

Gerdau S. A.

Gerdau announced US\$325mn divestment of South American JVs

Maintain Rating: NEUTRAL | PO: 24.00 BRL | Price: 20.56 BRL

Gerdau announced JVs divestment of US\$325mn

Gerdau announced this evening they entered into an agreement to sell their 49.85% stake at their JV Diaco S.A. and their 50% stake at their JV Gerdau Metaldom Corp for a combined value of US\$325mn to their partner Group INCIA. The joint ventures operate in Colombia, Dominican Republic, Panama and Costa Rica and have a 360Kt/yr meltshop capacity and 1,250Kt/yr rolling capacity. These JVs were under the South America division and the average EBITDA of the operation over the past six years is US\$134mn. Both JVs were not consolidated and were reported via equity income. According to Gerdau, proceeds should be used in the execution of the capex program.

Decent valuation from non-core less efficient assets

We estimate that this transaction was priced in an EV/ton of US\$520/t and an EV/EBITDA of 4.85x, considering no net debt on the JVs and the average EBITDA of the past 6 years. This compares to Gerdau currently trading at an EV/ton of US\$509/t and an EV/EBITDA of 4.1x 2024E. In our view this is a decent valuation for assets that we understand currently operate at a margin below the South American division. The JVs also operated in countries mostly free of import barriers, which limits the capacity to be a price shaper in these markets.

Keep Neutral and R\$24/shr PO

While Gerdau is currently trading at an attractive 4.1x 2024E EV/EBITDA, we keep our Neutral as Gerdau is facing some pressure in North America from lackluster construction demand and peaking metal spreads, and in Brazil from weaker demand and higher import penetration.

Estimates(Dec) (BRL)	2021A	2022A	2023E	2024E	2025E
EPS	8.43	7.08	4.57	2.67	2.85
EPS Change (YoY)	533.8%	-16.0%	-35.5%	-41.6%	6.7%
Consensus EPS (Bloomberg)			4.57	3.30	3.12
DPS	2.98	3.37	1.53	1.07	1.43
ADR EPS (US\$)	1.56	1.37	0.93	0.54	0.58
ADR DPS (US\$)	0.55	0.65	0.31	0.22	0.29
Valuation (Dec)					
P/E	2.4x	2.9x	4.5x	7.7x	7.2x
Dividend Yield	14.5%	16.4%	7.4%	5.2%	6.9%
EV / EBITDA*	1.9x	2.1x	3.2x	4.7x	4.3x
Free Cash Flow Yield*	21.9%	29.8%	22.1%	6.8%	5.3%

* For full definitions of *IQmethod*SM measures, see page 5.

17 January 2024

Equity

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Stock Data

Price (Common / ADR)	20.56 BRL / 4.19 USD
Price Objective	24.00 BRL / 5.00 USD
Date Established	9-Jan-2024 / 9-Jan-2024
Investment Opinion	C-2-8 / C-2-8
52-Week Range	20.52 BRL - 32.27 BRL
Market Value (mn)	35,966 BRL
Free Float	99.2%
Average Daily Value	37.79 USD
Shares Outstanding (mn)	1,749.3 / 1,749.3
BofA Ticker / Exchange	GGBUF / SAO
BofA Ticker / Exchange	GGB / NYS
Bloomberg / Reuters	GGBR4 BZ / GGBR4.SA
ROE (2023E)	16.4%
Net Dbt to Eqty (Dec-2022A)	15.4%

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Refer to important disclosures on page 6 to 9. Analyst Certification on page 4. Price Objective Basis/Risk on page 4.

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Timestamp: 17 January 2024 08:36PM EST

iQprofileSM Gerdau S. A.

iQmethodSM – Bus Performance*

(BRL Millions)	2021A	2022A	2023E	2024E	2025E
Return on Capital Employed	28.0%	22.8%	14.4%	8.4%	8.6%
Return on Equity	41.1%	27.9%	16.4%	8.9%	9.0%
Operating Margin	26.2%	21.5%	16.3%	9.6%	10.1%
Free Cash Flow	7,874	10,719	7,963	2,434	1,916

iQmethodSM – Quality of Earnings*

(BRL Millions)	2021A	2022A	2023E	2024E	2025E
Cash Realization Ratio	0.7x	1.2x	1.7x	1.8x	1.6x
Asset Replacement Ratio	1.1x	1.5x	1.8x	1.7x	1.7x
Tax Rate	24.0%	26.1%	20.6%	20.0%	20.0%
Net Debt-to-Equity Ratio	16.9%	15.4%	7.8%	6.1%	7.4%
Interest Cover	14.3x	11.9x	7.8x	4.0x	4.4x

Income Statement Data (Dec)

(BRL Millions)	2021A	2022A	2023E	2024E	2025E
Sales	78,345	82,412	69,881	63,387	66,403
% Change	78.8%	5.2%	-15.2%	-9.3%	4.8%
Gross Profit	23,476	21,613	14,675	10,039	10,958
% Change	178.5%	-7.9%	-32.1%	-31.6%	9.2%
EBITDA	23,221	21,506	14,077	9,529	10,406
% Change	202.0%	-7.4%	-34.5%	-32.3%	9.2%
Net Interest & Other Income	(948)	(1,892)	(1,273)	(257)	(454)
Net Income (Adjusted)	15,098	12,372	8,002	4,673	4,986
% Change	533.2%	-18.1%	-35.3%	-41.6%	6.7%

Free Cash Flow Data (Dec)

(BRL Millions)	2021A	2022A	2023E	2024E	2025E
Net Income from Cont Operations (GAAP)	14,900	12,372	7,749	4,673	4,986
Depreciation & Amortization	2,659	2,862	3,044	3,430	3,719
Change in Working Capital	(7,372)	(1,868)	1,462	332	(619)
Deferred Taxation Charge	407	670	119	0	0
Other Adjustments, Net	306	975	1,050	(35)	80
Capital Expenditure	(3,026)	(4,292)	(5,460)	(5,966)	(6,250)
Free Cash Flow	7,874	10,719	7,963	2,434	1,916
% Change	121.5%	36.1%	-25.7%	-69.4%	-21.3%
Share / Issue Repurchase	NA	NA	NA	NA	NA
Cost of Dividends Paid	(5,339)	(5,892)	(2,677)	(1,869)	(2,493)
Change in Debt	(4,642)	(1,095)	(517)	583	328

Balance Sheet Data (Dec)

(BRL Millions)	2021A	2022A	2023E	2024E	2025E
Cash & Equivalents	6,787	5,435	7,953	9,093	8,868
Trade Receivables	6,101	5,789	5,940	5,779	6,054
Other Current Assets	19,753	20,034	17,005	16,730	17,285
Property, Plant & Equipment	18,742	20,423	23,019	25,555	28,086
Other Non-Current Assets	22,432	22,119	23,499	23,499	23,499
Total Assets	73,815	73,799	77,417	80,656	83,792
Short-Term Debt	1,766	3,091	2,076	1,893	1,991
Other Current Liabilities	12,270	10,371	8,956	8,852	9,063
Long-Term Debt	12,273	9,486	9,909	10,538	11,087
Other Non-Current Liabilities	4,689	4,552	4,967	4,967	4,967
Total Liabilities	30,999	27,500	25,908	26,249	27,108
Total Equity	42,816	46,298	51,509	54,408	56,684
Total Equity & Liabilities	73,815	73,799	77,416	80,656	83,792

* For full definitions of iQmethodSM measures, see page 5.

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 Neutral. Gerdau is the least exposed on the long side to iron ore prices of LatAm steelmakers, while we also see operational challenges from weaker demand in its segments, especially Brazil and North America. We continue to like Gerdau's geographical diversification and high-quality asset base and see long-term positive fundamentals from the \$1.2tn infrastructure investment packages in North America.

Stock Data

Average Daily Volume	9,066,773
Shares / ADR	1.00

Quarterly Earnings Estimates

	2022	2023
Q1	1.71A	1.44A
Q2	2.48A	1.31A
Q3	1.77A	1.01A
Q4	0.91A	0.80E

Exhibit 1: Gerdau EV/ton calculation

We estimate Gerdau is trading at a EV/ton of US\$509/t...

Gerdau EV/ton calculation	
Gerdau mkt cap (R\$mn)	35,399
Gerdau net debt 2024 (R\$mn)	3,337
Gerdau EV (R\$)	38,736
BRL	4.9
Gerdau EV (US\$mn)	7,855
Gerdau rolling capacity (Kt)	15,442
Gerdau EV/ton (US\$/ton)	509

Source: BofA Global Research estimates, Gerdau, Bloomberg

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Exhibit 3: Gerdau EV/EBITDA

Gerdau is trading at ~4.1x 2024E EV/EBITDA...

Gerdau EV/EBITDA	
Gerdau mkt cap	35,399
Gerdau net debt 2024E	3,337
Gerdau EV (R\$)	38,736
Gerdau EBITDA 2024E	9,529
Gerdau EV/EBITDA	4.07x

Source: BofA Global Research estimates, Bloomberg

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Exhibit 2: Transaction EV/ton calculation

... while the transaction was priced at US\$520/t EV/ton

Transaction EV/ton calculation	
Diaco + Metaldom equity value (US\$mn)	650
Gerdau stake value (US\$mn)	325
Gerdau stake (%)	50%
Diaco + Metaldom net debt (US\$mn)	0
Diaco + Metaldom EV (US\$mn)	650
Diaco + Metaldom rolling capacity (Kt)	1,250
Diaco + Metaldom EV/ton (US\$/ton)	520

Source: BofA Global Research estimates, Gerdau

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Exhibit 4: Transaction EV/EBITDA

We estimate the transaction was priced at a 4.85x EV/EBITDA multiple

Transaction EV/EBITDA	
Diaco + Metaldom equity value (US\$mn)	650
Gerdau stake value (US\$mn)	325
Gerdau stake (%)	50%
Diaco + Metaldom net debt	0
Diaco + Metaldom EV	650
Diaco + Metaldom EBITDA	134
Diaco + Metaldom EV/EBITDA	4.85x

Source: BofA Global Research estimates, Gerdau

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Price objective basis & risk

Gerdau S. A. (GGBUF / GGB)

Our BRL24/share (US\$5/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.

Analyst Certification

We, Caio Ribeiro, Guilherme Rosito and Leonardo Neratika, hereby certify that the views each of us has expressed in this research report accurately reflect each of our respective personal views about the subject securities and issuers. We also certify that no part of our respective compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

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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
	CSN	SIDHF	CSNA3 BZ	Caio Ribeiro
	CSN	SID	SID US	Caio Ribeiro
	Dexco SA	DURXF	DXCO3 BZ	Leonardo Neratika
	Empresas CMPC SA	XEMCF	CMPC CI	Leonardo Neratika
	Enauta Participacoes S.A.	QGEPF	ENAT3 BZ	Leonardo Marcondes
	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	PTBFB	PETR4 BZ	Caio Ribeiro
	PetroReconcavo	XPXYF	RECV3 BZ	Leonardo Marcondes
	Suzano	XXRTF	SUZB3 BZ	Caio Ribeiro
	Suzano S.A.	SUZ	SUZ US	Caio Ribeiro
	Ternium	TX	TX US	Caio Ribeiro
	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
	Vibra Energia SA	XUBRF	VBBR3 BZ	Leonardo Marcondes
NEUTRAL				
	Bradespar	BRDQF	BRAP4 BZ	Caio Ribeiro
	Companhia Brasileira de Alumínio	XZUDF	CBAV3 BZ	Leonardo Neratika
	CSN Mineracao	XZRAF	CMIN3 BZ	Caio Ribeiro
	Ecopetrol S.A.	XESSF	ECOPETL CB	Caio Ribeiro
	Ecopetrol S.A.	EC	EC US	Caio Ribeiro
	Gerdau S. A.	GGBUF	GGBR4 BZ	Caio Ribeiro

Latin America - Natural Resources Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
	Gerdau S.A.	GGB	GGB US	Caio Ribeiro
	Metalurgica Gerdau	MZGPF	GOAU4 BZ	Caio Ribeiro
	Ultrapar	XLRUF	UGPA3 BZ	Leonardo Marcondes
	Ultrapar Pa-ADR	UGP	UGP US	Leonardo Marcondes
UNDERPERFORM				
	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
	Southern Copper	SCCO	SCCO US	Caio Ribeiro
	YPF SA	YPF	YPF US	Leonardo Marcondes
	YPF SA	YPSF	YPSF AR	Leonardo Marcondes
RSTR				
	Braskem SA-A	BAKAF	BRKM5 BZ	Leonardo Marcondes
	Braskem SA-ADR	BAK	BAK US	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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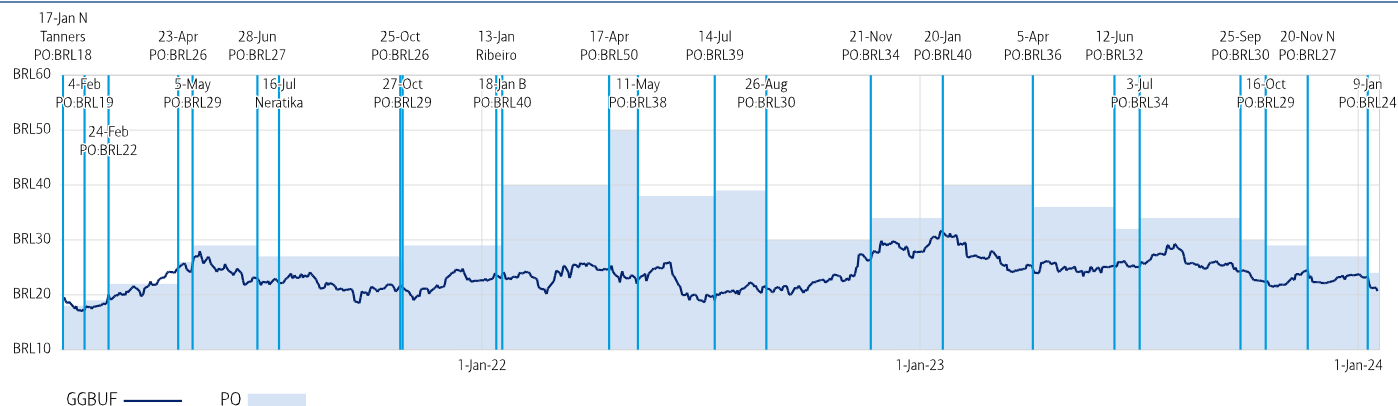
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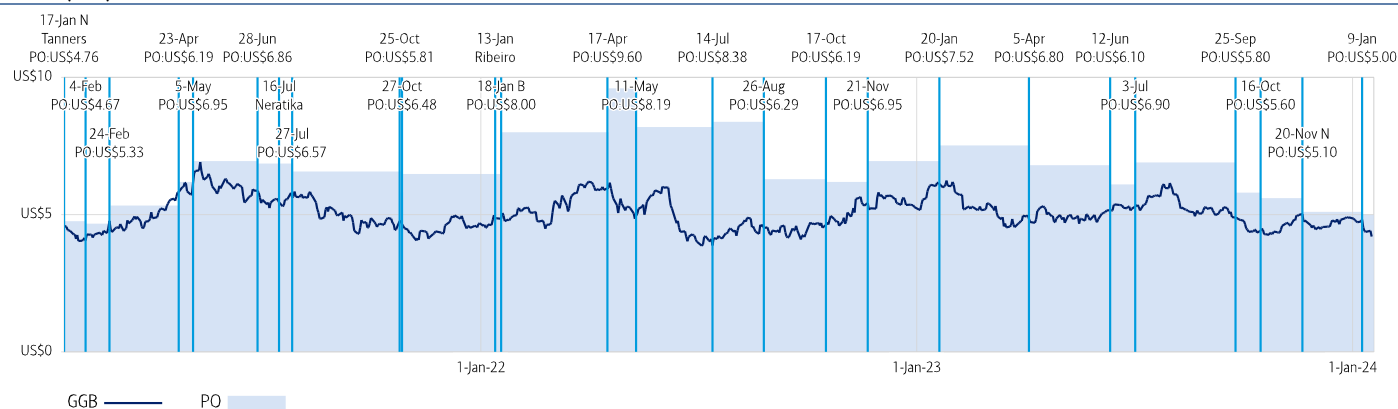
Important Disclosures

Gerdau S. A. (GGBUF) Price Chart



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 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	14	43.75%	Buy	9	64.29%
Hold	12	37.50%	Hold	7	58.33%
Sell	6	18.75%	Sell	3	50.00%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

^{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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