of the year. And behind that we had an expectation of growing NPL and then a slowing down or reducing actually in the Fourth Quarter.

So this reduction to 4.5, again in the fourth. Now, we don't think is going to happen this year. So our estimate for the year is the current level to go up around 20 bps. And then keeping stable during the Fourth Quarter. Regarding the collaterals on the SMEs, I hand to Sergio.

So I'll just give you the main number, I mean the most important number is the working capital. We increased -- we increased the working capital with collaterals substantially. We are close now to 50% of collateral in the working capital of small and middle enterprises.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. Okay. Do a follow-up then. What are you seeing then, Rogerio, that is different now for you to increase your expectation? Or what has changed in the operating environment for you to now not to think that delinquencies should be improving by the end of the year?

A - Rogerio Calderon

So there are couple of changes in the international scenario. So macroeconomics changed, some movements in regarding the interest rates. So some changes, it's not, it's not a big movement actually.

We are talking on 10 to 20 bps, it's also related to the -- to how fast we grow our portfolio. You know that NPL is also a result of how fast we grow the portfolio. You must consider that we have decelerated a little bit this area, SME. So this is altogether being considered in the model. This is not a matter of estimation by anything other than making our modeling and on top of this model, we have this new scenario, if you want.

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

And this is Alfredo talking about the expenses that you asked. We change the guidance because the level of expenses that we are running and what do we see for the second semester is better than we imagined. In these numbers, we also already included, the union negotiation under our expectations and also these personnel that we'll be -- that we reduced. But they will be hired by our JV partners in the retail side.

We -- if you remember, we last year had a very high level of expenses in terms of restructuring the branches of Unibanco into this Itau model and also the operational side of the branch changes also.

So this was almost 1 billion during the year of 2010. The level we expect that we have today, renovating the other branches are much lower than that level.

Also, we have some synergies to gain in the semester, as long as we can turn off this former system and the databases of Unibanco that are still in place because we -- at the first moment we changed the flow of new business into the systems of Itau. But we remain with the former systems of Unibanco controlling the inventory of credits and products. So this -- we are turning off during this year, especially during this semester.

Also, we -- we made some reductions, some restructurings in the credit card area because of the beginning of the merge we had seven different systems, we changed that for five and by the end of last year we changed for one platform. So because of this new efficiency of the platform of technology, we were able to make a huge restructure in the area during the Second Quarter and part of the expenses of these restructures of -- a little bit more, in reality then BRL100 million was expenses to lay off people and to make some provisions for labor litigation that made up here.

So we have also some gains that we are making during the second semester in the retail area, also under the new management of Marco Bonomi, he is also making some changes in these -- the branch level.

So many areas are changing and we have also these synergies and one-shop expenses last year. So we are very confident that we are able to achieve this level and we continue to reiterate 41% level by 2013.

Q - Mario Pierry {BIO 1505554 <GO>}

Great. Great. And just to follow-up Alfredo, just quickly on the headcount reduction. You said, you reduced about 2,000 people this quarter. But -- last quarter -- but you said you expect them to be re-hired by the bank, can you just clarify that?

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

No, no, not by the bank Mario. We reduced people in the bank employees. But around 1,000 of that reduction, these people will be hired by the JVs or even by the retail. These people will more -- the promoters that we call that go behind the clients to sell credit cards and personal loans inside the retail stores.

So part of these, around 1,000 of these people will be hired by all of -- even the Company, the retail company or by the JV that we have. So that's why, not all these expenses as part of that will return through the JVs costs during this second semester. But when we announced this 8% to 10% expected level, we already included this -- these numbers, this figures.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. Perfect. Thank you very much.

Operator

Mr. Victor Galliano from HSBC.

Q - Victor Galliano {BIO 1517713 <GO>}

Hi. Good morning. Yes, my question has been answered. But I have one follow-up, if we could continue with the renegotiated credits. Just looking at the allowance for loan losses related to those in the notes that you have in the financial statements. And that level, the allowance that for loan losses, the provision is now under 40% of the total renegotiated credits, is this a number that you are comfortable with? So looking at the past quarters, it looks like it's consistently been above 40% historically. Is this a number you are comfortable with? Or do you expect you may need to make some more provisioning here?

A - Rogerio Calderon

Victor, Rogerio. Yes. It's also treated by the model so we are comfortable with this and just remembering that whenever we talk on renegotiation, it does not change anything in terms of the provision we make on -- just change the -- for treatments of NPL, whenever we have seen cash is back through the performing loans. But we don't remove the provision if that provision was any specific provision.

Q - Victor Galliano {BIO 1517713 <GO>}

Okay. Thank you. Just -- and just one quick further follow-up on credit, credit charge going forward. So the new level that we have in terms of credit charge as a percentage of average loans, which is much higher obviously in the Second Quarter. Do you expect that to come down a little bit looking into Q3 and Q4, as a percentage of average loans? In other words, when you say that it should grow in line with the portfolio, should we look at year-on-year growth, should we look at quarter-on-quarter growth, in terms of level of provision in credit charge and loan growth?

A - Rogerio Calderon

I should think a little bit more on this. But I think it's more related to a year period because of you know, we are talking (inaudible). So I think a year makes more sense than a shorter. But I'm going to make some calculations on this and get back to you guys.

Q - Victor Galliano {BIO 1517713 <GO>}

Okay. Thank you.

Operator

Mr. Krim Delko from Orange Capital Partners.

Q - Krim Delko

Yes. Hi. This is Krim Delko. Thanks for taking my question. I have a question on the strategy generally, given that there are first signs at least of some problems with credit in your portfolio and generally in the country, coupled with the macroeconomic factor, which is worsened quite a bit. I'm a little bit surprised that you are still guiding the same growth in the portfolio, i.e., the way I interpret this is that from your perspective everything is fine, you have a couple of pockets of problems, which you think will go away.

I just feel like, I don't know, I mean it's your business, I'm the shareholder. But I'm a bit concerned about the risk of a hard-landing here. If you guys basically are pulling that -- pushing the pedal the same speed even though things are clearly deteriorating. Maybe you can just give me your perspective on that sort of this is more of a global macro view now. It's not just the situation in Brazil. But also with the rest of the world which is not looking as good, maybe three months ago. Thanks.

Krim, this is Sergio Werlang, okay. So let me first answer you just looking generally from the macroeconomic viewpoints. You know the Central Bank release its monthly data with some lag of course on NPLs on 90 days in the Brazilian system. And using these data and the aggregate credit data of the Central Bank, it is possible to join with our macroeconomic scenario, which actually every month we have a meeting to discuss in detail and about the new scenario.

Now this scenario has been shown for quite a while that the Brazilian Central Bank in order to -- by deflation would have to decelerate the economy, essentially through an increase in interest rates. Now given this, given this scenario, what we see is that the economic is already decelerating. But we expect the growth rate of this year to be below 4%, in between 2.5% and 4% and the same thing for next year.

So a deceleration of the pace of growth of the Brazilian economy. Furthermore, there is an increase in the interest rates. When -- so this is our basic scenario, which has been more or less like this for a while. Obviously, if you vary according to the Central Bank actions in each of the monetary policy committee meetings. So using this data and the macroeconomic data on credit provided by the Central Bank, it is possible to foresee that there is going to be some slight deterioration on the delinquency rates on the NPL ratio above 90 days. And in our forecast, we'll show that the average, I can tell you the forecast for -- till the end of the year. But our forecast for this average shows that the number from the Central Bank will go from 5.2% to 5.5% and decreased to about 5.4% by the end of the year. That -- this is how our macro scenario -- what our macro scenario is pointing out. And I would pass to Rogerio for the -- more details.

A - Rogerio Calderon

Just adding that in -- as in our case, we have -- we had a movement that was possible to identify specifically the segment and the type of clients. So it was actually -- the decision-taking was changing their criteria, the approval criteria. So reducing, making more selectivity and then focusing on the other segments. That's what give us that confidence that the information is correct. So we keep confidence on the guidance. We keep confidence on the ability to keep growing in a very safe scenario by changing the mix of the portfolio. That's it.

Q - Krim Delko

Okay. Got it. If I may ask a follow-up, just that -- I don't know if I'm stepping too far out here. But since we are global investors, okay, we look at countries and we have a lot of concern about two specific countries, one is Australia and one is South Africa. They have very similar macro kind of at least global driver such as Brazil. Now I understand Brazil is much bigger. But Brazil also has clearly driven much more to consumer credit than let's say these two countries, the two that I mentioned. And I'm just curious, your yield curve is flat or inverted, I mean, your signal is just, I guess my point that you -- are you confident the consumer credit growth that has been going on in the last couple of years that even if there is a macroeconomic slowdown and that Brazil can stomach that in a decent way that there is not going to be an issue, like a big problem or something like that.

This is Sergio again. Look, we don't see any special -- especially hard deterioration of the market in the models. Whatever we do, the behavior of the Brazilian consumer -- or consumers credit has always been -- the consumer has always had credit at a very high interest rates and this is historical. Sometimes the interest rates went down a bit.

Now it's quite down in relation to what it was some time ago. But has been even lower -- has been lower, the interest rate for the consumer sometime in the past. But if you go more to the past it's much lower now than it was before.

What I'm trying to say that there is no particularly different behavioral or there is no particular fast increase of indebtedness in this -- ending that as in the Brazilian -- of the Brazilian consumer in terms of how much income the person has to pay in terms of interest, has always been high. And this is no news, it has always been high for -- delinquency rates of the Brazilian consumer have been high historically. You can look at it and compare to international markets, you're comparing to Australia. But I don't know the numbers on the top of my head. But I'm pretty sure that Australia the delinquency rates for consumers is much lower than in Brazil.

So this is already factored in and that's why spreads are higher anyway in the country. So that's what it is. You can look at the behavior what happened in the prior year 2008. In 2008-2009 the delinquency rate of the Brazilian individual went up to 8.5%. This number I gave you that was going to -- now this number -- yes, 10% to 8.5%, which is even less than the numbers on that -- was the peak in the US to give you an idea.

So we don't see any particular bubble, our real estates credits are small in relation to the GDP of 4%. And with such high interest rates, we don't see any change in particular that would trigger any event that has not been happening in the past history.

Okay. Thanks guys. Thanks.

Operator

Mr. Maclovio Pina from Morningstar Equity Research.

Q - Maclovio Pina {BIO 16236843 <GO>}

Good morning. Thank you very much for taking my call. I have two questions and I hope this was the last one on credit. But I've seen your -- you're always very well reserved, always get 30% above the minimum allowance requirement. But your coverage has come down quite a bit and down to about 166% of NPLs. So I'm wondering if there is a particular level that you target?

Then as a follow-up, not on that. But it's -- for a while your deposit growth has lagged behind your loan growth and this is not always the case with your peers. So I'm wondering if you have any particular strategy to bring back some deposit growth and then perhaps gain some market share your -- especially seeing that your loan to deposit ratio is going -- cribbing up back to about 150% by my estimate. So I don't know if you have any thoughts on that front?

A - Unidentified Speaker

Well regarding the coverage ratio, I -- it's actually very comparable to the level of over-coverage we have. And it's quite similar to the historical level, we have kept expect for the fact that we -- up to December we have countercyclical portion in our bad debt provision. So we made a regression [ph] of this countercyclical portion by the end of the year. What's made this step-down from the 195 or something that we had to the 171, around 170 that we keep now. So that's the only movement, strong movement if you want that we posted recently. Other than this, this is very flattish with minor movements, ups or downs.

When you referred to the loans front, I think as you mentioned 150, I think you're not considering debentures as a source of funding. Debentures is a source of an instrument in Brazil. That works exactly the same way at times deposit does. So you should consider this in your ratio for loan to front and I'll be glad to explain details even legal terms et cetera if you want them in particularly.

Q - Maclovio Pina {BIO 16236843 <GO>}

Okay. I guess I'll give you a follow-up call then later off the line then. Thank you.

A - Unidentified Speaker

Great. We'll make sure we call you.

Q - Maclovio Pina {BIO 16236843 <GO>}

Great. Thank you.

A - Unidentified Speaker

Thank you.

Operator

Mr. Jorge Kuri from Morgan Stanley.

Q - Jorge Kuri {BIO 3937764 <GO>}

Hi. How are you? I just have a follow-up question on margins. We show deterioration in the net interest margin for clients if I'm correct 10 bps during the quarter, we just want to understand better what were the drivers behind this reduction and how should we think about this margin going forward? Thank you.

A - Rogerio Calderon

Well this is a minor -- Jorge, this is Rogerio speaking. It's a minor movement. I think it's much more related to the movement we had in sequential portion increases a little bit in this quarter when you compare to the quarter before. If you remove this movement I think would be flat. So if you look at the margin, actually the margins are growing exactly in line with the volume. So this is really flat -- the movement in the net interest margin.

Looking forward and we try to give you guys some more color on this. We have a chapter in the MD&A that we expanded a little bit by talking on the net interest margin dividing or segmented by performing loans and non-performing loans. It's clearly -- the performing loans shows a 30 bps up in the net interest margin. Also, we pointed out that the portfolio credit mix that we moved a little bit of our net margin in the First Quarter was actually replaced in the Second Quarter.

So by looking at the semester, that the mix, the credit portfolio mix is not impacting anymore the net interest margin. And there is a final segment in this chapter that I think is really very important and it's on page 9. I'm going to repeat because I think there are some new guys in line.

So if you look at the slide number -- on page 9, you're going to notice that the very recent portion of the portfolio is now occupying a much bigger size of our average portfolio. So almost 50% of the credit portfolio was recently originated. So originated things at the beginning of this year, end of last year. So this is in a better quality because we got to be more selective as mentioned before and it's also -- it was also originate in an average higher spreads if you compare to 2010. If not higher, then 2009, because we had the peak of the crisis. So spreads were much higher. But the portion of this, (inaudible) are reducing the portfolio.

So by looking forward, it seems that we have a favorable conditions to net interest margin to rebound and to increase as from now a little bit. This is hard to make any estimate back to the first point, because we don't know the movements are created the and that we calculated that based on the earning assets model. So -- but considering directly saying that conditions are favorable to re-bounce.

Q - Jorge Kuri {BIO 3937764 <GO>}

Okay. Thank you very much.

A - Rogerio Calderon

My pleasure.

Operator

Mr. Federico Rey from Raymond James.

Q - Federico Rey {BIO 21612520 <GO>}

Hi. Good morning, gentlemen. Hi, I have a follow-up question on the growth. You said that you are reiterating the 16% to 20% year-on-year increase till -- for year-end 2011. And I would like to, if you can provide more color about what should be the split in term of the different business segments.

So somebody mentioned that you took some corrective measures in the very small and small companies. I would like to know if this considered as growing less or this considered increase in collaterals for example. And I would like to understand also the acceleration that we see in the quarter in the growth, for example in the personal loan business? Thank you.

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

We reiterated 16% to 20% that the growth we expect to see -- it's in the rest of the year, it's pretty in line with the movements we saw in the first semester. So more or less, the same from when segmenting between individuals and companies. But if you look inside companies, the proportion of the corporate in very small and small and middle markets should show a reduction in the very small and small portion of the portfolio because of the decisions we make.

It is also important to highlight that we not only we reduced the speed on this segment. But we also increased the collateral level of this portfolio as I think Sergio mentioned before.

Q - Federico Rey {BIO 21612520 <GO>}

Okay. Thank you.

Operator

Mr. Victor Galliano from HSBC.

Q - Victor Galliano {BIO 1517713 <GO>}

Hi. Yes, my question has been answered. Thank you.

Operator

There being no further questions. I'd like to turn the call over to Mr. Setubal for his final remarks. Please sir, go ahead.

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

Thank you, all for being with us in this conference call. I think it was very good, very good questions and I think we are open here to -- if you have more, or want more details about our quarter, we are open to you through our IR team to -- if you need more assistance. Thank you. And would like to see -- to review with you again in the next conference call.

Operator

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