

Q2 2020 Earnings Call

Company Participants

- Candido Botelho Bracher, President & Chief Executive Officer
- Milton Maluhy Filho, Executive Vice President, Chief Financial Officer & Chief Risk Officer

Other Participants

- Carlos Gomez, Analyst
- Geoffrey Elliott, Analyst
- Henrique Navarro, Analyst
- Jason Mollin, Analyst
- Jorg Friedemann, Analyst
- Jorge Kuri, Analyst
- Nicolas Riva, Analyst
- Piedad Alessandri, Analyst
- Tito Labarta, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. Welcome to Itau Unibanco Holding's Conference Call to discuss 2020 Second Quarter Results. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session. (Operator Instructions) As a reminder, this conference is being recorded and broadcasted live on the Investor Relations website at www.italu.com.br/investor-relations. 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 on this conference call in Sao Paulo are Mr. Candido Bracher, President and CEO; Mr. Milton Maluhy Filho, Executive Vice President, CFO and CRO; Mr. Alessandro Broedel, Executive Director, Group Head of Finance and IR; and Renato Lulia Jacob, Head of Investor Relations and Market Intelligence. First, Mr. Candido Bracher will comment on 2020 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 Botelho Bracher {BIO 3158644 <GO>}

Thank you for taking time to attend to our 2020 second quarter earnings call. I hope you're all well and safe.

Let us now please move to Slide number 2. I'd like to start by briefly discussing the macroeconomic backdrop which influenced our performance and the management strategy, during this time period. So we have just been through what can arguably be considered the worst quarter in Brazilian history from a macroeconomic point of view. This becomes evident in our expectation of a GDP contraction of just over 10%, as well as in the extinction of around 1.3 million formal jobs in this period.

To face the scenario, government reacted and cut interest rates to new historical lows 2.25%. Additionally, to this date it has injected approximately BRL370 into the economy, roughly 5% of GDP. This very complex dynamic can be seen in the chart at the bottom of the slide, where we brought the daily variation of the Itau Economic Activity Index. This index was built upon the high frequency data that we gathered from our credit and Itaucard [ph] transactions and enabled us to monitor the economic reactions close and granularly.

The economic activity bottomed out at the end of March, with a 45% contraction when compared to pre-pandemic levels. However, we have already seen encouraging signs of a recovery over the following months. And last week's data show that we are already at 90% of pre COVID-19 activity levels.

Moving to the next slide now. We were quick in identifying this crisis that it would be different from any other challenge we had faced in our 96-year history, not just in its nature, but in net scale. We soon realized that credit would be the major risk factor for the financial sector, and that was exactly where we intensely focused our attention. Therefore, we acted fast and decided the right course of action was to be extra careful and go the extra mile to support our customers.

We believe that in the medium term, our initiatives will contribute to reduce potential credit losses and reinforce the perception of customers that we were present when they most needed us. We are convinced this will more than compensate for any short-term loss of profitability.

So here we show that since the beginning of the crisis, we have originated over 96 (Technical Difficulty) also work side-by-side with the government and actively participated in the programs they launched to support the most at-risk segments. We were the first private bank to commit participating in improvement [ph] program to finance more retailers. And we've disbursed all the facilities allocated towards in just a few hours, and 100% digitally.

In addition, we expect BRL1.6 billion in the emergency payroll financing program for micro and small companies, and we underwrote BRL2.9 billion to support energy generators, distributors, and retailers.

Finally, in the left part of the slide, we launched a program with a wide range of customized solution that includes grace periods, extended loan terms and additional credit offers. These unprecedented initiatives seeks to offer more breathing room to individual customers and micro and small companies, helping them to traverse through this crisis which came from COVID. By the end of June, this program has already benefited roughly 2 million customers with BRL52 billion in loans that were re-profiled.

So, on Slide 4 now. We go into more details about the BRL52 billion loan portfolio that was re-profiled with new repayment conditions, out of which 72% were individuals, 28% were micro and small companies.

Firstly, it's important to highlight that a 100% of those clients were performing, meaning, no past dues, by the end of February. 58% of this portfolio was already collateralized from the inception. Additionally, 90% of the portfolio is currently rated as AA to C, AA to C. Finally, we show that the number of grace period requests has decreased significantly over the past 45 days. You see on the bottom chart.

Now on Slide 5. Before we move into our earning analysis, I'd like to address two additional subjects. Here, in Slide 5, we described how do donations to the Todos pela Saude program were used. We have already allocated more than BRL1 billion and this results was spread out in four different of action to help fight the COVID-19 pandemic. Important to emphasize that this is a nationwide program, and as an example, I would like to highlight, not only the donation of 105,000 oximeters which were distributed to all the municipalities in Brazil over 5,000. But also the donation of BRL100 million to produce two of the most advanced vaccines in partnership with Fundacao Oswaldo Cruz and the Butantan Institute.

Now on Slide 6. Now the future, we present integration of ESG teams into the Bank's business and operations. Itau Unibanco has a long ESG story that began more than two decades ago. At the top of this slide, we present a timeline, showing the main milestones of this evolution, such as our participation in the Sustainability Index portfolios, and adherence and commitments to good sustainability practice.

Two weeks ago, we set a new milestone, when in partnership with Bradesco and Santander, we launched the joint plan to promote sustainable development in the Amazon. This plan consists of 10 concrete measures divided into three priority fronts, which are shown here. These actions were personally presented to the Vice President of the country and to all the government representatives. And our next step will be to define a clear and tangible goals and objectives for this goal. Being one of the largest financial institutions in Brazil, we intend to actively contribute to the country's sustainable development and protect the Amazon region.

Additionally, it is important to highlight two important initiatives. The first one is our goal to become 100% compliant with the Task Force on Climate-related Financial Disclosures by 2022. Lastly, in line with international transparency practices, we reported 12 out of the 40 Sustainability Accounting Standards Board indicators in our 2019 integrated annual report.

Moving now to the results of the quarter. Here, we show that the bank ended the second quarter of 2020 with a BRL4.2 billion recurring net income, which translated into an ROE of 13.5%. This 7.5% net income growth was led by a 23% reduction in the cost of credit and higher trading gains. However, these effects were partially offset by the negative impact of the prices on our fees and NII.

We also have a higher effective income tax rate due to the full impact of the 5 percentage points increase in social contribution effective in this quarter. Finally, the loan portfolio grew by 2.9%, ending the period with a balance of BRL811 billion, which we will discuss in further detail in the next slide.

Moving to the next slide. There are three things I'd like to highlight in this page. First, is that the loan portfolio was practically stable if we adjusted for the ForEx valuation in the period. Second is that there was a substantial change in mix between segments with large corporates growing a strong 3.6% quarter-on-quarter and individuals contracting by 3.9%.

Lastly, rebuilding individuals portfolio, there was a very important change in the mix of products. There was a substantial contraction in credit cards and secured personal loans and overdraft. This movement reflects not only a change in customers' behavior and a drop in consumption levels, but also, and very importantly, our active risk management approach as we discourage the use of those products. The growth of 44% in personalized credit with new payment conditions partially compensated for this drop. Naturally, these changes had a negative impact on our financial margin in the short-term as we will soon see in the next slide. But we do believe it is a good trade off, temporarily give up part of our margin in order to protect the principle.

On Slide 10, we show that the change in the credit mix as we explained in the previous slide generated two effects: the migration of products within the retail portfolio posted a negative effect of BRL600 million on our NII; secondly, the higher participation of the wholesale segment led to a further reduction of BRL700 million in the financial margins. Finally, the lower Selic rate had a negative impact of BRL300 million on the remuneration of our working capital. These effects were partially offset by the higher average credit volume and by the ForEx rate impact on the financial margin of our operations in Latin America and in aggregate drove the 80 basis points compression in our net interest margin.

Moving to Slide 11, we present the evolution of the expected loss provision model and cost of credit. Before entering the numbers specifically, I think it's important to explain the way we demonstrate the provision on this chart. The provisions for overdue operations strictly follow the rules defined by the regulator, where a minimal level of provisioning is required, when the loan is overdue. This is the gray layer. The next, the dark blue layer, is

what we call aggravated risks. These are related to the amount we have provisioned for overdue or renegotiated credits above the meaning defined by the regulator. Finally, the light blue layer, we have the potential losses, which contains the provisions we have made for credits that are not delinquent more renegotiated.

As the table on the left shows, the increase is not related to active delinquencies, and it is basically related to our future losses expectation. Thus, as in the previous quarter, our model required additional provisioning albeit at a much lower levels than in the previous quarter. This resulted in the growth of the coverage of the NPL 90 days for the third consecutive quarter as it reached 281%, the highest historical level for the Bank.

Although the cost of credit is still about the normal, it has already showed an important contraction of 23% this quarter. This is reflection of all the actions we have taken since the onset of the crisis and the improvement in the macroeconomic and financial conditions which fed -- which feed into our expected losses model.

Now moving to Slide 12. We show that due to the intensity of the credit negotiations and the proactive offering of more flexible payment terms, the non-performing loans went down considerably. We believe, though, these numbers do not properly reflect the full extent of the crisis yet.

Moving on to Slide 13. We can see that the financial margins with the market showing an important recovery in the quarter, now more in line with its historical levels. This performance was mainly due to higher gains in the trading desk and in our operations in Latin America.

On Slide 14, we see a 10.5% drop in service revenues in the quarter, basically reflecting the lower economic activity triggered by the COVID-19 crisis. Despite this effect, we observed that our revenues are stable in the semester when compared with the same period of the previous year. This is mainly due to the good performance of the Asset Management division as well as of the advisory and brokerage services.

I'd like to point out to that our acquiring operation volumes are already at the same level as in the previous year, and our credit card insurance operations is close behind. Finally, I'd like to highlight that our open platform for investments, which just started a couple of years ago, reached BRL275 billion of assets under custody, which represents a 7.2% growth over just one quarter.

On Slide 15, we show our non-interest expenses, which are another important element of our performance. When we compare this quarter with the same period of the previous year, we can observe a decrease of 4.4% in our consolidated expenses with a 6.8% decrease in Brazil. If we adjust for inflation, expenses in Brazil fell in real terms by an impressive 9% in the period. That can be seen in the chart at the bottom of the slide.

One of the reasons we became more efficient is due to our consistent investment in technology. As you can see on the left side of the slide, this is an area we continue to put more resources on, and we'll continue to do so in the future.

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Now on Slide 16, we show how the usage of our digital channels has evolved over this crisis. Our digital customer base increased by 17.1% over the last year, while we opened almost 1 million new bank accounts entirely through our app just this semester, which represented 131% increase year-over-year. Notably, we saw a particular increase in the adoption of digital channels of clients aged 50 and above. Currently, 47% of clients in the segment are using our apps and the website. And despite the higher demand and volume of transactions in the digital channels, the availability of services remain at the highest levels in our history, while our apps continue to be highly praised by our customers.

Finally, I'd like to share with you a success case in how technology can help clients, particularly in this crisis. In record time, we deployed new functionalities in our digital channels, which enabled a fast and seamless deployment of over BRL5.2 billion in government-sponsored facilities.

Now on Slide 17, we show that our Tier 1 regulatory capital has already shown a slight recovery despite the still volatile scenario and ended the quarter with 12.1% capital ratio.

And finally, on Slide 18, we decided to keep our guidance suspended due to the unprecedented nature of this crisis and due to the fact that the health crisis have not yet been quelled. And unfortunately, there is no prospect for that. And despite the still low visibility ahead of us, I believe it's important to give a sense of direction to you as to what we are currently expecting.

Capital and liquidity should remain at appropriate levels, considering our internal stress test scenarios. In the short term, we should continue to see the large corporate portfolio spending at a higher pace than retail. This trend of change in mix may reverse if there is an increase in demand for credit from individuals and more activity from capital markets.

Due to the above and the potential -- potentially lower SELIC rate, it is possible that we will see a further marginal reduction in the average rate of the financial margins with clients in the short-term. Commission, fees and results from insurance should perform in line with the recovery trend of economic activity and the reopening of capital markets. We should see a further reduction in the cost of credit in the short-term.

Our provisions will remain anchored in the expected loss model that will react promptly to changes in the country's macroeconomic scenario and the financial conditions of our clients. We feel confident we will be able to deliver additional efficiency gains in the next quarters as a result of the continuous investment in technology, new ways of working, optimization of distribution channels and structural efficiency projects.

So with this, I conclude this presentation, and we may now start the Q&A session.

Questions And Answers

Operator

Ladies and gentlemen, we will now begin the question-and-answer session. (Operator Instructions) Our first question comes from Jorg Friedemann of Citibank. Please go ahead.

Q - Jorg Friedemann {BIO 15405752 <GO>}

Thank you very much for the opportunity to ask questions. I have two questions. Starting on provisions, you were discouraged offering renegotiated loans despite increase in coverage versus total NPLs. And also reduced cost of credit quarter-over-quarter. So clearly, you expect the loss model is making you a bit more optimistic ahead. Although I understand scenario is still very fluid, I'd like to hear what you have seen from loans that already left your relief program, Travessia? How are they performing versus the normal renegotiated portfolio? And how relevant you believe this sample might be to predict future behavior of operations under risk analysis?

And my second question relates to fees.

A - Candido Botelho Bracher {BIO 3158644 <GO>}

Jorg, I'm sorry. I have a problem understanding you. I really can't understand what you're saying. I couldn't understand your first question. There's a problem in the reception here.

Q - Jorg Friedemann {BIO 15405752 <GO>}

Can you hear me better now? Or should I try to put the -- not much for -- another phone? Can you hear me now?

A - Candido Botelho Bracher {BIO 3158644 <GO>}

If you could dial in again or if you speak very slowly and clear because I really can't understand.

Q - Jorg Friedemann {BIO 15405752 <GO>}

Okay. So I'll try to speak very slowly. My question is, for the loans that already left your relief program, Travessia, how are they performing versus the normal renegotiated portfolio? And how relevant you believe this sample might be to predict the future behavior of operations under grace periods nowadays? Okay. This is my first question. Could you understand it?

A - Candido Botelho Bracher {BIO 3158644 <GO>}

Yes, I could.

Q - Jorg Friedemann {BIO 15405752 <GO>}

Perfect.

A - Candido Botelho Bracher {BIO 3158644 <GO>}

Well, without going too much into the details, Jorg, I can say that we had a first wave of renegotiations when we offered a 60-day grace period for basically everybody at the onset of the crisis. And we were -- so many of these -- all of these has matured now. Some of them went into the Travessia offers. That means prolonging the grace period. But many have paid. So the level of payments in this first prolongation of 60 days have surprised us. I mean it has been above what we would have expected given the fact that the crisis only worsened in the first 60 days. So when we follow up this renegotiated portfolio, the sensation is good. I mean what we are seeing in terms of liquidation, in terms of financial health of the company is rather positive.

Q - Jorg Friedemann {BIO 15405752 <GO>}

Perfect. And my second question relates to fees. You soft-guided that fees should improve quarter-over-quarter ahead. And I'd like to understand if you are incorporating this scenario, the implementation of PIX, the instant payment platform of the Central Bank, already this year, and if that could jeopardize growth of some line items such as checking accounts, debit cards and collections? Thank you.

A - Candido Botelho Bracher {BIO 3158644 <GO>}

Okay. Thank you, Jorg. Yes, we expect -- well, we expect peaks to be implemented during the second semester, but it will start slowly. I mean, it will certainly have an effect on some of our income, as TEDs and other transfer income that we have in the bank, but we rather think -- I mean, it will be a very powerful tool in accelerating financial activity in Brazil. That's positive for our -- I don't know, Milton, if you want to complement anything relating to this.

A - Milton Maluhy Filho {BIO 15220856 <GO>}

So I agree with you, Candido. We believe PIX is still a project. We're going to work towards making it to be important in the financial system. We are not forecasting the impact of this, for this year yet. Of course, there is a ramp-up of the project, and we don't believe that this will bring major impact this year. But yes, you are right, in the mid-term, we should see some impacts arriving from PIX, but more competition. It's more in terms of a better experience for our clients. And we're going to work very close to Central Bank to make it happen. So this is our strategy over here.

And in terms of fees, we believe that some of the reasons why we expect a better performance increase in the second semester somehow has to do with the investment banking activity, wealth management activity, those lines that we are doing in very good -- we are having a very good performance. And also in credit cards volumes, we see not only debit as credit cards, important recovery for the next semesters, as we already saw in the previous months. So we believe that the activity coming to more -- be more relevant in the second semester. This will have a direct impact in our fee lines.

Q - Jorg Friedemann {BIO 15405752 <GO>}

That's perfect. Thank you very much. Very clear.

A - Candido Botelho Bracher {BIO 3158644 <GO>}

You are welcome. Thank you, Jorg.

Operator

Our next question is from Henrique Navarro of Santander. Please go ahead.

Q - Henrique Navarro {BIO 16188960 <GO>}

Hi. Good morning, everyone. My first question is on provisions. I do believe -- I do understand, based on your presentation, that we shall see provisions going down on the second semester compared to the first semester. But my question is -- maybe can we see on the third quarter the cost of risk going back to normalized levels? Let's say if the current improvement in the macroeconomic scenario continues, so maybe can we see cost of risk coming back to normalized levels already in the third quarter? That's my first question.

The second question is I would like to hear your strategic view on two companies on Itau CorpBanca and on IRB. In the case of Itau CorpBanca, specifically, if you consider some de-listing or anything like that? Thank you.

A - Candido Botelho Bracher {BIO 3158644 <GO>}

Thank you. Thanks for your question. Regarding provisions, so we have adopted a prudent stance in this crisis, as I explained. Since we think that the most fragile quarter is to have it tendered. We have seen this since the beginning, Henrique. So, I tend to think it will be too soon in the third quarter to see the cost of credit going back to normalized. I think I mean we should, maybe paradoxically, see this happening as the delinquencies increase in the next year. So, so far, I mean, I think we will keep on seeing this movement of provisioning, complementary provisions and provisions designed, made based on the expected loss model. I think they will reduce, but not yet to what we may call normalized levels.

Then the two companies you asked, Itau CorpBanca and IRB. In Itau CorpBanca, we see a normal development. I mean, we see no societary activity there whatsoever. I mean, it's normal course of business. The management, I think, is performing well. The crisis is being contained adequately, in our view. I think the Chilean economy will recover normally, and so it's business as usual for Itau CorpBanca.

For IRB, as you know, we are in the process of a closed capital raising, and we have confirmed that we will subscribe our 11.5% share after the participation. And we are inclined to steadily [ph] raising this should there be room for this, which we will know by August 30. So that's it. Thank you.

Q - Henrique Navarro {BIO 16188960 <GO>}

Very clear. Thank you.

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Operator

Our next question comes from Jorge Kuri of Morgan Stanley. Please go ahead.

Q - Jorge Kuri {BIO 3937764 <GO>}

Hi, good morning, everyone. I have two questions, if I may. The first one is on your credit card business. Card issuance fee was down 22% sequentially and card acquiring, 16%. Evidently, the lockdown during the second quarter had a negative impact. I wanted to understand how July and the few days of August are trending. How rapidly is that coming back? Where are you sort of one a -- vis-a-vis a pre-COVID level? Are you at 80%, 90%? Or are you still below that? Any color that you can provide will be very useful.

And then my second question is on competition. How is competition shaping up in the banking system? The market was very varied in 2017, '18, '19 on competition, mainly from a lot of the new fintech-driven providers on all different verticals of your business. How is that going along? I mean, how does those companies doing? Are you seeing more aggressive, less aggressive, less funding, more funding? Say, a client has continued to pick up, do you see them impaired because their balance sheets are not as strong as yours? Any particular view that you have on how that fintech space is evolving during this pandemic would be helpful in order to understand relative [ph] competitive pressures that the business is facing and will face once this is done? Thank you.

A - Candido Botelho Bracher {BIO 3158644 <GO>}

Thank you for your question, Jorge. On credit cards, credit cards follows more or less the same standard that we've shown in the first slide of the economic activity. I mean, so it fell very drastically right after the credit card expenditures, right? So it fell over 40%. And right now, it's between 10% and 15% below what are the historical levels of expenditures in credit card level. Of course, this varies a lot sector to sector. You have some sectors where it's still way below what it used to be, sectors more tied to tourists and restaurants and things like this. And in other sectors, it never really fell like supermarkets and things like this. So -- but in average, we are between 10% and 15% below. It's just a guess. But I don't expect this to come to 100% very soon. So I think since the risk of contagion is still there, we don't see some of these activities recovering immediately and not in the foreseeable -- in this period to the end of the year.

Now, competition; how is competition going to perform? We continue to see a very strong competition in specific areas of the bank where the competition is strong. I think the competition is strongest in the acquiring business and in the investment business. In the acquiring business, the companies in the competition really managed to have good quality in their services, and they are having bigger penetration, whereas the incumbents, I mean, separate from a healthier [ph] cost structure and more less competitive systems. So I mean, here, we have a lot of work to do. I mean, we've been doing. I mean, we have just hired a new CEO for our acquiring business, AB [ph] I mean, [Paula], she comes from Credit Agricole [ph] and I mean, it's a sector where we have a lot of deals. We have already stabilized the loss in market share, but we have a lot to do in order to regain profitability in this segment. But I mean, as it always happens in competition, I mean, you

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learn who's your competitors, and we are doing that, and I'm optimistic about the prospects.

The other sector I would point out is investments in general. I mean, so we had an exciting quarter this last quarter with a lot of marketing activity in every site. And this is a sector where we have not only been able to defend our market share in the market, I think we are the only incumbent doing so. But as -- I mean, results have been neat and improved. But competition tends to increase. With the inception of PIX, I think, in the payments arena, you have even more competition in more traditional areas like credit and wholesale banking, that there is less visible competition from newcomers. And we see -- and of course, I mean, we have to stay on that.

But we see that we ourselves are improving a lot in the improvements we have made in our asset management platform. Recently, I mean, I'm impressed -- I mean, we are gaining market share there, gaining stability, as we show in one of our slides, I mean, our platform, our open platform in the asset management is growing. So I mean, it's a very varied portfolio with different competitors in each part of the portfolio. And as I said the strongest is the acquiring business and in the investment business. But in all of the business, we see competition. And this is why, I mean, we are also making investments and changes and trying to improve our services across the board.

Q - Jorge Kuri {BIO 3937764 <GO>}

Thanks, Candido, and if I may just add, specifically on the lending business of the fintech lenders and some of the fintech banks, how are those trending? Do they have the balance sheet strength to withstand the increase in NPLs that we've seen? Do they have the funding necessary to support their businesses? What -- how is that specific area of competition holding along?

A - Candido Botelho Bracher {BIO 3158644 <GO>}

Jorge, excuse me. I think I have a problem with my phone here because I'm having great difficulty in understanding. Milton, did you understand the question? Do you -- Milton didn't understand it either. So maybe if you could talk a bit slower and louder.

Q - Jorge Kuri {BIO 3937764 <GO>}

Sure. My question was a follow-up on competition. If you could be specific on the fintech lenders, as you were seeing how competition is evolving with the asset management, the brokerage and the payment. I want to get more specifics on the lending business, on the fintech lenders, on the fintech bank. How are those moving along? Do they have capital to manage the crisis? Are their NPLs performing worse, better than you would expect? A lot of them are new lenders, not a lot of experience. How specifically are fintech lenders doing in this environment?

A - Candido Botelho Bracher {BIO 3158644 <GO>}

We don't see them, Jorge. We don't see them yet. I mean, maybe -- I mean, as a lender, I could point out some credit card banks which also have a lending activity. Those are lending activities, not the core of it, and they are growing. But in terms of general loans

and so on, I mean, they are still very, very small in this market. I don't see no one, I mean, having an outstanding performance there.

Q - Jorge Kuri {BIO 3937764 <GO>}

All right. Thanks, Candido. And thanks for your answers.

A - Candido Botelho Bracher {BIO 3158644 <GO>}

Thank you very much, Jorge.

Operator

Our next question comes from Carlos Gomez of HSBC. Please go ahead.

Q - Carlos Gomez {BIO 15024854 <GO>}

Thank you, and good morning. I have two questions. The first one refers to how you see your position in XP going in the future. The second, if you can explain -- we believe that you wrote off much of the goodwill of CorpBanca this quarter, but it did not affect your financial statements. Can you tell us exactly what you did and whether you would consider an increase in participation in the bank in the future? Thank you.

A - Candido Botelho Bracher {BIO 3158644 <GO>}

Thank you, Carlos. So concerning all our participation in XP, I mean, this is a participation we invested in a little over three years ago because, I mean, we saw a company acting in a market which we had difficulty vertically, which model we had difficulty in replicating. And I mean, with very good leadership and spirit -- competitive spirit and so on. All these qualities are still there, and we are very happy with the investments we have made. So I mean, it's just -- we follow this closely. As you know, the Central Bank has barred us from acquiring control or for having a more active role in the company. So I mean, we follow this as an investment. But being an investment, I think it's an important one because it gives us a position in a market -- which in a part of the market, which is growing and which is not very easy to replicate from our own side.

We can compete in this investment segment. We do compete. We have been keeping our market shares there. But not exactly in the same model that XP is doing. So I mean, we are happy with the investment in XP and we do not intend to change this.

In terms of CorpBanca and the accounting changes, we have made there. I mean, I think your question is why did this have a small impact on our loan figures in Brazil? And the reason is performance. There is a difference between the Chilean legislation and the Brazilian legislation in how you treat the overprice that you pay. Here in Brazil, you can absorb it quarter by quarter and can deduct it, not in Chile. So we had already made almost fully deducted the overprice we paid for CorpBanca. This is why it had an impact of only BRL19 million. But I will pass to the -- only BRL19 million in our balance sheet. But I will pass to the experts who can go into more detail.

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A - Milton Maluhy Filho {BIO 15220856 <GO>}

Carlos, this is Milton. So let's just look through Itau CorpBanca. We had an impairment of almost \$1 billion in Chile. When we look to Brazil, you have to take in consideration two main effects. The first one is that we've been amortizing the goodwill since 2016. We will deduct for 10 years. So at the moment, we made impairment in Chile. We had already advertized an important portion of the goodwill we have accounted in Brazilian GAAP, okay? This is local regulation..

And second, you have to take in consideration that we have only 38% of the bank. So you have to address the amount of impairments to our participation in Itau CorpBanca.

And the third effect is that we can only generate a credit sheet, a tax credit here in Brazil to this impairment if there is an impairment in Chile. So as we reported a loss in the balance sheet, when we bring this profitability, in this case, the loss to Brazil, this impacts our credit -- tax credit generation. So tax is credit. Plus, the amount of the investment that we have already amortized, plus the 38% of the investment we have, it comes up to BRL19 million. This was impacting the quarter. So it was irrelevant for Brazil.

Q - Carlos Gomez {BIO 15024854 <GO>}

Okay. So again, essentially, your tax loss crystallized at the moment, there is a loss in Chile and you can impair it in Brazil? So the effective tax rate on impairment, as we saw, is high. It's almost 50%. Is that right?

A - Milton Maluhy Filho {BIO 15220856 <GO>}

Yes. We have around BRL700 million in tax credit in Brazil due to this impairment. This is the amount we have.

Q - Carlos Gomez {BIO 15024854 <GO>}

Thank you very much.

A - Milton Maluhy Filho {BIO 15220856 <GO>}

You're welcome. Thank you.

Operator

Our next question comes from Geoffrey Elliott of Autonomous Research. Please go ahead.

Q - Geoffrey Elliott {BIO 15944940 <GO>}

Hello. Thanks very much for taking the question. On the re-profiled loans, you gave an indication that the payments that have started up again have been better than you expected. Can you give us some numbers around that? How -- what proportion of clients who stopped paying are now paying again? And are those clients who've now resumed payments, are they included within the re-profiled loan numbers that you're providing?

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A - Candido Botelho Bracher {BIO 3158644 <GO>}

Thanks for your question, Geoffrey. We are not disclosing numbers on that. But what these clients made -- I mean, they paid in full. And I mean, they are not in any of the other programs now. And this has been a higher proportion than we had anticipated.

Another part of the clients went into what we call the Travessia, I mean, into the extended lines we have offered. And these clients, I mean, we follow their vital signs. And we are also positively impressed by what we are seeing. The result from this, what you see is in our provisioning based on expected losses. So the reason why our provisioning dropped this quarter compared to last quarter is because of the improvement we are seeing in these clients and in the perspectives of the portfolio.

Q - Geoffrey Elliott {BIO 15944940 <GO>}

Got it. And the BRL38 billion of loans to individuals that were re-profiled and the BRL15 billion of loans to small business, does that include those clients who were re-profiled that have now started paying again?

A - Candido Botelho Bracher {BIO 3158644 <GO>}

Yes, it does.

Q - Geoffrey Elliott {BIO 15944940 <GO>}

Thank you.

Operator

Our next question comes from Jason Mollin of Scotiabank. Please go ahead.

Q - Jason Mollin {BIO 1888181 <GO>}

Yes, hi. My question is also related to asset quality, kind of a follow-up. Itau Unibanco reported a decrease on the NPL ratio in the second quarter sequentially. And as you've even commented in your press release, this is the lowest level since the Itau Unibanco merger. You also just said, and I think it's written in the release as well, that the NPL ratios don't really fully reflect the current crisis, and the driver is what you were just describing, the re-profiled loans.

Can you help us understand the risk levels you see in the portfolio? You do show the D through H loans stable quarter-on-quarter, second quarter versus first quarter. And you just mentioned again the 23% decline in loan provisions quarter-on-quarter. So is this a signal that the risk is declining? I think that's what you were just mentioning. Or is this just reflecting the very high level of provisions in the first quarter? Thanks.

A - Candido Botelho Bracher {BIO 3158644 <GO>}

Hi, Jason. How are you? no, I think this is a -- this is both. I mean, I think we were prudent on the first quarter. And so we made an amount of provisions of a situation that we were

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seeing. And by then, we expected it could have had a worse evolution than the one we are actually witnessing. And also, I mean, we see an improvement in the situation going forward. When we look at this, the delinquency levels, I mean, it's a bit paradoxical, but I think that -- I mean, the credit quality, the provisions will come down as delinquencies go up next year. And because this is when we are going to see, I mean -- actually, I mean, how bad these companies and these individuals have been affected by the crisis. Of course, it's still pending to know. I mean, how well will Brazil emerge from the crisis? I mean, so far this year, I mean, we are seeing performance which is better than we would have anticipated. But as we mentioned on the second chart or in the first chart here, this was due to 5% of GDP investment by government from the onset of the crisis up to now. This is not sustainable. I mean, we will not have the same level of government intervention going forward. Maybe still for some months, but we can't have it forever. So in our provisioning, in our expected loss model, we, of course, assume that there will be a reduction in government support for these companies and for these individuals going forward.

Q - Jason Mollin {BIO 1888181 <GO>}

Very helpful, thank you.

A - Candido Botelho Bracher {BIO 3158644 <GO>}

Thank you.

Operator

Our next question comes from Tito Labarta of Goldman Sachs. Please go ahead.

Q - Tito Labarta {BIO 20837559 <GO>}

Hi Candido, and everyone, thank you for the call. A couple of questions also. First, on your margins. If you look, margins kind of fell a bit. We -- partly due to mix, lower interest rates, so we did see margins increase as your peers. You also did benefit from higher trading gains. So just to understand, do you think the margins have bottomed now? Do you think the mix shift continues to impact margins? Have you fully realized the impact of lower interest rates? Just to understand why, at least on a relative basis, your margin suffered a bit more. Are you being more aggressive in your pricing of loans? If you can maybe give some more color in terms of margins and how that should evolve from here.

And then my second question is on your capital. Also, comparing to your peers, they seem to recover a bit more. Your capital, your core Tier 1 ratio, did go up 10 basis points, but you're below the 11%, 12% that historically where you've been and where your peers kind of seems to have recovered too. Is that because of your offshore investments? Do you think you can get back to that 11%, 12% level? How comfortable are you with the capital at these current levels? Thank you.

A - Candido Botelho Bracher {BIO 3158644 <GO>}

Thank you, Tito. So on our margins, I think it's close to bottom, but they -- I do not say it fell, they have bottomed. I think we may still see some of the transfer from credits for

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individuals and small and medium companies to large companies going forward. And they reflect, I mean, the clear decision that we have taken to protect the credit portfolio. I mean, so to use the most adequate and cheapest possible lines to our clients in order to traverse the crisis. So our bet here is that not only this will improve the quality of the credit portfolio. But this will generate a very positive response in terms of reciprocity from the clients as the economy develops afterwards.

So I see we may still see some compression in the margin in the next quarter, but at a lower base. And then I think it's going to recover swiftly. As to capital, how comfortable are we with the present mix. I mean, as you know, our risk appetite says that we must have a 13.5% capital 1 ratio. And this is made so that we have enough capital to support shocks. And what happened is that the shocks, they were shocking. We have supported it and -- so in this circumstance, we are comfortable with the present net working capital we have. And we think it's adequate in the present situation.

Having said that, of course, I mean, we are in the wake of -- as the economy recovers, as our balance sheet recovers, of taking it back to the recommended level by the Board, which is that we think we are not in a haste to do it, but we are looking very seriously at it and looking at every measure we can in order to speed up this recovery.

Q - Tito Labarta {BIO 20837559 <GO>}

Thank you, Candido. That's helpful. That's helpful. If I could just follow up. On the margins, just -- do you feel that you are maybe being a bit more aggressive than your peers in terms of sort of offering better credit lines for the companies? And then as you mentioned, maybe that will play out better in the future where you have better asset quality than your peers. Just trying to understand the dynamics because it was a little bit different between yourself and your peers.

And also, just following up on the capital as well. Is your capital lower now compared to your peers? Is it because of the offshore international investments? Or was there anything else driving that?

A - Candido Botelho Bracher {BIO 3158644 <GO>}

Okay. The first question, as you know, I mean, we try not to speak about our peers, but I will just give you an example, which is this Pronampe. Pronampe is a line offered by the government. Let's see. If I'm not wrong, it has six months grace and then 30 months of payment. And it costs overnight rate plus 1.25%. It's a very cheap line. Very, very good for clients. It's for companies which have sales of up to \$800,000 a year or so, BR 4.8 million. We are the only privately-owned bank which has already disbursed the line. And we did it more than two weeks ago. And then right after it was approved, and we did it in two days, totally digital. So I think this somehow reflects the stance we have adopted, which appears to be somewhat different from our competitors there. I mean, more -- looking more at offering the best possible alternatives to clients so as to help them deal with the situation.

In terms of capital, yes, I see that the main difference is probably our investments abroad, which make us more subject to the effects in the exchange rate. I think this is what caused a higher effect in our capital when compared to us. So now we have already reduced this, as you know. But we still feel the ForEx effect a bit in the overhead strategy and a bit in the RWA.

Q - Tito Labarta {BIO 20837559 <GO>}

Okay. That's very clear. Thank you, Candido.

A - Candido Botelho Bracher {BIO 3158644 <GO>}

Thank you, Tito.

Operator

Our next question will come from Piedad Alessandri of Credicorp Capital. Please go ahead.

Q - Piedad Alessandri

Hi, thank you very much for in. I wanted to ask regarding Itau CorpBanca. We know that Itau CorpBanca and the capitalization strategy. We know that -- wants to bring forward the sale option of Itau CorpBanca Colombia for about \$350 million. How do you plan to finance that strategy? And do you expect to bring forward the sale? And if you could give us further details regarding the capitalization strategy.

A - Candido Botelho Bracher {BIO 3158644 <GO>}

Thanks for your question. I will ask Milton. He's more familiar with the reason to answer it.

A - Milton Maluhy Filho {BIO 15220856 <GO>}

Hi. Yes, we have actually a forward executed with the core group for January of 2022 for \$330 million plus interest. We are not planning to anticipate this acquisition. It's still pending the local regulation approval, regulator approval, not only in Chile, but also in Colombia. But as we still expect that this acquisition will be made in January of 2022. So we don't believe we're going to be anticipating that.

In the other hand, of course, when we do our capital planning, looking for five years ahead, we consider this acquisition because it has, in fact, an impact in capital. So all the capital planning that we discussed for the bank, we consider the acquisition, even though it's only going to be executed in 2022.

Q - Piedad Alessandri

Perfect, thank you very much. And another question is regarding Itau's grace period. We know that you have 120 and 180 days grace periods for the renegotiated loans. When do you expect to have most of the renegotiated loans to be free? When do you -- when they start paying again?

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A - Candido Botelho Bracher {BIO 3158644 <GO>}

Well, they have already started, as I just said. Because at the onset of the crisis, we offered a general 60 days grace period. And many clients took the 60 days grace period. It was only later that we offered the 180 and 120 days grace periods. And we also offered for those clients which had already taken the 60 days. But many of them decided not to take the new grace period and paid back in a proportion much higher than what we had anticipated. So -- and we follow the vital signs of the clients. So -- and yes, happy with what we are seeing there.

But to answer your question, I mean, we have started this practice late April. So it was April, May, June, good four months on that. So it will be started at the end of August, September, October when they start paying back.

Q - Piedad Alessandri

Thank you very much.

A - Candido Botelho Bracher {BIO 3158644 <GO>}

Thank you.

Operator

Our next question comes from Nicolas Riva of Bank of America. Please go ahead.

Q - Nicolas Riva {BIO 20589225 <GO>}

Yes, thanks very much for taking my question. Yes. I only have one question and it's kind of a follow-up on prior questions about the restructuring, the renegotiations of loans. And I saw that you seem to be including separately -- to be separating the loans which have been re-profiled because of COVID-19, this BRL52 billion in consumer loans and SME loans from the renegotiated loans from the stock of BRL35 billion. Is there a reason for that why you are not including them together? Is there a -- do you look at them differently? Or is there a difference in risk profile between these re-profiled loans, the BRL53 billion and the stock of renegotiated loans?

A - Candido Botelho Bracher {BIO 3158644 <GO>}

Yes, Nicolas, you are right. So the stock of BRL52 billion -- the stock of renegotiated loans, those loans which had already been renegotiated until February of this year were of companies which were having a poor performance in a normal environment, so which problems cannot be exclusively attributed to the COVID-19 crisis. So there, we have more elements of -- to be worried about these credits and to have a closer look at that.

Then after the COVID-19, we are treating them differently because we see that most of the companies, the problems are exclusively arising from the situation of sudden stop in the economy. And so these companies, which is the BRL52 billion, we put in a different bracket and report differently. Also, these companies, we separate in four different levels, companies and individuals, according to some standard data about them. And we follow

these four different levels separately, the delinquency -- not the delinquency levels, but I mean, the levels of activity, each of them, how their sales behave and so on. So we have a very precise follow-up on the financial health of these companies divided in these four groups and separated, as you correctly pointed out, from those which had already been renegotiated when the crisis struck.

Q - Nicolas Riva {BIO 20589225 <GO>}

Okay. Thanks very much, Candido. So then just a quick follow-up. Then it would be fair to assume, based on what you're saying, that there should be a higher recovery value and a lower need for loan loss provisions in the re-profiled loans in these BRL53 billion compared to the stock of renegotiated loans?

A - Candido Botelho Bracher {BIO 3158644 <GO>}

Yes. I think -- definitely, I think, I mean, that the performance of this BRL53 billion should be way better than in the stock.

Q - Nicolas Riva {BIO 20589225 <GO>}

Okay. Thanks very much, Candido.

A - Candido Botelho Bracher {BIO 3158644 <GO>}

Thank you, Nicolas.

Operator

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

A - Candido Botelho Bracher {BIO 3158644 <GO>}

So I just wanted to thank you all for listening, for the interest, for the questions and to reaffirm -- I mean, which was our strategy in dealing with this unprecedented crisis, which was one of support to our clients because, I mean, we thought it was the right thing to do and because we are looking at the quality of the credit portfolio as the main part of attention going forward.

Operator

That does conclude our Itau Unibanco Holdings earnings conference for today. Thank you very much for your participation, and you may now disconnect.

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