MO Weekly Equity Note: 07-30-2021

Quick Thoughts on Telefonica Brasil (VIV) and Nintendo (NTDOY

Operators,

It's been an eventful week in markets, and I wanted to send my quick thoughts on two items:

- Telefonica Brasil (VIV) Q2 Earnings
- Nintendo (NTDOY) Price Action / Trade Management Ahead of Earnings

We're keeping this one short and sweet, so let's get after it.

Telefonica Brasil (VIV): Q2 Earnings Confirm LT Thesis

VIV released its Q2 earnings Wednesday (07/27) with positive results. In fact, this quarter marked the first *positive earnings surprise* in the last eleven consecutive quarters.

Naturally, the stock rose a modest 1% on the news.

For those that are unfamiliar, VIV (or Vivo) is Brazil's largest telco operator with a 33% market share. Vivo boasts 97M total accesses, 4M fiber-to-the-home connections, and passes 16M+ homes.

New Collective members can read our original write-up here and our variant perception below (emphasis mine):

> *"On the surface, VIV is just another telco company with its consortium of fixed, mobile, and fiber businesses. Yet look deeper, and you find a company* ***rapidly transforming into a digital, one-stop-shop hub for its 96M Brazilian customers.***
>
> *Vivo's core businesses* ***generate sustainable cash flows that allow the company to invest in its digital transformation.*** *These investments include an e-Health platform and major FinTech initiatives like consumer loans and credit cards. The end game is a Vivo-first Super-App for every consumer's need.*
>
> *At the current stock price,* ***you're getting the entire Digital Services business for free****."*

First, the raw numbers. VIV grew total revenues by 3%, with core revenues increasing by 8% and fiber revenues by a blistering 50%. This led to R 4.2B in recurring EBITDA (3% YoY growth) and R 1.3B in net profits (21% YoY growth).

What explains the modest 3% total revenue growth rate despite tremendous fiber growth and solid core revenue growth? VIV's non-core business revenue shrunk nearly 25%. As of Q2, it represented roughly 11% of total revenue compared to 15% last year.

Mobile Business

The company continued its mobile market dominance in Q2. Market share stayed flat at 33%, while VIV grew its customer base by nearly 9%. Most importantly, VIV nearly 4x'd its net additions on its post-paid business last year while reducing churn to an industry-low 1.3%.

Fixed Business

Q2 marked the second consecutive quarter of 15%+ fixed-line growth as revenues ballooned to R 1.062B. Reasons for the revenue growth include ARPU increase, OTT bundles, and higher net additions.

Fiber Business

VIV added another 300K net homes passed during Q2 to reach 4M households. Said another way, the company has nearly doubled the number of homes passed compared to Q2 2019.

Additionally, the company increased ARPU by nearly 6%, from R 86 to R 91. Most of this ARPU increased is attributable to heightened demand for faster internet speeds and a wider assortment of bundled content.

Here's the exciting part. More homes are opting for increased video bundles with their internet. This leads to lower churn rates as customers have a more significant number of services to their platform. So far, VIV has seen a 26% churn reduction in customers that add video bundles.

VIV's Digital Transformation

A large part of our bull thesis centered on VIV's ability to transform its business model from an antiquated, cap-ex heavy telco model to a digital-first, high margin offering. So far, things are working.

The company grew digital top-up revenues by 28% and increased its Vivo Easy customer base by 118%. Finally, the company increased digital net FTTH adds by 18.6%. Digital channels should continue to gain popularity with VIV's existing customer base as the company takes a larger share of its customers' habits (banking, shopping, healthcare, etc.).

Despite the impressive earnings beat, the company still trades at ~4x 2021E EBITDA generating 41% EBITDA margins. Oh, and they pay a 7% dividend yield.

Alright, onto Nintendo (NTDOY).

Thoughts on Nintendo (NTDOY) Trade Management

Nintendo (NTDOY) has had a rough year. The Japanese gaming company is down over 20% after hitting an Intra year high of $82/share in February.

NTDOY's shares have traded in complete asymmetry to its underlying business performance. For example, the company grew revenue 24% with 56% gross margins while generating over $1B in operating income during Q1.

Of course, tangible bear cases are surrounding the stock. Michael Fritzell (former guest on the podcast) outlined the bear case beautifully in his recent article. The most considerable risk is that we're at a peak in the Nintendo Switch sales cycle.

94% of NTDOY's revenues come from its Switch sales. Any slowdown in its hardware sales will have detrimental effects on top-line revenue.

The other bear argument is that a return to "pre-COVID" normal will reduce video game consumption. While I agree that more people will get outside and travel, I don't see this having a negative impact on NTDOY's key product, the Switch.

One of the leading customer attractions to the Switch is its portability. And again, customers that don't play on the Switch can still enjoy NTDOY's myriad mobile games like Mario Kart, etc.

All that to say, we remain bullish on the company's ability to transform from a console-led cycle to a subscription-based model.

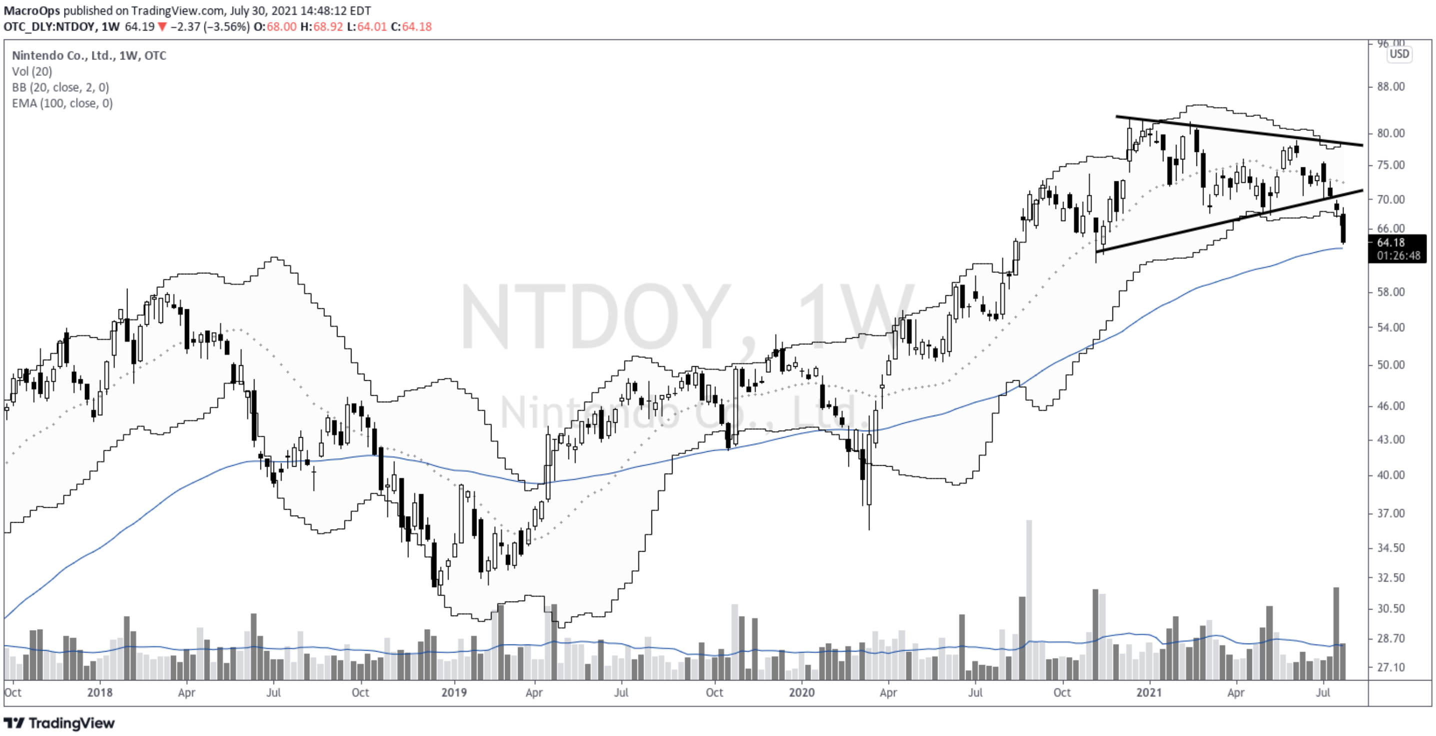
Now, onto trade management.

Removing Stop-Loss on NTDOY Long

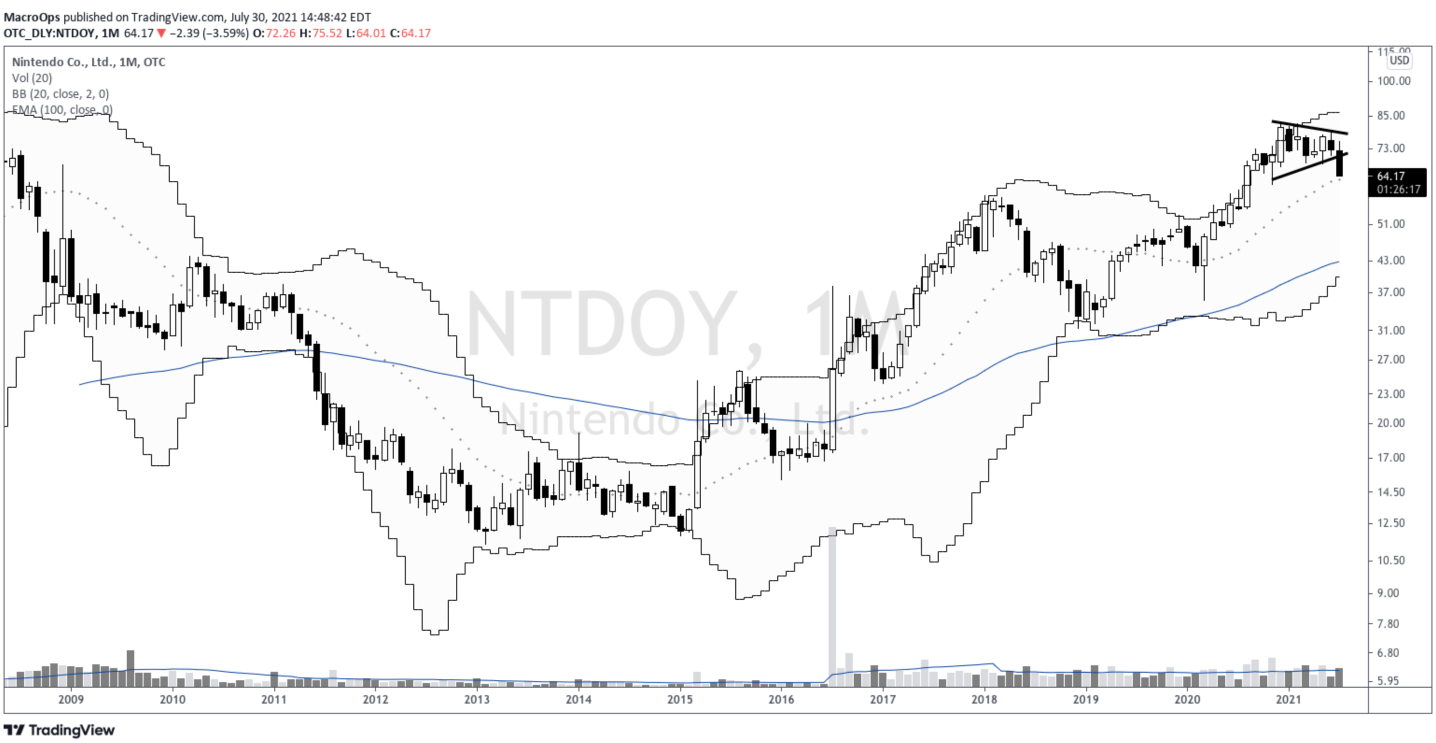
It's no secret that Cathie Wood is selling NTDOY in droves. Over the past two days, Cathie's firm *ARK Invest* sold nearly 100K shares. Currently, the stock trades around $64.30/share or 1% below our previously determined stop-loss point.

We're removing our stop-loss and will discretionarily manage the trade as we've done in the past with ARKK-led non-fundamental selling. We don't want to get stopped out of a long-term core holding because ARKK sold its shares, and the stock trades a mere 1% below our updated stop-loss price.

Plus, there are two technical reasons to remain bullish on the stock. First, check out the weekly chart. Notice how the price is drifting towards its 100EMA. This should act as temporary price support ahead of earnings.



Moreover, the monthly chart is approaching the midline of its Bollinger Bands (see below). The stock has historically honored this position, most recently during the March 2020 COVID crash.



That said, we'll monitor the upcoming earnings report for any signs of material weakness in our bullish theses and will quickly cut/trim if needed.

