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USIMINAS

3Q24 Review: Steel yourself

LatAm Metals & Mining

(i) The domestic market overcame the drop in the foreign market, with **shipments** reaching **1.13Mt** (+1.4% vs. Genial Est.), up +8.1% q/q; **(ii)** The consolidated realized price was R$5,502/t (-0.8% vs. Genial Est.), up a mere +0.1% q/q; **(iii) Mining**: shipments grew even in the face of operational difficulties, reaching **2.29Mt** (+14% vs. Genial Est.), up +13.5% q/q; **(iv)** Improvement in the level of sales in the mining segment was one-off; **(v)** The realized price of the mining unit stood at R$335/t (-1.1% vs. Genial Est.) with a drop of -13.2% q/q; **(vi**) Net revenue grew, driven by the steel division; **(vii**) **COGS/t** in steel reached **R$5,164/t** (-2.7% vs. Genial Est.), with a decompression of **-3.1% q/q**; **(viii) Adjusted EBITDA** registered **R$426mn** (+31% vs. Genial Est.), showing a **significant increase** of **+72.5% q/q; (ix)** Net income shows reversal of loss; **(x)** We have **doubts about the consistency of** the positive momentum. The EBITDA margin closed 3Q24 at 6.2%, but the company's historical potential is above 10%. To get there, **many factors do not depend on Usiminas' execution**, such as the USD/BRL exchange rate and the dynamics of competition with imported steel; **(xi)** Reduction in **CAPEX guidance** came with more force than expected, adjusting it to **R$1.1bn** (vs. R$1.7-1.9bn previously); **(xii) FCFE** of **R$316m** (+111% q/q) justified by the increase in EBITDA; decompression of WC and reduction in CAPEX, which totaled R$202m (-12.8% q/q); **(xiii)** Although the lower level of CAPEX may improve FCF *yield* in the short term, our adjusted assumptions end up erasing the effect. We rectify a **higher SELIC**, with an expected retraction in steel sales in 2025 due to the slowdown in the automotive segment forced by the reduction in the supply of credit driven by the cycle of higher SELIC; **(xiv)** Given the current scenario, combined with Usiminas' strong exposure to the flat steel segment, **we remain cautious about a possible change in the name bias**. We therefore reiterate our **NEUTRAL rating**, with a **12M Target Price** of **R$6.50**, reflecting a **downside** of **-4.8%**.

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

(Thousand Tonnes - kt)	Reported	Genial Est.					
Summary (Shipments)	**3Q24A**	**3Q24E**	**% R/E**	**2Q24A**	**% q/q**	**3Q23A**	**% y/y**
Steel	1.126	1.110	**1,4%**	1.042	**8,1%**	1.021	**10,3%**
Iron Ore	2.288	1.997	**14,6%**	2.015	**13,5%**	2.391	**-4,3%**

Source: Usiminas, Genial Investimentos

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

(R$ millions)	Reported	Genial Est.					
Income Statement	**3Q24A**	**3Q24E**	**% R/E**	**2Q24A**	**% q/q**	**3Q23A**	**% y/y**
Net Revenue	6.817	6.677	**2,1%**	6.349	**7,4%**	6.714	**1,5%**
Adjusted EBITDA	426	325	**31,2%**	247	**72,5%**	-20	**2239,2%**
Net Income	184	63	**192,4%**	(99)	**285,9%**	(166)	**211,1%**

Source: Usiminas, Genial Investimentos

Analysts

Igor Guedes
+55 (11) 3206-8286
igor.guedes@genial.com.vc

Luca Vello
+55 (11) 3206-1457
luca.vello@genial.com.vc

Isabelle Casaca
+55 (11) 3206-8244
isabelle.casaca@genial.com.vc

Company

USIM5 BZ Equity
Neutral

Price: R$ 6.64 (25-Oct-2024)
Target Price 12M: R$ 6.50

Usiminas released its **3Q24 results on October 25**, last Friday. In general, the **figures were mostly above what we expected**. Even so, there is **still a long way to go** before we see results that we can consider in good shape. In the **steel** division, **shipments** clocked in at **1.13Mt** (+1.4% vs. Genial Est.), growing +8.1% q/q and +10.3% y/y, and with a slightly improved realized price. **Iron ore** sales volume reached **2.29Mt** (+14% vs. Genial Est.), up +13.5% q/q, although it fell by -4.3% y/y. The realized price of the mining division decreased considerably due to the contraction in the 62% Fe reference curve.

The company reported **Net revenue** of **R$6.8bn** (+2.1% vs. Genial Est.), up +7.4% q/q and +1.5% y/y, driven by the improvement in steel sales with no offsetting reduction in realized price. **Adjusted EBITDA** registered **R$426mn** (+31% vs. Genial Est.), showing a significant increase of +72.5% q/q, and reversing the operating loss on an annual basis, with **steel COGS/t** reaching **R$5,164/t** (-2.7% vs. Genial Est.), showing a **drop** of **-3.1% q/q**. **Net income** was **R$184mn** (2x higher vs. Genial Est.), reversing losses both sequentially and y/y.

Valuation and rating. Following the release of **last quarter**'s results, Usiminas **shares fell an impressive -23%** in a single trading session. **Management's signaling of** a **reduction in the cost structure**, after the refurbishment of Blast Furnace 3 (BF3) was completed, was **disappointing at the time** (to most, not to us). The consensus expected a sequential reduction from 1Q24, which didn't happen. **This quarter, the company seems to have addressed this issue better**, with **steel COGS/t** falling **-3.1% q/q** to **R$5,164/t** (-2.7% vs. Genial Est.). This was possible thanks to the contribution of some factors, such as: **(i)** efficiency gains at BF3 and other furnaces (-R$86/t); **(ii)** retraction in raw material costs (-R$56/t), partially erased by the rise in the USD/BRL exchange rate, putting pressure back on the value of inputs in BRL (coke, iron ore and third-party slab).

In short, we recognize that Usiminas' stance remains in line with its strategy of building a solid foundation for the future. Although it has already had some effect in the short term, we are still **skeptical about the potential operational reversal** to an EBITDA margin comfortably above 10%, as the company had years before the turn of the cycle and the **excessive increase in flat steel imports** within Brazil's apparent consumption. In 3Q24, the margin closed at 6.2% (+2.36p.p vs. 2Q24), and even with the advance, it is **a long way** from what we consider ideal. In other words, if on the one hand the 3Q24 performance was generally better than we expected, it still falls short of what we would like to see in order to change our bias to a possible buy rating, not least because the comparative bases were very depreciated and there is a long way to go.

The company, therefore, should **(i)** continue to face the impact of a still volatile USD/BRL exchange rate, **(ii)** acquire dollarized inputs at higher costs, and **(iii)** find no room for significant price pass-throughs in the short term, justifying our continued reticence about the potential for a change in bias on the name. Even with a quarter of better-than-expected operating results, **we believe that the structural risks still outweigh the punctual advances**. In this context, Usiminas trades at an **EV/EBITDA 25E** of **3x**, and we recognize that it is well below the historical average. However, given the persistence of a challenging macroeconomic scenario and the competitive environment with continued pressure from Chinese steel imports, we reiterate our **NEUTRAL rating**, with a **12M Target Price** of **R$6.50**, reflecting a **downside** of **-4.8%**.

3Q24 Review: In detail!

The domestic market overcomes the fall in the foreign market. The company recorded total steel shipments (DM + FM) of 1,126kt (+1.4% vs. Genial Est.), an increase of +8% q/q and +10%y/y. We saw a significant reduction in the volume coming from the foreign market (FM), which registered 56Kt (-17.6% q/q; -37% y/y). We note that this reduction was offset by the growth in sales in the domestic market (DM), which reached 1,070Kt (+0.8% vs. Genial Est.), showing an increase of +10% q/q and +15% y/y. This increase, as discussed in our preview report, reflected stronger demand in the domestic industry, despite predatory competition from Chinese steel. Production capacity also benefited from the operational evolution of BF3, which reached a more mature level of ramp-up during the quarter, after the refurbishment was completed in November last year, resulting in an increase of +148% y/y.

Realized prices: slight increase in the domestic market. The realized price of steel for the foreign market (FM) stood at R$6,125/t (-5.0% vs. Genial Est.), a contraction of -2.7% q/q, but an increase of +14.0% y/y. While the price on the domestic market (DM) reached R$5,469/t (+1.1% vs. Genial Est.), achieving a mild rise of +0.5% q/q despite a slowdown of -3.0% y/y. As a result, the consolidated realized price (DM+FM) was R$5,502/t (-0.8% vs. Genial Est.), showing a slight rise of +0.1% q/q and a fall of -2.4% y/y. According to management information, a sequentially better result in the domestic market was possible due to price transfers to the client portfolio in the distribution and industrial segments. The effect did not translate into an even stronger realized price as it was impacted by a worsening in the quality of the sales mix. The September price, which indicates how the 4Q24 price might turn out, closed +1% higher than in 3Q24

Mining: shipments grow despite operational difficulties. For MUSA, Usiminas' mining division, shipments were higher than expected, at 2,288Kt (+14.6% vs. Genial Est.), up +13.5% q/q and down -4.3% y/y. We'd like to point out that since 1Q24 MUSA has been struggling with the shutdown of a treatment unit. When we asked management on the conference call whether this increase in sales was in line with the typical seasonality of the 3Qs or whether there had been some reorganization of the mining fronts that would have helped boost shipments, the answer was that the mining fronts that feed the shut-down treatment unit were not in operation.

Mining: improvement in sales was a one-off. As we mentioned above, there is a limitation on the other treatment units to produce the volume of iron ore in line with the company's installed capacity. As long as MUSA doesn't regularize the mining fronts that will feed the treatment unit that has been shut down, the company will continue to operate below its installed capacity. Production volume was 2.1Mt (-7.8% y/y). Management argued that the stronger increase in shipments in 3Q24 was one-off. In our view, one of the explanations that could support the more elastic figure than the estimates, since the problem has not been resolved, would be a more expressive level of sales of purchases from third parties. We therefore believe that the performance should not be interpreted excessively positively, given that third-party sales imply lower margins.

Mining: the contraction in the realized price was stronger than the fall in the benchmark 62% Fe. The realized price in the mining segment was R$335/t (-1.1% vs. Genial Est.), down -13.2% t/t, impacted by the deceleration of the 62% Fe curve, which fell -11% t/t. This contraction was only partially offset by the increase in volume sold, as mentioned above, and by the appreciation of the USD/BRL exchange rate. The result of these components, combined with our assumption of a higher level of third-party purchases, was a compression of the EBITDA margin to 11% at MUSA (vs. 26% in 2Q24).

Net revenue with growth is driven by the steel division. Consolidated net revenue totaled R$6.8bn (-2.1% vs. Genial Est.), showing growth of +7.4% q/q and +1.5% y/y. The result was mainly driven by the performance of the steel business division, which reached a net revenue of R$6.1bn (+0.5% vs. Genial Est.), up +8.2% q/q and +7.7% y/y, through an increase of +8% q/q in sales and a slight price gain in the domestic market, as we commented. In the mining segment, net revenue came in at R$767mn (-13% vs. Genial Est.), lower than we expected, with a drop of -1.2% q/q and -3.2% y/y, reflecting the lower prices charged, partially offset by the increase in sales volume.

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

(R$ millions)	3Q24E Genial Est.	3Q24A Reported	% R/E	2Q24A Reported	% q/q	3Q23A Reported	% y/y
Net Revenue	**6.817**	**6.677**	**2,1%**	**6.349**	**7,4%**	**6.714**	**1,5%**
Steel	6.195	6.162	0,5%	5.728	8,2%	5.754	7,7%
Mining	767	677	13,3%	777	-1,3%	793	-3,2%
Eliminations	(145)	(163)	-10,8%	(156)	-7,1%	168	-186,5%

Source: Usiminas, Genial Investimentos

COGS/t shows signs of efficiency gains, better than estimated. Although the steel business division's nominal COGS rose to R$6.4b (+6.3% q/q; +2.1% y/y) as a result of **(i)** the increase in sales volume (+8.1% q/q) and **(ii)** partial dependence on third-party slabs, the COGS/t of steel actually showed improvements in the degree of efficiency after the AF3 reform, being marked at R$5,164/t (-2.7% vs. Genial Est.), down -3.1% y/y. According to management, this was the result of a reduction in raw material costs and efficiency gains that were partially offset by the effect of exchange rate variations. Mining COGS/t, on the other hand, clocked in at R$306/t, slightly higher at +2.0% q/q due to higher exports in the sales mix, which translates into higher freight costs.

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

(R$ millions)	3Q24E Genial Est.	3Q24A Reported	% R/E	2Q24A Reported	% q/q	3Q23A Reported	% y/y
COGS	**(6.403)**	**(6.298)**	**1,7%**	**(6.022)**	**-6,3%**	**(6.539)**	**-2,1%**
Steel	(5.815)	(5.842)	-0,5%	(5.554)	-4,7%	(5.839)	-0,4%
Mining	(700)	(596)	17,4%	(605)	-15,7%	(623)	12,3%
Eliminations	112	141	-20,6%	137	-18,2%	(76)	-246,8%

Source: Usiminas, Genial Investimentos

EBITDA shows significant percentage growth, but on a weak base. Consolidated adjusted EBITDA reached R$426mn (+31% vs. Genial Est.), showing an increase of +72.% q/q and reversing the negative operating result on an annual basis. The steel division's EBITDA was R$378mn (+34% vs. Genial Est.), showing a 4x improvement vs. last quarter's performance, channeled by the reduction in COGS/t and an increase in steel shipments in the domestic market, with no loss of profitability in the realized price. As for the mining division, EBTIDA clocked in at R$44mn (-39% vs. Genial Est.), a contraction of -71.8% q/q and -65.8% y/y. MUSA's performance was weak due to an increase in COGS/t and a sharp drop in the realized price of iron ore, dragged down by the deceleration of the 62% Fe curve.

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

(R$ millions)	3Q24E Genial Est.	3Q24A Reported	% R/E	2Q24A Reported	% q/q	3Q23A Reported	% y/y
Adjusted EBITDA	**426**	**325**	**31,2%**	**247**	**72,5%**	**-48**	**985,1%**
Steel	378	282	34,1%	70	440,0%	-251	250,7%
Mining	44	73	-39,5%	156	-71,8%	129	-65,8%
Eliminations	4	-30	-113,4%	21	-81,0%	74	-94,6%

Source: Usiminas, Genial Investimentos

Net income shows reversal of losses. The company posted a net income of RS$185mn (2x higher vs. Genial Est.), reversing the losses of both the previous quarter and the same period last year. As we have already commented, the improvement comes from a higher figures of steel shipments in the domestic market, with slightly incremental prices, which boosted the steel division, the company's most relevant, which would have offset the more anemic performance of the mining segment.

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

(R$ millions)	3Q24E Genial Est.	3Q24A Reported	% R/E	2Q24A Reported	% q/q	3Q23A Reported	% y/y
Net Revenue	**6.817**	**6.677**	**2,1%**	**6.349**	**7,4%**	**6.714**	**1,5%**
COGS	(6.403)	(6.298)	1,7%	(6.022)	-6,3%	(6.539)	-2,1%
Adjusted EBITDA	**426**	**325**	**31,2%**	**247**	**72,5%**	**-20**	**2239,2%**
EBITDA Margin (%)	6,2%	4,9%	1,39p.p	3,9%	2,36p.p	-0,3%	6,55p.p
EBIT	**151**	**70**	**115,3%**	**(27)**	**659,3%**	**(245)**	**161,7%**
EBIT Margin (%)	2,2%	1,1%	1,16p.p	-0,4%	2,64p.p	-3,6%	5,86p.p
D&A	(306)	(255)	19,8%	(303)	-1,1%	(250)	22,3%
Financial Result	55	71	-22,9%	(196)	128,1%	(98)	156,2%
Net Income	**184**	**63**	**192,4%**	**(99)**	**285,9%**	**(166)**	**211,1%**
Net Margin (%)	2,7%	0,9%	1,76p.p	-1,6%	4,26p.p	-2,5%	5,17p.p

Source: Usiminas, Genial Investimentos

Our Take on Usiminas

We got the dynamics right before consensus. It's worth remembering that our analysis proved to be assertive in anticipating what would happen to the company's cost structure ahead of the street, which expected more aggressive COGS/t reductions since 1Q24, occurring sequentially in every quarter of the year. We believe that in 3Q24, Usiminas continued to face a challenging scenario, since competition with steel for the flat category did not cool down even with the measures implemented by the Ministry of Trade (MDIC) of a quota system with a 25% complementary tariff for 11 NCMs. Even so, the company posted higher operating results. The expected relief in operating costs following the refurbishment of BF3 partially materialized, with steel COGS/t contracting -3.1% q/q, actually a little better than we expected, but not by much.

A quarter of improvement, but challenges remain. The **(i)** persistent dependence on third-party slabs and **(ii)** appreciation of the USD/BRL exchange rate putting pressure on USD-indexed inputs continue to compromise the full efficiency of the operation. In addition, **(iii)** pressure from competition from Chinese steel linked to data from Aço Brasil (IABr) suggest a continued increase in the volume of imported subsidized steel, mainly of Chinese origin, which reached 934Kt of flat-rolled products in the quarter (+13% q/q). This brought the market share of imports to 22% of Brazilian steel consumption, consolidating a unfavorable scenario. Since the beginning of the year, our skeptical stance, as pointed out in previous reports, has been corroborated by the results released in 1Q24 and 2Q24, which frustrated the expectations of accelerated improvement projected by other sell-side firms. The market reacted negatively to the divergence between expectations and reality, resulting in a drop of more than -20% in shares on the day of the 2Q24 release, as we had been warning it would happen since February.

We have doubts about the consistency of the positive momentum. Even with the operational improvement seen in 3Q24, and **the shares rising +5% in Friday's trading session** as investors reacted to the above-expectations result, we believe that Usiminas still faces **difficulties in consolidating a sustainable growth trajectory**. We believe it is too early to assess whether the positive momentum will continue in the build-up to a consistent recovery, as the road is long and arduous. The EBITDA margin closed 3Q24 at 6.2%, but the company's historical potential is above 10%. To get there, many factors don't depend on Usiminas' execution, such as **(i)** the USD/BRL exchange rate, which doesn't look like it will cool down in the face of market concerns about the fiscal policy in Brazil and **(ii)** the dynamics of competition with imported steel, which are still being discussed to cover a larger group of NCMs. The latest GECEX, published less than two weeks ago, did not contain any progress to address flat steel imports. We believe that these factors jeopardize the continuity of better profitable margins.

The reduction in CAPEX guidance came harder than expected. Along with the 3Q24 results, Usiminas officially revised its **24E CAPEX guidance**, adjusting it to **R$1.1bn** (vs. R$1.7-1.9bn previously). As a result, the company is now reflecting a **more conservative pace of investment throughout the year**, adapting it to the challenging economic circumstances. As we had anticipated in our preview report, we warned that the likelihood of CAPEX being reduced was high. Even so, **the reduction came at a greater intensity than we had expected** (-R$300mn vs. our expectations). The total contraction generates additional FCF room for 4Q24, partially offset by us with tougher macro assumptions (as we address later). According to management, no investment projects were canceled.

There were some **unintentional postponements**. The company had budgeted the start of **(i)** the PCI project (pulverized coal injection) for BF3. The negotiation phase for contracting the labor service ended up taking longer than expected, with execution being pushed forward. Mobilization for assembly is taking place in 4Q24 and should continue throughout 1Q25. For **(ii)** the Battery 3 project, which began hot repairs at the start of the year, execution is slower due to the difficulties of carrying out repairs while the coking plant is still in operation, generating a shift in CAPEX to the 2025 budget. In addition, Usiminas had foreseen a **(iii)** CAPEX dedicated to battery 4. However, the company has not yet made a concrete decision on this coking plant, so it will become part of the budget later on. Management reinforced that there **should be no increase in CAPEX 25E vs. 24E**, with a stabilization of the figure being the most likely.

FCFE shows substantial improvement. We highlight that FCFE was R$316mn (+111% q/q) due to **(i)** the increase in EBITDA (+72% q/q); **(ii)** the decompression of working capital (-3% q/q) and **(iii)** the reduction in CAPEX, which totaled R$202mn (-12.8% q/q) in line with the change in guidance released (R$1.1bn 24E vs. R$1.8bn previously). In addition, it is worth noting the good adaptive behavior regarding the retraction of sequential leverage (0.38x vs. 0.79x in 2Q24), cooled by the **(iv)** improvement in operational efficiency and **(v)** positive effect of the exchange rate variation on USD debt.

Is FCF expansion structural? Although the expansion could improve the FCF yield in the short term, our adjusted assumptions of **(i)** a higher SELIC rate, **(ii)** an expected downturn in steel sales in 2025 due to the slowdown in the automotive segment as a result of the reduction in the credit supply driven by the SELIC rate hike cycle and **(iii)** the impact of the USD/BRL exchange rate partially offset the reduction in CAPEX announced, neutralizing effects derived from the company's good results to the detriment of structural factors. For the time being, this implies a mitigation of the potential improvement in FCF.

Steel yourself. We emphasize that the sharp fall in shares over the last three months does not reflect a typical “over promise and under deliver” scenario. In our perception, investors' frustration was largely amplified by inappropriate comparisons made by other sell-side firms, who approximated Usiminas' cost structure to that of its peers in Brazil, without properly considering the adverse macroeconomic impacts. These factors have limited the company's efficiency. In fact, Usiminas is trading at an **EV/EBITDA 25E** of **3x**, below its historical level, and there is a prospect of margins recovering in the long term, especially with **(i)** the conclusion of investments in coking plants and **(ii)** the full operation of BF3.

However, the short-term challenges are still significant, with **(iii)** intense competition from Chinese steel and **(iv)** operating cost pressure continuing to limit the stock's upside potential. Given the current scenario, combined with Usiminas' strong exposure to the flat steel segment, **we remain cautious about a possible change of bias in the name**. Therefore, we reiterate our **NEUTRAL rating**, with a **12M Target Price** of **R$6.50**, reflecting a **downside** of **-4.8%**.

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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Genial Rating

	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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