

Q3 2014 Earnings Call

Company Participants

- André Bier Gerdau Johannpeter
- André Pires de Oliveira Dias

Other Participants

- Alan Glezer
- André Pinheiro
- Ivano Westin
- Leonardo Correa
- Marcelo Aguiar
- Milton Sullyvan
- Thiago Lofiego

MANAGEMENT DISCUSSION SECTION

Operator

Good afternoon, and welcome to Gerdau's Conference Call to discuss the Results for the Third Quarter of 2014. At this time, all participants will be in listen-only mode, during the company's presentation, and later on, we will initiate a Q&A session.

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. André Gerdau Johannpeter, Director, President and CEO of the company; and André Pires, CFO and IR Officer.

With no further ado, I would like to give the floor to Mr. André Gerdau Johannpeter. You may proceed, sir.

André Bier Gerdau Johannpeter

Thank you. Good afternoon, everyone. And welcome to our conference call to talk about Gerdau's results. I would like to initiate our analysis with an overview of the world steel

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landscape. After that, I will talk about Gerdau's performance in the third quarter of 2014. And I will give you then details about investments in the period.

It's also important to highlight that we will analyze the performance of the third quarter vis-à-vis the same period of the year before. Further on, André Pires will give you details about the financial performance of Gerdau, and later on we will be available to take your questions.

For those of you who follow us on the web, I will start by discussing the very challenging landscape of the steel industry with increasing competitiveness, margin pressures and great volatility. And that's because we are still facing an overcapacity of the steel production, while at the same time we face a lower pace of growth of global steel consumption. Just to give you an idea, the industry has an overcapacity of approximately 690 million tonnes of steel a year, which will be the equivalent to approximately one-third of the total installed capacity in the world.

On the other hand, a good piece of news is the continuity of the recovery of the United States market. And I would like to highlight both the industry and non-residential construction sectors, which are important consumers of Gerdau steel.

In Brazil, there was reduction in the demand for steel motivated by the economic slowdown affecting the civil construction industry, the industry and automotive sector. According to the Instituto Aço Brasil, the brand consumption of steel in the country was down by 11% in the third quarter of 2014 vis-à-vis the same period of the year before, growing (3:29) from 7.1 million tonnes to 6.3 million tonnes.

Latin America, except for Brazil, also experienced a slowdown in demand with the slowdown in the economy, and it was greatly impacted by the growing introduction of imported steel in the region, according to studies by Alacero. Latin America is the second region with the largest inflow of world steel from China, second only to South Korea. In the first eight months of 2014, imports of world steel from China into Latin America totaled 5.4 million tonnes, which is 54% more than the same period of the previous year.

Now referring to specialty steels. The automotive industry in Brazil has experienced a reduction in the output and shipments, which impacted the entire chain. On the other hand, the North American market also experienced a significant growth, whereas demand in Europe and India are also presenting a gradual evolution.

Now I would like to refer to Gerdau's performance in the quarter. Starting with shipments, totaling 4.6 million tonnes of steel, this volume is 4.5% lower than that posted in the third quarter of 2013, mainly caused by reductions in demand for steel in Brazil and in the other countries of Latin America. Now net sales was R\$10.7 billion, up by 2% vis-à-vis the same period of the year before. This growth was mainly due to better performance of the operations in the United States.

Now EBITDA. EBITDA was R\$1.2 billion, 13% lower when compared to the third quarter of 2013. Now net income was R\$262 million, down by 59% stemming from a lower operating

result and lower financial result and also the addition to a program of tax reduction, known as REFIS, REFIS on profits generated abroad amounting to a net value of R\$87 million.

Even though, this is an event that occurred after the quarter under analysis, I would like to speak about the sale of our joint venture, Gallatin Steel in the United States, where we had 50% stake. This initiative is aligned with our strategy to concentrate our effort in the longs and specialty steels in North America. The proceeds from Gallatin's divestment will also be added to Gerdau's balance sheet.

The transaction was concluded in October, together with our other partner in this joint venture, ArcelorMittal. The company was sold to Nucor Corporation for an amount of \$770 million. Gallatin is a flat rolled steel mini-mill with a capacity for 1.8 million tonnes of shorts a year located in the state of Texas in the United States.

Now about investments in the third quarter. They amounted to R\$438 million and year-to-date, R\$1.6 billion. In Brazil, the main highlight was the startup of our finishing line of coiled hot-rolled strips in Ouro Branco, Minas Gerais, which occurred in October. This investment will be detailed in our next slide.

In the United States, there was a startup of the new continuous casting operation at the St. Paul mill, increasing the installed capacity of that plant growing from 520,000 tonnes to 620,000 tonnes of steel a year.

In terms of specialty steels, in the first quarter 2015, we will have the startup of a new rolling mill reheating furnace in the Monroe mill in Michigan. Both investments will allow for the expansion and the improvement in the quality of products and productivity of the unit. In terms of mining, our focus has been in the production of ore for our own consumption, which has also increased the competitiveness of the Ouro Branco mill located in Minas Gerais.

In view of the current situation of the global market, the pace of all of the investments in mining are still being revisited. I would also like to mention that considering the global landscape of the steel industry and volatility in the results of this sector, we once again reviewed our disbursement program of investments or our CapEx program for 2014, going from R\$2.4 billion to R\$2.1 billion in CapEx.

Now about the new finishing line of the coiled hot-rolled strip in Ouro Branco. As I said before, it started operating in October. I would like just to remind you that coiled hot-rolled strips are used in the following industry; distribution, agriculture, highway, civil construction, pipes and machines and equipment. With this new finishing line, we will be able to grow our share in other segments, such as auto parts, compressors, packaging and containers.

Now I will refer to the mill in Mexico, which should start operating at the end of this year with the beginning of the melt shop production. This initiative is being conducted through our joint venture, Gerdau Corsa. The new mill will have an annual installed

capacity of 1 million tonnes of steel and 700,000 tonnes of rolled products. The rolling mill should start production in early 2015. The plant will supply civil construction and the industry both in Mexico and also in the other countries of NAFTA.

With that, I conclude the first part of my presentation. I'll give the floor to André Pires.

André Pires de Oliveira Dias

Thank you, André, and good afternoon, everyone. Now I will talk about the results and the performance of each of our BOs in the third quarter of 2014. And later, I'll give you more details about the consolidated figures. And at the end, I will close by talking about our capital structure.

Now looking at slide eight. For those of you who follow us on the web, I'm starting with Brazil. The uncertainty environment vis-à-vis the economic environment is also causing demands to go down, and this has affected our business. By the end of Q3 of 2014, there was a reduction of 13% in shipments when compared to Q3 2013, a drop of 11% in the domestic market, especially in civil construction and industry.

In terms of Q2 of 2014, the sales volume had an increase of 4.5% due to greater exports. In the domestic market, shipments were more stable. However, our sales of long rolled products posted an increase of approximately 5% vis-à-vis Q2 of 2014, improving the product mix in this market.

Looking at EBITDA in the third quarter of 2014. The absolute value posted reduction of 37% in relation to Q3 of 2013 due to lower sales volumes, causing lower dilution of fixed costs. As a consequence, the EBITDA margin went from 23.5% to 16.5%. When we look at EBITDA of the third quarter of 2014 vis-à-vis Q2 of 2014, we noticed that the absolute value was very similar even though the margin was slightly lower.

In North America, the economic environment remains positive, and shipments grew 2.5% when we compare Q3 of 2014 to Q3 of 2013. This growth was due to better demand in the period caused by the good performance in the industrial sector and also the recovery of non-residential construction.

EBITDA in Q3 of 2014 increased 161% vis-à-vis Q3 of 2013, going from R\$129 million to R\$337 million. This increase is due to gains in metal spread and also the increase in volume sold in the period of comparison. With that, the EBITDA margin went up to 9.1% in Q3 of 2014, which is an important recovery when we compare to Q3 of 2013.

In Latin America, shipments in the third quarter of 2014 were down by 10% vis-à-vis Q3 of 2013 due to increases in imports, especially imports from China and Turkey and also the lower pace of economic growth in the region. EBITDA in Q3 of 2014 was down vis-à-vis the Q3 of 2013 due to drops in the sales volumes already mentioned. Now in terms of the second quarter of 2014, EBITDA remained stable.

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In our specialty steel BO, shipments in the third quarter of 2014 were stable vis-à-vis Q3 of 2013, but increase of shipments in our units abroad offsetted the lower demand in Brazil. Now in terms of Q2 of 2014, there was a reduction of 5% in sales, mainly due to the seasonality period in Spain or the summer vacation in that location.

The reduction of consolidated EBITDA in our specialty steels operation in Q3 of 2014 vis-à-vis 2013 occurred due to a larger stake of units abroad in terms of our total shipments. With that, EBITDA margin went down 13% in Q3 of 2013 to 11% in Q3 of 2014. In terms of the second quarter of 2014, both EBITDA and specialty steels BO remained stable.

Now, referring to iron ore BO. Shipments in the third quarter of 2014 vis-à-vis third quarter of 2013 posted an increase of 85%, mainly due to an increase in the production capacity, which occurred as of September of 2013. In terms of the second quarter of 2014, increases in ore shipments were due to sales from the Ouro Branco unit. EBITDA posted reduction of 80%, both in relation to Q3 of 2013 and Q2 of 2014, due to lower international prices associated to higher sales costs.

Now moving on to slide number nine and now referring to consolidated figures. EBITDA was R\$1.224 billion in the third quarter of 2014, down by 13% when compared to the same period the year before. Now if we look at the bridge chart on the upper part of the slide, we can also notice that this reduction occurred due to lower volume sold and higher costs, partially offset by higher net sales per tonne.

Thus the EBITDA margin was down from 13.5% in Q3 of 2013 to 11.4% in Q3 of 2014. However, if we verify the accumulated and consolidated EBITDA in the first nine months of 2014, there was a growth of 5.2% vis-à-vis the same period of the year before, with an EBITDA margin still remaining relatively stable. It is important to highlight the recovery of North America, which has paid a more consistent contribution to the company's EBITDA.

In the bridge chart in the lower part of the slide, we can also notice that the consolidated net income in the third quarter of 2014 had a reduction vis-à-vis the third quarter of 2013, due to lower operating results and also a higher negative financial result in addition to all of the effects of our REFIS program over profits generated abroad amounting to a liquid amount of R\$87 million in the third quarter.

In terms of dividends and based on the results obtained on the third quarter of 2013, the company will pay out R\$16.3 million of dividends through shareholders of Metalúrgica Gerdau S.A., the equivalent of R\$0.04 per share and interest on equity of R\$85.2 million to shareholders of Gerdau S.A. The amounts will be paid on November 27 based on closing positions of November 17.

Now moving on to slide 10 and referring to indebtedness and liquidity of the company. Our gross debt on September 30, 2014 was R\$18.1 billion, higher when compared to June of 2014 due to the effect of the exchange rate variation. Net of that variation growth, the gross debt would have been stable. So weighted average cost of the debt was 6.5% a year, with an average amortization term of 7.2 years. Cash increase of R\$708 million from June to September 2014 occur mainly because of cash generation in the quarter and also

due to exchange rate variation in the period. With that, net debt over EBITDA ratio went to 2.7 times.

Now looking at slide 11, and now referring more specifically to working capital. And looking at the chart, we can see that variations of the absolute value of working capital in the last five quarters have fluctuated between R\$9.3 billion and R\$10.2 billion, maintaining a stable cash conversion cycle with variations between 80 days and 85 days. More particularly referring to the comparative analysis between September 2014 and June 2014, an increase in working capital of R\$320 million contemplates the exchange rate variation, particularly over the working capital of companies abroad. Net of this variation, the cash effect was a reduction in working capital of R\$277 million.

Before concluding, I would like to comment on some recent measure adopted to optimize our assets in addition to the sale of Gallatin already mentioned by André. In September, we did a combination of the operations between INCA, a joint venture where we already had a stake in Dominican Republic and Metaldom. This combination seeks more efficiency gains and higher competitiveness in the Caribbean and Central American region, in addition to ensuring the supply of steel products for the construction sector in the Dominican Republic.

Moreover, on September 30, Gerdau sold the assets of Forjanor, a forgery (19:43) located in Spain, to Hay Group of Germany, concentrating, then the focus of our production on specialty long in Europe. The proceeds of the sale of R\$12 million is already recognized in our EBITDA from the specialty steel BO in the third quarter of 2014.

And I would like to give the floor back to André for his final remarks.

André Bier Gerdau Johannpeter

To conclude, I would like to once again comment on the overcapacity of the world steel industry, and this will continue to impact the industry in the next coming years. In addition, the world steel consumption is expected to be lower when compared to the initial forecasts, due to the slowdown in emerging economies despite the better performance coming from developed economies.

In terms of the markets where we operate, we see a positive outlook coming from the U.S. market that should increase the consumption of apparent steel in the region. But the Brazilian landscape will remain challenging given the outlook of slow economic growth impacting segments, which Gerdau operates: civil construction, industry and automotive sectors.

On the other hand, the prospects for economic growth is valid for the other Latin American countries at different levels. However, the region will continue to be impacted by high steel imports, especially imports from China. The European economy, on the other hand, should continue to advance in its recovery process as well as India, which presents an outlook of growth.

Gerdau will continue to focus on adjusting its operations to the developments in the world steel industry, which is still impacted by overcapacity and also margin pressures. This challenging landscape of the global market has motivated us to maximize our efficiency and seek for further reductions in operating costs as well as adjusting the level of CapEx in 2014 as I said before, which also includes mining activities.

Now, we will move on to our Q&A session. Thank you very much.

Q&A

Operator

Our first question comes from Thiago Lofiego from Merrill Lynch.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Good afternoon, everyone. I have two questions. The first one refers to your BO in America. Could you please refer to your margin sustainability in the U.S., whether it is possible for us to achieve margins around 8% to 12% as being the sustainable margins, considering that there are some ups and downs in some quarters?

And the second question is about scrap prices in Brazil, whether you could tell me a little bit about this scrap market, whether we could envision a gain in the metal spread in Brazil in the fourth quarter, considering these two variables of the steel price.

A - André Pires de Oliveira Dias

Hi, Thiago. This is André Pires. Well, in North America, in referring to sustainability of that margin, it's a bit difficult to give you a forecast for the next quarter because some factors must be taken into account. On the positive side, we still see great consistency in the recovery of the economic growth in North America, particularly the United States. We also see an increase in the number of non-residential constructions, if we get the information from dollars, if the growth in the last 12 months until September is 8.7%, which shows consistency in this recovery process. But by the same token, there is also the issue of the international price of longs in general, and also imports that still play an important role in the U.S. market. So it's an equation between a firm demand, but also a very aggressive offer of products coming into the U.S. market, and you must also factor in seasonality.

The price of scrap is stable, which improves the margin, but we have the seasonality impact of the winter season. Therefore, I think it's too soon to tell or to give you any outlook of consistency or speak about its sustainability capacity.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Still referring to the United States, if we were to talk to you about a year ago, your margin was close to zero, almost something like that. And we knew that you will get close to 10%, which is indeed what you delivered and that's what happened. So today, we can understand that what could have been done to improve your position in the market was

done, so whatever increases will not be too large. So are we close to a margin equilibrium?

A - André Pires de Oliveira Dias

It's difficult to give you a precise answer, Thiago. In terms of our internal measures to improve efficiency gains and to promote cost reduction, this is something that we can continue to do, and we will do so. But it will depend on the level of imports and also the competition capacity of the U.S. market vis-à-vis imported goods, and it also depends on in the international prices. There is pressure coming from the international market as André referred to in his presentation, with this overcapacity in the global market. And this pushes down on the supply side. But we believe that if things remain the same, this margin could be consistent. But it's difficult now to make a projection and tell you how things will be in the next three quarters. I think this is the point.

Now referring to scrap in Brazil, we've seen a stable movement, also slightly down. It's difficult to speak about a target for a spread in Brazil because when you calculate cost in Brazil, you have to factor some things in. But referring to the price of scrap, there hasn't been any specific pressure.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Fine. Thank you very much, André.

Operator

Our next question is from Marcelo Aguiar from Goldman Sachs.

Q - Marcelo Aguiar {BIO 3721791 <GO>}

Thank you for this opportunity, and thank you for your call. My two questions are related to the strategic side of the business, and the question is addressed to André. If you look at the evolution of Gerdau's leverage, I've seen a very big effort in the last quarters, but your net debt over EBITDA level hasn't changed too much. If you compare to your other quarters, nothing has changed, despite everything that has been done in the last quarters.

So I just want to understand, what else the company could do, so that we could see Gerdau generating a more relevant free cash flow, and I know that prices in the market cannot be controlled by you, but what is it necessary for us to see Gerdau within a net debt over EBITDA around 1.5 times or something like that. And also, if you could tell me something about your CapEx for next year will be nice.

And my next question refers to something that has been mentioned by André in several other occasions related to this very bad moment in the overall steel market, because the company has been carrying over relevant assets in Latin America, which deteriorates the return on capital and the situation tends to get worse because the markets are opened to imported products.

I just want to understand, up to what point Gerdau is comfortable in carrying over these assets in your balance sheet, because I don't think that the global steel market will change anytime soon?

A - André Pires de Oliveira Dias

Marcelo, this is André Pires. And referring to net debt over EBITDA, I don't know, whether I agree with you when you said that there hasn't been any changes in that number from January to now. But if you consider, the exchange rate variation was more than 15%. If you recall in the first quarter of 2013, our net debt over EBITDA ratio was 3.2 times with an exchange rate or with the real, much more appreciated than it is now, as 70% of our debt is denominated in U.S. dollars, exchange variation is very important. It's significant when we convert the debt into real. Therefore, I mean, certainly in our view, there was an important change in terms of this growth of net debt over EBITDA ratio. It was about 2.5 times in last quarter - it was 2.4 times and now it's 2.7 times, and mostly due to exchange rate variation.

And I think that we have done something to that end to change that level. And one measure was the divestment from Gallatin, which met two objectives. One was to leave an activity that it was not part of our core business; and also we decided to focus on our balance sheet. This generated an important effect and this effect will only be posted in the fourth quarter because the proceeds were only posted at the end of October, and certainly this level will come down. I think that we are doing our homework.

And what I can also say is that another measure that the company adopted that was announced today is our CapEx review. We are reviewing the CapEx to about R\$2.1 million this year, and this level should not change much next year. We've been very selective in terms of CapEx. We're focusing on our balance sheet, optimizing our assets. There were other smaller transactions like the sale of Forjanor, but I would say that we are focusing on our P&L to seek for the numbers that you refer to.

And now about the general global steel scenario, I'll give the floor to André.

A - André Bier Gerdau Johannpeter

Marcelo, referring to the global steel landscape, what we see is that there is a lower demand and data from world steel shows that there is a growth of 2% in the parent consumption, whereas IMF shows the general GDP at 4%, so it's growing less than GDP. This is just a reference number. And we've seen the optimization of the steel industry in terms of capacity of around 75%, 76%, depending on the region; and also the route to be integrated to scrap. In our case, it's around 70% to 75%. So this is a very challenging landscape, as I said before, and it will be so in the next few years. And I agree with you, but this is the landscape we have to work with.

But referring to Latin America, there are nine countries in Latin America where we operate in joint ventures or partnerships, and every country is very unique. When you talk about carrying the assets, you have to be more specific in terms of what assets and what countries. It's difficult to compete because of high steel imports. All I can say is, EBITDA

for Latin America from last year to this year in nine months was up by 13%. So that was an improvement in the performance of Latin America, which demonstrates part of the work we did. There are some other moves and one of them was a merger with Metaldom and Dominican Republic, and this is the optimization to improve efficiency in the region of the Caribbean and Central America, and that's why we did that joint venture. These are just alternatives. Others refer to investing more, and also optimizing assets. But the result is better this year than the year before, and this is because of all of the work that we've been doing. And you have to look on a country-by-country basis. Thank you.

Operator

Next question from Ivano Westin from Credit Suisse.

Q - Ivano Westin {BIO 17552393 <GO>}

Good afternoon. André and Pires. Thank you for allowing me to ask a question. Referring to the Brazilian demand or demand in Brazil, I think, André, you already referred to a very challenging landscape for next year. And if we look at the landscape, I think we can also add another competitor in terms of your longs mill.

Could you please tell me what is the volume or the shipment expectation year-on-year until 2015, whether the best scenario would be flat or whether there is more room to increase export, so that by the end of the year, in terms of Brazil consolidated figures, it will be flat year-on-year? And I think that you're already closing your budget for next year, and so this will be my first point.

The second, referring to mining, I think you already said that the landscape is challenging. A competitor of yours, a few days ago, talked about a possible reduction in cost around \$5 to \$10. I would like you also to tell me whether you see some room for maneuver there in terms of expansion with this possible delay. What about your volumes for the period 2015, 2017 and CapEx for the mining area?

A - André Pires de Oliveira Dias

Hello, Ivano. This is André Pires. Thank you for your question. Well, about the landscape in Brazil, you know that we never give any guidance about what we believe that could be the growth in the market.

In Brazil, steel had a 1.5% growth from now until 2015, which is pretty much in keeping with what we see. It's about 1% growth of GDP is what people are talking about. So this number that Aço Brasil mentioned seems to be reasonable, but the landscape is still very cloudy. It's very hard to tell. And depending on the exchange rate variation and then you mentioned something important which is the issue of imports. We think that depending on how the exchange rate will vary, we will have more possibility to export and this could probably help us to increase our shipments. This is an opportunity, but it still depends on the movements of the currency. But now, I'll ask André to talk about that mining.

A - André Bier Gerdau Johannpeter

Referring to mining, let's just recap. Today, our installed capacity is 11.5 million tonnes. And the expansion plan, that was announced is for in 2016, grow to 18 million tonnes and by 2020, 24 million tonnes. This is the plan that is being reviewed, and we just said that we are reviewing that CapEx vis-à-vis the global landscape. This is for CapEx.

Now in terms of volume, it's very difficult to predict at the moment because it will depend on how much we will export or not and the profitability, the profitable margins. And that has to include several factors, one of them being the price of ore; but also logistics, internal movements; there is the port, ocean freight, and we are looking at all the possibilities to see whether that is feasible, and this will impact volume.

But what I would like to highlight is that mining is very important to our own supply in Ouro Branco. With the drop in the price of ore, this will have an important impact in Ouro Branco's competitiveness, which we'll then be able to start importing slabs or selling slabs at a profit. So the effect of coal and iron ore, which is right next door to our mill in Ouro Branco, has been very helpful because it has helped us to increase competitiveness. The volume next year will go to our mill and then we will see whether we will grow export or do any exports or not.

Q - Ivano Westin {BIO 17552393 <GO>}

Thank you very much, André. Thank you for your answer. I would just like to follow-up on a particular point. When do you think that you will finish your CapEx review? And when you will announce it to the market? And Pires, when you talk about steel imports, could you tell me about what will be a good level of exchange rate that would give you a more profitable position?

A - André Pires de Oliveira Dias

Ivano, this is André Pires. Starting with mining CapEx, in fact, there is no date. The market is very dynamic, and you know it very well. We know that price variation happens in a very dynamic fashion. We are now constantly monitoring, but we do not know yet, when we will make the decision to go on or to continue to review it. So to answer your question, we do not have any particular date to announce it. And also, I would like to reinstate what André has said. Our position is very comfortable. We don't have any major obligation or we do not have any firmly developed business when it comes to ore exports our CapEx.

The CapEx at the moment is good enough to fulfill – I mean, to supply to our needs. It caters to our needs. And we are not in a hurry to make any decision because we find ourselves in a comfortable situation. And at this profitable level, which is lower than last year, continues to give us a return, a good return on equity.

Now speaking about exports, it's hard to say to how much. If you look at the current exchange rate, it is becoming more interesting, but it will depend on the international market. But at this level of exchange rate, we can see some good possibilities to export that and (41:12).

Operator

Next question is from André Pinheiro from Itaú BBA.

Q - André Pinheiro

Good afternoon. I have two questions. We've heard in some other conference call from competitors that some of them are talking to the government to supervise and to look at imports of other materials, and this would be affecting the market. Are you also engaged in these debates? Do you see any possibilities of seeing an increase in import taxes? And are you taking any measures to say about the domestic market?

And the second question is, still talking about sales of non-core assets and the optimization of your asset base as you did with Gallatin more recently. Do you see any further possibilities of doing anything else that, I mean, or maybe any assets that could be sold or what would be the potential size of non-core assets? Thank you.

A - André Bier Gerdau Johannpeter

Hello, André. Referring to imported products, at Aço Brasil, we are doing some work with them with the ABNT or the Institute of Standards and Norms. We want to ensure that products that come into the country are certified and comply with the standards, and we work together with the customs authority. And we are helping them to monitor the import of products.

We have to verify whether they comply with the standards or maybe there is any alloy in the product that changes the composition. It changes sometimes slightly, but it changes the category. So this is something that we've been doing on a regular basis, and Aço Brasil is also participating in that. In terms of exports, I don't have anything to tell you at the moment.

A - André Pires de Oliveira Dias

This is Pires. In relation to non-core assets, we don't have anything else from Gallatin. It's difficult to say whether there are other opportunities. Opportunities from now on of other operations similar to Forjanor, like I mentioned, they will always exist, and we are always looking. There is nothing in the radar, but we are still focused on the optimization of the assets that we may have that are not necessarily linked to our core business. In the case of Gallatin, it was much bigger and something of that magnitude, it's more difficult.

Q - André Pinheiro

Thank you. It's very clear now. Thank you very much.

Operator

Next question from Milton Sullyvan from Brasil Plural.

Q - Milton Sullyvan {BIO 19085202 <GO>}

Good afternoon. And thank you for the questions. I have two questions. The first is related to the domestic market. The prices in the domestic market increased quarter-on-quarter.

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Could you tell us a little bit what could be expected and or what could be understood in addition to the change in the mix and how do you see prices evolving from now on?

And the second question is on specialty steels. We see that the truck market is not showing signs of recovery. And to that end, I would like to ask two things. First, how do you see the volumes and margins of specialty steels from now on, and whether you can tell me anything about the price negotiation with the automotive industry, because we've been hearing some news lately about that?

A - André Pires de Oliveira Dias

Hello, Milton. This is Pires. In terms of the price, this is basically change in the mix. Lower sales of finished goods in the third quarter, and also, I talked about a 5% growth in finished longs. And this improved the mix allowing the net sales per tonne increase. Well, we do not have any particular outlook, but we will continue to work to improve our mix.

I think, your second question was about specialty steels, and I'll give the floor to André.

A - André Bier Gerdau Johannpeter

Hi, Milton. Referring to the specialty steels, the numbers about trucks that you mentioned, and also vehicles, are so far very similar to what we've seen throughout the year with a decline vis-à-vis the year before, because it was a year of the World Cup and election. So after this period, we hope that, next year, we should experience some growth.

We do not have any figures yet, but we heard the government saying that there might be some incentives or lower taxes to boost the sales of vehicles and trucks maybe allowing for more credit measures that had an effect in the past. But then we see that there will be (46:57) and then a decline.

So the forecast is 1% of GDP, GDP next year, which is relatively low. And this should have an impact in the automotive industry after the election, when the elections are over. But it's still too soon to tell whether there will be substantial changes. But we think that Brazil will resume growth going beyond 1%.

Q - Milton Sullyvan {BIO 19085202 <GO>}

Thank you.

Operator

Next question from Leonardo Correa from BTG Pactual.

Q - Leonardo Correa {BIO 16441222 <GO>}

Hello, and good afternoon. Thank you. I have just some very particular questions, and the first refer to your business in the United States. Can you please comment on the metal spread level? When we look at the prices on the screen, scrap, there has been a stronger variation on recent prices of scrap. Some said there will be drops of \$20 to \$30 in

November, but in the year, there was a decline of about \$80 in the scrap price in the last few months. I just want to hear from you whether you see the landscape of metal spread increases and what would be the level of the third quarter?

And the second question is about capital allocation. We saw a reduction of R\$300 million in your CapEx to R\$2.1 billion. So what should we expect for the next few years? In your speech, you seemed to be cautious in terms of the economic landscape in Brazil, low productivity. I just want to understand whether there is any change in the heavy plate project from now on.

And another question refers to the ore business. How to allocate the excess capacity that you have or your transfers to Ouro Branco, whether whatever is welcoming, you could be allocated to the domestic market, and whether the domestic market will be able to accommodate all of that supply because the export market is still a bit complicated with the spot price below \$80? Thank you.

A - André Pires de Oliveira Dias

Hi, Leonardo. This is Pires. About North America, today, the level of metal spread in the third quarter was about \$425, \$430 for short tonne and you have to convert it to metrics. And I mean, I think the lowest level occurred in the last few weeks, and there is always a delay in terms of the benefits that you have or you do not have, whenever there is any price decline. But today, our metal spread is around this level. If you recall about a year ago, the level was below \$400 per short tonnes. It was about \$380 and \$390, so there has been an improvement in the metal spread in the last 12 months, which was a very significant improvement. Now I think André can refer to CapEx and the heavy plate.

A - André Bier Gerdau Johannpeter

Leonardo, about heavy plate that you mentioned, the project is still on and by the second quarter of 2016, it will start to operate. Now referring to CapEx in amount, we promoted our second review this year, which is R\$2.1 billion. And I would say that next year, we should see something similar to that, maybe slightly above that. But there is also the exchange rate effect. We talk about reals, but most of our CapEx is denominated in U.S. dollars because of equipment from other countries. But I would say that it will be around this number, between R\$2.1 billion, R\$2.2 billion or R\$2.3 billion. This is what we believe the CapEx will be.

And this is also related to 70% to 75% in optimization of assets. So we still have a lot of assets to be utilized. And there are also some strategic investments, one being heavy plate. We also announced that we will review our mining CapEx and everything will be reassessed. The first thing refers to the review of the disbursement and we will now verify what project will continue and what will be approved next year. About mining, could you please repeat it because your question was not very clear? I think you were talking about domestic consumption and sales.

Q - Leonardo Correa {BIO 16441222 <GO>}

Yeah. I just want to understand your strategy because when we break down Gerdau's cost in the export market, we see a level of cash cost deliver in China over \$30. Therefore, I think that the profitability in the domestic market is much higher today considering this price level. So I just want to know whether you have buyers to accommodate all of this material in the domestic market.

A - André Bier Gerdau Johannpeter

No. We do not have buyers to buy all of this volume, and great part of what we sell is export. And our focus with this price of ore is to supply to ourselves, so that we can be more competitive in our Ouro Branco mill, which is important to continue to export and also to offer billet to other markets. We do not have a large enough domestic market to accommodate the entire volume.

Q - Leonardo Correa {BIO 16441222 <GO>}

Thank you very much.

Operator

Next question from Alan Glezer, Bradesco BBI.

Q - Alan Glezer {BIO 17508681 <GO>}

Good afternoon. Thank you for this opportunity. I have two questions. First about Latin America. We've noticed that net revenue per tonne in dollars was up by \$47 per tonne quarter-on-quarter in this third quarter. And so given the amount of imports that we've seen coming from China, how is it possible to increase the net sales per tonne that way? I understand that the cost per tonne was up just the same way, and the margins were not improving. But on the contrary, I just want to know what happened in the market that led to this increase in net sales per tonne the way it happened.

And the second question is about the strategy of selling slabs to the foreign market rather than the domestic market. I just want to know whether you could please tell me the difference between the profitability margins of slabs and exports of iron ore. Can you give us something that allows us to differentiate these two strategies? So these are my questions. Thank you.

A - André Pires de Oliveira Dias

Hi, Alan. This is André Pires. Well, first referring to Latin America. As André said earlier on, in Latin America, we are in nine countries, and each country is very peculiar and very specific. In some instances, there are countries where inflation moves faster than the exchange rate. We use to translate the results into our balance sheet. Therefore, there might be distortions that is a fact. So this is my answer in terms of Latin America.

But now speaking about slabs and ore. We do not have any specific calculation that considering the price of ore is worth it selling slabs or if the level changes, it is more worth it to export ore. But we just have to look at the opportunities where the exchange rate is

favorable to export slabs and when the foreign market has a consistent and stable demand at good prices that allow us to have a positive margin. So this is what we consider in our decision-making process. But we do not consider increasing the exports of slabs just because there was a decrease in the price of ore.

Q - Alan Glezer {BIO 17508681 <GO>}

Thank you very much for the answers.

Operator

Next question from Milton Sullyvan from Brasil Plural.

Q - Milton Sullyvan {BIO 19085202 <GO>}

Thank you for the follow-up. I have two other questions. First, going back to Latin America and looking at the global market, I would like to know whether you have any expectation concerning what we've just heard about a possible removal of tax incentives from China related to tax reimbursements. That's the first question.

The second question is, even referring to the parity now, even with the exchange rate depreciation and we see a drop in prices of steel in Turkey, how do you see this parity now and how do you see the evolution of the Turkish steel prices from now on?

A - André Bier Gerdau Johannpeter

Hi, Milton. This is André. Well, imports from China to Latin America and the rebate, which is a discount to import, that's one of the practices that we monitor not only in Brazil, but in the other countries of Latin America. And also, producers are constantly looking to see whether that is happening and that has to be avoided. So this is one of the things that we monitor. We have that also for iron ore for.

In terms of the parity of the exchange rate, well, it's difficult to talk about prices around the world. You talk about Turkey, but what is your question about risk rate. It does fluctuate according to the market, so we do not have any specific comments about that.

Operator

Now we conclude our Q&A session. I would like to give the floor to Mr. André Gerdau Johannpeter for his final remarks.

A - André Bier Gerdau Johannpeter

Well, thank you all very much for your interest, for your questions. If you still have any remaining question that or if we didn't answer your questions, please refer to our IR team. And I would like to invite you to participate in the results for our fourth quarter on March 4, 2015. Thank you very much, and have a good day.

Operator

Gerdau's conference call is now over. I would like to thank you all very much for participating, and have a very pleasant afternoon.

FINAL

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