

Telefonica Brasil

No signs of slowing down – Reiterate Buy rating and preference among the Telcos

Reiterate Rating: BUY | PO: 64.00 BRL | Price: 56.18 BRL

Same positive factors continue for 2024

4Q reinforced our bullish view on Vivo. First, all telcos reported solid results, with average MSR up +7.8% YoY (~4% inflation), showing more market rationality. Second, Vivo had the better relative results, with MSR up 8.7% (TIM 7.6%, AMX 7.1%), and posting EBITDA margin up 120bps YoY (+100bps ex-others). For 2024 we expect the positive trends to continue, with real growth leading to EBITDA margin expansion and stable/declining nominal capex. This dynamic should lead to a strong FCFE yield of 8.5% and dividend yield of 9.5% for 2024 (considering R\$2.9bn from the capital reduction). We reiterate our Buy rating and raise our PO to R\$64 from R\$63. (see report: [Year Ahead: Bullish on Brazilian large Telcos... selective on Tech](#)).

Better client mix alone should boost 1Q24 MSR by 2% YoY

In 4Q Vivo reported strong postpaid net adds at +690k (+100k prepaid). For 1Q24, even with zero net adds, its postpaid base would be up 4% YoY (prepaid -5%). Since Vivo's user base is +50% postpaid and the segment's ARPU is ~4x larger than prepaid, this net adds dynamic alone should contribute to ~2% YoY MSR growth in 1Q24 (ex-price hikes). We highlight this number considers a stable mix of hybrid and pure postpaid in revenue.

Looking at EBITDA margin ex-other revenues

The main pushback after 4Q, was that although EBITDA margin was up 120bps YoY (+120bps vs BofAe), it had a positive impact of R\$350mn (R\$290mn from towers negotiation) from other revenues (see: [4Q23 Review: Mobile market rationality with Vivo leading the pack](#)). In our estimates, we have other revenues at ~0.8% of revenues in 2024 (R\$400mn), vs 1.3% in 2023 and 1.3% in 2022. We highlight other revenues include equipment sales, tax benefits, reversion of provisions, among others.

Update our numbers – Reiterate Buy and raise PO to R\$64

We update our numbers for Vivo with (i) 4Q results, (ii) adjusted other revenues to ~R\$400mn/year from 2024 onwards and (iii) increased div. yield in 2024/25 to fully distribute Vivo's R\$5bn capital reduction.

Estimates(Dec) (BRL)	2021A	2022A	2023E	2024E	2025E
EPS	3.70	2.46	3.02	3.59	4.48
EPS Change (YoY)	31.2%	-33.5%	22.8%	18.9%	24.8%
Consensus EPS (Bloomberg)			2.94	3.45	4.11
DPS	3.71	1.85	2.83	5.34	5.73
ADR EPS (US\$)	0.69	0.48	0.61	0.73	0.91
ADR DPS (US\$)	0.69	0.36	0.57	1.08	1.16
Valuation (Dec)					
P/E	15.2x	22.8x	18.6x	15.6x	12.5x
Dividend Yield	6.6%	3.3%	5.0%	9.5%	10.2%
EV / EBITDA*	6.5x	6.4x	5.8x	5.4x	5.1x
Free Cash Flow Yield*	7.9%	2.1%	15.0%	13.4%	14.5%

* For full definitions of *IQmethod*SM measures, see page 6.

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Refer to important disclosures on page 7 to 10. Analyst Certification on page 5. Price Objective Basis/Risk on page 5.

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Timestamp: 22 February 2024 06:28PM EST

22 February 2024

Equity

Key Changes

(BRL)	Previous	Current
Price Obj.	63.00	64.00
2023E Rev (m)	52,036.4	52,100.1
2024E Rev (m)	54,610.1	55,214.4
2025E Rev (m)	57,575.0	58,223.1
2023E EPS	2.84	3.02
2024E EPS	3.42	3.59
2025E EPS	4.35	4.48
2023E DPS	3.15	2.83

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Stock Data

Price (Common / ADR)	56.18 BRL / 11.26 USD
Price Objective	64.00 BRL / 13.00 USD
Date Established	22-Feb-2024 / 9-Jan-2024
Investment Opinion	B-1-7 / B-1-7
52-Week Range	37.20 BRL - 56.18 BRL
Market Value (mn)	92,842 BRL
Free Float	23.9%
Average Daily Value	22.90 USD
Shares Outstanding (mn)	1,652.6 / 1,652.6
BofA Ticker / Exchange	XCPTF / SAO
BofA Ticker / Exchange	VIV / NYS
Bloomberg / Reuters	VIVT3 BZ / VIVT3.SA
ROE (2023E)	7.3%
Net Dbt to Eqty (Dec-2022A)	7.3%

MSR = Mobile Service Revenue

AMX = America Movil

TIM = Tim Brasil

iQprofileSM Telefonica Brasil

iQmethodSM – Bus Performance*

(BRL Millions)	2021A	2022A	2023E	2024E	2025E
Return on Capital Employed	8.6%	8.2%	9.1%	8.6%	9.9%
Return on Equity	9.0%	5.9%	7.3%	8.8%	11.4%
Operating Margin	15.8%	13.8%	15.2%	16.9%	19.0%
Free Cash Flow	7,375	1,929	13,930	12,464	13,472

iQmethodSM – Quality of Earnings*

(BRL Millions)	2021A	2022A	2023E	2024E	2025E
Cash Realization Ratio	2.6x	2.8x	4.6x	3.6x	3.0x
Asset Replacement Ratio	0.7x	0.8x	0.7x	0.7x	0.7x
Tax Rate	NM	16.0%	9.6%	16.1%	17.2%
Net Debt-to-Equity Ratio	-1.1%	7.3%	20.6%	22.3%	24.3%
Interest Cover	2.9x	1.7x	1.8x	2.7x	3.7x

Income Statement Data (Dec)

(BRL Millions)	2021A	2022A	2023E	2024E	2025E
Sales	44,033	48,041	52,100	55,214	58,223
% Change	2.1%	9.1%	8.4%	6.0%	5.4%
Gross Profit	40,811	44,200	47,799	50,983	53,790
% Change	1.4%	8.3%	8.1%	6.7%	5.5%
EBITDA	19,007	19,282	21,318	22,761	24,358
% Change	6.7%	1.4%	10.6%	6.8%	7.0%
Net Interest & Other Income	(1,989)	(1,790)	(2,355)	(2,162)	(2,051)
Net Income (Adjusted)	6,244	4,085	5,029	5,997	7,476
% Change	30.9%	-34.6%	23.1%	19.2%	24.7%

Free Cash Flow Data (Dec)

(BRL Millions)	2021A	2022A	2023E	2024E	2025E
Net Income from Cont Operations (GAAP)	6,239	4,085	5,029	5,997	7,476
Depreciation & Amortization	12,038	12,660	13,390	13,450	13,277
Change in Working Capital	(323)	1,249	521	36	(100)
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	(1,896)	(6,535)	3,950	1,816	1,698
Capital Expenditure	(8,685)	(9,530)	(8,960)	(8,834)	(8,879)
Free Cash Flow	7,375	1,929	13,930	12,464	13,472
% Change	-21.1%	-73.8%	622.0%	-10.5%	8.1%
Share / Issue Repurchase	NA	NA	NA	NA	NA
Cost of Dividends Paid	(6,264)	(3,075)	(4,720)	(8,908)	(9,559)
Change in Debt	3,283	1,565	(2,128)	0	0

Balance Sheet Data (Dec)

(BRL Millions)	2021A	2022A	2023E	2024E	2025E
Cash & Equivalents	6,479	2,275	4,359	3,471	3,140
Trade Receivables	8,100	8,691	9,318	9,618	10,070
Other Current Assets	6,481	6,318	5,567	6,430	6,621
Property, Plant & Equipment	33,656	34,581	34,238	35,689	36,988
Other Non-Current Assets	50,195	55,848	67,255	63,443	60,761
Total Assets	104,911	107,713	120,738	118,651	117,579
Short-Term Debt	3,999	2,517	4,476	4,369	4,502
Other Current Liabilities	15,553	16,151	15,609	16,807	17,350
Long-Term Debt	1,704	4,752	14,262	13,994	14,328
Other Non-Current Liabilities	13,171	15,213	16,765	16,765	16,765
Total Liabilities	34,427	38,633	51,111	51,934	52,946
Total Equity	70,006	68,456	69,627	66,716	64,634
Total Equity & Liabilities	104,433	107,089	120,738	118,651	117,579

* For full definitions of iQmethodSM measures, see page 6.

Company Sector

Telecom Equipment-Wireless/Cellular

Company Description

Telefonica Brasil (Vivo) is a full-service telco carrier, using the Vivo brand. It is the leading wireless company in Brazil with 77mn subscribers (34% share), the fixed-line incumbent in the state of São Paulo, and it has been deploying fiber-to-the-home (FTTH) in 268 cities to expand its footprint and enhance its network infrastructure. Today, Vivo has 14.6mn homes passed with FTTH and is expected to end 2024 with more than 24mn. Vivo is controlled by Telefonica of Spain, with 74% stake.

Investment Rationale

Vivo is going through an important transformation where Fiber (FTTH) is offsetting the legacy products and we expect to see a growth in the fixed business, after 5 years of decline. On mobile, it continues to rely on its premium base of clients which has proved to be more resilient in challenging macro periods. We also see the company well positioned to benefit from the acquisition of Oi's assets and the ICMS reduction. Finally, the high liquidity and low beta help in a difficult macro scenario

Stock Data

Average Daily Volume	2,015,203
Shares / ADR	1.00

Quarterly Earnings Estimates

	2022	2023
Q1	NA	NA
Q2	NA	NA
Q3	NA	NA
Q4	NA	NA

Key Changes

(US\$)	Previous	Current
2023E EPS	0.57	0.61
2024E EPS	0.69	0.73
2025E EPS	0.88	0.91
2023E DPS	0.64	0.57

Capex to continue declining as percentage of revenues

During Vivo's 4Q conference call, although no formal guidance was given the company shared it expects capex to continue declining as a percentage of net revenues in the coming years. In our view, not only should capex decline as a percentage of revenues, but there is also room for it to remain stable/decline in nominal terms. We also expect a similar tendency for TIM and AMX (see: [Capex is declining globally - A new era of profitability for the Brazilian Telcos](#)).

Exhibit 1: We expect a 2.2% positive impact from net adds in 1Q, even with no user base expansion in the quarter

Impact of net adds for 1Q MSR (assuming zero net adds in 1Q24)

Net adds	1Q23	2Q23	3Q23	4Q23	1Q24
Postpaid		468	551	692	0
Prepaid		-1,225	-908	104	0
	YoY Growth in 1Q (Assuming no net adds)	Average ARPU in 4Q	User base percentage in 1Q	Net adds impact on revenues in 1Q	Consolidated impact in 1Q
Postpaid	4.0%	51.3	52%	3.2%	2.2%
Prepaid	-5.2%	13.4	48%	-1.0%	

Source: BofA Global Research

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Exhibit 2: Even excluding the positive impact from other revenues on Vivo's Results, we still saw a ~100bps YoY EBITDA margin expansion

Evolution of Vivo's EBITDA ex-other expenses (Revenues)

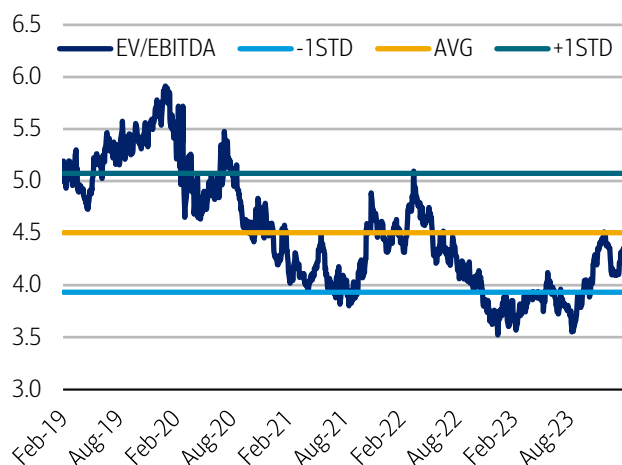
(R\$m)	4Q23	4Q22	YoY	3Q23	QoQ
Revenue	13,535	12,659	6.9%	13,112	3.2%
EBITDA Ex-Others	5,403	4,931	9.6%	5,265	2.6%
Margin (%)	40%	39%	1.0%	40%	-0.2%
(R\$m)	3Q23	3Q22	YoY		
Revenue	13,112	12,199	7.5%		
EBITDA Ex-Others	5,265	4,772	10.3%		
Margin (%)	40%	39%	1.0%		
(R\$m)	2Q23	2Q22	YoY		
Revenue	12,733	11,831	7.6%		
EBITDA Ex-Others	5,047	4,546	11.0%		
Margin (%)	40%	38%	1.2%		

Source: Company data; BofA Global Research

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Exhibit 3: Vivo is trading in line with its L5Y EV/EBITDA average

Vivo's EV/EBITDA L5Y

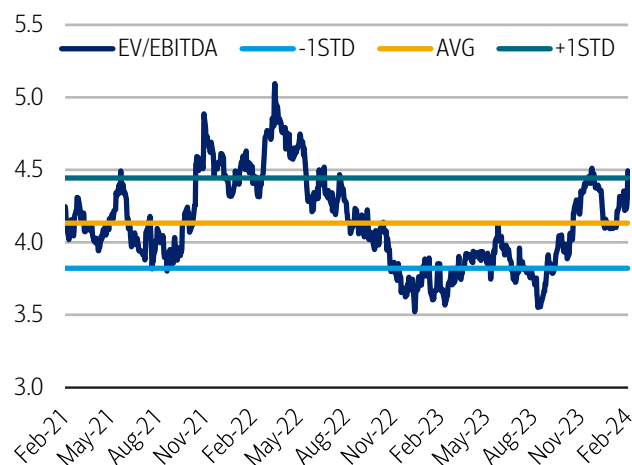


Source: Bloomberg; BofA Global Research

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Exhibit 4: Vivo is trading above its L3Y EV/EBITDA average

Vivo's EV/EBITDA L3Y



Source: Bloomberg; BofA Global Research

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Exhibit 5: We adjusted our numbers for Vivo after 4Q results, leading to revenue up 1% YoY and flattish net income for 2024

Vivo's Old Vs New estimates

	New			Old			% chg.			Consensus			New vs. Consensus		
	2024E	2025E	2026E	2024E	2025E	2026E	2024E	2025E	2026E	2024E	2025E	2026E	2024E	2025E	2026E
Revenue	55,214	58,223	61,112	54,610	57,575	60,458	1.1%	1.1%	1.1%	54,786	57,234	59,838	0.8%	1.7%	2.1%
EBITDA (adjusted)	22,761	24,358	25,852	22,486	23,810	25,365	1.2%	2.3%	1.9%	22,418	23,469	24,750	1.5%	3.8%	4.5%
EBITDA margin	41.2%	41.8%	42.3%	41.2%	41.4%	42.0%	5bps	48bps	35bps	40.9%	41.0%	41.4%	30bps	83bps	94bps
Net profit (reported)	5,997	7,476	8,569	5,714	7,265	8,619	5.0%	2.9%	-0.6%	5,779	6,861	8,112	3.8%	9.0%	5.6%
EPS	3.6	4.5	5.1	3.4	4.4	5.2	5.0%	2.9%	-0.6%	3.5	4.1	4.9	3.8%	9.0%	5.6%

Source: Bloomberg; BofA Global Research

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Price objective basis & risk

Telefonica Brasil (XCPTF / VIV)

Our price objective of R\$64/US\$13 per share is based on a 10-year DCF-to-Firm, discounted at a weighted average cost of capital (WACC) of 12.5%, assuming a capital structure of 95% equity / 5% debt in the long term. Our cost of equity (Ke) is composed of a Beta of 0.80, a risk-free rate of 3%, a market risk premium of 5.7% and a country risk in Brazil of 280bps. We use cost of debt of 5% and terminal growth rate of 3%.

Risks: (i) limited benefit from the macroeconomic recovery given its premium customer base, (ii) legacy business continues to pressure top-line growth, (iii) price pressure in the mobile segment given the highest ARPU in the space, (iv) creation of dividend tax would strongly impact Vivo.

Analyst Certification

We, Fred Mendes, CFA, Gustavo Tiseo, Lucca R Brendim and Mirela Oliveira, hereby certify that the views each of us has expressed in this research report accurately reflect each of our respective personal views about the subject securities and issuers. We also certify that no part of our respective compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

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Latin America - Telecom Services and Information Technology Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	America Movil	AMX	AMX US	Fred Mendes, CFA
	America Movil	AMXVF	AMXB MM	Fred Mendes, CFA
	Desktop S.A	XNUKF	DESK3 BZ	Fred Mendes, CFA
	Eletromidia	XSUHF	ELMD3 BZ	Fred Mendes, CFA
	Locaweb	XZVMF	LWSA3 BZ	Fred Mendes, CFA
	Telefonica Brasil	XCPTF	VIVT3 BZ	Fred Mendes, CFA
	Telefonica Brasil	VIV	VIV US	Fred Mendes, CFA
	Televisa	TV	TV US	Fred Mendes, CFA
	Televisa	GRPFF	TLEVICPO MM	Fred Mendes, CFA
	TIM Brasil	TIMB	TIMB US	Fred Mendes, CFA
	TIM Brasil	XZUAF	TIMS3 BZ	Fred Mendes, CFA
	TOTVS	XBEGF	TOTS3 BZ	Fred Mendes, CFA
	VTEX	VTEX	VTEX US	Fred Mendes, CFA
NEUTRAL				
	Intelbras S.A.	XLTXF	INTB3 BZ	Fred Mendes, CFA
UNDERPERFORM				
	Brisanet	XNHKF	BRIT3 BZ	Fred Mendes, CFA
	Megacable Holdings SAB	MHSDF	MEGACPO MM	Fred Mendes, CFA
	Unifiquê S.A	XFYDF	FIQE3 BZ	Fred Mendes, CFA



iQmethodSM Measures Definitions

Business Performance

Return On Capital Employed

Return On Equity

Operating Margin

Earnings Growth

Free Cash Flow

Quality of Earnings

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

Valuation Toolkit

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

EV / EBITDA

Numerator

$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) \times (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$

Net Income

Operating Profit

Expected 5 Year CAGR From Latest Actual

Cash Flow From Operations – Total Capex

Numerator

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt – Cash & Equivalents

EBIT

Numerator

Current Share Price

Current Share Price

Annualised Declared Cash Dividend

Cash Flow From Operations – Total Capex

$\text{EV} = \text{Current Share Price} \times \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} +$

Other LT Liabilities

Enterprise Value

Denominator

$\text{Total Assets} - \text{Current Liabilities} + \text{ST Debt} + \text{Accumulated Goodwill}$

Amortization

Shareholders' Equity

Sales

N/A

N/A

Denominator

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

Denominator

Diluted Earnings Per Share (Basis As Specified)

Shareholders' Equity / Current Basic Shares

Current Share Price

$\text{Market Cap} = \text{Current Share Price} \times \text{Current Basic Shares}$

Sales

Basic EBIT + Depreciation + Amortization

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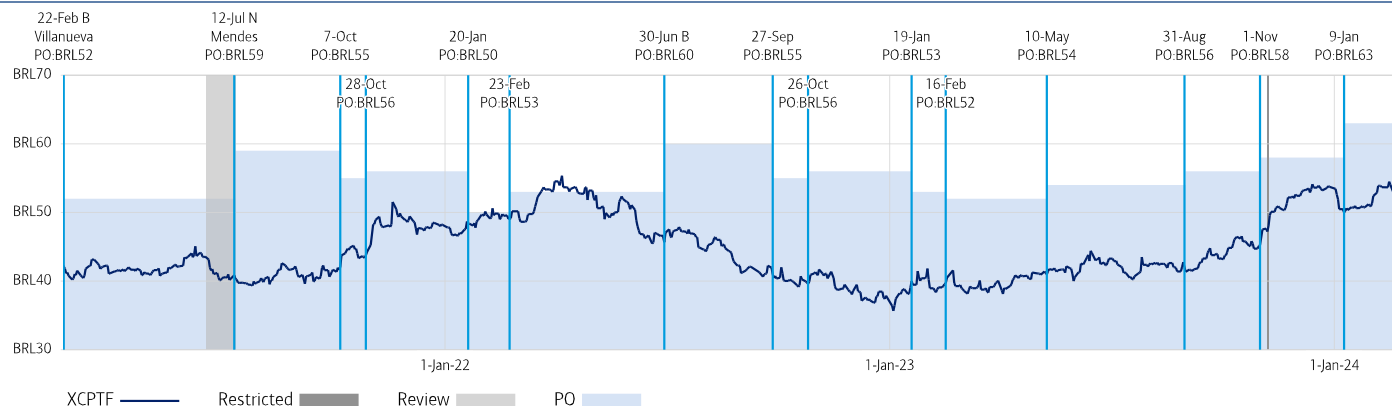
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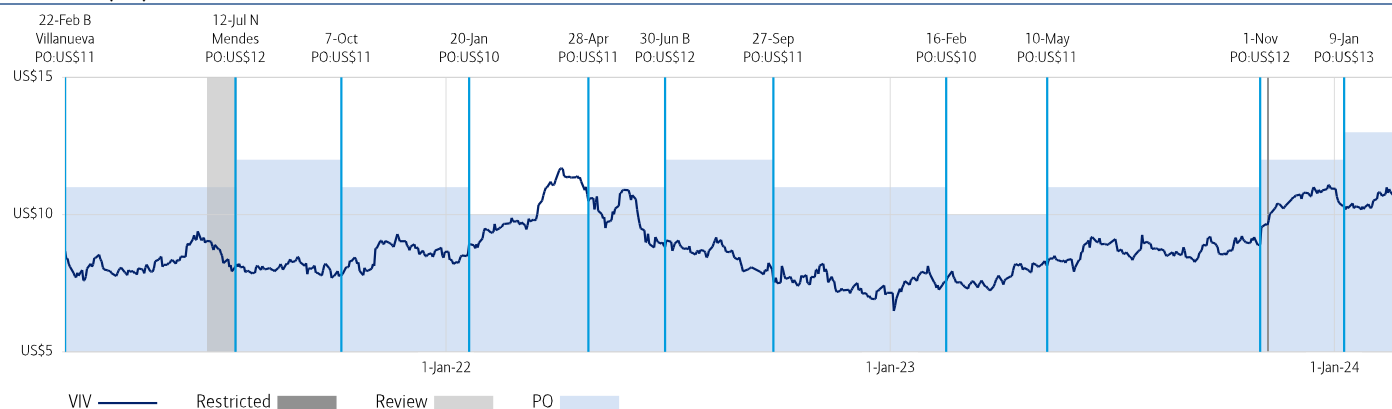
Important Disclosures

Telefonica Brasil (XCPTF) Price Chart



The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

Telefonica Brasil (VIV) Price Chart



The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

Equity Investment Rating Distribution: Telecommunications Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	57	51.82%	Buy	43	75.44%
Hold	27	24.55%	Hold	17	62.96%
Sell	26	23.64%	Sell	12	46.15%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster ^{R2}
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

^{R2}Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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