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LATIN AMERICAN
EQUITY RESEARCH

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Strategy Report | Brazil

BRAZIL STRATEGY

BETWEEN THE HOPE AND THE REALITY; FOUR THEMES WE LIKE; UPDATING PORTFOLIO

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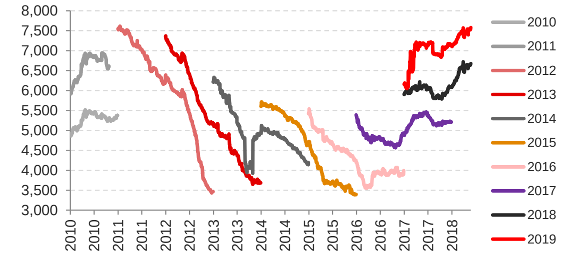
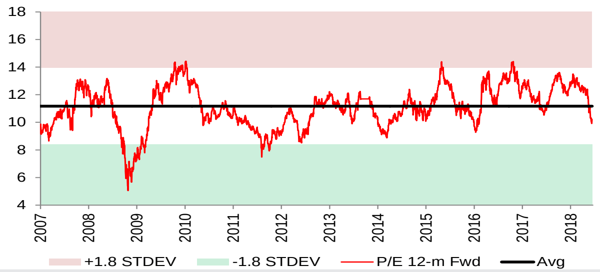
Net/Net: We have a more cautious view on Brazil at the margin and are reducing our YE2018 Ibovespa target price to 78,000 points (9% total return potential), given that the balance of risks has deteriorated domestically and internationally. Among the four pillars of our former positive call, only one remains in place: fair valuation (11x forward P/E, in-line with historical) with attractive PEG of 0.9x. The other three deteriorated: (i) earnings growth now with downside risk (2017-19E CAGR of 17%) following GDP revision to 2.0% from 3.2%; (ii) potential domestic asset reallocation temporally halted (equity AUM at 6.0% of total) on higher mid/LT rates; (iii) reform pillar: delayed; debt/GDP sustainability concerns on public spending on pensions and demographic profile (only 28% of population thinks pensions are unsustainable). Four portfolio themes we like: (i) growing dividend (moving Financial Services to Overweight); (ii) low beta with attractive growth: OW Utilities (~10% real IRR); (iii) US$ linked with reasonable valuation (we favor Industrials and Pulp & Paper); (iv) quality at reasonable prices (QARP), our new theme: upgrading Healthcare to OW plus selected quality cyclicals. **Five Top Picks:** CVC (replacing Lojas Americanas), Energisa (replacing Equatorial), IRB (replacing Petrobras), Itaú Unibanco, and Iochpe-Maxion.

- **Brazil Portfolio Profile:** We fine-tuned names in our Brazil portfolio, bottom fishing on quality names (comprising 67% of portfolio weight). We are balanced in style investing (55% weight in value stocks), with beta of 1x. Our recommended portfolio reached 170 bps excess return vs. Ibovespa, down from 330 bps in March.
- **Brazil Portfolio Main Changes:** Raising Financial Services to OW (the largest OW together with Utilities) and Healthcare (one of the worst performing sectors YTD). **Stocks Added:** Sul America, OdontoPrev, BR Distribuidora (replacing part of Petrobras weight), Suzano (replace Fibria), Vale (reducing UW), MRV (replace Cyrela). **Stocks Removed:** Ser Educacional, Cyrela, and Fibria.
- **Balance of risks deteriorated both domestically and internationally: reducing our YE2018 Ibovespa target to 78,000 points (from 97,000 points**), implying 9% total return potential from current levels. Our base-case target is derived from a Gordon Model (P/E target multiple: 11x forward), in-line with historical and a de-rating vs. former 13x. We cross-check it using risk-on/off probability approach. See our Risks section: elections, U.S. treasury, potential trade war. **What's the market pricing in?** We believe market is divided, pricing in a 50-60% bear case when looking at P/E ranges. More negative two-month view (earnings revision on weak 2Q).
- **What's new in the report?** Five new studies, highlighting: (i) comparing market behavior: May 2017 and 2018 events; (ii) Brazil CDS X Ibovespa; (iii) FX sensitivity.

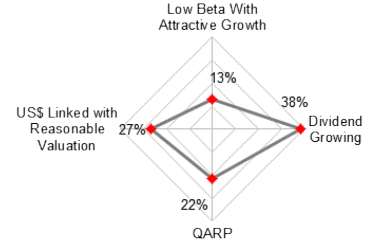
Ibovespa Consensus EPS Revisions



Investor Mood: Historical P/E Ranges



Portfolio Distribution by Theme (% Weight)



Three charts sources: Santander estimates and Bloomberg.

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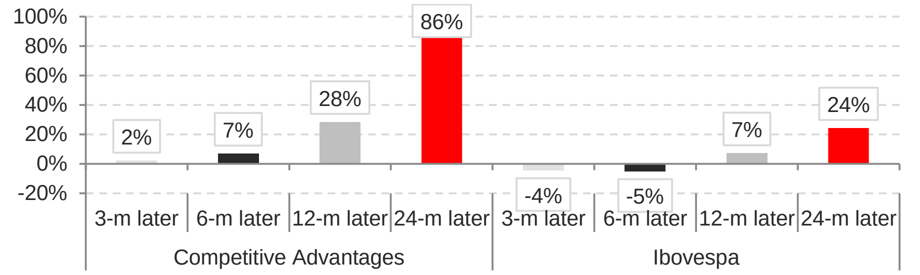
Summary

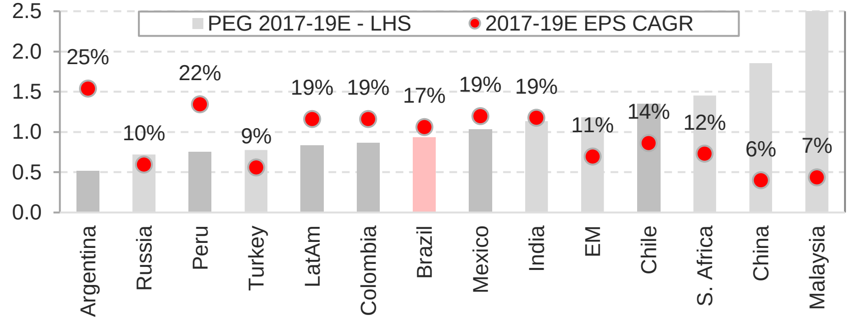
Brazil Key Conclusions

- **Is Ibovespa attractive?** Risk-adjusted return prospects deteriorated. The Ibovespa is trading at 2018E and 2019E P/Es of 10.5x and 9.3x, respectively, slightly below historical average of 11x, and offers 9% potential upside (78,000 points YE2018 Ibovespa target).
- **Four pillars: only one in place.** (i) fair valuation (10.5x forward P/E, in-line with historical) with attractive PEG of 0.9x. The other three deteriorated: (ii) earnings growth now with downside risk (2017-19E CAGR of 17%, or 29% using consensus) following GDP revision to 2.0% from 3.2%; (iii) potential domestic asset reallocation temporally halted (equity AUM at 6.0% of total) on higher mid/LT rates; (iv) reform pillar: delayed; debt/GDP sustainability concerns on public spending on pensions and demographic profile (only 28% of population thinks pension are unsustainable).
    - **Valuation breakdown:** 52% and 66% of companies are trading below their forward P/E and FV/EBITDA historical average, respectively.
    - **What is the market pricing in?** Divided: ~50-60% probability of a bear case in 2018.
    - **Macro: headwind for equities.** From 3.2% to 2.0% in 2018E (consensus at 1.8%), a sharp deterioration YoY; yet, still better YoY **GDP:** from -3.6% in 2016 to +1.0% in 2017 (consensus at 1.0%) and **Interest Rate Cycle:** 6.5% in 2018E (consensus 6.5%).
    - **Earnings trend:** In our view, expectations have downside risks: 2018E (+27% YoY; consensus +48%) and 2019E (+9%; consensus 12% YoY).
    - **Analyzing Ibovespa outlook:** Fair 2018E target multiple at: Minimum (~48,000 points), Average (~73,100), Maximum (~119,500).
    - **Are there marginal buyers?** Less conviction: foreign investors outflow. Foreign investors flows accumulated R$10.3 billion since May 21, (vs. R$1 billion 1-month outflow from May 2017 events). NTN-B back to attractive levels for local pension funds
- **Four Brazil themes we like:** (i) growing dividend stories (selected stocks with DY of 3.5-7.0% and DPS CAGR 10% or above): moving Financial Services to Overweight; (ii) low beta with attractive growth: we are OW Utilities (~9% real IRR); (iii) US$ linked with reasonable valuation (we favor Industrials and Pulp & Paper); (iv) quality at reasonable prices (QARP): positive ROIC spread over WACC trading below 20x P/E or PEG ratio below 1.5x; we think the lower quality operating leverage theme lost appeal. Five Top Picks: CVC (replacing Lojas Americanas), Energisa (replacing Equatorial), IRB (replacing Petrobras), Itaú Unibanco, and Iochpe-Maxion.
- **Short-term risks to monitor:** (i) political (volatility 10% higher in election years); (ii) the Fed and U.S. politics; and (iii) China (deceleration).

Returns Following an Ibovespa 15% Price Decrease within 30 Days:(1) (2)



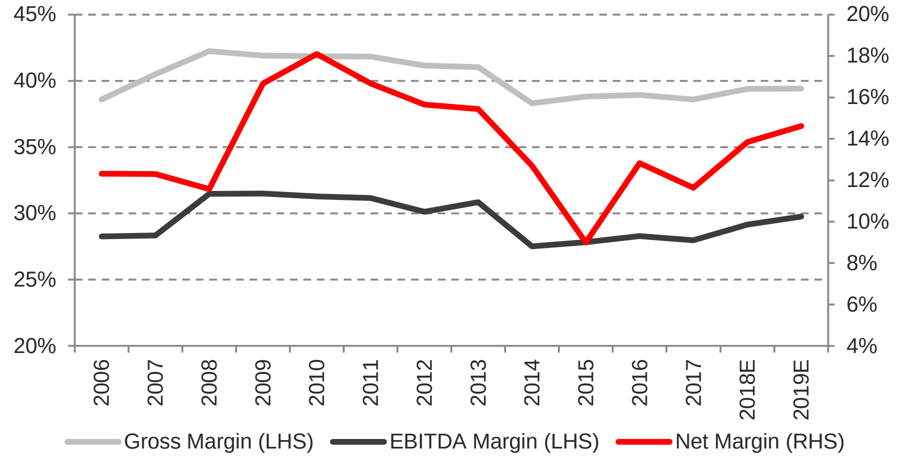
Brazil vs. Emerging Markets PEG, 2017–19E(2)



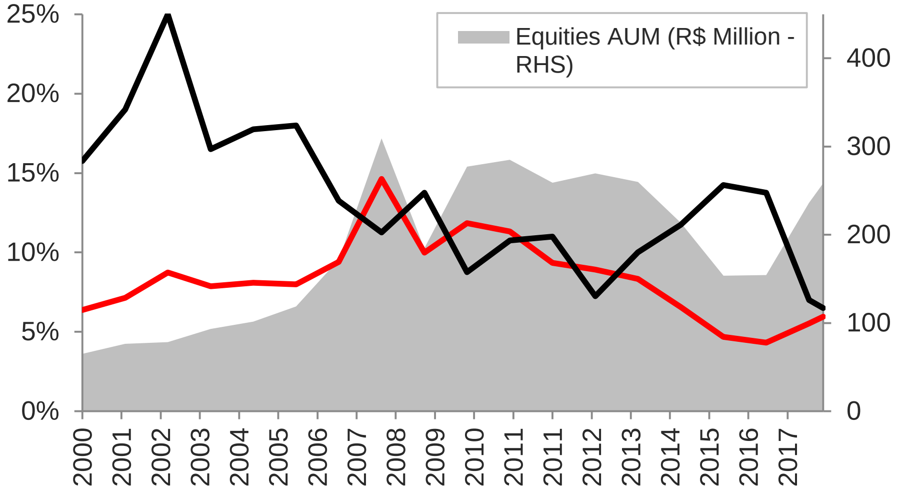
(1) Returns Following an Ibovespa 15% Price Decrease within 30 Days Period Since Year 2000 with 23 times/datapoints. (2) Sources: Bloomberg and Santander estimates.

Between the Hope and the Reality: Only One of Four Pillars in Place

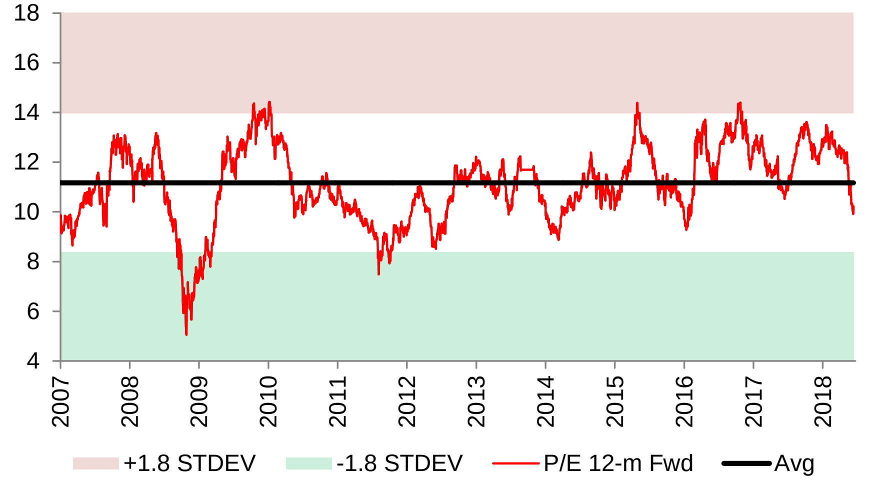
Earnings Trend Pillar: Negative; EPS CAGR 17-19E 19%; Santander Coverage—Margins Trend (1)



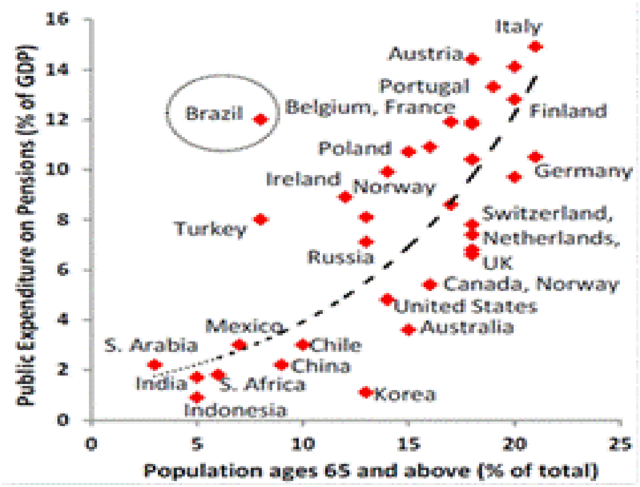
Flow Pillar: Temporarily Halted; Equity Funds AUM as % of Total Funds Industry AUM (R$ Bln) (2)



Value Pillar: Positive; Brazil at 10.5x 12-Month Forward P/E Investor Mood: Historical P/E Ranges (3)



Reform Pillar: Delayed; Debt/GDP Sustainability Concerns Public Spending on Pensions and Demographic Profile (4)



Sources: (1) Santander Estimates; (2) Anbima; (3) Bloomberg/; (4) OECD. Note: 2017 data accumulated until the end of June.

Brazil Overview – Key Fundamentals and Our View

	Metric		Our view on each indicator:	Trend we expect going forward:
Company/equities	**Valuation**	⬆	Ibovespa P/E became more attractive at 10.5x currently when compared to 13.6x from peak in January 2018 (and is now in line with 10.9x historical average).	Current valuations are cheaper, but in line with historical.
	EPS	⬇	Consensus EPS growth expectations remain high with 43% YoY 2018E (vs. 25.2% at the start of this year). EPS 2018E was revised upward +1.0% YTD (mainly given commodities).	We expect slight negative EPS revision trend in the short term given 2Q18 earnings season potentially being negatively impacted by truck strikes, goods outage and world soccer championship causing lower working/activity days.
	PEG	⬆	Attractive PEG ratio at 0.9x (2017-19E).	Adjusting valuations for growth, Ibovespa's PEG of 0.8 is one of the most attractive within EM countries (selected countries average of 1.1 PEG ratio).
Economics	**GDP**	⬇	GDP expectations worsened at the margin: consensus current estimates at +1.8% 2018 YoY vs. +2.9% reached in March this year. We note that 2019E YoY estimates have been revised downward to 2.7% from 3.0% one month ago.	We note that recent strike and stoppage in some sectors may have additional impact in the ongoing negative GDP revisions trend, at least for 2Q18. Need to monitor impact going forward, but we expect GDP of ~1.5%-2.0% from ~3% 2018E previously (our official estimate is 2%).
	Inflation	⬇	Inflation expectations improved to 3.80% currently vs. 3.96% at the beginning of the year, but recent events with fuel and food shortage should bring upward pressure on short-term inflation (question if it will be one-off or higher for the remainder of 2018).	Despite better inflation expectations since start of 2018, we believe recent products outage and consequential increase in goods and services prices should increase inflation prints in the short term. Need to monitor whether it is temporary or may affect the remainder of the year.
	Primary Result	⬇	Our economics team's expectation improved to -2.0% 2018E primary deficit as % of GDP, from -2.5% at the start of 2018.	Government's recent giving up of some taxes in trying to curb the truck strikes may have negative impact on the already constrained fiscal budget for the year.
	Structural Reforms	⬇	Current government was able to enact many measures/reforms (labor included). Yet with the current scenario in place, structural reforms (such as pension) are delayed until 2019, dependent on election outcome.	Pension reform is key for long-term fiscal sustainability of Brazil, in our view. Current survey (June) from Datafolha shows that only 28% of population thinks Brazil pensions are unsustainable, 51% thinks that they are sustainable, and 21% answered they did not know .
Markets	**10Y Interest Rates**	⬇	10Y Local Interest Rates climbed to 12.0% currently (vs. 9.4% lows in March).	Local long-term interest rates (10Y) remains above the 12% levels triggered by truck strike event, showing relatively higher overall risk perception from investors toward Brazil. We do not expect a meaningful reduction in short term.
	FX	⬇	BRL depreciated 19% to R$3.73 (after overshooting near R$4.00) vs. R$3.14 lows registered in January.	BRL reached the highest levels in the past 2 years and could have short-term stress movement. On the flip side, it could benefit balance of payments. Our macro team expects R$3.50 at YE2018, which we believe is on the bull-case side and dependent on a pro-market candidate winning the election.
	CDS	⬌	Brazil 10Y CDS continues rising at 387 points currently, the highest level since January 2017 (lows were at237 points lows from January).	We do not expect a meaningful reduction in short term.
Flows	**International**	⬇	Brazil had outflows of US$323 million in the past four weeks (still accumulating US$4.2 billion inflows YTD).	During recent days, we talked with many buy-side investors from SWF through hedge funds and long-only, showing a wide range of views. Unlike May 2017 (when foreign investors were clearly buyers and EM/Brazil was mentioned as a highlight during the Omaha conference we attended), this time the conviction isreduced: long-only seem to be in wait-and-see mode, hedge funds were sellers on Brazil.
	Bovespa Trades from Foreigners	⬇	We note that Bovespa foreign investors had R$10.3 billion outflows in the past 4 weeks and turned to an accumulated R$7.7 billion outflows YTD. Comparing May 2017 events, the 1 month outflow was only R$1 billion.	
	EM	⬇	Putting in context, EM strong inflows trend with US$54.4 billion YTD, but it has reversed during last 4 weeks (US$2.8 billion outflows) impacted by US 10Y interest rates increase.	U.S. treasury increase seems to have softened international investors' appetite for riskier assets such as the EM category, which appears to have diminished at the margin. Important to monitor FOMC 2H18 meetings.

Sources: Bloomberg and Santander estimates.

Top Four Themes/Theses in Our Portfolio

QARP

Quality At Reasonable Prices

Positive ROIC spread over WACC trading below 20x P/E or PEG below 1.5x)

Sectors Represented: Healthcare, Consumer, Transportation

- **Top Picks: CVC** (High ROIC trading at 15x 2019 P/E

- Additional Theme Stocks:
- Lojas Renner
- Localiza
- Lojas Americanas
- Linx
- OdontoPrev

GROWING DIVIDEND STORIES

Stocks with DY 3.5-7.0% range and DPS CAGR 10% or above = Selic post-income-tax show a declining trend (to ~5.4% at YE2018E)

Sectors Represented: Financials (both Services and Banks) as the main thesis, F&B and Industrials

- **Top Picks: IRB:** 29% ROE with 5% DY; upside risk to consensus EPS 2019E
- **Itau Unibanco** (Competitive Advantage Play at 9.5x 2018E P/E and 6.5% DY). Itausa as alternative at 25% discount to NAV

- Additional Theme Stocks:
Bradesco, Mahle Metal Leve, Sul America, Ambev

LOW BETA WITH ATTRACTIVE GROWTH

We are Overweight on Utilities, the sector with highest average IRR (~10% real vs. NTN-B 5.5%)

Sectors Represented: Utilities, Malls

- **Top Pick: Energisa** (Good capital allocation; with 10% real IRR

- Additional Theme Stocks:
- Equatorial
- Multiplan
- Transmissão Paulista

US$ LINKED WITH REASONABLE VALUATION

We always like to carry some FX hedge, 27% weight in FX-related stocks.

Our macro estimates point to BRL at R$3.50 at YE2018 and R$3.57 at YE2019, but we see downside risk

Sectors Represented:

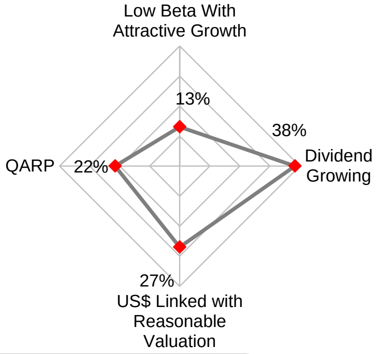
Favor Capital Goods and Pulp & Paper.

- **Top Picks**: **Iochpe-Maxion** (5.1x FV/EBITDA and a 2017E-20E CAGR EBITDA of 12%)
- Additional Theme Stocks:
- Suzano, Klabin
- Gerdau
- Mahle Metal Leve

PORTFOLIO BACKGROUND

- Portfolio alpha: 170 bps YTD; 430 bps in 2017, with a LTM 1.7 Sharpe Ratio. Since 2013, it has 1,270 bps alpha.
- 55% portfolio weight in value stocks.
- 67% weight in "competitive advantage" stocks (stocks with ROIC above WACC and market share stability).
- Portfolio EPS CAGR (2017-19): 31%.

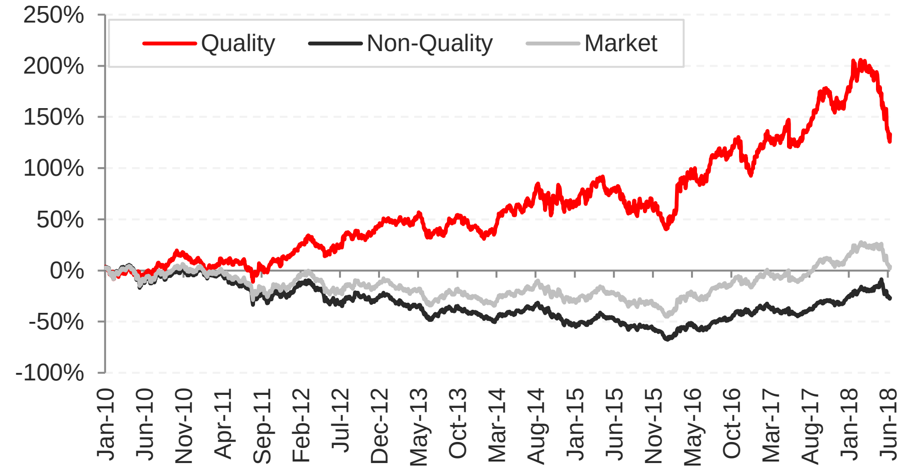
PORTFOLIO THEMATIC DISTRIBUTION



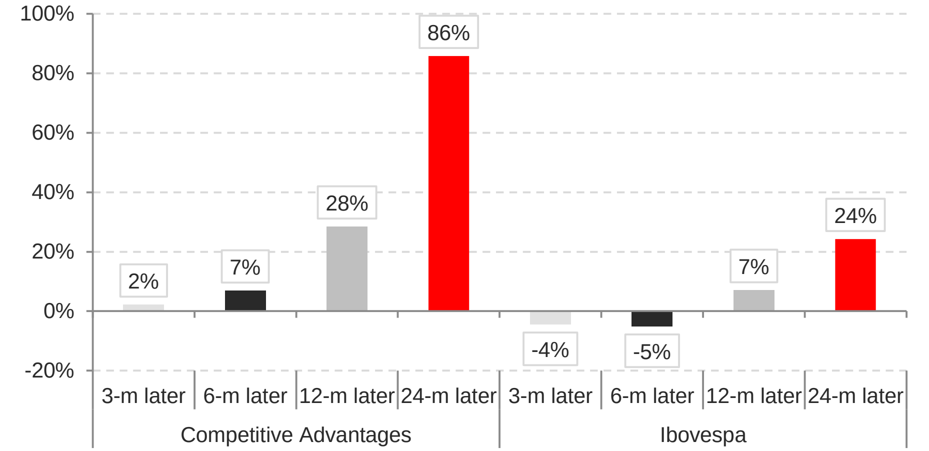
Source: Santander.

Introducing New Theme: Quality at Reasonable Prices (QARP) Companies Are a Good Investment Vehicle Through Time, Epecially in Uncertain Periods

Returns by Quality vs. Non-Quality Companies in Ibovespa – Accumulated Since 2010: (1)



Returns Following an Ibovespa 15% Price Decrease within 30 Days Period Since Year 2000: (2)



- Classification of Brazilian companies in Ibovespa by quality and non-quality categories shows strong performance for quality companies:
  - Quality companies had an expressive accumulated performance of 133% since 2010 to date, compared to Ibovespa's +4%.
  - Non-quality companies had negative performance of -27% in the same period.

- We also ran an analysis of periods since 2000 when Ibovespa had a 15% price decrease within a 30-day interval (23 times/data points):
  - Ibovespa average price performance was -5%, +7% and +24%, following 6, 12, and 24 months of the 15% price decrease.
  - Our competitive advantage companies list (2) had a much better performance, with +7%, +28% and +86% price change following the 6, 12, and 24 months of the Ibovespa 15% price decline.

- We believe that quality companies with high ROE levels and trading at decent valuations are among the best investment vehicles to navigate in a more uncertain scenario, along with their characteristic of compounding returns (high returns with potential reinvestment to generate higher than average returns from overall market).

- Main Themes Stocks: CVC, Localiza, Lojas Renner, OdontoPrev, and Lojas Americanas.

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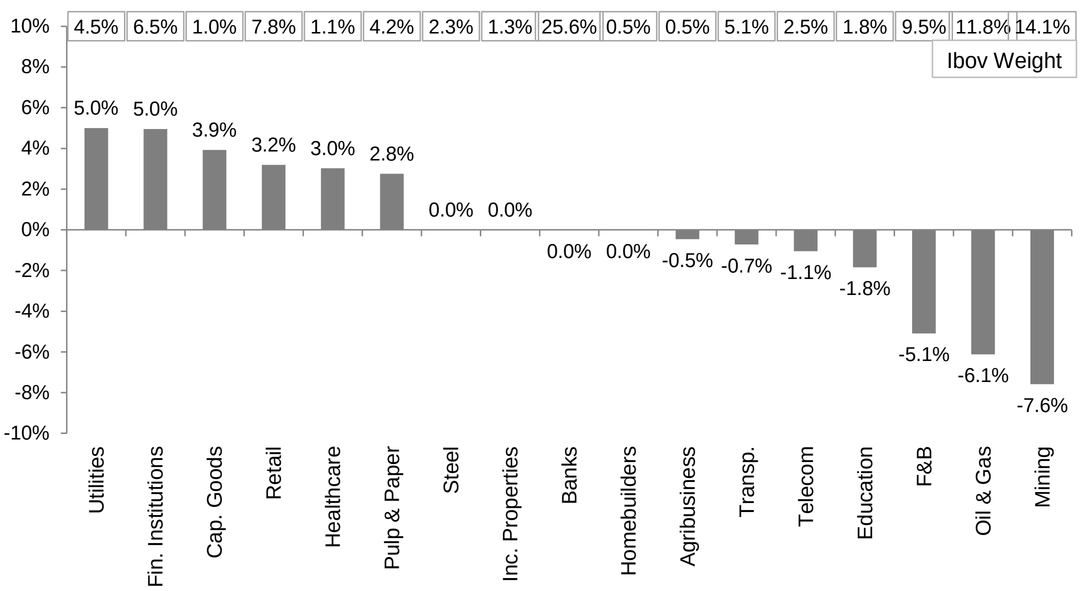
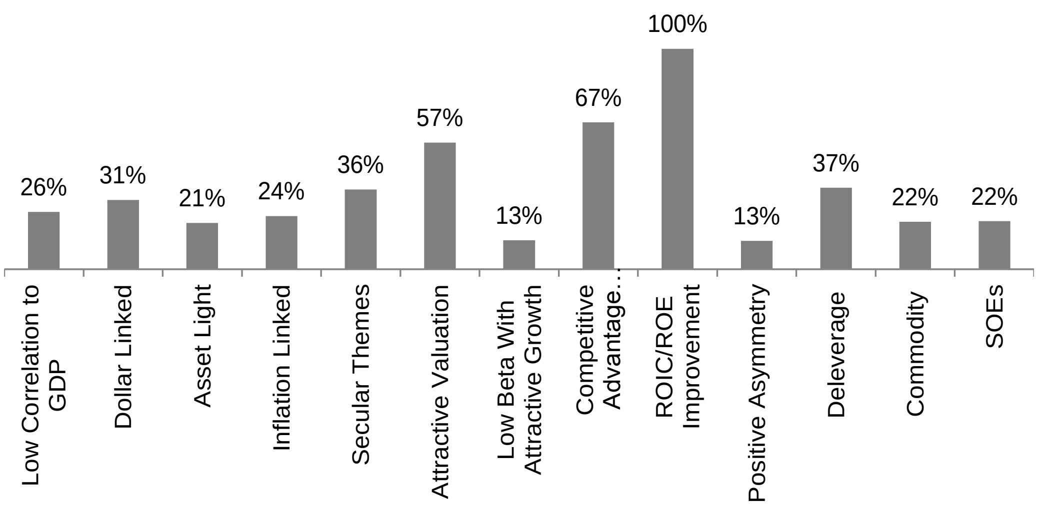
(1) Sources: Santander and Bloomberg. (2) Note: for more detail on our competitive advantages approach and companies, please refer to our "Hey Competition, Can You Jump a Wide Moat - Updating Competitive Advantage Companies and Theme Top Picks" report from 16 April 2018. Sources: Santander and Bloomberg.

Recommended Brazil Portfolio: Our Allocation by Sector

Sector Allocation over Benchmark



Portfolio Distribution by Theme



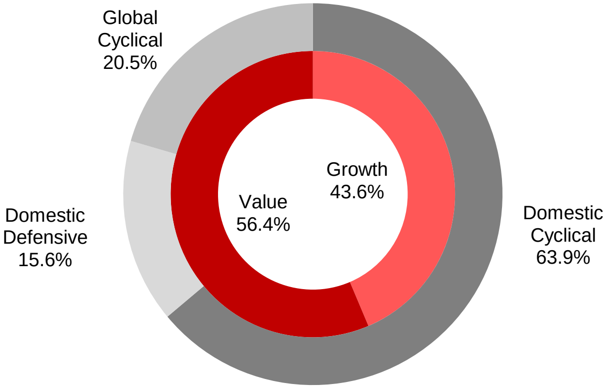
- **Main Overweight Sectors:** Financial Services (+500 bps); Utilities (+500 bps), Quality Consumer (+320 bps), Healthcare (+300 bps).
- **Sector Movements:** Upgrading Financial Services to OW from UW, Healthcare to OW from Neutral; Moving Education to UW from Neutral.
- **Stocks added:** OdontoPrev, Sul America, Vale (reducing UW), MRV (replace Cyrela), BR Distribuidora (replace part of Petrobras), Suzano (replace Fibria).
- **Stocks Removed:** Ser Educacional, Cyrela, Fibria.

Sectors	OW / UW		Portfolio	Benchmark
Utilities	●	5.0%	9.5%	4.5%
Fin. Institutions	●	5.0%	11.5%	6.5%
Cap. Goods	●	3.9%	4.9%	1.0%
Retail	●	3.2%	11.0%	7.8%
Healthcare	●	3.0%	4.1%	1.1%
Pulp & Paper	●	2.8%	7.0%	4.2%
Steel	△	0.0%	2.3%	2.3%
Inc. Properties	△	0.0%	1.3%	1.3%
Banks	△	0.0%	25.6%	25.6%
Homebuilders	△	0.0%	0.5%	0.5%
Agribusiness	◆	-0.5%	0.0%	0.5%
Transp.	◆	-0.7%	4.3%	5.1%
Telecom	◆	-1.1%	1.4%	2.5%
Education	◆	-1.8%	0.0%	1.8%
F&B	◆	-5.1%	4.4%	9.5%
Oil & Gas	◆	-6.1%	5.7%	11.8%
Mining	◆	-7.6%	6.5%	14.1%

Source: Santander estimates.

Recommended Brazil Portfolio: Profile by Stock

- **Balanced Portfolio:** With a tilt to value (56% weight), given that 2018 is a year with potential binary outcomes; focus on risk-adjusted returns; beta of 1x.
- Our portfolio currently has a 67% weight in “competitive advantage” stocks (stocks with ROIC above WACC and market share stability) with a high ROIC profile.
- **Portfolio alpha:** Excess return of 170 bps YTD. Yielded 31.2% in 2017, an alpha of 430 bps over Ibovespa’s performance. Since 2013, the accumulated alpha is 18.0%.
- Portfolio EPS CAGR (2016-18E): we expect it to reach 31%.



Company	Ticker	Sector	Low Correlation to GDP	Dollar Linked	Asset Light	Inflation Linked	Secular Themes	Attractive Valuation	Low Beta With Attractive Growth	Competitive Advantage Companies / High ROIC	ROIC/ROE Improvement	Positive Asymmetry	Deleverage	Weight	Ibovespa Weight	OW/UW
Itausa	ITSA4	Financial Institutions - Banks						✓		✓	✓	✓		4.0%	3.4%	0.6% △
Itaú Unibanco	ITUB4	Financial Institutions - Banks						✓		✓	✓			11.1%	10.1%	1.0% △
Bradesco	BBDC4	Financial Institutions - Banks						✓		✓	✓			7.1%	7.1%	0.0% △
Banco do Brasil	BBAS3	Financial Institutions - Banks						✓			✓			3.3%	2.7%	0.6% △
Energisa	ENGI11	Utilities	✓			✓		✓	✓		✓		✓	3.0%	NA	3.0% ●
Copasa	CSMG3	Utilities	✓			✓	✓	✓	✓		✓	✓	✓	1.2%	NA	1.2% ●
Transmissao Paulista	TRPL4	Utilities	✓			✓		✓	✓		✓		✓	1.3%	NA	1.3% ●
Equatorial	EQTL3	Utilities	✓			✓		✓	✓	✓	✓		✓	4.0%	1.0%	3.0% ●
Iochpe Maxion	MYPK3	Capital Goods		✓				✓			✓		✓	3.0%	NA	3.0% ●
Mahle Metal Leve	LEVE3	Capital Goods		✓				✓		✓	✓	✓		1.9%	NA	1.9% ●
IRB	IRBR3	Financial Institutions - Others	✓	✓	✓	✓	✓	✓		✓	✓			5.0%	NA	5.0% ●
B3	B3SA3	Financial Institutions - Others			✓		✓			✓	✓		✓	3.5%	3.5%	0.0% △
Sul America	SULA11	Financial Institutions - Others			✓		✓				✓			3.0%	NA	3.0% ●
Petrobras	PETR3	Oil, Gas & Petrochemicals		✓				✓			✓	✓	✓	4.7%	8.7%	-4.0% ◆
BR Distribuidora	BRDT3	Oil, Gas & Petrochemicals		✓				✓			✓	✓		1.0%	NA	1.0% ●
Suzano	SUZB3	Pulp & Forest Products	✓	✓						✓	✓			5.0%	1.8%	3.2% ●
Klabin	KLBN11	Pulp & Forest Products		✓						✓	✓		✓	2.0%	1.0%	1.0% △
Linx	LINX3	Telecom, Media & Technolog			✓		✓			✓	✓			1.4%	NA	1.4% ●
Localiza	RENT3	Transportation					✓			✓	✓		✓	2.1%	1.0%	1.1% ●
Rumo Logistica	RAIL3	Transportation				✓			✓		✓			2.2%	1.2%	1.0% ●
Multiplan	MULT3	Income Properties				✓			✓		✓			1.3%	0.4%	0.9% △
Gerdau	GGBR4	Steel		✓				✓			✓		✓	2.3%	1.2%	1.1% ●
Carrefour Brasil	CRFB3	Retail				✓	✓	✓		✓	✓			2.0%	NA	2.0% ●
CVC	CVCB3	Retail			✓		✓			✓	✓			4.0%	0.5%	3.5% ●
Lojas Renner	LREN3	Retail					✓			✓	✓			1.7%	1.7%	0.0% ◆
Lojas Americanas	LAME4	Retail					✓			✓	✓		✓	3.4%	0.9%	2.5% ●
MRV Engenharia	MRVE3	Homebuilding					✓	✓			✓			0.5%	0.3%	0.2% △
Ambev	ABEV3	Food & Beverage					✓			✓	✓			4.4%	6.8%	-2.4% ◆
OdontoPrev	ODPV3	Healthcare			✓	✓	✓			✓	✓			2.1%	NA	2.1% ●
Qualicorp	QUAL3	Healthcare			✓	✓	✓	✓		✓	✓			2.0%	0.4%	1.6% ●
Vale	VALE3	Mining	✓	✓							✓		✓	6.5%	13.5%	-7.0% ◆
Total	**31**		**7**	**9**	**7**	**10**	**14**	**17**	**6**	**18**	**31**	**5**	**12**	**100.0%**	**67.3%**	
% Total Companies			23%	29%	23%	32%	45%	55%	19%	58%	100%	16%	39%			
% Total Weight			26%	31%	21%	24%	36%	57%	13%	67%	100%	13%	37%			

Source: Santander estimates.

Recommended Brazil Portfolio: Top 5 Picks

Company	*Our Rationale*	*Catalysts*	*Risks*
IRB	• IRB Brasil RE is our preferred name in our non-bank financials universe of coverage. The company has leading positions in almost all reinsurance segments in which it operates in terms of written premiums, as well as a diversified portfolio and a predictable and stable business model that lessens volatility in key revenue lines. • We view IRB as the top dividend player among Brazilian financials given the 75% payout, excess capital, and cash-cow status. We expect IRB's dividend yields to surpass the CDI rate, averaging 7.0% for 2018E and 2019E. • We also expect the company to deliver EPS growth of 8% for 2018E and 22% for 2019E.	• Strong results in the upcoming quarters, revising the market consensus upward, as we believe that Bloomberg consensus earnings estimates for IRB undervalue the stock. • As part of its divestment plan, IRB created a real estate subsidiary that could eventually sell the company's real estate portfolio, generating an after-tax capital gain of R$381 million (~3% of IRB's market cap), per our estimate.	• Competition from new and existing players. • Regulatory risk – with regard to the reinsurance market and taxes. • Political risk – government's stake and golden share. • Stock overhang from the end of lock-ups – the second lock-up period ended on July 26, 2018.
Itaú Unibanco	• We believe Itaú presents a strong balance sheet, and we expect it to post a solid recovery trend in terms of profitability in the coming years. We see its high coverage ratio (239% in 1Q18) as a differential between Brazilian banks, as it demonstrates conservatism and shows how the bank is prepared to face the consequences of the current uncertainty in Brazil. • For 2018E, we forecast (i) another 7% YoY decline in provision charges; (ii) ongoing improvements in insurance selling expenses and retained claims (+1% YoY); (iii) non-interest expenses growing below or in-line with the expected inflation for the period; and (iv) a commissions & fees increase of 5%. Overall, we see recurring net income at 10% YoY. • Additionally, we expect a positive contribution from its Latin American operations (i.e., Itaú CorpBanca) after a period of substantial restructuring.	• Potential improvement of the operational performance for the coming quarters, with positive NPL trend and declining provision expenses YoY. • Maintenance of strong cost control (operating expenses growing below inflation) with room to improve efficiency through digital branches.	• Weaker than expected economic recovery in Brazil which could lead to higher than expected NPLs and/or specific problems in its wholesale/corporate banking segment.
CVC	• High ROIC (>32%) and asset-light business model. • Economies of scale, synergies from acquisitions, and high bargaining power with suppliers. • Leadership position creates an entry barrier. • EPS CAGR(17E-19E) of 25%, with potential upside, in our view. • More reasonable valuation at 18x P/E 12-m fwd (-26% below peak reached in April 2018).	• M&A opportunities in Brazil and Latin America. • Improving results on the back of a better economic environment. • Improving the OTA business.	• Delayed recovery in economic activity. • Tougher competition from main competitors. • Integration of companies that do not necessarily share same culture.
Iochpe-Maxion	• Iochpe is our top pick among our LatAm Capital Goods. We see the company as a diversified player in global wheel and structural component sourcing, and as a leveraged play in the global automotive market. After its successful (still ongoing; we see net debt/EBITDA at 1.9x at YE2018) deleveraging process and liability management, we expect the company to focus on operational benefits associated with volume growth in Brazil and NAFTA. • We believe that Iochpe offers a good combination of: (i) 39% total return; (ii) cash generation: 7.1% FCFE yield; and (iii) growth (2017E-20E EBITDA CAGR of 12%), while trading at 5.1x 2018E FV/EBITDA (11% discount to historical).	• Operational delivery resulting in consolidated margin expansion (we estimate ~12.5% in 2018).	• Weaker than expected GDP growth leading to weak domestic automotive sales and requiring further capacity adjustment.
Energisa	• Protection against inflation and strong embedded growth, as a result of its concession area profile (the company is exposed to the agribusiness segment). Last 14 years' CAGR volume increase of 4.8% vs. 3.1% for Brazil. • A proven track record in terms of turnaround of disco units. • Strong EBITDA growth in the coming years (2017-20 CGAR of 15.1%), due to the cost/loss reduction strategy and increase in the asset base. • Reasonable valuation: trading at 2018E EV/RAB of 1.92x and a real IRR of 10.3%.	• M&A activity in distribution segment. • Faster-than-expected economic recovery. • Significant change in interest rates (net debt/EBITDA of 3.2x in 1Q18).	• Overbidding in auctions or M&A. • High leverage structure and capex needs (~R$2.0 billion for 2018).

Source: Santander

Recommended Brazil Portfolio: New Additions

Company	*Our Rationale*	*Catalysts*	*Risks*
SulAmérica	• We see SulAmérica entering a more benign operational cycle (gross insurance margin expanded from 9.8% in 1Q17 to 10.2% in 1Q18 while the combined ratio improved from 100.9% to 98.6% in the same period), with the insurance operations more than offsetting lower financial results. We are confident that the company will benefit from better macroeconomic conditions (declining unemployment rates, medical inflation above CPI levels, and healthier household disposable income), which we believe should trigger higher demand for health insurance plans by both corporate and individuals (we expect written premiums to post an increase of 10% YoY in 2018E). • We forecast recurring net income for 2018 and 2019 to reach R$854 million and R$992 million, respectively, leading to EPS growth of 10% and 16%.	• We expect future upward earnings revisions throughout the Street, leading to more attractive valuations (we are 7% and 6% above market consensus for net income in 2018E and 2019E, respectively). • Potential for further strong earnings expansion in 2019, given a decrease in the Social Contribution Rate (CSLL) to 15% (vs. the current 20%).	• The company could engage in a strategy to grow via M&A, which may include potential execution risks. • Lower than expected growth, especially given poor economic growth prospects. • Regulatory risks in the individual health segment; increasing competition.
Odontoprev	• We see the company with a resilient moat based on: (i) scale, as the company is the leader in member base, holding ~27% market share with 6.3 million lives; (ii) strong distribution with its bank channel (Bradesco and Banco do Brasil represent a combined footprint of ~9.7k branches in Brazil); and (iii) proprietary IT platform, ensuring service quality and cost control with good risk management and fraud prevention. • We see the stock as one of the main beneficiaries of a pickup in net labor additions, which should sustain 2018E adjusted EPS growth at 20.0%. We also see the company as defensive name due to high returns (~60% ROIC), cash generation, and market share leadership (27% market share).	• Less fierce competition, once competitors that gained share in recent years (Hapvida and Intermedica) reached a high cross-sell rate (70-80%) within their health and dental member base. • Low dental plan penetration in Brazil (11%) vs. health care plans (23%) and US dental plan penetration (77%). • Decent quarterly results.	• M&A dxecution (Odontosystem). • Weaker than expected economic recovery in Brazil, which could lead to higher than expected DLR (dental loss ratio) and/or lower than expected net adds growth.
Suzano	• Accretive short-, mid- and long-term outlook: This year we believe Suzano should benefit from our constructive view on pulp prices and its valuable FX hedge feature in the context of national elections. Sequentially, Suzano should spend the following three years capturing synergies arising from the deal with Fibria and financially deleveraging, in our view. Then, we estimate Suzano will be ready to grow again, and we believe a potential brownfield expansion with low opportunity cost could add value to shareholders. • Suzano + Fibria, enjoying the best of each one: In addition to the value created/captured by the synergies from the deal, there could still be unpriced side effects, in our view. Before the deal, we identified in Suzano higher return to shareholders, whereas Fibria was able to grow with higher marginal ROIC. Consequently, we believe the combined entity could elevate the companies' individual qualities, posting decent returns with accretive growth opportunities, and this combination of qualities should ultimately result in expansion of valuation multiples, in our view. • Financial strength regardless of pulp prices: We believe the incorporation of Fibria should result in sufficient operational and financial strength that the company will be able to generate cash even under the most severe commodity price assumptions in 2020 (the first year of full consolidation).	• Implementation of pulp price increases recently announced by competitors. • FX volatility in the context of still uncertain domestic macro scenario.	• Chinese paper makers being unable to pass through cost pressure from raw materials to end consumers. • Severe remedies for the incorporation of Fibria by Suzano
Vale	• We continue to see an accretive carryover effect in Vale, as our US$61/ton and US$55/ton average iron ore price estimatea for 2018 and 2019, respectively, pave the way for 16% and 10% FCFE yield on those years, respectively. Additionally, we still believe positive outcomes could arise from the company's improved capital allocation and financial deleverage, helping reduce the risk to our investment thesis. • We see Vale as well positioned in a potential flight-to-quality movement in the iron ore value chain: in the context of the search for efficiency and environmentally friendly practices in China, we see Vale as well positioned due to its premium iron ore from the Northern system (representing approximately 55% of consolidated iron ore production volume). • We project Vale will hit the target of US$10.0 billion net debt this year, with upside risk for extraordinary dividend payments.	• Extraordinary dividend payments. • Divestment of non-profitable assets. • Decent quarterly results. • Continued financial deleverage heading to net cash position: • Partnerships (or even no replenishment of exhausted mines) in some nickel assets that could either boost cash inflows or reduce cash outflows.	• Downward trend in iron ore prices. • Political risk in Brazil. • FX volatility.
BR Distribuidora	• Despite being a state-owned enterprise, which is an out-of-favor theme currently, we believe BRD's operations should continue to improve in 2018 and that the current valuation of ~6.8x FV/EBITDA 2018E already incorporates the impact of the truckers' strike (lower sales and also inventory losses due to the cut in diesel prices by 10% at the refinery gate). In addition, the current valuation does not consider any improvements in the company's operations, which in our view continue to move forward and were already reflected in 4Q17 and 1Q18 results. • We expect the company to generate around R$1.3 billion in cash in 2018 that should translate into dividends of a similar amount, implying a dividend yield of ~7.0%.	• Ongoing trend of margin improvement throughout 2018. • Gas station conversions recovery, leading to an increase in the number of active stations. • Positive impact from the agreement related to debts with Eletrobras (~10% NPV).	• Increase in imported fuel, which improves competitiveness of white flag stations. • Exposure to the thermal power plant business. • Execution risk on company cost-cutting plan.
MRV	• We see sizable demand supporting the continued ramp-up in launches, likely approaching its target of 50,000 units/year in 2018. • We expect the combination of its improving margins, shortening operating cycle, and expanding operations to allow MRV to post improving ROEs in the coming years. • In our view, MRV is trading at attractive earning yields (13.0% and 16.2% for 2018E and 2019E, respectively), with increasing dividend yields (5.4% for 2018E and 7.5% for 2019E) and positive cash generation.	• Large liquidity events for Caixa Econômica, lowering the risk of restriction in its balance sheet and consequently, bottlenecks in mortgage concessions for low-income housing. • Announcement of the next stage of the MCMV program at similar or more favorable terms for Groups 1.5, 2, and 3.	• Unfavorable changes in the MCMV program could pressure margins or limit the volume of projects to be launched. • Further sizable withdrawals from the FGTS fund. • Balance sheet restriction for Caixa Econômica attributable to the Basel III banking regulation.

Source: Santander

Recommended Brazil Portfolio: Valuation

				Price (R$)				Trading Volume	P/E		FV/EBITDA		CAGR (17-19)E		Dividend Yield	ROE	P/BV	PEG	EPS Revision
Company	**Sector**	**Ticker**	**Rating**	**17-Jun-18**	**Target 2018E**	**Upside / Downside**	**Market Cap. (R$Bln)**	**R$ Mln(1)**	**2018E**	**2019E**	**2018E**	**2019E**	**Earnings**	**EBITDA**	**2018E**	**2018E**	**2018E**	**2017E-19E**	**12-m Fwd (3-months)**
Itausa	Financial Institutions - Banks	ITSA4	Buy	9.0	14.7	64%	78.0	303	NA	NA	NA	NA	NA	NA	NM	NM	NM	NM	-6.1%
Itaú Unibanco	Financial Institutions - Banks	ITUB4	Buy	39.4	52.0	32%	244.5	765	8.7	7.7	NA	NA	13%	NA	5.1%	19.7%	1.7	0.8	-1.4%
Bradesco	Financial Institutions - Banks	BBDC4	Hold	26.2	37.0	41%	167.7	454	7.7	6.9	NA	NA	15%	NA	4.5%	17.8%	1.4	0.6	1.4%
Banco do Brasil	Financial Institutions - Banks	BBAS3	Buy	26.2	42.0	60%	75.2	439	6.0	4.7	NA	NA	23%	NA	4.5%	12.1%	0.7	0.3	-0.5%
Energisa	Utilities	ENGI11	Buy	31.0	37.1	20%	11.9	26	13.9	13.8	8.3	7.7	40%	12%	1.3%	17.4%	2.4	0.7	-17.6%
Copasa	Utilities	CSMG3	Buy	41.1	54.6	33%	5.2	23	8.0	7.0	4.2	3.7	14%	9%	3.0%	9.5%	0.8	0.6	-6.3%
Transmissao Paulista	Utilities	TRPL4	Buy	60.6	73.8	22%	9.7	30	6.5	6.2	4.6	4.5	4%	3%	4.9%	14.5%	0.9	1.5	-2.2%
Equatorial	Utilities	EQTL3	Hold	60.0	71.1	19%	11.9	95	16.2	12.6	9.3	8.2	37%	18%	1.5%	14.7%	2.4	0.6	-4.5%
Iochpe Maxion	Capital Goods	MYPK3	Buy	21.1	28.0	32%	3.2	25	14.1	10.6	5.2	4.5	401%	15%	2.6%	8.8%	1.2	NM	-0.7%
Mahle Metal Leve	Capital Goods	LEVE3	Buy	25.5	27.0	6%	3.3	10	12.7	11.5	7.3	6.5	7%	9%	7.5%	18.9%	2.4	1.8	13.0%
IRB	Financial Institutions - Others	IRBR3	Buy	48.9	47.0	-4%	15.3	118	15.3	12.6	NA	NA	15%	NA	4.9%	28.3%	4.3	1.1	6.9%
B3	Financial Institutions - Others	B3SA3	Hold	19.9	25.0	25%	41.0	364	17.3	15.7	13.0	11.6	50%	33%	2.9%	7.5%	1.3	0.7	0.2%
Sul America	Financial Institutions - Others	SULA11	Buy	18.3	26.0	42%	7.2	21	8.5	9.5	NA	NA	-1%	NA	3.1%	14.3%	1.2	NM	2.0%
Petrobras (1)	Oil, Gas & Petrochemicals	PETR3	Hold	17.9	25.0	40%	219.2	426	8.4	9.6	4.3	3.9	NA	24%	2.1%	9.3%	0.8	NM	17.0%
BR Distribuidora	Oil, Gas & Petrochemicals	BRDT3	Buy	17.8	27.0	51%	20.8	119	13.4	12.1	7.2	6.4	22%	12%	7.1%	17.4%	2.3	0.8	4.7%
Suzano	Pulp & Forest Products	SUZB3	Buy	43.9	47.0	7%	48.5	281	25.0	31.2	11.1	12.0	2%	1%	0.9%	14.4%	3.6	NM	48.2%
Klabin	Pulp & Forest Products	KLBN11	Buy	19.9	25.0	26%	25.2	95	32.2	30.5	10.0	9.9	32%	10%	2.8%	10.5%	3.4	NM	-6.2%
Linx	Telecom, Media & Technology	LINX3	Buy	17.2	26.5	54%	2.9	12	18.7	15.7	14.8	12.1	20%	18%	1.5%	11.9%	2.2	1.1	3.3%
Localiza	Transportation	RENT3	Buy	23.9	34.0	42%	16.0	129	25.0	22.2	14.0	12.8	17%	13%	0.9%	20.8%	5.2	1.8	6.6%
Rumo Logistica (1)	Transportation	RAIL3	Buy	13.5	19.0	41%	21.0	120	NM	32.6	8.9	7.6	NA	16%	0.5%	4.8%	2.5	NM	-6.6%
Multiplan	Income Properties	MULT3	Buy	53.4	84.0	57%	10.7	65	19.6	17.8	11.9	11.1	27%	11%	2.6%	10.0%	2.0	1.1	-6.0%
Gerdau	Steel	GGBR4	Buy	14.0	16.0	14%	22.4	186	15.6	11.6	7.0	6.1	7%	14%	1.9%	5.4%	0.8	1.9	24.6%
Carrefour Brasil	Retail	CRFB3	Buy	14.9	19.0	28%	29.5	37	14.4	11.9	6.9	6.0	26%	15%	1.1%	15.7%	2.3	0.7	0.8%
CVC	Retail	CVCB3	Buy	44.4	55.0	24%	6.5	95	20.3	16.4	10.3	8.5	22%	17%	1.9%	64.9%	13.2	1.1	-3.3%
Lojas Renner	Retail	LREN3	Hold	28.5	37.0	30%	20.4	135	22.2	18.0	12.4	10.5	23%	16%	0.9%	26.7%	5.9	1.2	-2.9%
Lojas Americanas	Retail	LAME4	Buy	15.9	22.0	39%	23.4	81	29.0	22.3	10.3	8.8	66%	15%	0.5%	14.3%	4.2	NM	0.2%
MRV Engenharia (1)	Homebuilding	MRVE3	Buy	12.1	18.4	53%	5.4	39	7.1	5.8	5.9	4.8	24%	22%	8.8%	13.2%	0.9	0.4	-0.2%
Ambev	Food & Beverage	ABEV3	Hold	18.8	22.0	17%	295.6	398	21.1	18.2	13.0	11.4	37%	13%	2.9%	26.0%	5.5	0.9	-3.7%
OdontoPrev	Healthcare	ODPV3	Hold	12.5	17.0	36%	6.6	15	23.1	21.2	15.3	13.2	-16%	19%	4.3%	32.5%	7.5	NM	0.3%
Qualicorp	Healthcare	QUAL3	Buy	17.7	41.0	132%	5.0	95	10.2	7.9	5.0	4.1	28%	13%	7.7%	19.9%	2.0	0.5	5.3%
Vale	Mining	VALE3	Buy	48.3	40.4	-16%	255.2	1,065	12.7	18.2	6.5	7.6	-20%	-10%	2.1%	11.7%	1.5	NM	13.7%
Recommended Portfolio						**30%**			**14.0**	**13.8**	**0.0**	**0.0**	**27.5%**	**8.3%**	**3.0%**	**17.4%**	**2.8**	**0.6**	**3.9%**
Ibovespa									**13.9**	**13.8**	**8.6**	**8.0**	**16.4%**	**7.5%**	**3.2%**	**16.3%**	**2.5**	**0.8**	**NA**
Coverage Universe									**14.7**	**14.4**	**8.8**	**8.1**	**18.0%**	**6.8%**	**3.3%**	**17.5%**	**2.8**	**1.0**	**NA**

(1) Last 30 days ADTV, R$ millions. NM: Not meaningful. NA: Not available. Source: Santander estimates.

Ibovespa Upside Potential and Sensitivity: New YE2018 Target of 78,000 Points

Target P/E Multiple Model

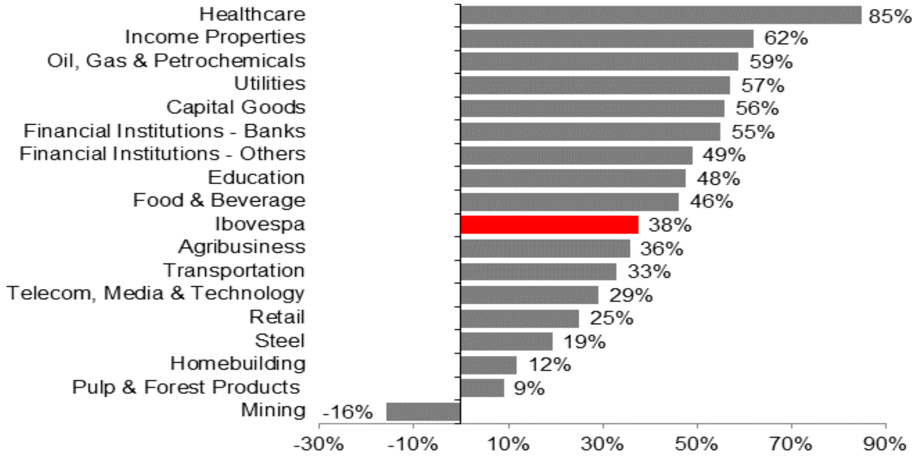
Main Assumptions for Our Target P/E Multiple Model (1)

		Implied Weighted Growth (Estimated period + Perpetuity)								
		5.5%	6.0%	6.5%	7.0%	7.3%	8.0%	8.5%	9.0%	9.5%
Ke	18.5%	8.1	8.5	8.9	9.3	9.6	10.3	10.9	11.5	12.2
	17.5%	8.8	9.2	9.7	10.2	10.5	11.4	12.1	12.8	13.7
	16.5%	9.6	10.1	10.7	11.3	11.7	12.7	13.6	14.5	15.6
	17.0%	9.2	9.6	10.1	10.7	11.1	12.0	12.8	13.6	14.6
	14.5%	11.7	12.5	13.3	14.3	14.9	16.6	18.1	19.8	21.9
	13.5%	13.2	14.1	15.2	16.5	17.3	19.6	21.7	24.2	27.4
	12.5%	15.1	16.3	17.8	19.5	20.6	24.0	27.1	31.1	36.5

Ibovespa Target Using Different Risk-Free Rates (2)

		Implied Weighted Growth (Estimated period + Perpetuity)								
		5.5%	6.0%	6.5%	7.0%	7.2%	7.5%	8.0%	8.5%	9.0%
Brazil Long Term Rates	13.5%	55,845	58,268	60,884	63,719	64,910	66,800	70,161	73,843	77,892
	12.5%	60,313	63,123	66,179	69,512	70,919	73,162	77,177	81,615	86,547
	12.0%	62,826	65,868	69,187	72,822	74,361	76,820	81,239	86,150	91,638
	11.5%	65,557	68,862	72,481	76,463	78,155	80,863	85,753	91,217	97,365
	11.0%	68,537	72,141	76,105	80,487	82,356	85,356	90,797	96,918	103,856
	10.5%	71,801	75,748	80,111	84,959	87,034	90,376	96,472	103,380	111,274
	10.0%	75,391	79,735	84,562	89,956	92,276	96,025	102,903	110,764	119,834

Cross Check – Bottom Up DCF Upsides: (3)



- We revised our target multiple Ibovespa forecast for YE2018 to 78,000 points from 97,000 points. Our new estimate implies a 9.3% return from current levels (plus dividends). We use a 12-month forward P/E target multiple of 10.9x, which is in-line with the historical average. (Our target multiple is derived using a 10-year curve of 11.5%.)

- Our 11x target P/E implies an equivalent 7.2% nominal earnings growth (used in a single-stage Gordon growth model), which we break down as: (i) 5.0% real growth during the first 10 years (9% nominal growth); and (ii) 7% nominal growth in perpetuity (composed of 3% potential GDP growth, in-line with our economists' estimate, plus 4% inflation). For the multiple calculation, we use a cost of equity (Ke) for Brazil of 17% (5.5% MRP and Brazil 10-year curve of 11.5%, slightly below the current 12.0%).

- Investor mood: In historical bull markets for Brazil, the Ibovespa traded at 14-15x forward P/E; in historical bear markets, the Ibovespa traded at 8-9x P/E.

(1) Sources: Bloomberg and Santander estimates. (2) Since we currently cover ~97% of the Ibovespa, we extrapolated our EPS growth forecast to the index. (3) Source: Santander estimates.

The Investor Mood: How Much Is Priced in Brazil?

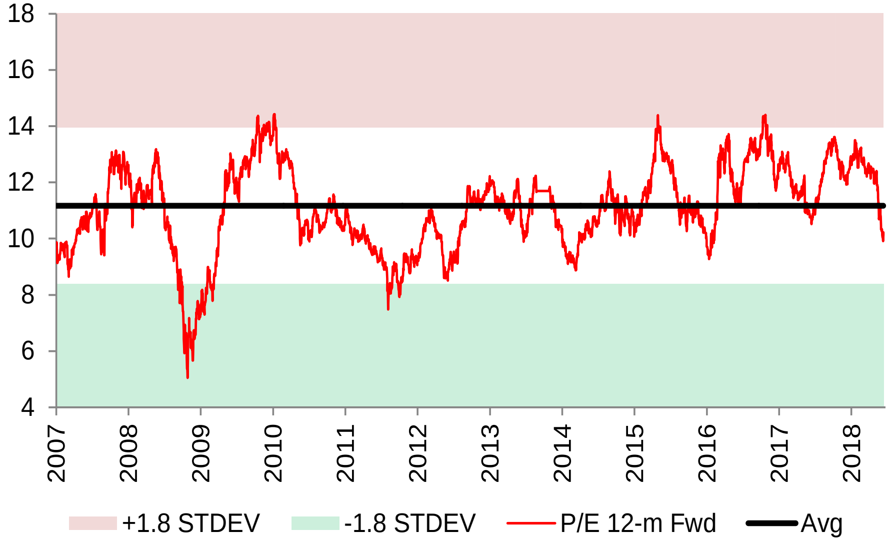
Target P/E Multiple Model

Brazil: Ibovespa New Macro Scenario Probability (1)

Current P/E:
10.5

12M P/E		Bull Case										
		0%	10%	20%	30%	40%	50%	60%	70%	80%	90%	100%
Bear Case	100%	8.0										
	90%		8.8									
	80%			9.7								
	70%				10.5							
	60%					11.4						
	50%						12.2					
	40%							13.0				
	30%								13.9			
	20%									14.7		
	10%										15.6	
	0%											16.4
Mid Range	Down/Upside	-34%	-28%	-21%	-14%	-7%	0%	7%	14%	21%	28%	34%
Current Prices		-24%	-15%	-7%	1%	9%	17%	25%	33%	41%	49%	57%
Asymmetry		2.42										

Investor Mood: Historical P/E Ranges (1)



- Brazil: Ibovespa is trading at a 10.5x forward P/E, compared to a bear scenario of 8x and a bull scenario of 16.5x.
- We believe the market is pricing in a 50-60% likelihood of a bear case scenario.
- Investor mood: In historical bull markets for Brazil, the Ibovespa traded at 14-15x forward P/E; in historical bear markets, the Ibovespa traded at 8-9x P/E.
- Adding global context: We believe that looking at external factors and risk-on or risk-off mood from global investors is also an important angle when considering the Ibovespa index target, in addition to considering Brazil's local fundamentals. Our final weighted target would be ~78,000, which is in-line with our official target P/E multiple model.

Ibovespa Target 2018E – Sensitivity Weighting by Different Risk, Global and Domestic Scenarios: (1)

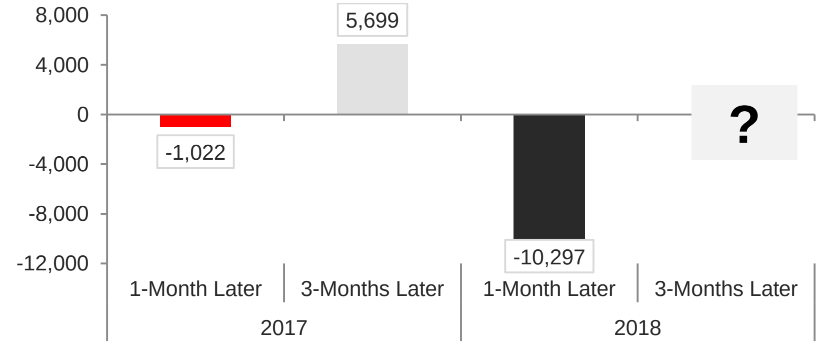
Four Scenarios	Global	Domestic	Nominal Long-Term	Real G	Inflation	Nominal G	Fair P/E	Target	Probability	Weighted Target
Bull Squared	Risk-On	Pro-market (Fiscal Adjustment)	8.5%	3.0%	4.0%	7.0%	15.3	109,232	30%	**32,770**
Bear Squared	Risk-Off	Non-market (No Fiscal Adjustment)	15.0%	1.0%	5.5%	6.5%	7.6	54,361	20%	**10,872**
Better Domestic	Risk-Off	Pro-market (Fiscal Adjustment)	10.5%	1.5%	4.0%	5.5%	10.0	71,801	20%	**14,360**
Better Global	Risk-On	Non-market (No Fiscal Adjustment)	12.5%	1.5%	5.0%	6.5%	9.3	66,179	30%	**19,854**
		Weighted	**11.4%**				**10.9**	**77,856**	**100%**	**77,856**

(1) Sources: Santander estimates and Bloomberg.

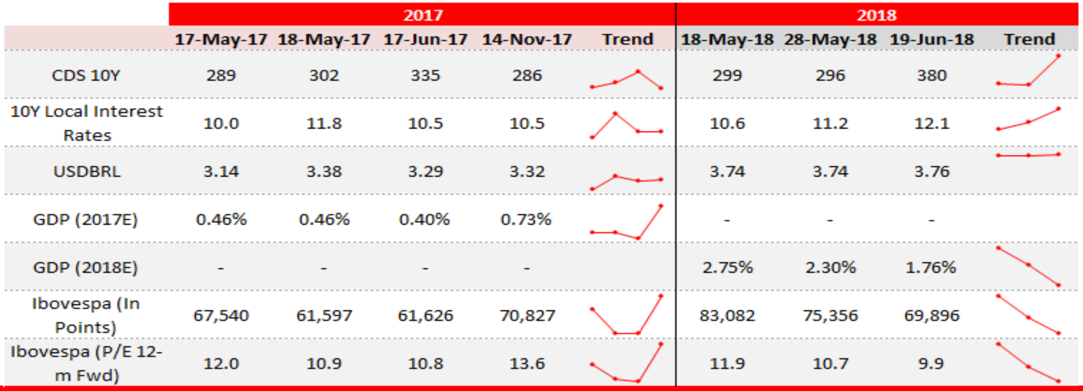
What a Difference a Year Makes: Comparing Market Behavior during May 2017 and 2018 Events

- We gathered some data comparing May 17, 2017 (tape recording of negative event) and May 2018 (truckers' strike) in order to find similarities and differences (i.e., a ~R$9 billion outflow difference vs. 2017 in the same time frame). Our key highlights:
  - Last year's market capitulation was marked by intense market stress (Ibovespa, long-term interest rates, CDS and FX had high correction movements), but it was followed by a rapid easing of markets' apprehension and return to stability in the following weeks.
  - In the current 2018 market sell-off to date, we notice that market fundamentals still have not stabilized. Indeed, fundamentals continue to deteriorate:
    - GDP expectations have been continually revised down for seven consecutive weeks.
    - Brazil 10Y CDS continues rising and is at ~385 points currently, the highest level since January 2017.
    - Local long-term interest rates (10Y) remain above the 12% levels triggered by truckers' strike, showing relatively higher overall risk perception from investors toward Brazil.
    - Flow trends: Foreign investors' outflows have accumulated R$10.3 billion since May 21, a continued negative trend and 15 days of outflows out of 17 days in the period. During recent days, we talked with many buy-side investors, from sovereign wealth funds (SWFs) through hedge funds and long-only, having a wide array of views. Unlike May 2017 (when foreign investors were buyers and EM/Brazil was mentioned as a highlight during the Omaha conference we attended), this time the conviction has declined: long-only seem to be in wait-and-see mode, and hedge funds were sellers of Brazil.
    - Valuations became cheaper at 9.9x P/E 12-m fwd (when compared to the 11.9x before truck strikes), but potential negative earnings revisions going forward may show different valuation levels. We note that trailing P/E is at 15.4x
- **Strategy view:** Last year's market capitulation was brief and followed by investors' support with long positions in Brazil, given higher clarity on Brazil's outlook at that time, while the current market turmoil in 2018 has a different backdrop, with an undefined scenario going forward for the country, along with economic forecasts worsening, which prevents us from being more positive on Brazil at least until the elections in October.

Foreign Investors Flows in Brazilian Stock Exchange (R$, Million):(1)



Key Indicators Evolution Throughout May and June: (2)

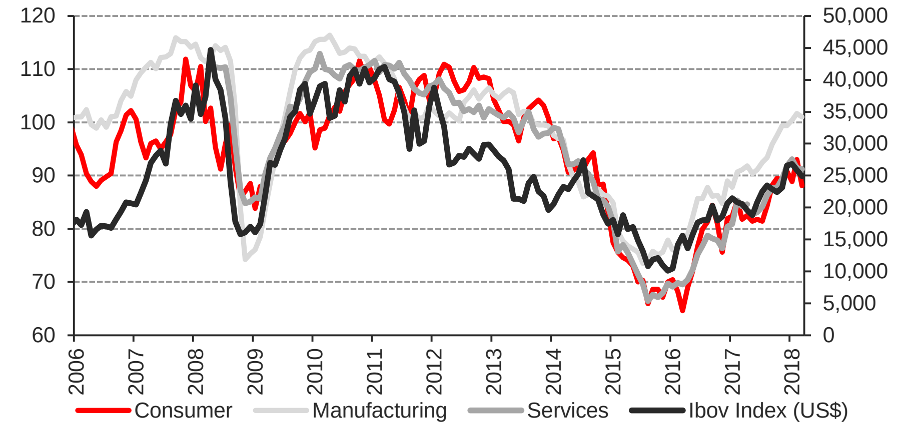


	2017					2018			
	17-May-17	18-May-17	17-Jun-17	14-Nov-17	Trend	18-May-18	28-May-18	19-Jun-18	Trend
CDS 10Y	289	302	335	286		299	296	380	
10Y Local Interest Rates	10.0	11.8	10.5	10.5		10.6	11.2	12.1	
USDBRL	3.14	3.38	3.29	3.32		3.74	3.74	3.76	
GDP (2017E)	0.46%	0.46%	0.40%	0.73%		-	-	-	
GDP (2018E)	-	-	-	-		2.75%	2.30%	1.76%	
Ibovespa (In Points)	67,540	61,597	61,626	70,827		83,082	75,356	69,896	
Ibovespa (P/E 12-m Fwd)	12.0	10.9	10.8	13.6		11.9	10.7	9.9	

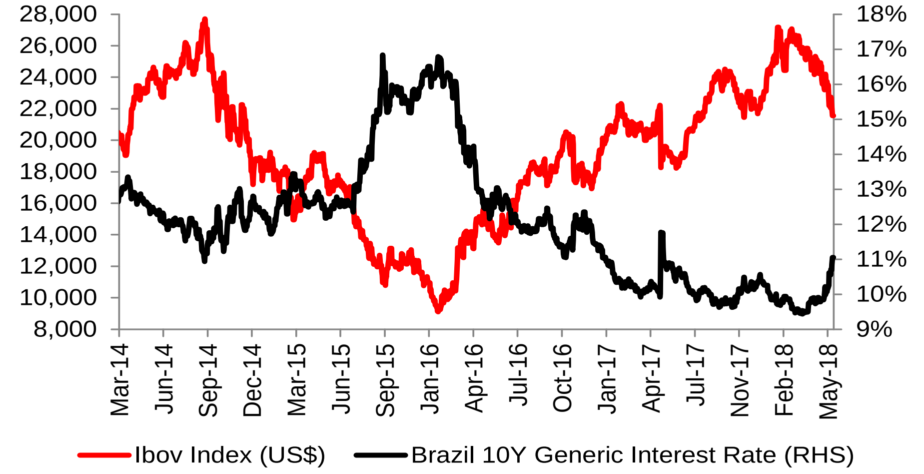
(1) Sources: Santander and Brazil Central Bank; 2) Sources: Santander, Brazil Central Bank and Bloomberg.

Key Market Indicators to Track? Rates, Confidence and GDP

Consumer and Business Confidence (In Points, Seasonally Adjusted)



Brazil 10Y Rates vs. Ibovespa (in US$)



- **Mixed Indicators:** Reform agenda temporarily on hold (lack of additional re-rating potential, fair P/E of 11x).
- **Rates vs. Ibovespa.** There is a high negative 0.8 correlation between interest rates and the Ibovespa in USD. Current LT rate is at 12.1% nominal and 5.9% inflation-linked NTN-B.
- **Confidence indicators.** Deteriorated in recent months even after May political events (coincident and confirmation index to Ibovespa).
- **Monetary Easing Behavior.** During the last four interest rate reduction cycles since 2003, the Ibovespa has performed well, rising an average of 34% in the subsequent seven months.
- **The bottom.** In the last 16 years, in six of the eight times that GDP bottomed, the market bottomed three months before.

Bovespa—First Interest Rate Cycle Reduction Date and Returns

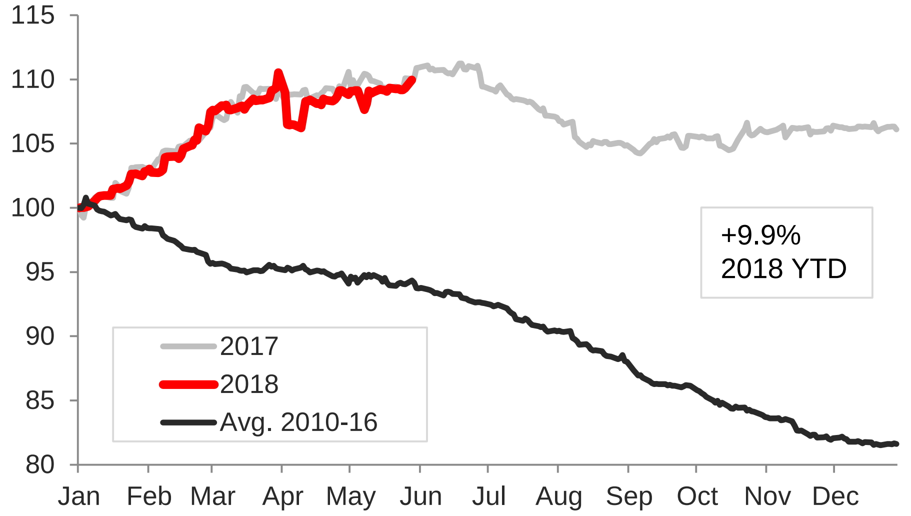
Date	Ibovespa (R$)	Ibovespa After 7 Months (R$)	Return After 7-Months
18-Jun-03	13,511	23,399	73.2%
15-Sep-05	29,366	38,082	29.7%
21-Jan-09	38,543	56,156	45.7%
31-Aug-11	56,495	65,079	15.2%
18-Oct-16	63,782	68,685	7.7%
Average			**34.3%**

Source: Bloomberg.

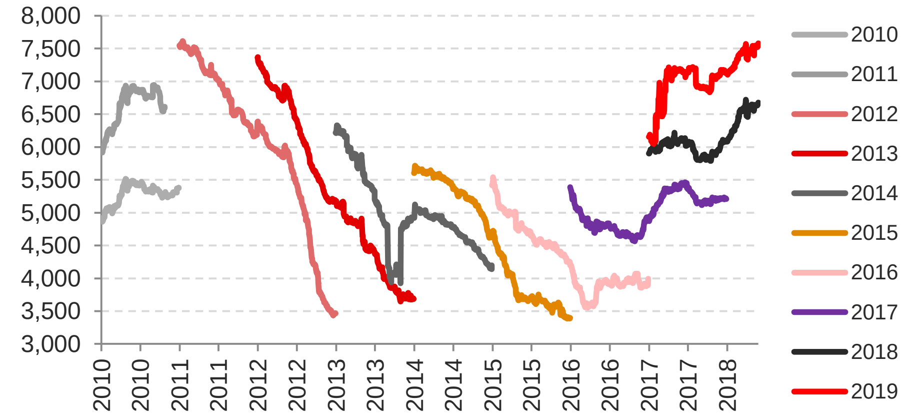
Sources: BCB, Bloomberg, and Santander.

The Movie Is No Longer Better than the Photo – Brazil EPS Trend Expected to Revise Downward

Ibovespa Consensus EPS Revisions: (1)



Ibovespa Consensus EPS Revisions: (1)



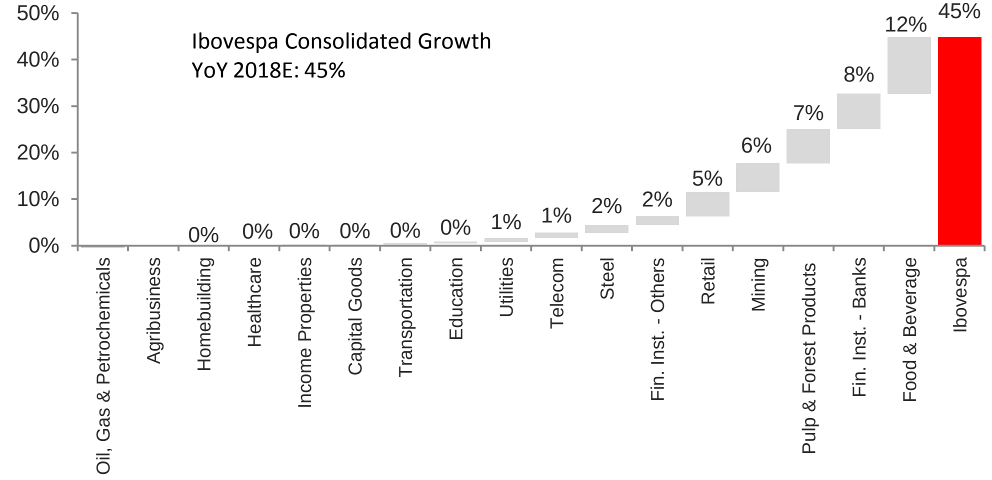
Ibovespa Historical Earnings Revisions Pattern:

- From 2010 to 2016, Ibovespa earnings were revised downward in six of seven years. In the same period, consolidated EPS for Ibovespa was revised an average 23% downward, with the highest negative revision reaching -45% in 2012.
- Looking at 2010, when we had positive GDP revisions, earnings were revised upward 9.4% from the start to the end of the year.

Largest contributors to consensus 2018E YoY growth of 45%:

- Food & Beverage represents 12 p.p. of the 45% YoY EPS growth for 2018E
- Financial banks accounts for 8 p.p. of consolidated growth.
- Pulp & paper sector accounts for 7 p.p. of Ibovespa growth.
- Mining contribution is 6 p.p. of consolidated growth.

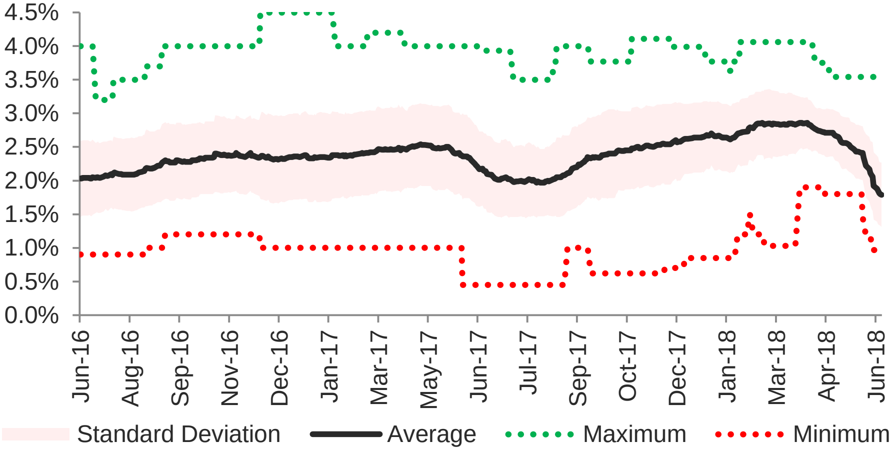
Decomposition of Ibovespa Growth Contribution by Sector (in Percentage Points) – 2018E: (1)



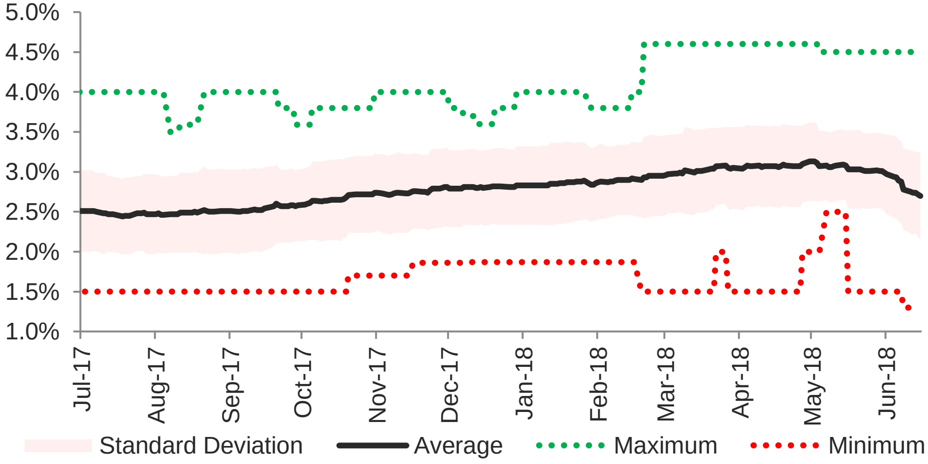
Sources: Santander and Bloomberg consensus.

Tracking Earnings Revision & Consensus GDP Forecast after Truckers' Strike

GDP YoY Growth Consensus Forecasts – 2018E



GDP YoY Growth Consensus Forecasts – 2019E



- After the truckers' strike and release of lower than expected economic data, consensus estimates for GDP were revised down to 1.76% YoY growth for 2018E (vs. a high of 2.9% in February); our economics team revised GDP downward to 2.0% (vs. 3.2% previously).

- We see additional room for negative revisions on consensus estimates for companies, as lower GDP is still to be fully incorporated in companies' earnings outlook for 2Q18 and potentially 3Q18.

Consensus Revision since May 18, 2018 – 20 Best and Worst Stocks

Best 20 Stocks

	Sales	EBITDA	Net Income	EPS
CSNA3	1.5%	-0.1%	56.8%	40.1%
USIM5	0.7%	-1.4%	17.5%	19.3%
CAML3	-1.2%	0.8%	10.9%	15.7%
GGBR4	1.7%	1.6%	8.1%	10.3%
SMTO3	0.5%	3.2%	3.2%	6.3%
CPLE6	1.7%	0.1%	4.5%	5.1%
LINX3	1.3%	0.7%	3.1%	3.1%
TEND3	0.1%	3.3%	3.3%	3.0%
ENBR3	1.7%	0.8%	0.1%	2.7%
CSAN3	0.5%	0.1%	2.5%	2.7%
MGLU3	2.1%	1.6%	2.7%	2.6%
CVCB3	0.2%	1.5%	3.5%	2.6%
LEVE3	0.5%	1.7%	1.7%	2.4%
POMO4	1.9%	2.0%	1.8%	1.9%
VALE3	1.2%	0.7%	0.4%	1.8%
TIMP3	-0.3%	-0.6%	1.8%	1.7%
PETR3	5.2%	4.2%	5.7%	1.5%
TUPY3	0.7%	1.1%	1.2%	1.4%
RAPT4	0.0%	0.0%	0.8%	1.4%
MOVI3	-0.6%	0.2%	1.3%	1.2%

Worst 20 Stocks

	Sales	EBITDA	Net Income	EPS
BEEF3	1.7%	0.1%	-35.3%	-36.5%
STBP3	-0.7%	6.3%	-14.9%	-29.8%
KLBN11	3.3%	6.9%	-15.8%	-27.4%
DIRR3	-1.5%	2.3%	-25.6%	-26.4%
BRPR3	-6.6%	-6.7%	-8.7%	-15.6%
CYRE3	-1.4%	-1.7%	-12.9%	-12.6%
GOLL4	0.0%	-0.6%	-36.8%	-11.6%
ELET6	-0.9%	-5.7%	-10.0%	-10.7%
TRPL4	0.8%	-7.8%	-1.3%	-9.3%
IGTA3	-1.4%	-0.5%	4.3%	-7.4%
LAME4	-1.4%	-3.9%	-4.3%	-6.9%
SBSP3	1.6%	-0.5%	-8.0%	-6.5%
B3SA3	1.5%	0.7%	-5.2%	-6.4%
ALUP11	0.7%	-0.8%	-4.4%	-6.0%
ITSA4	0.0%	NA	0.0%	-6.0%
MYPK3	1.4%	0.3%	-5.2%	-5.9%
KROT3	0.2%	-2.1%	-4.4%	-5.4%
TOTS3	-1.6%	1.3%	0.6%	-5.3%
EQTL3	1.2%	-1.1%	-4.7%	-5.1%
UGPA3	0.2%	-3.5%	-5.1%	-4.5%

Note: Total GDP is projected at market prices; sectoral GDPs are projected at added value. Source: Brazil Central Bank - Focus survey.

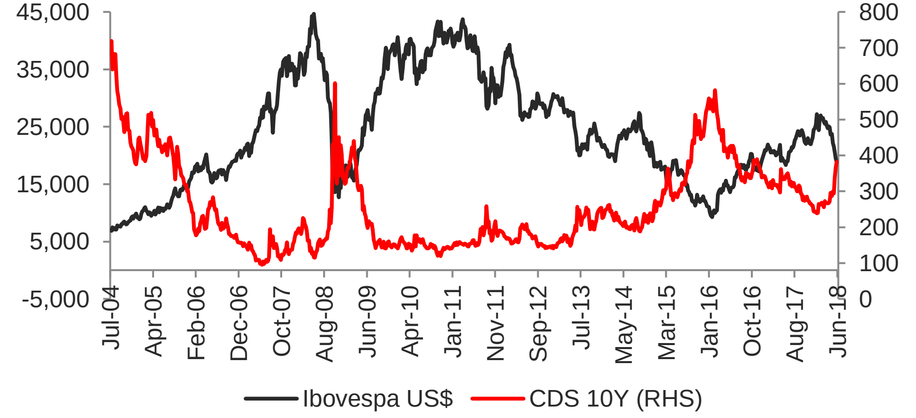
Brazil CDS Increase May Pose Some Downside Risk in Case of Higher Movements

Sensitivity – CDS and Ibovespa in US$:

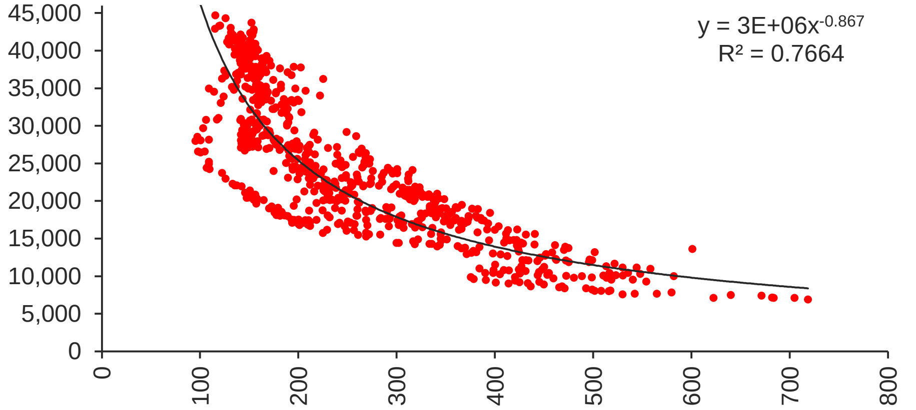
	CDS	IBOV (US$)
Sensitivity Analysis	320	16,898
	340	16,033
	360	15,258
	380	14,560
	400	13,927
	420	13,350
	440	12,823
	460	12,338
	480	11,891
	500	11,478
Expected	-	14,469
Current	383	19,100
Implied		-24%

- Brazil CDS 10Y increased 64% to 383 points from the last three years' lowest point, reached at the end of January 2018. We studied the relationship between Ibovespa (in US$) and the Brazil 10Y CDS.
- The inverse correlation of 0.82 and a 77% r-squared raises the importance of monitoring both indicators.
    - When plotting the current CDS of 383 points in our sensitivity, it would imply 24% downside for Ibovespa in US$ at 14,469 points (vs. the current 19,100 points).
    - In our sensitivity, considering a more negative scenario of CDS reaching 500 points, Ibovespa would have 40% downside to 11,500 points in US$.
    - In a positive scenario, if CDS reaches 200 points, it would imply a 33% upside to Ibovespa at 25,400 points in US$.
- We acknowledge the nonlinear relationship and that Brazilian companies are expected to see a positive earnings growth cycle in the next two years, with a 17.7% EPS CAGR for 2017-19E, along with lower than historical long-term and monetary policy rates.

Ibovespa in US$ vs. CDS 10Y – Historical



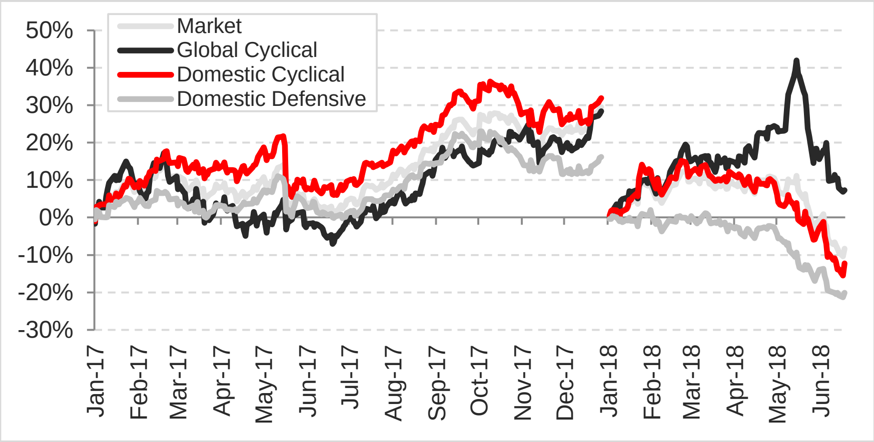
Ibovespa in US$ vs. CDS 10Y – Scatterplot



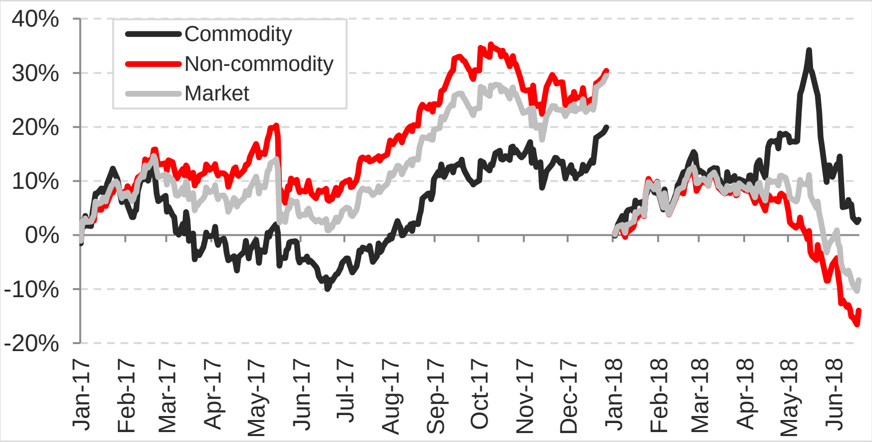
Note: Total GDP is projected at market prices; sectoral GDPs are projected at added value. Source: Brazil Central Bank - Focus survey.

Breakdown of Ibovespa Performance – Not Good When Excluding Commodities

Returns by Strategy Category in Ibovespa – Accumulated YTD – 2017 and 2018:



Returns by Commodity Exposure in Ibovespa – Accumulated YTD – 2017 and 2018:



- We look into the Ibovespa index and break down the stocks by our strategy categories, sectors, and exposure to commodities.
- We found that Ibovespa's -6.6% performance YTD has been mostly driven by domestic companies/sectors, while commodities-related are a positive contributor and are +5.8% up since the start of the year.
- In our strategy categories, global cyclicals are up +10.6% YTD. On the flip side are domestic cyclicals with -10.6% performance and domestic defensives down 19.3%.
- When classifying by commodity exposure, the commodity-related category is up 8.2% YTD, the while non-commodity-related category is down -10.6%.

Monthly Accumulated Return in 2017 and 2018

	2017	2018 YTD
Market	29.5%	-6.6%
Global Cyclical	28.4%	10.6%
Domestic Cyclical	31.8%	-10.6%
Domestic Defensive	16.1%	-19.3%
Commodity	19.9%	5.8%
Non-commodity	30.4%	-12.6%

Note: Total GDP is projected at market prices; sectoral GDPs are projected at added value. Source: Brazil Central Bank - Focus survey.

BRL Depreciation and Bottom-Up FX Sensitivity

- Following recent FX volatility and uncertainty, we ran a bottom-up sensitivity on the impact of a 10% depreciation on our coverage universe, focusing on which stocks have positive exposure to foreign currency in terms of (i) gross profit (revenue vs. COGS) and (ii) balance sheet (cash vs. total debt), ceteris paribus.
- **Highlights:** We see the Food sector, Industrials (Tupy, Iochpe, Mahle Metal Leve), Oil & Gas (Petrobras), Pulp & Paper (Suzano), Steel (Gerdau), and Agribusiness (São Martinho, Cosan), as the main highlights among companies positively exposed to a stronger BRL devaluation. Airlines is the sector we see as most negatively affected.
- **U.S. dollar-linked companies we like:** Among the screened stocks, we have five in our recommended portfolio: Iochpe Maxion, Petrobras, Fibria/Suzano, Gerdau, and Mahle Metal Leve. We like to hold ~20-30% of our portfolio in FX-related names with attractive valuation
- **Consolidated impact on Ibovespa:** In our sensitivity, the estimated consolidated bottom-up impact on Ibovespa's net income for 2018E and market cap would be +0.7% and +3.4%, respectively.

Sensitivity Analysis of a 10% BRL Depreciation vs. Our Currency Estimates

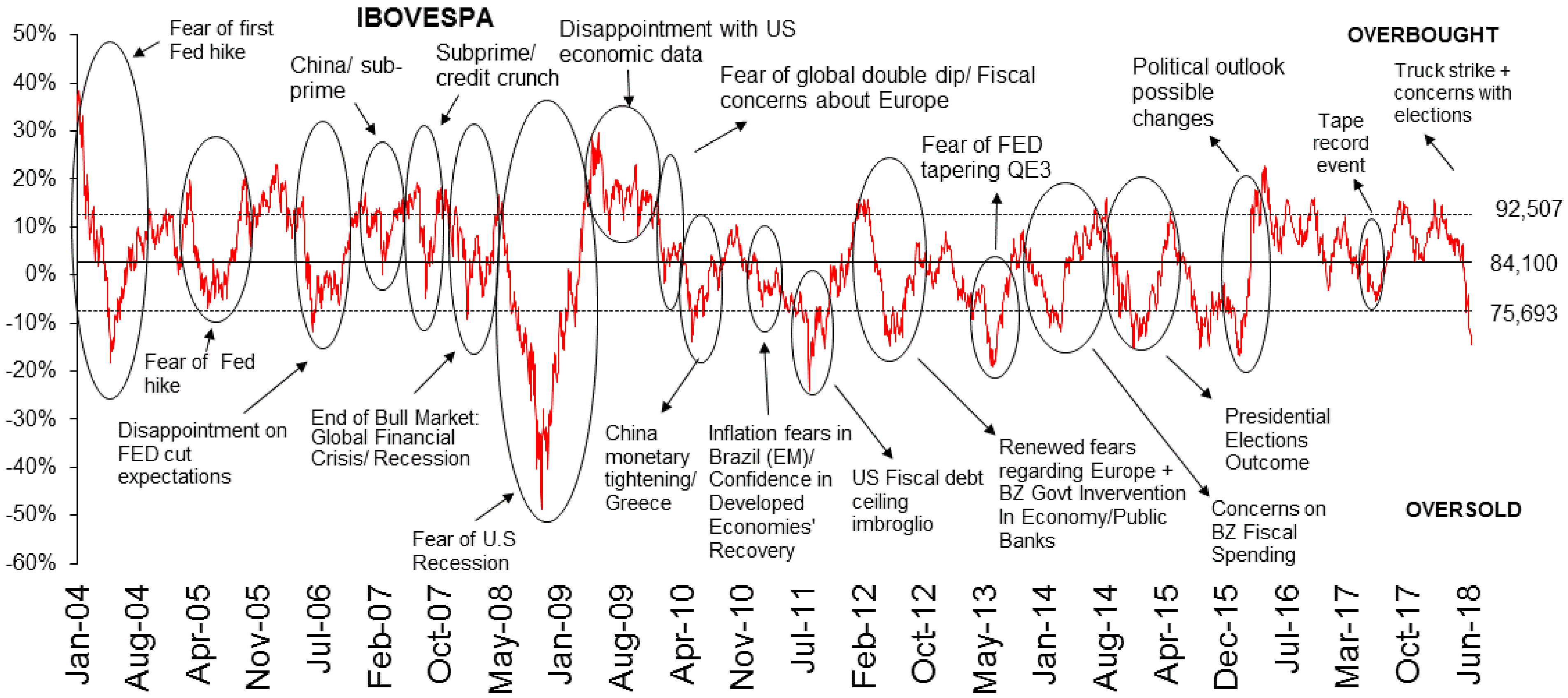
		Income Statement				Balance Sheet					IS + BS Impact		
		Revenue		COGS		Cash		Debt		Total Monetaty Exposure			
Company	Sector	BRL	USD (Foreign currency)	BRL	USD (Foreign currency)	BRL	USD (Foreign currency)	BRL	USD (Foreign currency)	Total Monetary Exposure (Gross Profit Variation + Net Debt Variation) - Perpetuity	Total Monetary Exposure (Gross Profit Variation + Net Debt Variation)	Total Monetary Exposure / NI 2018E	Total Monetary Exposure / Market Cap - Perpetuity
JBS	Food & Beverage	14%	86%	27%	73%	34%	66%	62%	38%	20,528.5	3,155.1	51%	89%
Marfrig	Food & Beverage	23%	77%	51%	49%	11%	89%	2%	98%	3,149.4	(37.1)	-418%	62%
Minerva	Food & Beverage	41%	59%	50%	50%	42%	58%	19%	81%	932.4	(234.6)	-53%	53%
Petro Rio	Oil, Gas & Petroch.	0%	100%	40%	60%	0%	0%	100%	0%	355.7	43.3	22%	37%
Brasil Foods	Food & Beverage	51%	49%	70%	30%	66%	34%	45%	55%	6,276.1	(2.2)	0%	32%
Tupy	Capital Goods	17%	83%	40%	60%	63%	37%	10%	90%	708.3	10.9	4%	24%
Fibria	Pulp & Paper	10%	90%	80%	20%	75%	25%	29%	71%	6,569.3	(196.4)	-8%	17%
Embraer	Transportation	10%	90%	20%	80%	21%	79%	14%	86%	2,783.1	175.0	20%	16%
Petrobras	Oil, Gas & Petroch.	12%	88%	30%	70%	0%	0%	14%	86%	53,600.1	(8,330.9)	-26%	16%
Iochpe Maxion	Capital Goods	33%	67%	39%	61%	31%	69%	23%	77%	595.3	(30.8)	-9%	14%
CSN	Steel	54%	46%	71%	29%	30%	70%	58%	42%	1,379.1	(415.6)	-48%	11%
Gerdau	Steel	30%	70%	40%	60%	50%	50%	20%	80%	3,210.3	(521.0)	-29%	11%
Suzano	Pulp & Paper	25%	75%	79%	21%	59%	41%	32%	68%	3,428.4	(45.9)	-2%	7%
São Martinho	Agribusiness	75%	25%	90%	10%	0%	0%	80%	20%	399.6	22.5	4%	7%
Klabin	Pulp & Paper	50%	50%	83%	17%	80%	20%	30%	70%	1,539.1	(821.8)	-85%	6%
Cosan Energia	Agribusiness	94%	6%	97%	3%	0%	0%	100%	0%	792.7	180.9	9%	5%
WEG	Capital Goods	51%	49%	60%	40%	98%	2%	33%	67%	1,694.2	(76.0)	-5%	5%
Mahle Metal Leve	Capital Goods	60%	40%	59%	41%	80%	20%	100%	0%	155.0	34.3	11%	5%
Ambev	Food & Beverage	53%	47%	60%	40%	67%	33%	23%	77%	12,722.5	2,007.8	12%	4%

Sources: Santander estimates and company data.

Ibovespa Technical Indicator (Entered the Oversold Territory)

- The Ibovespa experienced a correction and entered an oversold technical condition, a potential buy signal from this perspective. Typically, in an oversold condition, the market undershoots (panic selling, stop losses, and the like).

Ibovespa Technical Indicator Entered the Oversold Territory

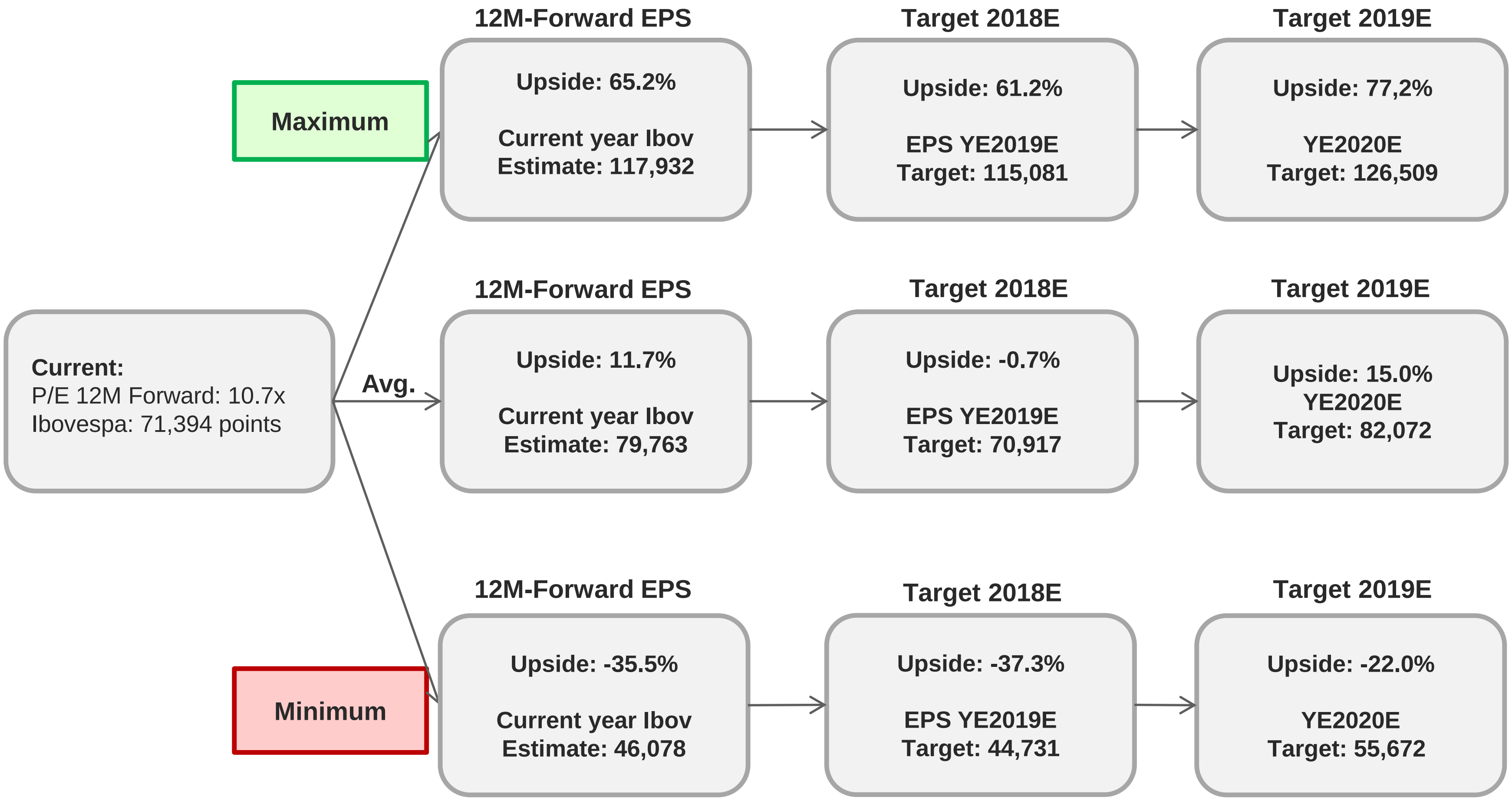


Date: 06/19/2018

Note: Chart Criteria: Ibovespa divided by the moving average of the previous six months minus one. We consider the overbought zone to be the region beyond one standard deviation above the average of the series since early 2004. We consider the oversold zone to be the region beyond one standard deviation below the average. Numbers at the far right indicate the equivalent Ibovespa levels for the overbought, the oversold, and the neutral zones.
Sources: Santander and Bloomberg.

Five Themes for 2018

1—Ibovespa Bottom-Up Valuation P/E Sensitivity—Upside/Downside if Index Converges to Average, Maximum, and Minimum Historical Multiples



Current:
P/E 12M Forward: 10.7x
Ibovespa: 71,394 points

Maximum

12M-Forward EPS
Upside: 65.2%
Current year Ibov Estimate: 117,932

Target 2018E
Upside: 61.2%
EPS YE2019E Target: 115,081

Target 2019E
Upside: 77,2%
YE2020E Target: 126,509

Avg.

12M-Forward EPS
Upside: 11.7%
Current year Ibov Estimate: 79,763

Target 2018E
Upside: -0.7%
EPS YE2019E Target: 70,917

Target 2019E
Upside: 15.0%
YE2020E Target: 82,072

Minimum

12M-Forward EPS
Upside: -35.5%
Current year Ibov Estimate: 46,078

Target 2018E
Upside: -37.3%
EPS YE2019E Target: 44,731

Target 2019E
Upside: -22.0%
YE2020E Target: 55,672

Sources: Bloomberg and Santander estimates.

Five Themes for 2018

1—Ibovespa Valuation Is Reasonable: The Valuation and Earnings Diffusion

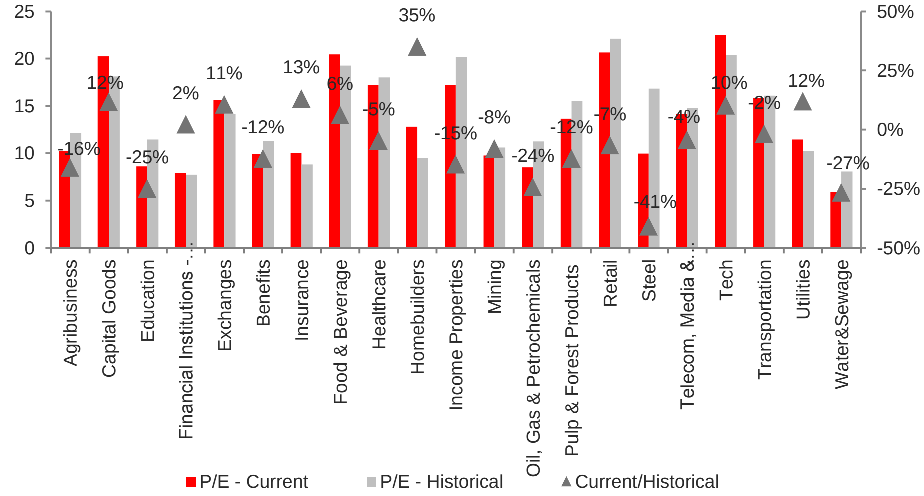
Companies in Ibovespa Index Trading 5% Above/Below Their Historical Average Valuation (1) and Operating Statistics 2018E (2)

	Above (#)	Neutral (#)	Below (#)	Above (%)	Neutral (%)	Below (%)
PE	16	5	23	36%	11%	52%
FV/EBITDA	11	4	29	25%	9%	66%
P/BV	18	8	21	38%	17%	45%

	Revenues Growth	EBITDA Growth	EPS Growth	EBITDA Margin Expansion	Net Margin Expansion
Expansion	41	39	40	35	33
Neutral	5	3	3	2	2
Contraction	4	7	8	12	14
Expansion (%)	82.0%	79.6%	78.4%	71.4%	67.3%
Neutral (%)	10.0%	6.1%	5.9%	4.1%	4.1%
Contraction (%)	8.0%	14.3%	15.7%	24.5%	28.6%

- 36% and 25% of companies are trading at a premium to their historical P/E and to FV/EBITDA multiples, respectively. We see 45% of companies trading at a discount to price to book.
- We see 82% of the companies growing revenue above LTM inflation. We forecast 71% of our coverage with increasing EBITDA margins and 67% with higher net margins YoY in 2018.
- From a sectorial perspective, we see six sectors out of twenty one trading at a higher than 10% premium to historical P/E.
- Assuming companies return to average historical multiples, Ibovespa would trade at 79,763 points, 11.7% upside from current levels (12-month forward P/E).

Historical 12-Month Forward P/E by Sector (3)



Ibovespa Valuation Sensitivity—Upside/Downside if Index Converges to Average, Maximum, and Minimum Historical Multiples (P/E 12-M Forward) (4)

Santander Portfolio:

Upside to Average Multiples	-1.6%
Upside to Maximum Multiples	72.1%
Upside to Minimum Multiples	-42.6%

Ibovespa Index:

Upside to Average Multiples	11.7%
Target Ibovespa	79,763
Upside to Maximum Multiples	65.2%
Target Ibovespa	117,932
Upside to Minimum Multiples	-35.5%
Target Ibovespa	46,078

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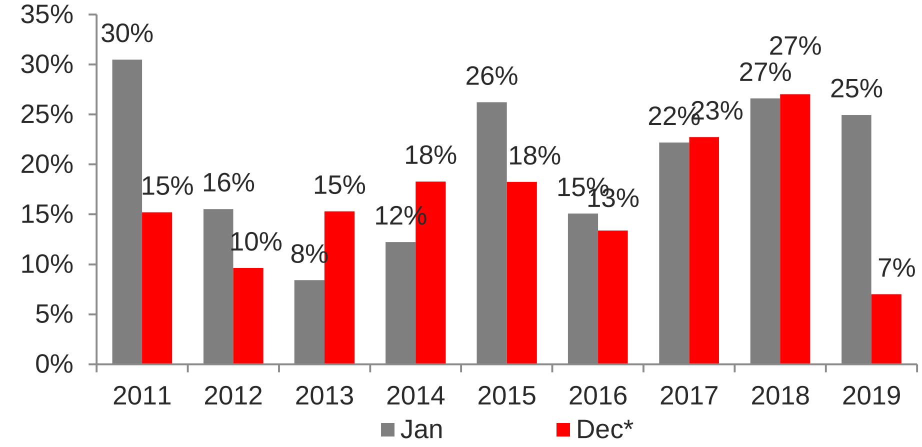
(1) Are considered above or below historical average by +5% or -5%, respectively; (2) Multiples are based on 12M forward estimates by consensus. Sources: Bloomberg and Santander estimates. (3) Note: Bloomberg consensus. Source: Bloomberg. (4) Sources: Bloomberg and Santander estimates.

Five Themes for 2018

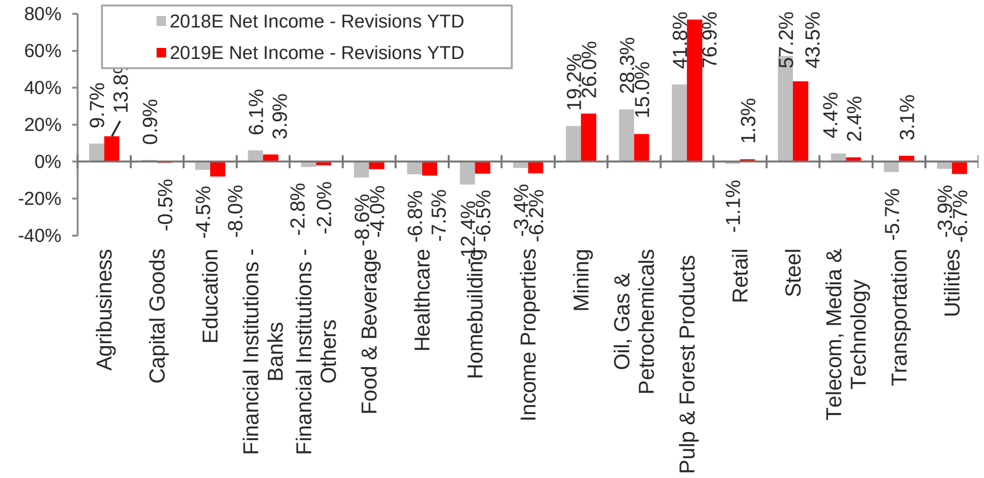
2—Playing the Hurdle Race: Looking at Earnings Momentum and Revisions

We believe we are near the end of EPS revisions

2011-18 Santander Coverage EPS Growth in January and December of Same Year (1)



Earnings Revisions (2018E and 2019E Net Income, YoY)—YTD (2)



- We see our 2018 27% EPS growth estimate at risk, given potential downside from lower activity (GDP 2018E revised down to 2.0% from 3.2%). We also still see financial deleveraging (avg. Selic rate for 2018E of 6.55% vs. 9.83% for 2017).
- Consensus GDP estimate is 1.8% for 2018E; our economists' GDP estimate is 2.0%.
- Year to date, 55% of sectors had negative earnings revisions for 2018E.
- Positive revision sectors: Steel, Oil, Gas & Petrochemicals, Pulp & Paper, Mining, and Telecom.

(*) 2017 and 2018 estimates refer to data as of June. (1) Source: Santander estimates. (2) Source: Bloomberg estimates.

Five Themes for 2018

2—Playing the Hurdle Race: Looking at Earnings Momentum and Revisions

EBITDA Growth by Sector Category—Ibovespa, 2017–19E (R$) (1)

Strategy Categories	Weights	2017E	2018E	2019E
Global Cyclical				
Oil, Gas & Petrochemicals	13%	-10.2%	38.2%	4.6%
Mining	11%	12.8%	-4.3%	-15.9%
Steel	2%	13.4%	6.6%	11.4%
Pulp & Forest Products	5%	20.1%	26.8%	-8.4%
Agribusiness	1%	-19.4%	6.0%	6.5%
Total	**31%**	**4.0%**	**18.5%**	**-4.3%**
Domestic Cyclical				
Financial Institutions - Banks	22%	NM	NM	NM
Financial Institutions - Others	6%	-5.7%	29.6%	6.9%
Retail	7%	22.6%	14.9%	16.3%
Transportation	4%	14.6%	9.5%	15.1%
Homebuilding	0%	-16.4%	25.5%	26.0%
Capital Goods	1%	5.7%	16.4%	16.4%
Total	**41%**	**11.8%**	**17.4%**	**14.0%**
Domestic Defensive				
Food & Beverage	15%	0.3%	17.9%	12.1%
Utilities	5%	0.0%	4.6%	15.5%
Telecom, Media & Technology	5%	5.6%	7.6%	7.5%
Income Properties	1%	0.9%	11.8%	9.8%
Healthcare	1%	24.2%	14.2%	17.4%
Education	1%	9.0%	12.6%	-1.8%
Total	**28%**	**2.0%**	**13.1%**	**11.5%**
Ibovespa	**100%**	**5.0%**	**16.3%**	**5.5%**

EPS Growth by Sector Category—Ibovespa, 2017–19E (R$) (1)

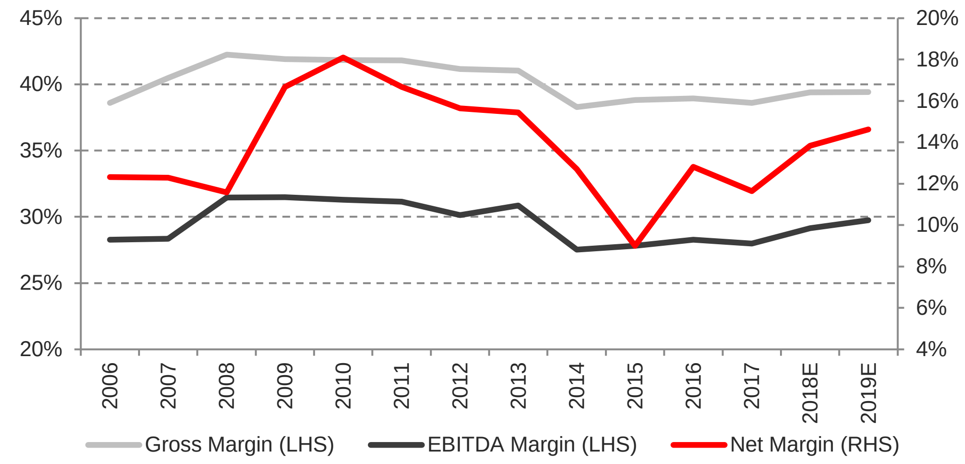
Strategy Categories	Weights	2017E	2018E	2019E
Global Cyclical				
Oil, Gas & Petrochemicals	13%	0.8%	-2.0%	-8.2%
Mining	11%	56.9%	-7.4%	-30.1%
Steel	2%	NM	-14.6%	14.1%
Pulp & Forest Products	5%	-33.4%	50.7%	-16.5%
Agribusiness	1%	21.3%	2.2%	-10.8%
Total	**31%**	**27.1%**	**7.3%**	**-16.5%**
Domestic Cyclical				
Financial Institutions - Banks	22%	20.8%	14.6%	15.1%
Financial Institutions - Others	6%	-9.0%	30.6%	9.1%
Retail	7%	64.3%	44.7%	23.8%
Transportation	4%	38.4%	11.1%	29.0%
Homebuilding	0%	7.6%	26.3%	46.6%
Capital Goods	1%	2.2%	12.4%	18.6%
Total	**41%**	**22.9%**	**22.2%**	**17.4%**
Domestic Defensive				
Food & Beverage	15%	-31.0%	68.5%	18.6%
Utilities	5%	6.1%	5.3%	22.1%
Telecom, Media & Technology	5%	22.3%	31.4%	20.0%
Income Properties	1%	14.0%	123.2%	14.7%
Healthcare	1%	19.5%	25.6%	24.5%
Education	1%	-9.2%	27.8%	0.8%
Total	**28%**	**-9.7%**	**49.1%**	**18.7%**
Ibovespa	**100%**	**13.5%**	**27.0%**	**7.0%**

(1) Market cap as of December 28, 2017. NM: Not meaningful. Source: Santander estimates.

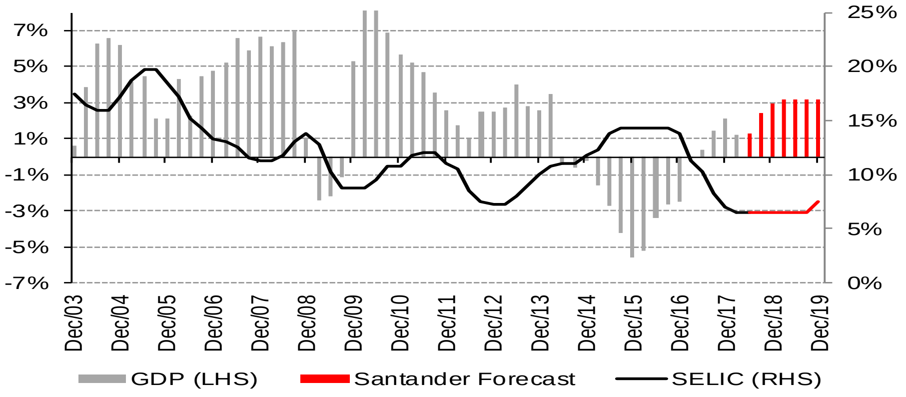
Five Themes for 2018

2 – Brazil Operating Leverage – A Hope: Earnings Cycle Is Positive YoY

Santander Coverage – Margins Trend (1)



Historical Selic and GDP Growth (2)



- We expect Brazilian companies to experience a period of above-average EPS growth in the next two years (27% in 2018E and 7% in 2019E), driven by a combination of: (i) operational leverage (due to a resumption in GDP growth, after a combined 7.3% decline in the last two years); and (ii) deleveraging (consolidated net debt/EBITDA of 2.1x as of 1Q18 and lower cost of debt, as we expect current monetary easing to amount to 700 bps in 2016-18E).
- We expect the aforementioned factors to positively affect our coverage universe, which we forecast to show improved consolidated margins in the next two years: (i) gross margin, up 82 bps; (ii) EBITDA margin, up 178 bps; and (iii) net margin, up 299 bps. In our view, the bulk of margin improvement will be seen in Homebuilders, Food & Beverage, Income Properties, Toll Roads, and Education.

Santander Coverage—Margins Trend (3) (4)

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018E	2019E	2017-19 Var. (p.p.)
Gross Margin (LHS)	38.6%	40.5%	42.2%	41.9%	41.8%	41.8%	41.2%	41.0%	38.3%	38.8%	38.9%	38.6%	39.4%	39.4%	0.82
EBITDA Margin (LHS)	28.3%	28.3%	31.5%	31.5%	31.3%	31.1%	30.1%	30.8%	27.5%	27.8%	28.3%	28.0%	29.2%	29.8%	1.78
Net Margin (RHS)	12.3%	12.3%	11.6%	16.7%	18.1%	16.7%	15.6%	15.4%	12.7%	9.0%	12.8%	11.6%	13.8%	14.6%	2.99

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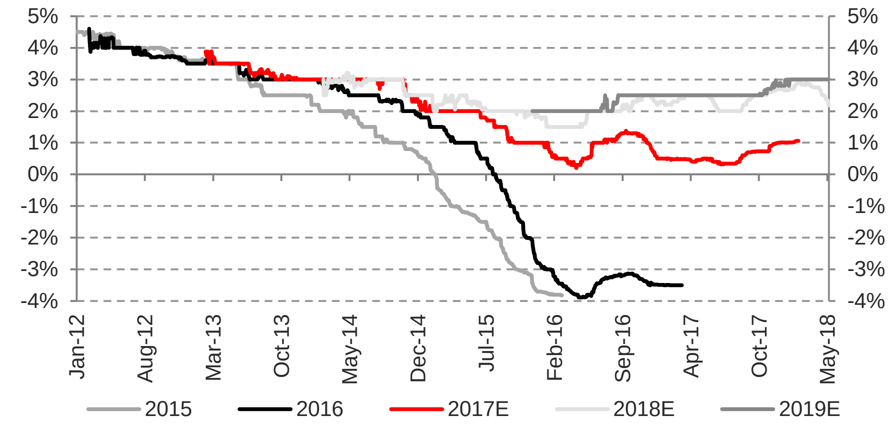
(1): Note: Market cap. weighted. Source: Company data and Santander estimates. (2): Sources: Brazil Central Bank and Bloomberg. Santander estimates. (3) Sources: Company Data and Santander Estimates. (4) Universe includes exporters (which have US$ linked debt) and do not experience strong impact from Selic reduction.

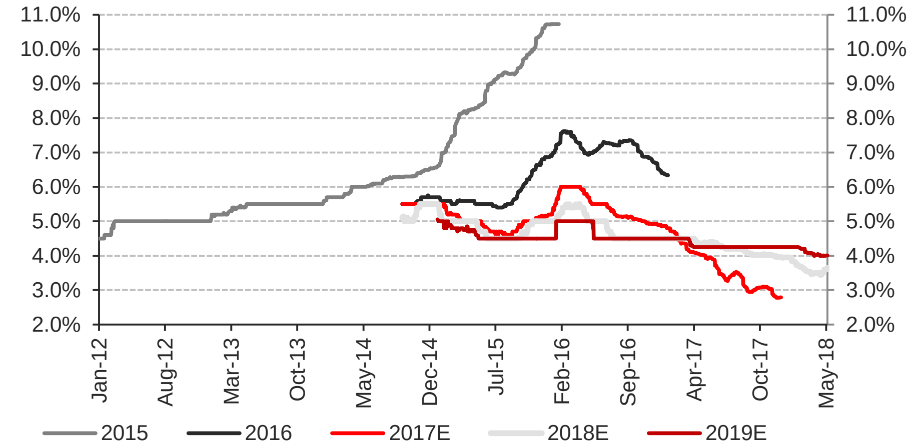
Five Themes for 2018

3—Macroeconomic Consensus Brings Deteriorating Data: Negative for Equities

Consensus Real GDP Growth Forecast, YE2015, YE2016, YE2017, YE2018, and YE2019 (%) (1)

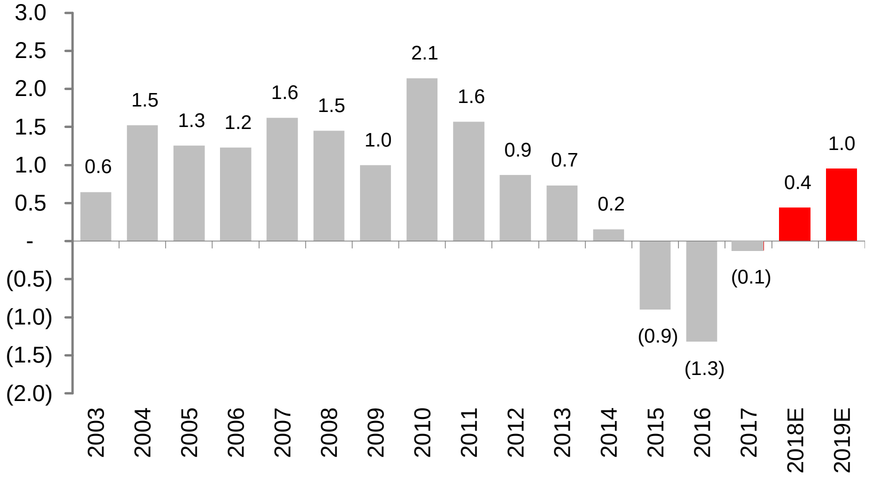


Consensus IPCA Inflation Forecast YE2015, YE2016, YE2017 YE2018, and YE2019 (1)



- 2018E consensus GDP is currently at 1.8%, below our macroeconomic research team estimate of 2.0%, while it is at 2.8% for 2019E (versus our 3.2% estimate).
- We expect this trend to have a slight positive impact on EPS estimates going forward.
- 2019 consensus inflation estimates have been in a upward trend to 3.8%, above Santander's estimate of 3.5%.
- In our view, pension expenditures are among the main long-term concerns for the fiscal environment in Brazil.
- Net formal job creation turned positive beginning in August 2017, and we believe it will remain positive through 2018 and 2019 (although at a lower pace, in our view).

Net Formal Job Creation (millions) (2)



(1) Source: Central Bank of Brazil. (2) Sources: IBGE, Ministry of Labor, Santander estimates.

Five Themes for 2018

3—Macroeconomic Consensus Brings Deteriorating Data: Negative for Equities

Macroeconomic Forecasts Snapshot (1):

	2014	2015	2016	2017	2018E	2019E
Real GDP (%)	0.5	(3.5)	(3.5)	1.0	2.0	3.2
Consumer Spending (%)	2.3	(3.2)	(4.3)	1.0	3.0	2.9
Capital Spending (%)	(4.2)	(13.9)	(10.3)	(1.8)	4.5	9.5
Government Spending (%)	0.8	(1.4)	(0.1)	(0.6)	0.1	1.0
Exports (%)	(1.1)	6.8	1.9	5.2	3.3	3.2
Imports (%)	(1.9)	(14.2)	(10.2)	5.0	8.7	3.5
GDP - Agriculture (%)	2.8	3.3	(4.3)	13.0	(3.0)	3.0
GDP - Industrial (%)	(1.5)	(5.8)	(4.0)	0.0	2.8	3.7
GDP - Services (%)	1.0	(2.7)	(2.6)	0.3	1.7	3.1
Industrial Production (YoY)	(3.0)	(8.2)	(6.4)	2.5	4.7	3.0
Retail Sales (YoY)	2.2	(4.3)	(6.3)	2.0	4.5	4.1
GDP per capita (US$)	12,109	8,803	8,702	9,896	9,459	9,999
Unemployment rate (%)	6.8	8.5	11.5	12.8	12.0	10.9
Inflation – IPCA (%)	6.4	10.7	6.3	2.9	3.5	4.0
Inflation – IGPM (%)	3.7	10.5	7.2	(0.5)	6.0	4.5
R$/US$ Exchange Rate (Year-End)	2.66	3.90	3.26	3.31	3.50	3.57
R$/US$ Exchange Rate (Average)	2.35	3.33	3.49	3.19	3.52	3.53
Interest Rate – Selic rate (%, Year-End)	11.75	14.25	13.75	7.00	6.50	7.50
Foreign Direct Investment (US$ billion)	96.9	75.1	78.9	70.3	79.9	81.0
Current Account Balance (US$ Billion)	(104.2)	(58.9)	(23.5)	(9.8)	(17.5)	(21.9)
Current Account Balance (% of GDP)	(4.2)	(3.3)	(1.3)	(0.5)	(0.8)	(1.0)
Primary Surplus (% of GDP)	(0.6)	(1.9)	(2.5)	(1.7)	(2.3)	(1.8)
International Reserves (US$ Billion)	374.05	368.74	372.22	381.06	380.00	380.59
Nominal Fiscal Balance (% of GDP)	(6.0)	(10.2)	(9.0)	(7.8)	(5.6)	(5.6)
World GDP growth	3.4	3.1	3.4	3.5	3.7	3.9
US GDP growth	2.4	2.4	1.6	2.3	2.2	1.8
Latin America GDP growth	0.5	(0.5)	(1.6)	1.5	3.5	3.5

- Economic growth seems to be losing momentum, in our view (we expect the unemployment rate to fall by 2.6 p.p. through YE2018, to 12%) and the lagged effects of monetary policy easing.

- We forecast GDP growth at 2.0% and 3.2% in 2018 and 2019, respectively, higher than market consensus (1.8% for 2018E and 2.7% for 2019E).

- The disinflation process that started in 2016 continued throughout 2017. Current inflation is running at 3%, and we estimate 3.5% for YE2018 (still below the BCB's mid-range goal).

- The combination of lower inflation and better inflation expectations gave the BCB space to accelerate the pace of cuts, and it shaved 625 bps off the interest rate in addition to the 50-bp cut made in 2016. For 2018, our economists believe that the BCB will cut rates and remain on hold at 6.50% for the year, as our team expects inflation to remain low.

Source: Santander estimates.

Five Themes for 2018

Brazil Reform Agenda—What's Next?

Reform Agenda Snapshot

Topic	Legal instrument	Current status	Expected conclusion date
Reduction in revenue earmarking (DRU)	**Constitutional Amendment**	**Approved by the Lower House and the Senate**	**Concluded in Aug 2016**
Investment Partnership Program (PPI)	**Provisional Measure**	**Approved by the Lower House and the Senate**	**Concluded in Sep 2016**
Change in oilfield auction rules	**Ordinary Law**	**Approved by the Lower House and the Senate**	**Concluded in Nov 2016**
New fiscal regime (freeze of gov't expenditures in real terms)	**Constitutional Amendment**	**Approved by the Lower House and the Senate**	**Concluded in Dec 2016**
Budget Law (PLOA) 2017	**Budget Law**	**Approved by the Lower House and the Senate**	**Concluded in Dec 2016**
States' debt renegotiation	**Complementary Law**	**Basic framework approved by Congress, and partially enacted by the President**	**Concluded in Dec 2016**
Labor reform	**Complementary Law**	**Approved by the Lower House and the Senate**	**Concluded in Jul 2017**
Creation of TLP (long-term rate for BNDES loans)	**Provisional Measure**	**Approved by the Lower House and the Senate**	**Concluded in Sep 2017**
Change in Eletrobras law to allow privatization	**Provisional Measure or Ordinary Law**	**Still to be sent to Congress**	**2018**
Social security reform	Constitutional Amendment	Approved at the commission-level by the Lower House	2019
Tax reform	Various pieces of legislation	Still to be sent to Congress	2018/2019

- The government spending freeze was approved in the second round by the Senate in December 2016. The amendment was approved by a comfortable margin, receiving four votes more than necessary.
- Also in December 2016, President Temer presented a plan for social security reform. So far the government has been expediting the reform agenda, but, realistically, achieving social security reform should take longer, in the view of our macro team (possibly by 2019).
- The table at left has an updated expected timeline of the main reforms in the government's pipeline.
- We highlight that labor reform was approved by the Congress in July 2017.

Source: Santander Macro Team.

Five Themes for 2018
Macro—Fiscal Policy Challenges Remain

Primary Balance and Public Debt Simulation (1)

		2016	2017	2018	2019	2020	2021	2022	2023	2024
	Primary balance	-2.73%	-2.05%	-0.94%	0.33%	1.40%	2.24%	3.18%	4.25%	5.17%
A	Net debt ratio to GDP	44.9%	48.4%	50.1%	50.8%	50.5%	48.9%	46.4%	42.7%	38.0%
	Gross debt ratio to GDP	74.0%	78.8%	80.5%	81.3%	80.9%	79.4%	76.8%	73.1%	68.4%
	Primary balance	-2.52%	-2.35%	-1.49%	-0.21%	0.78%	1.33%	1.66%	2.11%	2.40%
B	Net debt ratio to GDP	44.9%	48.5%	50.7%	52.0%	52.3%	51.6%	50.5%	48.8%	46.6%
	Gross debt ratio to GDP	73.8%	78.9%	81.1%	82.4%	82.8%	82.1%	80.9%	79.2%	77.1%
	Primary balance	-2.52%	-2.25%	-1.31%	-0.01%	1.00%	1.57%	1.83%	2.18%	2.37%
C	Net debt ratio to GDP	44.9%	48.4%	51.2%	52.6%	53.1%	53.0%	52.5%	51.7%	50.7%
	Gross debt ratio to GDP	73.8%	78.8%	81.6%	83.1%	83.6%	83.4%	83.0%	82.2%	81.1%
	Primary balance	-2.52%	-2.36%	-1.41%	-0.27%	0.53%	0.78%	0.83%	1.00%	1.00%
D	Net debt ratio to GDP	44.9%	50.7%	54.1%	57.4%	59.9%	62.2%	64.6%	66.8%	69.1%
	Gross debt ratio to GDP	74.3%	81.1%	84.5%	87.8%	90.3%	92.6%	95.0%	97.2%	99.5%

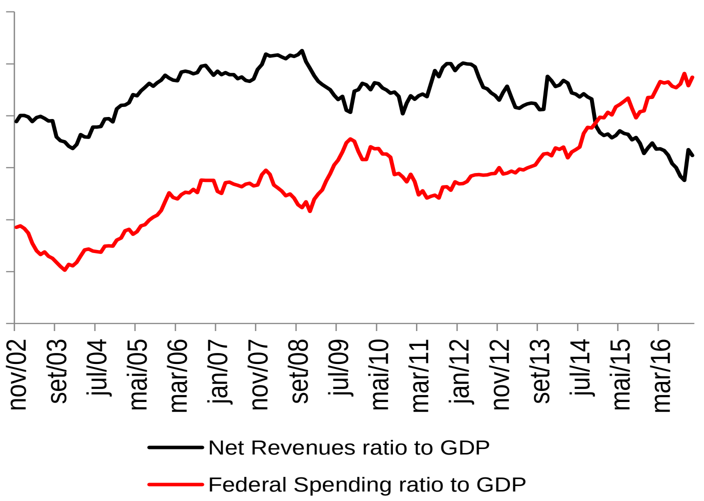
(A) considers the government budget proposals for 2016 and 2017; (B) considers our assumptions; (C) assumes the spending cap rule is r applied to health and education spending, and that the government offsets the negative impact on primary results by cutting capital spending; a (D) considers the spending cap rule being revised by the next government (2019-2021 period), and assumes that health, education spending, a capital spending are excluded from the spending cap rule from 2019 onward

Plan B . . . ? The End of Tax Exemptions, and, as a Last Resort, Tax Increases (3)

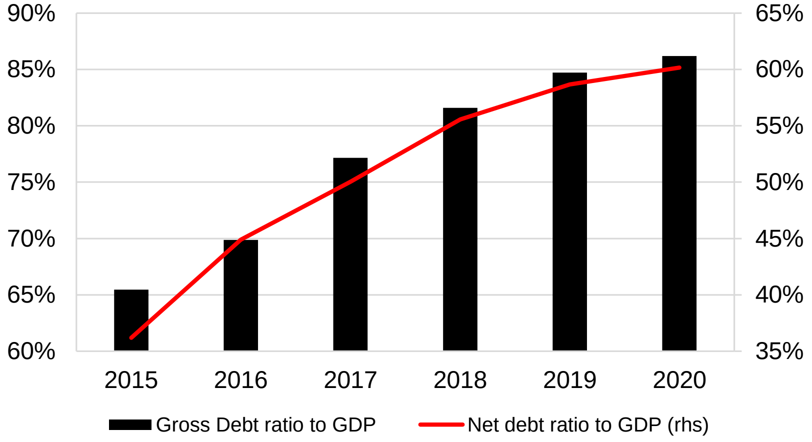
	BRL	%GDP
Simplified tax regime for SME	82.9	1.3%
Tax free industry zone	25.6	0.4%
Non profit entities	24.5	0.4%
Tax Exemption of consumer staples	23.8	0.4%
Reduction in payroll taxation	17.0	0.3%
Income tax deduction	16.9	0.3%
Worker benefits	11.4	0.2%
Tax exemption for saving account	8.4	0.1%
Tax exemption for medicines	7.4	0.1%
Tax exemption for Regional development	6.6	0.1%
Total	**224.5**	**3.6%**

	BRL	%GDP
CIDE (tax on gasoline)	11.8	0.19%
IRPF (tax income for individuals)	3.5	0.06%
IOF (tax on financial Operations)	3.7	0.06%
IPI (tax on manufacturing goods)	2.0	0.03%
PIS/Cofins	1.0	0.02%
Total	**22.0**	**0.36%**

Mismatch between Tax Collection and Spending
Central Government: Revenue/Expenditure % of GDP (2)



Worsening Dynamic in the Gross Public Debt-GDP Ratio
Gross & Net Government Debt (% of GDP) Baseline Scenario (4)

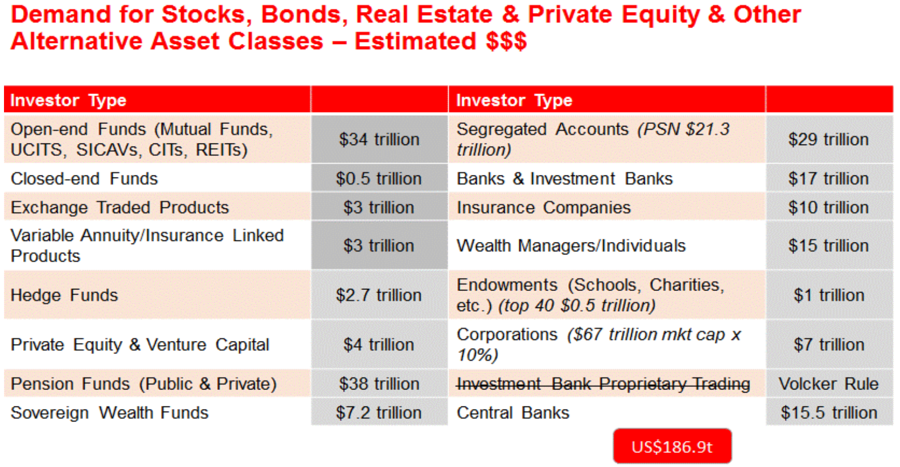


Sources: (1) Ministry of Finance and Santander estimate. (2) National Treasury Secretary (STN). (3) Ministry of Finance. (4) BCB and Santander estimate.

Five Themes for 2018: LatAm Funds & Flows

4—Funds & Flows—Drop in the Ocean: Opportunity Ahead?

Mapping Global Fund Industry—Size in US$ trillions



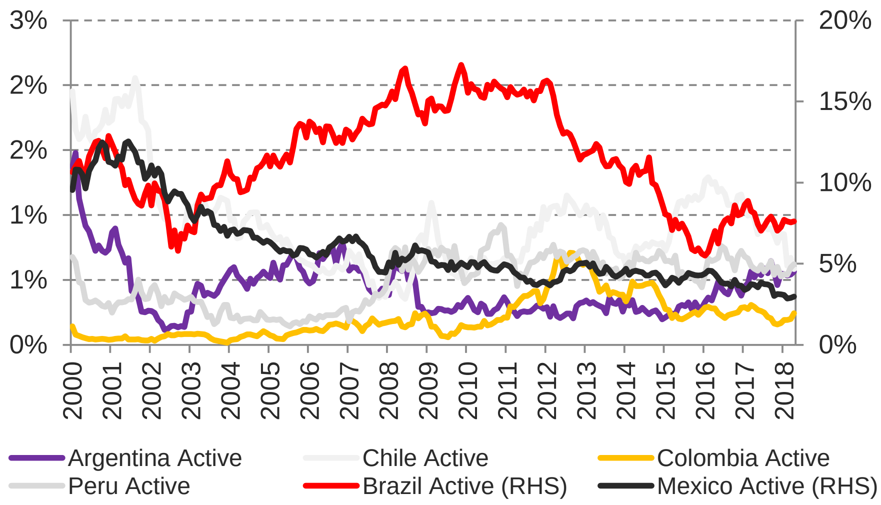
Demand for Stocks, Bonds, Real Estate & Private Equity & Other Alternative Asset Classes – Estimated $$$

Investor Type		Investor Type	
Open-end Funds (Mutual Funds, UCITS, SICAVs, CITs, REITs)	$34 trillion	Segregated Accounts *(PSN $21.3 trillion)*	$29 trillion
Closed-end Funds	$0.5 trillion	Banks & Investment Banks	$17 trillion
Exchange Traded Products	$3 trillion	Insurance Companies	$10 trillion
Variable Annuity/Insurance Linked Products	$3 trillion	Wealth Managers/Individuals	$15 trillion
Hedge Funds	$2.7 trillion	Endowments (Schools, Charities, etc.) *(top 40 $0.5 trillion)*	$1 trillion
Private Equity & Venture Capital	$4 trillion	Corporations *($67 trillion mkt cap x 10%)*	$7 trillion
Pension Funds (Public & Private)	$38 trillion	~~Investment Bank Proprietary Trading~~	Volcker Rule
Sovereign Wealth Funds	$7.2 trillion	Central Banks	$15.5 trillion

US$186.9t

- LatAm equities are a drop in the ocean with respect to total assets under management worldwide, at US$186.9 trillion.
- Considering that emerging markets (EM) have ~US$1,074 billion in AUM (US$726 billion active), each 100 bps of allocation could drive a meaningful ~R$34 billion to the market (4.0 days of trading volume).
- In terms of allocation, Brazil is close to neutral among international active investors' portfolios, according to EPFR as of April 2018.

Weight of LatAm Countries in GEM Active Funds



GEM Funds Allocations by Country—Active and Passive

	Active			Passive		
	Current	Hist. Avg.	Diff.	Current	Hist. Avg.	Diff.
LatAm	**12.7%**	**18.9%**	**-6.2 p.p.**	**12.6%**	**20.8%**	**-8.2 p.p.**
Argentina	0.6%	0.4%	0.1 p.p.	0.0%	0.3%	-0.3 p.p.
Brazil	7.6%	11.4%	-3.8 p.p.	7.2%	12.0%	-4.8 p.p.
Chile	0.58%	0.9%	-0.3 p.p.	1.4%	1.8%	-0.4 p.p.
Colombia	0.24%	0.2%	0.0 p.p.	0.7%	0.4%	0.3 p.p.
Mexico	3.0%	6.0%	-3.0 p.p.	2.9%	5.7%	-2.7 p.p.
Peru	0.62%	0.5%	0.1 p.p.	0.3%	0.4%	-0.2 p.p.

Note:: Funds allocations data as of October 30, 2017. Source for all charts: EPFR.

Five Themes for 2018: Funds & Flows

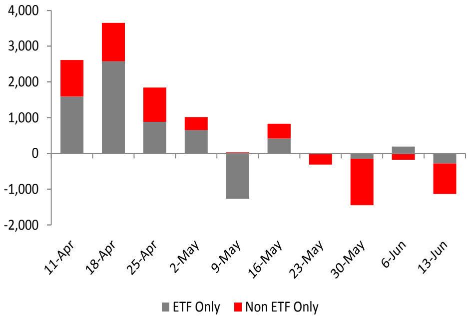
4 – Favorable Flows for Brazil Reversed Last Month

Emerging Markets and Regions

Total Flows through Regions YTD (US$ Millions)

All Funds - Regions	Current Week (US$ Mln)	% of AUM	Last 4 Weeks	YTD
EM	-1,132	-0.1%	-2,871	54,452
LatAm	-300	-0.2%	-628	8,327
Brazil	-129	-0.2%	-323	4,197
Mexico	-96	-0.3%	-153	2,495
Chile	-34	-0.3%	-81	436
Peru	-13	-0.2%	-40	252
Colombia	-2	-0.03%	24	258
Argentina	-21	-0.2%	-42	586

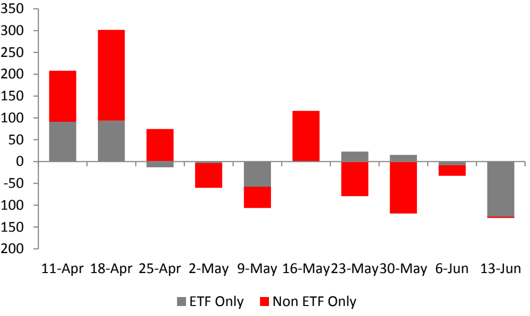
Flows by ETF Funds (US$ Millions)—All Emerging Markets



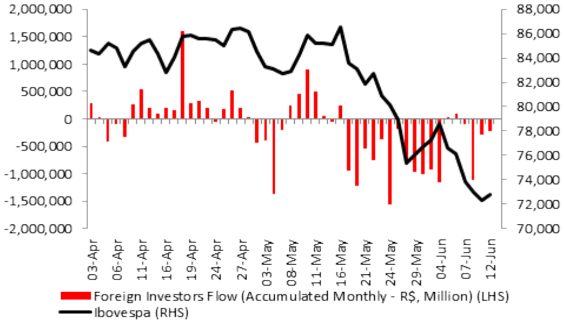
- Emerging markets had inflows of US$78,564 million in 2017 and have accumulated US$54,452 million year to date.
- Latin America had positive flows that accumulated US$15,006 last year and totaled US$8,327 so far this year. The main drivers were:
  - Brazil: +US$9,338 mn 2017 ; +US$4,197 mn YTD.
  - Mexico: +US$2,118 mn 2017; +US$2,495 mn YTD.
  - Chile: +US$948 mn 2017; +US$436 mn YTD.
  - Argentina: +US$1,203 mn; +US$586 mn YTD.
  - Colombia: +US$660 mn; +US$258 mn YTD
  - Peru: +US$414 mn; +US$252 mn YTD.
- Brazilian trades on the Bovespa had inflows during 2017 from foreign investors that amounted to R$14,566 million. Year to date outflows have amounted to R$7,677 million.

Brazil

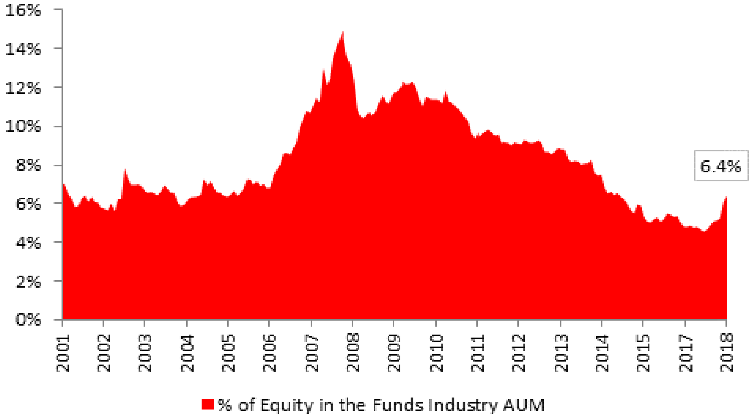
Flows to Brazil by ETF Funds (US$ Millions)



Foreign Investors Flows In Brazilian Stock Exchange - Daily data (R$, Million):



Local Mutual Domestic Equity Holdings (% of Total AUM) Near Lows (1)



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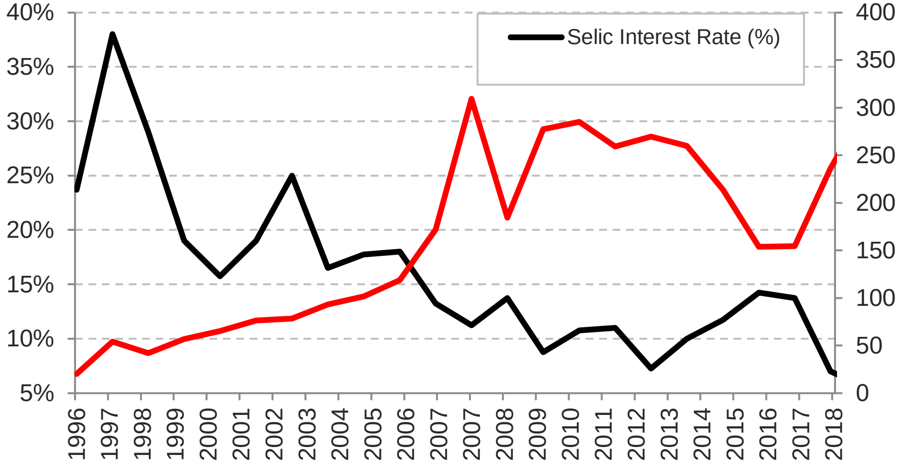
(1) Source: Abrapp - Associação Brasileira das Entidades Fechadas de Previdência Complementar.

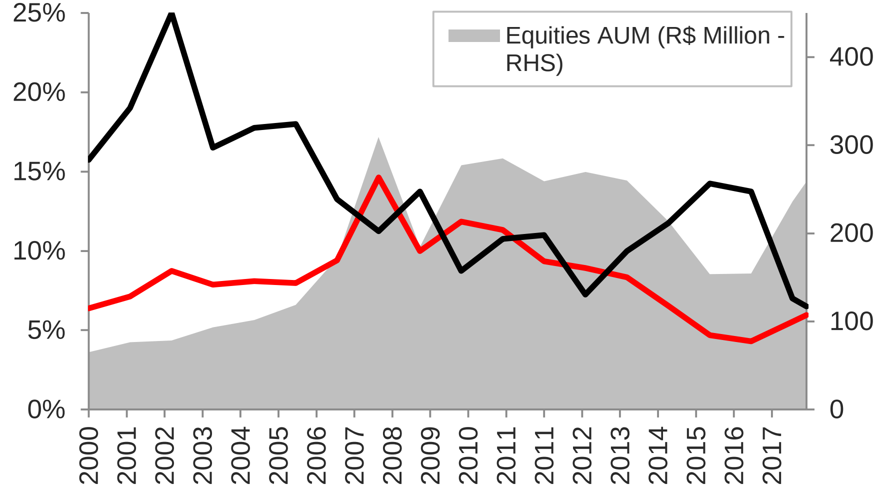
Five Themes for 2018: LatAm Funds & Flows

4—Domestic Asset Reallocation? A Lower Conviction

Equity Brazilian Funds Industry AUM (R$ Mn) vs. Selic Interest Rate (%)



Equity Funds AUM as a % of Total Funds Industry AUM (R$ Mn)



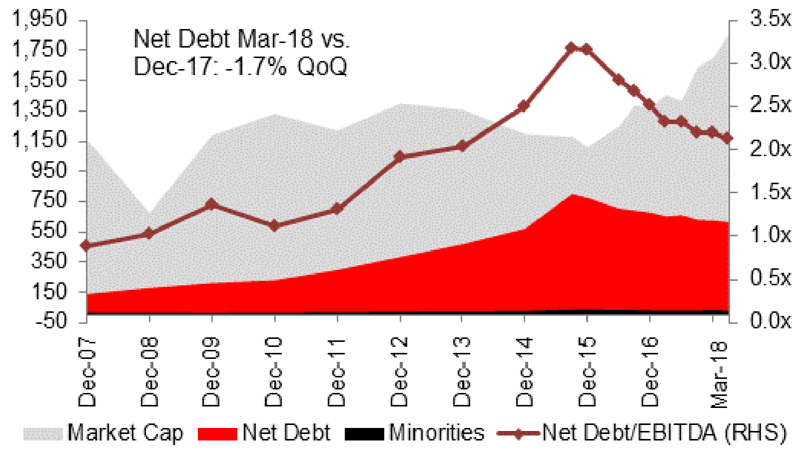
- Brazil is known as a “fixed income” market (indeed the Ibovespa earnings yield gap is at -1.9%). That being said, the Selic rate reached single digits in July 2017. In our view, this helped bringing significant inflows into equity funds. However, we expect this pattern to reverse. Below we show some numbers:
- During the cycle 2009-2013 (when the average Selic rate was 9.6%), equity funds had a total intake of R$21 billion (~R$4 billion/year).
- Average equity AUM reached R$266 billion during the 2009-2013 cycle, or 10% of total fund industry assets, according to Anbima. Currently, equity funds total R$258 billion, representing only 6.0% of total assets.
- If we were to assume the historical pattern, in which equity AUM was 8.9% of the total funds industry when the Selic reached 7.25% in 2012, which would imply an additional R$131 billion for the equity fund industry.
- During 2014-16, Brazil’s equity fund industry suffered R$37 billion in outflows.
- Brazil’s fund industry totals R$4.33 trillion, with R$1.958 trillion in fixed income and R$928 billion in multimarket funds.
- Pension funds’ equity allocation is 18.3% of their AUM currently, still low after reaching 37.7% in 2008. We believe that inflation-linked bond coupons (which used to be reinvested in the same assets) may be redirected to more risky instruments like equities. According to our tracking, there were R$11 billion coupons from pension funds due through 2H2018.

Note: 2017 data accumulated until the end of November. Sources: Anbima and Bloomberg

Five Themes for 2018

5—Corporate Leverage: We Believe the Worst Is Over

Firm Value Composition and Net Debt/EBITDA LTM—Ibovespa Index (R$, Bn) (1)



Leverage of Ibovespa Sector (2)

Sector	Weight in Ibovespa	Debt weight in Total Ibov Debt (1)	Net debt/ EBITDA (1)	FV/ EBITDA (1)	FV/ EBITDA (2)
Oil, Gas & Petrochemicals	13.6%	48.1%	3.2x	7.3x	6.3x
Food & Beverage	9.6%	10.3%	1.7x	13.5x	13.9x
Utilities	4.7%	10.2%	2.6x	7.7x	8.2x
Mining	11.9%	8.1%	1.0x	5.6x	5.7x
Steel	2.3%	7.0%	3.8x	8.7x	8.8x
Transportation	4.6%	5.5%	2.5x	9.1x	9.0x
Pulp & Forest Products	3.4%	5.4%	2.3x	9.1x	11.3x
Retail	7.4%	2.8%	1.6x	14.3x	13.8x
Agribusiness	0.4%	0.8%	1.4x	6.4x	5.1x
Telecom, Media & Technology	2.3%	0.8%	0.2x	5.8x	6.0x
Homebuilding	0.5%	0.6%	4.7x	21.9x	18.4x
Income Properties	1.3%	0.5%	NM	NM	15.3x
Financial Institutions - Others	6.6%	0.3%	0.2x	NA	NA
Healthcare	1.1%	0.0%	0.1x	7.3x	6.5x
Financial Institutions - Banks	27.1%	0.0%	NA	NA	NA
Capital Goods	0.9%	-0.1%	-0.2x	23.9x	24.4x
Education	2.1%	-0.2%	-0.5x	10.8x	9.7x

- **Net/Net:** Leverage improved slightly at the margin: Consolidated net debt/EBITDA fell to 2.1x in 1Q18 vs. 2.2x in 4Q17, driven by 1.7% higher LTM EBITDA and a 1.7% QoQ net debt decrease.

- **Three sectors account for 69% of consolidated net debt (Oil & Gas, F&B, and Utilities)** but only 28% of the Ibovespa by weight.

- **Leverage: domestic or global phenomenon?** The answer is “global,” in our view. The corporate debt of nonfinancial emerging market companies quadrupled between 2004 and 2014, reaching US$18 trillion. According to an IMF study (Global Financial Stability Report, October 2015), Brazil ranks fourth among those with the largest increases; China ranks first (+32%).

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(1): Sources: Economatica and Santander estimates. (2): (1) Last reported data as of 1Q18 financial statements and (2) last 12 months for EBITDA. NA: Not applicable. NM: Not meaningful. Sources: Bloomberg, Economatica, company filings, and Santander estimates.

Risks to Monitor in Brazil
1—Watch Out for Busy Electoral Calendar Ahead

Elections Calendar (1)

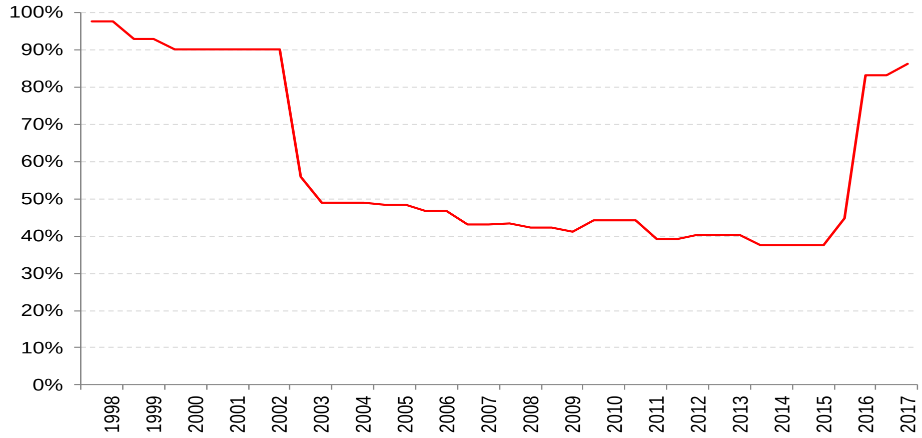
2017
- October: **Argentina** Parliamentary Elections
- October: Japan General Elections
- November: **Chile** Presidential Elections

2018
- March: **Russian** Presidential elections
- May: **Italian** General elections
- May: **Colombia** 1st round of presidential elections
- July: **Mexico** Presidential elections
- September: **Swedish** General elections
- October: **Brazil** Presidential elections
- October: **Venezuela** Presidential elections
- November: **US** mid-term election

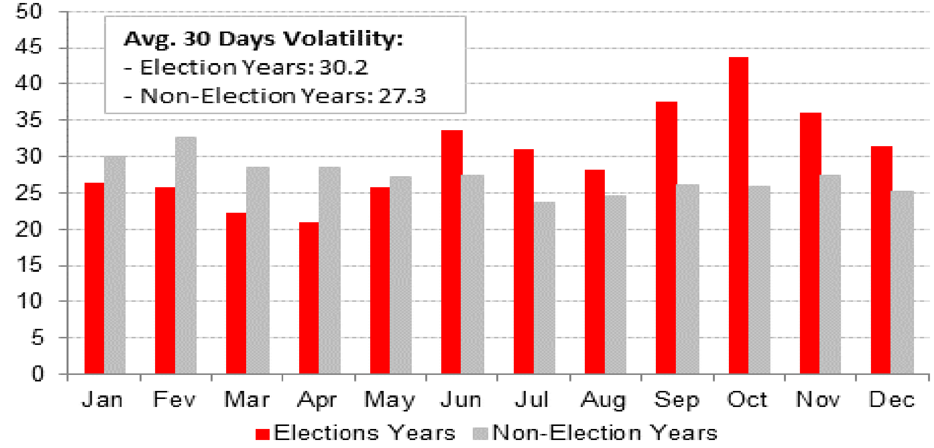
2019
- May: **South Africa**
- June: **European** Parliament elections
- November: **Turkish** Presidential elections
- **Greek** Legislative elections
- **Portuguese** Parliamentary elections
- **Australian** Parliamentary elections
- **Argentina** Presidential elections
- **Uruguay** Presidential elections

- The political climate has materially improved in LatAm during the last two years, with currently 87% of the region's population under market-friendly governments, according to an IMF study.
- 2018 brings a busy election calendar, with three of the six covered countries holding presidential elections: Colombia (May), Mexico (July), and Brazil (October).
- Mexico is where we see more risk and volatility. We remind readers that 6 and 12 years ago, presidential elections triggered significant volatility in Mexican assets. Specifically, the IPC Index registered a correction of ~24% and ~8% in the months before the 2006 and 2012 elections, respectively.

LatAm Is Open for More Market-Friendly Policies—LatAm Population under Market-Friendly Governments (2)



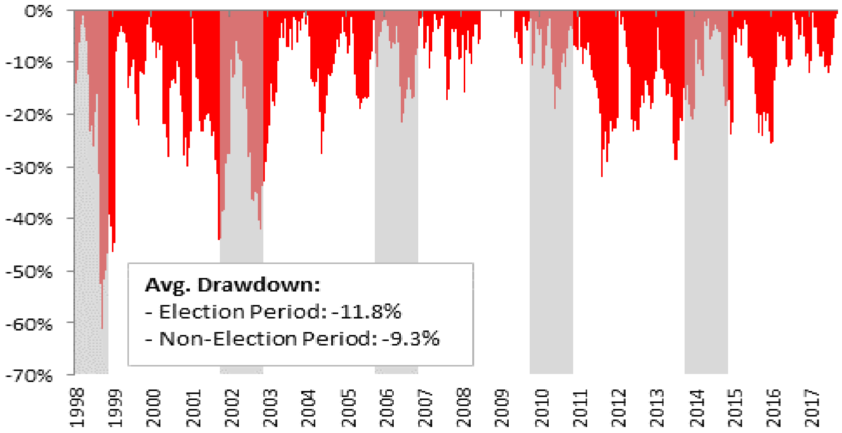
Average Ibovespa 30-Day Volatility—Election Years vs. Non-Election Years (3)



(1) Source: Bloomberg. (2) Sources: IMF and Santander. Populist government as defined by Steven Levitsky and Kenneth M. Roberts in "Latin America's 'Left Turn': A Framework for Analysis". (3) Sources: Bloomberg and Santander estimates.

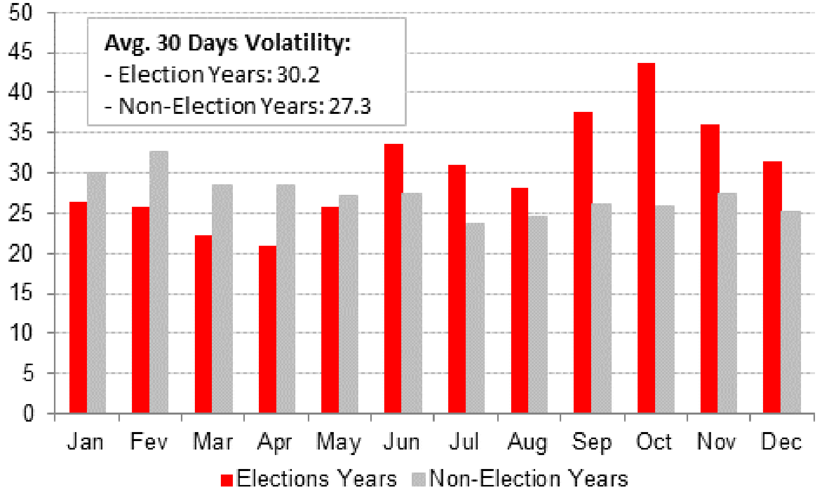
Risks to Monitor in Brazil
Election Periods Have Greater Potential Downside & Volatility than Non-Election Ones

Yearly Drawdown during Election Periods (Grey-Shaded Area) and Non-Election Periods—Brazil (1)



Avg. Drawdown:
- Election Period: -11.8%
- Non-Election Period: -9.3%

Average Ibovespa 30-Day Volatility—Election Years vs. Non-Election Years (1)



Avg. 30 Days Volatility:
- Election Years: 30.2
- Non-Election Years: 27.3

- A look at past Brazil presidential election years shows that Ibovespa volatility is expected to increase in election years. In our opinion, the positive outlook for the economy is a significant driver for equities, but it is also important not to overlook the potential increase in volatility that elections could bring in 2018.
  - The average maximum moving yearly drawdown during election periods was a negative 11.8% in the last 19 years, while non-election periods have a better -9.3% average drawdown. In other words, the average downside during election periods is higher than in non-election periods.
  - The average yearly 30-day volatility is higher in election years (30.2), compared to 27.3 in non-election years.

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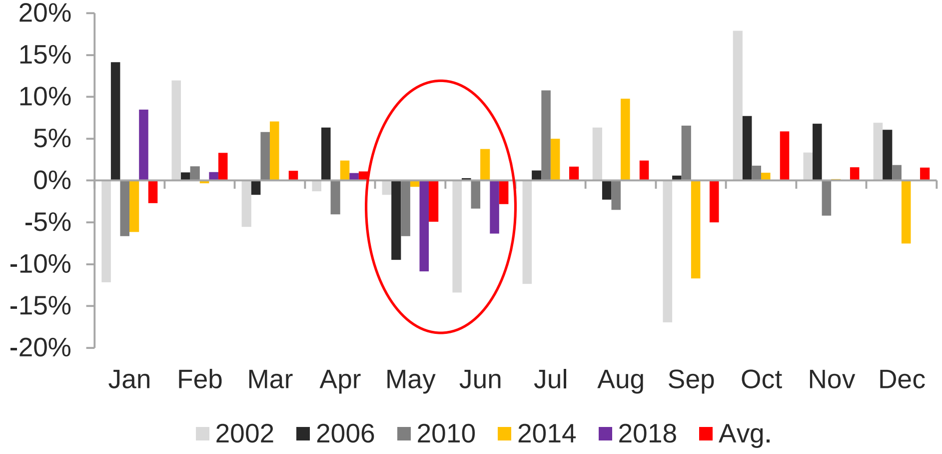
(1) Sources: Bloomberg and Santander estimates.

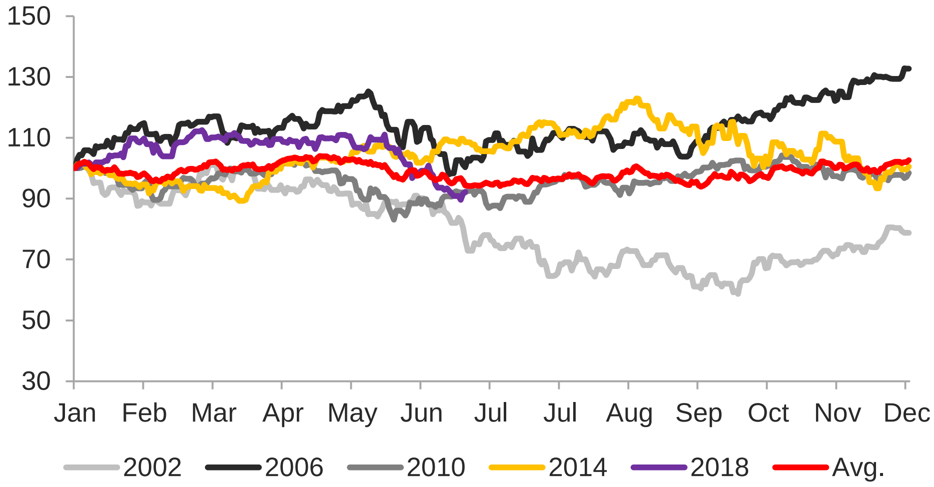
Risks to Monitor in Brazil
Election Periods Have Greater Potential Downside & Volatility than Non-Election Ones

- Second quarters of election years show historical negative performance and start of volatility increase.
  - May and June showed predominantly negative performance during election years, with -4.9% and -2.8% average performance, respectively, in the past four election years (2002, 2006, 2010 and 2014). Diffusion was negative in six of the eight months of the sample.
  - Additionally, the second quarter showed average negative performance for Ibovespa of -6.3%, with 75% of negative diffusion.
  - In the two subsequent months of July and August, Ibovespa had average positive performance of +1.7% and +2.4%, respectively.
  - For October, November, and December, average performance was +5.9%, +1.6%, and +1.5%, respectively, along with a positive diffusion of 10 positive months out of a sample of 12.

Ibovespa Monthly Performance Throughout Election Years



Ibovespa Performance Throughout Election Years

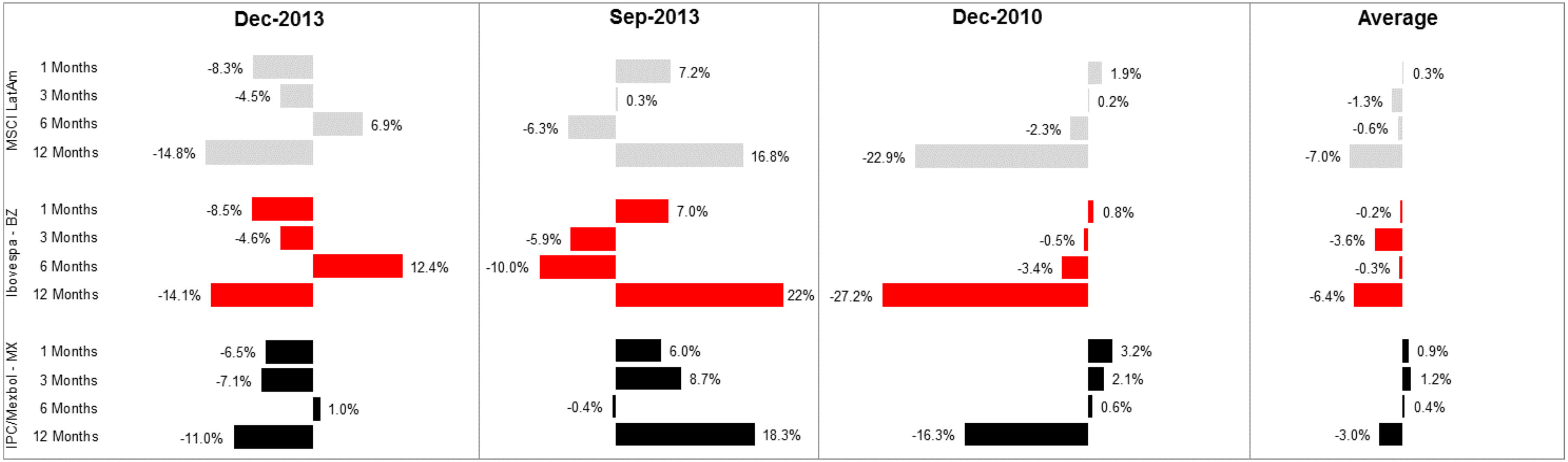


Sources: Bloomberg and Santander.

Risks to Monitor in Brazil
2—What If U.S. Treasuries Go to 3%? LatAm Markets Historical Performance (Slightly Negative)

- Following the recent rise in U.S. treasuries and increasing investor concerns about the Fed's next monetary policy steps, we assessed how LatAm equities behaved when the US 10Y rates reached 3% levels in an upward trend since 2010. We found that MSCI LatAm showed increased volatility with -10% and -14% maximum drawdown three and six months after treasuries reached 3%. But we also note that LatAm had a smoother average performance of -1.3%, -0.6%, and -7% in the 3, 6, and 12 subsequent months when treasuries climbed to 3% levels.
  - Brazilian equities reacted comparatively worse than MSCI LatAm and Mexico, with -13.7% and -17.7% maximum drawdown three and six months after U.S. treasuries reached 3%. Average performance after 3, 6, and 12 months was -3.6%, -0.3%, and -6.4%.
  - Mexico had relatively better performance than LatAm and Brazil, albeit still negative, with -9.1% and -11.0% maximum drawdown three and six months after treasuries reached 3%. Average performance after 3, 6, and 12 months was +1.2%, +0.4%, and -3.0%.

MSCI LatAm, Ibovespa and Mexbol Performance In US$ after US 10Y Rates Reached 3% Levels in an Upward Trend: $^{(1)}$



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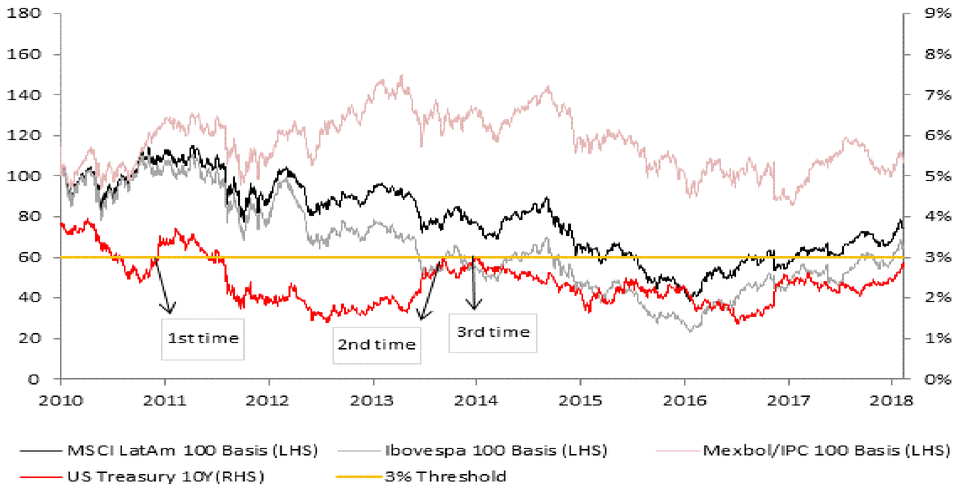
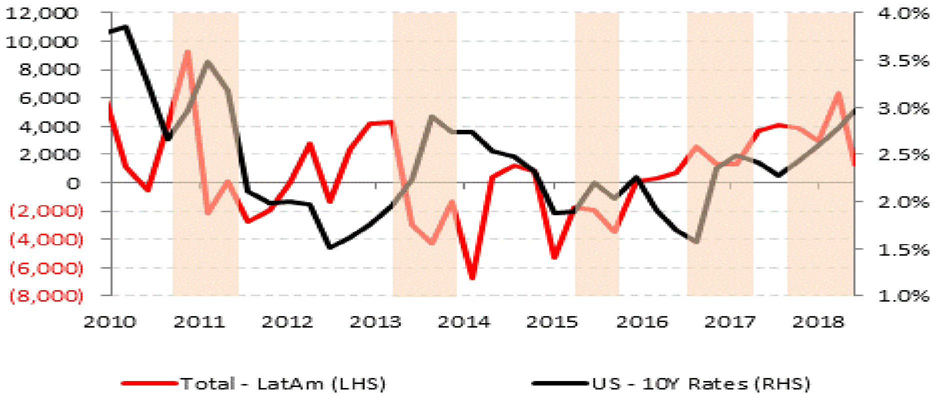
(1) Sources: Santander and Bloomberg.

Risks to Monitor in Brazil
2—What If U.S. Treasuries Go to 3%? LatAm Markets Historical Performance (Slightly Negative) (*continued*)

US 10Y Treasury vs. MSCI LatAm, Ibovespa and Mexbol In US$ (100 Basis) – Green Lines Refer to Periods When US Treasury Rates Reached 3% Levels in an Upward Trend: (1)



Flows to LatAm (3 Months Accumulated; US$ Millions) vs. Treasury 10Y Rates: (2)



MSCI LatAm – Maximum Drawdown In US$ after US 10Y Rates Climbed to 3%: (1)

Date	1-Month After	3-Months After	6-Month After
Average:	**-5.3%**	**-9.8%**	**-13.6%**
3-Dec-10	-3%	-8%	-10%
5-Sep-13	-4%	-10%	-19%
26-Dec-13	-9%	-12%	-12%

Ibovespa – Maximum Drawdown In US$ after US 10Y Rates Climbed to 3%: (1)

Date	1-Month After	3-Months After	6-Month After
Average:	**-6.5%**	**-13.7%**	**-17.7%**
3-Dec-10	-5%	-10%	-13%
5-Sep-13	-6%	-18%	-27%
26-Dec-13	-9%	-13%	-13%

Mexico – Maximum Drawdown In US$ after US 10Y Rates Climbed to 3%: (1)

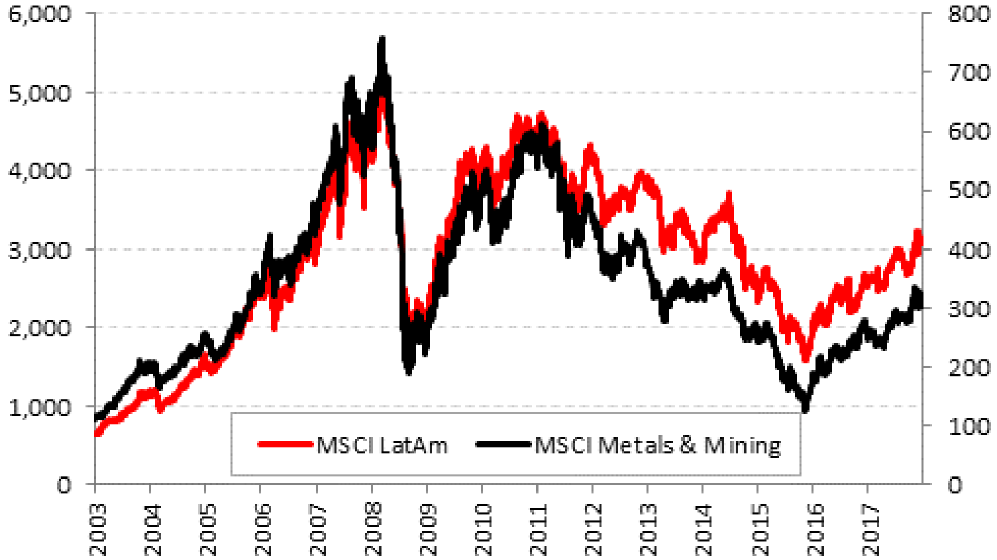
Date	1-Month After	3-Months After	6-Month After
Average:	**-5.1%**	**-9.1%**	**-11.0%**
3-Dec-10	-1%	-6%	-8%
5-Sep-13	-7%	-9%	-13%
26-Dec-13	-7%	-13%	-13%

(1) Sources: Santander and Bloomberg. (2) Sources: Santander, EPFR Global and Bloomberg.

Risks to Monitor in Brazil

3—LatAm Market and Commodities: Detaching? Lower but Still High Correlation (0.62) with Commodities (Mainly Metals)

MSCI World Metals & Mining Index vs. MSCI LatAm (In US$) (1)



We did an analysis of LatAm relative to commodities in the last 5 and 15 years and found that the region has a declining albeit still high correlation with the MSCI World Metals & Mining Index, while the relationship with the CRB Index (which comprises a different set of other commodities) is lower.

- MSCI LatAm has a 0.62 and 0.75 correlation with the MSCI World Metals & Mining Index (and a 0.39 and 0.57 r-squared coefficient, respectively) for the last 5 and 15 years, while the relation with the CRB Commodities index is lower, with a 0.31 correlation (and 0.10 r-squared).
- Brazil has a correlation of 0.53 with MSCI Metals & Mining (0.28 r-squared) in the past five years.
- Mexico has a 0.50 correlation with MSCI M&M (0.25 r-squared).
- Chile has a 0.55 correlation with MSCI M&M (0.31 r-squared).
- Peru has a 0.61 correlation with MSCI M&M (0.37 r-squared).
- Colombia has a 0.55 correlation with MSCI Metals & Mining (0.30 r-squared).
- Merval is the least correlated (0.36 correlation) with MSCI M&M (0.13 r-squared).

MSCI LatAm and Country Indexes Correlation with MSCI World Metals & Mining Index and CRB Commodities Index—in the Past Five Years (1)

		CRB	MSCI Metals & Mining	MSCI LatAm	Ibovespa	Mexbol	IPSA	SP Peru	Colcap	Merval
CRB	R-sqr	1.00	0.04	0.03	0.03	0.01	0.02	0.03	0.02	0.00
	Correl	1.00	0.21	0.16	0.16	0.11	0.15	0.18	0.14	0.06
MM	R-sqr	0.04	1.00	0.39	0.28	0.25	0.31	0.37	0.30	0.13
	Correl	0.21	1.00	0.62	0.53	0.50	0.55	0.61	0.55	0.36

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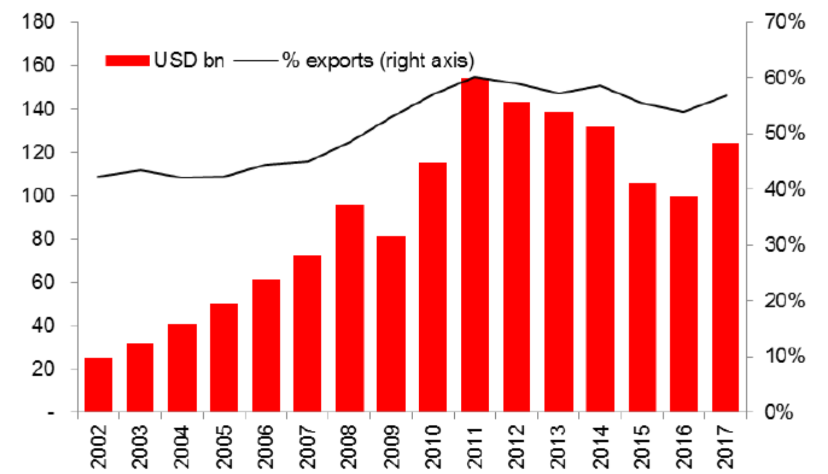
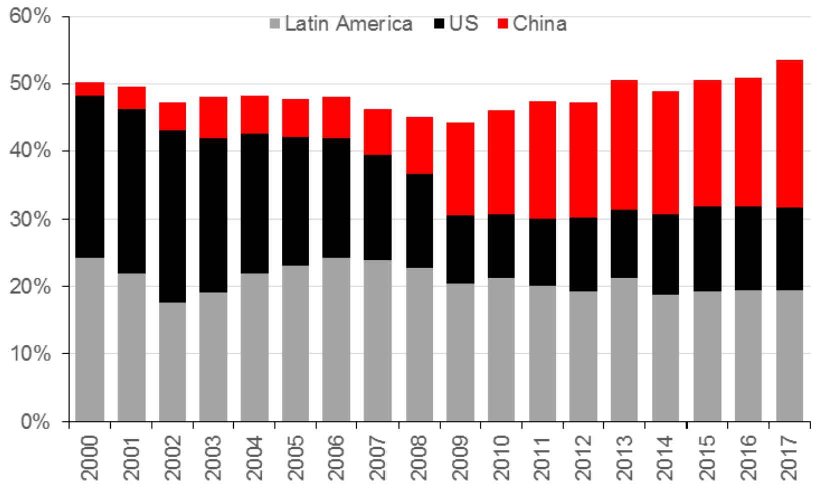
(1) Sources: Bloomberg and Santander estimates.

Risks to Monitor in Brazil:
4 – Potential Trade War Impact on Brazil – Direct and Indirect Risks

Brazilian Commodity Exports and Share of Commodities in Total Exports



Brazilian Exports: Main Destinations (%)



- Brazil has not been a target of U.S. trade barriers, as bilateral trade has been positive for the U.S. for more than a decade (USD 7.6 billion surplus in 2017).
- **The (narrow) trade channel: it's all about China.** In our view, the biggest risk for Brazil would be collateral damage, if the trade war leads to a slowdown in the global economy and in Chinese growth.
  - Slower Chinese growth could hurt commodity prices, which comprise ~60% of Brazilian exports. Also, it could have a spillover effect on Brazil's other trading partners. 41% of Brazil's exports go to China or LatAm, many other LatAm countries are exporters and have strong trade ties with China.
- **The (broad) financial channel: the risk of a change in tides.** A trade war would also affect international and local financing conditions. Considering this broader scenario, we estimate that Brazilian GDP could be affected by 0.4 p.p. in 2018 and 1.1 p.p. in 2019.
  - Our economic team modelled the impact a 25% tariff imposed by the U.S. and China on each other's imports would have on the global and Brazilian economy.

Model Outcome—Baseline and Adverse Scenarios

Variables	Annual Growth (%)			
	Baseline		Adverse	
	2018	2019	2018	2019
Brazil GDP	**3.2**	**3.2**	**2.8**	**2.1**
Real Interest Rate*	2.7	3.8	3.2	4.8
Consumer Confidence	7.8	4.6	5.6	-9.5
World Trade	**5.4**	**5.0**	**4.1**	**-2.6**
Volatility Index**	18	20	27	30
Commodity Prices	2.5	4.5	-6.5	-15
China GDP	6.7	6.5	6.2	4.7
USA GDP	2.7	2.5	2.3	1.6

Source: MDIC, IBGE, BCB, FGV, CPB, CBOT, CRB, Bloomberg, and Santander estimates

Are Brazil Quality Companies Expensive? A Look at PEG Ratios

Ibovespa: Top Companies Trading at Premium to Historical Average—PEG 12-Month Forward (1)

Company	PEG 2017E-19E	P/E 2018	P/E 2019
CCR	0.6	10.1	8.6
Bradesco	0.6	7.7	6.9
Equatorial	0.6	16.2	12.6
Energisa	0.7	13.9	13.8
B3	0.7	17.3	15.7
Itaú Unibanco	0.8	8.7	7.7
Telefonica Brasil	0.8	12.9	11.4
Ambev	0.9	21.1	18.2
Multiplan	1.1	19.6	17.8
CVC	1.1	20.3	16.4
IRB	1.1	15.3	12.6
Natura	1.1	23.0	18.9
Iguatemi	1.2	19.6	16.5
Lojas Renner	1.2	22.2	18.0
Localiza	1.3	25.0	19.2
Ultrapar	1.3	16.1	13.5
RD	1.5	34.2	26.0
Arezzo	1.7	23.0	19.6
OdontoPrev	1.7	23.1	20.2
WEG	1.8	24.8	20.9
Hypera	1.8	17.2	15.4
Cielo	3.1	10.4	10.0
Lojas Americanas	NA	29.0	22.3
Kroton	NM	8.9	9.4
Smiles	NM	8.8	8.1

Fair P/E Sensitivity for Different Level of ROE and EPS Growth(2)

	ROE Growth	25%		
	EPS Growth	5%		
Inputs	ROE Perpetuity	20%	Ke Growth	15%
	EPS Perpetuity	6%	Ke Perpetuity	15%

Fair P/E	**ROE in Growth Period**										
EPS Growth	5.0%	7.5%	10.0%	12.5%	15.0%	17.5%	20.0%	22.5%	25.0%	27.5%	30.0%
0%	6.9	6.9	6.9	6.9	6.9	6.9	6.9	6.9	6.9	6.9	6.9
2.5%	5.2	6.1	6.6	6.8	7.0	7.1	7.2	7.3	7.4	7.4	7.5
5.0%	3.1	5.1	6.1	6.7	7.1	7.4	7.6	7.8	7.9	8.0	8.1
7.5%	0.7	4.0	5.6	6.6	7.2	7.7	8.1	8.3	8.5	8.7	8.9
10.0%	(2.2)	2.6	5.0	6.4	7.4	8.1	8.6	9.0	9.3	9.6	9.8
12.5%	(5.6)	1.0	4.3	6.2	7.6	8.5	9.2	9.8	10.2	10.5	10.8
15.0%	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM
17.5%	(14.3)	(3.2)	2.4	5.8	8.0	9.6	10.8	11.8	12.5	13.1	13.6
20.0%	(19.9)	(5.8)	1.3	5.5	8.4	10.4	11.9	13.1	14.0	14.8	15.4
22.5%	(26.5)	(8.9)	(0.1)	5.2	8.8	11.3	13.2	14.6	15.8	16.8	17.6
25.0%	(34.2)	(12.5)	(1.6)	4.9	9.2	12.3	14.6	16.5	17.9	19.1	20.1
27.5%	(43.2)	(16.7)	(3.5)	4.5	9.8	13.6	16.4	18.6	20.4	21.8	23.0
30.0%	(53.8)	(21.6)	(5.6)	4.0	10.5	15.0	18.5	21.2	23.3	25.0	26.5

- **Net/Net:** We still like the quality strategy but are further screening it: we prefer companies trading at mid-teens forward P/E and whose PEG 2017-19E ratio is below 1.5x: i.e., in our portfolio we hold Itau Unibanco, Bradesco, Equatorial, Energisa, B3, Ambev, Multiplan, Lojas Renner, Localiza, IRB, and CVC.

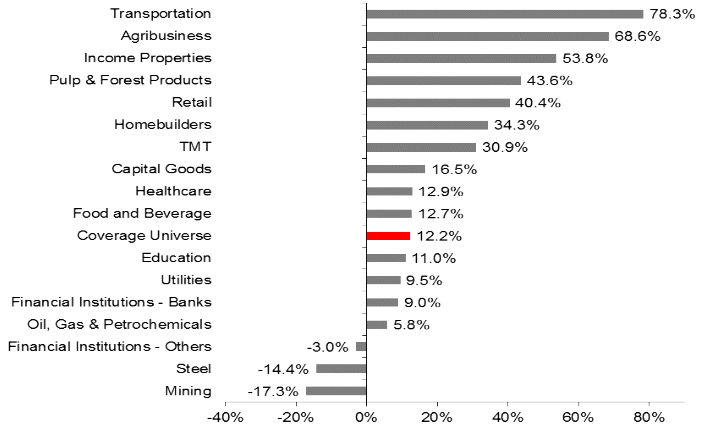
- According to our calculations, it is necessary to grow EPS at a 30% CAGR for 10 years with ROE above 20% to justify a multiple of ~20x P/E forward.

- **PEG ratio limitations:** David Einhorn's 2005 speech at The Value Investing Congress using Peter Lynch's PEG ratio is insightful, in our view, as it points out the limitations of the PEG ratio. According to Einhorn: (i) the PEG ratio does not tell us anything about valuation: i.e., if a stock has a PEG ratio of 3x, it may be cheap if its P/E is 3x and growth is 1x, and may be expensive if the P/E ratio is 60x and growth is 20%; (ii) P/E multiples and earnings growth have a nonlinear relationship; and (iii) the PEG ratio does not tell us anything about the quality of growth (whether it comes from the top line, margin expansion, or leverage, or if it is secular growth or cyclical growth).

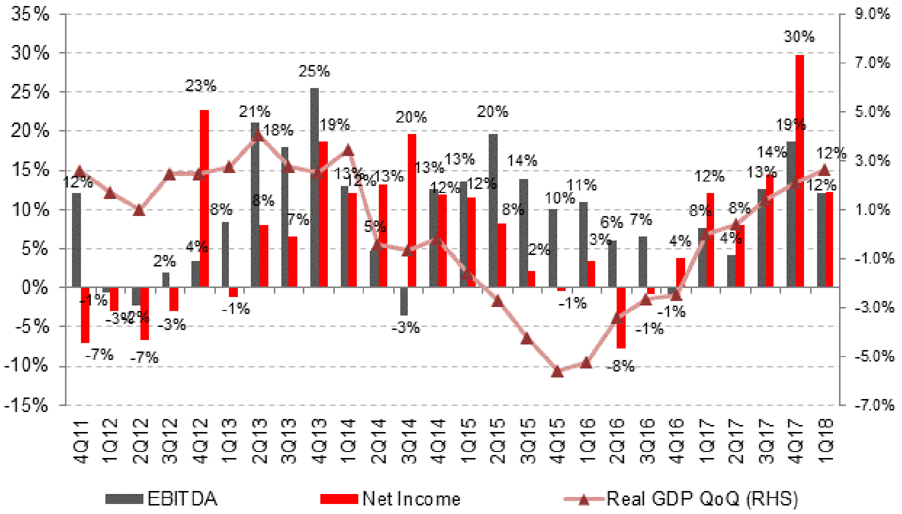
(1) Sources: Bloomberg and Santander estimates. (2) Source: Santander estimates.

1Q18 Wrap-up: High Diffusion Leads to Continued Double-Digit Growth in EBITDA and Net Income; Slight Deceleration of Earnings

1Q18 Net Income: YoY Growth(1) (%)



Historical Earnings: EBITDA and Net Income YoY Growth



- In 1Q18 companies under our coverage delivered another quarter of healthy double-digit growth.
  - Consolidated net revenue increased 10.7%, EBITDA was up 12.1% YoY (slightly below our forecast, -1.2%), and net income grew 12.2% YoY, short of our estimate by 5.4% (-1.1% excluding Vale).
- **Results diffusion remained positive:** 11 of 17 sectors delivered double-digit YoY net income growth, and 77% and 75% of companies covered posted YoY EBITDA and net income increases, respectively.
- **Positive perception overall.** Our analysts considered 50% of coverage results as positive, while only 20% were perceived negatively.
- **How was the season versus consensus?** Slightly below. EBITDA was 1.4% below Street estimates, and net income was 3.5% below.

Coverage – 1Q18 Performance on Main Lines (YoY)

Percentage of Companies Reporting	Expansion	Contraction
Net Revenues YoY >12m Inflation*	73.9%	26.1%
Net Income YoY >12m Inflation*	75.3%	24.7%
EBITDA YoY	77.2%	22.8%
Net Income YoY	75.3%	24.7%
EBITDA Margin	57.0%	43.0%
Net Margin	65.6%	34.4%

(1) Reported net income/EBITDA that surpasses our estimates by 10% or more, or fails to come within 10% of our estimates, as positive or negative surprises, respectively. Sources: Company reports, Economatica, and Santander estimates..

Companies Mentioned Table

Company	Code	Current Price	Target Price	Recommendation
AES Tiete	TIET11	9.7	14.8	Hold
Alliar	AALR3	13.0	21.0	Buy
Alupar	ALUP11	15.3	20.6	Buy
Ambev	ABEV3	18.5	22.0	Hold
Anima Educação	ANIM3	16.8	23.0	Hold
Arezzo	ARZZ3	42.4	50.0	Hold
Azul	AZUL4	23.4	38.0	Buy
B2W Digital	BTOW3	27.8	28.0	Buy
B3	B3SA3	19.8	25.0	Hold
Banco do Brasil	BBAS3	27.0	42.0	Buy
Banrisul	BRSR6	14.1	28.0	Buy
BB Seguridade	BBSE3	24.6	37.0	Buy
BR Distribuidora	BRDT3	17.4	27.0	Buy
BR Malls	BRML3	9.3	14.8	Hold
BR Properties	BRPR3	8.0	14.0	Buy
Bradesco	BBDC4	26.8	37.0	Hold
BRF	BRFS3	19.6	56.0	Buy
Camil	CAML3	7.2	11.5	Buy
Carrefour Brasil	CRFB3	15.4	19.0	Buy
CBD	PCAR4	77.2	86.0	Hold
CCR	CCRO3	10.2	19.0	Buy
Cemig	CMIG4	6.9	7.9	Hold
Cesp	CESP6	15.8	17.1	Hold
Cia Hering	HGTX3	15.2	32.0	Buy
Cielo	CIEL3	16.3	23.0	Underperform
Comgas	CGAS5	58.4	57.0	Hold
Copasa	CSMG3	41.4	54.6	Buy
Copel	CPLE6	22.8	31.6	Buy
Cosan Energia	CSAN3	35.0	45.0	Buy
CSN	CSNA3	8.0	9.0	Underperform
CVC	CVCB3	45.2	55.0	Buy
Cyrela Brazil Realty	CYRE3	10.8	14.7	Buy
Direcional Engenharia	DIRR3	5.7	8.8	Buy
Duratex	DTEX3	8.5	13.0	Buy
Ecorodovias	ECOR3	7.6	13.0	Buy
Eletrobras	ELET6	15.8	24.1	Hold
Embraer	EMBR3	24.4	16.0	Underperform
Energias do Brasil	ENBR3	13.4	18.2	Buy
Energisa	ENGI11	30.7	37.1	Buy
Eneva	ENEV3	12.3	17.1	Buy
Engie Brasil	EGIE3	33.5	42.1	Buy
Equatorial	EQTL3	59.4	71.1	Hold
Estácio	ESTC3	23.9	36.5	Buy
Even	EVEN3	3.9	5.5	Buy
EZTec	EZTC3	16.6	22.2	Hold
Fibria	FIBR3	70.9	74.0	Hold
Fleury	FLRY3	24.4	30.5	Buy
Fras-le	FRAS3	4.8	6.2	Buy
Gafisa	GFSA3	12.5	15.2	Underperform
Gerdau	GGBR4	14.7	16.0	Buy
Gol	GOLL4	11.8	15.0	Hold
Helbor	HBOR3	0.9	2.3	Hold
Hypera	HYPE3	28.5	38.0	Hold
Iguatemi	IGTA3	29.7	42.7	Hold
IMC	MEAL3	8.1	13.5	Buy
Iochpe Maxion	MYPK3	21.5	28.0	Buy
IRB	IRBR3	48.3	47.0	Buy
Itaú Unibanco	ITUB4	40.1	52.0	Buy
Itausa	ITSA4	9.2	14.7	Buy

Prices as of 20 June 2018. Sources: Santander estimates and Bloomberg.

Companies Mentioned Table (…Continued)

Company	Code	Current Price	Target Price	Recommendation
JBS	JBSS3	9.1	13.0	Buy
JSL	JSLG3	4.8	8.0	Hold
Klabin	KLBN11	19.7	25.0	Buy
Kroton	KROT3	9.8	14.0	Hold
Linx	LINX3	17.3	26.5	Buy
Localiza	RENT3	23.2	34.0	Buy
Locamerica	LCAM3	23.2	39.0	Buy
Lojas Americanas	LAME4	16.1	22.0	Buy
Lojas Renner	LREN3	29.3	37.0	Hold
Magazine Luiza	MGLU3	121.7	75.0	Buy
Mahle Metal Leve	LEVE3	25.6	27.0	Buy
Marcopolo	POMO4	3.4	4.0	Hold
Marfrig	MRFG3	8.0	8.0	Hold
Minerva	BEEF3	6.6	15.0	Buy
Movida	MOVI3	5.5	7.8	Hold
MRV Engenharia	MRVE3	12.4	18.4	Buy
Multiplan	MULT3	53.8	84.0	Buy
Multiplus	MPLU3	29.2	16.0	Underperform
Natura	NATU3	30.9	30.0	Underperform
OdontoPrev	ODPV3	12.5	17.0	Hold
OI	OIBR3	3.7	3.0	Underperform
Omega Geração S.A.	OMGE3	15.7	22.0	Buy
Petro Rio	PRIO3	67.1	65.4	Underperform
Petrobras	PETR3	18.6	25.0	Hold
Porto Seguro	PSSA3	39.5	34.0	Underperform
Qualicorp	QUAL3	18.1	41.0	Buy
Queiroz Galvão E&P	QGEP3	13.6	9.2	Hold
Randon	RAPT4	6.1	7.5	Hold
RD	RADL3	70.7	80.0	Hold
Restoque	LLIS3	23.4	47.0	Hold

Company	Code	Current Price	Target Price	Recommendation
Rodobens	RDNI3	3.9	6.2	Hold
Romi	ROMI3	5.8	9.0	Buy
Rumo Logistica	RAIL3	13.2	19.0	Buy
Sabesp	SBSP3	24.1	44.7	Buy
Santos Brasil	STBP3	2.5	3.0	Underperform
São Martinho	SMTO3	17.5	20.2	Buy
Ser Educacional	SEER3	17.0	27.5	Buy
Smiles	SMLS3	46.3	72.0	Buy
Sul America	SULA11	18.2	26.0	Buy
Suzano	SUZB3	43.1	47.0	Buy
Tecnisa	TCSA3	1.2	2.3	Hold
Tegma	TGMA3	16.6	26.0	Buy
Telefonica Brasil	VIVT4	46.5	58.0	Hold
Tenda	TEND3	23.5	33.4	Buy
TIM Participações	TIMP3	13.1	15.5	Buy
Totvs	TOTS3	27.1	35.0	Hold
Transmissao Paulista	TRPL4	61.3	73.8	Buy
Tupy	TUPY3	17.0	22.0	Buy
Ultrapar	UGPA3	46.6	83.0	Hold
Usiminas	USIM5	7.7	9.5	Hold
Vale	VALE3	48.8	40.4	Buy
Valid	VLID3	16.8	24.0	Buy
Via Varejo	VVAR11	20.0	27.0	Buy
WEG	WEGE3	15.4	23.5	Hold

Prices as of 20 June 2018. Sources: Santander estimates and Bloomberg.

IMPORTANT DISCLOSURES

Key to Investment Codes

Rating	Definition	% of Companies Covered with This Rating	% of Companies Provided Investment Banking Services in the Past 12 Months
Buy (B)	Expected to outperform the local market benchmark by more than 10%.	49.66	14.14
Hold (H)	Expected to perform within a range of 0% to 10% above the local market benchmark.	40.34	5.86
Underperform	Expected to underperform the local market benchmark.	9.66	0.00
Under Review (U/R)		0.34	0.34

The numbers above reflect our Latin American universe as of Wednesday, June 20, 2018.

For a discussion, if applicable, of the valuation methods used to determine the price targets included in this report and the risks to achieving these targets, please refer to the latest published research on these stocks. Research is available through your sales representative and other electronic systems.

Target prices are year-end 2018 unless otherwise specified. Recommendations are based on a total return basis (expected share price appreciation + prospective dividend yield) unless otherwise specified.

Stock price charts and rating histories for companies discussed in this report are also available by written request to Santander Investment Securities Inc., 45 East 53rd Street, 17th Floor (Attn: Research Disclosures), New York, NY 10022 USA.

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The benchmark used for local market performance is the country risk of each country plus the 1-year U.S. Treasury yield plus 5.5% of equity risk premium, unless otherwise specified. The benchmark plus the 10.0% differential used to determine the rating is time adjusted to make it comparable with the total return of the stock over the same period. For additional information about our rating methodology, please call (212) 350 3974.

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