Q2 2019 Earnings Call

Company Participants

- Benjamin Steinbruch, CEO
- Luis Fernando, Executive Officer
- Marcelo Cunha Ribeiro, CFO
- Unidentified Speaker

Other Participants

- Analyst
- Caio B Ribeiro
- Carlos De Alba
- Daniel sasson
- Gustavo Allevato
- Leonardo Correa
- Thiago K. Lofiego

Presentation

Operator

Good morning, and thank you for holding. Welcome to the CSN's Earnings Conference Call to present results for the second quarter 2019. Today, we have with us the Company's Executive Officer. 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.

Ensuing this, we will go on to the question-and-answer session, when further instructions will be given. (Operator Instructions) We have simultaneous webcast that may be accessed through CSN's Investor Relation website at www.csn.com.br/ir, where the presentation is also available. The slide presentation -- well, the conference of this event will be available for one week.

Once again, you can follow through the slides at your convenience. Before proceeding, we would like to state that some of the forward-looking statements made are based on expectations and trends and the opinion of the company management. Future results, performance and events may differ materially from those expressed herein, which do not constitute projection.

In fact, actual results, performance or events may differ materially from those expressed or implied in the forward-looking statements as a result of several factors, such as general and economic conditions in Brazil and other countries, interest rates and exchange rate levels, future rescheduling or prepayment of debt pegged in foreign currencies, protectionist measures in the U.S., Brazil and other countries, changes in laws and regulations and general competitive factors at global, regional and national levels.

We will now turn over the conference to Mr.Marcelo Cunha Ribeiro, Investor Relations Executive Officer, who will present the company's operating and financial highlights for the period. You may proceed, Mr.Ribeiro.

Marcelo Cunha Ribeiro {BIO 4997029 <GO>}

A good morning to all of you and thank you, for participating in our call. I would now like to give the floor to Mr.Benjamin Steinbruch, the CSN CEO, for his initial comments.

Benjamin Steinbruch {BIO 1499059 <GO>}

Hey, good morning, to all of you and thank you, for participating in our earnings conference call. Basically I believe that the results testify to what was said the last year, referring to an enhancement in our figures and an improvement in the company's situation. What was promised is now being delivered. We are undergoing a process of delivering and demobilization, improving our image, a process of growth, and appreciation of the company, once again as part of that process, which was announced in 2018. And the figures do not pose any novelty compared to what was said.

The great novelties are yet to come. We have a very optimistic view when it comes to the second semester. We have a given for the iron ore situation; you will have heard observe that we are purchasing more iron ore as well as producing more. We're producing at a lower cost. We have a very good price policy selling at future price and so far we have not contemplated the maximum price of iron ore differently from the Platts.

As you know we have been practicing prices that date back three months. We believe that the prices will continue to evolve in the coming quarter. And we have made the right decisions and of course we're being aided and abetted in terms of climate factors. If has not been raining and once again this contributes towards the ease of operation and the shipment of iron ore.

I would say therefore that mining is doing its very best and will be able to increase both qualitatively and quantitatively. We expect an improvement in quantity as well as an improvement in quality and consequently in price for the second semester when it comes to mining.

If you analyze the issue of the steel mills, we did have a price enhancement, which was significant in the first semester, when the economy did not show a reaction. We were able to rise or increase the price and in terms of amount we have an increase, we repeated what happened in the first quarter. Our problem, of course is cost. It's not the market that is doing poorly, it's our cost that is not correct because of the shutdown of the blast furnace. The process leading to the shutdown was ever more difficult at a higher cost than we had imagined and we were penalized because of the shutdown. Beginning in September, we are convinced that the blast furnace in terms of quantity and productivity will return with higher rates. It will have a better performance, and without a doubt, this will have an impact on our historical EBITDA of 20%. At present we're working at a 6% level.

Once again, this is a onetime issue. I would like to reiterate this and do not be surprised, if in the fourth quarter we present aggressive figures for the steel factor. This would be a natural process due to the coming into operation of the blast furnace number 3. In the domestic market we have significant optimism. We're following the policy, we have always followed of participating in all segments with differentiated products.

It is evident that the domestic market is challenging. The recovery of the economy that we expected has not materialized. Unfortunately this recovery will take place, perhaps, not in the second semester, but only in March of 2020. Notwithstanding this and considering the context and based on what we are able to do, we do believe in a significant improvement in terms of quantity, price and performance and margin because of the coming into operation again of the blast furnace 3.

The situation of cement remains the same. This is a competitive market, with signs of enhancement. As everybody else, we had a good January and February but beginning in April, we had a cooling down of our economy because of the delay in approving the reforms and economic measures that should have been taken and were not taken by the government to aid in the recovery of prices production and consumption.

We have a new guidance for you when it comes to production, EBITDA and margin. And I would like to underscore that this guidance is conservative. Figures have a life in itself and each company should carry out and exercise when it comes to the price of iron ore and the cost of the steel plants. These are the two factors, that will point to our final annual performance. What we are presenting here once again is quite conservative with the possibility of improvement.

We continue with our commitment towards deleveraging. We have not put aside what we have mentioned to the market and when I spoke about the number 25, which would be BRL2 billion EBITDA and BRL5 million of net-debt. I think that. The results will be even better than that, they challenge that I'm posing to myself is to present better figures than these until the end of the year.

And of course each will materialize based on the benchmark price for iron ore and the recovery of the blast furnace number 3 for the steel plant. But from the practical viewpoint, we are very optimistic at the company. We believe that we're still lagging behind when it comes to having the rating agencies and the market in general understand what is happening. We had a recovery of our equity in the last 12 months, but this does not point to the reality of the company nor does it point to the future. I think that we still have a great deal of room for valuing of our equity and bonds. The figures are given they are not a surprise.

The great surprise will be to be able to improve our guidance until the end of the year. Once again we're highly optimistic about the future. Now this optimism does not mean we're not being realistic. We do acknowledge the reality of our domestic market, but we're willing to face this situation and increase our market share. And this is what we have done regardless of the market. We need to work hard and obtain the best from the market. We will be competitive, we will be ever present in cement and in steel and without a doubt we will present very good results for the second semester.

I will remain until the end of the presentation of results. Should you have any doubts or questions, I am at your disposal. I now give the floor to Marcelo for his presentation.

Marcelo Cunha Ribeiro {BIO 4997029 <GO>}

Thank you, Benjamin. We will go on to our financial and operating highlights on Page number 4. We show you the EBITDA evolution in the last quarter sequentially. A year-on-year evolution 68% compared to the same period last year. An increase in volume and prices that have been continuous throughout the last year not only in the steel mills, and more recently in the last quarter, showing that mining has had a very significant share in our consolidated results.

Margin because of this is exceptional 33% in terms of the company and leading to BRL2.4 billion, which is a historical record for the company. Vis-à-vis the previous quarter, it is a growth of almost 40%, as we see in the previous graph with a great contribution of mining that had a 60% growth more than offsetting the performance of steel plant and the cost.

We had a growth in volume prices; logistics had a very good performance. In truth, this was a quarter with a positive evolution in general. On Page number 5, we look at our financial indicators that of course will lead to our cash generation. We begin with our CapEx. In the quarter, we have accelerated investments BRL461 million, something that was already expected. This quarter concentrates all of the expenses with a reform of blast furnace number 3 along with other important projects that will be commented by Gutenberg, centering as well as other projects. And in mining important deliveries, for example, the second tailing for mining within the second quarter will allow us to have full independence.

Now, this important indicator leads us to think about higher investments this year as well as an acceleration in production 33 million tons, and we will come to a CapEx very close to BRL1.92 billion when it comes to the working capital which was important in the first quarter. We have a certain inventory because of the shutdown of the blast furnace and accounts receivable. In this quarter, we had stability, a slight improvement in the working capital but the factors are still there. We have purchased Platts with a significant investment.

But the accounts receivable is a transitory event, the invoicing of shipments in the first semester and once again, we will have to take advantage of the increase in the price of Platts. Had it not been with this, we would have a more positive evolution. We are at

BRL3.4 million with the investment of BRL1 million. What we foresee for the second semester is to go back to the level similar with the first quarter, and the working capital will support our expectation of working with more than BRL2 million already shown in the second quarter.

We had a very good cash generation and adequate profitability for that business. And once again, we have benefited from lower interest rates enabling us to have significant cash generation. What was essential as we see in Page number 6, was to continue reducing our indebtedness. In this quarter, we maintained a very important goal, which was to get to 3.5x net debt EBITDA ratio. This is a framework compared to the -- for a company that two years ago was at 6 times. We had an enhancement in the EBITDA with significant growth and a reduction in indebtedness.

This quarter we had a small increase, because we paid out dividends, increasing our debt as a onetime event. As mentioned by Benjamin, this process does not stop here. We will be below 3.5x at the end of the year as this is part of our guidance. We will count upon strong operating results and other deleveraging initiatives. We're working on this, the subsidiary in Germany is working on this, as well as other companies, and we will guarantee an indebtedness closer to 3.5x in the near future.

On Page number 7, we see the other side of the management of liabilities, the average duration of indebtedness and our amortization schedule. The short-term versus long-term debt continues to be important. And the comment is that we see that the rating agencies still suffer from a certain inertia. They have not delivered the improvement that we have in credit and we're carrying out gradual payments. Now the company will take support from the capital markets. We have 20% of debt in the short term an improvement in the rating of agency and of course a better efficiency. This average duration of three years should be reduced and we will be able to reduce our indebtedness. In the long term we have the launch of debentures and new positions in the international capital market. We believe that the full potential of our rating will then be delivered until the end of the year and we believe in the initiatives, that will lead to this.

We go on to our highlights per business on Page number 9. The steel performance, when it comes to volume, stability shows that we are aligned with the market. Thanks to the volume, we didn't have a lower performance. We grew in distribution in the United States and the domestic market we're aligned with the market. Prices had a positive reaction. We had a price increase in April. Now, the average price is at 3% higher vis-a-vis last year and what had a very strong impact was a continuous increase in the cost of raw material, a lower performance in sales and a onetime issue of the shutdown of blast furnace number 3 that will be resolved during the third quarter and will be fully resolved. In the fourth quarter, we should go back to our normal levels.

On Page number 10, a highlights for the period. The mining performance was extremely strong growth and increase in growth and purchase from third parties. Thanks to the good prices, we were able to obtain very profitable and attractive purchases. The initial expectation is to obtain a higher volume and that is why the new expectation for annual sales goes beyond BRL40 million, because of the better production, better climate condition and a great efficiency and the use of our efficiency.

We have hit a record in production. We're working more efficiently and that is why we have that 65% EBITDA margin and a growth of 60%, vis-a-vis previous quarter was BRL2 billion. This would not have been possible if on the last page of the presentation, we would not have the grate increases in price and quality indicators, a 21% increase in Platts and quality indicators that continue to be very positive contrary to what we showed a year and a year and a half ago with a discount. We now have an increase of $3 per ton premium, which has contributed towards realizing our prices. And this quarter we have the support of cost and freight that was very attractive, because of the lower supply of iron ore allowing us to obtain exceptional results.

With this, we would like to conclude the presentation and open the floor for questions and answers. Thank you.

Questions And Answers

Operator

(Question And Answer)

We will now go on to questions-and-answers for investors and analysts. (Operator Instructions) Our first question is from Leonardo Correa from BTG Pactual.

Q - Leonardo Correa {BIO 16441222 <GO>}

Good morning to all of you. Thank you for taking my question, congratulation for your results. The first part when it comes to leveraging we have been following up on your efforts and the metrics show significant improvement because of the EBITDA that has changed levels. My question is the following. I would like to further explore the absolute net debt. We have seen that throughout the year this debt has changed timidly a reduction of BRL500 million approximately. Going forward I would like to see your levers. How is this absolute net debt going to be reduced, which will be the magnitude of reduction that we can expect in the coming quarters?

And a question to a Benjamin. If we could have a quick overview of conversations with streaming and SWT, I think this would be very helpful. To go on to a second point and to include Martinez in the discussion now the price of steel clearly has suffered an impact Benjamin clarified and underscored that this is a onetime event, it is not a recurrent event. But if we follow up on the evolution of results, we see the very strong impact and contribution of EBITDA.

Now in the second quarter last year, the contribution to EBITDA was much higher, this has -- this dropped to BRL350 million in the first quarter and now to BRL325 million in the second quarter, very, small figure for CSN. Now you have stated in the presentation that the fourth quarter will have more aggressive figures. What will happen in the third quarter, Martinez? Will we have a lesser amount for EBITDA? Is this the bottom? Is there room for improvement? If you could speak about the recovery in the third quarter and speak about normalization of steel that will be very important for CSN. Those are my questions. Thank you.

A - Marcelo Cunha Ribeiro {BIO 4997029 <GO>}

Let me begin with net debt, which is your first question. Well Benjamin very clearly stated his personal goal of getting to BRL20 million and the BRL5 million additional. Now we are at BRL23.5 million in terms of absolute net debt as you mentioned. When we look at cash generation and what is within our reach in terms of initiative. Now when it comes to the financial initiative and in terms of SWT last time, we mentioned that we had constant negotiations and this time the situation is not different. We have made advances and were ever more certain that this will be a real opportunity in the short-term. An M&A is an M&A and we're going to do it right once we get to the right conditions for CSN, but we are closer to coming to a solution.

A - Benjamin Steinbruch {BIO 1499059 <GO>}

When it comes to streaming, we're becoming quite demanding in terms of the conditions. We have better visibility in terms of the potential for growth and the average growth curve. And we have to obtain conditions that will reflect all of this potential.

We -- well, we could work with a more creative structure. And of course this structure will have to reflect all of the potential. This is what has delayed us, but we're quite confident in the process.

A - Luis Fernando {BIO 17590082 <GO>}

When it comes to the questions about the third quarter. Leonardo you asked about the EBITDA BRL200 million is the bottom figure. Going forward, the figures will not be a below BRL200 million. Quite the contrary at the end of the year and the fourth quarter, we should obtain BRL500 million in EBITDA for the steel plant. Evidently, there are some levers that Benjamin mentioned. And we expect stronger growth than in the first quarter. The figures of ABR show a growth of 4% for the second semester zero for the first semester, and I'm working with a sale of growth of BRL300 million to BRL400 million in the domestic market.

We achieved a BRL1.600 million, we need to achieve a BRL1.800 million. As a minimum, this is what we have to grow in the second semester. In terms of price, this is interesting. We're being somewhat selective in terms of our profitability. We're going to have a price carryover that is important for the third quarter and we're focusing fully on profitability.

I continue to speak about galvanized material up 40% and we're going to work strongly, so this increase to 63% to 64%. And price as mentioned by Marcelo will continue to increase and we have to be smart enough to capture the premium of BQ and BS in the market. Obviously, there is a situation of idle capacity for BQ that we will have to resolve. In the second quarter CSN maintained the prices for industry and the automotive market stable. And we had an increase of 3% on the average and a carryover of 2% or 3%.

Now the reform of the blast furnace should end at the end of August. And in the third quarter, we will get to a bottom line of 200 and some then onwards an increase. Leonardo I would like to underscore the following in terms of the sales to Germany. As we mentioned, all of this is an issue of price. We're going to have for sales to Germany. For the EBITDA, what we have presented as EBITDA in the second quarter is much more than just the sales to Germany. They will be reflected in the third and fourth quarter. We are committed with the sale of Germany as simply an issue of price but it doesn't justify burning out a good asset. In Germany, we pay BRL17 million in income tax. If we were to be more efficient, we could improve this EBITDA in terms of worldwide field market which is difficult. For Germany, we have already mentioned this, maybe sold, we're working toward selling this asset, but it is not an asset that we are going to simply throw away. When it comes to operating factors we are delivering much more of EBITDA per quarter than Germany and the same holds true for streaming. In the company in-house, it's natural for us.

We anticipate an improvement something that you still have not understood. And we are being very demanding when it comes to pricing. For example, our last bond was fixed on $0.06, two months ago -- two months ago. Today it is $6. It's propitious to do things, but we have to do things in a conscious way. Otherwise, it will be very difficult to explain to you why we made a decision to go to the market at $6.06 for something that presently is at $6, 2 months later. We need to be very stringent when it comes to cost, financial cost, once again because of this expectation for a reduction of interest rates that we observe in the domestic market and the stability of interest rates.

And a trend for low interest rates in the foreign market. Therefore, both for streaming and Germany this is simply an issue of price. And to make a long story short when it comes to the steel plant, this is very easy to understand if you consider a price per slabs of $700. And we know that in the market you can buy slabs at $450 and we know that CSN has always beat the market when it comes to the cost of slab. If you take away from our cost 30% or 40%, you will see the results that we should achieve, if we had a normal situation when it comes to liquid steel. This is simple mathematics.

It is mandatory for us to work in the fourth quarter with a cost that will be below $500 or $450. And we will be forced to work within this cost, which is the market cost. What is happening is a outlier, it is a coincidence of factors of an increase in raw material prices, an improvement in the quality of raw material due to the poor situation of our blast furnace. It is a process, that goes in another direction compared to cost.

And three months of nonproduction because of the renovation of the blast furnace we do think the average cost of the rest of our production. It's as simple as this. We're highly optimistic for the steel plant in the fourth quarter because of this recovery. And in the third quarter because of the slabs and due to the market, which in our opinion is not as bad as some market players are preaching we are going to have a third quarter that will be much better than the second quarter.

There will be a significant improvement in terms of the steel mill results. It's not even about the market, it's about cost. If the market improves a bit or if it remains as it is, if we reduce the cost of slabs 30%, we will have the results. Thank you Benjamin and Marcelo. Thank you for your responses.

Operator

Our next question is from Gustavo Allevato from Santander Bank. You may proceed sir.

Q - Gustavo Allevato {BIO 18933135 <GO>}

A good morning to all of you. I have a question that refers to mining. I would like to gain a better understanding of how might you have hedged in the quarter to get to your EBITDA guidance of BRL8.5 million. The second question to Marcelo who mentioned in the presentation that we are at BRL2 billion for 2019. Now after the guidance that we see for EBITDA this seems to be very low. Which will be your cash consumption to get to that final generation. Thank you.

A - Marcelo Cunha Ribeiro {BIO 4997029 <GO>}

Gustavo, this is Marcelo. When it comes to hedging well historically we have done very little of this. And in that BRL8.5 million there is practically none of this. We have been working with price-fixing somewhat further ahead in the curve. And we are able to do this in a very convenient fashion. At the end of the year, we had a certain problem, when it comes to slabs but there have been results. We have a favorable curve and we will reach that BRL8.5 million based on our expectation for the second semester.

As mentioned by Benjamin we're being conservative and we are being optimistic when it comes to the average Platts for the second semester. In terms of cash generation, once again we're being conservative. On the one hand, we foresee an increase of CapEx to get closer to BRL2 billion and an increase in income tax cash.

We have a very good situation a good EBITDA in mining that will generate exceptional results, when compared with the beginning of the year and this will have a significant cash impact and an impact in working capital. And with the higher cost of raw materials we end up having a higher consumption that was expected. Once again, all of these factors are transitory and we will continue generating strong cash to revert this.

Q - Gustavo Allevato {BIO 18933135 <GO>}

Thank you, Marcelo. If I can ask Martinez a question and he is -- he thinks that there is space to have a price increase in the third quarter.

A - Luis Fernando {BIO 17590082 <GO>}

Gustavo, an important thing is the premium. If we think of $500 FOB and an internal price at $2, 700 for BQ and, well, this premium is very low it is 2% or 3% premium. And we have the problem of international freight that has increased significantly. We believe that if the market acts with reasonable intelligence between volume, supply, and demand, we will have the obligation of recovering at least 7% or 8% of that premium. We have worked with historical premiums in 2002-2003 of 25%. We're only at 10% or 15 %.

It's our obligation to once again recover this space. The only problem that impacts CSN directly is coated material. Imports dropped 11% during the semester and grew 13% in terms of galvanized products. We have to be careful to ensure that the imported products will not gain penetration in the domestic market.

We're being very assertive and we think we can improve in the third quarter and it will have to be done in any way we can. There's nothing more relevant for us than the reform and the price of iron ore that had an increase of almost 70% during the year, and the increase of other raw material. Everything conspires to enable us to have this recovery and what we hope for is a stronger demand in the second semester. We truly believe that is this materialize. Gustavo if you observe the price of steel in the international market it is on the rise.

There's a strong movement in the United States as well as in China. And as Martinez mentioned, respecting this ratio we will see that the trend for a price upturn abroad is a reality and it should increase further. I believe that domestically we will be able to update our prices vis-a-vis international prices because of the need of increasing costs that apply to everybody and not only to our blast furnace an increase of 10% at least and this will be different to what is happening abroad. And whether the market reacts or not, part of this cost increase will be transferred to the market. This is simply based on what we observe internationally. There has been a price increase since last month. This is the reality. Thank you.

Operator

Our next question is from Daniel from Itau BBA. You may proceed.

Q - Daniel sasson {BIO 19234542 <GO>}

A good morning to all of you. Thank you, Marcelo and Benjamin for taking my question. The first question is cash flow. I wasn't able to conciliate the difference in terms of what was reported even if we consider the BRL1.1 million you paid out in dividend. If you could share with us, perhaps if there was a noncash effect that ended up not having an impact on EBITDA during the quarter, when it comes to the BRL20 million in net debt. I would like to know if you believe that this is an appropriate level, even if we have an accommodation in the iron ore prices. Now, if the results of mining are not sustainable at these very healthy and high levels that we saw in this quarter if we will see an increase in leverage throughout 2020, and still speaking about cash generation of BRL2 billion or BRL2.5 billion for the quarter, if you have any initiative in place for the prepayment of debt going forward? These are my three questions. Thank you for taking them.

A - Unidentified Speaker

Well, very broadly when it comes to conciliating this we generated BRL800 million in cash and the debt increased ZBRL800 million, that is BRL1.6 billion. 1.2 billion because of the dividend of this BRL400 million has also referred to working capital that are excluded from our definition of working capital. BRL100 million in foreign exchange variation and a BRL100 million in reduction because of our prepayment for Glencore and of course we have been rolling this over through a new payment. There is a revolving characteristic that we have excluded from our definition of working capital.

The rest is either nonrecurrent or nonoperating that is below the EBITDA line in nonoperating expenses. When it comes to leveraging, I would say that my analysis of what would be a healthy capital for a normal part of the cycle would be BRL12 million of gross debt and not net debt, and we would like to get to that in the near future. We're counting on projection, strategic planning to be able to define the horizon for this gross debt but not a net debt that would be more reasonable for us.

And finally, which was your third question, if you have any initiative undergoing for prepayment. Taking into account the growth that you expect in cash generation, in truth we do not. We have amortizations. Our debt has been lengthened with the banking sector. There is a short-term amortization as I mentioned. The debt continues high in the short-term and we will need to have prepayment because of the lengthening of the debt. We're going to replace bank debts with capital markets as mentioned.

Q - Daniel sasson {BIO 19234542 <GO>}

Thank you, that was very clear. Thank you very much.

Operator

Our next question is coming from Mr.Carlos De Alba with Morgan Stanley. You may proceed.

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

Thank you very much gentlemen. So just coming back to the target of net debt of BRL20 billion, can you comment as to when do you expect to reach that level? And based on the prior-year answer, is it fair to assume then that most of the reduction well depending again on when the target will be achieved, would come from increased cash balance rather than a reduction in gross debt? The second question, that I have is regarding, I think Benjamin you mentioned, that the company has been selling iron ore in the futures market. Can you comment a little bit more about for what period this is? Is this for the second half of the year or for further periods and more or less what prices have you been able to secure?

And then finally for Martinez. Martinez, I understood that or at least I saw some news about two weeks ago or a week ago that prices in Brazil had been come down to being -- or discounts had increased in the margin -- in the magnitude of 5% to 8%. Could you comment on this and also if they were implemented by CSN or given by CSN, what are the expectations for prices in the third quarter and the second half of the year? Is that embedded in the 3%, I think, I understood carryover effect in prices from what the company was able to hike in the first half of the year? Thank you very much.

A - Unidentified Speaker

Thank you for your question Carlos. We want to get the to BRL2.5 billion in terms of EBITDA the coming year and necessarily we'll have those BRL20 billion in net debt in 2020. I don't have the precise figure so far but we're going to begin the year below 3 times between December to 2019 and 2020. Now when it comes to the future sales, we know that the mining curve has performance that drops because of supply and at a certain point in time there should be a normalization or perhaps we will work with hedging.

We didn't do this in the past. We could use it more. And we have these long-term contracts that will enable us this ease, but so far we haven't priced and anything. Now when it comes to the price to reinforce what I said in the second quarter, we had already implemented price increase in the automotive industry and in others. So practically it was zero. In the second quarter, we tried to work with a 10% increase. We were able to capture 6% in construction and the white line.

Additionally another point that I mentioned is that there is no business logic with such a low premium. A premium of 2% to 3% is extremely low, especially in BS and BQ. And remember we have to increase prices in the third and fourth quarter as it is about 10% to take this premium to a value between 10%, 12% or 13% that would be reasonable. Of course, we know that importers have the risk of foreign exchange of delivery and others. This is what we're imagining in terms of prices for the second semester and we also work with enriching our portfolio day-after-day.

We continue to maintain 51%. When we have more than 6,000 clients we try not to have all the eggs in the same basket. And in the United States, as Benjamin mentioned, we have already captured an increase of $40 in the last few weeks. It seems to be accepted and of course we are going to try to send to the United States 250,000 to 300,000 tons, that will help us balance out the domestic market.

In tin plate, the good news is that there is no longer any imports of tin plate in Brazil. And the packaging which was importance in terms of profitability for CSN, once again occupy space vis-a-vis be plastic and other materials. All of this will enrich our portfolio the premium and our ability to penetrate the market. And we think we will be able to have a 10% price increase in the third and fourth quarters.

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

Thank you very much.

Operator

Our next question is from Thiago Lofiego from Bradesco. You may proceed sir.

Q - Thiago K. Lofiego {BIO 16359318 <GO>}

Hey, Good morning, and Martinez you remarked on that increase of 10%. Now, which has the risk of going back-to that premium, we see that there is a weaker demand in general. And as we see received demand once again is not very strong this year, which is the risk of not being able to increase the premium back to 10%.

If you consider the scenario of demand now you have mentioned that you are expecting an improvement. And once the blast furnace comes back into operation what will happen? What I'm attempting to do is to understand the risk of trying to return to that 10% premium. My second question that refers to mining, I would like to gain an understanding of the dynamic of purchases from third-party considering that these small producers tend to have a very high margin, which has been your procurement dynamic and if you are going to continue buying from third parties during the year.

A - Marcelo Cunha Ribeiro {BIO 4997029 <GO>}

Thiago good morning. When it comes to demand that I have to agree with you that a stronger demand will doubtlessly help us increase the price in the market. When we think about our cost context, the pressure is much greater 2% to 3% is a very low premium. If the premium were 8% to 10% the importer would not have the courage to import with those prices because of the very high risk. We are also not working only in the distribution market. There are other markets that demand other service levels and deliveries. I think that the risk is quite low, but the sector needs to work with greater intelligence. We need to recover profitability. We have to wait for the market to increase, increase to increase volume and understand the international dynamics.

Now in the second semester the buyers is positive and if demand increases, this would ease our work. Now, I think we will be able to implement this in the third and fourth quarter.

A - Luis Fernando {BIO 17590082 <GO>}

This is Martinez referring to the procurement from third parties. Last year we reached the goal of BRL7.2 million this year it has been of BRL6 million. Once we resolve the problem of demand we can look for more and this demand will be supplied by internal production. We're thinking of BRL40 million in sale of iron ore once again as guidance for the year.

Q - Thiago K. Lofiego {BIO 16359318 <GO>}

Thank you very much Martinez and Marcelo.

Operator

Our next question is from Mr.Caio Ribeiro from Credit Suisse. You may proceed sir.

Q - Caio B Ribeiro {BIO 18420483 <GO>}

Hey, good morning to all of you, and thank you for taking my question. My question refers to the iron ore freight that had a significant increase this year. If you could give us more color explain what has given way to this increase. Secondly, to speak about the environment of demand for steel in China, there have been some cut downs in production because of the Chinese government that should be reverted at the beginning of August, which means that at the beginning of August, perhaps there could be a greater steel production in China. I would like to know how you interpret this increase in steel inventory. Is this a sign that demand is increasing because of what we have seen until June of this year?

A - Unidentified Speaker

When it comes to freight we had an increase a significant increase in and there has also been an increase in the price of iron ore and we think that this will reach levels of $20 per ton. Now we are working with a positive outlook when it comes to the prices in iron ore until the end of the year. This is our specific case our prices are lagging behind, while we compare this with European and once again, we have a growing curve in terms of iron ore and there is that pressure. We understand that the iron ore inventories are dropping because there was a reduction in the premium price but we do believe that the prices will remain at the same levels until the end of the year.

Another important point China is much more complex than what we see. Perhaps it goes against what we are seeing. What is it that I see about China? $500 for BQ FOB is a very low price. Most of the Chinese plants are operating with negative results at this level of BQ price, because they buy all of the iron ore that is at a record historical level and we have to calculate things. In the case of China, they have imported enormous productions in the last few years.

They are trying to have a cleaner and more sustainable production and we do believe that the Chinese price cannot drop below $500, which would be impossible because of technical reasons and cost reasons. The most productive country, the most competitive country in terms of steel is Russia. They can produce a slab at $340, $350 China follows the international market, when it comes to raw material at least, this is our belief for this year. Obviously this issue of China and the United States has halted the deceleration, but we think there will be a trend towards an increase.

Q - Caio B Ribeiro {BIO 18420483 <GO>}

Thank you. Thank you very much.

Operator

Our next question is coming from Mr.Petr Grishchenko with Barclays. You may proceed.

Q - Analyst

Hi, thank you for taking my question. I couldn't hear too well on the call. Can you please help me a little bit better understand the actual items for the rest of the year? I don't know if you mentioned the dividends on CapEx and the role of payments to Glencore for the second half. Also can you please confirm if you do not include advance payment to Glencore as part of your risk calculation which appears to be the case?

And lastly, can you maybe share some thoughts on, I guess, there are some economics where you -- for proposed galvanizing plants and potential timing for CapEx. I mean, any details will be helpful, including capacities that you expect to bring in line. Thank you very much.

A - Unidentified Speaker

Peter, thank you for your question. When it comes to cash in the second semester, we're not trying to quantify this component, we do have our guidance. About your specific doubt the prepayment of iron ore by Glencore what it does is to just store things. You have the resource, you have cash vis-a-vis a nonfinancial liability. It will reduce the liability during the period against delivery and we did not consider this in our calculation of working capital. It is a reduction of liability during the period.

What we have planned and what we are executing is that every once in a while every six to nine months or every year, we will carry out new prepayment, so that this disbursement with the prepayment will not take place it will be replaced. In the cash flow calculations this should not be considered as an outflow. This is the way that we can figure things and that means that the cash flow for the year 2019 without taking into account financial initiatives at BRL2.5 billion.

Now as I mentioned, we are considering a CapEx of about BRL2 billion to address your second question, which is the expansion of capacity and investments in the galvanizing plant. This continues as is. We are moving forward in terms of planning financial aspects and engineering and evidently, this will not have an impact on the investments of this year, but in future years, it is an investment of about BRL350 million that will be carried out during a two year period during construction for 250,000 tons of galvanized products.

Operator

Thank you. As there are no further questions, we would like to return the floor to Mr.Ribeiro, the Executive Director of Investor Relations, for his closing remarks.

A - Marcelo Cunha Ribeiro {BIO 4997029 <GO>}

We would like to thank all of you for your presence, and we hope to see you at our next earnings conference call. Thank you.

Operator

The earnings conference call for CSN ends here. You can now disconnect your line. Have a good afternoon.