

## Q1 2019 Earnings Call

### Company Participants

- Alberto Akikazu Ono, Chief Financial Officer and Investor Relations Officer - Finance and Investor Relations Vice-President
- Carlos Hector Rezzonico, CEO at Mineracao Usimina
- Miguel Angel Homes Camejo, Commercial Director Vice-President
- Sergio Leite, Chief Executive Officer
- Tulio Cesar do Couto Chipoletti, Industrial Vice-President Officer

### Other Participants

- Carlos De Alba, Analyst
- Daniel Sasson, Analyst
- Gustavo Allevato, Analyst
- Leonardo Correa, Analyst
- Rafael Cunha, Analyst
- Thiago Lofiego, Analyst
- Thiago Ojea, Analyst

### Presentation

#### Operator

Good morning, ladies and gentlemen, and thank you for waiting. Welcome to Usiminas conference call to discuss the earnings results of the first quarter of 2019. At the moment all participants are connected on listen-only mode. And at the end of the presentation there will be a Q&A session, when instructions for participation will be given. (Operator Instructions) This conference call is being recorded.

This presentation comes with slides and is being transmitted simultaneously through the Internet at [www.usiminas.com/ri](http://www.usiminas.com/ri), where you can also obtain a copy of the release of the company. Participants who are listening in English can also post questions directly to the speakers.

Before proceeding, we would like to clarify that forward-looking statements made during this conference call regarding the company's business prospects as well as projections, operational and financial targets related to their potential forecast of growth are based on the management's expectations relation to the future of Usiminas. These expectations are highly dependent on the performance of the steel sector, the country's economic situation and the situation of the markets are therefore subject to changes.

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With us today is the Executive Director of Usiminas, Mr. Sergio Leite, Chairman; Alberto Ono, VP of Finance and Investor Relations; Tulio Chipoletti, Industrial Vice President; Takahiro Mori, Vice President for Corporate Planning; Kohei Kimura, VP of Technology and Quality; Miguel Homes, Commercial VP; Carlos Rezzonico, Executive Director of Mineracao Usiminas; Ascanio Merrighi, Executive Director for Solucoes Usiminas; Heitor Takaki, Usiminas Mecanica Executive Director; Bruno Paulino, Legal Director; Julio Arroyo, Director of Controllershship; and Leonardo Karam, Investor Relations General Manager.

Initially, Mr. Sergio Leite will make his initial remarks. Then, Mr. Alberto Ono will present the earnings result of the first quarter of 2019. At the end, all the executives will be available to answer questions. Now I would like to hand it over to Mr. Sergio Leite.

### **Sergio Leite** {BIO 4746000 <GO>}

Thank you very much. Good morning to everyone. It is a pleasure to be here with you, and I thank all of you for participating in our conference call of the first quarter of 2019. Here, the upper management heads of Usiminas just held a meeting with all our sites with over 1,500 employees. And as you're aware, after we communicate to the stock exchange market our results, we make a presentation to our employees. As I said in our last call, we ended Usiminas' revitalization process that lasted two and half years. We saw growing EBITDA throughout '16, '17, '18, BRL600 million, BRL2.2 billion and BRL2.6 billion. And now our focus as of the first quarter of 2019 is to focus all our effort in the construction of the long-lasting effect in our company in all areas.

What we are developing in our company has a focused people, the service to our customers, the innovation. And this morning, we communicated to the market an important fact after three years at a level of investment that was below BRL0.5 billion. We invested BRL220 million in both semesters. Last year, we had BRL 500 million. And this year, we announced that we are going to invest BRL1 billion. 70% of our steel area focused on the sustainability of our operations and other very important actions to guarantee our long-lasting existence.

Now people, that is the main focus of our efforts. Now we are in the third year of development of a project that we started in 2017, together with Fundacao Dom Cabral, to prepare our leaders that are 412 people so that they can lead our teams. We have over 13,000 people, this is together with our suppliers and totaling 21,000 people. And we want to constantly adapt ourselves to the -- we want them -- adapt themselves to the culture of our company and our new business reality.

Last year, we had a job rotation process. Now this process was started in September last year and every year, we will have job rotation in the company as a rule. And the month to carry out this process is the month of September last year. For you to have an idea, in Ipatinga plant, we have our production director and five main executives. In September, we rotated all of these executives. We had executives that have been, for over nine years, in the same position. And our view is that our executives should remain in the position between four, six, maximum eight years, but our focus will be between four and six years.

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Now in the month of April, we will have an important stage of job rotation. We advanced this because of the relevance of the month of April and we changed the production directory of Cubatao and Ipatinga to give new dynamic to the business. We are strongly working because we want to practice in the company a culture geared to our customer, who is all the work of the team. Because we want to service our customer, an innovation culture as well. We have created an innovation executive group, we have the digital committee in 2017.

Last year, we created the Innovation Committee. We are innovating. We are doing a lot of innovation because through small and major innovations, we will be prepared to build the future of this company. We want to interact more and more with start-ups because we want to bring new contribution to the company in this world that we're living in right now. And in a nutshell, what I would like to convey to the market is the message of the mobilization of the Usiminas team. Because we want to continue doing what we have been doing in the past three year, constant improvement of our results to build the present and the future of Usiminas.

And thank you very much to each one of you for your attention.

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

Good morning to everyone. I would like to thank all of you for participating in our earnings results and to see the figures that you can follow through our webcast. First and foremost, Steel Unit sales. We were -- our volume was around 1 million tons, very similar to the past quarter, that was the fourth quarter of 2018. In iron ore sales, there was a significant increase, that was 25%, the -- totaling almost 1.9 tons during this quarter. This had a very positive effect in our results and subsequently, I will show you what happened.

The adjusted EBITDA here with nonrecurring effects that we had during the last quarter, there was an improvement of 34%. This is a significant result. This comes from our Mining Unit, and net profit, that was positive BRL76 million this quarter. Now we go to our next slide. Here we have the evolution from the first quarter of 2018 up to the date. Here we had a margin of 14%. Here we have BRL488 million of consolidated EBITDA. Once again, here we can see here the second quarter of 2018 that was affected by the truck drivers' strike. And here you can see another quarter that had over 1 million tons as a result.

The next slide here, we can see the results of our Steel Units. The EBITDA was BRL301 million, that is highly aligned with the results of the fourth quarter of 2018 when we eliminated non-recurring effects. The margin is very similar. Here you can see our stability in volumes and in results. Our next slide here, we have iron ore sales. In Mineracao Usiminas, this is a record volume when we see at last -- the past 15 months. This is the result of the first quarter of 2019, reaching almost 1.9 million tons, with a very significant growth in sales to third party and also in exports.

The reflection of this volume increase and better prices that were observed during this quarter resulted better -- in better results in iron ore sales. And you can see, here we have BRL76 million in the past quarter. Here we have our steel transformation, Solucoes

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Usiminas. Here the evolution for the 2% with the EBITDA going to BRL17 million, and although as it appear here we had a concentrated effect during the last quarter. Debts for -- if we don't consider disposition, the result will be highly aligned with the fourth quarter.

And at last, Usiminas Mecanica. Here you can see, although our result is slightly negative in Capital Goods, there was enough recovery in the company. This is a result which presents a neutral EBITDA when we compare it to the past three quarters that were very negative quarters. Now, when we go to our next slide, here we have more information. First, we will talk about working capital, that was BRL3.7 billion. It was BRL3.5 billion, BRL4 billion, this is a normal level of working capital for this quarter. Now in steel inventory, we ended with 689 tons, this level is similar to the second and third quarter last year. Reminding you that the fourth quarter, because of scheduled shutdowns of the High Furnace and other equipment, there was also a reduction of steel inventory, but now we're back to normal.

The next slide here. Here we will show our cash position and indebtedness. There was a drop of our debt, we advanced the payment of BRL326 million to our creditors. So, now our debt is BRL5.5 billion, with a stable cash position that is almost BRL1.8 billion. And our CapEx of the quarter, the BRL89 million, I believe that this level is still a bit low within our project view. As it was announced today, our intention is to have a global CapEx of BRL1 billion this year.

And basically, these would be the main figures. And we're open to answer any of your questions.

## Questions And Answers

### Operator

Ladies and gentlemen now we will initiate our Q&A session. (Operator Instructions) Our first question comes from Thiago Lofiego, Bradesco BBI.

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

Good morning. I have two questions. The first one will be regarding the steel market. If you could tell us how you see the sales for the second quarter, is there like a higher demand or not? And within the steel segment, if you could talk about costs. What can we expect for the second quarter regarding the cost of slabs and cost of other raw material? And also Mineracao, here you mentioned 5 million tons of production. I would like to know if your guidance of 8 million, 9 million is still valid, and what kind -- what will be the amount of iron ore that you will buy from third parties?

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

This is Miguel. Regarding the market, we have to remember that the beginning of the year came with the great expectations connected to the growth of the GDP expectation and the growth -- and the forecast that the Brazilian economy was going to grow. But throughout the quarter, these expectations dropped. The GDP growth expectation was above 2.5%. Industrial production, the growth forecast was 3% for 2019.

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And the Central Bank said that the GDP will grow below 2% and the industrial growth will be around 2.3%. This drop in the growth expectations did impact the consumption of steel and, of course, on our sales of the first quarter. But I believe that we -- like, for example, the automobile industry expects to grow 9%, capital goods also expect to grow above 5%. So we believe that the growth in the second quarter will be better than that of the first quarter, but we will keep our eyes on the indicators.

I will talk about the COGS now for the second quarter. Our expectations for the price of products sold will be a drop of a 1% or 2%. This is our expectation of our COGS.

### **A - Carlos Hector Rezzonico** {BIO 20703029 <GO>}

Good morning. In your question regarding Mineracao Usiminas. Our production that was planned for 2019 had anticipated a production increase throughout the year because of the activation of two plants, that was the Samambaia plant and the East Mine. These plants will become operational, and they depend on licenses.

And as you know, licenses take a bit long because of the situation of the iron and ore situation that is saturating the jobs of the agencies that have two issue this license. But the production volume is considered between approximately 7.5 million -- 8 million tons, and this will also depend when these other two plants become operational. And this is why the increase of production that we will see throughout the year will follow the plan that we had already defined in our original budget.

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

Miguel is -- a word about the -- did you say that the second quarter will be better than the first quarter? Could you -- do you believe that we would have a consolidated volume above 1.1 million tons? Or is it too aggressive?

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

Thiago, it will also depend on the economic activity. During the first quarter, we observed that -- we observed a significant drop in the stocks of the distribution sector. There is a drop in -- there is a drop in the inventory. The different areas of the industrial sector, depending on these evolutions, we could have an interesting growth. Now everything depends of the evolution of the different indicators of the Brazilian economy.

### **Operator**

Our next question from Mr. Daniel Sasson, Itau BBA.

### **Q - Daniel Sasson** {BIO 19234542 <GO>}

Good morning, and for your presentation and for taking question. My first question is regarding the prices of the average prices dropping 1% quarter-on-quarter, and this is 8% in average prices. We would like to understand what was deterioration across it and price concession. And where do you see the parity of imports?

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Today, we've seen some competitors are now seeing an increase of price in their distribution. We believe that it's possible to increase prices when they go lower than that. And my second question is regarding working capital. We see BRL300 million for the working capital. I would like to understand how sustainable is the working capital at these levels. We should expect some increase in the upcoming quarter?

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

Good morning, Daniel. This is Miguel. Regarding the average price, it is important to clarify that the average price is impacted by 3 points. The first factor was throughout the quarter, there was an important pressure from the distribution center and this affected 10%. Now this drop of 10% in the distribution to -- they got added to greater volumes of the quarter was based on this quarter. So there is -- affects the average price of the quarter that was offset by the automobile sector because of their annual contracts. The average price was impacted by the distribution sector to have a, also greater volume. With the lower price at the end of the quarter, (inaudible) that was more connected to the commercial products that have a lower average price.

Regarding your second question regarding the increase of price. We are -- we want to increase 10% as of -- in the distribution in the industrial sector as of April 1, and this increase supply it is (inaudible) there was an increase in cost and we have to be competitive with the international market. At the end of the first quarter, we saw a negative parity in the distribution sector. And now we have a positive parity that is equal to 5% more or less.

Now regarding your work -- the working capital. We see that it will range between BRL3.5 billion and BRL4 billion because of the volumes, the costs of the inventories. So this still is a consequence of this, and in the future, we will remain in this range between BRL3.5 billion and BRL4 billion. So I believe that we will work in between these ranges when we think about the upcoming quarters.

### **Q - Daniel Sasson** {BIO 19234542 <GO>}

Okay, thank you very much.

### **Operator**

Our next question from Mr. Thiago Ojea, Goldman Sachs.

### **Q - Thiago Ojea** {BIO 17363756 <GO>}

Good morning to everyone. Thank you for your question. My first question is regarding cash generation in addition to the working capital that was approached in the past quarter. Your CapEx was low, it is BRL 1 billion. Can you explain why the CapEx was so low during the first quarter, and what would be your expectation for cash generation throughout the year, if you have a guidance? And going back to the domestic sales of steel, could you break up per sector where you had better sectors? The automobile industry stands out but are there other areas that are better and are there areas that are very slow right now?

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

Thiago, Alberto speaking. Number one, regarding working capital, it is cash generation. Unfortunately, we do not give you guidance. Now when we talk about CapEx, CapEx of the first quarter is but a reflection of what happened during the fourth quarter. We had a major growth during the fourth quarter. And the projects of the year were delayed during the first quarter, but there will be a catch up during the year. This is our expectation. And within our guidance, it was at BRL 1 billion. This is almost 70% for steel.

Regarding the different sectors. As you know, the automobile industry presented a slight drop regarding the production when we compare it to the first quarter last year. So Capital Goods and automobile industry is where Usiminas has strong performance. We believe that we still have opportunities of growth according to forecasts that engage the main players of this sector. In addition to Capital Goods and the automobile sector, well, we see construction is very slow. And civil construction is still slow here.

## **Operator**

Our next question from Mr. Rafael Cunha, Credit Suisse.

## **Q - Rafael Cunha {BIO 20229675 <GO>}**

Thank you for taking my question. My first question is a follow-up on your CapEx. Could you elaborate on your BRL1 billion CapEx? If this is regarding the High Furnace 3 of the patchina [ph] and what percentage is dedicated to the event? If there is an expectation to improve the cost of slabs after the revamp and iron ore, what is -- is there a discussion of a sale of a stake in MUSA or -- and what do you think about the life of the mine? And I would like some opinion or hear your opinion on what is going to happen.

## **A - Tulio Cesar do Couto Chipoletti {BIO 1653607 <GO>}**

Rafael, this is Tulio. This year, High Furnace 3 impacts 67 million, this is amongst the 70% of the sale unit. The other values are strongly impacted by sustaining investments, security, environment and asset replacement, permanent goods, et cetera. After the revamp, we expect a significantly improved operating indicators of the High Furnace 3, especially when we talk about fuel that are very important.

So we are working because yes, we want to drop -- we want there to be a drop in the price of the slabs. And I believe that there will be an interesting drop in prices that will be around 5% and this is the cost that is associated to calculate the rate, full rate. Rafael, regarding MUSA, the analysis for divestment continues, and this is an ongoing process. This is the only thing that I can say.

## **Q - Rafael Cunha {BIO 20229675 <GO>}**

Okay, thank you very much.

## **Operator**

Our next question from Mr. Leonardo Correa, BTG Pactual.

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

Good morning, thank you. My first question, when we see the profit of the energy [ph] of the Steel Unit during the last two quarters, there was a drop of the EBITDA margin below 10%, when we see the evolution of this during the first, second, third quarter of 2018, we were between 16% and 18%. I would like you to elaborate why of this and quality remarks because what is the direction of this metric for Usiminas and for your recent history, we believe that there is pressure, and you have difficulties in explaining of this point.

I know that you don't give guidance of the margins. And do you believe that we could expect some type of return on -- I don't know if this could be a margin of 15% that you deliver throughout some quarters during 2018. Now regarding iron ore, I know that the great jump in EBITDA and the great improvement in the quarter came from iron ore. You grew BRL120 million quarter-on-quarter, this helped you a lot on your results. And there are many variables that are changing, specifically spread, and adjustments in quality. I would like to know what is your breakeven in China. What kind of cost do you have in China?

And regarding your CapEx, one point that I would like you to clarify. I know that perhaps you cannot forecast 2020, 2021. Are you announcing there are companies that are announcing plans of three years? But as very little is being allocated to (inaudible), does it make sense to believe that this BRL1 billion will be sustainable and this will have a carryover? So Usiminas is going to work at a different level, and they will work well above the BRL560 million and that this will be a long-lasting activity.

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

Well, Leonardo, regarding the profitability in our margins, we have to remember that we are exposed to the international market in terms of costs. Iron ore prices, we already talked about parity, price differential, vis-a-vis in for the products. What we can see is that this evolution follows the international market during the fourth quarter specifically of 2018, this was an international quarter where prices deteriorated because of international steel prices.

And this was reverted during the first quarter. So the expectation is that it can sustain itself. We will be able to grow and following the international prices, both in cost and sales of steels. This is our expectation. In a certain way, this is relating to what happens abroad.

**A - Sergio Leite** {BIO 4746000 <GO>}

Answering your question about iron ore. As you mentioned, there are negative variables and the positive could be shipment exchange rate, but negative would be the increase of products like (inaudible) that we have to buy to complement our own production and negative points. We have the drop of premium in the international market. So I can say that today, in average, the breakeven in China would be around \$50.



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

Leonardo, your last question regarding the CapEx for the upcoming years. Your assumption does make sense. We believe that in the next two years, the level will be very close to what we're showing this year, that is around BRL1 billion. Although the High Furnace, that is between BRL60 million and BRL70 million. It will grow, and the total will be around BRL1 billion a year for the upcoming three years. But I believe that the production of the High Furnace is going to increase. And I believe that this is something that you should expect.

## **Operator**

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

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

Thank you very much and good morning everyone. So my question has to do with the steel sectors and the prices and that you expect to realize going forward in the second quarter. I understand that there is a push to this pricing between 10% and 15% in slab products. Can you talk about what are you doing with your clients? If you can confirm that you're also increasing prices along these levels and why you expected a decrease in realized prices for the second quarter?

And then could you comment a little bit as to what are the key initiatives the management is working on regarding costs or product mix changes or anything that the company can control from an operating perspective that you believe will improve your margins in the steel in the next few quarters, and it will be great if you can attach or quantify the potential impact from these initiatives.

## **A - Sergio Leite {BIO 4746000 <GO>}**

Good morning, Carlos, regarding the price expectation for the second quarter, we have to remember, as we mentioned we have only increased 10% for the distribution sector when we ended the negotiation with the Asian automobile industry in Brazil. This new evolution closed at a level that was very similar to the first round of negotiation of the end of last year. Now this increase in the automobile industry, together with the distribution sector, will increase the average price of the upcoming quarter. This will also impact because the growth is focused on products, more commercial products of lower added value with a lower average price. These two, three impacts possibly will generate today, and we believe that we will have between 2% and 3% when we compare it to the first quarter of this year. So this would be the increase, 2% and 3%.

## **A - Carlos Hector Rezzonico {BIO 20703029 <GO>}**

Carlos, regarding your question of the initiatives that are being realized within the Steel Unit and regarding cost reduction. What I can say is that there are a number of projects underway, which are basically focused on three main areas. One would be the production of sinter. That is the important part of the metallic load of the High Furnace and that this will give us a good result in the short, medium term.

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The second thing would be is also connected to fuel. We have a number of initiatives that want to reduce. This indicated that strongly impacts the use of coke. So we won't have to buy imported coke, and this can impact the short and the medium term. And in the future, we have projects. We have a number of projects. I can't mention all of them in the steel mill improving the production of a steel mill with more restrictive steel in meeting the market's demand. And also here in the laminated projects of energy efficiency that are underway, we also have projects to reduce our costs. And these areas are very important for us. And we're focusing on them to reduce all of our costs.

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

Thank you. Is there an estimated number of the benefits from these initiatives?

**A - Sergio Leite** {BIO 4746000 <GO>}

Well, generally, we cannot give you this estimate in the meeting because some of our problems -- projects are complex and we cannot disclose this type of information in our conference call.

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

Okay, understood. Thank you very much.

**Operator**

Our next question from Mr. Gustavo Allevato from Santander Bank.

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

Good morning, I have two questions. Now the first one would be pricing you set after the increase of 10% for distribution. You have a premium of 5%. But with the increase of raw material in the past weeks, do you believe that you will increase prices in medium to offset the increase in cost and to follow the international price?

And my second question is if you have an update to see the credits to receive from Eletrobras? And do you expect to receive these credits this year from Eletrobras?

**A - Sergio Leite** {BIO 4746000 <GO>}

Good morning, Gustavo. Yes, we continue monitoring the international prices. And as you saw, the last weeks presented a slight increase in prices. What is the current situation in the parity today. Of course, today, we could have a forecast of new increases during the year. Now, of course, these increases will depend a lot on the evolution of these indicators and the appetite of steel consumption in Brazil for the upcoming months.

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

Gustavo, regarding the Eletrobras credits, as far as we're concerned, what we saw in the fourth quarter is that we will receive this amount during this year.

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

Okay, thank you very much.

## Operator

As we have no further questions, we bring our conference call to an end. Should you have any question, our Investor Relations team is at your disposal. Thank you very much, and have a very good day.

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