

Q3 2021 Earnings Call

Company Participants

- Pedro Barros Mercadante Oliva, Chief Financial and Investor Relations Officer

Other Participants

- Carlos De Alba
- Isabella Vasconcelos
- Raphael Barcelos

Presentation

Operator

Good morning, ladies and gentlemen, and thank you for holding. At this time, we would like to welcome everybody to CSN's Mineracao conference call to present the results for the Third Quarter '21. Today, we have with us the company's Executive Officers.

We would like to inform you that this event is being recorded and all participants will be in listen-only mode during the company presentation. Once the company's remarks are over, there will be a question-and-answer section, at which time, further instructions will be given. (Operator Instructions) This event is also being broadcast simultaneously through Internet and can be accessed at the ri.csnmineracao.com.br site, where the slide presentation is also available. The replay of this event will be available soon after closing for a one-week period. Once again, you can watch these slides at your own convenience.

Please bear in mind, that some of the forward-looking statements made here are expectations or trends that are based on the current assumptions and opinions of the company management. These events may differ materially from those expressed herein as they do not constitute projections. In fact, actual results, performances or event may differ materially from those expressed or implied by forward-looking statements as the result of several factors, such as the general and economic conditions in Brazil and other countries, interest rates and exchange rate levels, future rescheduling or prepayment of debt denominated in foreign currencies, protectionist measures in the U.S., Brazil and other countries, changes in laws and regulations and general competitive factors at global, regional or national level.

We would now like to give the floor over to Mr. Pedro Oliva, the CSO and Executive Director for IR who will present the operational and financial highlights for CSN Mineracao for the period. You may proceed, sir.

Pedro Barros Mercadante Oliva {BIO 22218512 <GO>}

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I would like to thank you by joining us in this call for the third quarter '21. I will begin the operation with the highlights of the period. The EBITDA was negatively impacted by a combination of a lower sales volume, a steep drop in supply with an impact on the open accounts and an increase in the freight costs during the period. The free cash flow had BRL3.9 billion for the period impacted positively by the reduction in working capital. The projects for quality enhancement for commissioning and tests and the company ended the program to repurchase shares of 91% that had been approved and we opened up a second program that involves an additional 53,000 shares. We go on to the spot volume of production.

In the company, we had a production in line with the drop that we had in the previous quarter, which can be explained by a reduction in the volume of purchases as we have begun a new strategy to prefer quality instead of volume and our own production was higher than that of the second quarter. The inventories increased 2.2 million tons and most of this increase can be explained by a commercial strategy of the company of creating a year with a volume of cargo of 1.2 billion already shipped to China, but not sold as yet. This cargo will be realized in the fourth quarter. They have been sold and the company has adopted the right strategy to be able to work with lower discounts that were being offered vis-a-vis the market.

We go onto the sales slide. The company had a drop of 9.1 million to 8.1 million tons explained exclusively by this strategy of going through the end of the quarter with the volume still being shipped, but not realized. Regarding the net revenues, we had an expressive adjustment of \$153 to \$75. This is explained by the drop in the Platts also explained by the quotation of periods that are still open between the second and third quarter and because of the increase in freight.

In the next graph we show you the differences between total net revenues, which is reported of \$65 and the net revenues for the quarter taking away the impact of those cargos that have been sold with the quotation of price in the future throughout the second quarter. If you look only at the net revenues of the quarter, it would be \$99.2. And we see a difference of \$33 and \$5 explained by that volume of 5.3 million tons that are still pending at the end of the second quarter and sold as based on the future program.

We understand that this will be a non-recurrent event because of the significant drop in Platts. This is perhaps a record drop in our sector, the maximum price in the third quarter was \$222 and this drop to only \$94 in September of 2021. We understand that the magnitude of this readjustment will not be recurrent and if you look at the difference between these two indicators, total net revenues and net revenues for the quarter. The difference is minimal, if you look at the quarters be in 2020, its maximum of \$6 dollars.

We go to the slide this drop in TPP [ph] is explained by a drop in purchases and then improvement in mix, of course, favoring the volumes that we produce ourselves and with a drop in C1. We had a drop due to the drop in Platts and because we did not use third-party purchases during the period. Adjusted EBITDA stands at BRL911 million with a margin of 32.7%.

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In the next slide you will see the EBITDA of the second quarter to 11 million in the third quarter. Now, if we take away the effect of price provisions of previous quarters, due to the impact of BRL1.2 billion [ph], this quarter would be BRL1.3 billion [ph] showing you the relevance of this readjustment that took place during the period and perhaps the great impact was the drop of Platts and the drop of volume that is relevant, of course, but it's due to our commercial strategy that will, of course, favor the fourth quarter.

The volume of investments, a drop in expansion projects this quarter, and this, of course, highly associated to the conclusion of the test period that have already gone by and we're going to begin running at another level beginning in 2022, and in the Investor Day that we will have in approximately one-month, we will be able to go more in-depth into our growth projects, and give you an outlook of the strategic planning of the company, and share this with the market. When it comes to net capital, the adjustment was rather expressive this semester. There was a drop in accounts receivable explained once again by the drop in Platts, and the reduction in volume and increase in inventory, explained by our new commercial strategy of taking some of this volume into the fourth quarter.

In terms of suppliers, this is due to a reduction of purchases because of Platts and others due to the advances of clients that refer to the sales with higher provisional prices than the spot price.

We go on to the slide of our projects, where we would where we would like to highlight the results of the third quarter. Now to conclude these quality enhancement projects, which is in line with the new strategy of the company to privileged quality. We will benefit from this beginning in 2022, and at the end of 2021. The company carried out its first debenture issuance with a total amount of BRL1 billion during the first half of the year in two series one at 10 years at 4.9% and the second one 15 years for amortizations beginning in the 12th year. Now, these resources will be used to fund the expansion project of the port of TECAR going from 45 million to 60 million in terms of capacity.

In the next slide, we show you the strong cash exposure that the company has, but a comfortable liquidity to be able to face it's full of investments and perhaps a more unfavorable situation. We have BRL1.8 billion, an increase of 30% vis-a-vis the previous quarter. And if we deduct the debt, we have net cash of BRL718 billion.

Regarding the cash flow, we were favored by the reduction in net circulating capital and ended the third quarter with a rate of BRL3.9 billion. CapEx still at lower levels, they will be increased in 2022 and a positive financial result basically explained by the positive result of our hedge that we had opened up with an impact of 300 million is the period result and part of this have already been settled during the third quarter and all of this favoring our cash. This shows you the sustainability of the business and the resilience of the company, despite the adverse environment that we faced.

We go onto the slide of ESG where I would like to highlight some points. We have launched the first integrated report referring to 2020. We do have very relevant indicators referring to our emissions and if we compare ourselves with national and international peers in mining, we are exceptional, we are the best in the sector, and we will continue to

work on this differential. Regarding the dams, we have concluded a new cycle of auditing. We have full stability now in September and zero emergency level in all of our dams. This is the best level. In terms of security, according to the National Mining Agency, throughout the year, we had a reduction of 20% in the consumption of water in the production of iron ore.

I would like to end the presentation highlighting significant strides and diversity. The company has adopted a very active stance to move forward in this agenda. We have an increase of 27% of participation of women in the company, it has gone from 14% to 18%, and an increase of 10% in the same situation.

With this, I would like to conclude the presentation, and we would like to open the floor for questions. Thank you.

Questions And Answers

Operator

(Question And Answer)

We will now begin the question-and-answer session for investors and analysts. (Operator Instructions) Our first question is from Isabella Vasconcelos from Bradesco BBI. You may proceed, ma'am.

Q - Isabella Vasconcelos {BIO 20566061 <GO>}

Good morning, and thank you for taking my call. I have two questions on my side. The first referring to the price realization. If you could perhaps remark a bit which was the volume sold at the end of the second quarter? And if you could also remark on your expectation for the fourth quarter, this would be very interesting? My second question refers to your freight strategy for mining. Of course, things have changed a bit and I would like to understand your strategy, perhaps to be able to mitigate the impacts that freight has had? These are my two questions. Thank you very much.

A - Pedro Barros Mercadante Oliva {BIO 22218512 <GO>}

Thank you for the questions, Isabella. In times of the price realization, we sold 5.3 million of cargos with exposure to future periods this in the second quarter. The average fall price was a \$161.39 [ph]. Throughout the quarter, we had a new mark-to-market that ended with an average fall above \$190.70 [ph], which means that we have an impact of \$274 million in the result. Once again, because of this exposure, we ended the third quarter with 5.2 million tons pending open. We have the split of 52% that have been have been provisioned, 18% that is lagging behind, much of this link to the sales that go to Japan, Korea and Taiwan and a minor amount of the domestic market and 30% of exposure to the -- for the present quarter.

Regarding the fourth quarter, now this strategy of having sales with a future exposure is a strategy that has favored us and has allowed us to negotiate parametric formulas,

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enabling us to have a better price realization vis-a-vis the spot price throughout time perhaps the effect will be neutral because prices increase and drop. But this is a non-recurrent impact and expressive impact the third quarter because of its magnitude.

As I mentioned during the call this drop of \$129 is unprecedented. This does not mean that it won't happen again. We always have drops in prices from one quarter to the other. Now, this open cargo will become a result and we believe that through time, this will be resolved and there we will have had a better price realization vis-a-vis the spot price. And for the fourth quarter, we hope to and closer to 4.5 million with a slight drop with the level of 5 million tons.

Regarding our freight strategy, the market as a whole was taken, by surprise by the increase that reach \$49.99 less than a month ago on October 7th. We already have \$25.08 a drop of more than 50% in the freight in the period that is shorter than a month. And we foresee that this will continue. We believe that, it will become firmer during 2022, we have a different volume. We have 49 million tons for 2022 with a relevant position and this sure lead the freight to a level that is even lower than the present day one. We still have a 100% exposure to the spot market at present, and in a recurrent way, we have analyzed all the alternatives to secure prices in the long-term. I think it would be interesting to do this for the longer term. And in 2021, we decided that it was not a good moment to have this exposure with ship freighters. This has to be done for the long term, but we will go back to carrying out this type of exercise beginning now with a freight that is at a much more reasonable level.

Q - Isabella Vasconcelos {BIO 20566061 <GO>}

That was very clear. Thank you very much.

Operator

The next question is from Raphael Barcelos from Santander Bank. You may proceed sir.

Q - Raphael Barcelos {BIO 21185331 <GO>}

A good day to all of you. Thank you for taking my questions. My first question is about the iron ore delivered to China. If you could give us more comments on your figures?

Secondly, your strategy of purchasing from third parties, because of the market situation, we would like to hear about your strategy? Thank you.

A - Pedro Barros Mercadante Oliva {BIO 22218512 <GO>}

Raphael, thank you for the questions. In the third quarter with China, we had a C1 of \$18.8, and our average freight was \$26 during the period, which means that the top price to China is \$44.8, not very different from what we had in the second quarter of '21, somewhat higher. Once again, basically impacted by the freight because we had a reduction of more than \$1. Now, regarding our purchase strategy. With this adjustment in the discounts because of the Platts level and because of the pressure of the higher freight vis-a-vis other quarters, it is a time of adjustments in the market to exclude, the low content volumes. We're working with the expectation of ending the year with 10

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million tons. We have carried out a turnaround. We will reduce this to 8.5 million tons, and this alone will be an explanation. We were close to the range of 17 million tonnes with the expectation of purchasing 10 million tons. This has been reduced to 8.5 million tons and close to 36.5 -- 36 million to 37 million of production. For this year, this would be the updated volume.

Q - Raphael Barcelos {BIO 21185331 <GO>}

Well, how are you looking upon this for the fourth quarter, if you could remark on this as well?

A - Pedro Barros Mercadante Oliva {BIO 22218512 <GO>}

There won't be great variations. At the beginning of the fourth quarter, Raphael, we had a significant impact because of the impact in freight, the increase in freight, I'm sorry. But this just not impact our spot strategy that has already been contracted with their CIF volumes. We were able to go through that period of peak prices without having to lease new shift. And at this new level, our CIF freight was \$26 in the third quarter. Freight is already at \$24.8 and because of the spot price, we are at a better level. We don't expect great variations in C1. We will have a period of rainfall that generally has an impact on the total volume and we have a scheduled maintenance for November for the plants, but I can say that there won't be great variations, Raphael, vis-a-vis the figures for the third quarter.

Q - Raphael Barcelos {BIO 21185331 <GO>}

Thank you. Thank you very much.

Operator

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

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

Yeah, good morning, everyone. Thank you very much. My first question is regarding the CapEx guidance. It has been reduced and I would like to understand what is behind this considering how important the growth story for the company is? My second question is regarding working capital. Clearly that saved the quarter from a cash flow perspective. And what do you expect in accounts receivable next year -- sorry, next quarter in the fourth quarter given the positive impact of the price dynamic that we saw in the third quarter? Is it fair to suspect some sort of payback in the fourth quarter, as prices now are much lower and you still need to do another provision of price adjustment potentially in the fourth quarter, given what iron ore prices are doing?

And there is around BRL1.8 billion in Outras contas a pagar in your cash flow statement, which would be great if you could explain what that is? And then finally if you have already sort of a range or a view of how 2022 production and shipments of iron ore will look like that will be really useful? Thank you very much.

A - Pedro Barros Mercadante Oliva {BIO 22218512 <GO>}

Carlos, thank you for your questions. Regarding the CapEx guidance, we carried out this adjustment because most of the projects are still at the engineering phase and because the project is not necessarily associated to disbursement. To give you an example, we have the conclusion of the negotiations, signature of contracts and the first package for the plan of 50 million tons. But this won't have a cash effect during the quarter. We're always seeking to negotiate in favor of the company and the payment is associated to deliveries. So this ends up being a cash effect that is postponed for future periods, and only beginning in 2022 with a works in the query already happening.

We will have a completely different level of disbursement quarter-after-quarter with positive results for us. Through as the CSN Investor Day, we will give you more details regarding the projects in our portfolio. The schedule, the target of the schedule is quite challenging, but we're working. I'll just need to be able to adhere to it.

Referring to other accounts payable, the magnitude of the readjustment and accounts receivable will have a position going forward. Part of this explain by the expectation of having an increase in sales vis-a-vis, the volumes that were shipped and not sold. At the close of the third quarter, the results will be pretty much the same. We don't expect significant adjustments in that account.

Now regarding that BRL1.8 billion in other accounts payable, I did not touch upon this in the presentation. This is the realization, the recognition of a provisional price that has been paid by the client, we're calling this a client events that will have an adjustment, due to the exposure for the future quotation period where we will conclude the sale per se.

Now this account will have to be deducted quite expressively in the coming quarters. When it comes to 2022 and we will also approach this at CSN Day, Carlos, the trends are positive with based on the preliminary analysis that we have carried out, both in terms of volume compared to 2021 and in terms of quality. And I think this merits acknowledgement of the quality of the asset Stone House, Casa de Pedra that enables us to have this flexibility of seeking greater quality, and we sort of imposes in the market. So the outlooks for 2022 are very positive.

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

Thank you very much. Pedro, that was great.

Operator

(Operator Instructions) Our next question comes from Isabella Vasconcelos from Bradesco BBI.

Q - Isabella Vasconcelos {BIO 20566061 <GO>}

Thank you for the follow-up. Pedro, I would like to confirm with you the dividends policy of the company the payout of 80%, if this will be maintained despite the market situation? Thank you.

A - Pedro Barros Mercadante Oliva {BIO 22218512 <GO>}

Isabella, thank you for raising this point, that is so relevant for the investors. Despite the volatility the policy still stands. We have a liquidity position that will enable us to maintain this very aggressive policy of paying out 85% of the net profit every year and to continue to work on all of our growth projects and quality enhancement projects. For us, of course, this is a very important point as part of the rationale for investment in our company. This is something that investor's value and of course, we're not going to put aside something so fundamental for our growth strategy.

Q - Isabella Vasconcelos {BIO 20566061 <GO>}

Thank you.

Operator

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

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

Yes. Hello. Thank you again. Just -- Pedro, can you talk again or remind us or me, at least, the hedge -- the cash flow hedge that is in place. And the company posted a gain in Outras (inaudible). It was a solid gain and it is says, there is hedge on -- or is a derivative on the Platts index. Could you explain a little bit more what that is? Is the company basically hedging by selling forward some of the material? Or is the company taking a view on iron ore prices? Yeah, if you can give us some details, that will be great.

A - Pedro Barros Mercadante Oliva {BIO 22218512 <GO>}

Carlos, thank you for raising this point, and I think that this is a point that we have been including in our releases in the last quarter as part of a strategy to have more stability and forecasts stability in our information. Well, the market price was interesting for the investors and historically, we look at previous periods. This is not something we did very much in the financial market, but this is something that we did in the physical market, to look at the stability of the company and throughout this year. We have realized that the discounts in the physical market for future periods is not a good idea. We have stopped selling at fixed prices and we have made greater strides with this in the financial market with a greater impact.

We ended the quarter with a volume somewhat above 2 million tons for future sales as you mentioned, and the P&L result will be someone over BRL300 million. Now this has been recognized in the quarterly results. The part that refers to September that was somewhat lower, refers to the financial settlement at the beginning of October. Presently we no longer have any of these volumes that are part of the hedge. The future prices are flatter. The -- we're not seeing what happened in previous period, and this shows the market vision in general, where a restatement was done and going forward, the expectation is that the price level for 2022 will be very much aligned to the range that we have a \$100 or a \$120.

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

So just to confirm there, Pedro, the company does no longer have any open positions or neither derivatives?

A - Pedro Barros Mercadante Oliva {BIO 22218512 <GO>}

Perhaps, I wasn't clear, Carlos, but all the positions have already been settled. We no longer have -- no longer have any open positions, any open hedge positions.

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

Got it. Thank you very much, Pedro.

Operator

Ladies and gentlemen, as we have no further questions, I would like to return the floor to Mr. Pedro Oliva, the CFO for his closing remarks.

A - Pedro Barros Mercadante Oliva {BIO 22218512 <GO>}

I would like to end by once again thanking all of you for your participation in our call. We have paid a certain price for having a commercial strategy for having open cargos. Now the magnitude of this adjustment is not recurrent and we're quite enthusiastic with the outlook of 2022, where we will have greater volumes, better quality enabling us to adapt to this new market situation with initiatives that will set us aside in terms of quality and cost, to be able to fight in this very competitive market.

Operator

The conference call for CSN Mineracao ends here. We would like to thank everybody for their participation. Have a good day. You can now disconnect.

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