3Q20 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 the Nexa Resources Third Quarter 2020 Conference Call. [Operator Instructions] The presenters on this call are Mr. Tito Martins, CEO of Nexa Resources; Mr. Rodrigo Menck, CFO of Nexa Resources; and Ms. Roberta Varella, Head of Investor Relations. Please note this event is being recorded.

I would now like to turn the conference over to Mr. Tito Martins. Please go ahead.

T – Thank you, and good morning and good afternoon, everyone. Thanks for joining us in another Nexa's earnings conference call. Today we will be talking about our results for the third quarter of 2020. I hope you and your loved ones remain safe and healthy. Please let's move to slide 3, where we will begin our presentation.

In the last 8 months we have been confronted by COVID-19. The spread of the virus in LATAM is currently at a slower pace but remains a big concern. Additional health and safety protocols in all of our operations remain in place. Essential site personnel continue working remotely. Mining operations in Peru have gradually ramp up as we still faced some constraints related to workforce availability. As a consequence of this situation, we are reducing our copper production guidance for the year, but zinc and lead guidance are maintained. And mining cash cost has also been revised. Metal sales guidance for the year remains unchanged too. As promised in our last conference call, we are updating our 2021-2022 guidance that had been suspended at the beginning of the pandemic. Menck will discuss guidance in more details during this presentation. We, our industry and our clients are still learning how to adapt to this new reality. But I believe that we have done well so far, maintaining our operations under difficult conditions, keeping health of our employees, and providing support for our communities. Third quarter was a very strong quarter, our adjusted EBITDA stood at US$152 million and our cash generation was over US$150 million. As a consequence, financial leverage decreased from 4.97x to 3.23x. These results come from our commitment to capital discipline, and our efforts to reduce costs and improve our operational efficiency. I also would like to take the opportunity and thank our team, which step up in such challenge circumstance. Although a high level of uncertainty remains, going forward we are assuming our operations will remain operating at normal levels. Market conditions are better than we anticipated and as a consequence, we have also revised our investment guidance for the year. It will be discussed in the next slide. So, please, turn to the slide 4.

In the third quarter, we invested US$85 million with a cumulative capex of US$234 million in the first nine months of the year. In response to the COVID-19, and the Peruvian lockdown, last may we revised our capex guidance from US$410 million to US$300 million. At that time, we also assumed we would have a better view of the market in the second half of the year. Surprisingly demand improvement has been faster than anticipated, allowing us to operate in full capacity. Because of this positive situation and in order to keep our operations running safely and stable, we have updated our sustaining capex to this new reality. Additionally, on October 06 we published an update of the Aripuanã project and its capex for the year was revised to US$193 million. Considering this, now we are estimating a total capex of US$350 million for 2020. On the other hand, exploration and project development expenses have been revised downwards from US$68 million to US$50 million. Some of our exploration activities returned in the third quarter but we decided to maintain some of our projects on hold. Turning now to the next slide. Slide 5.

In early October, we published an update on the Aripuanã project. Zinc equivalent production is now estimated at 119kt per year for approximately 11 years, a slightly decrease from our previous estimate of 13 years. Based on current inferred mineral resources and considering our track record of conversion, we believe life of mine could easily be extended beyond 20 years. Total capex was revised to US$547 million, compared to the previously estimated of US$392 million. Project timeline was also updated and now mechanical completion is forecasted for the 4Q21. Cost increase and time extension resulted primarily from among other factors, delays in the completion of the detailed engineering and some exogenous events. Despite the challenges we faced, Aripuanã continues to be an accretive project. It is one of the few zinc projects under development in the world and its implementation is consistent with our strategy of increasing the integration between our mining and smelting operations. Moving now to the next slide. Slide 6.

On this slide we provide the updated milestones of the Aripuanã project. Overall project physical progress reached 56.7% at the end of September. With the current status of our engineering, procurement and construction packages, we believe we will continue to deliver according to the updated execution plan. In addition, we're preparing ourselves to the commissioning and future production, we have already mobilized the operational readiness team the pre-operational phase equipments are on site and stopes development should start in January 2021. Please move to the next slide.

This slide shows the other projects in our pipeline. Since the beginning of the pandemic, we have been very concerned about our capital allocation, because of that we decided to revise our project portfolio and its timeline. Magistral project today is the most advanced project in our portfolio, engineering studies continued to progress and we expect FEL3 to be completed in the first half of 2021. The pre-feasibility studies at Shalipayco and Puka remain on hold. In addition, we are renegotiating the environmental impact study for Puka, which should also cause the extension of the project timeline. Regarding Hilarión, we have already resumed our exploration campaign in the third quarter. Bonsucesso project, currently on hold, is expected to resume in the beginning of 2021.

Now, I would like to pass to Roberta Varella, our Head of Investor Relations, who will comment our third quarter results. Roberta, please.

R – Thank you, Tito, and good morning and good evening everyone. Please, let's move to slide 9.

Beginning with the first chart on your left, zinc production of 82kt decreased by 16% compared to 3Q19. The continued solid performance of our mines in Brazil was offset by the gradual ramp up of our Peruvian mines. Compared to the second quarter, zinc production was 31% higher. Copper production followed the same trend and decreased by 25% year-over-year but increased by 68% compared to the previous quarter. In respect to our smelting segment, total metal sales of 158kt were slightly higher versus the same period a year ago. Compared to the second quarter, sales were 32% higher, mainly driven by the recovery in demand in our home markets. On the following graph, consolidated net revenue was US$538 million compared with US$564 million a year ago, mainly driven by lower volume and decrease in zinc and lead metal prices. Turning to slide 10, we will comment on our consolidated EBITDA.

Adjusted EBITDA increased from US$58 to US$152 million in the third quarter of 2020. This strong performance was mainly driven by, (i) lower operating costs and expenses with a positive variation of US$44 million, (ii) the reduction in exploration and project development expenses, (iii) the increase in by-products credits due to higher prices and quarterly limestone sales record, which were partially offset by (iv) Atacocha expenses related to the underground suspension. The U.S. dollar appreciation against Brazilian real had a positive impact of US$21 million. Please let's move to slide 11, where we will discuss our mining segment performance.

As I mentioned earlier, the solid performance of our operations in Brazil was offset by the decrease in our Peruvian mines, which have gradually increased their throughput rates after restarting operations in second quarter. Cerro Lindo and El Porvenir still faced some limited workforce availability, while Atacocha San Gerardo open pit was able to resume full capacity. Regarding cash cost, in 3Q20 mining cash cost averaged US$0.33/lb, down 20% from last year, primarily driven by, (i) the temporary decrease in costs in Peru as we did not incur in some operating activities, following lower production volumes and also due to reduction cost initiatives, (ii) a positive impact of the Brazilian currency devaluation in Vazante and Morro Agudo costs, and (iii) higher by-product credits, which were partially offset by (iv) higher TC's and lower volumes. Compared to 2Q20, mining cash cost also decreased, positively affected by higher volumes and by-product credits. Moving to the next slide.

On slide 12, we will discuss the mining segment performance. Adjusted EBITDA in third quarter for the mining segment was US$67 million, compared with US$33 million a year ago. This increase was primarily due to, (i) the decrease in operating costs, as I explained in my previous slide, (ii) the positive impact from the Brazilian real depreciation against the U.S. dollar, (iii) an increase in by-products contribution, and (iv) the decrease in mineral exploration and project development expenses. Moving to the next slide.

On slide 13, we will discuss our smelting segment operational results. Total production was 154kt, down 1% from the same quarter a year ago. Compared to second quarter, production increased by 21%, primarily driven by Cajamarquilla smelter, which operated at reduced rates until mid may, following the measures required by the Peruvian government to control the spread of COVID-19. Total sales in the third quarter of this year were 158kt, slightly up year-over-year but 32% higher compared to the previous quarter, mainly driven by higher production and demand recovery in our home markets. Regarding cash cost, smelting cash cost decreased from US$0.99/lb in 3Q19 to US$0.79/lb in this quarter. The 20% decrease is explained by, market-related factors, such as lower LME prices, higher treatment charges and the Brazilian currency devaluation and lower operating costs, positively affected by the new energy contract and decrease in costs of materials in Cajamarquilla smelter. Moving on to the next slide.

Smelting EBITDA was US$86 million in third quarter, compared with US$25 million a year ago. This increase was mainly explained by, (i) higher treatment charges, (ii) the positive price effect related to changes in market prices in respect of quotation period adjustments, (iii) the decrease in operation costs, partially offset by, (iv) the negative impact of by-product credits due to lower sulfuric acid prices.

I will now turn over the call to Rodrigo Menck, our CFO, who will provide more detailed information about our debt profile. Menck, please.

M – Thank you Roberta. Good morning and good afternoon everyone. I am now on slide 15.

As demonstrated in the upper left graph, our liquidity remains strong and we continue to report a healthy balance sheet with extended debt profile. By the end of the third quarter, our current available liquidity was US$1.3 billion, which includes our undrawn revolving credit facility of US$300 million. The debt breakdown by category and currency, is showed on the lower left side of the slide. As of September 30th, the average maturity of our total debt was 5.4 years. On the right side, we see net debt decrease compared with the previous quarter reflecting the improvement results of our operations and cash generation. Our leverage, measured by the net debt to adjusted EBITDA ratio also decreased to 3.23x, as a result of higher adjusted EBITDA and improved cash generation. Now moving on to slide 16.

On this slide, we present Nexa's free cash flow generation. During the quarter, we generated one hundred and fifty nine million dollars. Describing it further, and starting from our US$152 million Adjusted EBITDA, we had a US$52 million gain in working capital, mainly as a result of increased average supplier payment terms, partially offset by US$30 million of sustaining capex and another US$9 million of interest paid and taxes. Still, Nexa has generated US$165 million of cash flow before expansion projects during this quarter. Non-sustaining capex, which includes mainly our expansion project in Aripuanã amounted to US$49 million. Finally, during the quarter, we had a positive net impact from loans and financial investments of US$71 million, partially offset by US$28 million of other non-operational expenses, resulting in a final cash flow generation of US$159 million. Now moving on to slide 17.

On this slide we will comment on our updated mining segment guidance. But before discussing guidance, I would like to comment on our assumptions behind the scenario. As previously-disclosed, our guidance is subject to the continuous evaluation of several factors, including the impact of COVID-19 on our operations, supply chain and demand for our products. After our YTD operational performance in 9M20, which reflected the temporary suspension of production at the Peruvian mines due to COVID-19 and their gradual ramp up in the third quarter, we maintain our 2020 production guidance for zinc, lead while slightly decreasing the copper production range by 4kt. In our efforts to continuously improve our disclosure, we have updated our production guidance for 2021 and 2022, which were temporarily suspended in response to COVID-19 uncertainties. For 2021, zinc production is estimated to increase 6% over 2020, and a further 10% in 2022 over 2021, after the Aripuanã ramp up. We also have revised our 2020 mining cash costs, due to the gradual ramp up of our mining operations in Peru and our estimates for Q4, we have updated our mining average cash cost to US$0.45/lb of zinc sold, down from US$0.59/lb. Now moving to slide 18.

On this slide we will comment on our updated smelting segment guidance now. Our sales guidance for 2020 remains unchanged, as our smelters are estimated to continue operating at higher utilization rates. Metal sales are estimated to be between 540-580kt in 2020. Despite the decrease in demand year-over-year due to COVID-19, demand has recovered from second quarter levels to this upward trend and is expected to continue in the fourth quarter. Similar to our mining segment, we have updated sales guidance for 2021 and 2022. For 2021, metal sales volume is forecasted to increase 65kt over 2020 at the midpoint of the guidance range, and a further 2.5kt in 2022 over 2021. Our smelting average cash cost has been revised slightly up to US$0.78/lb of zinc sold due to higher metal prices. I will now handle the call back to Tito. Tito please.

T – Thank you, Menck. Here, we will make some comments about the market fundamentals. During the quarter, zinc prices continued to recover, reaching pre-pandemic levels in August. Metal demand has shown some recovery in China, although in other countries industrial activities are taking longer to normalize. In terms of our home market (LatinAmerica), zinc demand trended upwards, driven by civil construction, infrastructure, energy, agribusiness and to a certain extent the auto segment. In terms of copper, prices have shown a significant appreciation during the quarter, driven primarily by a weaker U.S. dollar and the decline of inventories throughout the period. Similar to zinc, demand has improved in china, as sectors such as construction, infrastructure and transportation responded positively to the economic stimulus. The short-term outlook for zinc and base metals should remain volatile, as prices should continue to be influenced by the U.S. dollar variation. In terms of fundamentals, zinc concentrate supply is expected to continue to tighten, as the Chinese mining output may not perform as market expects, potentially pushing TC levels down and prices up. Moving to our last slide.

As I said earlier, in such a challenging scenario we have delivered a strong result. Third quarter performance demonstrates the resilience of our business, the contribution of Nexa way program and the commitment of our team with operational excellence and good performance. We remain confident with the recovery of demand, and we're preparing ourselves to generate long-term value creation for all our stakeholders, always keeping financial discipline and a strong balance sheet.

Thank you all for your time, and let's move to the Q&A session.

Q&A Session:

P - Thank you. We will now begin the question-and-answer session. [Operator Instructions] The first question will be from Jens Spiess with Morgan Stanley. Please go ahead.

Question – Yes. Hello. Thank you for taking my questions. I just wanted to ask, what are the main drivers behind the decrease in your 2021 to 2022 guidance versus the original guidance you had published before? And also, I noticed that the smelting sales guidance didn't change much. I was wondering why didn't it go down? Because you are no longer doing the Jarosite project, right? So didn't that have an impact on your guidance for those years? Thank you.

T – Hi Jens. Thank you very much for your question. Tito here, speaking. Let's go for the production guidance. You have to see during the COVID in the first half, we had postponed some of the development in our mines. So we were not able actually to have people working there. So because of this there was an impact in our development in the second half and so affecting directly production for next year. Besides that, we have to prioritize some routes in the production line. So it also affects, in some case, the type of the ore and the content of zinc or copper may be affected. So that's why we decide to be more conservative in terms of production for 2021. In terms of the smelting, production doesn't change much because we were never affected in the case of Brazil, we were never affected at all and in the case of smelting in Peru, production was affected for some time, but came back very easily. And the supply of concentrate has been very stable. So we are not expecting any change. Jarosite is suspended, we have not abandoned it yet and I don't think we will. We do intend to come back to the project as the market conditions come to a more stable situation. But surprisingly, the recovery in Cajamarquilla has improved along the last two years. So we believe that we can keep having a recovery between 44%, 45% even before Jarosite it'll come up with the end of the implementation of Jarosite. Thank you.

Question – Okay, great. Thank you.

P - The next question will be from Orest Wowkodaw with Scotiabank. Please go ahead.

Question – Hi, good morning. Tito, I'm curious, your comments that there's enough demand to run the smelters at full capacity. I'm just curious, is that domestic demand, or are you exporting a good chunk of the refined zinc outside of Latin America?

T – Hi Orest. Good to hear from you. I'm going to try to describe what's going on. But I doubt anybody actually can say that, we were not expecting to see such a strong demand we've seen since, let's say July. Clearly, let's talk about our home market, by home market, I mean LATAM, ok? It's not only Brazil. So what happened is, since July, looks like there was restocking, most of the countries. And then we thought maybe the strong demand will be weak on the fourth quarter. But I can tell you, we are still seeing the same strong demand. And actually, we are starting to believe that the situation came in May and the first quarter of next year. It has to do with a lot of steel makers in the first half, they cut production. Some of the automakers, most of the automakers also cut production. And suddenly everybody came back to an almost normal situation, and it is impacting. So it seems that there is a huge imbalance in supply of different materials, most basic materials. And it's actually helping us to sell more. Just to give an example, we stopped and reduced production in Juiz de Fora smelter at the end of the first half, assuming that we could actually have a cutting in demand, it never happened. If I have more metal available today, I will be able to sell it. Thank you.

Question – So it's not LATAM demand? It's not like you're selling to traders that's shipping to China?

T – No, no. Not at all. Not at all. Actually, we had to cut. We had to cut, we always have some small portion of our sales that we leave to sell in the spot market and if it's not possible to do it, we have long-term agreements with trading companies where we can sell to now. We have actually to reduce those sales to supply to our home market because of the strong demand. But nothing from us is actually moving to Asia, for example. I'll give another the example, it's very uncommon to bring metal from Cajamarquilla in Peru to Brazil or Argentina. We had to do it because of the demand.

Question – That's great to hear. Thank you.

T – Yeah, Thank you.

P – [Operator Instructions] The next question will be from Hernán Kisluk with MetLife. Please go ahead.

Question – Hello, good morning. Thank you for taking my question, and congratulations on the very good results. So my questions are on cost. We have seen a stabilization in mining cash cost in the last two quarters at lower levels than we have seen in the past. But nevertheless, the guidance for the year seems to point to an increase in the 4Q. So first question, could you please confirm if the 4Q is going to have a cash cost of US$0.58? I just want to check my math here. And the second one, thinking about the longer term, how sustainable do you think that the cost that we're seeing now are in the future, mostly thinking to 2021 when you will ramp up production in other mines and new projects?

M – Hello, Hernán. How are you? I'm sorry. I was on mute here and speaking. I think this is common now during the pandemic. Thank you very much for your question. I believe that it's good to clarify here. First of all, our costs, they have been really impacted by the price of byproducts, right? So our byproducts really have been benefiting us. So to that extent, even though we have been really reviewing our cost structure, this is volatile to the extent that external factors can also impact it in the coming quarters, right? But we have been seeing part of our cost efficiency from our Nexa Way program as well. And you can consider that as a successful program that helped us to become our operations more efficient. I don't know if I covered well your question. This is what we have been seeing here.

Question – Okay. So before byproducts, would you say that the cash cost that we are seeing today is going to be repeated more or less into 2021?

M – Yes. We are coming back to normality with our utilization rates at higher levels. So it's back to normality, as we say. So I would expect the same level that we are seeing now.

Question – Okay. Thank you very much.

M – Thank you.

P – The next question will come from Isabella Vasconcelos with Bradesco BBI. Please go ahead.

Question – Hi. Thank you for the questions, and good morning everyone. Congratulations on the results. I just have one question actually. If you could provide a little bit more color on what are the next steps and new opportunities identified for the Nexa Way program? And if you could give us a little bit of more timing in terms of execution for the new steps and new opportunities that you guys identified, that would be helpful. Thank you.

M – Hello, Isabella. Thank you for your question. I hope you're well. Nexa Way is a continuous program. It has identified many initiatives in all levels of the company, both operationally and corporate and when we see new initiatives, we implement it right away. This is all related to procedures, to feedstock utilization, recovery ratio. So, all of that goes toward what we have been disclosing to the market, which is an expectation of up to US$120 million of EBITDA impact every year on a recurring basis. So with this, we mentioned specifically this quarter, that's mostly because when we had our operation suspended, as much of our initiatives are related to production, this program was somewhat hindered in a way. But now, we are back to the full rhythm of production and then these initiatives can be seen, as we have shown this, gains that were recorded of US$24 million in the quarter, US$67 million in the year, on top of what was already identified last year. So this is what we are trying to convey as a message to you.

Question – Great, thank you.

M – Thank you Isabella.

P – Ladies and gentlemen, this concludes our question-and-answer session. Now, I will hand the call back to Tito for his final remarks. Mr. Martins, please go ahead.

T – Thank you. And before we finish, I would like to say that we were very glad to see our performance this quarter, and we remain very optimistic about the remain of the year. As I said before, demand is strong, we are back in full production after so many difficulties mostly caused by the lockdown in Peru. Nexa Way, as Menck just explained, helped us a lot during the pandemic, because in some ways we are not forecasting that, but the implementation of the program, which started last year helped us, not only with the continuous improvement program, but also changing the culture of our organization. And now, we are confident that it can actually help more in the short and medium term. Our expectations are huge in terms of keeping up with the lockdown so far and looks toward the prices of zinc and copper. Unless there is a disruptive condition caused by a second wave of COVID, this should remain in a very high and stable level, which implies that we should have hopefully better results to show you in the future. In terms of the Aripuanã project, as said before, we are optimist and we want to reassure you that we are back on track and actually, we have high expectations about the project, and we believe that the beginning of production at the end of 2021 will be in a time when demand will be stronger than we have today and I hope will be more stable. And we are also seeing that supply may suffer because we are not seeing new mining projects being developed, and clearly the supply of concentrate in China actions falling when you compare with the previous years. So if smelting production remains strong as it is in Asia, with a lack of concentrate, we should see actually a more positive market for us. And finally, I would like to thank our IR team for the work they have been doing and say that they are available for answer any questions or clarify any doubts you may have. Thank you very much for being here with us. Stay healthy, and have a nice weekend. Bye.

P - [Operator Closing Remarks]

Participants of the Q&A:

Jens Spiess – *Morgan Stanley*

Orest Wowkodaw – *Scotiabank*

Hernán Kisluk – *Metlife*

Isabella Vasconcelos – *Bradesco BBI*

(Call Duration: 37 Minutes)