

Q3 2020 Earnings Call

Company Participants

- Gustavo Werneck Da Cunha, President and Chief Executive Officer
- Harley Lorentz Scardoelli, Chief Financial Officer

Other Participants

- Andreas Bokkenheuser, Analyst
- Caio Ribeiro, Analyst
- Carlos de Alba, Analyst
- Daniel Sasson, Analyst
- Jonathan Brandt, Analyst
- Leonardo Correa, Analyst
- Rodolfo Angele, Analyst
- Thiago Lofiego, Analyst
- Timna Tanners, Analyst

Presentation

Operator

Good afternoon and welcome to Gerdau's conference call to discuss the results of the Third Quarter of 2020. (Operator Instructions) We would like to emphasize that any forward-looking statements that might be made during this conference call related to Gerdau's business outlook, projections and financial and operating goals are mere assumptions based on management's expectations related to the future of the company. Even though Gerdau believes that its comments are based on reasonable assumptions, there is no guarantee that future events will not affect this evaluation. Here today are Mr. Gustavo Werneck, Director, President and CEO; and Harley Scardoelli, Vice President and CFO.

Now I would like to turn the floor over to Mr. Gustavo Werneck. You may proceed, sir.

Gustavo Werneck Da Cunha {BIO 20318216 <GO>}

Well, good afternoon, everyone. I would like to begin by welcoming each one of you to Gerdau's conference call on the results of the third quarter of 2020. And I really hope that you are all well, in good health and safe and going through this period, the best way possible. Also present here today is our CFO, Harley Scardoelli. And so for both of us, it's always a pleasure to talk to you about our performance and also clarify possible issues and answer questions that may come up during this presentation. Scardoelli will then start

by talking about the highlights and the general results of the quarter and also about the performance of our operations. And next, I will refer to the markets where we operate, and also I will talk to you about the landscape looking forward. And then at the end, we will both be available to answer your questions.

So now Scardoelli, the floor is yours.

Harley Lorentz Scardoelli {BIO 7283603 <GO>}

Thank you, Gustavo, and good afternoon, everyone. It is a great pleasure to be with you once again for another earnings release, and I hope you are all well. I will start with the financial results for the third quarter 2020. As you can see on this slide, free cash flow in Q3 of this year was positive by BRL2.3 billion. This increase vis-a-vis the second quarter '20 reflects a combination of an EBITDA 62% higher than in Q2 and lower working capital attributed to the return to less than 70 days of the cash conversion cycle. It's also important to mention that in the last 12 months, the company posted positive free cash flow of around BRL4.4 billion, reinforcing its liquidity position. The cash conversion cycle went from 95 days in June 2020 to 63 days in September of this year, thus optimizing working capital after the effects of the COVID-19 pandemic, promoting a reduction in inventories in the period combined with days payable increasing more than days receivable, reflecting the recovery in the economic activity and good conditions for payment terms.

Now moving to Slide 3. I would like to emphasize that at the end of the third quarter of this year, our net debt came down to BRL12.3 billion. I also take this opportunity to mention that 89% of this debt is long-term with an average tenor of 7.7 years and almost 8 years, at an average nominal cost of approximately 5% with a well-balanced amortization schedule distributed along the next coming years. Currently, 85% or BRL16.5 billion of the debt is denominated in U.S. dollars. We understand that with a significant portion of our EBITDA being generated in U.S. dollars and with great part of our assets and operations located in North America, due to our geographic diversification, we have a natural hedge to support this debt position. In addition, this is a long-term debt with maturity scheduled throughout this period with no overlapping of commitments in any given year. Even so, we have been monitoring the Brazilian debt market to detect possible windows of opportunity to rebalance our exposure. The net debt over EBITDA ratio went from 2.78x in Q2 of '20 to 2.07x in the third quarter of the year due to higher EBITDA in the last 12 months. The company remains focused on reducing leverage and reaching the indicators defined by the Board, which is between 1.0 to 1.5x the net debt over EBITDA in the long range.

Now moving to Slide 4. We will now highlight the main factors that impacted the consolidated EBITDA, which went from BRL1.3 billion in Q2 of '20 to BRL2.1 billion in the third quarter. This increase was partially attributed to higher shipments to the domestic market in the Brazil BD, good levels of demand in the North America BD and improved results in the South America BD. EBITDA margin was also positively impacted, reaching 17.5%, with a margin of 25.1% in Brazil. It's also important to stress that the company's discipline regarding SG&A that reached 3% this quarter, the lowest historical ever posted by Gerdau with a direct positive impact on the EBITDA margin.

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Bloomberg Transcript

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In Brazil, EBITDA was higher due to an improved market mix. Shipments to the domestic market when compared to total shipments went from 73% in Q3 '19 to 86% in Q3 '20. I'll also take this opportunity to mention the increase of total shipments in Q3 vis-a-vis the previous quarter due to the vigorous rebound into the construction, both retail and direct sales to construction companies, in addition to the recovery of the industry and the domestic market. In North America, EBITDA in Q3 '20 was higher quarter-on-quarter due to resilient shipments and efforts to optimize costs despite the metallic spread reduction that went from US\$415 per short ton in the second quarter of this year to US\$402 of short ton in Q3 of this year. Also, margins of this operation were above 10%. In South America, the good result stems from the strong demand from the civil construction industry, mainly in Peru and Argentina, also considering the unsatisfied demand of the second quarter of this year when some projects were shut down during the pandemic period.

To conclude, at the Special Steel BD, the rebound came from the automotive sector with a positive impact on EBITDA. For almost 4 months, this industry was heavily hit by the negative impacts of the pandemic. In Q3 of '20, they've started to recover volumes, and as a consequence, the capacity utilization rate that was 30% in Q2 of this year is now at 50%.

Thank you all for your attention, and now I'll give the floor back to Gustavo, who will comment on the market outlook.

Gustavo Werneck Da Cunha {BIO 20318216 <GO>}

Thank you, Scardoelli. So please, let's go to the next slide where we will talk about how Gerdau has operated throughout this year of 2020. Scardoelli talked about Gerdau's performance in the third quarter, and we continue to post solid results. I would even tell you that acting fast to resume our industrial operations and also the fact that we were very close to our customers, all of that allowed us to fully serve all the different markets where we operate globally, in the midst of a robust rebound of steel demand, after a period of great uncertainties and also volatility brought about by the COVID-19 pandemic, as you've been also experiencing. I would also like to say that in the last few months, we were also able to accelerate the pace of our digital transformation strategy, which resulted in an increased number of quotes in our website from 14,000 back in January to 50,000 in September, thus reinforcing our commitment to generate greater value to our commercial partners.

Now moving to the next slide. I will talk about the markets operated by Gerdau, and I will also tell you about the outlook looking forward. Well, in Brazil, we are now reaping the benefits of having an anticipated and more constructive view about the rebound in different markets we serve, especially in the construction industry that is showing clear signs of a V-shaped recovery, driven by increased sales of properties and retail. With the speedy and gradual restart of all of our industrial units in the country in the second half of April, meaning less than a month after the onset of the pandemic, including the resumption in July of the Blast Furnace 2 in Ouro Branco, Minas Gerais, our team was able to diligently serve all of our markets and sectors where we operate. This agility to resume operations after a strong effort to make adjustments to our production capacity, as I said at the end of March, combined with a rebound effect of repressed demand seen in the

second quarter, led us to increased production volumes and long steels shipments in the third quarter when compared to the pre-crisis period and even similar periods of the last few years. This vigorous recovery of the construction industry in Brazil, especially between July and September, benefited not only from its growth trajectory but also it benefited from the resumption of several projects that had been interrupted or even slowed down in the second quarter. This led companies in the industry to accelerate the pace of their projects to compensate for this delay, which in turn boosted, as I said before, the steel consumption.

We monitor an indicator from CNI called (Foreign Language). This index evolved quite a bit, showing the construction activity at 51.4 points in September, meaning that it was at 3.3 points vis-a-vis July. This 51.4 index is the highest rating since June of 2009, which indicates a significant improvement when compared to the previous month. The third quarter was also impacted by a strong movement to replenish inventories in the construction chain as a whole, as the sector suffered a significant reduction in the inventory levels in the second quarter due to all the market uncertainties. I think it's worth mentioning the continued progress of the retail segment that has been showing impressive growth, mainly boosted by sales of construction materials to the so-called self-builders who received the emergency aid from the federal government.

According to the last monthly trade survey conducted by IBGE, the retail market for construction supplies experienced its third consecutive sales volume growth. It was 3.6% above July and 24.1% higher than what was posted in August 2019. Year-to-August shows a 4.9% sales increase when compared to the same period of 2019. Also, I think it's worth mentioning that different industrial segments in Brazil resumed their growth trajectory after a sudden interruption in March and April when soon after most of them restarted their production at levels equal or higher than those posted early in the year. I would like to mention in particular the sectors related to agri business, energy and durable goods. Similar to what we saw in the construction industry, we also experienced an important move towards replenishing inventories in the industrial market. The industry confidence index from Fundacao Getulio Vargas, something that we monitor very closely, advanced 8 points in September reaching 106.7 points, the highest level since January 2013, which again reinforces the recovery outlook.

Now looking forward, we are very confident that the demand for long steels in Brazil will be maintained, reflecting the increase in sales of new properties, retail purchases and also infrastructure projects. For instance, in terms of infrastructure, we already saw the restart of important projects, like the subway in Sao Paulo and Fortaleza and bridges and overpasses around the country. We are also very optimistic regarding the new legal framework for basic sanitation. Now as for the industrial sector, our outlook is also very positive for 2021. A recent survey conducted by CNI indicates that the confidence rate of industrial entrepreneurs increased in all 30 sectors of the industry considered in the survey. This indicator for the downstream industry rates 62.6 points, a leap of 5.1 points in the monthly comparison. I would also like to stress that the continuous growth of steel demand in Brazil relies on solving the structural problems of the country in the long run and also the evolution of the reforms proposed by the government, like the tax and administrative reforms, and also other measures to boost the economy and increase competitiveness and productivity in the industrial sector.

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Well, now I'll talk about our Special Steel's operation, and I will talk more about Brazil, especially when -- during the Q&A session. So starting with Brazil, I think the demand recovery of the automotive industry was intensified during the third quarter after 4 months of a significant drop in consumption, resulting in a relevant growth in the orders portfolio because right now, we are seeing a growth in the number of orders. Despite the positive outlook, automakers are still operating at lower levels when compared to the early projections for the year. According to the National Association of Automotive Manufacturers, ANFAVEA, the daily average production for new vehicles was 9,900 vehicles year-to-September, against 11,200 in 2019. Just to illustrate this point, in the worst moment of the crisis in April, only 1,847 vehicles were produced that entire month. On the following months, this -- the performance of the automotive industry will be paired by also a positive performance in the wind farming and agricultural machinery sectors. And we will remain very diligent to capture opportunities to increment domestic production of auto parts due to this new market dynamics that follows the crisis.

Now in terms of the U.S., the demand for special steels, especially in the automotive industry, is also growing in the second half of the year, thus contributing to an increase in vehicle sales, and by the end of 2020 when the industry should produce over 14 million units. The country continues to post a lower level of activity in the oil and gas industry, but in terms of other sectors like agriculture, they have been quite resilient despite the crisis. Moreover, we remain focused on our initiatives to increase productivity in the Special Steel units in the United States with the shutdown of the Jackson unit in Michigan and the transformation of the Monroe unit in that same state, which is a world-class mill that will be a global reference in technology and productivity. This mill is being prepared to fulfill the future demand for steel.

Now we will talk about long steels in North America. I would like to start by highlighting that the volumes for this operation remained very high during the third quarter since manufacturing and construction industries performed well. A very important index is the Architectural Billings Index, which anticipates the performance of the nonresidential construction sector in the U.S. And in 12 months, it jumped 40 -- it went from 40 points in August to 47 points in September, even above pre-pandemic levels. On the other hand, metallic spread had a slight decline in the quarter, reaching close to \$400 per short ton. But we believe that there should be a recovery in the next coming months, returning to previous levels of around \$415. Also, I would like to highlight our relentless initiatives to reduce costs and improve performance, including the shutdown of the St. Paul unit in Minnesota.

Now looking forward, we see a positive outlook, not only for the construction industry but also for the industrial sector. We are also closely monitoring the unfolding of their presidential election in the U.S., which will take place in early November. And we hope that the significant investments in infrastructure are finally released in 2021.

Now moving to South America. I would like to highlight the rebound of the industrial and civil construction sectors, especially in Argentina and Uruguay, and also in a very strong way in Peru with sales performance in their respective domestic markets being quite strong, particularly during this third quarter. And finally, to conclude this slide, I would like to say that we invested in this third quarter, BRL360 million in PP&E, plant, property and

equipment, as part of our BRL1.1 billion of investments during the first 9 months of the year, with a total investment estimate of BRL1.6 billion for 2020.

Now let's jump to the next slide. And here, I would like to mention the establishment of Ventures Gerdau, which is the recently created start-up for Gerdau Next, our new business arm which I mentioned to you before. In October, we ran the first batch of the accelerated, focusing on entrepreneurialship in the civil construction industry. By doing so, we connected with the main global innovation ecosystem and with Construtechs, seeking to generate value and propose solutions to our own sector. Furthermore, I would like to say that our teams have worked nonstop to serve our customers in this moment of a strong rebound. From the onset of the pandemic, we were very close to our customers, trying to understand their needs, and putting our teams at their disposals to help them capture all of the opportunities that we're able to identify. Very quickly, we were able to increase our overhead, and we are trying to operate in a very productive way, especially in Brazil, in order to serve all of the different markets.

And I have a special thanks that goes to our customers for their partnerships during this dire and challenging months and reaffirm Gerdau's commitment to generate even more value to the chains where we are a part of. Also, I would like to highlight another important move during this quarter which was the approval by CAGI of the acquisition of the steel producers, Steel Latin Sierra. The acquisition of this company will contribute to help Gerdau serve the future demand for steel in the Brazilian market and more specifically in the northeast of the country.

I would also like to say that at Gerdau, we have deepened our discussions around sustainability and how we evolve with our business. We are constantly seeking to generate more value to all the stakeholders involved. And as part of our commitment to sustainable development and also a consequence of our purpose, as of September, we became part of the B Movement Builders, a coalition launched by B Lab and Sistema B Brazil that gathers large listed multinational companies aiming at transforming the global economy into a more sustainable model that contemplates long-term value generation to all stakeholders.

And finally, to conclude this part, I would like to really thank our employees for their enormous effort and dedication during this third quarter because due to their hard work, we were able to ensure the quick rebound of our production units, and thus serve all of our customers. Also, I extend our thanks to the teams for putting the health and safety of our employees first because for Gerdau, nothing matters most than the lives of each one of us.

Now, I conclude this part and Scardoelli from now on will be at your disposal to answer your questions and also to give you more details about our performance in this third quarter and what we see looking forward. So now let's go to our Q&A session.

Questions And Answers

Operator

(Operator Instructions) Our first question comes from Mr. Leonardo Correa from BTG Pactual.

Q - Leonardo Correa {BIO 16441222 <GO>}

Can you hear me well, because I think my line is not very good?

A - Gustavo Werneck Da Cunha {BIO 20318216 <GO>}

We can hear you very well.

Q - Leonardo Correa {BIO 16441222 <GO>}

Right. Congratulations for your results. First question is about volumes, and I know that you've been monitoring the pace of the market. I think that the investors are debating the sustainability of this level of demand. What is happening in this third quarter is something that I've never experienced before. I don't know whether you've seen something like that before. But it is something unprecedented. Your demand is spiking in the domestic market, reaching -- increasing by 30% year-on-year. And I know that the chain was not well supplied, and I know that there was a drop in demand during the pandemic. And there is a lot of competition from the small market or the self-builders. It's hard to monitor all the data but we know that demand is increasing by 30% year-on-year. So it's a bit asymmetric. I think people are questioning how much longer this level of demand can be sustained, because maybe in the next few months, this will be exhausted because I don't think that we will -- the government won't be able to sustain this level of emergency aid for much longer. So what do you see looking forward once you look at your orders portfolio? How do you see this evolving towards the fourth quarter? So if you could tell us a bit about 2021, even though it's very soon, maybe this will help us understand whether this will be sustainable.

And the second point is about the fact that this is unprecedented. We are living in an unprecedented time. I think pricing is something very one-off thing. But I think what happened was the variable of FX because it increased by almost 40%, which led you to announce these 4 or 5 readjustment moves. But we still see zero-sum premium after the increase in November, depending on how you look at it. But how do you see this scenario? We are already looking at things from some associations. There is some political noise here and there. I just want to hear from you, how do you see the pricing behavior and whether you still think that you can revisit the premium prices in the future?

A - Gustavo Werneck Da Cunha {BIO 20318216 <GO>}

Great question. Let's start -- let's focus on demand and market and prices, et cetera. I would just like to say one important thing. People are constantly talking about digital transformation in other segments like services, et cetera, but I've always insisted, and I've always talked to you about the fact that Gerdau, being a centenary or 100-year-old company, that it's important that we introduce digital transformation that can bring good results for the company. So if you recall, back in May, in one of our earnings release call, I said that according to Gerdau, I think the worst is already behind us. But back then, I was very certain about what the landscape would be and that things were beginning to recover. I mean my reading could be based on intuition or feeling, but rather than that,

my reading comes from concrete data and elements that we were able to collect in the market.

I would say that today, our company has the capacity to utilize a lot of data and algorithms. And in a way, we also resort to artificial intelligence to anticipate future demand. Our projections looking forward contemplate science and digital transformation. Not only that, but I would say that it is higher than what we've seen because we are about to celebrate our 120th anniversary with long-term relationships with our customers. So we have an idea of what happens at the other end. This is just an introduction, just to say that our reading right now, it's very constructive and I know that demand will remain sustainable for longer throughout 2021. Our projection when you compare 2020 to 2021 should grow between 6% to 8%. And at the end of this year, our portfolios are already built up. Therefore, this move now should continue to last until the next few months. But throughout the year, we will have the accommodation of the main markets, and I'm talking about -- I mean civil construction and retail that was posting growth. I'm also talking about agriculture even though it's far from what it was months ago. I mean we already have a backlog of orders. I'm talking now about infrastructure. And the industry housed an important recovery as well, and we believe that this recovery will last longer. This is a positive moment when you think in terms of what is ahead of us.

Now in terms of prices, well, I just want to be very direct, and maybe my pricing answer could be a bit academic. I've been hearing opinions and rumors that are not really true in terms of that particular topic. But I don't want to stir any more polemic about this topic. But well, what I'm saying is that, that statement that some are saying that the price of steel has been sequentially going up, especially in the domestic market, is unfounded. It's not true. We've been facing a strong increase in the price of inputs, so the levels of steel in 2020 have not recovered when compared to 2019. Our financial results in the third quarter of 2020 reflect a combination of a very strong volume increase due to a stronger steel demand that nobody anticipated, but also that was due to a very strong move to reduce costs and expense. This is a movement that has been happening for a few years back because we are trying to focus there to support our cause. So the company is absolutely ready to face high demand. And we are able to then post very sustainable performance. The record we posted, this performance in terms of SG&A versus revenue, is proof of my statement. And also you have to think about our cost reductions being an important part of our bottom line.

We are working hard to supply the market. In our view, we are one of the first companies to resume production which -- it happened back in April, so therefore, we are able to fully serve our customers, this -- the rebound of the blast furnaces in Brazil until it resumes pre-crisis level for supply and demand. I mean we were -- despite that, we were able to fully serve our customers. We are supplying products to all of our customers. We do not anticipate any scarcity of products. Therefore, to conclude, we will increase our profitability levels. Scrap and input prices are going up in order to be profitable. And in order to remunerate our shareholders, we have to work really hard and diligently.

Operator

Our next question is from Daniel Sasson from Itau BBA.

Q - Daniel Sasson {BIO 19234542 <GO>}

Congratulations for your results. My question is a follow-up of Leo's question. Could you elaborate a bit on your market share? I mean comparing your volumes to that of the industry, how do you see this competition in the third and fourth quarters with the resumption of the blast furnaces? Do you think that there should be a difference in your market share once the other industries also resume their operations? Now as in regards to pricing, you talked about margin recovery and cost pressure. I know that you don't talk about potential future announcements, but maybe you could shed some light in terms of the pricing carryover to the fourth quarter of what has been already announced in the third quarter, I think this could be helpful.

My second question is about the South America margin. I think that the margins were repressed because of all of the shutdowns, and there are some countries where things were more restricted like in Peru. But 30% margin was the highest in your history, could you tell us what was behind that? And how sustainable the South America margin could be?

A - Gustavo Werneck Da Cunha {BIO 20318216 <GO>}

Thank you, Daniel. It's always a pleasure to talk to you. Well, the numbers that are public, we compare sales to the domestic market and the numbers published by IRBR and the numbers published this morning, they all prove that, that information about the share sales grew by 1.4%, whereas ours, it's 6.4%. There was a reduction of 8% in the market, whereas we grew 10%. Therefore, Daniel, this is what I said before. We were very quick to read the rebounding signs. I think we were, I think, the first company to resume operations. And we had the right products to deliver to our customers when they needed it. This is due to an enormous effort on the part of our teams. We were quick to market, and we were quick to act to serve the demand. So now what we have to do is sustain the current levels that we reached now. This is the work we have ahead of us. But I don't want to give you too many details about pricing because, certainly, there will be some carryover into the next months or the next quarter. This is natural. But we have to constantly seek for profitability. We are trying to revisit our historical spread volumes. The pressure is here to stay. Scrap prices have had an important impact, but certainly for the next few months, I think we should expect some carryover.

Now I will give the floor to Scardoelli to elaborate on the margins in South America. So I will just share the answer with him, and he will be able to give you more details about that topic. Thank you.

Scardoelli, I think you're muted. Could you please start over?

A - Harley Lorentz Scardoelli {BIO 7283603 <GO>}

I'm sorry, I touched the mute button inadvertently. In South America, we are seeing a demand improvement which has been very strong in the third quarter. What we can tell about these operations is that our EBITDA, it's part of the consolidation of South America. So sometimes there is also that aspect that we had a very good performance, in the case of Colombia and others, because they had a very good market recovery in the quarter.

And this had a positive effect on the margin. If you look historically, in the South America operation, margins have been much higher when compared to a few years back. So in fact, I would say, yes, these margins are sustainable in the long range. But if we look at the second quarter and looking forward, this third quarter, we experienced a strong leverage, especially because of our EBITDA numbers as well.

Operator

Our next question comes from Rodolfo Angele from JPMorgan.

Q - Rodolfo Angele {BIO 1541593 <GO>}

I have two questions. First, working capital. We've seen a major reversion of working capital even though this was a quarter of strong growth. So I would like to know whether Harley could comment on what we should expect looking forward, like fourth quarter and also 2021. And my second question is addressed to Gustavo. We clearly see that we are entering a very interesting phase for the company, strong growth. So my question to you is, within the company, the -- your agenda for next year and the following year, this cash surplus, whether next year is just as good, are we going to use that to pay out dividends? Or you are thinking in terms of organic growth?

A - Gustavo Werneck Da Cunha {BIO 20318216 <GO>}

Rodolfo, it's always a pleasure to talk to you. So Scardoelli will start with working capital.

A - Harley Lorentz Scardoelli {BIO 7283603 <GO>}

In terms of working capital, we were able to post an important reduction this quarter. If you look at the trends, you will see that according to the activity level we grew a lot this quarter, there was an increase both in terms of accounts receivable and payable. There was an increase in the activity of the company, but we were able to manage that accounts payable exceeded accounts receivable, I mean, there was some help because accounts receivable was not higher than accounts payable. On the contrary, there was also a restriction in terms of inventory mix. In the special steels in South America, it was quite robust considering also that we had some shutdowns due to the pandemic and we had an important reduction in inventory. There was a reduction in terms of BRLs of around BRL700 million, which is quite strong. But we have to look at the foreign exchange. If we look at that, this reduction could be even higher. The cash effect is high. And at the same time, when you look at the balance sheet in BRLs, it was down. The net sales was up, and this helped us to reach that 73 days.

For the next coming quarter, and especially the last quarter, we will still see an optimized working capital position. I think that we will be able to end the year at a good level of working capital. And even for the next year, if we look at every year, we start the first quarter with lower levels, and then it goes up the second and third quarters. But we do not see our working capital in terms of days cycle going beyond 70 or 75 days. This crisis gave us the opportunity to maintain this level of results.

A - Gustavo Werneck Da Cunha {BIO 20318216 <GO>}

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Okay. Thank you very much for, Rodolfo. Now as for your second question, and cash generation and also our agenda. I would say that we already know that the market can be very volatile and how this debt position is important to us. So nobody here will rest. Nobody will sleep until we can take the debt of the company to the level of 1.5x, which we set before. Therefore, we're still very obsessed with that. We are obsessed in reducing our indebtedness position. And this is the main topic in our agenda. In terms of the operation, we are constantly seeking to increase our performance in terms of cost and expenses, increasing profitability, trying to build Gerdau of the future.

And as I said in January, we will celebrate 120 years of history of the company, trying to still generate value to our stakeholders and shareholders for many years to come. We are constantly looking for ways to generate further profitability with our current units, looking for some niche operations. And now with Gerdau Next, we see other opportunities to generate further value to our customers. So basically, this is the company's agenda. I think you're familiar with it, and we don't anticipate any major change in the next coming quarters.

Q - Rodolfo Angele {BIO 1541593 <GO>}

Just another follow-up. What is the capacity utilization in Brazil today? Just so I can have an idea.

A - Gustavo Werneck Da Cunha {BIO 20318216 <GO>}

Rodolfo, in Brazil, it's currently 80%.

Q - Rodolfo Angele {BIO 1541593 <GO>}

With Usiminas or with everything?

A - Gustavo Werneck Da Cunha {BIO 20318216 <GO>}

With everything, Rodolfo, everything included.

Operator

Our next question is from Thiago Lofiego from Bradesco BBI.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Werneck, could you please talk about the inventories in the chain? You also said that this was a factor that boosted demand in the third quarter. How do you see this looking forward? Inventories are back to normal levels or you still see a replenishment in the fourth quarter and going towards next year? And the second question refers to demand for longs in Brazil. How much retail represents in terms of the demand for longs? I just want to understand the size of that part of the pie and how much it grew.

A - Gustavo Werneck Da Cunha {BIO 20318216 <GO>}

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Well, two very good questions, Thiago. Well, let me talk about the inventory in that chain. It is still below normal levels. A normal level would be 25 to 30 days of inventory. And currently, this level is at 10 to 15 days. So the trend is that there will be a recovery throughout the next 6 months. It's not a very quick recovery in the short term, but the trend is that there will be a full recovery until by the next 6 months. Retail accounted for 30% of our long shipments. And with the investments through Commercial Gerdau, the program Juntos Somos Mais, retail represents 30% of our shipments.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Now in terms of retail again. How do you see 2021, including that part related to income risk and moves by the government, how do you see this segment looking forward? And what kind of work do you have to do? I know you been doing a few things. Do you think that it could offset a negative move in terms of the income level?

A - Gustavo Werneck Da Cunha {BIO 20318216 <GO>}

Well, our grassroot work in terms of going directly to retail has been very positive in the past 2 years. Well, retail grows 60% every year. But currently, the demand is higher when you compare to pre-crisis months, but our position will remain very strong even after the removal of the emergency aid. I do believe that even with this decline that will occur after the termination of the aid, we will be able to still make strong shipments because we are very excited about this segment.

Operator

Our next question, from Caio Ribeiro from Credit Suisse.

Q - Caio Ribeiro {BIO 18420483 <GO>}

My first question is about special steels because -- in relation to other underperforming segments. Do you see any room for a potential price adjustment next year in Brazil? And what will be the magnitude of this increase? And how could that help improve your margins so as to reach a more normalized margin? My second question is about the margin of the Brazil segment because now it is above 20%. But with the price of scrap going up in Brazil, also considering that in the fourth quarter, there is traditionally weaker seasonality, how do you see the evolution of the margin in the fourth quarter and whether the price increases will also have an impact?

A - Gustavo Werneck Da Cunha {BIO 20318216 <GO>}

Caio, it's a pleasure to talk to you. Well, I'll jump straight to your second question. We will -- we believe that we will sustain the margins towards the fourth quarter. We are working with that assumption. Now in terms of special steels, pricing for special steels, we are just going along the global prices in the market. So I think in terms of performance improvement, this will come from increased demand. We had to face difficult months and we benefited from the automotive industry in our results afterwards, and we are very optimistic because with all of the incoming orders and our operations in Brazil and the U.S., we will experience a new phase of margin recovery from now on.

Operator

Our next question in English from Carlos de Alba.

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

So just following on the inventory question before. I think you mentioned, just to reiterate to make sure I understood, that the supply chain typically has tend to -- sorry, has around 30 days, and you are now seeing the inventories between 10 and 15 days. Can you make comments similar to this in terms of your own inventories? That there was a big important generation of cash from lower inventories in the quarter. How do you see that going forward in the fourth quarter, maybe into next year? If you can make comments both in terms of cash flow generation as well as the days of inventories that you currently have at your different plants, particularly in Brazil, I guess. It will be more interesting to me. And then given your target of reducing net debt to EBITDA to between 1 and 1.5x, we see a very comfortable net debt amortization schedule. You don't have too much coming due on 2021 and 2022 and really, until 2026, where you have a significant amount. What are you really planning on doing? Is this accumulation of cash in your balance sheet or retiring whatever is due in the coming years and not really raising more debt? I mean how should we think about your strategy of getting to the 1 to 1.5x? Obviously, EBITDA is going pursue an increase, but I'm more talking about the debt management.

A - Gustavo Werneck Da Cunha {BIO 20318216 <GO>}

Thank you, Carlos. Now I'll let Scardoelli answer your question. So Scardoelli, go ahead.

A - Harley Lorentz Scardoelli {BIO 7283603 <GO>}

Carlo's question was, firstly, related to inventories. And also we talked about the chain in our own inventories. And the second part of the question was about cash flow, which is very strong, and our debt cycle is well balanced. And what is our view about this cash position looking forward? And how do you see this scenario? Well, referring to your first point, as Gustavo was saying, especially in Brazil, our inventory levels are slightly below normal. But we still have some room to recover our inventory level in the next few months. And this allow us to predict that this market dynamic has a certain momentum or trend looking forward. Now at Gerdau itself, this strong inventory reduction that we mentioned, about BRL600 million from June to September, if we look at that per operation, this would be more related to special steels. North America and Brazil had a very stable inventory level. But certainly, we know that when it comes to rebuilding inventory in the system, there is the relationship with working capital. Maybe working capital will consume a bit more cash, yes. But in terms of cycle days, it should be more stable at regular levels. We maybe -- we may use a little bit of working capital to replenish our inventory level. There is also the issue of scrap and some other components that will probably need some additional cash to replenish the inventory.

In terms of strong cash generation, first of all, I would say that we try to minimize the maintenance of a negative carry or investments that were below the cost of the debt. It's easier to do that in Brazil rather than abroad. We try to carry the lowest possible negative carryover this year. In addition, our debt position is very well balanced. We had a -- we have a majority coming in 3 months. And that was because of a bonus that was issued that

matures in 2021. It is about close to BRL1 billion, about BRL600 million. Therefore, this cash will be used for that. Our trend is to use the proceeds to pay short-term debt. We haven't yet conducted any further evaluation in terms of paying out dividend. In this second and third quarter, this will certainly need more cash to pay more dividend. If we get more cash, we will be able to pay out more dividends. I think this is what I had to say about liquidity.

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Operator

Next question, from Timna Tanners from Bank of America.

Q - Timna Tanners {BIO 6766897 <GO>}

Wanted to ask two questions. One was regarding the guidance you gave for volume, thanks for that. But didn't know if the 6% to 8% improvement into 2021 applied to all of Brazil or for the entire company. So if you could just clarify that. And if it's just Brazil, any color on the other segments would be great. And then my second question is really more on the U.S. market. The nonresidential construction leading indicators are pointing to a decline. And the scrap demand is up, so just wondering if you have a little more color on the margin outlook in the seasonally weak fourth quarter and then into 2021. Thanks very much.

A - Gustavo Werneck Da Cunha {BIO 20318216 <GO>}

Thank you, Timna. Timna's first question related to the net growth and what is expected for next year. I said that we are expecting a demand growth of between 6% to 8%. And this refers to our operations in Brazil for flat and long steels. We have different numbers depending on the operation. We anticipate a 1% growth in demand for the long steel operations in North America. I think that was Timna's question. And also for -- in special steels, we predict a higher growth due to lower demand in Brazil. We anticipate 18% growth and in our Special Steel operation in the United States, we predict some growth of around 9%. I mean she asked for a bit more color per operation, therefore, I think that, with that, I answered Timna's first question. And her second question was related to the outlook for the fourth quarter of the year. Right now, our backlog is quite strong. It remains at the levels that we have been experiencing in the past few months. We see some good number of orders and good shipments coming. Our main issue in the U.S. is the spread. And as I said before, there was a reduction in metallic spread between the third and the second quarter. It was down by \$410 -- from \$410 to \$400 to \$395. We continue to buy in the U.S. at prices similar to what we had in the past. But we are now working hard internally to reduce cost and improve performance.

So therefore, in the fourth quarter, we will be able to sustain these margins. Basically, these were the two questions posed by Timna, and I would like to thank Timna for her questions, and please feel free to come with more questions if you have, and you can talk to our IR people. Thank you.

Operator

Our next question, from Andreas Bokkenheuser from UBS.

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Q - Andreas Bokkenheuser {BIO 7182883 <GO>}

I just wanted to follow-up on Timna's question. If we look at the construction industry, it tends to lag the overall economy by about 1 year. And typically, when it goes into a bear market, it typically declines for about 2 to 3 years. We're seeing a lot of -- in North America, a lot of U.S. construction steel producers doing quite well, to your point, like you have a very strong backlog. But we're also understanding that a lot of that backlog is due to projects that were started in 2018 and 2019 before COVID. And of course, these projects need to be completed. If we look at new orders, again to Timna's point, nonresidential construction starts are down 30%, 40%. I think you mentioned the ABI. The ABI is still in contraction level. We're seeing decline in construction jobs. There's a lot of leading indicators suggesting that with this damage to the economy this year, there's just not going to be a lot of money for projects into next year. So I guess the question is, given that construction sector does lag the overall economy by 1 year and given how bad the global economy did this year, what gives you the confidence that demand is going to do particularly well next year because it would suggest that we're going to get a material contraction in demand next year? That's just my one question.

A - Gustavo Werneck Da Cunha {BIO 20318216 <GO>}

Andreas, thank you for your question. Andreas is asking for more details about the outlook, not only for 1 year but 3 years ahead in the sectors where we operate in the U.S., especially nonresidential. And he wants us to elaborate on the growth in about 2 years, the conclusion of projects and the expectation looking forward, especially considering the results for the upcoming elections that will take place next Tuesday. Well, Andreas, this is a topic that has been extensively debated in the past few months. We looked at all possible scenarios, and we focused on the main indicators. And when we look at the indicators, we continue to see a positive outlook in the segments where we operate and the areas we serve with structural profiles and our lighter commercial profiles. We even see for the next 3 years some slight growth coming from these segments. We look at all the infrastructure gaps in the U.S., but at the moment, we do not see a major infrastructure project coming that would lead to a very strong demand pickup in the coming years. We just see a slight growth. But in parallel, for the past few years, we've been working very diligently to increase the performance of our operations. We made a decision to invest in our larger mills, and all of these investment decisions and decisions to reduce cost and increase performance will certainly lead us to improve our financial results in the next 3 years, even in a market that may not grow as much. But certainly, there should be some growth that will allow us to sustain our margins.

Operator

Our next question, from Mr. Jon Brandt from HSBC.

Q - Jonathan Brandt {BIO 5506998 <GO>}

Just to follow-up on Andreas' question. I just want to make sure that you're not expecting any major infrastructure spending despite the pledge from both U.S. presidential candidates to actually do just that. And I know we've seen this historically many times. But potentially, depending on the outcome of the election, it could be a bit of a better scenario than before. And sort of in relation to that, if we were to see U.S. infrastructure

spending, and it's of the "green nature", is there a big difference in steel intensity versus traditional infrastructure spending? And I guess my second question is somewhat related to that. On the ESG side of things, we -- this has been a major theme not only in Brazil but also globally. We've seen other companies in the sector make improvements. So I'm hoping you could comment a little bit on what your main initiatives are for improvement in the ESG world.

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A - Gustavo Werneck Da Cunha {BIO 20318216 <GO>}

Jon, thank you for your questions. His questions refer to our outlook for the U.S. after the election in terms of the stimuli, also 232, he also asked about ESG, where we are placing our efforts and where our priorities are. Well, I'll start with your first question, and then I'll give the floor to Scardoelli. From all of the analysis we've conducted in terms of the possible outcome of the U.S. election shows that in 2021, regardless of the outcome, there shouldn't be any major operation in terms of stimuli or economic aspects that could directly impact our business. Therefore, in 2021, we are projecting a certain stability, just a slight growth. But now I'll give the floor to Scardoelli to see whether he's got anything else to add to the comment, and then we can also talk about ESG, too.

A - Harley Lorentz Scardoelli {BIO 7283603 <GO>}

So talking about infrastructure, I think an important aspect is that when you look at our outlook for North America next year, we are not including any possible increase in infrastructure. There is a possibility that, that might happen, but the debate today on both sides of the political spectrum, Republicans and Democrats, this is in the event of both candidates. Therefore, we see a potential demand increase in the U.S., but we are not including that in our planning right now. Obviously, there is a possibility that we will see a significant demand for steel. It's difficult to compare because the U.S. needs to invest in infrastructure. So when finally these investments are materialized, the amounts at stake will be quite significant. Infrastructure investments in the U.S. that use any kind of funding from the government at any level, Federal, State or municipal levels, you have this famous so-called "Buy American" behind it. That means that this demand -- once it comes, it will be geared towards local producers like we are. And in a way, once we locked the rebar business some 2 years ago, we will not be so subject to market effect. I mean, at the same time, we were able to maintain our capacity to enter more strongly in the rebar market in case of a stronger demand. The effect will certainly be very positive for the steel producers and this steel market.

A - Gustavo Werneck Da Cunha {BIO 20318216 <GO>}

Thank you, Scardoelli. I will move on. First of all, I would like to thank Jon for his question on ESG. This is a very important question because it has to do with the future of the company. So I would like to thank you for giving us the opportunity to talk about such an important topic for the company. We believe that any company, and I'm right now speaking about the steel industry, it's important that if we want to continue writing a successful story in the future, we have to incorporate topics of sustainability like ESG. ESG is a very important topic and it gained relevance in this past year. Our Board is totally committed to ESG and we want ESG to reach every single employee of the company in every single thing they do in any area of the company. We evolved quite well in all of the 3 letters of ESG. In terms of G, governance, we made important advances. We approved

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our sustainability policies. We also approved human rights policy. We created a very important committee called Strategy Committee for Sustainability, just to ensure that all long-term strategic decisions like CapEx, investments, capital allocation is well adjusted to ESG. And in terms of the S letter of the acronym, social, we made important advances this year. And the major move was that we are now certified as a B company. We will be one of the largest B-certified companies. And this journey starts with the certification of our Brazilian operation. We also reviewed our strategy in terms of social responsibility at Gerdau Institute. We were able to escalate our activities like housing system, recycling systems. We also included other initiatives of inclusion, demonstrating respect for people and society. And that is also reflected in our overhead, in our employees. We include all brackets of society and ethnicities.

And in terms of the environment, the letter E, this is a challenge for all steel producers. In our case, we have an advantage because 70% of our production base uses electric furnace and scrap. But in the next few months, we will publicize our goals to reduce gas emissions and greenhouse effect. Therefore, I believe that in all 3 areas of ESG, we are -- we have well-structured plans, and they will be executed the best possible way. In the future, we want to be a reference in sustainability among steel producers.

Operator

We now conclude the Q&A session. I would like now to turn the floor back to Mr. Gustavo for his final remarks.

A - Gustavo Werneck Da Cunha {BIO 20318216 <GO>}

Well, I would like to thank you very much for joining us today. It is always a pleasure for both of us to talk to you. Also, I would like to invite you to join us again in our next earnings release related to the fourth quarter of 2020 that will take place on February 24 of next year. Time flies, it's almost early November. So in case we do not talk again this year, I would like to take this opportunity to wish you a very good 2021 with plentiful of health and the possibility of revisiting your personal plans or projects that have been put to sleep for now, and I wish you all brighter days in the future. Thank you very much, and be well.

Operator

Gerdau's conference call is now concluded. Thank you very much for participating, and have a very good afternoon.

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