LatAm Natural Resources

Marketing Feedback: Weak sentiment and low conviction all around

Industry Overview

05 March 2024

Equity
Latin America
Natural Resources

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Quite a challenging macro backdrop to navigate

We spent the last week marketing in Brazil discussing the LatAm Metals & Mining, Oil & Gas and Pulp & Paper sectors and met with nearly 50 accounts. Overall, we note that sentiment remains overall weak particularly regarding the materials space. Most investors we spoke to are still negative on China and concerned with the outlook for properties and the industrial sector. Investors appeared mostly underweight LatAm materials stocks and we noticed an overall lack of conviction over trade ideas in the space given meaningful uncertainties generated by the top down angle (will the Fed cut rates?, elections in the US, regional conflicts, ongoing China property slowdown, slower growth in Brazil, etc). Nonetheless, interest in the pulp & paper space was picking up with the latest price hike announcements coming as a positive surprise.

Metals & Mining: negativity is contagious

Overall, we noticed that most investors we spoke to were still quite negative and underweight metals & mining stocks in LatAm. Most believe that iron ore prices could likely remain under pressure in the coming months given a continuously challenging property outlook and weak steelmaker margins. We also noticed that investors we spoke with appeared less excited on copper in the short-term acknowledging that demand concerns have overshadowed the latest supply disruptions. In terms of steelmakers, they worry about a lackluster demand outlook given high interest rates, slowing GDP growth and import pressures. Investors still find FCF yields and valuations not that attractive to justify a high conviction long trade.

Oil & Gas: cautious on oil and underweight/short on PBR

Investors appeared more cautious on oil as they forecast surpluses in S&D driven mostly by higher US shale oil output coupled with slowing global demand. In addition, there is less conviction over the efficacy of additional OPEC+ cuts. We were surprised to see investors we spoke with largely underweight or short on Petrobras seeing an overall lack of triggers post 4Q results (and the dividend announcement expected in the Q).

Pulp & Paper: what if prices move up and not down?

Over the past months investors appeared to be mostly waiting for a pulp price drop in 1H24 to find a more attractive entry point for LatAm pulp stocks. However, our sense is that the latest price pulp hike announcements for March came as a clear positive surprise increasing interest in the space. Suzano appears the clear favorite in the space.

Refer to important disclosures on page 7 to 10. Analyst Certification on page 6. Price Objective Basis/Risk on page 5.
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Timestamp: 05 March 2024 01:37AM EST

Persistent underweight on Materials continued…

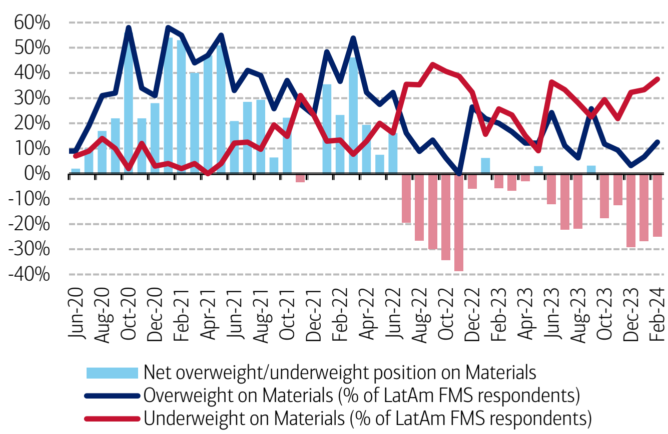
Despite some selective stock picking, our sense is that investors overall remained underweight on LatAm Materials (M&M and P&P), particularly led by a lack of conviction on iron ore and Vale, which more than offset the weight of some shy, long positions we noted mostly on Gerdau and Suzano. This is in line with the trend noted by our team's latest LatAm Fund Manager Survey (FMS) last month (Exhibit 1). In fact, the latest LatAm FMS shows LatAm investors became sequentially less underweight in February, but Materials remained the main funding for other sectors as investors remained net underweight since July 2022, with only three months where the number of overweight managers surpassed the underweight ones since then (Jan, May and Sep 2023).

… while Energy turned slightly overweight again in Feb

For the energy sector, LatAm Investors were overall net overweight in Feb after two months underweight. However, net overweight positioning was well below its recent peak, for a net of 3% of respondents overweight on the sector vs 44% in Oct (Exhibit 2), as per our LatAm Equity Strategy team (see the latest LatAm FMS).

Exhibit 1: BofA LatAm Fund Manager Survey – positioning in Materials

LatAm Investors are overall net underweight materials since July 2022, with only three months of net overweight positioning since then

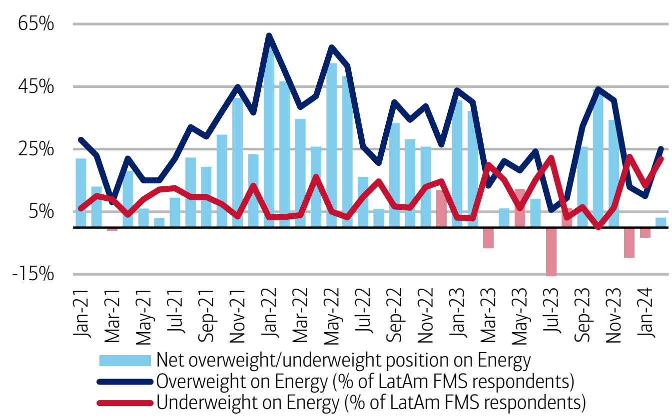


Source: BofA Global Research – LatAm Fund Manager Survey

BofA GLOBAL RESEARCH

Exhibit 2: BofA LatAm Fund Manager Survey – positioning in Energy

LatAm Investors were overall net overweight energy in February, coming out of two sequential months in the underweight territory



Source: BofA Global Research – LatAm Fund Manager Survey

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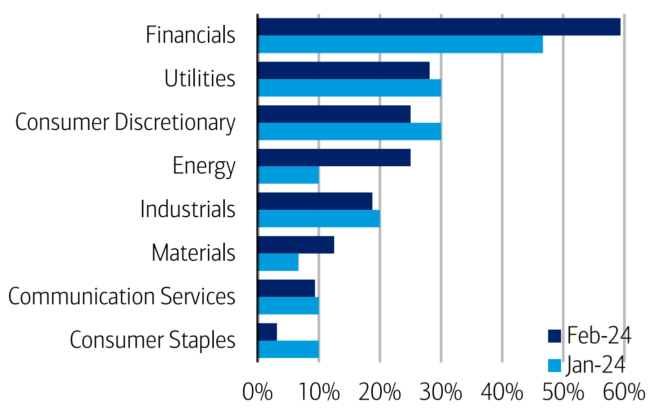
Exhibit 3: LatAm FMS – Which sectors within equities are you most overweight?

Participants were most overweight Financials in February

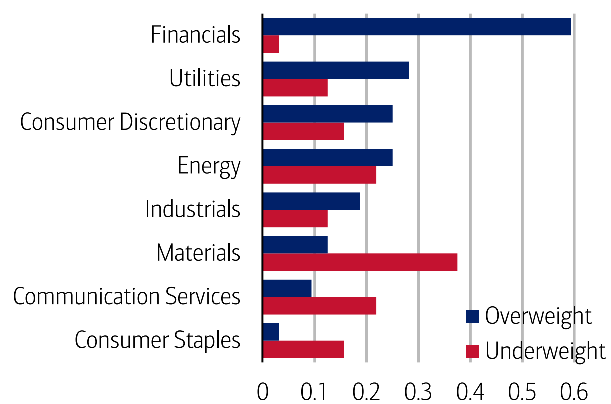


Source: BofA Global Research – LatAm Fund Manager Survey

BofA GLOBAL RESEARCH

Exhibit 4: LatAm FMS – Which sectors among equities are you most underweight?

Materials again was the highlight among sectors most underweight



Source: BofA Global Research – LatAm Fund Manager Survey

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Metals & Mining

Sentiment mostly weak regarding iron ore

Overall, we noticed that most investors we spoke to were still quite negative and underweight metals & mining stocks in LatAm. We think this mostly stems from a negative view on China and particularly the outlook for properties and the industrial sector. Most investors still struggle to see property markets rebounding and have low confidence over big stimulus measures being announced in the short-term. This coupled with weak steelmaker margins in China has led most investors to believe that iron ore prices could likely remain under pressure in the coming months. Most investors we spoke to seem to forecast iron ore at $110-120/ton on average for 2024. However, it is worth mentioning that despite the bleak outlook, few believe that iron ore could sustainably dive below $100/ton given cost inflation in the industry and very muted supply growth.

Vale: waiting for succession story to be resolved

Most investors acknowledged that Vale has underperformed other iron ore Majors and believe that uncertainties generated by the succession discussions are largely to blame for it. However, concerns over property markets in China, weak steelmaker margins and the resulting pressure on iron ore has tempered enthusiasm to bottom fish. We noticed that some investors were more comfortable using pair trades with long Vale against other iron ore Majors. But overall we sensed that positioning within Vale appeared light and most investors appeared underweight in comparison to Vale's weight in the local index.

Excitement w/ copper cooling... at least in the short-term

We also noticed that investors appeared less excited with copper in the short-term acknowledging that demand concerns have overshadowed the latest supply disruptions. Fears over a delayed rate cut cycle in the US and fears of a slowdown in demand (and fewer green spending tailwinds) have reduced interest in the red metal. Although most investors remain constructive on medium to long-term copper fundamentals, investors struggle to find "bargains" in the space and are puzzled by the re-rating of large cap copper pure plays over the past year with SCCO for example trading at 12.3x EV/EBITDA 2024 on our numbers.

A lot of negativity with steel but short interest dropping

Back in late last year, we noticed that investors appeared mostly underweight/short steel names concerned over the demand outlook given higher interest rates, import pressures and pricing outlook. Although short interest has diminished now vs. November 2023, sentiment still remains weak and positioning very light. Many of the top-down concerns remain in place and investors still find FCF yields and valuations not that attractive to justify a high conviction long trade. On CSN, we sense investors were relatively more worried about leverage, potential M&A and the pressure generated by lower iron ore prices. Ultimately, we sensed that positioning within the LatAm steels space was very light.

Oil & Gas

Investors are surprisingly underweight/short on Petrobras

We were surprised that most of the Brazilian investors are underweight/short on Petrobras. Most of the investors we spoke with believe that Petrobras's investment story will lack in positive triggers after the extraordinary dividend expected to be announced this week. Furthermore, even though the capex has been historically lower vs. guidance from the Strategic Plans, investors fear that the potential M&As (stake in Acelen Refinery and Renewables) could affect the Petrobras dividends in the short-to-mid term.

Regarding the dividend to be announced this week, an extraordinary payment is broadly expected, however, there is still some concerns related to the amount. We believe that the market expects a total dividend (ordinary + extraordinary) of around US$8 billion (7.5% yield); therefore, if the figure to be announced by Petrobras this week is lower than that, we believe that the market could react negatively.

Fuel distribution should be a strong call for the 1Q24

Investors agree that the fuel distributors should pass through a strong momentum at least during the first half of 2024. Recent feedbacks from the market participants suggest that margins in January and February have been as strong as in December. In addition to that, the fuel supply should be somewhat tight in March/April as Petrobras is expected to carry out maintenance in some of its refineries. Lastly, Petrobras prices are below international parity, which could be supportive for the majors distributors in Brazil (Ultrapar). These three factors should provide a positive competitive landscape for the fuel distributors at least during the first quarter of the year. We have recently published a report on our expectations for 2024, please see Brazil Fuel Distribution: Stronger margins all around; raising estimates for Ultrapar.

Pulp & Paper

Interest building as prices seemingly moving up, not down

During our conversations with Brazil investors over the past 4 months, the most common remark we heard from investors is that they were waiting for a pulp price correction in 1H24 before taking a long position in LatAm pulp stocks (waiting for better entry point). Fast forward to March 2024 and pulp prices seem to be on their way up and not down with the latest $30/ton HW hike for China and $80/ton hike for N. America and Europe coming as a clear positive surprise. If the price hike for China is sustainable, then HW prices would move to ~$680/ton. Investors seem to now be readjusting expectations ahead of the Shanghai Pulp Week (March 18-22), with the debate now revolving over "whether the price hike will stick" rather than "how low and for how long could prices drop in the coming months?". Although concerns of a price drop are still not entirely gone since we noticed that some investors still felt this was possible with Suzano's Cerrado project nearing its start-up in June, most investors seemed to agree that pulp price forecasts could move up this year. We noticed most investors working with a HW pulp price forecast of $600-630/ton for 2024 and a long-term forecast of $550-600/ton.

Growing optimism with the outlook post the LNY

We sensed that most investors were turning more positive on the outlook for pulp post the Lunar New Year (LNY). Feedback from industry participants has been more constructive lately pointing to a rise in pulp resale prices, strong paper demand in China, drawdown of paper inventories and paper price hikes being announced and passing-through. In addition, the tensions in the Red Sea seem to be hindering the ability of Chinese papermakers to export to Europe (see our complete report on the theme) which has allowed European papermakers to capture share from imports which has boosted pricing power. Typically, this would be a negative for Chinese papermakers but given that domestic demand in China has also improved, it seems that papermakers in China have been successful in shifting those volumes to the domestic market while also lowering their inventory levels.

Suzano appears to be the preferred stock within P&P…

Based on our conversations with investors in Brazil, most appear to prefer Suzano to position for a stronger outlook for pulp markets ahead. This view is supported not only by Suzano's greater EBITDA generation from pulp but also given that Suzano is adding 2.55Mtpa of additional HW pulp volumes which should also accelerate the cost reduction trend at the company (as Cerrado is a more competitive mill). In addition, investors believe that Suzano screens more cheap than other regional peers and offers better FCF yields in 2025. We see Suzano trading at 5.9x EV/EBITDA 2025 and generating a 11% FCF yield. The only concern we heard from investors was more related to capital allocation post the start-up of Cerrado particularly in regards to M&A (outside of Brazil) and recurring forestry asset acquisitions (should that lead to higher capex assumptions?). However, most recognize that Suzano has been very disciplined in the past regarding M&A (i.e. Kimberly Clark assets and Fibria acquisitions) and acknowledged that it is likely that this will continue to be the case.

Stocks mentioned

Prices and ratings for stocks mentioned in this report

BofA Ticker	Bloomberg ticker	Company name	Price	Rating
PBR	PBR US	Petrobras ON	US$ 16.53	C-1-8
PBRQF	PETR3 BZ	Petrobras ON	BRL 41.05	C-1-8
PBRA	PBR/A US	Petrobras PN	US$ 16.16	C-1-8
PTRBF	PETR4 BZ	Petrobras PN	BRL 40.08	C-1-8
SUZ	SUZ US	Suzano	US$ 11.83	B-1-7
XXRTF	SUZB3 BZ	Suzano	BRL 58.45	B-1-7
XLRUF	UGPA3 BZ	Ultrapar	BRL 29.2	C-2-7
UGP	UGP US	Ultrapar Pa-ADR	US$ 5.94	C-2-7

Source: BofA Global Research

Price objective basis & risk

Petrobras (PBRQF / PBR)

Our price objective of US$20.20/ADR (R$48.00/share) is based on a discounted cash flow (DCF)-based valuation using the BofA base case oil price scenario, which assumes a Brent price of US$80/bbl for 2024, and US$70/bbl for 2025 and beyond. We use a 14.70% weighted-average cost of capital (WACC) and an long-term growth rate of 2.0%.

Upside and downside risks to achieving our price objective are more favorable or less favorable results from the following factors: (1) oil price trends, (2) political/economic developments in Brazil, (3) possible increase in global risk aversion/higher interest rate environment, and (4) operational delays in production/development projects.

Petrobras PN (PTRBF / PBRA)

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Suzano (XXRTF / SUZ)
Our R$67 ($14/ADR) PO is based on an average of (a) a discounted cash flow (DCF) model, which uses a 9.4% WACC, 2.5% growth rate in perpetuity, and our forecasts through 2028E, and (b) an EV/EBITDA multiple of 7.0x 2024E, fairly in line with its average multiple over the past couple years.

Risks: (1) Global cycle trends, particularly in N America, Europe, and Asia, (2) global cycle trends in key products' pricing, particularly (though not limited to) hardwood pulp pricing to China, (3) potential volatility in the Brazilian economy and the Brazilian Real [BRL], (4) various operational risks associated with Suzano's large fleet of pulp and paper mills, (5) various merger-related integration and other risks associated with the Fibria combination, (6) capital-allocation, cycle, balance sheet/leverage and operating risks associated with large investment projects, such as (but not limited to) new pulp mills, (7) paper/board and pulp sector volatility & demand/pricing trends, (8) demand, supply-chain and other risks created by the COVID-19 pandemic.

As with all our paper/forest/packaging companies, fundamental trends (volumes, pricing, inflation, macro trends) may wind up better or worse than expected.

Ultrapar (XLRUF / UGP)
Our price objective of R$36.0/share (US7.60/ADR) is based on a DCF valuation using a 10.2% WACC and 2.5% terminal growth rate. This is consistent with our methodology for other similar energy companies under our coverage.

Upside risks to achieving our price objective are stronger than expect economic performance in Brazil, improved competitive environment for fuel distribution. And possible attractiveness of Ultrapar's stable business in periods of market volatility. Downside risks to our price objective are weak economic performance in Brazil (including lower car sales, which could affect growth in fuel demand), potential for lower pricing power in the highly competitive liquid fuels distribution business and LPG distribution, and possible underperformance in periods when the market is looking for higher beta stocks.

Analyst Certification

We, Caio Ribeiro, Guilherme Rosito, Leonardo Marcondes 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	PRIO3 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	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
	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	KLBAY	KLBAY US	Caio Ribeiro
	Southern Copper	SCCO	SCCO US	Caio Ribeiro
	YPF SA	YPF	YPF US	Leonardo Marcondes
	YPF SA	YPFSF	YPFD AR	Leonardo Marcondes
RSTR				
	Braskem SA-A	BAKAF	BRKM5 BZ	Leonardo Marcondes
	Braskem SA-ADR	BAK	BAK US	Leonardo Marcondes

Disclosures

Important Disclosures

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

Coverage Universe	Count	Percent	Inv. Banking Relationships [R1]	Count	Percent
Buy	83	61.48%	Buy	64	77.11%
Hold	28	20.74%	Hold	21	75.00%
Sell	24	17.78%	Sell	18	75.00%

Equity Investment Rating Distribution: Non-Ferrous Metals/Mining & Minerals Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships [R1]	Count	Percent
Buy	58	53.70%	Buy	26	44.83%
Hold	24	22.22%	Hold	10	41.67%
Sell	26	24.07%	Sell	13	50.00%

Equity Investment Rating Distribution: Paper/Forest Products Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships [R1]	Count	Percent
Buy	9	45.00%	Buy	8	88.89%
Hold	2	10.00%	Hold	1	50.00%
Sell	9	45.00%	Sell	5	55.56%

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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