Americas Metals & Natural Resources

Brazil Marketing Feedback: Cloudy skies and much uncertainty but Uranium glows

Industry Overview

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Equity
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Metals and Mining

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Increased uncertainty marked our Brazil marketing round

We spent the last week marketing our Americas Metals & Natural Resources coverage in Brazil and met with 25 local accounts. Our discussions spanned across several sub-sectors including steelmakers, iron ore, base metals, precious metals and uranium miners, oil & gas producers as well as pulp & paper companies. Overall, a high level of uncertainty marked our meetings, with hesitation regarding the next move for iron ore prices and a cautious view for base metals. That said, we noted significant investor interest for trade ideas, including our constructive view on US rebar and uranium.

Investors overall see the iron ore restocking trade done

The recent iron ore weakness was a key topic of discussion, with most investors believing that the restocking trend before the LNY is largely done. Investors were wary of further pricing weakness over the coming weeks amid rising iron ore inventories (although still below historical levels) and contracting China steelmaker margins. On the other hand, investors agreed that weather-related factors could tighten supply while a seasonal rebound in Chinese steel demand could drive steelmaker operating rates higher post LNY leading iron ore to catch a bid in the short term. All in all, we noticed most investors forecasting iron ore averaging $110-120/t in 2024, a tad below our $125/t.

Bearish on flat steel prices; interest in our long rebar view

Most investors are negative on the US & global steel sectors and seemed uncommitted, but largely open to our constructive view on US rebar prices through mid-2024E. We think CMC is the best way to get exposure. There was hesitancy to be more constructive GGB on this view. Broadly, the investors we met with share our view that US HRC steel prices are near a peak. Many believe this is most negative for STLD among our coverage.

Cautious base metals, where copper is king

We found investors in Brazil were on-balance cautious the base metals, with a clear relative preference for copper (in line to the BofA Commodities team view). There was significant interest in Teck Resources (TECK) but ownership of the shares seems limited.

Significant interest in uranium; modest interest in gold

Without question, interest in uranium among Brazil investors is widespread. Interestingly, not everyone is yet invested as some are still 'doing the work' to get ramped-up on this sub-sector. Among those invested, there is debate among how best to gain exposure but on average, all typical approaches are being employed. In precious metals (gold was the focus), a large minority of Brazilian investors like the idea of exposure as portfolio insurance should a U.S. recession develop. Ownership preferences seem to tilt toward gold exposure via the physical gold ETFs over the equities. Those preferring the gold equities tend to focus on a small group of North American large caps.

LNY = Lunar New Year

ST = short-term

CMC = Commercial Metals

STLD = Steel Dynamics

GGB = Gerdau

HRC = Hot rolled coil

STLD = Steel Dynamics

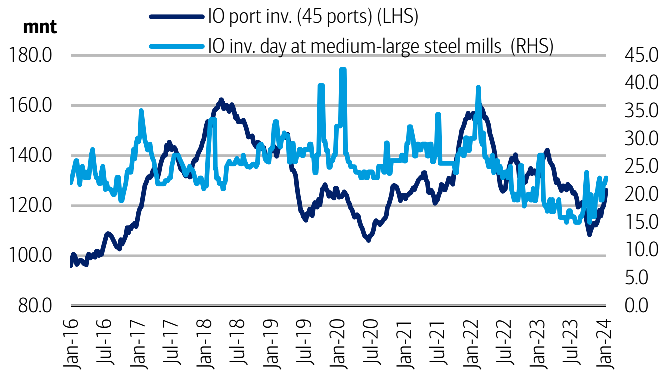
ETFs = Exchange traded funds

Timestamp: 15 January 2024 08:06AM EST

We sensed low conviction on short-term iron ore trends

We received a lot of questions regarding the recent price weakness for iron ore with most investors believing that the restocking trend before the Lunar New Year (LNY) is largely done. With iron ore inventories creeping up in the last weeks (although still low vs. historical levels) and steelmaker margins in China contracting further, investors appeared concerned about the recent iron ore price weakness extending itself over the coming weeks. Yet at the same time, investors we spoke to agree with our view that weather related factors (rainy season in Brazil, winter in China and cyclones in Australia) could tighten supply while a seasonal rebound in steel demand in China could drive steelmaker operating rates higher post the LNY leading iron ore to catch a bid in the short-term. Ultimately, we noticed an overall lack of conviction over the direction of the next move for iron ore.

Exhibit 1: Iron ore inventory at large-medium steel mills and at ports
Iron ore port inventory ended at 126.17mnt, +2.1% WoW as of 12 Jan



Source: Wind, BofA Global Research

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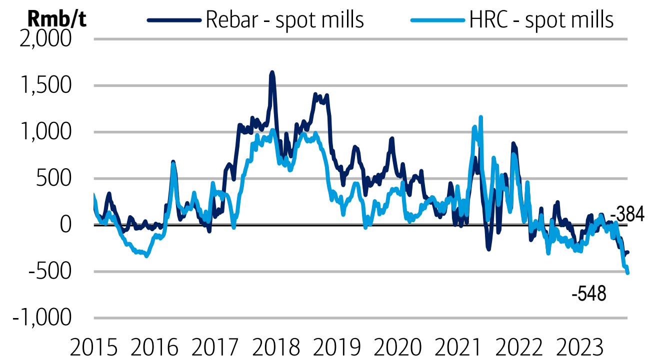
Exhibit 2: Spot cash margins at steel mills
Spot rebar cash margin +RMB61/t to -RMB384/t, and spot HRC cash margin +RMB46/t to -RMB548/t



Source: Wind, BofA Global Research

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On a longer-term horizon, we noticed most investors forecasting iron ore between $110-120/ton on average for 2024. Therefore, our forecast of $125/ton appears to be a tad above consensus. Investors do agree with our call that peak tightness in iron ore markets should take place in 1Q itself with this tightness gradually unwinding throughout the year as supply seasonally recovers leading iron ore to gradually correct throughout 2024.

Vale stood out as a consensus long among iron ore miners

Most investors we spoke to were positioned long Vale seeing FCFE yields looking attractive for 2024 (10-15%) especially vs. other Majors and also vs. regional steelmakers. Investors also see room for extraordinary dividends given expanded net debt should remain below the ceiling of $20bn.

The ongoing renegotiation of Samarco's remediation was also a key topic of debate. We noticed most local investors expecting a deal to be concluded at some point this year. Most expect that a final agreement could translate into $2-3bn of additional provisions booked by Vale (vs. our expectation of $1-2bn).

Investors were also looking closely to developments in the base metals division given the recent separation into a new entity, sale of a 13% minority stake, new leadership and a potential merger of Canadian assets with Glencore. However, our impression is that most believe that the turnaround of the base metals division will take time and is likely a longer-term trigger.

Investors remain largely negative on steel

We sensed that local investors were still underweight LatAm steels expecting 2024 to be a challenging year given still high interest rates, weak demand and import threats. We noticed most investors forecasting steel demand and prices in LatAm flattish-to-down vs. 2023 for the most part. As a consequence, most see earnings momentum looking lackluster in the coming quarters and see uninspiring single-digit FCFE yields for 2024.

Our outlook for US steelmakers calls for a peak in sheet prices in February. With the spot price of $1,100/st now above our forecast, a peak at ~$1,125/st in February is possible, driven by import arbitrage and significant new supply which should drive a correction in prices after that. On the long steel side, we see rebar prices rebounding from 2Q onwards given seasonally stronger supply, low import arbitrage and support from infrastructure bills. Although investors did not push back on this outlook, we noticed an overall hesitancy to price this potential rebound in 2Q via Gerdau right now, particularly given a weaker earnings outlook for the company in 4Q23-1Q24 and low conviction over additional extraordinary dividend announcements throughout that time horizon. Therefore, most remain underweight the stock. Having said that, a handful of investors believe the stock now screens cheaper than Usiminas and CSN (slightly below 4x EV/EBITDA 24 vs. other two closer to 4.5-5x) and offers higher FCF yields (closer to 10%), and were starting to position long Gerdau via pair trades against other regional steelmakers (yet this was clearly a minority of investors we spoke to).

On Usiminas, we noticed that quite a few investors upgraded their numbers and are now forecasting EBITDA closer to R$3bn for 2024 (in-line with our forecast), yet most worry about the timid FCFE yields for this year (single digits ex-working capital unwind) and about potential new capex announcements in 2025 (MUSA mine extension mainly). Similar to Usiminas, we noticed investors concerned about higher capex ahead for CSN and implications for leverage.

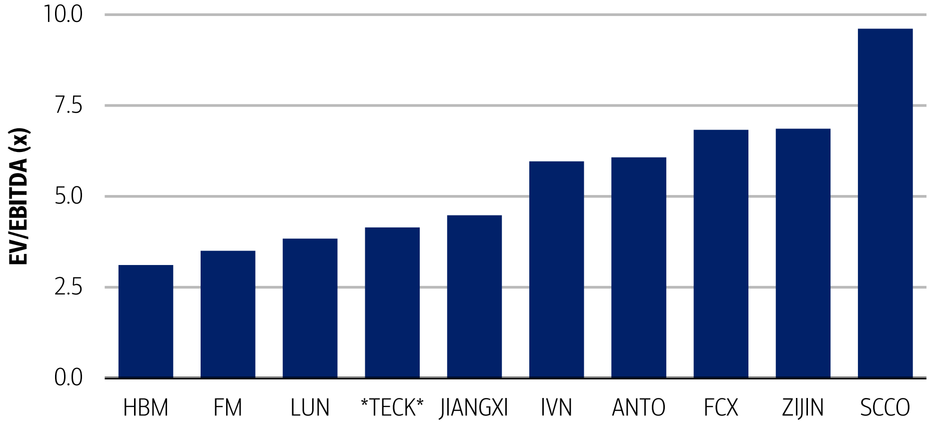
From the **North American point of view**, we think CMC is the best way to gain exposure to our forecast for an H1'24E rebound in rebar prices. While most investors we spoke with were sympathetic to this view, only a few seemed positioned long in Commercial Metals (CMC), our preferred vehicle for exposure to this trade. We think this is at least partly because of concern about a more severe slowdown in the U.S. economy. The BofAe house view is for an U.S. economic "soft landing" in 2024E. On the other hand, for Steel Dynamics (STLD), which we see as more exposed to falling sheet prices vs. other North American peers, many investors seemed to already hold a negative view of the stock with many appearing to be either avoiding it or short. Trading at nearly 8x 2024 consensus estimated EV/EBITDA, Brazilian investors think STLD looks susceptible, due both to the product mix and the strong valuation vs. its historical average of 6.3x. Given higher capex in 2024E vs. 2023E, investors think STLD's share buy-back activity could slow in 2024E vs. 2023E. Investors are also cautious on Nucor (NUE) but believe it is more defensive than peers in a potential economic down-turn.

Interest in the recently announced acquisition of U.S. Steel (X) by Nippon Steel (NSC) was broad, and the debate was lively on whether a Committee on Foreign Investment in the United States (CFIUS) review or a lack of support from the X unions could prevent the transaction from closing. Most investors seem to believe it ultimately will close given the robust acquisition price.

Cautious base metals where copper is king

We found investors in Brazil were on-balance cautious the base metals, with a clear relative preference for copper (in line to the BofA Commodities team view). This preference for copper was primarily due to the substantial recent supply disruptions, that have tipped market expectation from a 2024 surplus to a 2024 deficit. However, similar to the BofA house view, there's an acknowledgement that copper should benefit from decarbonization trends more than any other industrial metal. In terms of the **North American copper equities**, Ivanhoe (IVN) seems widely owned by the Brazilian investment community who like the ultra-high copper grades associated with IVN's flagship copper mine, Kamoa-Kakula, the strong copper production growth, and the exploration upside potential, from in particular, the Western Foreland.

Exhibit 3: 2025E EV/EBITDA for the global copper stocks covered by BofA
TECK is attractively valued vs. other large cap copper producers



Source: BofA Global Research, Bloomberg, Company reports

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There was significant interest in Teck Resources (TECK) as a copper exposed equity vehicle. However, based on our conversations, ownership of the shares seems limited. Most of the conversations focused on why the shares of TECK have not performed better since they announced the $8.6 billion sale of their steelmaking coal business (link: Teck Resources: Steelmaking coal business sold for implied value of US$8.9 billion, cash consideration 14 November 2023), use of cash proceeds, and concerns around TECK's execution to date on constructing its huge QB2 copper project in Chile. Despite Freeport McMoRan (FCX) being viewed as very expensive relative to copper producer peers, few investors we spoke with seemed willing to be short, while others acknowledged it as an ideal vehicle for long exposure to express a positive view on the copper prices.

Views on aluminum range from skeptical to bearish based on a weak Chinese economy. Thus, Brazilian investors are hesitant to be long Alcoa (AA) while at the same time unwilling to be short given the substantial sell-off from its May 2022 share prices peak and the recent volatile share price movements. Positioning on CBA follows a similar path, with shy interest on the name led by the more cautious aluminum outlook, on top of uncertainty regarding the extent of the cost recovery over the next couple quarters.

PRIO still a consensus long within O&G; PBR less so

Overall investors have been more bearish on oil prices as there's been some hiccups with the more bullish narrative for oil especially given more output from OPEC+ members coupled with weaker demand which drove prices below $80/bbl.

Regarding PRIO, we sensed that the company remains a consensus long for most local funds. However, we highlight that there has been some concern regarding the start-up of Wahoo given the recent newsflow on the strike of IBAMA's (Brazilian Institute of Environment and Renewable Natural Resources) employees. It is worth highlighting that IBAMA needs to issue two licenses for Wahoo – one to allow the drilling campaign at the field and one to allow the launch of the lines that will connect Wahoo and the platform FPSO Valente, located in the Frade field.

Regarding Petrobras, investors are looking closely to dividend announcements (particularly extraordinaries) that could come hand-in-hand with 4Q results. Our expectation is for a minimum dividend yield of 3.5% which could move to as high as 11% with extraordinary announcements. We sensed some mixed views regarding the likelihood that extraordinary dividends will be announced with some worrying about the creation of the capital remuneration reserve and its implications for net income retention. As a consequence, we sensed that PBR is much less of a consensus long vs. PRIO.

Waiting for the pulp price drop to buy pulp stocks

Overall, we sensed that for the most part investors were waiting for a potential pulp price drop in the weeks ahead to either build a long position in pulp stocks or add to an existing one. Most seemed surprised with the recent strength in Suzano shares despite the correction in pulp resale and futures prices as well as the appreciation of the BRL. With the drop in hardwood (HW) and softwood (SW) prices to levels deep within cost support in May 2023 and the resulting permanent shutdown of near 3Mtpa of SW capacity, most agree with our call that the downside for prices from current levels looks limited. We sense that the market has become more convinced over the past year that supply disruptions play an important role in setting a bottom for pulp prices. Therefore, most struggle to see pulp prices dropping to levels below $500-550/ton as that led to some swift and important supply disruptions this year such as: i) Suzano announcing a 4% production cut, ii) integrated players shutting down their pulp production lines and starting to acquire market pulp and iii) millions of tons of permanent shutdowns especially on the SW/Fluff/UKP (unbleached kraft pulp) side.

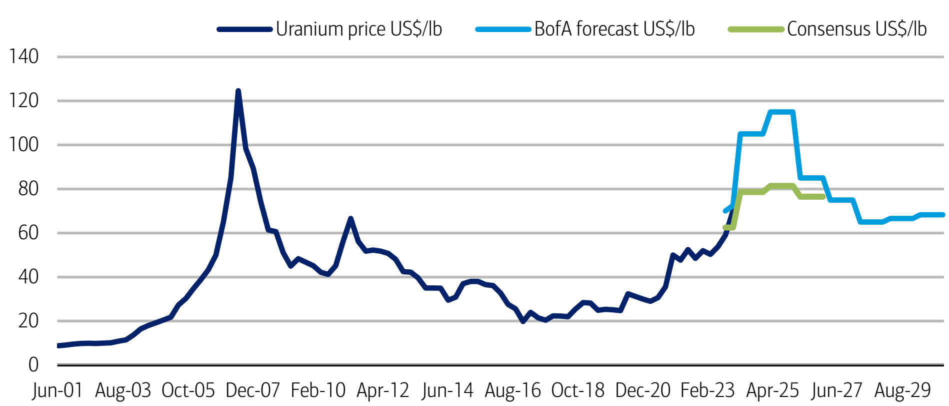
Most investors seem to prefer exposure to Suzano in the sector particularly looking to 2025 multiples and FCF yields which look very attractive assuming a ~$600/ton HW price in China (considered by many to be a long-term sustainable price). In addition, the market sees Suzano benefitting from lower cash costs ahead and volume growth as the highly competitive Cerrado project comes online and due to lower third-party wood consumption and shorter radius from forest to mill. Nonetheless, we did notice some concern over capital allocation with the company recently signaling a higher willingness to analyze M&A opportunities in geographies outside of Brazil yet most believe Suzano will remain very disciplined.

Uranium: huge interest, varying views on how to trade

Without question, interest in uranium among Brazil investors is widespread. Interestingly, not everyone is yet invested as some are still 'doing the work' to get ramped-up on this sub-sector. For those already invested in the sector, there is a strong debate as to how to get exposure. We recently increased our uranium price forecasts for 2024E and 2025E quite materially (link here: Global Uranium: Uranium prices will peak, but not yet. The bull market has further to run. Buy CCJ 07 January 2024).

Exhibit 4: Uranium price US$/lb

Spot uranium is currently trading at US$104/lb U3O8 (+87% in 2023) with BofA expecting the market to remain in deficit until sometime in 2025E.



Source: BofA Global Research estimates

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Brazilian investors see four main options: 1) buy Cameco (CCJ), the most liquid and largest market cap option, but offering limited near-term earnings leverage to higher prices due to its contracted sales book; 2) buy a financial vehicle that provides direct exposure to the spot prices (i.e. the Sprott Physical Uranium Trust (SPUT, uncovered), or Yellowcake Corporation (YCA) with this direct exposure countered by unit or share price discounts to net asset value (NAV); 3) buy the equities of various junior producers with less market cap and less liquidity but more immediate uranium spot price exposure, or 4) buy one or more of the various uranium equity ETF's that combine all of the above options, but with less liquidity than CCJ on its own. This is similar to the debate we're having with investors globally. Feedback suggests that all of these possibilities are being employed on average, with some investors tilting one way or another depending on preferences, style, strategy, fund size, and various other considerations.

Exhibit 5: Daily price of uranium (U_3O_8) in $/lb

U_3O_8 has been strengthening steadily since Cameco idled its McArthur River mine in late 2017

Source: UxC, LLC

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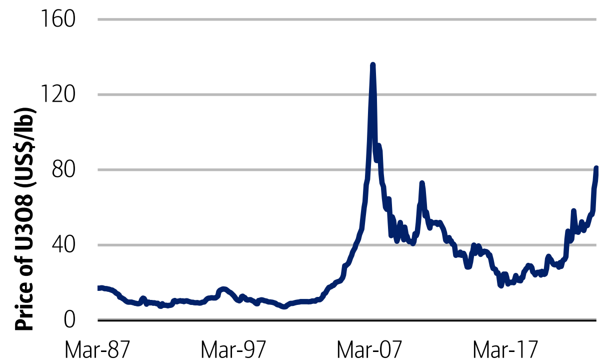
Exhibit 6: Monthly price of uranium (U_3O_8) in $/lb

...Yet U_3O_8 prices are still well below long-term peak prices reach in 2007



Source: UxC, LLC

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Precious: modest interest in gold, less so the equities

There is certainly interest from Brazilian investors in gold and its potential portfolio benefits in a recessionary situation. However, there is more that are comfortable with owning gold than the gold equities. Those seeking equity exposure are largely focused on the large cap producers (Newmont, Barrick, Agnico Eagle). There was surprisingly little engagement with the royalty/streaming companies (Franco-Nevada (FNV), Wheaton Precious Metals (WPM), and Royal Gold (RGLD)) but we found investors were curious to potentially engage more with this group of precious metal equities. FNV has garnered some attention in light of the recent sell-off related to the Cobre-Panama mine shutdown. We detected some push back on WPM given a view that a turn-around at the Vale base metals division, which accounts for over 40% of WPM's NAV, could take several years to materialize.

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Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

[R1]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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