genial Equity Research

USIMINAS

2Q23 Review: Like fire and ice...

LatAm Metals & Mining

Main takeaways:

(i) Sales in double-digit decline; **(ii)** Volume guidance announced for 3Q23 indicates stability, when normal would be progression; **(iii)** Steel realized price slightly better than expected; **(iv)** Mining with strong volume, but weaker prices; **(v)** Revenue with low-single digit contraction; **(vi)** COGS/t rising momentarily; **(vii)** EBITDA in continuous retraction, -53% q/q fall; **(viii)** Anemic net income; **(ix)** Given the poor short-term dynamics, with no catalysts for the stock to rise, we reiterate our **NEUTRAL rating**, with a **Target Price** of **R$7.50**, which leads the shares to a **narrow upside** of **+5.04%**.

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Company

USIM5 BZ Equity
Neutral

Price: R$ 7.14 (28-jul-2023)
Target Price 12M: R$ 7.50

Usiminas released today, on July 28th its results for 2Q23. Despite **reporting in-line numbers**, both steel and mining saw a retraction in their numbers, due to **rising costs and pricing difficulties**. In an update on the refurbishment of **Blast-furnace 3**, management commented in the conference call with analysts that there is an **expectation of resumption only for September**, possibly still resulting in negative impacts in 3Q23.

2Q23 Review

Sales in double-digit decline. Delivering a lower volume of steel production, due to the refurbishment of Blast Furnace 3 (BF3) in Ipatinga, Usiminas consumed its slab inventories in 2Q23, selling a total of 972kt (vs. -1.1% Genial Est.), in line with our estimates of getting closer to the upper guidance band of 900-1000kt. Still, total volume fell -10.7% q/q and -6.0% y/y. External market (EM) volumes came in line with our projections at 70Kt (vs. -2.8% Genial Est.), contracting by -31% q/q and -50% y/y. The domestic market (DM) showed the same trend, but at a slower pace, as it fell to 902kt (-3.4% q/q; -4.9% y/y).

Guidance for 3Q23 indicates stability, whereas normal would-be progression. Despite several price discounts in recent quarters, the guidance given for volume expectations in 3Q23 was the same as in 2Q23, between 900-1000kt. As we commented in our preview report, the normal behavior is for the Company to gain traction in terms of volume towards the 3Qs, which are the strongest quarters for steelmaking seasonality. So, what we would expect is a progression of sales guidance sequentially, reducing again only in the 4Qs.

Guidance being flat ends up demonstrating the challenging environment that the steel sector coming through, but also exposing how sensitive the BF3 operation is for Usiminas. Even though there is the dynamic of buying slabs to supply production during the period in which the blast furnace will be shuttered down, we believe that the lack of guidance progression can be partially attributed to the additional difficulties that the reform brings to the Company's productive capacity, which should only return in September, also impacting the next quarter.

Slightly better than expected realized price. With the expectation of new discounts for the automotive sector in the domestic market of around -12% q/q, which would reach ~80% of the clients' base of this segment in 2Q23, our projection was a retraction in the realized price in the domestic market. Although we had factored in our estimates that price increases for the distribution segment would partially offset price declines in the automotive segment, this offsetting dynamic occurred to a greater extent than we expected, bringing the realized price in the domestic market to R$6,080/t (+2.5% vs. Genial Est.), falling slightly by -1.6% q/q, although there is a larger retraction on an annual basis, at -16.9% y/y.

We highlight the realized price seen in the external market, which surprised positively even with our estimates already representing an upside. The strong decrease in volume allowed the Company to clean up its base and provide priority for pricing, which was reported at R$7,050/t (+15.2% q/q; +23.2% y/y), a figure +12.1% Genial Est. Thus, on a consolidated basis (DM + EM) the realized price stood at R$6,150/t (-0.5% q/q).

Mining with strong volume but weaker prices. Accelerating in production, MUSA (mining division) showed recovery after the heavy rains and preventive maintenance that took place last quarter, delivering a shipments volume of 2.4Mt (+2.8% vs. Genial Est.), with a sequential growth of +26.3% q/q. On the flip side, following the decline seen in the 62% Fe ore benchmark curve, which averaged ~US$111/t in 2Q23, being -US$14/t lower than the previous quarter, MUSA's realized prices stood at US$82/t (vs. +3.8% Genial Est.), falling -8% q/q and -23% y/y, also suffering jointly from the exchange rate, following the USD/BRL depreciation.

Revenue with low-single digit contraction. From the dynamics described, consolidated net revenue was reported at R$6.8bn (vs. -3.5% Genial Est.), slightly worse than our estimates. On the negative side, we have the steel division, which clocked in at R$5.9bn (-6.5% q/q; -22.8% y/y), due to a relevant volume loss not offset by a marginal increase in prices. While mining is the top line positive highlight, with the volume increase more than offsetting a decline in realized price, hitting R$905mn in 2Q23, up +15.5% q/q.

Table 1. Net Revenue Usiminas (2Q23 vs. Genial Est.)

(R$ millions)	2Q23 Reported	2Q23E Genial Est.	% R/E	1Q23 Reported	% q/q	2Q22 Reported	% y/y
Net Revenue	**6.887**	**7.140**	**-3,5%**	**7.255**	**-5,1%**	**8.531**	**-19,3%**
Steel	5.976	5.906	1,2%	6.390	-6,5%	7.738	-22,8%
Mining	905	907	-0,2%	784	15,5%	1.160	-22,0%
Steel Transformation	2.100	1.841	14,1%	2.134	-1,6%	2.416	-13,1%
Eliminations	(2.093)	(1.514)	38,3%	(2.052)	2,0%	(2.783)	-24,8%

Soure: Usiminas, Genial Investimentos

COGS/t rising momentarily. Due to the destocking, via working capital, the slabs purchased in recent quarters are being price-in P&L, due to the beginning of the BF3 stoppage, the COGS of 2Q23 is concentrated by the acquisition cost of the slabs sold, in a different way than usual. As we explained in our preview report, we believed that the cost of slabs in 2Q23 would be felt more intensely, given that there is a delay of ~60 days for the cost of the slabs purchased to pass through the P&L. At the beginning of the year (February to April) these slabs were purchased at much higher values, driven by the high price of iron ore, which experienced days of rally due to China's economic reopening. Therefore, COGS/t increased up to R$5,800/t, in line with our expectation of a quarter with less dilution capacity, rising +3.0% q/q and +2.4% y/y.

Within MUSA, COGS/t came in at R$285/t (+4.0% vs. Genial Est.), negatively impacted by the increase in ocean freight cost coupled with higher CFR sales, despite higher cost dilution capacity, meaning a +9.1% q/q rise. On a consolidated basis, total COGS ended up stable, with its nominal value at R$6.3bn (-1.0% q/q; -0.6% y/y), showing a slightly better efficiency performance than we expected (vs. -4.5% Genial Est.).

Table 2. COGS Usiminas (2Q23 vs. Genial Est.)

(R$ millions)	2Q23E Reported	2Q23E Genial Est.	% R/E	1Q23 Reported	% q/q	2Q22 Reported	% y/y
COGS	**(6.304)**	**(6.599)**	**-4,5%**	**(6.370)**	**-1,0%**	**(6.344)**	**-0,6%**
Steel	(5.651)	(5.745)	-1,6%	(5.875)	-3,8%	(6.144)	-8,0%
Mining	(685)	(639)	7,3%	(493)	38,9%	(654)	4,8%
Steel Transformation	(2.070)	(1.749)	18,4%	(2.054)	0,8%	(2.110)	-1,9%
Eliminations	2.102	1.533	37,1%	2.051	2,5%	2.563	-18,0%

Soure: Usiminas, Genial Investimentos

EBITDA in continuous retraction, -53% q/q fall. Affected by the two main units, which had a lower result in the period, consolidated EBITDA was R$366mn (vs. -1.3% Genial Est.), basically sticking with our projection, representing a -53.2% q/q and -81.0% y/y decline, with a slightly positive surprise in steel net revenue vs. our even more bearish estimates, but an unanticipated more negative dynamic in mining COGS. Steel division reported an Adjusted EBITDA of R$184mn (vs. R$72m Genial Est.), surprising positively on both price and costs, although still down -58.0% q/q. Mining division reported an Adjusted EBITDA of R$147mn (-38.6% vs. Genial Est.), pulled down by stronger than expected costs, bringing a -42.1% q/q decline.

Table 3. EBITDA Usiminas (2Q23 vs. Genial Est.)

(R$ millions)	2Q23E Reported	2Q23E Genial Est.	% R/E	1Q23 Reported	% q/q	2Q22 Reported	% y/y
Adjusted EBITDA	**366**	**371**	**-1,3%**	**783**	**-53,2%**	**1.930**	**-81,0%**
Steel	184	72	156,6%	438	-58,0%	1.454	-87,3%
Mining	147	239	-38,6%	254	-42,1%	385	-61,9%
Steel Transformation	2	50	-96,0%	65	-96,9%	269	-99,3%
Eliminations	34	10	240,2%	25	33,6%	(179)	-119,0%

Soure: Usiminas, Genial Investimentos

Anemic net profit. Usiminas' 2Q23 net profit was R$287mn (+0.1% vs. Genial Est.), perfectly in line with our estimate of a weaker quarter, halving from the R$544mn seen in 1Q23 and -72.9% y/y. Moreover, margin stood at 4.2% in 2Q23 vs. 7.5% in 1Q23, losing -3.3p.p. q/q in profitability.

Table 3. Income Statement Usiminas (2Q23 vs. Genial Est.)

(R$ millions)	2Q23E Reported	2Q23E Genial Est.	% R/E	1Q23 Reported	% q/q	2Q22 Reported	% y/y
Net Revenue	**6.887**	**7.140**	**-3,5%**	**7.255**	**-5,1%**	**8.531**	**-19,3%**
COGS	(6.304)	(6.599)	-4,5%	(6.370)	-1,0%	(6.344)	-0,6%
Adjusted EBITDA	**366**	**371**	**-1,3%**	**783**	**-53,2%**	**1.930**	**-81,0%**
EBITDA Margin (%)	5,3%	5,2%	0,12p.p	10,8%	-5,47p.p	22,6%	-17,31p.p
EBIT	**68**	**129**	**-46,9%**	**495**	**-86,2%**	**1.661**	**-95,9%**
EBIT Margin (%)	1,0%	1,8%	-0,81p.p	6,8%	-5,84p.p	19,5%	-18,48p.p
D&A	(262)	(242)	8,2%	(249)	5,4%	(220)	18,8%
Financial Result	205	155	32,1%	193	6,0%	(248)	-
Net Income	**287**	**287**	**0,1%**	**544**	**-47,3%**	**1.060**	**-72,9%**
Net Margin (%)	4,2%	4,0%	0,15p.p	7,5%	-3,33p.p	12,4%	-8,26p.p

Soure: Usiminas, Genial Investimentos

Our Take on Usiminas

Bringing overall numbers within expectations in 2Q23, Usiminas presented a weaker result, with a negative reflection of a profitability drop both in steel division, by new price adjustments and a COGS raised by the reform of Blast Furnace 3 (BF3), and in mining division, by the negative influence of the reference curve of 62% Fe, although a strong increase in shipments.

As we quoted throughout the report, the refurbishment of BF3, which started in April, is expected to end only in September, putting barriers in the next quarter to a gradual increase in sales volumes, which would be naturally expected from a 3Q.

Our take is that this would partially explain the maintenance of the 900-1000kt guidance, but the slow progress in sales is also due to **(i)** the slowdown in demand, as the slab inventory still remains high, around ~330kt related to the refurbishment. We believe that there is a lack of appetite in the market to absorb domestic steel, leaving slab consumption at very cooled levels, mainly due to **(ii)** unpleasant macroeconomic conditions with high interest rates. Even if the SELIC rate drops in 2H23, the decrease will be insufficient to bring demand to a healthier level. In addition, the effect is **(iii)** catalyzed by a process of increased penetration of imported steel within apparent steel use (ASU), in view of the reduction in the USD/BRL exchange rate, as well as successive price cuts that Chinese steelmakers implemented in 1H23.

Like fire and ice... Although normal for a refurbishment of such a size, given that it represents Usiminas' largest blast furnace, we see the new timetable for the refurbishment of BF3 as negative, potentially lasting more than 150 days (vs. 110 days initially expected), with an expectation of ramp-up after start-up that could vary in weeks, or even months. Despite these poor micro dynamics, we also see a challenging macro scenario for 2H23, with domestic flat steel trading at a high premium of ~20% vs. imported steel, pushing for new discounts going forward, which despite China operating with negative margins currently, results in contracts with automakers with shorter validity, already being renewed with stable prices, without passing-through cost hikes.

Therefore, we see a revenue without appreciation potential to accompany costs, which continue to rise and put pressure on Usiminas' margins. Like fire and ice, the lack of operation of BF3 to burn coal and produce steel comes against a cooling market in terms of demand, greatly complicating Usiminas' short term.

Moreover, with slab consumption creating a positive effect on working capital in 2Q23 by rebuilding i.o and coal inventories for the resumption of operations at BF3, the effect may be small in the next quarter. Trading at an **EV/EBITDA 23E** of **3.4x**, we reiterate our **NEUTRAL rating**, with a **12M Target Price** of **R$7.50**, implying a **narrow upside** of **+5.04%**.

Appendix: Usiminas

Figure 1. Usiminas – Income Statement in R$ Millions (Genial Est. 2023-2028)

Income Statement	2023E	2024E	2025E	2026E	2027E	2028E
Net Revenue	**28.619**	**29.885**	**31.815**	**32.864**	**34.653**	**37.003**
(+) Domestic Market	23.665	24.546	26.476	27.399	29.110	31.395
(+) Extern Market	4.954	5.339	5.339	5.465	5.543	5.609
(-) COGS	(25.631)	(26.828)	(27.150)	(27.818)	(29.377)	(30.337)
Gross profit	**2.988**	**3.057**	**4.665**	**5.046**	**5.276**	**6.666**
(-) Expenses	(1.615)	(1.680)	(1.728)	(1.749)	(1.822)	(1.943)
EBIT	**1.373**	**1.378**	**2.936**	**3.297**	**3.454**	**4.723**
(+/-) Financial Result	749	827	963	1.219	1.336	1.553
EBT	**2.366**	**2.469**	**4.163**	**4.780**	**5.054**	**6.540**
(-) Taxes	(667)	(736)	(1.312)	(1.522)	(1.615)	(2.120)
Net income	**1.699**	**1.733**	**2.851**	**3.258**	**3.439**	**4.420**
Profitability						
Net margin (%)	5,94%	5,80%	8,96%	9,91%	9,92%	11,94%

Figure 2. Usiminas– Cash Flow in R$ Millions (Genial Est. 2023-2028)

Cash flow (FCFF)	2023E	2024E	2025E	2026E	2027E	2028E
Net Revenue	**28.619**	**29.885**	**31.815**	**32.864**	**34.653**	**37.003**
(-) COGS	(25.631)	(26.828)	(27.150)	(27.818)	(29.377)	(30.337)
Adjuted EBITDA	**2.420**	**2.462**	**4.042**	**4.410**	**4.568**	**5.841**
EBIT	**1.373**	**1.378**	**2.936**	**3.297**	**3.454**	**4.723**
(-) Taxes	(667)	(736)	(1.312)	(1.522)	(1.615)	(2.120)
(+) D&A	1.008	1.084	1.105	1.113	1.114	1.118
(+/-) Δ WK	1.986	(125)	268	(293)	(550)	(121)
(-) Capex	(3.137)	(1.553)	(1.276)	(1.150)	(1.126)	(1.203)
FCFF	**564**	**48**	**1.721**	**1.444**	**1.277**	**2.398**

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	Definition	Coverage
Buy	Expected return above +10% in relation to the Company's sector average	**46%**
Neutral	Expected return between +10% and -10% relative to the Company's industry average	**44%**
Sell	Expected return below -10% in relation to the Company's sector average	**5%**
under Review	Under review	**5%**

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