Q3 2016 Earnings Call

Company Participants

- André Bier Gerdau Johannpeter, President, Chief Executive Officer & Director
- Harley Lorentz Scardoelli, Chief Financial Officer & Executive Vice President

Other Participants

- Caio Ribeiro, Analyst
- Humberto Meireles, Analyst
- Marcos Assumpção, Analyst
- Milton Sullyvan, Analyst
- Renan Criscio, Analyst
- Thiago Augusto Ojea, Analyst
- Thiago Lofiego, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good afternoon, and welcome to Gerdau's Conference Call to discuss the Results of the Third Quarter of 2016. At this time, all participants will be on listen-only mode. During the company's presentation and after the company's remarks, we will initiate the Q&A session.

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 and financial and operating goals are mere assumptions based on management's expectations related to the future of the company. Even though Gerdau believes that these comments are based on reasonable assumptions, there is no guarantee that future events will not affect this evaluation.

Here today are Mr. André Gerdau Johannpeter, Director, President and CEO; and Harley Scardoelli, Executive Finance Vice President.

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

André Bier Gerdau Johannpeter

Thank you. Good afternoon, everyone, and welcome to this conference call to discuss Gerdau's results. We will now start our analysis with an overview of the world steel industry and next we will comment on Gerdau's performance in the third quarter of the year followed by more details on our investment in the period.

It is important to mention that we will analyze the performance of the consolidated figures in the third quarter of 2016 in relation to the same period of the year before. After my remarks, Harley Scardoelli will elaborate on Gerdau's financial performance, and finally will both be available to take your questions. For those of you following us online, we are on page 2, and then I will talk about the general overview of steel.

Last October, the World Steel Association published an update of the forecast for apparent steel consumption for 2016 and the following year. It is anticipated that 2016 will end with 0.2% increase of global demand for steel after going through a drop of 3% in 2015. Excluding China, the outlook points to a 1.1% growth in demand, reaching 1.5 billion tonnes. For 2017, we should expect a 0.5% increase in global demand for steel, driven by emerging and developing economies. That, excluding China, should experience a 4% increase in demand. However, China should experience a 2% drop in demand for 2017 and that is due to the lower pace of their economy.

Despite our modest prediction for the consumption of global steel, the industry still faces the same difficulties and challenges that we encounter this year (03:18) next year due to unfair competition coming from certain kinds of (03:26) in the international scene. In addition, the economic recession in Brazil led to lower skill demand.

In 2016, steel consumption should be down by 14% in Brazil, probably the lowest level ever recorded in the last decade. The Brazilian economy shows signs that maybe the worst moment is already over. But it's worth mentioning that recovery will be slow and gradual.

We've taken some important measures in order to arrive at a better tax. The current debate around the proposal for constitutional amendment, PAC, that limits actual increases in product spending in addition to the proposal reform of the welfare system which is gradually moving forward and (04:17) Central Bank will be able to reduce interest rates in the country in order to boost investments. For 2017, we anticipate an increase of 3.8% in steel demand in Brazil according to Instituto Aço Brasil.

Now, if we look at North America, the steel industry, as most downstream industries, have been posting a decrease in demand since 2015. Moreover, we follow with some concern the recent increase in imports of rebars. That's why the local rebar producers submitted an investigation request to find out why there has been an increase in imports coming from Turkey, Japan and Taiwan. In addition, there is low demand in the industry and also it's a moment of caution due to the presidential election which we just heard this morning that the President-elect is now Mr. Donald Trump.

On the other hand, we see that the overall construction industry is recovering and this has been (05:21) the financial crisis, particularly in the non-residential segment, which now shows signs of a gradual and steady evolution. There is also a significant infrastructure deficit in the U.S., which represents a good opportunity for the industry in the region in the next coming years. Now, for 2017, we anticipate an increase of 3% in steel consumption in the United States according to the World Steel Association.

Now, if we look at South America, we must highlight the good outlook for 2017 in countries like Peru, which should experience a GDP growth of 4.1% and Colombia 2.7% growth, as well as in Argentina with a 2.7% growth.

As for specialty steels, the Brazilian automotive industry has posted significant reduction in the last three years. And as of 2017, we expect to see some recovery in demand, even though it will be slowing gradually. In the U.S., the markets for light vehicles should still remain at this good level or record level; however, in other relevant markets such as heavy vehicles, that should continue to post a weak demand. In India, the automotive industry is still performing well, and it's supposed to grow further.

Now, on slide 3, I will talk about the current landscape of Gerdau, starting with consolidated shipments. We consolidated 3.7 million tones. Shipments were down by 21% vis-à-vis the third quarter of 2015, and that was due to lower volumes sold in all of our business operations. Now, referring to net sales, it was BRL 8.7 billion, down by 27% vis-à-vis the same period of the year before. Now, profit before interest, taxes, depreciation and amortization, known by adjusted EBITDA, totaled BRL 1.2 billion, down by 7% vis-à-vis the same period of the year before, reflecting the lower performance of the North America operation partially offset by the improved performance of the other operations.

Now, when comparing to the second quarter of this year, EBITDA was stable, especially due to the improved performance of the Brazil operation in reduction with SG&A in the period.

Now, referring to net income, it was BRL 95 million, down by 51% when compared to the third quarter of 2015, due to lower EBITDA generation in the period. Now, in the first nine years (08:06) of the year-to-date, net income was BRL 293 million. I would also like to refer to free cash flow, one of the priorities of our financial management at Gerdau, which totaled BRL 1 billion in the first nine months of the year.

Slide 4, we will talk about investments. And in the third quarter, investments totaled to BRL 286 million in PP&F (08:37) or CapEx, The highest disbursement occurred in the Brazil BD, almost 50% of CapEx. And that was mainly to fund the investment at the heavy-plate rolling mill installed at the Ouro Branco plant in Minas Gerais, and the start up of this operation was in July. As announced before, at year-end, that Gerdau should have a CapEx disbursement of around BRL 1.5 billion, 35% below that of 2015. For 2017, the forecast for use of CapEx should amount to BRL 1.4 billion, focusing on the improvement of productivity and maintenance.

Now, I would like to give the floor to Harley Scardoelli who will elaborate more on our results for the third quarter of 2016.

Harley Lorentz Scardoelli {BIO 7283603 <GO>}

Thank you, André, and good afternoon, everyone.

On slide 6, I will talk about the results and the performance of each of our business operations in the third quarter of this year, and then I will give you some more details about our consolidated results.

Starting with the Brazil operation, in relation to the second quarter of 2016, sales to the domestic market were down due to the lower pace of the activity in the construction industry and industry in general, in addition to accumulated inventory from clients in the second quarter of 2016 anticipating price increases. Exports were down, especially in September. However, in the third quarter of 2016, they showed better margins.

Now, looking at the EBITDA for the third quarter of this year, the absolute value increased vis-à-vis the second quarter of the same year due to higher net sales per tonne in the domestic market and abroad, in addition to benefits from lower SG&A expenses. These factors combined allowed the EBITDA margin to go from 13.2% in the second quarter of 2016 to 19.7% in this third quarter.

Despite the good performance in the third quarter, the level of the economic activity in Brazil remains low, and we noticed a reduction in the performance of exports, giving us a more challenging landscape for the next month in addition to the seasonality in the period.

In North America, shipments were down by 17.5% when we compare to third quarter of this year with the second quarter of the same year due to strong competition from imported goods in the region and the lower pace of the industrial activity in addition to a certain caution because of the political landscape.

EBITDA in the third quarter of 2016 was lower vis-à-vis the second quarter due to lower volume sold as a consequence of the lower dilution of fixed costs. With that, EBITDA margin went from 9.5% in the second quarter to 7.9% in the third quarter of the same year.

Now, in terms of the third quarter of 2015, in addition to lower volume sold, the lower net revenue or net sales per tonne also impacted the reduction of EBITDA margin in the third quarter of 2016. The continuity of this strong competition of imported goods in the region associated to lower economic activity should result in the continuity of this landscape, which is very challenging for the operation in the months to come.

In South America, we experienced a slight reduction in shipment in the third quarter of 2016 when compared to the second quarter in almost all countries in the region where Gerdau operates. The EBITDA and the EBITDA in the third quarter of 2016 posted a reduction when compared to the second quarter of 2016 due to lower prices in the international market, but still remains at good levels. It's important to mention that profitability should remain good due to cost reduction efforts in all units of this operation.

Now, referring to specialty steel, shipments in the third quarter of 2016 were down by 26.6% vis-à-vis the second quarter of the same year, mainly due to the sale of the units in Spain. The improved EBITDA margin in the third quarter of 2016 when compared to the second quarter occurred due to the sale of the units in addition to higher profitability coming from the units in the United States.

Now, moving to slide 7. I refer to the consolidated figures of Gerdau. Adjusted EBITDA was BRL 1.2 billion in the third quarter of 2016, 7% lower when compared to the same period of the year before. If we look at the bridge chart at the upper part of the slide, we would notice that the reduction in adjusted EBITDA occurred due to lower shipments and lower net sales per tonne, partially offset by the optimization of costs and operating expenses, mainly SG&A.

In the other bridge chart in the lower part of the slide, you can notice that we went from an adjusted net income of BRL 193 million in the third quarter of 2015 to an adjusted net income of BRL 95 million in the third quarter of 2016 due to lower EBITDA in the period. It's important to mention that EBITDA stability in the third quarter of 2016 vis-à-vis the second quarter in absolute terms and improvement in the margin, 13.8% against 11.7%, was due to the best performance of the Brazil operation compensating for the poor performance of the other business operations.

Now, speaking about dividends, based on results obtained in the third quarter of 2016, the company will pay out dividends of BRL 34.2 million to shareholders of Gerdau SA, which would be equivalent to BRL 0.02 per share. These proceeds will be paid on December 1, based on the position of November 21.

Now, on slide 8. We will talk about indebtedness and liquidity of the company. Gross debt on September 30, 2016 was BRL 21.1 million, up by 2.1% vis-à-vis June of the same year due to cash contributions to fund working capital in addition to exchange variation in the period. The weighted average cost of the debt was 7.4% a year with an average amortization tender of 5.5 years. On September 30, 2016, only 10.4% of gross debt were short term, mostly in the form of working capital loans.

From the total of this debt, BRL 14.1 billion refer to the issuance of bonds in the capital market. It's also important to mention that in terms of the maturity of BRL 2.7 billion scheduled for 2017, BRL 2.6 billion out of that amount refer to bonds maturing in October of next year. The available cash in credit line of the company is more than enough to honor these commitments. Moreover, the company has the alternative to refinance the total debt or part of that debt. Cash generation allows for the relative stability of net debt compensating for the lower EBITDA of the last 12 months resulting in unstable net EBITDA or net debt over EBITDA ratio of 3.6 times.

Now, I would like to refer to the capital structure of the holding Metalúrgica Gerdau SA. In November 2015, the company entered a public offering of BRL 900 million with the purpose of reducing its debt position. Additionally, in August of this year, in 2016, the company issued exchangeable and convertible debentures amounting to BRL 4,500 million as a second step to optimize its capital structure. To that end, yesterday, at the end of the day, the Board of Metalúrgica Gerdau approved the sale of preferred shares of Gerdau SA, up to 40 million shares, with the purpose of paying short and mid-term debt of Metalúrgica Gerdau. With this strategy, the company understands that the capital of the holding will be in keeping with the expected cash flow for the next coming years.

Now, I'll go to slide 9, and we will talk about working capital. In September 2016, the cash conversion cycle was higher vis-à-vis June of 2016 due to a reduction of 15.1% of our net sales, an increase of 4.9% of working capital. Working capital increase occurred due to inventory increases due to a strong reduction in sales at the end of the third quarter mainly, in the Brazil LB (18:21).

For the fourth quarter 2016, we expect to see a reduction in working capital. I would like to emphasize that in the first nine months of the year, we were able to reduce working capital by BRL 1.3 billion, and the company still remains with a very firm focus on the management of this KPI.

And finally, going to slide number 10, I complete my presentation talking about our free cash flow. As can be noticed, in the chart a good level of EBITDA associated to the firm discipline of CapEx resulted in free cash flow of BRL 230 million in the third quarter of 2016. And BRL 1 billion was the accumulated result in the first nine months of 2016. This CapEx discipline and efforts toward the best management of working capital will continue to be an important element of our free cash flow generation in 2016.

And I will give the floor to André for the final remarks.

André Bier Gerdau Johannpeter

Thank you, Harley. Now, we are on slide 11. For those of you who are following us and to conclude the presentation, I would like to say that we were able, this quarter, to reduce the impact of this difficult moment of the steel industry and the world and in Brazil, and this reflects all of our efforts in management along with many other activities. Despite the challenging landscape in the industry, we were able to reduce expenses, improve our margins, limit CapEx, and maintain stable debt position. I also said that we were able to have a significant free cash flow position.

So, in terms of Brazil, despite the improvement in the margins, we anticipate the same challenging landscape for the following months but still considering a gradual recovery in the levels of exports. This challenging scenario also applies to the other operations in the Americas.

In face of that, we will continue working diligently in all of the different initiatives to generate further value to Gerdau. Some of those efforts are the modernization of our culture, the review in the potential of the profitability of our assets, reduction of costs and expenses which has resulted in a good generation of free cash flow, restrictions in CapEx, and also the deployment of several projects in the area of digital innovation which has been translated into efficiency gains and productivity gains in our operation.

With that, we conclude our presentation, and we are open to answer your questions.

Q&A

Operator

Ladies and gentlemen, we are now initiating our Q&A session. The first question is from Thiago Lofiego from Bradesco BBI.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Thank you. Good afternoon. Congratulations on your result. I have two questions. The first is whether you can comment on the impact of coal and if you could talk a little bit about the magnitude of the impact and how much of that impact that you and – along the same question, and I'm speaking about cost, do you still see more room to further cut cost – for further cutting cost? Now, the second question about the steel demand in Brazil, my question is whether you noted some positive signs of improved demand in the last few months, and whether you could also speak about the construction industry dynamics and whether you could refer to some of the most important factors that affect your industry? Thank you.

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

Good afternoon, Thiago. This is Harley. For the first part of your question, I think there are two important aspects to talk about when we speak about coal. Our production activity that is affected by coal refers to 5% of consolidated shipments which is – but in consolidated terms, our position – I mean, we have a percentage with scrap and 25% integrated with coal. We also have many contracts with fixed prices and they are short-term contracts. Now, this impact may occur maybe next year. But this will be mitigated by our mix between mini mill and the integrated mill.

The second part of your question referring to costs, we continue to be very diligent in our efforts. We were able to capture good cost reductions, especially in SG&A, but I'll tell you that we still have some room to achieve further improvements and we will still see some positive impacts to that end throughout the next coming months.

A - André Bier Gerdau Johannpeter

Thiago, this is André. Now, referring to demand in Brazil, we haven't seen yet in practical terms any increases in demand or increase in orders. But what we see is a change in the general mood in price levels. We have seen some improvements like lower interest rates. It was very significant, but it's in the right direction. We also see the possibility of further investments in infrastructure. Therefore, the landscape change, but in practical terms, we aren't experiencing it yet, but we believe that we will still have to go through difficult six or eight months, and things will begin to improve in the second half of next year.

I would also like to mention two other things. If we compare the domestic market in Brazil, comparing it year-on-year, there was an 18% drop. But if you compare the previous half of the year to this one, the drop was 8%. I mean, those are both significant reductions, but things are getting better. So, we gradually see signs of improvement, and therefore I believe that a rebound will occur soon, and the recovery will come. It will come. It's just hard to tell when and in what magnitude.

Q - Thiago Lofiego {BIO 16359318 <GO>}

In your last call, you said that you were beginning to see some signs of improvement on the consumer side. Are you talking about the small and spread around market?

A - Operator

This market, the small market doesn't suffer that much, but it's being now impacted by unemployment, by the drop in householding income. While there are some aspects that leads to reductions in consumption, but we don't see any particular recovery. And the outlook is good, but things are not materialized yet.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Thank you.

Operator

Next question from Marcos Assumpção from Itaú BBA.

Q - Marcos Assumpção

Good afternoon, everyone. My first question is about your partnership with GE Digital. This is still an infant project, but do you believe that this will be able to reduce your maintenance CapEx in the long run? And the second question is whether you could tell us about Brazil's EBITDA in September, particularly. Thank you.

A - André Bier Gerdau Johannpeter

Hi, Marcos. This is André. About GE, just to elaborate a bit more on that project, this is a pioneer project, and it involves the partnership between Gerdau and GE. This includes an important investment in sensors. We will put more than 1,000 machines to have a much better preventive maintenance operation. The sensors can measure vibration, machine temperature, vibration, rotations, et cetera.

And once you monitor all that, you prevent waste and outage and setup time. Therefore, we have important gains in maintenance and equipment use and equipment life, and this eventually can reduce CapEx because the machines will not require as much maintenance and the machines will probably have an extended life span. And this, as a result, should lead to reductions in CapEx. I cannot precise you how much, but there will be some.

The second question was about Brazil's EBITDA in September. Harley?

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

We will not refer specifically to the month of September. We can only refer to the quarter.

Q - Marcos Assumpção

Okay. So, let me ask you something else. We're seeing the flat steel (28:31) industry starting negotiations with the automotive industry and they were also able to post some price increases on the distribution side and the prices were a bit far from the automotive prices. Do you see an expectation for higher price increases during the negotiations with the automotive industry? Because maybe in addition to that mismatch of prices, demand is very much elastic. Do you also see the same trends in the area of specialty steels? Do you see any relevant changes in the short run?

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

Good afternoon, Marcos. This is Harley. This pricing dynamics in the specialty steels industry, it's not yet finalized. We haven't reached a final agreement. The outlook and how this will behave is something hard to predict now. But what we said is that we believe that there should be some gradual recovery throughout 2017, and this can certainly help, because this, coupled with some elasticity, can be good. But it's too soon to make any comment about prices in that market.

Q - Marcos Assumpção

Great. Thank you very much.

A - Operator

Thanks.

Next question from Caio Ribeiro from BTG Pactual.

Q - Caio Ribeiro {BIO 18420483 <GO>}

Good morning. I have two questions. The first question is about working capital. There was an increase on the quarter very much related to accumulated inventory or increase in inventory. How do you see this line going forward? In the first half of the year, there was a significant reduction in working capital, so do you think that the current level is something that is closer to a normal level or this could be – in the third quarter, this is closer to the normal level, and secondly in relation to the metal spread in the U.S., could you please tell us a bit about how do you see the evolution of metal spread vis-à-vis the previous quarter and what is your expectation looking forward into the next quarter? Thank you very much.

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

Good afternoon, Caio. This is Harley. Well, about working capital, the drop in sales that occur particularly at the end of the third quarter, especially if you look at it due to the days of the cycle and there were some characteristics that impacted it, but the drop in sales is that we still need some time to react. We have to look at working capital in a more continuous way, and our opinion is that in the fourth quarter we will be able to revert that trend.

New levels of working capital is something that – it's difficult for us to say anything to you in the short run, especially if you look at the trend in the last two quarters. It was not so low, I mean, as in the second and not as high as in the third, but the focus is still very firm in that area especially in North America when it comes to the fourth quarter. This is about working capital.

Now, speaking about metal spread. There are some particular elements. We were at probably the lowest level ever in the last few years due to a series of (33:10) things. We talked about the U.S. environment, a lot of imports, there was a lot of volatility in the political landscape because of the election that now has been defined. But what we see is pressure coming from raw material and this usually reflects an improvement in the metal spread. But it's too soon to make any predictions, but we believe that historically speaking we are at very low levels, so this should grow.

Q - Caio Ribeiro {BIO 18420483 <GO>}

Thank you very much.

Operator

Next question is from Thiago Ojea from Citibank [sic] [Citi] (33:55).

Q - Thiago Augusto Ojea {BIO 17363756 <GO>}

Good afternoon, and thank you for allowing us to ask questions. My question has to do with your U.S. business. I know that things are still very recent. But given the new outlook coming from the Trump government with more infrastructure investments, can you anticipate any idea about demand for 2017? Do you have any idea of quantities? And also, in terms of iron ore, the prices are going up in the international market. Do you believe that you will be able to resume exports or whether it will be worthwhile to resume exports of iron ore or not?

A - André Bier Gerdau Johannpeter

Thiago, this is André. I will talk about the United States. As you said, Trump was just elected, but we've been monitoring, and even both candidates had a very strong government plan when it comes to investments and infrastructure. So, our expectation with the new President-elect in the next few years, we believe that there should be more investments in infrastructure. The United States really need investments in infrastructure. This has been the case for many years, and this has an impact in the economy because this generates jobs, consumption and wealth. Infrastructure brings about many benefits to the local economy. Therefore, we believe that they should resume in investments in infrastructure once the new President takes over.

In terms of numbers, it's hard to make any predictions, but we do believe that there will be investments in infrastructure.

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

Good afternoon, Thiago. This is Harley. Now, about the second part of your question, even with losses in international prices, our focus remains in the supply of our own operations. So, therefore, we are much more focused on supplying to our own operations at competitive costs rather than selling abroad or exporting. Our focus remains in the local supply. There may be some opportunities in the spot market and if they come about, we will look at it. But, again, the main focus is on cost, and we want to deliver a competitive cost.

Q - Thiago Augusto Ojea {BIO 17363756 <GO>}

Fair enough. How much non-residential represents today in your sales mix, just to complete? Thank you.

A - Operator

Approximately 40% (37:01).

Q - Thiago Augusto Ojea {BIO 17363756 <GO>}

Thank you.

Operator

Next question from Renan Criscio from Credit Suisse.

Q - Renan Criscio {BIO 18747357 <GO>}

Good afternoon, everyone. I would just like to get more information on the production swap from the blast furnace in the Brazil unit. What is the status of that today and when would you consider exchanging the operation and whether you are already doing something (37:43)?

The second question is on South America. The margins, even though there was a slightly drop in the quarter, the margins are still quite high. What should we expect looking forward? Do you expect the same margin in the future? Thank you

A - Operator

Good afternoon, Renan. In terms of swapping production between the integrated operation and that one, we do not focus directly on that because these operations are dedicated to several segments in different markets, and we understand that both operations have a very good cost structure. Therefore, we are not contemplating anything in terms of swapping production. And I imagine that this has something to do with minerals and scrap.

And in a consolidated way, in terms of mini mills and integrated mills, production is half and half, and especially due to the ore that we have access to our cost structure is very good. And we are not contemplating that it's something necessary for the moment. So, there will be no swap between mini mills and integrated ones.

Now, South America, the margin levels that we attained. If we look at it historically, we've reached level above 10%. This has been the case since the second half of 2015. We are doing a lot of efforts to reduce cost. And in South America, the operations have been open to international prices for quite some time, especially Peru and Chile. So, we are making strong adjustments on the cost side. And we see some good outlook for Colombia and Peru, and we see a good performance in volume growth. And that's why for all of these reasons, we were able to achieve very good margins in those regions.

South America, in the short term, is also affected by seasonal elements. Usually, this part of the year is weaker. But in the long run, we believe that the margins, we will be above 10%.

Q - Renan Criscio {BIO 18747357 <GO>}

Thank you.

Operator

Next question from [Victor Teena] (40:35) from Bank of Brazil.

Good afternoon, everyone. My question has to do with the maturity of bonds in 2017. Given the landscape for next half of the year, if that is worse than expected and you generate less cash, are you looking at other alternatives in terms of maturities of debt or – so, in general, what I want to learn is what are your funding alternatives?

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

Good afternoon, Victor. (41:13). Speaking about the bonds that mature in October of 2017, well, first of all, that involves about $800 million or less. In terms of immediate liquidity, in addition to having more than BRL 1.5 billion in cash and most of it in U.S. dollars, we also have good working capital that is fully committed. It's available to the company. And the amount is higher than $1 billion. So, we have approximately $2 billion to pay for that disbursement if need be in October 2017.

We can also have the alternative to engage in a total or partial financing of the debt. So, there will be available credit lines in the market. And because of our investment rating, we have access to crediting. But we will continue evaluating the possibilities in the long run. So, everything has to do with our liquidity position and our view that if we believe that we have to engage in additional financing, they will be available.

Now, about divestments, André already talked about it before, and this is part of our portfolio reassessment that started last year. We are still looking at other possibilities like joint ventures and other investments or divestments. There is nothing yet decided. We just have to look into what the opportunities will be. Now, in terms of 2017, we do not necessarily need for anything of that to happen in order to fulfill our commitments.

Q - Operator

Thank you very much.

Next question from Humberto Meireles from Goldman Sachs.

Q - Humberto Meireles {BIO 16541842 <GO>}

Good afternoon, everyone, and thank you. I would like to focus on the Brazil business operation and whether you could help us get a better modeling of the business and help us understand what will be the contribution coming from iron ore to that margin of 19.7% of EBITDA. And what would be the EBITDA level that the third-party ore is running at? Because this would help us to get a better understanding of the steel business and run the model for the future.

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

Good afternoon, Humberto. This is Harley. Speaking about the margins of this quarter in Brazil, this is something more related to the alignment of some factors that we mentioned during this call, well, notably prices in Brazil. The prices had a positive impact in our figures for the quarter. Export materialized especially in the early part of the quarter with good profitability, and we also benefited from the large export towards cost reduction including SG&A. So, a combination of all the factors is what led us to this good alignment of prices, and therefore the result is that we had a good performance in the mill (44:52).

Now, referring specifically to ore, it's important to say that our mining operation is consolidated, and this has been the case for several quarters. So, in terms of the price effect, I mean, the price is not affecting these results because these have been already contemplated before. I think you should remove that from your analysis. And I reinstate (45:20) that that is all due to a combination of factors: Good prices in Brazil, good profitability coming from exports, and also a great effort towards cost reduction especially in SG&A that more than offset the situation.

Q - Humberto Meireles {BIO 16541842 <GO>}

Thank you. Could you also say something about volume from third parties because (45:47)? How did it run this quarter and in an annual basis?

A - Operator

This number varies from quarter to quarter. And this number is published in our quarterly reports, but one-third goes to third parties and sometimes (47:26). I, once again, repeat that our focus is the supply to Ouro Branco rather than sales to the foreign market. So, between 25% to 33% or 35% is what that represents.

Q - Humberto Meireles {BIO 16541842 <GO>}

Thank you.

Operator

Next question from Milton Sullyvan from XP.

Q - Milton Sullyvan {BIO 19085202 <GO>}

Good afternoon. I have two questions and both questions are just follow-ups of Humberto's question. I would like to get a better understanding of export prices in Brazil. This quarter, we noticed that there was a significant price difference quarter-on-quarter and Harley said that this operation occurred mostly in the early part of the quarter. So, what is Gerdau's price of the product today given the volatility experienced in the last few months, whether possibility is better or worse and what could be expected in terms of prices in the foreign market from now on?

And still on the Brazil operation, my question refers to other revenues. So, let me see if I understood. This ore is the ore that you sell to yourself, to Ouro Branco, but there is also ore third parties, these are volumes from third parties, and in a footnote, you mentioned that the Brazil revenue also includes sales of coke and coal for iron ore. Could you please elaborate more on the impact coming from other revenues and whether they are allocated in the domestic market or foreign market? Thank you.

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

Good afternoon, Milton. It's Harley. To elaborate on this subject, why don't we talk about export pricing? The dynamic of the business changed. A positive aspect in the third quarter refers to sales in the last of the quarter, which were accounted for later on and that was due to the business environment of experts that at the end of the second quarter reflected in the figures of the third quarter.

So, at the end of the quarter, the landscape is much more complicated. But as we speak, and looking towards the future, the export markets are giving signs of recovery. It's a better iron ore price, better price for rebars. And these are opportunities that may come up, but it's too soon to tell whether this will impact us in the short run. But what was positive in this third quarter is a reflection of what happened at the end of the second quarter that have implications that had results in the third quarter.

Now, speaking about sales of ore or coal, that impact affects sales of the domestic market, but they are not relevant enough when you analyze the entire period. It's not something that will impact your analysis that much. We do not get into a lot of details because, as we said, sales volume is very volatile and it varies quarter-on-quarter. Therefore, our focus is mostly related to supplying to our own operations. If we look at our indicators, we will see that sales per quarter varies. But on average, for the year, we would be between 25% to 35%.

Q - Milton Sullyvan {BIO 19085202 <GO>}

Thank you.

Operator

We now conclude the Q&A session. I would like to give the floor back to Mr. André Gerdau Johannpeter for his final remarks.

A - André Bier Gerdau Johannpeter

Thank you all very much for participating in this conference call and your interest. And on behalf of Harley and myself, if you still have any questions, please refer to our Investor Relations Department. I would like to take this opportunity to invite you all to participate in our next call on February 22, 2017 to discuss the results of the fourth quarter of 2016. Thank you very much. And have a good day.

Operator

Gerdau's conference call is now concluded. We would like to thank you all for participating. And have a good afternoon.