



GNAM Investment
Competition



Company: Banco do Brasil S.A.

Ticker: BBAS3

FGV EAESP T1

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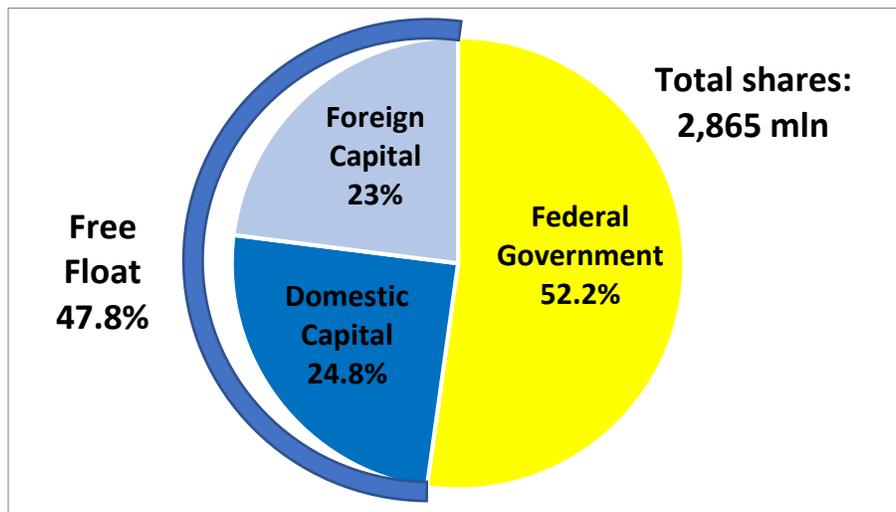
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BANCO DO BRASIL – BBAS3
BUY
INVESTMENT SUMMARY

Bloomberg's Ticker	BBAS3 BZ
Primary Exchange	BM&F Bovespa Index
Sector & Industry	Banks / Financial Services
Recommendation	Buy
Current Price (01/11)	R\$ 43.38/ US\$ 11.72
Target Price (YE 2019)	R\$ 47.80/ US\$ 12.92
Market Capitalization (mln)	R\$ 133,118/ US\$ 35,978
Float (%)	47.8%
3-Mth Avg. Daily Vol (US\$ mln)	93.3
Shares Outstanding (mln)	2,865

Figure 1. Major Shareholders


Source: Company reports

Founded in 1808, Banco do Brasil S.A. ("BB") is a state-owned company (Federal Government has 52.2%) and is the second largest retail Bank in Brazil (total assets).

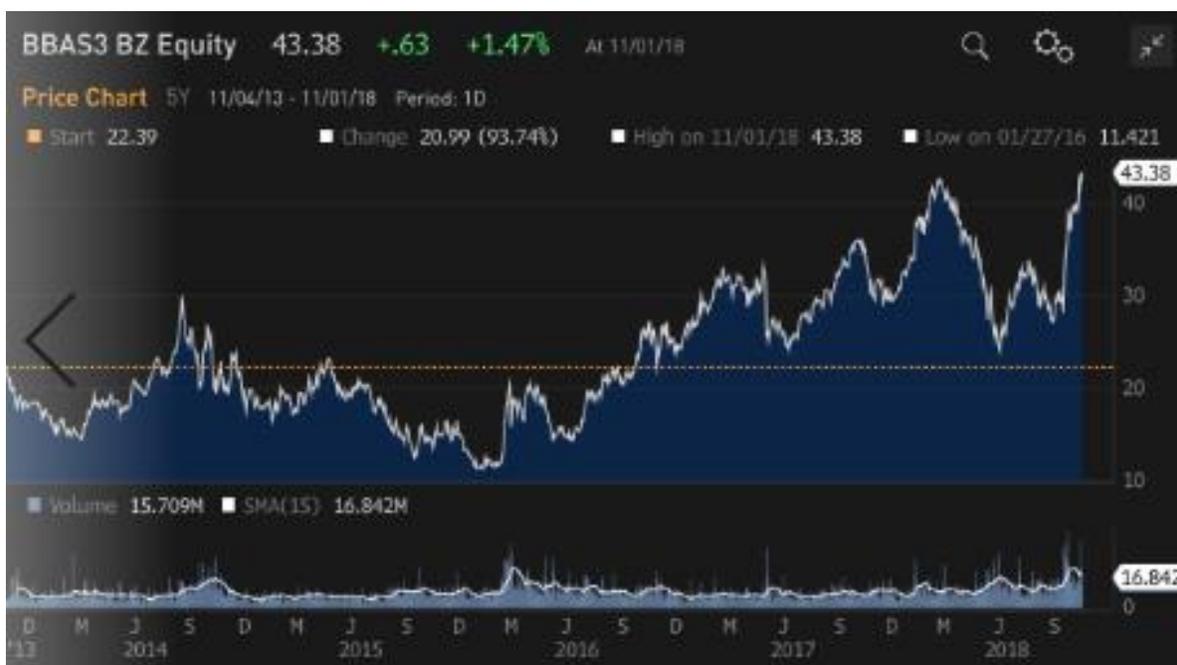
BB has 99.8% of presence in the Brazilian territory and operates in 16 countries through 26 units. BB also maintains relationship with 874 correspondent banks in 104 countries. The company actuates in Banking Services, Insurance, Capital Markets, Asset Management, Cards division and International Franchise. BB has a 50% stake in Banco Votorantim (5th largest private bank in Brazil, according to Central Bank of Brazil ranking), another 66.25%

in BB Seguridade (ticker: BBSE3:BZ), which is the largest insurance group in the country and 28.65% of the largest acquiring company in the country called Cielo (ticker: CIEL3:BZ).

The main pillar of our investment thesis is the economic perspective for 2019. The 2018 gradual recovery of economy, combined with a new government perspective with the election of the presidential candidate Jair Bolsonaro can lead to an increase of bank loans and we expect that the Bank's good management history continue to improve the bank's operational trend.

Our 2018 year-end target price is R\$ 46.75 per share and R\$ 47.80 per share by the end of 2019 and thus our recommendation is **Buy**. Considering these target prices, the upside potential is approximately 8% for 2018 and 10% for 2019 from the current price. The implied P/E ratios are approximately 11x and 9x, for 2018E and 2019E. Banco do Brasil is our Top Pick for the sector.

Figure 2. Stock Price Chart for Banco do Brasil (as of November 2nd, 2018)



Source: Bloomberg

Figures 3 and 4. Analysts' Recommendations for Banco do Brasil (as of November 2nd, 2018)



Firm	Recommendation	Target Price	Date
XP Investimentos	Buy	51.00	10/28/18
Eleven Financial Research	Neutral	40.00	10/26/18
Grupo Santander	Buy	48.00	10/25/18
Bradesco BBI	Outperform	47.00	10/25/18
Goldman Sachs	Neutral/Attractive	40.30	10/23/18
Itau BBA Securities	Outperform	48.00	10/21/18
Banco Safra de Investimentos	Outperform	51.00	10/19/18
J.P. Morgan	Neutral	36.00	10/18/18
Credit Suisse	Outperform	36.00	10/16/18
Scotia Capital	Sector perform	32.00	10/10/18
Planner Corretora	Buy	52.00	10/05/18
Nau Securities Ltd	Buy	48.00	09/26/18
Brasil Plural	Overweight	43.10	09/13/18

Source for figures 3 and 4: Bloomberg

BUSINESS DESCRIPTION

Banco do Brasil S.A. is the second largest bank by total assets in Brazil, as of September 2018, with a total asset of USD 392.4 billion. *Banco do Brasil* is present in more than 20 countries acting through its subsidiaries, branches and representative offices.



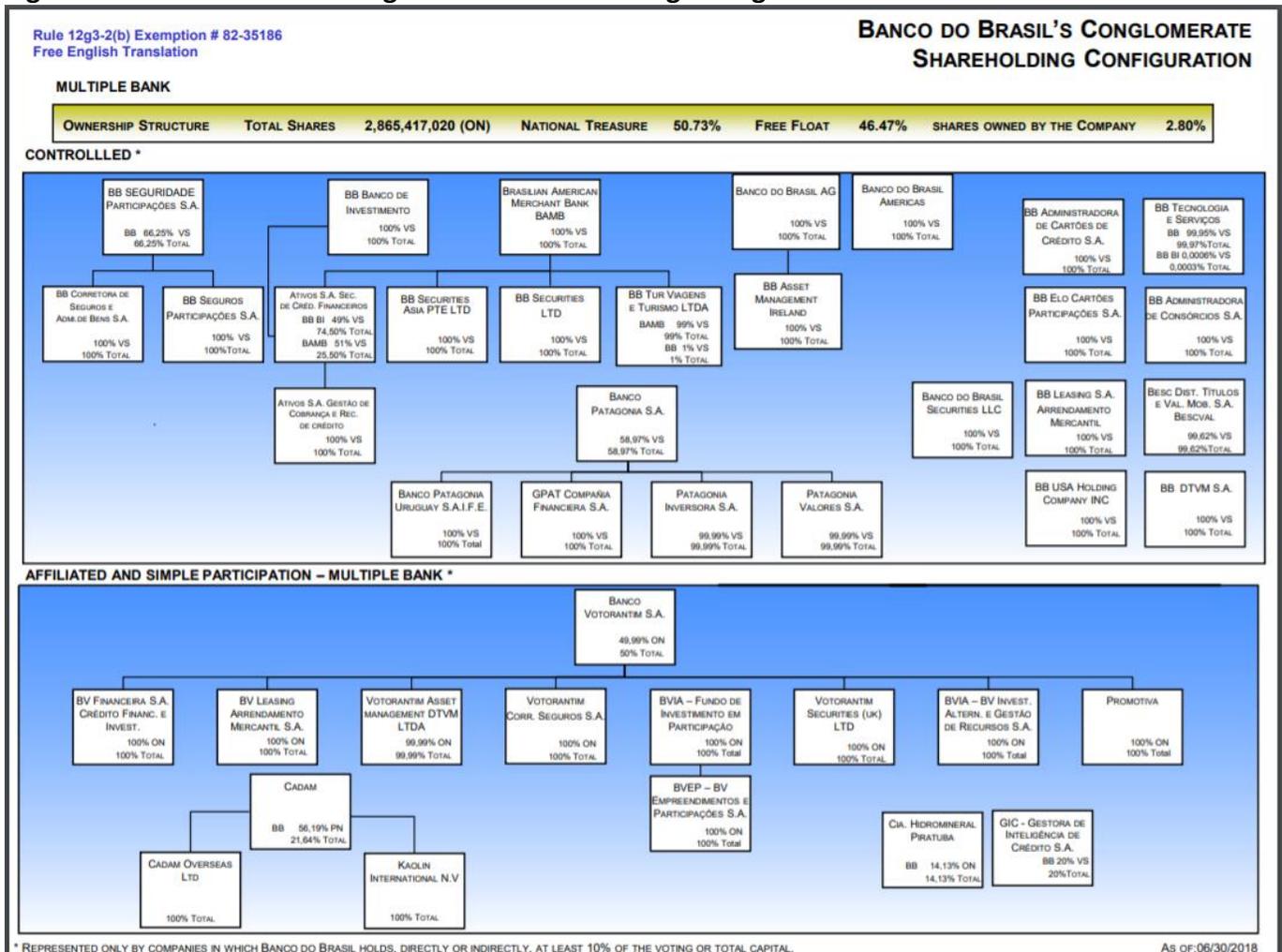
The bank was founded on October 12th, 1808 to finance the Portuguese public debt when the royal family moved from Europe to Brazil, becoming the first financial institution to operate in the country.

As a mixed institution under state control, *Banco do Brasil* served as a commercial bank, the government's fiscal agent, and Brazil's first bank of issue.

In 1992 it was restructured as a commercial bank, using its huge geographic distribution and credit assets to leverage its redesign as commercial bank. In 1998, *Banco do Brasil* became the first bank to obtain ISO 9002 certification in credit analysis and launched its IT Center, one of the most modern and best equipped in the world.

After decades of losses due to financing some of the Brazilian Federal Government public policies, the commitment to the best management practices through the corporate governance code let the bank became very profitable across the years and today is one of the market leadership with a solid financial report and large diversified and stable base.

Figure 5. Banco do Brasil's Conglomerate Shareholding Configuration



Source: Company reports

With 99.8% presence in Brazilian territory, more than 66 million customers and 99,161 employees, the business diversification includes many products, such as:

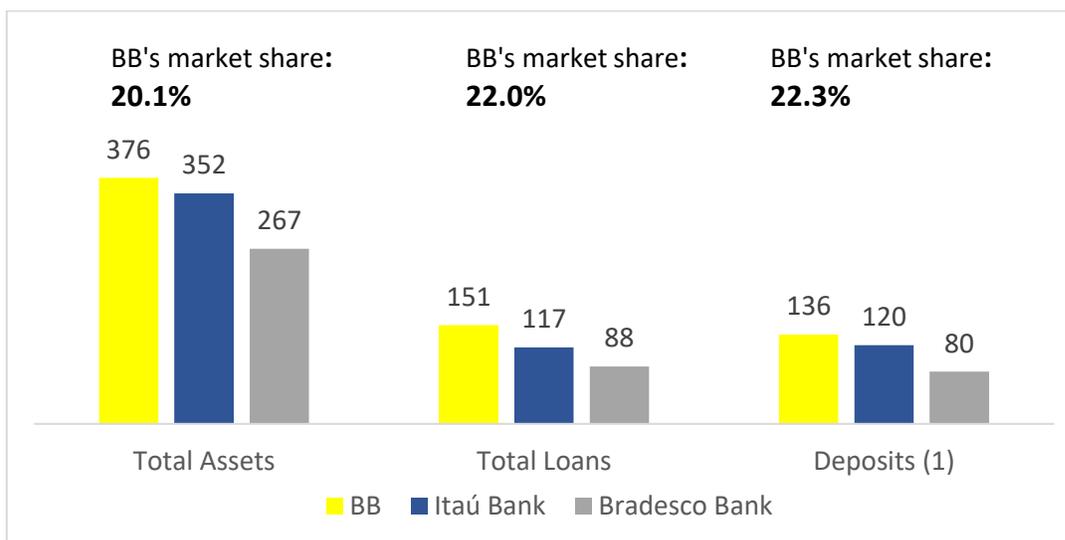
- Banking services
- Insurance
- Capital Markets
- Asset Management
- Cards division (credit cards and restaurant vouchers)
- International Franchise

1) BANKING SERVICES

Banco do Brasil is present in 99.8% of Brazilian municipalities, it has the largest number of branches (4,770) and 22.3% of market share, according to Brazilian Central Bank (BACEN) in June, 2018.

The bank offers a large variety of services to the consumer including bill payment services, ATM loans, and a bundle that contains the account numbers for checking, multiple savings accounts, and investment account.

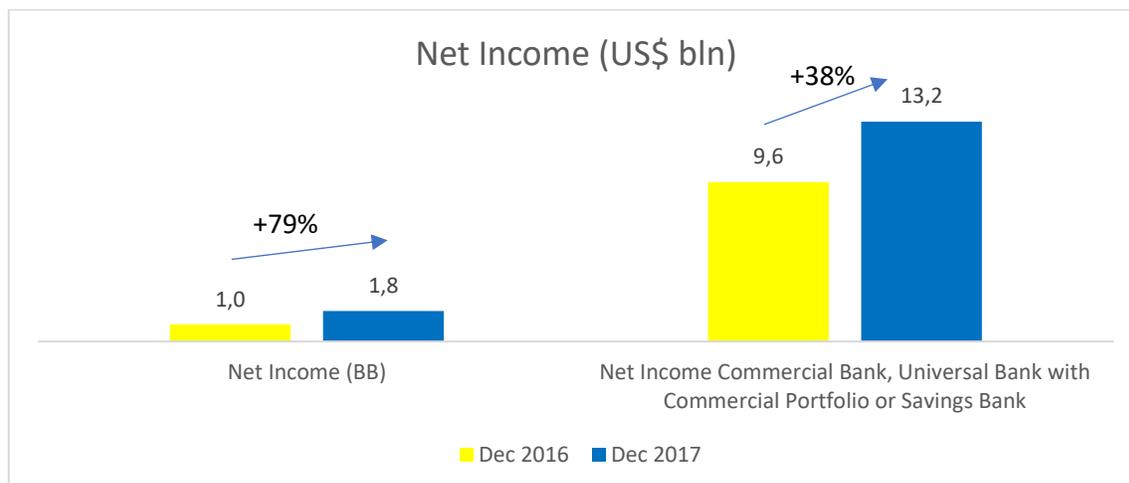
Figure 6. INDUSTRY LEADERSHIP AT BANKING SERVICE – Comparison between Banco do Brasil and the two largest Brazilian private banks, Itaú and Bradesco (as of June, 2018):



Source: BACEN Brazilian central bank – June 2018 elaborated by FGV EAESP T1
US\$ billions (converted at the PTAX selling rate) - Information based on documents delivered up to: 08/20/2018
(1) Statista, apud América Economía; (Profesional – 2017 US\$ billion).

In 2017 the **Net Income** almost doubled over 2016, while the market growth was 38%.

Figure 7. Banco do Brasil – Net Income



Source: BACEN Brazilian central bank – June 2018 elaborated by FGV EAESP T1
US\$ billions (converted at the PTAX selling rate) - Information based on documents delivered up to: 03/19/2018

2) INSURANCE

BB Seguridade Participações S.A. (BB Seguridade, ticker BBSE3:BZ) is a holding company controlled by Banco do Brasil S.A. (BB) which operates in the insurance, pension plans and premium bonds segments. Its equity investments are currently organized in two segments:

- 1) Risk and accumulation business - affiliated companies incorporated in the form of joint ventures or partnerships with private partners and operating insurance products, pension plans, premium bonds, reinsurance and dental care plans;
- 2) Distribution business: wholly owned subsidiary that distributes insurance, open pension plans, premium bonds and dental care plans

Counting on the network of Banco do Brasil as the main distribution channel of a complete portfolio of insurance, pension plans, premium bonds and dental care plans with the intermediation of their own brokerage firm, nowadays BB Seguridade occupies a prominent market position in every segment they operate.

With further improvements in economic conditions, as employer and companies became more confident with the new government the search for insurance services should increase over the first half of 2019.

Moreover, for the year 2019 is expected the approval of the retirement reform that should generate much uncertainty about public retirement, thus stimulating the acquisition of private retirement plans.

So, we expect good results for this company and consequently for Banco do Brasil.



3) CAPITAL MARKETS

BB-Banco de Investimentos S.A., BB Investimentos, is a subsidiary of *Banco do Brasil SA*, specialized in the domestic capital market, with operations in Fixed Income Structuring and Distribution, Securitization and Equities, Economic and Financial Advisory, Private Equity, Mergers and Acquisitions (M&A), Project Finance, Asset Management, Brokerage and Custody of Securities.

BB Investimentos has been an investor in the private equity and venture capital industry since 2004.

In compliance with *Banco do Brasil* investment policies, *BB Investimentos* holds interests in companies that complement the economic activity of the Conglomerate and investments in order to generate value and liquidity, prioritizing companies that adopt good Corporate Governance practices.

4) CARDS DIVISION

BB Cartões purpose is the administration and issuance of credit and debit cards, restaurant vouchers and traveler's checks.

Since 2004, the Company has provided customers with the largest electronic network for accepting vouchers in Brazilian market. There are currently around 500,000 commercial accredited establishments in more than five thousand Brazilian municipalities.

BB Cartões also manages the balance of travelers' checks sold and not settled, as well as of the amounts pending settlements, until the product is completely extinguished.

In 2017 results of this BU decreased 24.9% compared to the previous year. The reduction was mainly influenced by (i) the fall of the country's basic interest rate (SELIC) which directly affected the revenues and (ii) by the reduction of the staff as a result of the Incentivized Retirement Program that increased the company's SG&A expenses including severance payments.

For 2019 we expect improvements in economic conditions, the recovery of credit for buyer and consequently the growth of issues of credit and debit cards.

5) INTERNATIONAL FRANCHISE

Banco do Brasil Aktiengesellschaft (BB AG) was established in 1980 and is a wholly owned subsidiary of *Banco do Brasil S.A.* Besides its Head Office in Vienna/Austria, the bank has also four branches located in the following countries: Portugal, Spain, France and Italy.

The market strategy of BB AG is focused on Wholesale banking, mainly in deals with companies which intend to have commercial relationship with Brazilian companies (Brazil/Europe) abiding by country risk limits.



The main products of BB AG are corporate banking and trade financing. The product portfolio primarily comprises import and export finance transactions, letters of credit as well as forfait and guarantees. BB AG complements its product portfolio by domestic and international payment transfers and also money market deposits for corporate customers.

BB AG has taken relevant steps to consolidate its position as a financial institution for customers in Central Europe with trade relations to Brazil, creating significant global synergies within BB Group.

MANAGEMENT & GOVERNANCE

The Executive Board, which is responsible for the administration of business, is composed of the President (CEO), the Vice-Presidents and the Executive Officers.

The Executive Board has a three-year term of office and re-election is permitted. The President (CEO) of BB is appointed and dismissed by the President of the Republic. The vice president and directors are elected by the Board of Directors by appointment of the President of BB. The position of Director is exclusive to employees of the company.

On October 2018 Mr. Marcelo Augusto Dutra Labuto, 47, was appointed by Brazilian President Michel Temer as the CEO of BB. He has been in BB since 1992, held important positions in other companies of BB group (former CEO of BB Seguridade) and has a great reputation in the market.

The main risk in this kind of management, named by the President of the Republic, is the political influence that it represents. In a context like we have today, with a recent elected President for 2019, who represents an opposition to the old government, we could expect even more changes at the management of Banco do Brasil for the next 4 years.

INDUSTRY OVERVIEW

After a turbulent election period, Brazil's political and economic situation seems to head to a new era of economic growth and political stability. Here are our considerations about the new scenario after the recent federal Brazilian elections and the new government propositions:

- The new government is proposing a liberal economic agenda, which means more independence for the Central Bank of Brazil, less bureaucracy for local entrepreneurs and foreign investors, several privatizations of non-strategic public entities (Banco do Brasil is not included in the privatization's list) and decentralization of expenditures, giving more autonomy to the states (as the future Ministry of Finance Paulo Guedes says "More Brasil and less Brasília". All these factors lead to increasing the investor confidence in the coming years.
- The reforming agenda considers the unavoidable Social Security reform in order to rebalance the fiscal accounts. Also, it has been announced that the new government



will cut the number of ministries to reduce government payroll cost and centralize correlated matters. After Social Security reform, other important reforms might be under way, such as the tax reform and political reform. The Social Security reform can benefit bank's social security division (in our case BB Seguridade), since the demand for private pension plans tends to increase.

- The risk of non-approval of the aforementioned reforms by the congress exists, but now is minimized since the major part of the new congress in 2019 is composed by new government supporters.
- The role of Banco Nacional de Desenvolvimento Econômico (BNDES, the Brazilian Development Bank) is also under review. The proposed idea is that BNDES should give more focus in short term loans in the beginning of new infrastructure projects. This new BNDES' role might benefit other banks that may absorb long term loans along with infrastructure market players and investors.

Given this expected scenario, we believe that Brazilian economy and GDP will grow in the future years and that now is a good moment to invest in the Bovespa Index (B3 - Brazilian Exchange).

This expected growth may increase the population consumption, demanding more credit from the Financial sector. The M&A projects, investing and hedge activities may also benefit from this growth. This good projection and the recent economic recession have led us to set the Financial sector as our favorite to invest in Brazil as the prices are tempting by now.

VALUATION

Our 2018 year-end target price is R\$ 46.75 per share and R\$ 47.80 per share by the end of 2019 and thus our recommendation is **Buy**. Considering these target prices, the upside potential is approximately 8% for 2018 and 10% for 2019 from the current price. The implied P/E ratios are approximately 11x and 9x, for 2018E and 2019E. Banco do Brasil is our Top Pick for the sector.

We have estimated a 14.88% Cost of Equity (K_e , by CAPM), considering the Brazil Country Risk, a Brazilian equity risk premium and BBAS3 Beta (extracted from Bloomberg in Nov 2nd 2018).

Our valuation was based on the residual income method, i.e., the income surplus or deficit compared to the cost of equity (14.88%). First, we estimated the Equity Charge multiplying Shareholder's Equity by K_e . Then, we found the Residual Income, that is the difference between the projected Net Income and the Equity Charge. Finally, we estimated the Perpetuity using a projected growth rate of 6%.

The results of our estimates are as follows.

Figure 8. Valuation – Cost of Equity Assumptions

Cost of Equity Assumptions	
(a) 10y US Bond - US\$	3.21
(b) Brazil risk	3.08
(c) = (a+b) Brazil Country Risk	6.29
Equity Risk Premium	5.00
Beta	1.57
Cost of Equity (Ke)	14.88

Source: FGV EAESP T1 estimates and Bloomberg

Figure 9. Valuation

VALUATION	2018E	2019E	2020E
Free risk rate	6.50	7.00	8.00
Growth rate	6.00	6.00	6.00
Shareholder's Equity (R\$ bln)	105.96	122.27	139.03
Equity Charge	15.76	18.19	20.68
Residual Income (R\$ bln)	-3.52	-3.49	-2.01
PV of Terminal Value (R\$ bln)	31.52	18.19	10.34
Firm Value (R\$ bln)	133.97	136.96	147.37
Total Number of Shares (bln)	2.87	2.87	2.87
Target Price - R\$/Share	46.75	47.80	51.43
Last Share Price - R\$/Share	43.38	43.38	43.38
Upside (%)	7.78	10.19	18.56

Source: FGV EAESP T1 estimates and Bloomberg

Figure 10. Valuation – Multiples

VALUATION MULTIPLES	2017A	2018E	2019E	2020E
Target Price	31.82	46.75	47.80	51.43
Market Cap	88.62	130.21	133.12	143.23
Total Number of Shares (bln)	2.87	2.87	2.87	2.87
Number of Shares Outstanding (bln)	2.78	2.78	2.78	2.78
Price/Sales	0.65	0.99	0.99	0.99
Earnings per Share	3.95	4.27	5.13	6.52
Price/Earnings	8.05	10.94	9.32	7.89
Book Value Price per Share	35.45	36.98	42.67	48.52
Price/Book Value	0.90	1.26	1.12	1.06

Source: FGV EAESP T1 estimates and Bloomberg

FINANCIAL ANALYSIS

Figure 11. Earnings and Estimates – Income Statement (in billions of Brazilian Reais – R\$)

<u>INCOME STATEMENT</u>	R\$ bln						
	2017A	Δ% 2018E	2018E	Δ% 2019E	2019E	Δ% 2020E	2020E
Net Interest Income	52.71	-4.0%	50.60	2.0%	51.61	8.0%	55.74
Provision Expenses	-20.09	-12.0%	-17.68	-5.0%	-16.80	2.0%	-17.13
Adj Net Interest Income	32.61	0.9%	32.92	5.8%	34.81	10.9%	38.60
Non-Interest Income	24.90	8.0%	26.90	8.0%	29.05	8.0%	31.37
Total Operating Revenue	57.52	4.0%	59.81	6.8%	63.86	9.6%	69.97
Operational Expenses	-32.29	1.0%	-32.61	2.0%	-33.26	3.0%	-34.26
Other Results	-6.48	1.0%	-6.54	1.0%	-6.61	1.0%	-6.67
Profit Before Taxes	18.75	10.2%	20.66	16.1%	23.99	21.1%	29.04
Taxes	-4.60	15.0%	-5.29	16.0%	-6.14	17.0%	-7.19
Provision for Profit Sharing	-1.44	1.0%	-1.45	1.0%	-1.47	1.0%	-1.48
Minority Interest	-1.65	1.0%	-1.67	1.0%	-1.68	1.0%	-1.70
Net Income	11.06	10.7%	12.25	20.0%	14.70	27.1%	18.68

Source: FGV EAESP T1 estimates and Bloomberg

Figure 12. Earnings and Estimates – Balance Sheet (in billions of Brazilian Reais – R\$)

<u>BALANCE SHEET</u>	R\$ bln						
	2017A	Δ% 2018E	2018E	Δ% 2019E	2019E	Δ% 2020E	2020E
Cash and Equivalents	13.48	-4.5%	12.87	0.0%	12.87	0.0%	12.87
Interbank Investments	373.02	4.0%	387.94	6.0%	411.22	7.0%	440.01
Securities and Derivatives	138.92	12.3%	156.00	0.0%	156.00	0.0%	156.00
Loans	632.43	1.5%	641.72	5.9%	679.57	8.6%	738.27
Other Assets	179.51	12.0%	201.06	10.0%	221.16	9.0%	241.07
Permanent Assets	31.83	-0.3%	31.73	0.0%	31.73	0.0%	31.73
Total Assets	1369.20	4.5%	1431.32	5.7%	1512.55	7.1%	1619.94
Deposits	450.23	5.0%	472.74	7.0%	505.83	9.0%	551.36
Money Market	376.24	5.0%	395.05	6.0%	418.76	8.0%	452.26
Subordinated Debt	100.46	5.0%	105.48	6.0%	111.81	8.0%	120.75
Technical Provisions	25.77	40.0%	36.08	5.0%	37.88	7.0%	40.54
Other Liabilities	317.78	-0.6%	316.00	0.0%	316.00	0.0%	316.00
Shareholders' Equity	98.72	7.3%	105.96	15.4%	122.27	13.7%	139.03
Total Liabilities + Equity	1369.20	4.5%	1431.32	5.7%	1512.55	7.1%	1619.94

Source: FGV EAESP T1 estimates and Bloomberg

Figure 13. Earnings and Estimates – Loan Book (in billions of Brazilian Reais – R\$)

<u>LOAN BOOK</u>	R\$ bln						
	2017A	Δ% 2018E	2018E	Δ% 2019E	2019E	Δ% 2020E	2020E
Companies	227.02	-1.0%	224.75	2.0%	229.25	7.0%	245.29
Total Consumer	187.34	5.0%	196.70	8.0%	212.44	10.0%	233.68
Other Loans	218.09	1.0%	220.27	8.0%	237.89	9.0%	259.30
Gross Loans	632.44	1.5%	641.72	5.9%	679.57	8.6%	738.27
Loan Growth (%)	-3.24	-	1.47	-	5.90	-	8.64
Non Performing Loan	23.68	-6.0%	22.26	-5.0%	21.15	-4.0%	20.30
Provisions	36.69	-10.0%	33.02	-8.0%	30.38	-6.0%	28.55

Source: FGV EAESP T1 estimates and Bloomberg



Figure 14. Earnings and Estimates – Income Statement (in billions of US Dollars – US\$)

INCOME STATEMENT	US\$ bln*			
	2017A	2018E	2019E	2020E
Net Interest Income	14.24	13.68	13.95	15.06
Provision Expenses	-5.43	-4.78	-4.54	-4.63
Adj Net Interest Income	8.81	8.90	9.41	10.43
Non-Interest Income	6.73	7.27	7.85	8.48
Total Operating Revenue	15.54	16.17	17.26	18.91
Operational Expenses	-8.73	-8.81	-8.99	-9.26
Other Results	-1.75	-1.77	-1.79	-1.80
Profit Before Taxes	5.07	5.58	6.48	7.85
Taxes	-1.24	-1.43	-1.66	-1.94
Provision for Profit Sharing	-0.39	-0.39	-0.40	-0.40
Minority Interest	-0.45	-0.45	-0.45	-0.46
Net Income	2.99	3.31	3.97	5.05

* Parity 01Nov2018: USDxBRL 3.70

Source: FGV EAESP T1 estimates and Bloomberg

Figure 15. Earnings and Estimates – Balance Sheet (in billions of US Dollars – US\$)

BALANCE SHEET	US\$ bln*			
	2017A	2018E	2019E	2020E
Cash and Equivalents	3.64	3.48	3.48	3.48
Interbank Investments	100.82	104.85	111.14	118.92
Securities and Derivatives	37.55	42.16	42.16	42.16
Loans	170.93	173.44	183.67	199.53
Other Assets	48.52	54.34	59.77	65.15
Permanent Assets	8.60	8.57	8.57	8.57
Total Assets	370.05	386.84	408.80	437.82
Deposits	121.68	127.77	136.71	149.02
Money Market	101.69	106.77	113.18	122.23
Subordinated Debt	27.15	28.51	30.22	32.64
Technical Provisions	6.97	9.75	10.24	10.96
Other Liabilities	85.89	85.41	85.41	85.41
Shareholders' Equity	26.68	28.64	33.04	37.58
Total Liabilities + Equity	370.05	386.84	408.80	437.82

* Parity 01Nov2018: USDxBRL 3.70

Source: FGV EAESP T1 estimates and Bloomberg

Figure 16. Earnings and Estimates – Loan Book (in billions of US Dollars – US\$)

LOAN BOOK	US\$ bln*			
	2017A	2018E	2019E	2020E
Companies	61.36	60.74	61.96	66.30
Total Consumer	50.63	53.16	57.42	63.16
Other Loans	58.94	59.53	64.29	70.08
Gross Loans	170.93	173.44	183.67	199.53
Loan Growth (%)	-3.24	1.47	5.90	8.64
Non Performing Loan	6.40	6.02	5.72	5.49
Provisions	9.92	8.92	8.21	7.72

* Parity 01Nov2018: USDxBRL 3.70

Source: FGV EAESP T1 estimates and Bloomberg

Figure 17. Earnings and Estimates – Key Ratios

KEY RATIOS	2017A	2018E	2019E	2020E
Return On Equity (%)	11.90	17.86	19.22	21.35
Return On Assets (%)	0.80	1.31	1.50	1.79
Net Interest Margin	4.15	6.40	6.51	6.70
Cost (Oper Expenses) / ATAs	2.33	3.49	3.39	3.28
Loans / Total Assets	46.19	44.83	44.93	45.57
Loans / Core Deposits	140.47	135.74	134.35	133.90
Non Performing Loan Ratio	3.74	3.47	3.11	2.75
Effective Taxes	24.55	25.63	25.60	24.74
RWA (R\$ mln)	689.86	681.81	702.26	723.33
RWA % Total Assets	49.80	73.01	71.54	69.25
Core Tier I Ratio (%)	10.48	10.27	10.58	10.90
Dividend Payout (%)	29.19	30.32	30.32	31.02

Source: FGV EAESP T1 estimates and Bloomberg

INVESTMENT RISKS

The main risks to our investment in BBAS3 are:

- 1) Governance risk derived from its public sector ownership and control, especially considering the recent elections and what the new government represents (opposition to the last 16 years);
- 2) The forthcoming administration's agenda, with Jair Bolsonaro election, and the international environment should dominate the debate about financial stability risks and can influence market operations over the early 2019;
- 3) The amount of deposits and loans are the main drivers of the bank revenue and are directly related to the GDP. Brazil is starting an economic recovery and a potential weakening of the Brazilian economy given the political uncertainties, may represent a risk and consequently a fall in loans and deposits;
- 4) The cut in Selic rate from 14.25% in 2015 to 6.5% in 2018 will continue to push the bank's margins down. However, the spreads should maintain the current price level due to the caution of the market after the recent recession and the new economic scenario may bring to banks in turn more services and derivatives revenues;
- 5) If the market expectation about economy's growth is confirmed, NPL rates should stabilize and even drop in the next few years. Otherwise, in an unstable economic environment such as the last years, we may experience a worsening of default rates;



- 6) The agricultural loan portfolio may be affected by oscillating commodity prices due to volatile weather conditions (eg, El Niño events), which may also affect insurance operations through its subsidiary *BB Seguros* (Insurance).