Itaú Unibanco Holding S.A.

First Quarter 2016 Earnings - International Conference Call

May 4th, 2016

Operator: Good morning ladies and gentlemen, welcome to Itaú Unibanco Holding conference call to discuss 2016 first 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 May 10th by phone, on +55 11 3193-1012 or 2820-4012 – access code 0027080#

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**, IRO. First, **Mr. Eduardo Vassimon** will comment on 2016 first 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. Eduardo Vassimon**.

Mr. Eduardo Vassimon: Good morning, good afternoon. Welcome.

We are starting at **page 2** with the highlights of the period. We had a R$ 5.2 billion recurring net income in this first quarter, around 10% below what we had in the first quarter of 2015. We consider this result to be quite reasonable given the economic environment.

I'd like to highlight some aspects in this page. In credit quality we saw an increase in NPLs compatible with the challenging economic environment; financial margin with market showed a strong R$ 1.7 billion in this quarter; provision for loan losses, a relevant increase of 18% compared with the last quarter of 2015. Here I think it's important to reaffirm the guidance we provided in February. We don't see this figure to be repeated in the next quarter. We are going to talk more about credit quality in the slides ahead.

Non-interest expenses showed good performance, with growth well below inflation in twelve months. Credit portfolio, given the economic situation, showed a contraction of 5.6% in this quarter.

Moving to **page 3**, this resulted in a slightly below 20% return on equity, in twelve months we had 22.7% return on equity.

On **page 4** we have the P&L. I'd like to call your attention to some particular points. Again, financial margin with market strong at R$ 1.7 billion; financial margin with clients in twelve months a 5% increase, so, below inflation, basically related to the weak demand and our more restricted credit policies. Provision for loan losses, again, a high number here, 6.4 net of recovery. This has… is basically concentrated – as we are going to see in more details in the wholesale segment – and have basically an anticipatory element in it. So we don't see this to be, again, to be repeated in the next quarters.

We can see here also that there is a lower implicit tax rate. We had indicated in our previous call an implicit tax rate of 33%, we are revising this indication to 29%. What has changed since last call is that Brazilian Congress did not approve the limit on interest on capital for Social Contribution, so in average we see 29% as a more adequate implicit tax rate.

Moving to **page 5**, we have here the breakdown between Brazil and Latin America ex-Brazil. This is going to be more important in the future, after CorpBanca operations. Here we see an 8% reduction in the bottom line for Brazilian operations and a 30% for Latin America. This reduction is concentrated in Chile due to some specific sectors.

On **page 6**, we provide a *pro forma* table with CorpBanca. As you may know, we legally started the integration on April 1st so CorpBanca will be fully integrated and fully consolidated in our figures in the second quarter. And the idea of this table is basically to show that in several lines we basically doubled the size in Latin America ex-Brazil, for instance, financial margin 1.9 times, and assets and credit portfolio 2.2 times.

Moving to **page 7**, we have the breakdown here in our P&L between, on one side, credit and trading. That's a more volatile part of our P&L, with more risk, and on the other side insurance and services, that's more stable and sensitive to the economic cycles. We can see here that from the last quarter of last year to this first quarter, we had a relevant reduction in credit and trading, basically related to the increase in provisions for credit while we see some stability in insurance and services, where reduction in revenues was compensated by a reduction in expenses.

On **page 8** we have the breakdown of the credit portfolio. In the final line we see a 5.3% contraction, nominal contraction of our credit portfolio in this quarter, given the economic environment. If we eliminate the FX effect, this reduction would be a little bit lower, 3.5%, in twelve months 4.2% reduction.

I'd like to call your attention to some lines, specific lines. Credit card loans, for instance, given again the weak economic environment and also more conservative credit criteria, we saw a reduction of 3% in credit card loans. Vehicle finance continues to go down, very weak demand in this segment. And mortgage loans performing well, with a two digit growth, 17% in twelve months.

Moving to **page 9**, in the upper part we see the loan portfolio mix. We have a reduction in the corporate segment and we see the continuation of a more structural movement of increasing the less risky lines of businesses, mortgage loans and payroll loans continue to grow in relative terms.

On the lower part of this page 9, we see the financial margin with clients' breakdown and we can see that the single most important element that explains the reduction is the reduction of our loan book, the reduction of the balance.

Moving to **page 10**, financial margin, analyzed average rate basically stable, around 11%. When we include the risk element, we see a strong reduction in this margin. We don't see this as a trend, and it's again related to the high level of provisions that we booked in this first quarter.

On **page 11**, financial margin with market. We had again a strong R$ 1.7 billion in this first quarter. We don't see this figure as recurrent. What we consider to be a more “normal” level is something between R$ 1.2 and R$ 1.3 billion per quarter. So we are reaffirming our expectation of R$ 5 billion in this line for the whole year of 2016.

Moving to **page 12**, starting to talk about credit quality. In the upper part we have the 15 to 90 day NPL ratio. The total ratio increased 50 basis points, from 2.6% to 3.1%. Of course, reflecting the challenging economic environment. When we look at the individuals, there was a 40 bps increase. Here we see clearly there is a seasonality element; in previous years we had between 20 and 40 basis points, this year we had a 40-basis-point increase. Corporate we see a relevant increase of 60 basis points. Corporate is by definition more volatile, this indicator.

On the lower part of this page 12, we have the 90 day NPL ratio. Total ratio increased 40 basis points, from 3.5 to 3.9. Here just to highlight that this to 3.5 would have been 3.7 if we had not had the financial asset transfer that we disclosed in the last call that occurred in December. In any case, of course there is a deterioration of the economic situation, but here we see clearly the effect of the nominal reduction of our loan book.

For instance, in the case of individuals, out of this 20 basis points of increase, from 5.4 to 5.6, approximately 2/3 is explained by this reduction of the balance. The same applies for very small, small and medium market companies, out of this 70 basis points, from 3.6 to 4.3 bps, 30 bps is related to this reduction of the balance.

This segment is probably the one where we are facing more challenge in terms of managing credit risks. It's a segment that is suffering particularly from the economic situation.

Looking forward, we expect to see increases, moderate increases for individuals and also for corporate. Corporate is by nature more volatile, but, in any case, we don't see relevant increases in those indicators.

Moving to **page 13**, here we show the 90 day NPL ratio excluding fully provisioned credits and we can see, both for individuals and for companies, a stable level for individuals… actually, a small reduction from 2.3% to 2.2%, and for companies a small increase from 0.6% to 0.7%, so showing a stability after this exclusion.

On the lower part of this page, we have NPL creation and write-offs. We, for the first time, we present a breakdown of the NPL creation between retail and wholesale. We see a nominal reduction of NPL creation for retail and a relevant increase for wholesale. This increase is partially explained by the same transfer of assets that I referred to in the previous slide.

Here I think it's important to note that the total amount of NPL creation, that will be R$ 5.9 billion adding up retail and wholesale, is well below the level of provisions that we made in the same quarter. So, the ratio provisions to NPL creation is over 120% in this quarter; showing, in our view, the anticipatory element that we mentioned, related to the wholesale book.

Going to **page 14**, renegotiated loan operations, we see a stability in the nominal amount, around R$ 23 billion. Despite the very challenging economic environment, we had some recovered credits – particularly in the corporate segment – that explains the absence of an increase in this figure.

On the lower part of this page 14, we have NPL ratio for renegotiated portfolio increasing from 18% to 20%, compatible again with the credit environment. And we see a comfortable 184% at 90 day NPL coverage.

Moving to **page 15**, I think it's a particularly important page, we see here the breakdown of provisions for loan losses by segment. We can see here a nominal reduction of provisions in the retail segment, from R$ 4.6 to R$ 4.3 billion. We expect this figure to increase moderately in the next quarters, in the retail element.

In wholesale we can clearly see that the substantial increase of R$ 1.4 billion from last quarter to this first quarter, reaching R$ 2.9 billion, is an element that has a strong anticipatory way. We see this figure to going down in the next quarter, in a magnitude that is bigger than the increase we will see in retail banking. So in net terms we see this R$ 7.2 billion going down, and that's again why we are confident that this provision for loan losses will be within the guidance that we provided in our previous call.

We've seen here also some increase in the coverage ratio, from 2.08 to 2.10. We expect this coverage ratio to go slightly down over the next quarters.

Moving to **page 16**, I think here is worth investing some time. We are presenting here our allowance for loan losses in a different way. On the right side we have the way we have been presenting this element, we call here "regulatory breakdown" in three categories: specific allowance, generic allowance and complementary allowance. On the left side we have a new approach, we are moving to this new approach that, that in our view, reflects in a better way the way we manage the bank.

We have here three categories, from bottom up we have overdue operations, so this R$ 11.9 billion is the amount of provisions related to operations that are overdue, and this is the minimum required by the Brazilian Central Bank.

In the middle we have allowances for loan losses related to what we call “aggravated risk", here we have the amount of provisions related to overdue transactions that exceed the minimum required by Central Bank; and also allowance for loan losses related to the renegotiated transactions.

In the first block we can clearly see in green that most of the provision is related to fully provisioned operations, and in the second block, most is related to negotiations.

And finally, on the upper part of this chart, we see R$ 15.8 billion of provisions related to expected and/or potential losses. Here we are talking operations that do not present any type that are not overdue, but reflects, for retail basically, our statistic models of expected loss, and for wholesale preemptive downgrades and analysis by sectors, so there is a *julgamento* element, a judgment element here that constitutes these R$ 15.8 billion.

So in essence, we consider this complementary allowance very similar to the part of the generic allowance that is not related to overdue transactions or to renegotiated transactions. And we are moving to this new approach also because it's closer to the concepts of IFRS 9 that we expect that at some point in time will be adopted by Brazilian regulations. We are continuing to disclose the previous concept and the new one to allow you to follow the transition, but, again, we believe that this new approach reflects in a better way the form we manage the Bank in terms of provisions.

Moving to **page 17**, talking about commissions & fees and results from insurance, we had a below-inflation-growth in twelve months, 4.5%. This reflects partially the economic environment, and, in the case of credit operation and guarantees, the reduction in our credit portfolio. In terms of credit cards, we have here also the impact of a more conservative credit policy.

In terms of the proportion of those commissions & fees and results from insurance to the sum of the same elements in financial margins, we see that we are within the historical pattern, between 34% and 35%.

Moving to **page 18**, non-interest expenses. We have here, I believe, a very positive picture. We had a 3.4% growth in twelve months and an 8% contraction in this quarter. If we exclude operations abroad that have FX impact in twelve months, we would have 1.9% growth only, so well below inflation, reflecting our efforts and our commitment to reducing costs in the Bank.

This is reflected in the quite positive efficiency ratio that we presented in this quarter, 43%. If we take the trade in twelve months, we see the continuation of downwards trend reaching 43.9%, and a negative figure when we incorporate the risk element because, again, we had high number of provisions in this particular quarter.

Moving to **page 19** and talking about capital, I'd like to focus here on the lower part of this page, on the 12.7% indicator, that core equity tier 1 fully loaded by Basel rules, so anticipating the schedule. This figure was 11.8% in December; so a good evolution.

If we deduct CorpBanca that we show immediately on the right side, 1.1%, and this figure have been getting additional information, so allowing us to have a more precise figure, we would have still 11.6% core equity tier 1 after deducting the FX of CorpBanca that, again, will take place in the second quarter. So 11.6 of core equity tier 1 we believe to be a very comfortable level of capital that allow us, if and when we feel comfortable in terms of a better credit environment, to grow our credit portfolio, so to be prepared to grow. I think we are in a very good position for that.

On **page 20**, talking about our forecast, we are reaffirming the forecast range for all lines and we are particularly confident when we talk about lines related to P&L. This first line is more challenging, the total credit portfolio growth is related of course to several factors, including FX rate. Since today we believe we will be close to the lower bound of this range.

Financial margin with clients, here again we believe will be close to 2%, the lower end of this range. In terms of provisions for credit, we believe we will be a little bit above the midpoint here. Commissions and fees here, again, reaffirming our guidance, but closer to the low end, close to 6% growth in the year. And finally, non-interest expenses, again, here close to 5%, close to the low end of this range.

In the **next page**, stock market performance, despite the rally of the past few weeks, in historical terms we are still below historic standards, with 8.8% price-to-earnings ratio. In terms of liquidity, a good level of liquidity, with a sound equilibrium between domestic market and external market.

So with that I conclude my presentation and Marcelo Kopel and myself will be available for 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 Jorge Kuri, Morgan Stanley.

Jorge Kuri: Hi, good morning everyone. Two questions, if I may. The first one is on your expectation for Selic rates and what does that mean for your financial margins and revenues. I see from your institutional presentation you are expecting Selic to be at 10% year-end 2017, 12.25 this end of this year. So, can you remind us what your asset sensitivity is for every 100 basis points decline in Selic rate or else equal, what happens to your financial margins? What is a decline in financial revenues for you?

And in the context of what could potentially be a slow growth environment on the volume side, given that you are expecting the economy to contract 4% this year, basically be flat in 2017, it is just hard to see how there is going to be any volumes. What is your expectation for revenue growth when you put together the declining rates margins and the low-volume for 2017?

And then my second question is on… I just wanted to get your general view on the ground, and I hope I'm not misrepresenting your comments, but it does seem that you are portraying us the first quarter sort of like to be the worst of the year, that from here things could potentially improve. That's certainly the case when you look at how you reiterated your guidance, you know, your financial revenues are running well below the low end of the guidance, your provisions are already at the high-end of the guidance, and you are expecting them to improve from here, fee is the same. So what is it that you are seeing that gives you confidence that from here we are going to stabilize or improve? The numbers that we see – and granted obviously, banks have a lot of leading indicators that we don't see – the numbers that we see continue to show a deterioration overall, an acceleration of the deterioration actually, if you look at unemployment the last print the came out last week was, you know, quite scary, Chapter 11 filings, I mean, most numbers that you look at still show an economy that continues to be, you know, sort of like on a freefall. Thank you.

Eduardo Vassimon: Good morning Jorge, this is Vassimon. Starting with the Selic effect, given the present position we have, a Selic reduction would have a close to neutral impact on our P&L. We have a little bit more assets than liabilities indexed in Selic, actually indexed in CDI, but that's very close to Selic, so a reduction in Selic would produce some reduction in revenues here. On the other side, and assuming that a reduction in Selic would be at least partially followed by a reduction in the whole interest rate term curve, would benefit from a more structural prefixed position, long position that we have. So in net terms, in economic net terms, would be close to neutral.

Having said that, we would have a positive impact, that's more difficult to measure, that would be the reduction of the costs for economic agents. So, the potential improvement of credit conditions or both individuals and companies.

In terms of volume of credit, as I mentioned during the presentation, we are reaffirming our guidance for 2016. We are still not in a position to give forecasts for 2017. We see, as I mentioned, particularly in the credit portfolio guidance to be particularly challenging given the environment. But linking this to your second question, we started to see some signs of stabilization in some indicators. We see several confidence indicators stabilizing, still at a very low level, it is true, but stabilizing those confidence indicators, in our view, would be the first step to a possible improvement of the whole economy in the future.

We continue to see, you are right, an increase in unemployment that should peak in the beginning of next year, and that's why we continue to see, as I think I briefly mentioned, a deterioration in NPLs going forward. But on the other hand, we can see a better political environment. I think we are reaching a more stabilized political environment that could lead to a recovery in confidence. We are not seeing this yet clearly, but what we have seen, yes, is a stabilization of some leading indicators, basically confidence indicators.

So that's why we are reiterating our guidance in all lines, and particularly related to provisions, as I mentioned, we did a substantial amount in a more anticipatory way that we do not expect to be repeated in the next quarters.

Jorge Kuri: All right, thank you very much.

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

Carlos Macedo: Thank you. Good morning Vassimon, Kopel. A couple of questions, I'm just following up on Jorge's question. I'm struggling to see how you're going to get to your loan growth guidance. I mean, it implies that your loans are going to grow 10% through the end of this year, which given the context, I mean, if you do grow 10% then I would be concerned with your provision guidance, because it doesn't seem like the environment to be more aggressive in giving out loans. At the same time, it underscores the concern on your NII guidance, you know, if loans are not going to grow as much, if rates are going to come down, I know you are as neutral to slightly asset sensitive, but you are down 4%, 5% year-on-year to get to 1%, 2% up. It's going to be challenging. I just wanted to understand if there is anything that you expect to change materially over the next couple of quarters that will allow you to reach those two guidances. I'm just following up on Jorge.

Second question, talking about asset quality, I'm not as concerned on the provision guidance, it seems fairly adequate. I'm more concerned on what to think about next year. Again, you haven't mentioned, you said you can't really do any analysis or any guidance, but when do you expect NPL cycle to peak? I mean, Bradesco said in their call that they expected to flatten out late this year/early 2017, but they do not expect any improvement until 2018. Of course it's a different bank, different portfolio and you probably have a different answer. But what you seen for that and what would that imply just conceptually in terms of provision expenses for next year vis-à-vis this year?

Eduardo Vassimon: Good morning Carlos, it's Vassimon. Let me start with the second question. As I mentioned, it's too early to talk about 2017, but we are… our economic area is revising their projection, and I think we could see a better picture for 2017, we could see something around 1% growth next year and this would lead naturally to a better environment.

In terms of NPLs peaking, we see the beginning of next year as the most probable period for having that. So we are a little bit more constructive on the scenario for next year, with some stabilization already in the second half of this year.

And I will pass to Kopel in relation to the first question.

Carlos Macedo: Just Vassimon, if you allow me just a follow-up on that. If that really is the environment, conceptually would you probably see provisions coming down in 2017 from 2016, if the environment follows what you just meant?

Eduardo Vassimon: Yes. Yes, no doubt. I mean, if this is the scenario, we would see a reduction in the provision. And actually, if the environment improves or starts to improve already this year, we could see some reduction in the amount of provisions we have today, because it was made in a rather conservative way, in anticipatory way, and if the deterioration is not there, I think we would be in a position to reduce part of our provisions.

Marcelo Kopel: Hi Carlos, Kopel speaking here. On your first of two questions, which are, you know, one is linked directly to the other one, the portfolio growth is really a reflection, as Vassimon said, about the overall economic environment and how we're seeing each one of the portfolios. Obviously there is an FX component on that, which doesn't talk necessarily to NII, but may distort the number. The reason why, and this is the reason why Vassimon pointed out to the low end of the guidance, it could be affected by the FX. As I said, when we provided the guidance, the FX rate at the end of the year was 4.50. We've revised it, our economic team, into 2.75. So right off the bat, there is an element on that, so why wouldn't…, you know, it is important, and that's why we're signaling it to the low end of the guidance, okay?

Regarding NII growth, we did see, you know, the portfolio increasing, the NII increasing year-over-year around 5%. This is below inflation, but that talks to the low growth or the no growth that we're seeing in the portfolio, some repricing that is happening in the back book and some expansion in certain portfolios. So it is a challenging environment, meeting the guidance has its challenges as you described, but as of now, we are still maintaining the low end for both items, given that there could be a perspective that can change that in the later part of the year.

Carlos Macedo: Okay, but it does, I mean, it does consider that maybe things improve towards the second half of the year?

Marcelo Kopel: Yes. First, stop deteriorating like Vassimon described, which is confidence, leveling off at a low level, but leveling off, and we cannot, you know, discard that once you have political clarity and stability, the economic agents can start resuming their day to day in a more active way. And at the bank is well-capitalized and ready, you know, well-funded and well- capitalized for that moment to happen.

Carlos Macedo: Okay, thank you. Thank you both. Oh, thank you, thank you for your answers.

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

Philip Finch: Good morning Eduardo and Marcelo, thank you for the presentation. I've got a couple of questions as well. I'm surprised, but encouraged that provisions seem to peak and will be coming lower in the next few quarters. Related to this, you have R$ 11 billion of complementary provisions. My question is, what do you plan to do with this additional provisioning? Is there an area of specific concern or specific company that you plan to use this for in the future?

And my second question is regarding your Capex position, where we see steady, but impressive progress on… in terms of the capital built up. So on slide 19 of your presentation you show the Basel III fully applied level that you estimated at 12.6%. So the question is, what is an optimal level of capital that you would like to run at going forward? And two, what is your estimate in terms of internal capital generation per year that you expect to achieve going forward? And once you exceed that optimal level, what you're planning in terms of capital deployment? Thank you.

Eduardo Vassimon: Good morning Philip. In terms of the provision, as we mentioned in the presentation, we tend to see the additional provision, the complementary provision, in a similar way we treat the generic provision that is not related to overdue or renegotiated transactions. So, the movement in this type of provision will be related to our expectations, again, our models for retail basically, our judgment for retail, our analysis of the market situation or sectors. So, if there is some improvement, we will be reducing this provision, this would be a natural movement. If there is some deterioration, we would see some migration from this block to the lower block. So it depends upon the macro scenario, but, yes, we would consider definitely reducing the amount of this provision, should the situation improve.

In terms of capital position, we believe that, given the fact that Brazil lost its investment grade, we have to work with a slightly higher level of capital because of the implicit volatility of noninvestment grade country. So we would like to see core equity tier 1 consistently above 12% as a comfortable level. If we go consistently beyond this level, then a natural movement would be to be more active in the buyback activity. So this would be our response to additional capital that we could have.

Philip Finch: Thank you. And would it be fair to say that internal capital generation could be around 100 basis points per annum?

Marcelo Kopel: Yeah Philip, it's Marcelo. Around 80 to 100 bps is a fair assumption.

Philip Finch: Perfect, great. Thank you very much.

Operator: The next question comes from Lucas Lopes, Credit Suisse.

Lucas Lopes: Hi, good morning. Thanks for taking my questions, I have two. The first one is very straightforward, I'd like to understand whether the 50 basis points spike in the 60 day NPL has contributed materially to the deceleration in the NII clients due to the increase in non-accrual loans.

And if you allow me to ask a second one, the Bank has been expecting delinquency to peak at the end of this year or beginning of next one. I want to learn if anything has changed in that regard, and I understand that you have mentioned that provisions could decline next year, which is actually more important, but I'm also interested in your view on NPLs. Thank you.

Marcelo Kopel: Hi Lucas. Regarding the over 60 NPL, the was a…, the variance between the fourth quarter and the first quarter was around, somewhere between R$ 500 and R$ 600 million. So the slowdown in NII does have some sort of impact on that, but in a R$ 14 billion line you may say that this was not relevant impact. Even if you consider that you're still paying for the funding cost, which shows up [0:45:50 unintelligible] in the margin with the clients. And you have the loans as non-accrual. So there was an increase, this 600 million that I mentioned to you, but this was not the main response to that. It was affected, but not a determinant factor on that.

What's your second question?

Lucas Lopes: Regarding your expectation on the peak in NPLs.

Marcelo Kopel: Well, Vassimon mentioned that for individuals we should probably peak in the first part of 2017, and that's correlated directly to the unemployment expectation. So needless to say that, if for any reasons in terms of expectations and the trend of… a deterioration of unemployment being better or less severe than what we are seeing, this could be less severe peak, but nevertheless in the first half of 2017 is our expectation for individuals.

Mr. Lopes: Okay, thank you.

Operator: The next question comes from Nicolas Riva, Citi.

Nicolas Riva: Hi, thanks Marcelo and Eduardo for taking my questions. The first one is on your guidance, what it means for EPS. So you already said that you expect to be at the lower end of the loan growth guidance and also NII and fees, so if I assume 0% loan growth for this year and 2.5% growth in the net interest income with clients, around R$ 24 billion in loan loss provision, Opex around 5.5%, and then fees growing 6.5, with the tax rate at 29% that you said today, then I'm getting R$ 20 billion for the net income, which is a contraction this year of about 15%. So I wanted to ask you if my R$ 20 billion for this year, 15% EPS contraction, is in line with what you have?

And the second one, on Sete Brasil you of course mentioned that you increased loan loss provisions in your wholesale book for specific economic groups in the first quarter. If you can disclose at all what's… now that Sete filed for bankruptcy on Friday, what's your exposure to Sete, if you increased loans provisions specifically for Sete in the first quarter, how much it was, and if now, when the company is bankrupt, do you need to increase your loan loss provisions for a company that already filed for bankruptcy? Thank you.

Eduardo Vassimon: Hi Nicolas, this is Vassimon. So, starting with the second question, as you know, we cannot comment on specific companies. Having said that, we are very, very comfortable with the level of provisions we have for the wholesale sector. We tend to do it on an anticipatory way, and particularly for companies where we see very low probability of recovery we go to 100% provision, and this is reflected in the high number we have in the potential… the provisions for potential losses in the wholesale.

As a policy, we have at least 50% of provisions for companies that go to Chapter 11, except in very specific cases where we have very strong guarantees, and I cannot recall any case recently of this situation, but this is more where there is a surprise in a Chapter 11. There are cases where Chapter 11 is not surprising, typically in those cases we have already been provisioning for this event.

So, we are very comfortable with the level of provisions we have. In the most critical cases we have 100%. We are particularly well-provisioned in oil and gas sector, but we cannot comment on specific cases.

I will pass to Kopel on the first question.

Marcelo Kopel: Yes, on your first question, based on your assumptions, your math is okay.

Nicolas Riva: Okay, thanks Marcelo and Eduardo.

Operator: The next question comes from Diego Ciconi, Scotia Bank.

Diego Ciconi: Hi, hello, thanks for taking my questions. Actually, I wanted to have a follow-up on Sete Brasil. They filed bankruptcy last week and they disclosed that Itaú's exposure is about R$ 2 billion. So I would like to understand a little bit if you can disclose the amount they already have provisioned or the percentage that you have on that, so we know what to expect going forward.

And also on the effective tax rate, you registered about 25% this quarter, which is a very low level. So I wanted to understand a little bit where that came from and what we can expect going forward. Thank you.

Eduardo Vassimon: Good morning, Diego. As to Sete Brasil, I'm sorry, I have to repeat the answer I gave to Nicolas, we cannot comment on specific cases. We are very comfortable with the level of provisions we have in the wholesale portfolio, in corporate portfolio, particularly in the oil and gas sector. When there is a Chapter 11 we provision at least 50%, but this mainly when there is a surprise. Typically, when Chapter 11 is not surprising we have already provisioned most of the credit. And in the credits that are more critical in the sense that we have a very low probability of recovery, we go for 100% provision. So that's what I can say. I cannot comment on specific names.

In terms of the tax rate, we had 26% this first quarter, and this was basically due to the effect of interest on capital. Interest on capital, as you know, is related to the size of the net worth and the TJLP rate. TJLP rate increased this first quarter, our net worth increased in the last quarter, that's the basis for that, and this amount to be deducted is not related to the size of the pretax profit. So when we take a higher number of interests on capital compared with a lower pretax rate, we reach this effect. Besides that, we have a mix of financial and nonfinancial companies. Basically, Rede, our acquired company, that has a lower tax rate.

Diego Ciconi: Perfect. Thank you.

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

Victor Galliano: Hi. Yes, I have a couple of questions as well. Just firstly to continue with the coverage of delinquencies and just looking at your different buckets in terms of D, E, F and G categories of loans, I see that you've maintained the 100% coverage, dedicated coverage to E, F and G. But in the case of the D loans that coverage has halved. You know, at the end of Q4, it was 43% coverage is now 21%, I mean, still 100% higher, twice, more than twice for what it needs to be, the legal minimum. But I'm just trying to understand here, is this an indication that you see that the very highest risk of your delinquency is in the E, F and G buckets and you are less concerned about the…, shall we say, the write-off at this point in time of the D bucket? Is that a reason for lowering the level of coverage there? Or just if you can talk us through why that coverage has come down in the D bucket.

And my second question is about capital. I'm just looking at your capital deductions and the schedule anticipation of those Basel III rules on page 19 of the slide. I see that the deduction is actually lower in the first quarter this year than it was in any of the quarters last year. Can you just talk us through that as well? Thank you.

Marcelo Kopel: Hi Victor. Well, as Vassimon said, we did have some migrations. In this quarter we had important migrations and downgrades that were proactively done in the portfolio, and that gets reflected in the letters. And obviously this creates some dynamic between the provisions and how we see that. So this explains why, you know, you're keeping…, you're seeing a high coverage rate in certain cases. And the reason why you are seeing…, the letter D or the portfolio in D doesn't necessarily is linked to the delinquency, you know, it's something that we are evaluating, and some of the migration that went from D to E and F was also non related to delinquency.

So the bottom line of that is, the coverage is adequate to what we are seeing in that portfolio classified as D. And just remember that the minimum required by the Central Bank is 10% at that particular bucket. So we are comfortable with that and we will be managing, you know, on a dynamic basis the overall portfolio.

Please keep in mind also that, looking at the provisions the way we classify now them between delinquent, aggravated and the potential, the way we see the coverage is more holistically. So even though you have something classified as a D now, if it something that was aggravated, you know, you may not necessarily see that in the letter, but you could have coverage for that.

Victor Galliano: Okay, okay. Thank you. So we should look more your new definitions on page 16 really, of overdue aggravated.

Marcelo Kopel: Yes, yes.

Eduardo Vassimon: And on your question of – Victor, this is Vassimon – on capital, if I understood well, you are referring to the deductions schedule anticipation?

Victor Galliano: Yes.

Eduardo Vassimon: What happens is simply the fact that every year in the first quarter we have a 20% additional phasing in of Basel. So every year we move 20% forward, so in two more years this number will be, by definition, zero. That's what explains the reduction in this bucket.

Marcelo Kopel: Victor, just to add one last comment to what I said before, when you get the total provisions that we have and you use what we call in the accounting the "complementary provision", the way… the exercise we do to fill up the different buckets in our portfolio, we start from the more aggravated letter – which obviously is not H, because H is already fully provisioned – so you get into the F and the G and so on and so forth. So as you move credits upward in the scale, so we had more migration as I said from D, to E and to F, you fill in more the provisions throughout those buckets. Okay?

Victor Galliano: Yes, yes. Yes, that's impressive that you actually covered the E category by 100% as that almost doubled quarter on quarter.

Marcelo Kopel: Yes, that's part of the whole exercise.

Victor Galliano: Yes, sure. Thank you.

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

Anibal Valdez: Hi, good morning. I just have a follow up on what Victor just asked. Just, I'm a bit lost in the numbers, trying to make sure everything is okay, related to the deductions of Basel III related deduction to common equity. Because quarter-over-quarter the deductions we just went up 16%, if we had considered that you were applying a 20% additional deduction to the stock up deduction that you would have to apply in the first quarter. That's around R$ 5 billion, and that R$ 5 billion per year is consistent with the 1.4% in deductions that you say it would cost in terms of capital ratio if you were to anticipate those deductions.

So I just have trouble looking here the deductions that you have for the first quarter, which are R$ 11.7 billion, compared to R$ 10.1 billion in the fourth quarter 2015. And on the back of the envelope number, which would be consistent with the 1.4% in additional deductions that you would have to impose to your capital ratio if you were to anticipate all the deductions going forward, that number would be close to 5 billion per year, and not R$ 1.6 billion per year, which is the change quarter-over-quarter from fourth quarter last year into first quarter this year.

So if you can let me know if something changed or you moved other parts within the capital structure of the Bank that cannot like compensate for that 5 billion deduction that we were expecting. Thank you.

Marcelo Kopel: Well, Anibal, I'll make reference to the charts we have in the presentation and the previous charts we had in the fourth quarter, and if it's not enough we can take the question off-line. But let's start with the deductions. In the fourth quarter we had a 1.9 percentage points of deduction related to the Basel III anticipation of deductions, which basically accounted for – remember the phasing in is only in 5 years – in 2015 we had 40% of phasing in, so there was a 60% of the phase-in built in this 1.9 percentage point. Now, that number talks to the 1.4 that you see in the schedule that we have here, okay? So this is how one thing relates to the other one.

Talking about the tax credit that we had, we did have an important use of tax credit. In the fourth quarter these accounted for, you know, the future use of those accounted for 1.8 percentage point, now they account for only 1. So this is future use of them, so the reduction of that implies that there was usage of that in the quarter, and primarily related to taxable income, but mostly also related to the movement of the currency because, as you know, as the real appreciated, it produces local taxable income for us related to the hedges we have for our foreign investments. So those are the two elements.

And last but not least, risk weighted assets in general, you know, also benefited from appreciation of the real against the dollar, and we have less lending in our portfolio. So these are the elements that explain this. If this didn't cover your specific question, we can take it off line with the numbers and not the percentages.

Anibal Valdez: Okay, Marcelo, that's clear. I think it has to be the details, but we will take it off line.

Marcelo Kopel: Okay!

Anibal Valdez: Thank you.

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

Marcelo Telles: Hello Vassimon, hello Kopel. Thanks for your time. I have two questions. I'm going to try to get away a little bit of the provision discussion and try to focus more on the NII performance.

Regarding, you know, this anticipation of provisions that you made in the quarter, as you mentioned, did you… are you still recording any interest on these loans? And if you are, would you consider at some point, you know, having, you know, to stop accrue this interest on these loans and, you know, let's say, continue to move down the risk categories?

And my second question is regarding your NII growth for… more for 2017. How should we think about, you know, your top line growth in an environment, you know, of, let's say, no credit growth, rates stable or potentially, you know, coming down, credit spreads currently at all-time-highs? How comfortable are you that you will be able to grow your NII next year? And I am talking about NII with clients, right, not considering NII with treasury. Thank you.

Eduardo Vassimon: Good morning Marcelo, this is Vassimon. In terms of booking revenues, we follow strictly the Central Bank rule. I mean, up to 60 days we book, after 60 days we stop booking. So, nothing different from that.

For 2017, we still have some level of incertitude, so it's too early to say. We are again a little bit more constructive on the scenario because we believe that a potential political stability could bring more credibility and previsibility to the scenario, that could lead to some growth next year. We are talking here around 1%, but it's too early to talk about the effect of this scenario on NII.

Marcelo Telles: So, if you allow me to follow up – thanks for answering Vassimon –, so based on the first… so given that you are anticipating provisions, that means that you are still…, most likely I would assume that you still accrue interest on these loans for now, because they haven't really gone through the NPL category, or at least the majority of them. And regarding the answer to my second question, I mean, just digging a little bit deeper, I know it's early, right, but what we know right now is that your portfolio is going down, and that has certainly, let's say, a carryover effect into 2017, right? And given that the effect over the price of the back book should be approached… it ends this year, do you think that I'll be too wrong assuming flat NII next year and that will be kind of a reasonable scenario, or I'm being too harsh on the outlook for next year?

Eduardo Vassimon: Marcelo, on the first question, yes, we continue to book revenues because we basically did some downgrades in several corporate clients, but they continue to perform normally, they continue to pay normally, so they are not overdue, so we are, yes, we are booking normally those revenues, provided again that it's not overdue more than 60 days.

As to 2017, again, it's difficult to say. I believe that we could have a rather fast process of increasing credit portfolio if we are comfortable with the scenario. We have liquidity, we have capital, we will be prepared to take advantages of a more positive scenario. So I think it's premature to say that this means a flattish NII for 2017.

Marcelo Telles: That's very helpful. Thank you.

Operator: The next question comes from. Domingos Falavina, JP Morgan.

Domingos Falavina: Hi, good morning all, thank you for the opportunity. I have actually, in addition to a slide that you presented showing the breakdown of financial margin, I think on slide 9 of the presentation. You put in the same pie chart the delta and you put together the mix of products, clients and spreads. My question is if you could provide a little bit more color – I'm basically talking about the 15.5 billion in 4Q15 going to 14.8 and the 31 million coming from the three drivers –, if you could provide a little bit more breakdown, how much that has been spread and how much of that has been actually mix and product? Because I believe those are very strong oscillations in the same bucket. So we have an idea on how they are offsetting each other.

And my second question, if also I may, we continue to see very strong spread increase in Central Bank data. Last month, again, over 100 basis points on growth. So my question is, assuming that you continue to grow 0% in your loan book, the repricing effect given the new spreads, for how long do you believe that this could offset the mix shift or that it could still basically have a net positive effect of the loan book being repricing? Basically just to see for how long we can continue to mitigate the worsening in credit quality or you if we still have a booster for NII growth and 17.

Marcelo Kopel: Hi Domingos, I think part of your first answer you already provided in your second question, which is, spreads are mitigating to some extent the fact that we are growing on less risky products, like mortgages and payroll.

So it's getting to a point that the back book is repricing, but growing into those products brings us to a point where, you know, we will not be able to shelter indefinitely the fact that we are not growing the portfolio with the repricing of the portfolio and the mix shift. And that talks to the fact that we are signaling to the market the low-end of our NII guidance. So one thing talks to the other one and, as you move forward, you would see in the following quarters that behavior to happen.

Your second point about zero growth and spread increase and the impact of that, I mean, so much you can do in terms of increasing your new originations to a point that you start getting into a diverse selection. Because rates are high enough and the spreads are high enough. I think what we will see – and that talks to what Vassimon said before – in the event that we see the Selic rate going down, which is our scenario, the Selic going down 200 basis points from the mid part of the year until the end of the year, and confidence improving and things marginally starting to improve, you know, you may see some peak up on the lending piece very selectively, but, you know, everything now is basically at the same time putting pressure on NII growth. And that's why we are signaling it to the bottom part of our guidance.

Domingos Falavina: Perfect. Since you mentioned the 100 basis, I remember you… the guidance… not the guidance, but the impact of 100 basis points decrease on NII. What's the latest number on that, that you believe is the impact?

Marcelo Kopel: Vassimon…

Domingos Falavina: Oh, earnings!

Marcelo Kopel: Well, the shift in the interest rate curve – if it's a full shift in the curve – given our structural positions, the economic impact of that is basically neutral. So, what you would have to factor in is how structurally the country is behaving differently that this will allow us to resume growth. But in the positions we have today, the structural positions we have today, this is kind of neutral, that makes…, that shifts in the yield curve.

Domingos Falavina: Perfect, but not the yield curve, when the Copom comes in and cuts rates in 100 basis points, what's the impact on that? It used to provide 800 million, if I'm not mistaken, given the book value is continued…

Marcelo Kopel: Yeah, but that's purely looking at the long cash position that we have. That's why I'm giving you the answer on the overall structural positions we have. Because if you look at only…, on the cash, yes, you could do the math, but when you look at the overall structural positions, it's kind of neutral.

Domingos Falavina: Understood. Thank you Kopel.

Operator: The next question comes from Carlos Gomez, HSBC.

Carlos Gomez: Hello, good morning. I'm going back to the loan growth for this year. When I look at your book in reais it is now decreasing at about 5%, 6% per year, so as mentioned earlier by Carlos, a very quick turnaround. Which areas do you think that you can grow by the end of the year? You are now growing mortgages 70%. Can that grow faster? Can you start lending to others faster? What can turnaround? Thank you.

Eduardo Vassimon: Hi Carlos, it's Vassimon. We do recognize first that this is a challenging guidance, a challenging forecast, given the present environment. We will continue to move to less risky lines of business, so mortgages and payroll are lines that should grow more than average. And in a situation where we see some improvement in the economy, clearly corporate portfolio is an area where we could see some growth. Infrastructure, for instance, and other sectors that would reflect an improvement in the confidence, if this is the case.

Carlos Gomez: Thank you.

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

Victor Galliano: Yeah, hi. I just have a quick follow up here on moving away from all the financials and thinking more in terms of strategy. If you could just give us sort of five minutes on how you see the digital branches' strategy developing. And I can see here, you know, that you basically cut about 150 branches over the last of couple of years in Brazil. How do you see that developing? Do you see that as something that will get a momentum going forward and could be a… could it be a significant contributor to controlling costs going forward?

Eduardo Vassimon: Victor, this is Vassimon. Yes, actually, we are already seeing part of these movements. The digital branches are both more convenient to the clients and much cheaper than the traditional branches. We expect this year to have a similar number of reduction in physical branches, between 100 and 150 branches, and the continuation of the migration process from customers to digital branches.

The level of satisfaction that we measure very frequently is quite high, I mean, clients are very happy because they have the ability to do banking in different hours, in a more direct and more modern way through different channels. So this is definitely one of the main structural projects that we have in the Bank. I think that this should go in a faster pace going forward. Of course we have a process of communicating well to the client, of having the adequate environment in terms of technology and people prepared to give an adequate service in this new environment, but that's a very positive trend that will continue to be reflected in the cost.

Not only we are rationalizing internally in terms of using more technology in the back-office in our operations, but the use of the digital branches in the front-office is also a relevant source of reducing costs.

Victor Galliano: All right, thank you very much.

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

Eduardo Vassimon: Just to reaffirm that this was a quite reasonable quarter in our view given the present economic environment. We are reaffirming our forecast in all lines, we are confident that we will be able to deliver, within the range we indicated, the provisions we made this quarter in a relevant amount. We don't see this to be repeated in the future, and we are, I believe, particularly well-positioned to take advantage of a possible improvement in the scenario, given our position in terms of capital, and we expect that a possible stabilization of the political situation would lead to a better confidence in the local economy and a better development of the situation as a whole.

So thank you again for your attention.

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