Q2 2017 Earnings Call

Company Participants

- AndrÃ© Bier Gerdau Johannpeter, Group CEO, President and Director
- Harley Lorentz Scardoelli, CFO, Vice

Other Participants

- Caio B. Ribeiro, Analyst
- Carlos De Alba, Equity Analyst
- Gabriela Elerati Cortez, Banco de Investimento S.A., Research Division
- Ivano Westin, Director of Latin American Metals and Mining Research
- Jonathan L. Brandt, Head of LatAm Cement, Construction & Real Estate Equity Research Team
- Karel Luketic, Associate
- Leonardo Correa, Research Analyst
- Marcos AssumpÃ§Ã£o, Sector Head
- Milton Sullyvan, Analyst
- Renato Damaso Maruichi, Research Analyst
- Thiago K. Lofiego, Research Analyst
- Thiago Ojea, Analyst

Presentation

Operator

Good afternoon. Welcome to Gerdau's conference call to discuss the results related to the Second Quarter of 2017. (Operator Instructions) We would like to emphasize that any forward-looking statement that might be made during this conference call related to Gerdau's business outlook, projections and financial and operating goals are mere assumptions based on management's expectations related to the future of the company. Even though Gerdau's -- Gerdau believes that its comments are based on reasonable assumptions, there is no guarantee that future events will not affect this evaluation. Here today are Mr. AndrÃ© Gerdau Johannpeter, Director, President and CEO of the company; and Harley Scardoelli, Vice President and CFO.

With no further ado, I would like to give the floor to Mr. Johannpeter. You may proceed, sir.

AndrÃ© Bier Gerdau Johannpeter

Thank you. Good afternoon, everyone. Welcome to Gerdau's conference call to discuss the results for the Second Quarter of 2017. We will begin our analysis with an overview of the world's steel industry and after that I can't comment on the Gerdau's performance in the period. We will also analyze the consolidated results of the Second Quarter of '17 in relation to the same period of the year before and also in relation to the First Quarter of 2017. After my presentation, Harley Scardoelli will elaborate on Gerdau's financial performance and at the end, we will be available to take your questions.

So let's begin with the prospectives of the world economy in 2017, which are positive. So for those of you who are following me, I'm on Page 2. We are currently experiencing a time of consistent economic growth in the world. This year, the world's GDP show a growth of approximately 3.5% against 3.1% in 2016. Moreover, the recovery of the commodities industry as the recent increase in oil prices may be a positive impact of the performance of the industry. World's steel production grew 5% in the first six months of 2017 vis-Ã -vis the previous year, according to the Worldsteel Association. In Brazil, however, the outlook is still very challenging. On the other hand, the automotive and the industry sectors begin to show signs of recovery with a positive effect on employment in the Industrial segment. As for civil construction, the outlook remains negative. According Instituto Aco Brasil, Brazilian Steel Institute 2017 should end with the 4% increase in production and a slight growth in consumption of 1.1% when compared to the previous year, totaling 18.4 million tonnes.

If the automotive industry continues to perform well as anticipated by ANFAVEA, Aco Brazil could review its forecast for apparent consumption of flats for 2017 currently set in 4.5% of growth. However, at the moment, exports continue to partially offset the weak demand in the domestic market. Therefore, it is crucial to remain competitive in the international market. But in order for that to happen, there must be an increase in the REINTEGRA tax rate from 2% to 5%. REINTEGRA is a claim from the entire downstream industry and it's been discussed by Instituto Aco Brazil and also other associations. For those who are not familiar with REINTEGRA, is a tax mechanism that restitution of nonrecoverable taxes already paid for by the previous players of the productive chain.

Now I'll speak about North America, where the economy continues to recover and the country approaches full employment. In the steel sector, nonresidential construction continues to grow but the region is still impacted by a strong pressure coming from imported steel. The U.S. government recently approved measures of Trade, Defense in relation to Turkish. And Chinese and Taiwanese steel that could have a positive impact in Gerdau's operations in the region. In addition, it is expected that Trump's agenda will include the evaluation of Resolution 232 which

(technical difficulty)

is on the heavy inflow of imported steel in the country, although weighted our investments in infrastructure announced during Trump's campaign. And in case, the infrastructure improvement project is materialized, Gerdau could have a significant increase in demand in The United States.

Now looking at South America. We anticipate an economic upturn in the markets served by Gerdau, which have shown increases in steel production from January through May. However, the countries in the region continue to work together, defending the steel value chain in their respective markets. Just to give you an idea, in the last six years, approximately 60 antidumping investigations were proposed, most of them against China. As for special steel, the highlight goes to automobile exports from Brazil. In India, the industry remains robust. And in the United States, the automotive industry remains stable, while the oil and gas industry experienced a rebound.

Now I will refer to the major numbers of Gerdau in the Second Quarter of 2017, starting with shipments -- consolidated shipments we sold 3.7 million tonnes in the quarter, it was down 13% in relation to the same period of preceding year, mainly due to the sale of special steel units in Spain and to lower shipments by the Brazil operations. When compared to the First Quarter of '17, shipments were up 3%, driven by higher exports from Brazil and also an increase in special steel sales in Brazil, the U.S. and India.

Now net sales reached BRL 9.2 billion in the Second Quarter of 2017, down by 11% when compared to the same period of the previous year. This was mainly due to a foreign exchange effect in the period in the units abroad and also the sale of the special steel units in Spain. However, when compared to the First Quarter of 2017, net sales grew 8%, driven by higher shipments and almost the highest volume sold in all business operations of the company. Earnings before interest taxes depreciation and amortization, adjusted EBITDA was BRL 1.1 billion, 7% lower vis-Ã -vis the Second Quarter of the year before, due to lower gross profit partially offset by a reduction of 27% of expenses with SG&A. Despite the lower EBITDA in the period, the margin was better, going from 11.7% to 12.2%. When compared to the First Quarter of 2017, adjusted EBITDA grew 31%, showing improvement in all operations. The main highlights were the 54% increase in EBITDA in the special steel operation, going from 49% for EBITDA in North America and 22% growth in Brazil.

Now consolidated net income. Gerdau was able to reverse the adjusted loss of BRL 34 million posted in the First Quarter, reaching an adjusted consolidated net income of BRL 147 million resulting from a higher EBITDA in the period. This quarter, net income was adjusted by the loss incurred with the deconsolidation of the operation in Colombia posted in the balance sheet, which as of June has been considered a joint venture based on the sale of 50% of its interest in Gerdau Diaco to Putney Capital Management. I would also like to mention through our management effort that through these efforts we resulted in a free cash flow of BRL 241 million in the Second Quarter. This is an indicator that has been one of the financial priorities of Gerdau.

Now let's look at the investments in the quarter on Page 4. In the Second Quarter, we invested BRL 195 million in CapEx. Of this total, 33% went to the Brazil operation, 34% to the units in North America, 19% for the plants in other South American countries and 15% to the special steel operation. In Argentina, in June, Gerdau started up its new melt shop in the city of Perez, located 6 kilometers from the rolling mill plant we already operate in the region. The investment of BRL 786 million was initiated in 2014 and concluded this year. The install of the melt shop is 650,000 tonnes a year and it aims at fulfilling the demand of the domestic market, the rolling mill.

Now I would like to give the floor to Harley Scardoelli. And then after his presentation, I will come back with the closing remarks.

Harley Lorentz Scardoelli {BIO 7283603 <GO>}

Thank you, AndrÃ©. Good afternoon. I would like to start on Page six talking about the results and performance of each business division in the Second Quarter of this year and then I will elaborate on the consolidated results.

Before mentioning each business division, I'd like to stress that all operations posted sequential EBITDA and EBITDA margin improvement vis-Ã -vis the First Quarter, clearly demonstrating the company's efforts to reduce costs and SG&A expenses. Starting with the Brazil operation, shipments in the Second Quarter of '17 compared to the Second Quarter of '16 were down in the domestic market as a result of the slowdown in civil construction activity, whereas exports dropped because of fewer opportunities at the international market. Looking at EBITDA and the margin of the Second Quarter '17, we saw an increase due to higher net sales per tonne in addition to lower expenses with SG&A expenses. In terms of the First Quarter of '17, improvement in EBITDA and EBITDA margin were a consequence of higher net sales per tonne sold.

Speaking about North America, shipments were down when compared -- when we compare the Second Quarter of this year with the same quarter of the year before due to the early shipments in the First Quarter of 2017, as a consequence of the announced price increase. And this also explains stability in shipment when we compare Second Quarter of this year to the First Quarter of the same year, neutralizing the seasonal effect, which are very common in this period. EBITDA in the Second Quarter 2017 was down in relation to the Second Quarter 2016 due to further pressures on metal spreads, when higher raw material cost were not fully matched by higher steel prices. In addition until the impact coming from the foreign exchange variation in the period. When compared to the First Quarter of 2017, improvements in EBITDA and EBITDA margin were mainly due to the increase in metal spread in the period.

In the South America, GD as AndrÃ© mentioned, on June 30, we concluded the joint venture in Colombia. As a result of this transaction, the numbers referring to the Second Quarter of this year contemplate Colombia's results until May of 2017. And thus influencing the comparative variation. Shipments in the Second Quarter 2017 were down in relation to the same period of the year before, mainly due to the deconsolidation of the operation in Colombia, as stated before that started in June, in addition to lower volumes sold in the countries we operate impacted by lower economic growth. EBITDA and EBITDA margin in the Second Quarter of '17 were down vis-Ã -vis the same period of the year before, due to lower shipments and lower profitability in the Peru operation, due to heavy rains in that country.

Now speaking about special steel. Shipments in Second Quarter '17 were down in relation to the Second Quarter of '16, due to the sale of the units in Spain. In relation to the First Quarter of this year, shipments were up in all countries, particularly Brazil with the automotive sector. The improvement in EBITDA and EBITDA margin in the Second Quarter of 2017 vis-Ã -vis the Second Quarter of 2016 was a result of the sale of the Spain units, which have lower margins coupled with higher profitability in the U.S. units. In the Second Quarter of 2017, EBITDA margin was 18.4% as a consequence of higher profitability in all special steel units.

Turning on to Slide 7. I'll talk about consolidated figures. In consolidated terms such as adjusted EBITDA reached BRL 1.1 billion in the Second Quarter of this year, 7% lower in relation to the Second Quarter of '16. If we look at the bridge chart on the upper part of the slide, we will notice that the drop in adjusted EBITDA was a consequence of lower shipments. And therefore, lower dilution in our fixed cost, partially offset by higher net sales per tonne and also by a reduction in SG&A expenses. As mentioned by Andre, due to the efforts of the company, as that meant significant reduction of 27% when compared to the year before. On the bridge chart in the lower part of the slide, we noticed that we went from an adjusted net income of BRL 184 million in the Second Quarter of 2016 to an adjusted net income of BRL 147 million in the Second Quarter of '17. And that's certainly reflects impact of lower volumes and also a higher expenses with income tax and financial results. Speaking about dividends, based on the results, the adjusted results of the Second Quarter of 2017, the company will pay out BRL 34.2 million in dividends to Gerdau S.A. shareholders equivalent to $0.02 per share. These proceeds will be paid on September 1 based on the position of August 21, reflecting the good cash and liquidity positions of the company.

Now going onto Slide 8. I will talk about the company's debt position and liquidity. Gross debt on June 30, 2017, was BRL 20 billion, up by 1.5% vis-Ã -vis March of the same year, basically due to the effect of foreign exchange variation. Net of this effect, gross debt would have posted a reduction as a result of amortization financing in the period and also the deconsolidation of Colombia in June 2017. The average weighted cost of the debt was 6.9% a year with an average amortization term of 5.5 years. On June 30, 2017, 21% of gross debt was short term. As a reminder, BRL 3.4 billion of debt maturing in 2017, Whereas BRL 2.6 billion, the bulk of it refers to a 2017 bond to mature in October. And the remainder refers to working capital loan renewed on a regular basis. Available cash and the credit facilities of the company are more than enough to honor this bond. Moreover, the company has the option to refinance the debt in full or in part. Considering the good liquidity of the capital market, vis-Ã -vis the bond issuance. Net debt over EBITDA ratio was maintained at 3.6x in June 2017 as a consequence of debt amortizations made possible in view of the cash generation in the period, even despite the negative exchange variation effect.

Now speaking about the holding of Gerdau SA. On July 19, 2017, CBM approved the public offering of Metalurgica Gerdau SA, which offers shareholders of ordinary shares Gerdau SA the opportunity to swap their GGBR3 shares, ordinary shares by GGBR4 shares, preferred shares. Shareholders will have until August 21 to join the offer and the auction will take place on August 22. In order to -- for the tender offer to occur, it will be necessary that at least 2/3 of the outstanding shares or ordinary shares join the offer, which is the equivalent to approximately 38.4 million shares.

Now moving on to Slide 9. We'll talk a little bit about working capital. In June 2017, the cash conversion cycle was lower when compared to March of the same year, due to, an increase of 8.4% at net sales when compared to an increase of 4.1% of working capital.

Thus working capital increase in absolute terms was mainly due to the effect of exchange rate in the period. It's important to recall that in the last five years, the average cash conversion cycle was 93 days with a cycle of 101 days in March of 2015. In terms of the company's effort to reduce working capital. So the average is 79 days with an outlook for a drop as we see in the 77-day cash conversion cycle presented in the slide.

Now moving to Slide 10. I would like to talk about cash flow. As we can see in the upper part of the slide in the chart, in the last 12 months, the company generated positive free cash flow. Contributing to that was our CapEx discipline and the efforts to manage working capital, 2 main aspects that led us to that result. Particularly in the Second Quarter of this year looking at the bridge chart in the lower part of the slide, EBITDA was more than enough to honor our CapEx commitment, income tax and interest rate in addition to the use of working capital resulting from inventory readjustments. As a result, free cash flow was positive by BRL 241 million along the lines of what the company believes to be relevant to that indicator, which is EBITDA minus CapEx, income tax, cost of debt and the variations of working capital. Thank you.

And now I will give the floor to AndrÃ© for his final remarks.

AndrÃ© Bier Gerdau Johannpeter

Thank you, Harley. To conclude, I would like to highlight that this improvement in our performance vis-Ã -vis the First Quarter to rise from the recovery in our main markets at different levels when we compare to the First Quarter. Looking more closely to the steel market in the U.S., it continues to evolve and that we see good prospects in the U.S. economy and the U.S. has experienced a growing in employment, positive GDP, low interest and a very large and dynamic market. And all of that indicates that they should remain growing and certainly by the same token still will consumption will grow.

In Brazil, however, domestic demands remain low and some improvement is expected for 2018. We begin to say -- to see some signs showing that things should improve by the second half of year. But more particularly, we will see improvements in 2018. We will see that the employment is picking up, even though gradually, industry is recovering with -- there was a growth of 0.5% referring to the last six months. It's not too much but it's heading in the right direction. Now there was a growth of 21% of daily sales of vehicles not only for exports but also domestically experienced a growth of 9 vehicles per day. And in the worst moments, that was 7,000 and numbers are still picking up and this has implications in consumption and also boosted a very low inflation. And in some previous months, we even experienced deflation. In the last 12 months, IPCA was 12.5%. These are just some signs that begin to show more in the flat steels. But when it comes to longs and this has to do with civil construction and other areas, we see a rebound. But finally, we begin to see positive recovery signs, still infant and small but we see some good sign.

I would also like to say that all of our efforts in the quarter, we were able to reverse losses and have profits. Our free cash flow of BRL 341 million. We were able to have a reduction 27% in SG&A and our debt position was stable. Throughout the year, we will continue to work towards improving management, to generate free cash flow and to have a positive free cash flow. We are still selective in terms of CapEx spending, we are reducing that indicators when we continue focusing on expanding our profitability and generate value to our shareholders, having more stability.

And with that, I conclude our presentation and we are available to take your questions. Thank you very much.

Questions And Answers

Operator

(Operator Instructions) Our first question comes from the line of Felipe Hirai from Bank of America.

Q - Karel Luketic {BIO 16467278 <GO>}

In fact this is Karel. I have 2 questions. And you said during your presentation that you see some recovery signs in Brazil and you see also good prospects for improvement in the U.S. when compared to the Second Quarter. Could you please quantify something in regards to what you've seen in July and August? And what can you see further ahead? And my second question refers to working capital. Earlier this year, it was a bit complicated in terms of inventories. But now you were impacted by exchange rate variations. Do you think that we could work with the current level as being the normal level or you see any changes?

A - AndrÃ© Bier Gerdau Johannpeter

Karel, this is AndrÃ©. We refer to the outlook and then Harley can talk about working capital. As I said before, in Brazil, they are still small signs but there are significant signs that those figures are still very challenging. I think we also have to separate in Brazil, the flat area. There was 4.5% investment in that area that is an indication that we will have a positive demand. And in months we had almost 9% drop. So it's a different landscape. But once again referring back to what I said, employment, interest rates are down and some of the figures are picking up. So that is a sign of recovery. GDP of the year will still be around 0. But we believe the next year and some of the analysts are indicating that GDP should be around 1.5%, 2% for 2018. And that's when we expect a rebound for longs starting early next year. We also heard some people that are analyzing project for further construction and they still have like 4 to six months until they begin launching and then the steel consumption begins to occur. In the U.S., once again, economy is strong and solid. The challenge is steel import, with steel very heavy, there's heavy import from the imported goods. But when you look at the global steel landscape, we see a trend towards price increase: ore, 75; , coal about 170 and we say-- we see some other export markets like China, Turkey in rebars and other products also growing, part due to construction, part due to raw material. China, which is an important country, decreased their exports by 30% when compared to last year. China continues to grow and everything related to launch production via induction, leads other industries to fill in that gap. So I will say in general, steel is going through a positive momentum and couple that with the economic situation, we are very positive in terms of seeing a better next quarter. But it's still too soon to tell and we have to work hard because steel imports is a relevant aspect because there is, oftentimes, unfair competition when it comes to steel.

A - Harley Lorentz Scardoelli {BIO 7283603 <GO>}

Karel, this is Harley. Now referring to working capital, another and important aspect to highlight is that in terms of working capital, we reached a level in our conversion cycle that is comfortable. Our average on the last five years was more than 100 days. And today, we are below 80 days. In the last 3 quarters, the average was 77 days. And this alone is already a good use of working capital. So the trend is that we will intend to keep that level at below 80 days. But this will vary according to the business activity. So if prices and volumes grow, we will have to use up some cash and this will be offset on the other hand by other improvement. For this year, the trend is that in the first half of the year, working capital used up cash. So the trend is in the second half of the year, we would have a return, not in full. But probably part of the working capital used. And this is just a temporary effect. So in the first half, we used up more cash. And in the second half of the year, we will get the return of that cash but we will resume our position in terms of inventory days.

Operator

Next question is from Thiago Lofiego from Bradesco BBI.

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

I have 2 questions. AndrÃ©, could you comment on the position of metal spreads? What is your outlook, whether you anticipate any other price adjustments in the U.S.? I just want to understand the dynamic now for the Third Quarter. And my second question is whether you could give me an update in terms of discussing provisions, whether that updated amount is still in keeping? Or whether you expect any changes?

A - Harley Lorentz Scardoelli {BIO 7283603 <GO>}

Thiago, this is Harley. In terms of spread increases in the U.S., we saw a recovery of spreads, particularly now at the end of the Second Quarter is about $350 for short term. But we've seen already figures around $360 or higher. And this is pretty much due to the more recent price increases. There was an increase in the price of scrap but we were also able to make price adjustments in the most recent announcements in the Third Quarter, like it usually occurs because the Third Quarter is usually stronger. So in the short term, metal spreads should be maintained. By the end of the year, I think I would rather wait and see what will happen to the market. But in the short term, I would say that metal spreads should be expected it to be at slightly higher levels. In terms of the second part of your question, about fiscal themes or excise taxes, we have to wait. The agreement has not been published. It's still awaiting a decision by the Supreme Court. So we have to wait for the final decision to see what will happen and what will be the unfoldings after that. So we still have to wait.

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

Would you just revisit the metal spreads? So in the Second Quarter -- at the end of Second Quarter, metal spreads were higher. So you think that you should remain in these levels in the Third Quarter. So the average of the Third Quarter would be higher than the Second Quarter. Would that be a fair assumption or not?

A - Harley Lorentz Scardoelli {BIO 7283603 <GO>}

I think it's a good assumption, Thiago. But once again, this is very volatile but that is the trend.

Operator

Next question is from Thiago Ojea from Citi.

Q - Thiago Ojea {BIO 17363756 <GO>}

My first question refers to CapEx. CapEx in the first half of the year was around BRL 400 million and the guidance earlier this year was that the CapEx was BRL 1.3 billion. So we are looking at something slightly below that level. I would like to know whether you have reviewed CapEx for this year? And whether you have any outlook for CapEx next year? My second question then refers to restructuring of the business, the sale of assets. We see a global improvement in the steel milling industry and many assets that have lower margins today have posted higher margins. So I want to know whether this has had any impact? And how are you seeing Gerdau's positioning and seeing other opportunities to acquire asset or to sell others?

A - Harley Lorentz Scardoelli {BIO 7283603 <GO>}

Thiago, this is Harley. About CapEx, in fact in the first half of the year, we are working at a lower pace when compared to our guidance for the year. And there -- It's difficult to predict the pace of operations, because there is a natural volatility and it's difficult for us to pin it down. I mean, the guidance of BRL 1.3 billion is not divided by 4. But we have to consider exchange variation. So I think we will be below that BRL 1.3 billion for the year. We will not reveal the number now. But I think by the end of the year, we will end up spending less than BRL 1.3 billion. For 2018, we have no prediction yet. We are -- we will work with that figure more up to the end of the year. Once again, we have plenty of capacity to supply to the market, considering that the market recovers, we still have enough capacity to fulfill the demand. Therefore, as a trend for next year, we would have something similar to this year. But we will have something better to tell you by the end of this year. Now speaking about the asset optimization program, it's still ongoing. That's an interesting question, because we started that process over two years ago. The amounts or the profitability of the industry in general was worse when you look at the general landscape of the economy. But looking at it today, there -- we are more interested in the assets. There are more people looking for steel assets, people from the industry and out of it. Therefore, our program is still ongoing. Our decisions have not changed. But I could say that the environment is better when compared to what it was two years ago. Our goal is to in keeping, I mean, to that we want to continue with our program. And maybe by the middle of next year, we will have something else to tell you.

Operator

Next question from Ivano Westin from Citi (sic) (CrÃ©dit Suisse).

Q - Ivano Westin {BIO 17552393 <GO>}

My first question is about special steels. Margin is very significant at 18%. I would like you to comment on the level of utilization of that business operation as a whole and if you can give me enough look for the second half of the year and next year what will be the normalized margin that you expect for that division? The second question is about protectionism. AndrÃ©, you began by saying that there are some measures going on currently like REINTEGRA. And looking on the protection side, I want to know whether you expect any definition on part of government related to additional protection of the market in Brazil? And also I would like to hear from you, what is the timing and when do you expect to have final outcome off Resolution 232 in the U.S.?

A - AndrÃ© Bier Gerdau Johannpeter

This is AndrÃ©. And I'll start by answering your second question. We don't think it's protectionism, because at the end, what we want is just to reinstate that the international trade laws have to be enforced. And therefore, we have to fight unfair trade. This is our view. So I know that this word is commonly used. But to we do not agree with the word protectionist, what we want is equal -- to be on equal footing. REINTEGRA is just a mechanism for tax recovery. And today, we are not getting that because it's reexported. But we have a benefit, which can go up to 5% in today's 2%. So all of the exporting chain is claiming for the enforcement of the law, which states 5% with a drop in the domestic market. This has been an interesting alternative to increased volume. I mean, 40% of our production is exported. And therefore, this increase in tax rate will allow us to keep employment and keep our operations running. We are engaged in a discussion with other associations, speaking to the government. But this is not an easy decision. We haven't got a deadline yet. But we are working diligently because we know that this is very important when it comes to generating employment. And we will be able to achieve that with increase in the tax rate. About Resolution 3 -- 232, it's still in the schedule. The President and the Commerce Department in the U.S. still has to study this Resolution 232, which is part of a U.S. law entree. Once the study begins, there are about 270 days until it comes to conclusion. The expectation is that it should be concluded in 2, three months. But I think that the Commerce Department would need more time. They are still studying this resolution. We hope that they will come to an outcome sooner. But I think that they will expand this deadline until 2018. We expected it to be -- results soon. But it was impossible. We believe. And looking at the reality of imports and considering the damage caused by imports and penetration into the U.S. market, we expect that 232 should have a positive outcome, maybe not at the speed that we anticipated. And I think that's all I had to say in terms of your question related to commerce and trade.

A - Harley Lorentz Scardoelli {BIO 7283603 <GO>}

This is Harley. About special steel BD, on average, the capacity is about 75%. Of course, you have to look at the different segments in the market. Brazil, in terms of -- we lost capacity because of a drop. North America has a more robust operation. But on average, utilization is about 75% of capacity. About margins, if we look at the last quarters, particularly, after the sale of the operation in Spain that have lower margin, the margin tended to go up to almost 14%, 15%, 16%. And now, it's about 18%. And this is very much in line with our market view. The market in Brazil is showing signs of recovery. We are -- turning to exports in North America, as well is posting good volumes. And production still remains very strong in the automotive industry. And if you look at our figures and when you look at special steel on average, comparing quarter-on-quarter, we have a positive evolution in terms of shipments and average price. When we look at net sales per tonne and the results of a cost reduction, looking at fixed cost now or SG&A, in general, there was a reduction, which was very similar to the consolidated figures, all of that put together with the operation to present a more robust performance when compared to a year ago.

Operator

Next question from Leonardo Correa from BTG Pactual.

Q - Leonardo Correa {BIO 16441222 <GO>}

My first question. And as nobody asked that before. And I will try to ask something about pricing in Brazil. We've been monitoring the import levels of long steels in Brazil, which is still low. Prices abroad of short rebar is still increasing, together also with the global price recovery. Today, premiums were negative, almost 10%. So in view of this whole equation and considering the global landscape, which is quite favorable with price escalating almost all over the world, how do you see the pricing landscape domestically? I know that you do not comment a lot on that. But in view of the global landscape, how do you see Brazil. And whether you could assume that Brazil will just follow on the tail of the longs landscape? Now the second question is to Harley about the debt position. Harley, it's very clear, all of the options that we have about refinancing the debt this year. But what calls the attention is still the stability of the debt level denominated in U.S. dollars of the company. Historically, we've always talked about the ideal level. And I think these things tend to change with time. But what is your opinion about that 80% of dollar-denominated debt and whether you have any concerns about reducing that level? And third, the future, could you tell me about the leverage level that you are working with or net debt over EBITDA level? Also, what about your flat segment? I wouldn't be able to tell what was the advances or evolution in terms of heavy plates and hot rolled strips. So coiled hot rolled strips. I mean, I know that you have been following, whether it's been done by your peers considering all of the adjustments that have been practiced in the past few months or whether you're still practicing lower prices just to gain more market share. So these are my questions.

A - AndrÃ© Bier Gerdau Johannpeter

Leonardo, this is AndrÃ©. On prices, I'm not going to refer particularly about Brazil. But you already said some important aspects that I'm sure people can draw their own conclusions. But again, what we think -- what we are seeing in the world is something of a one-off situation, because it's been a long time since we see price increases or 75% prices of rebars and hot rolled strips. I mean, consumption in China has been maintained. It's growing in the U.S. It's growing in Europe. So there is a very positive momentum in the economy. And steel is just following suit. Considering this entire landscape in the markets where we operate: Brazil, South America, Central America and the U.S. and India, in these markets, we see a pricing environment that tend to follow the global price. And there is also things to be considered, like competition, consumption. And in Brazil, there is a drop in the consumption of longs. If you look back in the past six months, it's a very challenging market. But in terms of flats, there was an increase in consumption. Then answering the second question, in terms of flats, we do not break down the figures. I mean, heavy plate, most of our figures for flats, they operate about 85%, 90%. We follow the pricing policy of the market. We've been through that phase of being a new player. We've been operating in the market for over almost three years. So we have customers. And we are serving a large part of the market. But we are a follower of lower of -- we're a follower of the other peers. We are still learning. We are rolling our products. We see a good situation in the market, good penetration. Still, there is something on the exports. So in general, our plans are moving according to our expectation. We are mature in certain markets. But heavy plate, we still have some time to deal with consolidator. And meanwhile, we await for the rebound in the market. And in some sectors, we're very much impacted in the heavy plate segment.

A - Harley Lorentz Scardoelli {BIO 7283603 <GO>}

Leonardo, this is a Harley. In terms of 2017, we've been monitoring pricing very closely. But we haven't made any decisions about our position. What we know is that we have enough cash and cash-denominated in U.S. dollar to honor the debt. And we've noticed that the market has been very open and liquid. And all these new market events, have been very positive for dollar-denominated debt. But once again, we will continue to evaluate the results. But we are not under any pressure because we have enough cash available. Those cash, to us, denominated in dollars does not earn a lot because it's invested in the U.S. Therefore, our denominated dollar debt is only earning 5% interest. We've also worked hard to maintain liquid to working capital lines. And this is what we often used in the past few years, especially in transactions outside Brazil. And we will apply the same kind of structure to Brazil, which give us more freedom to use our liquidity as we deem necessary. And we are therefore analyzing several alternatives. And we think that the market is very open to this kind of market. In terms of leverage or net debt-over-EBITDA ratio, that's an important aspect. And we have our long-term objective to which almost 2x net debt-over-EBITDA ratio. So the idea will be to reach that level or even lower. And so we are working towards that goal. This year, because of the dollar rate is about $3.15. And today is $3.30. And our gross debt would be lower if the dollar would be at that level. I mean, 60% of our debt is denominated in U.S. dollar. So therefore, we were able to keep the levels the same as in March. And if things were -- have remained the same, our figures today would be better.

Operator

Next question from Marcos AssumpÃ§Ã£o from ItaÃº BBA.

Q - Marcos AssumpÃ§Ã£o

My first question, AndrÃ©, is whether you could tell us what will be a normalized level for the market share of longs in Brazil? We noticed that Gerdau lost a little bit of market share in the first half of the year. Sales domestically decreased by 9% in the domestic market. And 14% in the foreign market. Now looking at the curve for 2018, it is probably below the market. Keeping that lower market share when compared to the previous years, do you believe that if you have further opportunities to consolidate, would you see any restrictions coming from antitrust agents? The other question is that we talked a little bit about a more favorable steel market. Could you please tell me what you think in terms of the sensitivity of higher prices in China and steel prices in the world?

A - AndrÃ© Bier Gerdau Johannpeter

Marcos, let me elaborate on your question. About market share, we don't speak about a precise number. But the reality is that in the past three years, there were new players entering the market, not only ourselves. But other players. They ended up by being more accommodated. And that entry occurred because of a drop in the market because there's more capacity coming in with the drop in consumption. If there were an increase in demand, the story would be different. So that's why there was an impact. But we have to be careful when you compare direct numbers in terms of shipments. There is also things that should be considered, like mix and market share. But all in all, our philosophy. And that's what I wanted to say here, is that we are not only looking for market share. But we have to look at profitability and that varies month-on-month

(technical difficulty)

and quarter-on-quarter. And sometimes, you win; sometimes, you lost not only in Brazil. But last year, in the U.S., we lost. And then we went after market share again. So there was an accommodation of the new entrants, not only ourselves. But other players would have to give in. But what we see today is almost everyone has already their capacity in place, according to their operational level that's why people are not fighting that much for market share. But what we have to see is a rebound in consumption to more normalized levels if we want to see further profitability. So what we need is higher domestic volumes. That's why REINTEGRA is important to reduce exports and sell more domestically. About the antitrust process, the process is still ongoing. And with (inaudible), I mean, we have no comments at the moment. We just have to wait to see how things will evolve and how the process will be approved. About sustainable prices, it's always dangerous to make predictions. But what we see for the next 2, three months and I can say that because of our exports, which are already in place, I mean, for the next 2, three months. And they are in those price levels. And I can say that because of all of the business that we already have in terms of exports. But by the end of the year, we still have to see whether it will remain sustainable. Everything points that it will be because the world economy should be positive. And that's why I think that the DQ and rebar prices should remain stable, okay?

Operator

Next question from Caio Ribeiro from JPMorgan.

Q - Caio B. Ribeiro {BIO 18420483 <GO>}

Well most of my questions were answered already. But could do probably say something about the business in Brazil, where we can see a slight recovery of margin in the business and maybe due to a recovery in shipments quarter-on-quarter. But I want to know whether, further ahead, you see further opportunities of improving your margins. And also whether you could speak about scrap prices and how you see the performance of this price ahead. And what would be a sustainable margin for this business or maybe in terms of EBITDA per tonne? Also, in the U.S., I understand that we don't know much about the investment plans suggested by the government in infrastructure. But probably, I would like to hear from you, whether you think that there should be something coming soon. And whether you see something coming in 2018. And how much of that will help you to improve your utilization rate.

A - AndrÃ© Bier Gerdau Johannpeter

This is AndrÃ©. I will start with the U.S. and the infrastructure investment plan. The number that have been announced during Trump's campaign talked about $10 trillion in three years of investments spread. But thus far, nothing has been done. We haven't seen any evolution. And there are also other political priority or plans related to other sectors like changes in ObamaCare. There was an announcement about the possible tax reduction program. Therefore, the political agenda has to move forward. But it's is difficult to predict when that will happen. But we still believe that there will be investments in infrastructure. They could come next year. But I don't want to say anything or give you a date. But it's part of the Trump's agenda. And they should come. But we don't know how big that will be. And we haven't contemplated that in our plans because it's not materialized yet. But once again, it's just a matter of time and it's a matter of how they will fit that into the priority in the agenda.

A - Harley Lorentz Scardoelli {BIO 7283603 <GO>}

This is Harley. In relation to Brazil, we are focusing on a qualitative outlook. We see improvements in some areas. Inflation is very low. Interest rate had experienced a significant drop. And it's been revised to lower level. So all of that should help us. In our particular case, what I would like to say is that our margin in Brazil, I mean, when you compare to any other history figures, if your margin -- the margin of Brazil against that of last year is about almost 2% higher, in this quarter was too higher, almost 4% higher. And this year, we will expect the same thing even considering the drop in shipment. And this drop in shipment should be looked into more closely because there are flats and longs. I mean, those drop in long steel are very much present. And the civil construction industry is still very much affected by the slowdown in the economy. But in terms of flat, we are projecting volumes higher than 27%. We are putting a lot of efforts to reduce costs. And because of that, our margins reflected the significant improvement. A normalized margin for Brazil will certainly depend on the mix. We have to have a mix between flats and longs. And also, there is also the mix of the exports in the domestic market. Gerdau always exported 10% to 15% of its volumes. But today, exports reach 40%. But even then, we are performing well. So without giving any idea, with a better mix and when the volumes return to Brazil, certainly, the margins in Brazil will perform better -- will be better. We still have a good raw material funding with scrap, good access to iron ore at very competitive cost. So in the environment, where the market is bullish. This, all in all, help us to boost our model in Brazil, which is very sound, our model here. And as AndrÃ© said, this landscape maybe better for 2018, with further drops in interest rates and consumption rebound.

Operator

Next question is from Renato Maruichi from Santander.

Q - Renato Damaso Maruichi {BIO 17847481 <GO>}

I have 2 questions. The first is just a follow-up of the previous question. If they're delivering an excellent job in terms of cost reduction and even working capital and expenses, generating cash even when demand is still very weak in some regions, maybe you can give us an idea in terms of SG&A, its revenue or what would be another normalized level for Gerdau from now on? All I want, I think, is an update, especially in terms of churns in addition to Note 14 of ITR. That will help us tremendously.

A - Harley Lorentz Scardoelli {BIO 7283603 <GO>}

Renato, this is Harley. In terms of SG&A, it's important to say that this is a continuous and diligent work. And the levels we have now reflect our efforts to reduce fixed cost. So this is a cost reduction that is here to stay. We've had expenses in terms of net revenues, about 7%. And now we posted 4.5%. And this is in an environment with defined shipments. Therefore, going -- once volumes or shipments return and we have good pricing, the trend is that the figures should be even lower. But I wouldn't like to give you any firm direction. But first of all, the reduction in absolute terms is something that is here to stay. This is something that is part of the structure of the company in all operations, Brazil, the U.S., Special Steel and South America. About CapEx, I don't like to speculate. We just put in an explanatory note, all of the important aspects. We have a dispute ongoing with the judiciary. It's a very technical issue. And everything is very well explained in our documentation.

Operator

Next question is from Gabriela Cortez from Banco do Brasil.

Q - Gabriela Elerati Cortez {BIO 18801371 <GO>}

I do apologize for my rough voice. My question is related to Section 2002. After 2018, what are the insights you expect in the short run? And if it's not in the short run, what will be the timing that you expect and what will be the impact to the figures of the company in the North America business division?

A - Harley Lorentz Scardoelli {BIO 7283603 <GO>}

Gabriela, this is Harley. In terms of resolution 232, I think AndrÃ© already talked about it. And the period of time that goes until January. We are not counting on that resolution as the major solution for North America. We also have some expectations in terms of the infrastructure program that was announced in the U.S. and there are other things that should also help that. 232 is a plus. Certainly, we are not counting on that as one of the major recovery factors, at least, not for now. One point that I would like to mention is that resolution 232 generated higher pricing. And it's important to notice that, recently, we noticed in China, a reduction in production capacity, especially in terms of production furnaces that use up a lot of power. And they're not sufficient in terms of cost. They use up 3x more of power when compared to electric furnace. But in China, they have furnaces that are mostly used for the production of rebar. And therefore, this also raised the issue. These 3 points that are included in the initiatives, that in the mid run, could have a higher impact.

Operator

Next question from Milton Sullyvan from XP Management.

Q - Milton Sullyvan {BIO 19085202 <GO>}

My first question is related to cost. Harley, in the last call, for the First Quarter, I think we said that you are packed on the coal prices until August. I would just like an update about that. If we look at the energy cost of Gerdau, what is the coal that is marked there if we could have any comparison with hard coal in Australia, what will be the expected variation from now on? And my second question, going back to the debt position, my focus now would be in terms of the financial cash results of the company. Could you help us quantify 2 impacts, number one, the variation of interest rates in your results? Because I'm having a hard time to find a breakdown or indicator in the explanatory notes. And the impact of the bonds today. If we were to pay the bond. And then if we assume that hypothesis, what would be the savings and financial results in the future?

A - Harley Lorentz Scardoelli {BIO 7283603 <GO>}

Milton, this is Harley. In terms of coal, we wouldn't have any specific number to give you. But to draw a comparison, at that period of an extremely hike in coal, the impact was 68% only. But things are much lower now. So I would imagine that the effect would be amortized in terms of our cost. Something more specific, I wouldn't be able to give you at the moment. Maybe our Investor Relations people can help you with that later. In terms of debt and the reduction of the debt price and interest rates in Brazil, there will be -- there is this impact. But certainly, this will be more linked to other debts, like CDI and things that -- and debt that we have with BNDES. But this is a smaller part of our debt. The drop in interest rates will have a positive effect in terms of what it represents to the entire chain and our customers and suppliers. The indirect aspect is much more important to us than the direct impact in our funding. Now speaking about the bond for 2017, this -- what does that mean? This is a bond which coupon is 7.25% a year. Certainly, it will mature in October. But today, our cost of debt would be around or below 6%. So we should consider close to 6%. And we use cash that maybe earning about 1% in the U.S. So it's almost negative of about 5%. And the amount, the mature is close to $800 million. So we have to see further on what will impact our results.

Operator

Our next question is in English from Jon Brandt from HSBC.

Q - Jonathan L. Brandt {BIO 17988091 <GO>}

I have 2 questions both sort of related to demand. First, in Brazil, with an election year coming up next year, I'm wondering if you are expecting any type of stimulus or increased infrastructure spending over and above maybe what you would expect, given the rebound and the economy and lower inflation, et cetera. Then secondly, just returning to Section 232, if you could talk a little bit about -- I know you said there was still some pressure from imports. Has that pressure alleviated at all with the protectionist measures that we've seen in the first half of this year? And I know you said you don't like protection -- the term protectionist measures, that you wanted to see a level playing field. I wonder what that looks like to you, this Section 232, should we see quotas? Should we see tariffs? How much are you expecting?

A - AndrÃ© Bier Gerdau Johannpeter

So I'll start by the first part of the question on the election year. It's very difficult to make any projections that -- and in terms that we would have any special incentives. Well what we expect is to see a growth of 1.5% of GDP in 2018. And this should be reflected in the steel market. We expect some rebound. Maybe the only thing that we can highlight is regarding concessions or PPP, public and private partnerships, as we've seen before in ports, airports, highways and maybe other infrastructure projects. And if they occur from now until the end of the year, they will probably impact the steel market. This is not very much related to the election. And it's difficult to evaluate it. But maybe the next concessions will have an impact on the steel market. Now about Section 232, the import taxes are still very similar between flats and longs in North America. And it ranges between 20%, 25% in longs in terms of penetration. But what happened is that, currently, import licenses were reduced. But it's hard to say whether this will mean imports in the future. So for now, we haven't seen any potential impact about the outcome of Section 232 in the market. Well some things were not imported just because we are awaiting for Section 232. But nothing of great magnitude. We don't know whether it will be tariffs or not. We don't know. What we hope is that 232 comes to fruition to fight unfair trade, especially regarding the U.S. and countries like China and Turkey in our particular case.

Operator

Next question also in English is from Carlos De Alba from Morgan Stanley.

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

The first question has to do with the bond that you're maturing later in the year. Have you decided what are the parameters under which you would consider either to repay the loan with the cash balance that you have? Or maybe are you thinking of issuing another bond if the market is open, or perhaps getting bank debt to roll over this bond? And the second question is regarding corporate governance. The company has done already a very good job in reducing costs, including SG&A, selling assets, is really basically waiting for the markets to recover, both in Brazil and in the U.S. with the import situation. But on corporate governance, we have seen recently other names on the corporations in Brazil in mining or in pulp and paper moving to some more high level of corporate governance. Are there any prospects conversations for the short and medium term, Gerdau joining the group of companies that already canceled their corporate governance?

A - AndrÃ© Bier Gerdau Johannpeter

Okay. Let me refer to the first question, asked by Carlos de Alba, by referring to the bond maturing later this year and what will the company do with the cash balance or whether we will do refinancing. And the second question related to corporate governance, there are some companies in Brazil that recently announced their entry into Novo Mercado and in corporations with only voting shares. About the bonds that I mentioned before, today, we haven't yet decided on anything. But we are very comfortable because our cash position is good enough to honor the bond. And at the same time, the bond issuing markets for like 10 years, they are very open, at least, this is our opinion. And so we have several alternatives to deal with it. I think our first option would be to use the cash we have, today, denominated in U.S. dollars, to pay for the bond and any other alternative would be secondary, could also be decided further on in detriment of using that market window that is available. More and more, we've been using working capital lines because the cost is very competitive in the market. And we've been using that to maintain the company's liquidity in good shape. Now answering your question about governance, I think it's important to highlight that the level of alignment between a company with definite control and a diffused control company is different. The alignment between controllers in a defined control company may be very well put vis-Ã -vis the other companies in the market. And this is the case of Gerdau. Companies that are entering Novo Mercado that have this control, they made the decision based on their own parameters. But Gerdau continues to be a company with a very defined control without disregarding -- having any disregard for his corporate governance. We've been focused on it and this is the reality of the company today.

Operator

We now conclude the Q&A session. I would like to give the floor to Mr. AndrÃ© Gerdau Johannpeter for his final remarks.

A - AndrÃ© Bier Gerdau Johannpeter

Thank you, all, very much, on behalf of Harley and myself. If you still have any questions, our IR team will be available to answer your questions. And I would like to invite you all to our next call on November 8, where we will discuss the results for the Third Quarter of 2017. Thank you, all. And have a good day.

Operator

Gerdau's conference call is now concluded. I would like to thank you very much for participating. And have a very good afternoon.