

15 BRAZILIAN STOCKS – INVESTMENT OPPORTUNITIES ANALYSIS

I'll start by the top ADR alphabetically except for banks which I'll discuss apart.

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AMBEV S.A. (ABEV)

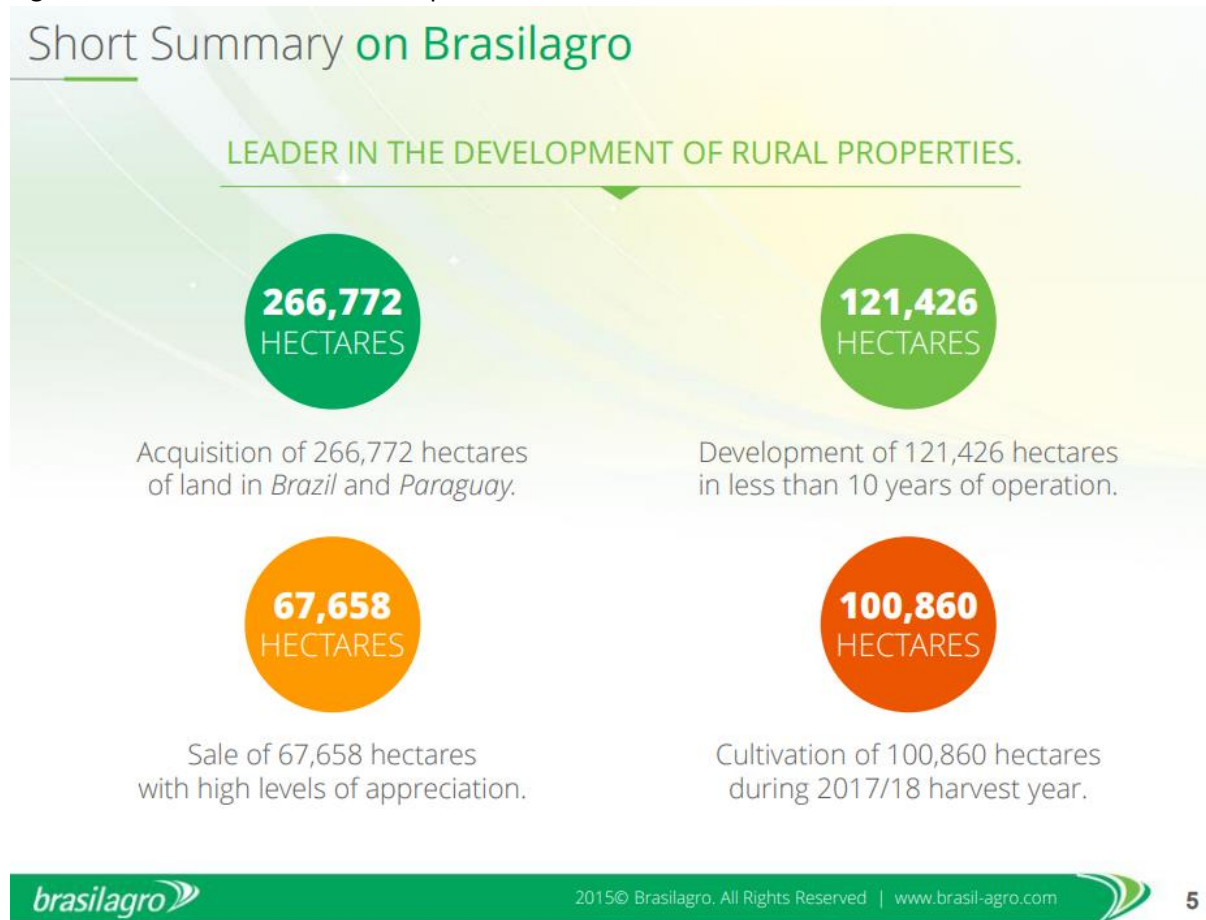
ABEV is a good company with high margins, slow growth, a moat, strong brands, high return on equity, return on invested capital just below 40%, negative working capital and no debt. However, it trades at a consensus forward multiple of 20.

So, it all boils down on whether you focus on relative or absolute factors. To me a forward PE of 20 means that my earnings yield will be around 5% at best. This might be tempting for relative investors as ABEV's forward PE ratio was above 30 just 3 months ago. However, as an absolute investor I worry about higher interest rates that might increase the required rate of return also for good businesses like ABEV, not to mention currency and economic risks in South America. Therefore, I'll avoid ABEV as long as it has such a high valuation where anything below a 10% earnings yield is high for me.

BRASILAGRO (LND)

LND is one of Brazil's largest companies in terms of arable land and its core business consists of the acquisition, development, operation and sale of rural properties suitable for agricultural activities. LND's business model consists of acquiring rural properties that are not fully developed or not developed at all, transform them into profitable agricultural land and then sell the properties at a profit.

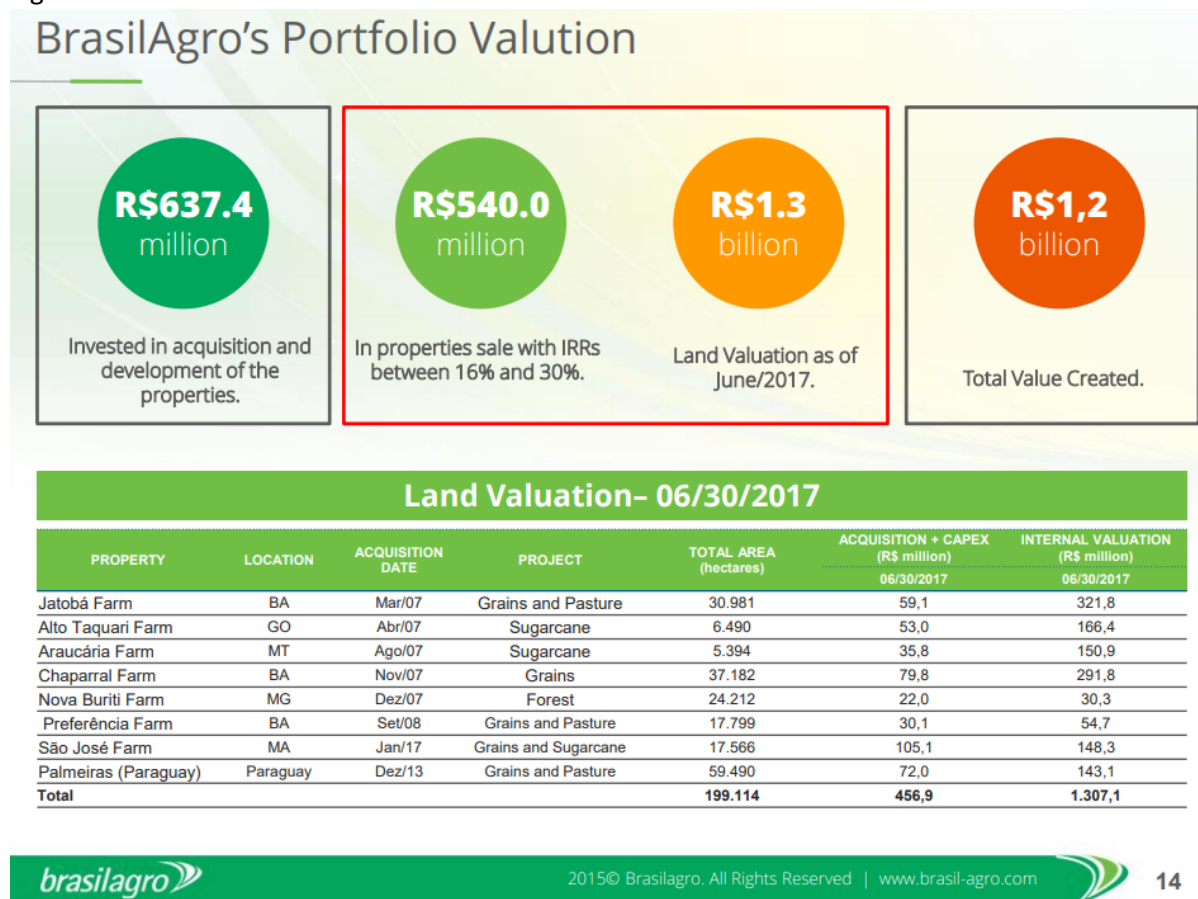
Figure 1 LND's business model and past sales



Source: [LND](#)

According to the company, the value of the land is now at R\$ 1.3 billion that translates into R\$22 per share or \$6. However, the accounting value is lower and the book value is at R\$ 12 per share of \$3.4.

Figure 2 LND's land value



Source: [LND](#)

However, with the properties appraisal the net asset value doubles. LND will probably slowly sell and unlock that value over the next 10 years and acquire more land.

Figure 3 LND's NAV

(R\$ thousand)	March 31, 2018	
	Book	NAV
BrasilAgro's Equity	716.977	716.977
Properties appraisal		1.307.136
(-) Balance Sheet - Net Agri Opening Capex		-89.643
(-) Balance Sheet - Land Value		-539.101
NAV - Net Asset Value	716.977	1.395.369
Shares	56.889	56.889
NAV per share	12,60	24,53

Source: [LND Q3 2018 presentation](#)

The problem is that the liquidity is really low with a few transactions per day, therefore, the price is volatile and a bigger position cannot be acquired. The majority shareholder is Cresud, an Argentinian company we are going to discuss in detail when analyzing Argentina.

As for investing, if you like land than develops, produces and pays dividends here and there, LND might be the little diversifier in your portfolio.

The issue with this company is deforestation which is something I personally don't like. I still have to think about a policy for deforestation.

LND will go into deep research when it comes to land investments as a sector. We have some interesting companies to compare for such a portfolio diversification play: CRESUD, ALEX, VCO, LND, COZAN.

LND is small, affected by regulation and the sales of that land don't really go smoothly while the profits of the agricultural business aren't really great. More about when it comes to land, for now, not enough discount. Here we have to find the catalysts that differentiate a value trap from a value investment. The sales of land are cherrypicked as the management says and therefore we don't know when and for what will the rest of the land be sold. This is why the discount is there and it might be even fair.

BRASKEM (BAK)

BAK is a petrochemical company, thus cyclical with volatile earnings. On top of that, LyondellBasell (NYSE:LYB) started talking with BAK's owners about a potential transaction. This pushed the price a bit higher lately (17%) but what is more important is that the stock is up more than 5 times over the last few years.

Figure 4 BAK's 5 year stock price



Source: [CNN](#)

The company has been enjoying strong margins in its polyolefins segment but new supply or a recession might change that. Therefore, I would not use the latest earnings as a guidance for the future. 5 year average earnings are R\$3.92 or just above \$1 that gives a 5-year PE ratio of 25 which is expensive for me. The high valuation is there for the takeover potential that has materialized with Lyondell. Not much for the bargain hunter here.

BRF S.A. (NYSE: BRFS)

Talking about bargains, BRFS is down 60% year to date.

Figure 5 BRFS in the last 5 years



Source: [CNN](#)

The stock price is down due to Operation Weak Flesh where the EU market closed its doors to BRFS and customers went renegotiating on price terms for the future.

As a meat producer a lot of factors have to be accounted here, especially input prices which is also something that weights on the company. Further, this is a turnaround story and as you can read in Buffett's investment criteria:

**BERKSHIRE HATHAWAY INC.
ACQUISITION CRITERIA**

We are eager to hear *from principals or their representatives* about businesses that meet all of the following criteria:

- (1) Large purchases (at least \$75 million of pre-tax earnings unless the business will fit into one of our existing units),
- (2) Demonstrated consistent earning power (future projections are of no interest to us, nor are "turnaround" situations),
- (3) Businesses earning good returns on equity while employing little or no debt,
- (4) Management in place (we can't supply it),
- (5) Simple businesses (if there's lots of technology, we won't understand it),
- (6) An offering price (we don't want to waste our time or that of the seller by talking, even preliminarily, about a transaction when price is unknown).

The larger the company, the greater will be our interest: We would like to make an acquisition in the \$5-20 billion range. *We are not interested, however, in receiving suggestions about purchases we might make in the general stock market.*

Now, why is he saying that – because probably the average return is negative but he does invest in future projections when it comes to strong brands with 3G.

So, we cannot know what will happen there. However, there is always fundamental analysis and a risk reward approach. The price to book is a bit high but if the new CEO, the one that restructured Petrobras, applies the same magic onto BRFs, you might see higher stock prices. More news on plans will be given in August so that might lead to another spike if the news is positive. The stock price jumped on the announcement of the new plan.

There is a lot of debt but there is also a business behind this company. The company is going to focus on Brazil, Asia and divest some of the expensive acquisitions made in the past few years.

Monetization of ~R\$5.0bi in 2018

Divestiture	<ul style="list-style-type: none"> ▪ Argentina ▪ Europe ▪ Thailand
Non-Core Asset Sale	<ul style="list-style-type: none"> ▪ Minority stakes ▪ Real Estate Assets ▪ Non-operational assets
Working Capital	<ul style="list-style-type: none"> ▪ Improvement in inventory management: frozen raw material + finished products
Securitization of Receivables	<ul style="list-style-type: none"> ▪ Issuance of Receivable Investment Fund

This will probably lead to more impairments but if it gets traction and a stream of good news comes, the stock might also do well. I'll put it on my to do list as I have to analyse the sector, check the risks there, compare it to other companies and their efforts etc. I don't know when it will come on my research plate as there are other opportunities to focus on now.

Those companies are usually extremely volatile and have to be well understood to own them. Just think of Pilgrim's pride.

Pilgrims Pride Corp (NASDAQ:PPC)

[Add to Watch List](#) [Set Alert](#)

19.60

Delayed Data
As of Jul 03

↑ +0.09 / +0.46%

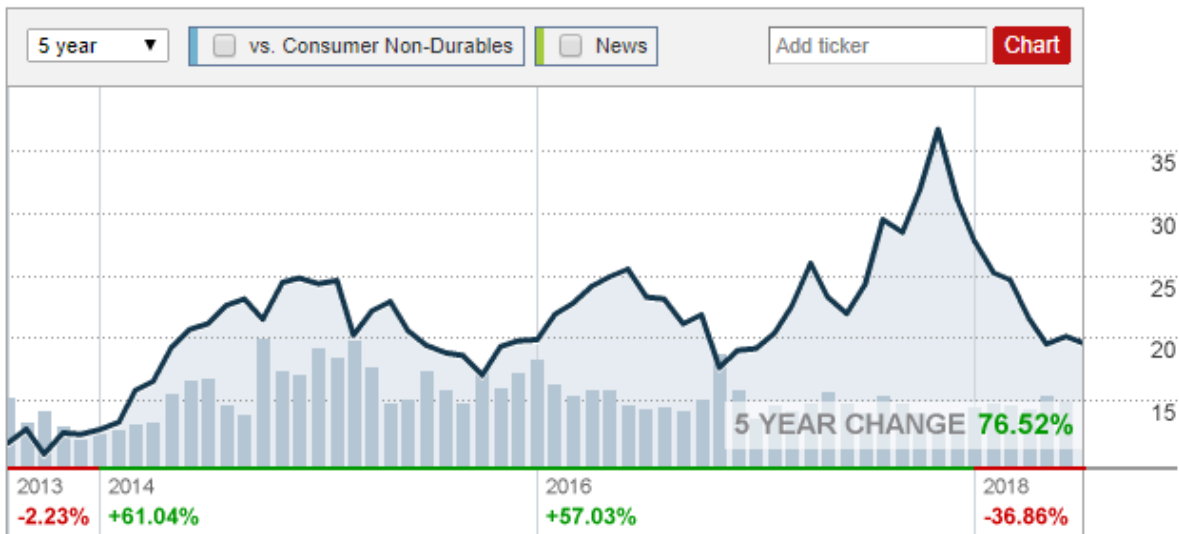
Today's Change



-36.90%

Year-to-Date

Quote	Profile	News	Charts	Forecasts	Financials	Shareholders	Competitors
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COMPANHIA SIDERURGICA NACIONAL (SID)

Sid is a steel producer and extremely dependent on the economy. Things are good now but you never know for how long. I prefer to look at such stocks in a downturn.

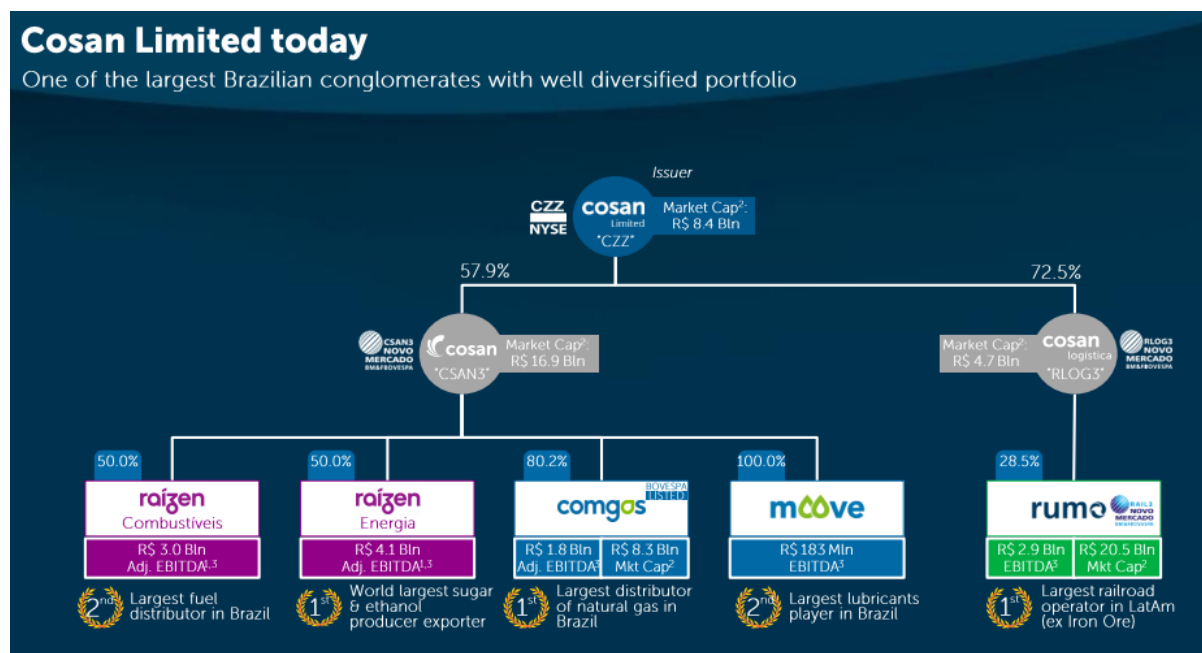
Steel consumption should be subsidized by the economic recovery and the improvement of the following sectors :



If the above sectors do not recover as planned, SID's debt will become an issue. That is why the stock is cheap. Additionally, SID is a very capital intensive business, not much left for shareholders.

COSAN LIMITED (CZZ)

CZZ is a complex company with sugar production, gas and fuel distribution, lubricants, ethanol and rail. It also recently acquired Shell's downstream assets in Argentina for less than \$1 billion.



Sugar prices haven't been good lately and this will impact the company. Increased supply from Europe and India might keep the price down.



You need a detailed earnings long term model to analyse this one, the same holds for Adecoagro (AGRO), another Brazilian ag conglomerate. I'll do those models and we can then always keep them, watch the stock and buy at a margin of safety for high returns in relation to the global cycle.

EMBRAER (ERJ)

I just made a video about the company and my issue with ERJ is that I don't know if at this price it is a sound investment. Their production, orders and backlog are cyclical and with them I am mostly exposed to the U.S. which is something I wouldn't want at this price. Further, if peak cycle earnings are \$3, the average will be around \$1.5 – thus giving me a 10% yield at \$15.

ESTRE AMBIENTAL (ESTR)

ESTR is the leading waste management company in Brazil servicing 31 million people. It listed on NYSE 7 months ago and the stock hasn't really performed.

Estre Ambiental Inc (NASDAQ:ESTR)

[Add to Watch List](#) [Set Alert](#)

8.27

Delayed Data
As of Jul 02

0.00 / 0.00%

Today's Change



-4.28%

Year-to-Date

Quote	Profile	News	Charts	Forecasts	Financials	Shareholders	Competitors
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I must say I don't see where the value can come here. Waste management is a complex business and this can be seen by how the Sao Paulo state renews agreements on a 6-month basis with lower rates. The company is also not profitable at the moment.

FIBRIA CELULOSE (FBR)

FBR is a company that benefits from a weaker Real as its sales are in dollars while its costs are in reals. It produces paper pulp and is one of the global leaders on cost with the new plants delivering as expected. The company is merging with Suzano and this shows how there is value in Brazil because the big global or local players will take a bite when the price is right. And, a takeover is also the exit strategy when investing in Brazil.



GAFISA (GFA)

GFA is a Brazilian home builder that was hardly hit in the last recession and by its own mistakes. It managed to lower its book value from above \$100 to the current \$11. The last financial report was positive but the company still depends on economic growth in Brazil. Important to analyse the risk reward here but not for the faint hearted.

GERDAU (GGB)

GGB is another steel producer and the 5th steel company in North America. It looks like a good company that has had positive operating cash flows in each of the last 10 years. This leads to dividends and it seems like a good company. However, the average free cash flow of \$0.25 per share tells me GGB is a bit overvalued here for my taste.

GOL LINHAS (GOL)

GOL is a stock that have looked at when it was trading below \$2 back in 2016.

Gol Linhas Aereas Inteligentes SA (NYSE:GOL)

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[Set Alert](#)

5.38

Delayed Data
As of Jul 03

↑ +0.24 / +4.67%

Today's Change

TODAY
4.42 | 14.49

52-Week Range

-38.58%

Year-to-Date

Quote	Profile	News	Charts	Forecasts	Financials	Shareholders	Competitors
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I didn't buy it then, let me see if that is still the case.

GOL is a South American airline and the reason for the good performance since 2016 is that it went from huge losses to good profits. If you can spot that, you make huge returns. However, you have to invest in companies that have negative book value and usually huge debt levels. The company revised its EPS estimates from \$0.7 down to \$0.5 for 2018 and the stock crashed. The expectation is for EPS between \$1 and \$1.5 for 2019 which would make this a stock with a PE ratio between 5 and 3.

I stick to my strategy of not investing in no book value stocks even if I might be wrong. I prefer to keep my life and investing simple.

NEXA RESOURCES (NEXA)

NEXA is a miner that recently listed on the NYSE. The price drop is significant and definitely a stock to watch when I'll be analysing zinc producers.

NETSHOES (NETS)

NETS is another recent Brazilian IPO that took advantage of the hot emerging market IPO market in the second period 2017. It was easy to sell anything then. However, the results were not spectacular.

Netshoes (CAYMAN) Ltd (NYSE:NETS)

[Add to Watch List](#) [Set Alert](#)

2.32

Delayed Data
As of Jul 03

↓ **-0.09 / -3.73%**

Today's Change

TODAY 2.00 | 20.90

52-Week Range

-70.63%

Year-to-Date

Quote	Profile	News	Charts	Forecasts	Financials	Shareholders	Competitors
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NETS is an online fashion platform from Brazil where the online penetration is just 2%. The company is not profitable and it managed to burn R\$335 million in cash in Q1 2018.

7 Building the Leading Online Consumer Platform in Latin America Well into the Future



With such investments you never know when and if something will happen. That is the risk reward.

TELECOMS

I don't like them and not at high valuations. Oi (OIBR) is just an example of what is going on there. The company is under a Judicial Restructuring plan now.

CONCLUSION

Stocks to make in depth analyses are COZAN, ADECOAGRO, GAFISA and NEXA for the riskier ones. BRFS is also a tricky play – I probably won't invest but perhaps I'll make an analysis, won't promise it thought.

Next stop - Argentina