

Telefonica Brasil

Vivo Day: Keep bullish view... but we expected some extra “salt”

Maintain Rating: BUY | PO: 64.00 BRL | Price: 52.07 BRL

New growth avenues are in place

We attended Vivo Day 2024 where the company shared the main points of its strategy for the coming years, with a focus on revenue growth. The main highlights were (1) performance of its new lines of businesses; (2) the creation of Vivo Pay (all financial services); (3) total distribution guidance, among others. We maintain our bullish view on Vivo, our Buy rating and PO of R\$64, given solid operational momentum and a positive outlook for cash generation with an 8% FCFE yield in 2024E. However, we expected more details on B2B digital opportunities and potential growth (no “salt” = no trigger).

New businesses: 10% of revenues growing 30% YoY

Vivo shared new data on new businesses/digital, which today represent 10% of revenues and have been growing at a ~30% YoY pace. B2B digital (Networking, IoT (Internet of Things), Big data, cloud, cybersecurity among others) currently represent 6.5% of revenues and the 2021-2023 revenue CAGR was 28%. For new B2C businesses (partnerships in education, healthcare, financial services, agribusiness, digital services, among others), it represents 3% of revenues and its revenues are growing ~40% YoY.

Leveraging its user base – the power of the invoice

One of Vivo’s main competitive advantages is its user base. Not only does it have 110mn telecom accesses in Brazil, but also ~60mn customers who pay them monthly (recurring revenue). Vivo also offers a product that is essential to its customers day to day. Moreover, it has a powerful channel to provide to partners so that they can combine services into a single invoice under Vivo, which has low delinquency and churn rates.

Our take: Digital business could boost growth

Despite Vivo’s conservative approach, we keep our bullish view on the Digital Business (10% of revenue), which could boost top-line growth by 150/200bps over the next years. Historically, Telcos have grown at ~70% the rate of inflation. For 2024, we see a scenario of rational competition, with ARPU increases (prices + upselling) and a positive impact from new growth avenues; while trading at 4.5x EV/EBITDA (in line the with 5Y average.)

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	3.52	4.19
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	14.1x	21.2x	17.2x	14.5x	11.6x
Dividend Yield	7.1%	3.5%	5.4%	10.2%	11.0%
EV / EBITDA*	6.2x	6.1x	5.5x	5.2x	4.8x
Free Cash Flow Yield*	8.6%	2.2%	16.2%	14.5%	15.7%

* For full definitions of *IQmethod*SM measures, see page 5.

05 March 2024

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Stock Data

Price (Common / ADR)	52.07 BRL / 10.45 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 - 56.61 BRL
Market Value (mn)	86,050 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%

Avg = Average

B2B = Business to Business

B2C = Business to Consumer

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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 5.

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	2,174,273
Shares / ADR	1.00

Quarterly Earnings Estimates

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

All financial services to be consolidated as Vivo Pay

Vivo announced it will consolidate all its financial services under the same brand “Vivo Pay”. This segment will incorporate Vivo’s solutions of credit, mobile phone insurance, credit card and other new solutions like consortiums and prepayments. In 2023 the segment already had R\$400mn in revenues, up from ~R\$300mn in 2022.

New share buyback program and distribution guidance

Today, Vivo announced a new share buyback program of up to R\$1bn to be completed in the next 12 months. The company also reiterated its guidance for a total payout (Dividends, loC, capital reductions and buybacks) of >100% in 2024-26 but did not share further information. In addition, it approved the payment of R\$1.5bn from its capital reduction in July. We highlight that Anatel approved a total capital reduction of R\$5bn, and this will be its first distribution.

2023 was a year of more upgrades than downgrades

Another fact shared by Vivo that supports our bullish view on the mobile market is that in 2023 it had more upgrades than downgrades in plans, vs ~50% more downgrades in 2022. Although there were some positive impacts in 2023, like the reduction in ICMS (tax on services and goods), seeing more upgrades than downgrades in a year of price hikes above inflation is a positive sign. Overall, with more aggressive price hikes, customers are more likely to downgrade plans.

Non-core businesses phasing out

Additional avenue that should help Vivo’s future growth is the phase out of legacy technologies. As a reference, in 2019 the non-core businesses represented 18% of revenues vs 6% in 2023, declining at a -20% CAGR during the period. With that, while in 2019, a 20% decline in non-core would represent a 4% negative impact on overall growth, today this represents slightly more than 1%.

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

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	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
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	VTEX	VTEX	VTEX US	Fred Mendes, CFA
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	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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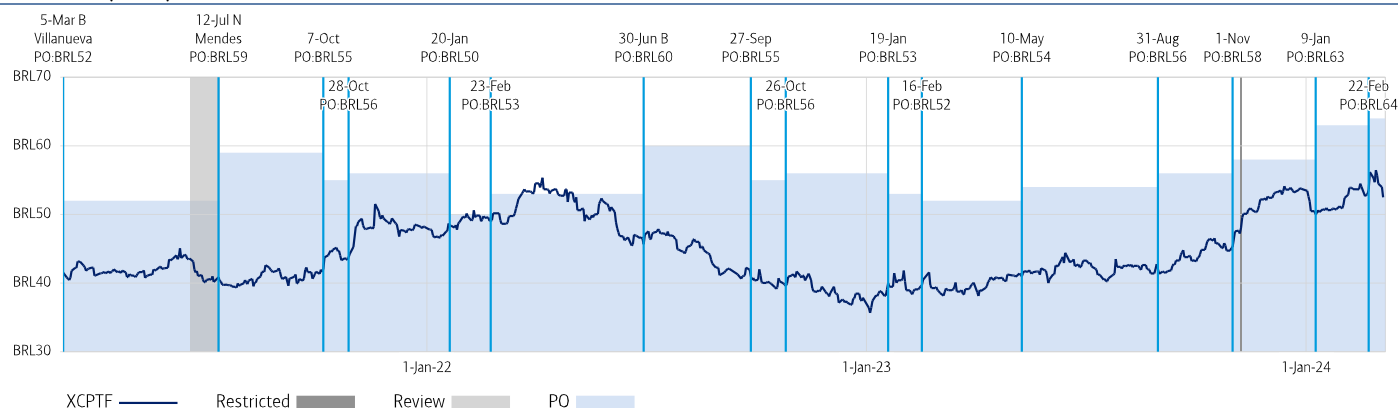
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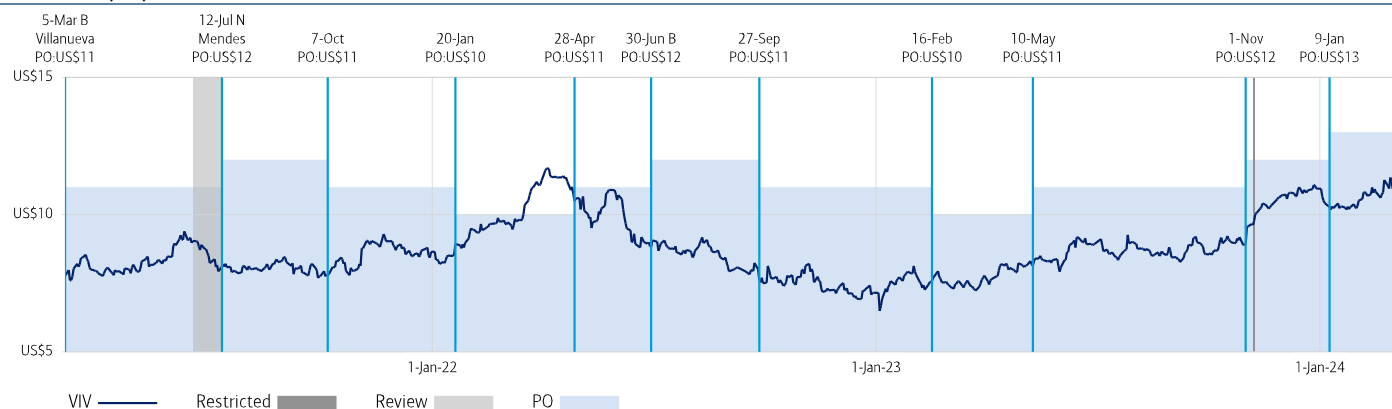
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Telefonica Brasil (XCPTF) Price Chart



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



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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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