Conference Call Transcript
Gerdau
3Q22 Results

Operator:

Good morning, everyone, and thank you for waiting. Welcome to the video conference for the release of Gerdau's 3Q22 results.

I would like to point out that for those of you who need simultaneous translation that this tool is available through the platform. Just click on the interpretation icon at the bottom of the screen and choose your preferred language, Portuguese or English.

For those of you listening to the video conference in English, there is an option to mute your original audio in Portuguese by clicking on "mute original audio". We would like to inform you that this video conference is being recorded and will be available on the Company's RI website, where the complete material for the earnings release is available.

You can also download the presentation using the chat icon. During the Company's presentation, all participants will have their microphones disabled. Following the presentation, we will begin the Q&A session.

To ask questions, click on the Q&A icon at the bottom of your screen and type your question to get in line, and if you wish, please indicate that you will want to appear on video while asking your question, and we will enable your camera. Once your name is announced, a prompt to activate your microphone will appear on the screen, and then you must activate your microphone to ask your questions.

We recommend that you ask all of your questions at once. We wish to emphasize that the information contained in this presentation and any other statements that may be made during this video conference concerning Gerdau's business prospects, projections, operating and financial goals are based on the beliefs and assumptions of the Company's management, as well as information currently available.

Forward looking statements are no guarantee of performance. They involve risks, uncertainties and assumptions because they relate to future events and therefore depend on circumstances that may or may not occur.

Investors should understand the general economic conditions, market conditions and other operating factors may affect Gerdau's future performance and lead to results that differ substantially from those expressed in such forward-looking statements.

Here with us today are Gerdau's CEO, Gustavo Werneck, and the Company's CFO and Head of Investor Relations, Rafael Japur. I will now turn the floor to Gustavo Werneck to initiate the presentation. You may proceed.

Gustavo Werneck:

Renata, thank you so much for the introduction and I would like to take this opportunity to say good afternoon to everyone. Also, I would like to welcome each one of you to the Gerdau's Video Conference regarding the results for 3Q22 and I hope that you are all well and healthy.

As Renata said, also joining us today is our CFO, Rafael Japur, and for both of us it is always a pleasure to talk to you about our performance and answer questions at the end that may come up during our presentation.

I will start by talking about the international scenario, the highlights of the overall results and then, I will detail the performance of our business operations in 3Q22. Next, Japur will share some information about our financial performance and finally, I will emphasize some points on our ESG agenda. At the end, we will both be available to talk to you about the issues you need to elaborate further.

But before I go any further, I would like once again, as I have been doing in other events, to give a special thanks to our thousands of employees in the countries where we operate for delivering the best nine months of Gerdau's 121 years of history.

Last year we had a historical record in terms of results, that was 2021, but once we compare the first nine months of 2022 to those of last year, we are better. In other words, we will be close to last year's results. This is something that will depend on the results of the fourth quarter that has already begun. Therefore, I would like to once again thank all of our employees for their outstanding performance during these past nine months.

Now, going to slide two, we will start this video conference by talking about the macro environment of how Gerdau operates. I would like to start by saying that we continue to closely monitor the uncertainties in relation to the growth of the global economy and the impacts that inflationary scenarios in Brazil, the United States and the world may have in relation to the demand for steel in the international market.

We also continue to monitor the possible slowdown in the Chinese market as a result of the restrictions imposed by the Zero-COVID policy enforced by the Chinese government. In addition, what is also relevant and we have been closely monitoring the impacts of the conflict between Russia and Ukraine on the global market, especially with respect to our case and the pressure on production costs and in particular energy costs.

Moving to the next two slides, here, I briefly bring you some highlights that reflect the sound performance achieved by Gerdau in 3Q22. Later on, Japur will elaborate on our financial performance.

We ended 3Q22 with an adjusted EBITDA of R$5.4 billion, with an adjusted EBITDA margin of 25.4%, the second highest in our history for the July-September period. This result, as you will see below, was driven by high levels of demand for steel from the construction and industrial sectors and also record results in North America, which we will elaborate on further on.

Gerdau’s net income totaled R$3 billion in 3Q22, while net revenues reached R$21.2 billion. In turn, shipments of steel totaled 2.9 million metric tons in 3Q22. Gerdau’s sound results reported in the 3Q22 allowed us to record in the first nine months of 2022 the best adjusted EBITDA in the Company's history totaling R$17.9 billion.

In this performance reflects the resilience of the Company in face of the uncertainties of the macroeconomic environment, but it is also the result of the transformation experienced by the Company in recent years, which has turned Gerdau into a more agile and innovative organization, adding even more value to our stakeholders and, in particular, our shareholders and customers.

Moving on to the next slide, not only we will talk about the financial highlights, but I would like to mention the approval by the Administrative Council for Economic Defense, CADE, of the joint venture between Gerdau and the Empresas Randon for the provision of leasing services for trucks, semi-trailers and other transportation related products, reinforcing Gerdau next strategy of developing new businesses with the future of mobility in mind.

This New company, which will be called Addiante, will be led by a new CEO, Flavio Leite, who has over 20 years of experience in the transportation and logistics industry.

Now, in the next slides, I will talk a bit more about the highlights of each of our business operations and the outlook for the markets in which Gerdau operates. And then I will start with the introduction that will then pop up some questions at the end.

I would like to start by talking about North America. Initially, I would like to highlight that the adjusted EBITDA of our North American BO total R$2.6 billion, with an adjusted margin of 32.9%, both historical records for a third quarter and above the margins achieved by our local competitors, confirming that our strategy and positioning in North America has been successful over the last few years, when we had, and you might recall that our margins were below two digits.

But I also like to comment that the metallic spread remains at a historically high level. And this is a trend we see going forward.

Well, volumes remained at high levels in 3Q22, reflecting strong demand from the nonresidential manufacturing and energy sectors. The outlook for the fourth quarter remains positive, even in the midst of seasonality in the period, since our order backlog in the U.S. remains at normalized and positive levels.

In view of this scenario, we will continue to operate our mills in the region at capacity of utilization levels above 90%. We remain optimistic about the demand for steel in North America, especially from the construction sector.

The Architecture Billings Index, which measures the activity of the nonresidential construction sector in the country, and the Institute for Supply Management Index, which monitors the performance of the manufacturing sector, for example, remain at accommodated positive levels above the 50-point line.

In addition, data from the U.S. Census Bureau show that total spending on domestic nonresidential construction reached a record high of almost US$80 billion in August of this year.

I would also stress the reshoring phenomenon that has continuously brought in new customer orders and the infrastructure investment package valued at US$1.2 trillion. Both should begin to generate additional steel demand of up to 5 million tons in the U.S. market through 2023 as states move forward with their projects.

In this context, we continue investing in digital transformation and in improving the productivity and profitability of our units in North America, making our steel even more competitive and generating more value to our customers.

For the next cycle, I would like to highlight the investments in the Whitby Mill in Canada, whose new melt shop will start operating in the first half of next year and the expansion of the product mix offer in the Jackson unit in Tennessee, meeting the new needs of our local customers.

Other points of attention for North America, which we have been monitoring closely, include labor shortages, which still remains an issue, inflation and interest rates, energy costs, the pace of the economy in general, and the logistical challenges of global value chains which have impacted many organizations not only Gerdau, but many other organizations in the region.

Now moving on to slide seven, I will now talk about our special steel operation. And I would like to start by highlighting the financial aspects when we reported in 3Q22 adjusted EBITDA, 17% higher than the same period of last year, driven by current profitability levels.

Well, in the United States, the impact of the chip shortage in the light vehicle market has been decreasing by logistical challenges, and labor shortages have affected local production levels. In any case, the production of light vehicles in the country should reach 14.4 million units, a volume much higher than the figures recorded in the last two years.

For 2023, the expectation is that production will be above 50 million units, confirming the recovery of the light vehicle market compared to historical levels.

With the recent approval by the US Congress of the so-called Chips Act, there will be a significant localization in the United States over the next few years of the manufacture of semiconductors, definitely solving this problem that has been impacting the production of vehicles in recent years.

In terms of heavy vehicles, the outlook remains positive, with truck production expected to total about 300,000 units this year and more than 320,000 units by 2023. The oil and gas sector, in turn, continues to expect growth influenced by fuel prices in the international market, and recounts should reach an average of 901 this year when compared to 603 last year.

I would also like to highlight the approval of an additional investment of around R$200 million in our specialty steel mill in Monroe, Michigan, for the modernization and technological upgrade of the rolling mill as part of an investment plan of approximately R$2 billion in the unit, aimed at making it one of the most modern plans in the world.

With this new investment, Monroe will become one of the most technological SBQ bar producing plants in the global market, with the goal to continue meeting the future needs of our customers and also to pursue solutions for the potential demand of the electric and hybrid car segment.

Well, in turn, the special steel market in Brazil continues to be affected by the lack of semiconductors in all their inputs, but there was a recovery in the light vehicles market in the country in 3Q22, whose production volume rose 34% year on year, according to ANFAVEA. For 2022, the production of light vehicles should grow around 4.4%, according to that same association.

Meanwhile, the heavy vehicles market remains positive, with a 16% increase in production volume between July and September compared to the same period of last year, especially in the bus segment.

The agricultural machinery sector should advance 4% this year when compared to 2021 to about 100,000 units, reflecting the expectation of a record harvest in Brazil, also according to ANFAVEA.

I would also emphasize that the sectors that consume specialty steels, especially auto parts, have shown to be very competitive in the global market, generating export opportunities starting from Brazil. I would also like to point out that we have recently started the operations of the new continuous casting of blooms and billets at the Pindamonhangaba mill in São Paulo.

This equipment will allow the specialty steel unit in Pindamonhangaba to have a more automated process with better yield, resulting in the delivery of differentiated products and in an even higher level of quality to the demanding markets.

Also, this technological updating of the Pinda unit is increasingly aligned with the future prospects for a growing number of electric and hybrid vehicles in Brazil.

Well, now I will move to slide eight and talk about the long and flat steel landscape in Brazil and the performance in 3Q22, that reflects an accommodation of demand for steel from the different sectors in which we operate at healthy levels, which shipments of steel from our Brazilian business operation growing 2% between July and September when compared to the second quarter of the same year, which, in my view, is one of the most important comparisons to be made.

Steel consumption in the construction industry remains at high levels, which is reflected in the number of active construction sites in Brazil that reached a historical record in October. Once again, I mentioned here other points that make us confident about the future of this sector. For instance, the FGV's Civil Construction Confidence Index reached its highest value in the last six years in September with 101.7 points.

Furthermore, I would like to highlight that the analysis of the civil construction GDP for the second quarter of 2022 compared to the same period of 21, shows a strong performance in the sector, growing 9.9%, according to the latest survey conducted by the Brazilian Chamber of the Construction Industry. And this reinforces the institution's projection of a 3.5% increase in the construction GDP for 2022.

Now, regarding retail sales, they remain flat impacted by inflation and by the decline in the average Brazilian household income. A positive point is that the consumer confidence index should close 2022 posting an increase of 2.8%, according to FGV data.

I also emphasized a gradual resumption of investments in infrastructure, investments that are expected to reach more than R$151 billion by 2022, according to the BNDS.

In addition, there is a demand for steel from the industrial sector that remains at a high level, reflecting the good performance of the agribusiness capital goods, machinery and equipment, yellow line and energy segments.

In terms of energy, it is also important to highlight what was recently published that Brazil, for example, exceeded 20 gigawatts of installed capacity from solar sources, an increase of 44% between January and October 2022, placing photovoltaic energy as the third power source in the Brazilian electric matrix.

In addition, I would like to emphasize the launching of our new business platform in Brazil called Gerdau Mais. This is an important advance in our digital transformation journey since by following the customer journey, the platform will provide us with data and insights that will allow us to offer personalized services, generating even more shared value for our customers.

Now, I will move to our next slide and I will talk about South America, starting with Argentina, where the demand for steel from the construction, agribusiness, energy and mining sectors remains strong, which has boosted sales in the local market. The Argentinean construction sector grew 6.4% between January and August and year on year comparison, according to the latest data released by the country's Statistics Institute INDEC.

For 2022, the remainder of the year, the forecast remains positive and the same scenario is repeated in the Uruguayan steel market.

Peru, in turn, another important market for us, the demand for steel continues at good levels, driven by the construction industry, which resulted in a 6% increase in sales in the local market in 3Q22 when compared to the previous quarter. The forecast for Peru's GDP remains positive and there is an estimate that the country's GDP will grow by about 2% in 2022.

So, this was just some of the highlights, and then we can further debate them later on. But now I will turn the floor to Japur to talk about the general aspects of our business.

So now I turn the floor to you.

Rafael Japur:

Thank you, Gustavo. Good afternoon to all and everyone. It is a great pleasure to be here with you once again in our Earnings Conference Call. I hope everybody is fine, healthy and safe.

So, let us talk about our financial performance for 3Q22. Now we have the best first nine months of our track record, like Gustavo said very well during the highlights of 3Q22.

Then, let us talk about cash flow and working capital. Like Gustavo said, in the 3Q22 was generated and EBITDA of R$5.4 billion. This is the second best EBITDA for a third quarter in our history and confirms the resilience of our performance in different scenarios.

We invested in this first part around R$100 million in working capital, very much in line with what we said in the previous quarter, and we invested R$1.1 billion in CAPEX disbursement. Let me give you a more color on the investments that we made and that we are assessing and performing, and I will be detailing this later on in the presentation.

What about operating cash flow? Taking into account what we had in costs and obligations for our debt and income tax paid, we will have free cash flow of R$3.1 billion in the 3Q22, equivalent to nearly 60% of EBITDA or 15% of our net revenue for the period transformed into free cash flow.

During the 3Q22, if we take into account this R$1.2 billion that we paid in the 3Q22 related to dividends paid in the second quarter plus R$600 million that we invested in share buyback of GGBR4, we have nearly 60% of our free cash flow of the 3Q22 invested in return to shareholders.

Moving on to the chart below, now focusing more on working capital, we can see that, basically, we did not have a lot of working capital use in the 3Q22. It remained flat at a level very close that we had in the previous period, with a cash conversion cycle, which is measured as a function of revenues for each quarter because we had a drop of 8%, like Gustavo said earlier in the presentation, we had an increase in the number of days, 64 to 70 days, but within a very comfortable level and taking into account the seasonality that we naturally have for the year in normal levels, according to the Company's track record.

Now, moving on to our investments and how we have been allocating capital in our CAPEX. Like we said in the previous slide, in 3Q22, we had a disbursement of R$1.1 billion CAPEX. Of this amount, 400 million were invested in competitiveness projects, trying to increase our capacity to generate results over this cash conversion cycle in the long run.

For 2022, we follow the same projection of CAPEX disbursement of R$4.5 billion. And, in the chart below, we would like to take this opportunity of being with our investors and the markets in general to bring more color on the main initiatives that we have been performing and which have already been approved by our board of directors or which are being studied in house.

Naturally, they are in different stages of maturity. As you can see, the major focus behind these projects is in three categories. First, assure competitive access to raw materials in the long run, improve our production capacity or to cater to our customers' needs and add increasingly more products or added value in our portfolio to our customers.

In the Earnings Conference Call of the fourth quarter of 2022, which will be in early 2023, we are going to go deeper into these initiatives and to give you an update on the forecast of CAPEX disbursement for year 2023.

Now on slide 13, let us address our cash position and indebtedness. In 3Q22, we reached the lowest level of net debt over EBITDA in our history, at 0.16 times. This stems from the deleverage process achieved in previous years and also the strong result generated within the first nine months of the year 2022, like Gustavo highlighted.

We closed the 3Q22 with a cash position that is very robust, R$8.6 billion, very close to what we had a year before, around 2% higher than the same period last year. We closed the 3Q22 with a gross debt of R$12.9 billion.

This increase of around R$500 million is mostly explained by foreign exchange variation of 3.2%, taking into account a significant portion of our debt, which is denominated in dollars due to the bonds that were issued in the capital markets.

It is important to highlight that the Company continues pursuing this level of gross debt below R$12 billion, but not only to maintain, but also to reduce the portion of our debt which is effectively denominated in dollars.

So, considering this, we would like to remind you that in the coming days now on November 21st, we are going to have the maturity of the 15th issuance of our debenture from 2019 with a principal amount of R$1.5 billion. Then, with that, we will basically go back to a level below R$12 billion of gross debt.

The lower chart shows our debt profile with an average maturity term of 18 years and distributed with amortization over time and with a long-term profile.

I also highlight that, in the 3Q22, we made use of the strong results that we have been posting and our solid cash position to renew our global credit line. It used to be US$800 million and now is US$875 million, which further increases our resilience, our financial flexibility and we make the most of this moment to extend the term.

This line would be due in October 2024 and now it will be due in October 2027. We would like to thank our partners, our banks that allowed us to extend this term. A highlight of that in the closing of the 3Q22, this line is absolutely operational and fully available, and not withdrawn by Gerdau or by any of its subsidiaries.

Moving now to slide 14, let us talk about return to our shareholders. Owing to the significant cash generation in the first nine months of the year, accrue in more than R$9 billion and taking into account the solid financial position, the board of directors of the Company has a dividend payout and interest on capital of approximately R$3.6 billion, or just around it up, R$2.50 per share to be paid to our shareholders on the 14th of 2022.

At Metalúrgica Gerdau, we are also going to have interest on capital and dividends, amounting to approximately R$517 million or R$0.50 per share. The payment of proceeds in Metalúrgica will happen on December 15th, and both for Gerdau S.A. and Metalúrgica, we will consider the position of these shares held now in December 2022.

With that, we highlight the payment of proceeds and accrue for the first nine months of the year, we declared almost R$5.8 billion as dividends at Gerdau equivalent to more than 60% of the free cash flow generated over the period.

Moving from dividends into our share buyback program, which was launched this May, in Gerdau S.A. we have 81% of the program performed or more than 45 million share buybacks for R$24.08, taking into account not only in the first quarter but also up to the beginning of the quiet period, on October 24th. With that, over the year of 2022, we have nearly R$1.1 billion invested in share buyback.

As for Metalúrgica Gerdau, we performed nearly 70% of the program announced. As a reminder, at Metalúrgica it is greater than Gerdau S.A., accounting for 5% of preferred shares and Metalúrgica has 10% of free flow of preferred shares of Metalúrgica.

So, until the closing, before the quiet period, almost 70% of Metalúrgica was performed or nearly 47 million shares of GOAU4, which were bought for an average price of R$10.36.

As already announced, in a material fact early on, the board of directors of Gerdau decided to cancel all GGBR4 shares in the share buyback and a lot of 1.7 billion common stock which were already in the Company’s program.

As for Metalúrgica Gerdau, it also canceled all the shares in the share buyback program and also an additional lot of 6 million preferred stock, which were also at the Company's treasury before the program started.

Then, taking into account share buyback and dividends, we go to the upper chart and we come for the last both months. If we put together everything we did when it comes to returning to shareholders, we come to a level that is very significant of R$7 billion return to our shareholders.

Taking you to account, adjusted profit for the period, a payout of nearly 55% in our results way above the 30% that were stated by our bylaws.

In the lower part of this slide, there is a chart that we always like to show, showing how the combination of better results and ongoing reduction in indebtedness in recent years allowed us to have a very positive impact on the dividend yield growth for our securities, moving from 3.6% dividend yield in 2018 to 14.1% for the last 12 months.

So, thank you again for your attention, and now I turn the floor back to Gustavo, who will make comments on our ESG initiatives for the 3Q22, and I will come back in the Q&A session.

Over to you, Gustavo.

Gustavo Werneck:

Thank you, Japur.

About the three final slides, I would like to call on some relevant aspects related to our ESG agenda, starting with some piece of information that has been already disclosed. In August we received certification for a Gerdau Summit, which is our JV with the Japanese Sumitomo Corporation and JSW for the supply of rolling mill rolls and parts for wind power generation as a B company.

As a result, Gerdau Summit became the first manufacturer in the world to become a B corporation. The certification reflects our commitment to the B Movement Builders Program and its ambition to certify all of our operations in all of the countries where we operate as a B company by 2025.

As part of our sustainability agenda, the certification recognizes that Gerdau follows good sustainability practices and effectively connects our businesses with our purpose of empowering people who build the future, leaving a legacy for society.

I should also mention that the certification as a B company is given by an independent, international nonprofit organization called B Lab, represented in Brazil by Sistema B, which was able to verify in a very tangible and immeasurable way how Gerdau Summit has worked to build an even more sustainable, diverse and inclusive business environment.

Furthermore, I would like to mention that we received a certification from the World Steel Association for our reporting on greenhouse gases in line with the institutional agenda.

Through our participation in the Climate Action Program, we are included among the 15% of companies with the best performance in CO2 intensity, which is the result of our governance and investments in the improvement of environmental practices.

We are the largest recycler of steel scrap in Latin America, and our greenhouse gas emissions rate is about half of the global average for the steel sector.

But, as previously announced, we want to go even further. So, this year we committed to new targets to reach 8.83 tons per CO2 equivalent of tons of steel by 2031 and we aim at being carbon neutral by 2050.

Finally, I would like to point out that, in September of this year, we were present at Rock in Rio Brazil 2022, being the official steel supplier of the festival. We supplied 200 tons of 100% recyclable Gerdau steel for the construction of the largest world stage in the history of Rock in Rio, bringing the concepts of sustainability, circular economy and innovation not only to the event but to the entire Brazilian society.

So, I would like to conclude by thanking all of you for listening to our remarks, and now we are available to take your questions and elaborate further on any point of greater interest to you.

So now, Renata, I will give floor to you so you can help us organize this Q&A session.

Leo Correa, BTG Pactual:

Good afternoon, everyone. I have two questions with regards to dividends at GOAU.

We noticed a dividend payout which is lower at GOAU vis a vis GGBR. I would like to understand the rationale behind this difference.

There is a second question about trends of profitability in Brazil. We have come to a level that is lower in the 3Q22 in terms of EBITDA margin, around 18%. I would like to learn more about profitability trends for the coming quarters, considering the drop of raw materials prices and one-off adjustments of price in the domestic market.

Gustavo Werneck:

Thank you, Renata, Leo. Thank you for the questions.

Let us answer in the sequence, first, about Gerdau Metalúrgica S.A. dividends.

Rafael Japur:

Hello, Leo.

Excellent question. It gives me the chance to bring an important clarification about this recurrent topic. There are many questions by analysts.

So, some reminders. We opened the share buyback program because we strongly believe our shares are depreciated vis a vis the intrinsic value and we keep on working on the share buyback both at Gerdau S.A. and Metalúrgica, which is larger at Metalúrgica compared to Gerdau S.A.

Considering the cash at Metalúrgica, if we do the math, we reasonably have today funds enough in Metalúrgica to conclude the buyback program which is already open at Metalúrgica Gerdau.

When we started the share buyback program, we started from historical levels of the intrinsic level of Metalúrgica vis a vis Gerdau S.A., so from 24 to 26% and even though we performed the program, which is twice the size of Metalúrgica vis a vis Gerdau S.A We keep on having a discount which is very significant, around 20%, which the Company's management does not consider to be adequate considering the nature of Metalúrgica Gerdau, which is a holding company, carries a single asset which is Gerdau S.A.

So, the intrinsic value of the participation of Metalúrgica and Gerdau S.A. is not a reason to have such a significant discount, considering that Metalúrgica has very low costs, very little expenses, basically no carry over costs to take this portion at Gerdau S.A.

Then, to summarize, if we take into account the level of price, we continue to consider adequate as a long-term investment to shareholders to allocate value, to keep on having share buyback at Gerdau S.A. and it makes more sense to keep on buying back shares from Metalúrgica Gerdau.

So, part of the dividends that will be received at Metalúrgica from what is proposed by Gerdau

S.A. to all its shareholders, this will be used over the coming quarters to follow the share buyback program of shares issued by Metalúrgica Gerdau.

I know it is a long answer, but I just wanted to make it very clear and I hope I have answered Leo's question.

Gustavo, let us talk about profitability.

Gustavo Werneck:

Thank you, Japur. Leo, about Brazil, let us focus on the main points of the business addressing 3Q22 onwards.

Think about demand. Demand is very solid. It remains solid in the 3Q22 and will keep on being solid, in our opinion, over 2023.

The segment that has more difficulties now with a slight drop in our portfolio is retail, very much affected by the level of indebtedness of the family, family and household, and income generation.

And there is some growth in infrastructure. Sanitation is an example of progress in Brazil, converted into demands for us right now, demand from the industrial segment or agribusiness and also from construction in general. Demand is very resilient.

I also mentioned in my opening remarks one important indicator, which is the level of construction sites active in Brazil and, once again, a record in October. I keep on showing this indicator in our calls as something very relevant for us for the resilience of this sector. So, demand in January in the domestic market is OK and we keep on being at this level, I would say, positive in the future.

What about our profitability level in the domestic market? They are also adequate. It is not by chance our import premium increases a lot. Prices in Brazil did not follow the drop in prices in the international market. I would say that, when it comes to profitability, this is OK, pretty OK and will remain as such in the future.

And now I come with the main point which explains the margins in 3Q22. These will be important drivers if we consider margins for the future. The first highlight is what just happened in 3Q22 about coal.

So, coal increased a lot in the first and second quarters this year. This was purchased and transported to Brazil and the costs happened in the 3Q22. Then, when it comes to the rising costs, this is happening owing to coal.

Coal prices remain very volatile in the world. In latest weeks, we have had a rise in coal. We cannot tell exactly how the price will behave over 2023, but that is a driver that might explain higher margins or lower margins next year.

A second highlight happening this second quarter, which is a maintenance shutdown in Ouro Branco. Ouro Branco is unlike other mills. We have based in EAF and scrap, life cycle is shorter and so pieces of equipment are being in maintenance and we keep on going under maintenance over the next five years.

So, we had maintenance of blast furnace number two, with results in the second quarter. Blast furnace is now up and running again and may be a factor that should bring more attention. It had an impact and it may keep impacting positively these margins in Brazil.

And referring to exports, margins in the domestic market, like I said, remain very solid. However, exports are driving down, driving margins down. As we speak, we are preparing the operation for the coming quarters, including 2023, so we can keep on exporting despite lower margins.

Then, we do not intend to have any demobilization of our capacity. It is not clear yet whether prices and international margins will remain at these levels. So, in the short term, there is an impact.

We slightly reduced our export levels in the 3Q22, from around 22%, which are our traditional number, to 9%. Now, we keep on exporting a little, particularly for our sister companies, in order to have an operation level that will bring opportunities for exports in the future.

So, these are the drivers behind the margins achieved in the current quarter and to some extent are the factors that will guide general margins of our operations in Brazil in the coming quarters.

But just highlighting that, in the domestic market only, margins remain pretty solid. We believe they will keep on being solid because the main factors that contribute to these margins remain stable. They will continue to be solid down the road.

Then, overall speaking, Leo, these are our answers to your questions. I give you the floor back, Renata.

Daniel Sasson, Itaú BBA:

Hello. How are you? Can you hear me? Great. Thank you, Renata. Thank you, Werneck and Japur for the presentation.

My first question in terms of capital allocation is whether you could give me a little bit more detail about the way you arrived at that extraordinary dividend to be distributed now. You said that you do not want to change the rule of 30% of payout, also because you want to have more flexibility throughout the cycles.

But what was behind that view? I mean, do you have any view about gross debt for the end of this year or the end of next year that could probably put a ceiling in terms of a leverage target? Because, an addition to that 12 billion of gross debt, your leverage would be 1, 1.5 times that debt over EBITDA. So, if you could, please, give me a little bit more color.

And now, my second question relates to the U.S. market. You had a quarter where shipments were not as strong, but prices were strong. Is this just a temporary dynamic because of lower demand at the end or was it something more deliberate when you look at your policy of value per volume?

So, looking forward, would it really be okay to lose a little bit more, so that you could still remain posting high profitability levels?

Gustavo Werneck:

Thank you, Daniel.

Rafael Japur:

Hi, how are you, Daniel?

Well, let us start with our capital structure. It is important that we make a distinction because we did not do any extraordinary dividends because we did not move forward on the reserves of the Company.

In 2022, we have more than R$10 billion of net profit. So, when we look at net profit in our base, we are not advancing towards our reserves. Then, we are not using that to payout dividends or even to execute our buyback program that is coming around the corner.

In other words, our philosophy, our mindset is pretty much in keeping with what I said earlier on, which is to maintain the net debt over EBITDA level close to R$12 billion, and our cash, also considering the different countries where we operate different businesses and the need to be flexible and also considering our financial soundness, this would be around R$6 billion as well.

Therefore, at the moment, we do not anticipate any structural change in our capital structure. This is not in the radar.

I think we miss a little bit of the beginning of your question, so, if I failed to answer your question completely, please let me know.

And now I turn the floor over to Gustavo to talk about the North America part of your question.

Gustavo Werneck:

Daniel, in terms of volumes in the U.S., we had some maintenance downtime and we had to use some windows of opportunities to take advantage of making some investments.

We had to make some maintenance downtime to invest in our profitability. Demand remains very sound. The backlog today is lower when compared to 2021, but even though it is a very healthy backlog.

Right now, and even looking towards 2023, we can operate at our full capacity, but probably our bottleneck in terms of operating with our productive capacity in our rolling mills utilization over 91%, so, the problem is labor.

There was a slight improvement in July and August, but now we still suffer with scarcity of labor. We have to deal with that difficulty even though we did not stop our productive capacity due to lack of people. We have not done that yet. But if you look at the flats market in the U.S. and in Brazil, these are two different things.

If we look at longer periods, ten, 15, even 20 years, and if you look at the longs market in the U.S., the margins are higher, it is more stable in general and it has less volatility when compared to the flats market.

In addition, another thing that we should take into account is that longs do not have delivery capacity. In other words, there are three well-established suppliers, each one of us having one third of the market. There are no new entries of capacity.

There are things that we are noticing in the short run and things that we anticipated that will probably happen in the mid-range. So, this reshoring is something that is already happening and an important period for us.

There is just one example that I mentioned during the presentation, but there are other things happening, like the approval by the U.S. Congress of the Chips Act that will increase the productive capacity of chips in the U.S. and they are already demanding long steels. The infrastructure investment of 1.3 trillion. This has not yet been translated into demand.

We have not seen anything coming from that new act, but I would say that, in general, this is still in the executive phase in different U.S. states, and this could probably be materialized into stronger demand maybe in the first half of next year.

Then, all in all, the longs market is much better prepared to deal with this inflationary scenario when compared to other markets in North America as well. The level of metallic spread remains very consistent. Scrap, right now, is at lower prices and transportation due to that extreme drought in the Mississippi River.

In other words, we do not rely too much on the Mississippi River to transport our scrapping products because we do that from our mill in Jackson, Tennessee, but there are some logistic pressures that have an impact on the price of scrap.

But even with lower scrap prices, the maintenance of long prices, the spreads are still at very high levels. Therefore, all in all, our operation is very healthy in the U.S., not only if you look at the market, but everything that has been happening in the past five years in terms of our transformation.

I remember that five years ago when I talked to you about that, when our margins were below two digits, the gap that we had in terms of operating costs and also in terms of updating our mills. The gap has been closed.

In general, speaking about the North American market, what I could tell you, it was just that. Thank you.

Daniel Sasson:

Thank you, Werneck and Japur.

Gabriel Simões, Goldman Sachs:

I have a couple of questions.

First question. We saw a very significant acceleration in dividends announced in the 3Q22 in addition to fast performance of the buyback program. I would like to understand how you see the leverage of the Company down the road.

You often speak of the target of R$12 billion as gross debt, and investors had in mind a target, close to 5 billion for net debt. Does it make sense to continue in the debt in these terms, or are you working with an optimum leverage level expected by year end? What is the best way to consider this?

Rafael Japur:

Hi, Gabriel. We do not see major changes when it comes to our philosophy about our balance sheet or our capital structure. The same applies to R$12 billion as something around these numbers. We would not like to have it downwards or upwards. And we also have some tactics about debt rollover over time.

As for dividends, they are a result of our capacity to generate profit and cash over time on a resilient basis. So, this is why we accelerated the 3Q22, because we have more visibility in our cash generation capacity until the end of the year, more than R$9 billion as free cash flow.

With regards to the leverage, we are not piloting the balance sheet to come to a position A or B when it comes to the year end position. We have some obligations and payments to be made. There are some questions in the Q&A. So, we have debenture maturity that we are going to fully pay.

In April next year, we also have 2023 with a maturity and the idea is to have it now, and owing to the high volatility of markets of bonds, it does not seem to be the most adequate moment for a new issuance. Maybe we can have a short-term operation with a commercial bank.

Our debt ratio today is pretty much concentrating on capital markets with a lot of room with commercial banks with slightly shorter lines. Taking into account that the average term today is around eight years, which is way above the six years, which is the minimum for our target of our debt maturity term.

So, I tried to answer your question and also questions from other analysts.

Gabriel Simões:

The U.S. operation delivered increasingly strong numbers in the 3Q22 with a very strong margin. I think it would be great for you to give us more color on the outlook for this segment. We used to speak of a stable margin, close to ten or 12% for this business front.

Do these levels make sense considering a normal level? If the answer is yes, when do you expect to see this normal phenomenon?

I would like to understand how we think about investments in orders and expectations about the timeline for these investments to flow in the Company's earnings results.

Gustavo Werneck:

I think this is what I answered to Daniel. If we think about the expression “normalization” in a world that is not normal anymore, it makes no sense. So, many things will keep on happening in the world. I do not think it makes sense to talk about normalizing. I think it makes more sense to say that we are absolutely prepared as a Company to grab all opportunities that are brought to us from the market.

This is the transformation that we have been going through for seven years. It did not start yesterday. The Company is very allied, very agile, SG&A, our revenues with historical levels this year. This is evidence.

So, I do not know exactly what will happen over 2023 or what the world will bring us in terms of surprises. But if you focus on what we can see now in the short term or what we envisage about the margins, four, ten or 12%, today, they are not on our radar.

We expect to work with higher margins. Like I said, we have demand, backlog and possibilities, new orders in terms of new production capacities in the U.S. Our customers, the infrastructure package, and also the transformations performed in our clients.

Then, we strongly believe that we will be working with margins that are way above this level in the coming quarters. There will be seasonality at the end of the year, not only in the U.S. but also in Brazil.

Seasonality has been different after the pandemic. But considering this, well, then we may go back to normal by year end with collective vacations or maintenance shut down, vacations, holidays and this year, more specifically, the World Cup, which affects some markets.

So, we have lower seasonality in December and I would like to say that December, whatever happens when it comes to seasonality, will be a decisive month. How close will we be to the historical level we achieved last year?

We closed the first nine months of the year above historical year last year. Then, let us see, November and December, how close we will get to the results achieved in 2021.

So, overall speaking, when we consider North America, maybe resilience and optimism, this is what drives us now and that is how we are getting ready to be in 2023.

Back to you, Renata.

Thiago Lofiego, Bradesco BBI:

Can you hear me? Well, thank you. Thank you, Renata, Japur and Werneck.

I would like you to elaborate a bit more on the Brazil BD and look at the market dynamics going forward.

On the demand side, you already said, Werneck, that there is some seasonality, it is a natural seasonality of the business in the fourth quarter. I would just like to understand whether this drop in potential volume in the fourth quarter. Is it within that normality or that seasonality thing or you understand that it could be a bit different than the normal trend?

And also, the second question is whether you could tell me something about how costs will evolve in Brazil. We see that the prices of scrap were down substantially in the past few months and on the other hand, the coal prices in the market are going up. So, how do you factor in this pricing dynamics?

And my other question, now looking at the Company as a whole, not only in Brazil, is there any maintenance CAPEX that is unusual, probably out of your radar or that could be relevant coming forward in the next two or three years?

I am saying that because we saw some of your competitors announcing unexpected CAPEX, not only in the steel milling industry, but we have seen also in other industries, companies reevaluating their maintenance CAPEX.

Is this a possibility that you see at Gerdau as well, not only in Brazil, but also in your other BDs outside Brazil?

Gustavo Werneck:

OK, Thiago, thank you very much for all your important points.

Seasonality is just normal. As you know, we all know for many, many years, with the exception of the specialty steel market, because probably there will be more inventory throughout the chain, because with all these downtimes from car manufacturers throughout the past two years, it was difficult to maintain a continuous flow throughout the chain and this has its impact.

So, I understand that this industry will rather work with a more stable flow in terms of working capital, in other words, higher working capital requirements. Then, for specialty steels, we will not have as many downtimes as we usually have, just to get prepared for the recovery in the market, especially in regards to heavy trucks and buses. These are things that we have been talking about with our customers.

Therefore, I think seasonality will not apply to this particular case, but it depends on how you look at it, if you look at demand as being something positive. The cost of the mining mills has been quite stable and somehow, we were able to maintain profitability. Of course, there are issues like increasing energy prices and a decline in scrap prices.

The cost of many mills is very flat. There is nothing out of the radar. The only thing is coal and it is not something that we can control. So, the expectation now is how prices of coal will perform going forward.

There is some coal that we bought at lower prices that will have an impact in the next coming months and this peak that occurred in the past few weeks, we are not sure whether how that price will behave going forward. Then, I think what will impact us at the Ouro Branco mill is the coal issue.

In terms of CAPEX, there are no surprises. I understand your comments because you are probably talking about maybe some large greenfield plant. We do not have a similar CAPEX when compared to what you have been seeing in the market in general.

What we have is the need to invest more in Ouro Branco, but that will not happen in only one year. This will cover a period of five, six, seven years. We have to refurbish the blast furnace one, so there may be some CAPEX spending, but this is pretty much in line with our cash position.

But now, in terms of new large capacities or maybe some very serious maintenance issue, none of that is in our radar.

Thiago Lofiego, Bradesco BBI:

Well, great. Thank you.

I just have a very quick follow-up related to costs. So, in the fourth quarter, maybe we should consider what is part of your cost, in other words, you will not have any large cost pressure, especially coming from coal and scrap prices are coming down.

Then, the net of your production cost, when you look at COGS in the fourth quarter, whether you anticipate something better or is still flat?

Gustavo Werneck:

It is still very flat because the coal that we acquired is still being used in 3Q22 and there will still be some seasonality in downtime. Therefore, more specifically referring to coal, we will see lower costs impacting this throughout, but this is more in terms of COGS.

Japur wants to add something.

Rafael Japur:

When you look at the main dynamics in downtime, we have some expectations that may not be materially and this relates to a higher or lower decline of fixed costs. So, in the fourth quarter, this change in the level of operation may be something important if you think in terms of BRLs per ton.

Now, referring to CAPEX, I would just like to say the opposite of what I said when I was presenting it. In the 3Q22, of the 1.1 billion that we spent in CAPEX, 400 million was invested in competitiveness and growth and 70% of that amount was dedicated for maintenance, still very much concentrated in some of our operations in Brazil like Ouro Branco.

It is not something that will happen that will change overnight but, as Gustavo was saying, it will take a few years. In other words, we will continue doing what we started doing last year when we significantly increased our CAPEX investments in 2022 when compared to 2021.

Thiago Lofiego:

Perfect. Thank you, Japur and thank you, Werneck.

Gustavo Werneck:

Thank you.

Carlos de Alba, Morgan Stanley:

Your comments in the press release rate are relatively optimistic on coming quarters in 2023, yet your shipments have declined quarter over quarter and global demand, including U.S. and Brazil, with a slight slowdown, and probably Brazil will also have a slowdown.

How can we reconcile this? What do you expect in terms of working capital in the coming months? Is it correct to assume that only the investment would add net steel volumes to Gerdau with all other only improving product mix?

Gustavo Werneck:

Thank you, Carlos. Let us break this question down, Japur and myself.

We are very comfortable when it comes to demand, Carlos, not only Brazil, but also in the U.S. Wherever we look, all the signs we read, all the clients we talk to, all the investments made, all the deals already closed, we keep on being very optimistic, demand wise, for 2023.

As we speak, we cannot precisely predict, however, we try to get prepared. Think about costs we do not manage. Well, we do not know the impact on our production. Maybe a clear example is coal and, to some extent, energy costs as well. So, to some extent, this is how we look at this.

I do not consider demand specifically in our case for geographies where we are or our product mix in the U.S. and the way how we set our operations in Brazil. I do not think it should be a problem. Maybe the most important issue about volume or shipment is how much we will export from Brazil.

As we speak, we are not dismantling any production capacity. We are not demobilizing any mill. We believe today that there are possibilities, concrete possibilities early next year to see some recovery or resumption and maybe we can have a more positive export margin favoring the average margin in Brazil.

Then, in terms of production, capacity and shipment, this is what we see.

Japur, anything to add?

Rafael Japur:

Hi, Carlos. How are you?

Just adding the second part of the question about working capital. Considering maintenance, shut down and our normal operations as usual we expect over Q4?

I'm not guaranteeing, but that is what we expect to see: a cash release coming from working capital, a reduction in inventory and finished goods, so, we have a maintenance shutdown and we consider to start selling again.

When it comes to investment CAPEX, maybe we could consider the list on the slide, Carlos, about the proceeds and the expansion capacity that I mentioned, not only would be that we understand to add capacity because some of our operations, for example, Michigan and Monroe, we have investment to expand the casting operation.

Today, we do not sell billets or blooms from this operation. So, there is some lack of balance between the rolling capacity and the melt shop. Then, when we increase the rolling capacity, we have an addition, an effective addition in the volume to the market, because maybe today we do not have a market in North America which is relevant for billets or rounded billets coming in from the Monroe operation.

Therefore, if you check the list of projects, I would say that the Ouro Branco coiled hot roll strips are more related to a change in mix rather than added capacity, because in Ouro Branco will eventually bring more value to shareholders.

But top of mind, there are other projects. Nearly all of them to a greater or lesser extent will bring an increase in shipment by the Company.

Gustavo, anything to add?

Gustavo Werneck:

Overall, speaking in North America more specifically, we do not focus mainly on the shipment growth in our plants. Maybe Midlothian is an exception. There will be a slight growth, but the focus on North America is competitiveness and catering to our customers' needs by expanding the product mix and becoming a one stop shop in most of our mills.

Maybe the most important example of investments is Jackson in Tennessee. We are expanding this important mill we have there in Tennessee to be very much focused on meeting our customers' needs.

So, to put it simply, I would say that this is how we intend to make progress in our investments in North America.

Back to you, Renata.

Guilherme Rosito, Bank of America:

I would like you to give us an outlook about volumes for the second half in 2023 in Brazil, as well regarding prices and how is competition with imported volumes in Brazil?

Gustavo Werneck:

OK, Guilherme.

Imports in Brazil are quite flat. It has an 11% historical level. It was up a little bit in 2020 during the pandemic or 2021, and it reached 15%. This year, it should be around 13%, and next year it should go back to historical levels of 11%. So, still imports in Brazil, that is not a problem.

Our outlook for volumes for this next quarter is slightly lower due to seasonality, the holidays and the World Cup. But, in January, we should resume to regular demand levels that we have experienced throughout the year.

Then, for us, and still to reinstate the comment for 2023, this will be a year where demand is not the main issue that we should manage. Profitability levels in the Brazilian domestic market are very stable and flat, I would say.

We do not see large possibilities of growing profitability because of price issues, but we do not see any pressure right now for further reductions of our profitability level.

Therefore, in general, this is what I can tell you.

Alejandra Andrade, JPMorgan:

You discussed the payment of 2022 debentures. What are the plans for you as dollar bonds maturing in 2023?

Rafael Japur:

Alejandra, how are you?

We talked about debentures in the previous question, but at first, we do not think it is a timely or a good moment for new bonds. We are interested in lowering our dollar denominated debt close to US$1.5 billion.

Today, we are around 1 billion, so with maturity in 2023, in April next year. So, getting to the level of debt that we want to see denominated in dollars, to fully pay with cash and settle this issue.

Thank you for your question.

Operator:

Thank you, Japur. Thank you, Werneck.

Well, in case you still have any more questions, please send them through the Q&A icon of the platform. As there are no further questions that were posted through the platform, in case you have any other questions or if you would like us to answer anything else, please send us your questions in writing or give us a call and then we will get back to you because it will be a pleasure for us to get back to you.

So now I turn the floor back to Werneck.

Gustavo Werneck:

Thank you, Renata.

I just have a few final remarks because we are constantly trying to increase the relationship we have with the market in general. So, any point that probably was missed during this conference call, please let us know, because all of us, we will always be available to you as our intention is to be fully transparent and to give you all of the details about our operations.

Thank you so much for joining us today. It is always a pleasure to talk to you. And I would like to take this opportunity to invite you to join us again in our next earnings release call for the fourth quarter and end of year of 2022, which will take place March 1st, 2023.

Thank you all very much. Please take care and have a great holiday season.

Thank you very much.