

Itau Unibanco

Winds of optimism. Notes from the road

Maintain Rating: NEUTRAL | PO: 31.00 BRL | Price: 28.67 BRL

On the road with management

We spent the past few days visiting investors in Europe with Itau's management (Renato Lulia, Head of IR and Market Intelligence, and Gustavo Rodrigues, IR officer). We came away more positive on the macro outlook and the bank's earnings perspectives for '24, as the BCB is likely to embark on an easing cycle in the 2H23. On the other hand, we became more cautious on the outlook for the acquiring industry, as Rede has been fully consolidated into the bank, implying continued market share gains and likely lower prices for the industry.

Improving macro

Management noted that recent macro data have been better than originally forecasted. The bank has increased its '23 GDP growth forecast to 2.3% from 0.9%, although it is being primarily driven by better figures from the agricultural sector. Nonetheless, unemployment has been more resilient than expected (currently at 10-year lows) and inflation is converging to within the BCB's target range. Management expects the BCB to embark on an easing cycle in September.

Cross sell and efficiency gains

Management reinforced some of the messages from its most recent investor day. It sees significant room to improve engagement of its existing c.70mn client base, and that recent investments in technology will place it among the leaders in the industry, allowing for future improvements to an already historical-best efficiency ratio of 38% in Brazil. Please refer to page 3 for detailed take-aways from our meetings.

We stay at Neutral

Itau boasts a solid balance sheet, earnings are expected to grow low double digits in '23 and '24, and support ROE c.20% levels, driven by better asset quality trends, efficiency efforts, and better fees (on the expected revival of capital markets and asset mgmt. in a lower rate environment). However, we see limited upside to our PO and maintain our Neutral rating.

| Estimates(Dec) (BRL) | 2021A | 2022A | 2023E | 2024E | 2025E |
|---------------------------|-------|-------|-------|-------|-------|
| EPS | 2.75 | 3.14 | 3.53 | 3.91 | 4.24 |
| GAAP EPS | 2.55 | 3.00 | 3.46 | 3.85 | 4.18 |
| EPS Change (YoY) | 44.7% | 14.2% | 12.4% | 10.8% | 8.4% |
| Consensus EPS (Bloomberg) | | | 3.55 | 3.94 | 4.17 |
| DPS | 0.64 | 0.85 | 1.07 | 1.17 | 1.27 |
| ADR EPS (US\$) | 0.51 | 0.61 | 0.74 | 0.82 | 0.89 |
| ADR DPS (US\$) | 0.12 | 0.17 | 0.22 | 0.25 | 0.27 |
| Valuation (Dec) | | | | | |
| P/E | 10.4x | 9.1x | 8.1x | 7.3x | 6.8x |
| GAAP P/E | 11.2x | 9.6x | 8.3x | 7.4x | 6.9x |
| Dividend Yield | 2.2% | 3.0% | 3.7% | 4.1% | 4.4% |

26 June 2023

Equity

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Stock Data

| | |
|-------------------------|---------------------------|
| Price (Common / ADR) | 28.67 BRL / 5.94 USD |
| Price Objective | 31.00 BRL / 6.20 USD |
| Date Established | 24-May-2023 / 24-May-2023 |
| Investment Opinion | B-2-7 / B-2-7 |
| 52-Week Range | 21.64 BRL - 31.29 BRL |
| Market Value (mn) | 280,112 BRL |
| Average Daily Value | 170.33 BRL |
| Shares Outstanding (mn) | 9,770.2 / 9,770.2 |
| BofA Ticker / Exchange | ITUBF / SAO |
| BofA Ticker / Exchange | ITUB / NYS |
| Bloomberg / Reuters | ITUB4 BZ / ITUB4.SA |
| ROE (2023E) | 20.1% |

BCB: Brazilian Central Bank
NII: net interest income
NPL: Non-performing loans
SME: Small and medium enterprises
VAR: Value at risk

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Refer to important disclosures on page 7 to 10. Analyst Certification on page 5. Price Objective Basis/Risk on page 5.

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Income Statement Data (Dec)

| (BRL Millions) | 2021A | 2022A | 2023E | 2024E | 2025E |
|--------------------------------------|----------|----------|----------|----------|----------|
| Net Interest Income | 70,467 | 89,641 | 97,838 | 102,158 | 107,892 |
| % change | 8.3% | 27.2% | 9.1% | 4.4% | 5.6% |
| Net Fee Income | 39,870 | 41,108 | 43,249 | 45,206 | 47,257 |
| Securities Gains / (Losses) | 7,679 | 2,921 | 3,194 | 4,500 | 4,800 |
| Total Operating Income | 116,298 | 132,450 | 144,279 | 152,267 | 160,572 |
| Operating Expenses | (51,186) | (54,614) | (58,072) | (61,220) | (64,540) |
| % change | 2.0% | 6.7% | 6.3% | 5.4% | 5.4% |
| Provisions Expense | (20,235) | (32,300) | (37,084) | (36,686) | (37,256) |
| % change | -33.0% | 59.6% | 14.8% | -1.1% | 1.6% |
| Operating Pre-Tax Income | 44,877 | 45,535 | 49,123 | 54,361 | 58,776 |
| Operating Net Income to Comm S/Hold. | 26,904 | 30,816 | 34,619 | 38,400 | 41,586 |
| GAAP Net Income | 25,013 | 29,445 | 33,913 | 37,800 | 40,986 |

Balance Sheet Data (Dec)

| (BRL Millions) | 2021A | 2022A | 2023E | 2024E | 2025E |
|---------------------------------|-----------|-----------|-----------|-----------|-----------|
| Total Assets | 2,166,019 | 2,469,958 | 2,691,431 | 2,882,590 | 3,087,046 |
| Average Interest Earning Assets | 1,864,441 | 2,017,272 | 2,288,069 | 2,447,646 | 2,640,337 |
| Total Gross Customer Loans | 819,074 | 906,188 | 968,502 | 1,079,068 | 1,202,255 |
| % change | 15.3% | 10.6% | 6.9% | 11.4% | 11.4% |
| Total Customer Deposits | 850,372 | 871,438 | 970,829 | 1,045,705 | 1,126,357 |
| % change | 5.1% | 2.5% | 11.4% | 7.7% | 7.7% |
| Tangible Equity | 128,126 | 143,203 | 164,438 | 190,690 | 219,169 |
| Common Shareholders' Equity | 144,554 | 160,925 | 182,786 | 209,038 | 237,517 |

Key Metrics (Dec)

| (BRL Millions) | 2021A | 2022A | 2023E | 2024E | 2025E |
|--|-------|--------|-------|--------|--------|
| Net Interest Margin | 3.8% | 4.4% | 4.3% | 4.2% | 4.1% |
| Effective Tax Rate | 36.5% | 30.0% | 27.8% | 27.8% | 27.8% |
| Loan / Deposit Ratio | 96.3% | 104.0% | 99.8% | 103.2% | 106.7% |
| Tangible Common Equity / Assets | 5.9% | 5.8% | 6.1% | 6.6% | 7.1% |
| ROA | 1.3% | 1.3% | 1.3% | 1.4% | 1.4% |
| ROE | 19.1% | 20.1% | 20.1% | 19.6% | 18.6% |
| RoTE | 21.4% | 22.7% | 22.5% | 21.6% | 20.3% |
| Dividend Payout Ratio | 23.2% | 27.2% | 30.2% | 30.0% | 30.0% |
| Efficiency Ratio (Cost / Income Ratio) | 47.1% | 42.2% | 41.2% | 41.4% | 41.4% |

Quality of Earnings (Dec)

| (BRL Millions) | 2021A | 2022A | 2023E | 2024E | 2025E |
|--|-------|-------|-------|-------|-------|
| Total Non-Interest Inc / Operating Inc | 39.4% | 32.3% | 32.2% | 32.9% | 32.8% |
| NPLs plus Foreclosed Real Estate / Loans | 2.5% | 2.9% | 2.9% | 2.5% | 2.1% |
| Loan Loss Reserves / NPLs | 218% | 199% | 190% | 190% | 190% |
| Loan Loss Reserves / Total Loans | 5.39% | 5.86% | 5.55% | 4.79% | 4.03% |

Company Sector

Banks-Multinational/Universal

Company Description

Itau Unibanco is the largest private-sector bank in Brazil, with approximately 18% market share in terms of assets. The bank has a top-notch management team and has consistently delivered the highest profitability in the system over the past 10 years. The group also provides financial products such as asset management, insurance, and investment banking, and is present throughout Latin America, including Argentina, Chile, Colombia, Uruguay and Paraguay.

Investment Rationale

We rate Itau Neutral as we see limited upside potential. The bank is well positioned for the upcoming challenging economic cycle, with limited exposure to riskier segments (low income individuals and SME). Itau's management has a proven track record on execution, strategy and communication skills.

Stock Data

| | |
|----------------------|------------|
| Average Daily Volume | 28,382,340 |
| Shares / ADR | 1.00 |

Quarterly Earnings Estimates

| | 2022 | 2023 |
|----|-------|-------|
| Q1 | 0.75A | 0.86A |
| Q2 | 0.78A | 0.88E |
| Q3 | 0.82A | 0.89E |
| Q4 | 0.78A | 0.90E |

Key take-aways from meetings

ALM (asset liability management). Itau has a fully hedged loan book in terms of liquidity, tenor and currency. Meanwhile, the treasury group manages a bank book where it hedges all the gaps, and a trading book where it can take directional views on rates within its VAR limits. Nonetheless, management noted that Itau's NII has been agnostic to rate movements over the years, especially when compared to peers. Market NII has been relatively stable during the hiking cycle but could improve with lower rates. Nonetheless, management noted that market NII should be lower structurally from the past considering that it hedges its capital ratio to currency fluctuation (c.R\$2bn cost per year) and that it no longer benefits from over hedge, which used to generate revenues of c.R\$1bn per year.

Efficiency. While management has reduced c.800 branches since 2018 (or c.20% of total), headcount has remained relatively unchanged at c.100k. However, there has been an important shift in the employee base, with lower back office/operation roles being offset by a higher number of tech, payments, insurance and agribusiness functions. Management sees room to improve its industry-leading efficiency ratio of 38% in Brazil by improving automation of activities. It noted that it embarked on a major investment plan in 2015 aimed at updating and upgrading the bank's systems, two-thirds of which are now cloud based, placing it well ahead of its peers.

Credit growth. Management attributes the slow growth in consumer credit more to a lack of demand rather than an appetite to lend, especially considering the bank's focus on the more affluent segment of the population. At the same time, corporates have been reluctant to undertake any major expansion projects given the political uncertainty in the country. Importantly, Itau has made significant strides in growing its exposure in the agribusiness segment, which already represents the largest portion of the corporate loan book. Finally, management warned that the overall credit growth in '23 could be negatively impacted by a stronger BRL on its international operations.

Asset quality. Management noted that it became more conservative in consumer lending in November '21, and believes that its NPL ratio peaked in 4Q22, although they do not foresee any major improvement through year end. On the other hand, industry NPL should continue to deteriorate through year-end '23, as other banks were slower to turn more cautious on growth.

Capital. Management noted that it should not accumulate capital beyond a Tier 1 ratio of 13.5% and noted that a change in regulation in 2Q23, which reduces the density of assets, should boost its capital ratio by c.50bp. On the other hand, the full implementation of new operational risk capital requirements in '25 should consume c.100bp of capital.

Credit profitability. Management expects the profitability of its credit operations to at least match its COE of c.14% in the medium term, as the consumer credit book is still feeling the effects of regulatory changes (especially interest rate cap on overdraft accounts), Covid-related measures implemented to help the consumer, and higher cost of risk.

Client engagement. Management estimates that every 1% increase in the engaged client base generates extra revenues of R\$1bn. The bank has reorganized its retail operations and invested heavily in technology over the past 5 years to take advantage of this opportunity, as approximately one third of its c.70mn client base do not have principalty.

Acquiring business. Rede is now fully consolidated with the corporate banking division. Management sees it as a significant advantage to be able to offer a fully integrated solution to its clients, even as it sees payments as a commodity. Management noted that revenues have been growing faster than volumes, even as it continues to gain market share.

Credit card regulation. Management does not believe in the implementation of interest rate caps on credit cards, as it would be detrimental to consumption. Nonetheless, the banks are likely to present a proposal to the government that could create a more balanced economics between all players in the system (card issuers, card brands, and payment companies).

International operations. Management was adamant about not making inorganic investments to gain share in existing international operations or in expanding into new geographies, and that the goal is to make the existing operations more efficient without committing more capital. Itau is in conversations to sell its Argentina operations to Banco Macro, although it was not actively looking to sell the assets and has not yet received an offer. Meanwhile, the tender offer for the Chilean operations was opportunistic given the weak share price performance in the past few years. Results of the tender offer are expected by July 6, and management reiterated that it wouldn't raise the offer price. Finally, the Colombian operations struggle due to lack of scale.

Insurance. Management sees significant opportunities to expand the operations in the future.

XP. Management is committed to divesting of its entire c.10% stake in XP, although no timeline was provided.

Price objective basis & risk

Itau Unibanco (ITUBF / ITUB)

Our price objective (PO) for Itau of R\$31/US\$6.2 is derived from the Gordon Growth model, assuming a sustainable ROE of 20%, a COE of 14.2%, and 4% growth in perpetuity. Our USD/ADR PO is derived from the local PO converted at an FX rate of 5.0.

Downside risks to our PO are 1) weaker economic activity could negatively impact loan growth, 2) corporate NPL deterioration requiring higher than anticipated provision charges, and 3) regulatory changes could be detrimental to profitability. Upside risks include: 1) stronger than forecasted loan portfolio growth, 2) lower than anticipated provision charges and, 3) better than expected insurance results

Analyst Certification

We, Mario Pierry, Antonio Ruetten and Flavio Yoshida, hereby certify that the views each of us has expressed in this research report accurately reflect each of our respective personal views about the subject securities and issuers. We also certify that no part of our respective compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

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Latin America - Financials Coverage Cluster

| Investment rating | Company | BofA Ticker | Bloomberg symbol | Analyst |
|-------------------|-----------------------|-------------|------------------|-------------------|
| BUY | | | | |
| | ABC Brasil | XBABF | ABC4 BZ | Flavio Yoshida |
| | B3 | XIMAF | B3SA3 BZ | Mario Pierry |
| | B3 | BOLSY | BOLSY US | Mario Pierry |
| | Banco do Brasil | XBBAF | BBAS3 BZ | Mario Pierry |
| | Banco do Brasil | BDORY | BDORY US | Mario Pierry |
| | Banorte | GBOOF | GFNORTEO MM | Mario Pierry |
| | Banorte | GBOOY | GBOOY US | Mario Pierry |
| | Bci | BZCIF | BCI CI | Ernesto Gabilondo |
| | BTG Pactual | XNXCF | BPAC11 BZ | Flavio Yoshida |
| | Caixa Seguridade | XDUF | CXSE3 BZ | Mario Pierry |
| | Cielo | CIOXF | CIEL3 BZ | Mario Pierry |
| | Cielo | CIOXY | CIOXY US | Mario Pierry |
| | ClearSale | XZUOF | CLSA3 BZ | Flavio Yoshida |
| | Credicorp Ltd | BAP | BAP US | Ernesto Gabilondo |
| | Genera | CMPRF | GENERAT* MM | Ernesto Gabilondo |
| | Grupo BMV | BOMXF | BOLSAA MM | Ernesto Gabilondo |
| | IFS | IFS | IFS US | Ernesto Gabilondo |
| | Inter | XBZIF | INBR32 BZ | Mario Pierry |
| | Inter | INTR | INTR US | Mario Pierry |
| | PagSeguro Digital Ltd | PAGS | PAGS US | Mario Pierry |
| | Porto Seguro | PSGUF | PSSA3 BZ | Mario Pierry |
| | Regional | RGNLF | RA MM | Ernesto Gabilondo |
| | XP Inc. | XP | XP US | Mario Pierry |
| NEUTRAL | | | | |
| | Bajio | BBAJF | BBAJ100 MM | Ernesto Gabilondo |
| | Banrisul | XGRBF | BRSR6 BZ | Flavio Yoshida |
| | BB Seguridade | XBDPF | BBSE3 BZ | Mario Pierry |
| | BB Seguridade | BBSEY | BBSEY US | Mario Pierry |
| | Bradesco | BRDPF | BBDC4 BZ | Mario Pierry |
| | Bradesco -A | BBD | BBD US | Mario Pierry |
| | Itau Unibanco | ITUBF | ITUB4 BZ | Mario Pierry |



Latin America - Financials Coverage Cluster

| Investment rating | Company | BofA Ticker | Bloomberg symbol | Analyst |
|---------------------|--------------------------|-------------|------------------|-------------------|
| | Itau Unibanco | ITUB | ITUB US | Mario Pierry |
| | Nubank | NU | NU US | Mario Pierry |
| | Qualitas | QUCOF | Q* MM | Ernesto Gabilondo |
| | StoneCo | STNE | STNE US | Mario Pierry |
| UNDERPERFORM | | | | |
| | Banco Chile-ADR | BCH | BCH US | Ernesto Gabilondo |
| | Banco de Chile | XHND | CHILE CI | Ernesto Gabilondo |
| | Banco Macro | BMA | BMA US | Ernesto Gabilondo |
| | Banco Macro | BCVMF | BMA AR | Ernesto Gabilondo |
| | Banco Santander Chile | BSAC | BSAC US | Ernesto Gabilondo |
| | Banco Santander Chile | XLDTF | BSAN CI | Ernesto Gabilondo |
| | GFINbur | GPFOF | GFINBURO MM | Ernesto Gabilondo |
| | Grupo Financiero Galicia | GGAL | GGAL US | Ernesto Gabilondo |
| | Grupo Financiero Galicia | GGABF | GGAL AR | Ernesto Gabilondo |
| | Santander Brasil | XCBDF | SANB11 BZ | Mario Pierry |
| | Santander Brasil | BSBR | BSBR US | Mario Pierry |
| | Supervielle | SUPV | SUPV US | Ernesto Gabilondo |
| | Supervielle | XAZFF | SUPV AR | Ernesto Gabilondo |
| RSTR | | | | |
| | Bancolombia | CIB | CIB US | Ernesto Gabilondo |
| | Bancolombia | XAFF | PFBCOLO CB | Ernesto Gabilondo |

IQmethodSM Measures Definitions**Business Performance**

Return On Capital Employed

Return On Equity
Operating Margin
Earnings Growth
Free Cash Flow

Numerator

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income
Operating Profit
Expected 5 Year CAGR From Latest Actual
Cash Flow From Operations – Total Capex

Denominator

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
Amortization
Shareholders' Equity
Sales
N/A
N/A

Quality of Earnings

Cash Realization Ratio
Asset Replacement Ratio
Tax Rate
Net Debt-To-Equity Ratio
Interest Cover

Numerator

Cash Flow From Operations
Capex
Tax Charge
Net Debt = Total Debt – Cash & Equivalents
EBIT

Denominator

Net Income
Depreciation
Pre-Tax Income
Total Equity
Interest Expense

Valuation Toolkit

Price / Earnings Ratio
Price / Book Value
Dividend Yield
Free Cash Flow Yield
Enterprise Value / Sales

Numerator

Current Share Price
Current Share Price
Annualised Declared Cash Dividend
Cash Flow From Operations – Total Capex
EV = Current Share Price × Current Shares + Minority Equity + Net Debt +
Other LT Liabilities
Enterprise Value

Denominator

Diluted Earnings Per Share (Basis As Specified)
Shareholders' Equity / Current Basic Shares
Current Share Price
Market Cap = Current Share Price × Current Basic Shares
Sales
Basic EBIT + Depreciation + Amortization

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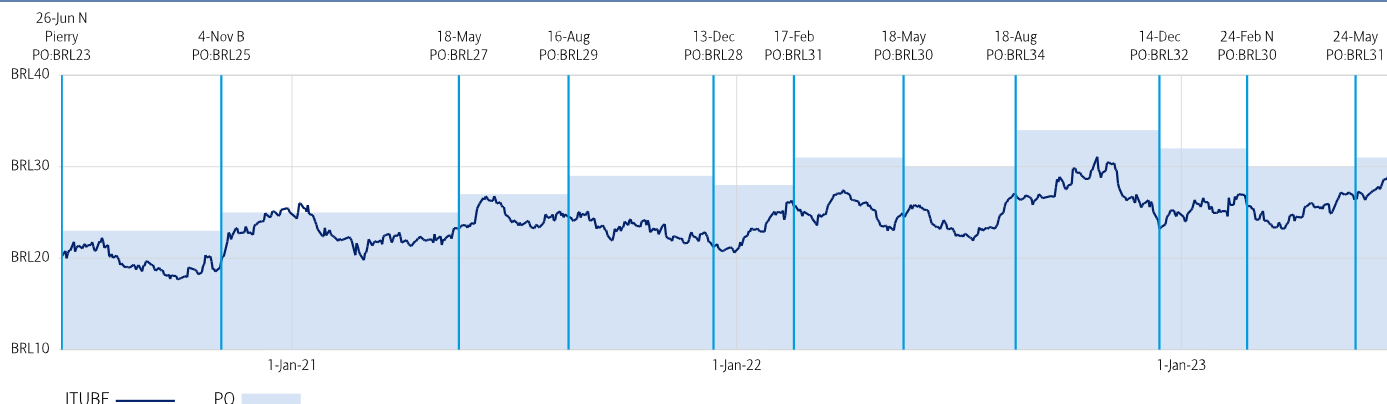
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Disclosures

Important Disclosures

Itau Unibanco (ITUBF) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

Itau Unibanco-A (ITUB) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

Equity Investment Rating Distribution: Banks Group (as of 31 Mar 2023)

| Coverage Universe | Count | Percent | Inv. Banking Relationships ^{R1} | Count | Percent |
|-------------------|-------|---------|--|-------|---------|
| Buy | 88 | 50.87% | Buy | 72 | 81.82% |
| Hold | 40 | 23.12% | Hold | 29 | 72.50% |
| Sell | 45 | 26.01% | Sell | 34 | 75.56% |

Equity Investment Rating Distribution: Global Group (as of 31 Mar 2023)

| Coverage Universe | Count | Percent | Inv. Banking Relationships ^{R1} | Count | Percent |
|-------------------|-------|---------|--|-------|---------|
| Buy | 1869 | 53.01% | Buy | 1030 | 55.11% |
| Hold | 827 | 23.45% | Hold | 476 | 57.56% |
| Sell | 830 | 23.54% | Sell | 389 | 46.87% |

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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| Investment rating | Total return expectation (within 12-month period of date of initial rating) | Ratings dispersion guidelines for coverage cluster ^{R2} |
|-------------------|---|--|
| Buy | ≥ 10% | ≤ 70% |
| Neutral | ≥ 0% | ≤ 30% |
| Underperform | N/A | ≥ 20% |

^{R2} Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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