genial Equity Research

USIMINAS

4Q23 Preview: Blast furnace reopening overcooked the shares

LatAm Metals & Mining

Main takeaways:

(i) Guidance stable, with prospects of reaching the upper band; **(ii)** Continued deterioration in the domestic market; **(iii)** We expect improved performance in the automotive segment for 2024; **(iii)** Third phase of the Néstor Kirchner project should help the foreign market; **(iv)** Iron ore prices will boost MUSA; **(v)** With mixed dynamics, we project consolidated revenue to shrink; **(vi)** COGS/t will continue to trend downwards; **(vii)** We estimate EBITDA is still negative, but progress is on the way; **(viii)** Despite improvement in operations, progress is still subtle and should not reverse losses; **(iv)** Although we have increased the **12M Target Price** to **R$8.70** (vs. R$7.00 previously), we believe that Usiminas' shares have risen too quickly, limiting further potential, which makes us reiterate our **NEUTRAL rating**. We even have a **downside** of **-6.09%**, since the **valuation seems to us to be slightly above the fair point**, trading at a **24E EV/EBITDA** of **5.2x**. We estimate a loss in 4Q23 for Usiminas, with a slightly more substantial improvement in results expected only for 2H24.

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Company

USIM5 BZ Equity
Neutral

Price: R$ 9.23 (01-Feb-2023)
Target Price 12M: R$ 8.70

Usiminas will report its 4Q23 results **on February 9th**, before the market opens. Our expectation is that the **figures will be slightly better than last quarter**. However, we do not expect a superior performance to the point of reversing the loss reported in 3Q23. **EBITDA should still be anemic**, and we project a **loss of around -R$123mn**.

Table 1. Shipments Summary (4Q23 Genial Est.)

(Thousand Tons - Kt)	Genial Est.				
Summary (Shipments)	**4Q23E**	**3Q23**	**% q/q**	**4Q22**	**% y/y**
Steel	986	1.020	**-3,3%**	963	**2,4%**
Iron Ore	2.308	2.391	**-3,5%**	2.400	**-3,8%**

Source: Usiminas, Genial Investimentos

Table 2. Income Statement Summary (4Q23 Genial Est.)

(R$ Millions)	Genial Est.				
Income Statement	**4Q23E**	**3Q23**	**% q/q**	**4Q22**	**% y/y**
Net Revenue	6.482	6.714	**-3,5%**	7.660	**-15,4%**
Adjust. EBITDA	86	(20)	**-**	579	**-85,2%**
Net Income	(123)	(166)	**25,8%**	-839	**85,4%**

Source: Usiminas, Genial Investimentos

Valuation and rating. Looking a little further ahead, despite a 4Q23 with expectations of difficulties, the dynamics in the automotive market (which seem to indicate an improvement), added to the end of the refurbishment of Blast Furnace 3 (BF3), should help Usiminas report a **2024 with less volatility** than we saw last year. Despite this, we would highlight some **uncertainties still linked to the high penetration of Chinese steel** for all players in the domestic steel market and **low demand at the top end** during the short term, especially for the industrial segment (~35% exposure within Usiminas' portfolio, similar weight to automotive).

As we'll cover in more detail throughout this report, factors that are positive and go hand in hand with our thesis commented on since the beginning of last year about **the unlocking of stock value after the refurbishment of BF3**, favored the shares between the end of last year and the beginning of 2024. As can be seen in this report, published in April 2023 (Usiminas: Why are the company's stock prices still falling despite a positive result?) in the "Our Take" section, we discussed that **three factors** would continue to impact the shares in 2023, but which seem to have been partially addressed by now.

As a reminder, almost a year ago we quoted: **(i)** regardless of having opened 2023 with a good EBITDA performance for 1Q23 (+35% q/q) and above consensus, discounts in the automotive steel segment would pose potential risks to sustainable revenue growth throughout the year. In addition, we point out that **(ii)** the steel sales guidance announced for 2Q23 signaled to the market a drop in revenue, due to a tighter market, considering the deteriorating market share of domestic steelmakers vs. imported steel, which had a gradual increase from the beginning of 2023 until December. As a final point, **(iii)** market confidence in Usiminas' case would only increase after the conclusion of the BF3 reform.

Despite beating consensus negativity on a few occasions over the past year, high real interest rates have made asset allocation more cautious, and the institutional investors we have been in contact with at the time preferred stocks with less instability and strong cash positions. If we look at it this way, given the three points mentioned, these investors' stock picking ended up overlooking Usiminas in 2023. Even though it reached an attractive valuation point, with an EV/EBTIDA below 3x at times last year, commodities investors have a certain difficulty in seeing long-term events, with the **short-term having a strong influence on the decision to structure long positions**. However, the situation looks (to some degree) better for 2024.

It's important to mention that **we were assertive on the three points we identified** at the beginning of last year. In the conference call with analysts after the 3Q23 report at the end of October, Usiminas commented that the BF3 reform would be completed in November. As a result, along with the downward SELIC rate and better prospects for 2024 in the automotive segment, Usiminas shares made a considerable gain in the final stretch of last year. The shares showed an impressive cumulative rise of +50% in just over 60 days, justified by the mitigation (at least partial) of the three points mentioned.

With the improvement coming in 2H24, our EBITDA projection is R$2.3bn (vs. R$1.2bn 23E). The expansion of the EBITDA estimate (vs. R$1.9bn 24E previously) justifies the decompression of EV due to the appreciation of the shares (+50% in ~60 days), so that we don't see the company discounted today. In other words, according to our view, all this increase in operating performance expectations has already been priced in.

Looking a little more closely at the risk reduction linked to these points, we'll comment on each one below. Regarding volume, the signaling of stable steel guidance for 4Q23 vs. 3Q23 is a positive sign, considering that 4Qs are usually quarters with lower seasonal demand, so the normal thing to expect would be downward guidance. From an interest rate point of view, we see the SELIC rate falling, which in turn increases risk appetite for institutional investors, as well as improving demand for durable goods, including light and heavy vehicles, whose segment accounts for ~1/3 of Usiminas' portfolio. With the end of the BF3 reform, we expect a slightly cooler COGS/t in 2024 vs. 2023, which should help take pressure off the company's margins.

Given the consolidation of these points, we are raising our **12M Target-Price** to **R$8.70** (vs. R$7.00 in our previous recommendation), generating a **downside** of **-6.09%**, with no upside catalyst after the quick appreciation of the shares. As a result, we still reiterate our **NEUTRAL rating.** Trading at an **EV/EBITDA 24E** of **5.2x** (vs.~5.5x historical average), we see little scope for the stock to continue its upward trend. In fact, the shares were slightly above the price we believe to be fair, bearing in mind that in the short term, for 4Q23 we still expect the company to report a loss and **with the reversal to profit in the bottom line only happening in 2Q24**, which would still be very timid. For companies linked to commodities, investors have a shorter investment period, so we believe that it is possible for the shares to give back part of the gains in the coming months due to the **lack of oxygenation**, which could **still last a few quarters**.

With the improvement that will come in 2H24, our EBITDA 2024 projection is R$2.3bn (vs. R$1.2bn 23E). **The expansion of the EBITDA estimate** (vs. R$1.9bn 24E previously) **justifies the decompression of EV due to the appreciation of the shares** (+50% in ~60 days), so we don't see the company discounted today. In other words, according to our view, all this increase in operating performance expectations **has already been priced in**.

4Q23 Preview: In detail!

Table 3. Net Revenue Usiminas (4Q23 Genial Est.)

(R$ millions)	4Q23E Genial Est.	3Q23 Reported	% q/q	4Q22 Reported	% y/y
Net Revenue	**6.482**	**6.714**	**-3,5%**	**7.660**	**-15,4%**
Steel	5.482	5.754	-4,7%	6.569	-16,6%
Mining	951	793	20,0%	812	17,1%
Steel Transformation	1.881	2.009	-6,4%	2.203	-14,7%
Eliminations	(1.831)	(1.841)	0,5%	(1.925)	4,9%

Source: Usiminas, Genial Investimentos

Guidance stable, with prospects of reaching the upper band. The company announced a sales guidance of 900-100kt for 4Q23, maintaining the same range as the previous two quarters, but higher than last year (4Q22) which was between 850-900kt. Our projection is for a total sales volume of 986kt Genial Est (-3.3% q/q; +2.4% y/y), approaching the upper limit of the guidance once again. Therefore, our estimates indicate a reduction vs. the 1,021Kt of 3Q23, and it is important to remember that 3Qs usually show an improvement in volume due to the favorable seasonality of the year, while 4Qs show a sequential downtrend.

Continued deterioration in the domestic market. Despite our expectation of achieving sales at a level closer to the upper band of the guidance, the issue of domestic demand is still crucial. Even if Usiminas manages to increase volume compared to the same period in 2022, this will be with the help of a greater redirection of sales to foreign markets, mainly Argentina, plus the effect of a slight improvement in the automotive market.

Even so, we believe that the company faces demand challenges in the domestic market due to steel imports from China. Over the course of 2023, we began to see a gradual increase in the penetration of imported steel within apparent consumption, reaching ~25% in December (+5.0p.p y/y), intensifying competition and promoting a price war, as we have commented on in various reports in our Metals & Mining coverage. As a result, we forecast a reduction in demand of -4.5% q/q in the domestic market in 4Q23, reaching 889kt Genial Est.

On the price side, for the domestic market we project a realization of R$5,544/t Genial Est. (-2.1% q/q; -16.8% y/y). The reduction, both on a q/q and annual basis, is in line with the difficulties faced by domestic steelmakers in a very tight environment, considering the sharp rise in the penetration of imported steel.

We expect an improvement in the automotive segment's performance for 2024. Although the domestic market is very weak, the segments most affected by Chinese steel imports are industry and, to a lesser extent, distribution. The automotive market, on the other hand, ended up showing an increase in steel consumption at the end of the year, due to the reduction in taxes (IPI, PIS and COFINS).

Although we considered the potential for an increase in demand to be not very elastic, the initiative by the Brazilian authorities to lower the value of cars by 1.5% to 10.8%, which was announced on May 25 through the change in tax rates we mentioned, ended up resulting in a slightly greater increase in appetite in the light vehicle segment than we had anticipated.

Regarding heavy-duty vehicles, due to the implementation of the Euro 6 standard, demand in 2023 remained significantly low, after the market anticipated a higher volume of purchases of Euro 5 vehicles. Considering that automakers' Euro 5 inventory are currently running low, companies that decide to renew their fleet in 2024 will have no choice but to purchase new Euro 6 vehicles, even at a higher cost.

Due to the strong correlation between demand for heavy vehicles and interest rates, we believe that a reduction in the SELIC rate will probably improve volumes in 2024. The last Copom meeting, held in yesterday, saw the fourth consecutive reduction in the SELIC rate. Copom made a total cut of -2p.p over the last year, closing at 11.75%. After yesterday Copom's decision, SELIC had a another cut of -0.5p.p, reaching 11.25%. The consensus is for a terminal SELIC rate of 9.25%, although our estimates point to a rate of 9.5% at the end of the year.

Considering that exposure to the automotive segment corresponds to ~1/3 of Usiminas' customer portfolio, we believe that 2024 has a better trend than we saw last year, both in terms of sales volume and, above all, with better pricing dynamics to steel sold to this segment. It's important to mention that Usiminas usually tries to phase in price adjustments for the automotive segment over the course of the year. First, the company adjusts 20%-30% of the segment's client portfolio in Q1 and 80%-70% of the portfolio in Q2. Last year, instead of passing on prices, we saw Usiminas promoting discounts, starting with 12% for ~80% of the automotive segment base. For 2024, we now believe that, given the new ANFAVEA figures released in December, the prospect of a warmer sector rules out the possibility of discounts like those seen in 2023, which is positive for Usiminas.

Third phase of the Néstor Kirchner project should help the foreign market. In the foreign market, we forecast an increase in sales for 98kt Genial Est. (+9.1% q/q; +7.0% y/y). According to our projection, this increase is due to the start of the third phase of the Néstor Kirchner gas pipeline construction project. Due to specific demand to meet the project, the quality of the mix should improve, pushing the price up sequentially. We therefore project a realized price for 4Q23 of R$5,635/t Genial Est. (+4.9% q/q; -32.0% y/y).

Iron ore price to boost MUSA. Within Usiminas Mining Division (MUSA), we project an increase in the realized price, reaching R$412/t Genial Est. (+24.3% q/q; +21.8% y/y). This increase can be attributed to the rise in the 62% Fe iron ore pricing curve, which reached an average of ~US$128/t (+12.1% q/q; +28.1% y/y). On the other hand, we forecast a reduction in volume, reaching 2,308kt Genial Est. (-3.5% q/q; -3.8% y/y). We expect the increase in price to more than offset the drop in volume, helping MUSA to post more favorable results.

With mixed dynamics, we project consolidated revenue to shrink. We project revenues of R$6.5bn Genial Est. (-3.5% q/q; -15.4% y/y). As a result, we expect total revenues to be slightly lower than in 3Q23 and to fall more sharply year-on-year, despite the increase in sales guidance compared to 4Q22. Among the business units, only mining (MUSA) is expected to grow in relation to the previous quarter, with revenues projected at R$951mn Genial Est. (+20% t/t; +17.1% y/y). However, as it is a segment with little weight in Usiminas, it does not have a significant impact on total revenue, due to the drop in the steel division, of which we project a decrease of -4.7% q/q and -16.6% y/y, reaching R$5.5bn Genial Est.

Table 4. COGS Usiminas (4Q23 Genial Est.)

(R$ millions)	4Q23E Genial Est.	3Q23 Reported	% q/q	4Q22 Reported	% y/y
COGS	**(6.282)**	**(6.539)**	**-3,9%**	**(6.887)**	**-8,8%**
Steel	(5.547)	(5.839)	-5,0%	(6.182)	-10,3%
Mining	(566)	(623)	-9,2%	(596)	-5,0%
Steel Transformation	(1.874)	(1.957)	-4,2%	(2.126)	-11,9%
Eliminations	1.705	1.881	-9,4%	2.018	-15,5%

Source: Usiminas, Genial Investimentos

COGS/t to continue downward trend. During the previous quarters, there was an increase in COGS/t due to the purchase of slabs for restocking, used during the refurbishment of Blast Furnace 3 (BF3). A little after the middle of 4Q23, BF3 was restarted and is in its ramp-up process, resulting in a reduction in slab costs and an increase in coke re-stocking. Due to the gradual ramp-up of production at BF3, the furnace has not reached the capacity that Usiminas intends to, resulting in a less significant increase in coke purchase costs compared to slab, which have fallen.

This is also because Usiminas now has a higher volume of coke production through metallurgical coal in its coking plants, generating less pressure on working capital through the stubbing process. As a result of this scenario, we project a reduction in COGS/t for 4Q23, estimating a value of R$5,619/t Genial Est. (-2% q/q; -10.5% y/y). Looking ahead, we anticipate that AF3 will reach its pre-established production level in ~60 days, increasing its coke consumption. However, due to weak demand from segments such as distribution and industrial, BF3 is unlikely to reach its maximum utilization rate, with an operation we estimate at 85% utilization after ramp-up, especially given the influx of Chinese steel as apparent consumption remains at these levels throughout 2024.

As a result, we are projecting COGS of R$6.2bn (-3.9% q/q; -8.8% y/y), with the nominal value decreasing, driven by **(i)** a reduction in steel shipments y/y and **(ii)** an improvement in COGS y/y dynamics after the reform of BF3.

Table 5. EBITDA Usiminas (4Q23 Genial Est.)

(R$ millions)	4Q23E Genial Est.	3Q23 Reported	% q/q	4Q22 Reported	% y/y
Adjusted EBITDA	**86**	**(20)**	**-**	**579**	**-85,2%**
Steel	(109)	(251)	56,6%	264	-
Mining	344	129	167,6%	171	101,0%
Steel Transformation	(12)	28	-	50	-
Eliminations	(138)	74	-	93	-

Source: Usiminas, Genial Investimentos

We estimate EBITDA is still negative, but progress is being made. As the steel division makes up a lot of the negative weight in EBITDA, even with mining (MUSA) offsetting some of it, we project a consolidated EBITDA of R$86mn Genial Est., which would represent an improvement on the previous quarter. This transition from a negative operating result in 3Q23 (-R$20mn) to a slightly higher EBITDA (+R$86mn 4Q23E) is attributable to a reduction in operating expenses and an increase in gross profit, mainly driven by MUSA. We anticipate that these factors will contribute to improving the company's margin, reaching 1.32% Genial Est. Although this percentage is considerably lower than Usiminas' historical levels, it is a recovery from the previous quarter, when the margin was -0.30%. The completion of the refurbishment of BF3 and its reactivation were crucial to this change, by reducing COGS, as mentioned earlier.

Despite the improvement in operations, progress is still subtle and should not reverse the loss. We project a loss of -R$123mn Genial Est. for 4Q23, and although there will be no reversal to profit on the bottom line, given the also negative result of 3Q23, with -R$166mn, it still represents a (subtle) improvement compared to previous periods. Lower costs and the better performance expected by us for the mining division, as iron ore prices accelerated in this period, were the factors that provided a small gain on the long way to reversing the loss, which should only occur in 2Q23.

Table 5. Income Statement Usiminas (4Q23 Genial Est.)

(R$ millions)	4Q23E Genial Est.	3Q23 Reported	% q/q	4Q22 Reported	% y/y
Net Revenue	**6.482**	**6.714**	**-3,5%**	**7.660**	**-15,4%**
COGS	(6.282)	(6.539)	-3,9%	(6.887)	-8,8%
Adjusted EBITDA	**86**	**(20)**	**-**	**579**	**-85,2%**
EBITDA Margin (%)	1,3%	-0,3%	-	7,6%	-6,24p.p
EBIT	**(164)**	**(245)**	**33,1%**	**(1.088)**	**85,0%**
EBIT Margin (%)	-2,5%	-3,6%	1,12p.p	-14,2%	11,68p.p
D&A	(249)	(250)	-0,3%	(234)	6,4%
Financial Result	8	(559)	-	376	-97,8%
Net Income	**(123)**	**(166)**	**25,8%**	**(839)**	**85,4%**
Net Margin (%)	-1,9%	-2,5%	0,57p.p	-11,0%	9,06p.p

Source: Usiminas, Genial Investimentos

Our Take on Usiminas

Despite the challenges foreseen for this quarter, with our expectation of a still pressured result for the following quarter (4Q23 and 1Q24), improvements in the automotive market and the completion of the Blast Furnace 3 refurbishment could lead to less volatility for Usiminas in 2024 and a gradual improvement throughout the year to reach a 24E EBITDA of R$2.3bn (vs. R$1.2bn 23E), basically 2x more than our estimate for the close of 2023. Despite the high penetration of Chinese steel in the domestic market, optimism about the steelmaker's shares is increasing.

At the end of last year, in conversations with institutional investors, we noticed many of them pulling back on their short positions. Now, we're seeing a very interesting effect of reduced pessimism, linked to an improvement in the components that previously prevented the stock from rising, even in the face of very low multiples.

The market quickly anticipated the improvement. The benefits of **(i)** the refurbishment of Blast Furnace 3, improving operational efficiency and reducing uncertainties with its completion in November, as well as **(ii)** the increase in demand for the automotive market, with the **(iii)** reduction in interest rates, were the factors that justified the rise in shares seen between the end of last year and the beginning of this year.

Long on Usiminas and short on Gerdau. Is it making sense? We know that there are institutional investors who have taken long positions in Usiminas and short positions in Gerdau in recent days. However, we believe that the pressures on Gerdau vs. the strong highs in Usiminas have reached a point beyond fundamentalist pricing, at least in our interpretation. Another factor that may have helped create this idea between the two players is the dynamics related to mining. Gerdau is less susceptible to the volatility of mining-related assets, for better or worse...

In this case, as the steel industry is weak and mining is on the rise, investors are looking to position themselves in stocks that have greater exposure to mining. Gerdau, in this case, is losing the fight. However, MUSA's (Usiminas Mining Division) exposure is very small. MUSA should represent ~15% of Usiminas' consolidated revenue now in 4Q23 (vs. ~12% in 3Q23), so we don't deny that there is progress in relation to the penetration of Mining within the results. Yet, Usiminas is a mostly steel company, and we believe it is unjustifiable to invest in Usiminas because it has some exposure to mining. On the other hand, we buy rated both true mining companies (Vale and CMIN).

Blast furnace reopening overcooked the shares. As the share prices have appreciated very strongly in such a short period, we are currently unable to consider a reasonable gap to fair value that would justify a buy rating and all the excitement surrounding Usiminas' name. It seems that the improvement in EBITDA for 2024E, as well as the end of the uncertainties of BF3, **have already been incorporated into the shares**. In fact, looking at how investors may price the stock in the coming months, we believe it might give back some of the gains, given our estimates of at least **three weak quarters ahead** (4Q23, 1Q24 and 2Q24).

Although our **12M Target Price** has been raised to **R$8.70** (vs. R$7.00 previously), there is still very little room for further upside at this time. We still reiterate our **Neutral rating**, as we see a **downside** of **-6.09%**. So, we even believe that the **valuation has stretched above the fair point**, with a **24E EV/EBITDA** of **5.2x**. We expect Usiminas to post a loss in 4Q23, with improvements to happen only **by the middle of 2024** in our model.

Appendix: Usiminas

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

Income Statement	2023E	2024E	2025E	2026E	2027E	2028E
Net Revenue	**27.339**	**29.356**	**29.270**	**29.451**	**29.687**	**29.458**
(-) COGS	(25.497)	(26.528)	(24.992)	(24.740)	(25.007)	(24.558)
Gross Profit	**1.843**	**2.828**	**4.278**	**4.711**	**4.680**	**4.900**
(-) Expenses	(1.687)	(1.508)	(1.513)	(1.628)	(1.455)	(1.424)
Adjusted EBITDA	**1.215**	**2.358**	**3.858**	**4.233**	**4.475**	**4.466**
(-) D&A	(1.011)	(1.038)	(1.093)	(1.150)	(1.250)	(990)
EBIT	**375**	**1.320**	**2.765**	**3.083**	**3.225**	**3.476**
(+/-) Financial Result	247	(240)	(329)	(238)	(126)	(61)
(-) Taxes	(62)	(354)	(666)	(772)	(838)	(919)
Net income	**543**	**866**	**1.910**	**2.212**	**2.401**	**2.636**
Profitability						
Net margin (%)	1,99%	2,95%	6,52%	7,51%	8,09%	8,95%

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

Cash Flow (FCFF)	2023E	2024E	2025E	2026E	2027E	2028E
Net Revenue	**27.339**	**29.356**	**29.270**	**29.451**	**29.687**	**29.458**
(-) COGS	(25.497)	(26.528)	(24.992)	(24.740)	(25.007)	(24.558)
Adjusted EBITDA	**1.215**	**2.358**	**3.858**	**4.233**	**4.475**	**4.466**
EBIT	**375**	**1.320**	**2.765**	**3.083**	**3.225**	**3.476**
(-) Taxes	(62)	(354)	(666)	(772)	(838)	(919)
(+) D&A	1.011	1.038	1.093	1.150	1.250	990
(+/-) Δ WK	967	(357)	383	(265)	82	104
(-) Capex	(3.002)	(1.813)	(1.559)	(2.573)	(2.058)	(1.955)
FCFF	**(712)**	**(166)**	**2.015**	**623**	**1.661**	**1.696**

Disclosure Section

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	Definition	Coverage
Buy	Expected return above +10% in relation to the Company's sector average	**49%**
Neutral	Expected return between +10% and -10% relative to the Company's industry average	**41%**
Sell	Expected return below -10% in relation to the Company's sector average	**5%**
under Review	Under review	**5%**

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