4Q23 and FY2023 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 Nexa Resources Fourth Quarter and Full Year 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 Fourth Quarter and Full Year 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 good morning to everyone. Please, let's move now to slide number 3 where we will begin our presentation. We appreciate you joining us today to discuss our fourth Quarter and full Year 2023 results along with insights into our outlook for 2024. I am pleased to report that we achieved our guidance for the year with metal production at the high-end of guidance and total smelting sales at the mid-range, while mining and smelting costs were in line with guidance. As many of you are aware, 2023 posed persistent challenges to our business, particularly due to lower zinc prices and the delay in the ramp-up of Aripuanã. Nonetheless, I would like to highlight the dedication and professionalism of our team, which supported us in improving efficiency across our organization, which enabled us to deliver solid operational results and also to mitigate in part the negative impacts of lower zinc prices in our 2023 cash flow. For the full year, total consolidated net revenues amounted to US$2,573 million, down by 15% year-over-year, mainly due to lower zinc prices and lower metal sales. Adjusted EBITDA in 4Q23 was US$105 million compared to US$120 million a year ago. This performance was mainly driven by lower smelting sales volume and zinc prices – zinc was down 17% year-over-year. Compared to last quarter, Adjusted EBITDA rose 28% due to higher zinc prices, which were partially offset by lower smelting sales volume. For the full year, Adjusted EBITDA amounted to US$391 million, down 49% year-over-year, primarily driven by lower LME metal prices, in addition to lower smelting sales volume. I want to reaffirm that we remain focused on completing the Aripuanã ramp-up and, consequently, reaching the nameplate capacity in the second quarter of this year; maintaining our operational and cost optimization discipline aiming to generate positive cash flow throughout this year;

and advancing with the formal approval process for the Cerro Pasco Integration Project. Now, I would like to go over the progress of our ESG initiatives. 2023 accurately portrays our efforts to strengthen our sustainable business model. Nexa registered its carbon emissions on the LME passport, the London Metal Exchange platform which promotes sustainability and transparency across the base metals sector. Nexa's zinc production has one of the lowest carbon footprints recorded in the sector, with an emission intensity of 0.36t of CO_2 equivalent considering (scopes 1 and 2). This achievement positions Nexa as one of the global leaders in carbon reduction within the zinc industry. Moreover, CDP ("Carbon Disclosure Project") recently concluded its evaluation cycle for the year 2023 and announced that Nexa's rating in the climate change questionnaire was upgraded, changing from C to B. This recognition is the result of our efforts, disclosure, and transparency related to governance, strategy, risk management, metrics, and targets. Now, moving to slide number 4.

Regarding the operating performance of the mining segment, you can see that zinc production increased to 90kt in 4Q23, up 21% year-over-year, mainly explained by higher production at the Aripuanã mine, combined with higher production from the Cerro Lindo mine. Compared to 3Q23, zinc production was up 3% explained by higher volumes from the Cerro Lindo, Atacocha, and Morro Agudo mines, in addition to additional production from the Aripuanã ramp-up. It is important to highlight that in 2023, production was up 12% compared to 2022. In relation to cash cost, in 4Q23 it increased to US$0.45/lb compared to the US$0.20/lb in 4Q22, mainly explained by lower by-product credits from our Peruvian mines, higher operational costs in El Porvenir and higher Treatment Charges. Compared to 3Q23, mining cash cost increased by US$0.10/lb, mainly affected by lower by-product credits from Cerro Lindo and higher operational costs in El Porvenir due to the increase in mine development. The cost per run of mine in the quarter was US$48/t, up 3% year-over-year explained by higher variable costs, and up 10% quarter-over-quarter, also affected by higher variable costs. Now, moving to slide number 5.

Regarding the operating performance of the smelting segment, metal sales totaled 143kt in the fourth quarter, down 14% from 4Q22 and 7% compared to 3Q23, mainly impacted by lower volumes in Cajamarquilla and Três Marias. In 2023, total sales were down 4% compared to 2022. Smelting cash cost in 4Q23 decreased to US$1.00/lb compared to US$1.20/lb in 4Q22. This decrease was mainly explained by lower zinc prices, reducing the costs of raw materials purchase, which was partially offset by lower by-products contribution. Compared to 3Q23, cash cost was down US$0.01/lb. Our conversion cost was US$0.29/lb compared to US$0.25/lb in 4Q22 due to higher maintenance and energy costs. Compared to 3Q23, conversion cost was relatively flat. Now, moving to slide number 6, where we will talk about Aripuanã.

In the fourth quarter, activities in Aripuanã have progressed as planned, with our efforts concentrated on further improving plant stabilization and reliability, as well as increasing metallurgical performance. In December, we had five days of downtime in the plant to address the replacement of equipment together with the execution of important debottlenecking task force activities. Considering this downtime the average plant capacity utilization in the quarter was 61%, 5% higher compared to the previous quarter. In the last quarter we also saw improvements in zinc recovery, while concentrate grades and quality were stable. As a result, there was an increase in production compared to the previous quarter. Our exploration plan in Aripuanã in the fourth quarter also progressed as expected, and the results confirmed the continuity of mineralization with high polymetallic contents, showing that we have a robust mining asset with the potential to operate for many years. We started 2024 with positive progress that keeps us confident in estimating the completion of the ramp-up in the second quarter of this year. In the next two slides, we will see more details of the operational performance of Aripuanã. Now, moving to slide number 7.

Starting with the plant downtime in the upper left side, we noted a decrease of 6% quarter-over-quarter, considering the 5 days planned downtime, which shows improvement in the stabilization of the plant. Average plant capacity utilization increased to 61%, versus 56% in the third quarter. In the lower left side, we can see the progress of the zinc recovery, which reached 66% in December, versus 59% in September. When looking at the January 2024 number, we see that the recovery ratio improved even further, reaching 73%. Copper and lead recoveries also improved significantly in January, showing a strong positive trend. Now, moving to slide number 8.

On slide 8, you can see that due to all the improvements mentioned above, compared to the third quarter of 2023, zinc production was 27% higher, reaching 7.4kt in the fourth quarter. Copper production increased 31%, while lead and silver production grew by 49% and 42%, respectively. This improvements show that we are in the right direction to achieve nameplate capacity in the second quarter of this year. Now, moving to slide number 9.

On this slide, I would like to highlight that we continue progressing with our exploration program. The 2023 plan shows indications of positive results for both brownfield and greenfield activities. In Cerro Lindo, the exploratory drilling program focused on extending the mineralization of the OB-8 and OB-9 mineralized bodies, as well as identifying new mineralized zones at the Pucasalla target and its extensions. For Vazante, the focus was on expanding existing mineralized zones in the northern and southern parts of the mine. In Aripuanã, the program was directed at increasing mineral resources at the Babaçu mineralized body and starting drilling at the Massaranduba target. Both targets have solid indications of potential resource addition, with attractive metal content. Finally, at the Cerro Pasco complex, the exploration program also showed relevant results. The program focused mainly on the integration target, which I will describe in detail in the next slide.

In slide number 10 you can see some of the exploration program results in the Pasco Complex, especially in the target integration, that keep suggesting potential resource extensions. The target integration is an exploration area located between the El Porvenir and Atacocha underground mines. The results of this exploration confirmed the continuity of mineralization at deeper levels with high metal content. We will continue to explore this area, with the aim of not only increasing the mineral inventory but also increasing the geological potential. 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 11. As you can see, beginning with the chart on your upper left, total consolidated net revenues for the fourth quarter decreased by 19% year-over-year, mainly due to lower zinc LME prices and lower smelting sales volumes. Compared to 3Q23, net revenues decreased by 3% also as a result of lower smelter sales volumes, partially offset by higher zinc prices and higher production in the mining segment. In 2023, consolidated net revenues reached US$2.6 billion, down by 15% compared to 2022. In terms of profitability, consolidated Adjusted EBITDA in 4Q23 was US$105 million, compared to US$120 million in 4Q22. This lower performance was mainly explained by lower smelter sales volume and lower zinc prices.

Compared to 3Q23, Adjusted EBITDA increased by 28%, mainly due to higher zinc prices and higher mining production, which was partially offset by lower smelter sales volume. In 2023, consolidated Adjusted EBITDA reached US$391 million, down 49% from 2022, this is also explained by the reasons I mentioned a moment ago. Now, let's move to the next slide, number 12.

On the top left of the slide, we can see that in 2023 we invested US$309 million in CAPEX, of which sustaining investments, including mine development, totaled US$293 million. The total investment in the fourth quarter was US$111 million, leaving us within our guidance for the full year. With respect to mineral exploration and project evaluation, we invested a total of US$92 million, of which US$52 million were related to mineral exploration and mine development to support the exploration activities that Ignacio presented a moment ago. The total investment in the fourth quarter was US$24 million. This was US$8 million below our guidance, as we deprioritized some activities as a result of the cash optimization program that we developed throughout the year. Now let's move on to the next slide, in which I will discuss our cash flow.

For 2023, starting from the US$391 million of Adjusted EBITDA net of non-operational items, we paid US$170 million related to interest and taxes, and spent US$309 million in total CAPEX in our operations, including Aripuanã. Additionally, loans and investments and dividends received had a positive net impact of US$66 million, mainly due to a new US$50 million export financing line that became effective in December. Furthermore, dividends paid had a negative impact of US$49 million, including the payment of share premium to Nexa shareholders and the contractual dividends paid to non-controlling interests. We then had a positive impact of US$8 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 during the period. Additionally, we had a positive contribution of US$101 million in working capital, as a result of the efforts deployed throughout 2023, which focused on shortening our working capital cycle. Combining all these effects, our free cash flow in 2023 was negative US$41 million. Finally, on the top right of the slide, we can see the evolution of our free cash flow generation quarter-over-quarter. Our operational and cost discipline, together with the improvements in working capital throughout the year enabled us to generate positive cash flow in the last three quarters of the year, despite the external and internal challenges we faced. Now moving to slide 14.

On this slide, you can see that our liquidity remains healthy and that we continue to present a sound balance sheet with an extended debt maturity profile. By the end of 2023, our available liquidity was approximately US$788 million, including our undrawn sustainability-linked Revolving Credit Facility of US$320 million. Regarding our debt, it currently has an average maturity of 3.8 years and a 6.1% average cost. It is important to mention that as of December 31st, our total cash is sufficient to cover the payment of all obligations maturing in the next three years. Nevertheless, we are always evaluating options to continue to keep a maturity profile that is in line with the long life of our mines and at the most competitive costs. Finally, despite the US$43 million increase in our cash balance quarter-over-quarter, leverage, which is measured by the Net Debt to Adjusted EBITDA ratio, increased from 3.1x to 3.2x in the last 90 days of 2023, this is mainly because of lower Adjusted EBITDA in the last twelve months, driven by the prevailing trend of lower zinc prices, year-over-year. Moving now to slide 15.

Regarding market fundamentals, it is worth noting that in 4Q23, LME zinc price averaged US$2,498/t, down by 17% from 4Q22. The main reason for the decline was a combination of the bullish scenario in 2022, mainly driven by the Chinese post-pandemic stimulus and the metal production cuts in Europe due to high energy prices and lower global demand in 2023, this driven by persistent high interest rate in key-economies and lower-than-expected performance of key Chinese zinc-consuming sectors, like the property market. Compared to 3Q23, LME zinc prices were up 3%, mainly related to the expectations of the Federal Reserve rate cuts in 2024 and to stronger demand expected in China. LME copper price averaged US$8,159/t in 4Q23, up by 2% from 4Q22 and down by 2% from 3Q23, also presenting high sensitivity to the Chinese economy throughout 2023. Looking ahead to 2024, metal prices are expected to be supported by easing monetary policy in the U.S. and macro-economic stimulus in China. In the mid to long-term, the fundamental outlook for both zinc and copper prices remains positive. Additionally, investments in construction, infrastructure and in 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 to fulfill expected demand. 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 2024. As we look ahead to this year, we anticipate that volatility across commodities may persist for a while and continue to put pressure on our business. However, we will remain focused on our priorities including the completion of the Aripuanã and Cerro Pasco integration project, in addition to our commitment to always seek alternatives to optimize costs, CAPEX, and corporate expenses, as well as strengthen our balance sheet. We will continue our journey as we foster the creation of shared value through operational excellence, environmental protection, and the integral development of our communities within a framework of ethics, transparency and responsibility. In summary, although we expect 2024 to be a challenging year, we are confident that the resilience of our business and the long-term fundamentals of our industry will be key to sustain our position. That concludes our remarks, thank you all for attending this presentation, operator we are ready to open the floor for questions please.

Q&A Session:

O – We will now begin the questions and answers session. [Operator Instructions] Our first question comes from Camilla Barder from Bradesco, please go ahead.

Question – Hi, good morning, thanks for the presentation. Just a quick question on the cost side, how you're seeing costs evolving throughout the year for the semesters? And if you also could provide some color on free cash flow expectations, it would be great, thank you.

I – So, regarding cost, as you saw in the presentation, we were able to keep costs flat in our mines in Peru and in Brazil, and this was a combination of higher throughput and measures around reducing fixed costs and incremental productivity. In 2023, we reduced about 500 people in all our operations and regardless of inflation issues, especially in Brazil and some in Peru, and some FX impacts, especially in Brazil, we were able to keep costs flat. However, there were some costs that we couldn't control because we needed to develop some mines such as El Porvenir. We have been taking additional measures for 2024, so the idea is that we also keep our cost of ROM flat this year, and we are very committed in making sure that all details at the mines and all these measures that we take are being followed up very closely, so we are confident that we might also have this under control for 2024.

Question – Thank you. And can you comment on free cash flow expectations as well?

I – Well, free cash flow expectations will depend on prices. I would say that last year, we had two effects on cash flow. The first one, was zinc prices, especially because zinc prices went down heavily in the second quarter and the second one was that the ramp-up of Aripuanã was delayed, and this cost us a lot of money, we spent in Aripuanã around US$200 million last year, and if you see the positive cash flow generation that we had in the third and last quarters, it was something that we feel proud of. In 2024, as we said, prices remain low, but Aripuanã is in the right track to reach nameplate capacity in the second quarter. So, the idea is that if prices go up a little bit, we expect that is the case as we are in the bottom of the price cycle, we might generate some cash flow in 2024. Having said that, cash flow for us is a priority because we have to start reducing our debt and debt went up. We are aware of the leverage we have, and debt went up mainly because of Aripuanã. So now that Aripuanã is being completed and is going to start generating cash flow, and with a combination of cash flow for the other mines, we believe that with some help on prices, the company is really in a good position to generate cash.

Question – And just to confirm, Aripuanã breakeven is expected in the first semester or the second one?

I – To give you some numbers, we are now producing at a rate of 220t/h, the nameplate capacity is 280t/h and we are very close on that. February and January have been good months, recoveries are high in the three metals, and quality of concentrate is also stable and good. So, second quarter, we see achieving nameplate capacity, we are very close on that, and we are confident that in the second quarter, we will be able to achieve that target.

Question – I mean, breakeven.

I – Yes, breakeven. We are working on controlling our costs, so a consequence of nameplate capacity is going to be breakeven as well. So, second quarter we should achieve breakeven on cash flow, yes.

Question – Thank you very much, and congratulations for the presentation.

I – Thank you.

O – There are no more questions in the question queue. I'll hand it back to Rodrigo for any webcast questions they may have.

R – Thank you, operator. Good morning, everyone. We're going to start with a question from Omar Avellaneda from Prima AFP. The first question, is the US$300 million your annual sustaining CAPEX?

I – No, US$300 million is the CAPEX that we have ongoing. Our sustaining CAPEX more or less is US$230 million or US$240 million, and the rest is additional CAPEX that we spend on explorations and other areas.

R – And the second question, also from Omar, what is the CAPEX for Pasco Integration Project and when do you expect to approve the project?

I – Yes, it's a good question. We have been talking about integration during the last year. We expect that CAPEX, and we are still fine-tuning and that's why we haven't approved the project yet, to be around US$150 million to US$200 million. This comprises a new piping system that goes from El Porvenir to Atacocha tailings dam, a mine development between the two underground mines in Atacocha and El Porvenir, some upgrade of the shaft and some other developments, especially in Atacocha. So, we are finalizing the studies here, and we expect to approve this project in the coming months, the idea is that we finish all these studies as we will have more certainty on the investments. So, we might approve this probably in the second quarter or towards the middle of the year, so we can communicate to the market what will happen in this very important project.

R – We have another question from Hernan Kisluk from MetLife. If Aripuanã reaches full capacity in the second quarter of 2024, why does the guidance show increased production over the next few years?

I – Yes. This is because the first quarter production was not on 100% and in the second quarter, as we achieve nameplate capacity, we are also not on 100%. So, I would say that if you extrapolate the second half of this year through the other years, you will achieve the number that we are showing for 2025 and 2026.

R – We have another question from Josseline Jenssen. When do you expect to start deleveraging?

I – As I was saying, we expect deleveraging this year, as I said, this is a priority. We are in good shape in terms of what we can control in our mines and smelters, we are working very hard on production costs and CAPEX, but we are exposed to prices, zinc prices did not begin the year in a very good pace, but we are confident that they will recover in the following quarter. So, with the cash flow that we will start generating, the idea is we start deleveraging the company.

R – We have a question from Rodrigo Murrieta from AFP Integra. Are you evaluating measures to decrease cost per ton of ROM in Cerro Lindo going forward?

I – Yes. Cerro Lindo is a challenge and is a big underground mine, probably, it's one of the largest underground mines in general. The cost per ton of ROM today is US$40/t, and we have to give you an idea, in Cerro Lindo, as mine development, we have to develop 35km per year. So, given that the mine is extending, we have pressures on all of these, so we have been managing in the last two years to keep this US$40/t flat, and this has been a challenge. As I was saying, we have some consolidation of contractors, we have some measures on productivity, reducing of people, we have some measures reducing costs, we have been optimizing our shotcrete that is in support of the mine, and many other measures. So, for us to keep the cost per ton of ROM below US$40/t is a challenge, but we believe that we can achieve that during 2024. In 2025, we'll see, but with the measures we take, the idea is that we keep our cost below US$40/t.

R – We have another question. What is the expected CAPEX that you are considering for the Integration Project in Pasco?

I – As I said before, between US$150 million to US$200 million and I already explained what are the components of that. We are still assessing how are we going to finance that, and this CAPEX is going to be invested in three years. So, part of the cash flow generation of Cerro Pasco is going to be allocated to this and the rest, we are assessing if it might be some debt or some other cash flow that we might have from other operations, but still, we will communicate that once we go forward.

R – Okay. We have another question from Hernan. Can you comment on the alternatives for the Morro Agudo asset?

I – Yes. The Morro Agudo asset is a marginal asset for us, it's a very small asset and this is not transformational it has a low life of mine. I cannot comment on specific actions, but what I can tell you is that we are assessing in detail what are our options in Morro Agudo. We have provided a guidance for production for 2024, but not for 2025 and 2026 because, as I said, this is a marginal asset, and we are assessing the options. As soon as we have some clarity on that, we will come back to the market and communicate what are the next steps on this asset.

O – There are no more questions in the queue. This concludes our question-and-answer session. We will now hand the call over to Ignacio for his final remarks. Mr. Rosado, please go ahead.

I – Thank you. Thank you, everyone, for attending. 2023 has been a very challenging year, as I was saying, the delay on Aripuanã, it consumed a lot of cash flow, prices have not been there, but we believe that we are in the bottom of the cycle, and we are confident that this year is going to be better. The evolution of Aripuanã and all the measures that we have taken will help us generating cash flow for this year and we are committed to our cash discipline and making sure that Aripuanã is up and running. We are hoping that we approve soon the Integration Project of Cerro Pasco. This is important for the company because it will unlock a lot of value, more life of mine for sure, because of all these resources that are in the underground part, but also more profitability, given the economies of the scale of the two assets. So, we are committed to that, we are committed to all these measures. We thank you for the time and we look forward to speak to you at the end of April with our first quarter results. Thank you very much and have a good day.

O – [Operator Closing Remarks]

Participants of the Q&A:

Camilla Barder – *Bradesco BBI*

Omar Avellaneda – *Prima AFP*

Hernan Kisluk – *MetLife*

Josseline Jenssen – *Lucror Analytics*

Rodrigo Murrieta – *AFP Integra*

(Call Duration: 38 Minutes)