Q2 2018 Earnings Call

Company Participants

- Gustavo Werneck, President & Chief Executive Officer
- Harley Scardoelli, Chief Financial Officer

Other Participants

- Andreas Bokkenheuser, Analyst
- Carlos de Alba, Analyst
- Ivano Westin, Analyst
- Jon Brandt, Analyst
- Leonardo Correa, Analyst
- Marcos Assumpcao, Analyst
- Milton Sullyvan, Analyst
- Thiago Lofiego, Analyst

Presentation

Operator

Good afternoon, and welcome to Gerdau's Conference Call to discuss the results related to the Second Quarter of 2018. At this time, all participants will be in listen-only mode during the company's presentation, and later on, we will initiate the Q&A session. (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 to Mr. Gustavo Werneck. You may proceed, sir.

Gustavo Werneck {BIO 20318216 <GO>}

Good morning, everyone, or good afternoon, everyone. Welcome to our conference call to discuss the results of the second quarter 2018. I must say that it is an enormous pleasure for me to be here again with you to discuss our results, our main highlights and also the outlook for the markets, where we operate. After my remarks, Mr. Scardoelli joining me today, will elaborate on Gerdau's financial performance and at the end, both of us will be available to take your questions.

I would like to begin by talking about Gerdau highlights in the second quarter of '18. We came to the end of the period with an impressive progress in our results as shown on slide two. This performance reinforces our confidence in the fact that we are on the right track, seeking for higher profitability and returns to our shareholders. We have the best quarterly consolidated EBITDA of the last 10 years. This was possible due to improvements in the world steel market and also our management efforts. These management efforts resulted, for instance in our capacity to maintain cost increases below the growth of net sales, through the extensive use of digital tools. This quarter, foreign exchange, and then more particularly, exchange variation of Brazilian currency was positive to us, because we posted gains converting revenues accrued outside Brazil into BRL.

Another highlight of the quarter was the good performance of our operation in North America, because as you know, it produces long. The quarterly EBITDA of this operation was the highest one since 2008, reflecting the economic effect stemming from the North American tax reform and the implementation of Section 232 that has a positive impact on our performance in the region. At a global level, we remain stringent regarding investments in CapEx, and SG&A reached its best historical level ever accounting for 3.6% of net sales.

I want to stress once again that at the base of this evolution is the transformation of our business culture, which involves being simple, more agile and more independent. In regards to indebtedness, the net debt over EBITDA ratio remains flat, and it might come down further looking forward in the year, after the divestment of the rebar units in the US announced in January. More recently, we completed the sale of our operation in Chile, in keeping with our divestment strategy already mentioned before, that focuses on asset of greater profitability potential in the Americas, also like the sale of the HPPs in Goias.

First, now let's look at the next slide, and then we will talk about the market outlook that remains positive. In Brazil, the highlight went to the gradual recovery of the industry, a sector that has become even more relevant to us. As in the last few years, we grew our product pipeline to serve that industry with the start up of the coiled hot-rolled strips rolling mill and heavy plate in the Ouro Branco Mill in Minas Gerais. The growth of shipments of flat steel by Gerdau to the domestic market was up 38% in the first half of this year, when compared to the same period of last year. However, the landscape is still very challenging in Brazil, so much so, that Instituto Aco Brasil posted a downward review on the outlook for steel sales growth in the domestic and foreign market as a result of truckers' strike (inaudible) uncertainty, lower than expected GDP growth and global trade protectionism. However, the forecast for the domestic market in general is positive according to Instituto Aco Brasil.

As for civil construction, the retail segment is recovering, and I am now referring to self construction and low income housing . It is in this niche market that we are stronger in

Brazil through commercial Gerdau.

For those that are not familiar with it, we have network of 76 branches extremely well positioned to serve all regions of the country, geared to self builders and civil construction workers. This segment should continue to grow throughout the year, mainly due to lower interest rates.

In regards to infrastructure works and the construction of mid and high-end real estate, we anticipate a rebound starting only next year. I would also like to emphasize the important role of our export from Brazil, that accounted for 37% of our shipments in the second quarter of '18.

Exports represent a risk reduction factor to us in view of landscape of low economic growth in Brazil. It is also very important to note that this quarter, we reduced our export volumes due to scheduled maintenance in the Blast Furnace 2 at the Ouro Branco mill in Minas Gerais. These maintenance activities have already been concluded and the equipment is operating normally.

In terms of our operation in the United States, the outlook is also very positive. The economy continues to grow in relation to 2017 with a solid domestic demand and the lowest unemployment rate of the last 15 years, then, leading to higher steel consumption. Moreover, the effect from the tax reform and Section 232 should continue to contribute to the growth of our operation. I would like to highlight the good prospective in the US industry and non-residential construction.

Now moving to Special Steel. In the first half of the year, automobile production in Brazil posted a significant growth of 13% according to ANFAVEA. However, in the second half, low consumer confidence level mainly after the truckers' strike should impact production volumes of the automotive industry that accounts for approximately 75% of our Special Steel shipments in Brazil. In spite of that, the automotive production forecast for 2018 should surpass that of 2017.

A recent innovation in Special Steel was the launch of a new product portfolio focused on automotive and wind power industries. It consists of four families of products that offer a series of new possibilities, such as lightness, resistance and flexibility of use. With these products, we will be able to cater to the new demands of urban mobility and also help our customers to innovate and develop solutions in line with the trends of the future.

We also have another piece of good news. We just started to produce parts for wind farms in our Pindamonhangaba unit. It is a partnership between Gerdau and two Japanese companies Sumitomo and Japan Steel Works, JSW. The parts will reach the market in the second half, before that, we have already been selling rolls manufactured by the joint venture and also products to the sugar and ethanol industry.

Well, in terms of the Special Steel market in the United States, automotive industry should grow even though the production base is already high, but it's being boosted by the favorable local economic scenario that I described earlier. And also the oil and gas market also contributed to our good results.

Now looking at the other countries. In South America, we anticipate growth for the region, even though the Argentinean financial crisis should be looked at more closely.

So, now let's move to the next slide, slide four and talk about our investments in the second quarter of '18. Considering the amount of BRL299 million, 49% was spent in Brazil, 36% went to the North America BD, 11% to Special Steel BD, including then the mills in Brazil, US and India, and 4% went to the remaining countries in South America. In the first half of the year, our CapEx totaled BRL516 million, and it was spent in performance improvements and maintenance of our operations.

Now I'll give the floor to Scardoelli, who will continue the presentation. And then I will see you again after the end of the presentation.

Harley Scardoelli {BIO 7283603 <GO>}

Thank you, Gustavo, and good afternoon to all. Now we will talk about our results and performance in the second quarter of 2018. And I am referring to slide, on page six. In consolidated terms, adjusted EBITDA was BRL1.8 billion in the second quarter of 2018. If we look at the chart on the upper part of the slide, we will see the evolution of adjusted EBITDA that was positive in constant, which margin went from 12.2% in the second quarter of 2017% to 14.6% in the second quarter of this year. This increase is a result of improved performance in all business operations. In particular, the operations of Brazil in North America, which posted the best quarterly result since 2008.

Now moving to slide seven, and also heading to the previous slide. On the bridge chart we see EBITDA evolution from second quarter '17 to second quarter '18, that reflects an increase in net sales per tonne that more than compensated for the increased costs per tonne. This come as a consequence of the improved environment in the world -- the world steel industry and the maintenance of international prices combined with management efforts by the company.

On the bridge chart in the lower part of the slide, we noticed that we went from an adjusted net income of BRL147 million in the second quarter '17 to an adjusted net income of BRL746 million in the second quarter of '18, mainly due to the improved EBITDA this year. Based on these results, the second quarter of '18 -- in the second quarter of 2018, we paid our dividends in the form of interest on equity of BRL238.3 million to shareholders of Gerdau S.A. the equivalent to BRL0.14 per share. Likewise in the second quarter of this year, Metalurgica Gerdau S.A., earmarked BRL68.4 million equivalent of BRL0.07 per share for dividend payments. These proceeds from both companies will be paid on August 31st based on closing positions of August 21st.

Moving now to slide number eight, I will elaborate on the company's debt and liquidity position. Gross debt on June 31, 2018 was BRL18.1 billion, down from BRL1.9 billion, vis-a-vis June, 2017. And that was mainly due to debt amortization in the period. The strong reduction in the net debt over EBITDA ratio from 3.6 times in June, 2017 to 2.7 times in June of this year was a result of our divestment program focused on the financial deleveraging of the company and the continued improvement of EBITDA.

In the second quarter of 2018, we experienced a strong appreciation of the US dollar versus the Brazilian real of over 10% vis-a-vis the previous year and the first quarter of this year. This effect was mitigated by improvements in our EBITDA and results. It is worth mentioning that as we've covered before we still have (Technical Difficulty) stemming from the sale of our HPPs in Brazil concluded on July 31st in addition to the assets in the US that one-third of the sales are concluded, our leverage will be even lower. And finally, I would like to mention the 14% reduction of net financial expenses in the quarter, when compared to the first quarter of the year before. This also reflects reduction in our debt position already mentioned.

Now I move to the last slide of my presentation slide nine, where we talk about free cash flow. The charts on the slide shows that the company generated a positive free cash flow of 86 million in second quarter '18. Also we were able to generate consistently positive free cash flow as a result of our CapEx discipline, lower indebtedness and working capital management effort.

In the second quarter 2018, we had the metro impact of cash consumption for the recovery of working capital in absolute terms due to a better business environment as noted on the bridge chart in the lower part of the slide. However, I would like to emphasize the continuous positive evolution of working capital in terms of cycle days, going from 77 days in Q2 '17 to 72 days in Q2 '18. As a reminder, this indicator has once been 100 days historically.

Thank you very much. And now I'll give the floor back to Gustavo for his final remarks.

Gustavo Werneck {BIO 20318216 <GO>}

Thank you, Scardoelli. And now moving to our final remarks, I would like to reinstate that we will continue to pursue our trajectory to face our main challenges in 2018. Gerdau's trajectory and its digital transformation process still in progress and our objective is to increase the potential EBITDA generation, increasing the main or growing the main areas of our business. We are also working very close to our customers so as to contribute to the growth of their businesses to digital innovation.

As I have been telling you in past quarters, the most recent event that it was not yet discussed to the market is that now we have our own office in the Silicon Valley. The purpose of that is to bring onboard new innovation and digital transformation is to expedite Gerdau's business, seeking for better margins to our operation. In 2018, we should also be able to reduce our debt position, despite the impact from foreign exchange. This should occur once we get the proceeds from divestments from our rebar operations in the US and HPPs in Goias, which process has concluded in the past few weeks.

As you know, the generation of positive free cash flow remains one of our priorities and we intend to expand it further this next quarters. And finally, we continue to focus on the profitability of our operations, seeking to improve and expand the results that we already reached in the first two quarters of 2018. Regardless of external factors and market volatility, I see that we can still have room for further improvement, especially considering the quality of the Gerdau team, and it is through this team of Gerdau that are dedicated my deepest admiration.

So, now I conclude my part of the presentation, and we go to the Q&A session.

Questions And Answers

Operator

Ladies and gentlemen, we will now initiate the Q&A session. (Operator Instructions) Our first question comes from Leonardo Correa from BTG Pactual.

Q - Leonardo Correa {BIO 16441222 <GO>}

Good afternoon everyone and congratulations on your results. I Just want to focus on the price issue in Brazil. I think that everybody is saying a mismatch of prices in the domestic market, the discounted price is probably double digits, when compared to what we had imported. So, I just want to learn more about all of this misalignment, or that are happening? In the media also talked about an increase of 15% in July.

All I want to know is learn more about this evolution. We saw a certain evolution in the second quarter because price of increase quarter-on-quarter and it's difficult for us to distinguish, what is the mix effect and what is the price effect. So, it's important that we get a little bit more color in terms of pricing evolution for the next two quarters of the year.

And the second point, if you allow me in the US, we saw a strong EBITDA margin evolution, almost reaching double-digit and this has been the goal of the company for several years. We already saw a result of 9% of EBITDA margin. So, looking at the pricing scenario with all of the benefits from section 232 metal spreads are still open. So, I just want to hear about, what you think will happen to metal spreads evolution?

And then what will be the import of volume scenario looking forward? This will help us map possible improvement towards the third quarter because I think that things will revolve positively there too. Thank you very much.

A - Gustavo Werneck {BIO 20318216 <GO>}

Leonardo, this is Gustavo. As you know Gerdau doesn't usually elaborate a lot on our commercial strategy, but what I can say is that today our recomposition of prices in the first quarter of the year just to compensate for increases in raw material and freight. We are constantly monitoring market conditions to evaluate the impact of costs on our margins. And in terms of export premium, our prices in Brazil vary between a slight negative premium and a balance in international prices. We believe the positive premium would only occur again, after a more intense rebound in demand from Brazil.

Now in terms of your second question about margins in North America. A good performance of the quarter, not only leads to larger steel demand, but there was also the fact of Section 232, the tax reform and a 20% reduction of long imports in 2018 vis-a-vis 2017. All of these factors have had a positive impact on our performance, not only ours, but also on the performance of other local producers. And so we still see good opportunities that will allow us to reach a double-digit like you mentioned in the near future. But in addition to all of the improvements that we noted, even revenues from the rebar divestment in the US should also contribute to our margins because as soon as the divestment is concluded, we will be able to pass more positive figures.

Q - Leonardo Correa {BIO 16441222 <GO>}

That's very clear. Thank you very much, Gustavo.

A - Gustavo Werneck {BIO 20318216 <GO>}

Thank you, Leonardo.

Operator

Next question from Thiago Lofiego from Bradesco BBI.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Good afternoon. And once again congratulations on your results. I have two questions. The first is on working capital. There was variation of slightly over 1 billion in inventories. If you could elaborate a little bit more on the variation of inventories, because when you look at production and sales figures, doesn't show such a large variation, large enough to justify that difference. So, what would be the expectation for the next quarters? And whether the working capital has compromised your cash generation. So, what do you think that will happen in the next quarter?

So, my second question relates to export volumes in the Brazil BD. I would just like to understand, what is the specific export strategy of the company? I know that recently you sold less in the quarter because the price realized or net sales per tonne was strong and then probably had an impact on your mix strategy and export volumes in the quarters looking forward?

A - Harley Scardoelli {BIO 7283603 <GO>}

Good afternoon Thiago, this is Harley. Well, I'll answer your question on working capital. Well, working capital, well we have here the absolute value and everything else. But it has been positive and we see that as I said, this quarter our cycle was in the past -- slightly above 100 days. But we are happy with the working capital in the cycle. It is natural that when you have the stronger business and prices are stronger and with the recovery of volumes, it's just natural that we will have, you know that we will have an impact on working capital.

If you take the variation of working capital in the first half of 2017 and the first half of this year, you will see that the effect was a bit better. In the second half of the year even due to seasonality effects, we may have positive effect from cash generation and working capital. So, in terns of the cycle, we are performing well and other thing that is important to mention is that inventory from North America also has the impact of the exchange rate in terms of working capital in absolute terms.

Now talking about exports Thiago, the market is positive. We have closed important deals with interesting delivery dates. The pricing has been maintained flat in the last few months and in particular in the second quarter there was a drop in export volumes, especially due to the scheduled maintenance of our blast furnace two in Ouromin [ph] and then the export factor maybe carried over in the third quarter, after the blast furnace resume operation it was everything went back to normal. So, once current prices are maintained and if the market remains strong as we anticipate, we should see an increase in export volumes in the fourth quarter. Initially exports of semi-finished goods, because in a way, it helps us to keep volumes despite all the commercial barriers that have been implemented by some countries like the US, in countries of Europe. So ,we see exports in a very positive way in the quarters looking forward.

Q - Thiago Lofiego {BIO 16359318 <GO>}

I don't know whether you could also comment on the margin differential between the domestic market and the export market, or at least give us in range that can helps us in our models?

A - Harley Scardoelli {BIO 7283603 <GO>}

Thiago, we don't usually breakdown the numbers like that, but I can tell you is that export margins are also positive and they will positively contribute to the overall result.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Okay, thank you.

Operator

Next question from Ivano Westin from Credit Suisse.

Q - Ivano Westin {BIO 17552393 <GO>}

Good afternoon Gustavo, Harley. And thank you for taking my question. And I would like to also congratulate you for your results in the quarter. My first question is on special steels, you just reported a flat EBITDA margin, also combined with the further recovery. I would just like you to draw a comparison between Brazil and US on that result.

And also looking forward into the second half, what do you expect in terms of margins looking towards 2019? And in terms of the North America BD you are very, you put a lot of emphasis in delivering high single digits this year and you did that. And I just want to know, whether you have the same thing in mind for special steels. Now speaking about investment and the divestment of your assets in the US, I just wanted to confirm the estimated cash and date?

A - Harley Scardoelli {BIO 7283603 <GO>}

Hi, Ivano it's Harley. As for Special Steel, we don't give guidance or breakdown figures for the US, but certainly between Brazil and the US these two operations are performing well, both markets, even with their own peculiarities, are performing well. The numbers for Brazil obviously have a lot to do with the results posted by ANFAVEA, but growth is still positive for oil and gas as well.

Since last year, we started to make some exports that the market that were not so active in the past, but today we are entering that market and that only illustrates our diversity. So, we are doing well, that is, we're not seeing anything negative looking forward. Now speaking about divestments in the US, even if we do not have a firm date to give you because this is a process that is in the hands of the US authority. Our expectation is that this will occur until the end of the year. But again, it's something that we are monitoring very closely the process is moving normally, but I think therefore that we hope that it will be concluded by the end of the year.

Q - Ivano Westin {BIO 17552393 <GO>}

That's clear. Thank you. Also in special steels, can you confirm the utilization level for both Brazil and the US? And what is the expected volume for the second half of the year?

A - Harley Scardoelli {BIO 7283603 <GO>}

Our special steel operation is close to 60%, it's an average in terms of rolling products. Rolling products, which would be our final product. If we look at the steel capacity, steel production capacity it's closer to 80%. But these are average figures for the Special Steel Operations in Brazil.

Q - Ivano Westin {BIO 17552393 <GO>}

Okay, clear. Thank you very much.

Operator

Next question is from Marcos Assumpcao from Itau BBA.

Q - Marcos Assumpcao {BIO 7474402 <GO>}

Good afternoon everyone and congratulations for this EBITDA over 5 billion after quite some time and also congratulations for your growing dividend. This reinstates a positive outlook for cash generation. So, first question refers to EBITDA per tonne in the US. EBITDA per tonne doubled in dollars, reaching $80 per tonne in the quarter. Could you please comment on that a bit and comment on that outlook, I mean, at the end of the quarter in June or July, so we will have an idea of how to project that forward.

Also my second question is given the fact that we saw a continuous reduction in SG&A as a percentage of revenue. Now we are beginning to see an improvement in the US market price wise, therefore better revenues should have a lower impact on G&A mainly. And also in Brazil with the perspective of prices being with a lower parity and prices reaching close to parity or maybe slightly above, as you said. So, where -- I mean how big would be the operating leverage considering Gerdau's goal? We saw SG&A as a percentage of revenue, but theoretically we see a little bit more pricing coming in and so that number could follow could drop a bit more. So, if you could shed some light, I would appreciate it.

A - Harley Scardoelli {BIO 7283603 <GO>}

Hi, Marcos, this is harley. I will start by talking EBITDA of North America and then Werneck will talk about SG&A. I mean, EBITDA in North America is a combination of factors. One, we have more profitability, the impact is also proportional in terms of EBITDA. Metal spread is better. The pricing environment is better. SG&A was impacted so there is -- there was an impact of lower prices of scrap. And if we have a better metal spread, we will also have positive impact on sales per tonne. We had EBITDA of around 45% in the past, so the operating leverage in a recovery period is important. So, once we have a better environment as we had in the US as a whole that improves our capacity and take us to good levels and also the improvement in metal spreads reflect and this improvement on EBITDA per tonne.

A - Gustavo Werneck {BIO 20318216 <GO>}

This is Gustavo, about SG&A I often reiterate that, I believe that SG&A at in a normal level measure the health of the company, because we are trying to build a simpler and more agile Gerdau, giving more independence to people as well. Therefore, it's worth mentioning that in the second quarter of this year SG&A was 3.6% of net sale and that was a historical figure for our company. In the second quarter of last year in 2017 that amount was 4.6% of net sales. Therefore, this result reflects our efforts towards simplification and deploying digital transformation. I just want to make clear that our efforts to reduce SG&A via zero based budget or ZBB has been very good. This is good news is that even with a growing revenue, we were able to, to hold back SG&A. And in the next quarters, we will continue to seek for all possible opportunities that will allow us to lead SG&A over net sales to even in lower level.

Q - Marcos Assumpcao {BIO 7474402 <GO>}

Thank you. I have a last question to Harley. If you could elaborate a bit on debt and average, dividends are beginning to increase and that helps to increase liquidity of Gerdau. So, how do you see things looking forward? Do you think that you will be able to reduce of zero debt leverage?

A - Harley Scardoelli {BIO 7283603 <GO>}

In terms of Metalurgica Gerdau, our level is very comfortable, because this initiative ZBB or zero based budget is helping. But with our results improvement -- improving and we know that, that now we were able to pay out more dividends. This will expedite the process. But we must recall that part of the debt of Metalurgica is -- will be totally converted by August of next year.

So, what we will have left Is our debt that matures in April. But we have several options to improve our results. And so we will have enough proceeds to pay off the debt. Therefore, we feel very comfortable that the debt along a timeline will be close to zero once our results, overall result improve. Thank you.

Operator

Next question in English from Jon Brandt, HSBC

Q - Jon Brandt {BIO 5506998 <GO>}

Hi, good afternoon and congratulations on the good results. I first wanted to ask you about the uses of cash. It looks like you have strong free cash flow in the second quarter because of better operating environment, the reversal of working capital as well as some enclose from asset divestments. I'm wondering if that's going to be used predominantly to pay down debt. And if you're sort of comfortable with the BRL18 billion gross that level? Or if you see opportunities to pay that down to liability management?

My second question relates to EBITDA margins on a pro forma basis, both in the US as well as Brazil. I'm wondering if you can comment a little bit about the EBITDA margins, what they would have been in the second quarter? Had you absorbed the rebar operations already and as well as what they would have been in Brazil given it was a bit of a noisy quarter with the truckers strike and the blast furnace being down for maintenance? That would be great. Thank you

A - Harley Scardoelli {BIO 7283603 <GO>}

Jon's question first -- first part of the question was about cash flow and how we are using the proceeds, whether we will be to pay off more debt and what is the comfortable level of debt that we want to have. At a normalized debt level, both in the US and Brazil in North America, if you consider the assets we have today that you know they have to do with rebar divestment and in Brazil, we also has to do with our divestments here. I mean, to answer your first question on free cash flow, our objective will be and we will remain being to use these proceeds to reduce our debt. So, we want to reduce leverage level of the company substantially. We are not giving any guidance in terms of what level that will be. The trend depending on the results will bring that debt down, and then obviously with the proceeds from the divestment, especially the sale of the rebar unit in the US that are not yet incorporated in the company this will help us lower our leverage. So, our purpose is to generate further positive cash flow and also we use the proceeds to reduce our debt position.

Now in terms of normalized EBITDA, we are not giving any specific guidance. These are figures that would be yet very preliminary therefore, we want to wait until the sale of the assets are concluded. And then after that we will communicate the market, what the impact of the divestment will be to our results. Now in relation to Brazil, the truckers strike is something that certainly impacted the business and to that end Instituto Aco Brasil mentioned the impact of the strike to the industry as a whole, there was also a direct impact on our freight costs. But nonetheless we are observing anything in our business and the results for the next quarters we show that we are able to absorb the impact without major setbacks.

Q - Jon Brandt {BIO 5506998 <GO>}

Okay, thank you.

Operator

Next question also in English from Carlos de Alba from Morgan Stanley.

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

Hey, good afternoon. Thank you very much. First question has to do with demand in the US, could you comment as to the latest news that you have received from the people that are talking to customers on a daily basis. Do you see a second half of the year assets strong as the first half or is stronger? And also, are there any segments or niches in market that you supply in the US that are starting to show some signs of slowing down? Any comment that you can provide on metal spread for the US in the third quarter would also be helpful. And then finally in Brazil, what are your expectations in terms of demand for the second half of the year? To what extent do you think that trucker' strike has affected sentiment and real economic activity that may jeopardize any credential strengthening of your shipments in the second half of the year?

And then if I may, on costs I mean clearly the quarter had a strong, strong performance on EBITDA generation, a lot of that has to do with better shipments and higher prices. But cost also went up on a per tonne basis, obviously there is lot of pressures that affect that. But how do you feel about cost going into second half of the year? Do you think most of the pressures that we had seen in the last few quarters or month will continue, or they have stabilized at this point? Thank you

A - Harley Scardoelli {BIO 7283603 <GO>}

Okay. His question has to do with margins in the US in the second half and also he asked a little bit about the demand in Brazil. And the second part of the question refer to the cost pressure in our results. And how do you see things looking forward? Okay. To answer the first part of your question related to US margins, our US operation is posting continuously better results, because the environment in the US has been impacted by the reduction of imports. Our capacity is at good levels even though scrap prices have gone down a bit. So, we have -- there has been no impact on demand in the markets, where we operate. So, the outlook is very good as also the second half of the year in our US operation.

Without considering the fact that we also had changes in that operation and we are focusing on improving our margins, sustainably. So, the outlook is very good. I will talk about now about our cost pressure. Our cost per tonne undoubtedly have gone under pressure. But if you look at the Brazil scrap prices here is stable, but in the US scrap prices are down. Coal also has some changes. But conceptually speaking, I do believe that the steel industry, whenever there is any pressure on raw material it ends up by improving its margins and sometimes it improves or keeps its margin and because there is more demand for the projects. And companies like Gerdau with a very good diversification of raw material collection and good penetration in its markets with good geographic penetration, and we have good penetration in the markets, where we operate. So certainly, the company can cope with price increases and at the same time maintain or even improve margin.

A - Gustavo Werneck {BIO 20318216 <GO>}

Hi, this is Gustavo. Truckers strike was certainly very important to Brazil. We always say that this happened before the strike and that happen after the strike. There is a feeling about demand that people are less optimistic, but when we look forward in the second half of the year demand in general from our business is slightly lower when compared to the first half of the year. The only exception is retail from civil construction, where we are not seeing any decline on the contrary. We believe that in the second half of the year retail and self construction are areas that we remain strong. And at Gerdau, we have the new branches of Comercial Gerdau and these branches can cater to this audience in a very different way. Therefore, in the domestic market this, the demand will be directly geared towards exports because we want to keep our volumes stable until the end of the year.

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

Thank you, Harley and Gustavo.

Operator

Next question also in English is from Andreas Bokkenheuser from UBS.

Q - Andreas Bokkenheuser {BIO 7182883 <GO>}

Thank you very much. Just one question from me. You obviously mentioned that rebar pricing have been holding up quite nicely in the US as well as Brazil and scrap prices have been stable in Brazil. Whereas even in the US scrap prices have actually been coming down lately, which is somewhat unusual to see normally the two are very, very correlated. And then, obviously, we are also seeing a bit of a disconnect between scrap and iron ore at the moment. So, just wanted to ask you, what do you think is driving this disconnect in the US and potentially even in Brazil. Thank you very much.

A - Harley Scardoelli {BIO 7283603 <GO>}

Andreas question relates to scrap prices in the US and what justifies the recent price changes? I mean in a way the US is a net generator of scrap in the export scrap. We also believe that with the strength of the US economy this also led to the recovery of the industry. This generates more scrap. So, this is an important aspect because the country generating scrap. And there in the US, we have a very robust and efficient scrap collection system and this also contributes to a lower scrap price.

Operator

Next question from Milton Sullyvan from XP Gestao [ph].

Q - Milton Sullyvan {BIO 19085202 <GO>}

Good afternoon and thank you for taking my question. First question relates to the impact of the truckers strike. And I do apologize for being repetitive, but even though the results were good. I would like to ask you to help me, you know, detect some one-offs that you saw because that you brought numbers related to volumes that were showed or maybe not reported as revenue or one-off costs that were incurred because of the strike. And then you had a scheduled maintenance this quarter that is not going to happen next quarter that is not related to the strike. So, could you please help me out here because I just want to have a better starting point, when I look at the results of the quarter. I just want to be able to quantify things a bit more. This is my first question.

My second question it's about cost. I know that the question was asked before, but I just want to revisit that. In relation to the Brazil BD costs last quarter, I think I asked you about the impact coming from raw material inflation more particularly talking about scrap. And the answer was, yes. And in this quarter, we saw an increase in net sales per tonne and I think that was impacted the raw materials. I want to know what brought about that change and I just want to understand looking forward, whether we can expect as of today, considering the foreign exchange and prices of other raw materials, whether expect further impacts on our cost because of that rather than due to the mix or anything else? Thank you.

A - Gustavo Werneck {BIO 20318216 <GO>}

Milton, this is Gustavo. In terms of the truckers strike, it is very difficult to tell you exactly, what was the financial impact to our company because our company in general, because there are many ways of doing that math. In fact there are many of our production lines stopped for 11 days. And this has an impact, but will be noted to our June and July. Was a gradual recovery of the volumes that were not delivered in May. I belief that the two mainly impacts stemming from the truckers strike -- well, it's also difficult to quantify per company because each one of them have a different impact, depending on how they operate. But one thing in common is freight, because freight can delay, deliveries to us and the company in general, and this is a relevant impact.

And the second impact relates to greater frustration from the general public, in particular coming from the automobile market. There was another, another aspect and we are working on it and that relates to REINTEGRA. And right after the strike, the government came up with a way of recovering from the negative impact. So, REINTEGRA from 2 to 0 now, impacts our business, especially because about 40% of our production in Brazil is exported.

Now in regards to the maintenance of blast furnace 2, it was already in maintenance during the strike. So, that didn't bring about any additional impact. This equipment had been scheduled for maintenance. Since last year, the schedule was for Ma of this year, which occurred. So, that blast furnace 2 focuses mainly, I mean, it's production focuses on exports, and in this, the volume of the second quarter of this year and even comparing it to the first quarter of last year. I mean, the blast furnace began operation, again this week and it's already producing materials for exports. We won't be able to deliver everything in the second half in this export market. We already closed deals that were closed three months in advance. Our export volume in the first quarter of this year and last quarter of last year and as of October this year, in the fourth quarter, we will start working with this export agenda.

In terms of cost, the main impact of our cost came from volumes. Due to the maintenance blast furnace 2 and the main inputs of our productive processes like refractory, iron ore et cetera remained flat. There is no any additional cost inflation coming in the third quarter and looking at the metallurgical side, we don't anticipate any price changes. So, in general terms, cost or the strike, there won't be any further impacts rather than those we already mentioned. Thank you

Operator

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

A - Gustavo Werneck {BIO 20318216 <GO>}

I would like to thank you all for participating. It was very good to talk to you again and I would like to invite you now to join us again in our next conference call related to the third quarter of 2018. It's scheduled to be on November 7th. Harley and I now say goodbye to you for now. Thanking you for your participation, and I wish you all the best. Thank you.

Operator

Gerdau conference call is now over. Thank you very much for participating and have a nice afternoon.