Q2 2020 Earnings Call

Company Participants

- Luis Fernando Barbosa Martinez, Executive Officer & Member of Executive Board
- Marcelo Cunha Ribeiro, Chief Financial & Investor Relations Officer, Executive Director of Finance & Investor Relations and

Other Participants

- Carlos De Alba, Analyst
- Daniel Sasson Itau, Analyst
- Gabriel Galvao, Analyst
- Leonardo Correa, Analyst
- Thiago Augusto Ojea, Analyst
- Thiago K. Lofiego, Analyst

Presentation

Operator

Good afternoon, and thank you for holding. At this time, we would like to welcome everyone to CSN's conference call to present the results for the second quarter '20. Today, we have with us the company 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 presentation. And following this, we will go on to the question and answer section. (Operator Instructions) We have simultaneous webcast that may be accessed through CSN's Investor Relations website at ri.csn.com.br, where the presentation is also available. The replay will be available for one week. Now, once again, you can look at the presentation at your own convenience.

Before proceeding, we would like to state that some of the statements herein are mere expectations of trends and are based on the current assumptions and opinions of the company management. They are future events, performance, and events that may differ materially from those expressed herein, and in fact, actual results, performances, or events may differ materially from those expressed or implied by forward-looking statements as a result of several factors such as general and economic conditions in Brazil and other countries, interest rate and exchange rate levels, future rescheduling or prepayment of debt denominated in foreign currencies, protectionist measures in US, Brazil and other countries, and general competitive factors at global, regional or national basis.

We would now like to turn the conference over to Mr. Marcelo Cunha Ribeiro, Investor Relations Executive Officer, who will present the company's operating and financial highlights for the period.

Mr. Ribeiro, you have the floor. You may proceed, sir.

Marcelo Cunha Ribeiro {BIO 4997029 <GO>}

A good day to all of you, and thank you for participating in our earnings release presentation for the second quarter '20. Before beginning, due to the logistic difficulties caused by the pandemic, as speakers, we have myself and Luis Martinez, our Executive Commercial Director.

Now, before we speak about the highlights of the period, I would like to highlight that we continue within the context of the pandemic, and I would like to take advantage of this earnings call to update the market on the impacts of the pandemic on the company. And making an analogy, well, our executive officers have obtained very positive results during this very turbulent period. We have the good fortune of having a very limited number of cases within our operating areas in the mines or at the port or even at our administrative offices. And all of this, thanks to the protocols and the very stringent procedures that have been followed not only by the leadership, but by our entire labor force, making it possible not to impact operations. We have not had any interruptions, and of course, we do have a higher absenteeism rate, a few impacts on procedures, but without an impact on results. All of this, thanks to this alignment and cooperation.

During the period, we were also able to comply with all of the requests of health authorities, the Labor Ministry, the Health Ministry, adjusting our operations. And we do believe that the worst is over, is behind us, and going forward, we think that we have a very low risk that this will continue to cause a problem for our business.

We go on to the highlights for the period. We are on page 2 of the presentation. The first highlight was a good operational result measured by adjusted EBITDA, especially the positive surprise in our business that has generated most of the results, which was mining, but also in steel and other businesses.

We have a beginning of the quarter highly impacted by the lockdown and the quarantines in the larger cities and the markets where we are active, and the initial situation was a deep impact on our financial results in cement and the steel production. The recovery has been a factored that we imagined, especially as pertains to demand, we have a price stability as you will see and continuity of our operations. And this has enabled us to sequentially recover our results and along with a gradual recovery of volumes in mining within the context of good prices -- valued prices, we got to an EBITDA of BRL1.9 million. Now, in the context of a pandemic, this was surprising and was surprising even for the more optimistic.

In terms of the second pillar of our highlights, this was a quarter of deliveries. We have been working to withdraw pressure on our liquidity, lengthening our liabilities, and in the second quarter, we were able to announce the lengthening of our debt with Banco do Brasil and Caixa Economica of BRL1.7 billion, and we have made advances with private banks. Very soon, this will be announced and we will comment on this during the presentation. Along with access to new financing in Brazil or abroad, using our companies in Europe and the United States, we had a significant increase in liquidity, which is essential during this crisis, and this is a highlight that we celebrate.

The last point is that one-off increase in leverage due to the currency devaluation. But once again, our hedge accounting policies have protected our results, avoiding the volatility of exchange rates. Then, as we have export revenues, this will offset this slight increase in leverage through time. Additionally, we made more than BRL600 million in mining to reduce our indebtedness, and this has enabled us to keep our leverage constant. Now, with that visibility of having better results, we will be able to set forth a very determined guidance to reduce leverage to less than 4 times until the end of the year. This is something that we announced last night and that we will remark on during the presentation.

These are the highlights, and we go on to page #4, the evolution of EBITDA business by business. The growth of consolidated EBITDA was 45%, an addition of more than BRL500 million. And the surprise was not the significant growth in mining because the base of comparison is very weak. We were affected by rainfall and low production. What surprised us were the better results of the steel mills even despite the context, a growth of 29% and a growth in other businesses as well.

In cement, the growth was 95% in terms of EBITDA, and with a favorable combination of a growth of volume and prices and a good operational performance when it comes to cost. And our efforts towards containing costs is showing results. We see a contribution of BRL57 million quarter-on-quarter, coming to BRL1.925 billion as total EBITDA.

We go on to page #5 to speak about financial indicators. We begin with CapEx. That remained at the levels of the first quarter, but with a significant trend towards reduction expected for the second semester. As we had commented, we carried out a review on investments expected for 2020. We devote a minimum to security, sustainability with a guidance of BRL1.1 billion, half of what it was last year. Of course, to preserve our liquidity within this context, that is temporary.

The second cash generation element was working capital. With good news on the front, we were able to offset the increase in the finished product inventory, because there was a sales restriction with a series of initiatives that went through the lengthening of periods offered to suppliers, shorter periods to receive our export revenue, and this led to a cash generation of more than BRL400 million during the period. And what we see below, it stands at BRL1.4 billion with a favorable comparison vis-a-vis previous quarters, and we're going to accelerate cash generation.

We go on to page #6 and that BRL1.4 billion, as you can see, was essential to offset a growth in our debt that arises from a devaluation in the exchange rate at the end of the first quarter, 1.44, it began at 1.20, it increased our debt by 1.48. And were it not for the strong cash generation, we would have had an increase in indebtedness. It remained constant at BRL33 billion. As I have already mentioned, this increase will be more than offset by a growth in EBITDA. This is our natural performance.

Our cash generation in dollars is up 65% to 70%. And for the next 12 months, we expect a proportional growth, which means that net debt EBITDA will move away from previous levels due to the exchange devaluation. That is why we were able to set forth a new guidance that will be less than 3.75 times. We hope to have a rapid evolution and still without financial initiatives. We have a guidance of less than 3 times for the end of 2021 and absolute net debt lower than BRL23 billion in 2021, a reduction of BRL10 billion from our balance, but this is something we will attain with cash generation and with financial initiatives that will be delivered until the end of 2021.

What we would like to highlight is the increase in liquidity as we see in page #7. Cash came to BRL5.2 billion in terms of adjusted availability. And of course, this is in accordance with our expectations for growth, a liquidity that is higher than our short-term obligations, and we can observe that we were able to achieve this through lengthening the access to new financing and other initiatives. Our liquidity is above our short-term debt.

We were able to finalize a negotiation with Bank of Brazil and we have BRL1.4 billion additionally and lengthening with private banks. With this, we conclude our efforts regarding the year 2020. And in the second semester, we will begin to focus on the years 2021 and 2022, where we have big dreams. We would like to completely finance this amortization to reduce our short-term pressure. We are at a good moment globally in terms of liquidity. We're going to reduce leverage, bring greater liquidity, and this will enable us to extend most of the amortization expected for 2021, 2022 in the second semester. With this, we go on to the highlights per business.

We begin on page #9 with the steel performance. And naturally, we had a reduction in volumes. The consolidated volume of 1,003,000 tons, a drop of 12%. Notwithstanding this, we should celebrate this, in the domestic market, a drop of 20%. And at the beginning of the crisis, the reduction foreseen was 40%. What we saw was a reduction of 29%. And even so, our reduction was less than that of the market.

In terms of pricing, products and sectors, we're not exposed as other sectors during the crisis as the automotive and white lines, and our geographic location has been very helpful. Although the global steel market has been weak and we were able to increase our exports by using our export channels, through subsidiaries in Portugal and the United States and direct exports, taking advantage of the appreciation in the exchange rate.

When it comes to prices, the results were also good. A drop of volume of 12% was practically offset by average prices that were 10% higher. Sequentially, the revenues were only 3% below. Thanks to the global environment of steel prices that surprisingly have been very resilient.

And one of the great factors is that recovery of the industrial sector in China, which translates into production and record steel productions in that country. And China has exported steel for the first time in June, and international prices have become interesting, bringing us at parity with local prices and giving us room to transfer cost. This still is not reflected here, and without a doubt, Martinez will remark on this during questions and answers. With this, we were able to have an increase in EBITDA 6%, despite the very challenging environment and with a significant improvement in the business in Brazil.

With the businesses in Europe and the United States being more impacted, we see a disproportional growth in EBITDA in Brazil, not only in flat steel, but also in long steels. Long steel was transformed in the last year through operational enhancements and resiliency of civil construction, and this quarter represents almost 10% of our results in Brazil for the quarter.

We go on to page 10, with a favorable part in terms of operations in steel. We're now producing more because of the revamping of blast furnace. And we had extraordinary events in the first quarter, an excess of rainfall, blackout. And this quarter has been much more stable and the Blast Furnace 3 has shown its capacity. We have a growing production.

Last year, at the worst point of the crisis, the blast furnace produced 6 tons a day. We now have a pace of 50% higher, 9,000 tons per day. And even with the stoppage of Blast Furnace 2 in May, our flat production has been constant vis-a-vis the first quarter, and of course, this translates into more competitive prices.

In the quarter, we have iron ore that increased its price, and of course, the exchange appreciation. And you see a cost of slab that is an indicator that we had not obtained in the last 2.5 years. Because of this, our adjusted EBITDA continues to improve, and the trend is to have an improvement in prices in the second semester with a positive impact on our sales per ton.

On page 11, we speak about the mining performance, as had been foreseen, an important jump vis-a-vis the abnormal prices in the first quarter due to delays in the mining front and rainfalls. The recovery was faster than we had expected. All of this was obtained in the middle of the quarter with growth. And we also have growth because of opportunity situations in mining. The price of iron ore is so favorable. But even the loads are below 58%, we have obtained surprising margins, enabling us to use the shipments as an opportunity and with better revenues per ton. And the price realization was marginally affected.

We see that the price realized in dollars was marginally lower vis-a-vis the first quarter, especially where the indicator slab has disappeared. But a positive impact on profitability and this is how we show that growth of 54% in our EBITDA, the second best EBITDA for the mining unit in history. What we see in terms of production is a clear trend for recovery. The guidance is 33 to 36 tons besides the purchases from third parties in 2020. And in the second semester, we expect a resumption of volumes closer to 10 million tons, which will enable us to increase our operational efficiency and cost of production, once again aiding and abetting our margins.

Finally, on page 12, a comment on our cement performance. Now, we hope that not only this quarter, but in coming quarters, we will have a positive phase of recovery. This is what we have observed, acceleration in the revamping and maintenance projects and civil construction projects that have come to a standstill. They accelerated during the pandemic, and the demand for cement has grown very speedily.

In June, we had a growth of 24%, something we have not seen for many years. And of course, this translated into our numbers as well, not only in terms of volume, we had a growth of 1 digit, but also in our prices. There's a 2-digit evolution in the market, and our net revenue grew almost 20% during the quarter with a positive impact in profitability measured by EBITDA, BRL27 million plus 16% of margin, which still does not show what is about to come in the third quarter. We believe that the residential projects and the new launches will continue to take place. The market is capitalized, and this is a trend that should prolong itself during the market, and the cement unit will gain another level of relevance within CSN.

With this, we would like to conclude the presentation, and we open the floor for questions and answers.

Questions And Answers

Operator

Thank you. We will now go on to the question-and-answer session for investors and analysts. (Operator Instructions). Our first question comes from Thiago from Bradesco BBI.

Q - Thiago K. Lofiego {BIO 16359318 <GO>}

A good day to all of you, and thank you. I have two questions. The first referring to volumes in mining for the coming quarters. How is this evolution going to work? And of course, you have that issue of authorization and we do think that this will have a strong impact on production during the year. Now, the work was 35 million tons, if this is feasible for this year.

The second question refers to the liquidity events and capital allocation. Considering you have been able to renegotiate your debt with the bank and you're generating cash, should we expect further prepayments, higher sales in mining, or are you somewhat calmer at present? And so you now have a positive accounting balance, which means that you are calmer when it comes to your balance in general. And well, this question leads to capital allocation. What is it that we should expect in mining or eventually in a new line downstream during this period of the pandemic? What is it that you're thinking about for this period? Thank you.

Operator

Ladies and gentlemen, please hold while our speaker reconnects. Thank you. Once again, Marcelo Ribeiro has been able to reconnect. Marcelo, would you like me to repeat the questions now? The first refers to mining volumes and secondly, the liquidity events. And I complemented the second question with capital allocation. This trend for improvement in your balance leads you to think about why in terms of capital allocation well they'll be done in mining or any new line, galvanized products as part of your steel mills.

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

Very well. Thank you for the questions, Thiago.

In mining, as I mentioned, our guidance is BRL33 million to BRL35 million, and we have been able to purchase from third parties in a very successful way, purchasing higher volume vis-a-vis last year. And as I mentioned, we have those opportunity shipments. Now the margins are still very good which leads us to think that we can be optimistic in terms of this range within the figures that you mentioned, Thiago.

Regarding the liquidity events, we will not put aside our goal of being below BRL23 billion for the coming year for 2021. And as I mentioned during the presentation, this is in effect with the assets, with the opening of capital and subsidiaries, or maybe both. We continue to work on this. We're going to perhaps survey an IPO for mining as we have already remarked on. I think the moment is favorable. We have good liquidity globally, and we're undergoing an analysis at this point.

The sale of the subsidiary in Germany continues to be a possibility. We came to a standstill because of the pandemic, but this is still part of our game. And there are other possibilities, a streaming in iron ore, Usiminas. Of course, these assets were already part of our plans and we will use this to reduce our indebtedness.

To respond to the second part of your question, all of this will be geared to investments, seeking opportunities, for growth opportunities that are attractive, and the most important is an expansion of mining. As mentioned previously, the project of the plant of BRL10 million plus BRL5 million is proceeding full steam. And in the month of May, we obtained a prior license from a tender, very interesting. And we're speeding up with a detailed part of engineering, and we're going to begin the coming year. We have $500 million that will be an investment for this. And we also have investments in steel mills and investment of capacity and revamping, and at this point in time, without totally expanding the production. Of course, the galvanized project is very interesting, but we have to be cautious because of what is happening with the automotive industry globally. And of course, dividends. With the minimum mandatory dividends paid off, we will continue on with 25% of our net revenues.

Q - Thiago K. Lofiego {BIO 16359318 <GO>}

Marcelo, if you allow me to go back a bit, which are the liquidity events that have greater probability of still happening this year? As the capital markets is quite receptive, you have had an improvement in mining. The situation is favorable. So which would be the ones with the greatest probability of happening in the short-term in the second semester basically? Which are the ones that you are focusing on mainly?

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

Well, the ones that we're working on actively at present, probability is a crystal ball, of course. But we're actively working on the possibility of holding an IPO for mining. And we're also working on negotiating the sale of some of our assets. These are the projects that are underway presently, and the probability of this happening, as I said before, is somewhat binary. I really can't say more than this. These projects are well in advance. They are very relevant possibilities. They are not remote possibilities.

Q - Thiago K. Lofiego {BIO 16359318 <GO>}

Very well. Thank you, thank you very much, Marcelo.

Operator

Our next question comes from Daniel Sasson from Itau BBA.

Q - Daniel Sasson Itau {BIO 16691350 <GO>}

A good day to all of you, and thank you for taking my questions. Another question, Marcelo, referring to your cash generation. I had a slight difficulty in understanding the BRL1.4 million for cash generation, especially because of the impact you have mentioned in the exchange variation. In the previous quarter, you had a problem with idleness, something that wasn't very obvious. Now, perhaps you could help us to conciliate this amount, and what it is that most impacted this cash generation during the quarter.

A second question to Martinez, who still has not spoken up this quarter. Martinez, if you could explain that surprising performance for the steel price in the domestic market. What is it that underlies all of this? Is it distribution? I know that you made some attempts in June and the quality, the COVID products. If you could share with us your expertise and your forecast for prices going forward. Thank you.

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

Well, regarding the evolution of net debt, we have a bridge that explains stage by stage of this variation, reaching 31, that BRL1.4 billion, and so being offset by BRL1.48 billion of exchange variation, and that is why we have that slight increase. Now the only thing that has not been included in these two concepts is the prepayment we advanced by Glencore. We had an increase of BRL68 million.

Now, why do we exclude this, because we just announced another one of BRL600 million, and we have a line of others, which is the only thing with a difficulty of consolidating BRL100 million. Part of this BRL60 million refers to our contribution to the Transnordestina work, which is something non-recurrent. It's the end of a commitment we had done at the beginning of the work. The rest, we have conciliated very well through explanatory notes in the release. You should look carefully at the footnotes referring to our cash flow.

Once again, should you have any doubt, we are at your disposal to clarify your doubt. I now give the floor to Martinez.

A - Luis Fernando Barbosa Martinez {BIO 7187744 <GO>}

Good morning, Daniel. Thank you for your question, and I have to be intellectually honest to be able to respond to your question and to respect the report done by analysts and to respond to your question with the necessary detail about the CSN performance. Marcelo has already told you some of this, but I will give you other details to solidify what we're doing going forward.

Our net revenue, with all of this turbulence in the market and the world dropped only 2.8%. We maintain a level of BRL3.5 billion for the quarter. Another aspect which is very important, and we see the importance of having a good price. The price is the best asset a company has. We have a price of [ph]3430, 10% in this highly challenging and unfavorable situation. You have to be more than resilient. You have to be tenacious not to go bankrupt.

And in the second quarter, Daniel, although there was a drop of 20%, we had a drop of 12% for the entire semester, which is something positive in my opinion. Now, if we go into greater details of what we did, I think perhaps we never had such a mix of added value. We got the 33% of our sale of flat steel. And if you add this, 750,000 tons of flat steel, 400,000 tons of coated material. And of the 400,000 tons, 100,000 tons or 110,000 tons were sold in the United States with a local premium, which helped us a great deal because of the dollar and the US prices.

Another very important price is that of the tin plate, which helped us to give thrust to our results. The prices at present are BRL5,500 per ton, and I got to a volume of 100,000, 750 sold 400,000 and then the tin plates. So if you calculate, the prices gave us a significant thrust. And besides this, we put in place the increases that we had mentioned at the beginning of the quarter. And in the last call, I mentioned that there would be a 6% to 7% price increase in the quarter, which did materialize.

Another aspect is the export of slabs. We exported 35,000 tons of slabs and 32,000 of tin plates. By adding all of this, and if you bring together these factors, this is what led to our revenue results that are very similar to other quarters. And that's the performance of CSN.

Now to speak a bit about prices, to speak more in depth about prices, what is happening -- we'll speak about what is happening at present. The domestic sales in the second quarter had a drop of 29%, and for the year, the drop of 15%. Our market projection in general terms is that flat steel will close at 10% or 12% for the year, long steel at 0%. And if we break this down further and to give you more color on our business, the industry had a drop of 4% to 6%; automotive is still unknown factor, it can be better than the 40% announced; distribution, we're quite optimistic, 5% to 10% of drop only; and civil construction practically stable.

Well, speaking about civil construction, CSN has an umbilical relationship with this market. And besides everything that I say of having a focus on the domestic market, working on added value, fragmentation, not putting everything in the same basket and working with geography, in civil construction, we can work with long steel and cement additionally. And all the sectors performed this year in a very satisfactory fashion. And the outlook is to end the year with a zero drop in civil construction and perhaps a growth in some sectors.

As part of these sectors, the more relevant that of packaging, for example, which is very relevant or the food sector and the chemical sector. We're working as we did pre-COVID. We're working at full steam. And highway implements or agricultural implements have had a drop of 30% at the beginning of the pandemic, have reached levels of usage of 80% to 90%, heading to the fourth quarter, reaching 95% to 100%. Consumption sectors, such as the white lines, with a change of consumption habits as people stay home more, the sales were practically normal during the second quarter with an excellent outlook for the third and fourth quarters.

The only sector that still brings down the demand for steel, and CSN has a relatively low stake in this, in the second quarter was 5%, is the automotive sector. They have said the drop will be 40%. But we had 60,000 vehicles being produced, which isn't so bad. Perhaps in the third or fourth quarter, this will go up to 80%. And machinery and implements speaks about ending the year at 90%. I wanted to give you more color on these businesses, because this is what will guide our second semester. The outlook is very good when it comes to the market.

Q - Daniel Sasson Itau {BIO 16691350 <GO>}

Thank you. Martinez. To make sure that I have understood about prices in the domestic market, in distribution, the prices are 7% higher than they were in the first quarter. And do you foresee the possibility of further increases?

A - Luis Fernando Barbosa Martinez {BIO 7187744 <GO>}

The increase was 10% in July, Daniel, for distribution. On September 1, we're going to have a new price increase for distribution. And depending on the product, this will vary between 10% to 12.5%. This is a new increase that of July has been fully put in place.

For you to understand this better in terms of premiums, if you think about at BQ, and there are two accounts that I will share with you, one on the table and what is happening in China. China has even bought slabs from Brazil. And the BQ reached $500 in China. Let's imagine that the variation at BQ is $470, in China it's $500 with a fixed exchange rate and the price domestically up to $800. Without that 10% increase, our premium will be from 8% to 12%. And the September price increase is more than rational when it is applied, and there is a favorable demand-supply ratio. The plants are working at levels of 750,000, 800,000 tons. There is no surplus in terms of surplus and demand. And we should have a normal export. And the dollar at the level it is will allow for stronger exports. Therefore, the scenario for price correction is fully favorable for September.

I don't know if this has remained clear. Once again, the price increase in July has already been implemented, and it is not in our press release, Daniel.

Operator

Our next question is coming from Mr. Carlos de Alba with Morgan Stanley. You may proceed.

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

[ph]Hello, everyone and good morning. Thank you very much. So my first question is, Marcelo, maybe coming back to your cash flow statement, there was about $604 million change in working capital throughout the cash flow operations in the quarter in the Portuguese or Russian, is it attributed to producers and fees? So I wonder if you can explain a little bit more about what that is, given the recent -- tell us a little bit more in terms of the cash [ph]flow integration in the quarter.

And then coming back to the balance sheet discussion. The expectation that the company has is to be able to reduce net debt and net debt-to-EBITDA to BRL23 billion and 3 times by the end of next year. What iron ore price are you forecasting implicitly in these numbers? As well as are there any subsequent increases in steel domestic prices that are embedded in that calculation? Thank you very much.

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

Carlos, thank you for your question. Now regarding the cash flow and working capital, as I mentioned in the presentation, we had significant variations, thanks to intentional initiatives. We carried out some activities during the quarter to increase the liquidity. In terms of the inventory, the finished product inventory increased, but we have taken actions to reduce the margin in parts and raw material. But presently, we have a higher inventory. When it comes to the liabilities, we have a significant lengthening with suppliers. We negotiated with those, and of course, can work with this, especially international vendors for coal, and this has helped us significantly in terms of our cash flow.

When it comes to our receivables, we have the fortune of having receivables in mining with confirmed letters of credit. And so these receivables are of very liquid currency. In some, we have no cost whatsoever. In others, we have a low financial cost. And that is why we have that significant cash flow. What helped mostly were those activities of support from the government towards liquidity, a reduction or deferral of taxes and rates and social security contributions. All of this helped us.

It is this set of actions that allowed us to have the working capital that has helped us so significantly. When it comes to our forecast, what we have in terms of iron ore is the consensus curve. It's a consensus of the analysts that the coming year, the projection will be of $75. We're not inventing anything. We think these figures are conservative at present and the other assumptions as well.

In terms of exchange rate, it will be the market exchange rate as foreseen and the focused survey of the Central Bank and the price of steel, we're working with the present day prices. And this is what has been included in our forecast.

Operator

(Operator Instructions) Our next question is from Thiago from Goldman Sachs.

Q - Thiago Augusto Ojea {BIO 17363756 <GO>}

Good afternoon to all of you. Thank you for taking my question. I have a question for Martinez regarding the steel supply and demand situation. You spoke about the general activities of the sector where activities came to a standstill. And now the demand is surprising you. So what will happen with the resumption of this activity? Will this increase the competition for prices despite having the parity that you have? And the second question refers to mining. We have seen an increase in volumes, but the cost per ton also increased. And there's a concept of idleness that was put in place during the first quarter. But why has the cost increased while the quality has decreased? If you could explain this.

A - Luis Fernando Barbosa Martinez {BIO 7187744 <GO>}

Good morning, Thiago. The accounts that I have at present for capacity, we have Usiminas operating with a blast furnace, Arcelor also operating with a blast furnace. They have announced the resumption of a blast furnace dedicated to exports. Gerdau working with long steel and others. So what they're going to do is quite restricted than CSN. If we bring together all of this installed capacity that is operating, according to my accounts, the supply of steel will be up 750,000 to 780,000 tons per month, which is a supply that can fulfill the market at present.

Additionally to this, we have two players in the domestic market that supply slabs. The [ph]Persian steel market and another that can also supply slabs. And we have the possibility of the resumption of the blast furnace from Usiminas and CSN. So, supply and demand is an important curve where we can implement a price increase. It is not a hurdle to already have that price increase in September.

All of this will move because of the demand in China. The price in China, no, there will be no price in China lower than $500 in the second semester. With the dollar at BRL5.15, the present day price of BQ will have a negative price that varies from 9% to 12%. The increase in September has to be implemented fast, and it has to go throughout the entire value chain. It's an issue of cost. We cannot fall behind.

Now, when it comes to capacity, we have to fully understand this. We have to look at this based on product lines, because imports in this scenario, well, they will impact CSN. What comes into the country is galvanized material. So, CSN will focus on supply and demand cost, the idleness and the value chain, and we will do whatever we can in our mix to maximize value.

In that quest for that figure that is mentioned by Marcelo, that idea of resuming profitability of steel by $100 per ton. This is an idea that we have. It is not a forecast, but this is what we're seeking. I don't think this will be an obstacle or a hurdle.

Does that respond your question?

Q - Thiago Augusto Ojea {BIO 17363756 <GO>}

Yes, thank you. That has been very clear by clarifying what is happening in mining. And the sequential comparison of prices of the second quarter with the first quarter is very useful.

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

The first quarter had distortions because of the high cost of idleness. These costs don't refer to the merchandise sold. Now, another point is that we also have an increase in the cost of the product that is purchased. We bought iron ore at a higher price. And of course, this makes the cost in reals somewhat higher as well, but this adds to the margin.

What is more relevant in this discussion is that our cash cost for production stood at $17, and this is a transition cost. This is not the cost that we would like to obtain in the second semester, with volumes going back to what we had last year, $10,000 per ton. Well, this will dilute our fixed costs and we will see an evolution -- a positive evolution in cost vis-a-vis what we saw in the second quarter.

Q - Thiago Augusto Ojea {BIO 17363756 <GO>}

Thank you, Marcelo. So there's no tripping issue. And my follow-up, do you have the figure of the iron ore for third parties, which is the percentage of the second quarter?

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

We stopped doing this because we weren't working according to the benchmark. We're trying to be transparent and also protecting strategic information such as the purchase of products from third party. This is not a market that will change a good deal year-on-year. It will be very similar to 2019. So it's only this transition going towards higher volumes in the second semester with the costs that we had last year, yes.

Operator

The next question comes from Thiago from Bradesco BBI.

Q - Thiago K. Lofiego {BIO 16359318 <GO>}

Just a quick follow-up with Martinez, the same question that Thiago has already posed, the demand and the steel price mix. So you are already selling at 2,850 and this is the price that you are working with after the increase in July. And with those 2850 you still have a negative result of 9%.

A - Luis Fernando Barbosa Martinez {BIO 7187744 <GO>}

That's it, Thiago. It's exactly that. The present day price of BQ without fees and [ph]corporate taxes in the domestic market is 2800, 2850 And if we think of BQ in China at $470, $500, this premium is negative between 8% and 13%. And that is why the increase should be from 8% to 12% in September, depending on the product.

Now, if we don't have this premium, we have to be more cautious. We want to work more with the market and not allow a penetration for imports. And for the industry, good questions. In the industry -- and I had forgotten that in industry at large, with the exception of some clients we have a contract with, we have a very small share in the automotive market. We work with 10% in the automotive market for August. And of course, we have this difference because there is a delay in the implementation. Otherwise, the spread of distribution for the industry will be much too strong. And we will begin to have a confrontation of distribution channels in industry. It's very hard to work with that. And on August 1, we will have an increase in galvo aluminum that is being invoiced in Brazil. And the increase will be for civil construction and distribution for the white line industry.

And for the increases for long steel, I forgot to about long steel. In long steel, we're working at full steam. It is the smallest of our markets. But we have 20,000 clients that are registered. And every month we sell to 10,000. And every month, we have 8,000 clients month after month. I sell less to more clients. So the increase will be about 12%. Last month, the increase was 6%. This month, another 6% price increase, 6% and 6%. That's it.

And long steel, the average sales per month here in our balance, 18,000 to 19,000 per month. In Brazil, once again, we haven't taken into account Germany here. Thank you.

Q - Thiago K. Lofiego {BIO 16359318 <GO>}

Thank you, Martinez.

Operator

The next question is from Leonardo Correa from BTG Pactual.

Q - Leonardo Correa {BIO 16441222 <GO>}

Good day, gentlemen. Good afternoon. The first question is to Martinez. Martinez, there is a great discrepancy in the data. The large steel mills had a double digit drop, while in distribution, we see an increase of double-digit as well. Now, I imagine that there has been a migration of volumes, perhaps. I would like to hear from you if something additional is happening in the market and if this change will continue going forward. Which is your reading of this movement? I think there's a big gap in the data.

And a question for Marcelo. You spoke about the guidance for iron ore for 2020, BRL33 million to BRL36 million. What happened with 2021 and 2022? This would be very helpful. Thank you.

A - Luis Fernando Barbosa Martinez {BIO 7187744 <GO>}

Leo, good morning, and this is a very smart question. It's hard to understand what is happening for those who don't closely follow up on the market. There has been an increase in apparent consumption. During this crisis, clients were hesitant in terms of planning and scheduling. They're buying only what they need. And as distributors had inventory and had to sell, they began to sell in fragmented amounts. It was easier for a client to access a distributor, purchase smaller amounts and wait a bit.

What happened simultaneously at present is the following. There was this certain relay. CSN did not stop production. It was the last to stop production, and there was a certain lack of planning in the industry. Besides losing their inventories, they did not plan correctly. The millers stopped production and clients had to resort to distribution as they had inventory.

What happened in June? Distributors saw ridiculous figures because everything was stuck with them. This dynamic of distribution and industry is normal whenever there is this crisis.

Q - Leonardo Correa {BIO 16441222 <GO>}

I'm still here, Martinez.

A - Luis Fernando Barbosa Martinez {BIO 7187744 <GO>}

So this dynamic industry and distributor happens when there are market asymmetries, and this is what happened. In the second semester, all of this should go back to normalcy. I don't know if what I said is clear.

Q - Leonardo Correa {BIO 16441222 <GO>}

No, that is great, Martinez. Thank you very much.

A - Luis Fernando Barbosa Martinez {BIO 7187744 <GO>}

Thank you for the question.

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

Regarding the coming year, it's still too early, but the expectation is to resume our normal levels, the levels we obtained last year. And Usiminas, this is what we expect for the time being. This is where we're going to remain until we have the coming, and to entry of our projects initially with BRL10 million and another BRL10 million beginning in 2023. This is the range of figures we're working with.

Q - Leonardo Correa {BIO 16441222 <GO>}

That's excellent, Marcelo. Now the project [ph]with ability to is this incremental? Let me reformulate my question. I think your capacity is about 40 million tons without requiring investment. The ceiling would be 40 million tons. Could you add 40 million plus 15 million to get to 55,000?

Now if you could simply clarify this point, I still have some doubts regarding this.

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

Yes. That's what it is. If you look at the consolidated figures, this is what we're working for, to put those 10 million incrementally. Now what is going to happen within the company, a gradual replacement of our central feed product based on the production of hematite to have a larger production of pellets. And the central plants during the coming years will have its production converted from hematite to itabirite. And we're going to do this without having any drop in shipment or production. And these 15 million are only a marginal value. We have several fronts and initiatives for this to happen, and this is what we're projecting.

Q - Leonardo Correa {BIO 16441222 <GO>}

Very well. Thank you very much. Thank you, Marcelo and Martinez.

Operator

The next question comes from Gabriel Galvao from Credit Suisse.

Q - Gabriel Galvao

Congratulations for your results. My first question refers to the resumption of the Blast Furnace 2. Is there a plan for this resumption? And if you could share with us what it is that you are expecting?

And the second question refers to possible expansions to enable you to reach that leverage of 3.75 in 2021. Are you planning to announce any expansion in the mega line of galvanized products? Are you going to invest more to have greater availability of pellet feed, as you mentioned, recently? This is my second question.

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

Regarding the Blast Furnace 2, we're working on this so that it will be ready by the end of the year. The preparations include the cleaning and the purchase of refractory material. We have already begun, and this will be ready before the end of November. Everything will depend on the demand. And the cost is between $10 million and $15 million. It's not such a high cost as mentioned formerly.

When it comes to the new investments, we have a broad range of opportunities, and this depends on the expansion of mining. Mining does have a project of 10 million plus 5 million, $5,500 million. And this will consume part of our cash generation. But we also have projects in other areas. And depending on our capital flow, we may diversify.

And the matter of energy, energy has always been an important sector for CSN. We want to go back to being self sufficient. And generation is something that we are considering for the future, logistic structure as well, a consolidation in the cement sector. Once again, these are opportunities that we're always considering.

Q - Gabriel Galvao

Very well. Thank you very much.

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

Thank you.

Operator

Thank you. As we have no further questions, we will return the flow to Mr. Marcelo, Head of the IR, Executive Officer for his closing remarks.

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

I simply would like to thank all of you for your presence on the call. We have more than one hour of discussion. We hope to be able to talk to you again when we release results for the third quarter. Thank you very much and have a good afternoon.

Operator

The release conference call for CSN ends here. You can now disconnect, and have a good afternoon.