Q2 2005 Earnings Call

Company Participants

- Benjamin Steinbruch, Chairman and CEO
- Jorgemar Almeida, Controlling Director**
- Luis Martinez, Commercial Director
- Otavio Lazcano, Financial Director

Other Participants

- Daniel Altman, Analyst
- Denis Parisien, Analyst
- Eric Mckee, Analyst
- Eric Ollom, Analyst
- Ivan Fadel, Analyst
- Jaime Nicholson, Analyst
- Marcelo Aguiar, Analyst
- Mark Cartlich, Analyst
- Rodrigo Barros, Analyst
- Unidentified Speaker

Presentation

Operator

Good morning, ladies and gentlemen. At this time we would like to welcome everyone to CSNs Second Quarter, 2005 Earnings Conference Call. Today we have with us Eneas Garcia Diniz, Production Executive Officer; Jorgemar Almeida, Controlling Director, Luis Martinez, Commercial Director, Otavio Lazcano, Financial Director, Duarez Albea [ph] Mining Director, Marcos Leite Ferreira, Head of Investor Relations.

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. After the company's remarks are over there will be a question-and-answer section, at that time further instructions will be given.

(Operator Instructions)

We have simultaneous webcasts that may be accessed through the Investor Relations section of CSN's web site at www.csn.com.br The slide presentation may be downloaded from this web site. Please feel free to flip through the slides during the conference call. There will be a replay service for this call on the web site.

Before proceeding let me mention that forward-looking statements are being made under the safe harbor of the Securities 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 of 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. Otavio who will present CSN's operating and financial highlights of the quarter. Mr. Otavio, you may begin your conference.

Otavio Lazcano {BIO 4999009 <GO>}

Good morning, everyone and thank you for joining us for the conference call. We will begin our presentation with some of the highlights for the Second Quarter and first half of 2005. As to the financial results, the highlights of the first half of 2005 were the increase in both EBITDA and net income. EBITDA increased by 30% to R$ 2.6 billion with consolidated and parent company margins of 48% and 52% respectively. High EBITDA margins are explained by sales allocation towards the domestic market, the sky-high price charged on domestic customers and the positive impact of lower coke prices in the Second Quarter of '05.

Net income went up by 50% in the first half of 2005 as a consequence of greater operating profit and the improvement in financial expenses. As to the net indebtedness, it remained within the range that the management gave to the financial community maybe one year and a half ago, I mean, from 0.5 times to 1.5 times consolidated EBITDA for the company.

Other highlights include the issuance of debt instruments in the international capital markets to further extend the life of our existing indebtedness. Including a $250 million, 10-years, 6% coupon, securitization of export receivables and just recently a $750 million, 9.5% coupon perpetual bond.

Just recently, we also had approval by BNDES of R$300 million credit line to support the expansion or the investment in the coal seaport Terminal to also handle iron ore exports. And we are now starting a new program, I mean our new share buy back program for additional up to 15 million shares.

Next slide we present the breakdown of our consolidated sales volume and revenues by market. In the Second Quarter sales volumes decreased by 60,000 tons in relation to the previous quarter. Such reduction is explained by the reduced domestic demand which was not fully offset by exports. It's important to highlight that sales for the first half of 2005 was higher than sales volume recorded for the first half of 2003 and 2004 by 11 and 2.5%, 2 and 5% respectively. Even after the record sales reported for the Second Quarter of 2004.

As to the sales allocation of the company, domestic sales accounted for 71% of the total sales in the first half of 2005 compared to 64% and 67% in '04 and '03 respectively. In the Second Quarter net revenues fell by 11% in relation to the previous quarter. But remained stable in relation to the Second Quarter of 2004. The drop in net revenues during the Second Quarter was mainly due to lower domestic volume. As to international price, it's important to highlight that in the Second Quarter CSN export price fell 10% in dollar terms, while reference price for international markets fell 17% in the same period. Price that we charge our local customers fell only 4% in R$ terms. A smaller reduction compared to the increasing international price.

Next Slide. It's possible to understand that our portfolio of high value added products which would account for 52% of the total sales and the well-balanced and widespread distribution of sales among values reduced for segments and a wide number of customers explained why the company can sustain high profitability and day-to-day margins over the cycles.

On Slide # Five, you can see production cost breakdown for the parent company. We would like to highlight the coal and scrap price increase and the reduction in coke costs. Coke costs went from $445 per ton in the Fourth Quarter of '04 to $380 per ton this quarter, while coal costs grew from $100 per ton to $112 per ton during the same period. The company expects coke costs to further drop along the year reflecting both the low international price and the reduction in coke inventories which are reported in our financials at a cost above current market price.

In the end of June, inventories of coal and coke were equivalent to two to three months of consumption which is considered a normal level by the company. CSN also expects to report a flat total cost of $200 per ton by the Fourth Quarter compared to $250 per ton of scrap during the first half of '05.

Slide # 6, we analyze CSN gross debt and net indebtedness over the last five quarters. In the Second Quarter of '05 net indebtedness grew by R$2 billion in relation to the previous quarter. Basically as a consequence of the payment of dividends on international equity in June. Those net investments return to the one-time EBITDA level -- and again, in line with the 2004 year-end ratio and in accordance with the guidance that management gave to the financial community, maybe 18 months or two years ago. It's worth to highlight the impact of the recent transaction executed by the company in the average life of the existing indebtedness. I mean it went up from nine years to 12 years and no negative impact at all on the cost of funds, I mean, remaining stable at 80% per annum.

Slide # 7, we reconciled the net income from the Second Quarter of 2004 to the net income for the same period in 2005. It's worth mentioning that figures are above considered a proportional consolidation of MRS and Itasa. Improving the financial results by R$229 million due to lower average net indebtedness and the reduced average cost of debt. We have an increase of income tax and social contributions provision, mainly due to the equity losses that cannot be deducted from taxable income. We had greater operational expenses, particularly those related to the wage agreement recently made. Which was partially offset by lower selling expenses as a consequence of the lower sales volume.

In the following slide we reconciled the net income in the first half of 2004 to the same period of 2005. And again figures above considered a proportional consolidation of MRS and Itasa. Improved average domestic price accounted for an increase in income by R$ 564 million being partially offset by lower sales volume; and by reduced leverage export price; and by greater production costs.

Financial results improved by R$ 300 million and again mainly due to the lower average net indebtedness of the company and the reduced the average cost of debt which was 9.4% per annum in R$ terms, in the first half of 2005 or equivalent to 51% of CDI. CDI is the Interbank referenced interest rate in our country. The increase in income tax and social contributions provision by R$ 410 million again, mainly due to the equity losses that cannot be deducted from taxable income. And the greater operational expenses again, as explained in the previous slide, mainly due to the wage agreement and the allowance for shift work.

Next Slide we present the comparative analysis of the results reported for the first half of 2004 and the first half of 2005. Net revenues from sales went up by 22% to R$ 5.4 billion. Gross income went up by 28% to R$ 2.6 billion. Gross margin went up by two%age points to 48%. EBITDA went up by 30% to R$ 2.6 billion. The EBITDA margin also increased by three%age points to 49% margin. Operational income went up by 86% to R$ 128 billion. Net income went up by 50% to R$ 1.1 billion and the net margin went up by 4percentage points to 41%.

Next slide, we would like to make some comments on domestic and international steel markets, performance in this quarter. Global flat steel consumption growth slowed down to approximately 2% in the first two quarters of '05 compared to a 7% average growth rate in the same period of 2004 and 6% in the last quarter of 2004. This had a great impact in the U.S. market where apparent consumption was reduced by 3% in the first half of 2005 in relation to the same period in 2004. In Europe, consumption growth decreased to only -- from 6% in the second half of 2004 to 4% in the first half of 2005. The poor performance of these markets is a consequence of the high inventory levels, particularly in the U.S. markets, which were built over the end of 2004.

In Asia we have a completely different scenario. Apparent consumption grew at the fastest pace in this half. Inventories remain at regular levels reflecting a price stability which has been only slightly adjusted at the end of June. In Brazil the performance in the first half of 2005 was similar to that of the European market. Apparent consumption grew approximately 4% compared to 5 and 20% growth rates in the first and second halves of 2004, respectively. Distribution network inventories entered a downward trend in May and by June they were one-month sales above 2004 average.

Next slide we present our main perspectives for the remainder of the year. Due to the worsening of the domestic and international markets the company has updated its guidance regarding sales volume and market mix announced early in this year. In this new scenario, sales outlook was changed from the 5.3 million tons of finished products to 5 million tons of finished products being sold in 2005. The domestic markets should account for 70% of total sales instead of the previously expected 75%. Despite this, total sales volume will grow by 300,000 tons when compared to 2004 figures representing a 5% increase. Production will be adjusted for the new sales forecast in order to maintain regular inventory levels by year-end.

As to price, we don't think that as to domestic -- the price we charge our domestic customers, we are forecasting stable prices during the Third Quarter and better price or better demand conditions during the Fourth Quarter. As to international prices, the company already started to benefit from a 5 to 10% price increase in international markets during the Third Quarter. And it's also important to highlight that average price in 2005 will be definitely higher than average price charged in 2004 so that the company will continue to report sky-high EBITDA margins over the next few quarters.

So now we have concluded our presentation for the Second Quarter of '05 results and we are available to your -- to answer any of your questions during the Q&A section. Thank you.

Questions And Answers

Operator

Thank you. The floor is now open for questions.

(Operator Instructions)

Thank you. Our first question is coming from Marcelo Aguiar, with Merrill Lynch. Please go ahead.

Q - Marcelo Aguiar {BIO 3721791 <GO>}

Hello. Good morning, gentlemen. Just one question regarding the Cade ruling -- on CVRD, the parentive rights of Casa de Pedra. Let's assume that CVRD pick the option that they're likely to move the parentive rights of Casa de Pedra. And it's very likely that CVRD will also appeal injustice regarding the -- to give up on this parentive rights. So, my question to you is assuming this scenario, does appealing justice; it could take a while. My question is if CSN has a contract in hand to sell to any customer around the world during this justice appealing, CSN would need to present this contract to CVRD or not? Or a Cade decision is -- with the employees and while the process is with justice you don't need to present any contract to CVRD anymore?

A - Jorgemar Almeida

Well Marcelo this is Jorgemar. And I would like to tell you that we are still understanding the decision of Cade and we have some lawyers involved in this action and we need some more days in order to understand better. If after the decision of CVRD about what kind of restriction they prefer, if to give up their pre-emptive rights of Casa de Pedra ore or to sell for debt, only after that we can -- we can... And based on our better understanding of the Cade's decision we can make our strategy in terms of what to do if CVRD makes any kind of legal action or so on.

So we -- in other words, we don't have the -- any strategy defined now because we knew about the decision of Cade very recently and we need time to understand better what kind of next step we can develop in the future.

Q - Marcelo Aguiar {BIO 3721791 <GO>}

Okay. And just another one on iron ore. You guys did produce 6 million, consume 9, resell like 6, 7, in the market, domestic market right? The Port will be ready in the beginning of 2006; You already have 5 million tons in long-term contract that will be sold to CVRD if they exercise. So with the Port ready next year I assume that you're going to start -- that you're going to revert the sale of the 6 million, the 6, 7 million in domestic market, export market. Therefore your total sales next year will -- I mean will be 12 million tons and now in the export market, is that correct?

Q - Unidentified Speaker

Not exactly. First of all our -- the start up of our export through Sepetiba Port will be in the July of next year, not beginning of 2006. But July 2006. So the -- our -- our capacity for the whole 2006 in terms of production will be around 18 to a little more than 19 million tons, in 2006. And if you see we are sending about 8 to 9 million tons to Walter Edunda. We have contracts signed with Quezita and Asominues and some other small producers, Imuno Gerrai. And the total domestic market is about 9, plus 2, plus 1, about 13 million tons, okay, for 2006? The demand for more...

Q - Marcelo Aguiar {BIO 3721791 <GO>}

For how much?

Q - Unidentified Speaker

Sorry?

Q - Marcelo Aguiar {BIO 3721791 <GO>}

How much, how...?

Q - Unidentified Speaker

13, 13 including -- one, three, including our...

...our consumption, okay? So the rest, the 5, 6 million tons, we have already a contract with CVRD signed last March that we have to supply to CVRD about 3.5 million tons in 2006.

So the -- our availability of ore for 2006 for export is about 3 to -- 3 million tons. Of course we can purchase some more ore in order to export when our port is ready. But we didn't finalize this decision. But in terms -- we have no more than 3 million tons to offer additional sales to 2006 to be sold. Okay, is it clear?

Q - Marcelo Aguiar {BIO 3721791 <GO>}

Yes. Yes, there's a lot of -- that is clear. Okay. And for 2007 what you would say is the best real scenario?

Q - Unidentified Speaker

Yes. For 2007 our -- the final condition of the port will be completed. So our capacity of exports will be around almost 30. But not exactly 30 because the port will be ready March, April, next -- 2007. So the capacity in 2007 for exports will be around 7 million tons. Okay. So in terms of production our capacity 2007 will be around 30 million tons, okay?

So we have space, we have room to additional purchase for in 2007 in order to match with the capacity of the port. So the point is, 2006 we are very close to be sold out for -- in terms of sales, of iron ore, 2006. And we need to sell no more than 3 million tons in order to match with the capacity of the mine and the capacity of the port. And we -- our strategy our commercial strategy we are developing now in order to -- from the year 2007 onwards. In terms of 2006 we are almost sold out.

Q - Marcelo Aguiar {BIO 3721791 <GO>}

Okay. Last one please. I don't know if the Benjamin is around. But it's a recurrent question with current investors. How he arrived at the $3 billion value added or (inaudible) I think consistent with the market range between 1 to 2, I would say $1.5 billion for this mine?

A - Benjamin Steinbruch {BIO 1499059 <GO>}

Marcelo, it's Benjamin, how are you?

Q - Marcelo Aguiar {BIO 3721791 <GO>}

I'm good, thank you Benjamin.

A - Benjamin Steinbruch {BIO 1499059 <GO>}

Marcelo if you compare Kayami [ph], that is in the market with CSN, you will have the answer.

Q - Marcelo Aguiar {BIO 3721791 <GO>}

Okay.

A - Benjamin Steinbruch {BIO 1499059 <GO>}

Okay. So, we are talking about something concrete. You have a company that is open, that is Kayami, that is smaller than Casa de Pedra. So, we are talking about the real value of Kayami, comparing with the potential of Casa de Pedra. So, it's something that is not a concept. It's something practical that you can do.

Q - Marcelo Aguiar {BIO 3721791 <GO>}

Yes, I was supposing that you was proceeding like Casa de Pedra's production, not 40. But 50 million tons, something like that also.

A - Benjamin Steinbruch {BIO 1499059 <GO>}

Yes, in principle, we will reach more than 40 million tons. As you know, depends of the mix that you want to explore in the mine, you can reach more than 40 million tons. But I think that if you want to be conservative and use 40 million tons like a reference, you will have the real value of Casa de Pedra comparing with Kayami.

Q - Marcelo Aguiar {BIO 3721791 <GO>}

Thank you, very much.

Operator

Thank you. Our next question is coming from Daniel Altman with Bear Stearns. Please go ahead.

Q - Daniel Altman {BIO 1855515 <GO>}

Hi. Good morning. A couple questions. In terms of the iron ore business, I know on the last conference call it was mentioned that the right of first refusal was making it a little bit more difficult to sign more contracts for iron ore. I wonder if you have in mind some specific customers that you've spoken with that have told you that if the right of first refusal is removed, that they would be willing to sign a contract with you. I wonder if there's any; if that type of situation has occurred.

My second question is, looking at your HRC price in the Second Quarter, it's approximately $700 per ton, it looks like. And that's versus, say, 500 in Europe. I'm wondering if your customers are coming back to you and saying this is too high, on a global basis, versus what they're paying elsewhere.

Q - Unidentified Speaker

Hi, Daniel. This Ralus [ph]. Again, for the first question, okay? Well, our cue now, our strategy was to finalize our fees before 2006. And, as I told you before, we are very close to finalize this question. So, from now on, we are finalize every strategy for the series from 2007 onward. But of course, this strategy is very linked with the Cade decision yesterday. Then we prefer to wait a little bit more in order to understand better what will be the next step of CVRD in order to speed up the; our strategy for 2007 onwards.

The point is we have several potential customers talking to us. We are now of this conversation, really, we are under a confidential agreement and, of course, I cannot disclose the names of this customer. But we have discussed with; we have many of them.

And they are very open to negotiate with us long-term contracts for the Casa de Pedra production. In fact, if we decide to sign long-term contracts now, we have demand for more than our; than the 40 million tons capacity we have in Casa de Pedra. More than that.

Of course, the decision about what kind of long-terms contracts we will sign will be very dependent of the optimization that results from CSN. We pretend; we intend to make; to prioritize the European market because, as you know, the pricing of European for Brazilian ore is better than the Asian market. But we have to have; we want to have some sales to Asia, of course, because we have; we want to have a balance between Asia and Europe and other to guarantee a bit more our project. But we are now discussing this strategy and it's very dependent of the CVRD and Cade decision in the next future.

A - Luis Martinez {BIO 7187744 <GO>}

Daniel. Good morning. This is Luis Martinez speaking. Regarding to your question, regarding to pricing, just to give you some numbers. In the local market, we are selling hot band in a price range of $620-690 per metric ton, depending on the specification, depending on the quality of the product. In terms of metal for exports, hot band, we are now selling in the range of $450-500 per metric ton. And we are perceiving that in this; in the Third Quarter that we are going to have price; another price; a better price for this quarter, maybe in U.S. and also in some business in Europe. So, we are keeping at least our price for second; for Third Quarter and we are foreseeing that we have a chance to recover some price in the last quarter of this year.

Q - Daniel Altman {BIO 1855515 <GO>}

Okay. I mean, I was, for the HRC price, I was using the number in your press release, which is the net revenue per unit. And it says, for HRC, it says R$1,709 in the Second Quarter, which, using the exchange rate today, is closer to 700. Is that maybe an average using a higher price at the beginning of the quarter?

A - Luis Martinez {BIO 7187744 <GO>}

So, you mean the 700 in the hot band price for local market, right?

Q - Daniel Altman {BIO 1855515 <GO>}

Yes.

A - Luis Martinez {BIO 7187744 <GO>}

Yes. I'm talking about; because we have prices in the range of $620-690 per metric ton. So, this is; and we are; we are working right now, in terms of hot band, in a price range closer than 700, than 620. That's the price.

Q - Daniel Altman {BIO 1855515 <GO>}

So again, my question is, if your domestic customers are paying $700 per hot roll, are they not coming back to you and saying why is it that I'm paying $200 more for hot band in Brazil than I'm paying in Europe or the U.S.? Has that discussion not come up or ...

A - Luis Martinez {BIO 7187744 <GO>}

Yes, Daniel, we are working with a premium of 30-35% over the external markets. So, we are forecasting that we are going to keep this price through the end of this year.

Q - Daniel Altman {BIO 1855515 <GO>}

Okay. Thanks very much.

Operator

Thank you. Our next question is coming from Mark Cartlich with ING. Please go ahead.

Q - Mark Cartlich {BIO 16540822 <GO>}

Hi. Could I just clarify one question about the iron ore contracts. Should we assume there's 11 million tons to be contracted for 2007 from what you're saying? That was the number that I've still got in my head. Is that correct?

Q - Unidentified Speaker

Well, as I told you, in 2006, almost 13 million tons will be for the domestic market. So, we have an additional of 5 to 6 million tons for export. Part of these is already sold to CVRD in international price. Okay? The contract we signed with CVRD. The long-term contract, we signed with CVRD in March is international price. So, we have around 13 million tons to the domestic market and then addition of 5 to 6 million tons for export in 2006. Based on, of course, the exports will be based on our international price.

Q - Mark Cartlich {BIO 16540822 <GO>}

Okay. And I'm going to ask another question on a strategy. I wouldn't expect you to comment on the press reports or market rumors or otherwise. But I wonder if we should, perhaps, conclude that, perhaps, this is some kind of change in strategy with regards to the possibility of finding a partner in the international market rather than focusing on the strategy of buying a rolling mill; another rolling mill in Europe or in the U.S. or even an integrated producer that may not have its blast furnace renewed or refurbished over time. So that it became a rolling capacity in Europe or the U.S. I wouldn't expect you to say that you are going to sell out to (inaudible) steel. But perhaps you could give us an idea of whether we should discern a change in strategy.

A - Benjamin Steinbruch {BIO 1499059 <GO>}

Mark, it's Benjamin. How are you?

Q - Mark Cartlich {BIO 16540822 <GO>}

Hi. Thank you.

A - Benjamin Steinbruch {BIO 1499059 <GO>}

Mark, about what kind of premium are you talking?

Q - Mark Cartlich {BIO 16540822 <GO>}

What do you usually sell out at.

A - Benjamin Steinbruch {BIO 1499059 <GO>}

Always everything depends, Mark. But we are continuing in our strategy. But if comes here; Santa Claus; to give us a present, then we will discuss.

Q - Mark Cartlich {BIO 16540822 <GO>}

Okay. So, it's all a matter of price, basically, then.

A - Benjamin Steinbruch {BIO 1499059 <GO>}

It's not price. It's a question of premium, the first thing. And then the result then of the discussions. So, it's not only price. But I believed in Santa Claus when I was a little younger. So, I think that we will continue to work here to produce better results and increase the company in Brazil and outside Brazil.

Q - Mark Cartlich {BIO 16540822 <GO>}

Okay. Fair enough. So, for now, we should see the strategy remains in place.

A - Otavio Lazcano {BIO 4999009 <GO>}

Sorry, can you repeat again, please?

Q - Mark Cartlich {BIO 16540822 <GO>}

We should assume that the strategy that you've talked about in the past of looking for downstream capacity in developed markets is in place and that's not likely to change in the short-term.

A - Otavio Lazcano {BIO 4999009 <GO>}

Yes, no change at all in the business strategy publicly announced about our company two years ago.

Q - Mark Cartlich {BIO 16540822 <GO>}

Okay. Thank you, very much.

A - Otavio Lazcano {BIO 4999009 <GO>}

You're welcome.

Operator

Thank you. Our next question is coming from Denis Parisien with Standard New York. Please go ahead.

Q - Denis Parisien {BIO 20333702 <GO>}

Hi, gentlemen. And I'd like to thank you for the additional disclosure that we saw in your press release. It's very much appreciated. You mentioned, Otavio, I think, toward the end of your presentation, that you're seeing 5-10% increases in international markets. We follow a series of prices that we get off Bloomberg, that are labeled for different products and they're labeled international; or export prices from Latin America to international markets. And I haven't seen those start turning up. Of course, you guys have much more in-depth knowledge and anecdotal evidence than we get, looking at screens. So, could you give us a little bit more color on that? What kind of products and what destinations that you're seeing 5-10% price increases for, please?

A - Otavio Lazcano {BIO 4999009 <GO>}

Listen, what I can say that is really that we already started to charge additional 5 or 10% to our international customers for a broad number of products in specifications. Okay? So, for September delivery, the international customers are already paying additional 5 or10%. In this regard, I believe that one player from U.S. just announced; just recently announce a 50% price increase for; 15% price increase for some of it's products also.

So, it can be the initial or apparent momentum for demand in price conditions in our industrial segment. That's what I can tell you. So, the 5-10% price increase is for real and we already started to charge this additional price increase to some of our customers for September delivery.

Q - Denis Parisien {BIO 20333702 <GO>}

Can you tell me anything about what kind of products you're getting that kind of price increase on, please?

A - Luis Martinez {BIO 7187744 <GO>}

We are talking about; this is Luis Martinez; we are talking about hot band and also, mainly cold rolled products.

Q - Denis Parisien {BIO 20333702 <GO>}

Okay. Thank you for that. Quick question. We saw, obviously, the dividend payment was fairly extraordinary. But your; also, your CapEx, of course, is expanding this year. Perhaps you could remind me what your guidance for CapEx is for full year. And also working capital, there's a bit of run-up in working capital according to my calculations. And, of course, your free cash flow was a pretty large negative this quarter and your net debt to EBITDA ratio has deteriorated somewhat. Obviously, the base of comparison, going into the end of 2004, makes it challenging for you to get much in the way of EBITDA growth in into the second half of this year. I'm just concerned that maybe your net debt to EBITDA target of 1 times; excuse me; is perhaps unrealistic at this stage. Could you respond to that, please.

A - Otavio Lazcano {BIO 4999009 <GO>}

Yes, as to the capital structure of the company and dividends and so on. What we can; what we have been telling to the market is really that our goal is to keep the ratio of net indebtedness to EBITDA from 0.5 times to 1.5 times at the peak of the investments. As to the investments, for maintaining this CapEx, what you should expect from the company as a rule of thumb is 40% of the depreciation. This company invested heavily from 1996 to 2002 in (inaudible) so there isn't much left to be done. Okay? We have additional investments mainly related to the iron ore project and we made available to the market a breakdown of the investments over time a few weeks ago. We can make it available to you again by e-mail after we finish here the conference call. Okay?

And as to our capacity to keep the ratio of the net indebtedness to EBITDA in the ratio, in the range that we gave to the market, you have to keep in mind that this company has reporting EBITDA margins above 45% for more than two years and a half in a row. And on top of that, we are executing our investments to increase the production of iron ore. Management has high expectations from this project. We believe that the EBITDA margin from this project will be well above margins reported for steel production.

And our expectation of free cash flow from the iron ore project is incremental free cash flow of at least $300 million each and every year. So, this way, the company will be able to keep its capital structure a conservative one, will continue; will be able to continue to pay high dividends to its shareholders and will continue to be able to report high EBITDA margins from steel operations and iron ore business.

A - Benjamin Steinbruch {BIO 1499059 <GO>}

And Denis, is Benjamin who is speaking. We will work hard in the second semester to reach the cost of $200 per ton slabs that I think that will contribute to keep the historical margins that we have. So, we decide to work very hard, reducing the cost and I think that reaching this $200 per ton, including the depreciation, we will increase the, dramatically, the margin for the third semester and for the second semester.

Q - Denis Parisien {BIO 20333702 <GO>}

Great. Thank you, very much, all.

Operator

Thank you.

(Operator Instructions)

Our next question is coming from Jaime Nicholson with CSFB. Please go ahead.

Q - Jaime Nicholson

Yes. Good morning. I was wondering if you could elaborate a little bit on your strategy regarding your high cash balances, even following your dividend payment in June and the financings in July. You have quite substantial cash. Can you describe what that strategy is? Do you have cash earmarked for potential acquisitions, as you've discussed? Or what do you have planned for that cash, given your strong free cash flow on an ongoing basis?

A - Otavio Lazcano {BIO 4999009 <GO>}

Jaime, it's Otavio again. Two things. First, we are in the process; we were in the process of extending the life of our existing indebtedness. We are a capital intensive company located in Brazil. So we have sort of the wrong zip code. And; I mean, we saw several financial crises in the past. There's no question that there will be others in the future. So, we decided to extend the life of our existing indebtedness. And we ended up accumulating more cash than what would be necessary to; I mean, daily finance our operations.

Second thing that I would like to tell you is that we will always carry a big cash position as a war chest so that no one can pull us off the wall. Again, it's Brazil. It's a capital intensive industrial segment. There were; we saw thousands of crises in the recent past. No question there will be others in the future.

Q - Jaime Nicholson

Okay. Great. That's helpful. And are you; are you currently evaluating any of the rolling mill acquisitions in Europe? Do you find the market favorable now or do you find the valuations still on the high side? What's your outlook for potential near-term acquisitions?

A - Otavio Lazcano {BIO 4999009 <GO>}

The company already made its mind so that we intend to acquire market share in one of the biggest consumption centers in the world. Our main targets are U.S. and Europe. I mean, there are advantages, I mean, in both markets. So, we made it clear to the market maybe 4 or five years ago and, as Benjamin said in the beginning of the Q&A session, we have been looking for opportunities abroad for quite a long time. You should not expect from us anything huge. But what you can and should expect from us is really that the company becomes more a sort of international player in the near future. And as soon as we face a good opportunity, no question that the company will be considering it serious, in a serious way.

Q - Jaime Nicholson

Great. Thanks very much. Thanks for the elaboration.

Operator

Thank you. Our next question is coming from Eric Ollom with ING. Please go ahead.

Q - Eric Ollom {BIO 4374335 <GO>}

All my questions have been asked already. Thank you.

Operator

Thank you. Our next question is coming from Eric McKee [ph] with Lazard. Please go ahead.

Q - Eric Mckee

Yes. Hi. Thank you. I was wondering if you could address the issue of relatively high inventories. Domestically, in Brazil, I believe, it's around four months now. And how long you think it will take to draw down those inventories and how you've been able to maintain pricing so strong, given these high inventories. And I think you mentioned before that you think that will be; you'll be able to maintain that. But if you could just sort of address how that's possible.

A - Luis Martinez {BIO 7187744 <GO>}

Eric, this is Luis Martinez speaking. We are forecasting that we are going to have better markets on the last quarter this year. And in the distribution markets, we are perceiving that we are going to have; we are going to have less inventories right now. And we are forecasting in other markets like auto makers and also home appliances, that we are going to have a better half, as always. And this is our fundamentals to have a better market for the second half.

A - Benjamin Steinbruch {BIO 1499059 <GO>}

Eric, it's Benjamin who is speaking. To complement Martinez, also, we are waiting for the U.S. Trade Commission that we'll agree to use hot bands from the zero to LEC. So, a part of our inventory is from hot coils. Also, as Martinez mentioned, we wait a little bit in the Third Quarter for the market to recover some margins. And as Otavio mentioned before, in September, we already increase our prices 5-10%. So, as we mentioned also, we will finish; finalize the year with 5 million tons sale. And we are quite comfortable to guarantee to you that we will reach this number.

Q - Eric Mckee

So, are you expecting, basically, international prices to catch up to domestic Brazilian prices as opposed to Brazilian prices falling back down to international prices?

A - Benjamin Steinbruch {BIO 1499059 <GO>}

There is two things different. Because in all the countries, the internal market is different from the price of exportation. And as you know, we have LNC in the States and also the internal market of the states is completely different than the price that you import to the States. So, this difference, more or less, in 30%; 35%; usually is consistent in all the internal markets. And in Brazil is the same. So, the price that you have for export, you have the transportation. You have the tax. You have the port expenses. And creates a value that, in the internal market, it's more or less comparable between all the internal markets. So, I think that the internal markets will increase the price in the last quarter and, in September, we already increase the price for exportations.

A - Luis Martinez {BIO 7187744 <GO>}

And another; just to complement Benjamin's point of view, just to give you some numbers. In terms of local market, we had sold 2.5% more than the same period comparing this last year. And for sure, we are; for sure, we are interested also in recovering some markets that we had; we had some problems. Considering, for example, auto industry. So, we are putting a lot of effort right now to recover some of the market share, mainly in the auto makers industry.

And continuing in the case of galvanized products, for example, we are not only placing our efforts in hot deep galvanizing. We are also investing in different projects in trying to put more color-coated products in home appliances. And galvalume in the building products lines. In the case of template, we have also to take into account that we grew 12% comparing to last year. And we are perceiving that we had a lot of room to grow in terms of innovation in some markets here in Brazil in templates.

Q - Eric Mckee

Okay. Thank you, very much. Appreciate it.

A - Luis Martinez {BIO 7187744 <GO>}

Okay. You're welcome.

Operator

Thank you. Our next question is coming from Rodrigo Barros with Unibanco. Please go ahead.

Q - Rodrigo Barros {BIO 5851294 <GO>}

Good afternoon, everybody. I have two questions. First, regarding Arcelor in Brazil. There are some rumors from market participants that they are very aggressive on price. I would like to see if you share this opinion and now we have a larger competitor to distribute flat steel. And my second question is regarding consolidation. We, as analysts, of course, we like very much when we see that there are people interested in CSN. But my question is if it's time to join right now or if there is time for CSN and other companies in Brazil to grow more and sell more expensively in the future, since Arcelor and Vega, they both, intend to double their size in the next five years. So, I would also like to see your opinion on that.

A - Luis Martinez {BIO 7187744 <GO>}

Okay, Rodrigo. This is Luis Martinez speaking again. Regarding to your question to Vega, as I mentioned before, we long some volumes in the auto industry last year for several reasons and we don't have an interest in going into details in this question. But in terms of recovering the market, I would like to emphasize that CSN is currently producing 1.5 million tons of hot deep galvanizing products in Brazil.

Not only hot deep galvanizing for normal applications in distribution or building products. We have GalvaSud that is ready now to recover market for; in the auto makers. And in the case of more valued products, we are putting a lot of effort in prepainted coils and galvalume. So, being very straight to the point, in the case of auto industry, we are ready to recover that we lost last year.

A - Benjamin Steinbruch {BIO 1499059 <GO>}

Rodrigo, always the new player comes more aggressively to the market. So, ARcelor did the same in Brazil and now it's time to recovering the participation that they get in the first month. And regarding to the second question, always is time to date, Rodrigo.

Q - Rodrigo Barros {BIO 5851294 <GO>}

Sorry, Benjamin?

A - Benjamin Steinbruch {BIO 1499059 <GO>}

Always is time to date.

Q - Rodrigo Barros {BIO 5851294 <GO>}

Okay. Thank you, very much.

Operator

Thank you.

(Operator Instructions)

Our next question is coming from Daniel Altman with Bear Stearns. Please go ahead.

Q - Daniel Altman {BIO 1855515 <GO>}

Hi. Just a couple of additional questions. Your volume forecast of 5 million tons, that would imply about 1.3; say, 1.33 million tons for the next two quarters. And that's about 200,000 tons above what you did in the Second Quarter and quite a bit above the First Quarter. So, I'm wondering, where will you place that extra demand on a sequential quarter basis for the next two quarters.

My second question is, in your press release, you mentioned that there wasn't an appreciable increase in finished product inventory. So, I'm wondering if you're including slab when you say finished products or was there an increase in semi-finished inventories? Thanks.

A - Luis Martinez {BIO 7187744 <GO>}

Yes, Daniel, regarding to your first question, we are forecasting to have our new guidance is 5 million tons total sales, 3.5 million tons to local markets. Considering that we have done, in the first half, we have something like 1.7-1.8 million tons to sell in the local market. And we are comfortable to have these numbers because we are talking about something like 290,000 metric tons to 300,000 metric tons amount in the local market. This is a volume that we have done last year and early in the First Quarter in the local market.

And just to reinforce that I mentioned minutes ago, we are interested in recovering some markets that we lost. So, basically, we are expecting that we are going to have a better market, as always, in the second half. And second, we are going to recover markets and some customers.

Q - Daniel Altman {BIO 1855515 <GO>}

Okay. Maybe one more question, if I could?

A - Luis Martinez {BIO 7187744 <GO>}

Could you say it again, the ...

Q - Daniel Altman {BIO 1855515 <GO>}

Yes. Well, okay. Just again, if you can clarify me on the inventories. We talked about finished products, if you're including slab and ...

A - Luis Martinez {BIO 7187744 <GO>}

Yes, it does include slab.

Q - Daniel Altman {BIO 1855515 <GO>}

Okay. And then, the other question I had, just a semantic question. When you; you said a couple times on the call that you think the Fourth Quarter will be better. Better than the Third Quarter or better than the Second Quarter?

A - Benjamin Steinbruch {BIO 1499059 <GO>}

Both.

Q - Daniel Altman {BIO 1855515 <GO>}

Both?

A - Benjamin Steinbruch {BIO 1499059 <GO>}

Yes.

Q - Daniel Altman {BIO 1855515 <GO>}

Okay. Great. Thanks a lot.

A - Benjamin Steinbruch {BIO 1499059 <GO>}

I think that the last quarter will be very good. Also, in the external market and the internal market. As you know, I think that the Brazilian government will start to decrease the interest next week. Also, we will have a elections this next year and I think that the government, we will start slowly to increase the internal market. And as we mentioned and this is something concrete, for exportation, we will increase the price in September 5 to 10%. Principally, cold band and also hot coil.

Q - Daniel Altman {BIO 1855515 <GO>}

Okay. Thanks again.

Operator

Thank you.

(Operator Instructions)

Our next question is coming from Ivan Fadel with CSFB. Please go ahead.

Q - Ivan Fadel {BIO 4827533 <GO>}

Hi, gentlemen. My question is regarding the possible extension, domestically, if I'm not mistaken, by 5 million tons as commented in the previous [ph]conference call. I was wondering if there is any projects already very well defined. If there is any indication of what could be a cost return of this project. And also if it would include the coking plant as well.

A - Otavio Lazcano {BIO 4999009 <GO>}

We basically keep it with the blackboard and we have two alternative investments to be blast furnace and the second one would be a greenfield project, maybe in (inaudible) to produce 5; almost 5 million tons of slabs to be further processed in international markets where we would acquiring whatever rolling facility or company. Okay?

So, we keep those projects in the blackboard and Benjamin has said in the previous conference, the company has, right now, enough liquidity to make it feasible. The company was able to extend the life of its existing indebtedness. We are basically buying time to; I mean, to make a decision in a more conservative way and this way avoid whatever negative impact from such an important decision for the company.

Q - Ivan Fadel {BIO 4827533 <GO>}

There's no raw idea of what could be a possible cost of both projects; the brownfield and greenfield?

A - Otavio Lazcano {BIO 4999009 <GO>}

The brownfield, I would say, roughly, $800 million. Okay. So, $200 per ton. Okay? And the greenfield project, $3.5 billion, from 3 -$3.5 billion.

A - Benjamin Steinbruch {BIO 1499059 <GO>}

Ivan, it's Benjamin. What I think that's important to say is that we have all the studies and we didn't consider it, the Chinese technology for these investments. After that, Asominas went to China and bought the new blast furnace in China. We are very optimistic with the numbers and we studying again to see exactly the real cost of the new investment, considering Chinese technology and we are quite confident that we will reach a very good number of investments. If this is true, we will be encouraged to study with more details in the fourth semester, the new investments.

I think that we have everything done in talking about the technical issues. And the fiscal issues, also. So, now it's a question of the time and I think that in the; for this year, I don't think that nothing will happen. But for the beginning of next year, I think that we will be ready to announce some new investment key in Brazil. In the principle, we considered 2.5-3 million tons. But now, if we have the numbers confirmed, maybe we decide to something; a little more, considering Chinese technology.

Q - Ivan Fadel {BIO 4827533 <GO>}

Very helpful. Thank you, very much, Benjamin. If you allow, I'm sorry to go back to the same question on prices, just to see if I got it very clearly. If we talk about prices in reais in local currency and take into account it is, for example, hot rolled coil is being sold at 1,700 in the domestic market, do you see room for prices to decline in reais terms as well? Because we kept talking about dollars. But I'm just trying to avoid any misassumption in effects rate. And see if you believe that, in reais terms, this fuel price, this hot rolled coil that is being treated at 1,700 right now, if there is room for a price decline or if you believe that you are very much likely to keep this stable in reais. Thank you.

A - Benjamin Steinbruch {BIO 1499059 <GO>}

Ivan, we are considering our pricing in reais very, very stable for the Third Quarter. And as I mentioned before, we need to; when we compare prices, not only local market. But also in exports, we have to compare apples with apples. In terms of local market, we need to take into account that we have sometimes a very specific product for specific customers and we charge a premium for this.

And if we consider, for example, some exports of a rock band to U.S. or for other parts of the world, sometimes we export not only a specified product. But also a common product that we can compare with CRU in the market.

Q - Ivan Fadel {BIO 4827533 <GO>}

Right.

A - Benjamin Steinbruch {BIO 1499059 <GO>}

Right.

Q - Ivan Fadel {BIO 4827533 <GO>}

Okay. Very clear point taken. Thank you, very much.

A - Benjamin Steinbruch {BIO 1499059 <GO>}

Also, something that you have to consider is that the currency is not real. We are having a discrepancy, something that we don't believe. So, I think that is very improbable; unlikely that the price in reais goes down. I think that we will be working in the opposite direction.

Q - Ivan Fadel {BIO 4827533 <GO>}

Okay. Benjamin, thank you very much for your help.

A - Luis Martinez {BIO 7187744 <GO>}

You're welcome.

A - Benjamin Steinbruch {BIO 1499059 <GO>}

Thank you.

Operator

Thank you. At this time, I'd like to turn the floor back over to Otavio Lazcano for any further closing remarks.

A - Otavio Lazcano {BIO 4999009 <GO>}

Okay. So, thank you again for joining us for the conference call and I hope to see you soon during the conference call for the results of the Third Quarter. Thank you, all. Bye-bye.

Operator

Thank you. This does conclude today's teleconference. You may disconnect your lines at this time and have a wonderful day.