

Q3 2020 Earnings Call

Company Participants

- Alberto Akikazu Ono, Chief Financial Officer, Vice President of Finance & Investor Relations and Member of Executive Board
- Miguel Angel Homes Camejo, Commercial Director, Vice President & Member of Executive Board
- Sergio Leite de Andrade, Chief Executive Officer & Member of Executive Board
- Unidentified Speaker

Other Participants

- Analyst
- Carlos De Alba
- Daniel Sasson
- Gabriel Galvao
- Rafael Barcellos
- Thiago Ojea

Presentation

Operator

Good morning, ladies and gentlemen. Thank you for standing by. Welcome to Usiminas Conference Call to discuss the Third Quarter 2020 Results. At this time, all participants are in listen-only mode. Later on, we will conduct a question-and-answer session, and instructions will be given at that time. (Operator Instructions) As a reminder, this conference is being recorded.

I would like to mention that this conference call is being broadcast live on the company's Investor Relations website at www.usiminas.com/ri. The earnings release and a slide presentation are also available on that site. Participants who are listening to the conference in English may also ask questions directly to the speakers.

Before proceeding, I would like to clarify that any statements that may be made during this conference call regarding the company's business prospects as well as projections, operational and financial goals related to its growth potential constitute forecasts based on management's expectations regarding the future of Usiminas. These expectations are highly dependent on the performance of the steel sector, the country's economic situation and the situation on international markets. So they are subject to change.

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With us today are Usiminas Executive Board, Mr.Sergio Leite, CEO; Mr.Alberto Ono, Finance and Investor Relations Vice President Officer; Mr.Americo Ferreira, Industrial Vice President Officer; Mr.Yoshiaki Shimada, Corporate Planning Vice President Officer; Mr.Kohei Kimura, Technology and Quality Vice President Officer; Mr.Miguel Homes, Commercial Vice President Officer; Mr.Carlos Rezzonico, Managing Director of Mineracao Usiminas; Mr.Ascanio Merrighi, Managing Director of Solucoes Usiminas; Mr.Fernando Mazzoni, General Manager of Usiminas Mecanica; Mr.Bruno Paulino, Head of Legal Department; Mr.Julio Arroyo, Controller; and Mr.Leonardo Karam, Head of IR.

First, Mr.Sergio Leite will make some initial considerations, followed by Mr.Alberto Ono that will comment on the third quarter 2020 results. After that, the management will be available for a question-and-answer session.

I'll turn the call over to Mr.Sergio Leite. You may proceed, sir.

Sergio Leite de Andrade {BIO 6771322 <GO>}

Thank you very much. Good morning, each of you. To us from the Executive Board of Usiminas, it's an important moment to have this call every quarter and to render accounts to the market, to the investors, to the shareholders, to the thousands and millions of people who invest in our shares and also to society. Today, I would like to highlight the presence of Vice President of Planning, Yoshiaki Shimada. He was elected at the end of September and he took over in the beginning of October, and he will be with us in the earnings conference calls.

The third quarter was an important quarter at the Brazil level. Brazil resumed the economic activities and we celebrated in Ipatinga on August 26 with the presence of Brazilian President and the Governor of Minas Gerais, Mr.Zema, Secretary of States, senator, representatives senators. We celebrated on that specific day the resumption of the growth of the Brazilian economy and it's being done in an intense way. And Brazil is one of the fifth countries with the highest performance in the resumption of economy. And this is great for us Brazilians to the Brazilian companies as well.

We at Usiminas will discuss the specific results of the third quarter. We did a great job in the field of what is our priority at the current moment, namely sustainability, in the economic pillar, the social pillar and environmental pillar. This is our priority. Our priority are summarized in the permanent construction of sustainability.

In the last call of results in July, I let you know that we had created a general management of sustainability connected to the management of the company. And we appointed Jose Andrade to lead it. And later on, we created on the third quarter our sustainability committee. And this committee has the presence of all boards of Usiminas, and we are working hard in sustainability in the field of all the eight pillars of ESG. In short, we're developing very important work in this line.

In the third quarter, we would like to highlight the project of diversity and inclusion. This project has been worked on, since last year, we started to discuss this in 2018 and we

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launched it. Last year. We have an inclusion committee at Usiminas. And we are working on the pillars of this diversity program that has inclusion considering ethnicity, gender, LGBT, people with disabilities, and we also have the joy of being recognized by the World Steel International, one of the fifth finalists in the Award of excellence and sustainability, and the project that we had to participate was the program of diversity and inclusion. But today, we have good results to present to you.

As a result of the characteristics of our business, we -- in March 2019, we had in considering all the manager, general managers and the board members, our -- all our Executive Board, we had the participation of 5.5 of women. One year later in September 2020, we doubled this figures. We have more than 11% occupying those positions, and we are working hard to increase this number in order to reach 20% or 30%. So we have -- we would like to invite women to work at Usiminas, our arms are open.

And today, we are presenting a number of results with -- significant results, the result of our team as Usiminas, R\$826 million. This is the second best of the last 10 years in terms of quarterly results for the company and the best one, the fourth quarter 2018, R\$4 million higher than that. We represented a number of R\$826 million. But basically, they are about the same level. And the consolidated cash position higher than R\$3.7 billion. It's the best consolidated cash level of the last seven years. And if we consider the cash level of the controller of more than R\$2.1 billion, it's the best of the last 9 or 10 years of the company.

Our net debt to EBITDA is the best ratio for more than 10 years. So we can bring to you to the market rendering our account of all the activities we have performed. And this results are really significant representing the work of all Usiminas team. Later on, I turn the call to our Vice President, Mr.Alberto Ono, who will provide the details on all those highlights that we had of our results for this third quarter 2020. Thank you very much. It was an honor. It's always an honor to be attending this meeting.

Alberto Akikazu Ono {BIO 20633628 <GO>}

Good morning, everyone. I would like to thank Sergio for his words. And let's move on to the presentation of the webcast. On the second slide, we can see the main figures of the company. And first, we have a recovery, which has been very strong of the sales volume of steel, 54% higher in total with highlight to the domestic market. So as we had already commented in the end in our -- in other words in the -- our earnings call at the end of July, we felt signs of a recovery in the domestic market demand, and it was very clear that it's materialized.

Now, moving on to iron ore sales. We can see that there has been a recovery of 21% in the total volume of iron ore sales. And as we explained in the second quarter, we had some stoppages of some plants for maintenance purposes. And in the third quarter, we had a regular quarter as we had commented, so we expected that the volumes would be closer to 2.1 million, 2.3 million.

Now, moving on to EBITDA. As we have already mentioned, the EBITDA of R\$826 million, a margin of 90% recovery, which has been very significant in relation to the second

quarter. And later on, we provide more details about it. And this has been driven specially by the favorable environment of the iron ore segment in terms of price and also in terms of exports. And we also had the recovery in the steel sector.

And talking about net profit. In this quarter, in spite we had some exchange devaluation that has adversely affected in more than a R\$100 million, in terms of financial expenses, we have an income or profit of nearly R\$200 million. So showing that the figures have been very positive.

Now, moving on to the next slide. We can see the details of the last quarters in terms of EBITDA and as Sergio had mentioned, it was the second highest quarter EBITDA in 10 years. And if we do not consider the non-recurring effects, we would have the highest quarter EBITDA in the last 10 years. As non-recurring effects for this quarter, we can see a very small portion. It's a gain that we had of restatement of Reintegra Manaus amount, that can be used as export. And it's non-recurring, because it's a value that has been accumulated in the past.

Now, moving on to the next slide talking about the steel unit. We would like to highlight especially the recovery that we had. In the previous quarter, we had the negative EBITDA and now we have a positive EBITDA of R\$157 million, and the non-recurring effect is very minor. Even though the margin is still below what we had achieved in the -- reached in the previous period, we can see that there has been a good recovery. We would like -- we would also like to mention that the steel volume has increased, but as both rolled steel and crude steel, we had the recovery. So all this has favored the numbers of the steel unit.

Now, moving on to the mining. The EBITDA of R\$644 million is a historical record. And in the second quarter, we had already reached the record and now (Technical Difficulty) and the record high of R\$642 million. And this has been favored in terms of -- because of the volume, which was higher. We had normalized the volume of production. And as we mentioned before, an average price for the quarter was very favorable and also the FX exchange rate has helped us.

Another highlight is record EBITDA for this steel transformation in Solues Usiminas, where we reached the R\$61 million. And we can observe that this is the double of the quarterly average in the past quarter, excluding the second quarter of 2020. And this shows the recovery of volume in relation to the second quarter of 90% and revenue of more than a 110% and we saw a major recovery in volumes.

Now, moving on to next slide. I would like to discuss the operations of capital goods. At Usiminas Mecanica, we continue with the restructuring of the company and it's going to continue affecting the results of the company due to this restructuring effort, and this will be extended up to the fourth quarter.

And now, moving on to the next slide. We can see other numbers. First, the working capital, we had a very important significant reduction of 26%. And in the next slide, I'm going to show you some effects related to the working capital in terms of inventory levels, but I would like to say that we finally received the amount of the lawsuit of Cubato

Usiminas dint of unavailable case. And now from R\$312 million have been -- have helped in this difference of R\$1 billion, okay?

Now, moving on to next slide. I would like to talk about that steel inventories Our inventories of steel in terms of tonnage, was reduced by 8% and this helped us improve the working capital. And at the end of the quarter, we ended at 555,000 tons. And now, we are going to back to the normal conditions of 55 days similar to the first quarter, which was not so affected by the crisis, which is 56 days. So in terms of inventory, we went back to the normal levels.

Now, moving on to the next slide. Slide 11. As Sergio mentioned, this is our cash position, more than R\$3.7 billion, it's the highest cash level in the last seven years. We had similar in the third quarter 2013. And also, even though we had this exchange variation, we had the total debt level at the same level, but with some leverage, in relation to the cash position and EBITDA. So it's now 1.2x. And this leverage is the lowest since the second quarter 2009, as Sergio mentioned, for more than 10 years, we hadn't had that this level of ratio.

Moving on to the next slide. Talking about CapEx. CapEx has been stable. We've maintained our guidance, and the expectation is that to reach the level of R\$180 million. On the last slide of the presentation, as Sergio mentioned, we created the area of sustainability and now we are also going to begin to report of what we are doing during the calls, in this quarter in terms of initiative connected to ESG, we would like to mention the inauguration of Environmental Monitoring Center that operates 24 hours a day, 365 days a year, and it's very focused on our issues of particulate and we count with a system of monitoring of releases. It's the first one that has been implemented in a steel company in Brazil and it's the first one in Brazil.

As Sergio mentioned, as a highlight of our diversity and inclusion efforts, we have the program that has been awarded. And we have been ranked among the 100 most innovative companies in Brazil in by 100 open startup ranking. And we have also installed the fatigue detection system, which is very important for mining operations. And this has been a great advance to ensure safety of our drivers, and lastly, our integrity program in order to communicate the importance of integrity to our community.

I finish the presentation now, and we will open the Q&A session now.

Questions And Answers

Operator

(Question And Answer)

Ladies and gentlemen, we are now going to start the Q&A session. (Operator Instructions) Our first question comes from Daniel Sasson with Itau BBA. You may proceed, sir.

Q - Daniel Sasson {BIO 19234542 <GO>}

Hello. Good morning, everyone. Thank you very much for the opportunity to ask questions. My first question -- I understand you do not make any comment on price increases, but if you could shed some light in the drop of prices or increase of prices that can have a positive impact on the fourth quarter? And how high the price can be in the domestic market and how do you see the prospects to negotiate with automotive sector?

My second question is in relation to supply and demand. We have seen some blast furnaces resuming production along the second quarter. Do you have any plan to reconnect the blast furnace? Number two. Do you think competition can increase in the second quarter? With this resumption of capacity of the market. How do you think we can see the balance of the market? Thank you.

A - Miguel Angel Homes Camejo {BIO 20661364 <GO>}

Good morning, Daniel. Thank you very much for your question. First of all, let's answer your first question related to price. As we have been observing in the first quarter, we have been following the fluctuation of international prices that have been pressed by the implementation of -- by the cost and raw material costs. As you said, we still have many challenges. As to steel capacity.

We have seen an official report that has been a higher capacity than 500 million and we understand that the prices should be aligned -- the international price should be aligned. So we have seen that there has been a high increase in raw materials. Charcoal has had a drop. But as for Brazil, there has been a devaluation of the foreign exchange and the -- with increase of raw materials the prices have been impacted and the prices -- our prices have been in the company is increasing prices and we could -- we have been observing that there has been an additional devaluation of the currency.

In summary, the average price on the third quarter, of course, the increase has been 6% in relation to the second quarter, but we have to observe the market along the third quarter, for example, the average price of September was 3% higher the average price of the third quarter and the increases that have been implemented do not impact on our results, but it will impact the total sales of the fourth quarter and -- which we are confident the dynamic. The price will accompany the price dynamics of the raw material prices and international prices and the level of the exchange rate in the Brazilian market.

We had high demand of steel that's started in the first week of April. Many of the production chains were affected in their cash positions and lot of raw materials are not being produced in the steel units. And now what we can see that there has been a strong demand in the supply and obviously this will generate a higher demand to recover the inventory levels that are lower in most industrial sectors in Brazil.

And in the last report, we had a level of inventory in production below two months of sales. So 1.7 months to be more exact and this obviously would generate an impact or an appetite for the recovery of the inventory levels in the following months. When you look at the latest reports in Brazil, you can see how offer and the higher level of production has

been following this activity resumption. So the normalization of the sector will happen I believe and the speed or the acceleration is still difficult to guess or to confirm, but we believe that this could happen in the next two or three months.

Q - Daniel Sasson {BIO 19234542 <GO>}

Okay, excellent. Thank you.

Operator

Our next question will be in English. Mr.Carlos De Alba with Morgan Stanley. You may proceed sir.

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

Well. Thank you very much. Good morning everyone. So just could you comment as to what are your plans to restart blast furnace 2 at Ipatinga. Second, the discussion on inventories a couple of things. The 55 days level that you achieved in the third quarter, is that in relation to your production, steel demand? Or it is just in terms of revenues, inventories over revenues? If you could clarify that. And then just going forward, I think you might have said just this, but do you expect the inventory levels in the supply chain, at least in the distribution channel to normalize in the next few months? Is that what you said? And it's not when do you expect to see that normalization? And then finally if I may ask about CapEx expectations for 2021 and maybe cost expectations for the fourth quarter? Thank you very much.

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

Thank you very much for your question. This is Alberto speaking. I'm going to answer some of your questions. And as to China aspects, I'm going to pass the floor. The resumption of blast furnace 2 which is the only one that has shut down at Ipatinga. Today, we still don't -- we are not sure. This equipment is going to return -- resume operation. We are waiting for a recovery of demand, as Miguel said. Today, there is a trend of re-stocking the inventory levels, but this trend has a deadline. So what will be the new normal in terms of demand and how does inventories will be recovered?

During this period, our option has been to use our capacity of adaptation of making adjustments to the market demand by slabs and rolled materials at Cubatao. We have lots of flexibility at Cubatao and this helps us lot at those moments when you have the demand. We still do not know how far it will reach. So this is the main point for us not to have clarity in relation to when we are going to resume our blast furnace 2. In relation to the 55 days of inventory -- 55 days of sales. So this is the steel volume which is an inventory corresponds to 55 days of sales, this is the position of course of the quarter, okay? So just to clarify, so this is related to sales -- physical sales, okay? There's another question, right.

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

Right.

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

In relation to China, I believe China as we have been observing has been presenting at recovery which is higher than the rest of the world and China is the only country that has been presented an economic growth and also in a higher demand in steel consumption. So it's pressurizing the commodity as a whole.

In the market that there are lots of uncertainties. We would know what would happen in China. And China went back and we saw the iron ore prices with a little drop lately. And it has already been stabilized at higher levels. What we could expect is that China pressing the demand of steel and will pressurize the commodities and also on the international prices of steel. Yes, you asked about CapEx as well, right?

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

Yes, correct.

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

In relation to CapEx, the guidance for 2021 is BRL800 million as we had informed and for next year, is BRL1 billion for the quarter BRL800 million and for the next year BRL1 billion.

Operator

Okay. Our next question is from Mr. Gabriel Galvao with Credit Suisse. You may proceed sir.

Q - Gabriel Galvao

Okay. First of all good morning. Congratulations on the results. Thank you for taking my questions today. I would like to have more details about the demand in the margin. If you could provide more details by sector how you see it all and that would be very useful to us. And the same lines if you could share how corona culture is affecting the demand that would be very interesting to have a perspective for next year?

My second question is in relation to the accident that happened in -- as if I'm seeing this month and we heard some news that you had lost part of the production. I would like to know how this can affect the result of the fourth quarter. I don't know if there will be any impact in terms of cost?

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

In relation to the demand or we have the automotive sector, construction infrastructure and capital goods. For the automotive is -- it has been a bit slower. And that's the last report of ANFAVEA, we saw that it was one of the best levels in terms of sales and growth could be happening until the end of the year. And the estimate of production according to ANFAVEA will be a drop of 35% in relation to the same period of the previous year and the preliminary numbers of October show that recovery of sales will continue from what happened in September, so we would expect October to be the best month of the year.

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The level of stock of cars is very low, namely only 20 days. So the production should follow this continuous improvement in sales in addition to the automotive sector, which is the sector with a lowest recovery. On the other hand the infrastructure and industry sectors have resumption -- consumption of steel in Brazil.

And this is something we also observe in the construction and also in the mining sectors, the industries and all businesses, all those related sectors have been resuming their economic activities. We expect the recovery to be maintained in the months to come. Obviously, the level of inventories that we have been observing all production chains will somehow press up the demand in the future months.

Gabriel, in relation to your question as to blast furnace, it was not an accident, it was an incident, an operational incident that generated some loss in production for some time. But today as we see it and this was even included in a communication to the market and has not affected client services or products to be delivered and this loss has been offset by an increase and with an increase in the purchase of slabs. The slabs are higher than the -- our cost to produce it internally. But this effect is not very significant. And still answering the previous question as to the modulation of production.

We are going to have a higher level of purchase of slabs, because we are using our flexibility of steel rolling production at Cubato. In the fourth quarter, we are going to have a volume -- a higher share of production and sales will be -- higher level of sales will be generated from the purchase of slabs due to the capacity we have at Cubato. Of course, the emergency assistance has been helping the retail segment in Brazil, increasing the consumption of wide line products that helped improve the level of demand. And this is what we saw in this emergency assistance was recovery of the (Technical Difficulty) and this is probably going to offset the decrease in the emergency assistance and we have been following closely of all this movement.

Operator

Our next question comes from with Mr.Thiago with Bradesco BBI. You may proceed, sir.

Q - Analyst

Good morning. Thank you. I have two questions. The first is in relation to the leverage. As we saw in your balance, of course, the level of leverage is much more comfortable in terms of indebtedness. So what's the level of absolute indebtedness that you understand to be a comfortable one?

And based from this point on, how are you going to allocate your capital? Higher level of dividends or can we expect that? Or are you going to invest in other projects or maybe bring previous projects? How is standing in relation to all this? And the second question is in relation to Solues Usiminas that has reached a very good level and do you believe that this level is sustainable? Or do you think there's a factor that led to this result? Or maybe there's absolute level of EBITDA will drop again?

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

Thiago, in relation to the indebtedness, even though we have been discussing this with our board members. We did not have a magic number yet. We are likely to be looking for reducing this level of indebtedness. We believe that in general a company like ours should be more conservative in the sense. However, we have to remember that we are now in a new cycle of investment at the company. We have announced the recovery or refurbishment of our blast furnace that will require investment in the next two years.

Yes, I've referred to 2021 and 2022. At this time, because of all the management that we have been doing and considering the high cash level that we have reached. In the next two years, we will need part of this cash so that we can continue our investment plan, which is already underway. I think this is a very important point to consider.

Solues Usiminas, it's important to clarify what are the activities of this segment. We have been focusing on the automotive sector. And obviously, it had a strong impact due to the stoppage of production of cars in the Brazilian car. It was almost absolute stoppage. And we mentioned in the previous quarter, we have to adapt to the new reality of the Brazilian market.

When we saw an increase in the demand of other sectors other than the automotive. And we also have to consider that the -- so it's something very important happens when you have an increase of prices, because you have to make adjustments to the price hikes of the market. And this is something that will happen every time the market will see all the effects that the steel prices have in the market.

Q - Analyst

Okay. Thank you.

Operator

Our next question comes from Thiago Ojea with Goldman Sachs. You may proceed, sir.

Q - Thiago Ojea {BIO 17363756 <GO>}

Thank you. Good morning, everyone. Thank you very much for answering my questions. I have two questions in relation to steel. I think mining sector has been very strong. And I believe that the major improvement may come from the steel segment. So the price increase is in the automotive sector. Could you tell me whether this has already started and what's your expectation for the increase of next year? What's the level of mismatch that you see of galvanized steel that you are applying in the market? And what has been agreed in the beginning of the year with the automotive industry?

And the second question, may be trying to project an improvement in the steel sector. How do you see the cost progressing for now and for next year? There has been a significant improvements in EBITDA, but much below the levels of 2018 when the steel unit was over BRL 500 million EBITDA per quarter. Maybe if you could provide some guidance as to costs and per tonnage? I think that would be very useful.

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

Thank you to what has been happening to assemblers, the answer is yes, we have been negotiating with some assemblers, car assemblers and part of the assembler have agreement that will come from lasts from January to December and some from other periods.

And for the agreement that starts from January go up to December, we have already started. The annual agreement have to reflect the what's happened along the year, we'll have the information and we have already confirmed all the price movements that have happened along the year. On the other hand, the expectations of the market for 2021. So in this sense, the data of 2020 show that there has been an important adjustment in terms of price and the expectation for 2021 as I said before will depend a little on the level or the dynamic -- the price dynamics of the raw materials. And this has to be reflected in the agreement of our -- with the assemblers for 2021.

To have speaking of costs what -- we do not provide guidance, but in relation to the costs for the fourth quarter connecting this to the previous question, we are going to have a higher level of slabs purchased higher than the third quarter. So this is going to improve our production costs and as a consequence our COGS because of the use of the quotas that have been purchased or the slabs that have been purchased. The profitability of the operation is also considered of course. So the global result would be favored but the cost per ton will have an increase as expected.

Q - Thiago Ojea {BIO 17363756 <GO>}

Now going back to the price increase in the automotive sector. Now there is the matter of raw materials. But, what do you consider to be the mismatch maybe 35%, 40%? Is this the level that you were expecting?

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

We need to observe the agreements that are not annual. So we have to observe all the other agreements which are not annual. And today, it's important to mention the price parity in the domestic market is about 4% or 5% lower than that international prices. As we said, our purpose is to have financial health to face up all the challenges. So the parity is expected to be 8% positive.

Q - Thiago Ojea {BIO 17363756 <GO>}

Okay.

Operator

Our next question is from Rafael Barcellos with Santander. You may proceed, sir.

Q - Rafael Barcellos {BIO 20593721 <GO>}

Good morning, everyone. Thank you very much for taking my question. Most questions -- the most important questions were answered, but I still have a quick question in relation

to the amounts to be received by Eletrobras lawsuit. What are you -- what's the value you're demanding? Is there any debt line for you to receive the amount? And the second question is related to iron ore. What can we expect in terms of production in the fourth quarter? Thank you.

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

Rafael, thank you for your question. In relation to the Eletrobras lawsuit. We still have the value, which we have a value which is being disputed divided BRL560 million of Cubato cause and BRL700 million for Ipatinga lawsuit.

Of course as to expectation, it's still too hard to tell because this is a complex amount. We have ever received which is the value which is undisputable and even Eletrobras recognized that it was to be paid. And this is a disputed amount that will take a bit longer. I cannot tell you when, we do not have any perspectives in the short term.

A - Unidentified Speaker

Good morning, Rafael. We cannot talk about the future. Especially, because next year's budget has not been approved yet. But for the time we are going to keep to the production level that we have today.

Q - Rafael Barcellos {BIO 20593721 <GO>}

Okay. Thank you.

Operator

Excuse me, if there are no further questions, we close this conference call. If you have any questions, our investor relations area, is available to take your questions. Thank you very much for attending this call. Have a good day.

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