

Q2 2018 Earnings Call

Company Participants

- Benjamin Steinbruch, Chairman & Chief Executive Officer
- Luis Fernando Barbosa Martinez, Executive Officer
- Marcelo Cunha Ribeiro, CFO & Executive Director-Investor Relations
- Pedro Gutemberg Quariguasi Netto, Executive Officer
- Unverified Participant

Other Participants

- Carlos F. De Alba, Analyst
- Ivano Westin, Analyst
- Leonardo Correa, Analyst
- Marcos Assumpção, Analyst
- Rodolfo de Angele, Analyst
- Thiago Lofiego, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good afternoon, and thank you for remaining on the line. Welcome to the CSN's Conference Call for the Presentation of the Results of the Second Quarter of 2018. We have with us today 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 Q&A session at this time further instructions will be given.

We have simultaneous webcast that may be accessed through CSN's Investor Relations website at www.csn.com.br/ir where the presentation is also available. The slide presentation will be downloaded from the 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 declare that some of the statements herein are mere expectations or trends and are based on the current assumptions and opinions of the company's management, and the future results, performance and events may differ materially from those expressed herein, which do not constitute a projection. In fact, actual results, performances or events may differ materially from those expressed or implied by forward-looking statements such as a result of several factors as the general economic conditions in Brazil and other countries, interest rate and exchange rate levels,

future rescheduling or repayment 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 on a global, regional or national basis.

Now, we will turn the conference over to Mr. Marcelo Cunha Ribeiro, Investor Relations Executive Officer, who will give the present highlights for the period. So please Mr. Marcelo Ribeiro, you can begin your conference.

Marcelo Cunha Ribeiro {BIO 4997029 <GO>}

Good afternoon to all. Thank you for your interest, and welcome to the earnings presentation call of the second quarter 2018. We will follow the presentation, which is on site and made available through webcast and I would like to give the floor to our Executive and CEO, Mr. Benjamin Steinbruch, who will talk about the highlights during the period.

Benjamin Steinbruch {BIO 1499059 <GO>}

Well, good afternoon to all. Thank you. I would say that following what we've been saying and presenting every quarter, we have had a significant operating improvement, working to reduce costs and in improving the results. And we have seen this since the first quarter of this year and we will continue improving. So we are presenting the adjusted EBITDA of 58% over year-over-year and 14% quarter-over quarter, which it shows an improvement in EBITDA and that we always worked with differentiated EBITDA margin for that on the market and we are working to increase this margin, and increase with differentiations.

And you will see further along the presentation that there's a reduction in cost and improvement in the price, especially in mining area - especially with quality, we have been able to offer better iron ore. We also had an amount that was higher than expected and we are working strongly to increase this quantity and have a better quality ore, so that we achieve this premium. In our opinion, this will be very important. So, mining, we've had EBITDA which was very good and I believe that for the third quarter it will be even better.

In the steel sector, we had a price improvement, which we have seen improve every month within what we had proposed to do at the beginning of the year. The quarterly increase of price, and we've had the opportunity of seeing this - see this price improvement and also try to reduce the cost and what we can do within the operating sector, so that we can improve our margin which was better in this quarter and we hope it will be also better in the third quarter.

Cement, we also had good results in the second quarter in relation to costs. And also in terms of quantity we increased our market share and we also had a better price and so a better margin. So I think in operating terms of the market outlook that we had planned to do at the beginning of the year and that we informed you, we are delivering what we had planned.

With regard to the financial aspect, we finalized this morning the extension with Caixa Econômica Federal. We had already done that with Banco do Brasil and Caixa, they are the main banks that we work with at CSN. So we had good conditions with CSN in terms of the extension of debts. This will also be presented to you and discussed with you. But according to what we have planned with Caixa and Banco Do Brasil, we have delivered on that too.

And with the private banks, we are very close of informing you of an extension so that we complete in terms of the financial side of CSN. We were able to finalize the LLC operations at the end of the quarter and we even with the payment, we were able to finalize the sale and payment of the plant in USA. And it was an inappropriate to do this at the time and then we'll get good results for CSN. And with the improvement of the operating results from the expansion of our ability and also the sale of assets which is what we are working towards and that we had said we would deliver to the market.

And my objective and the company's objective that by October, we will be able to finalize the sale of some other assets, and also streaming operation in the mining sector which will allow us to reduce \$1.5 billion the leverage of the company \$2 billion, which would be the \$500 million it would be LLC, and plus this \$1.5 million from the sale of assets and streaming operations will allow us to be in a different position.

My personal challenge and not the company's because probably Marcelo will afterwards explain this, and it will be that we would reach a fourth time debt to EBITDA. My personal challenge is that by the end of the year we reach 3.5 times EBITDA and that next year we are 2.5 times.

So my challenge, and this is a personal challenge, is to reach 3.5 times debt to EBITDA ratio at the end of year. So for this everyone has always questioned me saying that I wouldn't deleverage the company, but at the moment I now I'm saying that I am asking Marcelo to do this. And we have discussed this with the bank and we have a foreign bank to sell the assets abroad and we're talking with two or three banks in relation of the streaming operation and this communication is well advanced and I believe that we will be able to finalize this by the end of October. And once this is done, I think the company will change completely in terms of capital structure and the operating side, we have been working and delivering good results. We have a big challenge ahead of us in terms of sales and EBITDA.

In sales we are almost in line with what was budgeted. We have a 5% difference, which will be recovered in the second half of the year. And as consequence, I believe that we will also be able to deliver the EBITDA that we had set to do. I would say that we are very optimistic for the third quarter in terms of mining, steel and cement. We believe that we have the product, we have the client diversification, and we are working strongly on each client at the national market level, and our challenge is to continue to grow in the international market.

We believe in a reaction of price and we plan to have a new increase in price as from next month. We will have to discuss this with Martinez as well, but we believe that we can have

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an increase in price. And we believe that the third quarter in relation to what happened in June and the results that we have in August, we believe that the third quarter will be even better than the second quarter. September is almost finalized in all our segments, so we hope to deliver a better third quarter than the second quarter which was already very good.

So basically, that's what I had to say to you. We fulfilled what we had set out to do. And above all, our vision now and our priority in terms of deleveraging is that this will happen in a very short time because we're already in August and we only have September and October. And if the negotiations continue as they are, we hope that we will be able to deliver this deleverage by the end of October. Basically, that's what I had to say. And after our colleagues, other officers we'll have the opportunity of answering any questions that you may have, but that's what I had to say. Thank you very much. And I hope that you like what you see and which will be explained and the results achieved. Thank you very much.

Marcelo Cunha Ribeiro {BIO 4997029 <GO>}

Thank you, Mr. Steinbruch. We will now continue with the rest of the presentation. We're on page 4 now. With the operating results, I will mention this very quickly, because afterwards it will be discussed in greater detail. We have a BRL 1.4 million EBITDA. It was the best EBITDA since 2014, an increase in relation last year was 58% and the first quarter was 14%.

We had a problem with the truck drivers' strike in May and that caused some impact in the steel sector. But despite all this, the steel sector also evolved. So we avoided the effect that we had in other quarters where an improvement in the business opportunity was worsened in another sector. And we had a positive EBITDA what I would like to highlight mining sector in terms of quality of iron ore and greater growth. So we had an EBITDA margin of 23.9%, which is higher than what we had delivered before. And so it's important to mention that we continue reducing expenses and reduced our fixed cost.

On page 5, we continue with the other financial indicators. We also had a good evolution starting with CapEx, which continues within our annual expectation of BRL 1 billion to BRL 1.5 billion as CapEx at the moment. The company is going through dedicated to sustaining and maintenance projects which are extremely important for payback. And this way privileging cash generation for the deleveraging the financial cycle we are being very efficient in relation to previous years, when we focus on the foreign market we want to increase working capital from the last year to date we have been able to negotiate better terms with the suppliers. In this quarter, we have some delays because of the truckers' strike and also increase of costs of raw material, we had a BRL 400 million stocks above the previous quarter. If this was the case, we would have had constant working capital.

Financial expenses, ex-variation we've had a good (00:16:55) with low interest rates are low, so our cash flow continues to be positive. If it weren't for these specific points that I've just mentioned, we would have even had a higher cash flow than the first quarter of BRL 1.4 billion in the first semester. The \$400 million from the sale of the plant in the U.S., we had BRL 1.6 billion of positive free cash flow in the quarter.

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We have a greater liquidity. Our cash was BRL 4.4 billion, obviously, this had an impact in relative leverage, which was a priority that we wanted to reduce. And then as we reached 5.3 time debt net EBITDA. If it was for the strong exchange variation, this indicator would have been below the 5 time; it would be around 4 times. CSN has halved its revenue in dollars, so this exchange rate variation doesn't really affect the deleveraging target. We want to reach the end of the year with 4 times EBITDA, which is a challenge established by Mr. Steinbruch, which will be 3.5 times by the end of the year.

In slide number 7, least - last but not less important, we have our amortization schedule with our efforts of extending our debt. Since the beginning of the year, we had BRL 6 billion of amortization at the beginning of 2018. And after the implementation of the negotiations with Banco do Brasil and the recent agreement with Caixa, and the issue of bonds, we were able to reduce in almost BRL 4 billion of the amount to be amortized this year. And we removed BRL 7 billion of the short term pressure by 2019 and 2020. So we have a challenge for 2019 and 2020, which will be fulfilled with a better cash generation.

So these are the comments of the financial aspect, and I will give the floor to my colleagues starting with Luis Martinez, who will talk about the steel performance.

Luis Fernando Barbosa Martinez {BIO 17456025 <GO>}

I hope you can all hear me properly. I'm not in the same area. First of all, I would like to say that we had the best quarter of the last three years despite the truckers' strike. And we had about 90,000 tons to 100,000 tons loss with that strike. We had an excellent quarter and we focused on the domestic market. And this, as Benjamin has mentioned how resilient CSN is, they used its product portfolio and we have a diversified number of clients. And we say that we sell steel per meter and kilo. We sell steel all - in all ways. So we've been doing this for a long time already.

In terms of sales volume, in the second quarter - in relation to the second quarter in 2017, we had an increase of 22%. And the - comparing the first semester of 2018 with 2017, we had a 28% increase. If we have a look at - compare the semester to semester, we had a 45% growth. So this shows what I've mentioned before at the last call, we want to come back to the domestic market, we have to increase the volume of pre-painted and that's what we are doing. And we hope to continue in the domestic market. We can see a growth in revenue and we can also see increase of 20% on the unit cost per ton.

At the bottom, we see the profitability of our market and what's happening in the last quarter. I'd like to highlight that the EBITDA that we're generating per ton in the domestic market is around BRL 800 to BRL 850 per ton, just to give you an idea of what we're doing at the moment in the market. In regard to the other sectors, long steel that's doing very well; we increased the price about 16%. In Europe, we've got some protectionist and the price in Portugal is improving. And Germany is working at completely it generates cash and results for CSN.

And in the United States, as I've mentioned in the last call, we continue with our strategy of being a local player say selling our quota in the U.S. which is about 2,050 tons

(00:22:51) and working as if we were a trading company and working as a local player. So in the steel sector, in general terms, we've had an alignment, which was very favorable for us in this quarter.

Next slide, and here I show you what happened in the steel sector. The market in fact should end the year according to the IABR with 11 million tons, 12 million tons. Imports today are dropping but in the semester, it represented a 13%, which is quite a high number. And I don't want to consider what's happening in the market. I want to have 3.4 million tons in the domestic market, and we still have to sell about 1.8 million tons, 1.9 million tons for the second semester. We are working towards this, and I'm sure we will be able to reach this by the end of the year.

You've been following the market. The automotive market continues around the - we hope to have about 13% of the truck sales, as everyone is wanting to buy trucks, it's amazing. So there's been an increase of 36%. The distribution dropped from 4.7% to 3%, and the machinery area is improving.

With regards to civil construction, we have a positive result. Because the first time an index that we follow, which is the index of civil construction has stopped falling, which shows that the curve has reverted and another sector that I would like to mention, which is appliances and packaging, they've increased between 2% and 3%. So I say that CSN strategy for the second half of the year is focused on the domestic market, participating in the market - focusing on products, sell and work diversified, not putting all the eggs in the same basket.

During the Q&A, I will speak about the prices and the new galvanization line. I will give the floor now to Pedro Gutemberg.

Pedro Gutemberg Quariguasi Netto {BIO 19803245 <GO>}

Good afternoon to all. I would like to comment the highlights in the production area. You can see on the left, we had a lower slab production volume. We had to have some maintenance in our production lines but always aligned with the volumes that we have of inventories of products of raw material and finalized products. We want to maintain the commercial area well supplied, as Martinez said so that we can increase our volume in the domestic market.

When we look on the right, we can see that we have had an increase for this quarter. We had exchange issues, which were not favorable and also the cost of raw material, especially coal and coke and that impacted us more this quarter than the previous quarter. But although we have had this price pressure, what we can see here is that we were able to maintain the EBITDA per ton within a high threshold about - of BRL 540 per ton, BRL 536 per ton.

Other highlights as Martinez mentioned is our better mix which increases our cost, but is very - offset by a better product margin, which has a greater added value. The domestic,

you know, do a very good this quarter with increase in volumes and this slide that we can see now, we see a pool of slabs.

We had an exchange variation and a raw materials variation, which affected the price of the slabs during this quarter. On the right, you can see the variation of the raw material prices, so there's a lag with when the prices go up in the foreign markets and when we account for this cost within matrix and when we effectively use the material that we have in the stock. So this was the main motivating factor. We believe that we are in a favorable situation in terms of cost and we have a good arm for the next quarter.

I would give the floor now to Eneas (00:28:43) to talk about the mining performance.

Unverified Participant

Good afternoon to all. It's a great pleasure to be here with you again at the CSN conference call for the second quarter of 2018. We have Gustavo in-charge of the commercial area and Daniel Bueno in the area of production.

We would like to tell both of you of the iron ore market and how we can see it at CSN. We have seen a great - a tight supply and demand market. What we have? We've had a 7% growth rate at an annualized rate in Europe, Japan and Korea. They are also resuming their growth with 2% of fuel production during the same period. During the supply, it's still controlled by the main steel mills and this increased current size with accumulated reduction of 38% of the production of iron ore in China due to environmental reasons. So within this context, we believe that the Platts should be about \$75 at the second half of 2018. With the greater supply of iron ore from Australia, which have higher alumina and there will be a greater demand for Brazilian ore.

With regard to CSN Mineração, the mining department, I would like to stress the pillars of our business, which guide our projects. We work with an outlet of having a gradual increase of production every quarter associated to a differentiated quality of products, not depending on the - dependency on dam, so we are maximizing our margins.

CSN Mineração once again presented solid results in the second quarter, and we would like to highlight the following: an increase of 9% in sales, which was influenced by an increase of production about 600,000 tons despite the restrictions caused by the strike - truckers' strike, a negative net revenue of the limits of about 365,000 tons; the net revenue registered reached BRL 1.3 billion, up 16% increase during the quarter; the adjusted EBITDA had a 21% increase in relation to the first quarter apart from the great sales volume, we would also had a CFR+ FOB sales performance as we can see on our next slide.

With an increase of our exports that increased 2%, although there was a 12% fall in the Platts. With the average index, which we had in each quarter of the dry basis, and with the quotational period and the conditions, which were negotiated and removing the freight and the humidity, so with the Platts in the first quarter and second quarter we see a gain

of \$5 per ton. CSN Mineração has about 20% of its export sent to the Japanese, Taiwanese markets.

As a Platts Index of 56 was about \$9 per ton, the opposite occurred in the second quarter, and this led to the difference represent two thirds of gain in the quotational period. The remaining tranche is related to the spot sales and also the positive price, which were obtained in the first quarter of the year. We understand that these quotational periods are improved over time. We emphasize, however, the quarterly gain of almost \$3 per ton in relation to the quality and commercial conditions.

And in response to new market demands, we reviewed the quality of the products for the market in the fourth quarter of 2017 when we reduced silicon and aluminum. In one side, we have the stability of stratification has a significant impact and allows us to pay, we have a product, which is strong so often in the market and the production of silica and the reducing of - and the worsening of the Australian market, such that we had a discount in the second quarter of 2018.

As we believe, this scenario will continue. So, we're in a privileged conditions or the price that short-term, medium-term, long-term. So let's see the effects of this and the quality in terms of dams. The first tailing dam started its operations at the last week in June. It will allow a reduction in the tailings and a more dependency in dams. So we can increase the rhythm of the main plant of 30 million tons a year in the second half. And with regard to sales, they will achieve about 35 million tons by the second half.

We would like to highlight the good level of the progression of this second magnetic concentration, which will be principally the central plot in improving the production and increase it by 1 million tons. The second magnetic CMA will start operations in the third quarter of this year. We would like to accelerate the projects for this year. We want to reduce the use of dams and the positive impact. The first one we would like to mention is the spiral project which is the Central Plant. It will have a great quality and the use of the itabirites. And the second one is the filtering phase 2 basically reducing our dependency on creating dams. The filtering phase 2 dam and spiral project should be in operation in the first quarter of 2019.

And finally the dry production plant will reduce some 55%, the cost of 8 million tons a year. And they have already received the authorization by the environmental agency. I would also like to mention that work that CSN has done in the mining sector which is increasing the quality, reducing costs and reducing the dams. We believe that the results that we've had, the results of this - next quarters, we will have even a better results, we'll be advanced and getting more awards with our products in the market.

I would like to thank you for your attention, and hope to see you next time. On slide 17, we have the cement performance, which will be presented by Martinez.

Luis Fernando Barbosa Martinez {BIO 17456025 <GO>}

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What's interesting in terms of cement is that this quarter using the World Cup event, we launched the CSN and Energia - CSN Cement and CSN Energia. And when the buyer goes, have to buy their cement they remember the CSN cement. People think that CSN doesn't have a name in a market, but we are very strong in the southeast region. We - the plant in Volta Redonda is work at full capacity. And I would say that our cement here is extremely strong. And to have a 28% of the EBITDA margin in the quarter really is a very interesting result for a market that is very - so and CSN is a leader in this market.

So talking about this quarter result, the trimestreço, I'd like to highlight that our sales are around BRL 3.5 million to BRL 4 million a year, which is a very good number. We have a 4.2%, 4.3% margin. We haven't reached our limit yet. We hope to by the end of this year. And I think we've got this equation of price and volume of freight. So with cement, this asset of freight is a direct impact. You can't separate cement and freight, the two things go together. I think not only the impact of the freight, we will have to increase the price of the cement in 1% - 2.5% per pack, because of the increase of the freight. And that's something very big for the cement market. What's very important that we're learning with this campaign that we started during the World Cup is that our brand name is bringing some results and our long products, especially in the civil construction.

On the right here, we can see that we have recovered the 34% in the last year, and the margin reached 28%. So, obviously, it's not only a price recovery but there is a great and concentrated effort in the synergy with raw materials and other things that he will detail.

So I will give the floor to (00:39:58) and he will talk about our trimestreço, our results of the quarter.

Unverified Participant

Thanks you, Martinez. Good afternoon to all. I think Martinez has given a clear overview of the performance in the cement sector. And I would like to talk about the market outlook. Brazil had the market growth in the first months of this year, and this growth will drop slightly with a strike and lack of government investments. But we can perceive this estimated drop of 1% for this year is a significant result in the drop of sales of past years. We already have a threshold and we believe it will remain in this threshold and grow if we overcome these problems. But it's important to stress that as we present only in the southeast that our main market is in the southeast of Brazil, the south and east of Brazil the first half of this year grew 1% in relation to last year.

It's a very small growth but very positive that even with the truck driver strike, the market as a whole is starting to grow, and CSN also is growing, gaining market share in this market. Martinez mentioned the costs reduction and what we are doing to reduce costs since the operation of line two at Arcos we have consistently reduced costs. So despite the substantial increase that we have suffered with the increase of fuel, because of the cost of fuel, but even with that we are able to manage cost reduction and have higher competitiveness in the market.

Martinez also mentioned that we should expect an impact in relation to the freight but we have to offset this. Martinez have an increase in the distribution costs, but we're going to try to offset with the idea distribution costs. And we hope to be able to continue with that. So, we are operating with very low production cost. We are probably the most competitive in the market.

I will now give the floor to Marcelo.

Marcelo Cunha Ribeiro {BIO 4997029 <GO>}

Well, with this we end our presentation. And we can now go on to a Q&A session. Thank you.

Q&A

Operator

We will now start a Q&A session to investors and analysts. Our first question comes from Ivano Westin from Credit Suisse. Mr. Ivano, you can ask your question.

Q - Ivano Westin {BIO 17552393 <GO>}

Good afternoon, Benjamin, Marcelo and other officers at the call. Congratulations for the excellent operating result. My first question is for you, Benjamin. You mentioned \$1.5 billion of (00:44:10) October with sales of assets. And can you clarify this? Give us more details, which are the assets you had mentioned some before, but just to confirm what each negotiation is and also the (00:44:32), and this would be the first one with CSN, and how much would be – got involved and the other details that you can give us. And also you talked about your personal target of 3.5 times EBITDA by the end of the year and compared with 4 times EBITDA, which is the company's target. So why is this difference? Do you plan to sell another asset? Would it be a better cash generation of a company?

And the second question if you allow me, is a question to Martinez. Thank you for your comments. You said that the price question would be asked during the Q&A session. So I'm sure you will be doing a recap of who is announcing what was in terms of price. So I believe that you have a range of 10%, 12% now. So, maybe if you can give an outlook in terms of quality that would be very good. Thank you very much.

A - Benjamin Steinbruch {BIO 1499059 <GO>}

Well, Ivano, good afternoon. With regards to deleveraging as was mentioned previously, the assets that we have made available, are foreign assets because we consider that at the moment what can be sold of the assets in a strong currency because of their valuation and the better performance of mature markets. So in the United States, Portugal is very strong because of the recovery of the Spanish economy and we sold – we sell to Spain most of the production and the recovery is very strong. So we are having very good results in Portugal and also in Germany.

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We have a good margin and full potential and the market is very strong. So we believe that these assets abroad they are the assets that can give us a greater premium. And we have a bank already that were negotiating with. And I wouldn't be surprised if this would happen in a short-term because there are many people involved that the asset in Portugal is a very easily sold on this asset and also Germany very traditional in its performance so the variations are very small in terms of performance. And when there's an improvement in the market improvement of price and margin, this reflects directly in the results. So this is a well-known asset abroad and it has attracted many buyers. So this negotiation is quite advanced. We went to Europe in June and at that time we went to negotiate the expansion of our production and we contacted some interested parties and banks and traders.

And I wanted to sell part of the mining sector and part the equity to any possible buyer because of the improvement of the market in terms of price, the price of iron ore and also the quality award premium and we're going towards this. So I thought it was to talk about taking an interest in the mining sector and there was a possibility of having the screening operation and that wasn't our initial objective, but very briefly and consistent, it has structured itself. And as you know, if you have production, if you have a buyer, and you have trading and financing agents, that's a close equation. So we are working with this, obviously, respecting costs, that's the discussion. The operation itself is not complicated. What's complicated is the pricing, but we're very optimistic.

So I believe that in this universe of assets of foreign assets, and the participation of the mining sector and the streaming operation, we will be able to comfortably reach \$2.5 billion of leverage. So when I say that my challenge was to have - get to October with \$1.5 billion, I think it's feasible, I think Marcelo is negotiating this with banks and other interested parties. And all the negotiations are well advanced. So I wouldn't be surprised if a significant part of them would materialize by October, and we have till the end of the year for any other details. But this has become a priority for us. I had the opportunity of saying that when we went to issue our last bond in February-March, I was surprised by how conservative the market was talking that to consider a AAA company in terms of investors, it had to have EBITDA ratio of 2.5. And that was a surprise to me because we are used to always working with a higher leveraging but after talking to many people and thinking a lot about this, we came to the conclusion that the market is because of the political stability and economic stability. And we believe that it is the moment for a more conservative position and that's why we decided to reduce this - the deleveraging in a more aggressive way. So I would say this is our main priority.

And we have normal day-to-day challenges of production at a lower costs and better price. We also have this deleveraging challenge. We had the issue of the extension of the debt, and that's basically finalized also with the private bank. So our main priority is deleveraging. We believe that if our deleveraging the \$3 billion, we will be able to double the value of what remains in terms of market. So in fact we are giving up the good assets we own - we believe that we have a good assets. But if we deleverage \$3 billion we will gain \$6 billion. And that's what we plan to do in the very short-term. And I hope that our next earnings conference call the third quarter I can mention that for markets. Thank you very much.

Q - Ivano Westin {BIO 17552393 <GO>}

You mentioned two figures just to confirm the amount - the total amount that you expect by October? And what is the amount of the annual stream?

A - Operator

We're talking about BRL 1.5 billion by October. I would say that it can be half and half.

Q - Ivano Westin {BIO 17552393 <GO>}

Okay. Thank you. Can you explain the price dynamics?

A - Benjamin Steinbruch {BIO 1499059 <GO>}

An important concept that we have noticed that occurred in the past, because we can't separate an increase of distribution industry, distribution is the market is different a channel. So if - there's a big distortion when you have a very strong lag between the increase of the price and the distribution on the industry. I think what brings a great benefit to CSM is the increase of price in distribution and traction at very similar levels. I would say that the assembly lines we see in January we increase that by 18%, 22% in all assemble - car assembly. These are contracts that we review every six months.

In February, we had a slight increase for distribution because they had to realign it in about 6%. So in June, we had another increase for the distribution. And during this period, we are including the increase to the industry. And basically there is no difference between industry and distribution. And now in August, Benjamin has mentioned that next month, but in fact it's now in August we are implementing in the distribution sector a 12.25% in the cold and - cold and hot rolled and in the galvanized 10.25%. And the industry will go into mix and will be included in this mix on the 15th, so you can't have different policies if the materials are going to the same client or a smaller client, but within the same production chain.

Now, if there's space for this increase? Yes, there is because when we consider the price of the imported material, for example, the Chinese hot roll has a very unstable price in China. It remains around \$580, \$590 throughout the year. It only reached \$610 in March. So considering this price of \$580, \$509, this premium today is negative. It would be minus 3%, minus 6% in the hot and the cold roll. So if we talk about the 12% increase, this isn't a problem, because you have a relatively positive premium.

What's more delicate I would say is for the electric material, that's why CSN have suffered more it's products which are imported into Brazil, clearly which is not for the automotive sector and we have to be more careful. And there the premiums are more favorable to imports and we have to be more careful here. So, I would say that today there isn't a great secret here.

And another important point is the cost, Pedro mentioned this issue. When we talk about raw material for example, coal and coke, it's the price that in the market. So if you get coal, it goes from \$200, \$250 to \$260; coke to \$280 to \$360. Freight, freight affected the

steel industry, it affect the CSN. We are increasing freight 100%. We have to pass this increase onto the freight, because it is on an outbound, because that's also an important point. So this is the price dynamics that is in the market today, so that you have a model we can consider in the third quarter that CSN, an average increase of price of about 8%, 9%, on what we have today. That's it.

Q - Ivano Westin {BIO 17552393 <GO>}

It's very clear. Thank you very much. It's helped us a lot. Thank you, Martinez, and once again congratulations for your results. Thank you.

Operator

Our next question comes from Mr. Leonardo Correa, BTG Pactual. You can ask your question.

Q - Leonardo Correa {BIO 16441222 <GO>}

Hi, good afternoon to all. I will start by mentioning some points, I have some doubts and confuse with some figures. Martinez, you're talking about a second increase which would be after the June increase, a second increase in August, which is underway for distribution and industry, but you wouldn't have a third increase for September. So you only have two increases, Is that it? Can you confirm that?

The second one is that based on the -- I would like to confirm a point. In your initial presentation, you mentioned streaming of \$1.5 billion and now you said half and half till October, which would be streaming and sale of assets. I would just like to confirm if the streaming is really \$1.5 billion or not. And also Marcelo could help, I understand this streaming are structured transactions. It's like debt that you have and that will have a funding cost. It's a low cost, but I'd like to know how it compares with the cost of issuing bonds at CSN? Certainly, we'll get - obtain money at a lower cost in the 6%, 7%. And I know that the result was outstanding in terms of price realization and the assets are performing very well. What I would like to hear from you, what's the breakeven level for China and the trend for the future? And also you commented growth in the volume of iron ore. So can you tell us how this growth in production of iron ore will occur? (01:01:23)

A - Luis Fernando Barbosa Martinez {BIO 17456025 <GO>}

No, I'm going to answer you. I wasn't able to hear the end very well. Basically, it's what you can see in the report, the price is due to the report and the improvement in the mix. Apart from the increase, what we did, we also increased the number of galvanized materials. So, we grew the nation to the second - first half in relation to the first half of last year 45% in the galvanized products. So that justifies the increase of the average price. What Benjamin mentioned is that we are implementing this already in August this increase, so there is no other increase. It's the one for August. That's the one we are talking about.

Q - Leonardo Correa {BIO 16441222 <GO>}

Okay. That's clear.

A - Luis Fernando Barbosa Martinez {BIO 17456025 <GO>}

I don't know was there any other question? You asked something else, I don't hear it properly.

Q - Leonardo Correa {BIO 16441222 <GO>}

No. I think that was the only question I had asked you, Martinez. And it's very clear. Thank you.

A - Benjamin Steinbruch {BIO 1499059 <GO>}

Leonardo, I mentioned the increase wrongly. No, it's an increase in August, not September. So there are two increases. One, we had already and one that's implementing now in August.

With regards to your streaming question, we plan to obtain \$1.5 billion in streaming and \$1 billion in assets. And together with the sale of the USA, we would have \$3 billion of leverage. And we believe that that is what is necessarily ideal for the company. Within this and it's as I mentioned before, if we are able to have the \$3 million leverage, the company today has \$3.5 billion or something like that. And I believe that with that we will be able to double the value of the company with this deleverage.

I mentioned \$1.5 billion for streaming and \$1 billion of assets. So the streaming operation is a closed package now. It's the first one that's being done in terms of the mining sector. So we believe that we will have two or three operations, two, three keep streaming operations. When I mention \$1.5 billion deleverage till October, I'm considering one or two, and I'm also considering sale of assets. I decided to say half and half and it's around \$1.5 billion because the assets in Germany and Portugal or one interest in mining or it could - and the streaming operations I think that if we can do half by October and the other half by the end of the year, I think that's quite feasible. So that's why I mentioned \$1.5 billion of leverage by October plus a \$1 billion for the end of the year. And that way, we will have less than 4 times, and my objective is 3.5 times.

And in relation to the streaming operation itself, Marcelo can clarify it. And obviously, we are also hoping greater values, but also reduction in our financial costs. We're reacting but there's a big difference with our competitors. So we really hope that this value drops and the streaming operation would be at a lower value than what you see on the slide. So I believe it will be at a lower cost, but Marcelo is negotiating this daily and he can go into greater details.

A - Marcelo Cunha Ribeiro {BIO 4997029 <GO>}

I think it's important to mention that what you described is like a prepayment in streaming because streaming involves more risks in operations and volume. And that wouldn't be - it would be an operation of a non-debt or near equity, so the capital cost can't be comparable. So the capital cost of the streaming would be very low, it's about 5%. So we believe that we can have a very interesting operation and also sharing the risk. But we're still in the initial stages as Benjamin has mentioned. There is still a long way ahead of us.

A - Benjamin Steinbruch {BIO 1499059 <GO>}

Leonardo, as you know, we are working with the expectation of a gradual increase of production every quarter, but always associated with this quality of products. 26% in the first - the rhythm for the first semester was BRL 26 million, the second semester we'll plan to reach BRL 36 million. With regards to the cash cost, the price of the iron ore in China was \$40 per ton, but cash cost was \$44.

Q - Leonardo Correa {BIO 16441222 <GO>}

That's clear. You clarified all my doubts.

Operator

Our next question comes from Thiago Lofiego of Bradesco BBI.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Good afternoon. My question is of mining and also the dams. How is the production today independent of dams, and what is the target for 2020 for example? And also the discount of this, do you think this scenario will remain in addition to current market, what do you see for the premiums for better quality iron ore and also the level of silica and alumina that you have today in the iron ore?

A - Operator

Thiago, good afternoon, (01:09:04). Two-thirds of our production depends on dams, and we have started this filtering one and we have started filtering two project for the filtering the tailings. We hope to be independent of filtering dams in a year, year-and-a-half. With regard to quality of the fine sinters in China and iron ore 2018 from January (01:09:41) average quality was 65% of iron, 5.7% silicon, 1.6% of alumina. So, the average quality is sold to China is 62% iron, 6.5% silica and 0.7% alumina.

Q - Thiago Lofiego {BIO 16359318 <GO>}

When you go back to good dams, two-thirds to just you in a year-and-a half and offset of the CapEx associated two-thirds from going to zero use of dams.

A - Operator

So, the total CapEx is BRL 200 million.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Reais?

A - Operator

Reais.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Thank you.

Operator

Our next question is from Mr. Marcos Assumpção from Itaú BBA.

Q - Marcos Assumpção

Good afternoon to all. Congratulations for the results. First of all, I would like to understand more about the quality of the iron ore, what's changed recently? Yeah. I know you mentioned the quality of the iron ore and alumina, which is becoming more important but what's the specific difference from May and June to give a discount and a premium and looking into the future? And also considering the freight, what is the company's strategy in relation to the iron ore freight? We see that freights are increasing, and what's the impact? And if Pedro could add, what is the level of the cost of a slab that CSN can have after the impact of the strike has finished?

A - Operator

Well. Marcos, the market has changed a lot. We used to focus on production, and then with the Carajás project and the Chinese market with better quality, we had to change. So now we have a different mining sector. We have a gradual – our plan is to have a gradual increase in production and stay in the market with a greater added value.

Our Casa de Pedra asset is of great potential. It's the best reserve that we have in this region in Brazil, if you don't consider Carajás. So we believe that if we maintain the status of premium, we will continue with the same operating situation, and that's very important to get values for silica. Freight is increasing and expectation is about \$20 per ton from now onwards.

Q - Marcos Assumpção

(01:12:52), just to add then in the graph, there is no scale, but it seems that in May, you had a discount, which was slightly above \$1 ton. And in June, you had a premium of \$2 per ton.

A - Operator

That's alumina. So alumina, basically it's alumina. But now we are very strong in alumina as well. And we will also consolidate and it can become very strong in iron ore with low alumina. What I'm saying is that in the future, volume and quality cost is very important.

Q - Marcos Assumpção

So the slide where you show the commercial conditions where there was a \$3 discount and then it was flat in the second and then the third it would be about \$2 premium. So if you consider the quarter, you will see that it will be extremely positive.

A - Pedro Gutemberg Quariguasi Netto {BIO 19803245 <GO>}

Marcos, Pedro Gutemberg. You asked about the slabs. Well, it will depend on the exchange variation, and we had a drop of 5% in dollar terms in June. And we believe that by the end of the year as we show the lag of the cost of raw material, we might have 5% in dollar terms as well. And we hope that there will be a drop as well in the next following quarters.

Operator

Our next question comes from Mr. Rodolfo De Angele, JPMorgan. You can ask your question.

Q - Rodolfo de Angele {BIO 1541593 <GO>}

Good afternoon, I would ask Martinez if I'm not mistaken, talk about new project, a new line.

A - Luis Fernando Barbosa Martinez {BIO 17456025 <GO>}

Good afternoon, just adding, in the second half, we exhausted our capacity of producing galvanized products in Brazil. Just to give you an idea, our annualized number of galvanized should end the year in about 1.3 million tons. And this is a total volume per year. The Brazilian markets for galvanized products hot-dip galvanized is 3.2 million tons. So this is a surgical account, where we've to be very precise, because it's got many specific cities in terms of the auto industry, civil construction, appliances, galvalume, pre-painted.

So what has CSN done? They decided to do something different to what the market is doing. So today, we have total leadership in its market. So the leaders have just to do something innovative and something that will bring a direct benefit to the market. So what have we decided to do?

We have Pedro for this year. He has set an total annualized capacity of 50 million tons, 60 million tons of coated material to be sold. So this volume will be available as from October, November. That's one point, a very short-term. The short-term, which I mean next year, we are converting a line, which was stopped in the mill, which was for a chrome coating, which has no interest here in Brazil and it's used a lot in the U.S., so we're going to convert this line to produce a hot dipped galvanized product. This is going to be an extremely fine product. So then we will have an extra 150 million tons as from next year. I think in the annualized as from April, May. So it all depends on the process for approval of the product and we have a third option, which isn't an option, it was an option until two weeks ago, in fact, when we were in doubt if we would have another galvanized line.

So now we will have three lines in Getúlio Vargas, one at GalvaSud, and one at Paraná. And we decided then to invest in another line for coated materials with a capacity of 350,000 tons to 400,000 tons and at the moment, we are defining exactly which is the portfolio of the products. It can be a streamline, it can be worked with materials focused more on the auto industry or it can focus on more standard products for civil construction, for example. So we can see that this idea is very well considered and we believe that this project will be self-funded. Marcelo is working towards this. We can dedicate time a lot to

this funding, but we're also working with some clients so that we have a back-to-back project. You invest and you already receive. So that would be also very interesting for CSN and very innovative in the market. Because today the cold rolled use that we've had in past is now being transferred to coated materials.

And the whole world uses more coated materials and the materials are used to last. I mean unfortunately in Brazil, the - costs are much to improve the product. So now there's a greater trend in domestic market. There are some segments where there's a bottleneck already in demand. And in 24 months, we will have a new line in operations.

Another point that CSN is considering is where this line will be set up. It also depends on several aspects such as the portfolio of our clients. So this galvanized project has already been approved internally by the company. Again, this project is self-funded and this project only depends on a take from the clients that we will be working with. That's exactly what I wanted to know. I don't know if it's clear for you.

Q - Rodolfo de Angele {BIO 1541593 <GO>}

Yes, it is clear. Do you have any idea of CapEx?

A - Luis Fernando Barbosa Martinez {BIO 17456025 <GO>}

No. In fact - yes, of course I have an idea. It's no secret. A line depends on the type of line, the price will vary a lot. BRL 800 million for 430 million tons. But at the moment, we are doing our homework to know exactly, which is the CapEx for this line and the output of the line. We feel it would be very important, because don't forget that you have a complete portfolio. So I also have a pre-painting line which is complete. So I can include something more productive at the end of this line. So that is in fact the final details that we are analyzing at the moment. Thank you.

Q - Rodolfo de Angele {BIO 1541593 <GO>}

Thank you.

Operator

Our next question comes from Mr. Carlos De Alba of Morgan Stanley. Mr. Carlos, you may proceed.

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

Thank you very much, everyone, and congratulations on strong results. The question I have is just some clarification on the material fact that you put out on the renegotiation with Caixa. It says on there that the - basically that the decision will be concluded once the conditions as we implemented that Caixa conditions are fully implemented. So I wonder if you can give us more detail as to what are those conditions, and when can we expect them to be fully implemented so that the renegotiation is close? And also on the streaming deal...

A - Operator

Carlos?

We can continue the answer.

I think it's only the first part of the question, which is the full implementation of the extension of audit with Caixa. We signed this extension with Caixa today, and it has the amendments what we have at Caixa. But as part of the extension, we will issue debentures, which will be headed by Caixa in terms of efficiency in Caixa and CSN. And this - the issue of the debentures will be done in the next 60 days and that has been approved already by - approved by us and by them. So there's no additional negotiation or risk. I think it's safe to say that there is an implementation with Caixa and that it been finalized.

We will continue with Carlos question. Mr. Carlos, you may proceed.

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

Thank you. The second question I had was on the streaming deal in the mining business. If you can share some details so I can better understand, that would be great. Is it sort of a forward sale where the company will receive money upfront and will be committed to the leading material for seven years or is it going to sell a byproduct of the mining operation? What exactly the company means by the streaming deal in the mining?

A - Marcelo Cunha Ribeiro {BIO 4997029 <GO>}

As Benjamin has mentioned, this streaming of a core product, of basic material which is iron ore isn't a very common streaming. The ones that have been laid were with other products. So we are doing something that really is pioneering with the high volume, 1 billion, 1.5 billion as was mentioned. And as the classic streaming, doesn't talk about a fixed volume production but a percentage of the production of the life of the mine. So each streaming has a characteristic. There is something that you can get off the wall and it fits all. For CSN, it's important that it is very efficient in terms of capital cost and something that the leverages that cannot have a debt characteristic, and should reach the volumes expected. Within these conditions, we are trying to find the best option available.

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

Well. All right. Thank you very much.

Operator

If there are no further questions, I would like to give the floor to Mr. Marcelo Cunha Ribeiro, Investor Relations Executive Officer for his final comments.

A - Marcelo Cunha Ribeiro {BIO 4997029 <GO>}

Well. Thanks a lot. We've been here for over an hour-and-a-half. Thank you for the questions, and we were able to cover many of the important issues of the quarter. We

thank you all for your interest, and I wish you all a good day. Thank you very much.

Operator

We end the CNS (sic) [CSN] (01:27:26) conference call. Have a good day.

FINAL

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