

Q3 2003 Earnings Call

Company Participants

- Osvaldo Schirmer, Executive VP and IR Director

Other Participants

- Andres Perez, Analyst
- Daniel Altman, Analyst
- John Kodak, Analyst
- Marcello Giad, Analyst

Presentation

Operator

Good afternoon, ladies and gentlemen and welcome to the Audio Conference Call of Gerdau S.A. Thank you for standing by. At this time, all participants are in a listen-only mode. Later we will conduct a question-and-answer session and instructions to participate will be given at that time. If you should require assistance during the call, please press the '*' key followed by '0'. I would now like to turn over the conference to Mr. Osvaldo Schirmer, Executive Vice President and Investor Relations Director, please go ahead sir.

Osvaldo Schirmer {BIO 1754610 <GO>}

Thank you. Good afternoon, ladies and gentlemen. Welcome to our Third Quarter conference call. Our nine months financials were released last Wednesday and are available at our website.

Gerdau S.A. in Brazil and abroad. This quarter comes to an end under the lights of a recovery in demand in the Brazilian market, recovery in prices in North America. And followed by a relative stability of prices of raw materials and a positive outlook for the South Cone countries. The stable political and economic environment in Brazil has allowed the country to witness the improved perception of the country's risk at international community. The continued trade balance surpluses the inflow of foreign capital and a greater discipline in public spending has allowed the authorities to start treading the path of interest rates reduction, which had room even a more further reduction which promotes consumption. The country needs capital investment, needs to generate jobs in order to grow in a sustained manner. Macroeconomic variables indicate that things are falling in line.

The North American economy under the Bush administration is ending its third year with little economic growth. Nonetheless, given that 2004 is an election year, it is reasonable

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to believe that the current administration will put in an additional effort to foster economic growth. Signs that this is happening are already visible. Annualized rates for the last two quarters indicate a growth of 3.5-4% for the U.S. economy.

In the South Cone countries, Argentina is on the recovery track with a potential growth rate above 5% in 2003, Chile with a Free Trade Agreement just signed with the United States and a similar agreement with European community on the way is headed toward growth rates well above 5% and as it experienced for several years throughout the late 80s and the 90s. In a more direct assessment of operations, we would like to comment that we have made progress in our effort to expand the groups indebtedness profile. Two deals were completed in the quarter in a total of \$150 million of which two-thirds refer to an export receivable securitization tenure of eight years and the interest rate at 7.4% and (inaudible) in a 7-year deal being at 9.5% per annum. These funds would be used to pay off further maturities and more expensive loans. In fact, net financial indebtedness was reduced by 200 million reals this quarter.

To highlight the relevant issues for the period where performance is concerned we call your attention to the strong contribution of exports to the increase in revenues, which combined with improvement in demand in the domestic market this quarter allowed for a 15% gain in net revenues and the maintenance of operating results. Margins in general present an improvement in the long common steel operations in Brazil, remain stable in the South Cone countries and (sell) in North America. Improvements in Brazil resulted from gains in productivity whereas the decline in margins in the United States was due to the accelerated rise in input prices and a time lag in the price correction process.

Additionally, another factor was the schedule outages for maintenance purpose and 6 of 11 mills which led to the increase in operating cost by as much as US\$8m. A blackout in August also added to the decline in margins affecting 2 mills in Canada and 2 mills in the U.S. After reading in last Wednesday's quarter's results, a significant number of journalists highlighted the fact that there had been a decrease in profits in the Third Quarter when compared to that of the same period last year. Although correct the conclusion reached by this journalist is valid only when taking these numbers separately. It's important to note that to properly compare these numbers, it's necessary to consider the effect of foreign exchange variation over investments abroad and Brazilian dollar denominated debt.

In the Third Quarter of 2002, for instance, the (reserve) devalued 47% compared to only 1.8% in the last quarter. For a company such as Gerdau with about \$800 million in investments abroad and 400 million dollar based investments in (Brazil) unhedged, this sort of volatility can cause huge distortions. In evaluating the operating profits of these two periods and using EBITDA operating cash flow generation as an indicator, we observe that the decrease in EBITDA for the Third Quarter of 2003 was less than 1.6% down to 700 -- down to 671 million reals -- (680m). By the way it would be very interesting if the Brazilian Security and Exchange Commission, CVM, agrees with a market demand that these foreign exchange variations be not accounted for in the P&L but be recorded only in the (net worth). This would allow for more direct comparisons of company's operating profits which no longer would be contaminated positively or negatively by major currency fluctuation.

Capital expenditures. In 2003, capital expenditure reached \$68 million in the quarter and a total of 206 million in nine months.

Outlook for the next quarter. North America region; prices, improving; volumes, stable; prices of main inputs, tendency to stabilize specially (scrap) and power; inputs, stable at low level; synergies, pretty much on schedule; effort to improve operating costs, very but very intense; economic growth, possibly reaching 3% into the U.S. in 2004. Brazil, demand improving throughout the quarter, prices stable due to low inflation. Prices of main inputs stable due to the availability mainly in scrap. Export volumes, stabilized at high level. International prices, tendency to rise with Asia leading. Foreign exchange variation, relatively stable and posing no threat to the business. South Cone, very positive outlook for all three countries, especially, Chile with the announcement of new construction work and the recovery of the Argentine market. We'll now open the session for questions and answers.

Questions And Answers

Operator

Ladies and gentlemen. we will now begin the question-and-answer session. If you have a question, please press the '*' key followed by the '1' key on your touchtone phone now. If at any time you would like to remove yourself from the questioning queue, press the '#' key. Our first question comes from Mr. Andres Perez with Morgan Stanley.

Q - Andres Perez {BIO 18609546 <GO>}

Hi, how are you?

A - Osvaldo Schirmer {BIO 1754610 <GO>}

Fine.

Q - Andres Perez {BIO 18609546 <GO>}

I was (just) curious; you mentioned that within Brazil, you are seeing demand starting to pick up. I was wondering if you are also seeing that happening in the construction sector, if not, when do you anticipate that this segment in the economy will start to turn, how much lower do interest rates have to fall? And my second question was, if you have heard anything new regarding potential infrastructure spending by the Brazilian government and what your outlook is for 2004?

A - Osvaldo Schirmer {BIO 1754610 <GO>}

Okay. Related to demand in the Fourth Quarter, we also tried to associate how much further down should the interest rates go before we see recovery in the civil construction and (inaudible) where ever it goes, very likely the lead is going to still taken by the industrial sector due to the fact as Brazil is exporting a lot; there is a lot of cash flow into this agriculture and agro industry sectors of the economy and those are specific ones which demand tractors, machinery combined with agricultural tools. And so on. So, they

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have been leading this demand recovery and very likely going to continue throughout the Fourth Quarter. Nevertheless, as interest rates decline that level of let us say that segment of the economy represented by the individuals that is so called self-constructors. They are trying to regain momentum and then are going to be buying again.

It is difficult to say in which speed they are going to come back to the scenario and start buying again. But we have strong indications from the field that they are moving also and this is a specifically clear when you visit -- when you spend time talking to your distributors and they start building infrastructure which is the case right now. As far as infrastructure projects, we have read in the press and probably you too that the government is talking a lot about the necessity of creating jobs and the civil construction is one of the best instruments to create such a thing. So, we have not seen strong money on the table as (say) channeled to those projects. But this problem has been on loading basically ever they have promised. To some extent I believe some work I am going to start, especially in house very likely. But no major or no let's say identify strong -- big product has been announced so far.

Q - Andres Perez {BIO 18609546 <GO>}

Okay, thank you.

Operator

Our next question comes from Mr. John Kodak with Westwind Partners.

Q - John Kodak

Osvaldo, can you us this as cost reduction (effort) taking place in North America particularly with respect to targets are now from timing?

A - Osvaldo Schirmer {BIO 1754610 <GO>}

(Timing) is a more difficult issue but we are working right now, there is a potential effort put in place in order to revert the level of efficiency of, specifically, three mills, which are behind schedule. We are targeting to have them improved their cost in general by at least \$20 or even more. This particular value is -- we estimated because it is possible to be extracted from the operation; it's just a matter of time. And we are not talking about additional capital investments to put them back into track, it's more kind of process, those three mills as you probably remember, they were facing different difficulties due to time, they were under management of course too.

So it's matter of really dealing with people, (re-visiting) processes, improving the processing in such way that we could reduce the conversion cost at the melt shop, the conversion cost at the rolling mills. Simply saying, making them more efficient than they are right now. And, we have let's say, we have to ask the (inaudible) from different mills in the group, we are seeking together substantial effort in let's say using expertise that we have inside the house to restructure those mills. And, we are pretty confident that in a matter of time maybe 3 or 4 quarters we'll have that in the same level of the rest of the mills we have in North America. As far as the results or bottom line is concerned, very

likely this quarter they are going to approach breakeven. And in the following quarter after all of those outages for maintenance in place, they have all those -- there is another room to improve there efficiency.

Q - John Kodak

And on the same sort of topic, can you give us the sense of how you would go in about improving the flow of the shares given the number that are, how about the (books)?

A - Osvaldo Schirmer {BIO 1754610 <GO>}

Are you looking at our G&A shares or Gerdau steel shares?

Q - John Kodak

Gerdau AmeriSteel shares.

A - Osvaldo Schirmer {BIO 1754610 <GO>}

On G&A, we don't have anything planned or any instrument, we are now just (inaudible) instrument trying to improve the liquidity as you know roughly 26% of the outstanding shares are in hand of the general public basically institutional investors. Institutional investors don't trade too much. But they do trade so we are going to leave this in hands of the market per se. There is nothing thought about to be done in order to improve liquidity, as we never did for the Brazilian shares either.

Q - John Kodak

And is there is any intention to make any further acquisitions in North America at this time?

A - Osvaldo Schirmer {BIO 1754610 <GO>}

If I can guarantee you before seeing those markets in North America in the same -- all of them into the same level, you are going to be out of the shopping area.

Q - John Kodak

Okay thank you very much.

A - Osvaldo Schirmer {BIO 1754610 <GO>}

Okay.

Operator

Our next question comes from Mr. Daniel Altman with Bear Stearns.

Q - Daniel Altman {BIO 1855515 <GO>}

Hi, it's Daniel from Bear Stearns.

A - Osvaldo Schirmer {BIO 1754610 <GO>}

Hi, Daniel.

Q - Daniel Altman {BIO 1855515 <GO>}

Hi just two quick questions first, if you can update us on the price of scrap in Brazil during the Third Quarter and just compare that to the Second Quarter and do you have any projections for the Fourth Quarter and then my second question is relating to the growth of (work) in Brazil next year, I am just wondering if you have a number in mind in terms of what do you think, you think the magnitude of growth next year is going to be similar to the magnitude of the decline this year? Thanks.

A - Osvaldo Schirmer {BIO 1754610 <GO>}

Okay, scrap pricing in Brazil, as you well know, we are talking about different quality of scrap; not an automatic comparison between the prices of scrap in Brazil and the price of scrap in North America which these days are around \$125-130 per ton, in Brazil pay much less but you buy a different quality of scrap. If you try it let's say to level them up by contemplating also the cost of processing them and so we are talking about \$85-90 per ton in Brazil, maybe 95 in the major areas the most (conflicted) area that most that the concentrated areas Sao Paolo for instance. And as oppose to a 130 in U.S.

As far as gross rate for Brazil and taking the word and the opinions of majority of the economists in this country, the country is putting in place all the basic ingredients to grow next year and we have been reading and hearing numbers between 2.5% to almost 4% the most. And the optimistic side of the companies let say, a group were among the most optimistic. We are working with a number between 2.5-3% for next year and a very likely are trying to understand how much this would impact in the demand for our products. And basically we have these statistics or this correlation pretty much vested throughout that AGP in a countries such as Brazil goes around 2% or 3%. We cannot lie a multiple ranging from 2-2.5 times. So Brazil is going to grow 2 times, at least the demand in this country will come for a longtime on steel we're going to grow 6%.

Q - Daniel Altman {BIO 1855515 <GO>}

Okay great thanks very much.

Operator

Ladies and gentlemen. as a reminder if you would like to pose a question, please press '*' key followed by the '1' key on your touchtone phone now. Our next question comes from Mr. Marcello Giad with (inaudible).

Q - Marcello Giad

Hi Schirmer. Good afternoon.

A - Osvaldo Schirmer {BIO 1754610 <GO>}

Hello Marcello.

Q - Marcello Giad

Just a question on the freight side demand, the market has been talking a lot about the freight cost that sky rocketing. Any facts you know Aco Minas operations what you can predict was in this area?

A - Osvaldo Schirmer {BIO 1754610 <GO>}

That is a very critical point these days, that's a fact. There is lack of vessels around the world, prices of freight are increasing. This is -- we can feel that when we import coal. And we also feel that when we export steel, even though we normally export on an FOB basis, the client has to pay the price of freight. And they have increased it quite substantially. Aco Minas. So far has been rather protected from this surge in prices because it has long-term contracts with the port authorities and also with transporters, carriers. But, you are right. They have been growing quite substantially these days and this may impact somehow the business, the international trade flow.

Q - Marcello Giad

Just to define your (inaudible) -- all your exports are free onboard prices?

A - Osvaldo Schirmer {BIO 1754610 <GO>}

Not all this is the kind of too strong. We tend to sell on a FOB basis, by depending on client and depending on the situation, depending on the deal, we may use our, let us say, long-term contracts with some of the carriers, for just the dispatch. But we do both.

Q - Marcello Giad

Okay, one more question, in terms of -- I assume that your crude steel production in the Gerdau part and compound operation has been very strong in the last months even reaching levels that was not an -- not reached before, you guys are having more, I mean, additional capacity to the -- through the (bottle-necking) process? And in the same question, if you see the demands recorded in Brazil will of course signify reduce in exports. But your export level is reaching probably reaching new markets, that you did not reach before. So can we continue to prove that -- strong production revenue ahead? And the difference between domestic demand beating export or on the volumes?

A - Osvaldo Schirmer {BIO 1754610 <GO>}

You're totally correct in your assumptions. First of all yes, we have increased the volume of output due to major-- due to a few reasons. One of them is that our Aco Minas in full capacity is again after that little inconvenience a (few) years ago. Now it's in full speed. So it has added the capacity and by simple fact that way the (dow) has investment year-after-year in modernizing the plants, we end-up increasing the capacity, increasing the output. And you can continue to count that; the (dow) has invested the range of \$200-230 million a year. Basically modernization of the facilities and these end-up improving the output.

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For -- in terms of the ratio between what is exported and what is sold domestically, we have two situations, in the flat steel, not in the flat -- I am sorry, in the semifinished segment which is basically the export of our Aco Minas. And Aco Minas tends to export somewhere between 60-70% of the output. And this has very low volatility year-after-year, December is there. On the long common sector -- on the long common segment of our export, this ratio is more volatile. In recent years, we have been in the range of 20-25, about -- but considering the situation, the high price in international markets, very likely that this number is not going to fall even though recovery in the domestic economy; it is not going to fall below 30-35% in the future.

Q - Marcello Giad

Okay.

A - Osvaldo Schirmer {BIO 1754610 <GO>}

So, I'm basically saying exports are going to continue even though the (inaudible) of the local economy, to a high level.

Q - Marcello Giad

Great. And just a last comment -- question is, the restructure of this two companies in Brazil, Gerdau and Aco Minas when can we expect the sales to invest from the managerial fidelity?

A - Osvaldo Schirmer {BIO 1754610 <GO>}

Very shortly. That in November (no later than December), this is usually bringing to the market, the fast goods that we have constructed together with a representative of the employees, with full detail. And so basically confirmed that no later than mid-November we are going to have it.

Q - Marcello Giad

Okay, thanks a lot.

Operator

Again, ladies and gentlemen. if you would like to pose a questions, please press the '*' key followed by 'I'. Our next question comes from Daniel Altman with Bear Stearns.

Q - Daniel Altman {BIO 1855515 <GO>}

Hi, this is Daniel talking advantage to a second chance here.

A - Osvaldo Schirmer {BIO 1754610 <GO>}

You have all the chance to speak.

Q - Daniel Altman {BIO 1855515 <GO>}

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When you talk about your export expectations for next year, I'm wondering if you can give us kind of a geographic idea of where you are seeing this demand, where you find tax (inaudible) to you. And given the current price for freight, if the freight prices are sustainable where it is today would that alter your plans on the export side? And then another question is regarding your taxes, how much is the tax benefit from Aco Minas, which you see in the Third Quarter, how much is still left over, thanks?

A - Osvaldo Schirmer {BIO 1754610 <GO>}

Okay taxes. Okay, let's start with the geographic areas where we are conveying our export. This year due to the reduction in the demand in the local markets, we had to do some additional effort to sell out our products. We have been concentrating a lot of effort in the west Africa region basically the whole West Coast of Africa, we have been visiting and striking new deals. And on a very consistent basis. Looking ahead, Asia is going to be the chief market, going to continue to be the chief market. And -- but we are also selling and exporting to neighboring countries Central America in the case of Aco Minas and specifically we have in the North American market, a very important market segment for us.

So, its widespread but new markets are basically (African). And we are -- it is only selling to new customers, we are replacing exports coming from the European customers due to the strong Euro. And even presently we have some cases of European countries buying from us, not too much. But just as to give us some reference. In terms of freights, as I did have a chance to comment on the previous question we are facing this lack of facilities available to transport our products. And they -- the prices of freights have gone from 25 -- \$20 per ton to in some cases up to 40 tons, which complicates a little bit. But I should -- I mean, as I mentioned to you has suffered less and it is going to suffer less until some time. But if that thing continues, if the pressure continues, I am afraid, we are going to end up suffering sooner or later somehow. In terms of taxes or taking advantage of the fiscal losses accumulated by Aco Minas. In the Second Quarter, as you probably would remember, you took advantage of 198 -- basically 200 million reais. So it was a very positive -- generate a very positive impact in the Aco Minas balance sheet.

In the Third Quarter, which is now, we hadn't used anything without paying taxes again and we paid down the (inaudible) Brazil using the results of the long common sector as the Aco Minas. And basically a few counting on a balance of around 120 million to be used in the case of Aco Minas. We are at it.

Q - Daniel Altman {BIO 1855515 <GO>}

Okay. Thanks very much.

Operator

Again, ladies and gentlemen. if you would like to pose a question, press the '*' key followed by the '1' key on your touchtone phone now. Again, ladies and gentlemen. if you would like to pose a question, please press the '*' key followed by the '1' key on your touchtone phone now.

Again, ladies and gentlemen. if you would like to pose a question, please press the '*' key followed by the '1' key on your touchtone phone now.

That concludes today's question-and-answer session. I would like to invite Mr. Osvaldo Schirmer to proceed with his closing statements. Please go ahead, sir.

A - Osvaldo Schirmer {BIO 1754610 <GO>}

Okay. Since, there are no more questions, I'd like to thank you all for your attention and interest. And I hope to talk to you again at the end of the next quarter. Thank you, very much. Have a good weekend. Bye-bye.

Operator

That concludes the Gerdau audio conference for today. Thank you, very much for your participation. Have a good day. And thank you for using Conference Call Brazil.

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