

# Brazil

Equity preferences **08 April 2021 – 08:54 BST**

Chief Investment Office GWM

Corinne de Boursetty, CFA, Emerging markets equities strategist, corinne.de-boursetty@ubs.com

**Strategy:** We are neutral on MSCI Brazil and Ibovespa, following the close-to-doubling in both indexes since end-March 2020 lows. We see them now trading close to fair value. Based on our fundamental economic growth, earnings growth and long-term rate expectations, as well as perceived higher political risks, we see limited upside for Ibovespa in the near term. However, a faster-than-expected vaccine rollout, a more stable political environment, an improved outlook for reforms and fiscal consolidation, and strong equity retail inflows driven by low interest rates could provide support for local equities and the Brazilian real.

**Sector positioning:** We favor a mix of highly discounted cyclicals set to benefit from the reopening of the economy (retail banks, materials, energy, infrastructure, apparel retailer) and cheap defensives (insurance, healthcare). We like financials, energy, materials, and transportation and select consumer discretionary.

**Recent changes:** We have removed food retailer GPA following its recent strong performance and added exposure to quality apparel retailer Lojas Renner, which should benefit from the reopening of Brazil's economy.



Corinne joined UBS in 2018 as an Emerging markets equities strategist. She has over ten years of experience in equity research with a focus on consumer related sectors in developed and emerging markets. In close collaboration with the other CIO equity analysts, Corinne will identify investment ideas in EMEA and Latam equities and advice on country and sector allocation. She previously worked at Fidelity Worldwide Investment as a senior Latam consumer analyst in London and started her career as an M&A analyst at Lazard in Paris. She graduated from ESCP Europe Business School in 2004 with a major in Marketing and Finance. She is a CFA charter holder.

## Our view

Brazil underperformed its emerging market (EM) peers by 38% in 2020 and continues to lag by close to 15% year-to-date. The BRL's weakness (-25% versus the USD) explains about half of the underperformance, reflecting the still uncertain fiscal situation in the country while the Ibovespa Index has underperformed MSCI EM by 25% over the past 12 months. E-commerce-exposed consumer discretionary, healthcare and exporters (mostly materials and industrials) have benefited from a weaker BRL, and outperformed MSCI Brazil, we see scope for value cyclical sectors that have lagged (financials, energy, industrials, some consumer discretionary) to outperform as the global economic recovery continues.

**Limited valuation upside:** We believe valuation, at 10.5x 12-month forward P/E and 2.3x P/B (versus historical average of 1.6x), remains vulnerable to political risks and high earnings expectations. We see a balanced risk-reward in our bull, base, and bear target values of 130,000, 120,000, and 100,000 for the Ibovespa index.

**Positioning:** We believe cyclicals with strong balance sheets will outperform the broader Bovespa Index. We have close to 70% of our exposure to names in this category; these stocks are trading at material discounts to historical valuations and appear set to benefit from the global economic recovery and higher energy and commodity prices (energy, materials) and a domestic economic rebound once the country exits from lockdown (financials, consumer discretionary,

## Most Preferred

Banco Bradesco SA	BRL
BB Seguridade	BRL
Cia. de Concessões Rodovias - CCR	BRL
Hypera SA	BRL
Lojas Renner	BRL
Petrobras (ON)	BRL
Vale ADR (ON)	USD

Source: UBS

Thematic Benchmark: Ibovespa Index

transportation). We also continue to like cheap domestic defensives, which represent about 30% of our selection (insurance, healthcare). They have been resilient throughout the coronavirus outbreak.

Risks to our views include include negative political developments leading to disappointment in the pace or implementation of structural reforms in Brazil, adverse pandemic dynamics and delays in vaccines rollouts, and increased US-China tensions, which would add downside pressure on the global economic recovery and commodity prices (iron ore, oil, agriculture).

## Recent CIO selection changes

Company / Trade Date	Old	New	Comment
<b>Cia Brasileira N</b> 24 February 2021, 06:15AM	Most Preferred	Removed	We are taking profit in CBD following its strong performance as we see limited upside to valuation from current levels.
<b>Lojas Renner</b> 24 February 2021, 06:03AM		Most Preferred	Lojas Renner is a leading apparel retailer and a structural compounder with potential in the e-commerce and fintech sectors. The stock is trading about 40% below its pre-COVID-19 highs. We see recent weakness as an opportunity to add a quality company with material upside to the reopening of the economy in Brazil.
<b>Hypera SA</b> 27 October 2020, 11:21AM		Most Preferred	Hypera is one of the largest and most efficient players in the Brazilian pharmaceutical segment, and in our view one of the best ways to gain exposure to the Latam pharma market given its superior growth and profitability versus regional peers. Based on 12-month forward P/E, it is trading at the low-end of its historical range and also relative to international peers. It has material scope for re-rating in our view.
<b>BB Seguridade</b> 23 July 2020, 08:26AM		Most Preferred	BB Seguridade is a leading insurance and brokerage company in Brazil offering an attractive return profile and trading at an unjustified discount to emerging market peers.
<b>Cia. de Concessões Rodoviarias - CCR</b> 23 July 2020, 08:26AM		Most Preferred	CCR is a leading highway concession operator with one of the cheapest valuations following the negative impact from the COVID-19 disruption. It should benefit from the new infrastructure investment cycle in Brazil and a pickup in transportation volumes in our view.
<b>Telefonica Brasil</b> 14 July 2020, 07:04AM	Most Preferred	Removed	UBS Research has dropped coverage of the stock. We remove it from the Equity Preference List pending possible reconsideration in the future.
<b>Linx NM</b> 14 July 2020, 07:04AM	Most Preferred	Removed	UBS Research has dropped coverage of the stock. We remove it from the Equity Preference List pending possible reconsideration in the future.
<b>Linx NM</b> 10 June 2020, 11:25AM		Most Preferred	Linx is a leader in ERP software and has one of the cheapest valuations following the negative impact from the COVID-19 disruption, which led to temporary retail store closures. It should benefit from the nationwide reopening of retail stores in Brazil. Also, it is exposed to e-commerce.
<b>Telefonica Brasil</b> 10 June 2020, 07:16AM		Most Preferred	Telco operators in general should outperform other sectors amid uncertainty over the shape of the economic recovery in Brazil. We like its defensive nature given its leading market share in fixed line and postpaid, its resilient business model, consistent cash flow generation and low leverage. The stock provides income protection in case of a market correction. It has underperformed the Ibovespa by 38% over the past five years.
<b>Rumo</b> 10 June 2020, 07:16AM	Most Preferred	Removed	We remove Rumo to take profit following its 20% outperformance versus the Ibovespa index. We see better opportunities elsewhere and would re-enter at a more attractive level.
<b>PagSeguro-A Rg</b> 10 June 2020, 07:16AM	Most Preferred	Removed	We remove Pag Seguro to take profit following its 27% outperformance versus the Ibovespa index. We see better opportunities elsewhere and would re-enter at a more attractive level.
<b>Banco Bradesco SA</b> 12 February 2020, 00:00AM		Most Preferred	Bradesco is a main beneficiary of the positive credit cycle driven by faster economic growth, low interest rates, and market share gains from public banks. It enjoys strong loan and earnings growth driven by its exposure to consumers and SMEs. It has the cheapest valuation at a 15% discount relative to Brazil private bank peers.
<b>Petrobras (ON)</b> 12 February 2020, 00:00AM		Most Preferred	Petrobras is a high-beta stock. It should benefit from current deregulation and privatization. Upcoming potential catalysts include divestments, confirmation of an independent fuel price policy, higher oil prices (we forecast USD 50–60/bbl by March through September 2021), and a stronger Brazilian real (we estimate USDBRL 5 by March 2021).
<b>PagSeguro-A Rg</b> 12 February 2020, 00:00AM		Most Preferred	PagSeguro is a Brazilian fintech payments company with exposure to two attractive long-term trends: electronic payments and e-commerce. It has more attractive growth, market positioning, and valuation than its peers.
<b>Rumo</b> 12 February 2020, 00:00AM		Most Preferred	Rumo operates the most competitive railway route for grain exports from Mato Grosso. It has a solid investment plan for capacity expansion and cost reduction and should continue to gain market share. Profitability is expected to grow at a double-digit annual rate over the next three years.

Brazil Equity preferences

Name	Selection	ISIN	CCY	Share Price	52 Week		P/E		Div Yield		P/BV	Div. Cover
					High	Low	21E	22E	21E	22E	21E	21E
Banco Bradesco SA	Most Preferred	BRBBDACNPR8	BRL	25.32	28.41	16.11	8.9 x	8.0 x	6.29%	6.98%	1.5 x	1.8 x
BB Seguridade	Most Preferred	BRBBSEACNOR5	BRL	24.04	30.76	22.38	11.1 x	9.9 x	7.02%	7.93%	6.9 x	1.3 x
Cia. de Concessões Rodovias - CCR	Most Preferred	BRCCROACNOR2	BRL	12.96	16.10	10.31	24.9 x	19.8 x	2.20%	3.49%	3.1 x	1.8 x
Hypera SA	Most Preferred	BRHYPEACNOR0	BRL	32.78	37.15	27.01	14.7 x	12.9 x	3.06%	3.65%	2.0 x	2.2 x
Lojas Renner	Most Preferred	BRLRENACNOR1	BRL	43.13	49.90	30.83	33.0 x	24.8 x	0.74%	1.72%	5.4 x	4.1 x
Petrobras (ON)	Most Preferred	BRPETRACNOR9	BRL	23.80	32.34	15.52	5.6 x	5.6 x	1.98%	7.68%	0.9 x	9.0 x
Vale ADR (ON)	Most Preferred	US91912E1055	USD	18.65	19.00	7.36	4.7 x	5.7 x	9.11%	8.48%	2.0 x	2.4 x

Based on consensus estimates provided by Factset as of April 7, 2021

Name	Sector Market	ISIN Valor	Currency Share Price	52w High 52w Low	Selection Analyst
<b>Banco Bradesco SA</b>	Financials Brazil	BRBDCACNPR8 654577	BRL 25.32	28.41 16.11	<b>Most Preferred</b> corinne.de- boursetty@ubs.com UBS Switzerland AG

#### Company profile

Bradesco is among the largest Brazilian banks, holding market share in assets in the low-teen digits. The bank serves in Brazil and abroad to individuals, companies and important national and international societies and institutions. Also, it has a widespread retail branch network in Brazil and is involved in diversified financial service activities, including commercial banking, current account services, consumer lending, credit cards, asset management, capital market advisory and insurance, among others. Bradesco is listed at level 1 Corporate Governance of BM&F Ibovespa.

#### What drives our opinion

As a large-cap bank, we think Bradesco is well positioned to weather higher delinquency in Brazil—GDP projected to shrink by 5.5% in 2020—as it has been de-risking its balance sheet over the last three years. Its asset quality is better than peers, in our view, given its high pre-provision profitability and smaller consumer exposure. It is trading at 1.3x P/B, below its 10-year average of 2.0x. Over the medium term, we think it will benefit from: 1) near 10% loan growth reacceleration as credit growth recovers thanks to low interest rates; 2) strong operating cost control; 3) a loan mix shift to higher margin SMEs and consumers; and 4) controlled asset quality, which leaves room for higher dividend payout. We expect it to deliver close to 20% earnings growth in 2021 and 2022, with an ROE of over 15%. It currently boasts an attractive dividend yield of 5.3%. Key risks include the economic recession and its impact on loan growth/NPLs, higher taxes and competition, and a weaker BRL.

#### Why it is Most Preferred

Bradesco is a main beneficiary of the positive credit cycle driven by faster economic growth, low interest rates, and market share gains from public banks. It enjoys strong loan and earnings growth driven by its exposure to consumers and SMEs. It has the cheapest valuation at a 15% discount relative to Brazil private bank peers.

<b>BB Seguridade</b>	Financials Brazil	BRBBSEACNOR5 21099696	BRL 24.04	30.76 22.38	<b>Most Preferred</b> corinne.de- boursetty@ubs.com UBS Switzerland AG
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#### Company profile

BB Seguridade is one of the largest insurance, pension and premium bond companies in Latin America and the largest insurance broker in the region. It is controlled by Banco do Brasil (66.25%). BBSE is a holding company. Its insurance operations, pension plans, and premium bonds are managed through joint ventures controlled by private players, while BBSE owns 100% of the broker. It has a presence in various segments such as life, credit life, rural, dental, pension and premium bonds.

#### What drives our opinion

We believe the weaker operational trends and lower interest rates are priced in. At 13x 2021 P/E, BB Seguridade is cheap at about 30% discount to global peers and given a solid dividend yield of 6%, in our view. It is a defensive name that should benefit from 1) earnings growth accelerating to 10–12% in the next two years via better brokerage fee momentum (brokerage business is about 45% of 2019 earnings); 2) better strategy via the sole distribution of its insurance products through Banco do Brasil branches following a restructuring; and 3) resumption in pension contributions as the economy improves. Key risks include further macro deterioration, a second wave of COVID-19, competition, and income tax increase.

#### Why it is Most Preferred

BB Seguridade is a leading insurance and brokerage company in Brazil offering an attractive return profile and trading at an unjustified discount to emerging market peers.

<b>Cia. de Concessões Rodovias - CCR</b>	Industrials Brazil	BRCCROACNOR2 1359222	BRL 12.96	16.10 10.31	<b>Most Preferred</b> corinne.de- boursetty@ubs.com UBS Switzerland AG
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#### Company profile

CCR is the largest toll road concession operator in Brazil. The company manages eleven toll road concessions, four airports, and three subway lines, among other infrastructure assets. Its main shareholders are Soares Penido (15%), Camargo Correa (14.9%) and Andrade Gutierrez (14.9%).

#### What drives our opinion

CCR is a leading highway concession operator. We like its defensive business model, which proved resilient during the crisis, and its strong market share, which positions it well for upcoming auctions. We expect a positive outlook with close to 20% earnings growth in 2021 and 2022 driven by higher toll fees and an abundant pipeline of investment opportunities given Brazil's new infrastructure plans. Valuations are attractive at 3.5x P/B, well below peers' and historical averages. It has a strong balance sheet and attractive dividend yield of 5%. Catalysts include future auctions in 3Q as well as transport data improvement. Key risks include regulatory changes and virus-related setbacks.

#### Why it is Most Preferred

CCR is a leading highway concession operator with one of the cheapest valuations following the negative impact from the COVID-19 disruption. It should benefit from the new infrastructure investment cycle in Brazil and a pickup in transportation volumes in our view.

Name	Sector Market	ISIN Valor	Currency Share Price	52w High 52w Low	Selection Analyst
Hypera SA	Healthcare Brazil	BRHYPEACNOR0 3956645	BRL	37.15	<b>Most Preferred</b> corinne.de- boursetty@ubs.com UBS Switzerland AG
				32.78	

**Company profile**

Hypera is the second-largest pharmaceutical company in Brazil. The company's portfolio is balanced between OTC/consumer health (market leader), generics/branded generics (second player) and branded prescription drugs.

**What drives our opinion**

Hypera should benefit from the reopening of the Brazilian's economy with improvement in consumer mobility leading to a gradual recovery in medical consultations and traffic in points of sale. This should lead to topline growth acceleration. We expect continued operating cost efficiencies to more than offset the temporary negative mix impact from faster growth in the lower margin generics. Key drivers are market share recovery supported by an accelerated pipeline of new branded product launches, inventory loss normalization driving higher gross margins, lower FX pressure (one-third of COGS is in USD) and synergies from recent acquisitions. The potential approval of the Takeda acquisition would be a positive catalyst. Risks include regulation causing delays to product launches, the outcome of investigations, and changes to tax benefits. Hypera has superior profitability and offers a solid 3.5% dividend yield on our 2021 estimates.

**Why it is Most Preferred**

Hypera is one of the largest and most efficient players in the Brazilian pharmaceutical segment, and in our view one of the best ways to gain exposure to the Latam pharma market given its superior growth and profitability versus regional peers. Based on 12-month forward P/E, it is trading at the low-end of its historical range and also relative to international peers. It has material scope for re-rating in our view.

Lojas Renner	Consumer Discretionary Brazil	BRLRENACNOR1 5346	BRL	49.90	<b>Most Preferred</b> corinne.de- boursetty@ubs.com UBS Switzerland AG
				43.13	

**Company profile**

Lojas Renner operates 408 stores in Brazil: 284 Renner stores (department stores focusing on fashionable apparel, footwear, accessories and perfumes), 72 Camicado stores (houseware products) and 52 Youcom stores (smaller, specialized apparel stores focused on a younger audience). Renner stores target primarily women between 20 and 40 years old, with middle to high-end income levels. Lojas Renner's proprietary lifestyle concept allows the company to sell its own private label brands. The company also has a developed credit card operation.

**What drives our opinion**

Renner is a best-in-class apparel retailer in Brazil. We see potential for market share gains above its current 8%, as it should play a leading role in consolidating this very fragmented industry. Its resilient and compounding growth business model positions it well for top-line and profitability recovery once the Brazilian economy reopens, in our view. We expect around 15% top-line growth and retail EBITDA margin expanding from 16% this year to about 22%–23% in 2022E, in line with pre-COVID-19 levels. E-commerce could grow to 20% of total group sales to leverage the omnichannel retail integration, and we see scope to digitalize its financial services. Key risks include increased competition from pure online players (which should be mitigated by Renner's private label products and integrated supply chains, which can't be easily replicated), and renewed lockdowns delaying store reopening putting pressure on top-line and profits.

**Why it is Most Preferred**

Lojas Renner is a leading apparel retailer and a structural compounder with potential in the e-commerce and fintech sectors. The stock is trading about 40% below its pre-COVID-19 highs. We see recent weakness as an opportunity to add a quality company with material upside to the reopening of the economy in Brazil.

Petrobras (ON)	Energy Brazil	BRPETRACNOR9 38740	BRL	32.34	<b>Most Preferred</b> corinne.de- boursetty@ubs.com UBS Switzerland AG
				23.80	

**Company profile**

Controlled by the Brazilian federal government, Petrobras is Brazil's national oil company. The company has a dominant presence in the Brazilian upstream and downstream segments, being the largest oil producer in the country and holding most of the refining capacity. Its main assets and focus are its refineries in SP and RJ and its pre-salt fields, such as BÃºzios, the largest deep-water field in the world.

**What drives our opinion**

We see a positive risk-reward for Petrobras. The completion of the BNDES stake sale will increase liquidity and potentially its weight in MSCI indexes. Key drivers are 1) attractive valuation versus global peers and its own historical average, which could relate to precrisis forward EV/EBITDA of 6–7x on lower risk perception; 2) solid volume growth of up to 10% annual production growth expected in 2021; 3) upside to FCF generation on lower capex and higher refining margin; 4) deleveraging from current 2.5x to 1x net debt/EBITDA by end-2021 aided by USD 25bn in potential divestments in refining assets, driving strong earnings growth (15–20%) over the next three years; and 5) potential for higher dividend payout. Key risks include lower oil prices, higher taxes, and regulatory changes.

**Why it is Most Preferred**

Petrobras is a high-beta stock. It should benefit from current deregulation and privatization. Upcoming potential catalysts include divestments, confirmation of an independent fuel price policy, higher oil prices (we forecast USD 50–60/bbl by March through September 2021), and a stronger Brazilian real (we estimate USDBRL 5 by March 2021).

Name	Sector Market	ISIN Valor	Currency Share Price	52w High 52w Low	Selection Analyst
Vale ADR (ON)	Materials Brazil	US91912E1055 10230933	USD 18.65	19.00 7.36	<b>Most Preferred</b> corinne.de- boursetty@ubs.com UBS Switzerland AG

#### Company profile

Founded in 1942, Vale is the third largest metals and mining company globally, which also includes a position as the world's largest iron ore producer and second largest nickel produce. The company has a presence on all five continents within mining, processing, distribution, and transportation.

#### What drives our opinion

We see a positive risk-reward for Vale. It trades at 3.5x EV/EBITDA 2021e, versus international peers' average of 4.5x and a historical average of 6x. We think it should post strong free cash flow generation, making sizeable dividends a possibility, especially considering that leverage continues to trend down below to 1x net debt/EBITDA. We believe provisions made so far following the dam collapse are sufficient to cover the reparations and indemnities; this should lead to a lower cost of capital and a re-rating for the company. Key risks include lower iron prices and legal risks from higher payments following the Brumadinho dam accident.

#### Why it is Most Preferred

Vale has one of the cheapest valuations among its peers and among the highest free cash flow yields in the industry. It could resume its dividend payout in the next 12 months with 6% dividend yield easily achievable in our view.

## Appendix

### Contact

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**Equity selection system****UBS CIO GWM equity selection system**

We provide two equity selections: Most Preferred (MP) and Least Preferred (LP).

**Most preferred**

We expect the stock to outperform the benchmark in the next 12 months.

**Least preferred**

We expect the stock to underperform the benchmark in the next 12 months.

**Suspended**

Sometimes legal, regulatory, contractual or best-business-practice obligations restrict us from issuing research on a company. This situation normally stems from UBS Investment Bank's involvement in an investment banking transaction associated with that company.

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For more information about our present and past recommendations, please contact [ubs-cio-wm@ubs.com](mailto:ubs-cio-wm@ubs.com)

**Current UBS CIO global rating distribution (as of last month-end)**

Least Preferred	8%
Most Preferred	92%

**Disclosures (8 April 2021)**

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Banco Bradesco SA 1, 2, 3, Cia. de Concessões Rodoviarias - CCR 3, 5; Petrobras (ON) 2, 3, Vale ADR (ON) 2, 4,

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**History of Selection Changes (past 12 months)**

Company	Selection Date	Selection Status
BB Seguridade	23.7.2020	Most Preferred
Cia. de Concessões Rodoviarias - CCR	23.7.2020	Most Preferred
Cia Brasileira N	24.2.2021	Not Listed
Hypera SA	27.10.2020	Most Preferred
Linx NM	14.7.2020	Not Listed
	10.6.2020	Most Preferred
Lojas Renner	24.2.2021	Most Preferred
PagSeguro-A Rg	10.6.2020	Not Listed
Rumo	10.6.2020	Not Listed
Telefonica Brasil	14.7.2020	Not Listed
	10.6.2020	Most Preferred

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