Q3 2019 Earnings Call

Company Participants

- Alberto Ono, CFO and IRO, Vice President Officer of Finance and Investor Relations
- Sergio Leite, Chief Executive Officer
- Unidentified Speaker

Other Participants

- Antonio Heluany, Analyst
- Caio Ribeiro, Analyst
- Carlos De Alba, Analyst
- Daniel Sasson, Analyst
- Gabriela Cortez, Analyst
- Marcio Farid, Analyst
- Thiago Lofiego, Analyst
- Unidentified Participant

Presentation

Operator

Good morning, ladies and gentlemen. Thank you for standing by. Welcome to Usiminas Conference Call to discuss the Earnings of the Third Quarter of 2019. All participants are in a listen-only mode. Later on, we will conduct a question-and-answer session and instructions will be given for participation. (Operator Instructions) As a reminder, this conference is being recorded.

This presentation and the slides are being broadcast simultaneously on the Internet on www.usiminas.com/ri. You may also get a copy of the Company's release. Participants who are listening to the conference in English can also ask questions directly to the speakers.

Before proceeding, let me mention that forward-looking statements that may be made during this call regarding the Company's business prospects as well as projections, operating and financial targets relative to its growth potential are based on management's expectations about the future of Usiminas. These expectations are highly dependent on the performance of the steel industry, the country's economic environment and the situation of international markets and therefore are subject to change.

Today, we have the executive board of Usiminas: Mr. Sergio Leite, CEO; Mr. Alberto Ono, Finance and Investor Relations Vice President; Mr. Tulio Chipoletti, Industrial Vice President; Mr. Takahiro Mori, Corporate Planning Vice President; Mr. Kohei Kimura, Technology and

Quality Vice President; Mr. Miguel Homes, Commercial Vice President Officer; Mr. Carlos Rezzonico, Executive Director, Managing Director of Mineracao Usiminas; Mr. Ascanio Merrighi, Managing Director of Solucoes Usiminas; Mr. (inaudible) Managing Director of Usiminas Mecanica; Mr. Bruno Paulino, Head of the Legal Department; Mr. Julio Arroyo, Controller; and Mr. Leonardo Karam, General Manager of Investor Relations.

First, Mr. Sergio Leite will make some initial comments, followed by Mr. Alberto Ono who will present the earnings of the third quarter of 2019. Afterwards, the managers -- top managers or executives will be available for a question-and-answer session.

We will now turn over to Mr. Leite.

Sergio Leite {BIO 4746000 <GO>}

Thank you. Good morning, everyone. Thank you very much for attending our earnings conference call.

At Usiminas, this is the moment to announce the earnings, as you know, that we have a ritual at this -- in this Company. It starts on the previous day usually on a Thursday with the approval of the earnings by our Board of Directors. Then on Friday at 8:00 AM, it's communicated to the market, the CVM, then we hold a meeting with our employees. So we connect about 1,500 employees of our five companies on 14 sites through a web conference and we present our earnings to our employees. This meeting finished about 15, 20 minutes ago.

In the afternoon, we talk to the press. This is the ritual we usually follow. So in the meeting, we've just finished with our employees, our focus was a profound reflection on our results and our commitment with all our employees to work hard from now on to improve our earnings and results. So as we present these results to you today, our employees and the top executives have thought about these earnings and we committed to improving them on a daily basis.

In the third quarter, I have some highlights. And the major highlight is about the management of our debt. As you have followed us, in September 2016, we renegotiated our debt. At the time it was BRL6.9 million [ph] for a 10-year period with three indicators. In our grace period, in December 2017 or a year and three months after the agreement was signed, we started working on the debt. And then, December '17, January '18, March ' 18 and March '19, we started settling that -- repaying that debt and it is four moments of repayment. We reduced our debt in about 20%, BRL1.5 billion in our grace period. And within this grace period, in June we had a very successful operation, raising $700 million in the international foreign market and then soon afterwards we changed our debentures.

Our book building was finished last year of the 16th [ph] and the financial cost was released yesterday. Also communicated that to the market. So we raised another BRL2 billion [ph]. We also had on October 3 -- we had a court deposit in which we've got installments of the Eletrobras credits of two lawsuits that are being processed in our judiciary. So we got BRL751 [ph] million that came to our cash on this October 14, and this was used also to repay our debt.

So our balance today and everything we did -- our financial department did under the helm of our Vice President, Alberto Ono who will speak soon afterwards, we achieved well in our grace period, it finished at this September, so just a few days later we managed to pay off 100% of our debt and we now hired a new debt with new debentures with a maturity date on 23, 24 and 25 and 26 will be for another four years without paying off our -- without repaying our debt. And we reduced a debt that in September 16 was BRL6.9 million and now, currently today, it is about BRL5 billion depending on the exchange rate -- the valuation [ph] of the real, and it may even be lower than BRL5 billion.

And this means that with regard to our debt three years ago, we had a reduction of 25% roughly speaking. We've also reduced the cost of this debt significantly. So when this operation that was completed in the third quarter, it was highly successful.

Another point I'd like to highlight is about our sales record at Usiminas reached the level of 2.5 million tons in Q3, a very important number for us. And this would lead to 10 million a year, that would be the pace and this was a major result for us.

A third point I'd like to highlight is that we also closed Q3 with regard to our consolidated cash, and that was the highest level in the last five quarters. From now on, in addition to what I've already mentioned of our commitment as employees in this Company to work hard to improve our results, we would also work hard on having an increasingly more solid and higher cash.

So these were the points I'd like to highlight. Now I'd like to turn it over to our Financial Vice President, Mr. Ono. Thank you for your attention so far.

Alberto Ono {BIO 20633628 <GO>}

Good morning, everyone.

Let's start our presentation, our conference. Let's go to slide 1. So we have our steel sales -- steel unit sales which are stable with regard to the previous quarter. The domestic market of -- saw very low variation exports -- slight decrease that was caused by late loading at the turn of the quarter which was planned, but did not take place.

We're also expecting a quarter with boarding that was -- we expect it to be higher than that. As Sergio said, we had a significant increase in volumes with regard to quarter two, especially for exports where we doubled our volume. We exceeded 1,300,000 tons of volumes -- exported tons, and that was another record for Usiminas.

As for the adjusted EBITDA, we had a drop, 23%, BRL441 million, with a huge impact as we said before, in the previous quarter. It was greater than the expectation -- the expected number with regard to the increase of the cost of products that were sold, which I will comment later on as a result of increase in iron ore and the exchange rate fluctuations during the quarter, and this leads to --I mean, the exchange rate variation and our debt, which was dollar denominated which increased in quarter three, and we issued bonds. So in this quarter, we had a loss -- net loss of BRL139 million. We expect this exchange rate fluctuation on our debt in our earnings in net terms was BRL286 [ph] million.

Moving on to the next slide. We now have EBITDA in the previous quarters -- as we said, there was a drop with regard to the quarter three 2019. The margin about 11%.

Next slide. We now show our steel production volumes, both domestically and abroad. So domestically, we are stable with regard to quarter two but generally speaking, when you consider domestic and foreign sales, we are still on the level of 1 million tons in the quarter.

Next slide. It shows clearly the effect about margin compression as a result of the increase of the cost of the product that result affecting our steel production with a EBITDA of BRL213 million that was were [ph] BRL404 million in the previous quarter and the margin fell from 12% to 7%.

Next slide. We now have as we already -- as we've already mentioned, there was a significant volume in Usiminas -- Mineracao Usiminas with a total increase of 38% against quarter two, an increase of over 100% in our exports.

Next slide. Although we had the significant increase in our exports in Mineracao Usiminas, the result was basically aligned with quarter two, with lower margins caused by lower cost during this quarter, which was a consequence of increased lower premiums in this quarter -- quality premium.

Next slide. We now show Solucoes Usiminas earnings. Their EBITDA [ph] was slightly lower than quarter two '19 with a reasonable margin of 3%. Finally, our Usiminas Mecanica, that's our capital goods unit. Unfortunately we have a negative EBITDA in this as a result of a lack investment demand, which is still recurring [ph] in our domestic market.

Next slide, about other indicators. First, working capital. Consolidated working capital. So we have an isolated increase in quarter three of 16% and total caused by the credits from Eletrobras. So we now -- rather than long-term assets, we have now short-term assets also as a result of the expectation of receiving these credits, which did occur after the end of the quarter in October. Without this item, we would have a reduction of our working capital of about BRL200 million.

Next slide steel inventories. So we have a 15% increase, and this was caused as we mentioned before by the delays in our exports loading and shipping at the turn of the quarter and also with our fleet inventory. Seasonally, we had a of peak inventory, but that will be absorbed in quarter four, so expecting at the end of quarter four we will have normal levels.

Next slide. We should remember that our third quarter position is previous to what happened in our debt, as Sergio mentioned. So there is this increase as we can see of BRL400 [ph] million -- BRL50 [ph] million or slightly more than that relative to our gross debt, and this was a result of the exchange rate fluctuation. So we have now a higher debt in dollars. When we look at our net debt, it was reduced about [ph] BRL200 million because in spite of this increase -- because we had more cash -- BRL8 billion.

The next slide. This is our CapEx. So our CapEx increased relative to the previous quarter. That's over 40% following this increasing trend, as we mentioned -- meaning, our guidance of BRL800 million.

Next slide. This is our debt profile at the close of quarter three. So when compared this to quarter two, when you take our bond issues that took place in June, while this leads to a change in our debt profile. Although we seem to have a reduction in our duration of debt in our domestic market now the deadline in dollars increased significantly.

Finally, on the next slide, we now show you our pro -- unaudited pro forma relative to our debt after the developments that took place after the close of the quarter, as Sergio mentioned, so both the issuing of debentures of BRL2 billion as well as the use of funds of Eletrobras credit that was used for paying off our debt. So there was this reduction in our debt of our total debt with a new debt profile. So in the next four years, our expectation of projected paying off is really low, so only in 2022 that it will continue, s with a lower cost associated with it.

So this is the end of my presentation. We're open to your questions.

Questions And Answers

Operator

Ladies and gentlemen, we will now start our Q&A session. (Operator Instructions) Our first question comes from Daniel Sasson, Itau BBA.

Q - Daniel Sasson {BIO 19234542 <GO>}

Good morning, everyone, and thank you for the Q&A session -- thank you for your presentation. My first question about your prospects of steel price in domestic market in quarter four. Can you discuss parity and the average steel price has been below historic prices of the imported steel prices. So how can you compare distribution prices to the prices for the automotive industry. Maybe you have difficulty negotiating with the automotive sector at the end of the year.

And my second question is about import duties. So we've seen recent stories in (inaudible) newspaper a proposal to reduce duties -- import duties of steel from 12% to 4% in the next few years. I mean, of course be approved by all Mercosur members, but it seems to be a risk in a very short run, it doesn't seem to be a risk, but it may have an impact on our domestic steel prices. Can you talk about your expectations about this development? Thank you.

A - Sergio Leite {BIO 4746000 <GO>}

Good morning. As for your first question, let's answer them. So our price expectations and parity. The current price situation in the local market, where we have positive parity about 3% to 5% as a result of our goals of having parity between 5% and 10%. So we have an increased price window and this will take place throughout quarter four, as for seasonality.

And the impact and the increase of our debentures and our sales at the end of the year -- impact on average price will be much lower than parity -- is slightly lower than 5%. So we're implementing this increase of 5% and this will take place from now to the end of the year. This about your first question.

Now, as for the car -- the automotive industry, we have annual contracts. So unlike monthly prices (inaudible) that are defined in every moment. So for annual contracts, there'll be renegotiation in the next few weeks. So there is usually a fixed price for the entire year and then it should be -- in our view, at least, it should reflect an evolution of costs throughout the year. So we had a significant increase in the price of iron ore and coal and the expectation of international price is increase margins -- ADR -- but for the whole world, when we look at the situation worldwide. And then we see what has been going on. We're just seeing in the third quarter, change -- significant change.

So the situation when you could look at the situation worldwide, we saw increases in different steel companies, and there was actually taken that led to international price to increase significantly in 2017 and 2018. So prices, for annual contracts, they have to reflect the evolution of our prices with reasonable margins for the domestic market.

A - Unidentified Speaker

Thank you, Miguel. Now, Miguel, with regard to your second question about import duties, the external -- common external duty, since the transition at the end of the year after the second round of the elections to -- Bolsonaro administration -- but -- with Brazil, we've been talking to the Brazilian government, with the economic team as well as the Chief of Staff team and even President Bolsonaro himself about this topic. So economic liberalism and trade liberalism.

But in Brazil and steel we are in favor of economic liberalism. However, for us to practice economic liberalism in Brazil and its essence when you consider import duties not only for the steel industry with many other economic segments there should be equal trade relations even the PEC -- is a result of this imbalance in trade relations. So our commitment is to evolve over time to a reduced duty as a result of economic liberalism. But then we also need corrections or adjustment to ensure that we remain competitive, not only the steel industry, but the whole transformation industry in Brazil. And that also affects the tax reform. Our taxes to-date -- it affects our competitiveness not only domestically but also when we export. So we're working hard with the economic team.

We have a coalition of many segments of the industry. We've been talking to Minister Paulo Guedes, and this is on the government's agenda and also on our agenda.

This will take place in the long run, but we want a lot of measures to correct -- being adopted to correct these asymmetrical trade regulations.

Q - Daniel Sasson {BIO 19234542 <GO>}

Thank you very much.

Operator

The next question comes from Thiago Lofiego, Bradesco BBI.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Good morning. I have two questions. Can you give us an upgrade about the moves in potential investment and then liability management? What are you expecting after all these movements? Can you also give us -- analyze figures? Is there anything else that's relevant that you're expecting to take place on this front? Thank you.

A - Unidentified Speaker

Good morning, Thiago. As for the investment in the short run, we will keep investing strongly, considering improving our processes and as we said in many different opportunities, we'll also be working on our dry stacking which is also important. Now, about the long run, however we haven't defined how we will proceed. We have been working on this considering alternatives to solve or make sure that the operation remains that they will continue from 2024, 2025 onwards, considering industrial treatment. So far we can only discuss a short run investment. There is a lot of internal investment to recover these areas, and the creation have investment in our dry stacking project.

Now, Thiago, with regard to our interest savings, with regard to the EBITDA, we will also use our guidance in the next year. As for general cost -- generally speaking, we are expecting a reduction of 80 to 100 basis points relative to the cost so far.

Q - Unidentified Participant

Perfect. Thank you.

Operator

Our next question comes from Caio Ribeiro, Credit Suisse.

Q - Caio Ribeiro {BIO 18420483 <GO>}

Good morning, everyone. My first question is about galvanization, your galvanization conditions about which you've been discussing. Are you still considering conducting these projects? Do you want to continue moving on? And how about steel demand? Can you talk about your expectations in terms of steel demand in the next year? And what is the expected growth rate? Thank you.

A - Unidentified Speaker

Well, Caio. With regards to galvanized steel, we are still -- I mean, we keep studying the situation to define the type of equipment to be used as well as market interpretation. The projections for this year in terms of growth, while the automotive industry -- these expectations were not met. You look at MFavia [ph] figures for instance. So the market growth numbers should be reviewed and as a consequence, the need for investment should also be reviewed, our investment timing needs. In the next 12 months, we may -- were expected to reach a decision with our Board of Directors. Okay?

And Caio -- with regard to steel demand expectations, we should also discuss this until September, according to the -- latest report. We've seen a drop in the use of steel about 2%. So it was below at our expectations at the beginning of the year. But we have positive indicators with regard to the previous year, and this was explained by our inventory adjustment, both in terms of redistribution [ph] and also because many -- the many industries that use apparent steel in Brazil. Next year, we're expecting a growth rate of about 2% as a result of this GDP growth and this recomposition of our inventory throughout the entire CO chain, we can expect a growth of apparent use of slightly above 4%. So that will depend on economic development of this country's economic environment, the performance of different industrial sectors and the possibility of Brazil having other export destinations that might affect steel production and exports.

Q - Caio Ribeiro {BIO 18420483 <GO>}

Thank you. Very clear. Thank you.

Operator

Our next question will be asked in English. Carlos De Alba, Morgan Stanley.

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

Yes. Hello. Thank you very much. So my first question has to do with investments, the run rate even though it accelerated in CapEx in the third quarter is still way below the BRL800 million that you guided for the year. How do you expect the fourth quarter CapEx number? And then you have an early guidance or indication for 2020, that would be very useful. And then maybe complementing the prior answer on the galvanize line. One of your competitors in Brazil is also planning on potentially starting a new galvanize line. Do you think that there is room for two lines in the country or just one and so if I make a decision sooner than the other company then the window will be close for the latter.

And then finally, just a clarification on the Eletrobras credit. So is it right to understand that you already collected these almost BRL800 million in October and that was applied to repay debt and do you expect any more moving parts on this Eletrobras situation or that was it and you concluded the ongoing litigation that you had? Thank you.

A - Unidentified Speaker

Thank you, Carlos, for your questions. So the first question about our CapEx space for quarter four. We are still keeping the guidance -- the guidance of BRL800 million for the year, cumulatively, so we're expecting to have BRL450 million, BRL500 million. There will be a concentration -- large concentration in quarter four, and this is already underway. So in our view, as we had a -- in quarter four last year will have a speeding up of our pace so we will be aligned with the guidance of BRL400 million for the year.

As for 2020 investment, we're still working on the scenario for that year. But as we said before, there is a recovery of our investment levels. So this year, our guidance will be BRL800 million, but we don't -- we can't provide you with a guidance for next year, not yet. But in the projection that we released in the second quarter, we said about BRL1 billion for the next two years -- BRL1 billion each year for the next two years. So this is all I can give you right now. Okay?

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

Thank you.

A - Unidentified Speaker

As for the new galvanization line, you were asking if there is room for another new line in the Brazilian market. Well, I think this is -- it depends on how this line will be designed. In our case, for instance, it will be designed to meet the automotive market, preferably, but it's also flexible enough to meet the needs of other markets. So increased volumes of galvanized steel, although this is of course a high demand of the automotive market, it's not exclusive to this market.

Other markets also need galvanized steel, including civil construction or building construction -- there is, which is also increasing its need for galvanized steel. And when consider products that are exported in Brazil, a large part of them are galvanized products. So there may be room for more lines -- an additional line because there is this potential of exports substitution.

As for your question about Eletrobras' credits, two lawsuits (inaudible) and what the money that were paid for our Ipatinga and the Cubatao plants. So what we were paid were with the Ipatinga lawsuit. But this is just one part of this lawsuit, which is (inaudible). There's another installment, another part that is being discussed in courts in the judiciary. As for the Cubatao plant, the situation is still the same.

So the money that we received of BRL751 million, which -- and this took place in the fourth quarter of last year, that's when the money was recognized, and there was a monetary adjustment of the amount. But this refers just one part of -- one of the lawsuits that's being processed in courts. Everything has been discussed in court. So the remainder of the merits of the Ipatinga lawsuit and the entire merits of the Cubatao lawsuit are still -- we're still waiting for them. So we have expectations or we have lawsuits that are in the courts. So we're expecting to get more funds from these additional credits.

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

Thank you.

Operator

Our next question is from Gabriela Cortez of Banco do Brasil.

Q - Gabriela Cortez {BIO 18801371 <GO>}

Good morning, everyone. How are you? My first question is about mining or Usiminas Mineracao. Although you've had record levels in iron ore, the result was a little (inaudible) or about freight costs and so on and so forth. What are your expectations for the next quarters? How can you improve these results, considering all these costs? And my second question is about the blast furnace at Ipatinga. So how have you been investing amounts? And what are your expectations in terms of downtime as this year some players also shut down their blast furnaces and the return on these operations took longer than expected. So these are my two questions. Thank you.

A - Unidentified Speaker

Good morning, Gabriela. (inaudible) consider EBITDA margin -- this is a result of some events including the ramp-up of one of the plants. So in the ramp-up process, the quality is lower. At the same time, we also used some space in this plant that were idle to produce -- to make some products using inventory materials -- low quality materials, and this led to a sales mix with lower prices as regards the previous quarter.

To this we should add our increase in prices and the premiums that dropped as a result of a surplus of high quality products on the marketplace that were -- in this situation in this quarter our margin fell. Now, for the future, we have high quality products that will be sold in the next few months. So we have a standard product, so this rate is expected to improve and the margins will depend on prices and premiums and freight. Our expectation for the last quarter is to improve these figures.

Gabriela, as for your question about our Ipatinga blast furnace revamping, while the amount is being released, BRL1.223 billion -- sorry, BRL1.234 billion. Our expectation of downtime is about 110, 120 days. As for the other revamping or restructuring, we've been doing --well, I couldn't give you all the figures, but our reform is rather extensive in terms of what will be done to the equipment, all the changes. So we're expecting 110, 120 days' downtime.

Q - Gabriela Cortez {BIO 18801371 <GO>}

Thank you.

Operator

Our next question comes from Marcio Farid, JPMorgan.

Q - Marcio Farid {BIO 21017394 <GO>}

Good morning. Thank you for your questions. I have two brief questions. First, in terms of cost, we saw some aggressive moves in raw materials this year. What can we expect for quarter four and then for next year with regard to steel making cost. There were also some higher contingencies labor this quarter. Can you maybe explain if you have more recurrent patterns? Was this one a one-off situation? What was the origin of these contingencies?

A - Unidentified Speaker

Well, Marcio, as for cost, our expectation is, next year, it's still hard to say. I can discuss quarter four. We're expecting stability, both in terms of production costs and sold products. So we're expecting -- this is what we're expecting. There were strong moves in the second quarter that had consequences for the third quarter. Now in quarter three and the beginning of quarter four, there is more stability in cost. So for quarter four, both in terms of production cost and as SPV [ph] we expect to have stability. As for contingencies, you mentioned labor contingencies. There were also several law contingencies, and they go hand in hand and they were a consequence of extensive review of many lawsuits that are underway -- older lawsuits. Some more recent lawsuits. Others were older. So we needed to review them all. They are not recurrent. Again, they're one-off, kind of isolated events. So they are not recurrent.

Q - Marcio Farid {BIO 21017394 <GO>}

Thank you so much.

Operator

Our next question is from Antonio Heluany, Bank of America.

Q - Antonio Heluany {BIO 20614129 <GO>}

Good morning, everyone. My first question is a follow-up of the local market question. So what's the market in terms of competitiveness -- and I didn't understand when you said about expected prices in quarter four. Maybe you could explain that again. My second question is about steel. How do you see the exports scenario? What's the margin levels, with the current exchange rate and prices? What do you expect for 2020? Thank you.

A - Unidentified Speaker

Good morning, Antonio. As for quarter four prices, we released this increase of 5%, and this is a result of the exchange rate and international prices. We're expecting this to happen from the present to the end of the year as a result of the seasonality of quarter four and the impact of average price could be really low. As for the exports market, as you said, when you consider the situation in exports market, it's a little complicated.

Some markets, they have a similar situation in terms of -- the world steel production margins -- we're not looking at sales opportunities. So considering these margins and the cost of purchases of steel plates, we can generate value -- add value in higher negotiations. So we're keeping export levels between 2,000 tons like in the last quarters.

Q - Antonio Heluany {BIO 20614129 <GO>}

Thank you.

A - Unidentified Speaker

Excuse me. If there is no further question, we close this conference call. If you have any questions and queries, our IR team is ready to answer your question. Have a great afternoon. Thank you.