Q1 2016 Earnings Call

Company Participants

- Benjamin Steinbruch, Chairman and Chief Executive Officer
- Daniel Santos, Director, Mining & Minerals
- Luis Fernando Barbosa Martinez, Commercial Officer
- Paulo Rogerio Caffarelli, Corporate Chief Executive Officer and Investor Relations Officer

Other Participants

- Daniel Sasson, Analyst
- Ivano Westin, Analyst
- Leonardo Correa, Analyst
- Leonardo Shinohara, Analyst

Presentation

Operator

Good afternoon and thank you for standing by. Welcome to the conference call of CSN to report their results of the First Quarter of 2016. Today here with us we have the Company's executive officers. This conference call is being recorded and all participants will be in listen-only mode during the Company's presentation. And we are going to start the question-and-answer session, when additional instructions will be provided. (Operator Instructions) Today's conference call is also being simultaneously transmitted on the Internet and can be accessed at CSN IR website www.csn.com.br/ri, where you can find the respective slide deck. The selection of slides can be controlled by you. A replay of this conference call will be available right after it ends.

Before proceeding, we would like to clarify the statements made during this conference call relative to CSN' business prospects, operational and financial projections and goals are beliefs and assumptions of the Company's management and they are based on information currently available. Forward-looking statements are not guarantee of performance. They involve risks, uncertainties, and assumptions because they refer to future events and therefore depend on circumstances that may or may not occur. Investors should understand that general economic conditions, industry conditions, and other operational factors may affect the future performance of CSN and therefore lead to results that will be materially different from those expressed in such forward-looking statements.

Now we would like to turn the conference over to Mr. Paulo Rogerio Caffarelli, Corporate CEO and IRO. He is going to make the presentation on the operational and financial highlights of CSN in the period. Please, Mr. Caffarelli, you may start.

Paulo Rogerio Caffarelli {BIO 7429811 <GO>}

Good afternoon to everyone. I thank you for your participation and we'll start our presentation on page three with the main operational and financial highlights of Q1'16. We had an EBITDA of BRL733 million and EBITDA margin of 18.1%. 1.2 million [ph] tons of steel sales, 10% higher than in Q4 '15. We also had an increased share of Coated Products achieving 58% of flat steel sales.

Our total steel EBITDA amounted to BRL420 million in contrast to 222 million in Q4'15, and therefore an 89.19% growth. We had the production of 7.3 million tons of iron ore, with sales of 8.3 million tons, a record for our first quarter. So iron ore delivered in China of 31.2 in contract with 33.3 in Q4'15; and this puts our Company amongst the Top five mining companies in the world. We had 15% increase in cement sales, as compared to Q4'15, in spite of the drop of the market of 7% (inaudible) and also a reduction of BRL472 million in inventory.

Now on the next page, you can see our strategy of increasing competitiveness and recurring cash generation. This strategy is based on two main pillars. One is operational efficiency. The second is delivering the small (inaudible) in projects and also financial management.

On the next page, you can see the diversity of our businesses with a high integration between all these business lines even with energy costs.

Now on page six, you can see a snapshot of our consolidated results, while you can see the growth in revenues, profits and EBITDA in Q1 compared to 4Q'15. Our loss -- net profit/loss was 831 million in Q1'16, partially caused by the volatility in FX rates in the first quarter of 2016 [ph], where the net debt has remained constant at BRL26.6 billion.

On page seven, you can see a breakdown of our results showing the influence of the FX variation in the quarter.

On the next page, you can see our cash position and it's movement in the first quarter of 2016. Here once again you can see the impacts of FX variations on the position of our cash.

On page nine, you can see the net revenue and EBITDA of our businesses with highlights of steel and mining business lines. And it's interesting once you analyze the historical series of our EBITDA in terms of steel and mining in longer series, it's so clear that they complement each other to generate resilient operational results. And in this quarter, we saw that steel accounted for 68.2% of net revenue and 50% of our EBITDA.

On the next page, specifically about steel, you can see here growth of 10% in sales volume and therefore, an increase in net revenue and recovery of EBITDA and consequently EBITDA margin recovered. So the 10% volume increase, it's important to say that the same market shrunk this market by 7% and we had a 10% growth in volume and this market accounts for -- the foreign market accounts for 48% of all our sales.

On the next page, you can see the offers of our coated products, especially galvanized and tin plates totaling today 46% of our sales in the domestic market and 58% of our total sales, a growth of 23% in export comparing Q1'16 to 4Q'15.

The cost of slab is below US$280 per ton, in a reduction for assets even though we were buying ores at market pricing. The maintenance of our net revenue in spite of the appreciation of the FX rate, a strong drop in our COGS and thereby generate an EBITDA per ton of about BRL337 million.

Now shifting to the mining results. Production of 7.3 million is an absolute record for the quarter and for the period of the year and grew 23% higher than Q1'15. There was a drop in net revenue because of the FX rates and a smaller FOB price. But still eventually we generated 36% of EBITDA margin in this period.

On the next page, you can see the continued evolution of our cost. Cash delivered in China with a drop of 6% as compared to the fourth quarter of 2015. It's important to think the $31.20, it includes the price -- at average price of US$13, and as we said, the constant pursuit for cost reduction in mining really makes us one of the Top five companies in the world in terms of cost and gives us very good competitiveness, especially in Asia.

Now shifting to cement, we have a growth of 15% in sales, in spite of the challenging commercial scenario with a dropping or shrinking margins.

Now on the next page, you can see that we have expanded our production in cement from 2.3 tons to 4.3 million tons with our new grinding mill that started at last year. So this makes us one of the leading players in Brazil in the area of cement. As to our Tecon terminal at Sepetiba, we had 19% EBITDA margin, the most important is the maintenance of the number of containers is still low [ph] along with steel.

On page 18, I would like to reinforce once again a very strict discipline in terms of distribution of our CapEx, the amount that we spent in Q1 with our expectations of reducing CapEx, plus expenses of BRL330 million represents a reduction of almost 30% compared to the fourth quarter of 2015.

On page 19, you can see a reduction of BRL472 million in inventories, partially explained by the reduction of 172 per tons of finished steel products. Accounts receivables a result of the expansion of our sales and we should also say that default rates is close to zero.

On the next page, a snapshot of our financial agenda. Cash management, the focus is always and remains on liquidity. Liquidity is the name of our game. In terms of debt management, we are restructuring the operations with funding instruments of more interesting terms. In terms of cost reduction, we are all the time hitting to reduce costs, operational costs and also abrupt reduction of non-operational costs and inventory and CapEx discipline. We also try to reduce leverage, but as I said before all with encouraging sales.

On page 21, you can see our debt profile. 51% of our debt is in foreign currency, 49% in domestic currency. So this is linked with our revenue profile, where 53% of our revenue comes from foreign market and 47% from the Brazilian market and this is also correlated to our EBITDA.

On the next page, there is a solid provision of our cash, today more than BRL6 billion and on the right-hand side, you can see a snapshot of the schedule of the amortization of our debt and for comparison purposes, you can see the 64 [ph], we will find longer debt complex. The average time for the debt is 7.32 years and considering our preferential bonds, if we exclude those bonds they go down to BRL3.8 billion [ph].

We should also mention on the next page our commitment towards sustainable practices and integrations with the communities where we operate. So in April last year, CSN signed a Conduct Adjustment Agreement with the Government of Rio de Janeiro, including until September 2016 the resolution of the main environmental issues regarding our Presidente Vargas Steel mill in Volta Redonda and yesterday, Rio de Janeiro Environmental Agency issued a permit for us to operate as a consequence of signing of this agreement. We close with the message that we want to go on building a truly Brazilian company to do well to the more and to do forever.

I would like to turn the conference over now to our Chairman, Mr. Benjamin Steinbruch.

Benjamin Steinbruch {BIO 1499059 <GO>}

Good afternoon, thank you everyone. And I would like to present to you some items that I consider quite important. And some of them have already being mentioned by Caffarelli. But on the whole, they represent an effort of the Company and that means all our employees have agreed to start doing in end of last year and have already started collecting the fruits of this effort. In spite of the difficulties of Q1, all we are aware of, so I would like to highlight some positive accomplishments that we made this quarter.

We again have recorded an improvement as part of its consolidated results in all its operational indicators with increase in revenue, EBITDA and EBITDA margin in the first quarter of 2016, as compared to the fourth quarter of 2015. The net debt remains stable, adjusted at 2016, which demonstrates an indication of inflation. Actually I was kind of disappointed with this number, and I would like it to be even smaller than it was in the previous quarter in terms of absolute numbers. But there was few atypical facts that penalized us and which compromised the reduction of our debt, which was depreciation of the Brazilian Real and payment of financial expenses that were atypical and concentrated in the first quarter.

So the important need for us to think of the trend, the growing trend of the debt which has led us to make a commitment with you and with the market. Steel works have presented an increase in domestic and foreign markets. We have gained share, EBITDA margin, in spite of what Caffarelli said, average prices of the first quarter this year. And because of -- the meantime CSN now started receiving iron ore as market prices and of course, this has a consequence in higher costs, but this was offset and there was even a reduction of costs in our steel business lines.

As this -- the cost of products sold, we have a margin per ton of BRL337, which is one of the best in the world. And we believe term [ph] Russian steel company might be this number and maybe even a Chinese and we cannot really compare costs. But I can tell you that this margin of BRL337 is fantastic considering the market now and the crisis in the steel industry in the world.

And so we've had the implementation of higher prices in the Brazilian market of 10% in April, 10% in May, and we're going to implement another 10% in June. We think that the Brazilian prices are lagging as compared to international markets and today the prices in US, is $600 per ton. And here we are at less than $500 per ton. So we think there is room for us to increase prices in distribution and this is going to be accompanied by price increases in the industry. And so as of June, we'll be increasing our inventory prices.

In mining, we had an increase in production of 23% as compared to the last quarter of last year, and in spite of the smaller revenue, EBITDA went up from BRL156 to BRL283 in the first quarter of 2016. And our intention is to keep on this track of increasing production and to regularize it in terms of adding volume, and even some purchased products.

In terms of costs of the iron ore delivered in China, we like to mention once again even though Caffarelli has already said it, the cost delivered in China dropped by 6%. This cost in the fourth quarter of 2015 was at $33.3 per ton and now it has 32, which certainly places the CSN as one of the Top five most competitive companies in the world.

The cost of the iron ore is one of the things that we promised to deliver since the issue of cost is up to us but which makes us really very competitive in the international markets. There is a trade variable and then there was a sharp drop in prices and prices of transportation in the international market. But I believe that from now on, we are going to have even better results considering smaller transportation cost.

In cement, CSN, as you all know is increasing its production. Yes, they had a trend of growing through Arcos, and I'm even going through (inaudible). To see our project there, it's really great. It's something that we clearly work on, and you'll see it's the largest cement kiln in Latin America that we are building and we are going to complete it in June and we are now in our final stretch of this project and this is really construction and its design is really fantastic and it's going to provide us great competitiveness with high quality cement and a quite significant increase in capacity. And we are also going to reduce our logistic costs for Quente, which today we are making it for the shortage of product in Volta Redonda to Asia.

And in this manner, we believe that the EBITDA should go up, EBITDA in cement has been somewhat disappointing for us, but I believe that now once this new plant opens in July or

August, I believe that our EBITDA is going to be very competitive. So this is a plant that is really worthwhile in your differentiated projects after Arcos and Volta Redonda. I went there to see how the work is evolving there and I was surprised by the reduction in inventories, the value-added off production and the fact that the plant in Volta Redonda is doing very well.

As to investments as you know, the Company made a strong commitment to reduce its investments and the initial assumption was to hold this at 1.500 [ph] and now it's down to 1.300 [ph]. And I think we will be able to deliver even less than that with the completion of our plants -- clinker plants and the grinding mills. We want to do -- just be casual in this manner. In 2016, our investments will be less than 1.200 billion [ph].

Our working capital, another one of our assumptions, we've managed to reduce inventory by 472 million in 182,000 tons of steel projects. As we mentioned before, we've said that we were going to reduce by working with the market, exporting, seeking specific issues of high value-added products and we are doing this and we are delivering and on the next quarter, we are likely to reduce it even further.

As Caffarelli said at the end, we have signed an agreement with the State of Rio de Janeiro. There was a major concern in the market about the operation and then even greater concern with our foreign investments and all of this has been solved. And we are very confident in terms of all types of negotiations and relationships with the government of the state of Rio de Janeiro.

Lastly, I would like to say to you that in the next quarter we have the intention of delivering something else that we promised to the market with the sale of one asset and I hope that in this quarter we will be able to implement one of them as you know there is a major concern within our leverage level or debt level, but if you exclude the issue of the payment of interest rates and the debt that we have, then the Company would be highly devalued by the company, and by every -- by the market and by everyone, then we have a problem and we need to solve it.

The first demonstration will be next quarter. And we are going to continue this and we've been working in order to reduce drastically, by the sale of some significant assets, this level of debt. The longer debt has already been negotiated, now we just need to reduce our debt. As to what to achieve for the next quarter, just a quick outlook, I sit here with optimism there is an important implementation of another price increase in the market, the market itself is not wonderful but it's okay, in which you will have drawbacks and diversification of customers and market diversification. We are being able to sell our production. We are going to perform the budget we pledge, or that we made a commitment for earlier this year with good results.

In the case of mining we would have a favorable surprise of data, the price level, as you know and we do not see even in many big catastrophes this year in terms of price. So I think the prices will remain between 55 to US$65 and there is an adjustment in the market. Of course, China, is always a major reference for the iron ore market, but we are doing our homework. We know that our prices are significant, competitive and we want to go on working on that in order to reduce it even further.

As to cement, I am also optimistic about this. And as to the future of Brazilian economy, we have some prospects of improvement in cement, will certainly pick up soon. And with our new plant in Arcos, we are going to improve our EBITDA greatly because of lower logistic costs. We are also working with boards in terms of attracting more loads, we've obtained a significant victory with regards to Asia, when we signed a contract with Asia, and we have good prospects for growth in terms of revenue.

In the foreign market, we are working strongly in U.S., taking advantage of the good timing of the market, we have a plant here as you know. And there are more than 20 people working in the American market as Americans. And in this manner, we are managing to obtain very good results and are taking advantage of the American market. Germany is like clockwork as I said, we have constant results about 8 or 9% of our EBITDA and this level is stable, and just as Portugal is getting better because of Spain.

Though our outlook for the next quarter is good, I was sort of disappointed, as I said to you before with our results in the first quarter. I expected it should be better, but unfortunately there was still depreciation of the Brazilian real. But I believe that now as we see it will be 50/50 both in our debt and also in revenues. This make us confident in terms of our natural hedge and we wanted to explore this advantage in order to have fewer risks and to work better in terms of currency.

And that prospects for the second quarter are good. We hope still complete the sale of our assets and we want to work strongly now in cost reduction. We want to still hold our investment, as I said before and we are going to work more -- even more intensely on that. And in the second quarter we will able to reduce the delivery of debt reduction, I think that now our revenue is sort of guaranteed.

I would like to thank you for your participation in our presentation. And next quarter, I hope then to be able to give the details of that we are ranking now and I hope we will have even better results to show to the market.

Questions And Answers

Operator

Thank you. We are going to start our Q&A session for investors and analysts. (Operator Instructions). Our first question comes from Leonardo Shinohara from HSBC.

Q - Leonardo Shinohara {BIO 18788974 <GO>}

Good afternoon everyone. Thank you for your question. I have two questions. The first one is regarding investments that Mr. Caffarelli mentioned, 1.2, 1.3 billion [ph]. What should we expect a redistribution or higher investment at Arcos ramps up or would it really be a reduction? Then the other question is regards finished products, I thought that there was a 20% increase. What would be a healthy level in terms of finished products?

A - Paulo Rogerio Caffarelli {BIO 7429811 <GO>}

Leonardo, thank you very much for your question. We must focus on the issue of CapEx. As our President said, we are in the final phase of our investment in this company [ph]. So it's measured that is well safer part of the CapEx. So the total amounts that we have for CapEx today, our expectation of reaching one point to 500 million [ph] is for cement, the other part is more related to savings both in steel and mining.

In mining, it's also going through a deep analysis as ore prices improve. So you're trying to improve production and closely related to the prices of iron ore. The second thing regarding finished products, I'm going to turn it over to Benjamin to talk about inventory reductions.

A - Benjamin Steinbruch {BIO 1499059 <GO>}

Leo, good afternoon. First of all, CSN strategy, as always, would be working on course. We have always worked with our inventory that worked. So this was the first time in our history that we had this close our (inaudible). So this is the first time that we had an inventory of finished products of 700, 800 units of finished products. So there if you think of the Brazilian industry today, it's working at utilization rate of 75% and economy is slightly better already. So today the markets, not just for CSN, but in the production and it's well balanced.

So we are going to reduce 200,000 tons. We have BRL1 billion with a little bit from mining, which is quite significant. I imagined that the healthy thing would be to be at a level of 400,000 tons, which would make it possible to take 200,000, 250,000 in other quarters. It would be very convenient for us, because we now actually, we want to take advantage of prices at a very favorable timing in the U.S. market.

As Benjamin just said, the prices in the U.S., because the price of (inaudible) that is $600, and then in terms of fees it's almost 900. So all our materials, which are in the U.S. will show much better terms. So we are going to try to get margins to reduce our inventory at much better terms.

Another very important thing in taking advantage of your question, part of our inventory was sold substituting for the materials. So today, if you take the first quarter of 2016 in comparison to same period last year, there was a reduction of imports of 75%. So today in contrast to this time last year, so I am going to going to have a reduction of at least 250,000 tons and this is going to be very beneficial for us next quarter, especially in terms of EBITDA, because we are going to have price increases and also international raw materials.

Operator

Our next question comes from Daniel Sasson from Itau BBA.

Q - Daniel Sasson {BIO 19234542 <GO>}

So it's about price increase. We saw the price announced in May, the price increases that you've had something in May and another one in June. What's your outlook for global prices of steel?

A - Paulo Rogerio Caffarelli {BIO 7429811 <GO>}

Daniel, Luis will be able to answer your question.

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

Hello good afternoon. In China, just to give you an idea it was $482 FOB, what happened is that there was a slight drop recently 40 or $50, but still at the level of 420, $440 in China that brings 420, 440 through importing and nationalizing. I still have a premium in margining of 5 to 10%. So what Benjamin said in fact it makes it easier for us, since we make our new price increase in June, mainly increases already out, there is no discussion, it's interchanged.

The increase in June is priced with a slight drop that may occur in the Chinese market. If you compare to the American market, I can't even compare because prices are so much higher. So in the U.S., it's 600, 620 and compared to $500 in Brazil. So I don't see any problems in having a new price increase in June. We are going to be starting our change, the industry is already having this increase in May, and this increase is also going to be transferred to the industry. It's just a matter of us trying to recover the margins that we've lost along the past few years.

Operator

(Operator Instructions). Our next question comes from Ivano Westin from Credit Suisse. Please Mr. Westin.

Q - Ivano Westin {BIO 17552393 <GO>}

Good afternoon, Benjamin, Caffarelli, Martinez and others. I have a few questions. The first one about Q-on-Q, so the there was an impact in production in the second quarter. What is the total production expected for the year of 2016, and looking at your progress initial the levels that you reported in the first quarter with a strong contribution, should we expect the same level for the rest of year, what's the breakdown you're expecting in terms of sales for the foreign and domestic markets?

A - Benjamin Steinbruch {BIO 1499059 <GO>}

So first, the guidance just to facilitate your model, we are keeping exactly the same guidance, 5.7 million tons total and in the domestic 3 million tons, approximately 200 tons in France [ph] and 800 in Germany, and 270 of direct exports, which is about 60/40. I think it's more 55 to 45. So Q3 was something exaggerated. So the picture is ugly, but it's a minor problem, and it was down to three days, it's irrelevant and the mining inventory of finished products will be more than enough to support three days of production of

30,000 tons, so there is no problem in serving the market. And this is the guidance you asked me about volume and the kiln.

And I had forgotten about the charges. So it's not galvanized, there is -- I have a problem that's in place. And so we still have an idle capacity in our plant, and I'm working strongly to increase in U.S. and in Mexico. So it still have some space, this will take place along the year, but in terms of galvanized work, I'm going to work at least 50% in a domestic market and 78% in U.S. at least in terms of coated products. And affordably, there will be a significant increase in tin plates in regional markets such as Latin America and U.S. and Mexico. We have a reasonably interesting margin in these markets of $400 per ton.

Q - Ivano Westin {BIO 17552393 <GO>}

It's clear. Thank you very much for your answer. Now looking at your purchase of plates from third parties, you didn't have any purchase in this quarter. Is it reasonable to think that this will be the new structure or strategy for the Company in future.

A - Benjamin Steinbruch {BIO 1499059 <GO>}

No, the Company's strategy is to produce the steel, so buying plates is for people who cannot produce their own steel. Yes, there is a good opportunity which could not happen in the first quarter because the price of plates is much higher 340, 350, we can't buy them at this price. If there is a good opportunity, I will buy, but not at these prices.

Q - Ivano Westin {BIO 17552393 <GO>}

Thank you very much.

Operator

(Operator Instructions). Our next question comes from Leonardo Correa from BTG Pactual.

Q - Leonardo Correa {BIO 16441222 <GO>}

Hello, good afternoon to everyone. Still considering steel prices might be messy, let me see if I understood this correctly. In the third price increase for June 10%, even considering the recent drop that we have been seeing in China of about $50-$60, sometimes even more depending on their reference, in spite of this recent drop, would there still be room for the implementation of the third price increase?

And apart from that just complementing my question. In the automotive industry, we are in a scenario with longer contracts more difficult to adjust. How is the equation with such a gap or mismatch in terms of prices? Do you have any trigger for use to maybe increase and adjust these prices to level that will be closer to the reality? So is there this distortion and echoes as to what we see in distribution. Could you explain me a little bit there the difference in the automotive market and how do you see that grow into the future?

And the second question is more specific about iron ores. Could you give us some more color about volume? So (inaudible) has huge resource potential. I just wanted to see the trend of increasing volume over the next few quarters or years. So could you share with us what you are expecting in terms of volumes of iron ore over the next two or three years?

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

Hi, Leonardo, this is Martinez. Part of your question, well you answered. Though it's foolish and to sort of answer your question, actually it's an interesting question because we had the price increase in April for distribution, another one in May, and we will be making another one in June. If you take these two increase and if you take Chinese prices today discounting the jobs of the last week, I still have room for another price increase in June. If you take China prices it was 460, 480, next year prices with the job of 420 or 440, so I can increase 4% in June without any problem. So this is our scenario at today and we will recover.

In the case of the automotive industry, we normally work with contracts and the prices are much more stable. So distribution prices, they are like spot prices, they vary. So the pricing in the automotive industry dropped much less. So I will not have to increase that much for the automotive industry. They might have slightly more differentiated numbers because there is a price stability in the long-term.

So this dynamic is very simple and it's impossible not to recover and it's a matter of survival, because margins are well below what we expected. Just as we managed to go along with the market over the past years, we need to go with the trend now and it's a trend of the industry as a whole. It's not unique to feel all other sectors are going in the same direction. Let me turn it over to Daniel, the person who's responsible for mining.

A - Daniel Santos {BIO 19846897 <GO>}

As the guidance of mining we're keeping what we reported earlier this year, we have the 30 million tons. There will be about 6 million tons of third parties, and then it will be 31 million to ship [ph]. We are in condition of having of a gradual increase in production with investments that we've made over the past few years. There are some investments that we are discussing internally in the short term to create the bottleneck in Casa de Pedra and we have potential of always increasing a little bit more than our -- what we are planning. But depending on many other conditions, even the weather, but in the next few years we will definitely present -- we will review the CapEx and implement this additional capacity.

Operator

Thank you. If there are no further questions, I would like to turn the conference back over to Mr. Caffarelli, Corporate CEO and IRO for his closing remarks.

A - Paulo Rogerio Caffarelli {BIO 7429811 <GO>}

So once again on behalf of our Company CSN, I would like to thank you all for your participation also all our executives officers who are here with me. So once again stressing our commitment of increasing sales, improving our margins with a sharp reduction of our expenses with very strict discipline in CapEx and above all very intense work, as our Chairman said, in terms of producing leverage. So we'd like to reinforce the commitment of our Company CSN. Thank you very much and have a good afternoon.

Operator

Thank you. The conference call of CSN has now ended. You may disconnect your line and have a good afternoon. Thank you.