Q3 2018 Earnings Call

Company Participants

- Gustavo Werneck, Director, President and Chief Executive Officer
- Harley Scardoelli, Executive Vice President and Chief Financial Officer

Other Participants

- Gabriela Cortez, Analyst
- Gustavo Allevato, Analyst
- Leonardo Correa, Analyst
- Marcos Assumpcao, Analyst
- Renan Criscio, Analyst
- Thiago Lofiego, Analyst
- Timna Tanners, Analyst

Presentation

Operator

Good morning, and welcome to Gerdau's conference call to discuss the results of the third quarter of 2018. At this time all participants will be on listen only mode and later on we will initiate the Q&A session. (Operator Instructions).

We would like to emphasize that any forward-looking statement 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 its comments are based on reasonable assumption, there is no guarantee that future events will not affect this evaluation.

Here today are Mr. Gustavo Werneck, Director, President and CEO of the company; and Harley Scardoelli, Executive Vice President and CFO.

I would like now to give the floor to Mr. Gustavo Werneck. You may proceed, sir.

Gustavo Werneck {BIO 20318216 <GO>}

Once again, welcome to Gerdau's conference call for the results of the third quarter of 2018. I would like to say that I am really pleased to be here once again to comment on our results. Also the company's main highlight and the outlook for the market where we operate.

Next after my presentation, Ms. Scardoelli, sitting next to me here will elaborate on financial performance of Gerdau. And at the end, we will both be available to answer your questions.

I would like to start this conversation by talking about our main positive milestones of the third quarter 2018, which are summarized on Slide 2. We reached the best quarterly EBITDA of the last 10 years at Gerdau. Moreover, it is the third best quarterly EBITDA in the history of the company. This, therefore, reinstates and ensures that we are pursuing the right strategy to enhance profitability of our operations, while at the same time, we manage to reduce our debt position and promote a more stringent management, of course.

In the third quarter of '18, one of the highlights was the performance improvement in North America. I recall that earlier this year, we talked about our challenge to reach a 2-digit EBITDA margin in this operation, and this goal was reached now this quarter. This achievement motivates us to persist on our journey towards improving the efficiency gains of our assets. It is the best EBITDA margin of North America since 2008, boosted by the economic effects of the US tax reform and the implementation of Section (Technical Difficulty) in addition, another highlight was the performance of the Brazil operation that benefited from enhanced domestic demand. Also international prices remained good, despite being slightly lower than prices in the first and second quarters of the year.

Overall, Gerdau's impressive performance also reflects the management's effort in all our operations. This comes as a result of our austerity in managing CapEx investments and also the lower historical level of SG&A that reached 3.3% of net sales. Free cash flow generation was BRL 405 million. This quarter, foreign exchange, or more precisely, foreign exchange variation of BRL, was also positive to us because we posted gains in converting revenues generated abroad into Brazilian real.

In the period, once again, we were able to improve our net debt over EBITDA ratio. It reached 2.2x, being the best performance since 2012.

Our debt position follows a downward trend since the conclusion of the divestment of the rebar units in the US this week, and which was also previously announced back in January for USD 600 million in addition to the regular working capital adjustment.

Recently, we also announced the sale of our operation in India, in line with our divestment strategy already mentioned before that focuses on assets of greater profitability potential in the Americas. In addition, we would like to inform you that after the completion of the sale of the units in the US and India, we now concluded our divestment program.

In Brazil, the highlight goes to our partnership with Votorantim Cimentos and Tigre as part of the program that we call Juntos Somos +, together we are more, which is already in motion and which official launching should happen at the end of this month of November.

So now let's move to Slide number 3 to talk about the outlook for 2019 or next year. We are working with a very positive outlook for next year. A few weeks ago, in an event in Tokyo, the World Steel Association revealed that in the year 2018, actual global steel demand should grow 2.1% vis-a-vis the year before. In 2019, global demand for steel should grow another 1.4% over demand of 2018, growing to 1.68 billion tonnes, boosted by the rebound of investments in developed countries, coupled with improved performance in emerging economy despite the potential scenario of trade tension, as we've been seeing in the recent news.

In Brazil, the gradual evolution of the industry and the civil [ph] construction segment were the important highlights in the period. In this regard, we managed to increase the EBITDA margin of our Brazil BD to 20.3% in Q3 '18. We benefited from our extensive product portfolio of longs and flats, and also from our strong presence from north through south of the country through our 76 stores of Comercial Gerdau which continue to advance in its transformation journey to better serve our innumerous customers.

At the same time, we continue to work to mitigate the significant impact of inputs and raw material pressures, especially scrap, pig iron and coal in the quarter that could last throughout 2019.

Looking ahead, the Brazilian market trend is positive for 2019 as we believe in higher GDP growth when compared to 2018. And that is because we already see a gradual increase in real estate launches in the country, also investment in oil and gas that are currently going through a licensing phase and to be initiated next year. In addition to that, we have urban mobility works that should take place in the second half of 2019.

So in regards to our operation in North America, I already commented on our good performance with EBITDA margins of 10.5%. For 2019, the outlook is quite positive, led by the growth of the economy and lower unemployment, therefore, generating higher demand from industry and the construction segment.

We also expect to see the continuity of Section 232 in 2019, and we hope to continue having a high use of installed capacity in North America market as a whole of approximately 80%. At the same time, we see new investments being made in capacity in the market at the moment, which should leads to increased domestic competition when these new capacities start up in the US early next year. Another point to be remembered is that the Trump administration spent great part of its first year focusing on priorities like health, immigration and tax reform itself, even though one of his main campaign topics was trade and investment in infrastructure. Now we hope that he turns the focus to an investment plan in infrastructure, which should be announced in 2019. I also want to say that with the approval of the sale involving the rebar fabrication facility in the United States, we hope to see our margins going further in 2019, and that because we are continuously focusing on our core assets with greater return potential and products with higher added value.

In regards to special steel, we had an EBITDA margin of 16.1% in the quarter, impacted by inputs in raw material costs, mainly scrap and metallic alloy. And these alloys are extensively used in the manufacturing of our product, mainly those geared towards the automotive industry. However, I would like to emphasize that the EBITDA margin of the special steels operation does not represent a trend towards the future. In addition, our JV called Gerdau Summit, a partnership with the Japanese company Sumitomo and JSW is already producing parts for wind towers, and these products are currently being certified as we speak. So in next year, we should start shipping these products. And when that happens, we will experience a margin growth because these products have a high added value.

Looking forward to 2019, the outlook for our special steel operation is also very good. In Brazil, the automotive industry should post moderate growth. On the other hand, the oil and gas and wind power industries in Brazil should grow as we expect to see increased consumption as a result of a better economic landscape. In the US, now the perspective is also favorable for 2019, mostly influenced by the potential performance of oil and gas industry and growth of the automotive industry, particularly the production of commercial vehicle. Demand from the civil construction equipment industry should also experience a good momentum.

Now looking at the other countries in South America, the region should experience some economic growth, especially in Peru, where GDP is estimated to reach 4% growth in 2018 and also 2019. But the economy of Argentina is our point of attention in the region as the economy is supposed to experience a downturn in both years, according to estimates from the IMF.

Well, now let's move to Slide number 4, and we will talk about investments conducted in the third quarter 2018. Considering the amount of BRL 319 million, 43% was earmarked for Brazil; 32% earmarked for the North America operation; 20% for Special Steel; and 5% was earmarked for the remaining countries in South America.

In the first nine months of the year, CapEx spending amounted to BRL 835 million, aimed at improving performance and the maintenance of our operation.

And now I'll give the floor to Ms. Scardoelli who will continue the presentation talking a bit more about the financial indicators. And after this presentation, I will come back to my final remarks.

Harley Scardoelli {BIO 7283603 <GO>}

Thank you, Gustavo, and good afternoon, to all. Now I will elaborate on the results and performance of the third quarter 2018. For those following us online, we're on Slide number 6.

In consolidated terms, adjusted EBITDA reached BRL 2 billion in Q3 '18. If we look at the bridge chart on the upper part of the slide, we'll see the evolution of adjusted EBITDA margins that went from 12.3% in Q3 '17 to 15.7% in Q3 '18. This increase stems from the performance improvement in the Brazil and North America BD, reaching the best EBITDA since 2008. Adding to the previous slide, I would say that Gerdau presented this quarter is the best quarterly EBITDA.

Now moving to Slide number 7, and adding to the previous slide, we noted on the bridge chart that shows the EBITDA evolution from Q3 '17 to Q3 '18, whereas net sales per tonnes sold more than offset the increase in cost per tonnes sold. This stems from a better environment in the world steel industry and the maintenance of international prices combined with management effort.

In the bridge chart, on the lower part of the slide, we see that we went from an adjusted net income of BRL 145 million in Q3 '17 to an adjusted EBITDA of BRL 998 million in Q3 2018, this was mainly due to improvements in EBITDA. These net income figure does not contemplate the negative and nonrecurring effect of BRL 207 million from the investment program because it does not have an impact on cash.

Speaking about dividends, in the Q3 2018, we paid out BRL 221.3 million in dividends to shareholders of Gerdau SA, the equivalent to BRL 0.13 per share. And in the third quarter of this year, Metalurgica Gerdau SA, that controls Gerdau, put aside BRL 88 million, the equivalent to BRL 0.09 per share for dividend payout. Both proceeds will be paid on December 3 based on closing position of November 21.

Now we move to Page 8, where I'll talk about the company's debt and liquidity position. Gross debt as of September 30, 2018, was BRL 18.2 billion, down by BRL 0.5 billion in relation to September 2017, and this was mainly due to amortization of debt in the period in spite of a 26% depreciation of BRL in the period.

This strong reduction of net debt over EBITDA ratio from 3.4x in September 2017 to 2.2x in September 2018, was mainly a consequence of the continuous EBITDA improvement in addition to the divestment program focused on the financial deleveraging of the company.

With all that, net debt over EBITDA, one of the most important KPIs of the company's capital structure, reaches its best level since 2012, aiming at optimizing its financial leveraging and debt management.

Now I'll move to the next and last slide of my presentation on Slide 9, where we demonstrate that the company generated a positive free cash flow of BRL 405 million in the third quarter of this year, which, once again, reinstate the continuous improvement in EBITDA and the strength to improve the free cash flow.

In Q3 '18, we were impacted by cash utilization to restore working capital in absolute terms as seen in the bridge chart in the lower part of the slide, and that was especially related to higher inventory levels due to improved business environment.

Thank you very much. And I'll give the floor to Gustavo for his final remarks.

Gustavo Werneck {BIO 20318216 <GO>}

Thank you very much, Ms. Scardoelli. Now moving to our final remarks on Slide 10, I would like to reinforce that we will continue to work hard to enhance the profitability of our operation and also to differentiate Gerdau in the world steel market by means of a digital transformation, in addition to our efforts to continuously improve the way we serve our customers. We believe that as our customers grow, so do we.

We remain focused on reducing our debt position further and generating positive free cash flow to increase the profitability of our operation.

For the past 118 years of history, we have been able to evolve constantly due to the quality of the teams of people we have at Gerdau, to whom I am very thankful for their dedication and their capacity to overcome challenges.

And finally, I would like to reaffirm our conviction in the growth potential of Brazil, hoping that the new President-elect seeks to improve the country's competitiveness and addresses the necessary reforms that the nation thoroughly needs. We understand that downstream industry and the steel sector are slated to the upturn of the development in the country.

Well, here, we now finish the presentation, the formal presentation and the slide presentation. And we're ready now to move to the Q&A session together with Scardoelli. We'll be available now to take your questions and to discuss any issues you may think necessary.

Questions And Answers

Operator

Ladies and gentlemen, we will now initiate the Q&A session. (Operator Instructions) Our first question is from Thiago Lofiego from Bradesco BBI.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Good afternoon, and congratulations for the results. Just two questions. Actually, about North America, what about the margin looking forward considering the consolidation of assets and the operating improvement you posted. And also looking at the fair level of metal spread, looking forward do you think that the margin level is optimum at 10.5% or do you think that we still have room to gain more? And the second question related to capital allocation. The net debt over EBITDA or the deleveraging plan, I think, is already completed, so what is your view in terms of capital allocation? Are you going to pay out more dividends in 2019 and 2020? Or you still have other projects in mind that are in your pipeline?

A - Gustavo Werneck {BIO 20318216 <GO>}

Thiago, this is Gustavo, thank you for your question. About the first part of your question, I will give the floor to Ms. Scardoelli. But in relation to North America margins, so knowing the culture of the company as we do, we are never happy with the margins that we currently have. So naturally, with the conclusion of the divestment of the rebar units that we announced recently, the margins tend to go up. So we will start operating with core assets that give us greater profitability, and this brings about margin gains. But we will continue to work in the future months to verify all other additional opportunities that will allow us to improve the performance of our operation and thus having better margin.

A - Harley Scardoelli {BIO 7283603 <GO>}

Good afternoon, Thiago, this is Harley. About the leveraging question, in a way, our levels are much closer to what we deem to be necessary. The capital allocation, our dividend policy is still 30% of dividend payout, of adjusted net income, and we will allow some cash allocation for dividend payout. We just have to, I think, this BRL 6 million will be allocated to pay out dividends. But naturally, this number should remain very strong.

The second aspect is that we are experiencing a very careful moment. The simple comparison with the same period of last year already indicates that this year we have higher CapEx expenditures, which is natural because there is a downturn -- there was a downturn in the economy. Even though we don't have any major projects or M&A, we are still investing internally. So there shouldn't be any major changes in capital allocation, so we will experience stronger cash because the results are at better levels now.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Could you also tell us what would be normalized CapEx level looking forward? Already bear in mind this new economic landscape or maybe the increased capital. I think we are talking about BRL 0.3 billion or BRL 0.4 billion a year. I don't know whether you are thinking in terms of a bigger numbers in that.

A - Harley Scardoelli {BIO 7283603 <GO>}

The quality of the sound was a bit poor, could you repeat please.

Q - Thiago Lofiego {BIO 16359318 <GO>}

I couldn't hear Harley what you said. I am sorry.

A - Harley Scardoelli {BIO 7283603 <GO>}

Could you repeat your question please, we couldn't hear you well.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Sure. The question was about a normalized CapEx level and whether we could see a number above that 1.3, 1.4 that you refer to or whether you're envisioning something higher than that looking forward.

A - Harley Scardoelli {BIO 7283603 <GO>}

We are still concluding our budget for next year. So CapEx numbers will only be coming to the market in February. But again, the levels are similar to those of 2017. So the -- a CapEx level which is closer to realty. This will be the equivalent today of approximately 70% or 75%. And this is, I would say, more normalized. But as I said, we will be able to give you a more details and we will have details for the market next February, next year.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Thank you very much.

Operator

Our next question comes from Leonardo Correa from BTG Pactual.

Q - Leonardo Correa {BIO 16441222 <GO>}

Good afternoon, everyone, and thank you. Maybe I have a suggestion. Gustavo [ph], your line is a bit better. Harley's line is cutting a lot. I don't know whether you have any connection issue but it has been very difficult to hear your sometimes. My question, I'm still trying to understand a little bit about the operating results for the third quarter. I mean, Brazil is performing quite well with an EBITDA margin above 20%, but the question that I have is that this has been quite a polluted quarter because of Ouro Branco and some stoppages and maybe that probably impacted your results. But in spite of that it was spectacular but maybe it could have been a bit better yet. I just want to hear from you something about the nonrecurring impact and how could we look at those results in a more clear sense and whether you could shed some light on what could have happened if the results haven't been impacted by the issues?

The second question relates to special steel. Maybe I think that the performance was a bit more challenging, this time. I mean, this is something that has presented good performance in the past quarters and this quarter it was a bit down because as you said, there was cost pressure and this was probably one off situation when we talk about special steel, right? Just want to know whether this pressure cost was only in Brazil or it was also elsewhere. And in automotive, in price increases that you are announcing for Brazil in the fourth quarter, how is that evolving? And how would that also impact the recovery getting closer to 20% EBITDA margin? Thank you.

A - Gustavo Werneck {BIO 20318216 <GO>}

This is Gustavo, and thank you for your two questions. Answering your first question about the Brazil BD. In the second quarter, there was a maintenance stoppage in our blast furnace 2 in Ouro Branco, and this furnace is focused on steel production for export. So this stoppage in the second quarter was translated into volumes now in the third quarter. So if we haven't stopped the burners, we would have an additional revenue in this quarter, there will be additional shipments that we could have done probably.

Now in regards to special steel, throughout the last two or three quarters, we've been experience a very strong pressure costs, particularly with scrap and alloy. Alloy in that segment of special steel, it's very important in the overall cost basket, and prices have increased in the last quarter. The dynamics of special steel's operation does not allow for a very quick margin rebound because of several long-term contracts that we have with our customers. Therefore, in the long run, we do not anticipate any additional worsening in the margin. On the contrary, we understand that as we renegotiate our contracts and then we adjust our margins with the new contracts, we see a good trend to recover margins in special steel.

Q - Leonardo Correa {BIO 16441222 <GO>}

Thank you. Very good.

Operator

Our next question is from Gustavo Allevato from Santander bank.

Q - Gustavo Allevato {BIO 18933135 <GO>}

Good afternoon, Gustavo and Harley. I have two questions, still related to the cost evolution in special steel. I mean, this cost pressure still remains looking forward into the fourth quarter of 2019? Or do you think that this price review in Brazil could probably mitigate the price increase. And my second question relates to the North America BD. Looking at the business and with a better capacity use, do you see any bottleneck capacity? I mean, if we look at a very strong demand landscape that you depicted in your presentation?

A - Gustavo Werneck {BIO 20318216 <GO>}

Thank you for your questions. In terms of special steel, which is different when we talk about long because we consider other imports that are important like scrap itself. So we noted an escalation of costs in the first three quarters of the year. Now we see that prices and costs will be flat from now on. And the levels are much higher than what we had in previous years. So when we look, even looking forward to 2019, we believe that the high-level of growth will remain even though there is an additional pressure that we noticed in the first quarter this year.

In terms of our North America operation, we've been trying to work as much as possible for capacity. If we know that The US has full employment, this basically is not just at Gerdau, but all of the other companies are trying to find enough skilled labor so that we can put all of our assets in operation. So the question is, I mean, if we're able to increment our capacity in the next coming years, we will do so. But today, in our assets, we do not have any large plant or there no equipment stopping and everything is in operation but we just hope to increase the volume compared to the current volumes today.

Q - Gustavo Allevato {BIO 18933135 <GO>}

That's very clear. Thank you very much.

Operator

Our next question comes from Renan Criscio from Credit Suisse.

Q - Renan Criscio {BIO 18747357 <GO>}

Hello, Gustavo and Harley. Thank you very much for taking my question. My question is a follow-up when it comes to your North American decision. We recently saw an announcement by Gerdau and also other competitors said the same, referring to about $35 reduction for certain type of products. Could you elaborate a bit more about your demand per line of product in that division? And can you probably comment on what led to that price decrease or whether this is just a one-off situation? Or whether there is also a risk of a drop in prices to other lines?

And the second question refers to the Brazil BD. Imports now are much lower than what you had in previous quarters. Could you please tell me what latched to that? I know that the demand in the domestic market lead you to change things a bit. But could you comment on your profitability for exports versus domestic shipment? And how can we think -- what would you consider in terms of mix of sales looking forward?

A - Harley Scardoelli {BIO 7283603 <GO>}

Hi, Renan, this is Harley. I will answer the first part of your question about North America. The price drop in the case of longs, it's a one-off situation. I think that the highest effect more recently occurred with flat in the third quarter. We remain with a very positive environment and then in the second quarter as well. But the North America market is due to what I said before that we are looking at some very positive market outlook, the nonresidential construction market is keeping up, it's maintaining activities and our expectation is that the economy still reflects a very low unemployment rate, and Gustavo just said how difficult it is to hire people in the US. The recovery of metal scrap that we following -- saw through the past quarters is still maintaining, so the outlook is positive. And so in the case of long, the price variation is slower and is more like a one-off situation.

A - Gustavo Werneck {BIO 20318216 <GO>}

And now, this is Gustavo. The second part of your question related to exports from Brazil, this drop in the third quarter was mainly due to what I said before, when we had a stop for maintenance, our furnace 2 in Ouro Branco. The demand for international still remains robust. Today, there is a slight volatility in the steel prices in the international markets in the last three months, but they remain at very high levels.

For next year, this will remain a very important avenue, I mean, the delivery of our products until the internal market recovers in Brazil. It is also good to remember that we still have some assets in Brazil that are currently nonoperational. As the demand in the domestic market recovers, we can in a very short period of time, put more things in the market without jeopardizing our export. I see that once we have to reduce imports or exports to cater to the domestic market, this is something that may take a little bit of time.

Operator

Our next question is from Marcos Assumpcao from Itau BBA.

Q - Marcos Assumpcao {BIO 7474402 <GO>}

Good afternoon, everyone, and congratulations for more than 6 billion in EBITDA in the last 12 months. My first question refers to working capital. Harley, I would like you to comment on how you see this current level of working capital. Looking at the cash conversion cycle, I think it is very close to your normalized levels but there may be some events that may release some additional working capital as a conclusion of the divestment in the US, and also a stronger BRL currency by the end of the quarter or the semester.

Now in relation to the US, what would have been the EBITDA margin in North America? I know that you did that exercise, if the volume had remained flat quarter-on-quarter and you didn't have any nonrecurring issues more related to climate in the East Coast in Texas. So if you can tell us something about the margins in the US in September, in October, it would really be helpful because we can have an idea of how things will resolve looking forward.

A - Harley Scardoelli {BIO 7283603 <GO>}

Good afternoon, Marcos, this is Harley. To answer your first question on working capital, if we look in terms of days of cycle, our levels are quite optimized. But there is certainly always room to get more, and we go after these additional gains even though there may be marginal gains, but they're still gains that can be extracted from that cash conversion cycle and we will try to optimize it. In this particular quarter, we had an effect of higher inventory levels and the cost of these inventories impacted our working capital. And particularly, the working capital as of June to September, this was a one-off situation for the quarter. The annual seasonality is always present, so towards the end of the year, we want to try to reduce that working capital and return some additional cash to the company.

One thing that is worth mentioning, and if you look at our working capital through out the year that the price -- the sale price of the operations in North America, 600 million, had an upward adjustment of about $100 million, much of that is working capital. The base working capital we had at the end of the year up-to-date in those mills was up significantly, that's why there was an adjustment to the price. I mean, that was a direct return of working capital. This is an important aspect that has to be mentioned.

Now referring to the last part of your question related to North America and volume loss, this was the effect stemming from some one-off situations like the hurricane in the US. There were series of climate events that affected production. Now if you look at the North America production on a more structural way, we are at a different operating level. So obviously, we hope to continue improving our results. We also know that we have the divestment of rebar assets in the US. The products that remain in our portfolio like structural profiles, special steel and other bars, they have better margin, and the new portfolio will tend to generate stronger margins in the future.

Q - Marcos Assumpcao {BIO 7474402 <GO>}

Very good. Thank you, Harley.

Operator

Our next question is from Gabriela Cortez from Banco do Brasil.

Q - Gabriela Cortez {BIO 18801371 <GO>}

Good afternoon and congratulations for your results. My question relates to capacity utilization, it talks a lot about North America, but I would like you to comment a bit more on the Brazil BD. If you saw a more robust rebound in demand, and how are you going to cope with that additional demand? Or whether that would require additional investment to increase capacity and therefore cater to that additional demand. My second question relates to prices. What is the scenario for the fourth quarter and 2019 regarding pricing for both Brazil and North America? That's all. Thank you.

A - Gustavo Werneck {BIO 20318216 <GO>}

Gabriela, good afternoon, and thank you for your question. In terms of the capacity in Brazil, we have to be ready for, in a very short period of time, to place additional product offering. The plants are currently operating with a lower headcount lower-than-expected, but we should be increasing our headcount in these plants, so that we would be able to increase capacity quickly. More recently, when we face the need to expand our steel production in the special steel segment. In less than 30 days, we were able to mobilize everyone and restarted the plant. And this was because of the reforms that we had in the country, the labor reform and the outsourcing platform. And so in a very short period of time, we had the opportunity to add more people to operate in our plants. Some other plants are hibernating. The equipment is in place, so if we look at these plants, all we have to do is to put people there and initiate the operation. So in summary, I must say, that we are very ready to add additional offering as soon as the domestic market rebounds and needs our products.

A - Harley Scardoelli {BIO 7283603 <GO>}

Good afternoon, Gabriel, this is Harley. Related to your question on pricing, we don't usually comment on our commercial policies, but maybe some KPIs, just to mention some of the two major markets. In Brazil, the import volume remains under control because our prices are very much aligned to international prices, therefore, there is no excess pricing or quality issues in Brazil and this is very positive.

And in North America, metal spread are now at better levels. And if we look at our outlook for both market, the perspective is quite positive for both market. In the fourth quarter, we also have seasonality issues that may impact volume, but we are not concerned at all in terms of prices. And the international prices are at very good levels. They have been higher before but they're still very good. So pricing behavior, in general, is quite positive.

Q - Gabriela Cortez {BIO 18801371 <GO>}

That's very clear and thank you very much.

Operator

Our next question, in English, is from Timna Tanners from Bank of America.

Q - Timna Tanners {BIO 6766897 <GO>}

Question in English. Hope you all well Gustavo and Harley. I wanted to ask you about the amount of capacity coming on in North America, if not really overlapping with your new profile and footprint and -- but if you're also contemplating any capacity addition, is that tempting to you? And then secondly, in the North American side, how much of the improved margin going forward from the divestiture is shedding the downstream assets that I assume were bit the more challenge side, if you could quantify any of that.

A - Gustavo Werneck {BIO 20318216 <GO>}

Timna's question has two parts. First has to do with the capacity reduction in North America, and maybe also in relation to Brazil, whether we see the need to reduce capacity. And the second question relates to the margins of our businesses in North America and how much of that improvement has to do with the divestment, particularly in terms of downstream.

Well, in terms of capacity reduction, today, our levels are higher in some of our operations, more notably our North America operation. I mean, the capacity level is quite high, but we do -- we can cater to increased demand without having to increase capacity, and that can be achieved through productivity gains and some of our operations are still going through a ramp-up in terms of capacity. We have capacity in Mexico, in Argentina. We then can cater to any demand increase. In all of our operation, we foresee capacity increase. Most of our operations are mini-mills, and so we can work with different working shift and that will not require a major investment. So this answers the first part of your question.

Now as for the second part of your question, when you talked about margin improvements, I think that has to do with our own profile. I mean, our profile is very diversified in terms of products in North America and I believe that the products that remain in our portfolio are generating good margins, meaning that we will be able to have more consistent gains looking forward. Now in regards to downstream, I would say that this has to do with the way the commercial metal will operate. But we believe that this was a win-win deal because the markets were happy on the point of view of commercial. And on our point of view, we focus on those assets that in our view are core assets and we also focus on the deleveraging of the company. So these are the most important aspects. So we do not have any more specific things to share with you at the moment.

Q - Timna Tanners {BIO 6766897 <GO>}

Okay. Great. And can you quantify that capacity that you mentioned that's hibernating in Brazil? And can you quantify the available spare capacity that can be ramped up as you mentioned, in the US mini-mills?

A - Gustavo Werneck {BIO 20318216 <GO>}

Timna's question relates to the hibernating capacity in Brazil. I will then go back to the points that we are operating close to 70% or 72%, so we still have some capacity left. So today, we do not have any major projects. We have some mills that stopped in the past few years. And so if necessary, I'm sure, we could resume operation. So we are not considering that as our basis hypothesis because currently we are capable of absorbing any increase demand in the Brazilian market. Another important aspect about Brazil is that in the last few years, between 20% to 30%, maybe a bit higher part of our production has been exported, so that means that we still have some room to migrate that exporting shipments to Brazil in case of a sudden pickup in demand. Therefore, we still have a lot of flexibility without having to consider large expansion projects.

Q - Timna Tanners {BIO 6766897 <GO>}

Okay. We are done.

Operator

We now conclude the Q&A session. I would like to give the floor to Mr. Gustavo Werneck for his final remarks.

A - Gustavo Werneck {BIO 20318216 <GO>}

I would like to thank you very much for joining us today, and particularly for this very good debate we had during the Q&A session. And I would like to invite you to join us again on our next earnings release call related to the fourth quarter of 2018 that is scheduled to happen on February 21. Thank you all very much for joining us, and have a very good week.

Operator

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