3Q19 Nexa's Transcript Earnings Call and Q&A

	Participants
T	Mr. Tito Martins - CEO of Nexa Resources
M	Mr. Rodrigo Menck - CFO of Nexa Resources
R	Ms. Roberta Varella – Head of IR of Nexa Resources
P	Presenter

P - Good morning and welcome to Nexa Resources' Third Quarter Conference Call. [Operator Instructions] The presenter in this call is Ms. Roberta Varella Head of Investor Relations. Also joining the call and available for questions are Mr. Tito Martins CEO of Nexa Resources; and Mr. Rodrigo Menck CFO of Nexa Resources. Please note this event is being recorded.

I would now like to turn the conference over to Ms. Roberta Varella. Please go ahead.

R - Thank you. Good morning and good afternoon everyone and thank you for participating in another Nexa's earnings conference call. Today we will be talking about our results for the third quarter of 2019. Please let's move to slide three where we will begin our presentation.

Here we present some of the main highlights of the quarter. Beginning with our segment performance, our mining operations were solid. Zinc production was 97,000 tons, up 8% compared with third quarter of 2018, driven by Cerro Lindo and Vazante growth. Regarding our smelting segment, production was affected by technical issues in the purification process in Tres Marias smelter during September. As a result, metallic zinc sales in third quarter of 2019 decreased by 0.8% from last year. Compared to second quarter 2019, however, sales volume was up 1.2%. It was affected by the 6% volume increase in Cajamarquilla driven by higher export sales.

Moving to our financials, adjusted EBITDA was $58 million in third quarter compared with $120 million last year. Lower average LME prices and changes in market prices, in respect of quotation period adjustments, had a negative impact of $37 million. We also had a temporary increase in G&A costs related to operational efficiency initiatives that I will comment later in our presentation. Liquidity remained strong and we ended the quarter with a leverage of 1.4x.

Despite the challenging pricing scenario, operating cash flow was positive in $105 million, driven by working capital improvement. Free cash flow was also positive in $35 million. In third quarter, we recognized a non-cash impairment loss of $142 million in Cerro Pasco cash generating unit, primarily driven by life of mine reduction. As a result of the above-mentioned factors, net loss was $171 million in the third quarter.

Regarding guidance, we've revised our zinc production range downwards due to an equipment failure in Vazante. Equipment repair should last about 30 days and we expect a production loss of 8,000 to 10,000 tons of zinc in concentrates. We are maintaining the production forecast for the other metals.

In respect of investments, we have revised our capital allocation strategy and we are prioritizing operation investments that will contribute not only in the short term, but it will also sustain our long-term growth. As a consequence, project development expenses were reduced to $35 million.

Regarding our main project, construction works in Aripuana continued to advance with 66% of the total capex project committed, and 18% physical progress. We also closed the Karmin 30% state acquisition on October 3rd. Moving to the next slide, we'll talk about market fundamentals.

In third quarter, average zinc price was $2,348 per ton, down 7.4% and 15% compared to third quarter of 2019 and second quarter of 2019, respectively. Despite a modest recovery by mid-September, short-term prices were still affected by the uncertainties regarding global economy performance and its impact on sectors growth.

Refined zinc stocks worldwide remained at very low levels. There was an outflow in both LME and Shanghai Futures Exchange stocks during the quarter, and the stock forecast for year-end is still below 10 days of consumption.

The smelting production in China remained below initial estimates, and, as a result, treatment charges continue to be at high levels, reaching almost $300 per ton of concentrate in September.

Copper and lead prices also dropped during the quarter, impacted by the macro scenario, rather than market fundamentals. Let´s please turn to page five, where we will comment on our third quarter consolidated results.

Beginning with the first chart on the left, zinc production of 97,000 tons increased by 8% compared to third quarter of 2018, explained by higher production in Cerro Lindo and Vazante mines.

Copper production followed the same trend and increased by 3% year-over-year, primarily driven by a 4% increase in Cerro Lindo. In third quarter, zinc-equivalent metal production totaled 148,000 tons, up 8% and 9% compared to third quarter of 2018 and previous quarter, respectively. This increase was mainly driven by better metals average grades.

In respect to our smelting segment, metallic zinc sales volume of 149,000 tons was down around 1% versus the same period a year ago. Cajamarquilla increase was offset by lower production volume in Tres Marias, which faced technical issues in its purification process during September. Compared to the second quarter of 2019, sales volume increased by 1%.

The planned shutdown at Cajamarquilla smelter to implement the Jarosite process conversion has been delayed. The heat exchanger and the replacement of tubes had a different specification from what was contracted. As a result, production will not be reduced, and smelter recovery rate should continue to improve. The conversion to the Jarosite process is now expected to be completed in the first half of 2020.

On the following graph, adjusted EBITDA was $58 million, compared with $120 million in third quarter of 2018. Please let´s move to slide six where we will discuss EBITDA in more details.

Compared to third quarter of 2018, adjusted EBITDA decreased 52% to $58 million. This performance is primarily explained by: (i) a negative variation of $37 million due to lower LME prices; (ii) changes in market prices in respect of quotation period adjustments; (iii) an increase in operational cost driven by higher maintenance and personnel expenses; and (iv) the temporary increase in G&A expenses of $16 million, related to operational efficiency initiatives, which have already positively impacted our operations.

And before I continue, I would like to take the opportunity to discuss about those initiatives that I have just mentioned. First of all, it's important to clarify this is not a cost reduction program only, it's bigger than that. We, and when I say we I'm talking about all Nexa's employees, we are putting our efforts to analyze all our internal processes in order to capture opportunities. And not only short term, but to structurally improve our business model in the long run.

We still do not have a number of potential gains that we could share but we can highlight some of the achievements we already had in the quarter. In Cerro Lindo, for example, we improved our mining recovery as a result of more precise drilling and blasting activities. In Cajamarquilla, we have been improving our global recovery and as a consequence, our zinc metal production has increased.

We signed a new energy agreement in Peru beginning in January 2020 with the potential gain of up $50 million. We also signed a new agreement in Furnas, in Brazil, which provides us excess energy that we intend to use in Aripuana.

We will maintain our efforts to build the differentiated sustainable and cost-efficient business model generating value for our stakeholders. Please move to slide seven where we will continue our presentation.

On this slide, I will comment on our mining segment performance. Net revenue amounted to $248 million, slightly down year-over-year, as production increase was offset by lower average metal prices.

EBITDA was $33 million compared with $65 million in third quarter of 2018. This performance was mainly explained by: (i) lower LME prices; (ii) higher operating costs; and (iii) an increase in G&A expenses due to changes in corporate expenses allocation to the mining segment, compared to last year.

In third quarter of 2019, cash cost net of by-product was up 22% compared to last year. Compared to the second quarter, however, mining cash cost improved by 12% due to better volumes and higher by-product credits. Let's please move on to slide eight, where we present our smelting performance.

In third quarter of 2019 net revenue was $442 million, down 8% compared to last year, explained by lower volumes and lower price. EBITDA for the segment was $25 million, compared with $57 million in 2018. The decrease was primarily driven by a negative variation of $25 million due to lower LME price and changes in market price in respect of quotation period adjustments.

Smelting cash cost was $0.99 per pound, down 11% from third quarter of 2018. Different from our mining segment, market-related factors had a positive contribution of $0.10 per pound. Compared to second quarter of 2019, cash cost decreased by 5% primarily due to lower LME prices. Please move to slide nine.

Regarding our debt profile and cash position, we continue to report a healthy balance sheet with extended debt profile and low leverage, and maintained the debt breakdown characteristics by source and currency, as seen on the lower left side of the page.

According to our liquidity strategy and taking advantage of the current market conditions, in October 2019 Nexa contracted a revolving credit line of $300 million. We also entered into a 5-year export credit note agreement in the amount of $90 million. As a result, our current available liquidity is approximately $1.2 billion.

As of September 3rd, the average maturity of our total debt was 5.4 years. On the right side, we see net debt decrease as a result of a slightly reduction in our gross debt. Our leverage measured by the ratio of net debt/adjusted EBITDA of the last 12 months stood at 1.4x compared with 1.3x in the previous quarter, as a result of lower EBITDA. Please let's move to slide 10.

On this slide we present Nexa free cash flow generation. Starting from our $58 million adjusted EBITDA, we had a positive change in working capital of $88 million, driven primarily by the withholding tax payment normalization. Inventory decrease and improved receivables and payables, also contributed to working capital gains.

We spent $53 million in sustaining capex and interest paid. As a result, cash flow before expansion project was positive in $88 million. Non-sustaining capex, including Aripuana greenfield project, amounted to $62 million. Additionally, we increased our cash position below 90 days, which resulted in an increase of $35 million in our investment position. Although this is a non-cash event, it affected our free cash flow in the period.

As a result of the factors that we have just discussed, free cash flow was positive $36 million. Please let's move to page 11.

On this slide we will comment now on our 2019 guidance. As already disclosed to the market, we experienced an equipment failure at Vazante mine and its repair is expected to last about 30 days. During this period, Vazante mine should operate at 30% of its nominal production capacity and as a result, we have reduced our zinc production guidance by 15,000 tons. Production guidance for the other metals remains unchanged.

Smelting sales guidance is also unchanged. Production decrease in Tres Marias in the third quarter should be compensated by higher production in Cajamarquilla, as the planned shutdown to implement the Jarosite process conversion was postponed to next year, as already mentioned. Let's move now to next slide.

On slide 12, we will comment on our mineral exploration and project development investments.

In the third quarter, mineral exploration expenses were $22 million, mainly related to greenfield and brownfield explorations. Project development expenses amounted to $10 million, including $5 million in FEL1 and FEL2 project studies.

For the year, our mineral exploration guidance of $75 million remains unchanged, while project development was revised downwards to $35 million.

In respect to capital expenditure, we invested $104 million in the quarter, of which 56% related to expansion projects, including Aripuana. Capex guidance for the year remains unchanged. Let's move on to the next page.

Construction works in Aripuana continued to advance and by the end of third quarter, 18% of physical progress was achieved, in line with the construction schedule.

In third quarter, we concluded the execution of the Link ramp tunnel. Infrastructure and earthworks projects continue to progress as expected, including mainly roads providing access to the site. Around 66% of the total project capex has been already committed, and we maintain our investment guidance of $140 million for 2019.

In August, Nexa announced the acquisition of Karmin interest in the Aripuana zinc project for $70 million. The transaction was concluded in October, and now Nexa and its affiliates own 100% of the project. The acquisition reinforces not only our commitment to the project but the perspective to increase shareholder return through potential life of mine expansion, and operational and tax synergies with our operations in Brazil.

During the third quarter of 2019, we also began the training program for future miners and plant professionals as well as the refurbishment of the local school. Moving to our final slide.

As we have been discussing over the past two years, we expect to generate value through the performance of our operations and execution of our growth projects.

Our balance sheet was prepared to support our investment cycle, even in an adverse macro scenario. Our liquidity remains strong and we have just reinforced it with the new revolving credit facility.

We have revised our short-term capital allocation strategy, prioritizing operational efficiency initiatives, without jeopardizing our long-term growth.

The construction of Aripuana project continue to advance as expected. Mineral exploration activities also continued to progress in efforts to increase reserves and resources ensuring long-term sustainability.

In respect to our current operations, as previously mentioned, we signed new energy agreements, which should generate savings in Peru and Brazil, starting January 2020.

And in order to keep the market updated in terms of our potential value creation, we plan on filing updated technical reports on Hilarion, Cerro Lindo, and Magistral in the short term. Thank you all for your time and let's move on to the Q&A session.

P - [Operator Instructions] Our first question comes from Thiago Lofiego, with Bradesco BBI. Please go ahead.

Question – Hi thank you, it is actually Isabella here. So, I have a couple of questions. First, on the zinc market outlook. You mentioned that you expect the refined zinc market to remain at deficit in 2019. Well I was wondering if you could just share a bit of your outlook for 2020? It would be helpful. And also, on the temporary increase in SG&A that you registered in the third quarter. I was wondering if you could explain a little bit on what type of measures you are working on? And if possible what future benefits that you're expecting? These are my 2 questions.

T – Ok, thank you Isabella, this is Tito. Good morning good afternoon everybody. Two good questions. In 2019 what we are seeing in the market is clearly in the case of Asia and specifically China, there is an excess of concentrate availability which actually is helping the smelters -- the Chinese smelters. That's why the TCs are actually above the reference TC. We have seen transactions with the TCs actually close to $300 per ton. What it means in terms of the general market? The way we see it is that there was an expectation that more smelters in the -- zinc smelters in China would be in full operation now. Then there was more imports of concentrates to the country. And we are not seeing this additional capacity actually enter in operational. Because of that, there is no change in the stocks – in the stock availability of zinc either in LME or in Shanghai. We are with the lowest levels ever of zinc in the market. And it in some ways explains why price of zinc has been resilient. I mean we are talking about $2,500 per ton in a period of time where most of the analysts are saying that price should fall but the market is proving that there is a reason for price to remain where they are.

In terms of 2020 it's a big question mark. We don't see a major change in what is happening right now. I mean of course demand will be the important factor, but the stock should remain low and we are not foreseeing any increase in refined metal production, which implies that price should be pretty much around where they are today. I was in LME during this week and clearly there were different views about not only the zinc market but also the copper market. Part of the market was very pessimist and part positive. So there is a lack of right information or a level of uncertainty about what can happen. We are confident that our intelligence about the market is good. We have been right about what's going on in the last three to four years.

So I have no reason to believe that price should be mostly different from what we've seen in 2019. Of course, if there is a change in the discussions between U.S. and China and the trade war remains worse than it is today, base metals in general will suffer. On the other hand, if there is a mild solution for what we are discussing today we may see actually prices going up.

And the second question, SG&A. What we are doing here? We have not mentioned this until now basically because it's a program that involves the constitutional internal teams in Nexa and the help of some external consultancy. We have two consulting firms who work with us right now in looking at implementing or improving productivity in our operations and at that same time working with the corporate teams as well to make our people work simpler than it is has been until today. I will give an example. Production in the smelting despite the financial results not showing a good performing in the quarter, has improved along the last three months. If you look at individually Cajamarquilla is performing much better than it was before. Actually, the recovery expected to be achieved with the Jarosite project, half of it has been already achieved, and it has to do with the change of some practices or some procedures in the production process.

So, we are changing the way we are producing and the way we are managing our company. We were not expecting to have the expenses we incurred only in the third quarter when we started this program at the end of the first half. We were expecting to have the disbursements happening along the second half, but fortunately everything was kept in the third quarter. So, we are not expecting those expenses to happen again on the fourth quarter. And if everything goes as we expect, and we actually improve the production, and improve our performance, there will be other expenses next year. We don't know so far, the size of it. Why? That's because the consultants are working on a success fee basis. So, if we do well and as we are starting to do better, they will receive more for that. It´s a simple trick but I hope I've given you a broad picture. Thank you.

Question - Thank you. Yeah, it was very, very clear thank you Tito.

P - Our next question comes from Carlos De Alba with Morgan Stanley. Please go ahead.

Question - Thank you very much. And Tito just coming back to the question. Can you give us a sense of the potential savings that you expect to generate from these "investments" that have increased your SG&A expenses in the quarter and may increase your expenses next year? So that we can more appropriately evaluate the overall trend in SG&A, the net increase or net reduction. And then moving on to cost. Can you elaborate a little bit how you see the trends there? Presumably based on what you just mentioned on the smelting side cost should go down from where we are or where we were in the third quarter. But if you could elaborate on the mining side and overall cost trends for the company and not only in the fourth quarter but in 2020. That will be really useful. And then finally if I may, and I know that I may be abusing, can you remind us when do you expect to release the updated technical reports that you mentioned in the past conference call?

T - Thank you Carlos for the questions. First, I cannot provide you now with any number. There are many reasons for that but the most important one has to do with -- we still don't have the final numbers. We know that some of the KPIs have a very good chance to improve but we have not -- as we have not actually turn it to money, we cannot provide this sort of information. What I can say is that we intend to release at the beginning of the year the guidance for costs. And probably, or actually almost surely, you will see some of those changes and impacts of the programs we are implementing right now. So that we should release that guidance sometime in January next year. Regarding cost, I'm going to pass to Menck and he can give you an overview.

M - Good morning and good afternoon everyone, depending on the time zones you are. Carlos thank you for your question. As you could see from the second quarter to the third quarter, we have reduced our cash cost from $0.48 per pound to $0.42 in the mining sector. We believe that this operational improvement that we have been experimenting ever since we have began this program, are bearing fruits and we believe this will continue looking forward. I don't believe there will be a drastic drop. But in any case, we understand there is some marginal gains to be captured in this sense. On the smelting side, it´s been pretty stable. The cash costs from the smelting has been reduced for a variety of reasons and we are approaching let´s say a level that we believe is from a balance cash cost looking forward. About the technical reports.

T - I can comment there. As you know, Hilarion will be released in the next few weeks. To the end of the year, we will be releasing the new technical report for Cerro Lindo, and Magistral early in next year. So, we expect to have all of this information available even before we release the year's numbers by February.

Question - Thank you very much. Thank you.

P - [Operator Instructions] At this time I'm seeing no further questions. I would like to turn the conference back over to Tito for his final remarks. I'm sorry. Mr. Martins we actually do have an additional question from Orest Wowkodaw with Scotiabank. Please go ahead.

Question - Hi, good morning, everybody. Just curious you took a fairly large impairment on the Pasco complex noting both the zinc price and the reduction in reserves. Can you give us an idea of what sort of -- what the mine life looks like now at that asset? I mean how short is it?

T – Orest, thank you for the question. I´m checking here but basically the impairment was done on the Pasco Complex, because of Pasco Complex. We at the beginning of the year, in the MRMR, we released the information about Pasco, specifically Atacocha. We have a drop in the resource availability -- I don't have the information here right now. It's only Atacocha and the life of mine goes up to 10 years if I'm not wrong.

M - 13 years.

T - 13 years. 13 years sorry. So Atacocha was affected but it still has 13 years of production.

Question - Okay. Are you still planning to develop Shalipayco or no?

T - Yes. Shalipayco is in our pipeline. We are moving on with 2 analysis: the first one is Shalipayco being built and producing on a stand-alone basis; and the second one has to do with the use of ore of Shalipayco in the Pasco complex, which would mean that probably we'd have to make some adjustments in the plants in Pasco, in Atacocha plant and in El Porvenir plant. We are not 100% sure which of those plants should be actually improved in order to accept more ore from Shalipayco. That's exactly what we're looking at today. We should have some news about it at the beginning of the year. Because Shalipayco was in our pipeline as being developed for the alternative that the ore would be used in Pasco. Something around '21 '22. If it goes to stand-alone basis probably, we´ll be late and it will remain in the pipeline but we'll move back a few years.

Question - Okay. And Tito with regards to the project pipeline can you maybe just lay out kind of what the current thinking is in terms of which -- I mean after Aripuana which is being built right now, what do you see the sequencing to be on the various projects moving forward?

T - I have no doubt that Magistral is the first in line. After that, Pukaqaqa was close to Magistral but we are still having some additional studies in metallurgy for Pukaqaqa. So, because of that clearly Magistral it's by itself, it's alone as the first in line. If everything goes as expected, we should have the completion of the feasibility study of Magistral sometime in the second half of next year, which coincides with the end of the Aripuana project. So Magistral should be ready to enter in construction early in 2021. After that, Pukaqaqa could come or Hilarion, right? Because as Pukaqaqa has delayed, it will be closer to Hilarion. And we have Shalipayco running parallel depending on the decisions about only the use of ore or a setup of a new beneficiation plant.

Question - Okay. And Tito is Florida Canyon still somewhere on that list? Or is it...

T - Yes. It comes later. Yes, it comes later. We're assuming investing a significant amount in drilling there.

Question - Okay. Thank you.

P - Our next question is a follow-up from Carlos De Alba with Morgan Stanley. Please go ahead.

Question - Yes, thank you. So, a couple of further questions. One if you can provide a little bit more details on the energy contract in Brazil. Is there an expectation of how much -- I think if I understood you correctly in Peru you said that up to $50 million in savings. So, in Brazil, do you have a magnitude of potential savings? And just in that Peruvian agreement, the $50 million in potential savings is it in -- along the life of the project or is it going to be more in a specific year? That would also be helpful. And then finally can you remind us where is the balance of the intercompany loan that you have between Brazil and the Luxembourg subsidiary as well as what are your expectations there as to the balance in the coming quarters?

M – Hello Carlos how are you? Well the agreement that was signed was signed in Peru, right? It will be valid from January 2020 on, for seven years, right to the end of 2026. There is this -- the agreement that we have before they were separate, now we have one agreement for all the assets that we have in the country. This will provide us in the difference of energy costs approximately $50 million during the whole period. Due to the change of let´s say the value in time you probably have more value in the first years but there's no detail to be disclosed at this point in time. Then you can have your forecast, I think project the way you think is the best. About the intercompany loan. By the end of the third quarter we have $250 million. We have been reducing this ever since the beginning of last year and the idea is to reduce a bit further.

Question - I think the company loan was $250 million at the end of the third quarter?

M - Yes.

Question – ok, great. Thank you very much.

P - Our next question comes from Miguel Garcia with Citi.

Question – Yes, good morning. Just a follow-up on the SG&A expense. Just to be clear the entire $16 million is related to the efficiency initiative and this is a one-off non-recurring expense, correct?

T - Exactly. We will not have anything else along 2019. And if everything goes as expected, every time we have identified gain the consultants will be paid based on a success fee.

M - This program goes up until the end of next year. So, it will -- it's always a one-off expense. So, it'll be always related to some efficiency gains that will be identified in our results. Okay? And -- but they will occur proportional to the gains until the end of next year.

Question - Thank you.

P - [Operator Instructions] At this time I'm seeing no further questions. I would like to turn the call back over to Mr. Martins for any closing remarks.

T - Thank you. First of all, I think it's important for us to say that we are so disappointed with the financial results of the third quarter as everybody is. On the other hand, if you look into the details the numbers of our operations they have improved along the year. I mentioned before the smelting is doing very well in general. We had a setback in Tres Marias for two weeks when it was not producing well. And even with that, the production is matching the production from last year.

One point that's important to address, Cajamarquilla is recovering more. It's performing better even before the Jarosite. So, we are optimistic that production can be much -- can be higher than that when Jarosite is also implemented. Financial situation. We have a very strong position today. A bad quarter in financial terms but a very good quarter in terms of liquidity and debt position. You have to consider that we are in the middle of significant investment, which is Aripuanã. So, we have a strong financial position and it matches our plans. It's ready to support our plans.

Our projects are doing very well. We finished the dry stacking in Vazante in the first half. It's operating properly. We've finished it on-budget and on-time. Aripuana despite the difficulties we could face because of the location it's a place where there is not proper access and so on, we are doing well. We are keeping track of everything that was planned. We are on-budget so far, on-time so far. We just finished the earthworks. Before the rainy season we will start -- we've already started construction of the plant. The concrete group will be thrown to the soil in the next few days. We already have 5,000 tons of ore from the construction of the tunnels. So horizontal development is moving properly, and we should have the vertical development starting along the next two to three weeks.

So, as I said we were unhappy with the quarter, but we are optimistic about the end of the year. Fourth quarter should be better than the third for sure. And everything shows that 2020 is going to be a much better year. Thank you very much for the presence and the support. Have a good day.

P - The conference has now concluded. Thank you for attending today's presentation. You may now disconnect your lines at this time, and have a great day.

Participants of the Q&A:

Last Name	Name	Company
Alba	Carlos	Morgan Stanley
Lofiego	Thiago	Bradesco BBI
Wowkodaw	Orest	Scotia Capital, Inc
Garcia	Miguel	Citi