Itaú Unibanco

International conference call - 2nd quarter 2015 earnings results

August 5th, 2015

Operator: Good morning ladies and gentlemen, welcome to Itaú Unibanco Holding conference call to discuss 2015 second quarter results.

At this time, all participants are in a listen-only mode. Later, we will conduct a question and answer session and instructions will be given at that time. 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. A slide presentation is also available on this site. The replay of this conference call will be available until August 11th by phone, on +55 11 3193-1012 or 2820-4012 – access code 6138281#

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. Eduardo Vassimon**, Executive Vice President, CFO and CRO; and **Mr. Marcelo Kopel** Investor Relations Officer.

First, **Mr. Eduardo Vassimon** will comment on 2015 second quarter results. Afterwards, management will be available for a question and answer session.

It is now my pleasure to turn the call over to **Mr. Eduardo Vassimon**.

Mr. Eduardo Vassimon: Good morning, good afternoon, it is a pleasure to be here with you again to talk today about 2Q results.

For those that are following us in the Internet we will is start with slide number 2. We had a R$ 6.1 billion recurring net income, what we consider to be a positive result considering the more difficult economic environment we are facing.

I'd like to highlight the 17% financial margin with clients growth in 12 months, comparing the first half of this year with first half of 2014. Financial margin with market, although 17% below 1Q results, still a very robust R$ 1.6 billion result. Loan loss provision expenses flat, basically flat in relation to previous quarter. We are going to talk a lot about credit quality, I understand this is a point of particular interest of the market.

Moving to slide number 3 we had a 24.8% recurring return on average equity. When we see the 12 month figures we have seven quarters in a row of increase in this metric. The recurring return on average assets is stable at 1.9% in the past few quarters. When we take into consideration the risk elements, we see a nice trend of increase of recurring return on average assets reaching a robust 3.2% this quarter, what I believe to show that we are pricing well the risk in the present environment.

Page number 4. Again here a good increase in financial margin with clients: 4% in this quarter, 17% in 12 months. Results from loans and lease losses, in net terms, a small reduction, around 2%, and I'd like to call also your attention here to the increase in non-interest expenses: in 12 months 6.7%, well below the inflation in the same period. that's around 9%.

Moving to page 5 we have the loan portfolio where we can see in 12 months a 9.3% growth, so basically around inflation. When we exclude the effects of foreign exchange variation we see a much smaller figure, below 3%, 2.6% here, reflecting a low growth economic environment. The two main products in terms of growth in the past 12 months continue to be payroll loans with 52.3%, this is partially offset by acquisitions of portfolio that we made in the past months, this is basically a process that has ended in the first quarter of this year, and also mortgage loans with a robust 21% growth in 12 months.

Moving to slide number 6 we have been showing this breakdown since the end of last year. We basically divided the PNL in two main categories here, insurance and services on one side, and credit and trading on the other side. Insurance and services are revenues or business lines that are less related to the economic cycle, and in this particular quarter we had a positive growth of around 10%, moving from R$ 3 billion in the first quarter to R$ 3.3 billion in this quarter. In the credit in trading, that is a little bit more volatile and more related to the economic cycle, we saw also some increase. And here we basically can see that for credit and trading, we are showing returns that are similar to our cost of capital, while in the insurance and services we show a robust 49% return.

Moving to page 7, we have the breakdown of our loan portfolio. I would like here to call your attention on the upper side of this page, to the fact that the mortgage loans and payrolls together represent around 20% of our portfolio today. That's basically the double what they represented two years ago, so in line with our strategy of moving from more risky to less risky products.

Another business that has been growing in terms of participation is Latin America business. Here again aligned with our strategy of regional expansion. This is also positive affected by the FX rate.

On the lower part of this slide we can see the evolution of our financial margin with clients. The main factor was the mix of product, clients and spreads and here spreads played a particular positive role. We were also helped by a higher number of calendar days, despite the lower loan balance.

Moving to page 8 we can see here the net interest margin going up from 11.1% to 11.3% in this quarter. When we exclude the provisions, we see an increase from 6.9% to 7.2%, although below the historical levels.

Net interest margins with clients stable at 9.6% and when risk-adjusted slightly better than the previous quarter.

Moving to slide number 9, talking about financial margins with markets, here again we had a very positive quarter: R$1.6 billion, although below the previous quarter, it is very strong figure. We cannot consider this as a recurrent level of market results although historically we have been able to generate good results in more volatile environments, like the one we are living in today.

Moving to page 10 and starting to talk about the credit quality, we saw in the 15 to 90-day NPL ratio, as anticipated, an increase, a small increase here from 2.9 to 3%, both the same level of increasing individuals and companies.

In the lower part of the slide 10, the 90-day NPL ratio. Here we see a higher increase, from 3 to 3.3%. And we can see in this chart that is basically concentrated in the company's portfolio, individuals showed a slight increase. And here, to be transparent, we calculated what would have been this metric if we had not made this transfer of financial assets, it would have reached 3.5%. This was a transfer of one single client, a relevant amount around R$ 1 billion of an asset, a particular asset that has a very low probability of recover that was already 100% provisioned, so there was no effect on the bottom line. But because it was booked in an offshore vehicle, it was showing some volatility among different lines of the PNL, although, again, in the bottom line the effect was zero.

Moving to page 11 we see here the coverage ratio. Again here, as expected, we had a decrease in the coverage ratio from 200 to 187%. We can see that, although there was this reduction, the level of complementary allowance for loan losses was kept at the same level, R$6.3 billion. That's the amount we have in excess of the regulatory requirements by Brazilian authorities.

And in the lower part of this page we've broken down this coverage ratio by segments, and we can clearly see that the retail banking segment shows stability in this figure. So, in the last 12 months or more, ranging from 131 to 135%, so basically stable, and all the difference of this metric was due to changes in the wholesale banking. Because we have started already at the end of last year preemptive move in building up provisions, we have increased substantially the coverage ratio for wholesale banking operations, and at that time we expected some transactions to become overdue. This actually happened and then, because of those transactions, we saw this reduction in coverage ratio.

Moving to page 12, here we made an exercise to give additional transparency and excluded the fully provisioned credit in the company's portfolio 90-day NPL ratio. So the 2.2% figure goes down to 0.6% when we exclude those fully provisioned credits, and this 0.6% historically is quite stable. So most of the increase was due to credits that were already provisioned.

On the lower part of this slide we provide additional break down in the company's 90-day NPL portfolio. We have divided between very small, small and middle market companies on one side and corporate companies on the other side, and for us middle market goes until R$ 300 million of annual revenues. And this shows that the increase was clearly concentrated in large companies. The SMEs portfolio is doing quite well, actually with a small reduction in this quarter compared to March 15.

So all those elements give us a good level of comfort in relation to the level of provisions we have. So the increase in NPLs wa, to a large extent, due to the company's portfolio, within company's portfolio this was related basically to large companies. And in the company's portfolio, when we exclude the fully provisioned credits, we see a stability in this 90-day NPL ratio.

Moving to slide 13 and talking about credit quality for individuals, here again on the left side, on the top, we see the movement that we mentioned briefly before, moving and increasing lines of businesses that have higher level of guarantees, so mortgages and payroll together increased from 19% two years ago to 41% today.

On the right side we can see that, within payroll loans, the public sector, that is more stable and less related to the economic cycles in terms of employment, represents the vast majority of our portfolio. So only 11% is private-sector payroll loans, and even in this part in selected companies we operate with.

On the lower side on the left, just to update a little bit the recent vintages in terms of vehicles and mortgage financing, so we are generating, originating new loans with loan-to-value slightly below our historical pattern.

And in the middle and right side below, we talk a little bit about credit cards. What we have done here is, we took public information from Brazilian Central Bank about non-performing loans of the system, we excluded Itaú Unibanco figures and then we compared the system without Itaú Unibanco with our own figures. And in a 100-basis we can see that the quality in terms of non-performing loans of our credit card portfolio is substantially better than the average of the system. Three years ago we were 20% below the average, today we are even better, 32% below the level. So, in relative terms, we are doing quite well.

And this is related to the figures on the right side that is the breakdown of our portfolio. We spoke about it in the first quarter call. We have basically three quarters of our credit card portfolio as transactors, so this includes site payments, site payments and installments without interests, so with a lower level of risk, while in the market to this portion represents 70% roughly speaking. The more risky part of our portfolio, that's the revolving credit, in our case represents 15% compared with 24% in the market. So here again we show a good relative position to the market in terms of risk for credit cards portfolio.

Moving to page 14, loan loss provision expenses, as I mentioned, basically flat in this quarter when compared to the previous one, giving stability to the ratio at 4.8%. The net one was a little bit below previous quarter bringing the 3.9% down to 3.8%.

In the lower part you have NPL creation and write-offs, and I think it's interesting to make the relation between the two charts here. We can see very clearly that, starting in the last quarter of last year, we started to make provisions in a level that was substantially above the NPL creation, anticipating possible overdue for some specific clients, what happened in the second quarter. That explains that, in this particular quarter, the level of provisions was very close to the level of NPL creation.

Moving to slide number 15 we showed a similar chart in the previous quarter and, as anticipated, we saw some increase in the retail banking portfolio in terms of provision expenses and some decrease in the wholesale banking portfolio. Looking forward we expect to see this movement to continue, so in this environment we believe it's reasonable to expect slight increases in the retail banking provision expenses and some reduction in the wholesale banking portfolio.

Moving to page 16, very briefly, we had a 10.5% increase in commission fees from insurances. In relative terms it was little bit below the level of previous quarters because the margin has increased substantially.

Moving to page 17, again quickly here, just to mention that we had a good two-digit growth in our revenues for core insurance activities when comparing 12 months. Claims ratio and combined ratio at good levels, reasonably stable compared to the previous quarters and a robust market share for insurance, pension funds and premium bonds.

Next page, slide 18, we mentioned already, we had a 6.7% growth in 12 months of our expenses, and if we do exclude offshore operations, operations abroad that are affected of course by FX, FX it would have been 4.5%. So I think this shows our commitment to keep making strong efforts to keep costs below inflation level. This is reflected in the bottom of this page in what we consider to be a very good efficiency ratio, 42.9% this quarter, it's the best figure in this series, and when adjusted to risk, 61.8%, that's a very good level in our opinion showing that we are pricing well risks.

Moving to slide 19 and talking about capital, we had a substantial increase in our common equity tier I, from 11.6 in March to 13.2% now in June. This is basically related to three factors: first one is the result of the period itself; the second one is new consolidations that reduced the risk-weighted assets; and third factor was the effect of the FX appreciation of the real in the quarter that decreased tax loss carryforwards, so improving this ratio.

Fully loaded core tier I we now have a level of 11.3%, if we consider our investment optimization and full use of tax loss and carryforwards, we would reach 12.7%. Again, this was positively affected by FX. If we take the prevailing FX rate today or yesterday the present market this 11.3 would be around 10.5%, so it's an index that is sensitive to the FX rate. In any case it's a very comfortable level of capitalization, what has encouraged us to renew our buyback program, and we will be following closely the market to possibly take advantages of the prices that we deem to be attractive.

Moving to page 20, we see a low level historically, low historic level of price-to-earnings at 7.7. And in terms of net dividend yield, when we take the Bloomberg consensus keeping the same dividend policy and starting using the price at the end of last month, July, we reach 4.1 dividend yield, that's high compared to historical standards.

Liquidity has been divided basically 50-50 between domestic market and New York market.

On next page, 21, we are keeping our outlook for 2015. This outlook, as you know, was reviewed last quarter. Despite the more challenging economic environment we are keeping this outlook for all the lines we have here.

Finally, slide 22, just to reinforce the fact that shareholders for both CorpBanca and Itaú Chile have approved the merger. This was an important step in our Latin America expansion strategy and now we are waiting for the authorization of the Chilean regulator, what we expect to obtain in this third quarter of 2015.

And finally I'd like to invite you all to be present in our Apimec meeting that will take place in São Paulo in about two weeks.

With this I end this part of our presentation. Thank you for your time and Marcelo Kopel and myself will be available for possible questions that you may have. Thank you.

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 Philip Finch, UBS.

Mr. Philip Finch - UBS: Good morning everyone and thank you for the presentation. I've got a couple of questions, please. First is regarding your loan losses provisions. On the first quarter's earnings call I recall that you said that the Q1 level should be the peak level and obviously we've had Q2 at similar levels, maybe just slightly higher. Going forward, I mean, are we going to see this provisioning trend continuing upwards or can we safely say provisions have peaked for the rest of this year?

Secondly it's regarding your repricing of the loan book. Given you are clearly in a more challenging lending environment, asset quality environment, are you repricing risk in your loan book given the higher credit risk out there? And if so, can you just share with us how much was the magnitude of this and thereby what could be the indication be for margins over the next 12 to 18 months? Thank you.

Mr. Vassimon: Thank you Philip. Talking about loan losses provisions, as I mentioned, we keep our outlook between R$ 15 and 18 billion of net provisions for this year. Given the more challenging environment, it is reasonable to assume that it would be in the higher part of this interval, so between the midpoint and the ceiling. This means that, in terms of the amount of expenses, we expect this to be in the next two quarters slightly below the level we had in terms of provisions, net provisions. In terms of NPLs we are probably going to see a continuous increase, a slight increase in the portfolio.

In terms of repricing, we have done already a substantial movement in terms of repricing, as you can see in our margins. This is, of course, a dynamic process as risk moves. We also changed our price policy, so we have done this basically in the short-term portfolio that has matured. We will keep doing this as risk moves and we will start to do this in the longer part of the portfolio. It is difficult to quantify this, but the trend should follow the risk environment.

Mr. Finch: Thank you. Can I just follow up on that? So in terms of net interest margins, can, should we assume that margins next year should be higher than this year given that the repricing of the bad book takes maybe 12/18 months to filter through?

Mr. Vassimon: It is difficult to talk about 2016 in this environment that is still full of uncertainties. But for 2015 we will be probably close to the upper part of our expectations in terms of financial margin growth.

Mr. Finch: Okay, thank you very much.

Operator: Our next question comes from Marcelo Cintra, Goldman Sachs.

Mr. Marcelo Cintra – Goldman Sachs: Hi, good morning gentlemen. Thank you for taking my question. My first question would be basically a follow-up on the previous one regarding 2016. I understand that it is a little too soon to talk about next year, but maybe I'd just like to hear from you your expectations given that bank recently revised the GDP for next year for - 0.2, and maybe just hear a little bit about your expectations for asset quality for 2016. I understand that you mentioned that for the following quarters may be a gradual increase in NPL ratios, but how should we see the midterm? Thank you, and then I'll follow-up with my second question.

Mr. Vassimon: Thank you Marcelo. Again, we are not in a position yet to make projections about 2016. What we can say is that it will be still a quite challenging environment. We don't see growth next year, most probably the economy will continue to contract a little bit, so in this environment it's reasonable to assume that the risk will be still very present. But we are not making any specific projections yet.

Mr. Marcelo Cintra: Okay, perfect, thank you. And my second question is related to the evolution of the noninterest expenses. So basically growth seems to be under control and running at the low end of the guidance for this year. So, it is just for us to assume that it could be maybe a positive surprise a low interest expense growth, maybe below 7% growth? And also, also in this front, maybe a quick update on the new data center in Mogi Mirim. The operations are already fully running or you guys still have maybe operations running in two different centers and then maybe there could be some upside here as well? Thank you.

Mr. Vassimon: Marcelo, seeing from today we believe that the best expectation we can have in terms of noninterest expenses is the middle of the outlook, particularly because the environment is still uncertain in terms of the level of FX rate and inflation itself. And, as you know, we'll have the wage agreement negotiations in the second half of this year, so seeing from today, I think the midpoint is our best expectation for that.

The new data center is going as planned, the migration, it is a very careful process that has been planned in detail. We have basically migrated around 40% of our operations and this will continue until basically the end of next year. And then, at some point, we'll start reducing the processing of our old data center.

Mr. Cintra: Okay, that's perfect. Thank you very much for the clarifications.

Operator: Our next question comes from Mario Pierry, Bank of America Merrill Lynch.

Mr. Mario Pierry – Bank of America Merrill Lynch: Good morning everybody. Let me ask you two questions as well. When I look back at your NPL, your corporate NPLs specifically, since the merger with Unibanco we see a peak of 3.7%. Your corporate NPL is running at 2.2%. Do you think that we could see this level given the weak economic conditions in Brazil, given the sharp devaluation of the currency? I think that when we compare the consumer loan book it's hard to look historically, given the changes in your loan mix. But can we, could we use your historical numbers here to try to gage what is the potential peak that we could see in corporate NPLs?

Mr. Kopel: Hi Mario, this is Kopel speaking. The point on the portfolio is that, at that point in time, we had much more presence of SMEs than we actually have today, which at the end of the day end up pushing up the NPL ratio itself. So even if things stood at the same pace you would have a lower NPL, just by the mix of, the profile of the portfolio. What we mentioned before and we've been, you know, talking is that the NPL in the corporate portfolio has gone up by specific cases, and not that is a general behavior that we see in the portfolio. So trying to, you know, model that is really a case-by-case discussion that we've been having internally and I can't really give you a number, but one thing I can give you is that, if you look at the portfolio mix and even do the recalculation of the numbers based on what you mentioned, you would probably get to a lower number than it was in the past, given the profile.

Mr. Pierry: Okay, that's clear. My second question then is related to, you are likely to book some gains on your tax credits in the 3Q from the increase in the social contribution tax. So I was wondering if you can quantify to us this amount and the possible use of the proceeds, if you could be using this to boost your balance sheet, specifically to be boosting your reserve coverage?

Mr. Vassimon: Mario, this is Vassimon. We are following very closely the process in the Brazilian Congress. As you may know, there are several proposes of change in the original bill that was sent by the federal government. So I would say that it's still premature to quantify that, but certainly there will be, this will be a relevant figure. Our policy of provisions is independent of the existence of positive gains, but we could be encouraged in this more challenging environment to revise our provisional criteria. I'm not talking here necessarily about credit provisions, but in general. But it is the still premature to comment on that.

Mr. Pierry: And just to give us an idea of the potential side of this gain?

Mr. Vassimon: I would prefer not to comment at this point because, again, there are several possible alternatives being discussed in the Congress.

Mr. Kopel: Mario, just to add to what Vassimon said, depending on if it's a, the new ruling is for a certain time period you have a number, if it's something that is definite it's a different number, therefore, you know, we would skip on the comment based on that.

Mr. Pierry: Okay, thank you.

Mr. Kopel: Thank you.

Operator: Our next question comes from Jorge Kuri, Morgan Stanley.

Mr. Jorge Kuri – Morgan Stanley: I'm assuming you sold the portfolio of bad debt…

Mr. Kopel: Sorry Jorge, we didn't hear the beginning of your question. If you could please repeat it. Sorry.

Mr. Kuri: All right, sorry. So two questions. The first one is: Can you explain the transfer of financial assets, what exactly is that? I'm assuming you sold the portfolio of bad debt, I guess that's what I conclude from your comments. I understand that it was fully provisioned, but if you are selling something that is fully provisioned you should get some sort of positive impact as you recognize part of a gain, right? I mean, normally when you sell bad assets, if you've already provisioned them, write them off, you get some sort of recovery. Was that not the case here? Can you just walk us through exactly what is it that you did and what the different impacts are across your balance sheet and income statement? That's my first question.

Second is, you, in the last quarter conference call you seemed pretty confident that second quarter was going to be the peak of the NPL problems. We did see a sharper delinquency this quarter versus last quarter, and given how delinquency move, which is sort of like in waves, it's just hard to see that 2Q will be the peak. And so I just wanted to get your updated view on what you think delinquency will look like the rest of the year? I'm assuming that if someone had asked you at the beginning of the year that your NPLs would have gone up 50 basis points in six months you would have… NPLs creation if someone had told you were going to have the numbers at sort of 10 year high, you would have said no. So what gives you the confidence on what you're going to tell me about the next six months and how does that look like? Thank you.

Mr. Vassimon: Thank you Jorge. In relation to the first question, the transfer of assets, so we made a sale of assets to an internal company. It was one single client, one single operation, a relevant amount, R$ 1 billion, and those information, those details are in our MD&A. And this was, yes, fully provisioned, was sold by a very small amount because the way I see the possibility of recovery is very very limited, so no impact whatsoever in the bottom line. And even the remaining amount that was small that was sold was again provisioned, so there was no effect, zero effect in the bottom line. So, if it's not clear, please, tell me. I'm moving now to the second question.

In terms of NPLs, in the previous quarter we basically said that we saw the level of expenses to be the peak. Actually, this quarter is basically the same level in terms of gross provision and a little bit smaller in terms of net provision. In terms of NPL we anticipated some increase and looking forward we keep seeing slight increases in the portfolio. We expect to have reductions in the expenses, loan loss expenses in the company's portfolio because, as we explained during the call, this was related to a limited number of large clients. When we see our SME portfolio it is doing well. So the larger client segment should show some decrease. All together we expect some increase in the NPL that is compatible with this more challenging environment.

Mr. Kuri: Thank you Vassimon. And is there a way that you can help us quantify the… the provisions don't really matters more, because…

Mr. Vassimon: Jorge…

Mr. Kuri: … the provision don't really matter much because you can take the provisions out of the PNL, you can take them out of the balance sheet, you can get to your guidance of provisions through the PNL if you just use your access provisions, so that doesn't really help us much. I was really thinking more about delinquency and how bad do you think this is going to get. So we saw 50 basis points in the first six months of the year. How much do you think we are going to see over the next 6 to 12 months? If you can help us understand better what you think on a numerical way the NPL cycle is going to look like I that will be great. Thank you.

Mr. Vassimon: Jorge, it is difficult to quantify it, but we are seeing a slight increase in NPLs; we don't see any strong movements. Of course we are assuming here that we won't have any major problem in large companies, this is more uncertain. But when we talk about retail portfolio, given all the measures we have taken in the past several months, and this is a dynamic process, we keep adjusting our credit policy constantly, we don't see any major increase in NPLs for the individual portfolio.

Mr. Kuri: All right, thank you very much.

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

Mr. Tito Labarta – Deutsche Bank: Hi, good morning and thanks for the call. Also a couple of questions. First maybe in terms of your loan growth just given the weak economy, you know, growth continues to be pretty slow and given now you expecting a very weak growth also in 2016, could you give me some color on how you see loan growth to continue to evolve? You think you continue to be sort of at the lower end of the range that you've provided, maybe even into next year continuing to grow in the mid-single digit and will also continue to grow in the same segments that you've been growing in, like payroll loans and mortgages, given you've been growing a lot more in those segments? Do you think that is still sustainable given how weak the economy continues to look?

And then the second question, in terms of profitability, you know, you've reached, you know, very strong levels of profitability even in spite of the weak economy. But how long do you think that's also sustainable? I mean, you still benefited a bit this quarter from relatively high trading gains, so when you think of the bottom line with all the moving parts, what type of ROE should we expect? Is this 24% level sustainable? Should it go down may be closer to 20%? If you could maybe just give us some color on your thought to answer the profitability? Thank you.

Mr. Kopel: Hi Tito. It's Kopel speaking. In terms of loan growth what we provide as an outlook for the year is 3 to 7%. If you look into our portfolio, we have something around 20/25% of our credit portfolio denominated in non-local currency. So, within that number, the 3 to 7, obviously the FX can play some role on that. But, you know, we're, you know, as of now we are working from the midpoint to low end of our outlook for the year and that's just a function of how much we are seeing in terms of the market and then business confidence and consumer confidence. So for this year, that's, you know, that's what we see going on.

In terms of the strategy going forward, we will continue pursuing, you know, less risky assets. We've been doing a lot on individuals, on payrolls and mortgages, and for companies we are looking really, you know, especially the lower you go on the portfolio, we are really looking for security lending. A lot of activity going on with the acquire, you know, the bank is very present with the acquire, so we're, you know, are continuing to foster the prepayment business there. So that's the way we are growing our portfolio without necessarily adding risk one-for-one into our balance sheet.

In terms of your last point on profitability, there are three, let's say, if you consider that there are three major avenues here, one is portfolio growth, which we already said, odds are that it is going to be a slow growth portfolio; then services; and cost efficiency. So we really continue very keen on penetrating with more services into the, into our client base. Needless to say that in a slow economy it gets more difficult to have very high growth rates on that, but still, by introducing new products in different channels we still have room to grow on that. And on the cost discipline, I mean, we've been showing a lot of discipline in executing very thoroughly our plants and we will continue to pursue that. So predicting an ROE going forward is hard, but you should really look at, out of the three elements that we spoke, two of them are, you know, capable to maneuver. One more than the other one being the cost of base, and that's how much we can talk about the ROE going forward. And just one comment from Vassimon now.

Mr. Vassimon: Just to complement, you mentioned trading gains, just to point out that part of our margin with markets is related to the banking book activities that are a little bit more stable and we have a strong activity of market-making and, again, in more volatile times we tend to perform well. So it is not that volatile in this particular line.

Mr. Labarta: Thanks, that's very helpful. So is it safe to say that trading gains while maybe not staying at these levels could stay somewhat high at least in this somewhat volatile environment? And also following up on the cost discipline, I mean, do you think costs can continue to grow below inflation, or maybe looking at it more from the efficiency point of view, your efficiency has improved quite a bit, is there room for efficiency levels to continue to improve into next year?

Mr. Vassimon: Yes, this is a constant effort we make to improve our efficiency ratio and we are seeing a kind of a structural movement in terms of clients' demands for a more digital channel. So this reduces lower-cost transaction for the bank, so think this, I think, encourages us to believe that's possible to continue to pursue lower levels of efficiency ratios.

In relation to trading, again, I think it's reasonable to assume that in more volatile environments we would be, we would do a little bit better than we do in less volatile environments in terms of financial margin.

Mr. Labarta: Fair enough, thank you. It's very helpful.

Operator: Our next question comes from Mr. Saul Martinez, JP Morgan.

Mr. Saul Martinez – JP Morgan: Hi, hello everybody. I'm going to push a little bit more on 2016 and ask maybe a question that you've answered in pieces in response to the…post the factors that make the earnings and profitability outlook…

Mr. Kopel: Saul, sorry, it's Kopel. Sorry to interrupt you, but we, again, we missed the beginning of your question. Could you please repeat the beginning of your question?

Mr. Martinez: Yes, sure. Let me pick up the handset. I'm going to be a little bit repetitive and really push you onto 2016 again a little further because when I look at the profitability and earnings outlook for next year, it seems like there are a number of factors that are making it more challenging. You have cost pressures associated with the wage hike that you're negotiating in September, especially given inflation tax, which are going to go up probably at least five percentage points for financial institutions, maybe more, the Selic may come down the second half of the year, asset quality should persist, loan growth is probably going to continue to be weak. How do you think about all of this and how do you think about your ability to sustain returns on equity in that environment that are comfortably above your cost of equity? That's my first question and then I'll follow-up with an additional question on corporate credit.

Mr. Kopel: Okay, let's start with, you mentioned cost pressures and it is known for everybody that there is a wage agreement that happens every year. And, you know, the way we have to deal with this is, we have to obtain and be more productive year after year. So our workforce has a certain turnover number that is a natural turnover of the workforce. By, you know, reviewing our processes and doing for the automation and also, you know, with the behavior that the clients have our choosing to use more digital channels, what we, you know, the path we are following is that we have the opportunity to be less labor-intensive in certain channels than we actually are, and that provides an opportunity not by necessarily restructuring the workforce, but basically just managing down the workforce by simply managing the turnover. So that's one area that helps us deal with this.

Tax rate going up is a function of what has been announced and the 5% announcement doesn't hit us in full because the 5% applies only to financial institutions. You know, given our earnings mix, you know, given coming from different companies including nonfinancial companies, that number tends to be lower. So there will be an increase because of that, but in a lower amount.

Selic going down, yes, but average Selic next year still is going to be higher than this year and the average spread, you know, given that we are still repricing, tends to be higher than this year. And, you know, we can end up the year with a lower number, but the average of the numbers should be higher. It's a fair assumption at this point to be a higher number than this year.

And you mentioned, the last fact you mentioned is weak loan growth. It is true. This year we are seeing weak loan growth, next year, you know, as far, to the extent we have, the information we have, it shouldn't be materially different than that. So all those things considered just, you know, makes us having to work more on the efficiency gains by making the equation between revenues outgrowing expenses, you know, putting more focus on being more and more efficient on the expense side. And that's something that we, I'm not going to use the word "control", but we have better conditions to tackle, given the weak economic environment that you outlined.

Mr. Martinez: Okay great, that's very helpful. Let me ask on corporate credit. Can you give us any color on what common threads you saw in terms of the deterioration? Is this, it seems it is a very small group of credit *Lava Jato*-related in sectors that you can give any color on? And it seems like you commentary for some NPL pressure here, but no, lower provisions in, but you are guiding to lower provisions in wholesale. But do we see a risk of worsening in corporates for which you have not yet provision? Because obviously this quarter you provision for those corporates who had fell in the NPL status. But why are you comfortable that in the coming quarters you won't see additional worsening that could for companies you have not yet provisioned for for which you would have even more pressure on your loan losses?

Mr. Vassimon: In terms of the corporate cases, there is no particular concentration in terms of sector, a little bit related to *Lava Jato*, but no specific concentration. Of course there is a possibility of having a worse environment, but to the best of our knowledge seeing from today, we expect this to reduce a little bit because we had some specific cases with relevant amounts that were provisioned in these two first quarters.

So, another factor that makes us confident that we will keep within the guideline, within the expectations we have provided, is the good performance we have seen in the SMEs portfolio. So in our view the increase we had in the NPL in the corporate sector is really related to some specific cases that we don't see repetition of those cases in the near future. Of course all this is dependent on the evolution of the economic scenario, but seeing from today we believe that we will see some reduction in the level of expenses for corporates.

Having said that altogether NPLs should continue to go up a little bit, we see a slight increase in the next quarters.

Mr. Martinez: Okay, so to summarize: You are not seeing any, many particular large warning signs in terms of specific economic… to a deterioration?

Mr. Vassimon: I think that's a fair statements Saul.

Mr. Martinez: Okay, very good. Thank you very much.

Mr. Vassimon: Thank you.

Operator: The next question comes from Victor Galliano, Barclays.

Mr. Victor Galliano - Barclays: Hello and thanks for the opportunity. Just a follow-up really from me, my main questions have been answered, but on the transfer of financial assets again, I'm afraid. This affiliated company, is that a subsidiary of yours and therefore wouldn't that be consolidated within the group numbers? I'm just trying to get my head around this. Or is this a company you have a minority stake in? I just want to understand that a bit better.

Mr. Kopel: Hi Victor, this is Kopel speaking. Yes, it is a fully-owned subsidiary. So basically, you know, what we have is, since it's in a consolidated entity, any impact, it was, since the credit was fully provisioned, basically what you did see is a write-down of the asset to the,the value of the transaction, and, but with no impact. So it's basically a reduction of the asset value in the book, but PNL wise is, it was neutral.

Mr. Galliano: So it's a freeing up, it’s a freeing up capital, effectively?

Mr. Kopel: Yes, I mean, from a capital perspective you're basically writing down the asset and you have a full provision to that.

Mr. Galliano: Yes, I recognize this is no PNL, I just wanted to understand the sort of mechanics and rationale. Thank you.

Mr. Kopel: Right.

Operator: The next question comes from Anibal Valdes, Barclays.

Mr. Anibal Valdes - Barclays: Hi, good morning. Eduardo and Marcelo, thank you for the opportunity. I have two questions, one related to liquidity and the other one from capital. So, the question on liquidity is that, we saw a sharp decrease in all across the foreign deposits quarter over quarter, and also we noticed also that time deposits continue to drop sharply year-over-year. I just wanted to better understand the strategy of the bank behind the management of deposits and if this is more than adjusting asset liability management of deposits or you are seeing some sort of like outflows… first question. And I'll stop there then I'll ask the capital question.

Mr. Vassimon: Anibal, this is Vassimon. The reduction in deposits reflects the decrease in creditor demands. We basically managed our pricing for deposits according to our financial needs in terms of assets. As you know, in this weak economic environment demand for credit has reduced, so we have just accordingly adjusted our prices, so the reduction in deposit is basically related to this weak credit demand. And there was also some migration to other product of the bank, basically funds that may offer additional yields for our clients. So it's basically an asset management liability issue here.

Mr. Valdes: Thank you, Eduardo. Let me stop there. I understand that less demand for credit, but demand deposits went down 11% quarter over quarter, and time deposits are down 25% year over year. So I feel like there is more, there has to be something more behind that than just like liquidity management of the bank. It seems like a sharper reduction quarter over quarter, even though the trade portfolio slightly increased. I mean, there was a reason, but not by that amount.

Mr. Vassimon: No, there is nothing really different from what I mentioned, it's really an asset management liability strategy, and you can see that most of the reduction in deposits was migrated to funds and to other products. And also it's normal that in a weak economic environment there is a reduction in deposits from clients, and also in higher inflation environment clients tend to reduce the amount they leave in demand deposits and look for ways of protecting the real value of their savings.

Mr. Valdes: Okay, understood. Thank you. So, finally the question on capital. So we saw a material increase in the capital raise of the bank and one of the reasons you mentioned for that it was the BRL appreciation during the quarter. But this quarter, I'd just like to understand where would be the pro forma capital ratio as of 2Q 2015…

Mr. Vassimon: Sorry, could you repeat the end of your question?

Mr. Valdes: Oh, sorry! So in terms of capital we saw a sharp increase in capital levels during the second quarter relative to the first quarter and one of the reasons that you mentioned for that increase was the, think on the press release was the risk-weighted assets related to credit and had to do somehow with the BRL appreciation during the quarter. So considering the BRL depreciation that we have already seen since June 30, which tempers some plus, plus the future integration of CorpBanca in Chile and also the potential downgrade of the Brazilian sovereign, what is your more or less pro forma capital ratio for the bank?

Mr. Vassimon: Okay, in terms of core equity Tier I fully loaded, the figures we showed now in the first semester is 11.3% and I briefly mentioned during the call that this would be, considering the present FX ratio, this would be around 10.5%. So the depreciation of the real in this third quarter will reduce this figure. CorpBanca represents, will represent any impact of around 80 bps in terms of capital ratio. So still comfortable levels given particularly the ability that we have shown of producing returns and increasing the capital coming from the profit itself.

In terms of downgrading, we believe that the government is working hard to avoid this possibility. I think the government is taking measures in the right direction, but of course this is a process that is outside the control of the government and, although we do not consider this to be the most probable scenario, we cannot completely discard it.

The impact would be in the bank limited, markets have to a large extent already priced the NIM, when you see, for instance, the price of CDS, and in our particular case, as you may know, the bulk of our funding comes from domestic deposits, so we would have some increase in the foreign funding. But that's not a relevant part of our business.

Mr. Valdes: Okay thank you. Just to clarify, the impact of CorpBanca would be 8 or 80 basis points?

Mr. Vassimon: 80.

Mr. Valdes: 80, okay. Thank you.

Operator: The next question comes from Boris Molina, Santander.

Mr. Boris Molina - Santander: Yes, I had a question regarding your deferred tax asset. We've been noticing how your deferred tax assets for nonperforming loan provisions, you know, regulatory and excess has been increasing at a much faster rate than the increase in provisions to the fact that, you know, over the last three year, you know, they used to track the deferred tax assets were basically equal to the tax rate apply to your provisions stock. Now they are double. So it seems to me that there is a difficulty in converting deferred taxes assets into cash. I would like to understand how this goes forward because, you know, this growth is obviously not deducted from your fully loaded core Tier I because there is this current guarantee, but one can debate whether this is valid capital or not. But it's a little bit of a concerning situation.

And my second question is regarding the impact of the deconsolidation of Redecard from your capital ratio. How big was the impact from this change in consolidation parameter in the quarter?

Mr. Kopel: Hi Boris, let me start with the second one and then I go back to the first one. Redecard is still being consolidated under our numbers, so maybe I didn't get your question, but it still consolidated into our numbers.

Mr. Molina: No, what happens is that when you look at pillar three disclosures you find that Rede is not consolidated for capital calculations, so this reduces risk-weighted assets. So, how much of the impact in risk-weighted assets reduction was…

Mr. Kopel: Boris, sorry, we can take it offline, but it does consolidate into our numbers. So, you know, let's take it offline, but it certainly does consolidate.

Your first question is regarding the buildup on the DTAs? On deferred tax assets, right, related to credit?

Mr. Molina: Yes.

Mr. Kopel: Okay. If I recall that was an e-mail from yesterday to Marcelo and how we build that. We can take it offline, but let me anticipate part of the answer. The timing of how we take the deductions and the timing where we take the write-offs and we book the assets in the books, the deferred tax assets in the books, it doesn't necessarily one is married to the other one. So you can have a lag between one and the other one, therefore, you can have a distortion when you simply do the math and work backwards on how much you have of DTA and how much it means in terms of your loan book that was written off. But we will get back to you specifically on that on your e-mail.

Mr. Molina: Yes, because it appears that, you know, I was under the impression that once you write-off the loans you probably sell the loans to asset recovery companies and then you are able to clean your tax benefit on those loans, but this seems to have been broken down for the last couple of years.

Mr. Kopel: No, it's not the case Boris. If that was the case, you would see it much more often in our disclosure that assets were sold. And we do it very, you know, last year we probably, if we did it once it was a small amount and we disclosed that very thoroughly, like we did this quarter. So it's not the asset sale to crystallize the, let's say, the tax deductibility that drives that.

Mr. Molina: Okay, wonderful. And maybe if I may just one additional question on capital. The impact of CorpBanca of 80 basis points, does it assume an additional capital injection? Because when we look at CorpBanca, and the dividends that were paid out in the second quarter and the one that is going to be paid in the beginning of the year on a fully loaded basis, this bank is going to be left with around 3% core Tier I. In this capital calculation do you foresee an additional capital injection in Chile?

Mr. Kopel: Well, as part of the agreement, there is a US$ 550 million capital injection that we will do prior to the merger. Did you factor that 550 in your calculation?

Mr. Molina: No, it's, but the payments are much higher…

Mr. Kopel: Higher than US$ 550 million?

Mr. Molina: No, we can take this offline, but the bank is going to require for early capital increase.

Mr. Kopel: Well, the bank will be properly capitalized, that's the assumption you can make, for us to continue to grow and benefit from the opportunities there. That's as much as I can tell you now. But, please, do factor in that there is a US$ 550 million capitalization that will happen prior to the merger, okay? And it turns out to be that this will be a very well-capitalized entity in Chile.

Mr. Molina: Excellent, thank you.

Operator: The next question comes from Marcelo Telles, Credit Suisse.

Mr. Marcelo Telles – Credit Suisse: Hi, hello everyone. Thanks for the opportunity. My first question is regarding asset quality. Actually, I'd like to ask some more broad questions on asset quality. What would be, I mean, at what point of the asset quality cycle do you think Itaú is right now? I mean, are we reaching the peak, if not, when do you think the peak, you know, of delinquency should be reached?

And my second question is regarding, you know, the increase in spreads that, you know, we've seen, based on the Central Bank data that, you know, all banks have been increasing spreads quite materially and of course Itaú as well, particularly on… So, one of the doubts I have is, you have the increase in social contribution tax so, once the higher social contribution tax is effective, you know, from September on, what, would you intend to increase your spreads further or the spreads that you, you know, the increase in spreads that we've seen so far they are already in anticipation of the, you know, let's say the higher social contribution tax and of course, you know, a worse asset quality environment? Thank you.

Mr. Vassimon: Marcelo, in terms of spreads, this is a process that has been going on already, but you know that the market is very competitive so the ability to price it depends on competition. But of course there will be a net negative impact on the bank, banks in general, given this increase in the taxes.

The, we, as I mentioned during the call answering another question, it's still early to define the level that will be this one-off gain related to tax gain. Our provisions, provision policy is independent of this type of event, but we are always revising this, in a more challenging environment we could be even more conservative. But it's premature to mention that.

Mr. Telles: Okay, thank you.

Mr. Vassimon: Sorry, Marcelo. Talking about the, our position in the cycle, we expect still this to keep going up slightly, NPLs, we don't see that we reached the peak of the cycle. The peak of the cycle is related, of course, to the macroeconomic situation, and we still see unemployment going up this year and probably going further up next year. So, we will probably see this going up, but we don't see any major movements in this process.

Mr. Telles: Perfect. Thank you very much.

Operator: The next question comes from Victor Galliano, Barclays.

Mr. Victor Galliano - Barclays: Sorry, I just wanted to clarify, you were saying a sort of like-for-like on the catful side, the like-for-like fully loaded Basel III, would that be 10.5 you were saying? Factoring in no FX effect, is that correct?

Mr. Kopel: Yes Victor, that's 10.5. That will bring the number to 10.5.

Mr. Galliano: Okay, and that has no mitigations in there of any kind?

Mr. Kopel: No, no. If we had rerun our capital position of 11.3 today, it would have be 10.5. For reference, on page 19 of the presentation, it's where we are taking this number from, the 11.3.

Mr. Galliano: Okay, thank you. Thanks Marcelo.

Operator: This concludes today's question-and-answer session. Mr. Eduardo Vassimon, at this time you may proceed with your closing statements.

Mr. Vassimon: Thank you all for the time in our call. We believe, as I mentioned in the beginning, that we have delivered good results in the second quarter, particularly considering the challenging economic environment. An increase of loan loss expenses is, of course, inevitable in this type of environment, but on the other hand we are increasing margins, financial margins with clients, meaning that we believe we are pricing well this new risky environment. We are keeping costs under control, aiming at having them below inflation, and taking advantage of a more volatile environment in terms of market results.

So thank you very much again and hope to see you in the next call. Thank you.

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