Q1 2009 Earnings Call

Company Participants

- Andre Gerdau Johannpeter, President & CEO
- Osvaldo Schirmer, CFO & Director
- Unidentified Speaker, Unknown

Other Participants

- Carlos de Alba, Analyst
- Marcos Assumpcao, Analyst
- Rafael Bidderman, Analyst
- Rodolfo de Angele, Analyst
- Unidentified Participant, Analyst

Presentation

Operator

Good afternoon. Welcome to the Gerdau First Quarter of 2009 earnings conference call. Right now, all participants are in listen-only mode. And later on we will start our Q&A session. (Operator Instructions). We would like to stress that statements that might be made during this call related to the business outlook of Gerdau, projections and operating and financial targets, are beliefs on the part of Gerdau's management based on -- regarding the future of the Company. Although Gerdau believes that remarks to be made are based on reasonable assumptions there is no guarantee that future events will not affect this evaluation today.

With us, we have Mr. Andre Gerdau Johannpeter, President and CEO, and Osvaldo Schirmer, CFO and IRO, as well.

Now, I would now like to give the floor to Mr. Andre Gerdau Johannpeter. Mr. Johannpeter, you have the floor.

Andre Gerdau Johannpeter

Thank you very much. Good afternoon, to all of you. Welcome to our First Quarter of 2009 earnings conference call. As we always do, we shall start with an analysis of our operating performance during this period and we will talk about the outlook for the markets in which we operate. Later on Osvaldo Schirmer will give you detailed information about our financial performance. And soon after that we will be available to you in order to answer questions.

For those of you who are following us on the Internet, I would like to start by page number two, the major figures of Gerdau. In the disclosure of our 2008 earnings conference call, we had said that we had two years in one, and that 2009 had already started earlier, because of the drop in demand that it seemed to last long, which in fact was exactly what happened.

New levels for the market are being established and they are significantly lower than the levels that we had until October 2008. Therefore, the comparison that we will make is always between the performance of the First Quarter of '09 vis-a-vis the Fourth Quarter of '08 because these two periods belong to the same world economic scenario, so the comparison will be easier this way.

We were able to adapt ourselves fairly quickly to this new market reality impacted by the lower demands, and this capacity to adapt very swiftly is due to the flexibility of our operations, mainly many new units and we have ferrous scrap as a raw material and we have the dedication of our collaborators, which were fundamental in this difficult moment.

The very quick mobilization of our teams allowed Gerdau to make the necessary adjustments, and of course, reductions necessary vis-a-vis the new market reality, and in a very short time. Besides even with the uncertainties in the world economy, our teams were able to maintain a very positive climate in their work environment and all our operations in all countries.

As an example, we have increased our cash 5.8 -- BRL5.8 billion as of late March and we decreased our working capital 25% participation of fixed cost in our total production, and the production cost was reduced by BRL1.8 billion, which meant 38% reduction in the costs.

And this management effort will have a positive bearing on our costs during the next quarters and that will no longer be impacted by the high inventories kept in order to face the high levels of consumptions that were seen until October 2008. And in spite of the significant reduction in the world demand for steel, we have some signs of improvement in the markets in which we operate such as consolidated shipments in March in 2009 were 21% higher than the volume sold in December 2008, which in our evaluation was the worst month during the crisis.

Now, I would like to convey to you some of the major figures of our performance during this quarter. Steel production 2.5 million tonnes, a reduction of 22%; shipment 3.1 million tonnes, a decrease of 13%; net revenue, BRL7 billion, 26% percent lower; our net income BRL35 million, a reduction of 89% and investments in the period $242 million, which will be used for continuing the projects that were started in 2008.

Now, I would like to talk about the world market for steel, where the production of steel reached 264 million tonnes during the First Quarter, with a reduction of 10% vis-a-vis the Fourth Quarter of 2008, and undoubtedly due to the very high drop in demand for steel. And net of China, the reduction is even higher, 26%. However, we already see a gradual recovery in the overall production in the world, which grew 12% compared to March and December of 2008.

And now, I would like to talk about production in China, which differently from other countries, increased by 15% as compared to the Fourth Quarter of '08. And with this production, it accounted for 48% of the world's steel production.

Now, looking to the future, according to the data by World Steel Association, the apparent consumption of steel will have a reduction of 15% in 2009, reaching approximately 1 billion tonnes. And if we exclude China this reduction will be even higher, reaching 20%. And the World Steel Association estimate is that the global demand for steel will be more stabilized around the end of 2009 with a slight recovery in 2010.

Now, I would like to talk specifically about each one of our operations, starting with Brazil, where according to the Central Bank estimates the drop in the GDP was 1.5% but this is still to be confirmed. Besides Brazilian -- production closed the First Quarter with a reduction of 14.7% vis-a-vis the same period last year. Then the comparison between February and March, 0.7% growth. This was reflected in steel production, 5 million tonnes, a reduction of 27% vis-a-vis the Fourth Quarter of '08.

And the apparent consumption of long steel reached 1.6 million tonnes during the First Quarter with a drop of 25% vis-a-vis the Fourth Quarter. And sales by Gerdau operations in Brazil both domestic and in the foreign markets reached 1.1 million tonnes with a reduction of 13%. The internal market, because of the reduction in the activities of the industry and due to construction as well had a drop in shipments of 27%, going down to 721,000 tonnes.

However, when we compare March to December we see an evolution of 12% in shipments. We should stress exports now that partially offset this drop in sales in the domestic market and although their profitability is lower, it offset the volume and grew by 38%, reaching 375,000 tonnes. If we consider the outlook for Brazil's future, certainly we are still living in a period of uncertainties regarding the evolution of the Brazilian economy due to the consequences of the world crisis.

However, the good management of the economic policy shall give us some sustainability or improvement in the Brazilian market over the year. The IBS believes there will be a slow recovery starting during the Third Quarter, of course depending on the implementation of the support measures to the industry by the government and also consumption.

We should stress the reduction of the IPIs for cars and for whiteline as well as the housing plan, which is called My House My Life, and the housing plan shall generate a demand of up to 1 million tonnes of steel during a three; to five-year period considering a consumption on average of 15 kilos of steel per square meter in the construction of houses, popular houses and apartments together with the reduction of the IPI for civil construction projects that encompass some segments of the Gerdau product line.

This will have a positive impact on -- during the second half of 2009 together with the PSD rates [ph] to increase the sales of our products.

Now, let's talk about specialty steel. I would like to remind you that our operation is made up by Acos Especiais Piratini and Acos Villares in Brazil, MACSTEEL in the United States and Sidenor in Spain.

The Brazilian market, I had already talked about the reduction of the IPI which rose about 12% in the production of cars in -- during the Third Quarter -- First Quarter of '09 vis-a-vis the Fourth Quarter of '08 according to Ampavia [ph] in the segment where there was an increase of 12%. There are included light vehicles, trucks and buses. Regarding agricultural machinery a reduction of 32% compared to the Fourth Quarter of '08, in the North American market, a drop of 36% in the production of auto vehicles vis-a-vis the Fourth Quarter of '08.

However, the production of cars, vehicles in general, showed some recovery in February; 405,000 units were produced and in March 479,000 units. The European market was driven by government measures similarly to Brazil with the reduction of the IPI and there were incentives mainly in Germany. And licensing of light vehicles in March grew by 16% during the First Quarter of '09 vis-a-vis the Fourth Quarter of '08.

However, in the commercial vehicles from 3.5 to 16 tonnes weight in the European market there was a drop of 25% during the same period, and in Spain specifically there was a reduction of 7% in licensing of light vehicles and 31% in commercial vehicles, the heavier vehicles, in a comparison with the Fourth Quarter of '08.

And our sales in the specialty steels reached 398,000 tonnes with a drop of 32%. And in Brazil, like some other countries such as Spain and the US, what we see is that there are still inventories in the network. And in Brazil, this is being consumed by auto parts and vehicles as well, both auto parts and vehicles and we see some signs that this is going to have a slight recovery.

Talking about the outlook for the Brazilian automotive market, what we expect is that with the extension of fiscal incentives and the reduction of IPI, this will be sustained and as a consequence it will go back to production increase, and the inventory levels are already close to historical levels in the US and European markets. What we expect is a slow recovery of production and also expecting to have some incentives from the government similarly to what was announced by the United States still due to be approved by Congress, which is an incentive for renewal of the fleet and replacing them for more economical vehicles.

And we should mention our strategy as well, which is a diversification of markets, not only automotive but also looking for other markets such as energy, naval and infrastructure. And we should also tell about the energy market the example of Brazil, where our teams are working together with the technical people of Petrobras for the development of specialty steel that will be used in the exploitation of oil in the pre-salt level.

And there are adverse conditions in this kind of environment, very high pressures and very corrosive environment, and certainly they will require a lot from Gerdau's technological teams and involving also our technicians both from Spain and from the United States, from our development center in Spain as well.

And we believe that in the short run Spain and the United States will still continue to feel the effect of the crisis but the results will be offset by the development of Brazil.

Now, talking about our North American operation, where production by Canada and the United States reached 14 million tonnes with a reduction of 22% vis-a-vis the Fourth Quarter of '08. And this lower demand for steel in North America led to pressure on production, sales and prices of Gerdau Ameristeel.

In this the scenario the Company continues its initiatives regarding increasing productivity and many cost reduction which we had already started in September 2008. And what we see is that, for instance, in steel distributors, the service centers and although we have reduced steel volumes, the inventories are going down. And in March the inventory levels in the service centers went down to three months and it was 3.3 months, getting close to the historical levels, which is something positive.

Sales by Gerdau Ameristeel, 1.1 million tonnes during the First Quarter, 11% lower than the Fourth Quarter of '08. However, if we consider March and compare it to December, we see that sales increased by 10%, which shows that December was our worst month in terms of sales and now it starts to improve gradually month by month.

And looking to the future, of course, the measures taken by the US government with support to the financial systems will give support to the stabilization process in the credit markets, and also the stimulus packages will really lead the economy to a recovery. And the effect of many of these initiatives, especially investments in infrastructure, should be observed after the second half of 2009 and over 2010.

And we should stress in this area one of the programs, which is called Build America Bonds that tries to encourage investments, additional investments in infrastructure by local and state governments by means of bond issuance. And these contributions together with the recovery of trust on the part of US consumers will gradually reflect on an increase on the demand for steel.

Just to give you an idea, in the United States there is a deficit of $2.2 trillion in infrastructure and undoubtedly Gerdau Ameristeel is very well positioned in the market with a whole line of products and also to grasp [ph] a coverage in order to be able to participate in this renewal of all the infrastructure which is necessary in North America.

Now, I would like to talk about Latin America. Of course, economies were affected in Latin America as well and there was a slowdown at the beginning of 2009 but not as much as other regions in the world.

There was a decrease in exports from the region because of a reduction in international demand and also credit restrictions in the financial system, and of course this had consequences on consumption in Latin America. Production in the region, Brazil excluded, reached 5.1 million tonnes and this meant a drop of 26% vis-a-vis the Fourth Quarter of '08. And sales by Gerdau reached 487,000 tonnes during the first three months of the year and they were 10% higher than the Fourth Quarter of '08, which already shows a slight recovery for the region.

And looking ahead, our estimates show that a slow recovery is already being achieved. And although there is a poor external market most of the governments in the region are making investments in infrastructure, which should increase demand for steel in the domestic markets in the several countries of Latin America where we have a presence.

And to conclude I would like to tell you that we undoubtedly continue to work very strongly in order to adapt ourselves to this new market reality and we try to meet the needs of our clients in an efficient manner and this way we will continue to work strongly in order to generate cash and keep our liquidity. Undoubtedly, we are able to cope with these challenges because of the lower demand for steel. We are flexible, we are agile because of our business model. And undoubtedly, we have 100-year-old experience in order to cope with this situation.

Fortunately, we already see some signs of improvement in the market but because of this period of uncertainty we will certainly continue to monitor the evolution of demand in order to track the market very closely.

And due to the strong work that we are doing to reduce our cost and due to the signs of improvements in the market we believe that Gerdau's performance in our next quarter will be better and this will be seen later on.

And now Schirmer will be talking about the financial and operating performance for the quarter and then we will open for questions. Thank you very much.

Osvaldo Schirmer {BIO 1754610 <GO>}

(Technical difficulty) that we were -- also were affected by what happened in the last five, six months. Particularly in terms of fixed cost, we had to make some adjustments to adapt them to the new demand standards. The model of the productive process of Gerdau is focused on mini-mills. About three-fourth of our production are based on mini-mills, which allows us to have more flexibility and be more agile in terms of adapting ourselves to the new standards of demands.

With that we were able to maintain our fixed costs in a historical level of approximately 25%, which gives us a lot of flexibility despite the strong drop in productivity. So fixed costs account for about 25% of the cost. As a result of all of the measures that were implemented fixed costs of production without depreciation were also reduced by 25% in the Fourth Quarter vis-a-vis the First Quarter of this year, mainly those related to maintenance, outsourced personnel, and consulting services.

The depreciation in the period was also reduced by 14% due to the replacement of equipment and also some maintenance items. In total considering fixed and variable costs, we experienced a reduction of BRL1.8 billion in total production costs of which 73% were variable costs.

It is also important to highlight that inventory that we carried over in the previous months did not allow us to capture the totality of the reduction of those single [ph] costs which should take place in the quarters to follow.

Slide number 10. Now let's talk a little bit about liquidity and the cash position of the Company during that period. It is also important to mention that the cash position of the Company is very robust, and the numbers and the figures for the end of March will already speak to that end [ph]. The availability of cash or a cash-to-cash equivalent was like $2.6 billion or $2.5 billion on March 31st.

And this is higher in about BRL300 million when compared to our position by the end of December. Out of that total, 47% was invested in reais and 50% invested by companies abroad.

On line with the financial strategy followed by the Company, we are still preserving liquidity and at the same time we are investing in a more conservative fashion. Important initiatives to capture resources throughout the year of 2008 allow us to balance our capital structure, while at the same time we were reinforcing our liquidity position. Both aspects are very important in such a challenging time that we are facing now.

Some of these initiatives are worth mentioning. We had an equity offering for Metalurgica Gerdau S.A. and Gerdau S.A. which was able to raise BRL2.8 billion. We also reopened our 10-year bond with $0.5 million and we had a term loan of $400 million long-term.

We also took specific actions to preserve our cash, such as postponing some investments. We've reallocated them or we've canceled [ph] them. We also optimized our working capital in the First Quarter, which allowed us to experience a reduction of BRL1.7 billion, which were allocated in that account [ph]. This cash position once we add that to the committed credit lines gives Gerdau a liquidity of about BRL8 billion.

Now, slide number 11. Indebtedness and ratios. The gross debt on March 31st was BRL21 billion or $9.6 billion in March of '09. 16% of that was short-term and 84% was long-term. The amortization schedule for the year, which was around BRL3.4 billion is being severely followed [ph] with the generation of cash coming from the operation.

For the rest of the year the Company intends to stick to its amortization program without causing any harm to our current liquidity level and without increasing the indebtedness level. In the First Quarter of '09, we were also able to reduce our gross debt by BRL1.1 billion or $375 million were written off our cash.

In terms of distribution, the debt consists of the following -- 15% of it is denominated in reais; 35% is denominated in foreign currency that was taken by companies in Brazil; and 50% is in foreign currency taken by companies abroad. So the net debt totaled BRL16.3 billion or $7 billion by end of the quarter.

The average term of the debt corresponded to six years by the end of March. The average cost of the debt in March -- the cost of indebtedness could be unfolded like that. Our debt in reais cost us 8.7%, the other debt taken in foreign currency by companies in Brazil cost us 6.5% plus foreign exchange variation, and the indebtedness of companies abroad cost us 4.5% a year.

Now, indicators of our debt provision by March 31, 2009 if we take gross debt over total capitalization, it would be around 47%, which used to be 48% in December of '08. We improved our capital structure a little bit. Now, gross debt over EBITDA, that is 2.6 times and it used to be 2.3 times last December. Net debt over EBITDA, 1.9 times, and it was 1.8 times in December of '08.

Slide number 12. The performance in Brazil. Now, I would like to refer to the performance of our -- of all of our different business units. Now, I will start with Brazil. In that case our net sales in the First Quarter was BRL2.4 billion when compared to BRL3.3 billion at the end of Fourth Quarter of '08.

Brazil accounted for approximately 34% of all of the consolidated net sales of the Group. 83% of that net sales came from sales to the domestic market and 17% came from export effort.

In terms of reduction of the revenue, what contributed the most was the lower consumption of steel milling products in the domestic market as a consequence of industrial production slowdown and the slowdown of civil construction. I would like to make a comparison -- between March of '09 and December of '02 the domestic market experienced an increase of 12.2% in sales.

Better conditions in the international market boosted exports, which were very quite in the last quarter of last year and in that period came to offset the reduction of the domestic sales. The exports starting in Brazil totaled 374,700 tonnes in the First Quarter which represented increases of 38% vis-a-vis the Fourth Quarter of '08, generating revenues of BRL397 million.

Gross margin was 32%, but obviously, it is slower than that of the Fourth Quarter but is still very good. Prices in the domestic market were a little bit lower and in terms of exports, prices experienced a more significant reduction following what was happening in the international market.

The net sales per tonne on the First Quarter of '09 was BRL2,059 against BRL2,619 in the last quarter. So basically that was due to a poor production mix and also the higher weight of exports vis-a-vis the total delivery volume. EBITDA for the First Quarter of '09 was

BRL653 million with a margin of 28%. And net income was BRL473 million because, undoubtedly, Brazilian exports were the least ones affected by the worldwide crisis.

North America, net sales in North America in the First Quarter of this year was BRL2.4 billion, accounting for 34% of Gerdau's consolidated revenue, despite the fact that there was a reduction in demand in that period.

The sales in that quarter were growing month after month. January was better than December, February better than January and so on and so forth. And so, in March that was 10% higher than sales in December. Gross margin evolved from a breakeven position in the Fourth Quarter of '08 to 4.2% in the First Quarter of '09.

That is basically due to a reduction of 28% in the cost of sales, which is a direct consequence of all of our risk measures that were taken to adjust our costs to the situation since the last quarter of '08, even though the price of products went down more than the price of inputs. Now, not including the metallic spread, they are still very high, which today is over $520 per tonne. And I am talking about short tonnage.

EBITDA in the Fourth Quarter was positive by BRL88 million, representing a very strong recovery when we compare that to the negative result that we had in the last quarter of '08. Thus EBITDA margin in North America went from a negative figure to a positive 3.7% this quarter.

And improvement in the operation and generation of cash in North America, it is the consequence of the reduction of cost of sales and also lower expenses with general, administrative and sales, which also is a reflection of the Company's effort to adjust to the new market. Even though we had a negative figure, the results in North America had a slight -- a very good improvement vis-a-vis the last quarter of '08 when the Company had also a negative result of $260 million according to the IFRS system, which as a consequence reflects an improvement in our operation.

And also important to mention in Gerdau Ameristeel, it is in a very good and positive financial situation with approximately within the $70 million in cash in addition to BRL670 million available in committed credit lines. The Company's amortization schedule does not contemplate any investment until 2011.

Slide number 14, Latin American. Net sales for Latin America contributed with 13% of the total consolidated figures, reaching BRL912 million. Even though this cannot be a confirmed trend, shipments in the First Quarter experienced an increase of 10% when compared to those of the Fourth Quarter of '08.

The -- we see now a lower net revenue, and the net revenue per tonne in that region went from BRL2,100 to BRL1,872. That drop in price was what caused the strongest reduction in our gross margin, which was negative. And also in North America, there was a reduction in fixed costs, which implied important gains in terms of production costs. That effect was not very well captured in terms of the cost of sales in the quarter due to stocks that had higher prices.

EBITDA in the First Quarter was negative by BRL139 million when compared to BRL42 million, also negative, in the Fourth Quarter of '08. Margin was minus 15%. That drop in EBITDA margin was higher than the drop in the gross margin, and that was particularly due to the performance of joint ventures, which results were known in terms of equity pickup.

Then the net income of that segment of Latin America was negative by BRL232 million. If the growth of sales that we saw in the First Quarter is repeated throughout the other -- the next coming quarters, and also if we consider the differences in terms of cost and expenses and optimization of working capital, it would be just natural to expect an optimization of results from now on.

Now, slide number 15, specialty steels. Specialty steels was the segment that was most affected in the First Quarter. Net sales presented significant reduction vis-a-vis the previous quarter, reaching BRL1.3 billion in the First Quarter. Net sales per tonnage fell, had a decrease of 3% but that represented more than 30% drop in the shipments which really impacted our operational results in Brazil, in particular, despite the very strong demand in automobiles because of the reduction in the IBI tax.

Sales of trucks are still lagging behind. Trucks and heavy vehicles are the ones that consume a lot of specialty steels. In terms of auto parts, we have already seen a destocking, as the Americans say, which will certainly help boost our sales in the next coming quarters. Even though we are lagging behind in terms of recovery, sales in March of '09 have already shown a 10% growth when compared to sales in the last quarter of '08.

The lower dilution OpEx cost is the result of a drop in demand in sales in the last quarter. It took our margins to be a negative minus 1% in the First Quarter of '09. As a result of all of those things that I mentioned before, the generation of operational cash or EBITDA was negative in the First Quarter.

Now, slide number 16. To conclude my financial and accounting presentation, I would like now to give you the consolidated figures for the quarter. Net sales for the First Quarter was BRL7 billion as you can see in the slide, and that represents a reduction of 26% when we compare that to the net sales of the quarter before. It's important to mention that in the Fourth Quarter, sales of October in particular had a very favorable performance because they were still in the same levels of the nine previous months because they have not been influenced by the world crisis.

Other factors that should be considered, and in this case was a very positive thing, is the increase of 20% of our shipments in '09 when compared to December of 2008. The gross margin was 11% in the First Quarter, which was lower than that of the Fourth Quarter of '08, but that was due to a reduction in shipments and the conditions of the domestic market. In addition to that, the cost of sales were not able to capture the totality of the reduction of production costs because they had been -- still had all the inventory that was carried over at a higher price that I talked before when I referred to the different business units.

EBITDA in the First Quarter was BRL559 million and the EBITDA margin was 9%. Even though the absolute value of our expenses with sales, when we add to that also general and administrative expenses, was reduced by 15%, if we compare that with the last quarter of '08, they still represented in the quarter 9% of our net revenues. We hope that if we maintain expenses as they are in the next quarters with the expectation of sales increase, the EBITDA margin will be better.

In the First Quarter of this year, the financial result was negative by BRL178 million. That was much better than the BRL951 million, which was also negative, in the last quarter of '08, which was strongly affected by the foreign exchange variation of 20% in that quarter.

Funding and financing, in -- denominated in foreign currency, hired by [ph] companies in Brazil impacted the results of that quarter. As a consequence of all of the points mentioned, consolidated net income was BRL35 million in the First Quarter of '09, with a net margin of 5%.

Now, I would just like to comment about dividends. Metalurgica Gerdau and Gerdau S.A. have a policy, a very clear policy of dividend distribution, which is very much aligned to the market paying at least 30% of net income adjusted every year where the ongoing law in Brazil demands a minimum of 25% as base. But we still maintain our 30% policy despite the current economic scenario.

And also aligned to our objective to preserve our cash position, we will not anticipate dividends in this quarter. This position of not anticipating dividends will be reviewed and revisited in the next quarters.

But before I open the floor for questions and answers, I would just like to leave with you a message that translates the Company's philosophy at the moment. The crisis that fell over all the markets since last year required an enormous effort to reduce costs and expenses, and also caused us to promote adjustments in our operational structure of the Company.

Signs of recovery are not very robust at the moment, but they already give us an indication that we are experiencing a very slow change in the scenario when compared to what we experienced last year. A combination of these two factors will certainly generate more concrete results in the quarters to come. Thank you very much, and now I open the floor for questions.

Questions And Answers

Operator

Thank you very much. Ladies and gentlemen, now we will start our q-and-a session. (Operator Instructions). Our first question comes from Ms. Deborah Decolter [ph] from Goldman Sachs.

Q - Unidentified Participant

Good afternoon. I have two questions. The first one has to do with debt and cash generation. Gerdau has closed the first -- with a debt to EBITDA of 2.6 times and net debt of 1.9. However, if we take the EBITDA of the First Quarter and recalculate and analyze the ratios, you would have a total debt per EBITDA anualized for the First Quarter of 9.2 times and a net debt over the annualized EBITDA of 6.8 times. And these are very high ratios. I would like to know what measures Gerdau is taking or could take in order to bring down these multiples regarding cash generation. This is my first question.

And the second has to do with the metallic spread in the United States. How do you see metallic spread for the second half; and believing that we might have a recovery in demand and excess idle capacity in the United States?

A - Unidentified Speaker

Okay, let me answer first. Indebtedness -- okay, your maths are quite right regarding the multiples. Your calculation is right vis-a-vis 2.6 and 1.9. And what sounds incorrect to us is annualize the First Quarter of the year and do a proxy for the year because, year, we count on the recovery of market, recovery of shipments, and we have a sound cash position which would allow us, if there is no other way, to accommodate this indicator and bring it down to a more reasonable level.

The idea would be not to leave the comfort zone that we have had during all these years. This is why we believe that we are able to solve that if it be necessary although we are considering other alternatives, bringing down our indebtedness in case our cash generation does not offset it. We are working with these two variables; generation of cash and the possibility of bringing down debt using the liquidity that I mentioned in my previous presentation.

Regarding the spread for the second half of the year, as we have been repeating many times, in fact, we are still living a period of uncertainties regarding the possibilities of the market. We certainly believe that there will be a trend to squeeze these spreads even further.

And they continue to be quite comfortable. If we look back, during the Fourth Quarter of last year, it was around 600, and now it is 528. And they are higher than what we had at the beginning of last year. So I wouldn't be able to tell you more precisely, but we are counting on a squeeze -- with a squeeze on spreads and recovery of volumes, which should offset the profitability that we have in the bottom line.

Q - Unidentified Participant

Thank you.

Operator

Our next question comes from Mr. Marcos Assumpcao from Itau Corretora.

Q - Marcos Assumpcao {BIO 7474402 <GO>}

Good afternoon. Excuse me. Could you explain the indebtedness of Gerdau because -- or maybe demystify it, because I believe that the market has overestimated the negative impact that this could have on the Company. So let's consider the worst case scenario. Let's say you had to break your covenants of four times total debt per EBITDA.

And I would like first to understand what is the percentage of the gross debt of Gerdau which is subject to these covenants, and what impact could that take -- could that have? What would be the additional cost that you would have, let's say, if you had to pay a fine or an additional fee if you had to ask for a waiver from the covenant for 6 or 12 months?

A - Unidentified Speaker

Thank you very much for your question because it makes me go back to the previous question, although the first person who asked didn't mention any covenant. In most of our contracts, we have the 4 by 1 debt-EBITDA ratio. And also answering your question, we have 10 billion of total debt, and 4 billion of these 10 billion are subject to the covenants and not the six other ones.

So what does the Company think about it, what is the Company doing to mitigate the problem is over 2009 or early 2010, the Company, if the activity does not recover, doesn't have a recovery, if we breach one of the covenants, we have internal resources, as I said. And we can use our own liquidity in order to bring down our indebtedness and thereby complying with the covenants.

In the worst case scenario, we can -- we have a huge amount of scenarios here internally. Of course, we have considered the most adverse situations and we believe that with our internal results we would be able to solve that. It wouldn't be very prudent because the level -- the lack of knowledge about what the future holds wouldn't really recommend such a radical measure.

You mentioned how much a waiver with the banks could cost. We have a bankers' community that really tracks those for many years, and the Company has, and, of course, we have constant talks with them. We anticipated this situation, and we feel a reasonable degree of understanding, not to mention a high degree of understanding because they do understand that this is a very exceptional situation and that in some situations this was, even with acquisitions made by -- very daring acquisitions that the Company made, we reached 2.7, 2.8, 3 times. And soon after that it came down again.

So the level of covenant has been very comfortable over our history. And in talks with our bankers, we felt that they really understood that this just was an exception to the rule. And we didn't really discuss with anybody specifically how much would be necessary to pay so that banks could give us, to use your expression, a temporary waiver because we believe this is just temporary and this is an isolated case.

That could happen in about 12 months or something like that. So first, yes, this is a situation that could happen. If it does happen, the first thing is that we would use internal resources in order to mitigate the problem. The second alternative would be to negotiate a waiver with banks, and those that are more stringent. And I couldn't quantify that; we have not been in touch with anybody to negotiate any figures.

Q - Marcos Assumpcao {BIO 7474402 <GO>}

Thank you very much for your answers. And about the Latin American operations, could you give us more details about the negative impact that this had on cost, the fact that you had to carry inventories that were formed with higher prices in the past?

I understand that more or less you had an inventory writedown in your Latin American operation during the First Quarter, and which is what happened in the United States during the Fourth Quarter -- microphone please [ph]. Could we use this as non-recurring for the Latin American operation?

A - Unidentified Speaker

Of course, because of the change in the price levels in the market, we had to make adjustments in our inventories. And we did that more specifically in Latin America over the Fourth Quarter and also still this First Quarter. $140 million in adjustments in our inventories in a consolidated manner in the Group. Latin America counted for something like $40-something million of this amount.

Q - Marcos Assumpcao {BIO 7474402 <GO>}

You mean during the First Quarter?

A - Unidentified Speaker

During the Fourth Quarter of '09 -- of '08.

Q - Marcos Assumpcao {BIO 7474402 <GO>}

Do you have the figure for it, the First Quarter of '09?

A - Unidentified Speaker

We made some reversals during the First Quarter of '09, in fact 6 million. Of the $140 million, $40-something million were Latin America. Latin America accounts for about 9% to 10% of the size of our business in general.

Q - Marcos Assumpcao {BIO 7474402 <GO>}

Okay, I do understand, and $140 million were adjusted already, so from now on it will be very good because this part has already been absorbed by the costs and you're talking about the cost of the First Quarter because the margin had a negative impact of that as well.

A - Unidentified Speaker

Yes. Although as I said during my presentation that what really brought down was volume and price, what really impacted negatively our bottom line.

Q - Marcos Assumpcao {BIO 7474402 <GO>}

Thank you very much.

Operator

Our next question comes from Mr. Philip Grose [ph] from Banc of America-Merrill Lynch.

Q - Unidentified Participant

Good afternoon, to all. I have two questions, the first one has to do with working capital. Could you please quantify how much you're going to reduce your working capital further by the next two quarters?

And the second question has to do with the domestic market. Could you please talk about demand? Could you quantify -- how do you see the Second Quarter? And could you talk about prices? How much discount you had to give during the third -- the First Quarter and do you have anything projected for the next two quarter as well?

A - Unidentified Speaker

Well the easier part of the question is the one regarding working capital. Our major endeavor has already been made, as I said, from September to March, almost $1.5 billion were brought down from our working capital for many different reasons, price adjustments and the decrease in the activity and lower inventory but basically, it was the destocking or the stock-out, the sale of the inventory that we had, impacted our working capital formation.

For the rest of the year we're working between $200 million and $230 million additional -- less in our working capital but we hope this is not necessary so that we can have this amount still linked to our business because a higher demand will require a higher working capital. And we had lower demand during -- so we had to give some discounts for volume because the inventory grew very high and we had to continue selling. And this is no longer happening in the First Quarter. And with the recovery of demand it's not going to be spectacular but it will be slow, but sure, and it is being confirmed. So this is not going to be a current practice in the next few quarters.

Q - Unidentified Participant

So you mean that your price could go up in Brazil? Is this what you mean?

A - Unidentified Speaker

No, no. We might have not to make any important discounts or concessions.

Q - Unidentified Participant

Hello, I don't know if you can hear me because I can't hear you. Hello. I still can't hear anything.

Operator

Pardon me, sir, you are in the queue, please ask your question.

Q - Unidentified Participant

Yes, okay, thank you and now I can hear -- I couldn't hear anything for awhile. Yes, I'm wondering if you have an EBITDA target or guidance for 2009, if you can break that down quarter by quarter? Then in addition what is the minimum cash position that you would maintain? My intent is like how much of cash would you use to repurchase debt if -- to pay down debt if necessary to maintain compliance with the leverage covenants?

A - Unidentified Speaker

What would be the necessary effort in order to fit into the four by one leverage level required by the covenant. The first thing is that we are working with many different scenarios including those that could lead us to a problem in order to cope with the four by one covenant -- leverage covenant. And the answer is the following -- we have enough cash in order to face any situation whatsoever. Whether we're going use to our cash for this purpose or not, this remains to be answered.

It's very difficult to tell you quarter by quarter what the EBITDA would be because the level of uncertainty vis-a-vis the volumes that will be achieved still remains. So -- but I believe that our investors and our bankers could be sure that either with our own resources or with the consent of the bank we would have -- we would easily have solved this problem.

Q - Unidentified Participant

Then can I have one follow-up question? When you -- it was difficult to understand the call earlier, when you said that there was a -- you had liquidity resources of BRL8 billion, can you detail that in addition to the BRL5.8 billion in cash, what are the additional liquidity resources?

A - Unidentified Speaker

(Technical difficulty) So he's asking about where the liquidity would come from, I would like to clarify that from our total indebtedness of BRL10 billion only BRL4 billion are subject to the leverage covenant. Therefore, with cash in dollars of 5.8, 2.6 we would have the necessary cash in order to pass the test should the situation occur based on our most pessimistic scenarios and I also said and I repeat that if we're going to use our cash to comply with the covenant this is a decision that will be made later on because we really cannot really forecast what is to be expected in 2010. If the market recovers we would not hesitate doing that. But if there are many doubts and uncertainties in the market then we would have to use other paths. But in the $2.5 billion, which is our real cash could be used as well as some repos [ph].

We have 1.5 billion in repos in our consolidated results but it would of course depend on our banker's agreement, so I don't know whether I've answered your question or not. I cannot tell you what the EBITDA per quarter could be to answer more completely your question.

Operator

Our next question comes from Carlos de Alba, of Morgan Stanley. Please go ahead.

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

Yes. Good afternoon, gentlemen. I would like to see if you can give us a little more of details on Acominas, and the performance of that operation seems to be having -- having some -- or going through some rough times. Could you talk a bit more about the -- either EBITDA per tonne or profitability in that mill, and also what is the cost of coal that you are paying for this operation, it has already been cut [ph] as per the benchmark negotiations that have come out? That'll be my first question, thank you.

A - Andre Gerdau Johannpeter

Carlos question has to do with the performance of Acominas, I'm going to talk about that. And the second part I don't know whether it's quite clear, the EBITDA per tonne for Schirmer about Acominas?

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

Yes. If you can (multiple speakers).

A - Andre Gerdau Johannpeter

-- 1.5 million tonnes, and the other one, 3 million tonnes. And in December, we announced that we would bring forward the remodeling of the large one of 3 million tonnes and this continuance -- it is already happening. We said in December that we would go back in March or April and the remodeling is being finished, and we -- it took more time because of the time of market demand, and we used our own team. And the blast furnace could be available during May -- over May, and the return of this blast furnace depends on the market, and our forecast, it should go back to production during the second half of the year. So Acominas was impacted regarding demand, and this is why we have not put this blast furnace in operation because Acominas has a good part of its production devoted to the foreign market, and where there is excess supply, and worse prices. So we are reducing production, bringing it down to a level that might make Acominas competitive.

And we are still renegotiating one of our coal contracts, of course this is important because you have to renew the price and add your old inventory, and you have new coal coming and it has to be more competitive. So during the second half of the year we will have a much better situation for Acominas and the earnings will be better totally than too in the First Quarter and part of the Second Quarter as well. It is of importance to stress the integrated route, it's only 25% of the Group.

And the second part of the question, I'm going to ask Schirmer to answer your question.

A - Osvaldo Schirmer {BIO 1754610 <GO>}

Well in fact there are two questions; the EBITDA per tonne, and we don't supply only for Acominas in the (inaudible) segment but BRL596 per tonne or $275 for the whole of it, and the other segments of the question had to do with the coal prices. We have long-term contracts and some of them higher than $200 per tonne but the price of the spot market as all the analysts know has been dropping violently.

And today, coal is being bought for $89-$90 per tonne and which will probably show the reality in the renewal of contracts around the middle of this year.

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

Thank you. And just a follow-up -- or a second question, if I may, you mentioned that the total fixed cost is around 25%, I guess that's on a consolidated basis. I wonder if you can give us a breakdown by the different business segments of how much is your fixed cost in each one of them, thank you?

A - Unidentified Speaker

He was asking about fixed cost that I mentioned during my presentation, which were around 25%, and then he also understood that it was a consolidated reference that this same fixed costs by business segment (inaudible) so my answer is that indeed 25% is the consolidated information according to our level of fixed costs, and certainly the operation of the electric power points which are fed with scrap have a lower fixed cost when compared to the integrated mills our production of that is in Acominas, and in Peru it is 25, in a way applies to the whole of the mills. And so they integrated something like 25%.

Operator

Excuse me, our next question comes from Rafael Bidderman from Bradesco Corretora.

Q - Rafael Bidderman

Good morning. My question refers to cost reduction. I don't know whether I understood correctly, but how did you promote a cost reduction? In your press release you say that the cost was down by BRL1.8 million. Is it due to measures to promote a cost reduction, this BRL1.8 million, or that is mainly due to drops in volumes?

Could you also tell me what was the cost reduction because in your presentation you refer to 25% of BRL400 million; could you please elaborate that a little bit further. What accounts for the cost reduction effort on your part and what was the nonrecurring cost due to that offer because when you have, first the net reduction, you have dismissal charges and other expenses?

And my second question relates to sales in the US, you said that sales in March increased 10% vis-a-vis, the figures for December of '08. But December is usually a bad month because of the winter. So how are sales in the US?

Can you give me any other indication that can point us to improvements -- improvements are still very gradual. And in terms of Brazil, my impression before is that I thought that there should be a drop in the industry in Brazil. But my impression was mainly geared towards the industrial segment, even though I still had some questions about the construction industry in Brazil, even though you believe that there is still a slight resilience due to the fact that there were many new developments that were launched and that there -- they had to finish the construction. But the civil construction industry experienced a slowdown. I just want to understand whether the civil construction industry in Brazil is indeed resilient, or it is experiencing a slowdown in sales even because construction companies, even though they have to conclude their buildings they are going through financial hard-times.

I want to know whether you also feel the same way, and also in terms of the various low consumption; that low consumption is still very resilient.

A - Unidentified Speaker

Yes, Andre. We'll start by answering the question about the market in the US and then Schirmer will talk about cost.

In the US you know that December is a winter month in the Northern Hemisphere, and it is of course lower. And after December what we see, it is a slight recovery and then it starts picking up in February and March. And now spring is around the corner and we see some signs of a recover in sales. Not very significant but we can see some signs. It's also important to see that the entire industry was well stocked.

We also talked about the reduction in inventory levels of distributors in the US That reduction is very small but it's still getting close to historic levels. There is also the stimulus package that should have an impact in the construction industry very soon. And so I think that we will see some improvement in the next quarters in the US But it is very difficult to say what will be the percentage of improvement.

Now in Brazil, the civil construction industry has been impacted particularly, in January and February. It was higher impact that the one we expected. So when the crisis hit Brazil and it came here a little bit later, it just hit us by December, so the measures to offset the crisis in the construction industry were taken by the end of December and then we had a drop in demand. Now, we see that some of the developments were still being launched and there is some resilience but we see now some new uprise [ph] in the construction market.

Another important program is the one called My House My Life, it's a new government project that will boost the consumption of steel. I think we anticipate about 1 billion tonnes in the consumption of steel. We see that the construction companies are now making moves to buy more steel. So I think that we will see the effects of that in the next quarter.

The industry sector in Brazil is probably the one that is mostly affected and most investments are in a standstill. And now we also see some signs of recovery. But end market, they are a very slow market, are very small buyers is still there and we see the Commersal [ph] Gerdau which is the other end, and the drop in that area was lower than that of the civil construction industry. The activity is very good and very similar to what we experienced in 2007. Not at the levels of 2008 but we can compare that to 2007 and march more up to the point where Commersal Gerdau is more active.

And now I will the give the floor to Schirmer again to talk about cost.

A - Osvaldo Schirmer {BIO 1754610 <GO>}

Bidderman I think you would like to get more information about what we said, 35% in the reduction of total cost and then we also said the fixed cost had a reduction of 25%. The figures we have for total cost in the last quarter of '08 for production was BRL6.3 billion for the quarter and that dropped down to BRL4.5 billion in the First Quarter of '09. And that accounts for a savings [ph] of 1.751 million in saving between one quarter and the next which came up to 28% that I mentioned before. Part of the volume certainly the volume that has a direct impact in the reduction of variable costs but what we are highlighting as a major effort on the part of the Company was the maintenance of our fixed cost, around 25% of total cost and that is where the major effort came about.

Q - Rafael Bidderman

Then, fixed cost, I think that BRL400 million of fixed cost, how much of that dropped due to that effort of cost reduction?

A - Osvaldo Schirmer {BIO 1754610 <GO>}

Yes, 24%. It was a double [ph] 1.1 billion in our variable costs when you put both together it's 1.7 million and when you put those together that lead us to 25% reduction. And that drop in fixed cost is a recurring drop. There is no extraordinary fact that cause to happen, so in the next quarter I can consider fixed cost to be BRL400 [ph] million lower than that before that effort.

Yes, I could say that this is a reasonable assumption and in terms of variable costs it will depend on the behavior of market input. It is also important to say that there would be -- there won't be a lot of major things happening in terms of fixed cost. We are negotiating now with different vendors. And therefore maybe as Andre said, the effort will not stop right now.

Q - Rafael Bidderman

So what you're saying is that since it is BRL400 million per quarter. That is more than the BRL1 billion, BRL1.6 billion a year in terms of cost reduction. Is that right?

A - Osvaldo Schirmer {BIO 1754610 <GO>}

These are -- if you compare that to the levels we were operating by December of last year then the answer is yes. With anything nonrecurring in the First Quarter in terms of that First Quarter -- in terms of the fiscal charges could you be more specific? Nothing relevant.

Q - Rafael Bidderman

Like a follow on, when you talk about February spread consumption and that in Brazil that went down to levels of 2007, what will be the percentage drop? A double digit drop or it's below double digits?

A - Osvaldo Schirmer {BIO 1754610 <GO>}

It was below double digits.

Q - Rafael Bidderman

Very good, thank you very much.

Operator

Now, our next question comes from Rodolfo de Angele from JPMorgan.

Q - Rodolfo de Angele {BIO 1541593 <GO>}

Good afternoon. When it comes to your industry you talked about your blast furnaces in the US is operating at lower capacity and we are still talking about a scenario where there is lower visibility vis-a-vis the next quarters. What could we expect, I mean that's your point of view.

A - Unidentified Speaker

The United States is thinking about shrinking its capacity or what is in the pipeline. For Acominas once again we are hoping for a March market recovery and opening and starting with our 3 million blast furnace and it will very much depend on when the market will pick-up again. In terms of new operations for both North America and Latin America, we're operating at 40%, 60% of our capacity. It very much depends on the market of the product and the mills.

And currently, we have no plans to close anything up or to introduce major changes. But that is still a possibility because we are hoping for a recovery and there are signs of demand recovery and if that does not occur we have to revisit our installed capacity and to see whether it makes sense to maintain so many mills in so many countries and so many operations. But it is too soon to argue in that regard. So we will still continue operating with the plants we have here.

Operator

Our next question comes from Mr. Luis Albertobink [ph] from Fortis Investments.

Q - Unidentified Participant

Good afternoon, Andre, Schirmer, everybody, three question. Going back to coal shipment is that around $80, $90 inline with what is going on with the spot market do you expect this to happen here in Brazil. Is it along these lines because we saw some contracts being signed by other steel mills abroad and some mining companies around $120, $130. Could we expect something in line with the price of the current spot market prices?

A - Unidentified Speaker

For those who had long term contracts, higher than $200, and today with a spot around $89, $87 lower than $90. This should be reflected in the renewal of the renegotiated contracts that will be around the end of the year.

A $120 to $130 maybe would be a consistent figure, what I meant is that a low spot price brings the average down.

Q - Unidentified Participant

What about the spread in North America at margin? If we consider a spread at the current levels or maybe a little bit lower depending on price conditions for both steel and scrap and with all the cost reductions that you have already carried out and considering improvement in volume what kind of margin could we expect for the Second Quarter? I know that you are not going to give us a guidance but could you give us a range for instance?

A - Unidentified Speaker

Well I'm in dire straits because if we do not give guidance. Anything I say about this will be a guidance. I can only say that they will be better than we have in December and in the First Quarter.

Q - Unidentified Participant

And one last question. Among the different possibilities and the alternatives for your debt depending on this scenario, are you considering a capital increase for the Company and is there any possibility?

A - Unidentified Speaker

No. We are not contemplating among our alternative any capital increase in the Company. Thank you.

Now, we close our Q&A session and I would like to give the floor to Mr. Andre Gerdau Johannpeter for his final remarks.

A - Andre Gerdau Johannpeter

Here is Osvaldo Schirmer, I would like to start by thanking you for your interest and participation and we apologize for the translation system that sometimes went off and I know that Martin was not able to have his question answered and we hope this does not happen in the future.

And we continue to be available to you and also our whole Investor Relations department. And thank you very much for your interest and we hope -- we expect to have very positive news to give you during the next call.

Thank you very much for your interest, for your participation in our conference call. And we remain available to you as Schirmer said.

We were not able to answer all your questions and we count on your presence in August. Thank you very much and have a very good day.

Operator

Thank you very much and the Gerdau conference call is now closed. We thank you very much for your participation and wish you all a very good afternoon. Thank you.