3Q23 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 Third 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 third 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, Jose 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 start by providing you a brief overview on our third quarter of 2023. We continued to experience a scenario of downward pressure on metal prices, driven by negative external factors, such as inflation and high-interest rates in the U.S., in addition to uncertainty about the performance of key sectors of the Chinese economy. Although the prices of our main metals have performed at levels below our expectations, we remain committed to our financial discipline, which made possible to have a positive cash generation in the third quarter of this year. Our operating performance was in line with expectations in our mining and smelting segments. In both segments we also provided cash cost guidance revised downwards. Total net revenues reached US$649 million, and was down 8% year-over-year, mainly due to lower zinc LME prices and smelting sales volumes. Compared to last quarter, net revenues increased by 4%, as a result of higher mining production and metal sales volume in the period, which were partially offset by lower LME metal prices. Consolidated Adjusted EBITDA for the quarter decreased by 32% year-over-year reaching US$82 million. This performance was mainly explained by lower zinc LME prices. Compared to 2Q23, Adjusted EBITDA grew 14% due to higher metal sales, mine production and lower costs in Brazil. We revised the Aripuanã production range downwards for the year given the limitations we found related to the designed capacity of the flotation pumping system, which resulted in the extension of the ramp-up phase. Nonetheless, 2023 production estimates for Nexa's other mines and smelters remain unchanged. Our Cerro the Pasco integration project is advancing as expected. Exploration, Project Evaluation and other expenses were reduced by US$15 million. However, we are still prioritizing the expansion of the resource and mineral reserves base in our current mines. I would like to close this slide by mentioning that we have successfully closed a US$320 million sustainability-linked Revolving Credit Facility, which will support Nexa's liquidity profile and is linked to our carbon reduction key performance indicators. Jose Carlos will go into details later on in the presentation. Now, moving to slide number 4.

Regarding the operating performance of the mining segment, you can see that zinc production increased to 87kt, up 15% year-over-year, mainly explained by the increase in treated ore volume and the start-up of the Aripuanã mine. Compared to 2Q23, zinc production was up 8% explained by higher volumes from the Cerro Lindo, Vazante and Morro Agudo mines. With respect to cash cost, in 3Q23 it decreased to US$0.35/lb compared to US$0.57/lb in 3Q22, mainly explained by higher by-product contribution related to higher lead prices and copper concentrate volumes. Compared to 2Q23, mining cash cost decreased by 6%. Looking at the cost per run of mine in the quarter it was flat year-over-year and quarter-over-quarter despite inflationary cost pressures, especially in Brazil. Now, moving to slide number 5.

Regarding the operating performance of the smelting segment, metal sales totaled 154kt in the third quarter, down 5% from 3Q22 and up 3% compared to 2Q23. The nine months year-over-year production performance was relatively flat. Smelting cash cost in 3Q23 decreased to US$1.01/lb compared to US$1.36/lb in 3Q22 and US$1.12/lb in 2Q23. In both periods, this decrease was mainly explained by lower zinc LME prices, which reduced the costs of raw materials. Our conversion cost was US$0.29/lb and was up 11% from 3Q22 due to higher energy expenses and lower metal production. Compared to 2Q23, conversion cost was down 9%. Now, moving to slide number 6.

Since January of this year, ramp-up activities in Aripuanã have continued with a strong focus on steadily increasing the plant's throughput rate, reducing plant downtime, and improving recoveries and concentrate quality and grades. In 2Q23, the plant performed at an average of 66% capacity, versus 50% in the first quarter. In July, we observed some problems in the capacity of the flotation pumping system due to limitations identified in the original design and, as a result, the plant performed at an average rate of 56% in the 3Q23. The permanent replacement of pumps is scheduled to take place in 1Q24, driving ramp-up completion to 2Q24. We have also implemented additional actions in the plant, that include processes and systems improvements, as well as upgrades on water treatment facilities, that will allow us to return to a higher average throughput rate in a more consistent way. We expect to run at a 70% average utilization rate throughout the 4Q23. On the mine side, we have been successfully increasing our run of mine production, which reached 237kt in the quarter, compared to 61kt in 2Q23, up 290%. The exploration activities in the quarter progressed as expected. We are focused on upgrading the mineral resources and expanding our mineral reserves. Our priority in this asset, is to keep improving metal recovery and concentrate quality and grades, and to conclude the upgrades in the plant, aiming to achieve a stable operation and minimize additional financial impacts. Now, moving to slide number 7.

Starting with the plant downtime in the upper left side, we noted an increase of 5% quarter-over-quarter, as the limitations observed in 3Q23 required additional preventive hours. The plant capacity utilization averaged 56%, versus 66% in the second quarter. However, we can see an improvement in copper and lead recoveries, while zinc recovery slightly reduced compared to the previous quarter but has been recovering in the last few weeks. Now, moving to slide number 8.

On slide number 8, you can see that zinc production was 10% lower compared to the second quarter of 2023, reaching 5.8kt. Copper production reduced by 12%, while lead and silver production increased by 5% and 2%, respectively, mainly driven by higher grades. Now, moving to slide number 9.

On this slide, I would like to highlight that we continue to advance the technical studies of the Pasco Integration Project. These technical studies cover different works, from mine planning to important such as new mine design and studies for the underground interconnection, shaft upgrade, and engineering assessment of the plant, as well as the assessment of options to improve capacity to provide a long-term solution for tailings storage facilities. Furthermore, we continue to advance the required environmental permits and as studies progress, the project demonstrates the potential to unlock important value for Nexa through economies of scale, cost improvement, and extension of asset life. We expect to submit this project for board approval during 1Q24. 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 10. As you can see, beginning with the chart on your upper left, total consolidated net revenues for the third quarter decreased by 8% year-over-year, mainly due to lower zinc LME prices and lower smelting sales volumes. Compared to 2Q23, net revenues increased by 4% as a result of higher mining production and metal sales volumes, partially offset by lower zinc prices. In the first nine months of this year, consolidated net revenues reached US$1.9 billion, down by 14% compared to the same period a year ago. In terms of profitability, consolidated Adjusted EBITDA in 3Q23 was US$82 million, compared to US$121 million in 3Q22. This lower performance was mainly explained by lower zinc metal prices. Compared to 2Q23, Adjusted EBITDA increased 13%, mainly due to higher mining and metal sales and lower costs in Brazil, which were partially offset by lower zinc prices and FX rate. in the first nine months of this year, consolidated Adjusted EBITDA reached US$286 million, down 55% from the same period last year, also explained by the reasons I mentioned a moment ago. Now, let's move to the next slide, number 11.

On the top left of the slide, we can see that in the first nine months of 2023 we invested US$198 million in CAPEX, of which sustaining investments, including mine development, totaled US$185 million. The total investment in the third quarter was US$82 million. With respect to mineral exploration and project evaluation, we have updated our guidance for the year, and we now expect to be at US$100 million in 2023, which is a reduction of US$10 million from the previous guidance, mainly due to initiatives to improve our cash flow for the year. In the first nine months of 2023, we invested a total of US$69 million, of which US$39 million were related to mineral exploration and mine development to support our exploration activities. Now let's move on to the next slide, in which I will discuss our cash flow generation in the third quarter of the year.

For 3Q23 and starting from our US$82 million of Adjusted EBITDA net of non-operational items, we paid almost US$38 million related to interest and taxes, and spent US$75 million in sustaining CAPEX and HS&E in our operations, including Aripuanã. Additionally, loans and investments, and dividends received and paid had a positive net impact of US$3 million. We then had a negative impact of also US$3 million due to the effects of foreign exchange on our cash and cash equivalents, this was driven by the depreciation of the Brazilian real against the U.S. Dollar during this period. Finally, there was a positive contribution of US$95 million from an improvement in working capital, which is part of the result of our ongoing program of cash optimization measures for 2023. Now combining all these effects, our Free Cash Flow in 3Q23 was US$14 million. Now moving to slide 13.

On this slide, you can see that our liquidity remains healthy and that we continue to present a solid balance sheet with an extended debt maturity profile. Cash balance increased and net debt declined in 3Q23 as a result of positive cash flow generation during the period. As a result, available liquidity at the end of 3Q23 was approximately US$722 million, including our undrawn Revolving Credit Facility of US$300 million. I would like to highlight, that we recently announced the successful closing of a 5-year US$320 million sustainability-linked revolving credit facility, which became effective on October 20th, 2023. This new Revolving Credit Facility replaces Nexa's 2019 US$300 million RCF that was set to mature in October 2024. The amounts drawn are subject to an initial interest rate of 1.60% plus term SOFR. The applicable margin is subject to compliance with carbon reduction KPI's, reflecting Nexa's unwavering commitment to reducing its carbon footprint. As you can see these efforts are consistent with our ESG conviction and ambition. Regarding our debt, it currently has an average maturity of 3.9 years and a 5.6% average cost. It is important to mention that as of September 30th, our total cash is sufficient to cover the payment of all obligations maturing in the next 4 years. Finally, despite the US$14 million increase in our cash balance, leverage, which is measured by the net debt to Adjusted EBITDA ratio, increased from 2.8x to 3.06x 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 14.

Regarding market fundamentals, it is worth noting that in 3Q23, LME zinc price averaged US$2,428/t, down by 26% from 3Q22 and by 4% from 2Q23, at the same time LME copper price averaged US$8,356/t, up by 8% from 3Q22 and down by 1% from 2Q23. The main reasons for the decline in LME zinc prices were, speculation related to the global economy, such as potential new hikes in interest rates in the U.S., slower economic growth, and also, to acknowledgment that the Chinese economy has not responded as expected to economic stimulus, particularly in the property sector. Looking ahead to the rest of 2023 and the following months, despite the fact that we are already seeing some zinc mining production cuts as a result of the current challenging price environment, metal prices are still expected to be negatively impacted by short-term variables, such as monetary policy in Europe and in the U.S., as well as by the still-prevailing uncertainty about the Chinese economy. In the mid to long-term, the fundamental outlook for both zinc and copper prices remains positive. Additionally, investments in construction, infrastructure and the automotive sector, will continue to have a positive impact on demand expectations for base metals. On the supply side, both for copper and zinc, we anticipate that we will continue to see challenges to bring new significant production online. Now I will hand over the presentation back to Ignacio for his final remarks.

I – Thank you, Jose Carlos. On our last slide. I would like to close this presentation by mentioning our priorities for the rest of the year. The completion of the Aripuanã ramp-up is our top priority. The focus is to improve recoveries and quality of concentrates while replacing pumps at the flotation circuit to increase capacity. We are advancing on the studies related to the Cerro Pasco integration project. We look forward to approve this project in the first quarter of next year. We remain committed to looking for alternatives to optimize costs, CAPEX and corporate expense in addition to strengthening our balance sheet. We will continue to accelerate our exploration program, prioritizing the life extension of our assets. We will continue to focus on safety, productivity, and ESG public commitments. Looking forward, we are confident in the long-term fundamentals of our industry and our business. 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 – Now we are going to address some questions that we got from the online audience. We will start with a question from Alexandra Symeonidi, from William Blair & Company. What is the interest rate in this new sustainability-linked RCF?

J – Thank you Rodrigo, and good morning to everyone. This is Jose Carlos del Valle. In relation to this question, just to clarify, the interest rate is SOFR, which is the Secured Overnight Financing Rate, plus 1.6% with the possibility of another 10 basis points depending on compliance with the ESG targets that have been established for this sustainability-linked facility.

R – Thank you, Jose. We have another question from the audience from Alexandra Symeonidi as well. In terms of leverage, it seems that the leverage has increased in this quarter. Is there a leverage target for the company? How does the company plan to address this?

J – Thank you for the question. This is something that we talk about continuously and as you can imagine, leverage has increased mainly because of the reduced EBITDA, because our net debt hasn't changed that much. Currently, we are right above 3x and we are doing all our efforts to bring this below 3x towards the end of the year. However, in the mid to long term, definitely, we will feel more comfortable with levels around 2x. We don't have any leverage covenants in our facilities, but we believe that something around 2x would be more sustainable. So, we continue to work on a number of initiatives to bring this down and our top priority in the next month and years is to reduce our net debt. Obviously, a good part of that will depend on prices, but we're trying to influence all the factors that we can control to try to maximize cash flow generation and reduce net debt and consequently bring leverage to below the levels it currently is.

R – Thank you Jose Carlos. We have another question, from Camilla Barder from Bradesco BBI. What can we expect in terms of free cash flow impact in 4Q23 and 1Q24 for Aripuanã?

I – Ok, this is Ignacio. So far, the impact on cash flow in Aripuanã in the first 9 months of this year was US$146 million as we put it in the presentation. For the fourth quarter, we expect a number of cash outflow of around US$40 million to US$50 million, and depending on the ramp-up, how it goes in the summer or in the first quarter of next year, we will assess the impact on cash flow, but the idea is that we start to be in breakeven towards the end of the third quarter and the year in the fourth quarter. We cannot put a number here because this is a process, so we will keep the market posted when we provide guidance in January for the rest of the mines.

R – Thank you, Ignacio. We have a follow-up question from Camilla from Bradesco BBI. Could you provide some color on what do you expect in terms of volumes for zinc and copper for 2024?

I – Yes, this is going to come also in our guidance that is coming in January. I would like you, please to wait until we provide that in 2 or 3 months.

R – We have a question from Orlando Barriga from Credicorp Capital. Good morning, thanks for taking question. My first question is related to costs in Cajamarquilla. Why did costs increase quarter-on-quarter despite lower raw materials and conversion costs.

I – Yes, actually, the main driver of increasing the conversion cost or cost driving up in Cajamarquilla was energy…

R – Thank you Ignacio. We have a question from Alexandra Symeonidi, from William Blair & Company. There was a big working capital outflow due to higher payables and lower inventory in the quarter. Can you please give more color there? And shall we expect this to reverse in Q4?

J – Thank you for the question, Jose Carlos again. Actually, if you go back and you review the results of the first quarter, you will see that we had a very significant investment in working capital, which is actually what we've been reversing in the second quarter and the third quarter. So, if we compare ourselves with the beginning of the year, we're pretty much at the same level, marginally lower working capital. These variations actually are the result of a number of initiatives that we have taken to optimize working capital, have more control on inventory as we should always do, but also to changing a way that the terms that we have with our suppliers, for example, all within industry standards renegotiating slightly longer payment terms. So, this is a structural change that actually will continue, this takes time to implement as contracts renew. It´s related to our cost control initiatives when we renegotiate contracts, consolidated contracts in order to get better terms. So, I wouldn't worry about that, and I don't expect that there will be a reversal in the fourth quarter because I think the key point here is that we are recovering the working capital that we lost in the first quarter of the year.

R – Thank you, Jose. We will go back to one question because it seems that we had an audio problem. And the question was from Orlando Barriga, from Credicorp Capital. The question was related to Cajamarquilla costs. So why did cost increase quarter over quarter despite lower raw material and conversion costs?

I – I'm sorry about the problem with the communication. As I was explaining, Cajamarquilla is exposed to mainly to energy costs, inflation and this is linked to our contract, we have a longer contract that this has been to that, so this was the main variable that increment the conversion cost. Having said that, we started a program in September to work on reducing costs to work on increasing production, to work on productivity measures, to have fewer people in the operation, and this is being very successful. Most of these benefits are going to be shown in our budget for next year and in the first quarter of next year as well.

R – Thank you Ignacio, and sorry again for the issue with the audio. We have a question from Carlos Assumpção, from Bank of America. Thank you for the presentation, could you give us some color about capital allocation going forward? Is Nexa considering inorganic growth in other geographies?

I – Yes, this is a very important question. With these prices, it's worth mentioning that most of our mines and smelters still make money, and with all the optimization programs that we are running are also helping us in generating more cash flow. However, as you can see, we had a high debt and the priority in this capital allocation is to reduce the debt. We are putting together the budget for the coming months and for the coming year and we have to assess how much cash generation we're going to provide to start reducing the debt, as I was saying, this is the priority. Based on that, we might look for other options to change the capital allocation of the company. This is still early days and we will provide more color to the market at the beginning of next year or mid next year. From the inorganic growth, I think we have some good options in organic growth, and this is something that we are assessing. As I was saying today, the priority is to finish Aripuanã, have more clarity on the approval of Cerro Pasco project and reducing the debt. So, these are the three priorities that we have for the coming months and for 2024.

R – Thank you Ignacio. We have one question related to Aripuanã. It's from Alexandra Symeonidi, from William Blair & Company. What production should we expect from Aripuanã next year? And what is the annual capacity?

L – Ok, this is Leonardo speaking. So, we expect to keep the ramping up over the next year, so by the second quarter, we expect to start to reach full production and when reaching the full production, the running ratio is about 2.2 million tonnes a year. We're still working on the plan, and we're going to provide more color when we issue the guidance in the next quarter.

R – Thank you, Leo. There is another question related to Aripuanã from Orlando Barriga from Credicorp Capital. When would you expect Aripuanã to reach breakeven?

I – So as Leonardo Coelho was mentioning, we expect full capacity towards the end of the first quarter of next year and probably in those months, we will reach also breakeven. Having said that, this is also the case because the CAPEX that we are investing in Aripuanã is related to changing the pumps and installation of these pumps and it's a higher CAPEX. This is affecting our breakeven costs, but as we said in the presentation, in the second quarter of next year, we should be at breakeven.

R – Thank you, Ignacio. We have another question related to Aripuanã. It comes from Henrique Braga from Morgan Stanley. Are there any other bottlenecks for Aripuanã ramp-up that the management can identify?

I – Yes, this is a very good question. And as I can say as a summary that Aripuanã has been very difficult to start the ramp-up because there were some flaws in the original design that also affected construction. So, we had many small bottlenecks in some of the processes, but today I would say the main exposure that we have is in the flotation pumping system, so besides this, we don't see any other small bottlenecks. We might have some related to the ramp up, but this is the day-to-day. But the replacing of the pumps in the flotation system is the one that is going to take us to full production towards the end of the first quarter of next year. So, these are all the questions that we have. We go back to the moderator, please.

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

I – Thank you, everyone, for attending. As you can see, this is still a difficult quarter for us, as we were saying, we are committed to our financial discipline, we are working in many work streams to reduce the costs to try to bring the CAPEX down and to make sure that Aripuanã is up and running in the coming months. So, thank you very much again for the time, and we look forward to provide you more color in the next quarter at the end of the year. Have a good day. Thank you.

O – [Operator Closing Remarks]

Participants of the Q&A:

Alexandra Symeonidi – *William Blair & Company*

Camilla Barder – *Bradesco BBI*

Orlando Barriga – *Credicorp Capital*

Carlos Assumpção – *Bank of America*

Henrique Braga – *Morgan Stanley*

(Call Duration: 36 Minutes)