

Q1 2005 Earnings Call

Company Participants

- Osvaldo Schirmer, EVP & IR Director

Other Participants

- Leo Larkin, Analyst
- Luiz Mann, Analyst
- Maria Rove, Analyst
- Roberto Notzel, Analyst
- Rodrigo Barros, Analyst

Presentation

Operator

Good afternoon, ladies and gentlemen. and welcome to the audio conference call of Gerdau. Thank you for standing by. At this time, all participants are in a listen-only mode. Later we will conduct a question-and-answer session. And instructions to participate will be given at that time. (Operator Instructions)

We would like to draw your attention to the fact that certain assessments that may be made during the conference call with regard to Gerdau businesses and its prospectives, projections. And operating and financial objectives are merely forward-looking statements based on the expectations of the management of the Company's future. Although the Company believes that its statements are based on reasonable assumptions, there can be no assurance that future events will not affect their accuracy.

I would now like to turn the conference over to Mr. Osvaldo Schirmer, Executive Vice President and Investor Relations Director. Please go ahead, sir.

Osvaldo Schirmer {BIO 1754610 <GO>}

Good afternoon, ladies and gentlemen. Welcome to our First Quarter 2005 conference call. The quarter's results are available at our website and have been sent to the regulatory agencies and the exchanges. The quarterly data is in U.S. GAAP and also available at our website.

For our First Quarter Gerdau announced a net profit of R\$810 million with a net margin of 14%. The operating profit was R\$1.2 billion. Net sales revenue was almost R\$6 billion, generating an EBITDA of R\$1.4 billion. EBITDA margin was 24%. Consolidated shipments

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totalled 3.4 million tons. On May 24, Gerdau SA will pay dividends of \$0.40 per share, while Metalurgica Gerdau will pay \$0.72 per share.

Outlook. In the last few weeks, the international markets have gone through an apparent revaluation of risk, causing an impact on the prices of cyclical assets. The strong correction of steel companies' shares prices on a worldwide basis should point towards the sudden end of a positive cycle for the industry. But does not seem to be the case when we look at the fundamentals of the industry.

Last year, steel products prices were increased as a consequence of the reduction in the overall world exportable surplus, along with an increase in the world's demand. Both the main exporting countries, such as Japan, Russia, the Ukraine. And Brazil. And the largest importers, such as the United States, China, have grown at very high rates. For 2005, the behavior of these economies continues to be a determining factor for the formation of international prices. Additionally, we should take into consideration the effect of the increasing costs with iron ore and coking coal.

In principle. And based on the current expectations, we should continue to expect that favorable conditions should prevail for the steel sector worldwide. China, for instance, has announced specific measures to slow down the economic growth in order to avoid overextending its already stretched infrastructure and to put too much pressure on the demand for raw materials, both in the domestic and international markets.

Furthermore, there is an understanding that, due to the greater consolidation in the world, the steel industry will operate with new ranges for pricing and margins. With this, the likelihood of a return to historical spread is very low, even if there is a negative adjustment of the cycle, which may happen sometime in the future. The recent announcement of price increases in steel products in May in the U.S., along with the announced reduction in volumes to be produced in Europe, indicate that there is greater discipline in the markets today.

The year presents itself as being stable when compared to 2004. It is still hard to assess if next year will be the year of inflection on the current cycle.

Quarterly overview. In the Brazilian domestic market, this First Quarter shows that volumes are still below those of last year's First Quarter. Exports, although, with no significant changes contributed to improved revenues due to the increase in international prices. Apparently the restrictive monetary policy currently being enforced in Brazil is causing the expected impact of slowing down the economic activity.

After more than 5% GDP growth in 2004, Brazil will probably only grow about 3% in 2005. The lack of government investments in infrastructure and the delay in implementing the so-called PPPs so far has slowed down the demand for long steel. We expected that throughout the year, some of these projects will be implemented and get the public-private partnership to being [ph], which combined with the effects of a pre-electoral year may generate a positive momentum for the sector.

On the other hand, the prices of the main products are still at the same levels they were at the end of last year. In Gerdau's portfolio the special steel sector has enjoyed the good performance of the auto industry. As for metallic imports, [ph] steel scrap. And pig iron, their prices are on average lower than they were in the fourth [ph] quarter last year.

At the integrated mills, the readjustment in the prices of iron ore has happened in last April, increasing on average an 56%. In the future, this reliance on third-party suppliers will be partially reduced by the supply from Gerdau's own lines. The increase in the price of coking coal was roughly 90%; and despite the impact on costs starting June, it will only impact the bottom line in the First Quarter due to the inventory effect.

In North America, prices have on average experienced a slight decline through April. The metallic spread, however, hasn't changed as a result of the simultaneous reduction in scrap prices. More specifically, the prices of bars and profiles are comparatively stronger compared to the prices of flat steel.

Wire rod was by contrast impacted negatively due to imports in the last months of 2004; but there is less pressure today. This is due to a reduction in imports and a greater concentration of local produces [ph], is which by reducing the supply managed to avoid a stronger decline in prices. The recently acquired North Star mills have been performing above the average and have been contributing significantly to the Gerdau Ameristeel results.

The Gerdau Group is aware of the events and trends of the economies of the countries in which it operates. Within this perspective are the investments planned and underway, such as the acquisition of the Colombian mills. And most importantly the expansion and new mills in Brazil. It is worthwhile mentioning that Gerdau's policy has been to consolidate its position as a leader in long steel in the Americas.

At the more specific level of corporate activity, at Metalurgica Gerdau SA and Gerdau S.A., it was recently announced that these Companies would be both paying stock dividend of 50%. This measure was adopted in order to distribute accumulated reserves to shareholders. Additionally, by reducing the stock's prices, this made the cost of entry lower for investors and can potentially enhance liquidity. The latest news is that Metalurgica Gerdau preferred shares has just been confirmed as the new entry to the Bovespa Index, which will most certainly contribute to give the stock more exposure and maybe more efficient valuation.

We open now the phones to your questions.

Questions And Answers

Operator

Ladies and gentlemen. we will now begin the question-and-answer session. (Operator Instructions) Maria Rove [ph] of Bear Stearns.

Q - Maria Rove

My first question is, I would like to know what was the gross amount of the tax recovered in the First Quarter. You mentioned that the net amount was R\$33 million. Also I would like to understand the big jump in revenue per tons in both the U.S. and South American countries? Thank you.

A - Osvaldo Schirmer {BIO 1754610 <GO>}

The what per ton?

Q - Maria Rove

The increase in revenues per ton in the U.S. and also for South American countries.

A - Osvaldo Schirmer {BIO 1754610 <GO>}

Okay. There is no tax recovery as you suggested in the First Quarter. The average price, let me see, in the U.S., prices in the U.S.? About 21% was the price increase in the U.S. in the First Quarter compared to the First Quarter '04.

Q - Maria Rove

I am sorry, first on the tax recovery. On page seven of your press release you mentioned that you recovered an improper tax collection or --?

A - Osvaldo Schirmer {BIO 1754610 <GO>}

I misunderstood you. We had to sue a long time. And we won. Okay? This is the PIS recollection. So what is your question really related to this?

Q - Maria Rove

You mentioned here the net amount of \$33 million; and that is net of income taxes. So I would like to know what was the gross amount and confirm that it was run through the operating expenses lines as a revenue.

A - Osvaldo Schirmer {BIO 1754610 <GO>}

Okay, hold on. The gross amount was 50 million and it went through the P&L line. Right? Okay. R\$50 million was the gross amount; 17 was the effect; and 33 was the net.

Q - Maria Rove

Okay, thank you. And you were also mentioning the revenue per tons in South American next.

A - Osvaldo Schirmer {BIO 1754610 <GO>}

I understood North America. North America was 21%; and in South America it was 59%.

Q - Maria Rove

Can you explain why the big jump?

A - Osvaldo Schirmer {BIO 1754610 <GO>}

In North America, for reasons that you know, they started with the surcharges. And they maintained the prices even though some of the people discontinued the surcharge policies.

In South America it was a substantial increase in demand supporting the prices. Also, the scrap in Latin America basically went up; so it was not a necessity to transfer to prices that impact on the cost of raw materials. But supported by demand. If there was no demand there was no price.

Q - Maria Rove

Then you managed to transfer that increase (multiple speakers) ?

A - Osvaldo Schirmer {BIO 1754610 <GO>}

Right.

Q - Maria Rove

Thank you, very much.

Operator

Rodrigo Barros with Banco Pactual.

Q - Rodrigo Barros {BIO 5851294 <GO>}

(inaudible). I have a question regarding our costs in the domestic market. We were expecting some decrease in those, since we have been following the pig iron and scrap cost in Brazil has been falling since November and December of last year. And probably January too. So could you give us a hint what were the main lines that impacted cost in Brazil in the First Quarter?

A - Osvaldo Schirmer {BIO 1754610 <GO>}

Overall you have the iron ore already impacted since January to some extent. This is something. We had at the beginning of the quarter high levels of inventories. So affecting working capital and by consequence also affecting the overall cost.

Scrap went up for a while. And as we approached the end of the quarter, due to the abundance of the offer, prices went down slightly. And now maintain like that. So basically due to iron ore at the beginning; scrap to some part; and then scrap coming down; and a substantial amount of inventory.

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Q - Rodrigo Barros {BIO 5851294 <GO>}

Okay. So scrap in the First Quarter, compared to the Fourth Quarter of 2004 in Brazil, could you give us any (multiple speakers) how much it has decreased?

A - Osvaldo Schirmer {BIO 1754610 <GO>}

It was around \$180 to 150; almost \$30 reduction.

Q - Rodrigo Barros {BIO 5851294 <GO>}

One more question regarding government speech on price -- not even price controls. But doing some analysis on the steel value chain. And also eliminating import taxes for some kinds of steel. But (inaudible) flat steel so far. Is there any new development on this issue that we could be observing in the future?

A - Osvaldo Schirmer {BIO 1754610 <GO>}

As you know, Brazil imports very little long steel. So even though they reduced the import duties. And they also thought about imposing import duties on -- reducing import duties on long, there was a factor [ph]. Brazil has a norm, has a technical specification that nobody -- not anyone is able to supply. Every country changes according to its own needs.

The Chilean market for instance, even though it's a very open market, the specifications for the Chilean market due to the earthquakes and all that requires us a specific quality of steel. So imports of steel in Chile are I would say rather seldom.

In Brazil for different reasons we have a specific norm. So even though if they reduced the import duties to zero, as they did on flat in some cases, the impact will be small in one case. In another case, the Brazilian market is so well supplied, the structure, the distribution structures that the Brazilian players have developed throughout the years, gives such a competitive advantage to the locals that, even though with zero allowance, the impact would be relatively marginal.

Q - Rodrigo Barros {BIO 5851294 <GO>}

Okay, thank you very much.

Operator

Luiz Mann, CSFB.

Q - Luiz Mann {BIO 1963758 <GO>}

Two questions. First one is regarding inventories in the industry. Can you comment about the inventories level in Brazil; and in the U.S.; and your view on the inventories in China, if possible?

A - Osvaldo Schirmer {BIO 1754610 <GO>}

Inventories in Brazil and investments in China?

Q - Luiz Mann {BIO 1963758 <GO>}

No, inventories. Inventories in Brazil, in China. And the U.S.

A - Osvaldo Schirmer {BIO 1754610 <GO>}

We have been very high in the inventory levels both in Brazil and North America for different reasons in the First Quarter. In Brazil, due to the fact that the distribution channels were kind of overloaded with stock. So it was difficult; we had to wait until the end of the quarter to see this slowing down, demand picking up. And so on. So we only at the end of March we started reducing our inventory levels.

In the U.S., due to the seasonality, due to the part of the year where the trend is to build up inventories. So we also were high in inventories which are reducing right now. If you take numbers from the beginning of the quarter and the end of the quarter, you have reduced more than \$50 million our working capital. So as I had a chance to answer in the Portuguese version of this conference, the trend is to see lower levels of working capital for Gerdau starting this quarter.

Q - Luiz Mann {BIO 1963758 <GO>}

Okay. Second question is, considering your revision on the volumes growth for Brazil, do you see room to increase prices during maybe the second half of the year in Brazil in nominal terms?

A - Osvaldo Schirmer {BIO 1754610 <GO>}

I think there is a possibility. We may have to somehow dilute the impact of increasing iron ore and the coal prices as well. They are going to impact our numbers and our cost structures starting second semester. So depending on how the demand will be by that time, there will be a chance to increase prices, yes. But nothing like (multiple speakers) not that I can anticipate right now.

Q - Luiz Mann {BIO 1963758 <GO>}

But the idea is to -- because you're going to have a big pressure in terms of cost later in the year. The idea is to let's say maintain margins or just try to pass that overall inflation? (multiple speakers)

A - Osvaldo Schirmer {BIO 1754610 <GO>}

To maintain margins is a very nice objective; of course we will try to. And depending on how strong is the demand and how our customers -- or the capacity of our customers to absorb those costs, we will be able to -- we will try to transfer to them.

Q - Luiz Mann {BIO 1963758 <GO>}

Thank you.

Operator

(Operator Instructions) Leo Larkin of Standard & Poor's.

Q - Leo Larkin {BIO 1756825 <GO>}

Could you give us guidance for CapEx and DD&A for '05?

A - Osvaldo Schirmer {BIO 1754610 <GO>}

The CapEx program that we announced at the end of last year would contemplate somewhere between 900 and \$1 billion for this 2005. But reviewing those numbers, we may stay around 800 to 900. That's for CapEx overall.

You can have a rule of thumb kind of 80% Brazil, 20% abroad, which basically is -- coincidentally was the spread, or better the allocation we used in the First Quarter. And for DD&A, development? You said DD&A, right?

Q - Leo Larkin {BIO 1756825 <GO>}

DD&A, depreciation, depletion and amortization.

A - Osvaldo Schirmer {BIO 1754610 <GO>}

We're talking about 240, \$250 million a year.

Q - Leo Larkin {BIO 1756825 <GO>}

Okay, just one other thing. Do you have any preliminary estimate for CapEx for '06?

A - Osvaldo Schirmer {BIO 1754610 <GO>}

For '06? Another billion.

Q - Leo Larkin {BIO 1756825 <GO>}

Another billion? Okay, thank you.

A - Osvaldo Schirmer {BIO 1754610 <GO>}

Hold on. Sorry, instead of 250 you better take 280.

Q - Leo Larkin {BIO 1756825 <GO>}

Okay; and a working number, an estimate of roughly 1 billion in '06 as well?

A - Osvaldo Schirmer {BIO 1754610 <GO>}

Right. I was correcting the number for depreciation from 250 to 280. The rest is correct.

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Q - Leo Larkin {BIO 1756825 <GO>}

Okay, thank you.

Operator

Roberto Notzel [ph] with GAS Investimentos.

Q - Roberto Notzel

I would like to know, if you could, how were sales in the domestic market in Brazil in April? And in the U.S.? Were the higher than March? Are you already seeing any recovery?

A - Osvaldo Schirmer {BIO 1754610 <GO>}

I am being (inaudible) already because April is already at the end of the quarter. But I could say that we are optimistic based on April's numbers. In North America, the level of demand is maintained. We also have a very good outlook as far as price and scrap price, price for final products and scrap. We're talking about a price increase around \$20 per ton in May. And maybe see some reduction in the price of scrap. This is North America.

For Brazil, yes, we're witnessing a small slow recovery in the civil construction sector, which makes us rather more optimistic for the quarter.

Q - Roberto Notzel

Okay. I have a second question regarding the amount of cash generated by the Metalurgica Gerdau when you did a block trade by the end of last year. By that time you guided that that money would be distributed as dividends. However, I wanted to know if you still are looking for the money to be distributed as dividends. What is going to be the use of this money?

A - Osvaldo Schirmer {BIO 1754610 <GO>}

Basically, the intention was to give that benefit to the shareholders. And since there is no specific investment inside for Metalurgica, very likely it is going to be distributed in dividend throughout the time [ph].

Q - Roberto Notzel

There is no timing for that?

A - Osvaldo Schirmer {BIO 1754610 <GO>}

No.

Q - Roberto Notzel

Okay, thank you.

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Operator

(Operator Instructions) Sir, at this time there are no other questions in the queue.

A - Osvaldo Schirmer {BIO 1754610 <GO>}

Assuming there are no other questions, I would like to thank you for your time and attention. And hope to have you all with us again next year. I mean next quarter. Thank you, very much.

Operator

That does conclude your Gerdau audio conference for today. Thank you, very much for participating. Have a good day.

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