Results 2Q22

Opening

[Renato] Good morning, everyone. I'm Renato Lulia, Group Head of Investor Relations and Market Intelligence at Itaú Unibanco. Thank you very much for participating in our video conference to talk about the results of the second quarter of 2022.

We are broadcasting this event directly from our studio here at the Itaú BBA office at Faria Lima. I would like to give some instructions for the best use of our meeting today. For those who are using our website, there are three audio options on the screen. All content in Portuguese, all content in English, or in its original audio.

For the first two alternatives, we will have simultaneous translation. To choose your option, just click on the flag in the upper left corner of your screen. Questions can also be sent via WhatsApp: just click on the button on the screen. For those who are using the website or send a message to the number (11) 94552-0694.

Today's presentation will be available for download on our website and, as always, on our RI site. Now, I will give the floor to Milton, who will start the presentation of the results, and then I will come back to moderate the Q&A session. Milton, over to you!

[Milton] Good morning, everyone. Welcome once again to our earnings video conference, this time to talk about the results for the second quarter of 2022. I will go through an information session and some slides, and then we will have our traditional Q&A chat with investors. Thank you very much.

Slide 2 (quarter highlights)

So, we released a result of BRL 7.7 billion. It is the recurrent managerial result with a growth of 4.3% in relation to the previous quarter.

I want to draw attention to the ROI of 20.8 in the consolidated period. However, in Brazil, we are operating with a return of 21.6, which is strong. About the loan portfolio, I would like to highlight that we reached BRL 1.84 trillion. There is a 5% growth in the consolidated period, 5.5% in Brazil. I will detail it shortly.

The annualized average margin reached 8.4%. It has a growth of 0.5% in the quarter and 9.2% in Brazil, with a growth of 0.3%. Our delay rate, measured with delays of more than 90 days, reached 2.7% on a consolidated basis, an increase of 0.1%, and 3% in Brazil, also with a growth of 0.1%.

Finally, our consolidated efficiency ratio reached 40.8% in Brazil. Another quarter in which we reached the best index of the series here, 38.7%. These are some of the highlights. I'll go into a little more detail on the next slides.

Slide 3 (credit portfolio)

Speaking specifically of the credit portfolio, “individuals” grew by 7.2%, driven by credit cards, which affects consumption, increasing demand. So, this boosted credit card billing a lot, which has a natural impact on the portfolio. Personal loans growing by 6.8%. Within the personal loan portfolio, I would highlight... We have overdrafts, installment plans, and compositions.

But I would like to highlight the overdraft growth of 8% and 7.5% for installment plans. Both lines have grown above 50% year over year. But the main highlight is that 80% of this growth in the quarter came from the Personnalité and Uniclass segments.

Just to remind you that we went through a valley in these portfolios, and we have been recovering over time. Payroll-deductible loans had an important effect in the quarter, with a 5% increase in the payroll loan margin. So, it had a strong effect on the quarter. It should continue to grow over the next few years but at a different pace.

I would also draw attention to "large companies", with a growth of 4.1%, causing the portfolio in Brazil to grow 5.5% in the quarter and 25% year over year. Considering Latin America, this portfolio grew by 3.2%. But excluding the exchange variation, it grew 4.5%. Some important information about consignment. We had strong growth in the public agency. You may remember that I've been saying that it was precisely in this payroll business that we had our lowest share.

We repositioned the bank, we have been working with much more emphasis and, with that, we have been able to penetrate a lot in the public agency. It grew 12% in the quarter and 90% year over year. I also want to draw attention to the growth of micro, small and medium-sized companies. They originated a growth of 9.4% in the quarter, but 72% of it in this quarter was thanks to companies with higher revenue. So, the profile of our customers, where we have grown our portfolio the most, are companies with higher revenues in the micro, small and medium-sized segments. Finally, we announced a goal for the market to reach BRL 400 billion by 2025, structuring capital market operations and credit origination for sectors with a positive impact on ESG.

We have already reached 56% of the target, which means that we ended the quarter with more than BRL 224 billion in structured and disbursed operations. So, we continue at a very strong pace to meet our goal by 2025.

Slide 4 (financial margin with customers)

We had a very strong quarter in terms of financial margin with clients, as you can see from the numbers.

The financial margin in the line grew BRL 1.9 billion, up 9.7% quarter over quarter, a very strong result. But the important thing is that in the core, where you have the volume, spreads, operations in Latin America & Others, and funding, we grew by BRL 1.6 billion. A growth of 8.8% driven by the average volume, as you can see, but with an impact on all lines, including product mix, a greater number of calendar days in the quarter, spreads, and, above all, liability margins with interest rate increases and Latin America & Others has other launches that are also in this line.

And our working capital, which is allocated to the financial margin with customer line, because it is the capital used for loan portfolios with customers, also grew by BRL 400 million. So, a very solid growth. I mentioned earlier that our average annualized margin reached 8.4% on a consolidated basis. In Brazil, we reached 9,2% with the increases that I have already mentioned to you.

Slide 5 (financial margin with the market)

Speaking of margin with the market, I think we have good new, given the scenario. We have been saying since the beginning of the year, when we made the guidance, that this year would be a more difficult year for the market margin due to all the volatility, the external scenario, interest rates, and rates opening. Still, we managed to generate a good result. If you look here at 0.6, BRL 600 million in total. Remember that here we have the cost of the capital ratio hedge, which has cost us around BRL 500 million per quarter.

The guidance given at the beginning of the year would cost around two billion, which means that the margin alone was BRL 1.1 billion in the quarter. A good result, considering all the challenges. Obviously at a slightly lower level, but much closer to what we saw in the series. Remember that last year we had some exceptional quarters in the margin with the market.

Slide 6 (services and insurance)

Services and insurance, let’s see. Credit and debit cards growing at 6.6%, very strong. It has an effect of more invoicing in the issuance, but it affects the acquisition as well, not only with more volumes, but also with more penetration of financial products. I wanted to draw attention to the resource administration line. We had an exceptional quarter, excellent results, not only in the usual management but also in the performance of our funds, which had an important effect this quarter. We also had a very good quarter in economic and financial advice. Although the equity capital market is weaker, we saw a super opportunity in the fixed income market. We had solid results.

And the last line to which I would like to draw attention to in this table is insurance. In the insurance result, we reached a 1.8 billion margin. But what I would like to point out is that we have some launches in this line. We have the result of the core insurance operation. We have the actuarial result, the imbalance between assets and liabilities, and inflation indexes, which is the liability adequacy test.

We also have equity in the earnings of Porto, which has already been disclosed. So, in our core insurance operation, we have had a very expressive growth. I've been telling you for some time that we were having consecutive quarters of excellent growth. So, as you can see here, earned premiums grew 23.6% in the quarter. And the recurring managerial result grew by 88.7%. Another rhythm, another level. Good expectations for insurance operation. Card, as I mentioned before, grew by 33% year over year, and in acquiring, 22.1%.

Here, the highlight was our acquisition of Avenue. It is at an even smaller portion than the control but structured to achieve it in some time. It will complement our investment ecosystem, having an additional offer, and a new value proposition for our clients who want to invest in the international market.

Slide 7 (credit quality)

Credit quality. Good news. The delays from 15 to 90 are stable, as you can see, both in Brazil and in Latin America, as in the overview. In Brazil, the short delays for individuals, companies, and large companies were very well behaved, which is good news, given the scenario, and the challenges that we have seen. In the long delay, as I was already anticipating, we had a slight total growth of 0.1%, both in Brazil and in Latin America.

Looking at portfolios, we had a small growth in individuals, which I have been anticipating since the third quarter of last year. On the other hand, when we look at small and medium-sized companies, we had a certain decrease of 0.1%. In large companies, 0.4%. So, I think the delay rates are well behaved. We have challenges ahead, but I think we've managed to perform well despite that.

Slide 8 (quality and cost of credit)

As of relative indicators, there are two important pieces of information. All the delinquency rates that you saw on the previous slide are not impacted by portfolio sales. There were no portfolio sales in the quarter. This is very important information because when you sell active portfolios, it has an impact on the delinquency rates. In terms of credit quality, we also did not have a relevant increase in renegotiations, which is another lever that keeps our delinquency rates at lower levels.

Then, you can see here that this portfolio had a very small nominal growth, only 3.2%, which we call a renegotiated portfolio and that is great news. Growth of only 2%. Despite this, with very solid coverage of 195% over delays above 90 days.

The cost of credit reached 2.8% of the portfolio, still at a lower level than what we observed in the pre-pandemic, reaching BRL 7.5 billion. Nominals are expected to grow with much more portfolios. So, analyzing the relative indicators, it is much more important to have this relative measure.

We have good news about flexible portfolios. We reached BRL 24.1 billion. This portfolio has been dropping over time, we were amortizing around four or five billion per quarter. The speed is still very good. We will continue to disclose this portfolio. The good news is that 65% of this portfolio is backed by Real collateral, which is great. And we have a coverage of 267% on arrears above 90 in this portfolio. There was this drop of 11.2%, therefore, it's performing great. And there were no renegotiations in this portfolio, which is its normal behavior.

The coverage ratio is pretty good. We had a slight drop in Brazil and retail. Remember that we operated from 2015 to 2019 with a coverage ratio of 167% in the retail portfolio. We operate today with 195%, still well above what we have operated in the past. And we continued to provision 100% of NPL Creation in the quarter, which is also good news. In other words, the balance sheet is very well protected and well provisioned.

Slide 9 (non-interest expenses)

Non-interest expenses. Good news too. We had a growth of 6% in the semester and 5.6% in the quarter. The inflationary pressure, measured by the salary readjustment, IPCA, and IGP-M, is above double digits and we have been able to deliver a very solid cost agenda, with an efficiency program, and bring the bank's cost index to a very adequate level. A very solid efficiency index, as I have already mentioned.

We reached the lowest level, 38.7% in Brazil, and 40.8% in the consolidated. A downward trajectory, which is great news. But all this without ceasing to invest in the bank's core. Our cost agenda is tactical, strategic, and long-term oriented. So, if you look just to the core, we grew 0.9% in the semester, comparing the first half of 2021 with the first half of 2022. But in this same period, we have more than one billion in investments, going through the expenses line. And all expenses are following those lines. There are no other income and expenses. It's all included in these balance sheet lines.

So that's how we've been able to perform. It shows our discipline, focus, and concern for the future.

Slide 10 (capital)

Good news also about capital. We had a stable capital ratio here in this period. We went from 11.1% to 11.1%. So, the difference is decimal. Our level 1 reached 12.6%. The profit represents a 0.5% aid. Risk-weighted assets consume 0.3% and naturally have other effects listed here, such as prudential adjustments and the purchase of XP stakes.

The good news is that the exchange rate had an important variation, an appreciation from the first to the second quarter. And our index hedge has been very efficient. Its cost is at the margin of the market, which I have already mentioned. But if you look here, we are insensitive to the exchange rate, which was not true in the past. So, the capital ratio is quite defended with the index hedge.

Slide 11 (guidance 2022)

Finally, I would like to draw your attention to the guidance. What is the story we tell in it? Guidance is the management's most optimistic expectation with the challenges we see and the results we expect for the rest of the year. Therefore, we want, whenever possible, to be proactive in bringing you adjustments based on new information.

We understand that it was important to make some adjustments to four lines of guidance this quarter. The information is here. We changed the loan portfolio guidance. We imagined a growth of 9% to 12%. We are revising it to 15.5% and 17.5%. When we look at Brazil, we imagined a growth of 11.5% to 14.5%. We are talking about growth between 19% and 21%. The financial margin with customers was between 20.5% and 23.5%. We are revising to 25% and 27%. When I look at Brazil, on a consolidated basis, it was between 22% and 25%. We are revising it to 26.5% and 28.5%. Looking at the cost of credit, we have more growth in the portfolio and, naturally, it is necessary to make some adjustments to it. And the relative performance of net interest income has been very positive. We go from 25 to 29, to 28 to 31 billion in the consolidated. In Brazil, from 23 to 27, to 26 to 29 billion.

Finally, we know that increasing the portfolio, doing more business, and being closer to customers naturally generates more cross-sells. So, we understood that it was also important to review the line of revenue from services and insurance. We have had a better performance than we initially imagined. So, between 3.5% and 6.5% in the consolidated to 7% to 9%. In Brazil, between 4% and 7% to 7.5% to 9.5%.

On the other lines, both the financial margin with the market and the non-interest expenses and tax rate line were maintained.

So that's what I had to share with you, but I wanted to reinforce an invitation. On September 1st, we will hold Itaú Day. We inaugurated this format last year. The theme, as it has to be every year, will be about customers and we want to bring you much more details about what we have been doing, our strategy, and to tell you a little about the results.

These events are the thread of a story. We want to show what we said in the past, how we are delivering what was said, how we imagine the future, and how we imagine making it a reality. Implementation is as important as the story that is told. And I think we've been successful both in the narrative and the execution. Currently, 67% of our customers are engaged. We will explore this concept with you on Itaú Day. We gained more than 2.1 million new engaged customers, based on the metrics we track. Engaged customers grow faster than total customers. So, more than having customers, it's important to have engaged customers. And engaged customers are much more satisfied and profitable because it's a long-term relationship. So, I'm inviting all of you. I hope you can join us on Itaú Day. We will have a nice dynamic, with the Executive Committee actively participating. You are all invited. Now I go to the Q&A session. I'm going to join Renato. See you in a few minutes. Thank you very much again and see you soon.

Questions and Answers

[Renato] Hello. We will now start the Q&A session. Remember that you can send your question by WhatsApp at the number (11) 94552-0694. Well, we already have questions arriving. So, without further ado, the first question comes from Thiago Batista from UBS. Thiago, good morning.

[Thiago] Good morning, everyone. Congratulations on the strong results. I have a question about the quality of the portfolio. Clearly, Itaú is performing better than its peers on the main quality indicators. And we see the retail portfolio in Brazil strongly growing this semester. Can you talk a little bit about the expectations you have, about the NPL dynamics, whether the pre-Covid level, around 3%, will be exceeded in this cycle, and whether the focus of future growth in the portfolio will continue to be this mid to high-income Personnalité client?

[Milton] How are you, Thiago? Thanks for the question. Let me tell you a little bit about credit quality. First, I want to say that we had a very consistent delinquency rate, as shown by the numbers. I always reinforce that, within these numbers, we open. There was no sale of asset portfolio in retail, which ends up impacting these indicators. And we have been very disciplined in managing the renegotiation. Just look at the nominals of the renegotiated portfolios, which had a small increase of BRL 600 million. Although the index fell from 3.3 to 3.2 on the portfolio. So, the indicators are performing quite well.

It is important to comment on these portfolios. First, we have indeed made important adjustments to production. We have been doing this since the third and fourth quarters of last year when we noticed deviations in some businesses and crops. We acted quickly in two portfolios, in which the adjustments were stronger. The first one was in the card portfolio, especially open sea. So, we saw a detachment in the crops, and we made important adjustments. We have already cut production by more than 50%, so you have an idea. And we also made important cuts in the production of vehicles because we felt a deviation in the crops, in all the ratings. It's quite widespread.

So, the bank has been very timely and has made relevant adjustments. We talk a lot about real GDP, but to look at the loan portfolio is very important to look at nominal GDP. We entered a year with more inflation and more GDP. So, nominal GDP is higher, and this also impacts portfolio growth. When we look at the retail portfolio by its various subdivisions, there are some comments I want to make. Credit cards are heavily impacted by increased consumption and inflation. So, it has a lot to do with the consumption behavior of the population, of our customers.

And inflation has a relevant impact. Of this portfolio of BRL 120 billion that we have in cards, BRL 100 billion is related to interest-free. In other words, the financed card portfolio is BRL 24.25 billion. The rest is in the revolving transactional portfolio and interest-free installments. And this was an important growth driver in the quarter. Then there was the effect of the payroll, it was a large growth of 10%. And the consignment freed up the margin and brought new audiences to the consignment. So, we also had a much more active role and we also worked in public agencies, which was a gap, as I had already said.

We have been working very hard. We conquered Folha de Minas, and we have increasingly expanded our portfolio in the largest segment, which is public agencies. So, we have had quite an exuberant growth.

We are still very comfortable and yes, we have had a much more concentrated growth in the high-income segments, both Uniclass and Personnalité. As a matter of ability to pay. The effect of inflation is very strong. But I think the key message is that this scenario inspires caution. We have been very cautious about production. There has been active management of the portfolio, promptly looking at it all the time. At any sign of deviation or delay, we act fast. Anyway, using all the tools we have available. And I think the future scenario inspires caution.

So, there are macro risks, not only in Brazil but abroad. There are inherent risks here, with higher inflation and higher interest rates. And some portfolios have seen a drop in demand because of much higher interest rates. This goes for the real estate market. And we have also adjusted production to avoid adverse selection.

It's a scenario in which portfolios come in well. It is important to look at the base. Compared to 2021, we were perhaps at the height of the Travessia program, when we had a lot of amortizations of clean lines, both in overdraft and installment plans. And we were running with production costs below our fair share by design. And we clearly have recovered our fair share.

Not that it is a relevant gain in market share, but we recovered our fair share. Therefore, the annualized effects, year over year, still show relevant growth. It is important to look at a more normalized quarter of growth against a quarter in which portfolios were much more depressed. Looking ahead, we continue with caution, with active management of the portfolios, throughout the concession and production.

[Renato] Thank you, Milton. Thank you, Thiago. And the next question, which is already here, is from Flavio Yoshida of Bank of America Merrill Lynch. Hi Flavio, good morning.

[Flavio] Hi. Good morning, everyone. How are you? Congratulations on the strong results. My question is a follow-up to Thiago's. One point that stands out to me is the fact that you are growing your individual portfolio, especially in the higher-income segment, Personnalité and Uniclass. I think the good side of this is that those clients have better profiles with less risk. But, on the other hand, there is the fact that, if the high-income customer is resorting to credit, it may show that the default scenario is not the best at this moment. Historically, I think the higher-income client tends to turn to real estate here in Brazil. I would like to understand your opinion about this.

[Milton] Thanks for the question, Flavio. As I said just now, the scenario inspires caution and we have been closely monitoring the performance of the portfolios as a whole and the different segments. If we analyze it by segment, and not just by individuals, the credit performance of the Personnalité and Uniclass segments has been excellent. As in 2020 and 2021, we made a very intense transition at Travessia. These customers have repaid a lot of debt. So, they were customers who naturally stopped spending, ended up amortizing and we also ended up losing a lot of our fair share in that period.

So, when we look at it now, in this period, we recovered our fair share in the segment. We are penetrating clients who have more than two years of relationship with the bank. In other words, they are well-known customers. And customers who had a very low level of indebtedness for all the amortization that was made and who are currently recovering or resuming some lines.

Uniclass is a segment with clients who have an average monthly income of more than BRL 4,000. It's a slightly more upscale segment. But we are talking about a monthly income of BRL 4,000 and higher. So, it is not necessarily an indication that the scenario is getting worse. The scenario is getting worse for known reasons and we are monitoring it. But in these segments, we don't see any deviation in behavior that draws attention. I think everything is within the standards of what we observed in the pre-pandemic period. But they were heavily amortized portfolios, both the installment plan and the overdraft. So, these are volumes within what we had in the past. And, if we add inflation to these volumes, we are practically in line with the pre-pandemic period.

[Renato] Thank you, Milton. Shall we go to the next one? We already have Rafael Frade from Citi with us here. Hi Rafael, good morning.

[Milton] Your microphone is muted, Rafael.

[Renato] We're not listening to you, Rafael.

[Rafael] Sorry. Thanks. Good morning, everyone. Milton, you mentioned a few times that, last year, we were perhaps at the most acute point of Travessia and that we are now normalizing this process. This is very evident in your NIN. I think it was close to 10% before 2020 and now it's reaching 8.4%, 8.5%. Is it reasonable to imagine that it will approach that 10% mark? Or maybe a change in income mix will leave it somewhere in between? And the counterpart of this is concerning expenditure and default. As much as the NPL is well behaved, the NPL Creation has already seen a more significant increase this quarter. Would be reasonable to imagine that, as this mix changes, the NPL would also increase? So, the first question is about NIN. Whether the 10% mark is believable or not. And if we should expect NPL Creation to follow that same trend.

[Milton] Excellent. Thanks for the question. Talking a little about NIN. When we look back, we must look at how the portfolios were distributed. So, it was a much cleaner portfolio than secured debit and it had a greater retail mix than the wholesale one. Today we have a more secured debt portfolio than customers, which directly affects NIN, and a wholesale portfolio that grew a lot in the period, so there is more wholesale than retail in that period. So, this naturally has an impact on NIN.

The second big point is that we also had the overdraft cap in retail, as you remember. We were capped at 8%, which had a significant reduction in rates and returns. The good side is that the interest rate has helped the margin with liabilities. This has a positive effect. On the other hand, there are some portfolios, such as real estate credit. When there is this interest rate correction, it is not just the product at the margin that is affected, but all the portfolio. This generates a more negative impact and greater pressure on NIN. In other portfolios, such as payroll, there are regulatory caps, so the interest level ended up rising much more. Funding has gone up more than these caps did, and this has also put pressure on the margin.

So, I don't see people going back to the 10% level, because of the mix and the issues I mentioned just now. What I think is that we should continue to see a slight expansion, but very much in line with the numbers we are seeing now. There is also the effect of working capital, which has been positive in this scenario of higher interest rates. This was highlighted with the BRL 400 million that we had in the KG effect.

So, when I look at NIN, seeing this performance, I think we are reaching a very reasonable level. Perhaps imagining some stability at this level is reasonable for the two quarters ahead.

Regarding the mix of portfolios, I think the delay rate is well behaved, It's the dynamics of our provisioning, but remember that we operate by expected loss and not by running loss. So, when you look at the delay at the BACEN minimum, at 2082, it has an effect. But as we operate the bank by expected loss, at the end of the day, we look at the old lifetime, the lifetime loss of that customer.

In other words, when we are in a cycle of portfolio growth, as we have observed, it is natural that the level of provisioning in the balance sheet increases. So, we have seen this dynamic a lot. When we look at the coverages, I think the balance sheet is very well protected. Bearing in mind that, specifically in this quarter, we made a supplementary constitution. It was small, but we did. Which shows that we have not played in a relevant way. Now, the complementary ones are there and were created to be consumed over time.

So, today we operate with a very adequate level of coverage. Just see that in the retail portfolio we are operating with 218% coverage, being 195% coverage only in retail. In the past, we operated around 167%, when we looked at a series from 15 to 19. So, these are very adequate coverage ratios.

About the PDD expense, NPL Creation, which was the topic of your question. We provisioned almost 100% of Creation in the quarter, so it shows the provisioning dynamics. This, of course, puts pressure on the cost of credit. And we expect to continue provisioning around 100%. So yes, the expectation is that there will still be a gradual normalization of default, a term that I have been using for a long time. This should happen in the third and fourth quarters, so I think the defaults haven't stabilized yet. We should still expect an increase, but our best expectation is that they will stabilize still close to pre-pandemic levels. This too has consequences.

We must continue monitoring and with active management. The scenario inspires caution, we have provisioned all of Creation, we have a very solid balance sheet coverage level and I expect some consumption of this coverage over time, making the bank return to levels already observed in the past. So, we are in a period of gradual normalization, yes.

[Renato] Perfect. Thank you, Raphael.

[Milton] Thank you, Raphael.

[Renato] We already have Gustavo Schroeder from Bradesco on the screen. How are you, Gustavo? Good morning.

[Gustavo] Good morning, Milton, Renato. Thanks for the opportunity. I wanted to explore credit cards a little bit. Milton, you spoke well of the issue of transnationality. You know that credit cards have gained traction in relation to other payment options. So, it's natural for us to have credit cards expanding at a faster rate. But if we look at the credit part itself, the revolving and installment credits. I think there was a very significant evolution, especially the revolving one, which went from 6.3% of the total portfolio in June 2021 to almost 10% now. While the cash credit, the transacted, went from 85.4% to 80%, 81%.

We see the evolution of the credit card and several other indicators and surveys that we follow. I think Brazilians have used credit cards more, but it seems to me that, given your breakdown about the revolving card, there is greater use of this credit. I would like to hear from you, what is the level of revolving credit that we should observe in the portfolio, and how does this relate to the NPL that you reported for individuals? We have individual NPL breakdowns, but we don't have them for products.

So, I would like you to elaborate for us on this issue of rotation. About the increase in credit card usage and how it relates to the NPL.

[Milton] Great, Gustavo. Thanks for the question. When we look at the long term, the transactional one started to have very high levels in 2020 and 2021 for the reasons I mentioned. That is, much less consumption, which reduced the value of invoices, and the average amortization of invoices increased. So, we had two effects on the card portfolio, more payments, and fewer bills. This made the propensity for credit card financing reduce considerably.

So, a large part of the retail and card profitability result was affected by a relevant reduction in the propensity to finance. We do not and did not think that this propensity was sustainable, given how low it was. So, what we are seeing now is an increase in propensity much more in line with what we observed in the pre-pandemic period. Resumption of consumption, spending in general, and the inflationary process. Bigger invoices and smaller payments.

When we look at our portfolio today, of the BRL 126 billion, 80% are interest-free, 20% are financed and, of these 20%, 10% are revolving and 10% are invoice installments. Bearing in mind that the dynamics of the rotary has changed due to regulatory reasons, so the customer does not stay in the rotary for more than 30 days, but instead is taken to an invoice installment product afterward.

In other words, it is a healthy portfolio, we have financed our customers and paid our invoices in installments. It is a dynamic that we have seen in the past, there is no atypical behavior, and we are coming from very low levels. So, there are these deltas because this normalization of propensity does occur.

With that said, this is a major portfolio for us, as you know. Analyzing the retail portfolio, credit cards for individuals represent practically a third of it. This is a portfolio with multi-channel distribution. We have the bank channel, which we distribute on the network. This is a channel that is doing very well, the performances are great because the customer has a much deeper relationship with the bank. In the case of retailers, we have been feeling the channel a little more nervous. A little more default in finance. But remember that you also have the advantage of having the retailers' agencies. Value proposition, collection capacity, and timeliness help a lot in the portfolio's ability to react. And the open-sea portfolio has, in fact, much greater volatility.

So, any volatility in the large portfolio has an impact. We have already had an important worsening in these numbers. I think a large part of that delay that you see in individuals comes mainly from the card business. The other lines and products are well behaved in general. But everything that has a little more open-sea, less connection with the bank, and a more product-oriented relationship, is where we see some deviations. It happened in open-sea cards, and we saw this phenomenon in vehicles as well. These were the two portfolios that suffered the most. They practically explain the increase in the NPL in the individual. We don't break it down by product, but that is just to give you an idea.

Looking ahead, as I said, we have already performed very strongly in the portfolio and production. We continue to actively manage the portfolio, and this is a scenario that inspires caution, indeed. Our models anticipate provisioning, which is good. So, when we see a deterioration in delays or even in the macro scenario, our models indicate more provision and, therefore, we have a very protected balance sheet. But it is a portfolio that undoubtedly suffers the most. Our medium to long-term view is that it should stabilize at the highest propensity level and business profitability should improve a lot.

[Renato] Thank you, Milton. Thank you, Gustavo. And now let's switch to English because we have with us Tito Labarta from Goldman Sachs. Hello Tito, thanks for joining us today.

[Tito] Hi, good morning, Renato and Milton, thanks for the call and taking my questions. If I could get a follow up a little bit on the financial margin… You know, both – First on the financial margin with clients who I think benefited from two aspects, with high interest rates and the shift in loan mix rates, potentially close to peaking, maybe another small increase but probably close to the peak, maybe start to come down next year. Help us think a little bit how that could potentially impact that financial margin with clients, can that still go up because of mix and how dependent is it on the movement of rates. And then the other part of that, I don't know, market in II has been weak because of the high rates, if rates begin to stabilize, how do you see that market of II can evolve from here? Thank you.

[Milton] Sure, sure, Tito, thank you very much for your question. Well, talking about financial margin with clients, I was saying in a previous question that we believe that we should stabilize it in 8.4, around this in the next two quarters, maybe we'll see 10 or 15 points in the coming quarter. So, we believe, of course, we do have the impact of the interest rate that we can see in the chart above, but on the other hand, as you can see, most relevant impacts come from the core business of the bank.

So, you can see the volumes, very strong, you have impact in the spread, but much more on the interest rate on the liability side, on investments from our clients, and we don't see in the short term a movement in the interest rates. You're right, we believe we are very close to the peak, 13, 75, we may have 25 basis points, it's not our base case, but we believe and depend in many issues, especially in the fiscal discussions that we should have by the coming year to understand where the interest rate should start to reduce.

Whenever it happens, of course, we may see an impact the same way around as we are seeing here, in the same way we saw that huge reduction on the interest rate in the previous quarter. So, it's difficult to say now where should it stabilize. By this year, I still believe that around 8.4, 8.5 on a consolidated basis sounds reasonable. Let's see for next year what will be our interest rates, what will be our mix, what will be our capability of growing in some specific portfolios. So, this is the way we are approaching that.

Talking about the financial margin with the market, the most important thing is that our guidance had imbedded an estimation of a not very relevant profitability financial margin with the market for a few reasons.

First, as you know, we still had the overhead strategy for the coming years, the past years, they were very relevant. Just to give you a number, last year we had around BRL 800 million especially on this strategy. We don't have this anymore. We didn't have the cost of the hedge on the capital index, we implemented the hedge policy by the year's end. So, we've been investing or expanding around BRL 500 million per quarter, as you can see in the chart. But we had, of course, with the opening in the interest rates widing the way we are seeing it, the macroeconomic challenge that we see, FED raising, interest rates, Europe and all the impact that this has been gaining in Brazil, we expected to have lower financial margin with the market as the guidance was posted.

I think we did a decent quarter, as you see, excluding the BRL 500 million that we had from the cost of the capital index, we posted BRL 1.1 billion in financial margin with the market, which is relevant. If you go back to other quarters, you will see that it’s not so bellow that, but I think we posted a decent quarter. My view is that we’re going to have challenges for the next two, especially due to the interest rate effect, but we have a lot of results coming from trading.

Trading this quarter was not as good as it was in the first quarter. We have the financial market margin in the treasures abroad, in Latin America, which are doing a good job as well. In Chile, we have a very good profitability in treasure. So, it’s difficult to project, but I think we are doing fine due to the scenario we are facing now.

[Renato] Thanks Tito, thanks Milton. The next question came via WhatsApp, from Natalia Corfield of JP Morgan, which I'm going to read to you. It's about the AT1.

"With the proximity of the call, 6,125", which is the number of our Perpetual AT1, "it is clearer that if exercised, it will be a non-economic call, given the market conditions. How does management see the possibility of exercising a call that is not economically viable? Do you think it's worth it?"

[Milton] Well, Natalia, your question is very important. We've been talking a lot about this. There has been a lot of market demand. Our view is the following: We are, in fact, close to a call at the end of this year and we have another call at the beginning of next year. Both are relevant operations. We are talking about almost USD 3 billion in the total of these issuances.

Our reading is as follows. When we make a simple update today on what would be the reset of the coupon of these bonds for new issuance, we are talking about a difference of more than 250 basis points. It's a very considerable difference. So, first, we have a fiduciary and economic issue. To exercise the call by paying more than 250 basis points on a new issue does not seem reasonable. We still have a few months to go. We will make this decision at the appropriate time, and we will disclose it to the market.

But the fact is that, if it were a small premium that justified the exercise of the call, even if liability management was a little more expensive, we would be willing to study this possibility. But, looking at these conditions, our decision will be taken at the right moment, based on an exclusively economic perspective, in case the prize is of this magnitude. If it is of a smaller magnitude, we will evaluate the whole scenario. So, looking at today's market, it is difficult to say that we would exercise the call under these conditions.

And the second point is that it is not a matter of capital, we are quite comfortable with that. But the Central Bank also must make the approval and, as one of its requirements, in addition to showing that the bank has sufficient capital, it is necessary to prove that a new issuance will be economically more viable than the current operation.

The Central Bank will obviously work with ranges, reasonably. This is an ongoing discussion. But the differences are very important. So, even before submitting to the regulator, we would hardly exercise a call if the conditions were like what we are seeing now.

[Renato] Thank you, Milton. We go back to the screen. We are now with Nishio, from Genial. Nishio, how are you? Good morning.

[Nishio] Good morning, everyone. Good morning, Milton and Renato. Thanks for the opportunity to ask questions. I have a question regarding your ROI sustainability. Roberto Setubal once said that the difficult thing is not to have a 20% ROI, but to keep it like that. And he also said that it is generally possible to operate with higher profitability with a higher Selic rate. I would like to know if, looking at 2023, you envision a small increase or even an improvement in your ROI for the coming year, since the Selic will get higher.

[Milton] Good, Nishio. Thanks for the question. The first part of the answer is the following. When we look at the guidance that we have reworked now, it implies a ROI of around 20% if you analyze its lines. So, we have already managed to operate with this level of profitability. There has been a recovery over the past year. I think it's a reasonable thing to imagine for the next quarters, although we don't have guidance on ROI. Finally, the implicit conclusion of the guidance leads to an ROI of around 20%. That's how we made the guidance in the first quarter, giving an approximate reference of what a ROI could be.

The interest rate has a very good short-term effect on earnings. There were basically three major interest rate effects, the bank's working capital, and margin with liabilities, and it had a very relevant impact on the overhead strategy because of the arbitrage of the local coupon with the external coupon. The overhead strategy no longer exists. We are capturing an important part of the liability margin now. And if you analyze how working capital has been remunerated at the interest rate level, you will see that there is still a delay from the effective rate of working capital investment to the Selic rate.

The reason for this is that we do the overhead of working capital and liabilities also by vertices along the curve. And when there is an abrupt rate increase movement, as we are seeing now, it doesn't happen all at once, but over the quarters. In the same way that there is an important reduction in the interest rate, the working capital rate tends to fall more smoothly and not so abruptly.

What I mean by this is that the effective rate of working capital tends to rise in the coming quarters, as you roll over the overhead and capture all this rate increase. The downside of interest rates — and we don't advocate a scenario of high-interest rates, but a scenario of stable and balanced interest rates — is that it encourages default.

We talk a lot about individuals operating in a world where spreads at the margin are not repriced because, as a rule, individual portfolios are previously fixed. Now, this level of interest rates, from SMEs to larger companies, puts a lot of pressure on the debt of these companies and generates pressure on delinquency. So, on one hand, you have these revenues virtually growing, but this also puts pressure on the cost of credit. There's almost an overhead here. More interest that helps on one side but hinders on the other.

Our view is that we prefer to operate with a lower interest rate level, in which credit, which is one of the most important levers here in our PNL, continues to be relevant and sustainable in the long term. We do not want cycles of high volatility in the cost of credit. So, you must look at the whole picture.

Looking ahead, we do not foresee anything that would lead us to believe that the bank's profitability level could be significantly affected. However, making projections about 2023 and

2024 is a reasonable exercise in futurology, given the current scenario and all available information. So, I don't want to give any profitability guidance here. I think we have been able to defend the bank's profitability well. The quarterly result speaks for itself. I think the guidance that was given also incorporates a very adequate level of profitability.

The year 2023 has challenges. Competition, challenges in the credit scenario, and mature economies. What will happen with the slowdown in the United States? With the slowdown in Europe? China may perform even better than it will in 2022. Fed raising interest rates to 4%, opening rates. There are many variables that we will have to monitor and all the migration that we have made of some portfolios in which we have revenues. We are moving towards a more sustainable, long-term relationship, reducing churn.

So, there's competition pressure, there's pressure from all sides. I'm not going to give any long-term guidance on ROI here, but I think we have been able to deliver good profitability and in the short term we will continue to perform well, in my opinion.

[Renato] Thank you, Milton. Thank you, Nishio. Milton, let's switch back to English again, because we have here Jorge Curi. Jorge, good to see you, welcome. Thank you.

[Jorge] Hi, thank you, thanks everyone. Congrats on the quarter results. I wanted to ask Milton. You said along your presentation that you feel that is prudent to be cautious and you talked about a cautious environment. I'm just trying to understand what that means in the context of the balance in growth that you're seeing, and the guidance that you have. Right? I mean, you're guiding for growth that could be up to close to 18% a year, your consumer book grew 7% quarter on quarter, that analyses high double digit rates. Particularly riskier products like credit cards are growing at almost 40% annually.

I'm trying to understand that cautious commentary versus the velocity at which you plan to continue to grow the business. And I'm just wondering if, you know, evidently, there's risks out there and the world is not a great place today, and then those risks must be calibrated, but it just doesn't feel that you're particularly cautious with the level that growth that you're seeing.

Again, I just want to understand what that means. Does that mean that we're going to see a big deacceleration going forward, or we've seen the best? You maybe think "hey, there's some risk there, but we feel comfortable, and the environment is supportive for us to continue to grow at this pace"?

[Milton] Okay. Thank you, Jorge, good to see you again. Well, first of all, of course whatever we produce and all the growth we had in the portfolio that we posted in this quarter, of course we are comfortable with that. Otherwise, we wouldn't be growing the portfolio the way we did. As I was saying before, we are doing that in the most affluent segments, that are performing very well in terms of credit, and we still have good perspective looking ahead.

When I say "cautious", it's because we are always cautious. We are always looking and understanding the scenario, understanding what challenges we may see ahead. And when we look two quarters ahead and twelve months ahead, we don't have all the answers, no one has. So, we are cautious because on the short term, we've been seeing, as we are posting here, the delinquency measured by the NPL over 90 days has been growing every single quarter since the third quarter of last year. This is completely the way we expect it to be.

You might remember, in the third quarter of last year I was saying to the market, when we hit low, that we would see a gradual normalization of our delinquency ratios. And that's exactly what's happening.

So, when I say "cautious", it's because we are seeing the delinquency rates going up. We have been acting our portfolio the wat we should. We've been reducing strongly production in the credit card portfolio, we're reducing strongly in the auto loan. So, we've been effective and moving fast to make the adjustments that we need.

My point is: whenever you see a gradual normalization of the delinquency ratio, we still believe that we should stabilize, very close to what we saw in the pre-pandemic scenario. We have to follow through and we have to guarantee that we will execute this the way we would like to, so this is our base case scenario.

The other thing I was saying before, we lost in 2020 our fair market share in many credit lines. We've been recovering that, so there is a base level comparison that should be taken in understanding that we are comparing a base level of 2021. I know the quarter on quarter, but we have to look to the nominal DDP to understand why the portfolios are growing.

Especially those portfolios like credit cards, as you said, we've been seeing a behavior coming from our client, but we've been reducing credit limits for many clients that we believe may have an important deterioration or that, when we look forward, we understand that might have some issues in terms of capability of paying the bank.

We are comfortable with the growth we had; on a margin basis we are deaccelerating. But understand that the portfolio is not only retail, we have wholesale here, that's been growing a lot. As you can see here, we have a very healthy portfolio.

And we cut a lot of productions, as I said, so there is the event of putting together many productions of the retail, you see the impact on the portfolios coming in those quarters. We're confident with what we did but we are cautious with the future, so this is the way we are approaching it.

[Jorge] Thank you, that's very clear. If you don't mind, I think one of the points in your results that have been underappreciated and no one has asked, is on the expense side, you've done a great job at managing expenses. And I'm just wondering, how much more is there for you to continue to minimize expenses and maximize efficiency over the next few years? Have we seen the best years? Could we potentially start seeing an optic in growth? Or three years out we continue to see you improving on a year-on-year basis? Thank you.

[Milton] No, thank you very much. In fact, we are very focused on that. Of course, when we see 38.7 efficiency rate for Brazil, it's the best quarter ever, the best index that we've had if you look through a long series, whatever you look at. But we have the two effects here, we have a very strong topline growth that benefits the ratio, and we are also having a very strong efficiency program.

As you can see, showing that we grew only 0.9% year on year, looking at the semester is relevant when compared to the level of inflation we are facing in the market. So, we are confident, I'm sure many of our guys of the banks are watching our conversation, so I can tell you there's still a lot of room to reduce cost, to be very disciplined and to keep on this agenda, there's a lot of opportunities here, we are not there yet.

We will depend on the topline dynamics, of course, to see where we can stabilize the ratio, but I can tell you from the cost perspective, we still have room to improve, this is a message for everyone. And, on the investment side, we are investing a lot on technology, new businesses. So, all the growth that we had in terms of costs had to do with investing in the future of the bank. So, this is very relevant, we are not doing a short-term agenda, guaranteeing the profitability of the bank for the coming quarters, and not looking for the whole period. We are looking for a long-term agenda. This is the way we manage the bank. We have a very strong shareholder view. This is the way we are doing our investments here. Thank you.

[Renato] Thanks Jorge, thanks Milton. And now, switching back to Portuguese, because we have Daniel Vaz from Credit Suisse with us. How are you, Daniel? Good morning. Thanks.

[Daniel] Thank you, Renato. First, congratulations on the results, Milton, and Renato. My question is about liabilities. I think that in these last quarters we have seen a growth in the portfolio a little above the liabilities. When we analyze the portfolio-to-funding ratio, we see that it even dropped a little. I think it was a good capture performance.

I would like to understand how you have been growing funding, especially time deposits and bills of exchange. And how does this relate to your investment initiatives and fundraising strategy?

[Milton] Great, Daniel. Thank you very much. First, I would like to say that we have been able to gain market share in the investment world the way we measure it, both in private and retail. We have been acting very strongly here in ecosystems. We made an important investment in Íon, with a dedicated team. We have more than 110 offices in operation and the expectation is to reach 120 new offices by the end of the year. We have more than 400 billion, almost BRL 500 billion under management, under custody by this team of dedicated advisors. So, we have been able to navigate the investment world very well.

We have been able to reduce the outflow of net resources and gain from those who were also earning net resources. Finally, Net-Net Bank has been increasing net funding in the quarters, which is very important.

We have a clear strategy and I think your question is very important because when we say that we have been working hard on the advisory model for years, it is the best conversation for the client. If that means taking the client out of a multimarket fund, which has a performance fee, which has a higher management fee, and moving them to a CDB or a bill. We will do this whenever it is the best conversation, the best investment for the client, within the suitability profile, and assessed risk.

What ended up happening with this interest rate increase was a natural migration from higher-risk products to lower-risk products. Then, there was an important exit from funds that had a level of risk, hedge funds and other equity funds, and migration to fixed income. And the bank benefits from this because we have a complete product offer such as bills of exchange, LCA, LCI, LIG, and financial bills. So, we have been doing this quite consistently, especially in the retail world.

We also use financial bills as a funding instrument in the institutional market. We have been active, but less than what we have seen in some cases. And we have very close management of liquidity indicators here. We even had very high CSF levels. This had to do with FTC amid the crisis, let alone demand for credit. This scenario has been normalizing and demand for credit has increased, so this cash is being consumed. But even so, we have been operating with a level of LCR and NSFR well above the regulatory minimums, and quite comfortably so.

Our investment strategy and the entire model have stabilized. So, in the beginning, it was a lot of investment, because these things don't happen through brute force. It's not enough for you to get 1,500 people if you don't have a method, model, tool, product, offer, or digital. If you don't have the capacity and quality of human capital to do this model doesn't work. So, we have been working for some time, investing a lot in this model, and today we have seen a level of stabilization and very good results. So, this is super positive. We are clearly in the right direction; the model is working, and the prospects are very favorable.

And the ballasts? We have LCA backing, we have LCI backing, and we have portfolios that generate backing. We have the biggest market share. If you look at the LIG breakdown, then we have a distribution level in different products in all the bank's channels. Private banking too. And we have also been working very hard to close some gaps that we had in investment products at the bank. In addition to the traditional treasury products, which are the ones I mentioned, how we serve the client in other demands. The mini contracts, the limits there to operate in home brokers.

We have been doing this repeatedly and growing volumes. The COE volume itself — and this is super important — when you look at what we have seen in the market and our strategy, they are correct products from the point of view of strategy and alignment with what we understand the scenario wants, and with spreads that are compatible with the operations being carried out.

So, it is very important to view the whole picture, because, as we are not here to maximize the result of the investment in the quarter, because we have a result call, we are looking at the sustainability of the relationship with the client in the long term. Even if that means giving up margin and taking the best product to the customer. So, these are offers and products that are consistent with the strategy, with the moment we are currently living, and with spreads that are adequate for our clients. That's another talk.

And there is one last point that I would like to mention, which is the whole part of the secondary market, buying and selling assets. We have increasingly equipped ourselves to provide liquidity to customers in instruments that were not necessarily issued by the bank or instruments with less liquidity. But it's also worth it, and I think you can do these analyses, compare the level of spread and transparency that we give to the client, and how we've been doing it consistently and sustainably. Anyway, there is a super opportunity and we have grown well in the investment world. I am quite optimistic about what lies ahead. Thanks.

[Renato] Thank you, Daniel. The next question comes from Jason. With you I'm never sure whether you're going to ask your questions in Portuguese, in English, in Spanish or a mix of the three. So, I'll let you decide which one you want to take. But thanks for joining us today, Jason.

[Jason] Hi, thank you for the opportunity to ask questions. Congratulations on the strong results, in particular in Brazil's current economic context. Economists, as per consensus with the Central Bank, focus or expect real GDP to grow 0.4% now in 2023, down from, I don't know, 0.5 just a few weeks ago. Interest rates are expected to remain high now with Selic staying in about the 11% range by the end of 2023. And we have a presidential election.

I mean, you've addressed a lot of my issues, but I thought maybe you could give us your views on where Itaú Unibanco is in the current economic and banking sector cycle. You've talked a bit about where you see loan growth going and caution, etc. Maybe you could share where you see similarities and differences versus historical cycles with high rates and low economic growth and Brazil's fiscal challenges. That might be helpful.

And as a secondary part of that question in the current cycle, it is interesting and I appreciate the disclosure of those hedging strategy on the capital index. You showed that you spent BRL 500 billion on the second quarter after 400 million in the first, maybe if you can give us your views on how you see that working currently and going forward. Thank you.

[Milton] Okay, Jason. Nice to see you again. Thank you for your question. So, talking about this scenario, I think it's difficult to compare when we look back. I think we still have a few challenges looking forward.

First of all, you are right. When you see the focus, you are seeing this growth coming from 0.4. Our macroeconomics has a 0.2 figure for 2023. So it's not that different, even though it’s half of the focus, it’s still on a very low ratio. So that's a challenge for 2023. And especially due to the level of interest rate, we don't believe that we've been facing all the effects of the interest rate hike that we've been observing in the past month.

Looking forward, we believe they're going slow down the impact on the economy side. We might see commodities coming to a lower level due to the war, Russia-Ukraine war. But also, we expect that the GDP in U.S. coming from two this year, maybe one next year. In Europe, coming from two and a half coming to 0.7% next year. So, Mario has this mathematics that says that when the global GDP falls around 1%, we feel about 1% in our GDP as well. The good side of that is that in China, we might see a recovery coming from this year to next year, so, you won't see that major impact. But you are seeing this in the U.S., in Europe, in South America, we still have huge challenges. In many of the countries. We are going through reflationary inflationary process worldwide. This is not a phenomenon of Brazil.

So, our view is that the interest rate, depending on the fiscal policy, that we will understand, and everybody will know that in the coming years, we are going to an election process, so no one will be discussing here whether it will be a new or the same fiscal policy, depending on who wins. But we understand that by the beginning of next year and this will be a very relevant pillar to define where the interest rate may accommodate. So, it may stay at 13.75 for a longest period. It may go down our best-case scenario that it will go down to 9.75 by the year end. But it can happen different. We might see even a hike in interest rate depending on the fiscal side.

We have benefits of this year. The inflation helps. The level of indebtedness of the country. We have the GDP growing. We have a few impacts that are positive. So, we might have the year-end 80% of gross debt through GDP. But for next year, our base case is going to 84. So, the question is where it will stabilize. We are doing a few investments now. So more fiscal stimulus. Are they’re going to be permanent? Are they’re going to be only for this period or next year? It won't happen. So there's a lot of questions that we don't have to answer. So, this is what we are seeing in terms of macroeconomic challenge.

I think will be a challenging year. There are risks here. Interest rates going up in U.S. as you know, it might go more than 4%. So you have the BCE in Europe. Will it increase interest rates as well? So we are seeing these phenomenon worldwide. So that's why I'm saying that we have risks. We have to be cautious. We have to understand where we are. And I think when we go back for many crises in Brazil, we are almost 100 years old. So we have capabilities. We've been learning from our mistakes, and we've been learning from the macroeconomic environment. So we have the capability and we have a very relevant risk appetite tool to manage in this scenario. So, we are doing the measures that we need to do.

And linking to your second question, it has to do with the hedge on the capital index. When we decided to do that is because we had a volatility in our capital that we didn't control. And this has nothing to do with the over hedge strategy, it has more to do with the banks we have abroad. So when we look to Chile, Colombia, Argentina, Uruguay, Paraguay, they have dropped their capital in the local currencies. So, when you do the hedge, you have the benefit of the arbitrage. You don't have this BRL 500 million cost. But on the other hand, you have your capital very volatile. And this is not good to manage our bank the way we do. We want to understand what's our risk appetite, what are the levers that we can leverage, that we can work to keep the level of capital that we have, but the facts we don't control. So, the only way of doing that was hedging it. This is something that other banks are doing on international basis when they have subsidiaries abroad. We think it's relevant, but we are going through a phenomenon in Brazil of hiking interest rate. It will happen in the U.S. and in the other countries as well. So, what really costs to us is these spread over our local interest rate with this local interest rates of those countries.

In a more, I would say, sustainable scenario, this spread should be much lower than what we are observing now. This cost might be lower that what we are seeing, but we are confident, you can see from our capital basis the effects came from for 4.72, 5.25 and we had at the end of the day, a stable capital. If you take out the credit and if you take out some traditional effects and the consumption by the XP acquisition, you will see that the hedge was very effective. So, we are happy with the strategy, happy with the hedge and we have a much more controlled scenario, where we can predict and estimate our capital. So, our view is that by the year-end, our best guess now, we're going to recover our risk appetite, capital index, I'm talking about 11.5 core capital, common acquit.

[Renato] Thanks Jason, thanks Milton. Returning now to Portuguese. Dom, from JPMorgan, is here with us. How are you doing, Dom? Good morning.

[Domingos] Good morning. How are you doing, Milton? I'm going to add a little bit to Curi's question because we're curious here. Bloomberg and other news outlets are saying that the CEO is more cautious about rising inflation etc. And we have internal questions about how much is the portfolio growing. I was looking at the credit card portfolio and it grew 8% in the quarter. And if we go to the next risk level, which you mentioned a little bit about, the portfolio grew 86% in the year and the revolving part, which also has the NPL, grew 122% per year. And that percentage has reached close to 120% now.

I thought of several ways to ask which is the ideal approach, the revolving or the installment with the total percentage of the customer. But I think what we want to ask is whether you think a cautious scenario, with 8% quarterly growth in the portfolio, is consistent. Mainly knowing that this customer has not paid the credit card bill on time and has entered the revolving. And then, they often go down to the installments. So, it is as if they have already missed some steps in the payment process.

Can you relate this narrative with growth? How much will we see this slow down by the end of the year? How much of this growth is befitting caution? And the second question is about the wholesale bank array, which I think had a 30% record. I don't recall ever seeing such a large array of wholesale banking, and outperforming retail. Do you believe that this is a new structural pattern, with wholesale generating a greater return on equity than retail? Thanks.

[Milton] Great, Domingos. Good to see you. Thanks for the question. Let me get back to speaking Portuguese and I'll talk a little more about this issue. I think the question is super pertinent. The card portfolio ends up having a behavior that is very much associated with transactional, consumption. Quarterly card billings grew 11%. That was its growth. So, it shows the resumption of consumption. And we stratify consumption among various types of customers that we have, and between basic consumption and excess consumption of customers so that we can assess how low, medium, and high incomes have behaved. So, all audiences drive more revenue.

We got to run at very low levels of propensity. If you go back to 2020, 2O21, that's when there was a very large amortization, especially in 2021, of the revolving ones because of the dynamics of fewer expenses and much more liquidity in the system. All the support, the aid that was made, the liquidity that we saw in the system. In the end, there was a very important reduction in propensity.

The card business is a risk-return business. It indeed pulls a higher default level, but it has much higher rates and returns. So, we can operate with a level of risk and return within the best appetite for this product. It does not have a cap, so we have some leeway in the risk. And, obviously, we have no tolerance after a certain level of risk because no interest rate rewards the risk. In these cases, we are very careful in our cut policy.

Now, there is a very large installed base. So, if you look at the volume of the portfolio, BRL 126 billion, and we had been working there with 6% and 7% of financing between revolving and a little more in installments, it was natural that the propensity increased, and it has been increasing. But within levels that are quite adequate for what we observed in previous periods. With that said, this is the most volatile portfolio and the one that has suffered the most. So, a large part of what you are seeing in the cost of bank credit, in the overdue rates, is already capturing this effect.

It's not something to come, it's something we've already felt. And that's why we made the relevant cuts that I mentioned, especially in open sea. We have reduced production by more than 50% and possibly we will need to make additional cuts. The account card portfolio is very resilient. The customer has a much deeper relationship with the bank. The level of engagement, which is the call for our Itaú Day, is much higher. And the retailer's portfolio has, obviously, a higher level of risk in the partnerships that we have, but an installed collection capacity is also stronger. I always say that 2/3 of our short delay is charged to the network, just like in NACs, the customer service centers of our retailers, we can be quite effective in collecting. Now, these portfolios are a little more nervous than the others and this is where we do all the management. It is a portfolio with which we have been working for many years. We have always had a very similar market share, but our dispute is not for share, because we stay away from the excesses in the market.

There is clearly due to an oversupply of cards on the market. The higher income commitment level. Today, the cost of experimentation for the customer is very low, so they can issue a card free of charge and leave with four or five cards. So, there is, without a doubt, a higher leverage level in the product than we have seen in the past. And our strategy is not to defend market share at any cost. We will do what makes sense within our risk appetite.

It is a portfolio driven by transnationality and we must look at the nominal GDP, more inflation, more consumption, and growth in the portfolio. And management is not only taking place in production, but also in the way of operating in the installed portfolio and limits. What we have been doing very actively is acting on the limits of those customers who are clearly showing signs that their quality has deteriorated.

We operate in the installed portfolio and put a stronger collection structure. Depending on the channel, we have a more efficient billing. On the other hand, we have significantly reduced limits in several segments, especially those with the lowest income, where we have been experiencing a deviation in default. So, it's not that I'm looking ahead, thinking it could get worse. It's gotten worse and the bank's numbers already reflect that. But there is a risk and return balance.

And given the size of the portfolio, the portfolio effect, and the fact that there are many Uniclass and Personnalité clients, it makes the portfolio healthy. But if you look at retail profitability, linking it to your question about wholesale, it is experiencing this effect. It has a portfolio effect, but it also has a gradual normalization effect on delinquency. That's why profitability and cards are very relevant, it's a third of the individual portfolio, and ends up pulling profitability down.

Finally, it is possible to generate profit and work with profitability, depending on the product, which may or may not create value. We look at the relationship with the customer as a whole and the cross-sell that this relationship generates, we cannot look at the product in isolation, and we act in the portfolio. This has been our dynamic and that's why I speak of caution. And I think that our practices, when I talk about the third quarter here, have been aligned with this caution, adjusting production when necessary.

We are growing in areas where we are comfortable. If this was not the case, we would not grow while speaking of caution. Caution applies to the prospective scenario and the cuts that we have been making in marginal production. I think that's the main message.

About the wholesale bank return you asked, and it's not the wholesale bank, but the whole wholesale business. So, what is in here is not just Itaú BBA. We have all the WMS in here too. Asset and the entire result that is generated in our wealth business is here within the return. We are having the best years of wholesale banking. Speaking in isolation about Itaú BBA, a very strong revenue, coming from all lines of business, from credit, investment banking, fixed income, and variable income, which is a little weaker this year, as you know. But part of MNA is also having good results. The commercial portfolio and all the niches where we are operating are performing well. The entire cross-sell with foreign exchange products, derivatives, liabilities, and fundings, has had truly extraordinary results.

And I think the central point is that we are seeing a level of PDD in the wholesale world that is much lower than what we used to see historically. So, the cost of wholesale credit is at the lowest level in history. Our view is that at some point there will also be some gradual normalization. This will happen over time. I don't think it will go back to what it was, what we observed during crises. We are not anticipating this. But I also think that we are at a very low-level today. This goes for everyone who operates in this market.

In our specific case, and this is very important, we made an important change in the corporate business mix, moving towards better ratings over time. We carried out very active portfolio management. This has already been implemented for some years at Itaú BBA. I think that since the beginning of 2015 and 2016, during that great crisis, there was a change, a revolution in the way of managing the portfolio. And we are harvesting the results now. A very healthy portfolio, with excellent ratings, with a very strong level of results in all the lines of what you can generate with your customers and, at the same time, the level of PDD, delinquency, and very low cost of credit.

So, I would say the timing is perfect to take a picture of profitability. I don't think this profitability will stay at 30-something percent for a long time. But the wholesale with WMS will run with a very strong level of profitability.

[Renato] Thank you, Milton. Thank you, Dom. We already have Henrique Navarro from Santander on screen. Henrique, good morning. Thank you for your participation.

[Henrique] Good Morning. Thank you for the opportunity to ask questions and congratulations on the result. My question is about acquiring. The network put up a very strong result. I remember that, about three years ago, even within Itaú, it was said that eventually, in the future, acquiring would become a very profitable cost center, because the results were very good. My question is, has the acquiring dynamics changed? We also saw Cielo with very good results. Could it be a cyclical issue in which acquirers linked to large Brazilian banks are having some competitive advantage, perhaps due to the high Selic scenario, compared to new entrants?

In other words, if you could elaborate a little more on the quality of this result of the network, and on how we should look at this going forward, I would appreciate it. Thanks.

[Milton] Great, Henrique. Thanks again for the question. Good to see you here on our call. I'm going to talk about the networking business as someone who has sat in that chair at some point in the past. When we look at a long series, and I was looking at this long series these days out of curiosity... In the past, we managed to generate three billion annual profits on the network, in this order of magnitude. When you look at what has happened since then, the market has changed a lot. It is much more competitive, prices, MDRs, and stake rates have dropped considerably. So, there was a huge change in the competitive environment and things changed a lot in the acquiring world.

In the past, the external channel, which was not the banking channel, was very important in the market. And today we see that the customer wants a much more integrated offer. They want to talk about receivables and payments, they don't want to talk exclusively about the MDR and the credit card machine, although this dynamic is still under discussion. they want quality service and price because we know that the MDR has an important impact on the cost of retailers and companies that accept payments with cards. So, the market has changed a lot.

And what did we do here? First, there is a strategy to focus on the most profitable segments. In the past, and I remember this discussion, there was an insistence that market share was synonymous with results. And it never was, because 2/3 of the market share in the acquiring business comes from large customers, with very tight prices and negative contribution margins many times.

In our strategy, we gave up the negative contribution margin. This only happens, and the exceptions are rare, when the relationship with the customer makes sense. So, we now look at the customer with a much more integrated view than we did in the past. The acquiring business and the bank were almost independent of each other. The client is the same, so the look must be transversal. There is no decision made in the network without consultation and active management by a bank manager, whether in the corporate or wholesale segment. So, the integration is total in this segment.

The second element is that when you compare the results of the network, looking at the top line you will notice less, but looking at the bottom line, in our internal management model, we take the company's working capital and allocate it to the corporation. Independent acquirers have important working capital in their favor, it is the equity of these companies, which has zero cost from a financial point of view, in the NLP, and there is all the benefit of the increase in interest rates. Therefore, the cost of funding is also lower, as this capital does not pay interest to the shareholder, it pays dividends and has another type of profitability measure.

In the network, we isolate this effect. So, the marginal cost of the network is the opportunity cost of funding. It does not benefit from a lower funding cost to make financial products in advance. What we've been doing is focusing on the most profitable lines and we've been gaining market share. We lose a little share of the whole by design in a series. Although in the quarter we managed to defend market share, we gave up market share in some quarters, because it is a negative contribution margin.

And we have managed to penetrate in a very important way in financial products, whether single prepayments or the flex itself, which is a commercial regime and is in the MDR. What you look at in service and insurance revenue is the result of MDR and rent. The flex, the separate revenue anticipation, we leave it in the financial margin with the customer because it is almost as if it were a credit product. The cost of funding is also in the financial margin with customers instead of staying here.

So, what I see is that the interest rate hurt all acquirers a lot because of the mismatch between an advance and pre-fixed, and post-fixed funding. This had an impact on several of the acquirers. There is some normalization as you price your liabilities and assets, whether the anticipations or the commercial regime itself.

So, I think the market is readjusting prices as much as possible, not increasing the net MDR, but clearly improving the spread of financial products that were under great pressure due to this interest rate increase. I think that's what is being done. We are still very satisfied with the evolution that we are seeing in the bank. It is a cost center from the point of view of the business spirit because we don't want to look... It is not a cost center. We said that because we didn't want to look at acquiring as a business, as it had been in the past. It would be another facet of the customer relationship. And that's how we're treating it.

The customer view is the integral view rather than the acquirer view. And that's how we've been operating.

[Renato] Perfect Milton, thank you. And then we're going to switch back to English, because we have Nicolas Riva from Bank of America. Hello, Nicolas. Good to see you.

[Nicolas] Hi, Renato and Milton. Thanks for the chance to ask questions. I have a follow up on the on the payroll question about the perpetual bonds. So, you said clearly, you know, under current market conditions, it doesn't make sense for you to issue a new perpetual born in international market. My question is if you would consider calling the perpetual bond in December, losing temporarily that capital, the $1.25 billion and waiting for market conditions to improve to issue a new perp or also potentially if you would consider issuing a new perp in the domestic market and refinancing some of that international the market. Thanks very much.

[Milton] Thank you, Nicolas, for your question. Good to see you. Thank you very much. To be very clear here, we don't have a capital constraint. So, it's not relevant to discuss capital here. So, we still have room. We have the additional tier one of the banks consuming 1.5, So we are the regulatory cap.

So, we don't imagine to take this risk in a mismatch because at the end of the day, if I exercise the call, not being effective economic wise to the bank and then waiting for a new opportunity, we're thinking on market risk if we do that, and it doesn't make sense from the economic perspective, again, to exercise a call if the reset will give you a premium, a new issue will give you 250 basis point spread over all of what we have nowadays.

So, the answer is no. We will make the decision whenever possible. But thinking in controlling duration that if in economic view we should exercise the call, this is our fiduciary obligation, we will exercise the call. If we don't have to exercise the call due to economic perspective, we won't exercise the call. So due to the current market level that we are seeing now and we if we had to make this decision today, we wouldn't exercise the call. I think this is the best way to give you this answer.

Talking about the local market, we've been active. We have an important amount of local debt in the local market, and we are always analyzing. So when I say there is a huge spread, I'm not looking only on the international market because we may be able to access local pockets at decent conditions, but we do the same calculation. If this new liability doing locally, if it's better than the perpetual, of course we would exercise the call and issue a local, so we don't have a preference if it's either offshore or onshore. Our preference is to make the most relevant economic decision, we take other things in consideration, but this is the core element on the decision we make. So we will look to the local market as we’ve always done, but it's not so deep as we see the offshore market for this type of instrument. But we are looking to the local market as well.

[Renato] Thanks Milton, thanks Nicolas. Shall we go to the last one, Milton? Marcelo Telles, from Credit Suisse, is here with us. Hi Marcelo. Good morning. How are you?

[Marcelo] Hi, good morning. Thank you, Milton. Thank you, Renato, for the opportunity. Last question. Thank you for your patience. I have two related questions. It's not about the results themselves, because we've already talked a lot about it, but I would like to know your opinion, Milton, about the initiative of the Central Bank of Real Digital. Is there any concern at the bank that this could increase the risk of financial disintermediation and perhaps loss of demand deposits? Can you talk a little about your views on this?

And the second point is about Itaú Digital, in the tokenization area, I mean. Can you talk a little bit about your objective there? If there is a possibility of important cost, there. How are you guys preparing for web 3.0? It would be interesting to hear a little about it.

[Milton] Great Marcelo. Let's finish on a high note. Thanks for the question. I think these are two different questions than what we've talked about so far. First, about the CBD. We have, of course, been following it closely. The Central Bank has had conversations with the market and has signaled a little what its main objectives are. It's still too early to say, but in our view, the regulator has no interest in generating a systemic risk. Deep down, it doesn't want to become the taker of deposits and disintermediate the banks. This makes no sense because it carries a huge systemic risk. So that's not the agenda. It's an agenda much more focused on testing new technologies and understanding what consequences this will bring, including physical money. While Pix has had a very important impact on reducing physical money as well.

We always ask ourselves "What problem do we want to solve? And what is the solution to this problem?" So, I think it's still at a very embryonic stage, although there are rumors. But I don't think it ever crossed the regulator's mind, and we always heard that very clearly, that the objective was to disintermediate the banks. So that's not a risk, it's not a concern. But we must follow up and understand how this will be done, how it will be operated, and what the role of the banks will be. Whether or not it will have collateral, whether each bank will issue its own currency, and whether it will be a stable coin. Anyway, I think there are many elements still on the table. It's difficult to make a clear assessment at this point.

But I say it again, we don't see this systemic risk, at least from everything we've heard so far. Everything the Central Bank does not want, and this is part of the regulator's role, is to generate systemic risk. So, I'm quite comfortable with that. How big is the opportunity? To be discussed. How are we going to operate? To be discussed. It's hard to anticipate now.

We created the area of digital assets. It was already something that we had been doing fractionally at the bank. And we thought it was important to centralize this under a single area, under a dedicated and responsible person. We are open. We do not close our eyes to the revolution that is happening, whether in the currency, stable coins, tokenization markets, and blockchain technology, which, at the end of the day, has several applications beyond crypto and all that we've been talking about. We are looking at the bank's position on the metaverse. We have already made some initiatives. We have had a very strong presence among gamers. This also brings opportunities for us to understand the role of the bank in web 3.0, metaverse, etc.

We are super open, and we spend time discussing and understanding, and we are already acting. We are already making digital tokens pilots within the bank. I participated in the most recent pilot, I bought a digital credit token for us to see exactly how it works, how it settles, and what the customer experience is. So, it's something that we embraced. We think that there will be an important agenda for cost reduction tokenization over time, through more digital and efficient processes with digital certification and authentication.

And you also improve and facilitate the fractionality of products and the generation of much more liquidity, secondary, individuals. You democratize more and more and allow other people to buy a piece of credit that they don't have access to today. Through the token, it is possible to buy such an instrument.

I think there are many opportunities, I think it is a good question. The central message is that we are super attentive and working on these fronts.

[Renato] Thank you, Milton. Thank you, Telles. Milton, we received a series of questions on WhatsApp about Iti, default, costs, and the acquisition of Avenue. Due to lack of time, we will respond directly to people through the IR team. But thanks for the questions, we'll answer them all.

And with that, we come to the end of the Q&A session. But before I leave, I would like to invite you to Itaú Day 2022 again. This event will be on September 1, from 9:00 am to noon here in Brasília, and we hope to see all of you there. We will have the presence of the co-chairs of our board of directors, Pedro, and Roberto, as well as all the members of our Executive Committee. This year, as Milton has already said, the idea is to delve a lot into the theme that is the basis of our strategy, which is customer centricity. Looking at this topic from different angles. So, here's the invitation and I hope that everyone who is watching us will also attend on September 1st. Until Itaú Day. Thank you, Milton. Thank you all.

[Milton] Thanks. I would like to thank everyone for participating. It is always a pleasure to speak with you. A lot of the topics we've been talking about here are about consistency, which is very important to us. Transparency in our disclosures and in the quality with which we open this information to the market. The questions do not go unanswered. The answer may not be satisfactory, but we answer whenever we receive a question.

I thank and reinforce the invitation that Renato made. It is a great opportunity to be able to talk about the bank, talk to you, and tell you about our history and our trajectory. The bank wouldn't be what it is if it weren't for the investor base it has, and the trust placed in it all these years. So, it is very important for us to give you this feedback and share our agenda in depth.

It is also a way of giving visibility to the Executive Committee and other executives. Nobody does anything here alone. As I said, I believe in a collegiate, collective model, in which everyone works in the best interest of the client. You will see a lot of this on Itaú Day. Thank you once again for your participation and see you in specific meetings and the next call. Thank you.