

## Q2 2015 Earnings Call

### Company Participants

- Andre Gerdau Johannpeter, President and Chief Executive Officer
- Harley Lorentz Scardoelli, Chief Financial Officer, Director of Investor Relations

### Other Participants

- Alan Glezer, Analyst
- Humberto Meireles, Analyst
- Leonardo Correa, Analyst
- Leonardo Shinohara, Analyst
- Marcos Assumpcao, Analyst
- Rodolfo Angele, Analyst
- Thiago Lofiego, Analyst
- Unidentified Participant
- Victor Penna, Analyst

### Presentation

#### Operator

Good afternoon and welcome to Gerdau's Conference Call to discuss the results for the Second Quarter of 2015. At this time, all participants will be on listen-only mode during the company's presentation and later, we will begin the question-and-answer session.  
(Operator Instructions)

We would like to emphasize that any forward-looking statements that might be made during this conference call related to Gerdau's business outlook, projections, financial and operating goals are mere assumptions based on management's expectations related to the future of the company. Even though, Gerdau believes that its comments are based on reasonable assumptions, there is no guarantee that future events will not affect this evaluation.

Here today are Mr. Andre Gerdau Johannpeter, Director, President and CEO; and Harley Scardoelli, Financial and Corporate Director in also IR Officer.

With no further ado, I would like to give the floor to Mr. Andre Gerdau Johannpeter. You may proceed.

### Andre Gerdau Johannpeter

FINAL

Bloomberg Transcript

Thank you. Good afternoon, everyone and welcome to our earnings conference call to discuss Gerdau's results. We will start our analysis by looking at the global landscape of the steel industry, next I'll comment on Gerdau's performance on the second quarter of 2015, and then, I'll talk about our investments in the period.

I would like to emphasize that we will discuss the performance of the consolidated results of the second quarter vis-a-vis the same period of the year before. But before I begin this presentation, I would like to say, welcome to Harley Scardoelli, he is just beginning, this is his first earnings conference call. But I'm sure you are all very familiar with him.

I just want to welcome Scardoelli who will join me in this conference call and we'll have a presentation shortly. He will talk about the financial performance of Gerdau and right after that, we will be available to take your questions. For those of you who are following us through the net, we'll go to page two, where I'll talk about worldwide landscape.

We are currently experiencing a very challenging moment for the steel market as we have already mentioned in the previous quarters.

According to the World Steel Association, the global demand for steel is suppose to grow slowly in '15 and '16. That numbers are the following concerning steel consumption is expected to grow 0.5% in '15 and 1.4% in 2016, reflecting a slowdown in China and also the structural adjustments that are taking place in some economies around the world.

In addition to that, there is an excess installed capacity worldwide of about 720 million tonnes, which puts pressure on margins and hurts the profitability of the industry as a whole. Most of excessive capacity 425 million tonnes is in China versus the equivalent of six times the annual output of all Latin America. And this surplus covers China to export record volumes of steel in order to maintain the activity and jobs.

This is a clear reality in markets of Latin America and North America. Just to give you an idea, Chinese exports to Latin America grew 137% from the year 2000 to 2015, whereas in the period, the price was down 24%. In the U.S, we also saw an increase in imports of steel. The situation has caused significant damage to some markets due to unfair competition.

This serious issue of unfair competition has recently been tackled by means of the collision of the associations of steel producing companies in Brazil and also other countries in Latin and North America. And together, we are seeking competitive conditions of local producers, and then, we hope that they are reestablished.

In Brazil, I should mention the effect of the economic slowdown on the demand for steel, particularly in the industries such as construction and in the automotive sector. Added to that is the impact on steel imports in the domestic market.

In North America, the highlight comes from non-residential construction segment which is still strong, despite the heavy pressure of imported steel in the region. If you look at the

specialty steel segment in the United States, sales of light and heavy vehicles continue to grow, reaching some record numbers. Even though the energy gas and oil and gas is going through a significant downturn.

Europe shows a gradual recovery in the automobile market, however, it faces low demand in the oil and gas industry. In India, the market for light and heavy vehicles continues to rise and demand is supposed to increase mainly led by infrastructure and mining sectors. In Brazil, as you all know, we've seen a significant reduction in the production and sales of vehicles.

On page three, I would like to refer to the large figures and comment on the performance of the second quarter of 2015. Consolidated -- I mean, shipments amounted to 4.3 million tonnes, down by 6% when compared to the second quarter of the previous year. This drop in shipments stands from lower volume shipped from the specialty steels operations and also in North America.

Now, net sales reached BRL10.8 billion, growing 3% when compared to the same period of last year. This growth is mainly explained by the foreign exchange effect when converting into reals the dollars generated by the operations abroad and also exports from Brazil.

Now, SG&A expenses, the management efforts of the company are clearly seen in the 6.2% reduction of SG&A expenses when compared to the same period of the year before. Now excluding the effect from the exchange variations, the reduction of expenses was approximately 14%.

EBITDA. EBITDA amounted to BRL1.2 billion and remained flat, despite the adverse worldwide scenario of oversupply of steel and the economic hardships in Brazil, which reflected in the improved results of the North American operation and also our global effort to reduce SG&A expenses. Net income was BRL265 million, down by 33% when compared to the second quarter of 2014, and this drop comes from weaker operating results and higher financial expenses in the period.

Now I would like to refer to investments in the quarter, that's page four. Investments amounted to BRL648 million and this is for CapEx. I would like now refer to three important investments. One is the installation of the heavy plates rolling mill in Ouro Branco, the continuation of the melt shop construction in Argentina and the start up of the coke plant in the power generation plant in India. For the second half of the year, investments in CapEx should be lower when compared to investments in the first half of the year.

With that, I conclude this part of the presentation and now give the floor to Harley Scardoelli, and then, I'll come back for the final remarks.

**Harley Lorentz Scardoelli** {BIO 7283603 <GO>}

Thank you, Andre and good afternoon. I will now refer to slide six, when we talk about the financial results and performance of each business operation in the second quarter of 2015, and later, I will elaborate on the consolidated results of the company. I will conclude the presentation referring to the capital structure.

Starting with Brazil, the uncertainties in the economic environment are causing a slowdown in demand, which has also affected our business. Shipment of steel in the second quarter of 2015 were down in relation to the same period of 2014, due to a weaker level demand in the domestic market, offset by increased exports in the second quarter of 2015.

Looking at EBITDA in the second quarter of this year, the absolute value was down by 25% in relation to the second quarter of 2014, mainly due to lower shipments in the domestic market and the poor performance of exports. These effects also affected the EBITDA margin, which went from 17.4% in the second quarter of 2014 to 13.9% in the second quarter of 2015.

The North America operation shows a positive economic environment, however, there is a growing pressure over imported products and the comparison with higher shipments in the second quarter of 2014, resulted in a 6% reduction in shipments when we compare the second quarter of this year with the second quarter of 2014. It's worth mentioning that in relation to the first quarter 2015, shipment increased 11% boosted by the growth in the non-residential construction industry.

EBITDA in the second quarter of 2015 amounted to BRL413 million, the highest since the third quarter of 2008, compared to BRL281 million in the second quarter of 2014, it was up by 47%. This improvement was mainly attributed to gains with the metal spread which is the difference between the sales price and the scrap utilized, in addition to the exchange variation in the period. The higher metal spread contributed to the growth in the EBITDA margin from 7.8% in the second quarter of 2014 to 10% in the second quarter of this year.

So Latin America operation, shipments remained flat in the second quarter of 2015 vis-a-vis to the second quarter of 2014, with different behaviors in the countries where Gerdau operate, despite the higher level of imports in the regions. Thus, EBITDA margin in the second quarter of 2015 was stable compared to the second quarter of the year before, remaining at 8.3%.

At specialty steel, shipments in the second quarter of this year were down by 7% vis-a-vis the second period of 2014. Due to the strong weakening of demand in Brazil and also due to the learning curve of the new rolling mill in Monroe, in the United States. The reduction in the consolidated EBITDA of the specialty steel operations in the second quarter of 2015 in relation to the same period of the year before, occurred due to a weaker result in the specialty steel operations in Brazil and North America.

Therefore, the EBITDA margin decreased 10.5% in the second Q of 2014 and 9.5% in the second quarter of 2015. On the other hand, the India operation had its first positive

EBITDA this quarter resulting from the progress in the learning curve and investments done in this operation.

In our iron ore business operations, sales in the second quarter of 2015 when compared to the second quarter of 2014 increased by 13% mainly due to higher volume directed to Gerdau's unit, which the company focus to compensate for low prices of iron ore in the international market.

The EBITDA reduction in the second quarter of 2015 vis-a-vis the second quarter 2014 reflected the lower prices in the market and lower shipments of iron ore to third-party. On the other hand, the EBITDA margin showed a slight progress reaching 25.9% in the second quarter of 2015 due to a better sales mix, larger volumes directed to Gerdau's units, and also due to lower cost of iron ore shipments.

Now moving to slide seven, we refer to the consolidated results. This consolidated results showed EBITDA of BRL1.2 billion in the second quarter of this year, remaining flat when compared to the second quarter of 2014. We would like to call your attention to the fact that the better performance of North America business operation contributed to a better EBITDA margin.

If you look at the upper side of the bridge chart, we see that the maintenance of EBITDA was due to lower shipments and they were offset by better net sales per tonne and also a 6% reduction in SG&A as previously mentioned by Andre. Therefore, the EBITDA margin remained at 11% in the second quarter of 2015. In the lower part of the bridge chart, we see that the consolidated net income in the second quarter of this year was down vis-a-vis the second quarter of 2014, that was mainly due to lower operating income, which was impacted by depreciation and also higher financial expenses. Those items were impacted by the exchange variation.

In terms of dividend based on results. In the second quarter 2015, the company will pay out dividends of BRL8.1 million to the shareholders of Metalurgica Gerdau SA BRL0.02 per share and interest on capital of BRL84.3 million to shareholders of Gerdau SA equivalent to BRL0.05 per share. These proceeds will be paid on September 4, based on the positions of closing the trading on August 24th.

Moving to slide eight, we refer to our debt indicators during the quarter and we will also refer to the company's liquidity position. On June 30, 2015, the gross debt was BRL23.6 billion lower when compared to March 2015 and also due to the positive effects on the exchange rate variation in the period. The weighted average cost of the debt was 6.7% a year with an average amortization charge term of 6.6 years. It's also important to say that 70% of our long-term debt will only mature as of 2018, but mostly -- the major part of it is up to 2021.

The net debt over EBITDA ratio was 3.1 times in June 2015, due to the exchange rate variations that had a positive effect on EBITDA during the quarter and also caused by the devaluation of the Brazilian real vis-a-vis the dollar during the quarter. I would also like to

mention that on July 9, 2015, the Fitch rating agency reinstated the investment grade of Gerdau S.A. with a stable outlook.

Now moving to the slide nine, I would like to refer to our working capital. In June of 2015, the cash conversion cycle was reduced when compared to the March 2015, due to a 6.4% reduction in working capital, which is equivalent to BRL755 million in reduction, mainly due to inventory reductions and effects from the exchange variations compared to a 3% increase in net sales. With that, our cash conversion cycle went to 101 to 90 days.

Now moving on to page 10, we talk about our positive free cash flow position in the second quarter of 2015. In the upper chart of the slide, we see that in the second quarter, the company had BRL642 million of positive free cash flow. Part of the EBITDA generation of BRL1.2 billion, that's due to pay for CapEx of BRL649 million; BRL98 million to pay for income tax; BRL252 million in interest on debt; and working capital added BRL457 million to the company's cash, already excluding the effect of the exchange rate variation.

Now going to slide 11, which is the last slide of my presentation, I refer to the advances that we made in the simplification processes and ownership structure. Considering the current landscape of high competitiveness and the progress achieved in simplifying processes in the ownership structure, on July 14, the company communicated the following decisions.

Changes in the structure going from five to four business operations that will come into force in the third quarter of this year and the intent is to look for synergies in the operations of business events in new operations within Brazil, North America, South America and also in Specialty Steel.

The second point is the evaluation of the mergers of Seiva, Itaguai and Gerdau America Latina by Gerdau S.A. to promote further cost reductions.

The third point is the acquisition of minority interests in operating companies to support their future merger and also based on the long-term view. Amongst the benefit, we may mention the consolidation of receipt of dividend, lower cost due to the simplest corporate structure, in addition to improving the company's agility and the capital market which can also be translated into financial benefits to the company.

Now, I'll give the floor back to Andre for his final remarks.

### **Andre Gerdau Johannpeter**

Thank you, Scardoelli. To conclude, I would like to once again highlight the good results we had in the North America operations, which reduced the impact from the weaker demand in Brazil. And this really shows the importance of our strategy of geographic diversification.

Moreover, we are operating in several fronts to prepare Gerdau for the current and its future challenges of the market, so as to be more competitive in this worldwide scenario of oversupply and lower demand particularly in Brazil. This is already apparent through a more stringent discipline of cost and expense reduction and a more selective investment program CapEx [ph].

And as I mentioned before, we had a significant reduction of 6.2% in SG&A expenses in the second quarter and if we exclude the exchange variation, it will be 14%. And I would also like to refer to our Gerdau 2022 project. This is a worldwide initiative that involves the simplification of operations and internal structure, the modernization of our business culture and also the reassessment of the potential to optimize the return on asset according to a long-term strategic view.

With that, I conclude the presentation and we are available now to take your questions. Thank you very much.

## Questions And Answers

### Operator

Ladies and gentlemen, we will now proceed with the question-and-answer section. (Operator Instructions) Our first question comes from Mr. Thiago Lofiego from Merrill Lynch.

#### Q - Thiago Lofiego {BIO 16359318 <GO>}

Good afternoon, everyone. I have two questions. The first refers to the domestic market, if you could please talk a little bit about the outlook for the third quarter related to the shipment? How is the performance of shipments in July and August? And whether you can probably see any sign of recovery or whether it's too stringent to tell?

And the second question, Andre, is whether you can comment on the strategy of capital allocation? Maybe you think about some divestments, but also if there are opportunities in the domestic market and the large market, would you consider that or do you see that as an opportunity to go to market or given the trend leverage that you have today, this is not in your radar for the moment?

#### A - Harley Lorentz Scardoelli {BIO 7283603 <GO>}

Good afternoon, Thiago. This is Harley, and to answer the first part of your question about the market conditions and what we anticipate for the third quarter. We see a situation now that is very similar to the one that we had in the second quarter. The situation in Brazil has deteriorated throughout the first half of the year; on the one hand, we cannot see further deterioration. We do not see any signs of improvement. Therefore the expectations for the Brazilian market are those.

The positive side is that the North American operation is performing well. The positive outlook in the second and third quarters in North America are traditionally good quarters.

Therefore we anticipate a good performance in North America and that is what we attribute part of our result.

I just want to clarify one point, in terms of the third quarter, we've seen other companies more in terms of flat steel, but they've been referring to a drop, a more substantial drop in the third quarter and so things will continue to get worse. I don't think you'll see the landscape. Well, I would like to reiterate that in our market, particularly in Brazil; we do not believe that this deterioration will persist. I think it will be stable. We do not anticipate worse number, but I think it will be stable, but we are already at low level.

## A - Andre Gerdau Johannpeter

Thiago, this is Andre. Good afternoon. To answer your question about the asset. Throughout the years and you've been following our performance. Considering this worldwide landscape and changes in steel capacity and so many different challenges in the different geography.

We reevaluated every operation, every country and each business line, and therefore, we are currently analyzing what we will do, we don't have anything clear to communicate at the moment. But we are strongly firm in our position to analyze the different geographies and in different positions to find out what decision we will make in the future. It could involve a joint venture or maybe a partial sale or -- we are open.

What is important to say is that we are open to reassess our geographic position and the position of several operations in view of this new landscape of the steel world market. But I do not want to make any comment referring to each particular geography, because they don't have anything to say at this point. Thank you.

## Operator

Our next question is from Mr. Rodolfo Angele from J.P. Morgan.

## Q - Rodolfo Angele {BIO 1541593 <GO>}

Good afternoon, everyone. I would like to hear something about prices in the domestic market. How do you see the landscape in the third quarter? And if you could comment on kind of the situation, whether you see room to increase in prices of loan? And also I would like to Andre to elaborate more, because I know you just said that you could not be very specific in terms of each operations, but maybe you could give us more details about what you just call Gerdau 2022?

Can you tell me how you are evaluating your assets? You have a certain return rate or whatever is below the region rate, you will reassess it and along this line, could you please talk a little bit about CapEx? Do you anticipate any changes? What should we expect to see by the year-end and towards 2016?

## A - Harley Lorentz Scardoelli {BIO 7283603 <GO>}



Good afternoon, Rodolfo. This is Harley, and I'll answer your first question about price rate. Traditionally, we -- I think it is very complicated to comment on price trend, particularly considering the current status of the market, there has been a lot of oversupply all over the world. The Brazilian market is going through a very -- a lot of hardships in the economy. Prices are volatile, that's why it's complicated to make any more specific comments, and prices are impacted by this scenario that has been mentioned throughout our call.

And I think, Andre, now you can talk about Gerdau 2022.

## A - Andre Gerdau Johannpeter

Gerdau, referring to 2022, this initiative about optimizing the return on assets, the metric we use is return on capital employed and what is the possibility of having returns in the future and then, we'll make decision according to whether there will be or not returns. Nothing has been decided today. There has been some initiatives, and when things happen, we will certainly communicate it to you. But basically we focus on return on capital employed.

And also, you talked about CapEx, our initiative is to invest less in the second half when compared to the first half. We had a number of BRL1.9 billion, which was announced in November and this continues to be a target. However, given this exchange rate variation and volatility, we may not reach that number in reals and we will continue to pursue the goal in dollars. As we announced that in reals, that there may be a mismatch in terms of reals and dollars.

So we will invest less in the second half of the year and so, there may be changes in this number, depending on the exchange variation as lot of our CapEx is denominated in U.S. dollars, that's why they are impacted by the exchange variation.

## Q - Rodolfo Angele {BIO 1541593 <GO>}

Thank you.

## Operator

Our next question is from Marcos Assumpcao from Itau BBA.

## Q - Marcos Assumpcao {BIO 7474402 <GO>}

Good afternoon, everyone and congratulations for your results. My first question refers to net sales per tonne. In Brazil and the domestic market we see an evolution quarter-on-quarter. Can you please elaborate more on that evolution, whether that refers -- that is due to mix or price increases? And also, I would like you to comment on premiums in the domestic market vis-a-vis imported materials?

The second question, a bit more conceptual Andre is, whether you can tell me a bit about that recent measure taken by China when they depreciated their currency? And so, what

is the impact of that in the current prices or whether that should lead to an increase in production measures or some anti-dumping manifestation concerning that recent measure taken by China?

### **A - Harley Lorentz Scardoelli {BIO 7283603 <GO>}**

Good afternoon, Marcus. It's Harley, I will answer the first part of your question about prices and increases in net sales per tonne in the Brazilian market. Basically this is due to product mix, this is the most relevant part of that change in that sales per tonne.

The second part of your question was about a premium on international prices. In this environment, with the current exchange moves, we would say that the premium is very low and in fact it does not interfere in the market, because it is indeed very low.

### **A - Andre Gerdau Johannpeter**

Now Marcus about China and the devaluation, well, the Chinese Central Bank have been pursuing a very gradual depreciation of their currency or devaluation that was -- I mean, it was a surprise, but I think that the clear objective is, it has to do with the competitiveness of the Chinese industry, whether this will affect prices is something hard to say now in terms of international prices of iron ore and steel and also the depreciation of other currencies. That's why it's important in Brazil, things continue to depreciate, so that we can maintain our competitiveness.

This becomes like an exchange war, so to speak. So, lastly in Chile, whether this will unfold or whether they -- this will have other effects. What I've heard is that, there might be a fluctuation range, but it's hard to say whether this will have any domestic impact.

### **Q - Marcos Assumpcao {BIO 7474402 <GO>}**

Perfect. Thanks.

### **Operator**

Our next question comes from Evan Augusto [ph] from Credit Suisse.

### **Q - Unidentified Participant**

Good afternoon, Andre. Good afternoon, Harley and thank you. The first point refers to North America; you referred to a strong recovery of the EBITDA margin by 10%. So where do you see the metal spreads and how do you expect prices of steel, scrap and shipments in the region to go to and whether it's reasonable to expect a flat position quarter-on-quarter and seasonally a bit lower in the third and fourth quarters of this year? This is the first question.

The second question is that, I would like your comment about Brazil. You talked about hardships and challenges in the local industry and early this year, you announced disclosing of capacity and you're indicating that shipments could be flat quarter-on-

quarter. So should it be reasonable to expect that you will not have any additional closing of capacity?

And thirdly, just to clarify this dollar denominated CapEx for the year which is the target, whether you can break down that figure? Thank you.

### **A - Harley Lorentz Scardoelli {BIO 7283603 <GO>}**

This is Harley. Well, answering your question referring to North America, you have a correct reading. There we should expect the seasonally trend in the North American operation, and the third quarter should be more similar to the second quarter and as traditionally happens, the fourth quarter is usually lower and this is part of the normal trend and seasonally of North America.

In terms of metal spread, I think we can say that, vis-a-vis last year, it's probably slightly lower if you compare both periods, but in the beginning of this year, it got better. There was an improvement in the second quarter when compared to the first quarter of 2015. And this is also very much related to seasonality. We are benefiting from lower prices of scrap from earlier this year.

And then, you asked about capacity in Brazil. The adjustments that had to be done were already done. So you should expect stability in our production capacity for Brazil until the end of the year, particularly to cope with demands that we anticipate from now on. But currently, we do not anticipate any additional move.

And to as your last point about CapEx impact, we don't like to refer to that number in dollars, but what we can say is that, the phase we had in the first half of the year should improve -- I mean, should go down in the second half of the year. But the devaluation of real should put some pressure in the numbers. But we -- in terms new approvals we cannot analyze the first half and have that as basis for the second half, because the trend is to reduced CapEx in the second half of the year.

### **Operator**

Our next question is from (inaudible) from Merrill Lynch.

### **Q - Unidentified Participant**

Hi, thank you. Can you help me to understand your slide on free cash flow and working capital? I note that usually in the first half of the year that working capital was very -- I think, like BRL58 [ph] million change in terms of the reminder and actually being (inaudible).

And in spite of that, the previous slide and that's the working capital, it looks like -- actually, from the first half of the year, the working capital was about BRL900 million. So if I do have free cash over the first half of the year, I get about BRL880 million negative, because I have BRL209 million dividend and I have about almost BRL900 million increase in the working capital. And now I have the same thing this year for CapEx and the interest

expense. So really, the working capital, I don't understand, how you are saying working capital is a BRL57 million or suppose to have BRL900 million. Thanks.

### **A - Harley Lorentz Scardoelli** {BIO 7283603 <GO>}

The first question was about our working capital trend and the effect of free cash flow. In fact, I understand that your question refers to the difference of the effect of cash flow in our variation of working capital versus the nominal variation of working capital.

Usually what happens is, since in our free cash flow, we do not consider the effect of the exchange rate. We look at the cash effect and whereas in the previous slide, when we look at the nominal working capital, what we see is that there's also an exchange variation. And in the second quarter, there was a reduction in working capital of BRL755 million. And when we exclude the exchange variation, we still have a positive free cash flow generation and basically due to stock deductions of BRL457 million. Therefore, this trend towards reducing working capital is a trend that the company will pursue until the end of the year, because we believe that this is an important source of cash flow generation for the company.

### **Q - Unidentified Participant**

Okay. Thank you.

### **Operator**

Our next question comes from Leonardo Correa from BTG Pactual.

### **Q - Leonardo Correa** {BIO 16441222 <GO>}

Good afternoon, everyone. I have two questions and the first refers to your profitability level in exports. We saw a high level of exports in the second quarter, and you're still minimizing in a very efficient way this very strong drop in the domestic market and exports are growing about 30% [ph] quarter-on-quarter. I would like to hear whether you still have additional room to increase the level of exports or whether also what you shipped in the first quarter?

And whether you could comment on the possibility of exports, considering this current level of exchange rate of 3.50 [ph] and that is becoming -- exports are becoming more important in your results. In the past, we had very low levels of profitability, in some cases it will be the negative. I would just like to know how you're balancing things, considering this new exchange scenario.

And the second question refers to production. In revisiting this topic of depreciation and the large amount of Chinese exports, it's about a BRL100 million or even more the level of imports in China. So how do you see production?

We often hear about some more one-off moves in Brazil and in the industry. So, given the current scenario of crisis and unemployment, maybe the move would be closer to IVR and

production is more I want to hear from you is whether you see probably increase in tariffs or how do you analyze the global scenario? We see several economies in Asia and in the Americas imposing some production barriers? And how do you see this new global trend in Brazil when markets are becoming more protection?

### **A - Harley Lorentz Scardoelli {BIO 7283603 <GO>}**

Good afternoon, Leonardo. This is Harley. I'll refer to the first part of the question about exports topics. Our export volume for the third quarter should probably go down a bit. I mean this profitability is coming down certainly, that with a (inaudible) would narrowly change. But things will improve, this still have to dilute fixed cost. But even then we will be very selective in terms of the volumes exported. Our view at the moment is that probably it should go down a bit vis-a-vis in the second quarter. About protection, Andre will answer that part.

### **A - Andre Gerdau Johannpeter**

Okay. About international trade in the recent move by China. In all the countries where we operate, we've been working with the government, the local government to help us fight unfair trade. Certainly China has a very strong export policy and as you said, the number is close to about 110 million in exports in the world, and China is what causes the unbalance of international flow. Because they export a lot more because their domestic consumption has fallen.

And in Brazil and in other countries and in all the Steel Associations are getting together and also they are working with the government to try to mitigate that. There is a slow import and export that things have to be done according to the rules of the World Trade Organization and the rules of fair trade. We are in Brazil work also together with the government to import the international standard. This is not done by Brazil only, but by other countries because this move by China is proportional. And this affecting volumes and margins and the possibility of the industry as a whole, even putting at risk the entire sector if they continued to exports from China. But there are other countries, Korea Japan, Russia, Ukraine, and there are others. So I would say that China is the largest one.

### **Q - Leonardo Correa {BIO 16441222 <GO>}**

Okay, Andre. Only to confirm with you. So there is already an agenda or is there something going on in Brazil, and what would be the means of protection, would there be a tariff on imports or may be some specific banning, banning of market. Do you know what would be the way to protecting industry and still referring to protection which is the topic that is gaining momentum in the U.S. we saw in the past few weeks. First, a movement on galvanizing then cold coil and then yesterday, hot coil. Well, we do not see anything in long, but I think you've been saying that maybe we should expect something down the road. But is there anything new to be reported, do you see any move, even in the U.S. to prevent imports of long?

### **A - Harley Lorentz Scardoelli {BIO 7283603 <GO>}**

I will answer in a more general way, because there are several measures and alternatives according to the legislation on international practices. They could involve (inaudible) or

something like that. We, as a company, monitor and we follow the different markets, we had mentioned North America and Brazil.

If we see excess volume and we see that the prices are lower and they're even below cost, then we will certainly take action. We will not have anything specific to announce, but we're monitoring because volumes are increasing and in the case of North America, this is a reaction from the local producers to that over -- excess of exports at the moment.

**Q - Leonardo Correa** {BIO 16441222 <GO>}

Thank you.

## Operator

Your next question is from Victor Penna from Banco do Brasil.

**Q - Victor Penna** {BIO 16384328 <GO>}

Good afternoon. My first question, I just ran a very quick calculation of net sales per tonne in the North American market. And if you look at this dollar number, we see a drop vis-a-vis the first quarter of 2015 is just the reflection of a drop in international prices or this is part of a strategy of the company to incremental sales volume in the country to gain market share or has to do with products of lower added value?

And the second question refers to the new corporate structure. You said that your purpose is to find synergies and boost cost reduction. What unit will be more greatly benefitted from these activities?

**A - Harley Lorentz Scardoelli** {BIO 7283603 <GO>}

Good afternoon, Victor. This is Harley. About prices in North America, this drop in price in North America, the market has a different dynamic when compared to that of Brazil. We monitor the metal spreads, that's the difference between the products sold and the price of scrap.

What we said is that, from the beginning of the year to now, in fact -- I mean, the price of our product decreased a bit due to market conditions mix, but also scrap prices fell down a bit more. That's why we showed some improvement. We were able to capture better margins because of the fact that the decrease in our prices was lower than the scrap price, and so the dynamics are different in terms of North America and Brazil.

Regarding synergies and the simplification, we very clearly know that there are synergies and they are being pursued, but we are being very careful and we never disclosed synergies or any particular figure because we do not want to stir up expectations about timing and risks related to synergies. But they basis and we are looking into that.

## Operator

Our next question is from Leonardo Shinohara from HSBC.

**Q - Leonardo Shinohara** {BIO 18788974 <GO>}

Good afternoon, everyone, and thank you for the question. In the Congress, there is a proposition to reduce FGTS to fund the housing program. This will impact (inaudible) program. Given the fact that with the civil construction is an important market for you, do you have any idea how much that will impact your business.

And the second question refers to iron ore. In that level, 58 or 59 of an annual average. Do you see any possibility of that volume being exported. Is there any possibility? Thank you.

**A - Andre Gerdau Johannpeter**

Hi, Leonardo, this is Andre. You referred to changes in FGTS or severance pay. I would not like to speculate, we have to see in practical terms what happened still, then will be able to evaluate whether this will impact the civil construction market about four. If it reaches a level of \$58 per tonne and whether we still export. Our strategy is to focus in the domestic markets to supply to our mills first of all.

Secondly, in the domestic market, when there are opportunities when they appear we capital them. If the price is 58, 60, 65, it certainly depends on the exchange rates and freight prices of domestically involved vendor, several variables that come into play and also our cost vis-a-vis profitability. But we are constantly monitoring that as I said before, the focus now is to liquefy our mills and to be very competitive, particularly in Ouro Branco, because our mining cost is very good and this is certainly happening in the overall cost of the steel chain.

**Q - Leonardo Shinohara** {BIO 18788974 <GO>}

Thank you very much.

**Operator**

Our next question is from Alan Glezer from Bradesco BBL.

**Q - Alan Glezer** {BIO 17508681 <GO>}

Good afternoon, everyone. I have two questions. The first is about the specialty steel division, there was a drop of about -- almost about a 180 points in the second quarter of 2015 and I understand that part of that margin shrinkage has to do with changes in the regional mix with a great participation of Europe and India in the mix.

I just want to understand how recurrent this mix change is and whether it will be repeated through the second half of the year. Also, I would like to understand your expectation for your Brazil and North America division and in the U.S., you would go into a positive moment and I just want to know whether there has been any changes in the specialty steel operations in the U.S.?

The second question refers to mining, we've noted a 20% increase quarter-on-quarter of shipments of iron ore by Gerdau and the steel production in Brazil only increased by 9% quarter-on-quarter. What is the strategy behind that differences between increases of ore and steel exports in Brazil? And whether we could expect anything about rebalancing of mining mills and the production of mining mills being transferred to Acominas. So, these will be my two questions. Thank you very much.

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**A - Harley Lorentz Scardoelli** {BIO 7283603 <GO>}

Good afternoon, Alan. This is Harley. About your first question, the changing mix affecting our specialty steel unit, as you said it yourself, this is related to a drop in volumes in our Brazil unit. In relative terms, Europe and India, Brazil and U.S., they were more relevant and they also experienced a drop, that's why the results were a bit down. But it still account to forecast, because it will depend on recovery capacity and when that will take place in Brazil, because visibility is low today. In North America, the automotive industry has a good outlook and it has experienced a good performance. On the other hand, the oil and gas industry has been impacted. And even though that represents -- that has a lower representation in our mix. We also sell to that industry. So once again, I do not and have visibility that would allow me to tell you whether this will be maintained or not, but anyway. In order to more significant change, we would have to see improvement in these two major markets in Brazil and North America.

Now referring to ore. I mean the main element of the changes in terms of production has to do with the large competition that we see in our integrated operation. We have a very good structuring, our mining structuring this also reflects the large competitiveness of the integrated road and this had an effect on the production capacity of Mill in Minas and Ouro Branco.

And this is basically what we monitor and we allocate production according to differences between the two.

**Q - Alan Glezer** {BIO 17508681 <GO>}

Thank you very much.

**Operator**

Our next question is from is Humberto Meireles from Goldman Sachs.

**Q - Humberto Meireles** {BIO 16541842 <GO>}

Well, Andre I have two questions. First, I would like to go back to the U.S. and focus on volume from January to June versus the same period of last year. You remained flat and demand gradually grow, how do you see that behavior for the second half of the year. Whether if the volumes will remain flat versus the year before, or you can anticipate some improvement coming from the non-residential construction industry. And what about the capacity, how do you see the capacity performance in the U.S. in the second half of the year.



And my second question refers to imports Brazil. We talked about number, could you give me a break down of imports in Brazil rebar I think is not very significant. What can you tell me in terms of future risks and what is the possibility of having increase of imports from China.

### **A - Andre Gerdau Johannpeter**

Good afternoon Humberto. This is Harley, to answer your question about shipment growth coming from North America in terms of growing demand and stable shipments from last year to this year. This is very much linked to imports, they have probably absorbed part of the U.S. demand and that has been strong and sustained by the several industry that we serve.

Civil construction is one that has fantastic growth, but part of that has been observed by imports. And that is the point that was made, anyway the profitability as we've mentioned before, had a positive evolution due to an improved metal spread.

Referring to capacity and looking towards the future, we see a certain instability at least in the short run and a capacity devaluation that should remain in the same levels of today, meaning about 70% of our operation in North America.

I would just like to mention one point regarding the balance between demand and the absorption of demand by local producers. What we've seen is that investments in infrastructure, when they pick up in the U.S., the trend is that part of projects will tend to use products locally produced and this should certainly benefit the local producers. Once the infrastructure sector recovers the trend is that local producers will observe a major part of this growth. In the mid-range, this is a positive outlook for North America.

### **A - Harley Lorentz Scardoelli {BIO 7283603 <GO>}**

About imports -- good afternoon. In Brazil, imports are continuing, there has been some decreases in some areas and increases in some quarters, but we see some reduction because of the exchange rate. And the depreciation of real affects that market. While referring to Chinese rebars, we are not the traditional supplier, mostly it's Turkey, something comes from Asia, and it's very difficult to make any prediction, whether there will be any export of rebars.

### **Q - Humberto Meireles {BIO 16541842 <GO>}**

Thank you.

### **Operator**

We will now conclude the question-and-answer session. I would like to then give the floor to Mr. Andre Gerdau Johannpeter for his final remarks.

### **A - Andre Gerdau Johannpeter**

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Thank you all very much for participating in this earnings conference call. And if you still have any questions, our Investor Relations department will be available to answer your questions. Harley and myself are also available to help you and we will see you back again on November 4th, when we will announce the results of the third quarter. Thank you very much.

## Operator

Gerdau's conference call is now concluded. I would like to thank you all very much for participating and have a very good afternoon.

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