International Conference Call
Itaú Unibanco
Second Quarter 2018 Earnings Results
July 31st, 2018

Operator: Good morning ladies and gentlemen, welcome to Itaú Unibanco Holding conference call to discuss 2018 second quarter result.

At this time, all participants are in a listen-only mode. Later, we will conduct a question and answer session and instructions will be given at that time. If you should require assistance during the call, please press the star key followed by zero.

As a reminder, this conference is being recorded and broadcasted live on the investor relations website at www.itau.com.br/investor-relations. The audio webcast works with Internet Explorer 9 or above and Chrome, Firefox and mobile devices (iOS 8 or above and Android 3.0 or above). A slide presentation is also available on this site.

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

With us today in this conference call in São Paulo are **Mr. Candido Bracher**, President and CEO; **Mr. Caio Ibrahim David**, Executive Vice-President, CFO and CRO, **Mr. Alexsandro Broedel**, Group Executive Finance Director and Head of Investor Relations Officer, **Marcos Magalhães,** Merchant Acquirer Executive Director.

First, **Mr. Candido Bracher** will comment on 2018 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. Candido Bracher**.

Candido Bracher: Good morning and welcome to the second quarter 2018 earnings conference call.

Before I talk about our figures, I would like to briefly speak about the macroeconomic scenario. Since the beginning of the year, we have revised down our expectations of GDP growth in 2018 from 3% to 1.3%. This revision is mainly related to three factors: The impact coming from the truckers' strike, an event which directly affected the economy and also the entrepreneurs' and investors' level of confidence; second, the greater uncertainty regarding the approval of additional fiscal reforms, especially the pension reforms; and finally, the relative disappointment with the pace of job creation in the formal label market. Although it's important to say we are still seeing positive formal job creation.

Despite this negative revision in GDP growth, inflation remains under control and will continue to enable interest rates to be at low levels, reducing pressure on disposable income. And although the economy is not growing at the pace we expected in the beginning of the year, we still see some improvement in the macroeconomic fundamentals.

In fact, talking about the economy, I also want to share with you 2 commercial initiatives that we have just announced: (1) The first one is related to our insurance operation, where we replicated the open platform solution we have already adopted in an investment business. This means that we started to offer products from other insurances in our platform focused on making our customers' needs; (2) The second commercial initiative is related to our acquiring business. We launched the credit card brand, the merchant acquired segment with a POS machine family that can be purchased through its website. The first machines launched are the Pop credit card and the Mega Pop credit card. Besides selling POS machines, the strategy is to have a simple commercial proposal based on shorter payment terms to retailers and competitive rates for debit and credit card transactions. With this operation, we aim at reaching self-employed individuals, micro-entrepreneurs and small companies. This initiative complements our product offering in the acquiring market. Today I have invited Marcos Magalhães, the Head of our Acquiring Business, to address in the Q&A session any questions you may have about this new product. These 3 initiatives will reinforce our intention to better serve our customers and our confidence in the Brazilian market.

So moving now to slide number 3, I highlight our financial performance in the quarter, the key figures for the period. We see that our recurring net income remained almost stable in the quarter, in the level of R$6.4 billion. This result was supported by higher financial margins with clients, higher commission and fees and lower cost of credit. These positive effects were compensated by a decrease in our financial margin with the market and higher non-interest expenses. Concerning non-interest expenses, it's important to stress that excluding the exchange rate variation in our Latin American operations the growth was 4.4% in the quarter. We also continue to see improvements in the quality of our credit portfolio, with our nonperforming loan 90-day reaching 2.8%. Lastly, our credit portfolio increased 3.7% this quarter led by individuals and SMEs loans, and also by our Latin America portfolio.

On slide 4 we present our income statement. I would like to highlight our first semester 2018 results in which the income before tax and minority interest grew 10.5%. This performance is a result of lower cost of credit and higher fees and commission. This performance was partially compensated by a temporary higher effective tax rate, as a result of accounting of deferred tax assets at a 40% tax rate while still paying a 45% tax rate.

On slide 5 we present the evolution of the profitability and cost of equity of our operation. Our recurring ROE reached 21.6% in the second quarter, in line with the average return of the previous 6 quarters.

On slide 6 I present our business model chart, in which we breakdown the consolidated income statement of the first half of this year. As we see, the insurance and services business lines continue to be the main driver behind our profitability and represent only 60% of our net income. Although the insurance and services business continue to be responsible for almost all our value creation, I would like to point out that since the fourth quarter of 2017 our credit business creates value, as we see on the second column, we see a value creation of R$0.5 billion for credit with the recurring ROE in credit of 14.5%. This compares to a cost of credit during the first semester of 13.5%. After the first semester we have listed our cost of credit to the level of 14.5% also.

Now on page 7 we see that our credit portfolio was up 3.7% in the quarter. All portfolios for individuals had positive evolution in the quarter as we continue to see healthy demand from our clients. I want to highlight the increase of 3.5% in personal loans and of 2.4% in car finance. In the SMEs portfolio, we had another positive quarter with a 4.1% growth led by the stronger demand in the period. Looking at the past 12 months, the total portfolio grew 6.1%. Even excluding the impact of the acquisition of Citi’s retail portfolio in Brazil, the individuals and the SMEs delivered a good performance.

On large corporates, we continue to see a subdued demand for loans. The reasons for that are related to a still active capital market for the issuance of corporate debts, as I mentioned in the first quarter earnings call. Excluding this effect of foreign exchange variation, the corporate portfolio would have decrease 3.1% in the quarter and 10.5% in the year. The Latin America portfolio would have increased 2% in the quarter and 3.1% in the year. And finally, our total portfolio would have increased, without the foreign exchange variation, 0.4% in the quarter and 0.9% in the year.

On slide 8 we see that our credit origination continues to show positive evolution. The origination of our consolidated credit portfolio grew 14% when compared to the same period last year. This increase was led by the stronger demand from our clients, both individuals and SMEs. It is important to mention that the credit origination to individuals is already higher than in 2014. I would like to stress that this growth was exclusively driven by a better demand from our clients as we have not changed the risk appetite for the bank. As I mentioned in the previous slide, when it comes to large corporate the demand is still moderate, but we continue to advise and help these company to fund themselves in the capital markets, as shown for the securities chart on the bottom right, where we see that private securities issuance is 60% above what was the level in 2014.

Now on slide 9 we show our net interest margin and the changes in the financial margin with clients. This quarter, you see, we delivered a 4.5% growth in the financial margin with clients. This result, as you see in the bottom of the page, was mainly due to the change in credit mix towards higher yield in products and due to higher number of calendar days. We also saw a positive evolution in the Latin America financial margin driven by foreign exchange rate variation. So what we can see here, as the individuals and SMEs portfolio grow while the large corporates portfolio doesn't grow, this is positive for the credit mix and generates an increase in the financial margin with clients.

In the same period our consolidated NIM remained stable, while the NIM from our Brazilian operations increased 20 basis points. For the net interest margin, is increasing 20 basis points in the local market. More importantly, we saw an increase of 20 basis points in the consolidated and 50 basis points in the Brazilian risk-adjusted net interest margins due to lower cost of credit.

On slide 10 I present the evolution of the financial margin with the market. The decline observed this quarter is mainly a result of lower gains in the trading book and was in line with the guidance we have supplied in the beginning of the year, it's in line with our expectations.

Moving on to slide 11, credit quality, we see that our delinquency ratio continues to show healthy trends. The 90-day NPL ratio improved 30 basis points compared to the previous quarter and reached 2.8%. I highlight the important decrease of 60 basis points in SMEs and of 10 basis points in the individuals' portfolio in Brazil. We also had a decrease in the nonperforming loan ratio for corporate related to a renegotiation of a specific case which was mentioned in the previous quarter. This exposure was later sold to third-parties.

In the 15 to 90-day nonperforming loan ratio, we saw an increase of 90 basis points in the corporate segment. I highlight that this deterioration was not concentrated in any client or specific sector and is composed of companies that already have adequate level positioning for their respective risks. This increase was compensated by an improvement of 60 basis points in the Latin America portfolio, leading to a stability in our early delinquency ratios.

On slide 12 we present the evolution of our NPL creation. Our total NPL creation reached R$3.8 billion, a significant decrease compared to the previous quarter, mainly due to a specific exposure from the wholesale portfolio that negatively impacted this indicator in the first quarter. As I mentioned in the previous slide, this is specific exposure was renegotiated and later sold in the second quarter. The increase in the NPL creation of retail segment is a result of the credit origination growth. Even though we are still seeing some improvements in the credit quality of some individual portfolios, it is important to highlight that our loan book has resumed growing, the NPL creation for this portfolio will continue to present nominal increases.

On slide 13 we present the evolution of provisions for loan losses and cost of credit. The increase in our provision for loan losses this quarter is related to the growth in retail portfolio to the revision of preapproved limits mainly of credit cards and also due to the impact of foreign exchange rate variation. Despite the increase in provision expenses, our cost of credit decreased in the quarter due to lower impairment charges and better returns.

Now turning to slide 14 we present our coverage ratio, that reached 248% this quarter. And as I have mentioned in previous conference calls, we may experience some volatility in our coverage ratio mainly because of the wholesale portfolio. In this quarter, the increase of our coverage ratio was a result of a specific exposure of the wholesale portfolio that was renegotiated and sold afterwards. In the long-term, we expect the coverage ratio to go down due to improvement in credit ratings of corporates, but until then we may see some volatility.

Page 15, commissions, fees and results from insurance operations presented, we had an increase of 2.4% in the quarter. This performance was mainly driven by the 9.1% growth in asset management fees associated with higher assets in the management and performance fees and 2 more working days in the period. We also had an increase of almost 30% in advisory and brokerage fees related to our investment bank.

Now turning to our non-interest expenses on slide 16, we had an increase of 5% in the quarter. This growth was mainly due to the advertising expenses related to the soccer World Cup and to foreign exchange variation in our Latin America operation. I want to highlight that compared to the first half of 17, expenses from Brazil (excluding the impact of Citibank) increased half percent, much below the inflation for the last 12 months. In the quarter we saw a reduction of 56 brick-and-mortar branches in Brazil associated with synergies coming from the acquisition of Citi's retail operations in Brazil.

On slide 17 I comment in our capital ratio. Our tier 1 capital ratio reached 14.2%, the 70 basis points increase in 2018 was mainly due to earnings accumulation in the period and also by the approval from the Brazilian Central Bank of our additional tier 1 issued on March 2018. I also want to mention that we are going to pay a R$4.7 billion as complementary dividends and interest on capital on August 30, 2018.

Now a new slide, on slide 18 I want to share with you some figures related to our digital transformation journey. In the first half of 2018, as you see in the top left of the chart, we reached a milestone with more than 10 million clients using our Internet, mobile or SMS channels. It is important to say that mobile is already our most accessed digital channel with more than 8 million users.

Also for the first time we will break down our financial transactions in the digital channels. In that context, in the retail bank 80% of all credit originations, 38% of all the investments and almost 80% of the payments were made using digital channels. Through our app, we opened more than 120,000 new current accounts in the second quarter, which is close to 12% of the total accounts opened in this period, and as you see in the chart this figure is increasing rapidly and we expect it to continue to increase.

Now in the middle bottom, about our digital branches, we see that they already represent 30% of the operating revenues in the retail business with an efficiency ratio that is more than 4.000 basis points better than a brick-and-mortar branch. You see brick-and-mortar branches have an efficiency index of 69.8, and digital branches of 26.2.

Although we have seen a positive evolution in our digital efforts, we still have a long road ahead of us to better educate our clients in the benefits of using our digital channels.

On slide 19, I present the distribution of added value in the second quarter. Itaú Unibanco added R$18.3 billion to society that helped to boost the economy and to stimulate the transformational power of thousands of people. Of that value, 18% was designated to our more than 130,000 direct shareholders, and approximately 1,000,000 indirect shareholders in Brazil through investments and pension funds, 33% to taxes, fees and contributions, 29% to our employees, and 18% to reinvestment in our operations.

Now on slide 20 I would like to reiterate the forecast for 2018 that we originally disclosed in the beginning of the year. We are comfortable that the ranges presented herein still represent our best estimate for the year, even taking into account the revision in GDP growth for the year.

Last, on slide 21, I want to invite you for the annual APIMEC meeting on September 12. The event will be hosted in São Paulo but will also be webcast with simultaneous English translation.

With that, I finished this presentation and now I would like to open for the questions you may have. Thank you.

Question-and-Answer 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 2.

Our first question comes from Philip Finch, UBS.

Philip Finch: Good morning Mr. Bracher, thank you for your presentation. Two questions for me, please. My first one is regarding your effective tax rate, which was at 34.4% in the second quarter, a bit higher than what we were expecting. Now, can you discuss with us what you think could be a recurring level of taxes, bearing in mind the changes in the levels of social contribution?

And my second question is regarding the FX impact on your second quarter results. Obviously the real weakened not insignificantly in the second quarter, so how does that impact your numbers, not just loan growth, but NII as well as costs or even taxes? Thank you.

Candido Bracher: Thanks for your question Philip, I will hand the phone here to Caio Ibrahim to answer your questions.

Caio Ibrahim David: Hi Phillip, thanks for your question. Considering that the social contribution for next year would be around 15%, which pretty much is what we expect, FX tax rate would be around 30%, and that's the forecast that we are using for next year.

Philip Finch: And in a scenario that the social contribution doesn't come down, what should we assume then?

Caio Ibrahim David: That of course would be a little bit higher than this, around 32% more or less.

Philip Finch: Regarding your FX…

Caio Ibrahim David: Yes, go ahead.

Philip Finch: I was just going to ask about the FX question as well. Please, go ahead.

Caio Ibrahim David: In terms of FX assets in our balance sheet, as you know, we have our investment abroad fully hedged, so that contributes to not having later impacts in our PNL. Of course, when you have a devaluation of the real, you have some impacts in the deferred tax assets, which is pretty much related to an impact in the shareholders' equity, but, well, we managed that quite well in that sense or it's part of the risk management of the bank regarding market risk.

Philip Finch: And were your costs in any way inflated because of the FX?

Candido Bracher: Yes, Philip, I mean, our costs were inflated because of the FX because of the costs in our Latin America operations, so the Real devaluated in real terms against the currencies of the countries where we have operations, so this provokes a, expressed in real terms, I mean, this increase is the level of FX expenses.

Although relating to the level of expenses, it's important to stress that we have seen this second quarter increase in expenses every year for the past three or four years, and on top of the FX effect, you have the effect that the first quarter has seasonably lower costs, so in the second quarter we see increases. This year, besides the seasonal effect, we also had the FX rate and also other minor effects, as the soccer World Cup, for instance.

All that, taking into account…

Philip Finch: Okay, thank you very much indeed.

Candido Bracher: Just stressing, all that taking into account, I mean, we are comfortable with the guidance we have supplied for expenses for the year.

Philip Finch: Okay, thanks again.

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

Carlos Macedo: Hi guys. Good morning Candido, Caio. Couple of questions on loan growth here. First question: You keep your guidance for loan growth, they are already growing ahead of it, of course, the FX helped a lot in this quarter, but when you look at the origination rebounding, and you look at the levels where they're already growing in Brazil and your consumer book and at SMEs, should we think that it is possible yearly, so can we get to the top of the guidance have not surpassed?

Second question, you mentioned Candido that you haven't increased the risk appetite yet, the bank is still running at the same risk appetite, there is more of a demand function for that acceleration in growth. What would it take for the bank's risk appetite to increase? Where are you looking at? Is it any employment, is it GDP growth, is it the results of the elections in Brazil? I mean, operations outside of Brazil are doing really well, CorpBanca, as appears, have turned the corner, you know, Paraguay, Uruguay at first smalls, they are doing really well. What would it take for you to really say “okay, now we can do it, now we are going to lower the ratings on the corporate book, we are going to grow a little bit more now there, increase our limits”? What would it take?

Candido Bracher: Thanks for your questions, excellent questions, Carlos. So, on your first question, I mean, you are right, we are seeing good momentum in assets growth, we are also seeing good momentum in services fees and income growth, this is what makes us comfortable with the guidance we have supplied. In which part of the guidance we are going to stay? I mean, we have chosen now not to indicate any more within the guidance in which part they are staying, I mean, we are only saying that we are comfortable with the interval we have supplied. But I agree with you that there is positive momentum in the asset part of the book.

As to risk appetite, let me make one comment first: There are profitable segments of the market that we are not catering, that we have decided not to enter, and this is a structural decision taken already some time ago, and because of our perception that the higher risk segments of the market bring more volatility to results, and we have made an option to have growing results with low volatility. So when I refer to changing the risk appetite, what it would take for us to change the risk appetite is basically, I mean, to have the impression that another level of clients of higher risk has become less riskier because of GDP growth mainly, because of sustainable economic growth perspectives ahead, and we don't have it yet.

So we don't see yet that sustainability in economic growth which can give us the comfort that companies will emerge from a more risky part of the spectrum to become safer credit.

Carlos Macedo: So just a follow-up, the strategy therefore is to remain relatively conservative, though attacking the parts of the market where you see less volatility. So the consumer book, or the part of the consumer book that you have recently accelerated origination fall into that category, like some parts of auto, payroll loans, mortgages, that would be accurate to say, right?

Candido Bracher: Yes, I mean, that's right to say, I mean, that doesn't mean I'm saying that we are not intensifying our commercial efforts. I mean, so risk appetite is not the only driver of asset growth, assets also can grow because you make better efforts in the segments which you have already decided to serve, and this is what we're doing. That's right.

Carlos Macedo: Okay perfect, thank you. Thank you Candido.

Candido Bracher: Thank you Carlos.

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

Mario Pierry: Good morning everybody. Congratulations on the results. Let me ask you two questions as well. The first one is related to your net interest margin with clients in Brazil. You showed that your margin expanded 20 basis points quarter on quarter. Is it fair to say that you think that we have seen the bottom of margins in Brazil? And if you can also give us a little bit more details on this improvement, this quarter clearly part of this improvement is related to the mix effect, but I wanted to understand from your perspective if you can give us some color on spreads, credit spreads, if you can talk on a product-by-product basis, if you're still seeing spreads coming down or do you think they have normalized?

Second question is related to your asset quality. You showed very clearly the NPLs and provision charges are near historical lows, but at the same time when we look at your coverage ratios they there are historically highs, 250% coverage of NPLs, when I look at your corporate book, your wholesale book, your coverage ratio is around 950%. So, I'm trying to understand here, you know, looking forward, is there room for provision charges to still continue to come down? These are my questions. Thank you.

Candido Bracher: Thank you Pierry. Very good questions. First, concerning our net interest margin on our financial margin with clients, we are happy to see how resilient in this margin is proving to be and that we are able to grow. If you remember, just a year ago or so there were significant doubts in the market how this margin would react to the drop in the Selic rate, and I believe what we are showing is that this margin is quite resilient to the drop in the Selic rate.

And as we show in the bottom, the reason is not because spreads are not falling, this is why we break down in the bottom of the page the deferred effects when you see that we lose R$12 million in this margin because of asset spreads, and I still see a trend for spreads to reduce in the local market. I think that partially they will reduce because we will have better credit conditions, we will have the "Cadastro Positivo", I mean, the positive information about the companies, I mean, the government is also working in some tax FX, fixed rate, and I think that the general trend is that credit is going to become cheaper. But we expect the grow these margins because, frankly, I expected to seek a more vivid growth in assets, especially depending on the results of the elections, and because I think that this move in the mix towards lines of higher spread this is a trend that will still continue for quite some time. I mean, I think that the possibility of increasing lines of higher spreads, like in individual and SMEs, is a tendency that will stay for quite some time.

Now on asset quality and coverage ratios, I must confess that I am also a bit puzzled that this coverage margin doesn't drop faster. I mean, almost one year ago I said that the long-term trend would be to drop, although we could have some short-term volatility, and this is still the scenario. The dynamics here is very simple, I mean, we have today about R$36 billion, R$36.5 billion of provisions, a significant part of it (almost R$10 billion) is prudential provisions, provisions which we have made for companies that we think are still not out of the woods after the recession. Some of them are improving, some of them are being renegotiated and some of them will default, are defaulting and will default. So if these companies default, of course the NPL 90-day will increase, the coverage ratio will decrease. If these companies improve, we will be able to revert the provisions and also in this case the coverage ratio will decrease.

Meanwhile, we may see, and some effects are already happening, I mean, when I refer to a credit that we sold in this quarter, we sold this credit for a higher price than the amount we had last provisioned, so this provoked a positive effect. But when we, so the positive effect in this case decreased the coverage ratio, but at the same time, the NPL 90 drops and then the coverage ratio increases again.

So we will see some volatility in this coverage ratio, but, yes, I think the answer to your question is: Yes, there is the potential in the medium run for this coverage ratio to decrease significantly and for us to have lower provisions, especially in the corporate book.

Mario Pierry: Perfectly clear, thank you Candido.

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

Jorge Kuri: Hi, good morning, Jorge Kuri from Morgan Stanley. Could you please give us some details on your credit card Pop initiative? Can you describe what the offering is going to be? Is it going to be a payment solution only, if it's going to be full ecosystem of products and services in helping micro-merchants from your business better, are you going to have prepaid cards just as the competitors that are in that micro-merchants pays do, is it required to have a bank account with credit card Pop, I believe your competitors don't require one? How are you going to distribute the product, are you going to have salespeople, are you going to leverage the branches, are you going to advertise, and what do you thing the cost of acquisition is going to be, and what targets do you have of active merchants or PPV by the end of the year and next year? Thank you.

Candido Bracher: Thank you very much for your questions, Jorge, I will pass the phone to Marcos Magalhães, Executive Director of Acquiring Business.

Marcos Magalhães: Hi Jorge, Marcos year. Thanks for the question. First, let me comment on why we decided to launch this product, and the main reason is that because for our traditional acquiring operation this segment is pretty much new, our current offering traditionally didn't tap into that sort of segments, self-employed and micro-merchant segments, so in the commercial agenda that we planned for our business we devised this opportunity a while ago, and we finally launched this introducing the initial Pop as were announced as of last week.

The idea is to have a very simple product offering, we believe that this market is yet sub penetrated, currently we estimate that the penetration is around 20%, so there is still a lot of room to grow. When we started the market we also understood that there is a price elasticity in terms of the remaining 80% that didn't enter the payment industry, if you will, and so we decided also to simplify the pricing trading only one offering with a very aggressive pricing, if you will, and we did that again by simplifying the products and transferring all the operational efficiency that we gained through the consumer benefit, of the micro-merchants benefit.

We launched initially with the settlement being offered through a bank account or a saving account, not only a current account, also saving account as well, so it's very flexible in that respect. Going forward, it is also the plan to allow the settlement to be done into a prepaid card, as you mentioned, but again, always at the discretion of the client. So, if the client wants to have a prepaid card to settle, he will have it, otherwise he can use whatever currency account or saving account that he might wish to. And as for the other points regarding this evolving into a ecosystems, yes, of course it depends on the attraction that we expect from the project, but naturally all the products might be distributed through this into a cross sell agenda.

Jorge Kuri: Thanks for that, that was very useful. The last two parts of my question on how do you plan to distribute the product? Is it true online, is it through the branches, is it through salespeople? What do you think the cost of acquisition is and what are the targets that you have set for the business either active merchants by year-end 2019 or 18 or PPV as well? Thank you.

Marcos Magalhães: Okay, the main channel that we believe is a self-service business through channel, we don't expect to distribute this in other channels, and the main thing for that is that we believe that this kind of targets that we are aiming can be found at a very low cost of acquisition through these domains. As of the branches, in our case we don't see much overlap in our branches with this target group, so it is not a priority to introduce these in our branches at this point. As for volumes, what we disclosed is the initial goal of having around 100 to 250 thousand customers by this year-end, and that's what we have disclosed so far.

Jorge Kuri: All right, thanks a lot.

Operator: Ladies and gentlemen, as a reminder, if you would like to pose a question, please press the star key followed by the one key on your touchtone phone.

The next question comes from Jason Mollin, Scotiabank.

Jason Mollin: Hi. My question is about the sensitivity of your guidance to economic growth and FX volatility. I understand the comments that you are not changing the guidance despite the lower economic growth, Itaú-Unibanco has lots of earnings drivers and lots of businesses and I also recognize how resilient they have been, but how should we think about the sensitivity of your business to these kinds of, I mean, the Real moved 17% in the quarter, you know, interest rates on the long side moved up and have come back a little bit, we are seeing economic growth expectations slow. I mean, how should we think about it? I mean, it seems like the origination has not, you haven't seen a negative impact of this volatility as of yet in the second quarter, should we expect that, and if could just provide some color. Thank you.

Candido Bracher: Thanks for your question, Jason. So I would not say that we did not see a negative impact in the origination from this worse sentiment in the market. I think the origination would have been better if it was not for the truckers' strike, if the perspectives for the elections were clear, if we have a more, especially in the corporate sector. When you look at the corporate sector, you see that in the large corporates there is no growth at all, but also the confidence sentiment in general, the public sentiment in general, I think we can expect a more intense growth in demand for credit specifically, but also for services if we have better economic growth. Having said that, we try to have low volatility in our results by design, because we concentrate ourselves in less risky part of the market, and this is why we are not so much affected in the short term by the economic growth.

As to FX volatility, I mean, we try to operate hedged in FX and in interest rates as much as we can. So when we see this movement, and we had movements this quarter, significant movements this quarter, our hedging instruments protect our balance sheet. But expenses will be impacted by more devalued currency because of all the expenses which are made in the offshore banks and these are not hedged, I mean, they are hedged by their own results. So if results want to be affected necessarily, the results in Chile, the results in Argentina, Uruguay, Paraguay will not be affected by the level of FX rate in Brazil, but the costs in the line of expenses in our balance sheet will be affected by this rate.

Another important effect of the exchange rate is not on results, it's on capital. And you will notice that if you go through our MD&A that we have actively managed our foreign investments in order to avoid the capital consumption, which is normally created by a FX devaluation.

Jason Mollin: That's very helpful. Maybe just a follow-up question on your slide on digital transformation as well. You are showing an interesting move from 22% in operations representing 22% of your operating revenues moving up to 30% in the second quarter. Can you talk about what… like how you are measuring that? How should we think about your measuring this kind of retail operating revenues? Is there a deposit spread in there, clearly it's fee income, loan spread, etc. Any color would be helpful. Thanks.

Candido Bracher: Okay. The details on the account I'll pass on to Broedel.

Alexsandro Broedel: Hi Jason, it's Alexsandro here. Yes, basically we used the same criteria that we used to measure on the other part of our financials. For example, if we think about NIM, for example, we take into account the NIM of the transactions originated on the digital branches. So you consider the spread, you consider the costs allocated, it's a full-cost allocated system, and with capital allocated and everything else. So, it's pretty much allocation of our normal criteria to the digital branches and the brick-and-mortar branches. I'm not sure of if I answered completely.

Jason Mollin: Thank you.

Operator: Again, if you want to pose a question, please press star one.

The next question comes from Eduardo Nishio, Banco Plural.

Eduardo Nishio: Hi. Thank you for taking my question and for the presentation. I have two questions as well. First one is on regulation. If you can share your thoughts on recent CPI (parliamentary commission inquiry). Recommendations from Central Bank, I know that Mr. Setubal was very supportive with the end of cross subsidiaries in the sector. If you can give any color on what might happen would be very helpful.

And my second question, if you could give us an update on the XP deal I would also appreciate it. Thank you.

Candido Bracher: Thank you for your questions, Nishio. So, relative to the CPI in the Congress and its conclusions I believe the conclusions of the CPI were positive to the market, they dealt with real problems in the economy, one of these real problems is the very high nominal level of interest rates in credit cards, and as we know, one of the main reasons for this very high nominal levels of interest rates in credit cards is the cross subsidies. In our case for instance, of Itaú, our total credit card credit portfolio is R$60 billion, out of which R$5 billion bare interest, and the 55 don't bare interest. And out of the spread of these R$5 billion, we must pay all the delinquency of all the R$60 billion portfolio. So this is what causes the rates to be so high.

One idea that came out of the CPI is to incentivate a new market, an additional alternative through the installments without interest which would be the financing in the credit card, and in this case you would probably reduce the payment to the purchase from 30 days to 15 days or even to fewer days. So, I imagine that this is a more logical evolution, it's a gradual process, I mean, so the product has to be created, has to be adopted by many banks, and as this ends we will later gain some market share over the installment resulting this creating a better balance in the economy. So we will have a higher portion of our credit card portfolio, banks will have a higher portion of their credit card portfolio baring interests.

On the XP transaction, I think there is no comment to be made, we still await a decision by the Central Bank as to the approval of the transaction. Thank you.

Eduardo Nishio: Thank you. Just one follow-up question. So there will probably be a shift on economics of the industry, right, so probably you bare the float from 32 days, let's say, and then on the other hand you have the interest on the payment baring interests on credit cards, right? Is that correct?

Candido Bracher: Let me, so, when you go to a merchant to buy a shoe, the merchant will offer you two alternatives, or three: One alternative is to pay at site; one alternative is, as we have today, installment without interests, so your shoe will cost R$100 and you can pay it in 5 installments without interest, R$20 each installment; and another alternative, the new alternative would be: well, you can buy your shoe financed in the credit card with the interest of the credit card, but in this case the shoe won't cost R$100, but will cost R$92 and the merchant if he sells R$100 in installments he will receive the money also in installments 30 days after each installment, and if he sells it in this new modality, he will receive the funds two days after the sale.

Eduardo Nishio: Got it, thank you. Thank you so much.

Candido Bracher: You're welcome.

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

Mario Pierry: Yes, let me ask one more question then. Looking on page 15 of your presentation you showed that your headcount, especially in Brazil, continues to grow up, I think your headcount is up 6% year on year, you did have here the integration of Citibank, but also you show on page 17 the significant investments in technology, the digital transformation that you are making. So I was just wondering, given the benefits or the potential synergies with Citibank, all the investments in technology, why should your headcounts continue to go up? Or do you think that the trend in the future is to see much lower expenses going forward? Thank you.

Candido Bracher: Thank you Mario. Well, we are growing, still growing our headcount mainly because the investments in people we are making in our new insurance platform and in the acquiring business they outnumber the economies of people we are having due to technology improvements. I think that we are very much in an investing phase in the bank, and it's fair to say on the medium run that I expect the efficiency in the bank will improve significantly.

Mario Pierry: So, is it fair to assume then that expenses for you are unlikely they should be growing in line with inflation going forward?

Candido Bracher: I think they should be growing below inflation going forward.

Mario Pierry: Okay, thank you.

Candido Bracher: Thank you.

Operator: Once again, if you want to pose a question, please, press start one.

The next question comes from Carlos Gomes, HSBC.

Carlos Gomes: Hi, good morning. Hello? My question is on the cost of credit and we have already seen a reduction. How much lower do you think it can get and when do you expect the bottom in this cost of credit, I mean, the maximum amount of recoveries, the green point in this credit cycle? Thank you.

Candido Bracher: I'm not sure I understood your question, Carlos. It was concerning the provisions, how much lower it can get, how much lower the delinquency rates can get?

Carlos Gomes: Correct, how much lower can they get, how much lower can the cost of credit get, and when do you think we will reach that point?

Candido Bracher: Well, I think they can go lower. We still see this improving trend, of course, I mean, the provisions they will increase as the portfolio increases proportionately to it, but the cost of credit can still go lower because we are seeing still an improvement in the quality of credit. I think I estimate that we could see until the end of the year an improvement in these indexes, I mean, we see the new vintages coming with better figures, better delinquency rates than the old vintages.

Caros Gomes: So, you think that the delinquencies can continue to improve, let's say, next year or the year after, so we're not at the bottom yet?

Candido Bracher: Well, I can’t see that far forward, we still have the elections in the middle of the year and so on, I think it's prudent to say that we can see them still improving until the end of this year.

Carlos Gomes: Thank you very much.

Candido Bracher: Thank you.

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

Candido Bracher: Thank you. So I would like to thank you all for your attention and for your questions.

I think that our results this quarter they came with a top line which was not to our liking because it was below the previous quarter, but when we look inside the figures, we see very healthy trends, I mean, we see growing credit portfolio, we see growing fees and incomes, we see growing financial margin with clients, and the effects to the other side were costs, which were normally higher in the second quarter because of plans which we verify every year, and because of a lower financial margin with the markets, which is perfectly in accordance with the guidance we have provided and with our forecast.

So looking forward, we see a continuation of this positive trend in the balance sheet of growing income. Thank you very much.

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