Q1 2012 Earnings Call

Company Participants

- Daniel Santos, Mining Director
- David Salama, Investor Relations Officer
- Luis Martinez, Commercial Director

Other Participants

- Aristotle Niguera, Analyst
- Caral Nakicik, Analyst
- Carlos De Alba, Analyst
- Jon Brandt, Analyst
- Leonardo Correa, Analyst
- Marcos Assumpcao, Analyst
- Rodrigo Ferraz, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. At this time, we would like to welcome everyone to CSN's First Quarter 2012 earnings conference call. Today we have with us the Company's executive officers.

We would like to inform you that this event is being recorded and all participants will be in listen-only mode during the Company's presentation. After the Company's remarks are over, there will be a question and answer session. At that time, further instructions will be given. (Operator Instructions)

We have a simultaneous webcast that may be accessed through CSN's Investor Relations website at www.csn.com.br/ir. The slide presentation may be downloaded from this website. Please feel free to flip through the slides during the conference call. There will be a replay service for this call on the website.

We would like to inform that due to the number of participants, the Company will answer only up to two questions per participant with no right to reply and therefore we kindly ask that all the questions are made at once as soon as the line is opened by the operator.

Before proceeding, let me mention that forward-looking statements are being made under the Safe Harbor of the Securities Litigation Reform Act of 1996. Forward-looking statements are based on the beliefs and assumptions of CSN Management and on information currently available to the Company. They involve risks, uncertainties and assumptions because they relate to future events and therefore depend on circumstances that may or may not occur in the future.

Investors should understand that general economic conditions, industry conditions, and other operating factors could also affect the future results of CSN and could cause results to differ materially from those expressed in such forward-looking statements.

Now I'll turn the conference over to Mr. David Salama, CSN's Investor Relations Officer, who will present the Company's operating and financial highlights for the period. You may now begin your conference, sir.

David Salama {BIO 17456021 <GO>}

Good morning, and thank you for participating in the CSN First Quarter earnings conference call. With me today in this presentation are the Company's officers.

We will begin on slide three which shows our consolidated results for the First Quarter 2012. Net revenue in the First Quarter reached BRL3.9 billion, a decrease of 7% compared to the net revenue reported in the First Quarter of last year, reflecting mainly more lower iron ore sales volume and as well as lower prices.

Gross profit in the quarter amounted to BRL1.1 billion, a reduction of 29% compared to the First Quarter 2011. EBITDA totaled BRL1.1 billion in the First Quarter, a decrease of 24% in relation to the last quarter of 2012. And the EBITDA margin in the First Quarter term reached 29%.

Let's go now to slide four which shows the EBITDA evolution. First quarter 2012 EBITDA of BRL1.1 billion presents a 24% decrease in relation to the Fourth Quarter of 2011 due to a reduction in iron ore sales, lower iron ore prices in the quarter, and an increase in the production costs in the steel and mining segments. These effects were partially offset by the increase in the steel sales, basically due to our decision in that in Germany the First Quarter, SWT, and also the reduction in selling and administrative expenses.

Let's move onto the next slide, number five. Here we have the net revenue and the EBITDA by segment. The mining segment accounted for 30% of net revenue and 60% of the consolidated EBITDA in the First Quarter 2012. On the other hand, the steel segment reached 6% of consolidated net revenue and 39% of EBITDA.

Let's move on to slide number 6. Here we would like to provide some details on the CSN acquisition in Germany. SWT was acquired at the end of January for EUR480 million, so CSN started to consolidate the results as of February. The company is a producer of steel profiles in Germany with over 200 types of products following international standards.

Production capacity is 1 million tonnes of products per year. SWT owns Rail Logistics which favors the distribution of products in Germany, Czech Republic and Poland markets. 70%

of the scrap comes from the ranges of 70 to 100 meters of our menu. It mainly operates in the following segments, industrial equipment, transport, and (inaudible) construction.

Let's move now to slide number 7, where we represent the steel segment results. Let's begin with the chart on the top left-hand side. In the First Quarter, steel sales totaled 1.3 million tonnes, an increase of 9% when compared to First Quarter 2011, basically due to our Germany sales.

Of this total, 79% was sold into domestic markets, 19% in overseas subsidiaries, and 2% was exported. The top right chart shows the steel segment net revenue which reached BRL2.4 billion, an increase of 2% in relation to the last quarter of '11, basically due to higher sales volume.

The two charts on the bottom show the EBITDA and the EBITDA margin. It's important to highlight that we had some pressures in our costs during the First Quarter of 2012 and that affected our results. Then during the conference, we are going to give you more details.

First quarter, the steel segment EBITDA reached BRL466 million, 60% lower than in the First Quarter of 2011 mainly due to an increase in production costs and a poorer sales mix in the quarter. This directly impacted the EBITDA margin which stood at 19%.

On the next slide, we have the same analysis for the mining segment. Let's begin once again with the top left chart. In the First Quarter 2012, iron ore sales of CSN and Namisa totaled 6.7 million tonnes, 17% lower in relation to the First Quarter 2011. The reduction in iron ore sales volume occurred due to the seasonal effects and the heavy rainfall in the southeast of Brazil in the First Quarter of 2012. It's important to highlight that besides sales to our clients, CSN consumed 1.5 million tonnes of iron ore in the First Quarter of 2012 which is not shown in this chart.

Moving on to the chart on the top right side, net revenue fell by 27% in the First Quarter totaling BRL1.2 billion, reflecting mainly the smaller sales volume and lower iron ore prices. Our average prices were $107 per tonne First Quarter of 2012 compared to $118 in the last quarter of 2011.

Now let's move to EBITDA on the bottom. The First Quarter EBITDA totaled BRL590 million, representing a reduction of 34% when compared with the Fourth Quarter of 2011 due to higher production costs in the quarter and lower sales prices. The EBITDA margin stood at 49% in the First Quarter of 2012.

Let's move now to slide number 9 where we have our net debt evolution. At the end of March, 2012, net debt totaled BRL14.3 billion, an increase of approximately BRL1.8 billion in relation to the net debt in the end of December. This was essentially due to the following factors.

First, the acquisition of our subsidiary in Germany, SWT, in the amount of BRL1.1 billion, CapEx of approximately BRL900 million, and third, BRL700 million for disbursement related to debt charges. On the other hand, CSN generated an EBITDA of BRL1.1 billion in the First Quarter of 2012.

Moving on to slide number 10, here we focus on net debt to EBITDA ratio. The net debt to EBITDA ratio reached 2.3 at the end of the First Quarter of 2012, considering the adjusted EBITDA of BRL6.1 billion in the last 12 months. The Company had a cash position of BRL14.1 billion at the end of First Quarter of 2012.

That brings me to the end of our presentation. We will move onto the Q and A session. Thank you very much.

Questions And Answers

Operator

(Operator Instructions) Caral Nakicik, Merrill Lynch.

Q - Caral Nakicik

Good afternoon, everyone. Thank you for the questions. I have two questions. The first one is to Martinez. You provided a positive outlook for the steel market in the coming months and mentioned a potential price increase of 5% to 10% in the Portuguese call. I was wondering if you could provide if you have any timing there, an idea of timing for this potential price increase. What will be the eventual trigger for this to happen?

And my second question is regarding general growth. You recently provided an update on that on the last quarter call. I just want to know which are the next steps in the mining development and if you have an updated CapEx for Namisa. Those are my questions. Thank you.

A - Luis Martinez {BIO 7187744 <GO>}

Hello, Caral. Good afternoon. This is Martinez speaking. Just to summarize very quickly what we are going to do here in Brazil regarding how to increase our margins, we have basically two equations. First of all is to reduce cost, and also we have to improve our price in Brazil. In terms of cost of raw materials as I mentioned during this morning, we are going to have better costs in terms of increased price, so we are going to have something like $490 US dollars per metric tonne against $550 for the First Quarter. So it's very positive and we believe that we are going to reduce something like 6% for now on until the end of this year.

In terms of imports, another (bear) scenario for you. 2010, 4 million a year, 2011, 2 million, and we are forecasting to have by the end of this year something very close to 1 million tonnes of imports. So for CSN, it's much more important because we have something like 40,000 to 50,000 metric tonnes to be recovered in terms of (coated) products. So it could be interesting for us in order to increase the price here in Brazil.

In terms of exchange, exchange rates, it's also favorable for us. 1.9 to 1.95 could keep all the economy at another level. In terms of premium, we are bringing over imported (inaudible) in Brazil. Currently we have it in hot rolled coils. So below negative or slightly negative. In terms of cold rollers, slightly positive. And for hot deep galvanized products, our premium is something like 5% to 7%.

So we are expecting, as I mentioned, taking into consideration all these variables, and also the competition in the local markets, we are considering to recover the price by the end of this quarter in a range of 5% to 7%.

And now Daniel Santos, our Mining Director, is going to answer your second question.

A - Daniel Santos {BIO 5990682 <GO>}

Yes, regarding the total CapEx for Namisa, considering 100% Namisa, we have put it at BRL8.4 billion and we give the same position we presented in the last call. That's simple. 100% Namisa.

Operator

Carlos De Alba, Morgan Stanley.

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

Thank you very much. Could you also talk a little bit about how your iron ore shipments moved in March and early Second Quarter? Have you been able to speed up the production at the mine? And also (inaudible) after the rain? And second, if you can give us a very quick update as to how you're seeing your production ramp up this year and should be ramp up this year and next year. Thank you.

A - David Salama {BIO 17456021 <GO>}

Okay, Carlos. Regarding the performance of this year, in the First Quarter we are really effected by the rains as our peers as well in the region. And we implemented the necessary actions to recover our production and some extra actions to supplement part of the production in order to recover losses that we had in the First Quarter. We will see the result of these actions after this rainy season in our results in this month. We started this the month of May very well. We are recovering our performance and we are confident that we will deliver the expected production through the end of the year.

Regarding the ramp up, the shipment, we gave our estimates and we are pushing very hard to deliver the capacity at the port of 45 million tonnes to the end of this year, so we start up the utilization of this capacity in the beginning of next year. Our production, our delivery at the port last year was 30 million tonnes in round numbers. We already have 32 million tonnes of capacity now and we have all the conditions to deliver 45 million in the last quarter of this year.

Operator

Jon Brandt, HSBC.

Q - Jon Brandt {BIO 5506998 <GO>}

Hi. Good afternoon. Thank you for taking my questions. I just wanted to ask you about your debt levels. They've been coming up a little bit and I think on the Fourth Quarter call you said you had expected to max out at a net debt to EBITDA level of around 3 times. But that wasn't for a few years. Now you're up in 2.3 to 2.4 times. Could you just talk a little bit about that? Should we expect that level to fall throughout the year as EBITDA generation hopefully improves with the iron ore production and prices?

And my second question relates to the German steel assets. If you could talk a little bit about how the steel EBITDA margin was affected by the German steel assets, if you could give us sort of an indication what EBITDA level was in terms of those assets in the First Quarter, that would be much appreciated. Thank you.

A - David Salama {BIO 17456021 <GO>}

I'm going to start answering your First Quarter, Jon. First of all, in terms of net debt, you know that we are stating now a moment when we are going to have huge investments when we are investing in our mining expansion. It's the main project today inside the company. We have important investment coming in the next coming quarters. It's important to highlight that we have other investments also in terms of steel and cement.

But you are correct that we expect a better EBITDA generation in the next coming quarters and that is going to improve and to increment and in some ways our expectation is going to help us to maintain our ratio in comfortable level. Now I am going to ask Martinez to answer your second question.

A - Luis Martinez {BIO 7187744 <GO>}

Hello, Jon. Regarding to our German operations, first of all we are very surprised with the steel operation in terms of results. This operation is strategically located almost in the middle of Germany and we are able to supply Belgium, Denmark, Czech Republic, Switzerland, also in Poland. So we are supplying all the countries in Europe that is a better fit compared with other countries. So we are taking advantage of growth in these countries, especially in Germany.

And when we acquired the operation, the EBITDA was in the level of 9%, excuse me, 6%. Now in the First Quarter we achieved 9% and we are planning to achieve 15% increasing volumes so we are producing a level of 800,000 metric tonnes a year. We are going to jump to 1 million tonnes second half next year. And probably we are going to deliver something like 70, 7-0 million to 80, 8-0 million Euros of EBITDA margin net year. This is our forecast.

Probably this year we are going to ship a little bit less than this, but we are quite positive that we are going to achieve the results since the operation is outstanding, very well managed, low costs, many, many -- very effective in terms of man hour and manpower, and that's it. Thank you.

Operator

(Operator Instructions) Rodrigo Ferraz, Deutsche Bank.

Q - Rodrigo Ferraz {BIO 15155138 <GO>}

Yes. Good afternoon. I have two follow up questions from the morning call. First, if you can talk a little bit regarding the potential let's say de-consolidation of (inaudible). I do remember seeing in the past that eventually there would be some sort of arrangements to take (inaudible) debt out of CSN benefit. So that's my first question.

And my second question is regarding iron ore supply in Brazil. We are expecting to see next year in the next quarter to commence operations, and my question is if you see any risk of the mass price of iron ore increasing and what are your plans to buy iron ore in the mass markets in the years ahead? Thank you very much.

A - David Salama {BIO 17456021 <GO>}

Thank you, Rodrigo for your two questions. I'm going to answer the first one related to (inaudible). Yes. It's one of the possibilities that we have, but until this moment we don't have a concrete any development on this side. But this is a possibility that we are analyzing. Now I am going to ask Daniel to answer the second question.

A - Daniel Santos {BIO 5990682 <GO>}

Hi, Rodrigo. That's a pretty important element in our strategy in the mass market because part of the Namisa production is coming from the acquisition of third party iron ore in the local market. And since we started Namisa, we play it as a very important iron ore buyer in the local. When I mean local I mean in the area of iron ore (jungle).

Last year we bought a significant amount of iron ore, about 7 million tonnes, and we had the opportunity to establish some long term contracts with some of the suppliers. And this year we started the First Quarter with a very strong initiative in terms of increasing this number. And we had, so far we are succeeding with that. We are increasing our number in terms of long term contracts. So despite to have a new competitor in a few months operating there, we are supported by these long term agreements we had with the local suppliers in the iron ore (inaudible).

Operator

Marcos Assumpcao, Itau BBA.

Q - Marcos Assumpcao {BIO 7474402 <GO>}

Good afternoon, everybody. My first question is regarding the net debt to EBITDA ratio of CSN which is 2.4 times this quarter. Do you see this level as comfortable? And how do you see that evolving going forward? And my second question is also regarding capital structure of CSN. How do you see also that in the future? Do you expect to continue maintaining a high debt position? And also quite large cash amount as well?

A - David Salama {BIO 17456021 <GO>}

Marcos, I'm going to answer your question. First of all, we are starting a moment inside the company when again, we are going to have huge investments coming. In the mining side, in the iron ore, in terms of spend, in terms of logistics. And we are now prepared really to use part of this cash really to finance most of the investments that we have in the pipeline. That means that in some ways we are going to see this level of ratio in terms of net debt to EBITDA.

But in the same time, we are going to start to see also an increase in terms of investment at the same time and cash generation. In some ways that means that we are peaking in terms of our investment and it's natural to see this ratio increasing a little bit. But nothing fancy, so something that we believe is manageable and under control.

Operator

Aristotle Niguera, Flow.

Q - Aristotle Niguera

Good afternoon. Thanks for the call. My first question relates to the fiscal war in the ports. We may see the entry off the PRS72 in January 2013. I would like to know what is our expectation regarding the impact on the management of CSN both in terms of price and volumes (inaudible). And also if you think there may be some importers trying to take advantage of the incentives prior to then causing a temporary rise in imports. That's my first question.

And my second question is regarding dividend policy. What do you expect going forward seeing that the company has a significant CapEx spend. How should that work in the short and mid term? Thank you.

A - David Salama {BIO 17456021 <GO>}

Can you repeat again please some of your question?

Q - Aristotle Niguera

The first one is related to the fiscal war in the ports, about the PRS72 that will start in January 2013. By questions is about what are the impacts you are expecting for CSN in terms of price and volumes. And if you imagine that we can see some importers trying to take advantage of the incentives prior to then of these incentives causing a temporary rise in the imports? That's the first one.

And the second is about dividend policy, if we can expect any change in dividend policies given the CapEx spend that should rise in the short term?

A - David Salama {BIO 17456021 <GO>}

Martinez is going to answer the first question and I'm going to answer the second one.

A - Luis Martinez {BIO 7187744 <GO>}

Hello, Aristotle. Regarding to imports, take into account the current situation in terms of exchange rate and prices, not only in US but also in other countries like China. It doesn't work to import finished goods still here in Brazil right now. So even considering the board's incentives, now as I mentioned during this morning, we have negative premium over imported (leaden) material here in Brazil. So I believe that we are going to recover at least 100,000 metric tonnes a month. We are going to recover these volumes to Brazil and CSN will take advantage of these volumes due to the 30% or 40% of this is volume related to coated products. So we are going to catch up these volumes to our portfolio.

And regarding to pricing, it's not so easy and we are not so -- we are not only taking into consideration these imports, but we have to take into account markets and supply demands and competitiveness of the whole chain. But we believe that we are able to increase by June the prices in the range of 5% to 10% depending on the product. More in terms of hot (bends) and a little bit less in terms of hot deep galvanized products.

A - David Salama {BIO 17456021 <GO>}

Related to your second question, in terms of dividends, our policy is very clearly in terms to maximize each and every year the returns to our shareholders. In this way, that continues to be our strategy, But it's important to highlight that we are going to have important investments in this same time and we believe it's possible to continue doing both things in terms to implement all the investment that we have in the pipeline and also in terms to pay a reasonable dividend.

Operator

Leonardo Correa, Barclays.

Q - Leonardo Correa {BIO 16441222 <GO>}

Hi. Good afternoon gentlemen. Thank you. Martinez, this question is for you. And sorry to return to the same topic of domestic prices, but I just wanted to balance out some factors. On one had we have the currency, we also have import parody which is favorable. On the other had we have a domestic environment from the competitive standpoint which is maybe intensifying. We have (Real de Minas) who is potentially coming with a new strategy, and as you mentioned during the call, exports at this stage even with the currency at more depreciated levels are still not that attractive. So when we balance out all those factors and incorporate in the effect of potentially a very slow industry with a gradual recovery, when I look at what you said on the import parody, the numbers, right, so hot rolled coil products would be at a slight discount, cold rolled coil would be at a slight premium, and galvanized products would be at close to 5%, 7% premium.

When I incorporate all those numbers, would it be fair to interpret that as some isolated price increases in certain product lines? Would it also be reasonable to incorporate no price increases for galvanized products specifically given how wide the current premium is? So just if you can, and feel free to do it very briefly, but just explain on exactly what you mean by 5% to 7% price increases and if we should expect this to be a broad based increase or something more isolated. That's my first question.

The second question is for Daniel regarding potentially participating in a competing (Porto de Minas). In the past we've already seen CSN talk about potentially bidding for (inaudible). So I just wanted to understand if this is something that's still part of your agenda and if you have any developments on that side. Thank you very much.

A - Luis Martinez {BIO 7187744 <GO>}

Hi, Leonardo, thanks for your questions. I would like to mention that it's not only a matter of price increasing. According to your report this morning, we have also to recover our product mix in terms of, as you mentioned in your report, in terms of galvanized (tin) plates. We are something like 13% below our estimates. So we have to catch up the growth of galvanized products in Brazil to recover tin plates. And we are forecasting to increase all the products, galvanized products, hot rolled, and cold rolled products. We are not taking into account the possibility of having isolated price increase. There is no room to do this. We can recover prices in all the segments no matter what it is.

A - Daniel Santos {BIO 5990682 <GO>}

Leonardo, it's Daniel. Regarding Porto de Minas, it's in our radar and when the concession process starts up we will be prepared to analyze and to check how will be the best way to participate in it if we decide to participate.

Operator

This concludes the question and answer session. I will turn the conference over to David Salama for closing remarks.

A - David Salama {BIO 17456021 <GO>}

I would like to thanks everyone for participation in this conference call. Our IR team is available to answer any questions you may have. Good afternoon.

Operator

Thank you. This concludes today's CSN First Quarter 2012 earnings conference call. You may disconnect your lines at this time.