

Y 2018 Earnings Call

Company Participants

- Alfredo Egydio Setubal, Investimentos ItaÃ° S.A.

Other Participants

- Jason Barrett Mollin, MD of LatAm Financial Services

Presentation

Operator

Good morning, ladies and gentlemen. And thank you for standing by. Welcome to ItaÃ°sa's conference call to discuss 2018 results. (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 a slide presentation are being transmitted via Internet as well. You can access the webcast by logging onto 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 found that during the presentation the questions can be sent by webcast and it will be answered in the question-and-answer session.

With us today, we have Mr. Alfredo Egydio Setubal, CEO and Investor Relations Officer at ItaÃ°sa; Mr. Henri Penchas, Chairman of the Board of Directors at ItaÃ°sa; Mrs. Priscila Grecco Toledo, CFO at ItaÃ°sa; Mr. Bruno Brasil, Investor Relations Manager at ItaÃ°sa; Mr. Alexsandro Broedel, Executive Finance Director and Investor Relations Officer at ItaÃ° Unibanco; Mr. Guilherme Setubal Souza e Silva, Investor Relations and new Business Manager at Duratex; Mr. Julian Garrido, CFO and Investor Relations Officer at Alpargatas.

It is now my pleasure to turn the call over to Mr. Alfredo. Sir, you may now begin.

Alfredo Egydio Setubal {BIO 1528623 <GO>}

Thank you. Good morning. It's a pleasure to be here again to explain about our Fourth Quarter and on our results of ItaÃ°sa.

Following the agenda on Page 3, we have 4 divisions for this presentation. The macroeconomic scenario, highlights of subsidiaries, Itaúsa's numbers results and Q&A part for the end of the presentation.

On the Slide #4, macroeconomic scenario. We expect a growth of GDP for this year in Brazil of around 2%. It's better than last year. But below the expectations that we had at year-end of 2018. Inflation of 3.6%. And the Selic rate is stable during the year for 6.5%.

In this environment it's after good -- not as bad as some years before. But is better. We think it's good for the companies, for the stability for our business, for credit granting and possibly with this new liberal government policies, opportunities from privatizations.

We will follow up very closely the jobs and income recovery. We expect this job recovery to be very slowly and gradual. And anyhow -- anyway, we'll continue. We will follow the news and -- about the tax changes that can be or not be proposed by the government. Especially in terms of tax and social security reforms, we think it's essential for Brazil to grow in a sustainable and more powerful way from next year and ahead. So for -- in our view, it's essential that these -- especially the social security reform have to be very strong to really reduce the public debt to make more room for growth in Brazil in the coming years.

On Page 6, we see highlights from our subsidiaries. Starting from the bank. Last year, the bank had a very good year again. We started to see more growth in the loan portfolio that increased 6%, mainly from individuals and very small and small and middle-market companies. Default indicators continue the trend -- the downward trend that we saw last years. And probably this growth of the portfolio in individuals and middle-market companies will drive the growth again this year in terms of credits in the bank. The payout of the bank reached 90% almost, including share buybacks that were done during the year. And the total dividends interest on capital paid was BRL 22.4 billion.

In terms of digital transformation, it is the main strategy of the bank for the coming years, 76% of the payment transactions are carried through these digital channels.

We transformed the Fiscal Council on a permanent basis. It was elected every year, now it's permanent. Only the members can be changed according to the shareholders. We bought 11% minority interest in the Ticket company for food. And the Central Bank approved the XP business with some limitations in relation of the due sign between the shareholders of XP and Itaú Unibanco. But anyway, it was approved by the Central Bank. ROE of 20.4%, little growth from 2017.

And the loan portfolio for small companies, it showed a growth of 14% and the credit for individuals that grew 10%.

On Slide #7, this year's highlights for Duratex. Duratex made many changes, especially in the panel -- wood panel division. We used -- we announced a JV with Lenzing for definitely in dissolving wood pulp, using a forest that we were not intending to use for panel products. So we found a very good use for this forest. We sold land for Suzano, the land

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that we were not using for the wood market panel. And sale of facilities of wood fiberboard in Botucatu to Eucatex. In terms of CEUSA, we announced a plan for double the production, the capacity of sales in the market, an investment of BRL 94 million. And we, in the Fourth Quarter, did some impairments of intangible assets and other nonrecurrent effects. The total of BRL 300 million to let our assets more clean for the company. So with all these positive and negative nonrecurrent revenues, the expenses was 8.8%, BRL 432 million. Net debt reduced in operational recurring basis for 2x EBITDA. And we reconsidered the -- all the money that we received from Suzano, the net debt is 1x EBITDA at year-end. So we did very important deleverage for Duratex during last year with the results and the sale of ours.

On page 8, Alpargatas. We hired some external consulting firms to help us in terms of strategic movements, especially outside Brazil and for operation plans here in Brazil to reduce cost that we believe is, we'll be able to do in the coming quarters.

We redesigned the organizational structure of Havaianas. It is the main branded product of Alpargatas. And with the geographical division into dedicated units supported by global areas. So we did that under the new CEO that is Roberto Funari that have seen the company in the beginning of this year.

Alpargatas also announced a JV in India to start business there. We sold our -- part of our business in Argentina of Topper brand for -- in terms of articles for sports. And also we sold, at the end of the year, the line of professional boots. That was a traditional product of Alpargatas but was very small line of products. So we decided to sell it.

In terms of net income, we have a little reduction in the year of -- from BRL 362 million to BRL 332 million and recurrent EBITDA increased to -- from BRL 504 million to BRL 555 million. This year, in terms of Alpargatas, we expected a better year in terms of sales. But we'll continue to sell and to arrange more the strategy and the assets of the company, preparing the company for more sustainable growth in the coming quarters.

In terms of NTS, it's our participation in the current year industry. The highlights for the company was a debt restructuring. The company redeemed the debenture that was issued owing the privatization of the company from Petrobras. ItaÃ'sa holds some investment in the debenture. So we received BRL 442 million from NTS. And NTS reduced the cost of debt with a new debt for the company now in the much better cost.

We continued to receive capital dividends and interest over capital from NTS. The total last year was BRL 202 million, including a capital decrease that NTS also did in the total amount of BRL 694 million, the total for the company. And ItaÃ'sa receives BRL 53 million from NTS in this capital decrease.

Total revenues of the company is BRL 400 billion -- BRL 4 billion and EBITDA of BRL 3.6 billion. Net income, on the right side of the slide, increased 6.9% to BRL 1.9 billion. And as I said, the total receipt by ItaÃ'sa in terms of dividends, interest on capital and capital decrease, net total BRL 202 million, an increase of 17.4%.

On Page 11, main events for Itaúsa. We announced a dividend and interest on capital yesterday to complement. So the total that the company paid related to 2018 was BRL 8.4 billion in total, almost BRL 1 per share, 28% increase when we compare it to 2017. That means a 94% payout and the 7.4% dividend yield using the quotation of the end of December '19 -- 2018.

And we don't see this year any capital increase related to Itaúsa. Another event was the investment in Elekeiroz, as there was a company of this chemical sector that we've sold and amount -- total amount attributed value enterprise -- value of BRL 160 million. We finished the investments through Itaútec in the OKI Company. We sold remaining 10.3% of the investment that we had at OKI, Brazil. So we finish our participation.

An important issue is the end of usufruct on Itaú Unibanco shares. As the shares that are allocated in the capital of IUPAR. That is the holding of Itaúsa in the Moreira Salles family that controls the bank. The term end after 10 years. So from November, Itaúsa is paying also the tribute, the taxes over the interest on capital receipt from IUPAR. So that means that Itaúsa will have BRL 120 million extra PIS/COFINS this year in the cash effect. So the expenses of the company this year will increase to BRL 120 million.

In terms of capital markets, we achieved 130,000 individual shareholders with an increase of 83% in -- over 2017. A market value of BRL 101 billion. And we bought back shares -- 3.5 million shares -- preferred shares of the company.

On Slide 12, profitability, the result for the year, achieved BRL 9.4 billion, recurring result BRL 9.3 billion. That means in terms of net income, an increase of 15.9%, ROE of 18.2% and dividend payout, as I said, 94% and a dividend yield of 7.4%.

On Page 13, we continued the process of paying to shareholders the same amounts received from the bank in an accrual basis. So we obtained exactly the same amount that we received from the bank. From the bank, all of the dividends and the capital received from the nonfinancial companies are used to match the expenses that Itaúsa had itself. That is an amount of around BRL 550 million to BRL 600 million a year, including taxes, operational expenses, interest expenses from the debentures and so on. So that's why we continue to be able to pay the same amount received from the bank.

On Page 14, capital composition. As I said, the main liability of Itaúsa with the shareholders is the only debt that we have, is the debenture that we issued when we bought the participation in NTS of BRL 1.2 billion. That's on the right side of the table, we can see the conditions. And the amortization starts on 2022, BRL 400 million in 2022, BRL 423 million and BRL 424 million.

On Page 15, the portfolio of Itaúsa in the market value of BRL 143 billion, the participation in all subsidiaries that we have. And the market value of Itaúsa for BRL 111 million. That means that discount of sum of the parts compared to the market value of 22.3%.

On Page 16, we talk about sustainability and corporate governance of Itaúsa. Sustainability, we highlight the continued participation in the Dow Jones Sustainability

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Index. The participation in the DJ sustainability index of B3 here in Brazil. And CDP, where we were leader of transparency with the score of A minus. In terms of corporate governance of Itaúsa, this year, as I said, the permanent Fiscal Council was approved by the shareholders in the shareholders meeting. We approved the new policies related to transactions with related parties, relationship with private entities and public agents and policy for corruption prevention. We updated our code of conduct and created an independent reporting channel for our employees.

On Page 17, we talk about sustainability and corporate governance for our subsidiaries for the companies we participate. First, the bank, also the continued participation in the Dow Jones Sustainability Index. Also, on CDP leader in transparency and the participation index of B3. In terms of corporate governance of the bank. The permanent Fiscal Council also approved by the shareholders and the creation of Digital Advisory Board, LatAm Strategic Council and the social responsibility committee of these 3, linked directly with the Board of Directors of Itaúsa.

In the case of Duratex, also the leader of transparency in CDP, especially in the water -- efficient water management. Also participation in the index of Bovespa. In terms of corporate governance, internal restructuring for operational efficiency, especially in the panel woods market division.

And also a creation of IT and digital innovation committee, also directly linked to the Board of Directors. In the case of Alpargatas, developing of the first carbon emission inventory. So we started also as more actions in terms of sustainability for Alpargatas. In terms of corporate governance, election of the new CEO and the election of independent members in the Board of Directors. And all these independent boards coordinating sum of the committees of the company. And also advisory on strategy and management support from specialized consulting firms.

On Page 18, this is last slide. Itaúsa in the capital markets with good performance when we compare 10 years, five years and last year compared to Bovespa, with the dollar and the interest rate.

Well that's the end of the presentation. And now we are open for questions from all the shareholders and investors. Thank you.

Questions And Answers

Operator

(Operator Instructions) Our first question comes from Jason Mollin, Deutsche Bank (sic) (Scotiabank.)

Q - Jason Barrett Mollin {BIO 1888181 <GO>}

I have 2 questions. My first is on the strategic initiative for Itaúsa, the outlook going forward. We've seen you talked in the past about targeting a percentage of the portfolio

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in Itaúsa Unibanco shares. Can you give us an update now if you're looking into other potential investments that we should expect in the coming future? And my second question is on potential tax changes in Brazil. And if you're expecting the deductibility of IOC to be removed and how that might impact Itaúsa and how you might react to that change if, in fact, it turns out to be the case?

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

Jason, Alfredo. Thank you for your question. These 2 questions are very important for Itaúsa. We expected this year to make some investment, we didn't anything last year. The conditions of the economy, uncertainties and so on. We are not be able to continue. But we continue to study other opportunities for this year. So probably, we are going to have some investment this year from Itaúsa, because we expect this better environment in terms of economics and politics for the approval of reforms and so on. So without that, we expected also the cost of capital of Itaúsa to be reduced. Today, we are considering 14% in terms of cost of capital. We believe that this number is everything goes well in Brazil in terms of approval of reforms and better and strong economic growth. This number can be reduced to something around 13%. So this will probably -- we'd be able to analyze more investment for this portfolio of nonfinancial companies that we are using in the last years. And that said, I would say that the bank will continue to represent more than 90% in all the lines, all the comparables that we -- you can make. It can be in terms of assets or market capitalization or profit because the participation of Itaúsa in the bank is very huge, you know that. It's a -- more than 38% of the total shares of the bank. So we are building a portfolio of investments. We already have 3 investments that is Duratex, the traditional one; Alpargatas and NTS. And probably in the coming years, we will continue to build these portfolio. Always, we said that these portfolio have to make sense and also have to be profitable and create value to the shareholders. So we are not in a hurry to build this portfolio. We will find and look for opportunities. I think we found 2 good opportunities, which are Alpargatas and NTS. And we'll continue to search. All said, I would say that the bank probably will continue to represent more or around 90% of assets and more than 90% of profits because the ticket that we are searching is a ticket of investment of around \$500 billion to \$700 billion. So this is important to make a portfolio of known financial companies. But when we compare to the size of the participation that we have at the bank, this will not -- the bank will continue to represent more than 90% of the results of the debt and the market capitalization of the companies. In terms of your second question, also the possibility of a change of the tax for the companies and over dividends and I don't know if the interest of capital will continue. We don't know exactly because there is no official proposal from the government about that subject. We expect that this will appear during the year and probably something will change and will be approved by the Congress probably in the second semester. What has been said that is reduction to around 20% in the corporate taxes, an increase to something around 15% of the dividend. And just to remember, if you are aware or not, dividends in Brazil weren't taxed until 1996. In 1996 because of the end of the inflation as the real plan. So what was created the interest on capital. Then at that time, the corporate tax was increased and the tax over dividends was 0. And interest over capital was created with a tax of 15%. So we expected something going back to 1996, that reduction of the tax -- the corporate tax. So increase in the tax over dividends. And we don't know exactly what the government will do with the interest on capital. So when we -- there are many uncertainties. But at least everything that I said happens. And the interest over on capital continues, the reduction on corporate taxes and the increase on tax on dividends will be good for Itaúsa. We'll

reduce our tax payments that we have today a lot. That to this year, we'll be around BRL 400 million. The profit from the companies with the lower corporate tax will increase. So for ItaÃsa, it's not general. But dividends probably will be charges for special individuals, probably foreign investors will be not taxed. So for ItaÃsa, maybe, we'll reduce some of the inefficiency that we have as a holding company to be taxed over our revenue, especially interest on capital.

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Operator

(Operator Instructions) This concludes today's question-and-answer session. Mr. Alfredo, at this time, you may proceed with your closing statement.

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

Thank you for the presentation. I forget to restart the presentation with a sorry about the delay in issuing the information, we had a problem with the system between ItaÃsa. And the B3 and CDM. So we were just able to upload the financials of ItaÃsa early this morning. Sorry for that. It was not our fault. But it happened. And we are here, our investor relations team here to attend. And if you have any question, ask more detail with the financials, we are here and open to answer your questions. Thank you for the participation.

Operator

That does conclude our ItaÃsa's 2018 results conference call for today. Thank you very much for your participation. You may now disconnect.

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