Q3 2011 Earnings Call

Company Participants

- Daniel Santos, Mining Operations, Casa de Pedra
- David Salama, IR
- Juarez Avelar Saliba, Executive Officer, Mining Business
- Luis Fernando Martinez, Chief Commercial Officer

Other Participants

- Alex Hacking, Analyst
- Carlos de Alba, Analyst
- John Brandt, Analyst
- Leonardo Correa, Analyst
- Marcos Assumpcao, Analyst
- Renato Antunes, Analyst
- Rene Kleyweg, Analyst
- Rodrigo Barros, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. At this time, we would like to welcome everyone to CSN's Third Quarter 2011 earnings conference call. Today we have with us we have the Company's executive officers. We would like to inform you that this event is being recorded, and all participants will be in listen only mode during the Company's presentation. (Operator instructions.)

We have simultaneous webcast that may be accessed through CSN's investor relations website at www.csn.com.br/ir. The slide presentation may be downloaded from the website. Please feel free to flip through the slides during the conference call. There will be a replay service of this call on the website.

We would like to inform you that due to the number of participants, the Company will answer only up to two questions per participant, with no right to reply. And therefore, we kindly ask that all questions are made at once as soon as the line is opened by the operator.

Before proceeding, let me mention that forward-looking statements are being made under the Safe Harbor of the Securities and Litigation Reform Act of 1996. Forward-looking statements are based on the beliefs and assumptions of CSN Management and on information currently available to the Company. They involve risks, uncertainties and assumptions because they relate to future events and therefore depend on circumstances that may or may not occur in the future. Investors should understand that general economic conditions, industry conditions, and other operating factors could also affect the future results for CSN and could cause results to differ materially from those expressed in such forward-looking statements.

Now I'll turn the conference over to Mr. David Salama, Investor Relations Executive Officer. You may begin your conference, sir.

David Salama {BIO 17456021 <GO>}

Thank you very much. Good morning, and thank you for participating in CSN's Third Quarter 2011 earnings conference call. With me today in this presentation are the Company's officers. They will begin in slide number three, which shows our consolidated results for the Third Quarter.

Net revenue for the first nine months of 2011 reached BRL12.4 billion, a Company record, and 12% above the same period in 2010. In the First Quarter of 2011, net revenues totaled BRL4.2 billion. The gross profit into September amounted to BRL5.1 billion, in line with the first nines months of 2010.

In the Third Quarter gross profit totaled BRL1.7 billion. Year-to-date EBITDA reached BRL5 billion, an improvement of 2% over the same period of 2010. EBITDA in the Third Quarter amounted to BRL1.7 billion, with a margin of 40%. The first nine months of 2011 net profit totaled BRL2.9 billion, a season record and 38% higher than the same period in 2010. In the Third Quarter, the Company posted a net profit of BRL1.1 billion.

Now let's go to slide number four. We show the EBITDA evolution between the Second Quarter and the Third Quarters of the 2011. Third quarter EBITDA of BRL1.7 billion presents a 6% reduction in relation to the BRL1.8 billion registered in the Second Quarter. It's important to highlight the following points. First, iron ore sales volume reached 8 million tons, an increase of 18% in relation to the Second Quarter. This is considering 100% of NAMISA sales. The average iron ore prices of $148 per ton in the Third Quarter were higher than the average of the Second Quarter. And our average steel prices over BRL1,900 per ton in the Third Quarter also had a positive impact in the quarter of 2011.

On the other hand, steel sales volume of 1.2 million tons in the Third Quarter declined by 9% in relation to the Second Quarter and the steel and mining production costs were slightly higher.

Now let's move to slide five, which shows our results by segment. Here you have the net revenue and EBITDA by segment. It's important to highlight also again the growth of our mining operation that is growing each and every quarter. In the Third Quarter, mining accounted for 36% of consolidated net revenue compared to 34% in the Second Quarter. As for EBITDA, mining sales accounted for 59% of Third Quarter EBITDA compared to 54% in the Second Quarter.

Now we are going to move to slide six where you can see some figures of our steel segment. Let's begin with the chart on the top left. In the Third Quarter, steel sales volume totaled 1.2 million tons, a decline of 9% more when compared to the Second Quarter. Overseas total, 86% was sold in the domestic market, 10% by overseas subsidiaries (inaudible) and (inaudible), and 4% was exported.

The top right graph shows a reduction of 8% in the two segment sales and then net revenue in relation to the Second Quarter, which reached BRL2.3 billion, basically due to decrease in sales orders.

The two charts on the bottom show the EBITDA. In the Third Quarter, the two segments, which close to BRL600 million, 19% lower than the Second Quarter, mainly due to the decrease in sales volume and the relative increase of cost of goods sold in the Third Quarter. EBITDA margin in the steel segment was 26% in the Third Quarter, a decrease of 3percentage points when compared to the Second Quarter.

In the next slide we show the same analysis for the mining segment. Let's begin once again with the top left chart. In the Third Quarter iron ore sales of CSN and NAMISA, and considering 100% of the NAMISA, totaled 8 million tons, Company record, and 18% higher than the volume sold in the Second Quarter. Of this total, exports represented 96% or 7.6 million tons.

It's important to note that our steel mill in Volta Redonda, Rio, consumed 1.7 million tons of iron ore in the Third Quarter, but is not include it in this chart, which represents all of the sales shipped (inaudible).

Moving on to on the chart on the top right corner, we see the growth in net revenue pf 4% in the Third Quarter, reaching BRL1.6 billion, another Company record reflecting mainly higher sales volume in the Third Quarter, and a slight increase in average iron ore prices.

Now let's look at EBITDA on the bottom. In the Third Quarter EBITDA totaled BRL1 billion, in line with the Second Quarter. Year-to-date mining segment EBITDA reached BRL2.9 billion, a 74% increase in relation to the same period of 2010. The Third Quarter EBITDA margin achieved 66%, a slight reduction compared to the margin reached in the Second Quarter.

Let's move now to slide number eight, where we have our net debt evolution. In the end of September of 2011, net debt totaled BRL12.1 billion, BRL600 million more than the end of June. This was essentially due to the following factors. A CapEx of approximately BRL1.4 million in the Third Quarter. BRL700 million related to the cost of our debt. And an increase of BRL200 million in working capital located through our business. On the other hand, CSN generated an EBITDA of BRL1.7 billion in the Third Quarter, and then we achieved just BRL12.2 billion by the end of September.

Moving on to slide nine, here we focused on the relation between net debt and EBITDA. It's important to highlight that net debt EBITDA ratio reached 1.9 in the Third Quarter of 2011 based on the EBITDA of the last 12 months of BRL6.4 billion, a slight increase in relation to the Second Quarter. The Company has a very flexible debt profile with a cash position of above BRL15.6 billion at the end of the Third Quarter of 2011.

Move on to slide nine. On the previous slide, we look at the net debt. Here it's important to highlight that the net debt to EBITDA ratio came to 1.7 in Second Quarter 2011 based on last 12 month EBITDA of BRL6.6 billion, slightly higher than First Quarter figure. The Company has on a very flexible debt profile with a cash position of about BRL15.6 billion at the end of the Third Quarter of 2011.

That brings me to the end of our presentation. Now we are going to move to the Q&A session. Thank you very much.

Questions And Answers

Operator

(Operator Instructions) Leonardo Correa, Barclays Capital.

Q - Leonardo Correa {BIO 16441222 <GO>}

My first question is for you Martinez. You were talking about during the previous call indirect steel imports and also the trend of declining direct steel imports. Just thinking about the competitiveness of the steel industry in Brazil, I mean do you have any additional moves or is anything additional coming from the government likely going forward?

Also would like to hear your updates on the tax incentives granted by some states in Brazil. So any updates on the competitiveness of the Brazilian issue would be appreciated.

My second question is for Daniel and for Juarez. You also mentioned in the previous call about the breakdown of demands. (inaudible) is roughly one-third to Europe. Just wanted to understand if you've been seeing any type of slowdown in demand for iron ore? Yesterday in (inaudible) call the Company mentioned that some clients have cancelled some orders. So just to get your sense on how demand from Europe is behaving and if you have any type of additional plan of potentially migrating some tonnage to China if you see a more aggressive slowdown from Europe. So those are my two questions. Thank you very much.

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

This is Luis Martinez again. Leonardo, talking about the imports, one of the things that I've already mentioned during this morning, the most important thing to try and to divert is the indirect imports in Brazil. So according to our numbers, we are going to have this year something like 5 million tons of indirect still through finished products. It means almost exactly the production of CSN in Brazil. So this is very important and I believe that by the end of this year, early 2012, you are going to have these numbers much more reduced.

In terms of direct imported in Brazil, we are experiencing something like 42, 46 reduction. And probably by the end of this year, early 2012, we are going to have something like 8% to 10% maximum imports. So this could help us to jump the Brazilian market because if you take into account that you have something like 150,000 metric tons a month, considering let's say for each steel mill in Brazil, 30% of this volume, at least we are going to have an increase of 40,000 metric tons a month for each steel mill. It's a very positive point.

According to our -- we don't have all the details about the government. There is some information that we could not accept. But talking very specifically about trade remedies, for sure (inaudible) government much more of an open trying to divert this type of situation in terms of imports. They are hiring something like 300 people more -- 300 people just to take care of all the processing in Brazil.

And according to the plan that already announced one month ago, (inaudible), we have lots of good actions to be done. One of the things that we are working very, very hard is related to galvanized or to coated products. In my opinion, we have a very good case and probably early next year we are going to have good news.

So but now I think the most important thing, we need much more than -- we need arms, not only brains, and 300 people working this process could help us a lot at this moment.

A - Juarez Avelar Saliba

Leonardo, this is Juarez. Regarding the iron ore mining question, I'd like to tell you the following. First, I know to make clear, roughly we have one-third of our sales to Europe and Middle East, one-third to Japan, and one-third to China. And as you know, the sales we are doing currently to Japan and Korea, is basically to our partners in NAMISA and they're supported to keep buying the iron ore, even in this scenario of a little bit of slowing in the demand from Asia. But they are taking the ore based on the contracts we have with them. This is very important for us. This gives us some kind of very (inaudible) to Japan and Korea.

So regarding Europe and the Middle East, well fortunately and because we are not so big as our main competitor in Europe, our sales remain very, very positive and we do not have any problem with the shipments being sent to Europe. But anyway, we know that some competitors there have some problems there, and we are preparing ourselves to face if these problems become a reality for us as well.

But anyway, the main problem is China. China, as you know, China they are not respecting the quarterly basis context and they are trying to move to a spot basis price. And we are very strong on this thing. And we are -- I would say for this quarter a guaranteed and we are basically -- what we are doing from now on.

We really believe the quarterly basis price they are -- this process is finishing. The Chinese, they are burying this system. So we are preparing ourselves for let's say spot price basis for the near future. And because of these we are preparing ourselves to deliver iron ore in China in (C&F) basis. So we -- last quarter we -- the Third Quarter we sold the reds some shipments based on our C&F and we provided the transportation. And this quarter we are doing the same thing and we exchange for next year to follow the market or if they want the C&F based price, we can do this. So we are just adjusting ourselves to be prepared for this thing for next year.

What I can guarantee to you, this is not something that is new for us, okay? We studied this thing of shipping connected to our -- I don't know, our business, for a long time. I can guarantee to you that we know exactly what we have to do. And next year, 2012, we will be implementing the solutions we find out as the solution for this whole thing.

So we know that we need to get prepared for to take cargos based on a spot price of transportation. We need to have some (inaudible), we need to have some COAs, and also we are considering in the middle-term to build a fleet of vessels to have this thing fully controlled by CSN, you see?

So we know that the long-term view for transportation of iron ore mainly to China will be based on a C&F basis. And we are preparing ourselves to play a good role on this thing, okay?

Operator

Carlos de Alba, Morgan Stanley.

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

Just wanted to ask if you can mention any more details on the trend of the (inaudible) investment. We have seen a big amount of CapEx going to into that project and we don't have a lot of visibility. If you can talk a little bit around the details of when you expect this project to be finished, maybe the different stages. And particularly where are the returns that you see in terms of the (inaudible)?

And the second question is if you could describe a little bit more in detail also what is your port strategy? How do you expect this capacity to ramp up and which (terminal)? Thank you.

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

I'm going to answer the first question and then here my colleagues have a chance with the second one.

Let's start with trends on the (inaudible). On (inaudible) it's a very interesting project. You know that is located in the (inaudible) of Brazil. It's a project of (inaudible) of which CSN is going to invest BRL1.3 billion, divided of 680 million tons in terms of equity and 670 million in terms of debt.

So of this total, we have spent (inaudible) something close to BRL700 million, if you add that and equity. And our situation that you are going to have read in the first phase, yes, because you interconnect very much in the (inaudible) by the end of 2012. And the second phase that is (inaudible) the connection between (inaudible) and Fortaleza by the end of 2013.

A - Daniel Santos {BIO 5990682 <GO>}

Regarding to the core capacity, currently we have 30 million tons of capacity in the TECAR. And we are in the middle of implementation of the additional capacity of 10 million tons, which will give us the final capacity of -- or sorry, 15 million tons, which will give us the final capacity in the last quarter of 2012 of 45 million tons per annum.

And we have the next step to that phase is to add more 15 million tons to achieve 60 million tons per panel up to the end of 2013.

A - Juarez Avelar Saliba

And just to complete the answer for Daniel, I'd like to emphasize that we are working on additional capacity for TECAR in order to reach 100 million tons by 2015 and 2016. So that's our main product.

We are also considering the construction of two new berths in the TECAR feeders in order to enable the Company to reach a capacity up to 150 million tons of iron ore. But this is a little bit further.

Operator

John Brandt, HSBC.

Q - John Brandt {BIO 18264726 <GO>}

Just a quick question on the strategy for the cash stock buy. I notice it keeps increasing and so does the debt. I'm just wondering what the strategy is behind keeping such a high cash stockpile is my first question.

And the second question is if you could provide a little guidance for CapEx for 2012 and if possible break that up between the mining in steel and logistics and others. Thank you.

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

You know that we have been increasing our cash position in the last quarters. And it's important to highlight that CSN has important investment in the next coming quarters. Know that we are investing in iron ore. There is as just mentioned old extensions that we have in the pipeline. We have extensions in cement, we have in (long seal), as well as (inaudible). As well as we're seeing all these things together that (inaudible) an important part of the (sketch).

And we have all the time and we are analyzing good perspective in terms of M&A. That is something important because we have seen an association in some asset value and (inaudible) there I mean you are going to find good opportunities.

What I want to reassure that we are going to use this cash in I think the best possible way in terms that would we want to implement the value for our (inaudible).

If you add all these projects, which I have mentioned, our expectation that we are going to have something between 3.5 and 4 billion per year in the next coming years. That depends on the last (inaudible) we are going to implement all these projects. All of them, they are good projects. And in some ways we can regulate the speed of (inaudible).

Operator

Renato Antunes, Flow Research.

Q - Renato Antunes {BIO 17439917 <GO>}

The first question is related to iron ore and more specific to (slide) costs. You already mentioned that you are already selling some tonnage on a CFR basis. And I guess you wanted to get (inaudible) on how your exposure to spot price for each. I mean how should we expect freight costs to go over the following quarters? I mean you had seen flat rates increasing over the next -- the last weeks, so I just wanted to get a bit more color on that.

And the second question is related also to iron ore. On the earlier call you mentioned a target of 33 million tons of iron ore shipments for 2012. If you could just provide us a breakdown between Casa de Pedra and NAMISA, that would be great. Thanks.

A - Juarez Avelar Saliba

As to the first question, actually so far we are not facing yet the -- any problem in terms of our shipments. We are somehow preparing ourselves to sell in a share debt basis because we -- our understanding is that the market is changing and the Chinese, they are pushing us, not us only CSN, but the whole, I don't know, producers. So to deliver in China based on a (inaudible). So that's why. So we cannot wait this thing come to us in order to react. We are working on very practical things.

So last quarter, in the Third Quarter, I'm not sure, but I think we sold three shipments based on share debt, we provided the transportation. This quarter probably we are selling 10 shipments on share debt basis. And to be frank with you, most of these 10 shipments be selling to our current customers. Actually, we are replacing the vessels because we were better positioned then. But anyway, we are considering for the First Quarter 2012 something in the range of 10 versus -- 10 shipments again. And for the other quarters of 2012 we are still discussing here and discussing with our customers because we want to know if they want to move definitively to another basis.

So we cannot guarantee how many shipments we will sell in the last three quarters of 2012 on a share debt basis. But basically for sure, we will be prepared to give the right answer to the market in order to keep our sales in our limit. We don't want to waste any space in our port. That's our main target.

Regarding for the production for the next year, as we said in the last call, we are aiming 33 million tons per year and we have some flexibility in our contracts. And this is the defining factor to decide this split between NAMISA and Casa de Pedra. As we are in the middle of the budgeting cycle, what we can do is provide you by the investor relations the detailed information. Just send the question (inaudible).

Operator

Alex Hacking, Citibank.

Q - Alex Hacking {BIO 6599419 <GO>}

I just have one question. Can you remind us that trends (inaudible)? Do you -- does CSN have any iron ore concessions or other mining assets that would become accessible when that project is complete? Thanks.

A - Juarez Avelar Saliba

Well the (inaudible) be railed by the funds of the unit. They are in our visibility (inaudible), they were basically agricultural products and some gypsum. These were the basis for the (inaudible). Of course there are several third parties potential producers of iron ore in that area that we -- those I can't guarantee that (inaudible) talked with most of them. Some MOU have already been signed by between (inaudible) barge. Our iron ore division is also taking a look on the (inaudible) to understand the potential for tons of this shipment and also for us. But we still don't have any asset in the region. But we are strongly considering to talk with those that have truly potential to be developed.

Operator

Marcos Assumpcao, Itau BBA.

Q - Marcos Assumpcao {BIO 7474402 <GO>}

First question is to Martinez. Martinez, if you could share your views on international steel prices going forward, what you're seeing right now in the international markets. We have seen some weakness, if you could confirm that for us.

And the second question is actually a clarification regarding the CapEx of (inaudible). David, you mentioned some figures for the total CapEx of CSN on the project, but I was taking a look on recent reports, in 2010 actually CSN invested BRL1.4 billion on (inaudible). At least is what is written on the press release. And year-to-date already and an additional BRL1.2 billion. So I would like to understand if you are consolidating the CapEx and actually what the stake of CSN would be lower? Just to understand what we could expect going forward on CapEx for (inaudible). Thank you.

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

Marcos, regarding to international price, in my opinion I don't have any room to decrease -- to have some decrease in these current prices. So in our scenario, we are considering hot rolled coil in a range of 620 to 640. And we don't believe that we are going to have prices lower than this due to a cost situation.

I believe that if something happens below these numbers, probably we are going to have many shutdowns in the world. As (inaudible) announcing some shutdowns in Europe. So that's one of the reasons I think we are operating in the minimum price in my opinion.

A - David Salama {BIO 17456021 <GO>}

Marcos, related to the second question, sometimes it's important really to clarify a little bit in terms of this thing. Because again, it's a project of BRL5.4 billion, of which our stake is going to be something close to BRL1.3 billion divided. In terms of (inaudible), BRL680 million, and in terms of debt, BRL670 million.

The rest actually is coming from (inaudible) and the other governmental funds we are going to finance all the projects. But when we show in our press release, we are giving 100% of the project in a consolidated base and that gives you and an idea of other projects. But I want to highlight that by the end, our investment is going to be close to BRL1.3 billion.

Operator

Rodrigo Barros, Deutsche Bank.

Q - Rodrigo Barros {BIO 5851294 <GO>}

Just a follow-up question on the ports that you may develop on the area where previously you planned a steel plant. Because I think that's a very interesting option for both you and Gerdau. And in the previous call I just wanted to make sure that you said that you could develop this area together with Gerdau and Petrobras. And just can give us some clarification on what the status of the licensing, who is taking care of it, and how much additional annual capacities could bring to you. Thanks very much.

A - Juarez Avelar Saliba

Well this potential new port, we are working together with other players like Gerdau and Petrobras, but we don't have the intention to build it together. Each one will build its own facility. But we didn't start yet the process of (inaudible) -- I'm talking about the environmental even governmental approvals because we are now working on scope instead in order to understand how the area can accommodate the two together, you see? So we wait that very soon this phase will be terminated and then we can start the process of our licensing, okay? So but basically we are now just studying together and in order to decide how to share the area.

Operator

(Operating instructions) Rene Kleyweg, UBS.

Q - Rene Kleyweg {BIO 16569285 <GO>}

Just in relation to the CapEx, we're hearing a lot about potential further expansions of projects, et cetera, but we're seeing another quarter where the spend on mine expansion and port expansion combined are only BRL200 million. Can you give us an idea of when we can expect CapEx expansion in your major growth projects to start accelerating?

And also, in terms of NAMISA can you give us an update on when we can expect some visibility in terms of your future and CapEx costs and plans in terms of the NAMISA joint venture and how it affects Casa de Pedra as well?

A - Juarez Avelar Saliba

Now at the moment we are in the middle of the implementation of the additional (20) million tons at the port. For this phase of the expansion project for the port, we have a CapEx of BRL375 million and we spent BRL184 million. So that's the priority at the moment is to bring this new CapEx to the port, which you bring us -- increase the capacity 45 million tons. That's to the end of next year.

In the mine business, we are speeding up the duplication of the capacity of production in Casa de Pedra at the moment. We have this, say the 14 million tons as you recall, and in the end of the next year we will start up this operation as well.

So with that, we in fact we are preparing mine at the moment and preparing the contractors to have this job speeded up in the site in the next year, in the beginning of next year to deliver this extra capacity for Casa de Pedra in the end of the year.

For NAMISA we are focused in the license for the plant to produce 20 million tons per year of (inaudible) feed. And in the case of the (inaudible) number one, we are in the middle of the second (co-commercial) negotiation and probably have the end of this process in the end of this year to start the construction next year.

Operator

I would now like to turn the call back over to Mr. David Salama for any closing remarks.

A - David Salama {BIO 17456021 <GO>}

I would like to thank everyone for participation in this conference call. Our investor relation teams are available to answer any question you may have. Have a nice day.

Operator

Thank you. This concludes today's CSN Third Quarter 2011 earnings conference call. You may now fdisconnect your lines at this time.