

Q1 2018 Earnings Call

Company Participants

- Ronald Seckelmann, Chief Financial Officer and IRO - Finance and Investor Relations Vice-President Officer and Subsidia
- Sergio Leite de Andrade, Chief Executive Officer and Director, Vice-President, Technology and Quality, and VP, Director Comme
- Unidentified Speaker

Other Participants

- Ivano Westin, Analyst
- Leonardo Correa, Analyst
- Marcos Assumpcao, Analyst
- Thiago Lofiego, Analyst

Presentation

Operator

Good morning, ladies and gentlemen, and thank you for waiting. Welcome to the Usiminas Conference Call with the results of the First Quarter of 2018. All participants are connected on listen-only mode. After the presentation, we will have a Q&A session, where further instructions will be given to all participants. (Operator Instructions) Please remember that this conference call is being recorded. This presentation comes with slides and is being transmitted simultaneously via Internet at www.usiminas.com/ri. You can also obtain a copy of the company's release, participants who are listening in English, also may ask the questions directly to the speakers.

Before proceeding, I would like to clarify that forward-looking statements made during this conference call regarding the company's business prospects, as well as projections, operational and financial targets related to their potential forecast are based on the management's expectations regarding to the future of Usiminas. These expectations are highly dependent on the performance of the steel sector, the country's economic situation and the situation of international markets, and are therefore, subject to changes.

With us today are Usiminas' Executive Board, Mr. Sergio Leite, CEO and Technology and Quality Vice President Officer and Commercial Vice President Officer; Mr. Ronald Seckelmann, Finance and Investor Relations, Vice President Officer and Subsidiaries Vice President Officer; Tulio Chipoletti, Industrial Vice President Officer; Takahiro Mori, Corporate Planning Vice President Officer; Wilfred Bill, Managing Director of Mineracao Usiminas; Heitor Takaki, Managing Director of Usiminas Mecanica; Ascanio Merrighi,

Managing Director of Solucoes Usiminas, Bruno Paulino, Head of Legal Department, Julio Arroyo, Controller and Leonardo Karam, Head of IR.

First, Mr. Sergio Leite will make some initial comments, followed by Mr. Ronald Seckelmann, that who will comment on the first quarter of 2018 results. After, the management will be available for the Q&A session. Mr. Sergio Leite, you have the floor now.

Sergio Leite de Andrade {BIO 6771322 <GO>}

Good morning to everyone. Thank you very much for participating in Usiminas conference call. Our meeting is always a special moment, so that we can present to the market, the results and to comment on that. Now regarding the results of the first quarter of 2018, I would like to highlight some points. Number one would be the EBITDA, we reached a net EBITDA of BRL641 million. This represents a growth in comparison to the fourth quarter of 42% and this EBITDA is the best EBITDA, excluding the impact of the Sudeste Porto agreement last year. This is the best quarterly EBITDA in seven years for Usiminas.

I would also like to highlight that during the first quarter, we continued with the reduction of our debt. We started the advanced redemption of our debt in December 2017, \$90 million were amortized in December; January a \$118 million were settled, and in March, we had a cash free effectively amortized a \$100 million. These three amortizations, when we compare our debt to the end of the third quarter of 2017, and our debt during the first quarter of 2018 is a drop of around BRL1.2 billion. I believe this is a reduction of 17% in debt.

Another point that I would like to mention is that in Usiminas, we're intensively working, our teams are totally mobilized. Our teams are encouraged. We are undergoing a very special moment and internal climate, where people feel pleasure to come to work and people more satisfied and more encouraged, produce more. This is very important. And this result that we are presenting here that is the best quarterly result in the past seven-year, it's a result of the Usiminas team.

Now these three points for us in Usiminas are very important points and the commitment that I have assumed with each one of you on behalf of all of our team, means that we will continue working intensively. Everybody is extremely mobile. The group of the ten continues mobilized and I believe that these are lively meetings, where I participate. Our commitment with each one of you is to work intensively to have better results for Usiminas.

Now, I will give the floor to Ronald Seckelmann, that is our Vice President.

Ronald Seckelmann {BIO 3722329 <GO>}

Good morning to everyone. Thank you very much for participating. I'm going to make some comments and I believe that you can see it through the slides. As always we start on our first slide with some operating and financial indicators. Steel sales are at the same

level than last quarter 1.089 billion tons. There has been an increase of 3% in domestic sales. Iron ore sales increasing 20%. During the past quarter, we had a growth driven by export, this was strengthened during the first quarter, we will see in details.

The adjusted EBITDA, Sergio mentioned totaled a margin of 20% during the first quarter and at last, we had the reversion of losses and now we have a profit of BRL157 million.

The next slide here, we have the quarterly evolution of our steel sales. During the past five quarters, and here, we would like to highlight that during the past four quarters, we registered constant growth in sales to the domestic market and a drop in our exports and we see the total sales volume of steel. Now we see the EBITDA margin, here we reached 569 million in margin in steel of 19%, and Usiminas is within the ranking of the most profitable companies -- in the company in this area.

Here we see the iron ore sales and we see a very significant growth in exports during the first quarter. I would say that, if we saw the average of these two quarters, and I believe a yearly results would be 6.5 million, 7 million tons.

The next slide shows you the EBITDA and the EBITDA margin. Here in mining, practically the same level than last quarter growing in absolute figures to 49 million and the margin is around 20% like during the past quarter. Now we see the evolution of EBITDA and adjusted EBITDA margin of Solucoes Usiminas going to BRL29 million. We have BRL10 million more in growth and the margin is 4%. And this is something that we expected from a distribution center, from a service center.

Here we have Usiminas Mecanica EBITDA and EBITDA margin, positive results, because this is the conclusion of the contract of value. So in reality, these are results that theoretically should have been registered last year, but the conclusion of the contract was now and this quarter reflects the conclusion of this project.

Here we see the EBITDA and EBITDA margin and consolidated BRL641 million representing net EBITDA margin of 20%, and when Sergio spoke about the best result in the past seven years, excluding the second quarter of last year. Here you can see with the FX of Porto Sudeste. Last year, we had BRL750 million.

And here we see the evolution of the consolidated G&A. Here the level is 3.2% vis-a-vis the other net income, dropping 5% vis-a-vis the last quarter in absolute value. And I can say that our level of G&A under any metric absolute value, value per ton sales percentage is one of the best, if not the best in the Brazilian and the world's steel industry. Working capital growing from BRL2.8 billion to BRL3 billion. BRL3 billion is normal working capital. The part of this growth is due to the increase of accounts receivable that did not increase in turns, but yes in values reflecting the best values of steel sales. Perhaps in the future, we will have an increase in prices of slabs or raw material like coal. But for the time being, we cannot see nothing outside, what is coming.

Now here we have how our steel inventories that are very important part of our working capital, are totally stable and under control.

FINAL

Bloomberg Transcript

The next slide shows the evolution of our growth and net indebtedness, and what Sergio mentioned a drop of BRL1.2 billion between the end of the third quarter -- third quarter of 2017, and the first quarter of 2018 with no losses in our cash that is very, very good.

And at last the evolution of our CapEx. Our CapEx during this quarter is below expectation. We expect to accelerate this in the upcoming quarters, because we have new CapEx products -- projects and our expectation is at the end of the year to have a value of around BRL500 million. These were my comments and together with my colleagues, we are at your disposal to answer questions.

Questions And Answers

Operator

Ladies and gentlemen, we will start our Q&A session. (Operator Instructions) We would like to remind you that this conference call is for investors and market analysts. And if anyone have questions please send them to the press department of Usiminas through 3134-998-918 or at the following email impressa@usiminas.com [ph].

Our first question from Ivano Westin, Credit Suisse.

Q - Ivano Westin {BIO 17552393 <GO>}

Good morning, Sergio, Ronald, the rest of the team. The first one would be regarding the cost in steel. You said BRL1,875, per ton and an increase of 6% quarter-on-quarter, one would be the cost of the slab. What do you expect in terms of the evolution of cost of slab? If there is a trend to have a greater pressure, or if you believe that you will be able to transfer the price to offset the pressure of cost. I would like to know, how you see the evolution of the metal spread during the third quarter?

And my second point would be regarding a discussion from the past, regarding the blast furnace in Cubatao and throughout the last year, you said that the strategy would buy slabs from the market. Today, we have a cost, that is slightly a higher than what was initially expected regarding slabs.

And I would like to know if you are thinking about reconnecting the blast furnace in Cubatao and if there is a range of slab price that would encourage you to recognize the blast furnace?

A - Sergio Leite de Andrade {BIO 6771322 <GO>}

I am going to start with the primary area of Cubatao, when we decided to disconnect temporarily, the primary area in January of 2016, our view was to disconnect it for five years, this was temporary. And we have always mentioned that the resumption of the primary area of Cubatao undergoes, for that we need a robust recovery of the Brazilian economy and this hasn't happened last year. We grew a little bit this year. The expectation between 2%, 3%. Now we have seen in the last six weeks in the Focus Report from the

Central Bank that there is a cooling down. It was 2.9, now it's 2.75. What I can tell you is that this matter, is an important matter to us.

We constantly analyze this matter, but today there is no perspective in resuming the primary area of Cubatao. At least for three years, we have to study this and the Brazilian economy must recover for this to happen. Throughout this week, we resume the blast furnace of Ipatinga, Ipatinga 1. This operation is represents a 20% growth of slab production. So, this is our situation. Now the situation regarding the cost of the steel mill, you mentioned the cost of this slab. We are in a moment, where the cost of the slab in many moments is above the price of the Chinese reference in the international market. And our view because of 2, 3, to the slab market, that is a demanding market. It is strongly influenced by what will happen regarding 232 and it is clear today that there are three markets that offer slab, one is the Brazilian market with high, with elevated prices. This would be around \$600 per ton, because of the undergoing negotiations between Brazilian and US government. Another market that is a market that involves more Russia, have prices \$570 and \$580 a ton. And the third market that is the iron slab market. And I believe that the market is at a level between 500 and 540. So, our prospect regarding the price of slab in the international market is a small buyer.

Q - Ivano Westin {BIO 17552393 <GO>}

When will we have this drop?

A - Sergio Leite de Andrade {BIO 6771322 <GO>}

Well, this is a great question that we have because the market suffers pressures from demand, more than in the supply of a pressure.

Q - Ivano Westin {BIO 17552393 <GO>}

No, the drop of prices of slab that you expect, I know you try to transfer the price to the distribution as of June. Could you comment on this end and how much metal spread do you expect?

A - Sergio Leite de Andrade {BIO 6771322 <GO>}

What we are following constantly is following the market dynamic, in terms of the international price that impacts the domestic market. And seeing the exchange variations in our view, probably it will be possible to have a change of prices in distribution because of the increase in price in the international market that right now presents a slight growth, it was 570 and now it's about 580. And on the other side, the price differential that I always mentioned that you call premium right, the premium currently is around zero, that is the level that allows us to change prices.

Now in our view, the expectation is that in June if there is a slight high in the international market, and with a stable exchange rate 3.30, 3.40 that we have observed. I believe that we will be -- we will decide to increase prices in the domestic market.

Q - Ivano Westin {BIO 17552393 <GO>}

Can you quantify this increase, will it be reasonable to expect a premium at 10%?

A - Sergio Leite de Andrade {BIO 6771322 <GO>}

Ivao 10% is too much. I'm going to tell you that it would be, in our view, 5%, 10% is too much.

Q - Ivao Westin {BIO 17552393 <GO>}

Thank you very much.

Operator

Next question from Mr. Leonardo Correa, BTG Pactual.

Q - Leonardo Correa {BIO 16441222 <GO>}

Good morning to everyone. Thank you for taking my question. Number one, regarding prices and prospects for results during the second quarter. For you, look during the past quarters you indicated, how much could be the price carryover quarter-on-quarter? Many things were announced during the first quarter regarding price increase. The three major steel consumers most of this was implemented during the first quarter. The price increase is 8% quarter-on-quarter. So, what else can we transfer? What else can we expect in carryover for the second quarter? And if you could talk about cost pressure, so we can understand the EBITDA evolution quarter-on-quarter.

And my second quarter [ph] regarding volumes, you mentioned that we are observing a slowdown in some data, slowdown regarding expectation, within your data we still cannot see weak data, because they're very strong. What is the demand scenario for you for the second quarter? Thank you very much.

A - Unidentified Speaker

Okay, Leonardo. As you mentioned, during the past earnings call, we forecast what may happen regarding price variation. What I can say is that the expectation would be an average price variation during the second quarter between 3% and 5% and closer to 5%, when compared to the first quarter. Now in other assessment in terms of cost, our expectation is that the cost will continue aligned our average cost. COGS will be aligned with the price variation. Therefore, we would have -- we would maintain our margins.

Now regarding volumes, our expectation for 2018 that is Brazil Steel expectation, we are working with an expectation of growth of 7%. This would be for flat steel, Brazilian consumption and within this expectation during the second semester, we'll continue the growth of the first semester.

Now obviously, during the past five quarters, quarter-on-quarter, we have presented a slight improvement and we will continue on this path. But I would like -- I would like to say that we will be aligned in terms of volume, so stable volume quarter-on-quarter within the domestic market, yes.

Q - Leonardo Correa {BIO 16441222 <GO>}

Okay, this is clear. Thank you very much.

A - Sergio Leite de Andrade {BIO 6771322 <GO>}

Thank you, Leonardo.

Operator

Our next question from Thiago Lofiego from Bradesco BBI.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Good morning to everyone. Two question. Going back to the slabs, in the Ipatinga blast furnace, when will it make a difference in your steel production cost? And my second question regarding investments, if you have normal maintenance CapEx, that something that you will see during the next two years. What could be your next investment in terms to grow more, so perhaps and you galvanizing unit, something to supply more to the automated industry, and if you could say something about the blast furnace 1 and Ipatinga, what the timing will be?

A - Sergio Leite de Andrade {BIO 6771322 <GO>}

I will talk about your first question, the impact and reflection of the resumption of the blast furnace one of Ipatinga. We will see the real effects of the additional production of blast furnace 1 during the fourth quarter this year, and I'll explain why the blast furnace was resumed in the beginning. In June, we will stop the big blast furnace 3. It will go through a scheduled intervention of the 11 days. So, part of the production of blast furnace, when will replace? What will not be produced by blast furnace 3 from Ipatinga? When we go to the fourth quarter, the addition of production of almost 2,000 tons a day of blast furnace 1 will be felt? Now everything will be absorbed by the production of Usiminas plant, so we'll be able to increase the level of production of lamination.

What about purchase slabs and owned slabs in our mix, so we have 30% purchase slabs, 70% owned slabs in the consolidated results of both plants. This will depend a lot on the evolution of the price of the slabs. So, probably throughout the second quarter there will be no significant change in this result, perhaps we will see a drop of purchase slab during the third quarter and the fourth quarter. It's still too early to give you any type of forecast.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Now about slabs, you mentioned an increase of 3% quarter-on-quarter. If we see the current price of slabs in the market, if the price continues in this level with no impacts of cost, do you believe that the cost of the second quarter shows us the reality?

A - Sergio Leite de Andrade {BIO 6771322 <GO>}

If the price of slab is maintained this makes feasible, some businesses like the export business, as we only buy slabs in Cubatao, when we have a feasible sales business, what

FINAL

Bloomberg Transcript

FINAL

happens we will not realize some business and we will reduce the volume of purchase of slab.

You asked about relevant investment in the upcoming years. As a matter of fact, what we are studying is A third line of galvanization we started in A very preliminary fashion towards the partial resumption of the primary area of Cubatao. These would be the two new investments that we are evaluating and are also galvanizing, does not mean growth. But yes, having a greater mix of products, the resumption of blast furnace 1 and this would represent the replacement of purchased slabs by own slabs. So, you spoke about the blast furnace 3 of Ipatinga, this is the retrofit and this is something that is expected. I believe that this will not happen before 2021, and we are assessing the evolve for the retrofit of the blast furnace 3 Ipatinga going back to a new plant of galvanization and to reignite the blast furnace.

If the Board approves the investment by the end of this year and the beginning of next year, these two investments would take two years to deploy. We are talking about investments that will deliver results as of 2020, 2021.

Q - Thiago Lofiego {BIO 16359318 <GO>}

And what about the CapEx range here?

A - Sergio Leite de Andrade {BIO 6771322 <GO>}

No, we are working on this right now, we don't have this.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Thank you very much. I would also like to thank you for your help during the past years. And thank you very much.

A - Sergio Leite de Andrade {BIO 6771322 <GO>}

Thank you, Thiago.

Operator

Our next question from Marcos Assumpcao, Itau BBA.

Q - Marcos Assumpcao {BIO 7474402 <GO>}

Good morning to everyone. Sergio, a question regarding the flat spread. What will be the breakeven production of slabs in Cubatao, and when you have slabs available in Ipatinga to send to Cubatao, how much will this logistic cost to send slabs from Ipatinga to Cubatao?

Last year it was a very competitive, but now with a spread, the -- of low slab prices, perhaps it makes sense.

And lastly if you could comment on the pros and cons of making a great refurbishment on the blast furnace 3 of Ipatinga or a partial retrofit. Is there a possibility of about partial retrofit in the blast furnace 3 of Ipatinga to extend its life?

A - Sergio Leite de Andrade {BIO 6771322 <GO>}

Okay. Regarding the spread, here you mentioned the spread. In our view, to enable the transformation of slab in B2. The spread that is balanced is between the price of reference of the cue from China, minus the price of the slab. Let's say, for Brazil, Brazil is one of the great slab producers, about \$50. So, this is a spread that is the balance spread for us, so that we can carry out this operation. In the past weeks we found negative spread. The slab Brazilian price was above the queue price. Now regarding the increase of slab production in the Ipatinga, is that we want to -- we want to laminate them to machine them.

Now Ronald mentioned something that is very important. The retrofit will not take before 2021, at least 3, 4 years. Number two, we are studying the subject, just starting to study it. It is too early to position ourselves regarding, what is more convenient, a partial retrofit or a full retrofit, so that it can work for over 20, 25 years. Everything will depend on the economic analysis. And to see the feasibility of these two options, we have to be advanced in terms of basic engineering and in terms of equipment.

Q - Marcos Assumpcao {BIO 7474402 <GO>}

Perfect. Just to clarify something. So, today with the negative spread it wouldn't make sense to have finished products, finished slab in Cubatao. So, this trend will not continue. The price of the spread will increase and it makes sense to maintain your operation because today, it would make sense to have finished slabs in Cubatao, and you could close the operation.

A - Sergio Leite de Andrade {BIO 6771322 <GO>}

In Cubatao, we have three operations and our operation that deals with the domestic market. A second operation that sees the north and northeastern market. And then when we see the existence of the port. And a third operation that is of export, so with this spread. That is negative when we see the price of Brazilian slabs. If we see our Iranian and Russian price, it is below the breakeven of \$50, the export operations have been suspended. We expect an impact of three months here. And this unbalanced situation this in terms of the economics. This unbalanced won't last for a long period of time, but at least during three months and three months, this will impact the exports of the third quarter. We are not going to export, so finished products, finish slabs will be for the domestic market.

And Marcos another thing, you spoke about the breakeven of Cubatao. The breakeven of Cubatao was a 100 million tons per month. In the past, the average to reduce conversion cost in Cubatao already brought this breakeven to 18 million tons and we want to drop this 80,000 tons.

Q - Marcos Assumpcao {BIO 7474402 <GO>}

Okay. Thank you, Sergio. Thank you, Ronald. And I would like to thank you once again for all the support that you have given us, and lots of success and good luck in the challenges that come ahead of you.

A - Sergio Leite de Andrade {BIO 6771322 <GO>}

Thank you, Marcos.

Operator

Ladies and gentlemen, as we have no further questions, we bring our conference call to an end. Should you have any questions, the IR team is at your disposal. We thank you for your participation and have a very good afternoon.

This transcript may not be 100 percent accurate and may contain misspellings and other inaccuracies. This transcript is provided "as is", without express or implied warranties of any kind. Bloomberg retains all rights to this transcript and provides it solely for your personal, non-commercial use. Bloomberg, its suppliers and third-party agents shall have no liability for errors in this transcript or for lost profits, losses, or direct, indirect, incidental, consequential, special or punitive damages in connection with the furnishing, performance or use of such transcript. Neither the information nor any opinion expressed in this transcript constitutes a solicitation of the purchase or sale of securities or commodities. Any opinion expressed in the transcript does not necessarily reflect the views of Bloomberg LP. © COPYRIGHT 2022, BLOOMBERG LP. All rights reserved. Any reproduction, redistribution or retransmission is expressly prohibited.

FINAL

Bloomberg Transcript