Q3 2017 Earnings Call

Company Participants

- Andre Gerdau Johannpeter, President and Chief Executive Officer
- Harley Lorentz Scardoelli, Chief Financial Officer

Other Participants

- Caio Ribeiro, Analyst
- Carlos de Alba, Analyst
- Gabriela Cortes, Analyst
- Gustavo Oliveira, Analyst
- Leonardo Correa, Analyst
- Marcos Assumpcao, Analyst
- Peter Krawczyk, Analyst
- Renan Criscio, Analyst
- Thiago Lofiego, Analyst
- Thiago Ojea, Analyst

Presentation

Operator

Good afternoon, and welcome to Gerdau's Conference Call to discuss the Results of Third Quarter of 2017. At this time, all participants will be connected 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 of financial and operating goals are mere assumptions based on management's expectations related to the future of the company. Even though Gerdau believes that its comments are based on reasonable assumptions, there is no guarantee that future events will not affect this evaluation.

Here today are Mr. Andre Gerdau Johannpeter, Director, President and CEO of the company; and Harley Scardoelli, Executive Vice President and CFO.

Now I would like to give the floor to Mr. Andre Gerdau Johannpeter. You may proceed, sir.

Andre Gerdau Johannpeter

Thank you. Good afternoon, everyone, and welcome to Gerdau's conference call to discuss the results of the third quarter of 2017. We will begin our analysis with the world landscape for the fuel industry. And after that, I'll comment on Gerdau's performance in the period. It is also important to highlight that we will analyze the performance of the consolidated results in the third quarter of 2017 vis-a-vis the same period of the year before. Right after that presentation, Harley Scardoelli will elaborate on the financial performance of Gerdau. And finally, we'll be available to take your questions.

I will begin by speaking about the world scenario. The world economy is going through a good momentum, which has a positive effect on the demand for steel. According to the World Steel Association, fees of 2017 should end with an increase of 2.8% in global demand, reaching 1.6 billion tonnes. Now for 2018, the forecast points to a slower growth in world consumption of 1.6% in a landscape where China had almost zero growth, very stable.

However, there is growth in all of the other regions of the world. Okay. Meaning that worldwide consumption should be up 1.6% next year. So one positive thing is that China is moving in the right direction, which is through shut down capacity, and this has impacted positively, providing a better balance in the world and putting less pressure in the margins.

Now, I'd like to speak about Brazil where the apparent consumption of steel was 14 million tonnes from January through September 2017 when compared to the same period of the year before. The growth was 5% according to the Aco Brasil Institute, which already demonstrates signs of recovery of the economy in the country. However, civil construction, which is an important industry that consumes long steel, still posts low demand with a slower rebound.

Exports in the same period were 11 million tonnes year-to-date until September, which means that it grew 9% in volume vis-a-vis the same period of 2016, mainly impacted by exports. On the other hand, exports play a very important role to ensure sustainability of the industry when you consider a drop in domestic market. That's why the steel industry is still advocating in favor of REINTEGRA for us to recover for taxes in the productive chain.

Another important aspect is that the Brazilian government should follow the technical opinion of the trade defense agency from the Ministry of Industry and Trade, which identified dumping practices by Chinese and Russian producers, the exports of whole hot-rolled products to Brazil. In addition, that same department verified that there are significant subsidies created by the Chinese government to local producers which calls for countervailing measures to ensure trade -- fair trade of this product in the Brazilian market.

It's worth mentioning that trade defense instruments are legitimate according to the rules of the WTO, and that the Brazilian legislation are also frequently used by the steel industry in the world. The non-enforcement of the anti-dumping right and countervailing measures in this case will lead to the continuity of unfair trade practices, which will fasten the domestic change of high added value, especially in the steel industry.

Now speaking about North America, the economy continues to post a steady growth. There has been increase in demand by civil construction in the industry, but the region still feels the impact and high pressure from imported goods. The industry continues to hope that the Trump administration includes in the agenda the evaluation of resolution 232 that talks about the entry of imported steel in the country and also investments in infrastructure and the impact in the internal revenue.

In South America, there is a growth of 5% in the apparent consumption of worldsteel amounting to 44 million tonnes. But just as in North America, exports remain a concern, particularly from products coming from China.

Speaking about Special Steel. So the highlight has been the good performance of the automotive market in Brazil, India and the United States and the rebound of the oil and gas market in North America. Currently, in Brazil, they're selling about 10,000 vehicles a day. And the car licensing numbers increased 10% when compared to January through September of 2017 in relation to the same period of the year before. And exports already accumulated until September posted increases of 56% according to (inaudible).

Now we will talk about the major figures of Gerdau in this quarter, starting with consolidated sales. There were 3 -- we saw 3.9 million tonnes in the quarter. That was an increase of 5% when compared to the same period of the previous year due to higher volume sold in the North American operation in Special Steel. Net sales was BRL9.5 billion in the third quarter of 2017, a 9% increase vis-a-vis the same period of the year before. That was also due to increased shipments coming from Special Steel operations in North America.

Now interest before taxes, interest rates, depreciation and amortization, known as EBITDA, was 1.2 billion in keeping with the third quarter of the year before due to lower gross profit, partially offset by an 18% reduction in SG&A.

Now speaking about consolidated adjusted net income, it was BRL145 million, accounting for a growth of 53% vis-a-vis the same period of the previous year due to lower financial expenses in the period. I would also like to highlight here our management efforts that have also resulted in a generation of free cash flow of 500 million in the third quarter. This is a KPI that has become one of our financial priorities.

Now speaking about our divestments. We initiated this program in 2014, and up to now, the economic value of transactions really conducted in the US, Latin America and Europe totaled BRL3.2 billion. This amount already considers the sale of the operation in Chile that took place in October this year of BRL480 million, and its conclusion is still dependent on the Administrative Council for Economic Defense.

Now about our investments. In the third quarter, we invested 170 million in CapEx. From this total, 41% was invested in North America, 33% was invested in the Brazil operations and 13% in the South American plant, 13% in Special Steel. In the first nine months of 2017, CapEx investments added up to BRL602 million, which shows that we are concluding the investments with the conclusion of the heavy plate rolling mill in Ouro Branco and the melt shop in Argentina, which then stresses a transition from the focus in CapEx and maintenance and update -- technological update of the industrial units.

Now, I'll give the floor to Harley.

Harley Lorentz Scardoelli {BIO 7283603 <GO>}

Thank you, Andre. Good afternoon. Now let's look at slide seven, and I'll talk about the results and performance of each of our business divisions in the third quarter of 2017, and then I'll give you more details on the consolidated results.

Starting with Brazil. Shipments in the third quarter of 2017 in relation to the same period of 2016 were stable due to a balance between domestic and export markets. The domestic market posted an increase in the third quarter when compared to the third quarter of 2016, mainly due to improvements in shipments. Now speaking about exports, there was a drop in volumes sold, which took place due to lower profitability due to higher costs.

Now looking at EBITDA and the margins of the third quarter of 2017, they were down due to increases in raw material cost in addition to significant results that we obtained with exports in the third quarter of 2016. Now doing a comparison of Brazil vis-a-vis the second quarter of this year in particular, the EBITDA margin was down due to the product mix in the domestic market and also because the announced price increase announced to the market takes some time until they are fully consolidated throughout the months. And the increase in our basket of inputs, they -- we had them since the beginning of the year.

Now speaking about North America. Shipments were up when we compare the third quarter of 2017 to the third quarter of 2016 due to efforts of the company to put priority in the rebound of market share. EBITDA and the EBITDA margin of the third quarter of this year were down vis-a-vis the third quarter of 2016 due to greater pressures over metal spread where the higher raw material costs were not fully accompanied by higher steel prices.

Now looking at South America. Shipments in the third quarter of 2017 were down vis-a-vis the third quarter of 2016, mainly due to the deconsolidation of our operation in Colombia as of June of this year. Net of this effect, shipments were up by 7%, mainly due to higher volumes sold in Argentina and Peru. EBITDA in the third quarter of 2017 was down vis-a-vis third quarter of 2016 also due to the divestment of the Colombia operation.

Now looking at Special Steels. Shipments in the third quarter of 2017 were up vis-a-vis the third quarter of 2016 due to improvements in the automotive sector, especially in the countries where Gerdau operates in addition to the improvements in the oil and gas industry in the US. The EBITDA improvement and the improvement in EBITDA margin in the third quarter of 2017 vis-a-vis third quarter of 2016 was mainly due to better profitability coming from the Brazil and U.S. units.

Now on Slide eight, we talk about consolidated figures. Adjusted EBITDA was BRL1.2 billion in the third quarter of this year. If we look at the bridge chart in the upper part of the slide, we will notice a slight drop in adjusted EBITDA, which occurred due to higher cost of raw materials, especially in Brazil and North America. We must also notice the effort of the company to reduce SG&A, which was 18% lower when we compare the third quarter of this year with the third quarter of 2016, and 26% lower when we look year-to-date.

In the bridge chart on the lower part of the slide, we can look at adjusted net income of 95 million in the third quarter of last year to an adjusted net income of 145 million this quarter, meaning a 52% increase due to a lower cost of debt, which had a positive impact in our financial results.

Now speaking about dividends. Based on the results from the third quarter of this year, the company will pay out BRL51.3 million of dividends to Gerdau's shareholders, BRL0.03 per share and BRL19.5 million to Metalurgica Gerdau shareholders equivalent to BRL0.2 per share. These proceeds will be paid out on December 1st based on the positions of 21 of November of this year, which reflects our very good cash position.

Now looking at slide nine, we will talk about the company's debt position and liquidity. Gross debt on December 30, 2017 was BRL18.7 billion, down by 6.5% vis-a-vis June of 2017. That was based -- that basically reflected the foreign exchange variation and working capital debt amortizations. The average weighted cost of debt was 6.7% a year, with an average tenure of amortization of 5.3 years. In September 30, 2017, 24% of the debt was short-term. The reduction of the net debt over EBITDA ratio to 3.4 times in September 2017 came as a consequence of debt amortizations made possible by the good cash generation in the period.

I would like to remind you that the 2017 bonds that matured in October was amortized with cash funds from the company. I would also like to highlight the liability management executed by the company in October. We bought back $552 million of 2021 bonds and $35 million of 2020 bonds. And in order to do that, we issued $650 million in new bonds of debt to mature in 2027 and a 4.875% coupon a year. The purpose of this transaction was to extend the average tenure of the debt, which is now 6.9 years, and have a more balanced payment schedule for the years ahead, taking advantage of this good window of the market, which is a good opportunity for funding.

Also in October, the company renewed its global line of working capital for three years, amounting to $800 million. The new maturity is now October 2020, and the cost of the line is LIBOR plus 1.5% a year, very competitive. This renewal process was done together with nine international banks, which is an important part of our policy of maintaining liquidity and also to have quick access to additional funding.

Now speaking about the holding. On 19 -- on July 19, 2017, CVM approved a Stock Tender Offer of Metalurgica Gerdau S.A., which offer shareholders of ordinary shares of Gerdau S.A. the rights to swap their shares by ordinary share -- ordinary shares by preferred shares. So the offered auction occurred on August 22. And as a result, Metalurgica Gerdau acquired 70,714,542 ordinary shares issued by Gerdau S.A., accounting for 80.35% of the total shares of the offer and a 4.11% of capital stock at the company. The shares was swapped by 7,714,552 preferred shares issued by Gerdau. Until November 23, 2017, any shareholder of ordinary shares issued by Gerdau S.A. that wishes to stop their shares can still do so.

Now moving on to slide 10. We will talk a little bit about our working capital management. In September 2017, the cash conversion cycle was down vis-a-vis June of the same year due to an increase of 3.4% in net sales compared to a relative stability of working capital. It is worth mentioning that the 74-day cash conversion cycle is the lowest in the last 12 months, which shows the very firm focus of the company to manage its working capital.

Now going to the last slide of my own presentation. As we can notice, looking at the upper chart of the slide, in the last 12 months, the company generated positive free cash flow mostly due to CapEx discipline, lower indebtedness and working capital managing efforts. More precisely, in the third quarter of this year, when we look at the bridge chart in the upper part of the slide, EBITDA was enough to honor CapEx commitments, interest rates, income tax, covering yet the use of 167 million of working capital. And as a result, we have a positive free cash flow of BRL500 million, more than double in relation to the second quarter of 2017.

Now I'd like to give the floor back to Andre for his final remarks.

Andre Gerdau Johannpeter

Thank you, Ms. Scardoelli. To conclude, I would like to highlight that this improvement in the economic landscape that is taking place in several countries is already reflecting in the recovery of the demand for steel in some important segments where Gerdau operates as the automotive. The increase in steel consumption in Brazil reflects the market recovery. However, civil construction demand still remains low, and the rebound is still low. And then we see that this rebound tends to be better as of 2018. So with this drop in domestic demand, competitiveness of exports is a crucial factor in order to maintain sustainability of this industry in this country.

In relation to the performance of our financial results in the quarter, I would like to highlight continuity of our management efforts in all of our operations. In the period, we were able to reduce SG&A by 18%. We generated a significant free cash flow and reduced the debt level. In addition, our asset optimization program already accounts for 3.2 billion in divestments in the last four years.

As of 2018, as previously announced, we will enter another phase of our governance with a new executive leadership that will remain focused on increasing the profitability of the business through the pursuant of greater management efforts, asset optimization, cultural modernization and investments in digital innovation.

To conclude, I would like to thank you all very much in more than 10 years as Gerdau's CEO. And I would also like to bid farewell because this will be my last earnings call as an executive leader of the company. The earnings results of the last quarter of 2017 in

February 2018 will be presented by the new company -- the new CEO of the company, Gustavo Werneck, that takes over in January 2018.

And with that, we are now available to take your questions. Thank you very much.

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>}

Thank you. Good afternoon. Andre, congratulations for your work in more than 10 years in that position, and good luck in your new position as Chairman of the Board. I have two questions.

First, regarding metal spread end of the fourth quarter. So price of scrap was down to about $30 recently, whereas the price of steel is very stable. It had a very slight decrease of $5, more or less. Can we think in terms of an extension of the metal spread in the fourth quarter? And is there any other cost pressure that could lead the EBITDA margin of the industry and Gerdau, in particularly, would cause it to go down? I mean, the steel price minus scrap, but if there -- if you can think of any other type of cost pressure that could affect your margin, could you please elaborate on that?

And my second question also relates to costs and the electrodes. What is Gerdau's exposure to this market? We understand that you may not even have any position in the spot market, but anyway the annual contract should be reviewed upwards. So I just want to understand what we should expect in terms of 2018 for Gerdau?

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

Good afternoon, Thiago. This is Harley. Referring to metal spreads in the US, I think that, historically, metal spread has been very, very comprised [ph]. I mean it has been coming down, and it's been low due to the volume of exports that we've seen in the period. In our particular case, we know that in terms of market share recovery and that movement by the company since early this year, we had a slightly better performance of metal spreads. Today, we were able to see volumes picking up again, and we see that metal spreads in the industry has been about $50.

In the short run, I mean for the fourth quarter, just to answer your question, we don't anticipate any radical change. It should be still in the same level, but there might be a slight recovery but marginal recovery. So it will certainly depend on several factors, and it also has a lot to do with the recovery of the U.S. market as a whole.

Another relevant aspect concerning electrodes, and this is something that affects Gerdau as a whole. I think that the most important point is that our supply of electrodes is -- it's well-managed, and that's not a problem because we know that there is a concern because there are players in the market that have not yet solved this issue. So they may have difficulties to operate, but this is not our case. In our case, I mean, this is not an issue.

In terms of cost, it may affect, but it will affect the industry as a whole. There should be like -- in individual terms, it may be relevant. But our costs I mean is below 2%, and it is also mitigated by our Ouro Branco operation because it's integrated. So in terms of cost, it may affect a little bit, but we do not have the final numbers yet.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Harley, if you can, I mean going back to the initial question, and you said that the metal spreads will be stable with a slight recovery in the fourth quarter. But will that indicate a margin improvement, an improvement in the EBITDA margin or no?

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

I mean, Gerdau as a whole, not just North America?

Q - Thiago Lofiego {BIO 16359318 <GO>}

No. I'm referring to North America.

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

Okay, North America. The fourth quarter is complicated because of volumes, there's also the seasonality effect. And once again, we are putting great effort, a lot of our efforts in North America. The main focus there was to regain our volumes. So margins have always been affected by volume, so it's difficult to say anything at this time.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Thank you, Harley, very much.

Operator

Our next question is from Thiago Ojea from Citibank.

Q - Thiago Ojea {BIO 17363756 <GO>}

Thank you. Thank you for taking my question. Thank you, everyone. And Andre, congratulations, and I wish you all the best in your new position at the board. My first question relates to prices in Brazil this quarter. We noticed a significant increase in sales in the domestic market, but the average prices came down by 3%. So what's the cause of that? Was that related to mix? If you could elaborate on that, I would appreciate it. And what is the expectation for the fourth quarter? I think that most of the increases were at the end of the third quarter and more towards October. So can you give us some idea of prices for Brazil?

And secondly about cash generation, this was a very significant cash generation. And what is your visibility in terms of cash generation in the fourth quarter and also towards 2018?

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

Good afternoon, Thiago. This is Harley. To answer the first part of your question about prices, we know that the market focus on that drop. And this decrease that we can see in our number is that shipments per tonne. I mean we couldn't tie that to prices because there are many factors that affect that in the domestic market. We have such a mix that the difference by -- per product is very large. So the EBITDA of hot-rolled strip is one, rebar is another. So any change in the mix can cause changes in that net sales per tonne. And any price change that was mentioned in the market takes some time to be implemented.

So now going into the second part of your question, the fourth quarter should already reflect, in a larger scale, the higher prices that we are seeing in the domestic market, notwithstanding the fact that international prices or prices for exports in the fourth quarter are more favorable. So in the fourth quarter, we should have net sales per tonne improved. We should see an improvement in our net sales per tonne.

In terms of cash flow in the fourth quarter, we do a lot of efforts to maintain working capital. And so people try to optimize production. And we always manage to have a positive effect in terms of working capital. Our focus has been very, very much geared towards cash generation and working capital. So the long-term view is positive.

Q - Thiago Ojea {BIO 17363756 <GO>}

So if you allow me just to do a follow-up, in terms of your first answer on prices, could you give us an idea of what products you sold the most or you didn't sell as much that caused that net sales per tonne come down? Or if you could give us an idea of CapEx for next year. Thank you.

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

I think we'll take a rain check there because we cannot give you more details about that. We also have to look at export mix, et cetera. But about CapEx, we are precisely now looking at CapEx for the months ahead. So at the moment, I wouldn't be able to give you any estimate about CapEx, but we are already working on it. So maybe next time we meet again, I will probably have a figure to give you.

Q - Thiago Ojea {BIO 17363756 <GO>}

Thank you very much.

Operator

Your next question is from Leonardo Correa from Banco BTG Pactual.

Q - Leonardo Correa {BIO 16441222 <GO>}

Good afternoon, everyone. My first point is in relation to your mix. And more particularly, I want to learn more about your investment assets, or divestment assets. I would like to hear some about your projects. I know that many things are being analyzed currently. So if everything is on the table and the business do not post adequate returns to be divested and the company has been acting along these lines in the last few months, so I would just like to hear something related to the United States.

The US market has probably future potential, especially in view of a rebound in lower import. I mean, we see that the results or still insignificant, and so maybe we could consider that the rebound should take some time to occur, in view of this scenario, which is under pressure and maybe some areas are running below potential, how would you see -- how can you -- what do you see in terms of another relevant divestment coming forward in the US?

And the second point has to do with Special Steel, maybe one of the major highlights of the quarter. And I know it's difficult to map it because there are two very large operations being consolidated, one in Brazil and one in the US. But if you could tell me a little bit about how Gerdau is benefiting from this rebound in the automotive industry, particularly in Brazil, and if you could tell us something about future trends or whether you already exhausted your possibilities to increase margins. Part of that was due to the deconsolidation of Sidenor, but I just want to know whether you see any further room to grow EBITDA margin looking forward?

And now before I conclude, I would like to say to Andre congratulations for your new position. Good luck, and good luck to Werneck as well in -- when he faces new challenges. Thank you.

A - Andre Gerdau Johannpeter

Leonardo, this is Andre. Thank you for your kind words. And Thiago, thank you for your kind words and your wishes for success. Leonardo, I will start by answering the question on divestment. I mean, the press talks a lot about many things, and we do not comment on that. But I can talk about what we're doing, which is the asset optimization program that is already four years old. We recently announced the divestment in Chile, which is just awaiting for the approval from the local authority. And we are looking at other things. It could be the sale of a mill, the sale of another business or a joint venture.

But at the moment, we do not have anything to announce at this time because negotiations may take longer than expected. And along this time, maybe another opportunity arises. And looking at the improvement in the global landscape, there might be other opportunities along the lines. And as soon as we have something to announce, we will certainly do so. So currently, we do not have anything in particular to announce, but this is a program that will be continued.

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

Hi Leo, this is Harley. Now to answer the second part of your question on Special Steels, in fact, the Special Steels operation is running very well even not considering the fact that we deconsolidated one operation. The other three operations are going through a very good moment. We know that the automotive industry in these three operations is performing quite well with a lot of exports from Brazil. But in the US, the automotive industry and the oil and gas industry are performing well with good consumption levels.

And this is an operation that we often emphasize that demands great dedication. And this alone is something good because the company has to put a lot of effort and focus in the customers and products. And because of that, we can have better margins in this operation. And you know that it's in our results, in the last 12 months, 27% of our cash generation comes from this operation. And this compensates our pricing, I mean as we often say, we're a very diversified company. In the past, North America and Brazil were imbalanced. But today Special Steels is compensating for other areas of the company that are not performing that well.

Q - Leonardo Correa {BIO 16441222 <GO>}

It's clear. Thank you very much.

Operator

Next question is from Caio Ribeiro from JPMorgan.

Q - Caio Ribeiro {BIO 18420483 <GO>}

Good morning. I would also like to congratulate Andre, and good luck in your new position. My first question is about resolution 232 in the US. If you could please elaborate a little bit on that and also about timing, this will be very helpful? And secondly, I want to know about working capital. The cash conversion cycle is being reduced in the last semesters. Do you think that this could go down even further or it will be more stable? Thank you.

A - Andre Gerdau Johannpeter

Good afternoon, Caio. This is Andre. Thank you for your kind words. About 232, our expectation is that the outcome will be favorable to the industry. This was an initiative of the Trump administration, and the Commerce Department was supposed to run an analysis, and the expectation did not materialize because we thought that a report would be issued two months after that. And they just announced that this announcement will take longer. So until January, that is the deadline from the Department of Commerce to issue a report about that resolution. We hope to have a favorable opinion. And so we are just waiting to hear from our peers in the US about their own expectations.

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

Good afternoon, Caio. This is Harley. About working capital, we did a great effort to reduce working capital, both in terms of absolute value, reflecting a drop in shipments in the last few years, but more particularly, in terms of the cash conversion cycle. I mean this is something that is here to stay. It will be at levels that we consider very comfortable, which are the current levels. So below 80 days, 74, 75 is a very good level for this cash conversion cycle.

If we compare that to other companies in the industry, we have to take into account that we have a major advantage in Brazil because of our scrap purchase. This is a big advantage. But at the same time, we pay at tighter terms. And this also impacts our average cycle. But also we have benefits in terms of scrap cost. Therefore, I think the cash conversion cycle is at comfortable levels. There may be some additional reduction, but today, I would say that this would be just a marginal reduction.

Q - Caio Ribeiro {BIO 18420483 <GO>}

Thank you very much.

Operator

Next question from Marcos Assumpcao from Itau BBA.

Q - Marcos Assumpcao {BIO 7474402 <GO>}

Good afternoon, everyone. My first question is about the cost structure and CapEx of the company. In the quarter, CapEx was BRL170 million. And year-to-date, that will be about BRL800 million, and slightly below or very much below the guidance for the year and next year as well. But we also see other companies running at even lower CapEx levels, lower than what we thought they would be in the past. So in this effort to transform the company, do you believe that we could still keep the investment level even lower than what we expected?

My second question refers to the competitive environment. Could you please comment on the fact that last year at CSN's conference call, they said that the price for long steels to that company was higher. And it was up twice. And this shows probably a more favorable commercial environment. Their price is slightly lower than Gerdau's price because they are new entrants, but maybe they just try to catch up more recently, and this should probably alleviate some price pressure and, in turn, keep the market more favorable for future price increases. So could you please comment on new entrants and how they are behaving?

And finally, maybe a different question. You did an excellent work to deleverage the company in the past few years, your net debt according to my calculations is close to BRL13 billion after the divestment in Chile, we see the cash generation of the company being very strong, and it's becoming more recurrent. Financial expenses came down as well because you lowered your leverage level, and we also see some signs of demand recovery in Brazil, which is the operation that suffered the most in terms of EBITDA. So assuming that things will remain the same, don't you think that we are coming at the end of this divestment cycle of the company and maybe the company should start thinking about other growth projects looking forward? Because when we run our calculation, net debt over EBITDA, this may not be a major problem.

And finally, I would like to thank Andre for his support in the past few years. And I know that this is not an easy task to be a head of the company in the past 10 years where you have to face one of the most severe crises of the industry. And also, I wish Werneck the best of luck and a lot of success in his new endeavor.

A - Andre Gerdau Johannpeter

Thank you, Marcos, for your kind words. And Gustavo will take over as of January. So first part of your question about CapEx, we have to be careful not to annualize it because sometimes one quarter has a higher or lower investment depending on the project. And also, there is the impact of foreign exchange in Brazil and so on. Therefore, the third quarter, if we look at the numbers, we do not have a final figure. There may be some CapEx recovery in the last quarter, not very large, maybe not 1.3. But we do not have a firm figure today or a final figure. We will have it in February when Gustavo announces the results of the fourth quarter. But we are in this investment cycle already for a full year. When we look at heavy plate, that melt shop in Argentina probably was one of the last major investments.

So now our focus is mostly geared towards maintenance and technological advances that can bring about efficiency gains, and then the CapEx amount will probably reflect that. But we will only know the figures further on, and new technology is also part of our investment. As Spain left, there's a joint venture in Colombia, now Chile. And all of these divestments should impact our figures next year, and then we will announce that further in 2018.

Now about the competitive landscape and the current environment, not mentioning prices, what we see is that the global landscape is showing increase in demand globally. There is a cost pressure on raw materials, especially ore and scrap, and this has impacted global steel prices, which also reflect -- is reflected in the markets where we operate, Brazil and other markets. So when we spoke about other competitors, I wouldn't refer to Brazil alone, but around the world, we've seen an upward trend of prices.

So prices have been going up in the last 12, 18 months, and that was either due to higher demand or the fact that China is exporting 30% less than last year. So China is shutting down capacity. And all of that is leading to price sustainability at higher levels than in the past. And this affects markets, and Brazil is one of them.

About new entrants, I would just like to say that many new entrants already achieved their market share. They already achieved maturity. So the market doesn't have any strong impact from new entrants. We felt that before with hot-rolled strips and now long steels. We see now that in long steels, their production is already stable and their market share is already in place. So the market should be more stable in that regard.

Your third question about next steps, so we should expect further debt reduction, et cetera, and we're almost reaching our planned level. But there are still some things to be done to optimize assets. We have to improve our results or our net income. And I would say that our next steps will be announced by Gustavo and his team and together with us at the board, and we will start working on that as of next year to see what will be our next steps. We are still working on our asset management program. But once that is over, we will then start considering next steps.

Q - Marcos Assumpcao {BIO 7474402 <GO>}

Thank you. Thank you very much. Fine.

Operator

Next question is from Renan Criscio from Credit Suisse.

Q - Renan Criscio {BIO 18747357 <GO>}

Good afternoon, everyone, and thank you for taking my question. I also have to congratulate Andre for the excellent job in the past 10 years. I wish you luck in your next position, and I wish Gustavo Werneck, the best of luck. One of my question refers to South America. I think that with all the work you did in this division in the last quarter, we -- at least this quarter, we saw a very good level or a good margin when compared to the previous quarters. So with all of the divestments in Chile and also the Aco, what could we expect in terms of normalized margin?

And you also had divestments in Colombia and Chile, and you reduced your production capacity in that region. So the question is what is the strategy with the assets? Will you continue to keep focusing on that current portfolio or you will focus in a certain specific product? If you could speak a little bit about your strategy. On heavy plate, you also talked about the ramp-up of heavy plate. What about the utilization level at the rolling mill? And how do you see things performing in the fourth quarter. Also, if you could tell us how much you're selling in the domestic market, that would be greatly appreciated. Thank you.

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

Good afternoon, Renan. This is Harley. For the first part of your question about South America, I don't know whether you know but this quarter, Chile volumes are still in our figures. But your point is very relevant. We were able to maintain margins in South America above 10%, way above 10%. I would just like to remind you that three to four years ago, we were struggling to reach 10% margin because we were below that, only a single-digit number, so we did a lot of efforts to optimize the operation. And this is an operation that joined our divestment plan. And as in the case of Colombia, we believe that there are assets that will then have an adequate performance. The divestment in Argentina -- I mean, Argentina is a market that in a way has enough scrap to supply our new melt shop in Argentina. And the country is experiencing a good outlook. There should be a profitability improvement looking forward.

A - Andre Gerdau Johannpeter

Renan, this is Andre, and thank you for your best wishes, and I'll speak about heavy plate. We are still moving towards our learning curve. We are very pleased with the investment because the investment, due to the quality of products and market acceptance, the customers are proving us right that we made the right investment in technology. We also have a good support from JOC [ph], which is our technological partner, and this partnership has been reflected in the quality of the product. And so it's working according to plan.

About volumes, the market experienced a drop in overall consumption of steel in Brazil. So the rebound should occur in 2018 and 2019 when it comes to sales of heavy plate. We are also exporting into some markets, but to niche markets, and this is typical because of the quality of the product. So in general, this is the overall scenario of the heavy plate rolling mill.

Q - Renan Criscio {BIO 18747357 <GO>}

Thank you very much.

Operator

Next question is from Gabriela Cortes from Banco do Brasil.

Q - Gabriela Cortes

Good afternoon, and thank you for taking my question. Andre, congratulations for the 10 years. And it's always nice to wish good luck. But my question refers to the Brazil operation. Could you give us an outline of what you see coming ahead in the fourth quarter vis-a-vis costs? Because you said that your costs were impacted by increase in raw material costs, Thiago also mentioned that there was an increase in scrap prices. So if you could comment on that, I would appreciate it. Thank you.

A - Andre Gerdau Johannpeter

Hi Gabriela, and thank you for your good luck wishes. I would just generally comment on what we see coming forward in Brazil. What Brazil has left to recession behind it. We see that the industry is reacting, both automotive industry, windmill, -- I mean, wind farms, and so some segments of the industry are recovering. Civil construction is still slow. And we anticipate a better recovery next year when we will have a GDP at around 1%, 1.3%.

But now looking at the general figures of job generation in Brazil and drop in inflation and, as a consequence, drop in interest rates and better credit, we see some positive signs. So the fourth quarter is usually a weaker quarter, but we believe that exports will be maintained to offset for drops in the domestic market. So in the fourth quarter, we should see increases in exports, a drop in the domestic market. And at the moment, exports and also foreign exchange has an impact. So it's difficult to make a more precise comment.

Q - Gabriela Cortes

Thank you very much.

Operator

Next question is from the Gustavo Oliveira from SSR Investimentos [ph].

Q - Gustavo Oliveira {BIO 15129435 <GO>}

Good afternoon, Andre and Harley. First, I would like to congratulate Andre for your tenure at Gerdau and your next position. My question, is still on Brazil. At the end of the third quarter, in September, we saw scrap prices increasing substantially even more than the prices previously announced. I just want to understand whether in this third quarter, what was the mix or price pressure that affected the margin?

And for the fourth quarter, in addition to previously announced increases that you said it would take a while until it impacts prices, what would be the next price increases, maybe along the lines of what has been announced by CSN? And so what was the impact at the end of September and early October? Thank you.

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

Good afternoon, Gustavo. This is Harley. In fact, going back to my previous point, the effect of the margin in the quarter has more to do with the mix in the domestic market and export mix and also all of our management efforts. And this follows a historical trend throughout the year. There was a pressure. But obviously, the margins also reflect a slight improvement in the price environment. As I mentioned before, higher scale coming from better prices will be reflected in the fourth quarter. But in September, the scrap prices was something that was like a one-off situation, so we have to look at the trend. And once again, the trend is towards improvement in the foreign exchange for exports that will impact the domestic market.

Q - Gustavo Oliveira {BIO 15129435 <GO>}

Harley, if you allow me, just as a follow-up. Thinking in terms of the mix, is there anything to do with higher demand from the industry? Could we expect changes in this mix? Or do you think that it should be normalized throughout the next coming months? What will be the effect of this mix looking forward?

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

I think that once again, conceptually, the civil construction industry is still delayed in its recovery. Especially, in Brazil, we are working with the assumptions that there should be an improvement in GDP next year. And so -- and with the drop in interest rates, this would impact consumption. Therefore, the industry in general is recovering better than the civil construction.

To say anything about the fourth quarter, there's still a lot of factors that impact that mechanism. That's why it's difficult for me to say anything and to run a comparison from one quarter to the next. But there has been an increased recovery, whereas civil construction is still lagging behind. They still have a lot of inventory to sell, and then it takes some time until they show a firm recovery.

Q - Gustavo Oliveira {BIO 15129435 <GO>}

Okay. But the mix has to do with this segment that is growing more or not?

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

Yes, it does. Once again, as I said, within the industrial segment itself, we have products that are catered to the segment but at different levels. We sell to the industrial segment.

We sell iron rod, and we have many different products with different margins, and this also affects the mix. Once again, I reinstate the fact that from one quarter to the next, the net sales per tonne, I mean, in order to reconciliate that, we would have to get to many small details that, frankly, would make sense.

Q - Gustavo Oliveira {BIO 15129435 <GO>}

Thank you.

Operator

Next question from Carlos de Alba with Morgan Stanley.

A - Andre Gerdau Johannpeter

Thank you, Carlos. This is Andre. I will repeat the question that was in English. He asked about the North America market and the challenges that have been -- that, that market has faced reflected in the EBITDA per tonne and affected the margins. And he asked us to elaborate on some of the segments and products like rebars and others. And finally, he asked whether there is still some divestment to be done in the region of a product or a line.

So I will go back to the general consensus of the market. In fact, in North America, if we look at the long segment, it has been heavily impacted by metal spreads that is very low when compared to historical figures. And together with that, we have the utilization capacity of the industry in general. For long, it's about 60% to 65%. And together with that, we have a lot of imports coming in. And all of that impacts the market. There is growth in consumption. The market should go about 2% to 3%. But this does not really reflect in margins, which is along the lines of your question.

But with metal spreads at this level and a lot of imports and some products, that import level can be up to 25% to 30%, and that affects the margins. And certainly, we are not happy with the results. We have to be more efficient, and we've been working diligently to mitigate that problem. But the expectation is that if the market continues to grow as the Worldsteel industry predicts, we may have some recoveries up next year, and that will be due to a lot of internal effort but also the external market as well.

Now referring to the divestment, I am not going to comment on any particular region or a country, but we continue to optimize our assets globally. We still have some things that are moving forward like Chile that was recently announced. And as soon as we have any further announcements, you will hear about it.

Q - Carlos de Alba {BIO 15072819 <GO>}

Thank you.

Operator

Next question, in English, from Peter Krawczyk [ph] from Barclays.

Q - Peter Krawczyk

Hi, guys, thanks a lot for my questions. Can you please talk a little more about the North American segment? And I'm trying to understand the strategy of gaining market share at the expense of profitability. And I see your volumes are up, but EBITDA is down at 35% year-to-date. So I'm just trying a little bit to understand why you're focusing on the volumes here?

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

Peter -- just repeating Peter's question, his question has to do with our business environment in North America and the market share that we -- the issue of market share this year. This was something that happened in the first half of last year. We started seeing increased imports into the US of longs, and we tried to preserve prices rather than increase prices, and we did that to maintain market share. What happened is that the rest of the markets tried to preserve market share, so they went the opposite direction.

And then we lost volume in the first half of last year. Since then, we focused on recovering that lost volume, and we have to do some price concessions while, at the same time, the market had gone through pressures from the metal spreads. So we were successful in this initiative, and we recovered market share, but still -- the market is still very compressed. The average this year is around $350, $360, which is historically lower when you compare it to numbers from the seven, eight years prior to that.

Q - Peter Krawczyk

Got it. Thank you. And I guess switching to Brazil, can you please provide a little more color on the flat volumes? And in particular, we saw a 50% decline in the third quarter but your competitors in Brazil reports volume growth through the same period in a flat market. So I'm just trying to understand why was the market share -- is this due to the customer mix and maybe you're more focused doing product versus automotive customer? Just any color would be helpful.

A - Andre Gerdau Johannpeter

Hi Peter, this is Andre. I will just repeat your question. You asked about the flats market in Brazil and the development of this market that some competitors announced that consumption is coming down and whether that would reflect at market share and whether that would also be an opportunity to our company and if we could throw some color and talk a little bit about the flats market in Brazil.

Just to clarify, we have the production of hot-rolled strips that is operating according to plan. And so hot-rolled strips rolling mill is in a very good position, so we will keep our strategy, providing more commercial quality products. In the last few years, we've occupied that space, and we should maintain it.

Now when it comes to heavy plates, the market is different because the rolling mills started operating about a year ago. We are still moving in our curve, and we are using exports to offset the drop in the domestic market. But we are very pleased with our investments in the heavy plates, particularly because of the quality of the product and the good acceptance on the part of customers.

Now flats has been a better market when compared to longs. That's what the numbers show, especially because the recovery of the industry has been lower when compared to civil construction that is much lower. And the industry -- and an example is the automotive industry that posted a 7% increase in the sales of automobiles. And this has an impact in the flats market. So the recovery coming from flats is better when compared to the rebound coming from longs. So flats recovery is picking up better.

Q - Peter Krawczyk

Okay. Thank you so much. Best of luck.

Operator

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

A - Andre Gerdau Johannpeter

Thank you all very much. Thank you for your participation and interest, and thank you for your best wishes. And so Gustavo will be with you in our next call on February 28. And so thank you so much once again for your support and interest in Gerdau during all of these past years, and have a very good day.

Operator

Gerdau's earnings call is now concluded. Thank you very much for participating and have a very good afternoon.