

Q3 2005 Earnings Call

Company Participants

- Mauricio Wernak, Financial Director

Other Participants

- Daniel Altman, Analyst
- Edmo Chagas, Analyst
- Jennifer Corrou, Analyst
- Leo Larkin, Analyst
- Unidentified Speaker

Presentation

Operator

Good afternoon, ladies and gentlemen. and thank you for standing by. At this we would like to welcome everyone to the Gerdau's Third Quarter 2005 results conference call. We would like to inform you that this event is recorded and all participants will be in a listen-only mode during the Company's presentation. Later we will conduct a question-and-answer session. And instructions to participate will be given at that time. (Operator Instructions) We would like to draw your attention to the fact that certain assessments that may be made during this conference call with regards to Gerdau's businesses and its perspectives, projections and operating and financial objectives are mere forward-looking statements based on the expectations of management on the Company's future. Although the Company believes that its statements are based on reasonable assumptions, there can be no assurance that the future events will not affect their accuracy. I would now like to turn the conference over to Mr. Mauricio Wernak [ph], Financial Director.

Mauricio Wernak

Thank you, very much. Good afternoon, ladies and gentlemen. Welcome to our Third Quarter 2005 conference call. The financials presented by Gerdau are available at our website at the CVM and at the Stock Exchange. The Third Quarter presented a consolidated net profit of 812 million reais. And a net margin of 16%. The operating profit totaled 1 billion reais while net revenues reached 5 billion reais and generated an EBITDA of 1.1 billion real and an EBITDA margin of 22%. Consolidated sales were 3.4 million metric tonnes. On November 30, Gerdau S.A. will pay 199 million reais in dividends or R\$0.45 per share. While Metalurgica Gerdau doll will pay 93 million reais of dividends equivalent to R\$0.75 per share.

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Slide number two of the presentations two factors, Third Quarter '05. The world's steel output in this quarter was 1.7% lower than that of the Second Quarter with 272 million metric tonnes. If we were to calculate the full year based on the first nine months we would come up with a volume close to one billion tonnes in 2005. Of this total experts indicate that China should contribute with about 340 million metric tonnes, 25% more than in 2004 when it produced 270 million metric tonnes for the full year. It is worth mentioning that China is still consuming more than it can produce, continuing to be a mass steel importer. In North America the beginning of fall indicates seasonal price increases in fuel scrap and other inputs, such as natural gas and electricity. The expectation is that with the strong demand in the country the increases in scrap prices may be passed on to steel prices and therefore maintain the robust spreads that the long steel industry has been sustaining.

In the Brazilian domestic market output of crude steel has decreased 3.5% in the Third Quarter compared to the Second Quarter. Long steel sales, however, presented an increase of almost 4% in the same period. This is a repeat of the improved performance of the civil construction sector compared to the industrial sector in the quarter. It is worth noting that the level of steel product distributor inventories are back to historical levels, which allows for a better balance between supply and demand in the future. Prices in local currency terms remain at the same levels of the preceding quarters.

Slide number three shipments. At Gerdau consolidated sales in the Third Quarter remain in line with sales of the Second Quarter at 3.4 million tonnes. In Brazil Gerdau presented a slight decrease in shipments when comparing the last two quarters partially due to the reduction of exports. It's worth mentioning that although the decrease in exports was not completely offset by the increase in domestic sales, these are rising and generating higher margins. The North American operations saw its sales increase by 7.5% as a result of a better utilization of its in-stock capacity and a restocking of distributors' inventories.

Chile was the only market to present a decrease in sales in the quarter due to the increase of imported steel. The aggregate sales of the South American operations outside Brazil presented a decrease of 4%. Consolidated shipments for the nine months ended in September increased by 7.7% compared to the same period in 2004, reaching 10.2 million tonnes. This is explained in part by the incorporation of the new North American mills in November '04. In the same period the North American operations and the South American ones except Brazil, increased shipments by 21%. Tonnage shipped from units abroad added to exports south of Brazil represented 73% of the consolidated volume of the Third Quarter of '05.

Cost and prices. Exports with unfavorable foreign exchange in U.S. dollar prices continue to contribute to the sustainable operating rates. If domestic demand picks up as it seems to be, its feasible to expect margins to recover going forward. The downward trend of metallic inputs in the Third Quarter allow margins to remain at current levels. The First Quarter is expected to show stable margins and an increasing volume shipped when compared to the Third Quarter.

In slide number five, margin evolution. Consolidated gross margin remain at 27% in the Third Quarter this year mainly due to the relative stability in the cost of sales compared to

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those of the Second Quarter. EBITDA for the quarter reached 1.1 billion reais. It was 1.3 billion reais in the Second Quarter. Consolidated EBITDA margins stay at 23%, about the same level in the previous quarter when it was 24%. Net profit for the Third Quarter was 812 million reais, 9% lower than that of the Second Quarter and net margin was 16% in the Third Quarter staying at the same level of the previous quarter.

Slide number six, highlights of the quarter. On September 22nd Gerdau S.A. concluded the placement of its first issue of guarantee preferable senior securities or perpetual bonds for a total of \$600 million. The notes pay a coupon of 8.875% per annum on a quarterly basis as of December 22, 2005. Gerdau S.A. has a call on these bonds on September 22, 2010, or at every interest payment thereafter. The paper got a BA-1 stable rating from Moody's. The geographical distribution of the placement was 46% to Asia, 32% to Europe, 20% to the U.S. and 2% to Brazil. Most of the buyers were private banking managers. And individual investors.

At the end of the Third Quarter Gerdau concluded the acquisition process to buy a stake of 57% in Diaco S.A., the largest Rebar manufacturer in Columbia. The investments require this stake total \$75 million. Gerdau has also signed in September an agreement to acquire 36% of Sipar Aceros shares, a long steel rolling mill located in Argentina. This stake added to the 38.5% stake previously owned by Gerdau, represents now 74.4 of the capital stock of Sipar. \$40.5 million will be paid throughout the next three years for that stake.

Slide number seven, a summary of the financials. Although volumes shipped remain even in the Third Quarter the consolidated net revenue for the quarter was 6.3% lower than that of the Second Quarter. This is due to the foreign exchange impact on revenues generated abroad and on exports when consolidated in Brazilian currency. Operations in Brazil contributed worth 2.4 billion reais to net revenue this quarter, with 47.5% of the total. North America contributed with net revenues of 2.4 billion reais with 47.6% of the total. And South America with 252 million reais, the remaining 4.9% of the total. Companies abroad and exports from Gerdau Brazil contributed with 64% to consolidated net revenues for the Third Quarter.

G&A expenses increased 34% in this quarter, the consequence of cost increases in the long-term incentive program at Gerdau Ameristeel. Although there was a nontypical increase in these expenses in the quarter, the percentage for the first nine months in terms of G&A on top of net revenues remained relatively stable at 5%. So this recent increase does not indicate a trend.

The financial results for the quarter had a gain of 190 million reais, a result of the return of financial investments and the positive impact of the appreciated lower currency on the Brazilian based company debt in U.S. dollars. Revenues from monetary foreign exchange variation included in the financial results total 169 million reais in the quarter.

Slide number eight, investments. Out of the many indicators that are used to monitor Gerdau Company's investments, the gross debt to EBITDA ratio was barely 1.4 times. Net debt is approximately paid with six-month EBITDA generation and interest coverage ratio

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today is over 23 times. On September 30th cash and cash equivalents and investments totaled 4.7 billion reais, of which 1.7 billion reais or 35% were indexed to foreign currency, mostly the U.S. dollar. The issuance of the perpetual bonds is in line with the strategy of improving Gerdau's debt profile. It has strongly contributed to extend the average life of our debt from 4 to nine years.

On November 3, Standard & Poor's announced that it restated the risk in foreign currency for certain Latin American, Asian and Pacific region companies. In Gerdau's case the rating went from BB-, stable outlook following capped by the summary to BB+, stable outlook, which is a single notch below investment grade.

Slide number nine, outlook. The general view is that the outlook for the international markets for long steel products is positive given the current overall balance between supply and demand and also balanced inventory levels. Operating rate discipline is another factor that helps the stable market conditions to prevail. At the Brazilian scenario there are indications that the worst is over and economic recovery is on the way. Brazil and Gerdau have seen exports decrease mostly due to the disadvantage of the stronger real; from a domestic perspective the high interest rate spell seems over and the economy seems to be picking up confidence. Civic construction and infrastructure building may very well have an important role in the future economic growth of the country.

In the United States the recently announced TVP figure only reassures the economy that its not faltering. The recent approval of the Highway Bill worth about \$280 billion to be spent in the next four years alone will provide positive demand for our steel products. The general perception is that the economic activity will sustain economic growth at the strong pace enough to keep steel companies doing well. This will also allow for price adjustments to compensate for increasing costs mostly steel scrap. In the medium-term uncertainties related to the future path of rising interest rates continue to be a risk factor.

The South American operations continue to count on economic growth scenarios and should not present surprises throughout the rest of 2005. Both the Argentine and the Colombian operations will be consolidated in full in the Fourth Quarter, including revenues. The balance sheet items, however, have already been fully consolidated from the Third Quarter '05.

Thank you, very much for your attention. We will be very pleased to answer any questions that you might have now.

Questions And Answers

Operator

(Operator Instructions) Daniel Altman, Bear Stearns.

Q - Daniel Altman {BIO 1855515 <GO>}

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Two questions. One is the SG&A increase. If you look at this quarter versus last quarter, we are coming up with about a \$50 million increase. And it seems like the only a small portion of that can be attributed to the management decomposition issue at Ameristeel. I wonder if you can break out the quarter-over-quarter increase in SG&A from 3Q to 2 2Q. Second question is related to the U.S. GAAP numbers. When do you expect that those will be made available? Thanks.

A - Mauricio Wernak

Hello, Daniel. In terms of SG&A expenses, when we mentioned that previously we excluded sales because in our view the problem was not indicative of sales. It was mostly general and administrative expenses. And I'm really going to share with you the general impact in the number, you're going to see the bulk of the impact came from G&A. And that came as a result of the way they have their part of their compensation related to stock appreciation. In the previous quarter, Second Quarter '05, there was a reduction in SG&A as a result of the adjustment of the compensation to the decrease in the G&A share price. And that was about \$10 million equivalent to that. So we had a \$10 million reduction in the Second Quarter ordinary G&A expenses. This quarter, on the other hand, we have the stock appreciation in the case of G&A. And we had a negative adjustment in the expenses in the amount of \$12 million. So in total G&A compensation only responsible for more than \$20 million of this total variation. And there are several other nonrecurring items that we have a part of this related to adjustment in expenses with offshore subsidiaries. But almost half of the total variation can be attributed to Gerdau Ameristeel. And we understand that is the bulk of this variation. And as we mentioned, this does not configure a new trend. It was an event that happened for specific reasons but we don't see this as a trend to be impacting G&A expenses going forward. If you can repeat the second part of the question, I would appreciate that.

Q - Daniel Altman {BIO 1855515 <GO>}

We haven't seen the U.S. GAAP numbers, I'm wondering when they will be available.

A - Mauricio Wernak

We are finalizing those numbers here due to the recent acquisitions of those South American subsidiaries we had to -- we needed some extra time to consolidate the balance sheet numbers of those two subsidiaries in the U.S. GAAP rules. So they will be available throughout this night, tomorrow morning most likely.

Q - Daniel Altman {BIO 1855515 <GO>}

Okay. Thanks.

Operator

(Operator Instructions) Edmo Chagas, UBS.

Q - Edmo Chagas {BIO 1786085 <GO>}

I had a question regarding expected volumes into the Fourth Quarter and in 2006 especially North America given that you have a mill currently idle (inaudible) because of the strike, etc. Do you have any expectations when that may come on-stream and what kind of volume growth it may have in North America and Brazil next year?

A - Mauricio Wernak

In terms of the Beaumont situation we don't have any news on that, we continue to talk with the union to negotiate with. We certainly have a positive outlook for that. We are confident that we will reach a positive conclusion for the process. But it is still a pending issue. And by the way, it is not the strike. It is a lockout. We decided to seize the operations on our side to try to motivate the union to resume conversations on that.

In terms of volumes for next year, I think they will be very much in line with this quarter volumes. The Beaumont Mill is an important unit but as you know, it produces wire rod, volumes of wire rod. So far this year so far in the U.S. we are affected by larger import volumes. So volumes depend very much on how the market will develop. But in terms of operating rates I would say the most recent operating rates they are a very good base for future expectations. If we believe the market will continue with the fairly positive performance that it has been showing so far.

Q - Edmo Chagas {BIO 1786085 <GO>}

Okay.

A - Mauricio Wernak

No major capacity addition can be anticipated for the U.S. for the coming year.

Q - Edmo Chagas {BIO 1786085 <GO>}

And for Brazil, do you see anything different?

A - Mauricio Wernak

Well Brazil we are just starting to operate the Sao Paulo unit. So in terms of new capacity this is the capacity to look at. We talk about nominal capacity of 900,000 tons of accrued steel annualized. And we will probably reach this nominal capacity in actual terms by the end of next year. So there will be a learning curve for that. And besides we have to see how markets will develop. But an addition related to Sao Paulo unit can be considered. So the other units, they are operating very close to normal capacity.

Q - Edmo Chagas {BIO 1786085 <GO>}

Okay, there's plenty of time. So the current performance can be a base for future expectations.

Operator

Marcelo Angular, Merrill Lynch.

Q - Unidentified Speaker

Good morning. Good afternoon gentlemen. Actually this is (inaudible). Actually today we saw the (inaudible) publish the official statement on the CADE. And it is not clear to us yet how much is the total impact of this to Gerdau. We would like to know if this is 7% of gross revenues in 1999 or only for Rebar revenues.

A - Mauricio Wernak

About this CADE resolution, we are still working in terms of administrative claims on that. So the number is even not precise at this point in time. So it is a pending issue. And we can anticipate relatively long period of discussions on that. I think the announcement you're referring to did not change anything in terms of the situation because it was just the official publication of their resolution. Their resolution they took a month or so ago. So nothing changed and we continue to pursue our rights. We believe we have a good chance to revert the situation throughout this process. And we are still focusing our retentions and the proper measures that can be taken within the CADE. So at this point in time its very early to anticipate any kind of number. And in terms of our rights we continue to be positive on that. So we believe that at the end our rights will prevail and eventually we won't need to worry on the numbers and other things like that. But at this point in time everything is expanding so the Company is not, it is not up to the Company to disclose any specific figure on that.

Q - Unidentified Speaker

So you do not think this will have a final decision in the short-term right?

A - Mauricio Wernak

No. Certainly not, it will take quite a long time and if you draw a line and compare the situation with the previous CADE ruling on that. There was a ruling on flat steel in Brazil back in 1999 and the situation is still pending today, almost five years later. So you can assume that the current situation we are talking about might last as long as the other one. Long-term oriented event.

Operator

Leo Larkin, Standard & Poor.

Q - Leo Larkin {BIO 1756825 <GO>}

Could you give us guidance for CapEx and DD&A for '05 and preliminary guidance for '06?

A - Mauricio Wernak

Well, we are speaking to our regional plan of investing up to 3.2 billion on a consolidated basis from '05, '06 and '07. So this year CapEx is lagging a bit behind to what could be originally expected. We probably -- and with a number from 7 to \$800 million this year. Next year we consider something above one billion, 1.1 or so. And in '07 it should be above one billion as well from 1.1 to 1.3, depending on the products that will develop. And

in terms of depreciation amortization we normally, I think the number we can years on an annual basis something close to 300 million, 350 -- it won't change that much in dollar terms.

Q - Leo Larkin {BIO 1756825 <GO>}

Okay. Thank you.

Operator

(Operator Instructions) Jennifer Corrou, Citigroup.

Q - Jennifer Corrou {BIO 1503791 <GO>}

I was wondering there is a lot of talk or we're basically in sort of the pre-election phase. And there's always a lot of talk by companies like Gerdau and other companies that kind of say that government spending increases ahead of elections. My question is have you seen that? Have you started to see any of this sort of spending by the governments? And have you done any work or have you done any analysis that says in an election or in the four quarters prior to an election spending increases X% above normal?

A - Mauricio Wernak

Historically we can observe that in countries like Brazil. In previous election years it was noted that there was an increase in governmental spending. Some people bet that to be the case but on the other hand we have seen this administration very much committed to fiscal surplus and fiscal balance. So it is (inaudible) at this point in time; so far we haven't seen anything related to that. Some market participants expect this will be the case. Historically there is a positive effect on that but it is still too early to see if that will be the case again this year. But on top of that what we saw and we wrote about is that the market is coming up. Again, we apparently the worst is over in terms of a low economic activity. The situation has recently improved in the last quarter most notably probably to continue going forward. It is on a relative way first half of next year in spite of the election situation is likely to perform in a better way than the first half of this year. If the election plays a positive role, it will be a plus on that. But as I said, there is no way to be sure on that. We at Gerdau are not counting on anything specifically on that. We make our assumptions for next year in terms of demand. But we do not necessarily consider specific support from governmental spending, which if it happens it will be in excess of our expectations.

Q - Jennifer Corrou {BIO 1503791 <GO>}

And my second question actually goes back to the G&A line at Ameristeel. Is this something -- you sort of highlighted it yourself the Second Quarter there was an adjustment -- an upward adjustment the Third Quarter, there is a downward adjustment. Are we going to see a lot of volatility in this line going forward?

A - Mauricio Wernak

That depends very much on the stock price volatility. So we throughout this year, we experienced strong volatility in the stock price, not only G&A but steel companies in

general. So it will depend very much on market conditions. If the market continues to be that volatile we might continue to see this as an issue. But as I said, it doesn't translate into a rising trend. It is volatile; it can be up or down depending on market conditions.

Q - Jennifer Corrou {BIO 1503791 <GO>}

Okay. Thank you.

Operator

(Operator Instructions) Daniel Altman, Bear Stearns.

Q - Daniel Altman {BIO 1855515 <GO>}

I wonder if you have a pro forma number you can share with us in terms of the contributions from Columbia and Argentina starting in the Fourth Quarter, just kind of a round number if you have one.

A - Mauricio Wernak

Presently we are not planning to do pro forma statements on that. So First Quarter, at the end of the First Quarter we will be disclosing the numbers including Colombia results. But we are not going to make pro forma restatements.

Q - Daniel Altman {BIO 1855515 <GO>}

What about guidance? Are you providing any of that?

A - Mauricio Wernak

I can share a few of the basics of the operation, Colombia is about a 500,000 tonnes operation. It has margins very much in line with the other South American margins. EBITDA in the range of 30% margin or so in the current market conditions. So and it will be one quarter out of a year of contribution for this year for the consolidated results. So with that I think you can make some assumptions. But we cannot provide anything beyond that at least at this point in time.

Q - Daniel Altman {BIO 1855515 <GO>}

That's helpful. Thanks.

Operator

(inaudible)

Q - Unidentified Speaker

For the domestic market in the Fourth Quarter correct me if I'm wrong but you are expecting increased sales quarter on quarter. And also stable prices. I was wondering

what you expect in terms of costs specifically for the domestic market in the Fourth Quarter?

A - Mauricio Wernak

In general terms our current expectation is that margins will be fairly stable. So we expect both prices and cost to be in round numbers at the same levels they are today. This is our best expectation based on the current market conditions. We don't anticipate any material cost pressure. And as we said and you confirm we expect prices to remain at the same levels where they are in local currency so margins will be fairly stable.

Operator

At this time there appear to be no further questions. I would like to turn the floor back to Mr. Mauricio Wernak for any further or closing remarks.

A - Mauricio Wernak

Well, we just thank you very much for your interest and your attention. We look forward to hear from you in our next quarter conference call. Have a good day.

Operator

Thank you. This does conclude today's teleconference. Please disconnect your lines at this time. And have a wonderful day.

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