Q3 2017 Earnings Call

Company Participants

- Candido Botelho Bracher, Executive President and Chief Executive Officer

Other Participants

- Carlos G Macedo, Analyst
- Domingos Falavina, Analyst
- Eduardo Rosman, Analyst
- Jason Mollin, Analyst
- Mario Pierry, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentlemen. Welcome to Itaú Unibanco Holding Conference Call to discuss 2017 Third 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.

As a reminder, this conference is being recorded and broadcasted live on the Investor Relations website at www.itau.com.br/investor-relations. The audio webcast works with Internet Explorer 9 or above and Chrome, Firefox and mobile devices, iOS 8 or above and Android 3.0 or above. A slide presentation is also available on this site. The replay of this conference call will be available until November 6 by phone on 5511-3193-1012 or 2820-4012, access code 1636828#.

Before proceeding, let me mention that forward-looking statements are being made under the Safe Harbor of the Securities Litigation Reform Act of 1996. Actual performance could differ materially from that anticipated in any forward-looking comments as a result of macroeconomic conditions, market risks and other factors.

With us today in this conference call in São Paulo are Mr. Candido Bracher, Executive President and CEO, Chief Executive Officer; Mr. Caio Ibrahim David, Executive Vice President, CFO, Chief Financial Officer, and CRO, Chief Risk Officer; Mr. Alexsandro Broedel Lopes, Group Finance Director and Investor Relations Officer; and Mr. Marcelo Kopel, Executive Director.

First, Mr. Candido Bracher will comment on 2017 third 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. It's a pleasure to be here again to talk to you about our third quarter results. I will start on page 3 of the presentation. In previous quarter, we have started to present our six main structural challenges, which are focus on clients, digital transformation, people management, risk management, internationalization and profitability.

In the last quarters, we spoke about risk management and digital transformation. In this quarter, we will focus on profitability. So turning to page 4 now. Here, we present some important information about our profitability and we compare it to 2012 when we decided to implement a strategy that focused on, first, lower risk appetite, which resulted in a significant change in our credit mix over this period, especially for individuals on small and medium company.

Second, focus on less volatile sources of revenues, such as insurances and services. And third, a continuous search for opportunities of efficiency improvement. Implementation of this strategy was key for our performance and enabled growth and the value creation (03:58) cost of capital to our shareholders even in an adverse scenario for credit operations as we had during this period.

Let me compare our year-to-date performance this year to what we deliver in the same period of 2012. We see that our recurring net income expanded 76% due to 230 basis point expansion of our ROE and culminated in a 163% increase in the value created to our shareholders. Last but not least, the total dividends and interest on capital paid, provisioned or reserved in the stockholders' equity increased 484% and reached BRL 11.4 billion. We will talk about this subject later in this presentation.

So now, before I move to the next slide and start talking about our financial results, I'd like to make a few general comments. In this quarter, we observed the relatively calm mood in the market following the political turmoil of the second quarter of the year. We now see more positive signs in the economy. The base interest rate still is continuing at the downward trend. There's a positive shift in the unemployment rate, which started to go down, and we also see lower inflation and consumer deleverage, which create a positive scenario for credit demand.

Now on slide 5, we highlight the key performance figures from our third quarter results. The bank posted BRL 6.3 billion of recurring net income in the quarter and BRL 18.6 billion in the nine months of 2017. This latter representing a 13.9% increase when compared to the same period in 2016. The recurring ROE in the nine months of 2017 was 21.7%, which represents 170 basis points increase when compared to the same period in 2016.

Focusing on these first nine months figures compared to the same period of last year, it is important to mention we had a 3.2% decrease in our financial margin with clients, but this was more than compensated by, first, a 28.1% reduction in the cost of credit, a 4.1% increase in commissions fees and result from insurance and a 0.9% nominal decrease in non-interest expense. We will comment on the operational trends of our results in the following slides.

So now on slide 6, we present the same figures, the form of an income statement in which we look now to the right side, the left column. We can notice a small contraction on operating revenues. This 1.3% reduction was mainly due to the impact from the reduction of the Selic rate over our liabilities margin and remuneration of our capital and also due to lower credit volumes, which have affected our financial margin with clients.

These effects, as we said, were more than compensated by a substantial decline in cost of credit and increase in commissions and fees and a strict cost control. The combination of all these results led to a recurring net income increase of 13.9% when compared to the same period of the previous year.

On slide 7, we break down this profit and loss between Brazil and other Latin American operations. On the other Latin American operations, we have two different dynamics, which are important to differentiate. First, we have the more traditional markets where we fully own the operations, Argentina, Uruguay and Paraguay. And here, we continue to see a good performance at least.

Now, on the recently merged Chilean and Colombian operation, which was merged one and a half year ago, we see a more difficult than expected macroeconomic scenario and the natural challenges of a merger this size. These are impacting the profitability of the group. Nevertheless, I'd like to highlight that we've seen operational improvements. We have good evolution on the integration of our clients, of our branches, systems and themes.

Now on slide 8, we present a chart that reflects our business model in which we break down the consolidated income statement between income in operations, that the credit risk, including related fees, income from trading operations that bear market risk, income from insurance and service operations and excess capital.

What I like to stress in this slide is that in this nine months, besides the central focus in insurance and services, is the fact that our credit operations already reached profitability in line with cost effect. We believe that this should be a sustainable trend for the coming periods, which is quite different from the past few years. So you see there on the bottom, we have a recurring ROE of 14.1%, which is a bit above our present cost of capital, which is 14%.

Moving to slide 9 now. You can see that the total consolidated credit portfolio continues to show some contraction. Nevertheless, we note now with satisfaction that individuals portfolio on the first line (10:20). In the Wholesale segment, the company still show a moderate credit demand and are searching for alternatives in the debt and equity capital markets, which results in the contraction of this portfolio. I'd also like to comment that, in this quarter, we sold to the market some BRL 800 million of assets which resulted in a positive impact in our net income of approximately BRL 60 million.

On slide 10 now, we see that despite the reduction in the Selic rate and its impacts on the liabilities margins and our working capital, the risk-adjusted net interest margin, the blue line, increased 10 basis points this quarter, reaching 7.4%, mainly due to lower cost of credit.

Slide 11, we present the evolution of our margin with the market. The financial margin with the market was mainly impacted by the reduction of the Selic rate as anticipated. Looking ahead, we expect this margin level to be around BRL 6 billion for this year as forecasted.

Moving to slide 12, we see a stabilization in our delinquency ratios, both in the NPL 90 days and the NPL 15 days to 90 days. Regarding the 90 days NPL in Brazil, we see that it continues to improve in all portfolios. In the 15 days to 90 days NPL in Brazil, we can highlight the individuals portfolio performance that reduced 20 basis points this quarter.

On the other hand, the observed increase in the 15 days to 90 days figures in Latin America is caused by collection, operational issues in the individuals portfolio in Chile and Colombia and it's not related to the gross 90 days numbers in Latin America, which is associated mainly to the SME (12:26) portfolio.

On slide 13, we present the evolution of our NPL creation. There was stability in the overall level of the NPL creation in the quarter, with a slight reduction of BRL 45 million when compared to the previous quarter. This is the lowest level since March 2014. Operations in Brazil were the main driver of this reduction.

Slide 14, we present the evolution of provision for loan losses and cost of credit. In this quarter, we saw a significant decrease in the provision for loan losses in Brazil in line with the delinquency downward trend. As a result, the relation between provisions and our average loan portfolio reached 3.6%, which is the lowest level since the first quarter of 2009. Cost of credit also reduced despite an increase of BRL 157 million in impairment charges and corporate securities, reduced to 2.7% as we see in the lower chart.

Moving now to slide 15, we present our total allowance by type of risk. The bank's overall level of allowance decreased in the quarter from BRL 37.4 billion to BRL 36.6 billion. This reduction was in line with improvement in our credit quality performance, both in Wholesale and Retail portfolios in Brazil.

On Page – on Slide 16, we come to our coverage ratio. Here, it's going to – we see that our coverage ratio has reached now 246%, which we consider to be high. Here, I'm frequently asked about what is the trend of this coverage ratio. I was asked this question when the coverage ratio has reached to 231% at the end of the first quarter, and I said that my expectation was that this rate would drop, only to see it increase to 243% and 246% now. So, my answer now would be, I still expect this coverage ratio could drop. I think that no doubt the medium-term trend here is for this to drop. This is a very high level of coverage ratio.

But what causes this rate to drop is one of two things. Either the companies to which we have made precautionary provisions actually default and these provisions are moved to the normal provisions, though the NPL rate increases and the coverage ratio decreases with no impact in our result, these companies improve and we are able to revert the provisions. In this case also the coverage ratio decreases, which are positively impacting our results. But in the short-term, it may happen that none of these things happen. Neither the companies default (16:05) to a point where it can reverse the provisions. And if we couple this with a decrease in the 90-day NPL, we have an increase in the coverage ratio. This is what's been happening in these past two quarters. It may still happen in the short-term, but the medium-term trends, no doubt as far as a reduction in coverage ratio.

If we move to page 17 now – slide 17, commissions and fees. We see that they have increased 5.5% when compared to the first nine months of 2016. We can highlight the good performance of asset management fees in line with the solid growth of our assets and the management in the period. The decline in the result from insurance is partially explained by the three of our group life insurance, the Prudential, that became effective in April this year.

Now in page 18, we show the evolution of our non-interest expenses. Comparing the first nine months of 2017 to the same period in 2016, non-interest expenses decreased 0.9%. If we exclude the impact of some extraordinary events in 2016, non-interest expenses would have grown 1.9%, which is still below the cumulative inflation of the period.

Now, the page 19. I will comment now on our capital ratios. As of September 30, our common equity Tier I considering the full application of Basel III rules reached 14.6%, already including the impacts of the Citibank Retail Business acquisition and the acquisition of a minority interest in XP Investimentos (18:06). Since our stated earnings (18:10) is to have a 13.1% Tier I ratio – sorry 13.5% Tier I ratio, we have reserved 1.1% of our capital, which may be used to increase dividends or even to make share repurchases going forward.

This is better explained now in page 20. From September 2017, we have announced changes in our capital management practices aligned to our value creation strategy. First, we have excluded the maximum payout limit that used to be 45% and we maintained the practice of paying dividends and interest on capital of at least 35% of net income.

Second, we set forth that the total amount to be distributed each year, we'll consider, (19:09), first, the actual level of capitalization of the bank. Second, the minimum level of Tier 1 capital at 13.5% which must be composed of at least 12 % of core capital, 1.5% maybe in the future additional Tier I capital. Third, element to be considered, the profitability of the year. Fourth, the expectations of capital use, based on expected business growth, share buyback programs, potential mergers and acquisitions, and regulatory changes that may change capital requirement. And five, changes in the tax legislation.

So, the percentage to be distributed as payout may change every year based on the profitability and on capital demand. The table on slide 20 shows – I mean looking – a forward-looking estimative – estimation of what the payout ratios may be depending on ROE and risk-weighted assets growth.

So it is important to highlight that we do not intend to have capital surplus in excess of the level established without the prospect of using and that any possible surplus will be returned to our stockholders.

Moving to slide 21 now, talking about our forecast. We reiterate all ranges for the year. Having said that, as mentioned last quarter, we believe that we will deliver a credit portfolio growth, which will be around the bottom of the forecast range. For financial margin with clients, we expected (21:09) year also around the bottom of the range. For cost of credits, as mentioned last quarter, we expect to end the quarter close to the top of the range.

Commission and fees and result from insurance operations, we estimate now that we will run the year next to the top of the range. And to finalize, for non-interest expenses, we believe we will run the year around the bottom of the range.

Moving to slide 22 now. Last week, the Brazilian Central Bank authorized the acquisition of Citibank Retail operations in Brazil with the completion of all regulatory approvals, the financial settlement of the acquisitions happening today.

This operation adds around 300,000 clients to our client base and about BRL 9 billion in assets and BRL 6.2 billion in credit portfolio and close to BRL 5 billion in deposits. With this, we reaffirm our commitment to the Brazilian market and value creation for our shareholders. In addition, I'd like to take this opportunity to welcome all new employees and customers who joined Itaú Unibanco.

So, finally, before concluding and going to the questions and answers, I'd like to extend here a special complement to Marcelo Kopel, who has been our Investor Relations Director for many years and has always shown a level of care in this relation of transparency and quality of information that led to our Investor Relations having been repeatedly recognized as one of the best in the market. Thank you, Marcelo. Congratulations. Now, I'm sure know that Alexsandro Broedel who's taking over will be able to (23:12) distribution and take the area to an even higher level recognition.

So with this, I conclude my presentation and we may move to the question-and-answer.

Q&A

Operator

Ladies and gentlemen, we will now begin the question-and-answer session. Our first question comes from Eduardo Rosman, BTG Pactual.

Q - Eduardo Rosman {BIO 16314825 <GO>}

Hi. Good morning. I have two questions. The first one is on your credit deployment rate. We can see in the presentation that the ROE of your credit deployment is finally back to cost of capital levels, right. But as far as I remember, in previous presentations, you mentioned that you expected the divisions post an average returns close to cost of capital while the value creation would come from other more asset life areas, right, such as (24:21) insurance. So I wanted – what I wanted to understand why shouldn't we expect ROE in the credit deployment to be above cost of the equity at least in the coming quarters or in the next couple of years? At the end of the day, you're coming from, let's say, almost from a depression rate, the economy suffered a lot and you look forward (24:40) let's say very low ROE in the divisions for a while. Lending mix could improve your margins. Risk-adjusted margins in the large corporate segments are probably going to be higher, banking concentration increase, government on banks they're sort of (24:54). So I wanted to understand why can't we expect at least for a while higher ROE in this division, right?

And the second question would be on REDI (25:07). If you can talk a little bit about where do you write the acquiring business and the strategy there because when we see the results of (25:16) and Santander out, right, we can see they already underperformed again in terms of market share of both cost volumes and (25:25). So want to understand what's the strategy there. I know that the company just changed the CEO and the profitability remains healthy, but I wanted to understand what is the goal there, if you expect to keep moving market share, if market share – you can recover market share? So, if you can give a little bit color on the strategy there it would be helpful, Thanks a lot.

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

Okay. Thank you, Eduardo, for two very good questions. In the first question, yes, I think you're right. I think we may expect to see the return on equity for credit above the cost of capital for some time at least. Here, it's important to differentiate the Retail portfolio from the Wholesale portfolio of credit.

In the Wholesale portfolio of credit, which is taking longer to grow, but we believe (26:20) and this is coming as the Wholesale portfolio is facing a lot of competition from capital markets in Brazil, which are having a very active year. By the way, if you look in our line of fees and commissions, then see that the fees and commissions from advisory have grown considerably due to this growth in capital market. But anyway, in the Wholesale segment, we know from experience that when it starts to become profitable, capital markets competition from other banks, from foreign banks, keep seeing.

So, I think here it's easy to expect that we will have a much higher return on equity than the cost of capital. But we may have a higher return on equity than cost of capital for some time, especially for the next quarter. We will tell you, portfolio (27:09). Here, I believe we can maintain a higher return on equity than cost of capital for a longer period, but I think you're right here. And I think this may be one of the sources for next year that will compensate for the reduction in the Selic rate.

Your second question on hedge (27:35). Yes, you're right. I mean, we continue to lose market share on hedge and we continue to suffer, I mean, from a market with a new entrant, some quite significant price pressure and competition.

And here, I mean, we are making changes in our strategy as we said. I mean, we have nominated a new CEO to the company. And the new strategy, it essentially consists in clearly separating the two worlds, the worlds of the companies which are account holders with Itaú Unibanco from the companies which are open (28:24), which are in the open market.

So, we are having our different strategies for these group of companies to the companies which are account holders. We are having our offers joined with the offers of the products in the accounts which is already starting to show very good results. And we have higher than we are structuring a whole new status platform to deal with the companies which are not account holders. So, of course, this takes some time to generate its effects, but we are confident that the performance of the (29:03) will improve with these measures.

Q - Eduardo Rosman {BIO 16314825 <GO>}

Okay. Great. Thank you very much for your answers.

Operator

The next question comes from Domingos Falavina, JPMorgan.

Q - Domingos Falavina {BIO 16313407 <GO>}

Thank you, Candido, and thanks for taking the call. I have actually two questions. So the first one, I just want to make sure I'm understanding correctly what the BRL 11.4 billion in dividends. Part of it is only provision and the other part is actually still just under consideration for paying. This BRL 11.4 billion refer to the nine months or is it an expectation for the full year because if it is for the nine months I'm getting to 63% payout on the earnings. I just want to make sure the number makes sense and (29:54) number we can work for the full year. And then I'll make the second question next.

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

Okay, Domingos. Thanks for the question. It's very important that we clarify it. Yes, the BRL 11.4 billion in dividend which have been reserved for dividend refers to the nine months. And you said 63%, I mean, we expect the payout to be around 60% for the year as a whole.

Q - Domingos Falavina {BIO 16313407 <GO>}

Perfect. Super clear. The second question is just a followup on the comments you made regarding the coverage. Super clear when you described the mechanics of the coverage ratio and the fact that they have certain corporates allocated to them and either you have them going delinquent in which case this coverage will decrease or getting better in which case you reverse. And I understand those are very good definitions of two out of the three provisions you have in their ID. It's specific, the generic, but not the additional provision. Just to have about BRL 10.7 billion of addition or complementary provision as you name it, and you could in theory use some of those in previous quarters, so my question is just like even looking at the coverage ratio, is there a point where you've just started lowering these excess additional provisions or you just let this coverage ratio continue to rise?

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

Thanks for the question, Domingos. The mechanics I described, I think they apply especially to the additional profit, so the complementary profit. How is this provision made? First, this provision – in Retail, it's made according to models, okay. But as you see by the coverage ratio in Wholesale, which is over 900%, in Wholesale it is made on a case-by-case basis. So we look at individual company, which are not defaulting, which was creating (32:01) but which have somehow been affected by the (32:08) scandal or (32:12). We look – so we have an expected loss model. And based on this model, we established these complementary provisions.

And then we follow up this company quite closely. And this – it is with this company that now we look at them we see some improvement not enough in most of them, many of them, but not enough to revert the provisions yet. Orders received there are still not out of the woods, and that they may deport anytime in the next quarters or so. So we are following them up closely and expecting that else economy grows that you possibly improve and a part of this provisions we will be able to revert.

Q - Domingos Falavina {BIO 16313407 <GO>}

Okay. (33:07). Thank you very much.

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

You're welcome.

Operator

The next question comes from Jason Mollin, Scotia Bank.

Q - Jason Mollin {BIO 1888181 <GO>}

Thank you, Candido and team. I have two questions. First on loan growth expectations and drivers, can you talk about what it will take for Itaú and perhaps the banking sector in general to recover loan growth in the main loan segments?

And my second question is a followup on slide 8, the profitability that you show broken down into credit, trading, insurance and services, as well as excess capital. We see insurance and services contributing the largest value for the bank. Can you talk about the specifics in that contribution, credit cards, I think an important contributor is probably the deposit franchise, the deposit spread. I think it will be interesting to understand the drivers there. It's hard for us to reconcile those numbers in that table from your financial statements. Thank you very much.

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

Thank you, Jason. So, thanks for your question. On loan growth expectations, I think, here we have essentially two different dynamics for individuals and SMEs, maybe some dynamics in the Wholesale segment in the middle market and large companies and other dynamics. In individuals, as I note, we are already seeing some growth. And here, I think that the reduction in unemployment and the reduction in the level of leverage of the individuals coupled with the reduction in interest rates which we are witnessing, it will be a powerful tool for growth in this portfolio. For the large companies, I think they seek to have more of a confidence level in the future. So, I think that here, next year elections are still a problem in terms of investment decisions, which could lead to a more robust growth here. I think we are starting to see growth. There will be some growth in this portfolio, but I think still modest for the next quarter.

And, of course, we have, as I mentioned, the very intense competition from capital markets here. Capital markets are very active debt and equity capital markets this year in Brazil. And so, many of these large companies are preferring to borrow in capital markets where they get better rates since capital markets normally can have longer maturities and don't need to (36:27) capital to these loans.

Q - Jason Mollin {BIO 1888181 <GO>}

Candido, do you think that in this competition from capital markets that the fees, that the banking sector including Itaú will earn, will – can it fully compensate the shift to capital markets or partially? How do you view that?

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

No, I don't think it compensates, Jason. If you see on page, trying to find it here, have commissions and fees, slide 17, you see advisor services and brokerage, which in the nine months this year accounted for BRL 1 billion. So, this is basically capital markets activity.

So, this is what we've been making there in a good year. As you see, there has been – so, I don't think it compensates, but I think, I mean, especially as the company below the level of large corporate pickup on borrowing, I mean these companies have less access to capital markets and the middle market companies and so on. So, this should provide a growth and even some (37:58).

Now, your question on table eight. In fact, I mean it's not possible to reconcile from our financials, I mean this table 8. I mean, this is why we have devoted so much time and work to making this and seeing our business based on the type of risk we run when me make these points and just to give an example.

In provisions (38:32) in this column of provision and fees, you have also income which is – there's not very specific market or credit risk, for instance the over hedge. It's there. Credit card, a part of it is there, but the risky part of credit card is not there. The part of credit card that we have credit risk is not there. All the cash management is there.

You are right when I mentioned I mean the liabilities management, it's an important part of this. All the asset management fees, private banking fees are there. So, you have really to collect data from many different points in the balance sheet to compose this chart.

Q - Jason Mollin {BIO 1888181 <GO>}

And is there any way to give us maybe just a sense of what are the top three contributors to that? Is it in the order you suggested or that you stated, now that you're suggesting that or is it somewhere out? I mean, how – like what are the largest two or three contributors to that business, that business line?

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

Out of the top of my mind, I couldn't tell you. But Alexsandro will supply this information later, okay?

Q - Jason Mollin {BIO 1888181 <GO>}

Thank you very much.

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

You're welcome.

Operator

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

Q - Mario Pierry {BIO 1505554 <GO>}

Good morning, everybody. Congratulations on the results. Let me ask you two questions as well. First one is related to your cost of risk. You mentioned on your presentation that you're already running at 3.6% of average loans. This is already the lowest level since 2009. However, when we look at your loan mix, it's a lot more less risky than it used to be in the past. So I was trying to get from you an idea of where do you think this cost of risk can fall to in the next couple of years, especially in light of a recovering economy, lower inflation levels, less leverage consumer?

Second question has to do of your excess capital and your international operations. In particular, in Argentina, you show on slide 4 that you want to keep the same level of profitability in your international operations in quality of operations internationally that you have in Brazil. When I look at the your Argentina operations, you're too small in the country. I was wondering if there's already a strategy that you see, that you can get excited about the growth potential in Argentina and you like to get bigger or is this something that you're considering divesting in the future because it was small and you don't have the scale to compete? Thank you.

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

Thank you, Mario, for the questions. In cost of risk, I think it's risky to make any forecast and how low it can get, but it can get lower. Yes, I mean, my expectation is that it will get lower and especially I mean it is impacted by provision reversions in the future, then it can really get significant lower for a short period of time. I mean, we have weakness there when going out of prices in the (42:19). I remember specifically after the prices we had in 2002, for the years of 2004 and 2005 where it's very, very low cost of risk because of provision reverse.

So I think – I mean the trend is for it to go down, but I wouldn't risk saying how low it can reach. But I say that, sustainably, it's not much lower than that. I mean, if you look at the longer period of that.

Now, regarding our excess capital and if we should use it to make acquisitions and (43:03) with Argentina. Here, we have - of course, we are enthusiastic about the Argentina market. We are seeing the improvements, the channel improvements in the situation (43:18) which was optimism.

Having said that, there are two things which make it difficult for us to grow by acquisitions in Argentina. One is the very high valuation of assets in general in this Latin market. And the other one is the tax question. I mean, we, as you know, we have a corporate rate tax of 45% here in Brazil going to 40% from 2019 on. In Argentina, the tax rate, if I'm not wrong, is 30%. So we pay 40% independently if we repatriate the profits or not. So whenever we are bidding for an acquisition in these markets and we have to make our discounted cash flows, we start at a huge disadvantage against other competitors. And I mean, if we were to pay the prices asked, we wouldn't come, we wouldn't reach our cost of equity here. And I mean, so this is again what we've been thinking in terms of cost of the equity that we have been imposing on the bank.

Having said that, we do not intend to sell. Argentina right now, we think - I mean, we have stabilized the operation. I mean the operation is starting to yield some return to the bank and we intend to invest especially with the digital technology, which we are developing in Brazil and elsewhere, and we expect with this to be able to grow our operations there even if we don't make any major acquisition.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. Very clear. Thank you.

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

You're welcome.

Operator

The next question comes from Carlos Macedo, Goldman Sachs.

Q - Carlos G Macedo {BIO 15158925 <GO>}

Good morning, gentlemen. Thanks for taking questions. I have a couple of questions. One is a question on your margins and margins took a big drop this quarter. Of course, a number of factors as you highlight in slide 10. Going a little bit further, I mean your margins adjusted for risk at 7.4% as you show it. I mean, last time they were this high was 7.5% in 2014 - 2015 without CorpBanca and that was also the last time that your cost of risk was as low as it is now.

As you said, you might have a little bit of an improvement cost of risk as you go forward especially if there's some reversal, but your margin excluding risk is likely to come down for many factors not only the Selic as you mentioned, but also the fact that your portfolio has shifted to be much more defensive over the last few years. Where do you think this adjusted margin can go? Is this mid 6% level is something reasonable? Do you think it can stay above 7%? Where do you think it can go going out?

Second question, going back to something you said before, Candido, where most of the provisions, the excess provisions, as you call it, are on the corporate book, the 900% coverage, and that's based on your models and how to rate the companies. Can you give us a - is there any trigger that we can look at that will lead your credit models to change their views and allow you to release these provisions? In other words, is it GDP, the GDP expectations need to be higher? Does the cash flow outlook for the companies need to be better? Is there anything that we can point to so that we can have a little bit of - try to estimate when these reversals will take place? Thanks.

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

Thank you for your questions, Carlos. They are most difficult questions. (47:44) answers here. On the margins. On the margins, I expect in the near future, I mean, that we will be able to sustain this level of margins above 7%, although margin adjusted to risk. And this is, I mean – as we mentioned, I mean, we have two conflicting forces here. One upward, which is the cost of risk and one downward, which is the Selic rate.

As our portfolio grows and the portfolio grows, credit portfolio growth is essential for the profitability – for our profits to grow next year. As the portfolio grows, we believe we may be able to compensate a part of this Selic downward rate and even if there is some spread compression. And with the improvement in the cost of risk, I think that for still some quarters, we will be able to see this margin adjusted to risk above 7%.

Really looking for an honest answer in relation to the – what are – what indicators you can look at to know. I mean, the trend in our coverage ratio. I would say, I mean, it's to look at the research reports and the economic pages up in newspapers. After, I mean, the development of the large companies, which are known to be involved in clobbering in Brazil. I mean, we work with, I mean, respecting no company which is not in our books.

And I mean, I'm sure you can think of many companies, which should be that has started to grow again, but we just still have a very high net debt to EBITDA going sure that are not defaulting but when you look to the future I mean it's not quite clear how they will perform. I mean, these are the cases which we are following closely. Most of them are improving slightly, but not enough yet for us to abandon the level of provisions we have.

Q - Carlos G Macedo {BIO 15158925 <GO>}

Okay. Thank you, guys. Just a followup. When you say you're going to try to keep that adjusted margins above 7%, does that include potential reversals and provisions or is that a number clean of these reversals?

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

I think these reversals are a natural part of our cost of risk. I mean, they have weighted on our margins. As we view this provision, they should (50:46) as we build them in the future.

Q - Carlos G Macedo {BIO 15158925 <GO>}

Okay. Thank you.

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

You're welcome.

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>}

I just want to thank you all for your interest and for your very good questions, which no doubt can help us elaborate our explanations about our future. Thank you very much.

Operator

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

FINAL

Bloomberg Transcript