USIMINAS

3Q24 Preview: Still far from what was envisioned

LatAm Metals & Mining

Main takeaways:

(i) Total shipments at 1,110kt Genial Est. (+7.1% q/q; +8.8% y/y), growth in demand but no signs of a solid recovery; **(ii)** Consolidated **realized price** reaching **R$5,549/t Genial Est.** (+0.9% q/q; -1.5% y/y), showing pressure on the DM and deterioration in the FM; **(iii) Mining:** challenges persist in 3Q24, with shipments below expectations and the realized price at R$339/t Genial Est. (-12.1% q/q); **(iv)** Consolidated **Net revenue** with limited recovery, projected at **R$6.6bn Genial Est.** (+5.1% q/q; -0.6% y/y); with sequential growth driven by an increase in steel volumes; **(v) COGS/t** of the **steel division** is projected at **R$5,302/t Genial Est.** (-0.9% q/q), still not cooling substantially, even after the BF3 reform; **(vi) EBITDA** projected at **R$325m Genial Est.** (+31.3% q/q), with an expected high percentage improvement, but the comparative base is very depreciated; **(vii) Net income:** following the recovery trend, but challenges remain; **(viii)** Although we expected some relief in operating costs with the resumption of BF3, the still high dependence on third-party slabs, continues to put pressure; **(ix)** There is a recent upward trend in the **SELIC rate**, which rose **+25bps** to **10.75%**. We currently expect the terminal **SELIC rate** from this cycle of increases to be **12% in 1Q25E** and to remain at this level until 4Q25. Therefore, we point to the risk that the supply of credit will become pressured again in 2025, **cooling demand** from the automotive segment; **(x)** We expect the company's decision to announce a retraction of the **24E CAPEX guidance** to levels of **~R$1.4bn Genial Est.** (-22% vs. R$1.8bn in our previous model); **(xi)** Given this scenario linked to the **high exposure to flat steel**, we remain reluctant about the potential change of bias in the name. Therefore, we prefer to reiterate our **NEUTRAL rating**, with a **12M Target-Price** of **R$6.50** (vs. R$7.50 previously) and a marginal **upside** of **+6.21%**.

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Company

USIM5 BZ Equity
Neutral

Price: R$ 6.12 (18-Oct-2024)
Target Price 12M: R$ 6.50

Table 1. Shipments Summary (3Q24 Genial Est.)

(Thousand Tonnes - kt)	Genial Est.	Reported		Reported	
Summary (Shipments)	**3Q24E**	**2Q24A**	**% q/q**	**3Q23E**	**% y/y**
Steel	1.110	1.042	**6,6%**	1.021	**8,8%**
Iron Ore	1.997	2.015	**-0,9%**	2.391	**-16,5%**

Source: Usiminas, Genial Investimentos

Table 2. Income Statement Summary (3Q24 Genial Est.)

(R$ millions)	Genial Est.	Reported		Reported	
Income Statement	**3Q24E**	**2Q24A**	**% q/q**	**3Q23E**	**% y/y**
Net Revenue	6.677	6.350	**5,1%**	6.714	**-0,6%**
Adjusted EBITDA	325	247	**31,3%**	-20	**1730,2%**
Net Income	63	(100)	**163,1%**	(166)	**138,0%**

Source: Usiminas, Genial Investimentos

Usiminas will report its **3Q24 results on October 25**, before the market opens. We expect consolidated figures that can be considered weak, despite showing a partial recovery, which is still timid. We project consolidated **Net revenue** of **R$6.6bn Genial Est.** (+5.1% q/q; -0.6% y/y), highlighting the contribution of steel sales, given the higher level of shipments, which are in our model at 1.1Mt Genial Est. (+6.6% q/q; +8.8% y/y), reflecting the **(i)** improvement resulting from the typical seasonality of the 3Qs and **(ii)** slightly more elastic demand for the automotive segment. The mining division, on the other hand, is expected to fall, reflecting the challenging scenario in the iron ore market channeled by cooler Chinese demand. **EBITDA** is projected at **R$325mn Genial Est.** (+31.3% q/q), with a **Net income** of only **R$63mn** (reversing the 2Q24 loss).

Valuation and rating. Usiminas is the company under our coverage most influenced by the dynamics of the price war between domestic vs. imported steel. The level of steel exports by Chinese mills remains very high in the face of weak domestic consumption. We believe that the company's prospects for expansion in the short term are limited, with recovery linked to broader macroeconomic improvements influenced by the Chinese economy, which seem far from reality. In addition, our analysis indicates continued pressure on the company's costs. In the steel division, the **projected COGS/t** is **R$5,302/t Genial Est.** (-0.9% q/q), reflecting a small efficiency gain, but falling short of the strong cost reductions forecast earlier this year by consensus. **We remain skeptical that COGS/t reductions will align with the projections that other sell-side firms had** for Usiminas after the refurbishment of Blast Furnace 3 (BF3).

The short-term challenges remain significant, with **(i)** strong competition from Chinese steel and **(ii)** pressure from operating costs limiting the stock's upside potential. Given this scenario, coupled with the high concentration of exposure to flat steel, **we remain reluctant to see a potential change in the name bias**. Therefore, we prefer to reiterate our **NEUTRAL rating**, with a **12M Target-Price** of **R$6.50** (vs. R$7.50 previously) and a **marginal upside** of **+6.21%**. We believe that it may take a while for investors to become interested in the shares again, given the strong negative impact caused by the failure to meet the expectations that a portion of the market placed on the cost reduction following the refurbishment of BF3.

3Q24 Preview: In detail!

Domestic market shows resilience, but prices under pressure. In the steel division, although demand in the domestic market (MD) has shown some warming, with shipments projected at 1,061kt Genial Est. (+9.0% q/q; +14.0% y/y), we assess that the scenario for Usiminas remains challenging. The automotive sector, particularly light vehicles, has boosted sales, especially with incentive policies and a better credit offer y/y. However, strong competition with imported steel, especially Chinese, which dominated 18.5% of apparent consumption in 2024, continues to put pressure on the company to operate with reduced margins. Even with higher volumes, Usiminas faces difficulties in passing on cost increases, which is reflected in the realized price still in depressed conditions, which we project at R$5,407/t Genial Est. (-0.6% q/q; -4.5% y/y).

Foreign market: reduced volumes and narrow margins in a competitive environment. Shipments to the foreign market (FM), estimated at 68kt Genial Est. (-3.9% q/q; -27.5% y/y), reflect a significant downturn, with the end of major contracts, such as the Néstor Kirchner gas pipeline project in Argentina, which previously sustained the segment's performance with higher value-added products. In addition, global demand for steel continues to decline, especially due to the slowdown in the Chinese economy and the increase in Chinese steel exports, which intensify competition. Although the realized price of R$6,491/t Genial Est. (+3.0% q/q; +20.8% y/y) is up considerably year-on-year, the deterioration in the export mix, with a lower share of higher value products, restricts the capture of more robust margins. Margins remain under pressure, making it difficult to achieve a solid recovery in this segment.

Total shipments: marginal growth with no signs of a solid recovery. The increase in total shipments to 1,110kt Genial Est. (+7.1% q/q; +8.8% y/y) reflects a relatively resilient domestic market (DM) but does not indicate a substantial recovery for Usiminas. Growth is mainly driven by the automotive sector, with construction also contributing modestly. However, the competitive environment, especially in relation to Chinese steel, limits the potential for price increases in Brazil, and the international market remains under pressure. Despite the increase in volume, the challenges of internal and external competition indicate that the recovery, in terms of total shipments, is still fragile and does not point to a significant improvement in the short term.

Consolidated realized price: pressure on the DM and deterioration in the FM weigh on the result. We believe that the outlook for the consolidated realized price (DN + FM) reflects the difficulties faced by Usiminas, coming in at R$5,549/t Genial Est. (+0.9% q/q; -1.5% y/y). Even with a slight sequential improvement, it is clear that the price continues to contract on an annual basis, revealing the inability of the companies most exposed to flat steel to overcome competition from imported products, especially those of Chinese origin.

Table 3. Net Revenue Usiminas (3Q24 Genial Est.)

(R$ millions)	3Q24E Genial Est.	2Q24A Reported	% q/q	3Q23A Reported	% y/y
Net Revenue	**6.677**	**6.350**	**5,1%**	**6.714**	**-0,6%**
Steel	6.162	5.728	7,6%	5.754	7,1%
Mining	677	777	-12,9%	793	-14,6%
Eliminations	(163)	(156)	4,5%	168	-197,0%

Source: Usiminas, Genial Investimentos

The pressure on the domestic market (DM) reinforces the narrative that Usiminas continues to operate in an environment of squeezed margins, without sufficient room for notorious passing on of costs when setting prices, given the competition characterized as unfair by many members of the sector. In the foreign market (FM), although the realized price is higher, the deterioration of the export mix and the weighting of low volume vs. the DM should limit the gain in the consolidated effect, leaving the company in a challenging position.

MUSA: challenges persist in 3Q24. To put this in context, we remind investors that Usiminas' mining division (MUSA) faced significant challenges in 2Q24, and for us, the outlook for 3Q24 remains unfavorable. Demand for iron ore continues to be impacted by the slowdown in the Chinese economy, with shipments estimated at 1,997kt Genial Est. (+1.8% q/q; -16.5% y/y), still below the company's potential, including the restriction linked to the mining front. The realized price should be R$339/t Genial Est. (-12.1% q/q), which reflects both the drop in the quality of the ore in the mix and the adverse global market conditions. This context confirms the difficulties faced by the division and suggests that recovery, if it occurs, will only be gradual.

Consolidated net revenue with limited recovery. We project consolidated net revenue of R$6.6bn Genial Est. (+5.1% q/q; -0.6% y/y), with the contribution of steel sales standing out with R$6.1bn Genial Est. (+7.6% q/q; +7.1% y/y), given the higher level of shipments reflecting the **(i)** improvement resulting from the seasonality typical of the 3Qs and **(ii)** slightly more elastic demand for the automotive segment. The mining division, on the other hand, is expected to decline, with our model pointing to Net revenue of R$677mn Genial Est. (-12.9% q/q; -14.6% y/y), reflecting the challenging scenario in the iron ore market channeled by cooler Chinese demand. We believe that the prospect of expansion remains limited in the short term. Recovery seems to us to be conditional on a broader improvement in the macroeconomic scenario, since the cyclical condition is extremely correlated to the performance of the Chinese economy, which is succumbing to weaker macro data.

Steel: COGS/t not cooling substantially, even after the BF3 reform. Our analysis shows that pressure on costs continues to affect the company. In the steel division, COGS/t was projected at R$5,302/t Genial Est. (-0.9% q/q; -5.1% y/y), suggesting a slight sequential efficiency gain, but still far from the long-awaited strong cost reduction that the consensus projected at the beginning of the year. We have long been skeptical that the COGS/t reduction would not reach the stage framed by other sell-side firms.

We believe that **(i)** the strong acceleration of the USD/BRL exchange rate throughout the year and **(ii)** a level of dependence on third-party plates that is still considered high, continue to be the main factors driving up the company's cost structure in the short term. We believe it will be difficult for Usiminas to capture all the thermal efficiency and COGS/t reduction speculated by the market after the refurbishment of Blast Furnace 3 (BF3), which ended in November 2023 and should reach a more mature ramp-up just this quarter. Therefore, even though we recognize that there will probably be a benign effect on the cost structure in 3Q24, through the dilution of fixed expenses by the higher level of production and sales in 3Q24, we still believe that this efficiency will be partially erased by the impact of more expensive inputs.

Table 4. COGS Usiminas (3Q24 Genial Est.)

(R$ millions)	3Q24E Genial Est.	2Q24A Reported	% q/q	3Q23A Reported	% y/y
COGS	**(6.298)**	**(6.021)**	**-4,6%**	**(6.539)**	**3,7%**
Steel	(5.842)	(5.554)	-5,2%	(5.839)	-0,1%
Mining	(596)	(605)	1,4%	(623)	4,3%
Eliminations	141	137	3,1%	(76)	285,0%

Source: Usiminas, Genial Investimentos

Mining: COGS/t up slightly. On the other hand, in the mining division (MUSA), the COGS/t projected for 3Q24 is R$299/t Genial Est. (-0.5% q/q; +14.6% y/y), indicating partial cost containment compared to the previous quarter. However, the year-on-year increase reflects the challenges with the drop in iron ore quality and costs related to freight (which are expected to rise q/q) and logistics operations, causing a lower dilution of fixed costs than in the same period last year, given the lower level of movement on the mining fronts. Even with the cost management effort, the unfavorable macroeconomic scenario weighs heavily on the company's margins, along with higher costs for mining vs. 2023.

EBITDA: Expected percentage improvement is high, but the comparative base is very depreciated. We believe that EBITDA should reach R$325mn Genial Est. (+31.4% q/q; +774.9% y/y), with the steel division contributing most significantly, with R$282mn Genial Est. (+304.8% q/q +212.5% y/y), partially reflecting the better dilution of fixed costs, with BF3 reaching a more mature level of ramp-up and showing better thermal efficiency. Even so, these factors are attenuated by the upward movement in inputs, as we have already mentioned. As for the mining division, we believe that it should suffer a strong retraction, with EBITDA projected at R$73mn Genial Est. (-53.0% q/q; -42.9% y/y).

We attribute the expected slowdown to pressure on the realized price of iron ore, given the fall in the 62% Fe curve at -11% q/q, as well as high operating costs, showing that the challenges continue. In addition, it is clear that both comparative bases are not, in fact, a good relative picture. This is because they were atypically negative when compared to their respective histories. Therefore, any level of improvement in the case of the steel division makes a more striking percentage difference, in the face of a very depreciated numerical EBITDA base. We therefore believe that there is still a long and arduous road ahead to recovery.

Table 5. EBITDA Usiminas (3Q24 Genial Est.)

(R$ millions)	3Q24E Genial Est.	2Q24A Reported	% q/q	3Q23A Reported	% y/y
Adjusted EBITDA	**325**	**247**	**31,3%**	**-48**	**774,5%**
Steel	282	70	304,1%	-251	212,3%
Mining	73	156	-53,4%	129	-43,5%
Eliminations	-30	21	-239,9%	74	-140,4%

Source: Usiminas, Genial Investimentos

Net income: following the recovery trend, but challenges remain. We project a Net income of R$63mn Genial Est. (+162.8% q/q; -137.8% y/y), representing a recovery from the loss in 2Q24, but still short of 2023 performance. As we had commented since the beginning of the year, 3Q24 would coincide with the more mature ramp-up level of Blast Furnace 3 (BF3) after the refurbishment, with a typically better quarter, due to seasonality and improvement in the automotive segment on the demand side. On the other hand, we point out that pressure on costs and prices keep the company in a slow recovery cycle, with the macroeconomic scenario in China still weighing on the prospect of substantial improvement, given the still high level of imports within Brazil's apparent steel consumption.

Table 6. Income Statement Usiminas (3Q24 Genial Est.)

(R$ millions)	3Q24E Genial Est.	2Q24A Reported	% q/q	3Q23A Reported	% y/y
Net Revenue	**6.677**	**6.350**	**5,1%**	**6.714**	**-0,6%**
COGS	(6.298)	(6.021)	-4,6%	(6.539)	-3,7%
Adjusted EBITDA	**325**	**247**	**31,3%**	**-20**	**1730,2%**
EBITDA Margin (%)	4,9%	3,9%	0,97p.p	-0,3%	5,16p.p
EBIT	**70**	**(28)**	**354,4%**	**(245)**	**128,7%**
EBIT Margin (%)	1,1%	-0,4%	1,49p.p	-3,6%	4,69p.p
D&A	(255)	(302)	-15,5%	(250)	2,1%
Financial Result	71	(393)	118,1%	(98)	172,9%
Net Income	**63**	**(100)**	**163,1%**	**(166)**	**138,0%**
Net Margin (%)	0,9%	-1,6%	2,51p.p	-2,5%	3,41p.p

Source: Usiminas, Genial Investimentos

Our Take on Usiminas

It's worth remembering that we were ahead of consensus. We believe that Usiminas will continue to face significant operational difficulties in 3Q24. As pointed out in our previous reports, the expectation of a significant improvement in the company's performance after the refurbishment of Blast Furnace 3 (BF3) did not materialize as the consensus anticipated. Although we expected some relief in operating costs with the resumption of the BF3, the still high dependence on third-party slabs, with high prices, continues to put pressure on the company. In 3Q24, it is likely that we will not see a significant reduction in COGS/t. In turn, the cost structure will still jeopardize the company's EBITDA gains and margin expansion. Even with the advance in sales volumes in the steel segment for the domestic market, **(i)** the macroeconomic scenario in Brazil and **(ii)** competition with Chinese steel, prevent a robust recovery.

We believe that a large proportion of investors have become too optimistic about Usiminas' ability to quickly improve its operating margins in the first few months of the year. Proof that **our approach was more skeptical compared to the rest of the market** can be found in the 4Q23 Preview report, published in February, which is attached (Usiminas 4Q23 Preview). With the release of the 1Q24 and 2Q24 results, it became clear that these **improvements fell short of those projected by other sell-side firms**. As a result of this shock of reality, investors who had built up positions in the company expecting improved results became frustrated and sold their shares, creating very strong downward pressure in a very short space of time, especially after July 26, when the 2Q24 results were released. **The shares suffered losses of over -20% in a single trading session**, showing that **expectations were disconnected from reality**. Since then, the stock's performance has shown no signs of investors regaining interest in Usiminas' name.

Investments in coking plants and fluctuating slab prices. The company has invested in coking plants in order to reduce purchases from third parties and mitigate exposure to slab price volatility. However, as the project has not yet been completed, the expected gains from these investments have not yet significantly impacted the result. The appreciation of the USD/BRL exchange rate observed throughout 2024 was another factor that made it difficult for the company to show a reduction in COGS/t that was more appealing to investors. We understand that this factor was beyond the control of Usiminas' expectations and budgets. As, even with the reduction in interest rates in the US, the USD/BRL exchange rate did not cool down, only falling for a few days and then appreciating after communications from the Brazilian government that would interfere with the credibility of the fiscal scenario, we still highlight difficult horizons for the company, as costs are likely to remain higher for longer than we would like to see.

Demand in the automotive segment is improving, but there is a risk that it will worsen again in 2025. Price pressure for the steel division is aggravated by the absence of more effective measures against imported products, since the quota system via a 25% complementary tariff, implemented by the Ministry of Trade (MDIC) in June, showed no immediate impact. In addition, there has been a **recent increase in the SELIC rate**, which rose +25bps to 10.75%. Our current expectation is that the **SELIC** rate at the end of this increase cycle will be **12% Genial Est**. **in 1Q25** and will remain at this level until 4Q25, when the interest rate cut cycle begins, closing 2025 at 11.50% Genial Est. This trajectory is the one that puts inflation at 3.2% in 2Q26, according to the output gap and neutral interest rate assumptions in the Central Bank's model.

Therefore, we point to the risk that the credit supply will come under pressure again in 2025, **cooling demand from the automotive segment**. Under our assumptions, the upward cycle would have to go up to 13.50% to achieve inflation within the target in 2025, so we suggest that the Central Bank start cutting interest rates while inflation is still outside the center of the target. Our inflation projection is 4.6% over the next few years (2025 and 2026). These factors, combined with competitive pressure, reinforce the company's neutrality scenario, considering that the sectors allocated to Usiminas' client portfolio are very sensitive to interest rates and credit supply.

Updated CAPEX reduction vs. tighter macro assumptions. We expect the company's decision to announce a retraction of the **24E CAPEX guidance** to **~R$1.4bn Genial Est.** (-22% vs. R$1.8bn in our previous model), which would generate a **24E FCF** cash flow decompression drafted under flexible management capacity and adaptable to situational challenges. It's not official yet, but we hope it could happen soon. In this way, Usiminas would be aligning its budget with the current moment. We understand that this would be a welcome move, since it would reflect an expansionary FCF balance despite the adverse conditions for the flat steel market in Brazil, given the high competitiveness with increased imports, driven by a significant volume coming from China.

However, even with a potential improvement in the FCF yield due to the reduction in CAPEX, the updating of our macro assumptions, mainly **(i)** SELIC, **(ii)** a reduction in the level of steel shipments in 2025 due to a cooling of the good momentum in demand for the automotive segment and **(iii)** the USD/BRL exchange rate, caused this improvement to be erased and even led to **a reduction in the 12M Target-Price of R$6.50** (vs. R$7.50 previously).

Still far from what was envisioned. We believe it's important to emphasize that **we don't see the substantial drop in shares** over the last 3M as a problem typically anchored to the **label of "overpromising and underdeliver"**. The rise in previous expectations and subsequent frustration on the part of investors was caused more by what we believe to be inappropriate comparisons that other sell-side firms made about Usiminas' cost structure with its Brazilian peers, in addition to disregarding the effect of macroeconomic components that came to hinder a greater level of efficiency on the part of the company. Trading at an **EV/EBITDA 25E** of **3x**, in fact below its historical level, we also admit that there are still prospects for margin recovery in the long term, especially with the **(i)** conclusion of investments in coking plants and **(ii)** full operation of Blast Furnace 3 (BF3).

However, the short-term challenges remain significant, with **(iii)** strong competition from Chinese steel and **(iv)** pressure from operating costs limiting the stock's upside potential. Given this scenario, coupled with the high concentration of exposure to flat steel, **we remain reluctant to see a potential change in the name bias**. Therefore, we prefer to reiterate our **NEUTRAL rating**, with a **12M Target-Price** of **R$6.50** (vs. R$7.50 previously) and a **marginal upside** of **+6.21%**. We believe that it may take a while for investors to become interested in the shares again, given the strong negative impact caused by the failure to meet the expectations that a portion of the market placed on the cost reduction following the refurbishment of BF3.

Appendix: Usiminas

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

Income Statement	2024E	2025E	2026E	2027E	2028E
Net Revenue	**25.104**	**28.136**	**31.204**	**34.167**	**37.105**
(-) COGS	(23.626)	(25.754)	(27.974)	(29.505)	(30.596)
Gross Profit	**1.478**	**2.383**	**3.230**	**4.662**	**6.509**
(-) Expenses	(1.211)	(1.316)	(1.571)	(1.602)	(1.708)
Adjusted EBITDA	**1.341**	**2.120**	**2.745**	**4.213**	**5.698**
(-) D&A	(1.119)	(1.054)	(1.087)	(1.152)	(897)
EBIT	**267**	**1.067**	**1.659**	**3.061**	**4.801**
(+/-) Financial Result	(526)	(285)	(446)	(594)	(644)
(-) Taxes	(76)	(434)	(673)	(1.370)	(2.308)
Net income	**42**	**348**	**540**	**1.098**	**1.849**
Profitability					
Net margin (%)	0,17%	1,24%	1,73%	3,21%	4,98%

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

Cash Flow (FCFF)	2024E	2025E	2026E	2027E	2028E
Net Revenue	**25.104**	**28.136**	**31.204**	**34.167**	**37.105**
(-) COGS	(23.626)	(25.754)	(27.974)	(29.505)	(30.596)
Adjusted EBITDA	**1.341**	**2.120**	**2.745**	**4.213**	**5.698**
EBIT	**267**	**1.067**	**1.659**	**3.061**	**4.801**
(-) Taxes	(76)	(434)	(673)	(1.370)	(2.308)
(+) D&A	1.119	1.054	1.087	1.152	897
(+/-) Δ WK	1.360	(739)	(830)	(611)	(503)
(-) Capex	(1.443)	(1.241)	(2.047)	(1.638)	(1.556)
FCFF	**1.228**	**(293)**	**(805)**	**594**	**1.331**

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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