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USIMINAS

Site Visit Ipatinga: There was a stone in the middle of the road

LatAm Metals & Mining

(i) We believe that the company should still capture **efficiency gains and lower COGS/t**, but we understand that the **cost reduction will be far from the level projected by consensus**, as we have already mentioned throughout our coverage of Usiminas during the whole year. While we recognize the company's efforts, we prefer to give more weight to the challenging macroeconomic and sector environment with **(ii)** an unfavorable outlook for the steel market given the projected increase in the SELIC rate; **(iii)** iron ore prices still under pressure and risks associated with the mining division (MUSA). In addition, we see the **(iii) increase in the USD/BRL exchange rate to historic levels** as almost structural, given the fiscal framework in Brazil, and this puts pressure on the company's cost base and creates a dilutive character in the efficiencies brought by the gain in productive scale after the ramp-up of BF3. **(iv)** We recognize that the company is discounted, trading at an **EV/EBITDA 25E** of **3.5x** (vs. 5x historical average). However, we believe that the discount is reasonable due to the lack of interest from investors in forming a long position in the face of the difficulties affecting the flat segment in Brazil with competition from imported steel, as well as the three points we mentioned in the excerpt above. **(v)** Therefore, the event and the **conversation with management did not indicate any new information from a micro point of view** that would significantly alter our thinking about the difficulties the company is facing, especially from a macro perspective. We therefore reiterate our **NEUTRAL rating**, with a **12M Target Price** of **R$6.50**, reflecting an upside of **+6.20%**.

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$ 6.12 (09-Dec-2024)
Target Price 12M: R$ 6.50

Last week we took part in a **visit to Usiminas' main plant** in Ipatinga (MG), accompanied by other sell-side firms, followed by a conversation with the CEO, Mr. Marcelo Chara, and the CFO, Mr. Tiago Rodrigues, who highlighted the company's prospects for the future.

Visit to Ipatinga and meeting with management

BF3: Positive signs. The expectations with the cost reduction following the refurbishment of Blast Furnace 3 (BF3), completed in November 2023 after a CAPEX outlay of ~R$600mn, resulted in a -23% drop in the shares after the release of the 2Q24 results. As we commented on in our report at the time, this performance was pressured by **(i)** increased costs with the purchase of third-party slabs, **(ii)** and the lag effect in the recovery of operational efficiency in BF3.

After the visit, we assess that this scenario will be overcome in the coming quarters, with the company better positioned to capture productivity gains. To date, Usiminas has already achieved improvements of ~22% in productivity and ~8% in fuel efficiency with the reform. And, according to the company's technical staff, the full potential of BF3 has not yet been reached, improvements are still underway.

Fuel rate and coke rate enabling efficiency gains. Usiminas plans to reduce the use of fuel per ton of pig iron (fuel rate) to ~500kg/t compared to the current ~520kg/t (vs. ~600kg/t before the reform), achieving efficiency levels comparable to the most advanced blast furnaces in the world. The company is investing in the exchange of professionals with experience in high-performance blast furnaces and in the development of advanced technologies, using global benchmarks from Ternium's operations. In addition, Usiminas has been replacing part of the coke used as fuel with PCI (Pulverized Coal Injection) and is moving ahead with the construction of a new PCI plant, scheduled for completion in 2025. PCI is around 58% cheaper than coke, which more than offsets the need for 12% more PCI for the same amount of coke.

In addition, the refurbishment of Coke Plant 2, scheduled for completion in 2H26, will increase coke self-sufficiency from 30% to ~45%, which would benefit costs, improve logistics and operational reliability. Coke plant 3, which would guarantee 100% self-sufficiency, remains deactivated, with no plans to reactivate it.

Although demand has improved, we are more skeptical about 2025. Demand is mostly directed at the domestic market, which accounts for +90% of sales, with a share focused on the **(i)** automotive (~25%); **(ii)** industrial (~37%) and **(iii)** distribution (~25%) segments. Although the shipments expansion in 3Q24 was notable, we expect a deterioration in the automotive sector in 2025, with a greater impact on heavy-duty vehicles, due to the yield interest curve in Brazil and the higher USD/BRL exchange rate, amid the turbulent macroeconomic scenario, which will also impact the industrial segment.

In addition, the narrowing of the market share in the face of the influx of lower cost imported steel, mainly from China, competes directly with Usiminas in the flat segment. This isn't necessarily a new problem, but the point is that we see less chance of this situation equalizing in the short term, with discussions with the government about tariff barriers moving at a slower pace than the Brazilian steel industry needs. In contrast to our thinking, management has signaled that it expects the government to adopt stricter anti-dumping measures in 2025 that would protect local mills from predatory competition. If implemented, these measures could unlock some value for Usiminas.

Our assessment is that MUSA presents more risks than opportunities. Usiminas' mining unit (MUSA), made up of three deposits in the Serra Azul region (MG), has estimated reserves until 2030. The Compact Project, which would enable the extension of exploration, is pending approval for environmental licensing. If approved, the project would add ~12Mtpy of iron ore (pellet feed and sinter feed), extending operations to ~2050. The estimated CAPEX to make it viable is ~US$1.5bn, and the company has signaled uncertainties about the means to raise this funding. We consider this scenario to be a relevant downside risk in both directions: **(i)** if the project is not approved, there is a risk that Usiminas will lose its main iron ore extraction capacity from 2030 onwards, since, as far as has been disclosed, there are no other reserve alternatives in sight

(ii) if approved, the project will require a high capex outlay of US$1.5bn, in addition to implying a higher C1. In addition, **(iii)** the global commodity market remains challenging, with prices depressed on the 62% Fe curve and no signs of recovery. These factors jeopardize the profitability of the segment, which, in our opinion, presents more risks than opportunities.

Our Take on Usiminas

The company admits that it is not prepared to be competitive with this level o FX rate. Around 60% of Usiminas' costs are pegged to the dollar, due to the purchase of inputs such as iron ore, coal, coke and slabs from third parties, which exposes the company to the volatility of the USD/BRL exchange rate. According to the management, this percentage should remain stable over the next four quarters. Thus, the acceleration of the USD/BRL exchange rate to ~R$6.00, reaching a level never seen in history, reinforces our caution in relation to the company. During the 3Q24 conference call, Usiminas pointed out that an exchange rate above R$5.72 already puts significant pressure on costs. We believe that companies with revenues pegged to the USD and with a more export-oriented bias offer a more strategic investment profile at this time.

Ternium reinforces commitment to Usiminas' competitiveness and governance. During the event, the management's speech reflected a positive feeling of a change of course with the strong commitment of Ternium to the operation of Usiminas since it took control in 2023. We reinforce that in fact, Ternium has brought in efficiency benchmarks based on its global operations and implemented better governance practices. In addition, it has also set ambitious targets, including achieving EBITDA margins of 15% (vs. ~5.6% currently) and reducing carbon emissions by 15% by 2030, based on 2023 levels. However, Usiminas has not indicated clear paths to achieve these targets, and this should continue to weigh on investors' decision not to take long positions.

There was a stone in the middle of the road. We believe the company is now better positioned from a microeconomic standpoint to further reduce its COGS/t. However, the macroeconomic environment presents significant headwinds that could challenge its progress. We are concerned about **the damaging effect of the higher USD/BRL exchange rate in the short term** as a **factor restricting** the company's ability to capture the efficiency gains from the **BF3 reform**. Although, as we have commented throughout the report, we recognize that the company is focused on cost control, here the famous poem by Carlos Drummond de Andrade seems to fit perfectly, **"There was a stone in the middle of the road..."**

We recognize that the company is discounted, trading at an **EV/EBITDA 25E** of **3.5x** (vs. ~5x historical average). However, we believe that the discount is reasonable due to investors' lack of interest in forming a long position in the face of the difficulties. We therefore reiterate our **NEUTRAL rating**, with a **12M Target Price** of **R$6.50**, reflecting an **upside** of **+6.20%**.

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**

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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%**
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under Review	Under review	**5%**

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