

# Itaú

February 03, 2015

## 4Q14 results: Another strong result with improvement in asset quality

Itaú 4Q14 figures showed another strong result with recurring net income of BRL 5.7bn a rise of 3.7% qoq, 5.3% above BB-BI estimates due to a higher NII and lower provision expenses. The main highlights of the results are: a) strong NII in reason of the good treasury performance; b) loan growth of 5.3% qoq and c) improvement in asset quality (10 bps). The negative side was the use of non-recurring gain from sale of large-risk insurance operations to improve complementary allowance for loan losses (BRL 0,7bn). As we see in its private peers, Itaú released its guidance for 2015 and expected one digit loan growth, between 6% and 9% (8.1% BB-BI E).

**Announced versus Estimated.** Net interest income came 8.9% above BB-BI estimates, as a result of the good treasury performance, demonstrating the recovery of spreads. Provision expenses decreased by 2.7% qoq, 6.3% below our estimates, reflecting the improvement in asset quality. Fee income raised 4.1% qoq, with a higher performance from credit cards. Non-interest expenses improved 3.7% qoq and came 2.4% above BB-BI estimates due to a higher than expected growth in operational expenses (+9.5% qoq) mainly driven by the impact of credit card selling. Bottom line was 5.3% above our estimates while ROE fell 50 bps but remained in healthily 23.4%.

**Loan growth and asset quality.** The loan portfolio classified according to the Brazilian Central Bank concept showed strong increase of 5.3% qoq, and 1.2% above BB-BI estimates, with large corporates and Latin America's portfolio growing faster than expected. The NPL ratio maintains the course of improvement reaching 3.1% in 4Q14 (-10 bps qoq), the lowest level since the merge between Itaú and Unibanco.

**Outlook** – After the strong results reported by the private banks we remain comfortable with our thesis that the financial sector is one of the few sectors with a good earnings momentum in 2015, despite weak economic conditions. We do not believe in further deterioration in asset quality for private banks in 2015, as they are most likely to maintain the focus on low-risk loan portfolio. Based on 2015 guidance, we have updated our model and kept our YE2015 TP in BRL 41.90 maintaining the Outperform recommendation.

Income Statement (BRL million)	4Q14 A	4Q14 E	A/E	QoQ	YoY
<b>Net interest income - NII</b>	<b>14,705</b>	<b>13,508</b>	<b>8.9%</b>	<b>2.3%</b>	<b>15.8%</b>
<i>NIM - Net interest margin</i>	5.4%	5.1%	0.3 p.p.	0.2 p.p.	0.9 p.p.
Provision for loan losses	(4,614)	(4,923)	-6.3%	-2.7%	10.1%
<i>Provisions/ Avg. gross loans</i>	4.2%	4.5%	-0.3 p.p.	0.0 p.p.	0.5 p.p.
<b>NII after provisions</b>	<b>10,092</b>	<b>8,585</b>	<b>17.6%</b>	<b>4.8%</b>	<b>18.6%</b>
<i>NIM after provisions</i>	3.7%	3.6%	0.2 p.p.	0.2 p.p.	0.7 p.p.
Commissions and fees	6,825	7,281	-6.3%	4.1%	13.1%
Net insurance, pension, capitalization	1,446	964	50.0%	-5.8%	3.6%
Non-interest expense	(10,113)	(9,881)	2.4%	3.7%	8.1%
<i>Cost to income ratio</i>	44.0%	41.6%	2.4 p.p.	0.6 p.p.	-2.5 p.p.
<b>Earnings before taxes</b>	<b>8,340</b>	<b>7,805</b>	<b>6.9%</b>	<b>2.8%</b>	<b>21.6%</b>
Income tax and social contribution	(2,595)	(2,420)	7.3%	0.9%	n.a.
<i>Effective tax rate</i>	31.1%	31.0%	0.1 p.p.	-0.6 p.p.	-0.1 p.p.
<b>Recurring net income</b>	<b>5,660</b>	<b>5,375</b>	<b>5.3%</b>	<b>3.7%</b>	<b>20.9%</b>
EPS	1.01	0.98	2.7%	2.1%	7.7%
ROAA	1.9%	1.8%	0.1 p.p.	0.0 p.p.	0.2 p.p.
ROAE	24.3%	23.8%	0.5 p.p.	-0.4 p.p.	0.8 p.p.

Source: Itaú and BB Investimentos

### Banks

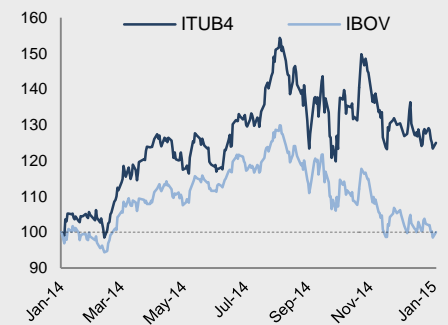
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ITUB4	Outperform
Last Price 02/02/2015 (BRL)	33.32
Target Price 12/2015 (BRL)	41.90
Upside	25.8%
Market Cap (BRL million)	174,682
1 Month Change	-1.5%
LTM Change	25.0%
YTD Change	-3.6%
52w Low (BRL)	26.09
52w High (BRL)	41.53

Valuation	BRL Million
Equity Value 2015E	229,621
WACC	15.5%
Growth in Perpetuity (g)	6.0%

Multiples	2014	2015 E	2016 E
EV/EBITDA	11.1x	9.8x	8.6x
P/E	2.4x	2.2x	1.8x
EPS (BRL)	3.76	4.30	4.90



Source: Bloomberg and BB Investimentos

## Loan Portfolio

Gross loans (BRL million)	4Q14 A	4Q14 E	A/E	QoQ	YoY
<b>Gross loans</b>	<b>451,760</b>	<b>446,378</b>	1.2%	5.3%	9.6%
Individuals	185,660	187,525	-1.0%	4.5%	10.4%
SMEs	79,911	79,834	0.1%	1.6%	-2.1%
Large corporates	144,514	140,103	3.1%	6.8%	14.5%
Latin America	41,675	38,916	7.1%	12.4%	15.0%
<b>Loan Mix</b>					
<i>Individuals</i>	41.1%	42.0%	-0.9 p.p.	-0.4 p.p.	0.3 p.p.
<i>SMEs</i>	17.7%	17.9%	-0.2 p.p.	-0.7 p.p.	-2.1 p.p.
<i>Large corporates</i>	32.0%	31.4%	0.6 p.p.	0.4 p.p.	1.4 p.p.
<i>Latin America</i>	9.2%	8.7%	0.5 p.p.	0.6 p.p.	0.4 p.p.
<b>Asset Quality (BRL million)</b>	<b>4Q14 A</b>	<b>4Q14 E</b>	<b>A/E</b>	<b>QoQ</b>	<b>YoY</b>
<b>Gross loans</b>	<b>451,760</b>	<b>446,378</b>	1.2%	5.3%	9.6%
Loan loss reserves	26,948	26,336	2.3%	6.7%	2.2%
<i>LLR/ Gross loans</i>	6.0%	5.9%	0.1 p.p.	0.1 p.p.	-0.4 p.p.
Non-performing loans	13,970	14,730	-5.2%	0.3%	-7.6%
<i>NPL/ Gross loans</i>	3.1%	3.3%	-0.2 p.p.	-0.2 p.p.	-0.6 p.p.

Source: Itaú and BB-BI

**Guidance.** Just as we saw in Bradesco's guidance published last week, Itaú released their estimates of a single digit loan growth for 2015, with indicative range between 6% and 9%. We believe that this expectation is more realistic considering the current environment.

### Guidance 2015

	Guidance	
	2015	BB-BI E
Loan Portfolio	6% to 9%	8.1%
NII	10% to 14%	14%
Loan Loss Expenses (BRL)	13bn to 15bn	15.7bn
Fee Income	9% to 11%	9.7%
Non-Interest Expenses	6.5% to 8.5%	5.6%

Source: Itaú and BB-BI

**Valuation.** Considering the new guidance, we have updated our model increasing 20015-2016 EPS by 0.3% and 7.5%, respectively and maintained our YE2015 TP in BRL 41.90. Our TP is derived from a three-stage DDM assuming a cost of equity (Ke) of 15.5%, with a nominal growth in perpetuity (g) of 6%. The bank is trading at 1.7x P/BV 2015 and 8.5x P/E 2015.

## Model update

Income Statement (BRL million)	2014	2015 E			2016 E			2017 E
		Previous	Current	% Change	Previous	Current	% Change	
<b>Net interest income - NII</b>	<b>51,887</b>	<b>58,765</b>	<b>58,871</b>	<b>0.2%</b>	<b>59,155</b>	<b>62,002</b>	<b>4.8%</b>	<b>65,522</b>
<i>NIM - Net interest margin</i>	4.8%	5.4%	5.3%	-0.2 p.p.	5.2%	5.4%	0.2 p.p.	5.7%
Provision for loan losses	(19,252)	(19,027)	(21,384)	12.4%	(21,377)	(23,298)	9.0%	(25,326)
<i>Provisions/ Avg. gross loans</i>	4.5%	4.0%	4.5%	0.5 p.p.	4.0%	4.5%	0.5 p.p.	4.5%
<b>NII after provisions</b>	<b>32,635</b>	<b>39,738</b>	<b>37,486</b>	<b>-5.7%</b>	<b>37,778</b>	<b>38,704</b>	<b>2.5%</b>	<b>40,196</b>
<i>NIM after provisions</i>	3.5%	4.0%	3.9%	-0.2 p.p.	3.6%	4.0%	0.4 p.p.	4.2%
Commissions and fees	27,740	30,838	30,419	-1.4%	34,539	33,765	-2.2%	37,479
Net insurance, pension, capitalization	3,834	4,181	4,181	0.0%	4,599	4,599	0.0%	5,059
Non-interest expense	(37,742)	(39,588)	(40,177)	1.5%	(41,332)	(42,553)	3.0%	(45,179)
<i>Cost to income ratio</i>	41.0%	38.4%	39.0%	0.5 p.p.	38.6%	38.5%	-0.1 p.p.	37.9%
Earnings before taxes	27,245	34,405	32,688	-5.0%	34,095	36,689	7.6%	40,316
Income tax and social contribution	(6,437)	(11,178)	(9,398)	-15.9%	(9,547)	(10,273)	7.6%	(11,288)
<i>Effective tax rate</i>	23.6%	32.5%	28.8%	-3.7 p.p.	28.0%	28.0%	0.0 p.p.	28.0%
<b>Recurring net income</b>	<b>20,618</b>	<b>23,475</b>	<b>23,538</b>	<b>0.3%</b>	<b>24,950</b>	<b>26,817</b>	<b>7.5%</b>	<b>29,449</b>
EPS	3.77	4.29	4.30	0.3%	4.56	4.90	7.5%	5.38
Dividends per share	1.11	1.30	1.32	1.3%	1.37	1.47	7.5%	1.61
BV per share	17.50	18.45	19.49	5.6%	21.64	22.91	5.9%	26.68
ROAA	1.8%	1.9%	1.9%	0.0 p.p.	2.0%	2.1%	0.1 p.p.	2.1%
ROAE	23.3%	24.6%	23.2%	-1.3 p.p.	24.4%	25.4%	1.0 p.p.	24.9%

Asset Quality (BRL million)	2014	2015 E			2016 E			2017 E
		Previous	Current	% Change	Previous	Current	% Change	
<b>Gross loans</b>	<b>451,760</b>	<b>499,903</b>	<b>488,415</b>	<b>-2.3%</b>	<b>563,248</b>	<b>535,876</b>	<b>-4.9%</b>	<b>589,723</b>
<i>% growth</i>	9.6%	12.0%	8.1%	-3.9 p.p.	12.7%	9.7%	-3.0 p.p.	10.0%
Loan loss reserves - LLR	26,948	27,495	26,863	-2.3%	30,979	29,473	-4.9%	32,435
<i>LLR/ Gross loans</i>	6.0%	5.5%	5.5%	0.0 p.p.	5.5%	5.5%	0.0 p.p.	5.5%
Non-performing loans	13,970	16,997	15,629	-8.0%	19,714	18,756	-4.9%	20,640
<i>NPL/ Gross loans</i>	3.1%	3.4%	3.2%	-0.2 p.p.	3.5%	3.5%	0.0 p.p.	3.5%

Source: BB-BI

## Sensitivity analysis

	Target Price					Equity Value					
	13.5%	14.5%	15.5%	16.5%	17.5%	14.5%	15.0%	15.5%	16.0%	16.5%	
<b>5.0%</b>	54.00	46.40	40.30	35.40	31.40	5.0%	253,853	236,299	220,617	206,543	193,860
<b>5.5%</b>	55.70	47.50	41.10	36.00	31.80	<b>5.5%</b>	260,015	241,435	224,915	210,152	196,899
<b>6.0%</b>	57.50	48.70	<b>41.90</b>	36.60	32.20	<b>6.0%</b>	266,849	247,094	<b>229,621</b>	214,081	200,190
<b>6.5%</b>	59.60	50.10	42.90	37.20	32.70	<b>6.5%</b>	274,481	253,367	234,805	218,383	203,771
<b>7.0%</b>	62.10	51.70	43.90	37.90	33.20	<b>7.0%</b>	283,072	260,371	240,549	223,117	207,690

	P / E					P / BV					
	14.5%	15.0%	15.5%	16.0%	16.5%	14.5%	15.0%	15.5%	16.0%	16.5%	
<b>5.0%</b>	10.8x	10.0x	9.4x	8.8x	8.2x	<b>5.0%</b>	2.4x	2.2x	2.1x	1.9x	1.8x
<b>5.5%</b>	11.0x	10.3x	9.6x	8.9x	8.4x	<b>5.5%</b>	2.4x	2.3x	2.1x	2.0x	1.8x
<b>6.0%</b>	11.3x	10.5x	<b>9.8x</b>	9.1x	8.5x	<b>6.0%</b>	2.5x	2.3x	<b>2.2x</b>	2.0x	1.9x
<b>6.5%</b>	11.7x	10.8x	10.0x	9.3x	8.7x	<b>6.5%</b>	2.6x	2.4x	2.2x	2.0x	1.9x
<b>7.0%</b>	12.0x	11.1x	10.2x	9.5x	8.8x	<b>7.0%</b>	2.7x	2.4x	2.3x	2.1x	1.9x

Source: BB-BI

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