

## Q2 2018 Earnings Call

### Company Participants

- Alberto Akikazu Ono, Finance and Investor Relations Vice-President
- Sergio Leite de Andrade, Chief Executive Officer

### Other Participants

- Caio Ribeiro, Analyst
- Carlos de Alba, Analyst
- Gabriela Cortez, Analyst
- Gustavo Allevato, Analyst
- Ivano Westin, Analyst
- Leonardo Correa, Analyst
- Marcos Assumpcao, Analyst
- Milton Sullyvan, Analyst
- Thiago Lofiego, Analyst

### Presentation

**Alberto Akikazu Ono** {BIO 20633628 <GO>}

(Starts Abruptly)

that is provision of taxes from Rio Grande do Sul and the EBITDA had a loss of BRL62 million.

This impact is observed in the steel mill. We will also see other effects and during the last line of net income, so here we had a loss of BRL19 million and we had profit of BRL157 million during the first quarter. In addition to this provision of taxes, we also have the exchange variation on our debt. We reported an exchange rate loss of BRL150 million, much higher than what was observed during the first quarter that was BRL25 million. These two effects of the provision plus the exchange rate variation affected the net profit, the net income that was negative. Without these effects, you could see that we would have had positive income like the first quarter.

Now I'll go to our next slide. Here we're specifically talking about steel volumes. Here you can observe that we were -- our pace was above 1 million tons per quarter since the second quarter of 2017. Unfortunately, with the impact of the strike of the truck drivers, although in our sales, our orders, we expected the level of sales during the second quarter would be similar to that of the first quarter of 2018. We weren't able to materialize this -- these results because of logistics. So with this, here you can see the -- there was a

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drop of 9%. And our level was below 1 million tons of (inaudible) that although we had a logistic problem for shipments. And for sales, we were able to maintain a production there for our gross steel production, although it increased. Here we see the resume of the blast furnace of Usiminas one in Ipatinga. And if you see the production of finished good, that was stable, that was something that we had predicted in terms of sales volume.

Now when we go to our next results. Here we have the EBITDA and the adjusted EBITDA margin for the steel business unit. Here you can see the effect of the ICMS of BRL62 million regarding EBITDA. And our EBITDA was reported in BRL471 million and without this, nonrecurring effect would be BRL530 million. And the margin instead of 16% would be 18%. Anyhow, we were able to maintain a pace above BRL 450 million that was something that we observed in average during the 4 past quarters.

Now our next slide. Here we are breaking out sales of iron ore. Here you can also see that mainly the volume of the second quarter in exports if we have more variations. So here we can see a drop of 37% in exports. Now in reality, what happened is one thing that we expected. One shipment that was delayed and will only be shipped in July. So the expectation would be that shipment would be 5 vessels, and only 4 vessels received shipment.

Now going here in the next slide, we have the mining business EBITDA. Once again, here we have a significant effect on volume when compared to the past quarter. And it went from BRL44 million to BRL33 million. This in terms of EBITDA.

Now when we talk about our steel unit, Solucoes Usiminas, the effect of the strike wasn't as significant. We could recover, in terms of shipment. So volumes, if you see, the volumes of shipment in Solucoes Usiminas was higher than that of the first quarter. This is a combination of greater volumes with better prices and we had a better result during this quarter, up BRL37 million, vis-a-vis BRL29 million in the first quarter. I would like to observe that Solucoes Usiminas had 4 quarters with ever-growing results.

On the other hand, our capital goods unit, Usiminas Mecanica, is still suffering because of the low level of investment in the country. This is where this unit generally performs. And in addition to this, during this quarter, we faced a problem. There was a problem of wagons and here we had a negative EBITDA of BRL20 million.

The upcoming slide is here. We're going to talk about the adjusted and consolidated EBITDA of the past quarters.

As Sergio just highlighted, here we have -- during the first semester, we have an average of almost BRL 600 million, when we have both quarters and the nonrecurring effect that is a caveat. Another point that also impacted us was working capital, because of the truck strike. With this increase of 22% of working capital that was around BRL 660 million, the increase of inventories was BRL524 million and this increase of working capital is due to the increase of level of inventories and this impacted, because we weren't able to ship the orders and send them to our customers.

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On our next slide, we are breaking out the steel inventories in tons and here you can also observe the matter that I just mentioned. Mainly here you can see that there was an increase of 81 million tons and we expect that during the third quarter, our levels will go back to normal. And there was an increase of slabs -- volume of slabs because all the chain is affected when you have an inventory accumulation. Our expectation is that this will be reverted during the upcoming quarters. So our expectation is in the upcoming quarters, our working capital will go back to normal level. So finally, this increase of working capital impacted our cash position. So our cash position suffered a drop. Last quarter, it was BRL1,563,000,000 versus BRL1,104,000,000. So this variation is due to the increase of working capital, and we expect to correct at the end of the next semester. Other effect of this quarter was the exchange rate variation on our debt. The increase of 3% of our growth debt quarter-on-quarter is explained by our debt that is in dollars.

And finally, our investments, CapEx. During this quarter, we were at a level very similar to that of the first quarter, BRL67 million, vis-a-vis BRL65 million, but we observed that during the upcoming quarters, we will have an acceleration in investment. And what we observe here is yearly CapEx of around BRL500 million that would be the correct level for our activities.

With this, I bring my presentation to an end, and we are at your disposal to entertain question.

## Questions And Answers

### Operator

Ladies and gentlemen, we will initiate our Q&A session. (Operator Instructions) We would like to remind you that this conference call is for investors and market analysts. Questions from journalists should be made to the press department of Usiminas through 31 3499-8988 or imprensa@usiminas.com. Our first question from Caio Ribeiro, JP Morgan.

### Q - Caio Ribeiro {BIO 18420483 <GO>}

Good morning to everyone and thank you very much for taking my question. I would like to understand today how you see strategic or a candidate for divestment? And what is the situation of allocating more capital to maintain the production at the current level during the next years? And the Cubatao blast furnace, because you're going to expand it to galvanized products, I would like to know what are the priorities and if you believe that it makes sense to approve one or the other.

### A - Alberto Akikazu Ono {BIO 20633628 <GO>}

This is Alberto. Regarding MUSA, all our assets are constantly being evaluated. So what we can say is that any novelty regarding these or other actions on our assets, you -- we will maintain the markets informed. Now regarding the Cubatao blast furnace and galvanized products, I believe it's the resumption of primary areas of Cubatao because we have a new line of galvanization. These are investments that are being assessed currently, are being studied, but for the time being, we haven't decided anything. In the

company, neither the board, neither the management hasn't said anything regarding timing and amount. This will take some time to mature.

**Q - Caio Ribeiro** {BIO 18420483 <GO>}

Could I also follow up regarding MUSA? If you could update regarding the CapEx that is necessary for this asset? Is there something else that you have to invest to maintain the production at the current level?

**A - Alberto Akikazu Ono** {BIO 20633628 <GO>}

CapEx -- we already announced this two weeks ago, we are investing, okay, in -- BRL170 million in dry fit [ph] because the weather was for mining industries are very complex matter. So we -- this has been announced. And I believe this is an investment that we will have for the upcoming years that is the most significant investment that would be dry piling.

**Operator**

Now, Thiago Lofiego, Bradesco BBI.

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

Good morning. One would be steel demand for the third quarter. What do you feel from your customers? What are your orders like for the third quarter? I would like to know if the third quarter could be better than the other quarters, because of the recovery of loss volumes during the second quarter. If you could talk about pricing? There has been recent increase in distribution. And I would also like to know if there is some initiative for the industries that weren't readjusted during the first semester. So what would you expect for your industry, from the industry buying large for the second semester?

**A - Alberto Akikazu Ono** {BIO 20633628 <GO>}

The Brazilian -- the steel Brazilian market is undergoing a very positive dynamic during the 5 first months, the growth have been around 11% for flat steel. But we believe that this growth has varied the expectations from the Brazilian economy and the steel markets are varying for the second semester. Now vis-a-vis, the behavior over the first semester, although there is a perspective of steel growth at a level of 5%, these are the last figures that we obtained, okay. Respectively, we believe that during the second semester, we will have a growth slightly above that over the first semester. Regarding prices, as you are aware, we informed an increase of 5% that will be applied throughout the third quarter of this year, this increase of price. And we believe that it will be materialized during the third quarter.

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

Yes, there is a bit of echo. It was very difficult to understand the first part of your answer. Could you talk about the potential of improvement during the second semester?

**A - Sergio Leite de Andrade** {BIO 6771322 <GO>}

Of course, we have the matter of seasonality. The audio isn't crystal clear, so it's difficult to understand and to listen to your answer. I will answer again. For the second semester, we expect a growth lower than what we had during the first semester of the year. With this prospect of growth of steel demand during the second semester, we believe that 2018, we will have a steel consumption in total Brazil that will be 5%. This would be the total result for the end of the year. We believe that our sales will follow up the growth of steel consumption in Brazil.

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

Okay. Thank you very much.

## Operator

Our next question is in English from Mr. Carlos De Alba, Morgan Stanley.

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

Yes. Good morning, or good afternoon, everyone. Could you repeat again what you mentioned on potential price hikes? There has been some confusion because I think the flat steel producers try to increase prices in May or early June or late May, early June and that was not implemented because of the strike. But then they announced again price increases in late July following a revision in late July or through August. Can you please clarify what the price increases have gone through in the second quarter or having announced in the second quarter and in the third quarter? And when those will be implemented, if everything goes well?

**A - Sergio Leite de Andrade** {BIO 6771322 <GO>}

Good afternoon, Carlos. During the second quarter, we increased our prices, but at the end of the year, Brazil suffered the effect of the strike and the market became a bit difficult to accept this increase. We announced this increase and we are implementing this increase throughout the third quarter of the year.

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

And that increase is 12%, 16%? Can you comment on the increase? And if you believe that it'll be implemented earlier in the third quarter or throughout the third quarter? Thank you.

**A - Sergio Leite de Andrade** {BIO 6771322 <GO>}

The price increase is around 10% for the distribution sector. As you know, we have different sectors. We have distribution sector, we have the automobile sector and industrial and civil construction sector. For distribution, this will be increased throughout the third quarter. For other sectors, it's going to depend on negotiation dynamics. Some of them have yearly negotiations naturally quarterly. And these increases will be implemented throughout the third quarter.

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

Thank you.

## Operator

Our next question from Leonardo Correa of BTG Pactual.

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

Good afternoon to everyone. Thank you for taking my question. The first point regarding the export market. This is a very important market to maintain. The results of the company when I see your breakout, there, it is highly concentrated and players like Argentina that is 35%, Germany 25%, other major European markets Spain, Belgium. Now before this scenario, with protections that are implemented in Europe and possible slowdown, we've seen the data from Argentina that are way below what was expected. There is also fear of recession because of Argentina. Would like to know from you what is your expectation in order to sustain the level of exports of Usiminas. And how the domestic market is going to ship forward?

And the second point here would be, Sergio during the last quarter have helped us to map the results one quarter ahead, giving us an equation of increase of price versus price of cost. So if you could help us to better understand what direction you're following. And how -- what is going to happen during the third quarter regarding the increase of price and cost? What I understood from this call, there is a 10% increase. We're now talking about 2 price increases and this would be only for distribution that -- and you're trying to implement this during the third quarter. I would just like you to clarify if my understanding is right.

### A - Alberto Akikazu Ono {BIO 20633628 <GO>}

Good afternoon, Leonardo. Regarding export, as you said, Argentina and Europe are our main markets. Now regarding Argentina, the main sector are the power sector and the automobile sector. For the time being, we haven't seen any difficulties to continue with our level of exports. Now Europe, Europe has presented two months of great uncertainty because the safeguard measures implemented by Europe. These measures were implemented by the end of June. Although we've had markets with a lot of uncertainty during the past two weeks, but now that the roads are clear, I believe that we will have additional exports, more than what we had during the past month.

Now regarding cost. Our expectation of the third quarter is an increase of cost. It's difficult to know right now because the exchange rate is being volatile. And today, part of our cost is affected by the exchange rate. Sometimes it's higher because of the purchase of slabs. So it's very difficult to know right now, but absolutely or certainly, the backlog will have an increase in price during the third quarter.

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

Okay. Now what about exports of Cubatao? There was an equation, the price of the slabs were too high, you reduced with the pace of export of Cubatao because this didn't make

sense. I would like to know if you've normalized the situation? And if you are exporting more from Cubatao?

**A - Sergio Leite de Andrade** {BIO 6771322 <GO>}

This was sort of like piggyback on my past question. Yes, as a matter of fact, due to the 232 measure imposed by the U.S., we had contracted markets to sell slabs. But we believe that the market is recovering at more healthy -- with more healthy results. I believe that we will be able to recover our exports at very reasonable levels.

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

Thank you very much.

**Operator**

Our next question from Ivano Westin, Credit Suisse.

**Q - Ivano Westin** {BIO 17552393 <GO>}

Good afternoon to everyone. Thank you for taking my question. Point number one is a follow-up on the consequence of the strike. Of course, volume and cost have already been commented. This had a reasonable impact on the second quarter. I would like you to tell me what you expect in terms of working capital for the third quarter? And my second question would be regarding CapEx. If you could please confirm what do you expect from the second semester? And if you could please confirm the CapEx?

**A - Sergio Leite de Andrade** {BIO 6771322 <GO>}

Now regarding our working capital, our expectation is that it will recover during the third quarter, that is around BRL3 million. And this is our view. We are going to have to see what is going to happen with the cost of raw material because this is part of our inventory and it also depends on the exchange rate of the dollar. Our expectation is the great part of this variation of working capital to be normalized during the third quarter. And CapEx where we still maintain our expectation of ending 2018 with around BRL580 million.

**Operator**

Next question from Marcos Assumpcao, Itau BBA.

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

Good afternoon. My first question, if you could elaborate on your capital goods unit to explain the performance of the EBITDA has dropped BRL50 million quarter-on-quarter, and this was due to the wagon result. If you could explain this better? Second question to Sergio, if you could elaborate on the strategy for the future for Usiminas? You said that during the past quarters until last year, the company was restructuring itself and generating positive results. Now you are generating cash, but there is still a perspective of important and necessary investment. How do you see Usiminas five years from now? How do you believe Usiminas is positioning itself for the future?

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## A - Sergio Leite de Andrade {BIO 6771322 <GO>}

Now when we talk about Usiminas Mecanica, we have observed the difficulties of the market for the past two years. We want to at least have a neutral result, and it has been difficult. The result of this quarter shows this, but the gap that we saw what happened during the first quarter is we ended a major project in the assembly sector. And after this project ended, we received a significant amount during the past semester. And this, of course, affected the result of Mecanica during the first quarter. First semester, well, this result, let's say this, there would be another top one digit. This would be the break-even point. Now when you see the second quarter, this is a negative effect that we suffered. Specifically in this wagon project, we incurred in cost higher than what we expected in our project. And this cost, that was higher than what was expected, will also be reflected during the third quarter, not in the same magnitude. But anyhow, as we have very low level of occupation that is 16%, 17% of capacity, any variation caused by cost or revenue variation, this affects the results of Mecanica. This is at the level of the operation that is very low. So any variation -- when -- this can happen when you end the project and now negatively was affected because of the wagons. Marcos, now regarding our effort, the team's effort of Usiminas for the upcoming five years and our last year and our vision last year, we became a normal company. And here we've resumed everything that a normal company has to do when it comes to strategy. So today, we already have a vision for the upcoming five years. In terms of what we have to do the next five years, presents a challenge. That -- and what is the challenge to improve our results?

So we operated on 2016 during the second semester of BRL300 million in EBITDA. 2017, we went up to BRL500 million. And this year, we're close to BRL 600 million in EBITDA. So there is a constant challenge to improve our EBITDA. And this is a challenge for the entire Usiminas team. Now we're improving our processes. The structural matter is something that we constantly see the increase of our sale is also another effort, not only the domestic, but the foreign market as well. Everything in this part of company is dynamic and we believe that Brazil although has undergone a catastrophic period in terms of economy during the past five years. These three years were one of the worst recessions that we had in our history. And I'm talking about '14 '15, '16 and '17, '18, very, very small growth, very, very -- way below what we need. But now we believe that our country will grow at higher levels, perhaps 2.5%, although it's not enough, perhaps we will grow at levels 5%. If we grow in the domestic market in Brazil, Usiminas will grow together. Our plans for the future are investments. We're analyzing a number of investments I would like to highlight. The new galvanization line. We're operating our three galvanized lines in full capacity. This is a point that we'll study. Another point that is the Cubatao primary areas. We are analyzing the primary areas of Cubatao. When we temporarily interrupted the operation in 2016, we knew that this was a temporary measure, but this was a decision of medium and long term. So nothing will happen in Cubatao before 2020. And it will depend on the Brazilian economy. This will depend on all the dynamic of the country, because we still don't know what is going to happen, because we're undergoing political uncertainty. Now Usiminas is prepared for the challenges. Next year, we have a 10 million ton finished product line. And what we are going to do is to occupy the installed capacity. So yes, we see the future with positive prospects. Now for the foreign market, we -- our prospect is that there will be protectionism, of course, unleashed by President Trump in the United States that unleashed the wave of protectionism in Europe. Only Brazil is against this worldwide trend. Although, we in the steel industry are in favor of free trade, Brazil is being a liberal country within protectionist world. These would be my comments.

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

Thank you very much.

## Operator

Next question from Gustavo Allevato, Santander.

**Q - Gustavo Allevato** {BIO 18933135 <GO>}

Good afternoon. I have two questions regarding demand. You talked about marginal acceleration of demand during the second semester. Which industry do you believe will drive this increase of demand? I would like to understand what is the comfortable level for the company for 2019.

**A - Sergio Leite de Andrade** {BIO 6771322 <GO>}

The sectors that drive the steel industry are construction, capital goods, household appliance and the automobile industries. They will have a lower growth during the second semester. Although there is growth, the growth will be lower than that of the first semester. Now regarding the level of leverage, we want to deleverage our company a bit more. The ideal level here would be, we're still assessing actually this. For this year, we expect to reduce the leverage level of the company. The intention is to delever the company a bit more.

## Operator

Next question from Gabriela Cortez, Banco do Brasil.

**Q - Gabriela Cortez** {BIO 18801371 <GO>}

I would like to know your comment regarding steel imports for the second semester. If you believe that there can be an increase? If there is a drop in the price of the dollar, you will maintain the same levels? I would like to understand how you see the situation. The input during the second quarter was 120,000 tons. What's the current situation?

**A - Sergio Leite de Andrade** {BIO 6771322 <GO>}

Levels of the local price, with uncertainty regarding the exchange rate dollar-real, we expect this level of import to be maintained throughout the year, calculating around 10%, 11% on the total consumption of steel in Brazil.

**Q - Gabriela Cortez** {BIO 18801371 <GO>}

Okay. Thank you very much.

## Operator

Next question from Milton Sullyvan, XP Gestao.

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**Q - Milton Sullyvan** {BIO 19085202 <GO>}

Good afternoon. Thank you for taking my question. I would like to -- here we'd like to compare the volumes. I would like to understand a certain point, the volumes -- volumes that were transferred for the upcoming quarter. I would like to confirm if I am right or when you aren't able to ship the product, you lose the sale? And I would like to know how you see the market share of Usiminas during the -- throughout this context because when we see the volumes of the quarter, it's -- according to the data that you have disclosed, it seems that this has increased and the domestic demand has dropped 1%. And this shows us that Usiminas lost market share and not that we have a bad market because of the strike.

**A - Sergio Leite de Andrade** {BIO 6771322 <GO>}

Regarding volumes, as I already mentioned, the volumes that were transferred from the second to the third quarter, yes, we have the orders. The problem was that we weren't able to ship them. So the volumes that are being transferred will be part of the third quarter. Now regarding the sales of the third quarter. As Miguel just stated, there is an expectation that the second semester will have a slowdown in growth when we compare to the first semester. So what the second semester is going to be like, we have to evaluate this more. But volume was transferred. This will be seen during the third quarter. And now, regarding market share, it is very difficult to make any type of analysis because to follow up market share, well, it is something difficult to do to have trustworthy figures. And I believe that the difficulty is -- it is difficult because some publications don't make sense. And we can't really say much about this matter.

**Q - Milton Sullyvan** {BIO 19085202 <GO>}

Thank you very much .

**Operator**

Our next question is in English from Carlos De Alba, Morgan Stanley.

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

Yeah. Thank you very much again. I just wanted to check what are the expectations regarding iron ore shipment in the third quarter and, clearly, there was one vessel that sailed onto July, were dispatched onto July. But do you have already a sense of the number of vessels that you expect to ship for exports of iron ore in the third quarter? And if there is any visibility for the fourth quarter, that will also help us.

**A - Sergio Leite de Andrade** {BIO 6771322 <GO>}

Our expectation is to meet the volumes, the 6.5 million tons. What does this mean? We're going to try to increase our sales. Now when we think about the vessel that we weren't able to ship last semester because of the strike of the truck drivers, this is our expectation, okay. The market for the time being is solid with no problems, and everything is going to depend on the mine production and also on our shipping system and international shipment that increased a lot in the past time. But this is our expectation.

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

Got it. Thank you.

## Operator

As we have no further questions, we bring our conference call to an end. If you have more further questions, our Investor Relations team is at your disposal. Thank you very much for your participation, and have an excellent day.

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