Q2 2013 Earnings Call

Company Participants

- Andre Gerdau Johannpeter, CEO
- Andre Pires, IR Director

Other Participants

- Carlos de Alba, Analyst
- Ivano Westin, Analyst
- Leonardo Correa, Analyst
- Marcos Assumpcao, Analyst
- Renato Antunes, Analyst
- Thiago Lofiego, Analyst

Presentation

Operator

(interpreted) Good afternoon. Welcome to Gerdau's presentation of the First Quarter of 2013 earnings. At this time, all participants are in a listen-only mode. Later on, we are going to start a Q&A session. (Operator Instructions).

We would like to highlight that forward-looking statements that might be made during this conference call relative to Gerdau's business prospects, its projections. And operating and financial goals, are new predictions, forecasts, based on the expectations of the management regarding the future of the Company. Although Gerdau believes that its comments are based on reasonable assumptions, forward-looking statements are no guarantee of what is going to happen.

Here with us today, we have Mr. Andre Gerdau Johannpeter, Managing Director and CEO. And Andre Pires, Vice President and IR Officer.

I would like to give the floor now to Mr. Andre Gerdau Johannpeter. You may proceed, sir.

Andre Gerdau Johannpeter

(interpreted) Thank you. Good afternoon, everyone. Welcome to our Third Quarter of 2013 earnings conference call.

We will start this presentation with an assessment of the global status of the steel market. Then we'll move to Gerdau's performance in the Second Quarter of the year. And talk about the outlook for the regions where the Company operates. After that, Andre Pires will give the details in the financial performance of Gerdau. And at the end, we will be available to answer questions you might have.

It is important to highlight that in our presentation, we will be assessing the performance of the Second Quarter of 2013, vis-a-vis the same period of last year. However, in the case of Gerdau's balance sheet, we will also analyze the figures as they related to the First Quarter of 2013, showing our performance in the period.

Let us start with a (inaudible) view on global steel production, which reached 401.1 million tonnes in the Second Quarter of 2013, up 1.8% compared to the same period of 2012. Excluding China, global production reached 203 million tonnes, down 1.8% vis-a-vis the Second Quarter of 2012. This is data from the World Steel Association.

In Brazil, steel production reached 8.6 million tonnes, the volume which is in keeping with the same period of last year. Steel production in other Latin American countries, not including Brazil, showed a 3.9% increase in the Second Quarter of 2013 compared to the same period as of last year, reaching 8.3 million tonnes. Steel production in the United States was 21.8 million tonnes, 5.3% below the figure posted in the Second Quarter of 2012.

As for the outlook for the economy, according to IMF estimates, global GDP growth should be 3.1%, or the estimate of the IMF pointed to 3.1%, including 2013. The estimates were revised downward by the IMF. According to the World Steel Association, global steel consumption this year should grow to 0.9%, compared to 2012, reaching 1.45 billion tonnes.

Now, let us talk about Gerdau's performance. In comparison with the First Quarter, the improved performance in the Second Quarter of 2013 reflect a gradual rebound of the market at decent levels [ph], as well as a management effort in our operation, which resulted in a reduction of BRL1.1 billion in working capital, which boosted the Company's cash. In addition, shipments to the Brazilian domestic market showed the best performance since 2008.

But for North America, another significant market to Gerdau, the outlook points to growth in the next couple of years.

Net sales amounted to BRL10 billion, in line with the same period of 2012, primarily driven by the rally of the Brazilian market in the segment of long steels and specialty steels, which offset part of the reduction in the volume of exports in Brazil. And lower sales in North America.

Earnings before interest, taxes, depreciation and amortization, known as EBITDA, was BRL1.2 billion, down 3.9%, compared to the Second Quarter of 2012. Net income (inaudible) amounted to BRL401 million, compared to BRL549 million in the same period of 2012.

As I mentioned at the beginning of my speech, the balance sheet of the Second Quarter 2013 also reflects the recovery of Gerdau's performance when compared to the first three months of 2013. EBITDA, for instance, showed a 48.6% increase. And net income had a positive variation of 160%.

Talking about investments, or CapEx, in the Second Quarter, Gerdau's investments reached BRL635 million. And year to date, BRL1.2 billion. These counts were geared primarily to the implementation of projects already announced, highlights going to the straight up production of flat steel products in Brazil scheduled for this week. Now, at the beginning of the month of August, an increase in our own capacity to produce iron ore, which is unfolding as planned.

According to what we have announced previously, BRL8.5 billion are planned to be invested in the Company's industrial plants, indeed, 2013 to 2017 period.

Considering steel and mining activities, it is also important to remember that due to the launch of one of the investments made in 2012. And to the uncertainties about the world's economic market, Gerdau is becoming more selective in the evaluation of its future investment projects.

Now, let us talk about the quarterly performance of operations. If you are following us over the Web, we are on screen 4.

Starting with Brazil, I'd like to remind you that it does not include specialty steel operations in Brazil. In the Brazilian domestic market, except for specialty steel, Gerdau sold 1.5 million tonnes, concentrating both finished and semi-finished goods, 6.3% more than in the same period of last year, while exports dropped by 47.4% to 262,000 tonnes.

Regarding the Brazilian economic outlook, the forecast report points to a 2.3% GDP growth in 2013. However, we believe that in order to boost the economic activity level the country requires more investments in infrastructure. And that the necessary structural reforms be made.

According to Instituto Aco Brazil, Brazil Steel Institute, steel consumption should reach 26.7 million tonnes, 4.3% more than last year.

Regarding the major industries supplied by Gerdau, the expectations are as follows. Let us start with civil construction.

According to the inflation reports by the Brazilian Central Bank, estimates point to a 1.1% increase in the GDP of this segment in 2013. Infrastructure works remain underway, despite some delay on their execution. And this has been one of the major challenges for Brazil, how to speed up these works and their execution.

In the segment, we highlight urban mobility projects for the 2014 SIFA World Cup. And projects related to the 2016 Olympic Games in Rio de Janeiro.

As for the industrial sector, the industrial GDP should grow approximately 1.2% in 2013, according to estimates by the Brazilian Central Bank. Recent data disclosed yesterday by IBG [ph] showed that year to date, the industrial GDP grew 1.9%.

Talking about agriculture and cattle raising, the expected GDP growth in the segment reached 7.6% in 2013, this being the main driver expanding the economic activity this year. As a result, it's important to highlight the good performance of the machinery in agricultural equipment sector, an important consumption market to Gerdau.

And let's now talk about our North American operation. I'd like to remind you that we exclude Mexico and specialty steel operations. We are on screen 5, if you are following us over the Web.

In Canada and the United States, sales decreased by 3%, to 1.5 million tonnes. It is worth highlighting that the demand in the residential construction segment is already picking up. And it is usually followed by the non-residential construction segment, which is a big consumer of Gerdau's steel products. According to the United States Census Bureau, residential construction showed a growth above 24 [ph]% in the first six months of the year, compared to the same period of 2012.

The architecture billings index, ABI, remained an indicator of investment in non-residential construction. And in turn, grew for the second consecutive month, reaching 61.6 points in June. Anything above 50 points indicates growth.

The MI, main indicator of industrial production in North America, reached 50.9 points in June. And again, anything above 50 points represents growth. On the other hand, the US market and the Canadian market has been dealing with a significant growth of steel imports, which has driven the results of the sector to fall below the expectations. To give you an idea, in the last six months, the volume of long steel products imported by the United States grew 15%, while the market remained relatively stable.

In 2013, US GDP is expected to grow 1.7%, according to IMF estimates. But that steel consumption should increase 2.7% to practically 100 million tonnes. Just to give you an idea, this volume is way above the volume posted in 2009, which where the crisis when steel consumption was only 59.2 million tonnes, practically 60 million tonnes. This shows that the rebound has been slow, gradual. But positive, in the US market.

Let us talk about Latin America. It does not include Brazil. Sales volume in the Second Quarter grew 6%, reaching 726,000 tonnes. Highlight going to a demand increase in some countries of the region. Most of the countries in Latin America where Gerdau operates should continue to grow. But at a slower pace in the second half of 2013. Still, we should post a good economic performance, the highlights being Peru, plus 6.1%, Chile, plus 4.6%. And Colombia, plus 4.1%. Nevertheless, despite positive prospects of economic growth, Latin American countries are going through a period of the industrialization, driven by substantial volume of growth and direct and indirect steel imports, mainly indirect steel imports.

With regard to our investments in the region, we highlight direction of a new structural (inaudible) plant in Mexico. The main equipment has been already contracted. And the civil construction is well underway.

For 2013, in Latin American countries, should reach a steel consumption of 44.5 million tonnes, up 6.4% compared to 2012.

Let us talk about our specialty steel operation. I'd like to remind you that here we quote Brazil, the United States, Europe. And India. We're on screen 6.

In the specialty steel operation, sales amounted to 766,000 tonnes, against 731,000 tonnes in the same period of the previous year, due to the recovery in the production of vehicles in Brazil, especially trucks.

In Brazil, while the production, vehicle production in the Second Quarter increased 23% year on year, crossing the 1 million unit mark for 2013 now, well, it continues to be favorable. But (inaudible) growth of the Brazilian economy might have some impact on the sector's performance in the second half of the year. Without investments in Brazil, notably in specialty steel, notably in the (foreign language) plant in Sao Paulo, show that the Company truly believes in the growth and the rebound of investments in the automotive industry, which has been growing and will continue to grow in Brazil. The rolling mill, with an installed capacity at 500,000 tonnes of specialty steel per year, is in its final phase of installation. And startup is expected by the end of this year.

In Latin America, 4.3 million units of automobiles and lightweight commercial vehicles were manufactured during the Second Quarter of 2013, 6.1% up, compared with same period of last year. The (inaudible) continuing growth of this total vehicle production in North America, the demand for our specialty steel during in the Second Quarter was slightly lower than that in the same period of 2012, mainly due to the lower production of heavy duty trucks, the lower demand from the oil and gas sector. And to the high inventories in the distribution chain. Expectations for the second half of the year are of a slight rally, primarily driven by normalization of inventories at the distributors.

In Europe, the number of vehicles licensed in the Second Quarter of the year dropped by 3.5%, compared to the same period of the previous year, with 3.2 million units licensed. In trends, the number of commercial vehicles licensed was 430,000, posting a 2.3% increase compared to the Second Quarter of 2012.

As for this year, the trend points to a reduction in sales volume, given the lower economic activity in the region.

The other, the volume of vehicles, which is -- remains very low, the demand for specialty steels in Europe in the Second Quarter was positively influenced by factory rebuild in the production chain, since inventories reached excessively low levels in the end of 2012. With the end of restocking, demand should recede. However, the required compliance for the new legislation, Euro 6, in 2014, might lead to an anticipated production of trucks in the second half of the year. As for India. And the production of pig iron and steel, as well, the generation of own electricity are doing quite well. And the operating of the rolling mill continues in its learning curve.

I will now move to my final remarks. I'm on screen 7. Worldwide, the steel industry has been facing important challenges. As of (inaudible) now, as we are now living a cyclic moment of lower levels of profitability, the concerning points for the sector are, a growth slowdown in the global economy, especially China. And the crisis in Europe, as well as the supply/demand imbalance which resulted in a significantly excessive installed capacity for steel production. And definitely the main problem in the sector today. We should add to the list the growing imports of steel by the United States. And the industrialization process of the steel chain in Brazil and other Latin American countries.

In Brazil, the process of the industrialization that we are experiencing has led to a deficit in our trade balance, negatively impacting the Brazilian GDP. Another point of concern in Brazil is also the current moment of economic uncertainty that the country is going through. In particular, the inclusion interest rates, which tends to reduce GDP growth.

On the other hand, the current exchange rate is collaborating to improve the competitiveness of the steel industry. We even have the possibility to reactivate our exports of steel. And steel-containing products. Despite this complex scenario that we are living today, (inaudible) that Gerdau has experienced in capacity of management, to get out of the current moment of the steel industry even stronger than we are now.

I turn the floor over to Andre Pires. And after his presentation, we will move to a Q&A session. Thank you, very much.

Andre Pires {BIO 17698724 <GO>}

(interpreted) Thank you, Andre. Good afternoon, everyone. Now we are addressing the consolidated results of the Second Quarter of 2013. And I now get some details about every business operation. The idea is to conclude the presentation specifically addressing the capital structure in debt (inaudible) and cash generation.

Starting on screen 8, for those who are following us over WebEx, the net revenue had a slight reduction of 0.9% in the Second Quarter of 2013, vis-a-vis the same period of the previous year. And that was due to lower volumes sold, around 3%, which was partially offset by an increase in net sales revenues per tonne, which was 2.1%.

When compared with the First Quarter of 2013, there was an increase of 7.8% in net sales revenue, mainly due to the higher net sales revenue per tonne, growing by 6% in Gerdau's consolidated basis.

Costs of sales had a slight reduction this quarter, mainly due to the reduction in volumes sold, therefore leading to a lower dilution of fixed costs. As a result, gross margin went down 0.7percentage points this quarter, closing at 13.6%.

The share of SG&A expenses vis-a-vis the net revenue or net sales remains stable, at 6.4% in the Second Quarter, when compared to the same period of the previous year, therefore reflecting the Company's efforts to rationalize these expenses. We highlight the real depreciation, particularly vis-a-vis US dollars. The pressure of SG&A stemming from our operations abroad tend to increase in reals. And this shows the Company's efforts to maintain their stable figures.

EBITDA was BRL1.196 billion in the Second Quarter of 2013, dropping 3.9% vis-a-vis the same period of the previous year. If we look on the bridge chart on slide 8, we can see that the main factor to lower EBITDA was a reduction in net revenue. Compared with the First Quarter of 2013, EBITDA increased 48.6%. Lastly, the EBITDA margin closed at 12.1% in the Second Quarter of 2013.

On the right, at the lower part of slide 8, we can see EBITDA margin performance since 2012 up to now. The higher negative financial result in the Second Quarter of 2013 stems mainly from the higher negative net exchange variation. And would let us -- or expand the higher financial revenue and higher lower financial revenue and higher financial expense in the first -- or, vis-a-vis the First Quarter of 2013. It stems from a net exchange variance that was negative in the second half of 2013, compared to a positive variation in the previous quarter. At the end of the presentation, we'll be addressing a comparison with our balance sheet and our P&L, which is more important when we work on our figures.

There was a drop in net income in the Second Quarter of 2013 vis-a-vis the same period of the previous year, at BRL401 million. When compared to the First Quarter of 2013, net income increased 150.6%.

As for dividends, based on the Company's income, we'll be anticipating dividend payout, amounting to BRL44.7 million, to (inaudible) Gerdau shareholders, or BRL0.11 per share related to performance in the Second Quarter. And BRL119 million for holders of Gerdau as a securities, or $0.07 for stock. These dividends will be paid on August 21st, based on the status of August 12th.

On slide 9, we show the result and performance of each one of our business units. Starting with Brazil, the reduction of 1.2% in net revenue stemmed mainly from a drop in volumes sold, approximately 7.7%, offset by the better market mix, domestic versus foreign market. And better net sales revenue per tonne.

The domestic market grew 6.2% in shipment. And 1.6% in net sales revenue per tonne, whereas in exports, there was a drop of 47.4% in the sales volume. And an increase by 16.6% in net sales revenue per tonne. Please note that these revenues include iron ore and coal, plus the exchange effect.

The better net sales revenue per tonne, vis-a-vis the cost per tonne and the better market mix, allowed for growth of 27% in EBITDA in the Second Quarter of 2013 vis-a-vis the same period of the previous year, the EBITDA margin growing in Brazil from 15.8% to 20.3%.

The increase in sales volume in the domestic market and the growth of net sales revenue per tonne also contributed to an increased EBITDA end margin, vis-a-vis the First Quarter of 2013. Please note that on the right, at the bottom of screen 9, we can also see the performance of our EBITDA margin since the Second Quarter of last year.

On slide 10. And now more specifically about North America, we had a drop of 3% in sales volume in the Second Quarter of 2013, vis-a-vis the Second Quarter of 2012. This was mainly due to the implementation of our new management software throughout 2012 and early 2013. And also, to our growth in exports, which amounted to 20% of the long steel products market at the end of the first half of 2013. This lower sales volume and better prices in dollar led to a reduction of 2.9% in net sales revenue vis-a-vis the same period of the previous year.

The lower dollar denominated prices and lower dilution of fixed costs reduced our EBITDA from BRL328 million in the Second Quarter of last year, to BRL158 million in the Second Quarter of 2013. As a result, the margin went down from 10.3% to 5.1% in the same period. As to the First Quarter of 2013, EBITDA end margin were relatively stable, despite the metal spread and the slightly higher pressure.

Now, on slide 11. And addressing Latin America, always excluding Brazil, the sales volume grew 6% in the Second Quarter of 2013 vis-a-vis the same quarter of last year, mainly due to improved demand in some countries in the region. As a result, our net revenue grew by 4.6% this quarter.

An increase in EBITDA in the Second Quarter of 2013, well, it totaled BRL109 million, stemmed from the higher volumes sold. And consequently, higher dilution of fixed costs, providing a better EBITDA margin, which was 8.2% this quarter, vis-a-vis 5.5% in the same period of the previous year.

As to the First Quarter of 2013, the EBITDA more than doubled, whereas the margin grew from 4.6% to 8.2%, especially due to an increase of 12.4% in volumes sold.

On slide 12, we address specialty products, including our business operations in North America, Europe. And India. There was an increase of 4.8% in sales volume in the Second Quarter of 2013, vis-a-vis the same quarter of the previous year. And this stems from stronger growth in our units in Brazil, where there was a recovery in vehicle production, increasing 23.2%, according to (inaudible) figures, particularly trucks, an increase of 67.7%. This increase in sales was not fully reflected on the net revenue, which increased 2.5% in virtue of a lower net sales revenue per tonne that took place in Spain and in the US.

As a result, there was a reduction of 23.8% in EBITDA in the Second Quarter of 2013, when it totaled BRL276 million. And a drop in margin from 17.5% the Second Quarter of 2012 to 13% in the Second Quarter of 2013. However, vis-a-vis the First Quarter of 2013, there was a significant recovery in EBITDA end margin, due to an increase of 14.8% in volumes sold. EBITDA grew 78.1%. And the margin increased from 8.5% to 13%.

On slide 13, the idea is to slightly address indebtedness and liquidity. And also, cash generation. First of all, about amortization, I'd like to remind you that in April this year, Gerdau issued bonds worth $750 million. And the purpose was to expand the average debt maturity, which changed from 5.7 years in June 2013, vis-a-vis 4.6 years in March. The use of these funds was exclusively to pay short-term debt, as we said on that occasion.

On top of that, we also reduced our short-term debt in another BRL284 million by using our higher cash generation. In other words, we amortized more $1 billion as short-term debt in the Second Quarter of 2013. As a result, our short-term debt dropped down from 20.1% of the total debt in March, to 9.3% in late June.

Increase in cash, from March 2013 up to June 2013, was driven by lower working capital. And an increase in cash generation. On June 30, 36.9% of cash was held by Gerdau's companies abroad, particularly in US dollars.

The exchange effect over debt denominated in foreign currency was offset by higher cash, which allowed for a reduction of 2.8% in net debt on June 30 when compared to March 31st. As a result, the net debt over EBITDA ratio went down from 3.2 times in March, to 3.1 times in June. Please note that this happened at a time in which the dollar appreciated 10% vis-a-vis the real. As you all know, we have more than 60% of our gross debt in dollars. The weighted nominal average cost of the growth of principal debt on June 30 was 6.1%.

Now, more specifically about working capital. And the cash conversion cycle, there was a significant improvement this quarter. Working capital had a reduction of 6% vis-a-vis March, despite the growth of 7.8% in net revenue in the Second Quarter of 2013, vis-a-vis the previous quarter. And this shows the Company's efforts to reduce working capital and improve liquidity.

As a result, the cash conversion cycle had a reduction by 13 days vis-a-vis March 2013, closing at 85 days. Please note that reduction in working capital from BRL593 million from March to June, which is, in our corporate figures, considered the exchange variation, particularly the own [ph] working capitals in companies abroad. Net of this variation, the net effect of this reduction was BRL1.1 billion, the cash effect.

As I said in the beginning, I would like to address the exchange effect in our performance in general. Gerdau, through its Brazilian operations, owns investments and assets abroad in US dollars, amounting to $6.6 billion, which are greater than capital borrowed from Brazil under the same currency, totaling $4.8 billion. Therefore, the real depreciation vis-a-vis the dollar in the Second Quarter of 2013 had a positive net effect to the Company when it comes to our property and assets. Usually, the exchange effect on asset investments abroad is directly recognized in shareholders equity, where there's the same effect on -- or, in foreign currency, should be posted as P&L.

However, as you all know, based in IFRS standards, the Company has a policy to earmark part of the dollar-denominated investments as hedge, net investment hedge, recognize the shareholders equity in order to offset. However, despite the hedge effect, the

Company also owns other net liabilities under different currencies or functional currencies in the countries where it operates, which led to a negative exchange variation of BRL130 million in the Second Quarter of 2013, which were then posted in the P&L.

From the operation standpoint, in the Second Quarter of 2013, revenues and cash from operations abroad, once converted by reals by the average US dollar rate of the period, led to higher absolute amounts. But with no effect on the Company's operating margins.

As of now, concluding this part, Andre and I will be happy to take any questions you may have. Thank you, very much.

Questions And Answers

Operator

(interpreted) Ladies and gentlemen, we are now going to start the Q&A session. (Operator Instructions). Our first question comes from Mr. Marcos Assumpcao, Itau BBA. Mr. Assumpcao, please proceed.

Q - Marcos Assumpcao {BIO 7474402 <GO>}

(interpreted) Good afternoon. And congratulations on your results. My first question has to do with the net sales revenue per tonne. Could you talk about the price of rebar? And what is your price expectation, looking at the second half of the year?

My second question has to do with the volume of the domestic market. The volume grew 6% quarter on quarter. And you mentioned that you redirected the sales of semi-finished goods in Brazil. Could you talk about how much the volume has grown, ex-semi-finished goods? Thank you.

A - Andre Pires {BIO 17698724 <GO>}

(interpreted) Hello. This is Andre Pires. As for the premium for rebar compared to imported, it is about 13%. The total vision and the change in this level of premium price in the second half, nothing significant.

As for the mix, you are correct. There was a growth in the sales of semi-finished products in the domestic market. That phenomenon happened already the First Quarter. And continued in the Second Quarter, a growth of 6.2%. If we exclude this volume -- in other words, ex-semi-finished goods, growth would be around 2% for traditional rolled products.

Q - Marcos Assumpcao {BIO 7474402 <GO>}

(interpreted) And a follow up question, Andre. With the sales -- regarding the sales of semi-finished goods in Brazil, do you expect it to continue to be high? Are you selling to other players, other local players?

A - Andre Pires {BIO 17698724 <GO>}

(interpreted) Well, it is hard to say. It is a market opportunity that we enjoyed in the first and Second Quarters. The international market remains with relatively pressurized prices. It includes the (inaudible) end of the Second Quarter. The trend is that if there's a demand, then we'll continue to supply the domestic market.

Q - Marcos Assumpcao {BIO 7474402 <GO>}

(interpreted) Thank you, very much.

Operator

(interpreted) Our next question comes from Ivano Westin from Credit Suisse. Please continue, sir.

Q - Ivano Westin {BIO 17552393 <GO>}

(interpreted) Good afternoon. And thank you for the opportunity to ask a question. I want to ask about the North American unit. Do you have a recovery in the sales volume? But the EBITDA margin remains at around 5%. You, Andre Gerdau, mentioned the rally of the special construction and non-residential construction in the region. What is your expectation for the second half of the year for 2014? Could we expect a normalized margin for the North American unit? My first question.

My second question goes to Andre Pires regarding working capital. You reported a 6% reduction. Could you comment on the expectations for the second half of the year and 2014? Thank you.

A - Andre Gerdau Johannpeter

(interpreted) This is Andre. Well, about North America, the first half of the year was much slower than what we expected in terms of volume. It was a significant pressure by imported products. So even if we increased our volume a bit, there was a pressure from imports, putting pressure on our prices and margin down. This has been a challenge in North America. And with an excess of supply in the world, the US is a traditional importer. And their imports have grown for structural and merchant products in this quarter. It is for six months, actually.

But what we expect, according to the KPIs published, they came in with residential construction which has been picking up again. And normally, the next cycle is non-residential construction. And that is our main consumer market. So we envision that for next year and the year following that, we should see a substantial rebound in the non-residential construction segment.

Industrial sector is another important industry to us. They remain with positive KPIs, growing. And again, that has to do with the competitiveness of the US for energy, with shale gas. And now shale oil, which really lowers the price of gas, electricity. And productivity. And also, positively impacts the automotive production chain.

So, our expectation is that the US will grow more next year. This year, they expect to grow 1.7% their GDP for next year, preliminary figures by the IMF. And the market points at 2.5% GDP growth.

So overall, we expect a rebound in sales volume and demand in North America.

A - Andre Pires {BIO 17698724 <GO>}

(interpreted) Good afternoon, Ivano. Thank you for the question. As for working capital, indeed, the Company spared no effort during the Second Quarter. That effort was started in the First Quarter. But the results appeared in the Second Quarter in all lines, in all line items, particularly inventory. And there was a reduction of 13 days in the financial cycle.

Our expectation is that there are opportunities to reduce even further during the second half of the year. We're working on it. We have a strong focus on that. We don't want to disclose any figure. I would say that the Second Quarter was above what we were expecting. But we believe that there are opportunities for reduction. There is a lot of homework to be done. And we are working, aiming to reduce the financial cycle even further to below 80 days. That would be the objective.

Q - Ivano Westin {BIO 17552393 <GO>}

(interpreted) Clearly, thank you very much, Pires, Gerdau. And congratulations on your results.

Operator

(interpreted) (Operator Instructions). Our next question comes from Mr. Carlos de Alba of Morgan Stanley. Mr. Carlos, you may proceed.

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

Thank you, very much. I would like to understand what is the strong performance that we saw in the Latin American division, which is the one that has been struggling the most, I would say, in the recent quarters, it's sustainable. It's the only business unit that increased shipments year on year and quarter on quarter. And also, the only one that increased EBITDA margin year on year and quarter on quarter.

So if this is the beginning of a turnaround, it will be very encouraging. And I would like to understand how sustainable this is. Thank you.

A - Andre Gerdau Johannpeter

(interpreted) So, just repeating Carlos' question, his question is about the performance of our unit in Latin America, which improved both in terms of delivery and also sales. And also margin. So he wants to know if this recovery is consistent, or is expected to continue in the future. Carlos, thank you for your question.

So this stems from our efforts in these countries. It's worth mentioning that basically all Latin American countries had better performance, both in delivery and also in EBITDA generation, more specifically. This stems from higher growth -- how should I put it? -- in the economies of these countries.

But the major focus is on Peru, where we improved results. And also, Argentina and Chile, to some extent. And we feel this recovery is consistent. And also stems from our efforts to use costs and improve efficiency in our operation.

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

Excellent. And then, just coming to the iron ore business, can you comment about, when did you expect to make the decision to pursue the second phase of your expansion. And I think a key element of that expansion is the ability of a port, which used -- you had an option on to develop your own. But it will take a few years for you to do so. And right now, there may be opportunity to do a negotiation with MMX and get access to this western [ph] port.

Could you comment about the timing for the decision of your expansion. And also, your views on potentially doing something with MMX? Thank you, very much.

A - Andre Gerdau Johannpeter

(interpreted) Andre speaking. So, Carlos wants to know about ports, our projects in the port terminal in rail. So what is the schedule, the expectation of the expansion project, or process. And if we are interested or if we are considering the port option MMX from company MMX.

Well, in our project, we keep on working on engineering, to define the project as a whole. We also maintain the license front. And so on and so forth. But we don't have any dates provision. But the idea is to have the project ready so we can make decisions as to where we'll be building the terminal or not.

As to MMX, there are no negotiations. We are involved in a process. But as logistics clients, we have been following up to see whether this will be sold or not. So we use the existing port options in Brazil to our exports. And we have already 150 intents [ph] for iron ore exports. And we expect to have 700,000 using the existing alternatives. MMX port is not completed yet, it is not in operation. So that's why we're still following up to see when the investment will be over. And when the operation will develop, because one of the alternatives of existing ports in Brazil that we are assessing, we have also our own terminal project. And then we see how and when to invest.

So this is what we think about port logistics in our mining business.

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

Thank you, very much, Andre.

Operator

(interpreted) (Operator Instructions). Next question from Renato Antunes from Brasil Plural. Please go ahead, sir.

Q - Renato Antunes {BIO 17439917 <GO>}

(interpreted) Good afternoon. Thank you for taking my question. First of all, about long steel products operation in Brazil, could you comment on the demand scenario. And how do we envisage demand when it comes to these long steel products? Based on June figures, I would like to know if there has been any changes, compared to what you have in July. And also, how you see the second half of the year. That's my first question.

The second question, well, what about specialty steels in Brazil? Can you talk about the market in the second half of the year, please? So, what about -- because we had the heavy vehicle production. And it was very strong in the first half of the year. Do you think you can link in the same pace in the second half of the year? Thank you.

A - Andre Gerdau Johannpeter

(interpreted) Thank you, Renato. Andre speaking. About long steel products, what we saw in the first half of the year was a relatively stable market, compared to the same period of the previous year. Some lines with flat growth, others with lesser growth. But nothing so significant.

The outlook for the second half of the year is to have an uptake. So we do expect to see increased consumption by the end of the year.

Early this year, we considered 3% to 4% steel consumption growth. And because, in the first half of the year, we did not have this result, we expect to have a recovery for the second half of the year. But that's for long steel products.

As to specialty products, as you put it well, the first half of the year was very positive, with an important reaction, particularly for trucks. And we expect to keep on growing. But not as strongly in the second half of the year. So that's about what we see in the market. And based on some signs, we had record production, sales records. So we don't expect to have it repeated.

So these are unvetted [ph] data. Maybe there will be growth. But not as strongly as we had in the first half of the year.

Q - Renato Antunes {BIO 17439917 <GO>}

(interpreted) Thank you.

A - Andre Gerdau Johannpeter

(interpreted) Thank you.

Operator

(interpreted) Our next question comes from Thiago Lofiego from Merrill Lynch. Please go ahead, sir.

Q - Thiago Lofiego {BIO 16359318 <GO>}

(interpreted) Good afternoon. I have two questions. If you could talk about prices in the domestic market, please confirm the figure that Andre mentioned. I think 13%, compared to imported goods. Do you see a potential for price increase in the domestic market, or do you think that this price would be sustainable? What level do you think it's sustainable?

A - Andre Pires {BIO 17698724 <GO>}

Hi, Thiago, this is Andre Pires. Thank you for the question. As for the premium price in the domestic market compared to imported goods, as I mentioned before, it is around 13%. We believe that this should be for (inaudible) between 10% and 15%. That is a relatively comfortable level.

It's hard to say regarding what to expect looking forward. We believe it depends on whether the FX depreciation in Brazil can stay, whether the real will rebound. It's too early to say. And it also depends on the international price. It also depends on the international market.

So I would say it's too early to say where this is going. But the premium today is at a comfortable level. And should remain at levels set before, between 10% and 15% in the coming months.

Operator

(interpreted) Next question comes from Mr. Leonardo Correa, HSBC. Mr. Correa, please proceed.

Q - Leonardo Correa {BIO 16441222 <GO>}

(interpreted) Good afternoon, to all. Thank you. My first question has to do with the margin trend. If we look at the Brazil EBITDA margin, the level is quite strong, close to 20%. I would like to understand from you, can we expect a level above that 22%, 23% for 2013, considering that we are going to have high production of our ore [ph]. And we are going to see the (inaudible) rolling mill operating.

And my second question has to do with CapEx in 2013-2014. If I look at the number for the first half, you're talking about BRL2.5 billion for the year. For 2014, can we work with something close to BRL8 billion for the 5-year period? Can we work with that? These are my two questions. Thank you, very much.

A - Andre Pires {BIO 17698724 <GO>}

(interpreted) Hello, Leonardo. This is Andre Pires. Thank you for the question.

As for the margins, you are correct. In 2014, we'll have some transformational projects that will be coming on more definitely. The (inaudible), rolling. And also, the mining part, with higher volumes. And this should contribute with a better margin.

As you know, we don't like to give a guidance. If it's 20%, 22%, 23%, it's hard to say. But we believe that around 20% of EBITDA margin for Brazil, which is what we achieved in the Second Quarter, would be a good number to work with, looking forward, particularly considering (inaudible) mining. That should give us an upside, rather than a downside.

I'll give the floor to Andre to talk about the CapEx.

A - Andre Gerdau Johannpeter

(interpreted) As for CapEx, I have a number of BRL1.2 billion in the first six months of the year. And we should close the year with about BRL2.1 billion, or BRL2.2 billion, something around that.

When you talk about BRL1.6 billion per year looking forward, it's very difficult to define. When we announced BRL8.5 billion for a 5-year period, that is an estimate. That needs to be readjusted every year. So I would say that it's hard to figure we're going to have BRL1.6 billion invested every year looking forward, because there's a level of depreciation, there's a minimum CapEx, which is a 50 [ph] CapEx that has to be invested in infrastructure. And then we have to invest in expansions, or more strategic projects that need to be implemented.

So, it's very difficult to give you a specific figure for every year.

Q - Leonardo Correa {BIO 16441222 <GO>}

(interpreted) It is clear, thank you. But if I might add, in CapEx, perhaps you could give the information about the plates [ph]. Anything expected for that, for heavy plates [ph]? What are you expecting?

A - Andre Gerdau Johannpeter

Well, the project is expected for the second half of 2015. That is the schedule. We are really focused on charting the operation of the coiled hot rolled strips, rolling mill, this coming week. And we continue with the civil construction for the heavy plate project. That is the schedule that we're working with.

The equipment has been purchased. So now it depends on -- to how fast we'll be able to do the civil construction, then the building. And then all the assembly part.

Q - Leonardo Correa {BIO 16441222 <GO>}

(interpreted) Thank you, very much.

A - Andre Gerdau Johannpeter

(interpreted) Thank you.

Operator

(interpreted) This is the last announcement. (Operator Instructions).

Our next question comes from Mr. Carlos de Alba of Morgan Stanley. Mr. Carlos, you may proceed.

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

Thank you, very much for taking the follow up question. I just want to know, I mean, clearly, you are doing a good job managing the working capital. And your CapEx should continue to come down. So, what are you planning on doing with the extra free cash flow that you will generate? If everything goes well (inaudible), the free cash flow here is going to improve significantly going forward.

So, would you return this money to shareholders via dividends, would you plan on just serving -- repaying debt, or perhaps you spot another cycle of M&A activity that in the past, the Company used to expand outside Brazil. Thank you.

A - Andre Gerdau Johannpeter

(interpreted) Thank you, Carlos. So, just repeating your question, your question regards -- well. If we take into account this reduction in working capital. And also, the slightly lower CapEx vis-a-vis last year, we are giving more cash flow. So you want to know the Company's purpose, if it's really to work on distribution in terms of dividend payout, or to lower indebtedness, or perhaps the expectation to improve the M&A activity.

Basically our main goal is. And will continue to be, working with lower leverage levels, compared to what we currently have. Obviously, our focus is to maintain the investment grade. This is key to the Company. And this additional free cash flow generation has the purpose to lower net indebtedness. And consequently, lower our level of net debt over EBITDA ratio.

It's important to say. And I mentioned this in my talk, that we lower this 3.2 to 3.1 this quarter, despite the impact this quarter of foreign exchange variation that would naturally leave this figure close to 4, rather than 3. I also mentioned that we had amortization of short-term debt, closed to $1 billion.

So clearly, the major goal of the Company, when it comes to free cash flow, is the reduction of our net indebtedness level.

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

All right. Thank you, very much, Andre.

Operator

(interpreted) Our next question is from Renato Antunes from Brasil Plural.

Q - Renato Antunes {BIO 17439917 <GO>}

(interpreted) Thank you for the follow up question. Just a brief question about the figures of the Second Quarter. When you consider the cash flow statement, we have about BRL400 million, if I'm not mistaken, in the line of non-controlling shareholders. Now, when we look at the balance sheet, well, I would just like to have a better understanding if you could explain what had an impact on the cash flow of this quarter. Thank you.

A - Andre Pires {BIO 17698724 <GO>}

Renato, Andre Pires speaking. It goes as follows. This has to do with our funds management for pension. So actually, when we migrated benefit -- by the way, this kind of technical. But anyway. When we decided to migrate our (foreign language) pension plan from defined benefits to contribution, because we had a (inaudible) high surplus, part of the funds, our contingency reserves, were earmarked for future contributions, to offset future contributions of the Company. In other words, this is the Company's capital. And this is only used to offset future contributions.

So we can work for our pension funds for over 20 years. And these funds were in this migration process, to some extent, invested together with other funds that were ensuring our employees' retirement plan.

So we broke them down, these funds. And included it with our cash management, because according to IFRS, our cash consolidates, or investments, including investments that come from minority shareholders, well, this is part of the account.

So basically, it was a treasury decision, in order to allocate these resources together with our cash, because it is really the Company cash. The only thing is that it's used for contribution purposes. And not for other purposes that are not those contribution offsetting.

So it is Company's capital. But separate, for cash that is not part of the daily operations of the company. So that's about it. And if you want any further details on that, we can talk later.

Q - Renato Antunes {BIO 17439917 <GO>}

(interpreted) This is clear. Thank you.

Operator

(interpreted) We are closing now the Q&A session. I would like to turn the floor over to Mr. Andre Gerdau Johannpeter and Andre Pires for their final remarks.

A - Andre Pires {BIO 17698724 <GO>}

(interpreted) This is Andre Pires. Just to close, I would like to thank you for all your questions. If you are interested in our Company, to sum up, in this quarter, we're very focused on any continued improvement of our balance sheet. This has been one of our main goals. And we will continue with this objective. And this is my final message to you, my take home message.

I'll give the floor now to Andre Gerdau Johannpeter.

A - Andre Gerdau Johannpeter

(interpreted) Likewise. Thank you for participating, for your questions. And I would like to invite you to our next earnings conference call on October 31st. Please join us then. And just, thank you very much, have a good day.

Operator

(interpreted) Gerdau's conference call is coming to an end. We would like to thank you, all of you, for attending. Have a good afternoon.