2Q23 Nexa's Transcript Earnings Call and Q&A

Participants:

I - Mr. Ignacio Rosado – CEO of Nexa Resources
J - Mr. José Carlos del Valle – CFO of Nexa Resources
R - Mr. Rodrigo Cammarosano – Head of IR of Nexa Resources
L - Mr. Leonardo Coelho – Senior VP of Mining of Nexa Resources
O - Operator

O - Good morning and welcome to Nexa Resources Second Quarter 2023 Conference Call. [Operator Instructions]

I would now like to turn the conference over to Mr. Rodrigo Cammarosano, Head of Investor Relations, for opening remarks. Please go ahead.

R – Good morning, everyone, and welcome to Nexa Resources' second quarter 2023 Earnings Conference Call. Thanks for joining us today. During the call, we will be discussing the company's performance as per the earnings release that we issued yesterday. We encourage you to follow along with this on-screen presentation through the webcast. Before we begin, I would like to draw your attention to slide number 2, as we will be making forward-looking statements about our business, and we just ask that you refer to the disclaimer and the conditions surrounding those statements. It is now my pleasure to introduce our speakers. Joining us today, is our CEO, Ignacio Rosado, our CFO, José Carlos del Valle, and our senior vice president of mining, Leonardo Coelho. So now I will turn the call over to Ignacio for his comments. Ignacio, please go ahead.

I – Thank you, Rodrigo, and thanks to everyone for joining us this morning. Please, let's move now to slide number 3 where we will begin our presentation.

Let me begin by giving you a brief overview of our second quarter of 2023. We continue to experience a volatile macroeconomic scenario, as weak economic indicators from China came in below expectations. Additionally, concerns over the global growth outlook, in addition to persistent inflation in some sectors of important economies and tight monetary policy are negatively affecting base metal prices, especially zinc, the main metal in our portfolio. In this second quarter, zinc price fell 19% quarter-over-quarter, and 35% year-over-year. In this difficult scenario, we are working on a portfolio of initiatives focused on cost reduction, and CAPEX and working capital optimization, which I will discuss in more detail later in the presentation. Our net revenues for the quarter reached US$627 million, 24% down year-over-year, mainly driven by lower LME metal prices compared to 2Q22. Net revenues decreased by 6% quarter-over-quarter, also reflecting the lower LME metal prices, which was partially offset by higher mining production and metal sales volumes. Our Adjusted EBITDA in 2Q23 was US$72 million compared to US$133 million in 1Q23. This performance was mainly explained by the impact of lower LME metal prices, as explained initially. Despite this significant drop in prices, we were able to deliver a positive cash generation, and we would like to reaffirm that our 2023 annual guidance remains unchanged. Aripuanã is progressing well and, at the end of June the plant downtime hours reduced significantly, the plant reached 76% of the nameplate capacity, while the recovery rates improved, as well as the quality of the concentrates. In terms of exploration activities, our brownfield exploration programs are moving towards increasing the life of mine in our mining operations. As mentioned also in our previous presentation, we are prioritizing the studies related to the Pasco integration project, to consolidate a robust strategic organic growth option for Nexa in the near future. We remain confident in the long-term fundamentals of our industry and our business. We will continue focusing on safety, productivity, and cost control, in order to create value for all our shareholders. Now, moving to slide number 4.

In slide number 4, regarding the operating performance of the mining segment, you can see that zinc production increased to 81kt, up 2% year-over-year, mainly explained by an increase in treated ore volume and the start-up of the Aripuanã mine. Compared to 1Q23 zinc production was up 8% explained by the resumption of operations at Cerro Lindo and higher volumes from Aripuanã. In relation to cash cost, mining cash cost in 2Q23 increased to US$0.37/lb compared to US$0.16/lb in 2Q22, mainly explained by lower by-products prices and higher TCs. However, our cash cost in the first half of 2023 positively exceeded what we forecasted in our guidance for the year, decreasing almost US$0.10/lb, compared to the lower end of the range. Looking at the cost per run of mine, which is the one metric that we control, it decreased quarter-over-quarter, due to higher ore mined and the implementation of initiatives to reduce our costs. Now, moving to slide number 5.

In slide number 5, regarding the operating performance of the smelting segment, metal sales totaled 149kt in the second quarter of 2023, down 2% from 2Q22 and up 4% compared to 1Q23. The quarter-over-quarter performance is mainly explained by slightly higher production volumes and sales strategy in line with our working capital improvement initiatives. Smelting cash cost in 2Q23 decreased to US$1.12/lb compared to US$1.46/lb in 2Q22 and US$1.25/lb in 1Q23. In both periods, this decrease was mainly explained by lower LME zinc prices, affecting the cost of concentrated purchases, which was partially offset by lower by-products prices. Our conversion cost, which is the metric that we control remained flat quarter-over-quarter. Now, moving to slide number 6.

On this slide, I would like to highlight the competitive position of our mining and smelting segments. In times of tight prices, it is important to understand how resilient and competitive our portfolio of operations is. As you can see, our mining and smelting segments are positioned in the lower quartiles of the cost curves. This competitiveness is supported by flagship polymetallic mines, and smelter operations with competitive energy costs, access to raw materials under competitive conditions, in addition to adequate logistics costs and operational efficiency. Now, moving to the next slide.

In slide number 7, I would like to highlight the productivity program we are performing at some of our mining operations. It is a broad program that seeks to operate on different efficiency levels, including initiatives such as higher availability of mine equipment, manpower reduction, optimization of mining methods, and reduction of scope and rates of our main contractors. All of these initiatives are aimed to increase productivity, reduce our headcount, reduce fixed and variable costs, and optimize investments and working capital. The next stage will extend this program into our other mines and our smelting operations, which we expect to star in the next few weeks.

Ramp-up activities at Aripuanã continued to progress significantly and we are currently focused on steadily increasing plant throughput rate, asset reliability, reduction of plant downtime hours, as well as improving metal recoveries and concentrate grades and quality. During the quarter, treated ore volume was 372kt, an increase of 100kt from the previous quarter, while zinc production reached 6.5kt, up 156% quarter-over-quarter. In the next slides, we will see some of these improvements. For the upcoming quarters, we expect to conclude the adjustments related to the bottlenecks in the pumping and piping systems that we mentioned in the previous quarter, and further improve the recovery and concentrate grades. We also continue with mine development activities at Arex and link mines. The exploration activities in the quarter progressed as planned. We are focused on upgrading the mineral resources at the Babaçu deposit and expanding again our mineral reserves at the end of 2023. Now, moving to the next slide.

On this slide I will talk about the progress of some of the main KPIs for the ramp-up phase of Aripuanã. Starting with the plant downtime in the upper left side, we noted a reduction of 32% quarter-over-quarter. Average plant capacity utilization increased by 32% in the second quarter to 66% and in June utilization reached 76%. This utilization rate already includes the plant downtime hours, therefore, if we do not consider those hours, the utilization would be at much higher levels. That is why we are focused on plan reliability. Finally, we can see the progress of zinc recovery which reached 63% in June compared to 48% in March, and the quality of concentrate in zinc increased significantly. Now, moving to the next slide.

On slide number 10, you can see that compared to the first quarter of 2023, zinc production grew by 156%, reaching 6.5kt in the second quarter. Copper production grew by 36%, while lead and silver production grew by 37% and 61%, respectively. That said, we are confident with the progress of the operation, and we will remain focused on completing the ramp-up in the coming months. Now, moving to slide number 11.

On this slide, I would like to highlight that we continue to advance with the technical studies for the Pasco integration project. As we have been discussing in previous calls, this is a project with the potential to unlock important value for Nexa, through economies of scale, cost improvement, and extension of the life of the asset. We have 4 work fronts underway, focusing on the integration of the underground mines, increasing the capacity of the El Porvenir plant, increasing the capacity of tailings storage facilities, as well as studies for support functions. Exploration activities are following our program for the year, which already included activities focused on supporting the mineral inventory for the project. We are moving forward with the project and expect to submit it for approval by our board of directors in the fourth quarter of this year. Now, I will turn over the call to José Carlos del Valle, our CFO, who will present our financial results. José, please go ahead.

J – Thank you, Ignacio. Good morning to everyone. I will continue on slide 12. As you can see, beginning with the chart on your upper left, total consolidated net revenues for the second quarter decreased by 24% year-over-year, mainly due to lower LME metal prices and slightly lower smelting sales volume. Compared to 1Q23, net revenues decreased by 6%, also driven by lower LME metal prices. This decline was partially offset by higher mining production and an increase in sales volumes. In the first half of this year, consolidated net revenues reached US$1.3 billion, versus US$1.6 billion in the first half of 2022, a decrease of 17%. Consolidated Adjusted EBITDA in 2Q23 was US$72 million, compared to US$302 million in 2Q22. This important reduction was driven primarily by 35% and 11% declines in zinc and copper prices, respectively, as well as by higher operating costs related to the start-up of Aripuanã. Compared to 1Q23, Adjusted EBITDA decreased by 46%, explained by lower metal prices and by the negative impact of exchange rate, partially offset by higher by-products volumes and a positive hedge effect. In the first half of this year, consolidated Adjusted EBITDA reached US$205 million versus

US$519 million in the same period of last year, also explained by the reasons I mentioned a moment ago. Now, let's move to the next slide, 13.

On the top left of the slide, we can see that in the first half of 2023 we invested US$116 million in CAPEX, of which sustaining investments, including mine development, totaled US$115 million. The total investment in the second quarter was US$ 60 million. As mentioned by Ignacio, we have been implementing initiatives and programs focused on cost reduction and on working capital and CAPEX optimizations. It is likely that some of these initiatives may result in lower CAPEX intensity for the year, therefore, we may revise downward, in the next quarter, our guidance for 2023. With regards to mineral exploration and project evaluation, we invested a total of US$42 million in the first half of 2023, of which US$21 million was related to mineral exploration and mine development to support exploration activities. Now let's move on to the next slide, in which I will discuss our cash flow generation in the second quarter of the year.

For 2Q23 and starting from our US$72 million of Adjusted EBITDA net of non-operational items, we paid almost US$40 million related to interest and taxes, and spent US$63 million in Sustaining CAPEX in our operations, including Aripuanã. Additionally, loans and investments had a negative impact of US$6 million. We then had a positive impact of US$6 million due to the effects of foreign exchange on our cash and cash equivalents, driven by the appreciation of the Brazilian real against the U.S. Dollar. Finally, there was a positive contribution of US$83 million due to an improvement in working capital, in part as a result of management initiatives implemented in 2Q23. Combining all the effects described above, our free cash flow in 2Q23 was US$34 million. Now moving to slide 15.

On this slide, you can see that our liquidity remains healthy, and we continue to present a solid balance sheet with an extended term debt profile. Cash balance increased and net debt declined in 2Q23 as a result of positive cash flow generation during the period. As a result, current available liquidity was approximately US$721 million, including our undrawn revolving credit facility of US$300 million. In relation to our debt, it has an average maturity of 4.2 years and a 5.6% average cost. It is important to mention that as of June 30th, our total cash is sufficient to cover the payment of all obligations maturing in the next 4 years, with only 2% of total debt maturing by the end of 2023. Finally, despite the US$40 million increase in our cash balance, leverage, measured by the net debt to Adjusted EBITDA ratio, increased from 1.9x to 2.8x quarter-over-quarter, mainly because of lower Adjusted EBITDA in the last twelve months driven by the prevailing trend of lower LME prices. Now moving to slide 16.

Talking about some key market fundamentals, it is worth highlighting that in 2Q23, LME zinc price averaged US$2,356/t, down 35% from 2Q22 and 19% from 1Q23. The main reasons for this decline in LME metal prices were: concerns about the health of the global economy; persistent high interest rates, driven by resilient inflation in some sectors in relevant economies; and lower-than-expected pace of recovery of the Chinese economy, driven, in part, by some key economic variables surprising to the downside last quarter. However, despite tight prices in the short-term, we believe zinc fundamentals remain positive in the mid and long-term, supported by potential lack of feasible supply to fulfill forecasted demand, which is expected to be driven by investments in infrastructure, construction, and the auto sector, now also boosted by electric vehicles sales. Regarding copper, the LME price is down 11% from 2Q22 and 5% from 1Q23. In terms of demand, we are all aware that copper will play a key role in the energy transition. On the supply side, volumes from greenfield and brownfield projects are expected to come online until

2024-2025, contributing to a mild surplus in the market, which could revert in the following years. Now I will hand over the presentation back to Ignacio for his final remarks.

I – Thank you, José Carlos. Before going on slide number 17, I would like to mention one provision that impacted our net income in 2Q23, in line with our last quarter's financial disclosures regarding an ongoing investigation of commercial and VAT tax-related practices of certain of Nexa's customers between 2018 and 2022, I would like to inform that Nexa has been cooperating fully with the state of Minas Gerais authorities. Considering that the current deferred VAT state rules imply secondary liability for Nexa if a customer with primary responsibility does not make the required payments to the state, Nexa may decide to voluntarily make some tax payments on behalf of these customers to avoid higher tax exposures in the future and reserves the legal right to recover such amounts from them in the future. This potential resolution can also include a contribution to the state of Minas Gerais to support its ESG-related efforts and enhance its monitoring and investigation tools to avoid this type of situation in the future. Therefore, in connection with this situation, the company has decided to record a provision of approximately US$70 million for 2Q23. We will keep the market informed as appropriate of the evolution of this situation.

I would like to close this presentation by mentioning our priorities for the remaining of the year. We will continue working on completing the Aripuanã ramp-up, on our mineral exploration programs, as well as on advancing with the studies related to the Cerro Pasco integration project. We will remain focused on productivity aiming to reduce costs and optimize CAPEX and working capital. This will contribute to strengthening our position in the current challenging price scenario, in addition to supporting our balance sheet. We are confident we are on track to deliver our full-year targets and with the guidance we laid out at the beginning of the year. Thank you all for attending this presentation. With that, we will be happy to take your questions.

Q&A Session:

O – We will now begin the questions and answers session. [Operator Instructions] We might be able to move over to webcast questions now.

R – Hi everybody. Thanks for the questions. The first question is from Hernan Kisluk from MetLife. The question is, Nexa sits in the first quartile of mining cost curve, but yet with low zinc prices, the EBITDA margin was only 7%. Does it mean that higher cost producers are having negative EBITDA?

J – Thank you, Rodrigo. Hi, it's José Carlos del Valle, CFO. Thank you for the question. Here, the way I would see it is that certainly, higher cost producers are struggling with these prices. However, the results that we're seeing for Nexa don't necessarily represent what Nexa's future performance is going to be. One important item here is that Aripuanã still in a ramp-up status, so that is going to continue to evolve favorably and contribute to our margin in the next few quarters. So that's one point and there are always things that may not be that clear for the market in terms of provisions, for example, in this quarter, we have had close to US$15 million in provisions that somehow are not really seen by the market and are related to NRV, mark-to-market, legal provisions, which don't happen in a recurring way. So having said that, higher cost producers definitely see some difficulties at these prices, but I would say that the 7% margin that you are mentioning for Nexa is not representative of what Nexa could achieve under normal conditions with these prices.

I – I'm Ignacio, and to add to what José Carlos is saying, in this case of this 7% and US$72 million, which is really low for us, besides the provisions that José Carlos is saying, we have the effect of Aripuanã. Aripuanã is a mine that is still in the ramp-up, so it's losing money and that influences that and one comment that is important is that if you go mine by mine and smelter by smelter, which is the curve of the first quartile that you have, most of them at these prices make money. The thing is that, that money is being used in Aripuanã and in other CAPEX activities today, so going forward, I will say that with the programs that we are launching and with the profitability increase that we want in our mines and Aripuanã, now starting to be positive, the cash flow generation from all operations will improve and will reflect more or less that we are in the first and beginning of the second quartile.

R – Ok, thank you Ignacio, thank you José Carlos. We have another question here from the audience. It comes from Declan Hanlon from Santander. Regarding the working capital cash generation, can you provide more detail on how this and how you anticipate these management actions to impact the working capital cash cycle in the second half of the year? Secondly, where you see EBITDA for the full year, given the guidance line items presently?

J – Thank you, Rodrigo. Thank you, Declan, also for your question. Here, I would say that the key aspects here are related to mainly reducing inventory so that we can shorten the working capital cycle, and in part, it's simply the reversion of the negative working capital impact that we had in the first quarter. And if you remember, I think it was in the last call, we said that this will revert in the next few quarters, so, part of that is the reversion of this and the rest is related to initiatives, as I mentioned, mainly to reduce inventory, trying to optimize transportation and inventory levels in all the operating units to reduce working capital. In terms of EBITDA, as you know, this will be largely influenced by price, which we cannot predict, so it will be difficult to give you a view on this. What we can say is that we are reaffirming our production levels, so, that's the one piece that we do control and we're always focusing on as well as on cost optimization.

R – Ok, thank you José Carlos. We have another question from Jens Spiess from Morgan Stanley. Could you please elaborate on VAT investigation provision? How certain is that the final amount paid will be US$70 million? Will you be able to recover that amount from the customers through legal measures?

I – Yes. The provision of this US$70 million that we have comprises all the customers that are involved in the investigation today, so, we are certain that this amount is 100% of the amount in investigation. What we are discussing with the authorities is that half of this amount, we will use tax credits that we have. We have accumulated over the years a lot of tax credits, so half of them will be used in paying this amount if we arrive at this condition and the other half is going to be paid in long installments, in 36 months, so that's more or less where we are in this regard. There is still an investigation for other two clients, that is early days today, and we cannot provide any information on that because the process is just starting.

R – Thank you, Ignacio. We have another question from Morgan Stanley. The company mentioned the possibility to revise down the CAPEX guidance for the year. Where would Nexa reduce their investments if it comes to that?

J – Yes. Thank you, again, for the question here. It's too early to tell, and we are not making that revision right now because we're evaluating what those areas will be and that's why we believe that we would be announcing this in the next quarter. But obviously, it will be in CAPEX components that are not that critical to the company's performance or to the company's safety, but we will be announcing that once we complete the evaluation.

R – Ok, thank you José Carlos. We have another one question from S&P Global Platts. There have been recurring roadblocks at Atacocha. Do you foresee further trouble with the communities this year?

I – Yes. Actually, the Atacocha strategy has changed very much in the last 18 months. What we are doing now is that before the communities around Atacocha were working on pressing the company, stopping the pit, so, they claim more amounts on the agreement that they were opened at that time. So, they were pushing the company to pay them more, and if not, I will stop the pit and I will commit vandalism around our offices and on our equipment. So, the strategy we did was, we changed to say, okay, we cannot negotiate with you in these terms. If we stop the pit and the operations are stopped, you will also suffer and we have been legally demanding them, we have been firing some of the workers, and we have been cutting on the benefits that these communities, workers of the communities were exposed, so they can feel the same as us that these stoppages hurt the company and themselves. So, this has been the case for the last 18 months, most of the communities understood that by doing that, there were a lose-lose situation, and we agree with most of the communities on an agreement that we closed all our agreements, accounts are clear, and we move forward as partners in developing the mine and developing the community. This last stop of Machcan, which is this small community, as I would say, the last one in this context, it took us almost a month. We resumed operations yesterday, we were speaking with the authorities and with them, and now we are talking in the same terms as before. So, I would say that the answer to your question is, given this new strategy, they know that it's a lose-lose strategy if they stop us, I will see that in the coming months, and complying with all the agreements that we have and making sure that the community also gains some of the business that generates at Nexa, we don't see any other stoppages. But having said that you know, this is Peru, it's very difficult the context sometimes to keep monitoring that, but I would say that there is a probability that we won't have any other stoppages in the coming months.

R – Okay, thank you, Ignacio. We have one question from Neil Botha from Ninety One. Net leverage has increased a bit recently, currently at 2.8x net debt-to-Adjusted EBITDA ratio. Where do you see this trading towards year-end? Is there a risk of pressure on credit ratings if this weakening trend in leverage continues?

J – Thank you Rodrigo and thank you Neil for the question. Yes, that is correct, leverage has gone up, however, this increase is mainly related to lower prices and lower Adjusted EBITDA that are a consequence of the lower prices, so, it's a part of the leverage that we don't really control much, right? The levers that we're focusing on are the ones we are trying to optimize with a business perspective, preserving cash, optimizing costs, increasing productivity and the EBITDA is going to be a consequence of that on those factors that we can control. Prices, unfortunately, we cannot do much about, so we're just continuing to try to make sure that we have the most efficient operations. In line with that, I think it's also important to emphasize again that all of our operations make money at these prices, so that doesn't mean that we cannot improve this further. That's what we're working on right now, both at the mines and at the smelters, and if prices improve, that's better. In terms of rating agencies, we have close communication with them, they understand our business, and they are aware of the measures that we have been taking to preserve cash and maximize efficiency and productivity under this low price scenario, and as far as we know, there should be no impact on our current rating.

R – Thank you José. We have one more question from Orlando Barriga from Credicorp Capital. Good morning, thanks for taking my question. I would like to know what can we expect in Aripuanã for the following quarters, given the quarter-on-quarter increase? What are going to be the cost there?

I – Yes, it's a good question. I think this also relates to another question that was asked, and we haven't talked about that yet. In the second quarter, we lost US$30 million in Aripuanã because of the ramp-up, I mean the cost and the CAPEX are higher than the metal we are selling, in the first quarter was more, was around US$40 million to US$45 million and in the third and fourth quarter, we expect that these amounts are going to be much lower, that have been the trends there. The downtime hours that is very important for us because it creates reliability from the plants are going to go down in July, it's going to be close to 100 hours, and that's going to improve, recoveries are up, quality of concentrate is up, so, the second half of this year is going to create a positive environment for this ramp-up. Having said that, to give you an idea of costs guidance today is early because we are still stabilizing the process and we're spending probably more CAPEX to make sure that the plant is up and running on 100% basis. We are spending some CAPEX more in the mine, so we can prepare the mine to fedd the plant in the right direction, so, we are not comfortable giving you some of the costs that we have. What I can say is that the negative cash flows that we had in the first half are going to be much lower in the third quarter and hopefully positive in the fourth quarter. The guidance that we are giving around achieving nameplate capacity towards the end of the year, it is still there, you guys can see the KPIs that we are showing, so Aripuanã is going in a very good direction, and that's actually what we can say today.

R – Thank you Ignacio. We have another question from Morgan Stanley. You mentioned that on Aripuanã ramp-up had a US$30 million negative impact on free cash flow in the second quarter. How much has the total accumulated impact since the start-up of the project?

I – Yes. As I was saying, this year, US$30 million in the first quarter and in the second quarter almost US$40 million or US$43 million, as I was saying, and we expect that this number is going to be much lower in the second half of the year because the plant is going to generate more quality concentrate. Costs will go down, CAPEX is going to slow down, so, second half of this year, we will be in a much better position and much better shape, I would say.

O – And with that, we will conclude our question-and-answer session. Now, we will hand over to Ignacio for his final remarks. Mr. Rosado, please go ahead.

I – Thank you very much all for attending this call. This was a very difficult quarter for us given the 35% decrease in prices of zinc. As you know, zinc is the main metal we produce, we are conscious that this situation won't reverse soon, we know that China is still not getting all the indicators in the industrial segment that we need. Some positive indicators in the states are helping, that's why zinc price is recovering a little bit, but in any case, we are prepared to face any type of prices for the rest of the year. We will have to be prepared and probably the next year as well, so we are very committed to make sure that we produce positive cash flow. We are very committed that Aripuanã will be up and running in the outlook that we are projecting, we are very committed to achieve our guidance, and hopefully, when prices go down, we will benefit from that in our cash flow. The reduction of the debt is a priority for us as well, we spent a lot of money in our Aripuanã project, so we are very aware that reduction of that is our priority, we are also committed on that and you will see the trends that we are projecting in the coming quarters. With that, I would like to thank everybody, and we will see you in 3 months presenting our third quarter results. Thank you. Thank you very much to everyone and have a good day.

O – [Operator Closing Remarks]

Participants of the Q&A:

Hernan Kisluk – *MetLife*

Declan Hanlon – *Santander*

Jens Spiess – *Morgan Stanley*

Henrique Braga – *Morgan Stanley*

Alexander Emery – *S&P Global Platts*

Neil Botha – *Ninety One*

Orlando Barriga – *Credicorp Capital*

(Call Duration: 43 Minutes)