Q2 2012 Earnings Call

Company Participants

- Daniel dos Santos, Mining Director
- David Salama, IR Executive Officer
- Luis Martinez, Commercial Officer

Other Participants

- Ivano Westin, Analyst
- Marcos Assumpcao, Analyst
- Renato Antunes, Analyst
- Thiago Lofiego, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. At this time we would like to welcome everyone to CSN's Second Quarter 2012 Earnings Conference Call. Today, we have with us the Company's executive officers.

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

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

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

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

Investors should not -- should understand that general economic conditions, industry conditions and other operating factors could also affect the future results of CSN and could cause results to differ materially from those expressed in such forward-looking statements.

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

David Salama {BIO 17456021 <GO>}

Good morning, everyone, and thank you for joining CSN's Second Quarter results conference. Here with me today are the CSN officers. Just let's begin with slide three where we can see the consolidated results for the Second Quarter of 2012.

Net revenue totaled BRL4.1 billion in the Second Quarter, 6% up in the First Quarter, chiefly due to higher steel sales abroad. In the first semester, net revenue reached BRL8 billion. Gross profits reached BRL1.2 billion in line with the First Quarter of this year.

EBITDA reached BRL1.1 billion in line with the First Quarter 2012 totaling BRL2.2 billion in the first half. The EBITDA margin was 27%. The Second Quarter CapEx reached approximately BRL800 million, first half investment totaled BRL1.7 billion.

CSN posted our Second Quarter's last loss of BRL1 billion basically due to an accounting reclassification with no cash effect. Note that these adjustments is not recurring. Based on the accounting rules as well on the Company's investment policy, management proceeds evidence of significant reduction in the Company's investment in Usiminas' shares by the end of June 2012 and decided that on the reclassification of accrued losses recorded on their shareholder's equity to the income statement.

It's worth mentioning that this reclassification has no cash impact and doesn't affect the capacity of dividend payments due to existing profit reserves. Excluding the effects of this reclassification, net income would have totaled BRL550 million in the Second Quarter and BRL640 million in the first semester of this year.

Now, let's move to the slide four where we present the EBITDA evolution. The EBITDA totaled BRL1.1 billion in the Second Quarter in line with the First Quarter of 2012. It's worth mentioning certain factors that partially offset one another.

On one hand, EBITDA was positively impacted by higher average mining prices and the upturn in prices in reais due to the appreciation of the dollar. And second, the increased steel sales abroad. However, its effects were partially offset by lower iron ore sales volume and higher SG&A expenses.

Now, let's go to the slide number five. On this slide, we can see net revenue and EBITDA for CSN operational segments, mining accounting for 27% of net revenue and 50% of the EBITDA in the Second Quarter 2012 while steel was responsible for 62% of net revenue and 39% of the EBITDA.

Let's move now to slide six which shows the results from the steel segments. We will begin with the graph on the top left. Steel sales totaled 1.4 million tons in the Second Quarter, 10% more than in the First Quarter mainly due to the increase in steel sales abroad thanks to the German subsidiary, SWT whose results were fully consolidated in the Second Quarter.

74% of the sales came from domestic market, 23% from our subsidiaries abroad and 3% from exports. As you can see in the graph on the top right, net revenue from steel operations totaled BRL2.7 billion, 11% more than in the First Quarter in 2012.

At the bottom, we have our EBITDA figures, steel segment EBITDA stood at BRL470 million in line with the First Quarter 2012 and the EBITDA margin was of 18%.

As now in the next slide, we are going to make the same analogies for mining segment. You will see once again -- we start with the -- in the top left graph. In the Second Quarter, CSN and Namisa iron ore sales reached 6.4 million tons, 9% less than in the First Quarter considering some operational issues that we have in the Second Quarter and affected our operation and we are going to give more details during this call.

It's worth mentioning that in addition to the sales supply CSN itself consumed 1.5 million tons of iron ore in the Second Quarter, a figure that is not shown in this graph.

Moving up to the top right graph, you can see that the net revenues totaled BRL1.1 billion in the Second Quarter, impacted by lower sales volume, partially offset by the appreciation of the dollar and higher average prices which reached $109 per ton in the Second Quarter versus $107 in the First Quarter of this year.

Now, let's look at the EBITDA from mining operation at the bottom left. In the Second Quarter, mining EBITDA totaled BRL600 million and the EBITDA margin of 55%, 4% higher than in the First Quarter of 2012.

Now, let's go to the slide eight where we show our net debt evolution. Net debt moved up by 9% in the Second Quarter totaling BRL15.6 billion with gross debt of BRL29.3 billion and a substantial cash position of BRL13.7 billion.

The main factors that impacted were the payment of BRL1.2 billion in dividends, investments of BRL700 million in fixed assets, BRL600 million from disbursements related to debt charges and other effects that together had BRL100 million impact on the net debt. Its effects were partially offset by the Second Quarter EBITDA of BRL1.1 billion and the reduction of approximately BRL200 million in the working capital allocated to the business.

I want to highlight that CSN has made an important progress in reducing its working capital. In the last 12 months alone, it decreased by around BRL900 million, the -- our working capital position. And the cash conversion cycle has shortened from 104 days to 67 days. The net debt EBITDA ratio closed the Second Quarter at 2.9 times the EBITDA of the last 12 months.

On June, 63% of the gross debt was denominated in reais and 37% in foreign currencies, especially US dollars. Of total debt, 8% is short-term and 92% long-term.

That brings us to the end of our presentation. We will now move to the Q&A session. Thank you.

Questions And Answers

Operator

Thank you. The floor is now open for questions. We would like to inform that due to the number of participants, the Company will answer only up to two questions per participant and therefore, we kindly ask that all the questions are made at once as soon as the line is open by the operator. (Operator Instructions)

The first question comes from Ivano Westin of Credit Suisse.

Q - Ivano Westin {BIO 17552393 <GO>}

Hello. Good day. Thank you very much for the call and for the question. I'd just like to touch base again on the discretionary head on the Portuguese call. I'd just like to get a bit of color on the breakdown of the mining CapEx for the period in 2012, second semester this year and 2013 to 2015. This is the first question.

And the second question refers to Namisa Pellet plant which you mentioned that it was approved. I just wonder whether you expect to have a second balance planned on your expansion project. Thank you very much.

A - David Salama {BIO 17456021 <GO>}

Hi. Daniel Santos, our mining director, he's going to answer your question.

A - Daniel dos Santos {BIO 6218699 <GO>}

Ivano, we can send the breakdown of the CapEx by -- through the investor relations. I think it's better because we have a lot of details here and I think it will be more productive if you receive it from investor relations.

But relating to the second pelletizing plant that you asked, we are scheduling the startup of this pelletizing plant for the First Quarter of 2016 because we need to have -- we have due to the license procedures a gap of some months between the start up of one plant and the implementation license for the second one. But it's something that is agreed with the state government through the licensed agents, and we have the schedule to start up in the First Quarter of 2016.

Operator

The next question comes from Marcos Assumpcao of Itau BBA.

Q - Marcos Assumpcao {BIO 7474402 <GO>}

Hi. Good afternoon, everyone. First question is regarding domestic prices of steel in Brazil, if Martinez could help a little bit here.

First, is -- I think that probably the -- actually, do you think that increasing prices in September will be possible, considering that probably imports will be lower from September onwards given that imports that are going to be order now are going to be arriving in Brazil only after 2013? So they will not benefit anymore from the ports best legislation?

And my second question would be if you're seeing an increasing risk from competition in the flat steel market coming from Gerdau in 2013? And also, if you could just -- what will -- could you just comment on what are the volumes that you are considering for long steel in the domestic market from the new plant in 2013 as well as you're going to be starting up the new line? Thank you.

A - Luis Martinez {BIO 7187744 <GO>}

Hello, Marcos. Good morning. This is Luis Martinez speaking. As I mentioned during the morning -- during the morning call, I would like to emphasize that first of all, we are completely focused in the local markets. We are just selling something, like, 95% to 98% to the local markets and we are going to continue to pursue this type of objective here inside the CSN.

Regarding to recall, we can recover margins in the market. We need to take into account that we are working very, very strong on trying to reduce our costs and we have been doing successfully according to my understanding not only for the raw materials, but also for the plans that we had already implemented involved (inaudible) plants. So we are going to benefit in margin in terms of cost analysis.

In imports, I'm a little bit concerned about imports not only for the past situation, but the current situation. We are feeling -- we are perceiving that in China, for example, they are starting to trying to export hot rolled coils in a range -- in a price range of $530 per metric ton and probably, they are going to do the same with coated materials.

In case -- in the case of coated materials, CSN has been suffering a lot during the last four years, especially in 2010 and 2011. So far as I mentioned in the first semester of the year compared with the same period last year, imports increased 5% and we start to experience a slowdown in imports just for two or three months. We would like to confirm that's going to happen no matter what's going to happen with the ports.

We are also considering that we are going to have some benefits of -- regarding to the season -- regarding the taxes and mainly Santa Catarina and Northeast of the country. So in terms of pricing, according to -- we are perceiving in the markets, our competitors start -- just start to increase prices in the distribution markets.

And as I mentioned during this morning, distribution is not a mark. It's just a shadow. We need to understand what's going on with all the productive channels like auto industry, white line, home appliance and so on and so forth. We are expecting to have a better mark for the second half. We wouldn't like to lose any opportunity to recover our margin and then we are going to keep marking the markets exactly what we are doing so far.

So basically, this is the situation of our current price and future demand in terms of the industry.

Regarding to long products, we -- as David mentioned during this morning, we are forecasting to have the startup of the plants the second half of next year. Obviously, we have a ramp-up and -- but we are considering that in six or eight months we are running -- we are going to be running something, like, 500,000 metric tons a year, 100% to local market. We are not forecasting to import just supplying to the local market and take advantage of some growth in the building products and the infrastructure in Brazil.

Operator

The next question comes from Renato Antunes of Flow.

Q - Renato Antunes {BIO 17439917 <GO>}

Good afternoon, everyone. Thank you for taking the follow-up from the Portuguese call. First question is related to the recently implemented mining tax in Minas Gerais. If I'm not mistaken, BRL2.17 per ton. We have been seeing some companies already provisioning these payments and I just wanted to hear how is CSN positioning on the matter and what are your views on the theme? We understand that this is being contested in judicial courts. That's the first question.

And the second question is related to the iron ore business unit from a strategic point of view. I just wanted to hear your views about the consolidation theme among miners in the Minas Gerais region. Is this something that CSN could be looking at or would be interested to look at? You mentioned that M&A would be opportunistic, of course, but, from a more broad point of view, is this something that -- is something that you're looking at? Thank you.

A - David Salama {BIO 17456021 <GO>}

Okay. Daniel is going to answer your questions.

A - Daniel dos Santos {BIO 6218699 <GO>}

Yes, related to this last question where you are mention possible M&As in Minas Gerais state, our focus is to finish the pipeline of projects we've presented so far in Casa de Pedra and Namisa. We have a strong portfolio of projects that need to be finished in debts of the priority of the Company at the moment.

Of course, if there is any opportunity in the region, we stood carefully and see if it makes sense to and it is in accordance with this strategy of the Company.

If you are mention of -- if you are mention the movements that some companies are doing in the area called Serra Azul, we are in different location when you compare with the assets of other players in Serra Azul area. We are in the southern portion of Iron Ore Quadrangle in an area called the (Autrodop Para Wapiba). And in this area, we are already the dominant company and we have the most of the good assets that's in the region.

If you compare the quality of the assets of CSN in the region with the other players in the area, you see that the most of them depleted the amortized resource and we have -- we still have a significant amount of amortized in Casa de Pedra mainly that is preserved and it is our differential -- it would create more competitiveness for us.

Our portfolio is based on this advantage -- in this strategic advantage. That is the amount of amortize that you have there. Then we will be in the -- one of the steel producers of sinter feeds when the most of the players in the region will be producing only pellet feed.

So our capability is to buy low-grade ore from the others to mix with this high grade material and transform and standard products for the market. We have this capability now and we will take advantage of this in the future.

A - David Salama {BIO 17456021 <GO>}

Okay. Renato answering your first question related with this new tax -- this local tax, we really started to see an increase in taxes in Brazil, not only in taxes, but, in fact, all this discussion related to royalties and all the mining industry. Not only in Brazil is suffering a lot. And we have here specifically just new charge of BRL2.6 per ton that started by the end of May.

We are discussing the -- at this point using the national consideration of the industries here in Brazil and you are making all the deposits of this new tax, but in our accounting, we are making all the provisions and so on and we want to see what's going to be the final decision on that considering that we have -- we pay a lot of taxes in ore and other charges in the mining industry.

Operator

(Operator Instructions) The next question comes from Thiago Lofiego of Merrill Lynch Brazil.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Hi. I have two questions. The first one is to Martinez. Martinez, up until what kind of premium to imports are you comfortable on having domestic prices and also, if you could, tell us where the current premium or discount to imports the local prices are? That's the first question.

The second question is just to clarify from the Portuguese call, on your volume expectations for iron ore for the remaining of the year and also 2013, you mentioned that you expect the quarterly run rate to return to close to 8 million tons or close to your previous guidance, which would mean 28 million to 29 million tons for the year. Is that reasonable? And also, if you could, tell us what your guidance for 2013 is. Thank you.

A - Luis Martinez {BIO 7187744 <GO>}

Hello, Thiago. This is Luis Martinez again. Just to give you some other colors regarding two imports in the market, let's talk about galvalume, for example. This is aluminum and zinc steel. If you take into account just this example, year-to-date we have something, like, 128,000 metric tons of total imports of galvalume in Brazil this year.

It means something, like, 18,000 metric tons a month, 18,000 a month, this is our current production in CSN Parana, just to give you. So we are receiving every month from galvalume one month of production of one of our coaching lines in Parana.

So this is just to illustrate it to give some other colors regarding to the imports. And I'm a little bit concerned about this situation because the current -- the current prices in the international market are giving some signs not only -- not in US and not in Europe, but what makes me more concerned is regarding to the China, for example. If they are facing some very bearish situation in China, they could revert or they could divert production to Brazil. I'm a little bit concerned about the situation.

So in terms of premium prices -- not a premium price -- if you consider the imported material landed in Brazil with importers and other taxes, in the case of coated products, we have a premium, something, like, 2% right now -- 2% to 3% in terms of -- in galvanized products.

In terms of cold rolled products, something like, 3%. And in the case of hot rollers, we are almost in the break even. So this is the current situation. We are going to analyze all the value chain to have -- to be sure that we are going to have the right decision in terms of price increases.

A - David Salama {BIO 17456021 <GO>}

Now, Daniel is going to answer your second question related to our iron ore sales for this and for next year.

A - Daniel dos Santos {BIO 6218699 <GO>}

Yes. After this First Quarter in this year where we were pretty affected by the atypical rainy from January mainly where you experienced the catastrophic scenario in the areas around the mine operations in the southern portion of Iron Ore Quadrangle, we implemented all the repairs needed to recover the infrastructure around because it involves a lot of Earth movement in the (recurring) oil slopes, roads access in the area.

And since July, we are in line with our budget. Then the second half of this year we'll be at full capacity in terms of production and we expect it to achieve a number similar to last year, as you mentioned, something between 28 million to 29 million tons. We believe we can achieve these 29 million tons as a little bit higher and compared with -- than the -- compared to last year.

And at the same time, we are finalizing the works in the duplication of the production in Casa de Pedra. Till the end of this year, we will have some lines (in) operation and do you have the capacity to produce 40 million tons installed in Casa de Pedra next year? So all the resources are there and we will have this capacity there and we will start the ramp-up of the production to achieve the maximum capacity of 40 million tons next year.

Operator

The Q&A session has now concluded. I'll turn the conference back over to Mr. David Salama, CSN's Executive Investor Relations Officer for his closing remarks.

A - David Salama {BIO 17456021 <GO>}

Thank you, all for participating in our conference call. The IR team is available to answer any questions you may have. Good afternoon.

Operator

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