

Gerdau S. A.

Investor day feedback – Rough(er) seas ahead but Gerdau is a weathered sailor

Maintain Rating: BUY | PO: 30.00 BRL | Price: 24.30 BRL

More challenging market ahead yet Gerdau well positioned

Today Gerdau hosted its annual Investor Day in which management discussed the company's aspirations to become in ten years one of the safest, most profitable, and admired steel companies in the world while maintaining its core focus on the Americas. Although according to management, 2H23 has been mired in several headwinds for steel markets including excess steel production in China translating into more exports, lower global steel prices, fewer project starts in Brazil and a potential of higher-for-longer rates in the US, Gerdau is well positioned to navigate more challenging markets given its geographical diversification, high value-added portfolio, initiatives to deliver output growth & boost profitability and its discipline in capital allocation. Additionally, management sees lower interest rates in Brazil eventually translating into a rebound in construction activity and also expects significant demand growth potential in the US due to infrastructure bills which should prevent a hard landing for the economy. We maintain our Buy on Gerdau particularly due to its leverage to higher US infra spending ahead and due to attractive valuation seeing it trading at 5.5x EV/EBITDA 24 (vs. 6-6.5x historical level) and generating an 9% FCF yield.

Brazil: low rates bump to demand behind upbeat outlook

Management shared a more constructive demand outlook for Brazil, despite the short-term challenges for several sectors, as the lower interest rates should trigger improvements for new residential units going forward while government-led infra investments and social housing could offer some support. Meanwhile, the oil & gas, agro and retail segments have good prospects. They also expressed confidence that the Brazilian govt could eventually hike import taxes to limit aggressively priced Chinese products.

Continued on page 3

Estimates(Dec) (BRL)	2021A	2022A	2023E	2024E	2025E
EPS	8.43	7.08	4.73	3.78	3.39
EPS Change (YoY)	533.8%	-16.0%	-33.2%	-20.1%	-10.3%
Consensus EPS (Bloomberg)			5.17	3.39	3.09
DPS	2.98	3.37	1.42	1.70	1.70
ADR EPS (US\$)	1.56	1.37	0.94	0.75	0.67
ADR DPS (US\$)	0.55	0.65	0.28	0.34	0.34
Valuation (Dec)					
P/E	2.9x	3.4x	5.1x	6.4x	7.2x
GAAP P/E	2.9x	3.4x	5.1x	6.4x	7.2x
Dividend Yield	12.3%	13.9%	5.8%	7.0%	7.0%
EV / EBITDA*	2.2x	2.4x	3.6x	4.3x	4.5x
Free Cash Flow Yield*	18.6%	25.4%	16.0%	8.8%	4.1%

* For full definitions of *IQmethod*SM measures, see page 6.

28 September 2023

Equity

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Stock Data

Price (Common / ADR)	24.30 BRL / 4.81 USD
Price Objective	30.00 BRL / 5.80 USD
Date Established	25-Sep-2023 / 25-Sep-2023
Investment Opinion	C-1-8 / C-1-8
52-Week Range	22.08 BRL - 32.27 BRL
Market Value (mn)	42,251 BRL
Average Daily Value	41.35 USD
Shares Outstanding (mn)	1,738.7 / 1,738.7
BofA Ticker / Exchange	GGBUF / SAO
BofA Ticker / Exchange	GGB / NYS
Bloomberg / Reuters	GGBR4 BZ / GGBR4.SA
ROE (2023E)	17.0%
Net Dbt to Eqty (Dec-2022A)	15.4%

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Refer to important disclosures on page 7 to 10. Price Objective Basis/Risk on page 5.

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Timestamp: 28 September 2023 07:46PM EDT

iQprofileSM Gerdau S. A.

iQmethodSM – Bus Performance*

(BRL Millions)	2021A	2022A	2023E	2024E	2025E
Return on Capital Employed	28.0%	22.8%	14.4%	11.1%	9.6%
Return on Equity	41.1%	27.9%	17.0%	12.5%	10.6%
Operating Margin	26.2%	21.5%	16.5%	12.6%	10.5%
Free Cash Flow	7,874	10,719	6,775	3,700	1,737

iQmethodSM – Quality of Earnings*

(BRL Millions)	2021A	2022A	2023E	2024E	2025E
Cash Realization Ratio	0.7x	1.2x	1.5x	1.5x	1.4x
Asset Replacement Ratio	1.1x	1.5x	1.9x	1.9x	1.8x
Tax Rate	24.0%	26.1%	21.6%	20.0%	20.0%
Net Debt-to-Equity Ratio	16.9%	15.4%	9.1%	7.6%	9.5%
Interest Cover	14.3x	11.9x	8.2x	6.4x	6.4x

Income Statement Data (Dec)

(BRL Millions)	2021A	2022A	2023E	2024E	2025E
Sales	78,345	82,412	71,656	70,184	75,076
% Change	78.8%	5.2%	-13.1%	-2.1%	7.0%
Gross Profit	23,476	21,613	14,937	12,581	11,979
% Change	178.5%	-7.9%	-30.9%	-15.8%	-4.8%
EBITDA	23,221	21,506	14,329	12,121	11,480
% Change	202.0%	-7.4%	-33.4%	-15.4%	-5.3%
Net Interest & Other Income	(948)	(1,892)	(1,141)	(618)	(536)
Net Income (Adjusted)	15,098	12,372	8,228	6,569	5,895
% Change	533.2%	-18.1%	-33.5%	-20.2%	-10.3%

Free Cash Flow Data (Dec)

(BRL Millions)	2021A	2022A	2023E	2024E	2025E
Net Income from Cont Operations (GAAP)	14,900	12,372	7,975	6,569	5,895
Depreciation & Amortization	2,659	2,862	3,017	3,291	3,576
Change in Working Capital	(7,372)	(1,868)	564	(24)	(1,307)
Deferred Taxation Charge	407	670	211	0	0
Other Adjustments, Net	306	975	774	64	18
Capital Expenditure	(3,026)	(4,292)	(5,766)	(6,200)	(6,445)
Free Cash Flow	7,874	10,719	6,775	3,700	1,737
% Change	121.5%	36.1%	-36.8%	-45.4%	-53.1%

Balance Sheet Data (Dec)

(BRL Millions)	2021A	2022A	2023E	2024E	2025E
Cash & Equivalents	6,787	5,435	7,793	7,114	6,047
Trade Receivables	6,101	5,789	5,903	5,782	6,185
Other Current Assets	19,753	20,034	18,102	18,341	19,828
Property, Plant & Equipment	18,742	20,423	22,960	25,869	28,739
Other Non-Current Assets	22,432	22,119	22,549	22,549	22,549
Total Assets	73,815	73,799	77,307	79,655	83,348
Short-Term Debt	1,766	3,091	2,468	2,233	2,274
Other Current Liabilities	12,270	10,371	9,118	9,212	9,796
Long-Term Debt	12,273	9,486	9,968	9,018	9,187
Other Non-Current Liabilities	4,689	4,552	4,643	4,643	4,643
Total Liabilities	30,999	27,500	26,197	25,105	25,900
Total Equity	42,816	46,298	50,847	54,287	57,185
Total Equity & Liabilities	73,815	73,799	77,044	79,392	83,085

* For full definitions of iQmethodSM measures, see page 6.

Company Sector

Steels

Company Description

Gerdau S.A. is the largest long steel manufacturer in South America. The company produces crude, long, specialty, rolled and drawn steel products. Gerdau manufactures its steel primarily in mini-mills. The company operates in Brazil, Uruguay, Chile, Argentina, Europe and North America. Gerdau currently has nearly 17M tons of crude steel capacity, with half located in Brazil.

Investment Rationale

We rate Gerdau as Buy. We like its geographical diversification, high quality asset base and its muted exposure to iron ore pricing volatility. Solid property demand indicators are supportive for its Brazil division, while its North America division should benefit from the \$1.2trn infrastructure bill and the continued application of Section 232.

Stock Data

Average Daily Volume	8590373
Shares / ADR	1.00

Quarterly Earnings Estimates

	2022	2023
Q1	1.71A	1.44A
Q2	2.48A	1.31A
Q3	1.77A	1.09E
Q4	0.91A	0.86E

US: Recessions risks compensated by infra bills

Although Gerdau acknowledges that a slower economic environment in the US in 2024 is likely due to higher interest rates, they expect steel demand to remain healthy due to announced fiscal stimulus packages (IIJA, IRA, CHIPS Act). Gerdau forecasts 250-500kt/yr of additional demand for merchant bar and beams and 500kt-1Mt/yr of additional demand for rebar throughout the duration of IIJA expenditures (translating into a total increase of steel demand of 20Mt). Regarding the IRA, Gerdau estimates 500kt-1Mt/yr of additional demand for beams and value-added downstream steel products through 2032. Finally, the CHIPS Act is likely to maintain a high level of non-residential activity but across a different project mix (i.e. more industrial plants, less data centers/warehouses). As a result, Gerdau is investing BRL1.5bn at its Midlothian mill in Texas (1.4Mtpa) to increase capacity to 2Mtpa which according to them should translate into an additional EBITDA of R\$500mn/yr. Regarding Section 232, management does not anticipate any significant changes through the election cycle.

Brazil: capex cycle focused on value-added steel, mining

Mgmt stressed Gerdau is not a long-steel-only player anymore, and targeted flat steel products becoming 35% of its portfolio in Brazil by 2025 (vs 30% today), with a 250Kt/yr new hot rolled coil mill. Long steel should also increase mix participation by 5% to 60% by 2025, boosted by a structural profile capacity growth of 500Kt/yr. Semi-finished steels, also focused on exports, should drop from 15% to 5% by 2025 to make room for the higher value-added products. A 5.5Mt/yr, 65% average Fe grade dry-stacking iron ore operation is the other major project in Brazil, with a R\$3.2bn capex planned by 2026. Regarding the Ouro Branco maintenance schedule, its 3Mt/yr blast furnace (BF) I should have a R\$1bn revamp in 2025 to expand its life by 10 years, while its coke plants should receive a R\$950mn investment to extend life of asset to 2030 for one plant and 2034 for the other. Its 1.5Mt/yr BF II had a R\$330mn repair last year which extended its life to 2030.

Special Steels: Brazil to lead SBQ consumption growth

For special steels, mgmt anticipated Brazilian auto production to grow to 3.2M units/year by 2030 from 2.3mn this year, boosting special bar quality (SBQ) demand to 1.3Mt/yr from 0.9Mt. In the US, SBQ demand is expected to drop modestly to 4.4Mt/yr by 2030 from 4.5Mt this year, with battery EVs and hybrids accounting for 72% of the market by then. The United Auto Workers (UAW) union strike did not have any impact on their shipments so far, and mgmt believe Gerdau should be relatively insulated given its growing exposure to OEMs outside of the top three automakers that are 40% of the market today and the focus of the strike but noted an impact could be seen if the strike persists for longer.

South America: relatively stable outlook for shipments

In South America, mgmt expected a 4% GDP drop in Argentina next year but saw sustained demand for domestic products amid import restrictions. In Uruguay, moderate economic growth should sustain stable demand, while prices were seen closer to international prices hurt by threat of more imports. In Peru, mgmt forecasted a greater stability in 2H23 and a recovery in 2024, while noted El Nino phenomenon could be a headwind during the final months of 2023.

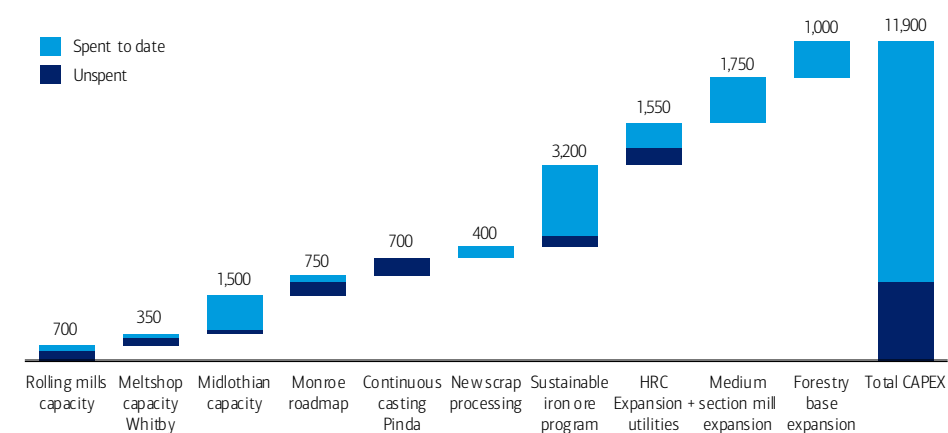
Higher capex bill should lead to a R\$4bn/yr extra EBITDA

The growth and efficiency investments planned for the next years translate into a high capex bill, for a total of R\$11.9bn investment between 2021-2026. Mgmt anticipated these projects could generate R\$4bn additional EBITDA annually (out of which R\$600mn has already been captured), along with an extra capacity of 700Kt/yr of crude steel and 1.4Mt/yr of rolling steel (see Exhibit 1 and Exhibit 2), and a haircut to GGBR's CO2 emissions, expected to drop 0.04tCO2/t of steel to 0.82 by 2031. In Brazil, their R\$3.2bn new sustainable mining platform no longer uses tailing dams and all processing is done through dry stacking. Other initiatives that contribute with the ESG agenda include a

20% expansion of its forestry base in Minas Gerais and maintaining its position as the largest metal scrap recycler in LatAm and largest charcoal producer in the world. Meantime, for Gerdau Next mgmt plans to become a top three player in every segment they operate, for instance the logistics and the renewable energy businesses. Its logistics arm reached a R\$1,075mn net revenue in 2022 (+62% y/y), while its joint-venture with Randoncorp for heavy vehicle and equipment rental services already signed 949 assets ytd (2.6x planned) with an average contract of 5 years and a lifetime EBITDA margin expected at 91%.

Exhibit 1: Gerdau's strategic capex 2021-2026 (R\$m – cumulative)

The company is expected to invest R\$11,900mn until 2026 ...

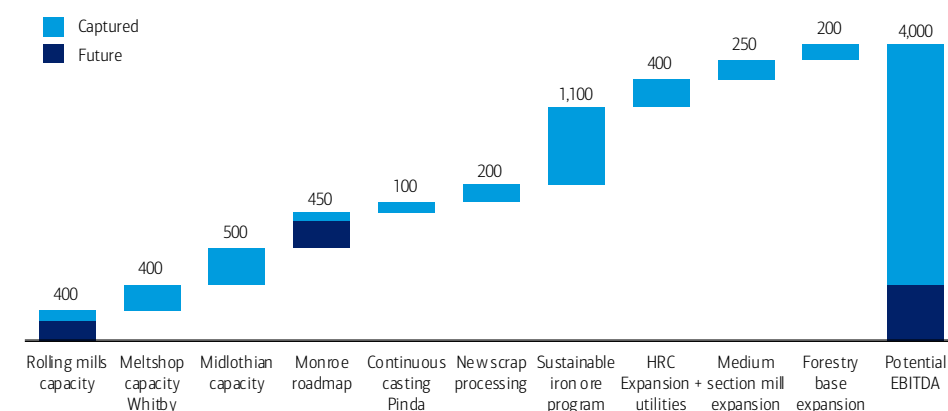


Source: Company's presentation, BofA Global Research

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Exhibit 2: Potential annual EBITDA impacts 2021-2031 (Over cycle – R\$m)

... these investments could lead to a potential R\$4bn annual additional EBITDA



Source: Company's presentation, BofA Global Research

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Price objective basis & risk

Gerdau S. A. (GGBUF / GGB)

Our BRL30/share (US\$5.80/ADR) price objective reflects a 50/50 blend of DCF and EV/EBITDA analysis. Our DCF factors in a 10.8% WACC. Our EV/EBITDA analysis uses a 5.5x 2024E multiple, below its historical average and global peers given peak earnings.

Upside risks to our price objective are: 1) stronger-than-expected demand in N. America and Brazil, 2) stronger-than-expected improvement in global macro outlook, and 3) higher-than-expected steel prices in the Brazilian market.

Downside risks to our price objective are: 1) higher costs, leading to weaker margins, 2) weaker-than-expected demand in the US long steel market, 3) weaker-than-expected demand environment in Brazil, and 4) lower-than-expected Chinese steel prices.

Special Disclosures

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Latin America - Natural Resources Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	3R Petroleum	XPXXF	RRRP3 BZ	Leonardo Marcondes
	Alpek SAB de CV	ALPKF	ALPEKA MM	Leonardo Marcondes
	Dexco SA	DURXF	DXCO3 BZ	Leonardo Neratika
	Empresas CMPC SA	XEMCF	CMPC CI	Leonardo Neratika
	Gerdau S. A.	GGBUF	GGBR4 BZ	Caio Ribeiro
	Gerdau S.A.	GGB	GGB US	Caio Ribeiro
	Metalurgica Gerdau	MZGPF	GOAU4 BZ	Caio Ribeiro
	Orbia	MXCHF	ORBIA* MM	Leonardo Marcondes
	Petro Rio	HRTPF	PRI03 BZ	Caio Ribeiro
	Petrobras	PBRQF	PETR3 BZ	Caio Ribeiro
	Petrobras	PBR	PBR US	Caio Ribeiro
	Petrobras PN	PBRA	PBR/A US	Caio Ribeiro
	Petrobras PN	PTRBF	PETR4 BZ	Caio Ribeiro
	PetroReconcavo	XPXYF	RECV3 BZ	Leonardo Marcondes
	Suzano Papel e Celulose S.A.	XXRTF	SUZB3 BZ	Caio Ribeiro
	Suzano Papel e Celulose S.A.	SUZ	SUZ US	Caio Ribeiro
	Vibra Energia SA	XUBRF	VBBR3 BZ	Leonardo Marcondes
NEUTRAL				
	Companhia Brasileira de Alumínio	XZUDF	CBAV3 BZ	Leonardo Neratika
	Ecopetrol S.A.	XESSF	ECOPETL CB	Caio Ribeiro
	Ecopetrol S.A.	EC	EC US	Caio Ribeiro
	Ternium	TX	TX US	Caio Ribeiro
	Ultrapar	XLRUF	UGPA3 BZ	Leonardo Marcondes
	Ultrapar Pa-ADR	UGP	UGP US	Leonardo Marcondes
	Usiminas SA	USNZY	USNZY US	Caio Ribeiro
	Usiminas SA	USSPF	USIM5 BZ	Caio Ribeiro
	Vale	VALE	VALE US	Caio Ribeiro
	Vale	VALEF	VALE3 BZ	Caio Ribeiro
UNDERPERFORM				
	Bradespar	BRDQF	BRAP4 BZ	Caio Ribeiro
	CSN	SIDHF	CSNA3 BZ	Caio Ribeiro
	CSN	SID	SID US	Caio Ribeiro
	CSN Mineracao	XZRAF	CMIN3 BZ	Caio Ribeiro
	Empresas Copec SA	PZDCF	COPEC CI	Leonardo Neratika
	Grupo Mexico	GMBXF	GMEXICOB MM	Caio Ribeiro
	Klabin S.A	XLWDF	KLBN11 BZ	Caio Ribeiro
	Klabin S.A	KLBY	KLBY US	Caio Ribeiro



Latin America - Natural Resources Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
	Southern Copper	SCCO	SCCO US	Caio Ribeiro
RSTR				
	Braskem SA-A	BAKAF	BRKM5 BZ	Leonardo Marcondes
	Braskem SA-ADR	BAK	BAK US	Leonardo Marcondes
RVW				
	Enauta Participacoes S.A.	QGEPF	ENAT3 BZ	Leonardo Marcondes
	YPF SA	YPF	YPF US	Leonardo Marcondes
	YPF SA	YPFSF	YPFD AR	Leonardo Marcondes

IQmethodSM Measures Definitions**Business Performance**

Return On Capital Employed

Return On Equity
Operating Margin
Earnings Growth
Free Cash Flow

Quality of Earnings

Cash Realization Ratio
Asset Replacement Ratio
Tax Rate
Net Debt-To-Equity Ratio
Interest Cover

Valuation Toolkit

Price / Earnings Ratio
Price / Book Value
Dividend Yield
Free Cash Flow Yield
Enterprise Value / Sales

EV / EBITDA

Numerator

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income
Operating Profit
Expected 5 Year CAGR From Latest Actual
Cash Flow From Operations – Total Capex

Numerator

Cash Flow From Operations
Capex
Tax Charge
Net Debt = Total Debt – Cash & Equivalents
EBIT

Numerator

Current Share Price
Current Share Price
Annualised Declared Cash Dividend
Cash Flow From Operations – Total Capex
EV = Current Share Price × Current Shares + Minority Equity + Net Debt +
Other LT Liabilities
Enterprise Value

Denominator

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
Amortization
Shareholders' Equity
Sales
N/A
N/A

Denominator

Net Income
Depreciation
Pre-Tax Income
Total Equity
Interest Expense

Denominator

Diluted Earnings Per Share (Basis As Specified)
Shareholders' Equity / Current Basic Shares
Current Share Price
Market Cap = Current Share Price × Current Basic Shares
Sales
Basic EBIT + Depreciation + Amortization

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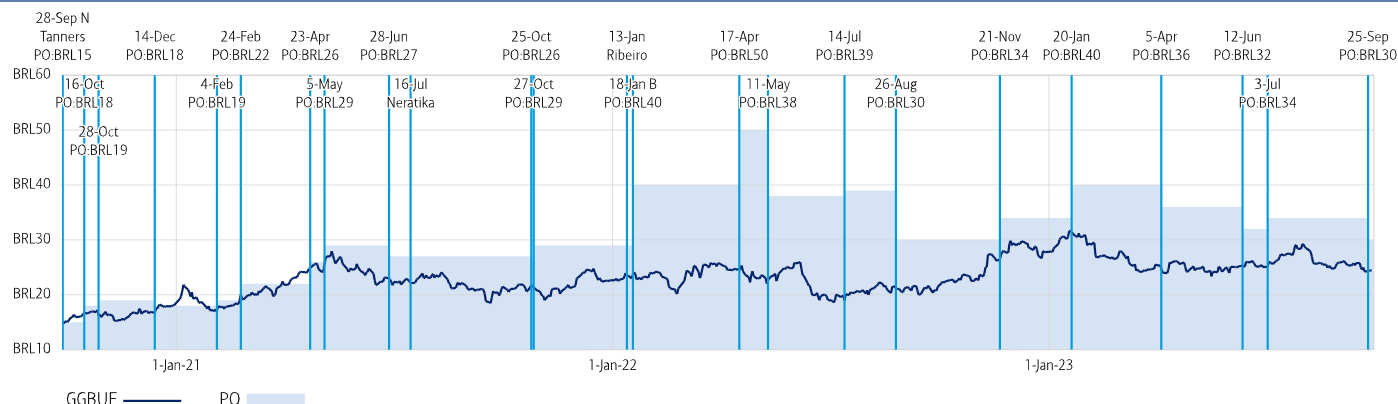
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Disclosures

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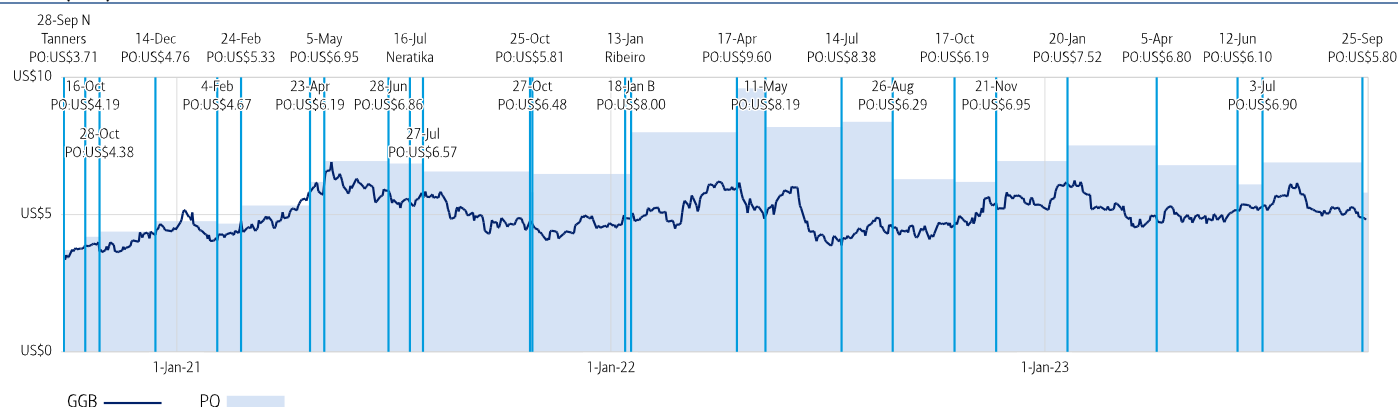
Gerdau S. A. (GGBUF) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

Gerdau S.A. (GGB) Price Chart



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Equity Investment Rating Distribution: Steel Group (as of 30 Jun 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	14	42.42%	Buy	9	64.29%
Hold	11	33.33%	Hold	5	45.45%
Sell	8	24.24%	Sell	6	75.00%

Equity Investment Rating Distribution: Global Group (as of 30 Jun 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1877	53.28%	Buy	1040	55.41%
Hold	815	23.13%	Hold	464	56.93%
Sell	831	23.59%	Sell	385	46.33%

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.



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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster ^{R2}
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

^{R2} Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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