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USIMINAS

4Q23 Review: The man in the iron mask

LatAm Metals & Mining

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Company

USIM5 BZ Equity
Neutral

Price: R$ 9.28 (09-Feb-2024)
Target Price 12M: R$ 8.70

Main takeaways:

(i) How the **provision reversals ended up reflecting in EBITDA**? The total amount of **R$532mn related to actuarial liabilities** was reversed almost entirely within the steel division. Adjusted EBITDA without the non-recurring effects would have been -R$42mn, an apathetic performance and even worse than our estimates; **(ii)** Robust steel volume in the face of difficulties, helped by the foreign market; **(iii)** Steel prices suffering in the domestic market, but with a better mix in the foreign market; **(iv)** Mining division takes advantage of low grade scenario to pass on price and maintain volume; **(v)** Steel revenue down -1.6% q/q, to R$5.8bn (+3.5% vs. Genial Est.) and mining revenue up +32.3% q/q, clocking in at R$1bn (+10% vs. Genial Est.), helping to mitigate the impact of steelmaking. Total revenue reached R$6.7bn (+4.6% vs. Genial Est.), up a marginal +1% q/q; **(vi)** Mining COGS/t rose +5.4% q/q to R$275/t (+16% vs. Genial Est.), coming in much higher than we expected; **(vii)** Artificial increase in net income to reach R$975mn (vs. -R$123mn in 3Q23). Therefore, we cannot attribute recognition of an improvement in operations to justify the strong increase in net income, since the positive result comes from the reversal of provisions; **(viii)** For us, **there is no reason to be much more bullish on the stock**. The shares seem to have already priced in the improvements that the BF3 reform will bring. We reiterate our **NEUTRAL rating**, with a **12M Target Price** of **R$8.70**, setting up a **downside** of **-6.25%**.

Usiminas released its 4Q23 results on February 9th. Operating figures were in line, with **revenues up slightly**, driven by **Steel segment sales above guidance**, but with **cost dynamics slightly worse** than our projections. If we take this effect into account, **EBITDA would have been moderately lower** than our estimate. Reaffirming what we said in our earnings preview. **Operating performance is not yet at the ideal point** to justify the great optimism we have seen around the name.

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

(Thousand Tonnes - kt)	Reported	Genial Est.					
Summary (Shipments)	**4Q23**	**4Q23E**	**% R/E**	**3Q23**	**% q/q**	**4Q22**	**% y/y**
Steel	1.041	986	**5,5%**	1.020	**2,1%**	963	**8,1%**
Iron Ore	2.383	2.308	**3,3%**	2.391	**-0,3%**	2.400	**-0,7%**

Source: Usiminas, Genial Investimentos

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

(R$ millions)	Reported	Genial Est.					
Income Statement	**4Q23**	**4Q23E**	**% R/E**	**3Q23**	**% q/q**	**4Q22**	**% y/y**
Net Revenue	6.781	6.482	**4,6%**	6.714	**1,0%**	7.660	**-11,5%**
Adjusted EBITDA	625	86	**628,3%**	(20)	**-**	579	**7,9%**
Net Income	975	(123)	**-**	(166)	**-**	(839)	**-**

Source: Usiminas, Genial Investimentos

There were **non-recurring effects** that **inflated EBITDA** and **net income**. Investors shouldn't be fooled here: the **sector environment is still in a bad shape** in the short term and the **improvement in COGS/t is only gradual**, so there is still a way to go before we see a substantial improvement in results. The increase in EBITDA and net income compared to our estimates was due to the **reversal of provisions**.

Reversals of provisions were the highlight... The reversals affected operating expenses (SG&A), before the EBITDA line, generating a positive effect of ~R$600mn, due to the return of amounts linked to actuarial liabilities (+R$532mn) and the loss of tax credits at Soluções Usiminas (+R$118mn). In addition, expenses with idle equipment decreased, also generating a gain (+R$50mn) due to the return of equipment refurbished by the company.

For the mining unit (MUSA), although **revenue was higher than expected**, due to an increase in the volume of shipments, costs were more pressured, affected by inventory adjustments on material inventory, geological inflation, and greater difficulties in moving up mass, with a review of RoM stockpiles. As a result, the **COGS/t of mining was a negative point**.

Incorporation of the "Steel Transformation" line into the "Steel" line. As of this 4Q23 release, Usiminas has been reporting the Steel Transformation line within the Steelmaking figures. In the company's view, as the transformer's biggest client was Usiminas Siderurgia, this generated a very large adjustment in eliminations. Now, therefore, eliminations have decreased due to fewer intercompany transactions being reported between businesses that were very similar. To make the figures easier to read and compare with our estimates published in our preview report, we have taken the liberty of making adjustments to our figures to better reflect the aforementioned dynamics.

Valuation and rating. Although in our assessment Usiminas did not perform well from an operational point of view in 4Q23, the dynamics of the automotive market and the completion of the refurbishment of Blast Furnace 3 (BF3) point to potential improvements for the company over the course of 2024. However, challenges remain due to the high penetration of Chinese steel and relatively low demand in the short term, especially in the industrial segment.

We know that **Usiminas adopted a 6% price increase** for the “grande rede” (**distribution**) as of February on flat steel, which represents **~30% of sales**, but the **industrial segment**, with **~40% sales penetration**, has more **leeway to avoid adjustments**. We believe that the segment price may even continue to fall due to a lack of demand. Therefore, the net effect for 1Q24 on Usiminas' total realized price should be lateralization, reflecting still tight margin conditions.

The stock registered a significant increase of +50% in ~60 days due to the mitigation of identified factors (falling interest rates and the end of the refurbishment of BF3). However, we still believe that the **market has priced in too early an improvement** in the figures, which should be slower than some investors imagine, as we quoted in our preview report (link here). The 4Q23 result proves this... Operationally, it was a weak result, except for the changes in provisions and accounting reversals. We reiterate our **NEUTRAL rating**, with a **12M Target Price** of **R$8.70**, setting up a **downside** of **-6.25%**.

Straight to the point!

How the provision reversals ended up reflecting in EBITDA? In 4Q23, Usiminas recorded a consolidated EBITDA of R$625mn (+7x. vs. Genial Est.), also reversing the negativity of 3Q23 (-R$20mn). However, this much stronger than estimated performance was not the result of an operational improvement. As we commented in the introductory section of the report, the company booked a reversal of provisions in the amount of R$532mn related to actuarial liabilities.

This reversal, when analyzed by segment, was incorporated into the Steel unit, which achieved an EBITDA of R$267mn (vs. -R$165m in 3Q23). If we exclude the value of the liability reversal from the effect on SG&A, we actually see a deterioration in this segment's operating performance compared to the previous quarter. So, the truth is that operationally things haven't improved yet.

Steel COGS/t did not cool down as expected. We were waiting for a reduction in COGS/t due to the completion of the BF3 reform, reducing the costs of slabs going through the P&L. However, we saw 4Q23 with a COGS/t of R$5,894/t (+2.4% vs. Genial Est.), basically flat q/q. On the positive side, Usiminas mentions: **(i)** related operational efficiency gains in the coking plants, which became more in demand at the end of the BF3 reform, as well as **(ii)** optimization of the metal load. However, bringing a negative dynamic to costs, there was also a point to counterbalance. The company included **(iii)** non-recurring effects of -R$214/t for obsolescence provisions and low turnover.

Our analysis suggests that, as demand is weak, Usiminas probably has inventory that has been paralyzed, losing some of its characteristics and becoming obsolete. As a result, the company has made provisions for inventory losses in COGS/t, preventing it from benefiting from the improved efficiency brought about by the coking plants and the reform of BF3.

Sales volume guaranteed, with prices above estimates. Steel sales reached 1,041kt (+5.6% vs. Genial Est.), slightly above guidance and accelerating +2.1% q/q and +8.1% y/y. We categorize this as a good figure, exceeding expectations. The company also recorded a realized price slightly above expectations, reaching R$5,658/t (+1.8% vs. Genial Est.), indicating stability sequentially, with a drop of -17% y/y, due to tighter conditions in the bearish phase of the steel cycle.

As for MUSA's activities, iron ore shipments reached 2.3Mt (+3.3% vs. Genial Est.), representing a drop of -0.3% q/q and -0.7% y/y. Although there was a sequential slowdown, it was milder than expected. The realized price was R$440/t (+6.8% vs. Genial Est.). We believe that the company capitalized on the favorable demand for low-grade iron ore.

4Q23 Preview: In detail!

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

(R$ millions)	4Q23 Reported	4Q23E Genial Est.	% R/E	3Q23 Reported	% q/q	4Q22 Reported	% y/y
Net Revenue	**6.781**	**6.482**	**4,6%**	**6.714**	**1,0%**	**7.660**	**-11,5%**
Steel	5.890	5.689	3,5%	5.988	-1,6%	6.915	-14,8%
Mining	1.049	951	10,3%	793	32,3%	812	29,1%
Eliminations	(158)	(158)	-	(67)	-	(67)	-

Source: Usiminas, Genial Investimentos

Robust steel volume in the face of difficulties, helped by the foreign market. Despite delivering a volume of 1,041kt (+5.6% vs. Genial Est.), up +2.1% q/q and +8.1% y/y, Usiminas did not indicate official guidance for 1Q24. Looking at 4Q23, domestic sales (DM) reached 920Kt (+3.5% vs. Genial Est.), down -1.2% q/q and up +5.5% y/y. We believe that the sequential slowdown indicates the tighter domestic steel market in Brazil. Even so, we would point out that Usiminas performed a little better than we had imagined regarding volume.

The foreign market (FM) closed 4Q23 with 121Kt in sales (+23% vs. Genial Est.), with a strong boost from the Néstor Kirchner gas pipeline construction project. As we said in our preview report (Usiminas Preview 4Q23), the bidding for the third phase of the project would give a boost to sales in the foreign market. Even so, the increase was higher than our estimates, with a rise of +34% q/q and +32% y/y. This double-digit growth in the foreign market helped to mitigate the still weak sales in the domestic market, consolidating a more robust total volume, despite the difficult macro scenario for steelmakers in Brazil.

Steel prices suffering in DM, but with a better mix in FM. In 4Q23, we noted that Usiminas continued to face significant challenges, mainly due to the persistence of exports from China, which have exploited markets such as Brazil, creating greater competition for market share. As a result, the prices obtained by Usiminas continued to be weak, especially in the domestic market (DM), which was reported at R$5,604/t (-5.8% q/q). On the other hand, the situation in the foreign market (FM) was different in 4Q23. In line with what we said in the preview, both the volume and the realized price would witness a sequential rise due to the Néstor Kirchner project, since the oil and gas industry needs a mix with greater added value. The price then rose to R$6,066/t (+11.2% q/q), illustrating that domestic dynamics actually had a more significant impact on the aggregate realized price (DM+FM), which was sideways in 4Q23, reported at R$5,658/t (+1.8% vs. Genial Est.).

MUSA takes advantage of low-grade scenario to pass on price and maintain volume. Usiminas' mining business division (MUSA) took advantage of the wave of demand for low grade iron ore, promoted by weak industrial activity in China. The price of iron ore in the 62% Fe benchmark reached an average of US$128/t, a considerable acceleration of 12.3% q/q. Despite the strong expansion, the steel mills don't seem to be adhering to the quality premium, since the expectation of future demand (not in the present times) was one of the reasons for the sharp rise in iron ore prices by the end of last year.

The other reason seems to be the supply side. Ports in China closed 2023 with the lowest level of inventory in the last 5 years.

As such, we believe that there is a detachment of real demand from the 62% Fe reference spot curve that was in force during 4Q23. This dynamic justifies the greater demand for low-quality iron ore, since steel mills in China continue to lack real demand for steel and are producing at high utilization rates mediated by local government incentives. As Usiminas' iron ore is more geared towards low grade, there was a greater marginal benefit sequentially in the realized price, which rose to R$440/t (+6.8% vs. Genial Est.), composing a strong rise of +32.8% q/q and +30% y/y.

Steel revenue down and mining up q/q. In line with the trend observed in our preview report, we commented that the penetration of the mining business within revenues would rise in 4Q23. MUSA (Usiminas' mining division) reached revenues of R$1bn (+10% vs. Genial Est.), a relevant increase of +32.3% q/q and +29.1% y/y, making up 15% of Usiminas' total revenues vs. 12% in 3Q23. The steel unit, on the other hand, reported a marginal drop of -1.6% q/q and a stronger reduction of -14.8% y/y. Even so, it also came in above our expectations, reaching R$5.8bn (+3.5% vs. Genial Est.). Total revenue reached R$6.7bn (+4.6% vs. Genial Est.), up +1.0% q/q and down -11.5% y/y.

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

(R$ millions)	4Q23 Reported	4Q23E Genial Est.	% R/E	3Q23 Reported	% q/q	4Q22 Reported	% y/y
COGS	**(6.636)**	**(6.282)**	**5,6%**	**(6.539)**	**1,5%**	**(6.887)**	**-3,6%**
Steel	(6.136)	(5.871)	4,5%	(5.964)	2,9%	(6.339)	-3,2%
Mining	(655)	(566)	15,7%	(623)	5,1%	(596)	9,9%
Eliminations	155	155	-	48	-	48	-

Source: Usiminas, Genial Investimentos

Mining cost upscaled. Mining COGS/t rose +5.4% q/q to R$275/t (+16% vs. Genial Est.), coming in much higher than we expected, given the potential level of fixed cost dilution by shipment volume, which was flat in 4Q23. The company claims that this increase is due to one-off inventory adjustments on strategic materials in the amount of R$8mn and a review of RoM stockpiles for future use.

Increased EBITDA does not reflect reality. The steel unit's adjusted EBITDA was R$267mn in 4Q23, a strong increase compared to the negative activity in 3Q23 (vs. -R$165m) and to our estimates (7x above Genial Est.). However, this does not mean that the quarter's operation was exemplary. To understand how a setback in steelmaking revenues (-1.6% q/q) and a sequential stability in the cost per ton can generate a representative advance in EBITDA, we need to look at the "Other Expenses" line.

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

(R$ millions)	4Q23 Reported	4Q23E Genial Est.	% R/E	3Q23 Reported	% q/q	4Q22 Reported	% y/y
Adjusted EBITDA	**625**	**86**	**628,3%**	**(20)**	**-**	**579**	**7,9%**
Steel	267	(289)	-	(165)	-	392	-31,9%
Mining	327	344	-5,0%	129	153,5%	171	90,9%
Eliminations	31	31	0,0%	16	93,8%	16	93,8%

Source: Usiminas, Genial Investimentos

The company reversed provisions in 4Q23, related to an actuarial liability account, amounted in R$532mn, added before the EBITDA line in SG&A (Other Expenses) and entirely in the steel segment. In other words, a rate of provision, compounded over ~10 years, ended up being withdrawn all at once, generating a large one-off effect as a result. It is worth mentioning that the provisions did not have a cash flow effect. Mining EBITDA stood at R$327mn in 4Q23, an increase of +153% q/q, with no major consequences related to the reversal of provisions. Despite the significant growth, MUSA's performance was below our projections (-5% vs. Genial Est.) due to higher cost dynamics.

Total EBITDA stood at R$625mn (vs. -R$20mn in 3Q23), with growth inflated by the dynamics of provision reversals. Adjusted EBITDA without non-recurring effects would have been -R$42m, an apathetic performance and even worse than our estimates.

Artificial increase in net income. The increase in Usiminas' net income in 4Q23 to R$975mn (vs. -R$123m in 3Q23), reversing last quarter's loss, follows the same dynamics as EBITDA mentioned above. Therefore, we cannot attribute recognition of an improvement in operations to justify this strong increase, since the positive result comes from the reversal of provisions.

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

(R$ millions)	4Q23 Reported	4Q23E Genial Est.	% R/E	3Q23 Reported	% q/q	4Q22 Reported	% y/y
Net Revenue	**6.781**	**6.482**	**4,6%**	**6.714**	**1,0%**	**7.660**	**-11,5%**
COGS	(6.636)	(6.282)	5,6%	(6.539)	1,5%	(6.887)	-3,6%
Adjusted EBITDA	**625**	**86**	**628,3%**	**(20)**	**-**	**579**	**7,9%**
EBITDA Margin (%)	9,2%	1,3%	7,89p.p	-0,3%	9,51p.p	7,6%	1,66p.p
EBIT	**373**	**(164)**	**-**	**(245)**	**-**	**(1.088)**	**-**
EBIT Margin (%)	5,5%	-2,5%	8,02p.p	-3,6%	9,14p.p	-14,2%	19,7p.p
D&A	(289)	(249)	15,9%	(250)	15,5%	(234)	23,2%
Financial Result	65	8	702,2%	(559)	-	376	-82,7%
Net Income	**975**	**(123)**	**-**	**(166)**	**-**	**(839)**	**-**
Net Margin (%)	14,4%	-1,9%	16,27p.p	-2,5%	16,84p.p	-11,0%	25,33p.p

Source: Usiminas, Genial Investimentos

Our Take on Usiminas

In general terms, Usiminas posted another weak result in 4Q23, which was inflated by provision reversals that do not constitute operating performance. Despite this, the volume in the steel business division came in higher than our estimates (once again...). We would point out that Usiminas consistently manages to surprise in volume, and this is a positive point. However, the sector dynamics and the segments to which the company is most exposed remain very challenging, especially in relation to pricing.

FCF generation in line, with a strong release of working capital. The release of working capital continues to drive cash flow generation, with a mark of R$240mn (-5.8% vs. Genial Est.). The release of working capital was R$1bn, slightly above our expectations. Our analysis suggests that from 1Q24 onwards, the release of working capital will decrease, with the end of the slab destocking process, in order to weight EBITDA (and therefore the operation) more heavily within cash flow.

The man in the iron mask. Usiminas did not have a good operating performance in 4Q23, but we do expect an improvement throughout 2024 due to the dynamics of the automotive market and the refurbishment of Blast Furnace 3 (BF3). On the other hand, challenges remain regarding the high penetration of Chinese steel and low demand, especially in the industrial segment. Usiminas increased prices by 6% for “grande rede” (distribution segment), which represents around 30% of sales. However, the industrial segment, which accounts for ~40% of sales, can avoid readjustments, leading to potential price drops. Therefore, the net effect on Usiminas' price in 1Q24 should be the stabilization, indicating still tight margin conditions.

At the earnings conference call, management confirmed that they feel confident about the **turnaround in net operating income in 1Q24**, as we also have in our model. Even so, we expect a weaker, but gradually better 1Q24 and 2Q24, until the 3Q24 comes along, when the seasonal peak for steel and the effect of the reduction in the SELIC rate on the real economy should really coincide to improve Usiminas' figures more strongly. Until then, we're not bullish on the stock.

The company's 4Q23 result confirms that the situation is still weak, since the **improvement in EBITDA came from a non-recurrence**, with the reversal of provisions, and **not from a healthier environment** from an operational point of view. For us, the **EBITDA and net income figures masked the company's bad performance in 4Q23**. We know there are better days ahead for Usiminas, but there's no reason to be overly optimistic. The shares seem to have already incorporated the improvements that the BF3 reform will bring. We reiterate our **NEUTRAL rating**, with a **12M Target Price** of **R$8.70**, setting up a **downside** of **-6.25%**.

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**

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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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