GERDAU

1Q24 Preview: Not to depend on the stroke of a pen

LatAm Metals & Mining

Main takeaways:

(i) Realized prices still suffer from the macro context with a -11.9% y/y drop at Brazil BD; **(ii)** Volumes should recover on a sequential basis, growing +4.3% q/q; **(iii)** Difficult start to the year for South America BD, driven by inflation and interest rates; **(iv)** Special Steel Unit: USA stable and Brazil gradually gaining traction; **(v)** Revenue with low double digit improvement on a quarterly basis; **(vi)** Costs expected to increase in 1Q24 and 2Q24, but generate high expectations of a reduction in 2025; **(vii)** EBITDA growing q/q and falling y/y; **(ix)** Net income in strong sequential advance; **(x)** Steel macro scenario continues to be the stumbling block; **(xi)** Increase in steel import tariffs, with discussions gaining more momentum in the US and Brazil; **(xii)** Cost cuts should be the company's driver, so that there is no dependence on the government's stroke of a pen to increase tariffs; **(xiii)** Negotiating a **24E EV/EBITDA of 4.2x** (vs. 5x historical average), **considering cost cuts** that the company intends to make over this and next year, we calculate our **12M Target Price at R$23.40** (vs. R$20.42 previously after bonus). We believe that **this improvement was not priced in by consensus**. We are therefore **upgrading to BUY rating**, with an **upside** of **25.81%**.

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Company

GGBR4 BZ Equity
Buy

Price: R$ 18.60 (29-Apr-2024)
Target Price 12M: R$ 23.40

Gerdau will release its **1Q24 results on May 2nd**, after the market closes. The main change in our assumptions is the incorporation of the **cost reduction plan** announced by the company. With the guidance given by management on cutting costs, we expect a **significant margin improvement in 2025**. We believe that this margin gain is not priced in by consensus, and we are therefore **upgrading Gerdau's rating to BUY**. (more details throughout the report).

Table 1. Shipments Summary (1Q24 Genial Est.)

(Thousand Tonnes - kt)	Genial Est.				
Summary (Shipments)	**1Q24E**	**4Q23**	**% q/q**	**1Q23**	**% y/y**
Brazil BD	1.322	1.268	**4,3%**	1.256	**5,3%**
North America BD	916	885	**3,5%**	1.104	**-17,0%**
South America BD	222	243	**-8,7%**	281	**-21,1%**
Special Steel BD	348	339	**2,6%**	355	**-2,2%**

Source: Gerdau, Genial Investimentos

Table 2. Income Statement Summary (1Q24 Genial Est.)

(R$ millions)	Genial Est.				
Income Statement	**1Q24E**	**4Q23**	**% q/q**	**1Q23**	**% y/y**
Net Revenue	16.317	14.716	**10,9%**	18.873	**-13,5%**
Adjusted EBITDA	2.699	2.039	**32,4%**	4.328	**-37,6%**
Net Income	1.270	588	**116,0%**	2.964	**-57,2%**

Source: Gerdau, Genial Investimentos

Regarding 1Q24, we expect sequentially better data, with an increase in revenue and a **substantial rise in EBITDA and Net Profit**, taking the t/t comparison as a reference. On a y/y basis, the company continues to be pressured by lower price dynamics in Brazil and cooler demand in the US. For the main business divisions, with the exception of South America BD, we should see sequential sales growth. We expect Brazil BD to be the only one to grow volume on a yearly basis, given the efforts we believe Gerdau has made to **regain market share** in its Brazilian operations.

Valuation and rating. Specifically, for 1Q24, we expect opposite realized price dynamics for the different divisions, since the company tends to maintain a stable price level in Brazil, focusing more on volume to execute a resumption of market share, with a slight increase caused more by an improvement in the product mix than by a price pass-through.

Although Gerdau is less exposed to flat steel compared to its peers in Brazil, we still see impacts from the volume of Chinese steel imports on the domestic market. On the other hand, the company raised prices in North America, restoring the metal spread after the increase in scrap prices last quarter.

Regarding South America, we would like to remind investors that last quarter the company included a one-off mark-to-market effect in the pricing of steel sold to the Argentine operation, which occurred as a result of the purposeful maxi-devaluation of the USD/ARS exchange rate, an event resulting from the macroeconomic policy adopted after Javier Milei became president. This event will not be repeated now in 1Q24, making the sequential comparison basically useless, because it will show an exaggerated advance in the net revenue of the BD.

Finally, for Special Steel, this dispute with imported steel is still strong within the automotive segment, and we therefore believe that discounts should have been offered to the business unit's Brazilian operations. For the North American operations, the end of the United Auto Workers (AUW) strike probably helped sales to pick up, although the degree was less than initially expected, since this effect should be partially erased by even weaker demand, with interest rates high by historical standards in the US.

Looking ahead... We will share what we're expecting for the company's dynamics, broken down by each business division.

Brazil BD:

Prices for hot-rolled coil (HRC), are trading at a premium of +21.6% vs. imported steel, significantly above the historical average of ~12%. Although Gerdau's portfolio is still mostly focused on long steel, the company has also become more exposed to different markets, as it has been diversifying its product mix over the last few years. Rebar prices, on the other hand, show a more stable picture, trading at a premium of +4.5% vs. imported steel, which suggests a better chance of success in passing on prices in long steel, in line with what we have been saying since the 4Q23 preview report.

Along these lines, we have learned from market and unofficial information that a group of steelmakers, including Gerdau, have proposed a **price increase of +8% for long steel used in construction**, between February and March. However, the actual negotiations are still revolving around increases of **only +4%**, **which should be confirmed for 2Q24**, according to our market analysis. On the volume side, we expect the end of execution of the **BQ2 project in 3Q24**, which will add **+250Ktpa of hot-rolled coil (HRC) capacity**, helping with versatility, although the price dynamics for flat steel are likely to remain under pressure.

Even with the recent measures imposed through the Executive Management Committee (GECEX), mediated by the Chamber of Foreign Trade (CAMEX), with an **increase in the steel import tariff to ~25%** (vs. ~14% previously), **only 11 flat steel NCMs were covered** (with IABr's request being for 30 products). In addition to the low number of NCMs, the 25% rate will appear as a complementary rate levied only on the difference between the total import volume and the average quota recorded between **2020 and 2022** (which seems out of date). We believe that the measure should not create an environment that would give domestic steelmakers more bargaining power in their price negotiations with the industry. Through conversations with investors over the last few days, we've noticed the **market's discouragement with the measure**.

North America BD:

Despite high interest rates in the U.S., currently set between 5.25% and 5.5%, there is significant momentum in the construction of new factories, especially semiconductors, as well as expansions in the food, beverage and chemical sectors. This increase in construction activity, influenced by **Reshoring** and reflecting legislative support and supply chain concerns, has kept Gerdau's order backlog at healthy levels of **~60 days** over the last few quarters.

Notably, industrial construction spending increased +80% y/y in the last 12M vs. a modest +6% y/y growth in other non-residential private construction categories. However, **demand for durable goods is falling**, pressured by high interest rates, causing apparent steel consumption to decrease in the US. Gerdau's addressable market today is smaller than it was in 2022 and 2021.

In fact, the US manufacturing PMI did enter the expansion zone in February and March, but remained at the 50pt threshold, still lagging behind the robust performance of the services PMI, which keeps hovering around 52Pts. As we've already argued, the services sector isn't a driver of steel consumption, but it is part of a strong inflationary movement. The consensus is increasingly bearish, revising its expectations for a **later cut in interest rates**, with the FED's speeches not signaling a clear tone, through the lack of cohesion that we believe exists between different directors and Chairman Jerome Powell.

Until the cut comes, apparent steel consumption tends to become more impoverished. In this scenario, we believe that Gerdau will lose sensitivity, when the cost of scrap rises again, to make new price adjustments and recompose the metal spread. We know that the company, right after announcing the adjustments at the end of last year to take effect in 1Q24, **ended up backtracking and conceding price discounts**, which will come into **effect in 2Q24**.

According to Nucor's (Gerdau's peer in the USA) volume guidance, which has already been published, **2Q24 will still be pressured by demand**, making up a scenario that is not bullish in the short term.

When we spoke to Gerdau recently, we had the impression that the **price pass-through made in 1Q24 did not have the intended effect**, either by reducing the orders and causing the backlog to fall below the 60-day margin, or through clients who potentially refused the price transfer.

South America BD:

With the expected normalization in 1Q24 in relation to the devastating exchange rate effect seen in last quarter's result, we should see expressive growth figures on a quarterly basis, but the comparison should be ignored, precisely because it is a one-off. In the y/y scenario, there will still be a strong influence from operations in Argentina, which according to our estimates make up ~30% of the business unit's EBITDA and are beginning to cool down on demand due to high interest rates.

We recall that the exit of the Colombian, Dominican Republic, Panamanian and Costa Rican operations after the **sale of the JVs to the INICIA group** will generate a cash flow gain to help fund the robust **24E CAPEX of ~R$6bn**, with **funds raised by the sale of US$325m** (~R$1.6bn) in **2Q24E**. On the other hand, the operations in Argentina will take on more weight within the unit from this point onwards. And we know that the outlook for volumes and prices in Argentina is not good at all.

Special Steel BD:

Following opposite vectors, the business unit is made up of a portion of operations in **Brazil and the USA**, attributed to the automotive market. In the US, the automotive market continues to lack traction, as the Fed has not yet started the monetary easing cycle. On the other hand, Brazil's automotive sector is growing gradually, driven by consecutive reductions in the SELIC rate by COPOM since August 2023. We would point out that the total impact is at a slow pace since there is a delay between the cuts and the effect of perceived demand on the real economy. This illustrates the **divergent market dynamics**, influenced by local monetary policies between the two countries.

Upgrading to Buy

Although the **scenario doesn't look promising** in the short term, **we're upgrading the company's rating** (from Neutral to Buy), and we'll explain the rationale below.

Given the more pressured outlook, in line with the trend we wrote about in our preview of last quarter's results (4Q23 Preview: Squeezed on both sides), the macro situation is mostly bad for steel producers in both Brazil and the US, Gerdau's main countries of operation. Knowing that **the macro situation is out of the company's control**, Gerdau's management has once again demonstrated its capacity for **micro execution**, by taking firm action in search of the **most profitable solution for shareholders**, no matter who it hurts...

The company announced a **plan to rigorously cut fixed costs**, which amount to ~R$400mn per quarter, piling up to **~R$1.5bn on a full year**. A significant part of this cost reduction will take place **via payroll cuts**. As the process of laying off employees will take place over the next few months, the severance cost will inhibit the improvement in EBITDA for basically the whole of 2024. An improvement of **~R$400mn is expected in 4Q24E alone**. From **2025 onwards**, the gain will be seen more emphatically.

With these new assumptions being incorporated into our proprietary model, **personnel costs at Brazil BD fell to R$1.3bn in 4Q24E** (-8.2% vs. 3Q24E), reaching **~R$1bn in 4Q25E**, when the cost reduction is complete. In 2026, with the workforce completely remodeled, the company would have an **annual payroll cost** at **Brazil BD 26E of ~R$3.7bn** (-28% vs. 24E), a considerable double-digit reduction compared to the expenses we project for this line in 2024 (~R$5bn 24E).

When we update our assumptions with this cost-cutting package, we see a considerable difference in the company's result, with a substantial margin improvement at ON Brasil, where most of the cost-cutting is expected to take place. Our model indicates, for ON Brasil, a **24E EBITDA** of **R$2.5bn** (-25% vs. 2023), which would jump to a **25E EBITDA of R$6bn** (1.4x higher vs. 24E), **with a very strong margin expansion to ~22%** (+12p.p vs. 24E), a level close to that of Brazil BD during the best years of operating profitability ever recorded by Gerdau (2021 and 2022).

Another comparison exercise to show the power of cost-cutting on valuation, is to look at the **consolidated** figures, **EBITDA 25E before and after cost-cutting**. We are projecting **R$14.4bn Genial Est.** (vs. R$12.3bn in our previous model), a **net gain of ~R$2bn**, reflecting the importance of the strategy. But it's important to bear in mind that this **improvement will only be seen in 2025**, as we've already explained. Until then, there's a lot of ground to cover...

Trading at an **EV/EBITDA 24E** of **4.2x** (vs. historical average of 5x), considering the cost cuts the company intends to make this year and next, **we believe that the company's austerity plan has not been priced in by the market**. We emphasize that the short term is still challenging, with **2024 being a year of tight margins and loss of traction in EBITDA**. We're looking at margin gains in 2025, not the short term of 2024.

We know that **this call may take a while to work**, but we are convinced of the company's ability to execute. Therefore, **we are raising our recommendation** to **BUY rating**, with a **12M Target Price** of **R$23.40** (vs. R$20.42 previously, but post bonus), providing **an upside** of **25.81%**. Gerdau is the first steel company under our coverage to exit Neutral rating territory after ~7 months with all players within this bias, due to a macro decision we made at the time, which is now being reversed by a company's micro plan.

1Q24 Preview: In detail!

Chinese steel continues unabated. During 1Q24, we didn't see anything very different regarding the penetration of imported steel in Brazilian apparent consumption, which closed March at 19.6% (+4p.p vs. 2023) according to the Brazil Steel Institute (IABr), rising even more compared to the same period last year. So, although they have fallen compared to 4Q23 in the sequential movement, which amounted to ~25% in December, they still remain well above the historical average (~10-12%).

This is the main trigger for steel companies to continue cutting prices, especially in flat steel, which is most affected by the upward movements in imports, in the monumental effort to compete with the unfair conditions of subsidized Chinese steel. We see Hot Rolled Coil (HRC) prices trading at a parity premium of +21.6% vs. imported steel, closed last week. We would point out that this is still well above the ~12% that would be the historical level. As Gerdau diversified the product mix in its portfolio, even though its core business is long steel, it ended up exposing itself more to flat steel, the main victim of this event.

Brazil BD: Attempt to pass on prices in long steel. Within this context, which is still under pressure, we had access to market information (not public) that Gerdau had tried to pass on prices for long steel, mainly to construction companies and real estate developers. We are aware that some steelmakers, with strong possibilities that Gerdau in among them, tried to apply increases in December, January, February and March.

However, only the February and March efforts were actually discussed with the construction sector, and we would point out that they were at lower levels than those initially proposed by the producers. Our market intelligence points to negotiations increasing by +4%, while the producers initially sought +8%. Following this point, we also found stability in rebar, the benchmark for long steel, trading at a parity premium of +4.5% vs. imported steel, more normalized levels compared to the more affected dynamics of flat steel. As a result of this much lower premium, we believe there is a greater likelihood of price increases in long steel, as we have been pointing out since the end of last year.

Brazil and North America BDs: Projected realized prices up slightly. We continue to monitor the market closely, and our assumption is that Gerdau has managed to improve realization a little sequentially, but largely due to its mix, which was very weak last quarter. We believe that negotiations to increase steel prices for the construction sector should take place in 2Q24, and still with a margin lower than initially requested. Therefore, for 1Q24 we estimate a realized price for Brazil BD of R$4,856/t Genial Est. (+2.0% q/q; -11.9% y/y).

As for North America BD, the realized price in our model stood at R$6,747/t Genial Est. (+0.8 q/q; -4.4% y/y). Looking at the movements in the US, we know that Gerdau announced two price increases, as we had already mentioned in our 4Q23 preview. The price increases were divided into product groups: **(i)** the first announcement, on December 23, targeted rebar (+US$50/t) and merchant bars (+US$65/t). **(ii)** the second announcement, made on January 5, targeted beams (+US$50/t). The main reason for the adjustments was the maintenance of very healthy metal spread levels after the price of scrap rose last quarter.

Brazil BD: Sales focused on recovering market share. For Brazil BD, even though the macro challenge remains very tight, we are estimating sequential volume growth as the company has been vocal about its strategy to regain market share. For the domestic market (DM), we are projecting sales of 1,058Kt Genial Est. (+9.7% q/q; -0.8% y/y), while for the foreign market (FM), we expect shipments of 264Kt Genial Est. (-13.0% q/q; +20.0% y/y).

We believe in a change in the mix for the better, with an improvement in the domestic dynamics due to a regain of market share. This should end up increasing added value and reducing shipments to foreign markets. The dynamic is in line with the price realization we expect, since the product exported to South America, for example, is semi-finished and has a lower added value. Consolidating the two markets (DM+FM), we see a total volume for Brazil BD clocking in at 1,322Kt Genial Est. (+4.3% q/q; +5.3% y/y).

North America BD: Demand picking up after seasonal event, but in a tighter market. At North America BD, we believe demand should rebound in 1Q24, after the seasonal downturn. Interest rates remain high by US standards, with the FED rate in the range of 5.25% and 5.5%, making consumption of durable goods sluggish and, therefore, the market for steel tighter compared to a couple of years ago.

On the other hand, we have noticed manufacturing companies significantly increasing the construction of new plants in the US, mainly emphasizing semiconductor facilities, but also expanding into sectors such as food and beverage processing, as well as chemicals, energy, and plastics. This trend, known as Reshoring, keeps Gerdau's order backlog close to healthy levels of ~60 days, although it has fallen slightly below this mark recently.

We recall that the Reshoring movement is being driven by motivations such as the **(i)** CHIPS and Science Act, **(ii)** concerns about supply chain fragility after numerous freight cost shocks and **(iii)** US geopolitical tensions with China. In the last 12M, we found that industrial construction spending increased by +80% y/y vs. +6% for other non-residential private construction categories. Therefore, a resilient part of Gerdau's non-residential construction steel demand in the US has come from reshoring policies in the US and near-shoring in Mexico.

Therefore, we project a shipment volume of 951Kt Genial Est. (+7.5% q/q; -13.8% y/y). As for the next few quarters, we believe that the electoral scenario in the US could put the brakes on the Biden administration's infrastructure investment packages, which after the ~2-year bureaucratic process for approving bids, should be slowed down in order to redirect funds in the electoral race, without us seeing this package really having an effect in terms of demand since it was launched in his first year in office.

South America BD: Difficult start to the year. We believe that volumes are likely to fall q/q with a more difficult start to the year, driven by high interest rates, which is finally generating cooler demand in Argentina. According to our calculations, Argentina accounts for ~30% of the business unit's EBITDA, considering the total package of assets including the JVs that have already been sold.

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Therefore, Argentina's weight should increase from 2Q24 onwards, as the operations in Colombia, the Dominican Republic, Panama and Costa Rica will come off the balance sheet following the sale of the JVs to the INICIA group. For 1Q24, we estimate a shipment volume of 222Kt Genial Est. (-8.7% q/q; -21.1% y/y). As for the realized price, we are projecting R$5,379/t Genial Est. (-7.3% y/y). As already mentioned, the q/q price comparison is not valid due to the one-off effect of 4Q23.

Special Steel: US stable and Brazil improving. The macro scenario in the US did not generate any changes for the automobile market, since the FED rate remained at its previous level and this segment is very sensitive to interest rates. The United Auto Workers (UAW) strike came to an end in November, in the final stretch of last quarter. So, we might have expected a sequential increase in sales. However, we believe that the impact on demand for vehicles is much more correlated with interest rates. As a result, the volume boost in the US with the end of the strike should occur, but only marginally.

In Brazil, on the other hand, market is gradually heating up again, due to the successive cuts in the SELIC rate. Therefore, as COPOM has been cutting interest rates since August 2023, and there is still a delay until the real effect is felt in the real economy, we see opposite dynamics between Brazil and the USA. Given this context, we are projecting a marginal increase in shipment volumes for the Special Steel unit, reaching 348Kt Genial Est. (+2.6% q/q; -2.2% y/y), as a result of the offsetting effects of progressive dynamics in Brazil vs. a stable US. For the realized price, we project R$7,689/t Genial Est. (+0.9% q/q; -7.3% y/y).

Table 3. Net Revenue Gerdau (1Q24 Genial Est.)

(R$ millions)	1Q24E Genial Est.	4Q23 Reported	% q/q	1Q23 Reported	% y/y
Net Revenue	**16.317**	**14.716**	**10,9%**	**18.873**	**-13,5%**
Brazil BD	6.422	6.034	6,4%	6.925	-7,3%
North America BD	6.182	5.927	4,3%	7.793	-20,7%
South America BD	1.194	326	266,2%	1.617	-26,2%
Special Steel BD	2.672	2.580	3,6%	2.948	-9,4%
Eliminations	(153)	(152)	1,1%	(411)	-62,7%

Source: Gerdau, Genial Investimentos

Revenue up low double-digit q/q. After slight mid-single digit improvements in the Brazil, North America and Specialty Steels divisions, we saw the main change in South America BD. This is because the currency maxi-devaluation in Argentina impacted the operation's realized price in 4Q23. We project consolidated net revenue of R$16.3bn Genial Est. (+10.9% q/q; -13.5% y/y), with South America BD clocking in at R$1.2bn Genial Est. (-26.2% y/y), showing a significant increase of more than 2x in revenue q/q, as per last quarter's exchange rate effect.

For Brazil BD, we estimate net revenue of R$6.4bn Genial Est. (+6.4% q/q; -7.3% y/y), driven by market share recovery. We believe that North America BD will report R$6.2bn Genial Est. (+4.3% q/q; -20.7% y/y), with sequential growth due to the composition of price increases and the exit from unfavorable seasonality for demand. As for Special Steel, we project net revenue of R$2.7bn Genial Est. (+3.6% q/q; -9.4% y/y), with a slight sequential increase.

COGS/t rising in Brazil and falling in the US. A significant improvement is expected for the future. Gerdau expects to undergo a cost overhaul, cutting fixed expenses, mainly payroll. Management expects a reduction of ~R$400mn per quarter starting in 4Q24, resulting in a total cost-cutting package of -R$1.5bn in 2025, mainly at Brazil BD (as we already cover).

For 1Q24, the company should not yet feel the effects of these cost cuts, due to the termination process, where payroll costs increase and then decrease. We estimate a COGS/t for Brazil BD of R$4,701/t Genial Est. (+4.1% q/q; -2.1% y/y), especially considering the pressure from the cost of metallurgical coal and severance payments. As for North America BD, we may feel a cost reduction, mainly due to the dilution of variable expenses by the sequential increase in volume and reduction in the scrap cost. Therefore, we project a COGS/t clicking in at R$5,443/t Genial Est. (-2.1% q/q; +2.8% y/y).

In the South America BD, we estimate a COGS/t of R$4,390/t Genial Est. (+252.2% q/q; -0.8% y/y), an increase that was offset on a quarterly basis by the effects of the maxi-devaluation of the exchange rate in Argentina. Finally, for the Special Steel unit, we expect lower costs, in the range of R$6,648/t Genial Est. (-3.5% q/q; -6.2% y/y). As a result, the nominal value of COGS for the period should be R$14.3bn Genial Est. (+9.2% q/q; -6.3% y/y).

Table 4. EBITDA Gerdau (1Q24 Genial Est.)

(R$ millions)	1Q24E Genial Est.	4Q23 Reported	% R/E	1Q23 Reported	% y/y
Adjusted EBITDA	**2.699**	**2.039**	**32,4%**	**4.328**	**-37,6%**
Brazil BD	449	512	-12,2%	1.064	-57,8%
North America BD	1.465	1.135	29,0%	2.355	-37,8%
South America BD	286	135	111,1%	489	-41,6%
Special Steel BD	431	340	26,8%	497	-13,3%
Eliminations	69	(83)	-182,9%	-77	-189,6%

Source: Gerdau, Genial Investimentos

EBITDA showing significant sequential improvement. Our EBITDA expectation stands at R$2.7bn Genial Est. (+32.4% q/q; -37.6%), comprising a margin of 16.5% (+2.7p.p q/q; -6.4p.p y/y). North America BD is the unit that should perform best, reaching an EBITDA of R$1.5bn Genial Est. (+29.0% q/q; -37.8% y/y), while Brazil BD should suffer a reduction, reaching R$449mn Genial Est. (-12.2% q/q; -57.8% y/y), pressured by higher costs and low price realization capacity. As for Special Steel, we calculated EBITDA of R$431mn (+26.8% q/q; -13.3% y/y). Finally, for South America BD, we project R$286mn Genial Est. (-41.6% y/y).

Net income with projected growth of +116% q/q. Since we see a sequential decompression in EBITDA and estimate a financial result of -R$177mn Genial Est. (vs. -R$155 in 4Q23), we will consequently also see an increase in net income, reaching R$1.3bn Genial Est. (+116% q/q; -57.2% y/y).

Table 5. Income Statement Gerdau (1Q24 Genial Est.)

(R$ millions)	1Q24E Genial Est.	4Q23 Reported	% q/q	1Q23 Reported	% y/y
Net Revenue	**16.317**	**14.716**	**10,9%**	**18.873**	**-13,5%**
COGS	(14.288)	(13.083)	9,2%	(15.243)	-6,3%
Adjusted EBITDA	**2.699**	**2.039**	**32,4%**	**4.328**	**-37,6%**
EBITDA Margin (%)	16,5%	13,9%	2,69p.p	22,9%	-6,39p.p
EBIT	**1.768**	**891**	**98,3%**	**4.294**	**-58,8%**
EBIT Margin (%)	10,8%	6,1%	4,78p.p	22,8%	-11,92p.p
D&A	(801)	(791)	1,3%	(715)	12,0%
Financial Result	(177)	(155)	14,5%	(303)	-41,4%
Net Income	**1.270**	**588**	**116,0%**	**2.964**	**-57,2%**
Net Margin (%)	7,8%	4,0%	3,79p.p	15,7%	-7,93p.p

Source: Gerdau, Genial Investimentos

Our Take on Gerdau

The macro scenario continues to be the stumbling block. We believe that Brazil BD will continue to suffer in the short term, as we don't see any major changes ahead. China continued to increase blast furnace capacity utilization after the Lunar New Year holiday and the PMI continues to indicate a migration of activity to services, as the indicator remains higher than in manufacturing. As such, we don't see China shutting down its blast furnaces, given that the activity contributes immensely to the country's composition and that many subsidies are given to local steel mills.

China produces ~60% of global steel and have dispatched ~9% of its production to the rest of the world last year. This month, we've seen various mobilizations to try to prevent this surplus steel from entering other economies. Last week, President Joe Biden gave a speech in Pennsylvania, a state where Blue Collar Workers vote heavily, and in order to get more votes, he commented that he could triple the tariff on imported steel and aluminum in order to safeguard jobs in the industry. More recently, we have seen the Brazilian government increasing the tariff on steel imports.

Increase in steel import tariffs. On April 23, CAMEX (Chamber of Foreign Trade) approved an increase in the steel import tariff to ~25% (vs. ~14% previously). However, this tariff is only levied on the difference between the total import volume and the average quota recorded between 2020 and 2022. Therefore, we don't believe that this measure represents a solution to the size of the problem. It clearly helps, but it doesn't solve it.

Brazil: Our bias towards fewer construction sites. We believe that in Brazil, with the migration of construction sites from high and middle income to low income, with programs such as Minha Casa Minha Vida (MCMV), steel consumption should be lower. Brazilian savings and loan system (SBPE) on real estate financing data suggests that less capital has been allocated to the real estate sector in recent years and CBIC data shows that launches have been falling since 2023. This means that there is less space being built and, consequently, less steel consumption.

South America: Sale of JVs and greater weight of Argentina. Gerdau intends to reduce the level of operations in other Latin American countries and has already taken steps to do so. Just this quarter, the company announced the sale of its subsidiaries in the Dominican Republic, Colombia, Panama and Costa Rica (JV Gerdau Metaldom Corp. and JV Diaco S.A.) to the INICIA group for US$325mn and remains active only in Argentina, Peru and Uruguay. However, the low profitability of these assets and the macro conditions, which we saw in 4Q23 (hyperinflation and currency devaluation in Argentina), seem to discourage the continuation of these operations in the long run.

Special Steel: Opposite trends for Brazil and the USA. The specialty steel market, which is very sensitive to the automobile sector, is showing a recovery, with lower interest rates and government programs in Brazil. The Mover program, created in December 2023, should also boost the heavy-duty market, demanding more steel. The program provides a tax incentive of R$19.3bn and should last 5 years. In the US, the sector is still unknown, as it is totally dependent on interest rates and we still don't see the economy cooling down, resulting in a postponement of the rate cut.

Not to depend on the stroke of a pen. As we discussed in the introductory part of the report, we have become more optimistic about the company as a result of the announcement of a rigorous plan to cut fixed costs. We believe that this plan dismantles the understanding of Gerdau's management team not to depend on the stroke of a pen from the government, in relation to a tariff barrier model that is effective in inhibiting the strong penetration of Chinese steel within apparent consumption in Brazil.

Comparing **25E EBITDA before and after the cost cuts**, we find ourselves with **R$14.4bn Genial Est.** (vs. R$12.3bn in our previous model), a **net gain of ~R$2bn**, reflecting the importance of the strategy. But it's important to bear in mind that this improvement will only be seen in 2025, as we've already explained. Until then, there's a lot of ground to cover... Trading at an **EV/EBITDA 24E** of **4.2x** (vs. historical average of 5x), considering the cost cuts the company intends to make over the course of this and next year, we believe that the company's austerity plan has not been priced in by the market. We emphasize that the short term is still challenging, with **2024 being a year of tight margins and loss of traction in EBITDA**.

Gerdau is the **first steel company under our coverage to leave Neutral rating territory after ~7 months** with all players within this bias, due to a macro decision we made at the time, which is now being reversed by a micro plan of the company.We know that **this call may take a while to work**, but we are convinced of the company's ability to execute. Therefore, **we are raising our recommendation** to **BUY rating**, with a **12M Target Price** of **R$23.40** (vs. R$20.42 previously, but post bonus), providing **an upside** of **25.81%**.

Appendix: Gerdau

Figure 1. Gerdau – Income Statement in R$ Millions (Genial Est. 2024-2028)

Income Statement	2024E	2025E	2026E	2027E	2028E
Net Revenue	**65.957**	**66.628**	**67.907**	**69.433**	**71.736**
(-) COGS	(56.697)	(55.257)	(54.833)	(55.976)	(56.782)
Gross Profit	**9.261**	**11.371**	**13.074**	**13.458**	**14.954**
(-) Expenses	(1.875)	(1.777)	(1.802)	(1.823)	(1.871)
Adjusted EBITDA	**10.615**	**14.122**	**15.989**	**16.449**	**18.253**
(-) D&A	(3.230)	(3.569)	(3.900)	(4.197)	(4.464)
EBIT	**7.714**	**10.258**	**11.947**	**12.323**	**13.795**
(+/-) Financial Result	(1.041)	(1.067)	(880)	(711)	(780)
(-) Taxes	(1.127)	(1.807)	(2.153)	(2.218)	(2.510)
Net income	**5.545**	**7.384**	**8.914**	**9.394**	**10.505**
Profitability					
Net margin (%)	8,41%	11,08%	13,13%	13,53%	14,64%

Figure 2. Gerdau– Cash Flow in R$ Millions (Genial Est. 2024-2028)

Cash Flow (FCFF)	2024E	2025E	2026E	2027E	2028E
Net Revenue	**65.957**	**66.628**	**67.907**	**69.433**	**71.736**
(-) COGS	(56.697)	(55.257)	(54.833)	(55.976)	(56.782)
Adjusted EBITDA	**10.615**	**14.122**	**15.989**	**16.449**	**18.253**
EBIT	**7.714**	**10.258**	**11.947**	**12.323**	**13.795**
(-) Taxes	(1.127)	(1.807)	(2.153)	(2.218)	(2.510)
(+) D&A	3.230	3.569	3.900	4.197	4.464
(+/-) Δ WK	(822)	220	(430)	(474)	(212)
(-) Capex	(5.998)	(6.063)	(6.130)	(6.198)	(6.267)
FCFF	**2.997**	**6.177**	**7.135**	**7.631**	**9.270**

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