

Q2 2019 Earnings Call

Company Participants

- Candido Botelho Bracher, Chief Executive Officer

Other Participants

- Domingos Falavina, Analyst
- Eduardo Nishio, Analyst
- Jorg Friedemann, Analyst
- Luis Fernando Azevedo, Analyst
- Marcelo Telles, Analyst
- Mario Pierry, Analyst
- Neha Agarwala, Analyst
- Olavo Arthuzo, Analyst
- Otavio Tanganelli, Analyst
- Tito Labarta, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. Welcome to Itau Unibanco Holding Conference Call to discuss 2019 Second Quarter Results. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session and instructions will be given at that time. (Operator Instructions) As a reminder, this conference is being recorded and broadcasted live on the Investor Relations website at www.itaubank.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 macro-economic conditions, market risks and other factors.

With us today in this conference call in Sao Paulo are Mr. Candido Bracher, President and CEO; Mr. Milton Maluhy Filho, Executive Vice President, CFO and CRO; and Mr. Alessandro Broedel, Group Executive, Finance Director and Head of Investor Relations. First, Mr. Candido Bracher will comment on 2019 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>}

Good morning, everybody. Welcome to our second quarter 2019 earnings conference call. I will start the presentation where we show the main highlights of our performance for the quarter. Recurring net income was BRL7 billion, which represented a 2.3% growth when compared with the previous quarter and resulted in a 23.5% ROE. The key drivers of this performance were the acceleration of our financial margin both with clients and with the market as well as a stronger fee revenue generation. These effects were partially offset by two expected events, seasonally higher non-interest expenses and a higher cost of credit. The latter is the result of a continuous growth of the origination of credit to individuals. Lastly, our effective tax rate increased 70 basis points as a

result of the lower TJLP long-term interest rate in the period, which is used to calculate the tax shield from our interest on capital.

In the next slides, we will provide a more in-depth view of these figures. On Slide 3, we show that our value creation increased 9% in the second quarter and reached BRL3.2 billion, a record figure. This was a result of our performance in the quarter as well as due to a lower cost of equity. Moving now to Slide 4, we show that our Brazilian credit portfolio grew 7.9% over the last 12 months driven by individuals and SMEs, which have grown 14% and 19% respectively. Origination continues to accelerate in both portfolios resulting in a richer credit mix as will be shown in the next slide. On the other hand, our credit portfolio in Latin America remained practically stable compared to the previous year. This is a consequence of the appreciation of the real against other currencies in the region. If we discount this effect, the portfolio would have grown 7% when compared to the same period in 2018 and the portfolio lot -- and the portfolio as a whole would have grown 7.7%.

Now I want to draw your attention to Slide 5, which portrays a crucial element of our results dynamics, it's in the bottom of Slide 5. Financial margin with clients is composed by two distinct elements. One is related to working capital, which is mainly affected by its own volume and the Selic rate. And the other, which is the core element of NII and MN&H from spread-sensitive operations. The spread-sensitive NII grew around BRL800 million as a result of the credit portfolio expansion and continuous change of mix towards higher spread-bearing products. This amount was partially offset by a lower working capital NII, which was a result of two effects. One, lower average balance after dividends payment and two, lower interest rate. Consequently, we are observing a robust increase in the spread-sensitive NII.

On Slide 6, we show that our financial margin with the market increased 26.4% this quarter. This performance was largely attributed to higher accruals in the foreign investments overhead strategy and in our insurance reserves management. We consider those gains to be structural as they are an integral part of our core banking activity. Turning to Slide 7 now, we show our credit quality. Short-term delinquency remained stable in the quarter while the NPL 90-day ratio decreased 10 basis points. The latter was a result of loans written off from specific large corporate clients and a further improvement in the SMEs' NPL ratio, which reached 2.5%, the lowest level since the merger between Itau and Unibanco. The NPL 90 days coverage ratio remained stable at 208% and the cost of credit ratio increased 10 basis points as would be expected given the acceleration of the change in credit mix in the period.

Slide 8 shows that our revenues from services and insurance grew 5% in the quarter. This performance was mainly driven by asset management and investment banking fees. It is worth to highlight the growth of almost 50% in the year of the funds from our Open Platform initiative, which reached BRL155 billion. Also of note is our credit and debit card issuer fees, which continued to grow consistently. Lastly, the acquiring business fee revenues declined 12.8% on the quarter mainly as a result of the new commercial initiative, which consists that no longer charge interest rates on the prepayment of credit card transactions, which are now paid in 3+2. In the next page we examine in more detail the initial results of this initiative.

On Slide 9 now, we show that after the 3+2 initiative, our acquiring operation had an upsurge of demand. New clients acquisition increased 73% while new clients choosing Itau Unibanco as their bank domicile more than doubled in the same period. More importantly, net promoter score increased 8 points in the year. These KPIs reinforce our perception that this was the right move.

Now turning to Slide 10, we show that our non-interest expenses grew 4.3% in the quarter. This growth was largely expected as expenses in the first quarter are seasonally lower than the rest of the year, but it is important to highlight that the growth was more subdued this year than in 2018 when our expenses grew 5% in the same period. It is worth pointing out that the quarter concentrated the closure of almost 200 branches just in Brazil, which added further pressure in our immediate OpEx, but will positively impact our efficiency from now on. Finally, our first half expenses grew 3.7% when compared to the same period in 2018, roughly in line with inflation for

the period. Another important message, yesterday, we announced a voluntary severance program. It -- this program affects the potential population of 6,900 employees potentially. They will have from 1st to 31st of August to decide whether they will join or not the program. As we have more information about this, more confirmed information about this, we will inform the market.

Now Slide 11, illustrates the organic capital generation of the Bank as we finished this quarter with a Tier 1 ratio of 14.9%, an increase of 30 basis points compared to March '19. It's worth mentioning that we announced the distribution of BRL7.7 billion as a complementary dividend to be paid in August 23rd, 2019. Finally, now, I want to discuss our expectations for the remaining of the year. On Slide 12, we show that the actual performance of the economy so far makes it clear that the original forecast for economic growth was too optimistic with the interest rates forecasted in a higher level than the one we foresee now. Lastly, it is worth mentioning the appreciation of the Brazilian real against the Chilean and Colombian pesos. So bearing these effects in mind, I now want to comment on our guidance and go item by item here. So we still abide by our guidance for the year, but it's continuing to situate our base scenario for each line. Total credit is well within the interval in Brazil, but the changes in exchange rate for LATAM places our base scenario around the lower end of the range for the consolidated portfolio.

The forecast of a lower SELIC rate and a narrower future yield curve have a negative impact in the expectations for our liabilities margin and for our working capital NII. Therefore, we anticipate our financial margin with clients to finish the year close to the lower end of the guidance. We expect our financial margin with the market and our cost of credit to be around the midpoint of their respective ranges. As for the commissions and fees, we anticipate to finish the year between the mid and lower point of the guidance. And finally, we expect our non-interest expenses to finish the year around the lower end of the guidance.

With this, we conclude this presentation and are now open to any questions you may have.

Questions And Answers

Operator

Ladies and gentlemen, we will now begin the question-and-answer session. The questions will be limited to two per participant. Our first question comes from Jorg Friedemann, Citibank.

Q - Jorg Friedemann {BIO 15405752 <GO>}

Thank you for the opportunity. I have two questions. The first question -- thank you very much for sharing your impression, Candido, on where you should be in terms of the guidance by each line. But here I just want to understand bit better why you are so conservative in terms of the financial margin with the market because if you look into the run rate so far, you are already above the upper end of the range. So, just wondering if there is anything that might negatively impact the results for the coming quarters that you aren't aware or this is just a matter of being really conservative there?

And the second question, I understand that you're still looking for additional clarity about the early dismissal program, but just a couple of points there. First, I understand that the 6,900 employees that are eligible for the program are all based in Brazil so it's approximately 7,000 out of the 85,000 that you have, is that correct or this could be also extrapolated to other regions? And the second point, just wondering if you had already contemplated such early dismissal program when you put together the OpEx guidance and how the potential effects of such a program will be contemplated in the guidance. You mentioned that you believe that they are going to be in the midpoint of the OpEx guidance here, this is already contemplating or not the potential effects of the layoffs for this year. Thank you very much.

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

Hi Jorg. Well, thank you very much for your questions. First on guidance. On guidance, I must say I think you're right. The financial margin with the market is probably the line more difficult to forecast and we had a positive semester, two positive quarters in the beginning of the year above our initial guidance and so we were relatively conservative when forecasting the end of the year. I think it can be better, but I cannot be certain about it. Now concerning the early dismissal program. First, you're right, it only concerns Brazil. So, it's 6,900 -- the eligible population is 6,900 employees in Brazil. And the costs of this program, of course they fall into the non-recurrent costs so it didn't -- do not affect our guidance. As to the benefits, we will wait until we have a clear figure of how much adherence to the program days. So far we have not included any of this impact when we guide the non-interest expenses to the lowest point of the guidance.

Q - Jorg Friedemann {BIO 15405752 <GO>}

Okay. That's perfect. And by the way, could you just give us some kind of niche ideas about what could be the impact if you have like, I don't know, 10% or 50% adherence or you're still working on the numbers? Thank you very much.

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

You know, Jorg, last time we made a program like this was already 10 years ago. So, we really have no statistic evidence to make any kind of forecast here. It depends very much on the adherence in which level this adherence will happen. So, we -- it's too soon to tell about our expectations.

Q - Jorg Friedemann {BIO 15405752 <GO>}

Okay. Thank you for the answers and congratulations on the results. Thank you.

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

Very much.

Operator

The next question comes from Otavio Tanganelli, Credit Suisse.

Q - Otavio Tanganelli {BIO 20615779 <GO>}

Hi, good morning. Thanks for taking my question. I have only one question, if I may. I wanted to ask about the asset management fees. We saw an acceleration from previous quarter, it was growing at about 5% year-on-year and this quarter is accelerated up until almost 15%. I wanted to get a little more color on what's driving this because the assets under management continued to grow at a similar pace than what we saw in the previous quarter, but the average rate if we divide the revenues by the assets under management, they increased as a percentage of the AUM. So, I wanted to understand a little better. Thanks.

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

Thank you, Otavio for your question. I have a very direct answer, I mean what drove this improvement in the margin were the performance fees. We had a good quarter in terms of performance of the more sophisticated funds and this improved the -- this line in our balance sheet. Okay.

Operator

The next question comes from Mario Pierry, Bank of America Merrill Lynch.

Q - Mario Pierry {BIO 1505554 <GO>}

Good morning, everybody. Let me ask you two questions as well. The first one is related, Candido, to this 6,900 employees that you think are eligible for business. So, if you can give us some color what kind of functions are you targeting and what kind of jobs these people have? And related to your costs also right, this quarter you closed close to 200 branches and laid off 1,000 people. Can you disclose to us the costs that you had related to this branch closings and layoff of people? And then I'll ask a second question related to something else?

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

Okay. Mario, thanks for your question. So this 6,900 employees, they are above 55 years of age until -- they must become 55 before the end of this year, and there are people who enjoys or not above age party, people who enjoy some kind of stability, which according to Brazilian legislation happens when you have a health license or whether you are a member of a syndicate or Director of a syndicate or things like this. So they are not divided by functions specifically. So they cover all the spectrum of functions in the Bank. As to the 200 branches we closed, I do not have a figure of the cost involved, but of course, there is some cost involved after the -- there are always an issue when you have to lay off people and we expect to -- the benefits to come along the time. You said you had another question.

Q - Mario Pierry {BIO 1505554 <GO>}

Yes. So, just one follow-up then on this 6,900 people. So it's fair to assume then these are people they have an above average salary at the Bank. It's just that we're trying to understand here what could be the potential benefit of this plan, so if you look at the average salary, but like it seems to me that this will be people earning well above the average salary?

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

Yes, I think this is a reasonable assumption, Mario.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. And then second question is related to your net interest margins, right, you show on Page 5, the ability of the Bank to maintain net interest margins relatively stable over the last few years even though the Selic has contracted quite a bit. Can you discuss -- I understand why the big chunk of this is related to improved mix, but can you discuss a little bit the type of pressure that you see on credit spreads especially new specific segments, if you're already seeing rent spreads coming down, looking at Central Bank's data, we see mortgage rates are down pretty much every interest that you are charging on your loans have been coming down. So, the question then becomes about your ability to maintain your financial margins of clients stable for the foreseeable future?

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

Well, you know, Mario, the Central Bank calculate the wages, an item -- an index called ICC in (inaudible), which is a compound weighted average of all the financings in the Bank. During the past year, our ICC dropped 0.1%. It would have dropped, but the mix made it increase 0.6%. So spreads alone had a negative impact of 0.7%. And I see this as a continuous trend especially with the improvement in the economy that we expect from the pension reform and so on. I think that competition will increase and that there will be pressure on spreads. This may still be somehow offset by a richer mix in terms of -- in terms of portfolio, but there is a limit to what you -- to where you can grow in terms of mix. So, I think that the general trend is for more pressure on stocks.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay, that's very clear, Candido. Thank you very much.

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

Thank you, Mario.

Operator

The next question comes from Andrew Brodsky, Goldman Sachs.

Q - Tito Labarta {BIO 20837559 <GO>}

Hi, is that for Tito?

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

Hello?

Q - Tito Labarta {BIO 20837559 <GO>}

Hi, not sure if that was for Tito Labarta at Goldman or is this somebody else from Goldman on the line.

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

Andrew Brodsky, yes, I hear you.

Q - Tito Labarta {BIO 20837559 <GO>}

Sorry, I'm not sure where you got Andrew, but this is Tito Labarta from Goldman Sachs. Sorry for that, but good morning...

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

Hi Tito, how are you?

Q - Tito Labarta {BIO 20837559 <GO>}

Good, thanks, thanks for the call. A couple of questions also. I guess, first, just a little bit color on REDE, we saw the volumes only grew about 0.9% in the quarter despite the price reductions and the free prepayment and receivables. So just curious why -- it looks like you're still losing market share in REDE despite the price reductions? And then I have a follow-up question on expenses after that?

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

Okay. Tito, thank you for a very good question. If you pay attention, I mean, our T+2 offer targeted the market with net revenues up to BRL30 million a year. We think that this is the richer segment of the market. There is more profit to be made. But this is not the segment that make the most of the market share. Most of the market share is made by the large corporations well above BRL30 million a year. And in this segment we have been losing market share for quite some time already. And so this is why despite our offer and despite our improvement in the segment up to BRL30 million in the overall figure, we grow very little in our what -- total volume.

Q - Tito Labarta {BIO 20837559 <GO>}

Okay, that's helpful. So, do you think you'll continue to lose share overall given these trends that you're seeing?

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

Well, it depends on the willingness of our competitors to go below cost on the larger corporations' segments because that's something we are not doing.

Q - Tito Labarta {BIO 20837559 <GO>}

Okay, got it, makes sense. Great. And then a follow-up question on expenses, I know you've given some color there. But maybe just thinking a bit longer term, do you think the expense growth can remain around the 3% to 5% guidance that you're giving for this year particularly with some of the initiatives that you're announcing. So is it around inflation, is that a good level of cost growth for the next few years? And are these sort of initiatives, is it because of the pressure you're seeing on spreads and competition that sort of forcing you to reduce costs or is it something else?

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

Well, Tito, I -- as I said, I mean, I see the non-interest expenses in the bottom of the range this year and we will certainly keep a strong hand on that in the time coming ahead. I don't see this as a result of pressure. I see this as an opportunity. I mean, you know, I mean, we -- as you remember, we started the year with a much higher guidance 5% to 8%. Then when we saw that the economy would have a weaker performance, we decided to make the big corporate effort around efficiency and costs. And we are happy with what we are discovering with the opportunities we are seeing and we certainly think they do not finish this year, I mean, that will -- we will -- I mean, that this will be a trend.

Q - Tito Labarta {BIO 20837559 <GO>}

Okay, great, thank you, Candido.

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

Thank you, Tito.

Operator

The next question comes from Eduardo Nishio, Banco Plural.

Q - Eduardo Nishio {BIO 15333200 <GO>}

Thank you for the opportunity. Good morning, Candido. Two questions as well. First on the guidance, if you can go back again. I think there is two items that are either missed or you didn't talk about, cost of credit, if you can give us your views on that and also effective taxes? I appreciate it, then I have my second question. Thank you.

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

Okay, thank you, Nishio. Cost of credit will be in the middle of the range as it's going very well along the lines we had forecasted. Effective tax rate will also be in the middle of the range this year.

Q - Eduardo Nishio {BIO 15333200 <GO>}

So for cash -- cost of credit BRL4 billion posted this quarter a little bit more than that and then last quarter was BRL3.8 billion, so more or less the same level, no changes probably to reach to BRL16 billion, right? Then my second question is concerning your digitalization, your digital transformation, if I will, you've been reducing staff this quarter was about quite a lot, it's 1,200 people, reducing branches and we crosscheck here across all regions. What would be the ideal size and what are your ideal Bank size in this digital transformation, and by when do you expect it to reach, and by the way you've been hiring IT folks as well. So what will be the mix of people and if you can give us some color on the future of your digital transformation? I appreciate it. Thank you.

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

Okay, thanks, Nishio. Here we have two conflict -- conflicting forces. So in one hand, we expect the growth in the economy, I mean, coming after the pension reform approval to put some pressure in growth in terms of absolute growth and this also implies people. On the other hand, digital transformation has been enabling us to reduce people in a faster pace. So when you combine

those movements, I would think that the reduction will still more than compensate the economic growth factor, but not quite sure about it. In terms of digital transformation, I mean, we are increasing, I mean, the opening of the accounts totally digitally. We now are using facial recognition in many aspects, including vehicle financing. So there are many progresses being made and that will be made in the future.

In the closing of branches, it's not only the digital, I mean, it's all, of course, it's an effect of digital transformation, but the digital transformation is driving less people to our branches. But we are not closing branches, which are isolated geographically. We are only closing branches so far that are very close to one another. So when two branches are very close less than 500 meters distance, and one of them is capable of absorbing the population of both the branches, these are the cases when we are closing. We still have some room for that in our portfolio.

Q - Eduardo Nishio {BIO 15333200 <GO>}

Got it. Thank you.

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

You're welcome.

Operator

The next question comes from Domingos Falavina, JPMorgan.

Q - Domingos Falavina {BIO 16313407 <GO>}

Good morning, Candido and everyone, thanks also for taking the question. Candido, my question is a bit more structural. When we look at the fee composition this quarter, it looks very good to us like the evolution-based investment banking and broker growing 40% plus and above all, it seem to us that the Bank is not really pushing hard current account fees, which in our view here at least, it seems like a smart decision given the competitive threats. So, my question is, when we look at this fees, is this kind of reading correct, so basically do you also share this view that current account fees are unlikely going to grow substantially and it makes sense to hold back on some of these adjustments or not, is that something we are reading in a wrong way, and then I'll ask the second question?

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

No, we take these decisions on a decentralized manner, Domingos. But I think our reading is right, I mean, we are preferring to grow in the areas where we can grow volumes more significantly, as in investment banking and asset management, and we are not pressing on the fee level. I mean, we are more -- we are very more, I mean, growing volumes than the level of fees, which we tend to keep, I mean, a slow growth as we can.

Q - Domingos Falavina {BIO 16313407 <GO>}

Understood. Second question is on REDE and I'm sorry if I missed any specific comment there. But, I mean, volumes came in -- at first it seems some additional deceleration, but when we look at the industry in general, I mean, GetNet decelerated massively to 6%, Cielo grew 9%. So versus the big players, Itau still did well, but it kind of left us with the question here like what's happening to volumes like, are we are not seeing one big player, I'm not sure the Suape [ph] or someone else growing and taking away volumes. Did you guys notice an overall industry deceleration maybe in credit and debit volumes, and what kind of effect did your 3+2 have in NII and fees like if you could comment a little bit like given the quarter has passed?

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

So in relation to the T+2, the effects of those, I mean, I have described to you, saw a 73% increase in new accounts more than double the increase in companies choosing us to be the Bank, where they receive the conditions and so on. I'm not sure I understood your doubt about the total volume, difference has been what I explained in the last question. I mean, so it's really linked to the large corporations, I mean, this is where we are losing market share. There are -- we will see revenue. There are some competitors, which are very aggressive in this segment, I mean, looking specifically for market share, but at prices which, I mean, in our experience give a negative margin. So this is why we are not going there. And I mean, not too worried about it either.

Q - Domingos Falavina {BIO 16313407 <GO>}

You know my question was more like, do you believe you're losing share, because when we look at GetNet, they grew 6%, when we look at Cielo grew 9%, so you grew more than those two. So, my question was more like, do you believe you're losing share or do you believe the industry in general is growing below 14%?

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

I'm not sure about the answer here, sorry, Domingos, I'll have to go back and refer to answer you this. Thank you.

Operator

The next question comes from Olavo Arthuzo, Santander.

Q - Olavo Arthuzo {BIO 19964942 <GO>}

Hi, everybody, Candido, good morning and thank you for taking my question. Actually I wanted to shift a little bit -- shift to other topic that has been calling the attention of the market. I would like to understand the Bank's digital strategy. So in other words, I just wanted to have a clear view on Itau's approach as a digital bank, because Bradesco has their own feature called Next, that has few service free of charges and all the -- then the client must pay a fee, and Banco do Brasil has another digital solution that is free of charges for some services, but different from Bradesco it is within the Bank and we know it has to counter fast [ph]. So my two questions are, first, what is exactly the Itau perception on these approaches from your main competitors in light of a lot of other initiatives and digital banks that targets Itau customer base? And the second question is in few words, what is the main focus of Itau digital strategy? Thank you, Candido.

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

Thank you, Olavo, very good question. So as to your first question, I think I can come back to something I have been saying for some time, which is, there is a basic decision to be made in terms of digital strategy, which is do you separate a new bank from an old bank and we will concentrate your digital efforts in a new venture or do you work, I mean, to transform the existing bank, the legacy systems and so on and to modernize the incumbents then so to say.

And here our strategy is clear in the second one. So we are working hard in order to digitalize Itau as a whole and not a new bank. We have new initiatives like Ichi [ph] for instance, which is quite a new product, it's a platform, but it's integrated into Itau. We have as you know Cubo, which is a hub of co-working and joining companies, I mean, which is the largest in Latin America and we learn a lot from them there. We have -- we are leaders in digital wallets in Brazil. Apple Pay, Samsung Pay and all the others. We have now just launched the Neft [ph] for people to buy foreign exchange in the app. We are opening more than 200,000 accounts a quarter exclusively by us. So we are digitizing the Bank as a whole and not in some separate initiative. Our digital strategy here, I mentioned this in an interview recently is, I like that phrase that incumbents must find innovation before innovators find distribution. And I thought as an incumbent used to see this as an incumbent that finding innovation was basically, I mean, being fast in replicating the initiatives of FinTechs and so on. I have changed my view in this point. I think it's not simply replicating what they do, but it's learning to do it differently. It's producing technology in an integrated way between the technology

area and the business area, which by the way I think that in a few years from now, we will not be talking anymore about technology and business area, this will be one and only thing. And I mean, this is the path we are creating and I think we are making consistent progress there.

Q - Olavo Arthuzo {BIO 19964942 <GO>}

Okay, that's very interesting. Thank you, Candido.

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

Thank you, Olavo.

Operator

(Operator Instructions) Our next question comes from Marcelo Telles, Credit Suisse.

Q - Marcelo Telles {BIO 3560829 <GO>}

Hi, good morning, Candido. Thanks for your time. I have two questions. My first one is a follow-up on your comment about credit spreads. I think you mentioned earlier right that you expect some pressure in credit spreads down the road. And my question to you is in which segments you think that this should happen, because when you look at the credit spreads evolution at least as per the Brazilian Central Bank data, we actually see spreads very fairly resilient particularly on the retail side. So, if you could elaborate what would be the timing, which segments, what would be driving that, maybe that is more the FinTechs or the competition would come from among the big banks, just to understand what would cause that spread compression to take place?

And my other question is with regarding costs, I think it's very good to see the banks so much focus on reducing costs through the severance program. And my question to you is, going forward, I mean, if you think like 2020 and on, does the Bank have some sort of goal of not growing operating expenses at all and try to become more competitive, you know, allow for some fee decline or use OpEx as an operating leverage to leverage earnings growth down the road, because with this program, it could be that maybe your OpEx next year could be -- could not grow at or even decline. Is that a reasonable assumption you think in the -- consider the efforts that you've been undertaking? Thank you.

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

Thank you, Marcelo. First on the spreads, I'm expecting the competition to come more from traditional competitors and maybe from -- as is usually the case, I mean, when the economy starts to perform well, you have more appetite also from foreign banks in the local markets. I mean, the corporate sector faces quite a significant pressure in this situation. So, I'm not seeing the pressure on spreads coming in any specific segment.

I'm just thinking that with a better economic environment, there will be more people willing to take credit risk and this will possibly, I mean, generate some extra pressure on spreads. As, I mean, spreads have been already under pressure for quite some time, not too much pressure, but some pressure and I think this may increase. And what relates to costs, I mean, we certainly intend to keep a very strong focus on that. I think that cost reduction is fundamental to -- in order to enable the Bank to be more competitive in pricing. And I think we will need to be more competitive in pricing, everybody will need to be more competitive in pricing going forward. Therefore, I mean, a strong activity in costs is fundamental there.

Q - Marcelo Telles {BIO 3560829 <GO>}

And Candido just one follow-up on your answer. The -- being very competitive on costs and being able to have better pricing, does that mean that you think you could sustain your current ROE

levels where they are today, do you think they are sustainable, let's say, in the short to medium term at least with all these efforts you are undertaking?

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

As you know we guide very much our efforts in the Bank on the value creation. And so, I mean, I look at the ROE always in relation to the average cost of capital. I see a clear trend of decline in the cost of capital in Brazil. So, I think that there may be some pressure also on ROE.

Q - Marcelo Telles {BIO 3560829 <GO>}

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

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

Thank you very much, Marcelo.

Operator

Our next question comes from Neha Agarwala, HSBC.

Q - Neha Agarwala {BIO 17722501 <GO>}

Hi, thank you, Candido for taking my question. I wanted to understand that for your REDE business, the acquiring business, you made recent cuts in prices, but apart from competing in pricing, any other changes that you're making, structural changes that you're making in REDE, which would improve its competitiveness given the evolving dynamic of the sector? And my second question is, can we have any update on Iti, is the platform operational, how is the uptake been, how do you see it integrating with the Bank, any update there would be very helpful? Thank you so much.

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

Thank you, Neha. So on the acquiring business, I think you're right, I mean, it's not only ad pricing that we are looking. I mean, we have been investing a lot in improving the quality of our services, I mean, the quality of our machines of our support service to the clients and so on, and we are seeing improvement in the levels of satisfaction, which are not only derived from the pricing activity. As I have mentioned in another question in relation to competitors, I think we have really good examples, we are looking at the competition and, I mean, they are, I mean, it keeps us under pressure to improve more the quality of our services. In relation to Iti, I will tell, I mean, it's too soon to say more about this product, I mean, it's just being opened to some groups of clients -- to smaller groups of clients. I think we will know more next quarter and the quarter after that.

Q - Neha Agarwala {BIO 17722501 <GO>}

Okay. If I can follow up on the acquiring business, have you adopted any other distribution model apart from the Bank channels, especially, for the Micro-Merchant segment. I believe you have been spending a little bit more on the marketing and advertising, but any other specific changes in your model or the way you reach clients that has been made for REDE? Thank you.

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

Yes, we have been focusing also, I mean, more to the segment of non-current accountholders and we are investing a lot in the support for this clients.

Q - Neha Agarwala {BIO 17722501 <GO>}

Okay, thank you so much.

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

You're welcome.

Operator

(Operator Instructions) The next question comes from Luis Fernando Azevedo, Banco Safra.

Q - Luis Fernando Azevedo {BIO 6695858 <GO>}

Hi, Candido, good morning, everybody. My question is a follow-up on the ROE dynamics looking ahead, if you look in the appendix, there is a breakdown of ROE per segment, it's a very good chart, and we can see a big improvement in the ROE of the credit operation. On the other hand, the services has been under pressure. I would like to know Candido, how do you see the ROE per segment moving ahead, and, of course, the idea is do you think that the ROE, the cost of the ROE is already peaked at this 23.6%, and if you could open -- how is the assumption of the cost of capital that you're assuming now? Thank you.

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

Thank you, Luis Fernando. Yes, I think this chart that you refer to the business model, I mean, it shows the convenience, the advantages of having a wide portfolio of products, I mean, services and credit. And over time, we have seen services performing better and now we are seeing credit improving in the past one year and so on. And I make no specific forecast here, I mean, what is for these areas. As even within the groups of insurance and services and you have products which improve during the time and others which face more competition. As to the general -- but I just say that, I mean, I feel comfortable in having such a wide portfolio of products, where one tends to compensate the other.

In terms of the ROE, what I can tell you is that the distance now between ROE and cost of credit is, I think probably the widest in our historical series. So let's see if we can keep this present levels. I'm -- you asked me what's my take on how cost of capital is going to evolve, here I'm a bit appalled, let's say, because we -- I see our cost of capital in 13% [ph] and with a reducing trend, on the other hand, I see the cost of capital used in developed economies remaining around 10%, way above the interest rate in this markets.

I would expect that some moment in time, there would be a convergence, I mean, not really they will go to the same level, but that this wide margin would reduce in the developed economies, that's not what we are seeing so far. And while we don't see a reduction in the cost of credit of 10% in the developed economies, it's difficult to imagine that Brazil will have a cost of capital, which is only 2% above what you have in developed economies, So I see this as a resistance for a drop in the cost of credit in Brazil -- cost of capital in Brazil, sorry.

Q - Luis Fernando Azevedo {BIO 6695858 <GO>}

So you think that you are going to -- you're already stabilizing the cost of capital?

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

Unless we see a drop in cost of capital in developed economies, I think, yes, that we are already around the bottom, around the narrowest margin, reasonable margin between cost of capital in developed economies and in Brazil.

Q - Luis Fernando Azevedo {BIO 6695858 <GO>}

Okay, great. Thank you, Candido.

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

Thank you, Luis Fernando.

Operator

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

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

You know, I mean, just to thank you all for the very good questions and for the interest in our results. Thank you. Have a good day.

Operator

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

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