International Conference Call
Itaú Unibanco
Second Quarter 2017 Earnings Results
August 1st, 2017

Operator: Good morning ladies and gentlemen, welcome to Itaú Unibanco Holding conference call to discuss 2017 Second Quarter Result.

At this time, all participants are in a listen-only mode. Later, we will conduct a question and answer session and instructions will be given at that time. If you should require assistance during the call, please press the star key followed by zero. As a reminder, this conference is being recorded and broadcasted live on the investor relations website at www.itau.com.br/investor-relations.

The audio webcast works with Internet Explorer 9 or above and Chrome, Firefox and mobile devices (iOS 8 or above and Android 3.0 or above). A slide presentation is also available on this site. The replay of this conference call will be available until May 10th by phone, on +55 11 3193-1012 or 2820-4012 – access code **3987548#**

Before proceeding, let me mention that forward-looking statements are being made under the safe harbor of the Securities Litigation Reform Act of 1996. Actual performance could differ materially from that anticipated in any forward-looking comments as a result of macroeconomic conditions, market risks and other factors.

With us today in this conference call in São Paulo are **Mr. Candido Bracher**, Executive President and CEO; **Mr. Caio Ibrahim David**, Executive Vice President, CFO and CRO, and **Mr. Marcelo Kopel**, Investor Relations Officer.

First, **Mr. Candido Bracher** will comment on 2017 second quarter result. Afterwards, management will be available for a question and answer session.

It is now my pleasure to turn the call over to **Mr. Candido Bracher**.

Candido Bracher: Good morning, it's a pleasure to talk to you about our second quarter 2017 results.

Starting first on slide 3, we present you the main themes we see as our challenges looking ahead. There are 6 topics which I will briefly describe. In this quarter, we will explore the main evolution points in the digital front: (1) first, focus on clients. So, first and for most, we will strive to offer our clients a significant enhancement of products and services. We want to reach a new level of customer satisfaction. We know this is not an overnight, but it should be a permanent objective of the bank. In order to improve clients' satisfaction, we must keep in touch with digital transformation. Financial systems worldwide are undergoing a deep digital change and we strive to be at the forefront of this movement. We seek to implement the best practices available – not limited to the ones available to the financial system – in order to continue improving clients experience and our efficiency. This digital transformation and clients' intrinsity require an adjustment of our HR practices in order to foster even more the cooperative work in communities and agile cells while promoting a fair and meritocratic environment. And we already talked at length here about risk management in previous presentations, but we shall keep protecting our risk management tools and we continue to move forward with our internationalization process. At the moment, we strive to reach in the countries where we already have presence the same management quality which we accomplished in Brazil, rather than expanding our business abroad.

This all should allow us to keep a consistent level of profitability and value creation to our shareholders.

On slide 4 we go into more detail about our investments in the digitalization of our services and products, and also present the innovations that we have recently implemented. Today, internet and mobile transactions already represent 77% of our clients' transaction. Digital clients amount of 13.6 million and mobile users amount of 10 million, an increase of 15% over the last 6 months. The speed at which the world is becoming increasingly digital is unprecedented and financial services are no exception. In particular, mobile services have enjoyed exponential growth, our mobile apps already represent the number 1 channel through which our clients access the bank. Innovation in this environment requires a very strong customer focus, a deep understanding of customer experience, multifunctional teams to work in agile methods and competent investment in data and analytics. Our initiatives in digital platforms, digital branches, mobile, and Internet channels have seen relevant developments. The highlight here is the launch of our Itaú Light app, targeted at less digitally-literate clients. It offers a simpler interface and runs on entry levels smartphones, and has been the new force in digitizing previously nondigital clients.

The second development to point out is a new Internet banking channel for our SMEs clients and credit cardholders with a new and improved customer interface. Finally, this quarter we reached a milestone of 100.000 bank accounts opened through our mobile app in a fully digital process.

Turning now to page 5, in our results, but still before talking about our financial results, I would like to make a few general comments about this quarter. This quarter, as you all know, was impacted by a significant change in mood, which was triggered by events that caused great instability. Because of those events, the likelihood of having reforms approved reduced, negatively affecting confidence levels in Brazil. These events postponed the recovery of credit demand, which was beginning to happen and will probably resume in a more modest pace in the second half of the year. It is important to note that we observe a relatively calm period in the market following a short high volatility spam. This can probably be attributed to the good perception the market has from the economic team and the expectation that this team will remain in its functions.

As a result of that, demand for credit and financial services was affected, but not as seriously as one would have feared given the intensity of the events.

Well, now on slide 5 we highlight the key performance figures from our second quarter results. Bank posted a R$6.2 billion of a recurring net income in the quarter and R$12.3 billion in the first half of 2017. This ladder represents a 15% increase when compared to the same period in 2016. The recurring ROE in the first half of 2017 was 21.8%. Focusing on the first half of the year figures compared to the same period of last year, the highlight was the decline of our cost of credit. We will comment on the operational trends of our results in the following slides.

On slide 6, we show a brief history of quarterly recurring ROE, which highlights the stability of our performance even in an adverse enviroment. In the second quarter of 2017, the recurring consolidated return on equity was 21.5% and the consolidated recurring return on assets was 1.7%. When we segregate the Brazilian operations, the ROE was 22.7%.

On slide 7 now, if we look on the right side, with the first half of the year figures we can notice a small contraction in operating revenues of 0.2%. It was due mainly to a decrease on the credit portfolio in the period, which affected our financial margin with clients. But this effect was more than compensated by a substantial decline in cost of credit, an increase in commission and fees and strict cost control. The combination of these results led to a recurring net income increase of 15% in the period when compared to the same period of the previous year.

The slide 18, or, on slide 8, we disclosed the breakdown of our profit and loss between Brazilian and Latin American operations. We note that Latin American operations are in the building process, notably Itaú CorpBanca, which was merged one year ago and still have significant room for progress.

Slide 9 is where we present our business model chart. This chart we breakdown the income statement between credit operations, trading, insurance and services and excess capital. Throughout the past 5 years, we placed a special focus on our services business and the results presented in this chart I think they are a reflection of this strategy. You can see that insurance and services business account today for more than 50% of our recurring net income. This is one of the reasons why we've been able to keep our profitability at current levels in such an adverse scenario for credit operations. But an important point to mention here is that we see now in this quarter that the credit business is recovering and showing returns in line with our cost of equity, and the effect you see, I mean 14.9% recurring ROE on our credit operations, which is above our cost of credit practice, which is 14.5%.

So, on slide 10, talking about credit portfolio, we, what we observe here is the impact of a low credit demand environment, which translates into originations yet unable to outpace amortizations, even if they are growing. Nevertheless, the reduction pace of our loan book has been slowing down as the year-over-year contraction in this quarter is 30 bps lower than what was presented last quarter. Here, our expectation is for the loan portfolio to stabilize in the second semester, and we are prepared to resume credit growth whenever credit demand allows.

Slide 11, financial margin with clients, we see that despite this more difficult economic scenario and the SELIC rate reduction, our net interest margin remained stable at 10.3% in the quarter. The risk adjusted net interest margin improved significantly due to better cost of the risk, cost of risk in the quarter. The lower part of the chart, we present the evolution of our financial margin with clients. Despite the effect of the new credit card regulation and the lower SELIC rate, which affected our liability margins, there was some compensating factors in the quarter that allowed our financial margin with clients to increase, like higher number of calendar days, some structural operations of the wholesale segment, and higher gains with commercial derivatives in our Latin American operations. Going forward, Tier 1 could expect that the drop in the SELIC rate will cause pressure over our liabilities margins.

Slide 12, financial margin with the market, we had another positive quarters here, which, given the unexpected events of May 17th, we consider to be an especially good result. Moving ahead now, we believe that for the full year of 2017 the financial margin with the market will reach a level around R$6 billion. Because the financial margin with the market has some correlation with the SELIC rate, therefore, if our macroeconomic scenario, where average SELIC rate will be single digit from 2018 on, proves to be correct, it is very likely that this margin trend is to reduce in the future years.

Slide 13 now, comments on our credit quality. Here there are good news. As you can see, there was a 20-bps improvement in our total 90-day NPL ratio in the quarter. There were improvements in individuals, in SMEs and corporate. So, improvements across the board here.

Regarding the 15 to 90-day NPL ratio, there were also improvements in all segments in Brazil. For the corporate segment, we've mentioned in the last conference call that the 130-bps increased observed in the first quarter was related to the construction companies' exposures. This quarter, there was a 100-bps improvement as these exposures were renegotiated, and therefore included in our renegotiated portfolio.

Slide 14 we see the NPL creation. There was an improvement in the overall level of the NPL creation in the quarter, mainly led by a significant improvement in the wholesale segment. The small increase in the retail segment here is due to typical seasonality, it is not a trend.

Page 15 now, provision for loan losses and cost of credit. We see there were improvements in the overall provision expenses due mainly to the wholesale segment. Retail provision expenses increased a little bit in the period, but as I said this is a normal behavior for second quarters, as you can see in the historical data here. There was also a small increase in Latin America provisions. The same trend we can see for cost of credit, but with an even bigger improvement in cost of credit since there were less impairment expenses in this quarter.

Page 16, we present our total allowance by type of risk. The bank's overall level of allowance reduced marginally, the quarter, from R$37.6 billion to R$37.4 billion. Considering the sum of allowances for aggravated and overdue loans, there was a reduction from R$20.5 billion to R$20.2 billion in the quarter, which is in line with the improvement observed in the 90-day NPL ratios. Therefore, there was a slight increase in the potential provisions from R$17.1 to R$17.2 billion in the quarter.

On page 17, we present our coverage ratio, and here you see that the coverage ratio reached 243%, increasing from 231% last quarter. Such high coverage level is not only due to the NPL improvement, but also due to some credit exposures from the wholesale segment, for which we have made anticipatory provisions, but that are neither defaulting nor improving sufficiently for the provisions to be reversed. This effect can be seen as the wholesale segment coverage ratio reached 715% in this quarter.

On page 18, commissions and fees and results from insurance. Here we see that the provisions have increase 4.9% when compared this first half of 2017 with the same period in the previous year. We can highlight here the good performance of our asset management fees in line with the solid growth of our assets under management in the period. We see also decline in results from insurances, and this is explained mainly by the sale of our group life insurance to Prudential, that became effective in April this year, the discontinuing of our extended guarantee activity, and to the fact that lower inflation and lower SELIC rate negatively affected the remuneration of insurance assets. That all said, we see performance in this segment is still below optimal, and we are working on improvements which should bear results going forward.

On page 19, on interest expenses, expense evolution is in line with our plan. Comparing the first half of 2017 with the first half of 2016, noninterest expenses growth was only 1%.

Well, now on page 20, moving to our core capital ratio. As of June 30, our common equity Tier 1, considering the full application of Basel 3 rules, the interest of Citibank retail business acquisition and the investments in XP, well, this capital ratio reached 13.5%. As you may notice, we continue to observe organic capture generation even continuing with our buyback program during this year, where we bought back 37.9 million shares until July 17, we are still accumulating capital.

On slide 21, here there are 2 important observations to make. The first one is purely technical and relates to the fact that we are reclassifying discounts granted for margins to cost of credit line. This amount should be added to the result from loan losses plus impairments line, that should now be named “cost of credit”, and you see that in this quarter that the guidance then, which was R$14.5 to R$17, goes up to R$15.5 to R$18, increasing the forecast of 2017.

Now talking about our forecast, we reiterate here all our ranges for the year. Having said that, the events of last May led us to believe that we will deliver a credit portfolio growth around the bottom of the forecast range. Regarding financial margins with clients, we believe that we will end the year between the bottom and midpoint of the range. For cost of credit, we believe we will end the year around the top point of the range. For commission and fees and results from insurance operations, we now estimate that we will end the year around the middle of the range. And to finalize, non-interest expenses we believe we will end the year between the middle and the best point of the range.

Just to finish, on the slide 22 you may see the invitation details of our annual APIMEC meeting, which will be held on September 26. We would like to reinforce the invitation for you all, and remember that the event will also be webcasted with simultaneous English translation.

That finishes our presentation, and now I'd like to open for questions and answers.

Q&A Session

Operator: Ladies and gentlemen, we will now begin the question-and-answer session. If you have a question, please, press the star key followed by the one key on your touchtone phone now. If at any time you would like to remove yourself from the questioning queue, press star two.

Our first question comes from Mario Pierry, Bank of America Merrill Lynch.

Mario Pierry: Hi, good morning everybody, congratulations on the quarter. Let me ask you 2 questions, please. The first one is related to your ROE of your credit operations that you showed on page 9. You are showing the ROE at 14.5%, significant improvement from a year ago, your ROE now is in line with your cost of capital. I was wondering, you know, as far as I remember, the target has always been to reach the cost of capital, but I was wondering if you do think you could go above your cost of capital at least this year given the expected improvements in provisions. So that's question number 1.

Question number 2 has to do with the big spike up in your wholesale coverage ratio to 715% as you mentioned. It seems like you made some provisions in anticipation. But if you could give us a little bit more color what sectors are of concern that led you to boost such coverage ratio. Thank you.

Candido Bracher: Thank you Mario for your questions. The first question, you asked whether the ROE on credit operations could go above cost of capital, 14.5% as a result of the expected improvements in credit quality. My answer is: yes, it could. I think modestly because we expect this improvement in credit quality to be slow over time and not to be in a jump, and also cost of credit could see some reduction maybe further due to the lower yield of the bonds in which we base our evaluation of cost of credit. So, yes, I think it's possible that ROE in credit will be above cost of credit.

Now, as to our coverage ratio, maybe it's good here that, I mean, at the risk of going a bit too much into details, I explained that dynamics of these provisions of this complement allowance which we make and which we have made. As the crisis hit the companies, I mean, we looked at many companies and here especially companies in some way related to the "*Lava Jato*" scandal, but not exclusively, so many companies, I mean, would face difficulties, their Ebitdas are dropping, at the same time interest rates are going up, exchange rate was devaluing, so the relation net debt to Ebitda was increasing much more than what had been forecasted when we extended these credits. As a result of that, we make anticipatory provisions, what we call the "potential allowances" for these companies, I mean, based on the expected loss method ,which we used, and these provisions they tend to accumulate.

How is the way that this coverage level decreases – I even said in the last conference that I expected it to decrease, and I was wrong then – The normal way these provisions decrease, they decrease in one of 2 ways, either these companies for which we made anticipatory provisions they effectively default and when they do default the provision is transferred from the potential provision to the regulatory provision, or they improve to a point where the expected loss is reduced, they can be upgraded and the provisions can be reversed. What happened in this quarter is that neither of these 2 things happened with the bulk of the companies. They have neither defaulted nor improved to a point where the provisions could be reversed. And I think, I mean, given our scenario of slow improvement in the economy in Brazil, that this trend may continue for some time, that the companies are in this twilight zone, let's say.

So, it's not impossible that the coverage ratio could even increase from the point where it is because NPL may reduce, so not because the provisions will increase, but because NPL 90 may reduce and so the coverage ratio could be a little reduced.I hope this answers your question.

Mario Pierry: Yes. So, just to be clear, though, this increase is primarily because you had more companies having a problems or you're seeing more companies having problems than before and that led for you to reduce the risk rating of some of these companies, or their expected losses are now higher than you expected?

Candido Bracher: No, the main reason for the coverage ratio increase is the decrease in the NPL 90.

Mario Pierry: So, it's just primarily that the NPL has come down, not necessarily the provisions went up. Okay, very clear. Thank you very much.

Candido Bracher: Provisions, as I showed, they went from 17.1 to 17.2 the potential provisions.

Mario Pierry: Okay, thank you.

Operator: The next question comes from Eduardo Rosman, Banco BTG Pactual.

Eduardo Rosman: Hi, good morning everyone. I have 2 questions. The first one is kind of a follow-up on Mario's question. It's on your cost of equity. I remember the last year when Mr. Setubal presented the fourth quarter 16 results he mentioned that cost of equity above 18% for Itaú, which is very high, right. Of course that given all the improvements seen since then cost of equity has been improving the last quarter. If I am not wrong, you mentioned the cost of equity of 14.5%, I think. But this was before May right. So, I wanted to know if this cost of equity increased since then or not, and what are the drivers that could bring this cost of equity down in the next 12 months. So, this would be question number 1.

Question number 2 would be on trying to understand a little bit how do you see your results next year right, because we still have like very weak lending activity, it seems that given all the political uncertainty we are not going to see any big, you know, acceleration until presidential election so, and the sight that the SELIC rate will also be a lot lower next year, it seems that NII will barely grow - if it grows at all –, and when we look to your other P&L lines, you are already delivering very good figures in most of them, right, expenses are growing only 1% in nominal terms, cost of credit coming down, that's why your pretax is going to go up probably more than 20% this year. So, of course, this is very good, but it also creates a tough base of comparison for next year. So, my question is what to expect for next year, if you guys think that it's possible to grow above inflation earnings next year? That's it, thank you.

Candido Bracher: Thank you Rosman for your questions. The first one concerning cost of equity, yes, I mean, last conference our cost of equity was 14.5% and it remains in this level, I mean, the events of May have not altered this, I mean, there was a brief spike in the formulas which we follow, which are basically based on risk premium, but they already improved back, we did our present cost of cause that did not escape the range in which we position it, and we don't like to change the cost of equity, I mean, very often. So, we expect for it to get out of bandage, is not in the bandage has reduced again, so it maintained at 14.5%.

As to 2018 results, I mean, we are not making any forecasts or any guidance on the 2018 results. What can be said is that, I mean, we will keep our focus on cost control, on improving efficiency, and of course we are ready to grow assets as soon as demand picks up. I think it's a fair assumption that if the assets do not increase, I mean, if it loans do not increase, it will be difficult to grow results next year. But let's see, I mean, how the demand for loans behaves going forward this year and the beginning of the next.

Eduardo Rosman: Perfect. Just a follow-up on the cost of equity question, do you think it's possible for cost of equity to come down before presidential election next year or no? Until then, given all the uncertainty, probably we're not going to see any changes?

Candido Bracher: I don't see cost of equity coming down very significantly in Brazil. I mean, when we compare the cost of equity we use in Brazil with the cost of equity that European and American banks use for them, around 9% or 10%, it appears to us that this difference of 4 to 5 points, I mean, at least fairly represents the differences of risk in the different markets.

Having said that, I mean, it could go down marginally. Yes, I think it could go down marginally in the next quarters.

Eduardo Rosman: Okay, thank you very much.

Operator: The next question comes from Jorg Friedman, Citi.

Jorg Friedman: Thank you very much for taking my questions. So, I'm also having 2 questions today. Just the first point on the NPL progression, I'd like to understand how do you see, you know, the prospect for NPLs going forward? I am particularly referring here to the NPL creation in the retail book, that deteriorated a bit, and also the increase in renegotiations. So, just wondering if, putting all together these trends together with what you just commented on the corporate book, you believe that really the worst is already behind of us?

And my second question is related to the prospects for NII, net interest margins. You mentioned during your presentation that you had at least 3 potential impacts that are affecting NII, of course, the most important one is credit growth, but also, I think you referred to structured operations that helped the NII this quarter plus the mix shift. So, I'm just wondering if you could comment in your prospects for NII with the normalization of those conditions, and your guidance implies a slight pickup of credit volumes, so you also believe that worst is behind in terms of NII or if this pressure of lower rates will not be compensated by pickup in credit volumes? Thank you very much.

Candido Bracher: Thank you Jorg. First, on NPL, the NPL creation in the retail book in this quarter we attributed to seasonality, typical second quarter seasonality. Here we think that the trend is of stable to small reduction in the NPL 90 in this book. The question, you asked me whether for corporate credit if I think that the worst is already behind us, yes, I mean, this is my impression. And as to the renegotiations you mentioned, I think, I mean, they are a natural consequence of that dynamics I have explained before. So, when this companies which have had their debt aumented, the Ebitda reduced, and when they have difficulties in meeting their commitments in the agreed dates, it's natural that we give them some room for breathing and to recuperate, and this is done through renegotiation of credits. Following the renegotiation, as I said before, I mean, one of 2 things may happen, either they default because they cannot recuperate, or they improved their conditions and then we are able to reinforce the plan. In both plan cases, the provision flows out of the complementary allowance, of the potential allowance.

Concerning NII, I think here it's very much, I mean, what I said on the slide, first, going forward, I think what we could expect here is that a drop in the SELIC rate will cause some pressure on our liability margins, which are an important part of NII. Of course, I mean, if we managed to have credit growth we can compensate for this. So, I mean, I think this is all reflected in the guidance I have just given you concerning NII.

Jorg Friedman: Okay, that's perfect. Thank you.

Operator: The next question comes from Philip Finch, UBS.

Philip Finch: Good morning Mr. Bracher, thank you for your presentation. A couple of questions from my side, please. First of all, regarding your loan growth, when can we really check some color in terms of what you are seeing in terms of loan origination, and which segments do you think will most likely rebound first? So, we saw in the 2Q numbers, I think on slide 10, that sequentially credit card growth was slightly positive, all the other segments are negative. Going forward, which segments should we assume to recover first? And maybe an explanation why. And linked to this set of questions, do you have any visibility in terms of the sensitivity to economic recovery in terms of credit demand, so if GDP growth was to recover sharply next year to 2% or more, you know, does that mean for credit demand is there a lag? Does it come back quicker? So, any color on that front would be very helpful.

Second question is regarding asset quality, and specifically the slide 15 in your presentation. So, whether is a top chart or the bottom chart, you are seeing the levels of provisions to loans or cost of credit in Q2 approaching or at historical low levels or top levels? So, the question is, going forward, I mean, how much more scope is it to come down given that you could argue that the loan composition of your book is so much more defensive than it had been previously? Thank you.

Candido Bracher: So, Philip thanks for your question. I will give you a very generic answer on your first question because it's not very clear to us which segments could first respond to an economic recovery and increase demand in loans. But what we see is that, I mean, working capital needs would come before investment needs, so, I mean, generally this could mean the reaction coming first in individuals than in corporates. In corporates is more specific for working capital. Although, I mean, if we really experience a more robust recovery in the economy, I think corporate loans have more potential to grow going forward. Not in the first moment, but going forward.

Then, your question on asset quality on our slide 15, I mean, how much more room for improvement there is. I think there is still room for improvement. I mean, we have relatively small loan book now, which was built conservatively and which has a high level of provisions. So, when we look forward in the corporate segment, we have difficulties to look forward important basis, name by name basis, not only statistical, and we have the impression that there is still some room for improvement. Not too much, but still some room for improvement.

Philip Finch: Okay, thank you very much.

Candido Bracher: You're welcome.

Operator: The next question comes from Tito Labarta, Deutsche Bank.

Tito Labarta: Hi good morning. Thanks for the call. A couple of questions also. First, on your financial margin with clients, looking at the slide 11 we can say it's probably held up pretty well given the reduction in interest rates, the lower rates on credit cards, I know the lack of competition has kept spreads somewhat high, but if we think, you know, once the rates have finished coming down by year-end and maybe as growth starts to come back, how much do you think this financial margin with clients can come down from this 10.3%? I know you don't have a long history given the incorporation of CorpBanca, but I'm just trying to get maybe a little sensitivity of that line to the lower SELIC in a more normalized environment with better growth. Do you see it falling below 10%? Is any color you can give on that would be very helpful.

And my second question, you started the call talking a lot about your digital strategy, a lot of internet and mobile transactions have picked up quite a bit. What does that mean for expense growth over the next few years? Do you think you continue grow in line with inflation, you made some additional investments that could place you above that or maybe some benefits and improvements in efficiency because of that? So, if you can maybe give us some color on how you see this is going to impact the expense growth for the next couple of years will be helpful. Thank you.

Candido Bracher: Thank you Tito. So, on your first question, I mean, the trend in a financial margin with clients, as I mentioned, I mean, the SELIC rate will put some pressure, the reduction of the SELIC rate will put some pressure on this margin, and for it to grow we will need a growth in the loan portfolio. Having said that, what we look more here is the financial margin with clients adjusted by risk, which has been growing. And here we believe that we will be able to keep this margin stable over time.

Your second question, how much our investments in technology development may affect our total level of costs investments in the bank, here I don't have a precise answer to you, but we must remember that technology has double effect when it comes to costs, I mean, it increased costs because it requires a lot of investments and we are making investments, we want to increase the rate at which we are able to produce our apps and things like this, we are investing a lot in adapting our way of production here and having the community cells, the agile cells, this all represents investments. On the other hand, technology presents great possibilities of cost reduction, like cloud computing for instance, it's a great example of that. So, I think that all things added, one should at least compensate the other and we shall be able to keep a very strong hand on cost growth.

Tito Labarta: Thank you, sorry, go ahead.

Candido Bracher: I was just going to complement that the low inflation environment, of course, also helps.

Tito Labarta: Right, that makes sense. Thanks, Candido, that's helpful. Maybe just one follow-up on the first answer. You mentioned looking at the financial margin adjusted for risk, which is 7.3%, and it has come up from 5.4 in the first quarter 2016, so when you say it can remain stable you mean around this 7.3% more or less? Is that kind of what you're thinking in terms of the stability?

Candido Bracher: I think that on average we can have this margin around that. But on average. I mean, of course it will float around.

Tito Labarta: Sure. Okay, thanks, that's very helpful.

Operator: Our next question comes from Domingos Falavina, J.P. Morgan.

Domingos Falavina: Thank you. Hi Candido, Caio, Kopel and team, thank you very much for taking the call. Actually, I have 2 questions. My first one is regarding the asset quality trend, which at least here was surprisingly good on the early delinquencies, specifically on the 15 to 19 on the SMEs, which is supposed to be a bit less volatile I guess than the large corporates, and still it came down substantially. So, my question I guess on this part of asset quality is if you could explain a little bit more what happened on the SMEs, if it is just you being more cautious, if the market is getting better, and what kind of coverage ratio do you feel comfortable working? Because I understand that you explained that your coverage went up because new NPLs formation came down, but you could have provision less too and kept the coverage flat. So, I guess my question is, what is kind of a reasonable for the year coverage ratio?

And my second question has to do a little bit with the NII, and we've been a bit more concerned with the NII, we are looking at the loan book shrinking 3% this year, which we used your guidance, it basically implies in 2018 starting with loan book the same level it started 17, and then we have all the additional headwinds, SELIC coming down, spreads coming down and so on. So, just on the top line and then we look Bloomberg estimate and it bakes in like the market baking either flat or slightly growing NII. And my question is more directionally if it's really reasonable to assume top line growing in 18. And that's it, thank you.

Candido Bracher: Domingos, thanks for your questions. So first, on asset quality trend concerning 15 to 90 days SMEs, here what I can tell you is that our experience is that the most recent waves of credit we have made, the vintages, the most recent vintages of credits are showing better results. So, I think that we still can enjoy this trend for some time in the SMEs. Then you asked me about what my guidance would be for the year-end in coverage ratio, and I don't know. Here, I mean, really it depends on so many variables. I thought last quarter that the general trend was 40 to decrease because, of course, I mean, 231 was already a very high level, and you see that things tend to no bounce and this coverage ratio should reduce. But since there is the possibility, given a very slow growth of the economy here, that this credit for which we have the complementary allowance that they neither default nor improved to a point of being able to reverse and at the same time NPL may reduce, so, I mean, it could really go up or down here in this short period of time. If you ask me about what my forecast would be to the end of 2018, then I would say that surely it should be lower, significantly lower than it is today. But for the end of this year, I am not comfortable in making any forecasts right now.

Your question about NII, I think you are right, I mean, there are some headwinds on NII, the SELIC rate is especially remained headwind, I mean, we also had the credit card, the change in credit card flows, and things like this. My impression here is that, in order for NII to grow next year, it will be necessary a growth in assets, which right now is higher than we can foresee.

Domingos Falavina: Very clear, thank you very much.

Operator: The next question comes from Rafael Frade, Bradesco.

Rafael Frade: Hi, good morning all. Just going back to NII, you highlight in your release that there was structural operation with a corporate client. I would like to have an idea of how relevant it was for the NII given that you highlight this.

And second, despite the lower interest rate, in fact, the results with working capital grew QoQ, mostly it seems because a larger base. I would like to understand a little bit this base. I saw that there were some changes, for example, in the capital there are all located in the insurance company, it seems that maybe some of it goes to this line because the result of all of this is that when you restate your guidance for the NII for the year we are getting a little hard to reach it because it's basically the NII needs to be almost flat for the second half and given the lower interest rates it seems a little harder. So, we would like to understand this a little better.

Candido Bracher: Okay, thanks Rafael. Not quite sure I got your second question slightly, but I'll try to answer. Concerning the NII, I mean, this structural operation with corporate client it was around R$100 million the result, the impact on NII.

And, yes, I mean, you are right, we expect our NII to be relatively stable throughout the year now. I mean, balancing positive and negative effects which we will see ahead, I think that the most probable scenario for us is for it to remain on this level.

Rafael Frade: Right, thank you Candido. Just a follow-up on this, it's just that I'm seeing more negatives than positives, that are basically the lower interest rates and the impacts on credit card. Which ones would be the positives that you think that could compensate for that?

Candido Bracher: It's important Rafael to notice that, I mean, in credit cards the main impact was already in this quarter, we expect this situation now to stabilize or even improve a bit as the installment credits, as the installment portfolio should grow a bit more now.

Rafael Frade: All right. It's perfect. Thank you.

Candido Bracher: You're welcome.

Operator: Our next question comes from Carlos Macedo, Goldman Sachs.

Carlos Macedo: Thanks. Good morning gentlemen, thanks for taking questions. Actually, I have a couple of questions. First question is related to loan growth Candido said you're going to land when the demand comes. Looking into the second half of the year, your guidance implies an annualized growth rate between 5% and 12%, which is something that the market hasn't done for a while and you haven't done for a while. Where do you think the growth will come in the second half of the year? To get to the bottom end of your guidance, which would imply 5% annualized.

Second question, going back to capital 14.5% that doesn't even consider the R$8 billion you have in excess reserves that essentially is capital on the other side of the book. Obviously, what you've been doing even with the XP you haven't really made a dent into that capital, and that's just continued to, it's going to continue to build as long first quarter assets don't grow, you know, buybacks aren't making a dent. I mean, is there a time when you will consider to make a payment of a complementary dividend, something large in order to get capital back to more manageable lower position?

Candido Bracher: Thanks Carlos for your questions. So, concerning loan growth, we are already seeing originations growing, and even in this quarter they were already enough to offset the amortizations. We expect this trend to continue and to allow us to reach the bottom part of our guidance. I think we will see this, I mean, now sectors more or less widespread and we think we have a good chance of getting there.

Concerning our capital level, I mean, you are right, we keep on accumulating capital. Of course, our preferred way to deploy this capital would be through a growth in our WA, but it's not coming as significantly and possibly not coming in the near future, and then we will have to consider alternatives, that is the one you mentioned of making a dividend increase.

Carlos Macedo: But is this, I'm sorry, just a follow-up, I mean, you already raised the payout, that helps, but to, that just basically stems the flow, it doesn't lower it from the current level. Is there a deadline or timetable for you to think about that? And given where risk assets to the risk assets are growing, or is that something that will be decided when the conditions present themselves?

Candido Bracher: Well, we are permanently thinking about these aspects, I mean, we are evaluating this cautiously, and I think if we come to the conclusion that it's a structural situation that we cannot alter with the natural evolution of our business, even with acquisitions, I mean, we will have to decide something based on dividends. The format which we will take it's too soon to tell.

Carlos Macedo: Okay, thanks. Thanks for the answers.

Operator: The next question comes from Eduardo Nishio, Banco Plural.

Eduardo Nishio: Hi good morning, thank you for taking my question. I have 2 questions as well. First one is regarding Rede, your acquiring unit. The volumes have been running below market average, I was wondering with the full acquiring time up what strategy on Rede if you plan to grow a bit more faster than what you have done so far.

And my second question is a bit more on the long-term. Looking into your forecast, in your macro forecast here, we see interest rates going to 7%, GDP is roughly 3% in a normalized environment. How do you see in that environment your normalized growth in loans, and how you see that recovering over time, if you see a spike before and then come down later, or it will be a gradual growth, a normal growth over time? Thank you.

Candido Bracher: Thank you Eduardo.

Eduardo Nishio: Sorry! And perhaps if you can also elaborate a little bit on costs and the entire, you know, how the bank is moving towards that direction, you know, costs, technology, and perhaps cost of risk and how do you see this turning around in a more normalized environment? Thank you.

Candido Bracher: Thank you Eduardo for your questions. They basically cover everything. So, let me start by Rede. Well, the situation here in Rede is not yet one where we can speak about growing the numbers in Rede. In Rede, we are still facing an adverse competitive scenario, which started a couple of years ago with the opening of the market, and since then what we have seen is a new commerce also with new technologies gaining market share in this market, and we consequently losing some market share. We are present here intensely reviewing our commercial structure and our commercial practices in Rede, in this acquiring business, aiming at first stabilizing this negative trend, and then it seems this is what our goal is right now and where most of our efforts are placed.

The second question concerning macroeconomic forecasts, I mean, if we see some improvement in economic growth for next year, which our economy points at 2.8, when we protect our business we do not quite use such an intense, such a large figure, but I think the economic growth could be gradual, and here this is just a guessing exercise, could be gradual until the result of the elections, and then when we have the results of the elections, depending on how the market sees the new president, we could have a spike in growth.

Finally, you asked about costs, technology and cost of risk. Cost of risk, as I mentioned, we see improving, I mean, still in this second half of this year and the next year as credit quality, I mean, credit quality has basically improved and if the economy recovers it is to be expected that this positive trend we are seeing in credit will endure. On technology, I believe I already answered it. Here we are investing in the size of the online technology aiming at giving our clients a much better digital customer experience, and these are big investments and we must also say that we have a very high demand for regulatory demand for our technology services as every other bank, as every bank in this market has. In terms of costs, I mean, there is nothing much new, and we keep a tight grip on cost in the bank and we expect to administrate them close or below inflation levels.

Eduardo Nishio: Okay, thank you so much.

Candido Bracher: Thank you.

Operator: The next question comes from Natalia Kornfield, J.P. Morgan.

Natalia Kornfield: Good morning everybody. So, my question is a little bit going back to your regulatory capital and also involving your subordinated debts. As was mentioned, you're building capital right now and your subordinated debt is losing capital treatments due to Basel 3 rules, specifically the Itaú 20s I believe probably is counting very little now for capital. So, my question is do you have any strategy with regards to these subordinate debts? I know like all of them are trading above PAR right now, but wouldn’t it make sense to replace some of these debts? That's basically my question.

Candido Bracher: Thanks Natalia for your question. Listen Natalia, I think that if we had a lower level of capitalization then we could, I mean, consider replacing and issuing some new subordinated debt. At 13,5 of core equity tier 1 that really makes no sense for us right now to consider this hypothesis.

Natalia Kornfield: For sure, that's clear, but for instance, you have, a portion of your subordinated debt is losing capital treatment right now, so wouldn't it make sense for you to keep this, to have these debts still even if they have a higher coupon and they are not helping you in terms of capital as much as they used to do like few years ago?

Candido Bracher: Yes, I mean, you are right mentioning that this subordinated debt is entering in the phase when it loses its capital effect, but so far it still has some capital effect, so we are not seeing in the short term of doing anything with it.

Natalia Kornfield: Okay, thank you.

Candido Bracher: You're welcome.

Operator: The next question comes from Olavo Arthuzo, Santander.

Olavo Arthuzo: Hi everyone. Thank you for taking my question. I just wanted to go back and clarify some points related to the excess of capital of the bank that in this quarter it increased once again. Talking about the expansion in Latin America, we used to hear from you that the focus was the integration of the operations Itaú CorpBanca, but today, looking through all the adjustments that were made throughout 2016, the expectation is that those operations will report higher and more normal returns going forward. So, do you see some room for more M&A's or investments, but outside of Brazil?

Candido Bracher: Thanks Olavo for your question. So, concerning Itaú CorpBanca, we have merged a year ago, a bit more than a year and 2 months ago, we still see a lot of work ahead of us in the integration of this operation, especially if we move to Colombia now. So, we are not in this moment, I mean, contemplating the possibility of making other acquisitions. Of course, as always, should something very interesting appear in the market which gives us a significant market share and so on, we will consider, but nothing of this type has appeared so far.

Olavo Arthuzo: Okay.

Operator: Once again, to make a question, please dial star one.

This concludes today's question-and-answer session. Mr. Candido Bracher, at this time you may proceed richer closing statements.

Candido Bracher: So, thanks very much. I mean, thank you all for participating in the call, thanks for your very good questions and I hope my answers were adequate. I would like now to pass the word to Marcelo Kopel to make some remarks.

Marcelo Kopel: Yes, just to say a few words, we have Marcelo Barreto here with us today and he is transitioning from the IR role into a Treasury, a very important function at Treasury, is part of his career development, and I would like to take the opportunity to thank him for all the work he's been doing for IR, it's been a pleasure to work with him and I am sure you guys share the same view, so thanks for him being here and we will be making some changes and announcing them shortly in the IR team.

So, thanks everyone and look forward to seeing you.

Operator: That does conclude our Itaú Unibanco Holding earnings conference for today. Thank you very much for your participation. You may now disconnect.