

Gerdau

WEAK RESULTS; IRON ORE = POTENTIAL RE-RATING

Gerdau has reported its 4Q10 results. Despite the fact that EBITDA was 11% lower than our estimates and 17% below consensus, we believe the stock will react positively owing to (i) the positive outlook for results over the coming quarters - we expect margins to start to recover in 1Q11; and (ii) the announcement of the upward revision of iron ore resources to 2.9bn tons along with the green light from the Board of Directors for management to seek ways to monetise these resources.

EBITDA margin lower than our estimate; We expect a recovery in 1Q11

Gerdau's sales volume and net revenues were practically in line with our estimates. EBITDA, of R\$ 815m, however, was 11% below our estimates, representing an EBITDA margin of 10.4% vs. our forecast of 11.8% and 12.8% by consensus. Both COGS and SG&A were slightly higher than our estimates, and were mainly responsible for the difference in the EBITDA margin. Net income in 4Q10 was R\$ 369m (ex-minorities), 60% higher than our estimate, although there was a gain of R\$ 289m (net of income taxes) in the quarter relating to the impairment testing of Gerdau's assets, a non-recurring effect not included in our estimates.

Iron ore resources revised up to 2.9bn tons; potential re-rating of shares

The highlight was the material fact the company disclosed yesterday, reporting that it had revised up from 1.8bn to 2.9bn tons the resources of Várzea do Lopes, Miguel Burnier, GongoSoco and Dom Bosco iron ore mines, and had included land that it had acquired. Gerdau reported it was evaluating ways to monetise these resources. We believe the sale of a minority stake in Gerdau's mining assets to a strategic partner would make sense as it would speed up the company's current expansion plans. We would go so far as to say that Gerdau's next step should be to spin off the mining assets and create a company in order to sell off a minority stake to a strategic partner. However, Gerdau's management has not disclosed any details about its plans.

Considering the current iron ore price, the high price of mining assets around the world (in our view), the lack of good quality reserves available for sale and strong demand for iron ore assets from steelmakers, we believe Gerdau has a unique opportunity to extract value from its mining assets with a partial sale to a strategic partner being the optimal way. Moreover, it could establish off-take contracts for ore to supply its own demand, taking into account the fact that Açominas could expand its steel production to up to 13m ton, according to the management. Gerdau's shares do not reflect the intrinsic value of its mining assets, in our view, and therefore we believe the stock could undergo a re-rating as the company reveals its strategic details and the next steps for its iron ore business.

EBITDA margin target of 16-20% in 2011; We reiterate Gerdau (BUY) as our top steel pick

After many conference calls presenting a conservative view on the outlook for earnings, this time Gerdau's management appeared optimistic about its performance in 2011. Gerdau expects: (i) 8-10% growth in domestic demand for long steel; and (ii) a 10% increase in long steel sales in North America, which should raise capacity utilization from the current 60% to 65-70%. Gerdau expects the EBITDA margin to be between 16-20% in 2011 vs. our estimate of 18.9%. With regard to M&A, Gerdau said no asset is currently being assessed and that it will focus on the cost-cutting process and reducing working capital without affecting sales.

Gerdau's shares are trading at an EV/EBITDA11E multiple of 6.0x, according to our estimates, representing a 28% discount to Usiminas PN (NEUTRAL, PT R\$ 24) and a 6% discount to CSN (BUY, PT R\$ 36.2). We maintain our BUY rating on Gerdau (Dec-11E TP of R\$ 31.8/share).

R\$ m	Actual 4Q10	BES 4Q10E	% Diff Act/BES	Cons. Estimates	% Diff Act/Cons	4Q09 Gerdau
Net revenues	7,800	7,811	-0.1%	7,714	1.1%	6,363
EBITDA	815	920	-11.4%	988	-17.5%	1,246
EBITDA mg.	10.4%	11.8%	-1.3 p.p.	12.8%	-2.4 p.p.	19.6%
Net income	369	231	59.7%	250	47.7%	747

Source: Company for historical figures, Bloomberg for consensus and BES Securities for estimates.

Analyst

Juliano Navarro

jnavarro@bessecurities.com.br +55 11 30747320

BUY

Price Target (Dec. 11)

GGBR4	R\$ 31.8
GGB*	US\$ 18.2

Price (2 Mar 11)

GGBR4	R\$ 21.7
GGB	US\$ 13.4

Upside Potential

GGBR4	+46%
GGB	+36%

* US\$/R\$ 1.75

Trading

Bovespa Ticker	GGBR4
Bloomberg Ticker	GGBR4.BZ
Shares Outstanding (m)	1,506
Market Cap (R\$ m)	32,748
Avg. Daily Vol. (ths. shares)	5,811
Avg. Daily Turnover (R\$ ths.)	131,586
Ibovespa Index Weight	3.0%
52W High / Low	31,4 / 19,4

Performance (%)	Abs.	vs Ibov
3M	2.4	5.8
6M	-9.1	-9.8
YTD	-4.1	-1.2

Financials

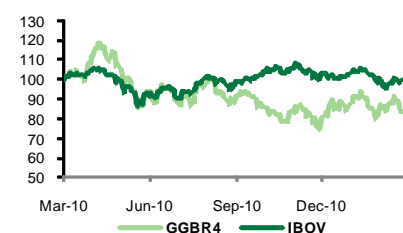
EBITDA mg.	18.9%
Interest Coverage	7.7
Net debt / EBITDA (x)	1.4
ROCE	14%
ROE	16%

Shareholders (%)

Metalúrgica Gerdau S/A	42.0%
Bndespar - BNDES Part.	3.3%
Treasury	0.8%
Free Float	53.9%

Source: Bloomberg, Gerdau for historical figures and BES Securities for estimates.

HISTORICAL RELATIVE SHARE-PRICE PERFORMANCE



Source: Bloomberg.

Summary financial information

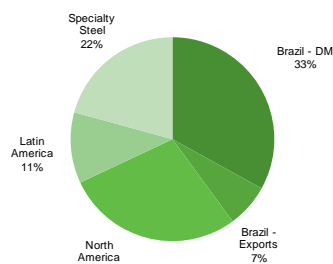
GERDAU

Rating	BUY
Price Target (Dec. 11, R\$/sh):	31.8
Price Target (Dec. 11, US\$/ADR):	18.2
Share Price (2/Mar/11, R\$/sh):	21.8
Share Price (2/Mar/11, US\$/ADR):	13.4
Upside / Downside potential (GGBR4)	46.2%
Upside / Downside potential (GGB)	35.6%
Previous Target price (R\$/sh):	na
% change to target price:	na
Previous Target price (US\$/ADR):	na
% change to target price:	na
Bloomberg	GGBR4.BZ
IBOV	GGBR4
Shares in Issue (Less Treasury)(m)	1,506
Market Cap (R\$ m)	32,748
Net Debt 4Q10E (R\$ m)	11,609
Adjustments for Associates & Minorities (R\$ m)	2,282
Enterprise Value (R\$ m)	46,639

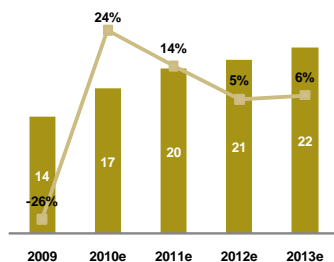
Forthcoming Catalysts
1Q11 Earnings release - 5/May/11

BES Securities Research Analyst
Juliano Navarro
+55 11 30747320
jnavarro@bessecurities.com.br

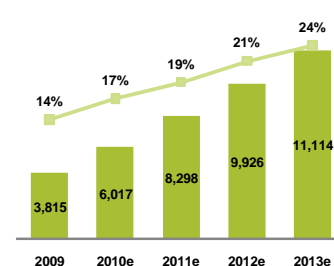
Revenue breakdown (2010E)



Sales (m ton) and YoY variation (%)



Ebitda (US\$ m) and Ebitda mg. (%)



Valuation Metrics (Year end Dec)	2008	2009	2010E	2011E	2012E
Recurrent P/E (x)	5.3	36.3	15.9	10.7	7.2
Reported P/E (x)	5.3	36.3	15.9	10.7	7.2
EV / Sales (x)	0.9	1.9	1.4	1.1	0.9
EV / EBITDA (x)	3.9	13.2	8.4	6.0	4.4
EV / EBIT (x)	4.8	23.2	13.5	8.2	5.7
FCF Yield (%)	-38.7%	16.8%	9.2%	7.9%	14.1%
Dividend yield (%)	7.9%	0.8%	1.8%	2.8%	4.2%

Key Ratios	2008	2009	2010E	2011E	2012E
EBITDA margin	23.9%	14.4%	16.9%	18.9%	21.5%
EBIT margin	19.1%	8.2%	10.4%	13.8%	16.6%
Capex / Revenue	0.2	0.1	0.0	0.1	0.1
Capex / Depreciation (x)	3.6	0.9	0.3	1.3	1.2
Net Debt / EBITDA (x)	1.8	2.6	2.2	1.4	0.7
EBITDA / Net Interest (x)	-4.5	20.7	-11.4	-7.7	-24.0
ROE	24.0%	5.8%	11.1%	15.5%	20.4%

P & L Summary (R\$ m)	2008	2009	2010E	2011E	2012E
Revenue	41,908	26,540	31,405	37,721	41,845
% change	37%	-37%	18%	20%	11%
EBITDA	10,025	3,815	5,306	7,132	8,977
% change	60%	-62%	39%	34%	26%
% margin	24%	14%	17%	19%	21%
Depreciation and Amortisation	1,896	1,745	2,903	1,915	2,038
EBIT	8,005	2,179	3,280	5,217	6,940
% change	66%	-73%	51%	59%	33%
% margin	19%	8%	10%	14%	17%
Associates	123	(109)	16	133	74
Operation Profit	8,128	2,070	3,297	5,349	7,013
Net Financials	(2,235)	185	(467)	(928)	(375)
Other Pre-tax Income	0	(1,223)	0	0	0
Pre-Tax Profit	5,893	1,031	2,830	4,421	6,639
Income Tax Expense	(948)	(27)	(478)	(944)	(1,444)
Minority Interests	(1,004)	117	(296)	(416)	(622)
Net Income	3,941	1,122	2,056	3,062	4,573
Recurrent Net Income	3,941	1,122	2,056	3,062	4,573
Reported EPS (R\$)	2.6	0.7	1.4	2.0	3.0
Recurrent EPS (R\$)	2.6	0.7	1.4	2.0	3.0
DPS (R\$)	1.1	0.2	0.4	0.6	0.9
Payout Ratio	41.9%	29.3%	30.0%	30.0%	30.0%
Shares in Issue (Less Treasury) (m)	1,506	1,506	1,506	1,506	1,506

Cash Flow Summary (R\$ m)	2008	2009	2010E	2011E	2012E
EBITDA (net of provisions)	10,025	3,815	5,306	7,132	8,977
Taxes Paid	(948)	(27)	(478)	(944)	(1,444)
Interest Paid / Received	(2,235)	185	(467)	(928)	(375)
Change in Working Capital	(4,584)	4,595	(1,552)	(1,161)	(459)
Associate & Minority Dividends	0	0	0	0	0
Other Operating Cash Flow	1,378	(2,080)	1,106	1,760	3,321
Operating Cash Flow	3,635	6,487	3,914	5,859	10,020
Capital Expenditure	(6,817)	(1,530)	(1,001)	(2,450)	(2,450)
Free Cash Flow	(3,182)	4,957	2,913	3,409	7,570
Acquisitions & Disposals	0	0	0	0	0
Dividends Paid to Shareholders	(1,650)	(329)	(617)	(919)	(1,372)
Equity Raised / Bought Back	2,835	(13)	0	0	0
Other Financing Cash Flow	2,271	(5,259)	(4,103)	94	(2,177)
Net Cash Flow	274	(644)	(1,807)	2,585	4,021

Balance Sheet Summary (R\$ m)	2008	2009	2010E	2011E	2012E
Cash & Equivalents	5,413	4,770	2,963	5,548	9,568
Tangible Fixed Assets	1,797	1,220	1,173	1,306	1,380
Goodwill & Intangibles	21,768	17,724	16,592	17,127	17,540
Associates & Financial Investments	1,797	1,220	1,173	1,306	1,380
Other Assets	28,276	12,446	14,543	16,032	16,823
Total Assets	59,051	44,583	43,497	48,238	53,536
Interes Bearing Debt	23,234	14,521	14,572	15,640	16,190
Other Liabilities	10,773	8,058	9,004	10,116	11,042
Total Liabilities	34,007	22,579	23,576	25,756	27,232
Shareholder's Equity	20,167	18,471	18,670	20,813	24,014
Minority Interests	4,877	3,534	1,252	1,668	2,289
Total Equity	59,051	44,583	43,497	48,238	53,536
Net Debt	17,821	9,751	11,609	10,093	6,621

Source: Company for historical figures, Bloomberg and BES Securities for estimates.

TABLE 1: 4Q10 AND FY10 RESULTS

IFRS	4Q10	4Q10E	Actual/Est	3Q10	QoQ %	4Q09	YoY %	FY09	FY10	YoY %
Total Volume - th. ton	4,513	4,504	0.2%	4,415	2.2%	3,725	21.2%	14,040	17,357	23.6%
Brazil	1,811	1,793	1.0%	1,635	10.8%	1,413	28.2%	5,175	6,646	28.4%
<i>Domestic market</i>	1,077	1,187	-9.3%	1,211	-11.1%	1,091	-1.3%	3,650	4,716	29.2%
<i>Exports</i>	734	606	21.1%	424	73.1%	322	128.0%	1,525	1,930	26.6%
North America	1,442	1,446	-0.3%	1,506	-4.2%	1,206	19.6%	4,935	5,742	16.4%
Latin America	565	571	-1.0%	565	0.0%	538	5.0%	2,069	2,204	6.5%
Specialty Steel	695	695	0.0%	709	-2.0%	568	22.4%	1,861	2,765	48.6%
R\$ million										
Net revenues	7,800	7,811	-0.1%	8,190	-4.8%	6,363	22.6%	26,540	31,393	18.3%
COGS	-6,851	-6,834	0.2%	-6,840	0.2%	-5,029	36.2%	-22,306	-25,873	16.0%
Gross income	949	977	-2.9%	1,350	-29.7%	1,334	-28.9%	4,235	5,520	30.4%
Gross margin	12.2%	12.5%	-0.3 p.p.	16.5%	-4.3 p.p.	21.0%	-8.8 p.p.	16.0%	17.6%	1.6 p.p.
SG&A	-629	-612	2.8%	-612	2.8%	-516	21.9%	-2,144	-2,358	10.0%
EBITDA	815	920	-11.4%	1,265	-35.6%	1,246	-34.6%	3,815	5,201	36.3%
EBITDA margin	10.4%	11.8%	-1.3 p.p.	15.4%	-5.0 p.p.	19.6%	-9.1 p.p.	14.4%	16.6%	2.2 p.p.
Financial result	-184	-17	988.5%	0	-47158.8%	-131	40.7%	185	-685	-471.1%
Taxes and contribution	-71	-48	48.7%	-172	-58.7%	-45	58.6%	-27	-501	1760.7%
Minorities	-51	-31	61.2%	-73	-30.5%	103	-149.1%	117	-315	-368.1%
Net income	369	231	59.7%	536	-31.2%	747	-50.6%	1,122	2,142	90.9%

Source: Company for historical figures and BES Securities for estimates.

TABLE 2: VALUATION

NPV - Free cash flow	R\$ m	41,163	DCF (WACC=11.9% / g=4%)
NPV - Perpetuity	R\$ m	21,680	
"g" in perpetuity (nominal)		4%	
Firm value	R\$ m	62,843	
Net debt (30/Sep/10)	R\$ m	12,669	
Participation in capital @ P/BV	R\$ m	2,282	
Equity value	R\$ m	47,892	
# shares	m	1,506	
Price target	R\$/share	31.8	
Current price	R\$/share	21.8	
Upside potential		46.2%	

Priced as at 2/3/2011;

Source: Company for historical figures, Bloomberg and BES Securities for estimates.

DISCLAIMER

Ratings

Buy	47.1%
Neutral	47.1%
Sell	5.9%

Gerdau PN - GGBR4

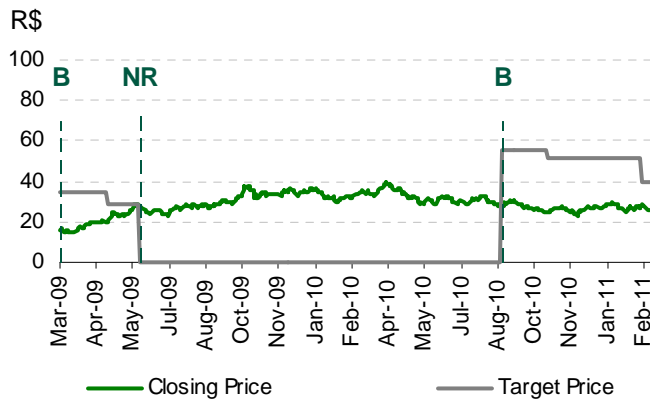


Date	Rating	Target Price	Closing Price
29-Apr-09	NEUTRAL	19.5	15.3
08-Jun-09	NOT RATED	-	-
30-Aug-10	BUY	35.7	23.4
25-Oct-10	BUY	32.7	20.7
17-Feb-11	BUY	31.8	23.7

Source: Bloomberg for closing prices, Bes Securities do Brasil S.A CCVM for ratings and price targets.

Note: closing price refers to the adjusted close of the previous session.

Metalúrgica Gerdau PN - GOAU4



Date	Rating	Target Price	Closing Price
29-Apr-09	BUY	28.60	20.30
08-Jun-09	NOT RATED	-	-
30-Aug-10	BUY	55.80	28.10
25-Oct-10	BUY	51.20	24.70
17-Feb-11	BUY	39.40	28.00

Source: Bloomberg for closing prices, Bes Securities do Brasil S.A CCVM for ratings and price targets.

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BUY: Expect the company to perform better than the primary market index over the next 12 months.

NEUTRAL: Expect the company to perform approximately in line with the primary market index over the next 12 months.

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Contact Information:

Andrea Czarniak – Head of Sales (212) 351-6050	aczarniak@esinvestment.com
Joy Bejasa – Equity Research Sales (212) 351-6055	jbejasa@esinvestment.com
Michael Williams – Sales Trader (212) 351-6052	mwilliams@esinvestment.com

E.S. Financial Services, Inc.

New York Branch

340 Madison Avenue, 12th Floor

New York, N.Y. 10173

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IBERIAN EQUITY RESEARCH
Oil & Gas, Food Retail

Filipe Rosa +351 21 330 2184
Head of Research Portugal
 frosa@besinv.pt
 Manuel Albuquerque +351 21 330 2173
 malbuquerque@besinv.pt

Telecoms

Nuno Matias +351 21 330 2133
 nmatias@besinv.pt

Iberian MidCaps

Nuno Estácio +351 21 330 2276
MidCap Coordinator
 nestacio@besinv.pt
 Rui Dias +351 21 330 21 57
 rdias@besinv.pt

Pharma, Food

Luis Navia +34 91 400 5271
 lnavia@esinvestment.es

Cement, Pulp & Paper

João Pedro Mendes +351 21 330 2154
 jmendes@besinv.pt

Macroeconomic Research

Carlos Andrade +351 21 310 6493
Chief Economist
 caandrade@bes.pt

Construction, Real Estate

Juan Carlos Calvo +34 91 400 5316
Head of Research Spain
 jccalvo@esinvestment.es

Utilities & Renewables

Fernando Garcia, CFA +34 91 400 5280
 fgarcia@esinvestment.es
 Felipe Echevarría +34 91 400 5449
 fechevarria@esinvestment.es

Banks, Insurance, General Financials

Juan Pablo López, CFA +34 91 400 5273
 jplopez@esinvestment.es
 María López +34 91 400 5331
 mlopez@esinvestment.es

Media, Leisure and Travel

María Martínez +34 91 400 5272
 mmartinez@esinvestment.es

IBERIAN EQUITIES
Management

João Baptista Pereira +351 21 330 9503
Head of Iberian Equities
 jpereira@besinv.pt

International Equity Sales

Manuel Paiva Raposo +34 91 400 0902
Head of Sales Spain
 mraposo@esinvestment.es
 Ana Oliveira +44 207 456 9125
 ana.oliveira@execution-noble.com
 José Peixoto +351 21 319 9740
Head of Sales Portugal
 jpeixoto@besinv.pt
 Nuno Brito e Cunha +351 21 319 9730
 nbcunha@besinv.pt

New York Office

Pedro Marques +1 212 351 6051
Iberian Equity Sales
 pmarques@esinvestment.com

Domestic Equity Sales

Pedro Llamas +34 91 400 0902
Spanish Accounts
 pllamas@esinvestment.es
 Barbara Romeu +34 91 400 0902
Spanish Accounts
 bromeu@esinvestment.es
 Pedro Santos +351 21 319 9755
Portuguese Accounts
 pmsantos@besinv.pt

Equity Trading

Nigel Williams +34 91 400 5358
Head of Sales Trading Spain
 nwilliams@esinvestment.es
 Susana Ferreira da Silva +351 21 319 9756
Head of Sales Trading Portugal
 ssilva@besinv.pt

Trading Desks

Madrid +34 91 400 5399
 Lisbon +351 21 319 9750

POLISH EQUITY RESEARCH
Banks, Insurance, General Financials

Szymon Ozóg, CFA +48 22 347 4040
Head of Research Poland
 sozog@esinvestment.pl
 Kamil Stolarski +48 22 347 4048
 kstolarski@esinvestment.pl

Media, Telecoms

Adrianna Kocięda +48 22 347 4042
 akocieda@esinvestment.pl

Utilities, Construction

Maciej Hebda +48 22 347 4043
 mhebda@esinvestment.pl

Construction & Real Estate, Consumer

María Szymańska +48 22 347 4045
 mszymanska@esinvestment.pl

POLISH EQUITIES
Management

Rodrigo Carvalho +48 22 347 4030
Head of Polish Equities, Equity Sales
 rcarvalho@esinvestment.pl

Equity Trading

Miguel Passos +48 22 347 4017
Head of Equity Trading
 mpassos@esinvestment.pl
 Paweł Tofil +48 22 347 4014
 ptofil@esinvestment.pl
 Sebastian Kosakowski +48 22 347 4016
 skosakowski@esinvestment.pl
 Aleksander Mazur +48 22 347 4013
 amazur@esinvestment.pl
 Wojciech Józwiak +48 22 347 4019
 wjowizk@esinvestment.pl
 Artur Zareba +48 22 347 4018
 azareba@esinvestment.pl

BRAZILIAN EQUITY RESEARCH
Oil & Gas, Sugar & Ethanol

Gilberto Pereira de Souza +55 11 3074 7325
Head of Research Brazil
 gsouza@bessecurities.com.br

Utilities & Infrastructure

Alexandre Kogake +55 11 3074 7327
 akogake@bessecurities.com.br
 Gabriel Laera +55 11 3074 7322
 glaera@bessecurities.com.br

Mining, Steel, Pulp & Paper

Juliano Navarro +55 11 3074 7320
 jnavarro@bessecurities.com.br

Macroeconomic Research

Jankiel Lima dos Santos +55 11 3074 7344
 jsantos@besinvestimento.com.br
 Flávio Zientara Serrano +55 11 3074 7343
 fserrano@besinvestimento.com.br

Management

José Martins Soares +351 21 330 2140
Global Head of Equity Research
 jmartinssoares@besinv.pt

Consumer

Luis Felipe Bresada +55 11 3074 7321
 lbresada@bessecurities.com.br

Financials & Real Estate

Gustavo Schroden +55 11 3074 7356
 gschroden@bessecurities.com.br
 Rodrigo Manso +55 11 3074 7412
 rmanso@bessecurities.com.br

Telecoms, Media, Technology

Caimi Reis +55 11 3074 7334
 creis@bessecurities.com.br

BRAZILIAN EQUITIES
Management

Rui Marques +55 11 3074 7103
Head of Brazilian Equities
 rmarques@bessecurities.com.br

Equity Sales

André Julião +55 11 3074 7392
 ajuliao@bessecurities.com.br
 Karin Augustinska +55 11 3074 7390
 kaugustinska@bessecurities.com.br
 Ricardo Copia +55 11 3074 7398
 rcopia@bessecurities.com.br

New York Office

Andrea Czarniak +1 212 351 6050
 aczarniak@esinvestment.com
 Joy Bejasa +1 212 351 6055
 jbejasa@esinvestment.com

Lisbon Office

Igor Maresti +351 21 319 9735
 imaresti@besinv.pt
 Xiaomao Chen +351 21 319 9786
 xchen@besinv.pt

Equity Trading, BM&F

Luiz Eduardo Sposito +55 11 3074 7393
 lsposito@bessecurities.com.br
 Gustavo Vieira de Oliveira +55 11 3074 7394
 goliveira@bessecurities.com.br
 Jorge Alexandre de Almeida +55 11 3074 7010
 jalmeida@bessecurities.com.br
 Diogo Vinicius de Andrade +55 11 3074 7369
 dandrade@bessecurities.com.br
 Marcos Prado +55 11 3074 7410
 mprado@bessecurities.com.br
 Mauricio Albarnaz +55 11 3074 7009
 malbarnaz@bessecurities.com.br
 Ney Mendonça de Aquino +55 11 3074 7340
 naquino@bessecurities.com.br
 Simone Klein +55 11 3074 7011
 sklein@bessecurities.com.br
 São Paulo Desk +55 11 3074 7400
 bes_securities@bessecurities.com.br

Corporate Access

Rita Gonzalez +351 21 319 9740
Analyst & Corporate Marketing
 rgonzalez@besinv.pt

– This report was prepared by the Equity Research Team from BES Securities do Brasil S.A. CCVM –

BANCO ESPIRITO SANTO, S.A.

Av. da Liberdade, 195
 1250 - 142 Lisboa
 PORTUGAL

BANCO ESPIRITO SANTO DE INVESTIMENTO, S.A.

Rua Alexandre Herculano, 38
 1269 - 161 Lisboa
 PORTUGAL
 Calle Serrano, 88
 28006 Madrid
 SPAIN
 Oddział w Polsce - 59th Złota
 Street Floor V 00-120
 WARSAW, POLAND

BES SECURITIES DO BRASIL S.A. CCVM

Av. Brigadeiro Faria Lima, 3729 – Mezanino, Itaim Bibi
 04538-905 S. Paulo
 BRAZIL