Q1 2014 Earnings Call

Company Participants

- David Moise Salama
- Luis Fernando Barbosa Martinez

Other Participants

- Ivano Westin
- Marcelo Aguiar
- Renato Antunes
- Thiago Lofiego

MANAGEMENT DISCUSSION SECTION

Operator

Good morning and thank you for waiting. Welcome to CSN's Earnings Conference Call for the First Quarter of 2014.

With us today, we have 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 conference presentation. After the company's remarks are over, there will be a question-and-answer session. At that time, further instructions will be given.

Today's event is also being simultaneously webcast by the Internet and you can have access through CSN's Investor Relations website at www.csn.com.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.

Before proceeding, we would like to say that forward-looking statements are being made under the Safe Harbor of the Securities Litigation Reform Act of 1996 (sic) [1995] (01:25). 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 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 period.

Please, Mr. Salama, you may begin your conference.

David Moise Salama {BIO 17456021 <GO>}

Good morning, everyone. Thank you for listening to CSN's earnings presentation. Here with me today, the Executive Committee of the company. I'd like to start on slide number three, where we have the consolidated results for the first quarter of 2014. In the first quarter, net consolidated revenue of BRL 4.4 billion had an increase of 20% vis-à-vis the BRL 3.6 billion reported on the first quarter of 2013, mainly thanks to higher revenues in mining and steel. When compared to the fourth quarter of 2013, the net revenue dropped 12%, mainly due to lower revenue in mining.

Gross profit for the first quarter of 2014 reached BRL 1.3 billion, 69% higher vis-à-vis the first quarter of 2013. And comparing the fourth quarter of 2013, gross profit was lower 19%. CSN has reached net profit of BRL 52 million in (03:41) above our net profit in the first quarter of last year. Adjusted EBITDA of BRL 1.4 billion was 60% higher than the BRL 902 million from the first quarter of 2013, led by mining and steel results.

Comparing to the fourth Q of 2013, adjusted EBITDA was 18% lower. EBITDA margin on first Q 2014 was 30%, 8 percentage points higher than the first Q 2013 (sic) [2014] (04:16), and 2 percentage points lower than the EBITDA margin of the fourth quarter of 2013.

Investments in the first quarter of 2014 totaled BRL 355 million, of which BRL 114 million in steel for Casa de Pedra and Port of Itaguai, BRL 108 million in steel. And basically, caused by renovations on the hot strip mill, as well as on the coke oven battery, besides BRL 12 million invested on the expansion of production capacity.

Now let's turn to slide number four, where we have the results per segments. On this slide, we have net revenue and EBITDA by the main segments of CSN. In the first quarter of 2014, steel represented 64% of the net income and 50% of EBITDA. Mining accounted for 26% of net income and 39% of EBITDA.

Now let's turn to slide number five, where we are going to have a breakdown for steel segment. Starting by the top left chart, on the first quarter of 2014, the total sales volume of steel was 1.4 million tonnes, 4% lower than total volume in the fourth Q 2013, considering the seasonality of sales in the domestic market. Out of total sales, 73% were in the domestic market, 25% by our overseas subsidiaries, and 2% exported.

Now on the top right chart, steel net revenue was BRL 3.1 billion, 1% higher than 4Q 2013, basically thanks to higher prices that reached an average of BRL 2,216 in the first quarter, an increase of 6% vis-à-vis the last quarter of last year.

Now, to the bottom of the slide, we have the EBITDA information. On 1Q 2014, steel adjusted EBITDA was 761 million, 20% higher than 4Q 2013, basically thanks to higher prices, and it's been the highest EBITDA since the third quarter of 2010.

Adjusted EBITDA margin of 24% on first Q 2014 increased 3 percentage points vis-à-vis the fourth quarter of 2013, also the highest EBITDA margin since the third quarter of 2011. These results show a margin recovery for the steel segment.

On the next slide, we'll talk about mining. Once again, I'd like to start with the top left chart. In the first quarter of 2014 sales of iron ore for CSN and NAMISA totaled 6.4 million tonnes, 18% lower vis-à-vis 4Q 2013 due to maintenance on Tecar at Itaguai Port. Of that volume, 2.2 million tonnes were sold by NAMISA. In addition to sales to customers, CSN consumed 1.5 million tonnes of iron ore on the first quarter of 2014.

Still on the top part, but now to the right corner, we see that net revenue of BRL 1.2 billion in the first quarter was down 35% vis-à-vis 4Q 2013, due to smaller volume sold, as well as lower prices that have reached $89 in the first quarter vis-à-vis $96 in the fourth quarter of last year. And also, in the fourth quarter of last year, we received BRL 323 million regarding insurance compensation due to loss of profits from a claim in the ore reclaimer and the conveyor belt system of Tecar.

Now let's turn to mining EBITDA on the bottom of the slide. On the first quarter of 2014, EBITDA amounted to BRL 585 million, a 43% drop vis-à-vis the prior quarter, and the EBITDA margin of 47% was 6 percentage points lower.

On slide seven, we'll discuss EBITDA trends. EBITDA of BRL 1.4 billion in the first quarter was down 18% vis-à-vis 4Q 2013. Higher steel prices had a favorable impact on the EBITDA. On the other hand, contributing to EBITDA reduction, lower prices and volumes sold of ore, smaller steel volume sold, as well as insurance payment for Tecar posted in 4Q 2013.

On slide eight, we will talk about the net debt trend. On March 31, consolidated net debt totaled BRL 15.8 billion, very close to 2013 year-end figure. Net debt/EBITDA ratio was down from 2.91 times to 2.7 times at the end of March 2014.

Also contributing to the increase of net debt, dividends and interest on equity of BRL 400 million paid to shareholders, CapEx of BRL 300 million, and also disbursement of BRL 700 million for debt charges.

As an offsetting effect, EBITDA reached BRL 1.4 billion in the first quarter of this year. 60% of net debt in March was denominated in reais and 40% in foreign currency, mainly American dollars. From debt position, 88% is long-term and 12% of the debt is short-term.

That concludes my presentation. Let's now turn to the Q&A session.

Q&A

Operator

First question from Renato Antunes, Brasil Plural Company.

Q - Renato Antunes {BIO 17439917 <GO>}

Good morning, everyone. Thank you for the question. First, about steel, could you speak a bit more about how you view 2014 regarding the demand? This is one of the big questions from the market. And how do you view end user demand, now that we have a few issues with the automotive industry. This is my first question.

Second question, about CapEx, could you speak a bit more specifically about what you expect for this year, also the expansion of the mine and a change in the dam. We could see that the CapEx number is low and I would like to understand how CapEx will evolve as we have the project to expand the mining operation.

A - David Moise Salama {BIO 17456021 <GO>}

Renato, thank you for your question. Martinez will answer the first one about the steel segment. And your second question I will answer, together with Daniel Santos (12:53), our Mining Director. Martinez, you have the floor.

A - Luis Fernando Barbosa Martinez {BIO 16386589 <GO>}

Hello, Renato. Good morning. First of all, to understand what CSN thinks about the market in 2014, demand, et cetera, first, we believe there is a lot of pessimism in the market because of elections, holidays during the year and the World Cup, the FIFA World Cup. Our view is that 2014 will be a good year. We still have good wages, income, and enough consumption to sustain the economy during this year. Now, the issues in the automotive industry, also considering cars, trucks, buses, we believe it is only an isolated issue. To our mind, the issue will be solved in the next few days, so that this industry will resume growth.

Another piece of information, which we believe, our foreign exchange rate is an outlier today and we believe the foreign exchange rate will come back to more market levels - will come back to more realistic market levels.

Now, speaking about CSN operations, we're operating at full capacity today, with approximately 100% of our production in the domestic market. Our margins have rebounded because of a new price alignment in the domestic market from 68% and also because we've had a very strong program of cost reductions in effect. Under this umbrella of cost reduction, we have a very daring plan to improve operating excellence, led by our production team. Just to give you an idea, the margin of flat steel, considering Brazil in the first quarter, is around 30%, which is a favorable level compared to what we've seen in previous years.

Another important point, we firmly believe in adding more value. In the first quarter 2014, the coated products represented 40%; in the first quarter 2013, only 35%. So, we've also improved our product mix during this period of time. We also wish to highlight that our portfolio is quite rich. That is we are not concentrated in specific markets, so that we have a very good market distribution of products.

Now, the good news, as of May 1, we've had the first sale from the new operation of long steel and this year, we will deliver to the market approximately 160 million tonnes of long steel or long products. As part of our operating excellence, we will reduce inventories as compared to the first quarter 2013, and this reduction was approximately 40%, which has, of course, also contributed for our result.

Regarding maintenance, the last maintenance was in the HSM, or the hot strip mill. This was a 10-day stoppage. Our production is 20,000 tonnes to 40,000 tonnes (16:37) per day, so you can actually calculate the production loss we had because of the maintenance on the HSM, which is our bottleneck today, the hot strip mill. So this slight drop in volume in the first quarter is certainly associated to this scheduled maintenance stoppage.

Also interesting, we had a lower purchase of slabs, 102,000 tonnes, in the first quarter. So in general, we have an optimistic view of the market, as we analyze value chains, except for the automotive chain. When you look at construction, white line consumable goods, also retail and distribution, all of these industries expect growth in 2014. Of course, we cannot forget about the automotive issue. This market is important. It accounts for 30% of apparent consumption, but as I said, I firmly believe this is only an isolated issue which will be solved in the next few days.

A - David Moise Salama {BIO 17456021 <GO>}

Renato, now let us talk about CapEx this year. You have actually seen that in this quarter we disbursed BRL 355 million, basically in mining BRL 114 million, where we include Casa de Pedra mine, and also Itaguai Port; another BRL 108 million in steel operations. Our guidance for this year, BRL 2.8 billion. And the highlight is mining, accounting for BRL 1.5 billion in new investment. Also, BRL 628 million will be invested in the steel operations, BRL 400 million in cement, and other projects account for the remaining BRL 239 million, adding up to BRL 2.8 billion investments.

Now, mining is highly relevant in 2014. Investments of BRL 1.5 billion out of BRL 2.8 billion, so it is our number one project in 2014. And let me now ask Daniel dos Santos (19:17), our Mining Director, to provide more details about these efforts to expand our capacity in Casa de Pedra. Daniel (19:27)?

A - Operator

Hello. Yes, we have good news about the expansion of Casa de Pedra mine. We now have this construction work being conducted in the dam. We needed more capacity to store tailings, which is quite common in this area of iron ore exploration. Now we have been able to implement a greater capacity in our tailings dam as we finish the construction work of Casa de Pedra Dam. The construction work ended in March, in the first quarter. We finished the elevation work, but as we had a drier season in January and February, we were able to advance this construction work, so that it was concluded before the deadline.

In terms of the final disposition of tailings, we have enough capacity. We have a comfortable position, not only for 2014, but also in the long-term. In addition, as we've had a drier summer, we were able to move faster with some other projects. When you look at sterile material (21:01) or materials that cover the ore during mining operations, we've been able to make a lot of progress in the development of our main deposit of sterile material (21:12) in Casa de Pedra. So, both the tailings dam and also these new deposits have enough capacity to support our production plan for 2014 and further on in the next five years. So, we are in a very comfortable position because the efforts in the last two years were actually very big efforts, but now we stay at an advantageous position. We were quite successful in these efforts.

In terms of ore production, as I've mentioned, we're currently about to conclude the installation of additional lines in the Casa de Pedra processing plant. We already have the benefit of some lines that have been delivered. That is, we made progress as you can see, looking at our product mix in the first quarter. The quality of our pellet feed is really very high. And now, in the second quarter, we will begin to deliver the new loading lines in the railway yards. So, we have a few contracts being negotiated. We will soon be able to sign these contracts to be able to start the operations, to start the construction work now that we will begin the dry season between May and October.

So, we will need this CapEx as David mentioned in the dry season, in the Brazilian winter between May and October, which is the best time for construction work. We expect to conclude Casa de Pedra expansion up until the first quarter next year. And with the strategy we've adopted of delivering line-by-line, production will increase gradually along this year, according to our plan.

Q - Renato Antunes {BIO 17439917 <GO>}

Thank you.

Operator

The next question comes from Mr. Thiago Lofiego from Bank of America. Please, Mr. Thiago?

Q - Thiago Lofiego {BIO 16359318 <GO>}

Good morning. I have two questions. Going back to Martinez. Can you comment on the premium of the domestic markets vis-à-vis imported? And do you think there could be price pressure for the next months due to the value – the amount of the exchange rate and also the realized average price for the second quarter, considering the carryover that we had in the beginning of the year?

And then my second question is to David. Can you elaborate a little bit more about NAMISA (24:29), that merging of NAMISA and Casa de Pedra, how is that going?

A - Luis Fernando Barbosa Martinez {BIO 16386589 <GO>}

Good morning, Thiago. About the premium, if you think today, the hot band, the FOB price of $530 per tonne and freight of $45, you will have $575. That coil, that hot band here in Brazil would cost around $760. If you consider today the price that we have in the domestic market under the same comparison basis, not considering certain potential taxes (25:12), the price is of around 8% to 9%.

When an importer brings a product in, usually, they have to finance and then the price is added for $10 to $15 for 90-day payment. So, basically, cold-rolled product and zinc galvanized is a little bit higher. The galvanized a little bit higher, around 8% to 9%.

And as I said in the beginning, when I was talking about the first question, we believe an improvement of the foreign exchange rate, that really is an outlier exchange rate. And the scenario for the exchange rate is price stability, but we are going to do adjustments in any type of deviation, whether in the dollar or in the cost (26:05). The idea is to keep the margins we are able to recover in this first quarter, whether it is coming from the price or the cost, which is very important.

A - David Moise Salama {BIO 17456021 <GO>}

Thiago, about NAMISA, what I can tell you is that both parties are still negotiating. And we are analyzing all possibilities in terms of merging. We have a schedule for us, to reach a consensus up to September. We have already extended that date. But you should understand that this is a complex negotiation and involves a lot of people, high values. That's what we can see is that there is goodwill among all involved and we expect to come into a good agreement in negotiations. Thank you.

Operator

Our next question is from Marcelo Aguiar from Goldman Sachs. Please, Mr. Marcelo, the floor is yours.

Q - Marcelo Aguiar {BIO 3721791 <GO>}

Thank you for this opportunity. About price in the domestic market, it's a question for Martinez. Can you elaborate a little bit more on the slower demand scenario in Brazil? And you always have that expectation of the depreciation of the foreign exchange rate. But what happens if there is lower demand in Brazil? Do you see higher competition among Brazilian players that could cause a drop in prices in the Brazilian market? And also, I would like to know, how do you see imports in the Brazilian market?

And my second question has to do with mining to Daniel (28:14). Daniel (28:15), you talked about the lines delivering. Can you tell us how many lines you have operating now and how many will be operating from next year on, when I believe you'll be reaching 40 million capacity in Casa de Pedra?

Just to have an idea of the sizing, what you have operating today and how many lines do you have operating in the future? And also, you talked about CapEx for 2014. Can you talk about the CapEx for the long term, 2015, 2016? That would help. Thank you.

A - David Moise Salama {BIO 17456021 <GO>}

Marcelo, thank you for your questions. Actually, well, I'll start by the last question, talking about CapEx. We don't have right now (29:07) estimate for 2015 or 2016. But in general, I should say that we do not expect something too different from what we have already done last year. And also that should happen along this year. And as soon as we have more details and other figures available, we'll disclose them to you. So, Martinez will address your first question, and Daniel (29:35) the second question.

A - Luis Fernando Barbosa Martinez {BIO 16386589 <GO>}

Marcelo, good morning. I will start by imports. First, with good news, in indirect imports, which is a figure that I always mention on the calls, and I say that this is the problem of our industrialization processes. The problem is what we already have in Brazil that is finished, the final product, the finished product that (30:01). The first quarter of 2014 had an import, indirect import level of 1.2 million tonnes. If we annualize the figure, and obviously, this is not a simple math, but that already shows a drop in the indirect imports of 11% vis-à-vis 2013, which was 5.6 (30:24). So, that is excellent news, because it shows a recovery of some sectors in the industrialization. And therefore, this volume ends up being provisional or being provided by local industry.

So, about direct imports, that has increased from 6% to 7% in the first quarter of 2014 vis-à-vis the fourth quarter of 2013, basically, in coated products. Now, about coated products, that is not an import where you're bringing the coil. In spite of having 40% of our mix in that sector of coated products, we deliver much more than coils, also serving white line, auto sector, civil construction. So, the package of services that we have to the market does not explain any type of increase in imports.

In addition to that, in this insulated market (31:37), we should have good news this quarter. We are fighting a series of imports that are coming below the specs used in the Brazilian market, so CSN is refusing (31:50), or rather is going to the correct agencies so that we could have the same comparison basis of those imported products for Brazil. In my understanding, these are fraudulent imports in terms of the specs and they could cause problems in the near future. About the market premium, we talk a lot about the foreign exchange rate, but when I talk about a premium of 8% to 9% in the hot band, I am considering an exchange rate of BRL 2.23.

Considering 8% to 9%, and let's not forget about the $10 to $15 of financing for those that import, it's not worth it to increase that import level. The risk is too high when compared to the benefit that the importer might have when thinking on a short term.

And finally, about the demand, no matter what is the demand, CSN is going to operate at full capacity, providing products to the domestic market. And I would say, once again, there is a lot of pessimism in the market, but the distribution sector is going well. In the last quarter, it was better than last year. Machinery replacement, capital goods, civil construction, white line, all of those have posted growth. We are only having a specific problem in the auto sector, and I believe this is going to be addressed very quickly. That market represents 30% to 35% of the steel consumption, of the apparent consumption. That is very important, not only for steel, but also for the whole Brazilian economy.

A - Operator

Okay, Marcelo, let us now speak about mining. Let me provide you with some background information before I answer your question. In the first quarter, we have produced at a very strong pace in NAMISA mining operations and also at Casa de Pedra, and we continue to deliver our expansion program. Our production has been growing ever since January. The first quarter closed with a very strong pace. We reached 27 million tonnes in the end of the first quarter and this number will continue to grow as the new lines come into operation.

And also, with the new facilities, I'll provide you with some more details on the new facilities, especially at Casa de Pedra. We have a high level of inventory at Casa de Pedra, and also at Itaguai Port. And if you ask about this, we will keep our guidance, 37 million tonnes of sales in the foreign market, in international market. The port has an installed capacity of 44 million tonnes since late last year, when we concluded the expansion work and we also have third-party ore we've purchased to achieve our targets this year and also next year. So, our port capacity surplus will be filled in by providing port services, as we've done in the last six years.

In the last week of March and also during April, we came to a point at the port where we truly used the full capacity of Tecar equipment. So, as we could conclude, the implementation of the new installations. Since this was done for the first time, we had a few maintenance issues, as we mentioned in the press release, especially related to our conveyor belts.

As we've mentioned, this problem was solved in the end of April, and now in May, we are operating at a very fast pace, in line with what we planned for. All in all, regarding mining operations, we've been able to attain the planned results, despite these issues we had in Tecar in March and April.

Now, regarding the details of this expansion in Casa de Pedra, bringing it down to very simple terms, so that I can explain to you the new lines, I mean, I should actually have a chart with flowcharts, so you would understand the processes in Casa de Pedra. But in simple terms, the production of lump ore and sinter feed, we have seven production lines that have already been in operation and now we're implementing eight new lines. Out of these eight new lines, four are currently contributing, not in full capacity, but they are already contributing significantly for us to reach our production targets.

Up until October, the other lines will probably be ready to operate. This is sinter feed and lump ore. You also have to consider the fines generated from this process. But now, with a new process, we'll generate two new flows. One, will be tailings going to the dam. The other one will be feeding the concentration circuit to produce pellet feed.

So, we do concentration by flotation, and there, in the flotation area, and bringing it, again, down to very simple terms, we currently have seven lines in operation, but there are five new lines to be implemented until June. So, by late June, our flotation loop will be ready and it will add capacity in the production of pellet feed. But more importantly, it will help us improve the prices of products sold. Basically, this is what I can tell you about Casa de Pedra.

In the second half of this year, as we've announced previously, we will begin the conclusion of the electric – electromechanical assembly of the railway yard installation. So, with that, we will have concluded the expansion of Casa de Pedra. As you can see, we are now coming to the end of the construction work in this expansion program, which shall be concluded, as announced, so that we will be able to use our full port capacity as soon as possible.

Our next question comes from Mr. Ivano Westin from Credit Suisse. Please, Mr. Ivano?

Q - Ivano Westin {BIO 17552393 <GO>}

Good morning, everyone. Thank you for the questions. The first is about purchasing slabs from third parties. You already mentioned that it was 102,000 tonnes for this quarter. What can we expect here? What is the company's target? If the company wishes to go back to self-sufficiency in slabs, can we expect a higher reduction in the next months? (40:29) my second question is for you, you talked about cutting in costs. What can we expect there? You have reported a significant reduction in the first quarter, also a reduction in SG&A. What can we expect for the next quarters?

A - David Moise Salama {BIO 17456021 <GO>}

Thank you, Ivano, for your questions. Martinez will address the first one, and then I'll talk about the expense cost cuts here in the company.

A - Luis Fernando Barbosa Martinez {BIO 16386589 <GO>}

Ivano, just to go back a little bit, we were purchasing slabs last year, and I won't go too deep on that, but there are several reasons that started this. Since the last quarter of 2012, we had the renovation of the blast furnace, the quality of the iron ore, the reclaimer, the beginning of maintenance of coke ovens, and then we also had a renovation of the hot roll mill that started in December.

So, the trend is to reduce purchasing slabs by the end of the year and we want to be self-sufficient in the slab production, as we always have been. Obviously, any kind of market opportunity will be analyzed, because, in spite of having purchased the slabs last year and this year, (41:50) have a positive result to CSN. So, in summary, we'll go back to being self-sufficient, but we will also take into consideration opportunities in the market to purchase the slabs.

A - David Moise Salama {BIO 17456021 <GO>}

Ivano, about costs and expenses. I've been saying that we are doing work on that area. I've been saying that on the last calls. We have started those efforts a little while ago and there are several ongoing programs, both for production, as well as for administrative area in terms of cost reduction.

And I believe the results start to show. You saw that we had a favorable impact. Sometimes, it's difficult to exactly quantify the figures because that involves a series of programs that are running simultaneously. But what I can say is that we still have that purpose, that objective. That is going to be seen both in the operational, as well as in the administrative areas. We are aiming for that goal along this year and along next year, as well.

Q - Ivano Westin {BIO 17552393 <GO>}

Thank you very much.

Operator

Thank you. Since there are no more questions, I would like to turn the floor to Mr. David Salama, Executive Director, Investor Relations, for his final remarks.

A - David Moise Salama {BIO 17456021 <GO>}

I would like to thank you all for participating on this call and just would like to go back and highlight a few topics, showing our point of view. You have seen that we are at a strong pace in mining. Our production is back to normal. We did have a specific problem along the fourth quarter (44:24) due to the port shipments and that has been solved already. And something else that I would like to highlight, our commercial strategy for mining along the first quarter, that also has brought important results, and it has helped increase the profitability in mining.

On the other hand, for steel, as I just said, we have a lot of programs for cost reductions and we do have a favorable – we foresee a favorable scenario ahead. We've seen some reports that are not as optimistic, but we still carry out that optimism for the year. And that's why we bring you these figures for the first quarter.

So, that was the message that I wanted to convey and also to say that the IR team is available for all of you. If you have any other questions, we'll be available to address them. Thank you very much and have a good day.

Operator

The conference call for CSN Earnings Results is concluded. Have a nice day.