

Y 2019 Earnings Call

Company Participants

- Alfredo Egydio Setubal, Vice Chairman, Chairman of Executive Board, Chief Executive Officer & Investors Relations Officer

Other Participants

- Adriana de Lozada

Presentation

Operator

Good morning, ladies and gentlemen. Thank you for standing by, and welcome to Itausa's Conference Call to discuss 2019 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. The file will be available at the company's web at www.itausa.com.br/en at the Investor Relations section. This conference call and a slide presentation are being transmitted to the internet as well. You can access the webcast by logging onto the company's website at 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 questions-and-answers.

With us 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; Mrs.Priscila Grecco Toledo, CFO at Itausa; Mr.Bruno Salem Brasil, Investor Relations Manager at Itausa; Mr.Gerald Suarez, Head of Investor Relations at Ita Unibanco; Mr.Guilherme Setubal Souza e Silva, Investor Relations and New Business Manager at Duratex; Mr.Carlos Biehl, Investor Relations Manager at Alpargatas.

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

Alfredo Egydio Setubal {BIO 1528623 <GO>}

Thank you. And thank you for those who are participating in our annual results conference. First of all, I'd like to mention that we changed some of our financial statements. We think is more modern, more transparent, with more information, relevant information for the shareholders. So for those who want to look at that and also give some suggestions for that improvement, that we made in our financial statements, we'll be glad to receive and improve even better for the coming quarters.

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Starting our conference on Page 4. The business environment that we see, we put here what we saw in 2019, one year ago exactly. Most of that was confirmed by the scenario. What we expect for 2020. We expect interest rates to keep it an inflation low. Interest rate can even reduce a little bit more. Let's see how all this coronavirus and inflation in Brazil goes on. But there is some room in our view to a little bit more reduction, not in the short-term, but for the medium-term.

We think consumption, job and income levels will continue to grow because we expect the economy to grow -- growth around 2% for this year is still low compared to the Brazilian potential, but it's better than in the last two or three years, that the growth was around 1%. We expect lower global growth, because of the reduction in the growth of China especially. And now, we have to see what will happens also with this corona crisis in China, how it will affect the China production and so on. Probably, the global economy will suffer some reduction in terms of growth for this year.

We continue to expect the capital allocation from local investors to the stock market, into real estate markets and to some more hedge funds. So this movement, we expect it to continue what will of course affect the capital markets.

We expect that the government, the federal and state governments, to go on the privatization and constructions projects for this year. So this will give some opportunities for investments. What do we see under this 2020 environment, what we see for our companies that we have invested? In the case of the bank, we see the lower portfolio growth. We continue to expect the growth of a portfolio, especially in individuals and middle markets.

Big companies will continue, in our view, to use the capital markets locally and internationally. We see the mutual funds industry equity and hedge funds growing. We see the companies using more the capital markets for issuing debt and equity. So the investment banking will continue to grow in terms of revenues. So we think for the wholesale products for the bank, we will get the benefit, because we are very well positioned in terms of asset management, investment banking, and private banking also.

In the case of consumer goods, we continue to expect the growth, because we see the total income growing because of reduction in unemployment. This probably will benefit the local market for Havaianas here in Brazil. We see civil construction, especially residential and commercial buildings going on. Not only in the Sao Paulo state but going on to other states also in Brazil.

We are already seeing that happening in the case of Deca products, in the case of Duratex. And we expect the new gas legislation that can offer some new opportunities to NTS, that is our company that we have a participation of distribution of natural gas.

Going on to Page 5, we see the results of the allocation of capital that we did in the last 2.5 years. NTS, that we make the equity investments of BRL926 million. We made the calculation for this financial statement of the fourth quarter. And the fair value of the equity is BRL1.2 billion. So we have a gain in that investment.

And also, we received in this period, almost BRL600 million and earnings, and dividends and the interest over capital. So these investments have been very good and very accretive for Itausa.

In the case of Alpargatas, we bought that by the end of last quarter of 2017. And using the metric of the share value in the stock market, the Alpargatas shares are almost double the total return of the Ibovespa index. So also a very good investment for Itausa.

By the end of the year, we announced a new investment, an investment in Copagaz. Copagaz is one of the players of GNP distribution here in Brazil. We were the winners, our consortium, Copagaz, Itausa, and National Gas were the winners of the privatization of this company from Petrobras in November of last year. We are now waiting for the Antitrust Authorities. They are already analyzing this deal.

Itausa will invest BRL1.4 billion in the capital of Copagaz, that will use that money to buy to pay Petrobras for the stake that Copagaz will remain in the Liquigas. And also, Itausa will increase the corporate governance of Copagaz. That is a family-owned company, and we have to improve a lot to put in the better standards of all the companies that Itausa has in their investments.

Going to Page 8. Some highlights of the companies that compound our portfolio. First one is the bank. We saw the loan portfolio growing 10.8% with a very good performance, especially in middle markets, where our portfolio grew by 25. And also in the segment of individuals, where we grew 13%.

Commissions from investment banking and fees in general insurance operations were up 7%. Investment bank, the wholesale bank in general, it was the main sector that this growth appeared, especially related to asset management, private banking and investment banking fees for debt and equity issues.

We improved our efficiency ratio by 2.5 points. We had kept by the end of the year 45.5%. And we will continue to improve this efficiency ratio in the coming years. That is very important to face the new competition, the new environment of competition here in Brazil.

We continue to invest a lot in the digital transformation of the company, with high investments in products and systems and apps and so on. And also in the evolution of the

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customer experience to -- and we improved our NPS by 900 basis points in the last 16 months, showing that the customers are reacting to our new position in terms of products and experience provided to that. With all that, the net income increased 5% last year, and the ROE, recurrent ROE almost 21%.

Going to Page 9. Talking a little bit about Alpargatas. I think Alpargatas grew almost 10% the revenues, mainly driven by the volume of Havaianas in Brazil, and also internationally. We continue to move the company on. We changed the management last year, Roberto Funari was elected as the new CEO, and started at 1st January of 2019, and he is doing a quite good job improving the company, and changing the management, the strategy, the people, culture, and we are getting the benefit from that.

We are also doing a lot of investments in the digital. Alpargatas is very behind in our view, in terms of e-commerce and the user experience. So, we are investing a lot since last year and in the coming years, to really reduce the gap that we have here, especially in e-commerce, not only in Brazil, but also internationally, in the markets that we want to be like China, Indonesia, India. We think the e-commerce will be the main channel to improve sales in these countries.

We continue to keep our eyes in the capital management. We sold all the textile operation of Alpargatas in Argentina, and also sold all the assets related to the Topper i.e., shoes, sportive shoes, in Argentina also. We are going on in the strategy that focuses the company especially in Havaianas brand, not only in flip-flops, but also in accessories and clothes and things like that.

With all that, the net income increased almost 30% last year. And recurring ROE 30.5%, and the EBITDA also increased by 18%, reaching BRL620 million. So the company is showing a good trend in terms of results and cash generation.

On Page 10, we have the highlights for Duratex. Duratex's EBITDA went up 7%. We saw very good improvement in terms of efficiency operations, and also the acquisition of Cecrisa, and the Deca division of performance, especially in the last quarter of 2019. And we expect Deca also to have a good year in 2020. We reduced a lot our financial leverage because of the strong cash generation recurrent and through the sales of farms and forests that we did last year.

We acquired Cecrisa that is a Portinari brand. With that and Ceusa, we are very well positioned in the high-end ceramic tiles markets. There is where we want to be, we don't want to go down the channel to lower value products. So with these two acquisitions in the last two years, we think we are very well positioned.

We finished the investment in the second line of Ceusa, and we use the second line as the most digital line of ceramics in Brazil, to also produce Portinari products, so this line will be probably full this year, next year, with full capacity -- in terms of capacity for the high income products that we want to sell. We finished the total approval of the new JV, with Lenzing, related to the cellulose to the pulp investments that we are making. The total

investments projected is in BRL5.2 billion, and we already started the construction of this factory in the state of Minas Gerais.

And also, we continue to rationalize our investments in terms of farms and forests. And we sold the excess that we have in the state of Sao Paulo, because we are not planning any panel investments in the future. So we decided to sell and use this money to generate cash for acquisitions of Cocrisa, pay dividends, and rationalize our assets.

There Duratex increased still with low results, we expect every coming years to improve more. We still have our recurrent ROE much lower than we expected, but we are very confident with all these measures that we have taken on new business. This ROE will increase in the coming years. We finished with 5.8% last year. And the recurrent EBITDA increased by 7%, achieving BRL900 million.

On Page 11. NTS, the gas distribution, revenues increased 9%. The company continues to over perform the projections that we did when we made these investments. Revenues increased by almost 15% last year. And we received BRL211 million in terms of dividends and interest on capital, an increase of 9% over 2018.

Going to Page 13. We see some numbers that we released. Net income increased by 9.3%, achieving BRL10.3 billion recurrent net income of 9.7 billion, with an increase of 3.6%, ROE of 19.4%. Total assets BRL58 billion on the holding and; stockholders' equity BRL55 billion and a market value of BRL118 billion. The payout for this year, the dividend yield was 8.5%.

On Page 14, we can see all the dividends interest on capital that we paid. We continue distributing all the dividends that we receive from the bank and use non-financial sector, dividends interest on capital to pay the accounts that we have as a holding company, especially taxes. You know that we have not the best structure in terms of fiscal.

As a holding, we pay more taxes on the interest on capital. So we use the dividends from Duratex, NTS and Alpargatas, to serve the expenses that we have. At the holding level that is around BRL 400 million per year. In the last two years, we are able to do that. We expect this year also to pay all the expenses and taxes using the non-financial sector dividends. So probably this year, we are going to continue to distribute the whole dividends that we received from the bank. And we don't see any necessity for capital increase for this year of 2020, because we have a cash position of more than BRL1 billion.

On page 15, we see the market value of Itausa portfolio. That the total is BRL145.7 billion, and the market value of Itausa BRL118 billion, that means that the holding has as a discount in the market of almost 19% by the end of the year. Our daily traded volume in the Bovespa and B3 has increased 24% and achieved BRL282 million per day; that is a good liquidity for the share. And we end 2019 with 364 individuals are in the base of shareholders of the company.

And the last slide on Page 16. It's the return of the company in the last 10 years, 5 years and 12 months, compared to the interbank to the Bovespa index and the US dollars. And in long-term, we have been showing a good performance for the shareholders.

That's our presentation, and now we are open for questions, that you probably have for the management and for all the people that are here at this conference today.

Questions And Answers

Operator

(Question And Answer)

Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. (Operator Instructions) Our first question comes from Adriana de Lozada, Scotiabank.

Q - Adriana de Lozada {BIO 19985282 <GO>}

Hi everybody, and congratulations on your results. I would like to ask you if you can give us an update on your M&A outlook. I know you said in a previous call that you have several NDAs signed and a big pipeline of offers. So if you can give us some details about the industries that you're looking into, that would be great. And then a second question would be on your outlook of dividend payout if you can give us a range in what you see there as well? Thank you.

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

Thank you, Adriana. The M&A outlook we've just announced this investment on Copagaz. We are expecting the Antitrust Authorities during this first semester to approve that investment. So we will start to work with Copagaz in this new investment. And we are very confident that it will be very accretive also, like NTS and Alpargatas that we did in the other years.

In terms of new investments, we continue to analyze what are being offered to us by the investment banks, private equity companies and so on. We have many NDAs signed, but we at this moment, we don't have anything really advanced in terms of studies and for new investments.

And we want to see the changes in the natural gas law in the regulation. The regulation of the -- I don't remember the wording. No, there is -- laws that will change. We want to follow the concessions and privatizations. So we are very cautious because we have limited capital to use in these investments in the coming year. So we have to be very -- we have to analyze very well and deeply the opportunities that we have to see makes sense or not to make new investments. For the moment, we have nothing real concrete in the pipeline for the coming quarters.

In terms of payout, the payout of this year reduced, because the bank reduced the payout in the bank, because the bank will need more capital this year according to our guidance in terms of credit growth. So the bank distributed less than last year in terms of payout. And by consequence, Itausa also distributed less than the previous year. It's difficult to say how much capital the bank will generate in need for this year, need for 2021.

So -- but anyway, we will continue to the practice of distributing the whole dividends and interest on capital that we receive from the bank to the shareholders. So -- but today it's very difficult to say what will be the payout of the bank. Because it'll depend a lot on the needs for growth of the bank in the coming years, especially in the next year.

Q - Adriana de Lozada {BIO 19985282 <GO>}

Got it. Thank you very much.

Operator

This concludes today's question-and-answer session. Mr. Alfredo, at this time, you may proceed for closing statements.

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

Thank you for those who participated with us. I think we released a good result for the year. All the companies are I think -- we think have performed very well. The bank of course had their challenges, but I think we are facing them and improving efficiency and improving digital products, competing with the feedbacks and so on. And Duratex, Alpargates also improving results, improving revenue. So we think results are very good and all the investments that we made have been very accretive. And as I said, we expect taht Copagaz also to be very accretive for our shareholders.

Thank you for your time, and we'll be back in the middle of the year with the results of the second quarter. Thank you.

Operator

That does conclude our Itasa's 2019 results conference call for today. Thank you very much for your participation. You may now disconnect your line.

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