

Q2 2020 Earnings Call

Company Participants

- Alfredo Egydio Setubal, Chief Executive Officer and Investors Relations Officer

Other Participants

- Jason Mollin, Analyst

Presentation

Operator

Good morning, ladies and gentlemen, thank you for standing by, and welcome to Itausa's Conference Call to discuss the First Half of 2020 Results. At this time, all participants are in a listen-only mode. Later we will conduct a Q-&-A session, and instructions to participate will be given at that time. (Operator Instructions) As a reminder, this conference is being recorded.

The file will be available at the Company's website at www.itausa.com.br/en. at the Investor Relations section. This conference call and slide presentation are being transmitted via Internet as well. You can access the webcast by logging on the Company's website www.itausa.com.br/en.

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. I inform that during the presentation, the questions can be sent by webcast and it will be answered at the section of Q&A.

With us here today, we have Mr. Alfredo Egydio Setubal, CEO and Investor Relations Officer at Itausa; Mr Henri Penchas, Chairman of the Board of Director at Itausa; Ms. Priscila Grecco Toledo, CFO at Itausa; Mr Bruno Salem Brasil, Investor Relations Manager at Itausa; Mr. Renato Lulia Jacob, Head of IR and Market Intelligence at Itau Unibanco; Mr. Carlos Biehl, Investor Relations Manager at Alpargatas; Ms. Natasha Utescher, Investor Relations Coordinator at Duratex.

It's now my pleasure to turn the conference over to Mr. Alfredo. Sir, you may begin now.

Ladies and gentlemen, please hold. Mr. Alfredo, you may proceed now.

Alfredo Egydio Setubal {BIO 1528623 <GO>}

Yes. Okay. Thank you. Hello, everybody is listening. I'll start...

Operator

Yes, you can proceed. Mr. Alfredo, you may proceed now.

Alfredo Egydio Setubal {BIO 1528623 <GO>}

Hello? Hello?

Operator

Yes, we can hear you. You may begin.

Alfredo Egydio Setubal {BIO 1528623 <GO>}

Hello?

Operator

Mr. Alfredo, you may proceed.

Alfredo Egydio Setubal {BIO 1528623 <GO>}

Okay. I'm restarting please. Thank you. Sorry for the connection problem. We are starting from our conference call for the first semester results for Itausa. That's our agenda for today, we'll pass through quickly from the slides and then we open for Q-&-A session.

Going to the next -- the next slide please. We are in Slide number 4. About COVID. Actions and reactions in our operations for our company. Of course, all companies suffered, especially at the beginning of the crisis, sanitary and socioeconomically in Brazil. The bank had to make, the Central Bank approved some measures to facilitate the banks for renegotiate credits. We did millions of renegotiations for individuals and small and medium companies, but especially smaller ones.

So we are passing this moment with a lot of many millions of renegotiations in credits for individuals and companies. Let's see what will happen when these renegotiations started and we have to go back to -- we'll go back to the normality of the situation. But at the same time, we had increase in loans in the portfolio, especially at the beginning, especially for big companies that use their credit lines to increase cash for face the pandemic and medium-sized companies also.

The bank in the first semester made additional provisions for about BRL9 billion in terms of credit above the minimum required for the Central Bank, in the policy of the expected provisions policy that we have in terms of loan losses. Let's see how the economy and

how the credit performs in the next quarters to see how much is more necessary to complement this level of provisions.

As you know, the Central Bank imposed restrictions for the distribution of dividend and interest over capital. So we have a limitation in our statutory bylaws. So, we -- the bank can only distribute this year 25% of the results of dividends or interest in capital. That of course will impact the inflow of Itausa in terms of dividends that we are going to receive.

Alpargatas also had problems at the beginning, we have huge reduction in production, so we adjust the production in the beginning. We have also term extension for clients. We made provision for losses from the Company, in terms of our clients, especially in terms of distributors. And to face all these factors, at the beginning, we raised BRL2.1 billion in cash from the bank, using the disposable lines that the Company has in the banks.

Today the situation is much better. The Company increased productions in May, in June, and also in July. We are operating at full capacity now back, due to the better conditions in the local market. And also because of export, there are a very good base especially for Havaianas. So I think, in this case of Alpargatas, most of the problems are gone, and we are going back to normal activity in this third quarter.

In the case of Duratex, also we have a huge impact at the beginning. We practically closed all the factories in the end of March, beginning of April. We also had to renegotiate, it's time for extensions for the clients, in our supply chain, but we also made provisions around BRL25 million for the possible losses and the Company also increased liquidity at the beginning in BRL1.6 billion to face the crisis.

Also Duratex restarts the production back in the middle of April. All the chain of distribution of Duratex products we made it open during all the periods. The material companies and companies -- and all the material companies remain open, someone is -- with the microphone open. Please shut down, please.

So Duratex increased their production in April and May and June and July. We operate full, in July, probably full for this quarter. So in the case of Duratex and Alpargatas, I think most of the problems are gone, and we are back to normal activity for the moment. What is good news, probably both of the companies are reducing the loans that we raise it for -- face the pandemic crisis. I think the situation to-date is much better than we were expecting during the first days or first weeks of the economic situation or the economic crisis in the beginning. And in NTS, we had also to grant a temporary deferral for Petrobras that is returning to normal, normal pace now. And we also postponed some investments that we were doing during this period.

We can move to the next slide. Where we can see how the companies that we participate and how Itausa itself made support for the crisis. Itau opened a line to our foundation for culture and social benefits for the Brazilian society in BRL1 billion, in a new line, in a donation for the foundation. We also received more BRL250 million from donation from other companies, individuals and especially from the Moreira Salles family that is the

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family that's with Itausa, controls the bank. So, it is only through the bank, BRL1.35 billion in donation for supports especially hospitals, public hospitals in the combat of the COVID-19.

Duralex also made donations, also for the Itau Unibanco foundation and products -- from our line of products, especially for the new hospitals, that were made to support the public service indeed during this period. Alparagas also made donations of BRL16.5 million, including also a donation for the Itau Foundation of BRL5 million. And many products and masks and uniforms for hospital, attendance and serological tests, respirators, shoes for medicals -- plastic shoes. So, we are back to our fabric, our products to support that we gave for the public hospitals.

NTS also BRL4.1 million in donations for an equipment for the hospitals. Itausa itself donate BRL550 million for the project, Todos pela Saude, that is the initiative of the foundation of the bank. And also this two families Setubal and Villela also made donations of BRL50 million for the foundation Itau Unibanco. So I think all the companies and all the families are helping the country and the public health system to support the pandemic that in Brazil is taking a long time in terms of decline of this considered first phase.

Going to the next slide. We are going to see now more things related to our governance. ESG practices, we all know that Itau's and all the companies that we participate, are very concerned about the ESG practices. In this quarter we -- Itausa released again the '19 integrated report where you can find detail of our strategy, the way we took decisions, how we analyze M&A's, how we do as we are seeing from the companies, all the commissions and committee that supports the administration of the Company is a very complete and very transparent reports that we release this year for the second time. Itausa joined now the FTSE4Good. That is a index from the Financial Times for companies that demonstrate outstanding ESG practice was -- but for us is that, we are very proud to be part of this index also, among all those that we participated like the Dow Jones Sustainability Index, (inaudible). So I think this also confirmed the good process that we have related to ESG and our shareholders and our activation also in our (Technical Difficulty) in Brazil.

We again created that commission for corporate awareness, of course we did many things through these last years, but we decided to have a special focus and a special commission to work in all the policies and practices that we have, and that approves now our Board of Directors. So we now have a formal commission, analyze all the governance and proposals for the company. And to keep it updates to the best practices that we see in Brazil and outside Brazil also.

We are going now to the next slide, where we are pass through one slide per company, all the companies showed already their results and made their own conference call. So here is just a glance, quick -- glance in the results. We, in the case of the bank, we put in this highlight the loan portfolio that grew 20% in the period. Also related to medium and small-sized companies. And as I said in the beginning of the crisis with large companies requiring huge amount of lines that were preapproved for them to face the pandemic.

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We have been very strictly continued to be -- expenses of the bank, so we have a decrease in nominal terms. And we increased the expected losses in 120%, as I said at the beginning of the explanation. But we have been very cautious in terms of new loans. Of course, we are providing new loans from billion of clients. But where we wanted how really the economy will perform in the coming quarters. And so we have been very concerned and very conservative in terms of providing new loans to the clients, because there are lots of uncertainties related to the economy, unemployment, how the economy will really perform after the support that the government are giving for the family. So many uncertainties related to the economy. So we have been cautious in this period to see how things will go in terms of the economy.

Continue to operate the bank, we took advantage of these new scenario for the economy. So we increased our digital operation and increased 1 million new accounts for the banks opened in -- through our -- in the first half of '20. So it's a good performance. We had BRL22.9 million on digital -- of digital customers now. We have an increase of 17% when we compare one year ago. So clients are using more the digital channels that we provide for them. So we are happy to see that, that the possibility to continue to reduce costs and increase the digital transformation of the Company.

We continue to provide credit. We opened new lines, as I said with more conservative approach. But we provide credits from the new lines, also that the government provide for the banks, for payroll and et cetera. Anyway, the results we do see here -- we have seen the numbers little different from the number that the bank showed in the analysis, because here we have seen the numbers in IFRS, so we have a difference when we compare to the bank numbers, released the last week, because the bank continued to use the Central Bank regulations for account.

So we have a reduction in the recurrent net income of 41.7% in the bank, BRL33.8 billion, also, of course, a reduction in the ROE from 22% to 12% almost. The loan portfolio as I said, increased in the period.

Going to the next slide. Slide number 9, we can see highlights from Alpargatas. Alpargatas increased almost double, 93% growth in online sales for the first half in all regions. So minimize the effects of the store closures in the period. But anyway we have a recurrent EBIT that reduced 42.7%. Anyway it was a good results, much better than we expected, when the crisis started.

Most of the -- that we used to sell products of Alpargatas especially, supermarkets remained open. So we could operate the company in a lower level, but in a reasonable level during the period. And these were growing from May, June, July. So we are now almost normal in terms of production. So the online was a big highlight for the company that increased dramatically in all the channels that we operate in terms of digital.

We continue to manage the capital, we definitely grow the investments in Argentina. So it was a bad investment when we bought the company. We took some years to close, that we finally closed and sold all the operations that we had there. We sold the factories, we sold (inaudible). And now we start -- we are in Argentina, only selling Havaianas products.

Bloomberg Transcript

What is good because there were a loss of capital. It was -- we had bad results in Argentina for many, many years. Net income reduced, recurrent net income, 63%. We showed BRL25 million now. Of course, also the ROE reduced to 0.6, 0.5 it was 6.6, and EBITDA also reduced. But this is for the first half. We, in this quarter, we expect a much better result almost a normal results for Alpargatas, considering the trend that we see in June and also in July.

Now we're going to see Duratex on the Slide number 10. Now Duratex also suffered at the beginning of the crisis. We almost stopped all the -- all the factories of the company, in the end of March and beginning of April. But since then, we started reopening the operations and all the factories now operating, since June, in a very good level, July was very, very good. We are full operation 24x7 in all the sectors. Remembering that the material constructions network and stores and so on, continue to be open it, during (Technical Difficulty) all the periods (Technical Difficulty) segment that the government didn't ask to close. And the sector with low interest rate and so on are very active.

We gained market share, we used our financial strength to renegotiate and give more term extension for clients. We gain market share during our strength and brands and also with problems that our competitors had especially in April and May. So we regain market share in all the lines and all the products that we have. Our factory that we are building with Lenzing of dissolving pulp continue to be constructed.

We don't see delays in the start of the operations that is, in the beginning March of 2022. This continues to be in line. And we announced the -- how the project will finance -- how is the financial structure for that investment. Duratex for the first year, released their integrated report also with long-term strategic vision, how the company operates, how decisions are made. Why we are inspectors, I think, it was a very important releases for our shareholders and analysts and portfolio managers, that's follow the Company. They found that a very good deed for the company.

In terms of results, of course we had bad results because the March -- second half of March and first part of April was very bad. But we recover and second quarter was better, third quarter looks to be very, very good for the Company. Also the ROE reduced 43% [ph] and EBITDA reduced less than we expected. So Duratex is also Alpargatas probably going to have a good third quarter.

In the case of NTS, we have received BRL95 million in earnings from the Company in the first half of '20. As I said, we have deferred some revenues from Petrobras. Petrobras started the process of divesting the 10% stake that remains with Petrobras in their portfolio. And we are analyzing what we -- how we are going to do with this process of investing of NTS. Of course, the consortium that bought the Company and that we are in this consortium, interested in buying this remaining stakes from Petrobras. NTS acquired, Mantiqueira compression station in the state of Minas Gerais for BRL46 million. And we have affirmation from Fitch ratings of a AAA rating here in Brazil.

Going forward, on Slide 12, we are going to start to talk a little about our own results, that was results that we released last night, a net income of BRL1.6 million, a reduction of 67%.

The recurrent net income of BRL2.5 million a reduction of 46% ROE, recurrent of 9.4%, mainly because all the companies had bad results in the period, especially the bank that shows also is reversion and is our main investment in our portfolio. Shareholders equity of almost BRL53 billion and total assets of BRL56 billion. That is mainly the investments that we have in the companies that we have -- dividend yields in the last 12 months, 9.1%. Of course this dividend yield will be reducing in the coming quarters, because they said we are going to receive less dividends from our subsidiary. And we pass-through less dividend from -- for our shareholders this year.

Going ahead, we can see that we continue the practices of paying to our shareholders, same amount that we -- the dividends that we received from the bank. We have the restrictions, as I said from the Central Bank to pay more dividends than 25%. We are going to continue to pass through the dividends that we received from the bank to our shareholders and keep the dividends from the other companies to pay for the costs of the holding to face the cost that we have in terms of fiscal and administrative expenses to our client, to our companies.

And as I said we have dividend yields, so here we continue to pass through the dividend that we received from the bank. And we announced a dividend for this month of August, that we pay at the end of the month, that 0.2 per share that is equal for what we pay each quarter for our shareholder. So we will be, as a new quarter in terms of dividends for our shareholders that we are going to receive this month.

Going ahead, we see the discounts that we have, the discounts of 20.3% [ph] compared to the sum of the parts and market value -- fair value for our portfolio. The discount reduced during July is around 16%, 17% at this moment. We continue to have a great evolution of the individual client -- stockholders. We achieved 751,000 shareholders at Itausa in June '20. Our trade increased to BRL226 million to-date. And the discounts reduced from 25% to 20% and now is around 17% to 16% [ph] during the last weeks.

And the final slide is the performance of the shares. Of course, the performance in recent periods are not so good, especially because our main investment, that is Itau Unibanco Holding had a bad performance in terms of results due to the crisis, that we all know and I'll talk a little about the deferral results of the bank. That's what I had to say, and we are open now to question -- and open question-and-answer session, through the web or through the telephone as you wish. Thank you.

Questions And Answers

Operator

Thank you, Mr Alfredo. Ladies and gentlemen, we'll now begin the Q&A session.
(Operator Instructions) Our first question comes from Jason Mollin with Scotiabank.

Q - Jason Mollin {BIO 1888181 <GO>}

Hello, everyone. Thanks.

A - Alfredo Egydio Setubal {BIO 1528623 <GO>}

Hello.

Q - Jason Mollin {BIO 1888181 <GO>}

Good to hear from you. My question is related to the outlook for tax policy in Brazil, particularly given that, the PIS/COFINS that you pay on the dividend flows. What are you thinking about, can you hear me, what are you thinking about the future tax regulation changes in Brazil and how that could impact Itausa?

A - Alfredo Egydio Setubal {BIO 1528623 <GO>}

Okay. Thank you for your question, Jason. Nice to hear from you. Well, we saw during the last week, that the government sent to the Congress a law project to change the law in Brazil related to taxes, involving especially the PIS/COFINS and ISMS [ph] -- ICMS from the state. So it's a total new regulation that has been proposed by the government. Of course, this -- we'll need a lot of negotiations from the government and the Congress. That they're very -- that my opinion, difficult issues that are proposed by the government that we need huge negotiation with the governors, the payers and the Congress to really achieve a negotiation that can be approved.

I personally believe that the way the proposal is done, we are going to see many changes, especially in the percentage of the new tax that is -- has been proposed at 12%. It seems by many economists to see -- seems to be higher than necessary. So we are going to see what will happen in that case. For what we see from this new law, is good for Itausa, because we will reduce the tax that we paid. And I think part of the reduction of the discount that we had in the last weeks is due to the new proposal from the government, that we reduced the costs that we have in the holding to support the operations and the tax that we pay. But we have to see how this will really be approved by the Congress.

In the terms of dividends and corporate taxes directly, the government didn't send yet their proposal. So we need to wait and see how the government will propose the change in incorporating taxes for the companies. Now the Finance Minister already confirmed that they will propose reduction in corporate taxes and increase the tax for dividends in the coming years. But what I personally understood, this will be done in the coming years, not immediately. So they will reduce the corporate tax and they will increase the tax from dividends that is zero to date, in the coming years in a base that is not yet known. So we have to wait, there is not a clear answer, but it seems that the -- that we are going to have less tax expenses and that's what the market is reading and we agree that is probably what will happen. Let's see how much this will be really approved by the Congress in the coming months.

Any other question?

Q - Jason Mollin {BIO 1888181 <GO>}

Sure. Wanted to talk about, maybe you could give us an update on the Liquigas investment. We understand that it's still under review by CADE. What is the status at this

point?

A - Alfredo Egydio Setubal {BIO 1528623 <GO>}

The status is -- the CADE changed the person that was analyzed the case. So we had some, some backwards, because the new person is studying the case. So we were expecting to have the CADE proposal or approval as we enter the case in the CADE for -- by October or September, probably these will take more time, probably by the end of the last quarter of this year or beginning of next year. But we continue to be confident that the proposal that the consortium made to the CADE already offer solutions from the concentration in many regions, in Brazil, especially in the Northeast. So we are confident that the proposal we approved essentially as we propose all these small restrictions imposed by the CADE. But fortunately, this changing in the person is analyzing the key (Technical Difficulty) are some small bills under the proposal that we made, that we continue to be confident that at the beginning of the year -- next year the maximum, we are going to start the process of integration of the two companies. In terms of financing from Itausa, we need to BRL1.4 billion for that investment, and we analyze with banks, probably the best solution, will be issue of debentures for finance this acquisition around seven years, due for -- like the one that we issued for the acquisition of NTS. So we are expecting probably by the end of the year, we had views and we probably issue a debenture in the capital markets from Itausa again in a seven-year period for that.

Q - Jason Mollin {BIO 1888181 <GO>}

Thank you very much.

A - Alfredo Egydio Setubal {BIO 1528623 <GO>}

Okay, Jason. And nice to hear from you.

Q - Jason Mollin {BIO 1888181 <GO>}

Thank you. Same here.

A - Alfredo Egydio Setubal {BIO 1528623 <GO>}

I don't know if we have other questions from phone, otherwise, we can stop.

Operator

Yes. We don't have any questions. So this concludes today's Q&A session. Mr. Alfredo, at this time you may proceed with your closing statements.

A - Alfredo Egydio Setubal {BIO 1528623 <GO>}

Okay. Thank you for the participation of this intermediate conference call that we made. We don't made conference call, every quarter, because all the companies make, our subsidiaries. So we don't want to be repetitive in terms of information. And the holding level, we don't change many things from one quarter to the other. We increased 30% in the numbers of attendance this quarter. So we are happy to be here for the foreign

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investors that follow us (Technical Difficulty). Now from the beginning of the crisis with Alpargatas and Duratex operating their full capacity is probably we are going to show a much better result in the third quarter and the second semester.

The bank, also, the economy overall is performing better than expected. Most of the economies now reducing, the reduction on GDP for the year, so it's a good news. Hope this help also in the terms of the bank, we renegotiate millions of contracts. As you know, and we expect as the economy is performing a little better than expected, that (inaudible) capital provisions that we probably will have to make in the coming quarters, will be less than we expected at the beginning of the crisis.

So I think the scenario for the industrial capital of the bank, also, we expect a better scenario -- not a good scenario, but a better scenario than we saw at the beginning of the crisis. So the inflation continued to be very local, interest rate was in the lower level. (Technical Difficulty) how the unemployment will comport in the coming months and quarters to see how we (Technical Difficulty) and how we will perform in the coming quarters [ph]. But anyway, we'd see (Technical Difficulty) and we're in a better pace for the coming quarters, so what we'll be -- all good for our Company.

Thank you for your time, being with us. Take care all. See you in the next conference call.

Operator

That does conclude Itausa's conference call for today. Thank you very much for your participation and you may now disconnect.

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