Q3 2016 Earnings Call

Company Participants

- Cristina Morgan, IR & General Manager
- Romel Erwin, CEO and VP of Technology and Quality
- Ronald Seckelmann, CFO, Finance & IR Vice-President Officer and Subsidiaries Vice-President Officer
- Sergio Leite, Commercial VP
- Unidentified Speaker
- Wilfred Bill, Executive officer, Usiminas Mineracao

Other Participants

- Alfonso Salazar, Analyst
- Carlos De Alba, Analyst
- Felipe Hirai, Analyst
- Ivano Westin, Analyst
- Leonardo Correa, Analyst
- Marcos Assumpcao, Analyst
- Rodolfo D'Angele, Analyst
- Thiago Lofiego, Analyst
- Unidentified Participant

Presentation

Operator

Good morning, ladies and gentlemen, and thanks for waiting. Welcome to the Conference Call of Usiminas to discuss the earnings of the third quarter, 2016. Right now, all participants are in listen-only mode. Later on, we are going to start the Q&A session when further instructions will be provided. (Operator Instructions) It's important to remind you that this conference call is being recorded.

This presentation together with slides, is simultaneous webcast on the company's website www.usiminas.com/ri. And there, you will also be able to have a copy of the company's release. The participants that are listening the conference in English will also be able to ask questions directly to speakers.

Before going on, we would like to let you know that any statements made during this conference call relative to the company's business prospects as well as its projections, operating and financial goals concerning its potential growth are based on expectations of the company's management with regard to the future of the company.

Forward-looking statements highly depends on the performance of the steel market, the country's economic scenario and the situation of international markets and therefore, is subject to changes.

Today with us, is Usiminas' executive management; Mr. Romel Erwin, CEO and VP of Technology and Quality; Ronald Seckelmann, VP of Finance and Investors Relations and VP of Subsidiaries; Sergio Leite, Commercial VP; Tulio Chipoletti, Industrial VP; Takahiro Mori, Corporate Planning VP; Wilfred Bill, Executive officer of Usiminas Mineracao; Heitor Takaki, Executive officer for Usiminas Mecanica; and Cristina Morgan, Investor Relations General Manager.

First, Mr. Romel Erwin is going to make his initial considerations and then Mr. Seckelmann is going to present the results of the third quarter 2016. Later on, our officers are going to be available to answer your questions.

We will now turn the floor to Mr. Erwin.

Romel Erwin {BIO 17406447 <GO>}

Ladies and gentlemen, good morning. I thank you very much for attending this conference call to present Usiminas earnings for the third quarter 2016. I would like to once more highlight the crisis the industrial sector is going through, both because it's been a long crisis and also because of how important it is, and especially in mining and steel. All, us in the industrial sector have been forced to reduce expectation, plan correct directions and make major adaptations.

Usiminas is always paying great attention to the market. It started more aggressively to adapt to the adverse expectations of the market in the end of 2014. And therefore, we reduced production to the minimum techno [ph] levels in 2015, with the disconnections of number 1, machines of Ipatinga and Cubatao in 2016, in the temporary downtime of the Cubatao plant, changing its model to process own slabs to acquired slabs. Together with this, with the reduction of the volume of production, we worked hard to reduce costs and prioritize investments in order to seek better market opportunities and adapt the company to this reality.

Part of all our efforts is a bit more visible in the results of this third quarter 2016. We are fully aware that the work that has been developed has to be continued and we have to be persistent and directed to seek better results. I would like to use this opportunity, since Usiminas is turning 60 years of its foundation and 54 years of its operation and I would like to thank and pay tribute to our team for its commitment, dedication and competence.

Usiminas is a company and that is the reference for its technology, the quality of its product, its know-how, and that constitutes an important differentiation of the company in the market.

Now I'm going to turn the floor to Mr. Ronald for his presentation.

Ronald Seckelmann {BIO 3722329 <GO>}

Good morning, everyone. I'm going to make some comments about the results of the third quarter 2016 consolidated results and I would like to highlight the main indicators in steel and mining. Hence, you can take a look at the slides on our website.

First, we talk about our operating and financial indicators. Volumes of sales of steel that grew by 7% in the quarter. Iron ore sales basically stable quarter-on-quarter. Adjusted EBITDA that had a quite strong evolution, reaching BRL307 million in the quarter and a reduction of the net income loss quarter-on-quarter of 13%.

The next slide shows the evolution of our sales of steel in the past 12 months, since the third quarter last year. And then quarter-on-quarter, we can see that there was an increase of 7%, as I mentioned before, comprising 26% of increase of exports and 4% increase in the domestic market.

The next table shows the results of the steel business segment with highlight to some non-recurrent events, like the sale of -- assets sale and the sale of surplus. So quarter-on-quarter we see quite an evolution in the Steel segment with EBITDA of 295 million, including non-operating factors.

The next slide shows the same numbers excluding those non-recurring effects. And then we see an operating EBITDA, so to speak, of BRL332 million with EBITDA margin of 16%.

The next slide shows sales volumes for mining, practically stable compared to the previous quarter. The difference is that in the previous quarter we developed more exports. In this quarter, we had a greater volume of -- to third-parties in the domestic partners [ph]. Sales also remained quite stable quarter-on-quarter.

The next slide shows EBITDA results in mining. Again, the highlight is here the non-recurring effects that are much more reduced in this market segment.

Finally, consolidated results on slide number eight, quarter-on-quarter, showing the non-recurring effects, non-operating effects. Again, asset sales and write-off sale or surplus reaching 307 million with EBITDA margin of 14% consolidated numbers.

The next slide eliminates again the non-recurrent effect, non-operating effect. And here, we therefore see what we call an operational EBITDA of BRL344 million, which is equivalent to an EBITDA margin of 15% consolidated numbers. We continue our efforts on controllable variables. One of them, G&A expenses that continues to be controlled at very low levels. And that represent relatively lower percentage as compared to the company's net revenues.

We continue to work with our working capital. The working capital grew compared to the previous quarter, going back to exactly the same level it was at the third quarter 2015. Working capital, we already talked about that in the previous quarter. It's one of the variables that suffers seasonal influences.

The next slide shows a breakdown of our working capital with regard to our steel inventories. And we can see that inventories continued to be quite well controlled at low levels, a bit more than 40 days of inventory turnover.

The next slide shows the evolution of our net and gross debt. Gross debt was strongly affected by the valuation of the Brazilian real and therefore devaluation of the debt in foreign currency. The cash already had the effects of the investments of capital and our net debt grew a bit quarter-on-quarter, because of a series of adjustments that we had to renegotiation our whole indebtedness package.

Our debt after the negotiation has the profile that we can see on the next slide, quite comfortable profile now. Three years of debt average tenor with some debt to be matured in 2018. And then we have a curve that starts very distinctly in 2019, growing to a higher level in 2022 only.

CapEx, another manageable variety that we are controlling from close, is probably going to closer to BRL250 million in the end of the year.

This is what I had to talk about with regard to the results of the third quarter and therefore we are now open for your questions.

Questions And Answers

Operator

Ladies and gentlemen, we'll now start the Q&A session. (Operator Instructions) Our first question comes from Thiago Lofiego from Bradesco BBI.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Good morning, everyone, thanks and congratulations on your results. I have some questions. First about coal costs, if you could please talk about when we should see the impact of coal prices on your results. We know that you are fully contracted, so contract prices are not going to fully reflect the spot prices, but if you could help us quantify that a bit, it would be great.

Second question to Sergio Leite. Sergio, if you could talk a bit about demand, what do you see in the short term? Do you see some industries specifically already recovering, any specific sign in the flat steel segment in Brazil, and also about prices? If you could talk about what the premium is now compared to the imported products, and if you are already feeling the increase of prices? You had an increase of 5%. But we know that prices are going up strongly, especially in China.

A - Ronald Seckelmann {BIO 3722329 <GO>}

Well this is Ronald. Thiago I'm going to talk about coal and then I'm going to turn on to Sergio, because you asked like seven questions to him. Well, coal, we do not have 100% of our demand contracted, just two-thirds and one-third is in the spot market. Current coal prices account for 12% of our COGS. The high volatility of prices in recent weeks has made difficult for us to make any quantitative forecast. However, we should not have any impact on costs before the first quarter next year.

A - Sergio Leite {BIO 18922519 <GO>}

Thiago, with regards to demand, what we have seen in recent months, and it continues to be so today, as of June, the drop that we had been feeling since June 2014 stopped. So as of June, we have experienced a flat steel market that is stable with a small trend up growth in the third quarter. We had the Brazilian flat steel market slightly better than the second quarter and basically the outlook is to have market stability. For 2017, we believe that we are going to have slight growth. And in Usiminas we have about 400 clients, and in conversations with them in the different sectors that consume steel, the prospect for most companies is that 2017 is going to have a slight growth.

As for prices, today we are introducing the increase of 5% in our products, in our four products. In our views, and you mentioned that, we see an increase of prices in the international market and therefore, we have room for the next two, three months to have a new increase.

Another point that you talked that is about premium prices compared to imported goods. After this increase, we have a premium between 8% to 12%. So depending on what happens in the coming weeks with regard to the prices in the international markets and exchange rate, we might have room for a new price increase.

Thiago, I'm just going back to tell you something more about coal. When I mentioned that coal accounted for 12% of our COGS at current prices, I'm talking about in the places that we produce slab switches in the Ipatinga plant. This is where coal accounts for 12%.

Q - Thiago Lofiego {BIO 16359318 <GO>}

And do you think that this potential price increases can offset this increase of coal that is to come or not and if therefore you're going to have a pressure on margins?

A - Ronald Seckelmann {BIO 3722329 <GO>}

Well, as I mentioned, the price volatility in recent weeks has been such that today we cannot really quantify what the real effect is going to be like, because it is very recent, I really couldn't tell.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Okay. Thank you very much gentlemen.

Operator

Our next question comes from Felipe Hirai from Bank of America.

Q - Felipe Hirai {BIO 15071781 <GO>}

Hello. Good morning, everyone. I have two questions. The first is still about prices, Sergio. So just to understand, this increase of 5% is on top of the three increases of 10%, if you can confirm that. And steel prices, if you could tell us how much of this 30% of prices that we have seen reflect the results of the third quarter and how much we are going to see in previous -- in next quarters?

And also about cash generation; we have seen a significant increase of working capital in the quarter, but the net debt grew very little. So it seems that even with an EBITDA of BRL300 million, cash generation was reasonable, because of the working capital you have. Today, what do you think your breakeven would be like after the renegotiation of debt? Thank you very much.

A - Sergio Leite {BIO 18922519 <GO>}

Felipe, let me answer first your question about prices. This year, we had in distribution three increases of prices; April, May, and June, about 10% each. This increase of 5% today is being applied to distribution and as of them, we are going to negotiate it with the industry. In the industry, we had increases as of July in the third quarter.

In the automotive industry, we are precisely now negotiating increases. Most clients have annual contracts whose date of effectiveness starts on the 1st of January and right now we are negotiating with the automotive sector.

A - Ronald Seckelmann {BIO 3722329 <GO>}

Felipe, as of projections of EBITDA and breakeven for the future, I'm going to abstain to do that, because I think there are several hypothesis to be built, and I think that each one of you can do that in a more suitable manner than me trying to talk about just random numbers.

Q - Felipe Hirai {BIO 15071781 <GO>}

Okay. And how about -- how much of the price increases that we have seen have already been reflected in the results of the third quarter?

A - Ronald Seckelmann {BIO 3722329 <GO>}

Well Felipe, basically everything that was already increased was reflected in the third quarter. In the fourth quarter, we are going to have the impact of this increase up to date.

Q - Felipe Hirai {BIO 15071781 <GO>}

Okay. Thank you very much.

Operator

Our next question comes from Leonardo Correa from BTG Pactual.

Q - Leonardo Correa {BIO 16441222 <GO>}

Good morning. Thanks for taking my call. The first question, Sergio, I'm sorry to insist about prices, but with regard to automotive, in recent years, we saw a price almost still. Some say that there were some discounts along the way. So I would like to know how much we have in terms of discounts in automotive compared to distribution. That is, what is the level of lack of adjustments that you have? This is my first question.

I have two more questions; in CapEx, we are seeing a very low level currently, even below what you had mentioned for the beginning of the year. How long can you support this low level of CapEx looking into the following years? For the next year, can we expect something close to this BRL350 million, because I know that there are many changes going on, especially in Cubatao and I would like to know what's your maintenance CapEx is going to be like.

And finally, your cost base is still a bit polluted because of the downtime in Cubatao and I would like to know when are things going to go back to normal. Are we going to have for the next quarter a clean base, or are we going to still suffer the non-recurring effects? Thank you very much.

A - Sergio Leite {BIO 18922519 <GO>}

Leonardo, with regard to prices for the automotive industry, you know that we have annual negotiations and we started the year of 2016 with balanced prices, both in distribution and in the automotive industry. Of course, there was a detachment along the year and the detachment is of about 20% to 30%.

A - Ronald Seckelmann {BIO 3722329 <GO>}

Hi, Leonardo. As for CapEx, you are right, we were giving a guidance of BRL300 million for 2016. Now we are talking about BRL250 million, and this is a matter of prioritization of what we are doing. It's not really that we are putting aside important things. For next year, our guidance is going to go back to BRL350 million. For 2018, it is a bit early for us to talk about. Part of that regards the prioritization efforts that we are having at the plants, and certainly there is a substantial change because of the new industrial configuration of Cubatao that removes those needs of maintenance CapEx in very important areas.

As for costs, I could tell you that the cost of the third quarter already reflects the new industrial configuration of Usiminas, with Ipatinga fully integrated, producing cold and hot rolls and slabs and the industry of Cubatao buying the slabs and having the rolling process. So they are already a clean base that reflects our new configuration quite well.

Q - Leonardo Correa {BIO 16441222 <GO>}

Well, thank you very much.

Operator

Our next question comes from Marcos Assumpcao from Itau BBA.

Q - Marcos Assumpcao {BIO 7474402 <GO>}

Hello. Good morning, everyone. My first question is about the use of your capacity in Ipatinga, if you could talk a bit about that and if you are already thinking of reconnecting some furnaces that are still in downtime? And Ronald, could you talk about the new normalized of net revenues after the recovery, renegotiation of you debts? And about Cubatao, what would be the price of iron ore that would encourage you to reconnect one of the small plants that you have? Thank you very much.

A - Romel Erwin {BIO 17406447 <GO>}

Well, this is Romel speaking. As for the reconnection of our furnaces in Ipatinga, we are, of course, paying attention to the market and as soon as we have clear signs that there is room to reconnect the machinery, we will, but we are still analyzing that.

A - Ronald Seckelmann {BIO 3722329 <GO>}

Marcos, good morning. As for your question to the new level of financial expenses for the future, once again, I'm going to not abstain to making estimates, but I think that you can do the math very well. We have all the information available in our press release.

A - Wilfred Bill

And this is Bill. As for prices that you ask in terms of iron ore, what we have been witnessing is unexpected, I would say, increase. We are talking about 73 last week in the beginning of -- last week we had a new increase. And another positive effect is the dropping prices of ship freights. But there is a problem, the exchange rates also went down, which neutralizes part of this positive effect. We do not have a magic price. I always say that it is the combination of several variables that will give you a level of competitiveness to export. Not to mention our cost that also goes along in this calculation.

But if we have freights at the level of 10 from the 12, 13 that we had before, and an exchange rate of 3.20, 3.25, if the price goes close to 70, I think it would be already an encouragement for us to try and pick up production, at least in one of the plants that is not in operation.

Q - Marcos Assumpcao {BIO 7474402 <GO>}

Okay. I just have a follow-up talking about the furnaces. Romel, are you already feeling the impact of the increase of coal in the slab that you buy from third parties? The prices of slabs that you're buying from CSI, is it going up, because of an increase of raw material costs?

A - Romel Erwin {BIO 17406447 <GO>}

Yes. Today we are negotiating slabs at higher prices than we have before. So part of the co-impact is already being felt in the price of the slab.

Q - Marcos Assumpcao {BIO 7474402 <GO>}

Okay. Thank you very much.

Operator

Our next question is going to be asked in English by Carlos De Alba from Morgan Stanley.

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

Good morning. And so the first question I have is on (inaudible), it's a combined question on iron ore and coal cost. You said in the release that due to a change in mix, iron ore cost and coal cost declined in the third quarter. So, could you comment as to what effect will be, you mean, by these, why the change in mix that you are referring to, and how sustainable this is to try and keep your iron ore and coal costs lower in the future?

And then the second question is what do you expect to see in terms of working capital? We saw a very dramatic increase quarter-on-quarter, and so you -- obviously that operation suffered as a result of that. What can you tell us in terms of how you see working capital evolving going forward? Thank you.

A - Ronald Seckelmann {BIO 3722329 <GO>}

Hi, Carlos. With regard to your question in terms of raw material costs, iron ore and coal and about what kind of actions we are taking to offset the increases in the cost of these raw materials, especially with coal; well, I would say that there is one factor that is partially offsetting the increase. In the case of coal, the increase of costs has -- have not gotten to our own production of slabs.

As I mentioned, this is only going to happen in the first quarter next year, because of the inventory levels that we have. So far we haven't felt that. So far, we had just the benefit of devaluation of the Brazilian real before the dollar, the Brazilian real value added, so decreased the impact of raw materials purchased in dollars and we are using iron ores and coals that are cheaper for us then.

And in addition we tried to replace part of the consumption of coal with natural gas in our furnaces and therefore, we have an alternative to use coke instead of coal. So, again, very strong increases in raw material costs is not something that is happening for the first time in our industry. It happened before in the past and the steel industry has alternatives to offset part of the increases, and we are working on that. But anyway, we are not going to see any reflex of these increases before the first quarter next year.

As for working capital that you talked, you referred to as a dramatic increase, well it went back to exactly the same level that we had the third quarter last year. Our sales have seasonal impact. We had an increase of sales in the domestic market and we had an increase of price of sales that we have in the domestic market and although we kept our financing terms with the clients at the same levels, the monetary amount of our accounts visible went up.

Steel products inventory levels, as I showed in my initial presentation, even reduced a bit. So the increase of working capital, the nominal increase is not of concern, because the most important variables continue to be fully under control. We should see an increase in working capital levels in the coming quarters, because of the increase of price in raw materials. So raw material inventory levels tends to increase value in the next quarters. This is the trend.

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

All right. But, nonetheless, in the third quarter of last year, with lower EBITDA the company posted better cash from operations and this quarter, unfortunately the increase in EBITDA wasn't translated into cash from operations. So I just wondered, then if you could give us an indication of how you see cash from operations in the coming quarters.

A - Ronald Seckelmann {BIO 3722329 <GO>}

Carlos, as I mentioned answering a similar question that was asked by one of your colleagues, we do not want to make EBITDA projections or financial expenses or any other variable for the future. I think that each one of you has the tools and the information available to make your own projections.

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

Understood. Thank you.

Operator

Our next question comes from Ivano Westin from Credit Suisse.

Q - Ivano Westin {BIO 17552393 <GO>}

Good morning, everyone. Thanks for taking my question. I would like to ask questions to Mr. Leite. Going back first to demand, you said that the demand stabilized in the beginning of the year. Now it's a bit better. Thinking about line by line, cold rolled galvanized you had an improvement compared to the last year, but heavy plates hot rolled continues to go down. What do you expect in terms of demand per line of product? Do you expect a fast recovery in cold rolled galvanized than hot rolled heavy plates? What is your expectation and also talk a bit about mix in the domestic and foreign market and also imports/exports?

A - Sergio Leite {BIO 18922519 <GO>}

Okay. As for demand, if we are to compare what happened in the first nine months of this year, and I'm going to focus more on our sales now, we basically had the following. If you compare most products, you're going to see that the behaviors were quite close, hot rolled is a bit different.

Well, in the case Usiminas, we did have a greater drop in sales, because there is a new entrant in the market. This new player that entered the market last year did affect our sales. I'm making my comments comparing the first nine months of this year [ph] to the first nine months of last year. So this is why we had our sales affected, we had a new player.

As far heavy steel, we do have a small expectation to pick up investments last -- next year. But it's not -- we don't have much evidence for that. But we have also a new player in the heavy steel market. Today we have in Brazil installed capacity of 3,100,000 tons for a consumption of 0.5 million tons. So this is a market that has a very high pressure of supply and it is a market that is centered investments and product. So there is prospects for growth next year, but not quite significant. The automotive industry, we have more cold rolled products. We have also a prospect of small growth for next year. So in terms of domestic market, this is what we see for the year.

As for our sales mix for next year, I think it should be quite stable, considering that heavy steel has a second player now. As for export margins, we basically have two markets for exports. We have one market that basically comprises Argentina and Mexico, and then we have regular supply contracts. And in this case, the exports generate EBITDA margin. Markets such as Europe that in the third quarter accounted for more than 50% of our margins, we operate with a contribution margin and this probably is not going to change for next year.

Q - Ivano Westin {BIO 17552393 <GO>}

Okay. Very clear, thank you very much.

Operator

Our next question comes from Rodolfo D'Angele from JPMorgan.

Q - Rodolfo D'Angele

Good morning. I have two questions. First is, as I think this year was a year of change and the main novelty in Usiminas is this new operating configuration and this is the first quarter that we are probably taking a look at what the potential of this new Usiminas setup is going to be like.

My question for you, management members is the following; are we already at where we wanted to be, or is there room for us to further increase volumes and margins? And also, I would like to know if your operation in Cubatao already had positive EBITDA this quarter?

And then my next question is about financial expenses. You know that you had an effort to renegotiate your debt, the debt is quite suitable for the coming years. I would like to know if there is anything to be commented in this quarter with regards to the subject. Thank you very much.

A - Unidentified Speaker

Well, as for Usiminas capacity, we obviously have room to grow. Today, if we are to take into consideration, we have idle capacity for the hot strip machine in Cubatao, so we have room to grow our production in Ipatinga. We have our furnace number one, that is stopped. So we can also increase, so we still have room to grow. And even in the reductions that we had in the downsizing of Usiminas, we still have some room to operate. So this is what we are doing and we certainly have room to grow.

A - Ronald Seckelmann {BIO 3722329 <GO>}

Rodolfo, as for financial expenses, I answered a similar question from one of your colleagues just now. And, in fact, we do not wanted to make projections for future levels of finance expenses, because all our debt in Brazilian reias is indexed by the CDI. That is now going into a down trend. But it's easy to predict what we are going to have. And we have an average spread that increased after the negotiation, so it's very hard to make projections. Of course, we have projections internally, but it's very difficult to publish them and we think that you can make your own projections with your assumptions and with the information that we have in our release.

Q - Rodolfo D'Angele

Ronald, I understand. I don't want projections. I just would like to know if in this quarter you had some kind of cost of anything out of the ordinary that has to do with that.

A - Ronald Seckelmann {BIO 3722329 <GO>}

Oh! Yes. There were impacts that are a result of the renegotiation process. It's a myriad of things, because it is almost as if we had closed all the debt that we had before the renegotiation and therefore we had lots of deferred expenses of that old debt that were recognized in our results. And then a new debt was created and some disbursements that were made at the time of the renegotiation started to be deferred in the lifetime of this new debt. So there is a mixture of effects that are very difficult to isolate individually. But no doubt, financial expenses of this quarter were affected as a consequence of the restructuring of our debt.

Q - Rodolfo D'Angele

Okay. Thank you very much. I don't know if you can say that, but did Cubatao had positive EBITDA this quarter?

A - Ronald Seckelmann {BIO 3722329 <GO>}

We do not break down EBITDA per plant.

Q - Rodolfo D'Angele

Not even if it's positive or negative?

A - Ronald Seckelmann {BIO 3722329 <GO>}

It is starting to be blue.

Q - Rodolfo D'Angele

Okay. Thank you very much.

A - Cristina Morgan

There is an additional comment. This is Cristina. I have some numbers there. We are reporting BRL286 million of interest -- interest alone BRL180 million and BRL100 million expenses, because of the debt restructuring, non-recurring expenses.

Q - Rodolfo D'Angele

Okay. Thank you very much for the answer.

Operator

Our next question comes from Thiago [ph] Ojea [ph] from Citibank.

Q - Unidentified Participant

Hello, thanks for taking my question. I just have a follow-up with regard to premium prices compared to imported steel. Sergio mentioned 8% to 12% today. And historically we have always worked with the number from 5% to 10%. Do you believe that this level of premium that you have today has changed and today we are going to work above the historical level of 5% to 10%?

And second, you talked a bit about changes in Cubatao, gains of cost in Cubatao. It seems to me that there are some things to be completed. I remember that in the last call you talked about the renegotiation of contract, in addition to downsizing. Could you tell us if you are at 80%, 90% of the process and if there is anything similar going on in Ipatinga? These are my questions.

A - Sergio Leite {BIO 18922519 <GO>}

Hi Thiago. With regards to prices and more specifically to premium, we believe that the balanced premiums is 5% to 10%. With the increase today, we are going a bit up. But clearly, when you're going to make a decision on import, you have risks, you have exchange risks, you have demand risks, which is the main one, because the demand is not really heated to encourage imports.

Now, our expectation is that there is an increase in international prices in the coming weeks. And if so, this premium that is at the upper limit, will go back to that range that you mentioned. And as I mentioned, in our view that can even open way for a new increase of prices.

In terms of measures that were taken, we do not have individual measures. So, when you talked about renegotiation of contract, that is not for a specific plant. When we renegotiate contracts, we renegotiate with all our suppliers. So everything that we are doing in Cubatao is also being done in Ipatinga, of course considering the differences in size of each one of the plants.

Q - Unidentified Participant

Okay. Thank you very much.

Operator

Our next question comes from Milton Sullivan [ph] from GP (inaudible).

Q - Unidentified Participant

Good afternoon and good morning, really and thanks for taking my questions. I have two questions. The first about coal. Could you give us a bit of color with regards to coal agreement terms when they're going to be mature, if you have an average time and what is price like? Is it a fixed price, is it indexed to something?

And the second question is with regard to capacity. And now I have two complementary questions about Usiminas capacity today. Could you tell us the amount of volume that you could grow today without having to reconnect furnaces and hire new work shifts? And second, is there a way we can estimate the cost of reconnecting a furnace today and how long the ramp up would take?

A - Ronald Seckelmann {BIO 3722329 <GO>}

Hi Milton. Good morning. This is Ronald. With regard to coal, in which we have two-thirds of our needs supported by agreements, generally they are quarterly or six months agreements. What is good about having an agreement is that in a way it cushions increases of raw material prices. Of course they will not avoid us to go into market prices. But the curve in which prices increase is a bit milder. On the other hand, when prices start to go down, the agreement prices also take a bit longer to go down, but most are quarterly contracts and at the most they will last six months.

As for Usiminas' capacity to be explored, well that depends on how we are going to increase production. If we start with the capacity of our hot rolling, you're talking about 1.5 million tons. We have another roll for heavy steels with another million tons. So we do have capacity for our rolling.

As far the furnaces that will depend on what kind of effort you want. If you're talking about a large furnace, you can revamp a furnace in 120, 150 days, but that's a huge effort. So the time for ramp-up depends on the amount of your efforts. But I would say on average 90 to 120 days for it to go back to line.

Q - Unidentified Participant

And how much does it cost?

A - Ronald Seckelmann {BIO 3722329 <GO>}

It also depends on the level that you have. So if its -- you're going to change the whole factory apart, if you're going to change the whole internal coating, it will change. Imagine that you don't have to do anything inside, you just want a reconnection, then it's about BRL2million, BRL3million, not doing anything, just reconnecting it.

Q - Unidentified Participant

Okay. Thank you very much.

Operator

Our next question is going to be asked in English by Alfonso Salazar from Scotiabank.

Q - Alfonso Salazar {BIO 18358082 <GO>}

Hello, everyone, and thank you for taking my question. I have two questions. The first one is regarding what -- because of the big increase we saw with the met coal price, have you considered using more ferrous scrap in the charge mix to lower your cost. Is that something feasible for you? If you can also tell us what is the charge mix you are using now, that could be very helpful.

And the second is regarding the inventory level. It seems like you expect demand to start increasing in 2017, steel demand. If that is the case, are you planning to have more final product inventories, because otherwise you might be losing sales to your competitors. Is that something that you also are considering, how you see that happening in 2017? Thank you.

A - Unidentified Speaker

Hi Alfonso. Well, I will start talking about how we are going to react to the increase of prices of coal. I already answered a question just recently that the steel industry and Usiminas particularly has gone through other situations of very high increases in raw material costs. And there are several operating alternatives that have already been used before and are going to be used if necessary. Change in the energy mix, replacing coal with natural gas or green oil coke increasing the metal charge by the use of scrap iron, if the price of scrap iron does not go up.

So there is a series of ways that we can change the energy mix, poor ores, poor coals, so there is a series of alternatives that the industry is aware of and knows how to manage, through which we can minimize the effect of the increase of prices of raw materials. As I mentioned, this cost alternatives are already being thought of. But the increase of prices of coal per se will only show in our costs as of the first quarter of next year.

And then you asked about our low levels of inventory, finished products and also products being produced and if that could not affect our capacity to respond to an increase in demand. Well, we are monitoring our demand very cautiously. We have a very good market visibility, at least for the next three months and we have the capacity to suit our production levels and therefore our inventory levels at a speed that is sufficiently fast for us to meet demand variations, even if they take place in a relatively short time, that is to say from one quarter to the other.

Q - Alfonso Salazar {BIO 18358082 <GO>}

Okay. Thank you. Just if you can tell us what is the charge mix that you are using now in your furnace, please?

A - Unidentified Speaker

Well, Alfonso, what do you mean, I didn't quite understand what you want to know?

Q - Alfonso Salazar {BIO 18358082 <GO>}

Just want to know how much ferrous scrap are you using right now to produce steel?

A - Unidentified Speaker

Today we are using approximately 15% of scrap in our metal load.

Q - Alfonso Salazar {BIO 18358082 <GO>}

Great. Thank you. Very helpful.

Operator

Well, there are no further questions and therefore we are closing this conference call. In case of questions, the IR team are available to answer your questions. We thank you very much for your participation and wish you a good afternoon.