

GERDAU S.A.  
Form 20-F  
March 29, 2019  
Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**

**FORM 20-F**

**REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934**

**OR**

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**For the Fiscal Year Ended December 31, 2018**

**OR**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**OR**

**SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission file number 1-14878

**GERDAU S.A.**

(Exact name of Registrant as specified in its charter)

**N/A**

(Translation of Registrant's name into English)

**Federative Republic of Brazil**

(Jurisdiction of incorporation or organization)

Edgar Filing: GERDAU S.A. - Form 20-F

Av. das Nações Unidas, 8,501 8º andar

São Paulo, São Paulo - Brazil CEP 05425-070  
(Address of principal executive offices) (Zip code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange in which registered
Preferred Shares, no par value per share, each represented by American Depositary Shares	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: **None**

---

Edgar Filing: GERDAU S.A. - Form 20-F

Table of Contents

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: **None**

The total number of issued shares of each class of stock of GERDAU S.A. as of December 31, 2018 was:

573,627,483 Common Shares, no par value per share  
1,146,031,245 Preferred Shares, no par value per share

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes  No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

Yes  No

Note Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from their obligations under those Sections.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files).

Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or an emerging growth company. See definition of large accelerated filer, accelerated filer, and emerging growth company in Rule 12b-2 of the Exchange Act. (Check one):

Edgar Filing: GERDAU S.A. - Form 20-F

Large accelerated filer

Accelerated filer

Non-accelerated filer

Emerging growth company

If an emerging growth company that prepares its financial statements in accordance with U.S. GAAP, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

---

The term new or revised financial accounting standard refers to any update issued by the Financial Accounting Standards Board to its Accounting Standards Codification after April 5, 2012.

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP

International Financial Reporting Standards as issued  
by the International Accounting Standards Board

Other

If Other has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow.

Item 17  Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

---

Table of Contents**TABLE OF CONTENTS**

	<b>Page</b>
<u>INTRODUCTION</u>	2
<u>PART I</u>	4
<u>ITEM 1.</u>	4
<u>ITEM 2.</u>	4
<u>ITEM 3.</u>	4
<u>ITEM 4.</u>	21
<u>ITEM 4A.</u>	54
<u>ITEM 5.</u>	55
<u>ITEM 6.</u>	81
<u>ITEM 7.</u>	93
<u>ITEM 8.</u>	96
<u>ITEM 9.</u>	101
<u>ITEM 10.</u>	104
<u>ITEM 11.</u>	119
<u>ITEM 12.</u>	120
<u>PART II</u>	121
<u>ITEM 13.</u>	121
<u>ITEM 14.</u>	121
<u>ITEM 15.</u>	121
<u>ITEM 16.</u>	122
<u>ITEM 16A.</u>	122
<u>ITEM 16B.</u>	122
<u>ITEM 16C.</u>	123
<u>ITEM 16D.</u>	123
<u>ITEM 16E.</u>	124
<u>ITEM 16F.</u>	124
<u>ITEM 16G.</u>	124
<u>ITEM 16H.</u>	125
<u>PART III</u>	125
<u>ITEM 17.</u>	125
<u>ITEM 18.</u>	125
<u>ITEM 19.</u>	125

Table of Contents

**INTRODUCTION**

Unless otherwise indicated, all references herein to:

(i) the Company, Gerdau, we or us are references to Gerdau S.A., a corporation organized under the laws of the Federative Republic of Brazil (Brazil) and its consolidated subsidiaries;

(ii) Açominas is a reference to Aço Minas Gerais S.A. Açominas prior to November 2003 whose business was to operate the Ouro Branco steel mill. In November 2003 the company underwent a corporate reorganization, receiving all of Gerdau's Brazilian operating assets and liabilities and being renamed Gerdau Açominas S.A.;

(iii) Gerdau Açominas is a reference to Gerdau Açominas S.A. after November 2003 and to Açominas before such date. In July 2005, certain assets and liabilities of Gerdau Açominas were spun-off to four other newly created entities: Gerdau Aços Longos, Gerdau Aços Especiais and Gerdau América do Sul Participações. As a result of such spin-off, as from July 2005, the activities of Gerdau Açominas only comprise the operation of the Açominas steel mill;

(iv) Preferred Shares and Ordinary Shares refer to the Company's authorized and outstanding preferred stock and ordinary stock, designated as *ações preferenciais* and *ações ordinárias*, respectively, all without par value. All references herein to the *real*, *reais* or *R\$* are to the Brazilian *real*, the official currency of Brazil. All references to (i) U.S. dollars, dollars, U.S.\$ or \$ are to the official currency of the United States, (ii) Euro or the official currency of members of the European Union, (iii) billions are to thousands of millions, (iv) km are to kilometers, and (v) tonnes are to metric tonnes;

(v) Installed capacity means the annual projected capacity for a particular facility (excluding the portion that is not attributable to our participation in a facility owned by a joint venture), calculated based upon operations for 24 hours each day of a year and deducting scheduled downtime for regular maintenance;

(vi) Tonne means a metric tonne, which is equal to 1,000 kilograms or 2,204.62 pounds;

(vii) Shipments means the volumes shipped and Consolidated shipments means the combined volumes shipped from all our operations in Brazil, South America, North America and Asia, excluding our joint ventures and

associate companies;

(viii) Worldsteel means World Steel Association, IABr means Brazilian Steel Institute (Instituto Aço Brasil) and AISI means American Iron and Steel Institute;

(ix) CPI means consumer price index, CDI means Interbanking Deposit Rates (Certificados de Depósito Interfinanceiro), IGP-M means Consumer Prices Index (Índice Geral de Preços do Mercado), measured by FGV (Fundação Getulio Vargas), LIBOR means London Interbank Offered Rate, GDP means Gross Domestic Product;

(x) proven or probable mineral reserves has the meaning defined by SEC in Industry Guide 7.

The Company has prepared the Consolidated Financial Statements included herein in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB). The following investments are accounted following the equity method: Bradley Steel Processor and MRM Guide Rail, all in North America, of which Gerdau Ameristeel holds 50% of the total capital, the investment in the holding company Gerdau Metaldom Corp., in which the Company holds a 50% stake, in the Dominican Republic, the investment in the holding company Corsa Controladora, S.A. de C.V., in which the Company holds a 49% stake, which in turn holds the capital stock of Aceros Corsa S.A. de C.V., in Mexico, the investment in Gerdau Corsa S.A.P.I. de C.V., in Mexico, in which the Company holds a 50% stake and the investment in Dona Francisca Energética S.A, in Brazil, in which the Company holds a 51.82% stake, the investment in Diaco S.A., in Colombia, in which the Company holds a 49.87% stake, the investment in Gerdau Summit Aços Fundidos e Forjados S.A., in Brazil, in which the Company holds a 58.73% stake and the investment in Juntos Somos Mais Fidelização S.A., in Brazil, in which the Company holds a 27.50% stake.

Unless otherwise indicated, all information in this Annual Report is stated as of December 31, 2018.

Table of Contents

**CAUTIONARY STATEMENT WITH RESPECT TO FORWARD-LOOKING STATEMENTS**

This Annual Report contains forward-looking statements within the meaning of the Private Securities Litigation Act of 1995. These statements relate to our future prospects, developments and business strategies.

Statements that are predictive in nature, that depend upon or refer to future events or conditions or that include words such as expects, anticipates, intends, plans, believes, estimates and similar expressions are forward-looking statements. Although we believe that these forward-looking statements are based upon reasonable assumptions, these statements are subject to several risks and uncertainties and are made in light of information currently available to us.

It is possible that our future performance may differ materially from our current assessments due to a number of factors, including the following:

- general economic, political and business conditions in our markets, both in Brazil and abroad, including demand and prices for steel products;
  
- interest rate fluctuations, inflation and exchange rate movements of the *real* in relation to the U.S. dollar and other currencies in which we sell a significant portion of our products or in which our assets and liabilities are denominated;
  
- our ability to obtain financing on satisfactory terms;
  
- prices and availability of raw materials;
  
- changes in international trade;
  
- changes in laws and regulations;
  
- electric energy shortages and government responses to them;



- the performance of the Brazilian and the global steel industries and markets;
- global, national and regional competition in the steel market;
- protectionist measures imposed by steel-importing countries; and
- other factors identified or discussed under Risk Factors.

Our forward-looking statements are not guarantees of future performance, and actual results or developments may differ materially from the expectations expressed in the forward-looking statements. As for the forward-looking statements that relate to future financial results and other projections, actual results will be different due to the inherent uncertainty of estimates, forecasts and projections. Because of these uncertainties, potential investors should not rely on these forward-looking statements.

We undertake no obligation to publicly update any forward-looking statement, whether as a result of new information, future events or otherwise.

Table of Contents**PART I****ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS**

Not applicable, as the Company is filing this Form 20-F as an annual report.

**ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE**

Not applicable, as the Company is filing this Form 20-F as an annual report.

**ITEM 3. KEY INFORMATION****A. SELECTED FINANCIAL DATA**

The selected financial information for the Company included in the following tables should be read in conjunction with the IFRS financial statements of the Company, appearing elsewhere in this Annual Report, and section Operating and Financial Review and Prospects. The consolidated financial data of the Company as of and for each of the years ended on December 31, 2018, 2017, 2016, 2015 and 2014 are derived from the financial statements prepared in accordance with IFRS and presented in Brazilian Reais.

	(Expressed in thousands of Brazilian Reais- R\$ except quantity of shares and amounts per share)				
	2018	2017	2016	2015	2014
<b>NET SALES</b>	46,159,478	36,917,619	37,651,667	43,581,241	42,546,339
Cost of sales	(40,010,100)	(33,312,995)	(34,187,941)	(39,290,526)	(37,406,328)
<b>GROSS PROFIT</b>	6,149,378	3,604,624	3,463,726	4,290,715	5,140,011
Selling expenses	(570,431)	(524,965)	(710,766)	(785,002)	(691,021)
Impairment loss on trade receivables	(9,914)				
General and administrative expenses	(1,082,449)	(1,129,943)	(1,528,262)	(1,797,483)	(2,036,926)
Impairment of non-financial assets		(1,114,807)	(2,917,911)	(4,996,240)	(339,374)
Gains and losses on assets held for sale and sales of interest in subsidiaries	(414,507)	(721,682)	(58,223)		636,528
Other operating income	235,421	260,618	242,077	213,431	238,435
Other operating expenses	(270,413)	(168,887)	(114,230)	(116,431)	(150,542)
Reversal of provision for tax liabilities, net		929,711			
Equity method investees	10,141	(34,597)	(12,771)	(24,502)	101,875

Edgar Filing: GERDAU S.A. - Form 20-F

<b>INCOME (LOSS) BEFORE FINANCIAL INCOME (EXPENSES) AND TAXES</b>					
Financial income	4,047,226	1,100,072	(1,636,360)	(3,215,512)	2,898,986
Financial expenses	204,000	226,615	252,045	378,402	276,249
Bond repurchases expenses	(1,579,341)	(1,726,284)	(2,010,005)	(1,780,366)	(1,397,375)
Exchange variations, net	(223,925)				
Reversal of interest on provision for tax liabilities, net	(322,621)	(4,057)	851,635	(1,564,017)	(476,367)
Gains and losses on derivative financial instruments, net		369,819			
	32,092	(9,441)	(38,930)	87,085	36,491
<b>INCOME (LOSS) BEFORE TAXES</b>	<b>2,157,431</b>	<b>(43,276)</b>	<b>(2,581,615)</b>	<b>(6,094,408)</b>	<b>1,337,984</b>
Current	(629,209)	(313,758)	(110,511)	(158,450)	(571,926)
Deferred	798,160	18,367	(193,803)	1,656,872	722,315
Income and social contribution taxes	168,951	(295,391)	(304,314)	1,498,422	150,389
<b>NET INCOME (LOSS)</b>	<b>2,326,382</b>	<b>(338,667)</b>	<b>(2,885,929)</b>	<b>(4,595,986)</b>	<b>1,488,373</b>
<b>ATTRIBUTABLE TO:</b>					
Owners of the parent	2,303,868	(359,360)	(2,890,811)	(4,551,438)	1,402,873
Non-controlling interests	22,514	20,693	4,882	(44,548)	85,500
	2,326,382	(338,667)	(2,885,929)	(4,595,986)	1,488,373

Table of Contents

	(Expressed in thousands of Brazilian Reais- R\$ except quantity of shares and amounts per share)				
	2018	2017	2016	2015	2014
Basic earnings (loss) per share	in R\$				
Common	1.35	(0.21)	(1.70)	(2.69)	0.82
Preferred	1.35	(0.21)	(1.70)	(2.69)	0.82
Diluted earnings (loss) per share	in R\$				
Common	1.34	(0.21)	(1.70)	(2.69)	0.82
Preferred	1.34	(0.21)	(1.70)	(2.69)	0.82
Cash dividends declared per share	in R\$				
Common	0.45	0.08	0.05	0.15	0.25
Preferred	0.45	0.08	0.05	0.15	0.25
Weighted average Common Shares outstanding during the year (1)	571,929,945	571,929,945	571,929,945	571,929,945	571,929,945
Weighted average Preferred Shares outstanding during the year (1)	1,129,851,598	1,137,012,265	1,132,626,373	1,117,034,926	1,132,483,383
Number of Common Shares outstanding at year end (2)	571,929,945	571,929,945	571,929,945	571,929,945	571,929,945
Number of Preferred Shares outstanding at year end (2)	1,124,233,755	1,137,327,184	1,137,018,570	1,114,744,538	1,132,613,562

(1) The information on the numbers of shares presented above corresponds to the weighted average quantity during each year.

(2) The information on the numbers of shares presented above corresponds to the shares at the end of the year.

	2018	2017	On December 31, 2016	2015	2014
	(Expressed in thousands of Brazilian Reais - R\$)				
<b>Balance sheet selected information</b>					
Cash and cash equivalents	2,890,144	2,555,338	5,063,383	5,648,080	3,049,971
Short-term investments	459,470	821,518	1,024,411	1,270,760	2,798,834
Current assets	17,503,082	17,982,113	17,796,740	22,177,498	20,682,739
Current liabilities	8,504,253	7,714,120	8,621,509	7,863,031	7,772,796
Net working capital (1)	8,998,829	10,267,993	9,175,231	14,314,467	12,909,943
Property, plant and equipment, net	15,546,481	16,443,742	19,351,891	22,784,326	22,131,789
Net assets (2)	25,938,571	23,893,941	24,274,653	31,970,383	33,254,534
Total assets	51,281,029	50,301,761	54,635,141	70,094,709	63,042,330
Short-term debt (including Current Portion of Long-Term Debt )	1,822,183	2,004,341	4,458,220	2,387,237	2,037,869
Long-term debt, less current portion	11,545,658	14,457,315	15,959,590	23,826,758	17,148,580
Debentures - short term	2,755				
Debentures - long term	1,536,118	47,928	165,423	246,862	335,036
Equity	25,938,571	23,893,941	24,274,653	31,970,383	33,254,534
Capital	19,249,181	19,249,181	19,249,181	19,249,181	19,249,181

(1) Total current assets less total current liabilities.

(2) Total assets less total current liabilities and less total non-current liabilities.



Table of Contents**Dividends**

The Company's total authorized capital stock is composed of common and preferred shares. As of December 31, 2018, the Company had 571,929,945 common shares and 1,124,233,755 non-voting preferred shares outstanding (excluding treasury stock).

The following table details dividends and interest on equity paid to holders of common and preferred stock since 2014. The figures are expressed in Brazilian reais and U.S. dollars. The exchange rate used for conversion to U.S. dollars was based on the date of the resolution approving the dividend.

Dividends per share information has been computed by dividing dividends and interest on equity by the number of shares outstanding, which excludes treasury stock. The table below presents the quarterly dividends paid per share, except where stated otherwise:

Period	Date of Resolution	R\$ per Share Common or Preferred Stock	\$ per Share Common or Preferred Stock
1st Quarter 2014 (1)	05/07/2014	0.0700	0.0312
2nd Quarter 2014	07/30/2014	0.0600	0.0265
3rd Quarter 2014 (1)	11/05/2014	0.0500	0.0199
4th Quarter 2014	03/04/2015	0.0700	0.0235
1st Quarter 2015 (1)	06/05/2015	0.0600	0.0197
2nd Quarter 2015 (1)	08/12/2015	0.0500	0.0144
3rd Quarter 2015	10/29/2015	0.0400	0.0102
2nd Quarter 2016	08/10/2016	0.0300	0.0096
3rd Quarter 2016	11/04/2016	0.0200	0.0062
2nd Quarter 2017	08/08/2017	0.0200	0.0064
3rd Quarter 2017	11/07/2017	0.0300	0.0092
4rd Quarter 2017	27/02/2018	0.0300	0.0092
1st Quarter 2018 (1)	08/05/2018	0.0800	0.0224
2nd Quarter 2018 (1)	07/08/2018	0.1400	0.0373
3rd Quarter 2018	06/11/2018	0.1300	0.0345
4th Quarter 2018	20/02/2019	0.1000	0.0268

---

(1) Payment of interest on equity.

Table of Contents

Brazilian Law 9,249 of December 1995 provides that a company may, at its sole discretion, pay interest on equity in addition to or instead of dividends (See Item 8 Financial Information - Interest on Equity ). A Brazilian corporation is entitled to pay its shareholders interest on equity up to the limit based on the application of the TJLP rate (Long-Term Interest Rate) to its shareholders equity or 50% of the net income in the fiscal year, whichever is higher. This payment is considered part of the mandatory dividend required by Brazilian Corporation Law for each fiscal year. The payment of interest on equity described herein is subject to a 15% withholding tax. See Item 10. Additional Information Taxation .

**B. CAPITALIZATION AND INDEBTEDNESS**

Not required, as the Company is filing this Form 20-F as an annual report.

**C. REASONS FOR THE OFFER AND USE OF PROCEEDS**

Not required, as the Company is filing this Form 20-F as an annual report.

**D. RISK FACTORS**

We are subject to various risks and uncertainties resulting from changing competitive, economic, political and social conditions that could harm our business, results of operations or financial condition. The risks described below could adversely affect our business, consolidated financial position, results of operations or cash flows. These risks are not the only ones we face. Other risks that we do not presently know about or that we presently believe are not material could also adversely affect us.

**Risks Relating to our Business and the Steel Industry**

*Demand for steel is cyclical and a reduction in prevailing world prices for steel could adversely affect the Company's results of operations.*

The steel industry is highly cyclical. Consequently, the Company is exposed to substantial swings in the demand for steel products, which in turn causes volatility in the prices of most of its products and eventually could cause write-downs of its inventories. In addition, the demand for steel products, and hence the financial condition and results of operations of companies in the steel industry, including the Company itself, are generally affected by macroeconomic changes in the world economy and in the domestic economies of steel-producing countries, including general trends in the steel, construction and automotive industries. Slow growth in steel consumption was not accompanied by a corresponding slowdown in capacity expansion over the last few years, resulting in an even greater excess of global steel capacity. Since then, the price has experienced a high volatility. A material decrease in demand for steel or exports by countries not able to consume their production could have a significant adverse effect on the Company's financial condition and results of operations.

***Global crises and subsequent economic slowdowns may adversely affect global steel demand. As a result, the Company's financial condition and results of operations may be adversely affected.***

Historically, the steel industry has been highly cyclical and deeply impacted by economic conditions in general, such as world production capacity and fluctuations in steel imports/exports and the respective import duties. After a steady period of growth between 2004 and 2008, the marked drop in demand resulting from the global economic crisis of 2008-2009 once again demonstrated the vulnerability of the steel market to volatility of international steel prices and raw materials. That crisis was caused by the dramatic increase of high risk real estate financing defaults and foreclosures in the United States, with serious consequences for bank and financial markets throughout the world. Developed markets, such as North America and Europe, experienced a strong recession due to the collapse of real estate financings and the shortage of global credit. As a result, the demand for steel products suffered a decline in 2009, but since 2010 has been experiencing a gradual recovery, principally in the developing economies. The steel sector is experiencing challenges mainly due to excess global steel capacity, the Chinese economic slowdown, and the entry of imported steel into countries with more open economies.



Table of Contents

The economic downturn and turbulence in the global economy can negatively impact the consuming markets, affecting the business environment with respect to the following:

- Decrease in international steel prices;
  
- Slump in international steel trading volumes;
  
- Crisis in automotive industry and infrastructure sectors; and
  
- Lack of liquidity in the international market.

If the Company is not able to remain competitive in these shifting markets, our profitability, margins and income may be negatively affected. A decline in this trend could result in a decrease in the Company's shipments and revenues. As a result, the Company's financial condition and results of operations may be adversely affected.

*Our results and financial condition are affected by global and local market conditions that we do not control and cannot predict*

We are subject to the risks arising from adverse changes in domestic and global economic and political conditions. Our industry is cyclical by nature and fluctuates with economic cycles, including the current global economic instability. The global financial markets experienced significant disruptions in 2008 and the United States, Europe and other economies went into recession. The recovery from the lows of 2008 and 2009 was uneven and is facing new challenges, including the uncertain effects of the United Kingdom's decision to withdraw from the European Union (BREXIT) and increasing political uncertainty and instability in a number of countries. There continues to be considerable uncertainty over the long-term effects of the expansionary monetary and fiscal policies that have been adopted by the central banks and financial authorities of some of the world's leading economies, including China. These policies may have a negative impact on the global and local economy, and consequently our business, financial condition and results of operations. We cannot predict if the actions taken in the United States, Europe, China and elsewhere in the world to address this situation will be successful in reducing the duration and impact of the economic instability and political uncertainty. More recently, the risk of trade protection measures in favor of local producers of competing products and the disruption in existing trade agreements or increased trade friction between countries (e.g., the U.S. and China) could have a negative effect on our business and results of operations by restricting the free flow of goods and services across borders and exacerbating global economic conditions. Global economic weakness may prompt banks to limit or deny lending to us or to our customers, which could have a material adverse effect on our liquidity, on our operations and on our ability to carry out our announced capital investment programs and may prompt our customers to slow down or reduce the purchase of our products. We may experience longer sales cycles, difficulty in collecting sales proceeds and lower prices for our products. We cannot provide any assurance that any of these events will not have a material adverse effect on market conditions, the prices of our securities, our ability to obtain financing and our results of operations and financial condition.

*Gerdau faces significant competition in relation to their steel products, including with regard to prices of other domestic and foreign producers, which may adversely affect its profitability and market share.*

The global steel industry is highly competitive with respect to price, quality of products and customer service, as well as in relation to technological advances that allow the reduction of production costs. Brazilian exports of steel products are influenced by several factors, including protectionist policies of other countries, foreign exchange policy of the Brazilian government and growth rate of the world economy. Moreover, continuous advances in material sciences and the resulting technologies facilitate the improvement of products such as plastic, aluminum, ceramics and glass, allowing them to replace steel.

Due to the high initial investment costs, the operation of a steel plant on a continuous basis may encourage mill operators to maintain high production levels, even in periods of low demand, which would increase the pressure on industry profit margins. A competitive pressure that forces the fall in steel prices can also affect the profitability of Gerdau.

The steel industry has historically suffered from excess production capacity, which has recently worsened due to a substantial increase in production capacity in emerging countries, particularly China and India and other emerging markets. China is currently the largest global steel producer. In addition, China and certain steel exporting countries have favorable conditions (excess steel capacity, devalued currency or high market prices for steel products in markets outside these countries) which may significantly impact the price of steel in other markets. If Gerdau is unable to remain competitive with China and other steel-producing countries, its financial condition and results of operations may be adversely affected in the future.

Table of Contents

***An increase in China's steelmaking capacity or a slowdown in China's steel consumption could have a material adverse effect on domestic and global steel pricing and could result in increased steel imports into the markets in which the Company operates.***

One significant factor in the global steel market has been China's high steel production capacity, which has been exceeding its domestic consumption needs. This has made China a net exporter of steel products, increasing its importance in different countries of the transoceanic market and consequently pushing down international steel prices. Moreover, China's lower growth rate has resulted in a slower pace of steel consumption in the country, consequently reducing demand for imported raw materials and putting pressure on global commodity prices. Any intensification of these factors could adversely affect the Company's exports, results of operations and financial condition.

***Higher steel scrap prices or a reduction in supply could adversely affect production costs and operating margins.***

The main metal input for the Company's mini-mills, which mills accounted for 78.0% of total crude steel output as of and for the year ended on December 31, 2018, is steel scrap. Although international steel scrap prices are determined essentially by scrap prices in the U.S. local market, because the United States is the main scrap exporter, scrap prices in the Brazilian market are set by domestic suppliers and demand. The price of steel scrap in Brazil varies from region to region and reflects demand and transportation costs. Should scrap prices increase significantly without a corresponding increase in finished steel selling prices, the Company's profits and margins could be adversely affected. An increase in steel scrap prices or a shortage in the supply of scrap to its units would affect production costs and potentially reduce operating margins and revenues. As a result, the Company's financial condition and results of operations may be adversely affected.

***Increases in iron ore and coal prices, or reductions in market supply, could adversely affect the Company's operations.***

When the prices of raw materials, particularly iron ore and coking coal, increase, and the Company needs to produce steel in its integrated facilities, the production costs in its integrated facilities also increase. The Company uses iron ore to produce hot pig iron at its Ouro Branco, Barão de Cocais and Divinópolis mills located in the state of Minas Gerais.

The Ouro Branco mill is the Company's largest mill in Brazil, and its main metal input for the production of steel is iron ore. This unit represented 48.8% of the total crude steel output (in volume) of the Brazil Business Segment. A shortage of iron ore in the domestic market may adversely affect the steel producing capacity of the Brazilian units, and an increase in iron ore prices could reduce profit margins.

The Company has iron ore mines in the Brazilian state of Minas Gerais. To mitigate its exposure to the volatility in iron ore prices, the Company invested in expanding the production capacity of these mines, which, commencing in 2012, met 100% of iron ore demand from the Ouro Branco Mill.

All of the Company's coking coal requirements for its Brazilian units are imported due to the low quality of Brazilian coal. Coking coal is the main energy input at the Ouro Branco mill and is used at the coking facility. Although this mill is not dependent on coke supplies, a contraction in the supply of coking coal could adversely affect the integrated operations at this site. The coking coal used in this mill is imported from Canada, the United States, Australia, Mozambique, Peru, Russia and Colombia. Although the market for the supply of coking coal is relatively balanced at the moment, and we have entered into long-term contracts with negotiable prices periodically to minimize the risks of shortages, a

shortage of coking coal in the international market would adversely affect the steel producing capacity of the Ouro Branco mill. In addition, an increase in prices could reduce profit margins. Another related risk is the currency depreciation to which the Ouro Branco Mill is exposed, since all coking coal consumed by the operation is imported.

As a result, the Company's financial condition and results of operations may be adversely affected.

**Risks Relating to our Operations**

*The Company's projects are subject to risks that may result in increased costs or delay or prevent their successful implementation.*

The Company invested to further increase productivity of its operations. These projects are subject to a number of risks that may adversely affect the Company's growth prospects and profitability, including the following:

- the Company may encounter delays, availability problems or higher than expected costs in obtaining the necessary equipment, services and materials to build and operate a project;

Table of Contents

- the Company's efforts to develop projects according to schedule may be hampered by a lack of infrastructure, including availability of overburden and waste disposal areas as well as reliable power and water supplies;
- the Company may fail to obtain, lose, or experience delays or higher than expected costs in obtaining or renewing the required permits, authorizations, licenses, concessions and/or regulatory approvals to build or continue a project; and
- changes in market conditions, laws or regulations may make a project less profitable than expected or economically or otherwise unfeasible.

Any one or a combination of the factors described above may materially and adversely affect the Company's financial condition and results of operations.

***Unexpected equipment failures may lead to production curtailments or shutdowns.***

Unexpected interruptions in the production capabilities at Gerdau's principal sites and installations would increase production costs, reducing shipments and earnings for the affected period. These interruptions result from: (i) unpredictable/periodic equipment failures, which are essential to the development of the production processes of Gerdau, such as steelmaking equipment, such as its electric arc furnaces, continuous casters, gas-fired reheat furnaces, rolling mills and electrical equipment, including high-output transformers; and/or (ii) unanticipated events such as fires, explosions or violent weather conditions. As a result, Gerdau has experienced and may in the future experience material plant shutdowns or periods of reduced production. Unexpected interruptions in production capabilities would adversely affect Gerdau's productivity and results of operations. Moreover, any interruption in production capability may require Gerdau to make additions to fixed assets to remedy the problem, which would reduce the amount of cash available for operations. Gerdau's insurance may not cover the losses. In addition, long-term business disruption could harm the Company's reputation and result in a loss of customers, which could adversely affect the business, results of operations, cash flows and financial condition.

***Failure to obtain the necessary permits and licenses could adversely affect our operations.***

We depend on the issuance of permits and licenses from governmental agencies in order to undertake certain of our activities. In order to obtain licenses activities that are expected to have a significant environmental impact, certain investments in conservation are required to offset any such impact. The operational licenses require, among other things, that we periodically report our compliance with emissions standards set by environmental agencies. Failure to obtain, renew or comply with our operating licenses may cause delays in our deployment of new activities, increased costs, monetary fines or even suspension of the affected activity, which may materially adversely affect us.

***Climate change may negatively affect our business, financial condition, results of operations and cash flows.***

A significant number of scientists, environmentalists, international organizations, regulators and other commentators sustain that global climate change has contributed, and will continue to contribute, to the increasing unpredictability, frequency and severity of natural disasters (including, but not limited to, hurricanes, droughts, tornadoes, freezes, other storms and fires) in certain parts of the world. As a result, a number of legal and regulatory measures as well as social initiatives have been introduced in numerous countries in an effort to reduce carbon dioxide and other greenhouse gas emissions and combat global climate change. Such reductions in greenhouse gas emissions could result in increased energy, transportation and raw material costs and may require us to make additional investments in facilities and equipment. Although we cannot predict the impact of changing global climate conditions, if any, or if legal, regulatory and social responses to concerns about global climate change, any such occurrences may negatively affect our business, financial condition, results of operations and cash flows.

*The Company's operations are energy-intensive, and energy shortages or higher energy prices could have an adverse effect.*

Crude steel production is an energy-intensive process, especially in melt shops with electric arc furnaces. Electricity represents an important production component at these units, as also does natural gas, although to a lesser extent. Electricity cannot be replaced at Gerdau's mills and power rationing or shortages could adversely affect production at those units. As a result, the Company's financial condition and results of operations may be adversely affected.

*Layoffs in the Company's labor force could generate costs or negatively affect the Company's operations.*

A substantial number of our employees are represented by labor unions and are covered by collective bargaining or other labor agreements, which are subject to periodic negotiation. Strikes or work stoppages have occurred in the past and could reoccur in connection with negotiations of new labor agreements or during other periods for other reasons, including the risk of layoffs during a

Table of Contents

down cycle that could generate severance costs. Moreover, the Company could be adversely affected by labor disruptions involving unrelated parties that may provide goods or services to the Company. Strikes and other labor disruptions at any of the Company operations could adversely affect the operation of facilities and the timing of completion and the cost of capital of our projects.

***We could be harmed by a failure or interruption of our information technology systems or automated machinery.***

We rely on our information technology systems and automated machinery to effectively manage our production processes and operate our business. Advanced technology systems and machinery are nonetheless subject to defects, interruptions and breakdowns. Any failure of our information technology systems and automated machinery to perform as we anticipate could disrupt our business and result in production errors, processing inefficiencies and the loss of sales and customers, which in turn could result in decreased revenue, increased overhead costs and excess or out-of-stock inventory levels resulting in a material adverse effect on our business results. Although we have procedures in place to prevent and minimize the impact of a potential failure, including a data back-up system for our management systems, 24/7 monitoring of our servers and a cybersecurity program, there is no assurance that these will work properly or that there will not be an impact on our results of operations or financial condition.

In addition, our information technology systems and automated machinery may be vulnerable to damage or interruption from circumstances beyond our control, including fire, natural disasters, systems failures, viruses, cyber-attacks and other security breaches, including breaches of our production processing systems that could result in damage to our automated machinery, production interruptions or access to our confidential financial, operational or customer data. Any such damage or interruption could have a material adverse effect on our business results, including as a result of our facing significant fines, customer notice obligations or costly litigation, harming our reputation with our customers or requiring us to expend significant time and expense developing, repairing or upgrading our information technology systems and automated machinery.

Further, while we have some backup data-processing systems that could be used in the event of a failure of our primary systems, we do not yet have a disaster recovery plan or a backup data center that covers all of our units. While we endeavor to prepare for failures of our network by providing backup systems and procedures, we cannot guarantee that our current backup systems and procedures will operate satisfactorily in the event of a regional emergency. Any substantial failure of our backup systems to respond effectively or on a timely basis could have a material adverse effect on our business and results of operations.

***We are subject to information technology risks related to breaches of security pertaining to sensitive company, customer, employee and vendor information as well as breaches in the technology used to manage operations and other business processes.***

Our business operations rely upon secure information technology systems for data capture, processing, storage and reporting. Despite careful security and controls design, implementation, updating and independent third party verification, our information technology systems, and those of our third party providers, could become subject to employee error or malfeasance, cyber-attacks, or natural disasters. Network, system, application and data breaches could result in operational disruptions or information misappropriation. Access to internal applications required to plan our operations, source materials, manufacture and goods and account for orders could be denied or misused. Theft of intellectual property or trade secrets, and inappropriate disclosure of confidential company, employee, customer or vendor information, could stem from such incidents. Any of these operational disruptions and/or misappropriation of information could result in lost sales, business delays, negative publicity and could have a material effect on our business. We also could be required to spend significant financial and other resources to remedy the damage caused by a security breach, including to repair or replace networks and information technology systems, liability for stolen information, increased cybersecurity protection costs, litigation expense and increased insurance premiums.

**Risks Relating to our Mining Operations**

*Estimates of Gerdau's mineral resources are based on interpretations and assumptions and may differ substantially from the quantities that actually can be extracted.*

Gerdau's mineral resources refer to estimated quantities of iron ore and minerals. There are a number of uncertainties that are inherent to such estimates of resources, including many factors that are beyond our control, such as geological and technological factors. The engineering of reserves involves estimating mineral deposits that have yet to be measured accurately, and the accuracy of any reserve estimates is directly related to the quality of the data available, geological interpretations and judgments and engineering. Moreover, estimates from different engineers may vary. As a result, the volume of mineral resources available that will or may be extracted at commercially feasible rates cannot be guaranteed, which could adversely affect the operating results and financial condition of the Company.

Moreover, in order to determine whether a project should advance to its development stage, Gerdau relies on estimates of the mineralized material occurring on its properties. Since Gerdau may not have conducted a feasibility study demonstrating proven or probable reserves, estimates of mineralized material content are less accurate than if they had been made in accordance with the



Table of Contents

definition of proven and probable reserves recognized by the SEC. Furthermore, until iron ore is effectively mined and processed, any reserves and grades of mineralization must be considered mere estimates. Such estimates are inaccurate and based on geological interpretation and statistical deduction drawn from analyses of drillings and samples, which may not be reliable. We cannot guarantee that such estimates on mineralized material are accurate and that such mineralized material can be extracted or processed profitably. Therefore, any decision to advance to the development stage is inherently risky. We also cannot guarantee that any minerals recovered in small-scale testing can be replicated in large-scale testing under actual conditions or on a production scale. Any material changes in the estimates of mineralized material will affect the financial feasibility of making a property productive, as well as the return on capital of such property.

***Gerdau does not have any proven or probable mineral reserves, and Gerdau's decision to start industrial production to supply its steelmaking activities and sell the surplus is not based on studies demonstrating the economic recovery of any mineral reserves, and therefore is inherently risky. Any resources employed in exploration or development may not be recovered.***

Gerdau has not established any proven or probable mineral reserve on any of its properties. All exploration activities are based on mineral resources classified as mineralized materials, since they do not comply with the SEC definitions of proven or probable reserves. Gerdau is conducting comprehensive exploration studies to determine, in accordance with SEC definitions, the quantity of mineralized material that could be transformed into proven or probable reserves. Therefore, part of the volume of mineralized materials informed and discussed in this report may never make it to the development or production stage.

To demonstrate the existence of proven or probable reserves, it is necessary to carry out additional exploration activities to prove the existence of sufficient mineralized material, with satisfactory continuity, and to obtain a positive feasibility study demonstrating, with reasonable certainty, that the deposits can be extracted and produced profitably and legally. The absence of proven or probable reserves makes it more probable that the Company's properties cease to be profitable and that the financial resources employed for exploration and development are never recovered, which would adversely affect the operating results and financial condition of the Company.

***Drilling and production risks could adversely affect the mining process.***

After the discovery of mineral deposits, it could take several years from the initial drilling phase to the feasibility of production, and during such period the economic feasibility of production could suffer changes. Substantial time and investments are necessary to:

- create mineral reserves through drilling;
  
- establish adequate mining and metallurgical processes to optimize the recovery of the metal contained in the ore;
  
- obtain environmental and other types of licenses;

- build mining and processing facilities as well as the necessary infrastructure for greenfield properties; and
- obtain ore or extract minerals from the ore.

If a mining project proves to be economically unfeasible when Gerdau reaches the profit-earning stage, we could incur substantial losses and be forced to write off mineral assets. Furthermore, potential changes or complications involving metallurgical or technological processes during a project cycle could cause delays and generate higher-than-expected costs, rendering the project economically unfeasible and adversely affecting the financial condition and operating results of the Company.

***The Company has one mining dam for the disposal of tailings, and any accident or defect that affects the structural integrity of any of its dams could affect its image, operating results, cash flows and financial condition.***

Gerdau has one mining dam for the disposal of tailings in the state of Minas Gerais, the Alemães Dam, which has been in operation since 2011 and is regularly monitored. The data from the monitoring instruments are within the safety limits, with the dam classified as Class C (low risk) in accordance with the National Mining Dam Registry available on the website of the National Mining Agency (ANM). Gerdau adopts rigorous standards for engineering control and environmental supervision and conducts a half-yearly Geotechnical Stability Audit to ensure the stability of the dam. Gerdau has Mining Dam Emergency Action Plans that are filed at the regulatory agencies, as required by applicable law.

The Company also has other structures that are treated as Mining Dams by the ANM: Bocaina Clarification, UTM 1 Bays, UTM 2 Bays, North Dike of Tailing Pile 01, and North and South Bays of Tailings Pile A. These are structures that receive stormwater runoff and/or effluents from drainage at the Ore Treatment Units to enable the sedimentation of solid waste before the water is returned to the environment.

They also undergo external audits that attest to their geotechnical stability, as well as regular inspections and monitoring.

Table of Contents

An accident involving any of these dams could have serious adverse consequences, including:

- Temporary/permanent shutdown of mining activities and consequently the need to buy iron ore to supply mills;
- High expenditures on contingencies and on recovering the regions and people affected;
- High investments to resume operations;
- Payment of fines and damages;
- Potential environmental impacts.

Any of these consequences could have a material adverse impact on the Company's operating results, cash flow and financial condition.

**Financial Risks**

*Any downgrade in the Company's credit ratings could adversely affect the availability of new financing and increase its cost of capital.*

In 2007, the international rating agencies, Fitch Ratings and Standard & Poor's, classified the Company's credit risk as investment grade, enabling the Company to access more attractive borrowing rates. During recent reviews, the Company maintained its investment grade with S&P and Fitch, with positive and stable outlook, respectively, and its Ba1 rating with Moody's with positive outlook.

The loss of anyone or more of Gerdau's investment grade ratings could increase its cost of capital, impair its ability to obtain capital and adversely affect its financial condition and results of operations.

*The Company's level of indebtedness could adversely affect its ability to raise additional capital to fund operations, limit the ability to react to changes in the economy or the industry and prevent it from meeting its obligations under its debt agreements.*

The Company's degree of leverage, together with the change in rating by the credit rating agencies, could have important consequences, including the following:

- It may limit the ability to obtain additional financing for working capital, additions to fixed assets, product development, debt service requirements, acquisitions and general corporate or other purposes;
- It may limit the ability to declare dividends on its shares;
- A portion of the cash flows from operations must be dedicated to the payment of interest on existing indebtedness and is not available for other purposes, including operations, additions to fixed assets and future business opportunities;
- It may limit the ability to adjust to changing market conditions and place the Company at a competitive disadvantage compared to its competitors that have less debt;
- The Company may be vulnerable in a downturn in general economic conditions; and
- The Company may be required to adjust the level of funds available for additions to fixed assets.

As a result, the Company's financial condition and results of operations may be adversely affected.

Table of Contents

In September 2015, the Company concluded the process of eliminating financial covenants in all of its contracts. Since October 2015, only financial transactions with BNDES contemplate monitoring of the Company's indebtedness indexes, but with distinct characteristics in relation to those previously contained in the contracts with commercial banks (for more information, see Item 5.B. Liquidity and Capital Resources – Indebtedness Ratios). In the event of a failure to satisfy the annual tests, the Company would have a grace period and a subsequent renegotiation of the security for the financing, and an event of default would not occur.

*Variations in the foreign exchange rates between the U.S. dollar and the currencies of countries in which the Company operates may increase the cost of servicing its debt denominated in foreign currency and adversely affect its overall financial performance.*

The Company's results of operations are affected by fluctuations in the foreign exchange rates between the Brazilian *real*, the currency in which the Company prepares its financial statements, and the currencies of the countries in which it operates.

For example, the North America Business Segment reports its results in U.S. dollars. Therefore, fluctuations in the exchange rate between the U.S. dollar and the Brazilian *real* could affect its results of operations. The same occurs with all other businesses located outside Brazil with respect to the exchange rate between the local currency of the respective subsidiary and the Brazilian *real*.

Export revenue and margins are also affected by fluctuations in the exchange rate of the U.S. dollar and other local currencies of the countries where the Company produces in relation to the Brazilian *real*. The Company's production costs are denominated in local currency but its export sales are generally denominated in U.S. dollars. Revenues generated by exports denominated in U.S. dollars are reduced when they are translated into Brazilian *real* in periods during which the Brazilian currency appreciates in relation to the U.S. dollar.

The Brazilian *real* appreciated against the U.S. dollar by 16.5% in 2016, depreciated by 1.5% in 2017 and depreciated by 17.1% in 2018.

The Company held debt denominated in foreign currency, mainly U.S. dollars, in an aggregate amount of R\$11 billion at December 31, 2018, representing 73.8% of its consolidated gross debt (loans, financings, and debentures). Significant further depreciation in the Brazilian *real* in relation to the U.S. dollar or other currencies could reduce the Company's ability to service its obligations denominated in foreign currencies, particularly since a significant part of its net sales revenue is denominated in Brazilian reais. As a result, the Company's financial condition and results of operations may be adversely affected.

*We are subject to LIBOR-based risks.*

On July 27, 2017, the head of the Financial Conduct Authority, or the FCA, announced the desire to phase out the use of LIBOR by the end of 2021. As of the date of this report, there is no definitive information regarding the future utilization of LIBOR or of any particular replacement rate. As such, the potential effect of any such event on our net investment income cannot yet be determined and, at this time, it is not possible to predict the effect of any establishment of alternative reference rates or any other reforms to LIBOR that may be enacted in the United Kingdom

or elsewhere. Uncertainty as to the nature of such potential changes, alternative reference rates or other reforms may have a material adverse effect on our business, financial condition and results of operations.

*Unfavorable outcomes in judicial, administrative and regulatory litigation may negatively affect our results of operations, cash flows and financial condition.*

We are involved in several tax, civil and labor disputes involving significant monetary claims.

The principal litigations are described more fully in Legal Proceedings. Among the material matters for which no provision has been established because are considered as possible contingent liabilities (possibility of any outflow in settlement is possible):

- The Company and its subsidiary Gerdau Aços Longos S.A. and Gerdau Açominas S.A., have lawsuits related to the ICMS (state VAT) which are mostly related to credit rights and rate differences, whose demands totaled R\$ 613,642 thousands.
- The Company and certain of its subsidiaries in Brazil are parties to claims related to: (i) Imposto sobre Produtos Industrializados - IPI, substantially related to IPI credit on inputs, whose demands total the updated amount of R\$ 341,659 thousands; (ii) PIS and COFINS, substantially related to non-approval of compensation of credits on inputs totaling R\$ 968,047 thousands, (iii) social security contributions in the total of R\$ 88,374 thousands and (iv) other taxes , whose updated total amount is currently R\$ 641,782 thousands.

Table of Contents

- The Company and its subsidiary Gerdaу Aços Longos SA are parties to three administrative proceedings related to Withholding Income Tax, levied on interest remitted abroad, linked to export financing formalized through Prepayment of Exports Agreements (PPE) or Prepayment of Exports (RAE), in the updated amount of R\$ 410,893 thousands, of which: (i) R\$ 125,365 thousands corresponds to a lawsuit of the subsidiary Gerdaу Aços Longos, which had its Voluntary Appeal judged at the first instance of the Administrative Council of Tax Appeals (CARF), which was dismissed by the quality vote, by means of the judgment published on September 3, 2018, in the face of which the Company objected Embargoes of Declaration, which awaits judgment;; (ii) R\$ 132,643 thousands corresponds to a lawsuit filed by the subsidiary Gerdaу Aços Longos, which was challenged and dismissed and filed a Voluntary Appeal at the first instance of CARF, on August 28, 2018, which is pending of judgment; and; (iii) R\$ 152,885 thousands, corresponds to a lawsuit filed by the Company, which was challenged and dismissed and filed a Voluntary Appeal at the first instance of CARF, on August 31, 2018, which is pending of judgment.
- The Company (as successor of Gerdaу Aços Especiais S.A.) and its subsidiary Gerdaу Internacional Empreendimentos Ltda. are parties to administrative and judicial proceedings relating to IRPJ Corporate Income Tax and CSLL Social Contribution Tax, in the current amount of R\$ 1,200,672 thousands. Such proceedings relate to profits generated abroad, of which (i) R\$ 1,023,337 thousands correspond to two lawsuits of the subsidiary Gerdaу Internacional Empreendimentos Ltda., of which (i.a) R\$ 988,819 thousands correspond to a lawsuit whose administrative discussion has already been closed and are currently in Fiscal Execution, in relation to which the Company filed Execution Embargoes, which are pending of judgment by the first instance and (i.b) R\$ 34,518 thousands are remaining from a notice originally of R\$ 372,213 thousands and correspond to a suit partially provided by the Superior Court of Tax Appeals (CSRF), in a decision published on May 25, 2017 and has already become final; currently the process is awaiting proceedings by the first instance of the Administrative Council of Tax Appeals (CARF), for analysis of matters not previously analyzed, as determined by the CSRF decision; and (ii) R \$ 177,335 thousands corresponds to a lawsuit filed by the Company, which had its Voluntary Appeal adjudicated by the first instance of CARF, which was dismissed, reason why a Special Appeal was filed with the Superior Court of Tax Appeals (CSRF), known in part and pending of judgment.
- The Company (as successor of Gerdaу Aços Especiais S.A.) and its subsidiaries Gerdaу Aços Longos S.A. and Gerdaу Açominas S.A. are parties to administrative proceedings relating to the disallowance of the deductibility of goodwill generated in accordance with Article 7 and 8 of Law 9,532/97 as a result of a corporate restructuring carried out in 2004/2005 from the tax base of the Corporate Income tax - IRPJ and Social Contribution on Net Income - CSLL. The total updated amount of the proceedings is R\$ 7,062,878 thousands, of which (i) R\$ 5,128,470 thousands correspond to four proceedings involving the Company and its subsidiaries Gerdaу Aços Longos S.A. and Gerdaу Açominas S.A., for which administrative discussions already ended and are currently in the judicial collection stage; and the Companies obtained injunctive relief to permit it to offer a judicial guarantee using a liability insurance policy, for judicial discussions on Embargoes to Execution in the respective proceedings, and in the Embargoes to Execution filed by the Company (as successor of Gerdaу Aços Especiais S.A.), on May 17, 2018, a judgment was rendered dismissing the fiscal launch, in the face of which the National Treasury filed an appeal, which is pending of judgment in the Federal Regional Court of the 4th Region; (ii) R\$ 629,753 thousands correspond to a lawsuit filed by the subsidiary Gerdaу Aços Longos SA, which had its Voluntary Appeal judged at the first instance of CARF on September 18, 2018, which was given partial relief and it is pending of publication of the judgment, in the light of which the Company will take the appropriate measures; (iii) R\$ 255,531 thousands correspond to a lawsuit filed by the subsidiary Gerdaу Aços Longos SA, which had a Voluntary Appeal rejected by the first instance of CARF, which

is why a Special Appeal was filed in the CSRF, which was partially dispatched by an order of which it became aware on July 6, 2018 and in the face of which it filed Regimental Grievance, which is awaiting judgment; (iv) R\$ 297,033 thousands correspond to a lawsuit filed by the subsidiary Gerdau Aços Longos SA, which had its Voluntary Appeal rejected, reason for which was filed a Special Appeal, which was given partial follow-up; currently, the company awaits judgment of its Special Appeal in so far as it is known and awaits collection of the amounts corresponding to the part in which its Special Appeal was not known, in order to adopt the appropriate judicial measures; (v) R\$ 128,404 thousands correspond to a lawsuit filed by the Company (as successor to Gerdau Aços Especiais SA), which had its Voluntary Appeal rejected by the first instance of CARF, which is why a Special Appeal was filed, by an order of which it became aware on September 12, 2018 and in the face of which it filed a regimental grievance that awaits judgment; (vi) R\$ 100,686 thousands corresponds to a lawsuit filed by the Company (as successor to Gerdau Aços Especiais SA), which was rejected as unfounded, by decision of which it became aware on September 17, 2018 and in the face of which it filed Voluntary Appeal in the first instance of CARF, currently pending of judgment; and (vii) R\$ 522,731 thousands correspond to a lawsuit filed by the subsidiary Gerdau Aços Longos S.A., which was challenged as unfounded, by decision of which it became aware on November 27, 2018 and in the face of which it filed a Voluntary Appeal at the first instance of CARF, which is currently pending of judgment.

The Company's legal advisors confirm that the procedures adopted by the Company with respect to the tax treatment of profits abroad and the deductibility of goodwill were strictly legal, and, therefore, the likelihood of loss with respect to said proceedings is possible (but not probable).

In connection with the so-called Operation Zelotes and other matters, Brazilian federal authorities and the judiciary branch are investigating certain issues relating to CARF proceedings, as well as specific political contributions made by the Company, with the purpose of determining whether the Company engaged in any illegal conduct. The Company previously disclosed that, in addition to its interactions with Brazilian authorities, the Company was providing information requested by the U.S. Securities and Exchange Commission ( SEC ). The Company has since been informed by the SEC's staff that it has closed its inquiry and therefore is not seeking any further information from the Company regarding these matters.

The Company believes it is not possible at this time to predict the term or outcome of the proceedings in Brazil, and that there currently is not enough information to determine whether a provision for losses is required or any additional disclosures.



Table of Contents

Furthermore, as previously disclosed, the Company retained outside counsel, reporting to a Special Committee of the Board of Directors, to investigate certain matters relating to CARF proceedings and ultimately political donations by Company entities. That investigation by outside counsel has now been concluded and its results have been reported to the Board of Directors and the SEC.

*The failure to pay by our clients or the non-receipt, by the Company, of the credits held before financial institutions and originated from financial investments could adversely affect the Company's revenues.*

Gerdau may suffer losses from the default of our clients. Gerdau has a broad base of active clients and, in the case of default of a group of clients, Gerdau may suffer an adverse effect on its business, financial condition, results of operations and cash flows.

This risk arises from the possibility of the Company not receiving the amounts due to it from sales transactions or credits payable by financial institutions, which originated from our financial investments, which could also have an adverse effect on the business, financial condition, results of operations and cash flows of Gerdau.

**Regulatory Risks**

*Restrictive measures on trade in steel products may affect the Company's business by increasing the price of its products or reducing its ability to export.*

Gerdau is a steel producer that supplies both the domestic market in Brazil and a number of international markets. The Company's exports face competition from other steel producers, as well as restrictions imposed by importing countries in the form of quotas, ad valorem taxes, tariffs or increases in import duties, any of which could increase the costs of products and make them less competitive or prevent Gerdau from selling in these markets. There are no assurances that importing countries will not impose quotas, ad valorem taxes, tariffs or increase import duties, which could adversely affect the Company's financial condition and results of operations.

*Costs related to compliance with environmental regulations could increase if requirements become stricter, which could have a negative effect on the Company's results of operations.*

The Company's industrial units and other activities must comply with a series of federal, state and municipal laws and regulations regarding the environment and the operation of plants in the countries in which they operate. These regulations include procedures relating to control of air emissions, disposal of liquid effluents and the handling, processing, storage, disposal and reuse of solid waste, hazardous or not, as well as other controls necessary for a steel company.

Non-compliance with environmental laws and regulations could result in administrative or criminal sanctions and closure orders, in addition to the obligation of repairing damage caused to third parties and the environment, such as clean-up of contamination. If current and future laws become stricter, spending on fixed assets and costs to comply with legislation could increase and negatively affect the Company's financial

condition. Moreover, future acquisitions could subject the Company to additional spending and costs in order to comply with environmental legislation. As a result, the Company's financial condition and results of operations may be adversely affected.

***Laws and regulations to reduce greenhouse gases and other atmospheric emissions could be enacted in the near future, with significant, adverse effects on the results of the Company's operations, cash flows and financial condition.***

One of the possible effects of the expansion of greenhouse gas reduction requirements is an increase in costs, mainly resulting from the demand for renewable energy and the implementation of new technologies in the productive chain. On the other hand, demand is expected to grow constantly for recyclable materials such as steel, which, being a product that could be recycled numerous times without losing its properties, results in lower emissions during the lifecycle of the product.

The Company expects operations overseas to be affected by future federal, state and municipal laws related to climate change, seeking to deal with the question of greenhouse gas (GHG) and other atmospheric emissions. Thus, one of the possible effects of this increase in legal requirements could be an increase in energy costs. As a result, the Company's financial condition and results of operations may be adversely affected.

Table of Contents

***Our operations expose us to risks and challenges associated with conducting business in compliance with applicable anti-bribery anti-corruption and antitrust laws and regulations.***

We have operations in Brazil and other countries in South America and North America. We face several risks and challenges inherent in conducting business internationally, where we are subject to a wide range of laws and regulations such as the Brazilian Anti-Corruption Law (Law 12.846/2013), Antitrust Law (Law 12.529/2011), the U.S. Foreign Corrupt Practices Act, or FCPA, and similar anti-bribery, anti-corruption and antitrust laws in other jurisdictions. In recent years there has been an increased focus on corruption in Brazil and also the investigation and enforcement activities of the United States under the FCPA and by other governments under similar laws and regulations. These laws generally prohibit corrupt payments to governmental officials and certain payments, gifts or remunerations to or from clients and suppliers.

Violations of these laws and regulations could result in fines, criminal penalties and/or other sanctions against us, our officers or our employees, requirements to impose more stringent compliance programs, and prohibitions on the conduct of our business and our ability to participate in public biddings for contracts. We may incur expenses and recognize provisions and other charges in respect of such matters. In addition, the increased attention focused upon liability issues as a result of investigations, lawsuits and regulatory proceedings could harm our brand or otherwise impact the growth of our business. The retention and renewal of many of our contracts depends on creating a sense of trust with our customers and any violation of these laws and regulations may irreparably erode that trust and may lead to termination of such relationships and have a material adverse effect on our financial condition and results of operations. If any of these risks materialize, our reputation, strategy, international expansion efforts and our ability to attract and retain employees could be negatively impacted, and, consequently our business, financial condition and results of operations could be adversely affected.

In March 2015, it was reported in the press that the Brazilian Federal Police had started an operation called Zelotes (the Operation ), to investigate whether a number of corporate taxpayers attempted to influence the decisions of the Administrative Board of Tax Appeals (CARF) through illegal means. On April 6, 2015, the Company received an inquiry from the CVM requesting clarifications regarding news reports linking the Company to the Operation. The Company clarified that, up to that moment, it had not been contacted by any public authority concerning the Operation.

Considering the involvement of Gerdau's name in press reports concerning the Operation, the Board of Directors decided to engage external legal counsel, to report to a Special Committee of the Board, to conduct an investigation.

On February 25, 2016, the Federal Police came to Gerdau's premises to execute court ordered searches and seizures, taking documents and data for examination. The Federal Police also interviewed certain individuals associated with Gerdau, including its Chief Executive Officer and another current Board member. On that same date, the Company filed a press release with SEC and CVM and informed Bovespa and the New York Stock Exchange (NYSE). Furthermore, as previously disclosed, the Company retained outside counsel, reporting to a Special Committee of the Board of Directors, to investigate certain matters relating to CARF proceedings and ultimately political donations by Company entities. That investigation by outside counsel has now been concluded and its results have been reported to the Board of Directors and the SEC. See Note 17 to the Consolidated Financial Statements (Tax, Civil and Labor Claims and Contingent Assets) for further information.

Although the Company does not presently believe that these matters will have a material adverse effect on its business, given the inherent uncertainties in such situations, the Company can provide no assurance that these matters will not be material to its business in the future.

*Our governance and compliance processes may fail to prevent regulatory penalties and reputational harm.*

We operate in a global environment, and our activities extend over multiple jurisdictions and complex regulatory frameworks with increased enforcement activities worldwide. Our governance and compliance processes, which include the review of internal control over financial reporting, may not prevent future breaches of legal, accounting or governance standards. We may be subject to breaches of our Code of Ethics and Conduct, anti-corruption policies and business conduct protocols and to instances of fraudulent behavior, corrupt practices and dishonesty by our employees, contractors or other agents. Our failure to comply with applicable laws and other standards could subject us to fines, loss of operating licenses and reputational harm.

#### **Risks Relating to Brazil**

*Any further downgrading of Brazil's credit rating could adversely affect the price of our shares.*

We can be adversely affected by investors' perceptions of risks related to Brazil's sovereign debt credit rating. Rating agencies regularly evaluate Brazil and its sovereign ratings, which are based on a number of factors including macroeconomic trends, fiscal and budgetary conditions, indebtedness metrics and the perspective of changes in any of these factors.

Table of Contents

Brazil has lost its investment grade sovereign debt credit rating by the three main U.S.-based credit rating agencies, Standard & Poor's, Moody's and Fitch. Standard & Poor's downgraded Brazil's sovereign debt credit rating from BBB-minus to BB-plus in September 2015, subsequently reduced it to BB in February 2016, and maintained its negative outlook on the rating, citing Brazil's fiscal difficulties and economic contraction as signs of a worsening credit situation. In December 2015, Moody's placed Brazil's Baa3 sovereign debt credit rating on review and downgraded Brazil's sovereign credit rating in February 2016 to Ba2 with a negative outlook, citing the prospect for further deterioration in Brazil's indebtedness figures amid a recession and challenging political environment. Fitch downgraded Brazil's sovereign credit rating to BB-plus with a negative outlook in December 2015, citing the country's rapidly expanding budget deficit and worse-than-expected recession, and further downgraded Brazil's sovereign debt credit rating in May 2016 to BB with a negative outlook. In January 2018, Standard & Poor's downgraded Brazil's sovereign debt credit rating from BB to BB-minus, citing that as doubts grew about the result of a presidential election in October and a push to trim its costly pension system, seen as vital to closing a huge fiscal deficit. In February 2018, Fitch downgraded Brazil's sovereign debt credit rating from BB to BB-minus saying the country's failure to put a social security overhaul to a vote undermines public finances.

Brazil's sovereign credit rating is currently rated below investment grade by the three main credit rating agencies. Consequently, the prices of securities issued by Brazilian companies have been negatively affected. A prolongation or worsening of the current Brazilian recession and continued political uncertainty, among other factors, could lead to further ratings downgrades. Any further downgrade of Brazil's sovereign credit ratings could heighten investors' perception of risk and, as a result, adversely affect the price of our shares.

***Brazil continues to experience political instability, which may adversely affect the Company.***

Brazil's political environment has historically influenced, and continues to influence, the performance of the country's economy. Political crises have affected and continue to affect the confidence of investors and the general public, which have historically resulted in economic deceleration and heightened volatility in the securities issued by Brazilian companies.

Brazil has experienced heightened economic and political instability derived from various causes such as corruption scandals and currently ongoing investigations into allegations of money laundering and corruption being conducted by the Office of the Brazilian Federal Prosecutor, including the largest such investigation, known as *Lava Jato*.

As a result of these investigations, a number of senior politicians, including members of Congress, and high-ranking executive officers of major corporations and state-owned companies in Brazil, have been arrested, convicted of various charges relating to corruption, entered into plea agreements with federal prosecutors and/or have resigned or been removed from their positions as a result of investigations.

After the impeachment and removal of President Dilma Rousseff in 2016, Michel Temer, the then-vice president, served the remainder of her presidential term through the end of 2018. The Temer administration was marked by significant political and economic unrest, the continued emergence of corruption accusations, political impasse, slow economic recovery, a national transportation strike, low approval ratings and foreign commercial disputes, among other factors. Mr. Temer has himself recently been accused by the Federal Public Prosecutor of corruption charges.

The potential outcome of ongoing corruption scandals and their related investigations is uncertain, but they have already had an adverse impact on the image and reputation of those companies that have been implicated as well as on the general market perception of the Brazilian economy, political environment and the Brazilian capital markets. The Company has no control over, and cannot predict, whether such scandals, investigations or allegations will lead to further political and economic instability or whether new allegations against government officials will

arise in the future or will adversely affect the Company.

In addition, the Brazilian economy remains subject to government policies, which may affect our operations and financial performance. Governmental policies and actions, if unsuccessful or poorly implemented, may affect our operations and financial performance. Uncertainty regarding the implementation by the new administration of promised transformational changes in monetary, fiscal and pension policies, as well as the enactment of corresponding legislation, could contribute to economic instability.

***Inflation and government actions to combat inflation may contribute significantly to economic uncertainty in Brazil and could adversely affect the Company's business.***

If Brazil experiences high levels of inflation once again, the country's rate of economic growth could slow, which would lead to lower demand for the Company's products in Brazil. Inflation is also likely to increase some costs and expenses which the Company may not be able to pass on to its customers and, as a result, may reduce its profit margins and net income. In addition, high inflation generally leads to higher domestic interest rates, which could lead the cost of servicing the Company's debt denominated in Brazilian *reais* to increase. Inflation may also hinder its access to capital markets, which could adversely affect its ability to refinance debt. Inflationary pressures may also lead to the imposition of additional government policies to combat inflation that could adversely affect our business. As a result, the Company's financial condition and results of operations may be adversely affected.

Table of Contents

*Developments and the perception of risks in other countries, especially in the United States and emerging market countries, may adversely affect the market prices of our shares.*

The market for securities issued by Brazilian companies is influenced, in some degree, by economic and market conditions in the United States and emerging market countries, especially other Latin American countries. The reaction of investors to economic developments in one country may cause the capital markets in other countries to fluctuate. Developments or adverse economic conditions in other emerging market countries have at times resulted in significant reductions of the investments from investment funds and declines in the amount of foreign currency invested in Brazil.

The Brazilian economy is also affected by international economic and market conditions, especially economic and market conditions in the United States. Share prices on the B3, for example, have historically been sensitive to fluctuations in United States interest rates as well as movements of the major United States stocks indexes.

Economic developments in other countries and securities markets could adversely affect the market prices of our shares, which could make it more difficult for us to access the capital markets and finance our operations in the future on acceptable terms, and could also have a material adverse effect on our financial condition and results of operations.

**Risks Related to our Corporate Structure**

*The interests of the controlling shareholder may conflict with the interests of the non-controlling shareholders.*

Subject to the provisions of the Company's bylaws, the controlling shareholder has powers to:

- elect a majority of the directors and nominate executive officers, establish the administrative policy and exercise full control of the Company's management;
  
- sell or otherwise transfer the Company's shares; and
  
- approve any action requiring the approval of shareholders representing a majority of the outstanding capital stock, including corporate reorganization, acquisition and sale of assets, and payment of any future dividends.

## Edgar Filing: GERDAU S.A. - Form 20-F

By having such power, the controlling shareholder can make decisions that may conflict with the interest of the Company and other shareholders, which could adversely affect the financial condition and the results of operations of the Company.

*As a foreign issuer, we have different disclosure and other requirements than U.S. domestic registrants.*

As a foreign issuer, we may be subject to different disclosure and other requirements than domestic U.S. registrants. For example, as a foreign issuer, in the United States, we are not subject to the same disclosure requirements as a domestic U.S. registrant under the United States Securities Exchange Act of 1934, as amended (the Exchange Act), including the requirements to prepare and issue quarterly reports on Form 10-Q or to file current reports on Form 8-K upon the occurrence of specified significant events, the proxy rules applicable to domestic U.S. registrants under Section 14 of the Exchange Act or the insider reporting and short-swing profit rules applicable to domestic U.S. registrants under Section 16 of the Exchange Act. In addition, we intend to rely on exemptions from certain U.S. rules which will permit us to follow Brazilian legal requirements rather than certain of the requirements that are applicable to U.S. domestic registrants.

Furthermore, foreign issuers are required to file their annual report on Form 20-F within 120 days after the end of each fiscal year, while U.S. domestic issuers that are accelerated filers are required to file their annual report on Form 10-K within 75 days after the end of each fiscal year. As a result of the above, even though we are required to file reports on Form 6-K disclosing the information which we have made or are required to make public pursuant to Luxembourg law, or are required to distribute to shareholders generally, and that is material to us, you may not receive information of the same type or amount that is required to be disclosed to shareholders of a U.S. company.

*As a foreign issuer, we are permitted to, and we do, rely on exemptions from certain NYSE corporate governance standards, including the requirement that a majority of our board of directors consist of independent directors. This may afford less protection to our shareholders.*

The NYSE's rules require listed companies to have, among other things, a majority of their board members be independent and to have independent director oversight of executive compensation, nomination of directors and corporate governance matters. As a foreign issuer and a controlled Company, we are permitted to, and we will, follow home country practice in lieu of the above



Table of Contents

requirements. Brazilian law, the law of our home country, does not require that a majority of our board consist of independent directors or the implementation of a compensation committee or nominating a corporate governance committee, and our board include fewer, independent directors than would be required if we were subject to the NYSE rules applicable to most U.S. companies. As long as we rely on the foreign issuer exemptions to the NYSE rules, a majority of our board of directors is not required to consist of independent directors, our compensation committee is not required to be comprised entirely of independent directors, and we will not be required to have a nominating and corporate governance committee. Therefore, our board's approach may be different from that of a board with a majority of independent directors, and, as a result, the management team's oversight of the Company may be more limited than if we were subject to the NYSE rules applicable to most U.S. companies.

**Risks Relating to Our Preferred Shares and ADSs**

*If we do not maintain a registration statement and no exemption from the Securities Act registration is available, U.S. Holders of ADSs may be unable to exercise preemptive rights with respect to our preferred shares.*

We may not be able to offer our preferred shares to U.S. holders of ADSs residing in the U.S. pursuant to preemptive rights granted to holders of our preferred shares in connection with any future issuance of our preferred shares unless a registration statement under the Securities Act is effective with respect to such preferred shares and preemptive rights, or an exemption from the registration requirements of the Securities Act is available. We are not obligated to file or maintain a registration statement relating to any preemptive rights offerings with respect to our preferred shares, and we cannot assure you that we will file or maintain any such registration statement. If such a registration statement is not filed and maintained and an exemption from registration does not exist, our depositary, will attempt to sell the preemptive rights, and you will be entitled to receive the proceeds of such sale. However, these preemptive rights will expire if the depositary does not sell them, and U.S. holders of ADSs will not realize any value from the granting of such preemptive rights. Even if a registration statement is effective, we may decide and are allowed to not extend any preemptive or subscription rights to U.S. Persons (as defined in Regulation S under the Securities Act) that are holders of our preferred shares and ADSs.

*Judgments of Brazilian courts with respect to our preferred shares will be payable only in reais.*

If proceedings are brought in the courts of Brazil seeking to enforce our obligations in respect of the preferred shares, we will not be required to discharge its obligations in a currency other than *reais*. Under Brazilian exchange control limitations, an obligation in Brazil to pay amounts denominated in a currency other than *reais* may only be satisfied in Brazilian currency at the exchange rate, as determined by the Central Bank, in effect on the date the judgment is obtained, and such amounts are then adjusted to reflect exchange rate variations through the effective payment date. The then prevailing exchange rate may not afford non-Brazilian investors with full compensation for any claim arising out of, or related to, our obligations under the preferred shares or the ADSs.

*If an ADS holder surrenders its ADSs and withdraws preferred shares, it risks losing the ability to remit foreign currency abroad and certain Brazilian tax advantages.*

An ADS holder benefits from the electronic certificate of foreign capital registration obtained by the custodian for our preferred shares underlying the ADSs in Brazil, which permits the custodian to convert dividends and other distributions with respect to the preferred shares into non-Brazilian currency and remit the proceeds abroad. If an ADS holder surrenders its ADSs and withdraws preferred shares, it will be entitled to continue to rely on the custodian's electronic certificate of foreign capital registration for only five business days from the date of withdrawal.

## Edgar Filing: GERDAU S.A. - Form 20-F

Thereafter, upon the disposition of or distributions relating to the preferred shares unless it obtain its own electronic certificate of foreign capital registration or qualifies under Brazilian foreign investment regulations that entitle some foreign investors to buy and sell shares on Brazilian stock exchanges without obtaining separate electronic certificates of foreign capital registration, such former holder of ADSs would not be able to remit abroad non-Brazilian currency. In addition, if an ADS holder does not qualify under the foreign investment regulations, it will generally be subject to less favorable tax treatment of dividends and distributions on, and the proceeds from any sale of, our preferred shares.

If an ADS holder attempts to obtain its own electronic certificate of foreign capital registration, it may incur expenses or suffer delays in the application process, which could delay its ability to receive dividends or distributions relating to our preferred shares or the return of its capital in a timely manner. The depositary's electronic certificate of foreign capital registration may also be adversely affected by future legislative changes.

Table of Contents

**ITEM 4. COMPANY INFORMATION**

**A. HISTORY AND DEVELOPMENT OF THE COMPANY**

Gerdau S.A. is a Brazilian corporation (*Sociedade Anônima*) that was incorporated on November 20, 1961 under the laws of Brazil. Its main registered office is located at Av. das Nações Unidas, 8501 - 8º andar, São Paulo, SP, Brazil, and the telephone number is +55 (11) 3094 6300.

**History**

The current Company is the product of a number of corporate acquisitions, mergers and other transactions dating back to 1901. The Company began operating in 1901 as the Pontas de Paris nail factory controlled by the Gerdau family based in Porto Alegre, who is still the Company's indirect controlling shareholder. In 1969, Pontas de Paris was renamed Metalúrgica Gerdau S.A., which today is the holding company controlled by the Gerdau family and the parent company of Gerdau S.A.

From 1901 to 1969, the Pontas de Paris nail factory grew and expanded its business into a variety of steel-related products and services. At the end of World War II, the Company acquired Siderúrgica Riograndense S.A., a steel producer also located in Porto Alegre, in an effort to broaden its activities and provide it with greater access to raw materials. In February 1948, the Company initiated its steel operations, which foreshadowed the successful mini-mill model of producing steel in electric arc furnaces using steel scrap as the main raw material. At that time the Company adopted a regional sales strategy to ensure more competitive operating costs. In 1957, the Company installed a second unit in the state of Rio Grande do Sul in the city of Sapucaia do Sul, and in 1962, steady growth in the production of nails led to the construction of a larger and more advanced factory in Passo Fundo, also in Rio Grande do Sul.

In 1967, the Company expanded into the Brazilian state of São Paulo, purchasing Fábrica de Arames São Judas Tadeu, a producer of nails and wires, which was later renamed Comercial Gerdau and ultimately became the Company's Brazilian distribution channel for steel products. In June 1969, the Company expanded into the Northeast of Brazil, producing long steel at Siderúrgica Açonorte in the state of Pernambuco. In December 1971, the Company acquired control of Siderúrgica Guaíra, a long steel producer in the state of Paraná in Brazil's South Region. The Company also established a new company, Seiva S.A. Florestas e Indústrias, to produce lumber on a sustainable basis for the furniture, pulp and steel industries. In 1979, the Company acquired control of the Cosigua mill in Rio de Janeiro, which currently operates the largest mini-mill in Latin America. Since then, the Company has expanded throughout Brazil with a series of acquisitions and new operations, and today owns 12 steel units in Brazil.

In 1980, the Company began to expand internationally with the acquisition of Gerdau Laisa S.A., the only long steel producer in Uruguay. In 1989, the Company acquired the Canadian company Gerdau Ameristeel Cambridge, a producer of common long rolled steel products located in Cambridge, Ontario. In 1992, the Company acquired control of Gerdau AZA S.A., a producer of crude steel and long rolled products in Chile. Over time, the Company increased its international presence by acquiring a non-controlling interest in a rolling mill in Argentina, a controlling interest in Diaco S.A. in Colombia, and, most notably, additional interests in North America through the acquisition of Gerdau Ameristeel MRM Special Sections, a producer of special sections, and the former Ameristeel Corp., a producer of common long rolled products. In 2002, through a series of transactions, the Company merged its North American steel production assets with those of the Canadian company Co-Steel, a producer of long steel, to create Gerdau Ameristeel, which is currently the second largest long steel producer in North America based on steel production volume.

In December 2003, Gerdau Açominas S.A., signed a purchase agreement with the Votorantim Group. Under this contract, Gerdau Açominas S.A. agreed to purchase the real estate and mining rights of Companhia Paraibuna de Metais, a company controlled by Votorantim Group, whose mines were located at Miguel Burnier, Várzea do Lopes and Gongo Soco in the state of Minas Gerais. The assets involved in this transaction include extraction concessions. The price agreed upon for the purchase of the real estate and mineral rights described above was US\$ 30 million (R\$88.1 million on the date of the acquisition). In 2012, Gerdau guaranteed its iron ore self-sufficiency for the integrated mill (Ouro Branco).

In September 2005, Gerdau acquired 36% of the stock issued by Sipar Aceros S.A., a long steel rolling mill, located in the Province of Santa Fé, Argentina. This interest, added to the 38% already owned by Gerdau represents 74% of the capital stock of Sipar Aceros S.A. In the same month, Gerdau concluded the acquisition of a 57% interest in Diaco S.A., the largest rebar manufacturer in Colombia. In January 2008, Gerdau acquired an additional interest of 40% for US\$107.2 million (R\$188.7 million on the acquisition date), increasing its interest to 99% of the capital stock, a figure that also takes into consideration the dilution of non-controlling interests, which explains the higher Gerdau share compared with the share in the two major acquisitions made. In June 2017, Gerdau concluded the operation to form a joint venture, based on the sale of its 50% interest in Gerdau Diaco, in Colombia, with Putney Capital Management. The transaction value attributed to the joint venture was US\$165 million (R\$546 million on the transaction date).

Table of Contents

In January 2006, through its subsidiary Gerdau Hungria Holdings Limited Liability Company, Gerdau acquired 40% of the capital stock of Corporación Sidenor S.A. for US\$ 219.2 million (R\$ 493.2 million on the acquisition date). In December 2008, Gerdau Hungria Holding Limited Liability Company acquired for US\$ 288.0 million (R\$ 674.0 million on the acquisition date) a 20% interest in Corporación Sidenor S.A. With this acquisition, Gerdau became the majority shareholder (60%) in Corporación Sidenor. In January 2013, as a result of the settlement of a put option held by the Santander Group, the Company acquired the remaining 40% of Corporación Sidenor S.A., for R\$ 599.2 million. In May 2016, the Company closed the sale of Gerdau Holdings Europa S.A. in Spain (the subsidiary which held Corporación Sidenor S.A.). The transaction value was 155 million (equivalent to R\$ 621 million on the completion of the sale).

In June 2006, Gerdau won the bid for 50% plus one share of the capital stock of Empresa Siderúrgica Del Perú S.A.A. (Siderperú) located in the city of Chimbote in Peru for US\$ 60.6 million (R\$ 134.9 million on the acquisition date). In November 2006, Gerdau also won the bid for 324,327,847 shares issued by Siderperú, which represented 33% of the total capital stock, for US\$ 40.5 million, totaling US\$ 101.1 million (R\$ 219.8 million on the acquisition date). This acquisition added to the interest already acquired earlier in the year, for an interest of 83% of the capital stock of Siderperú.

In March 2007, Gerdau acquired Siderúrgica Tultitlán, a mini mill located in the Mexico City that produces rebar and profiles. The price paid for the acquisition was US\$ 259.0 million (R\$ 536.0 million on the acquisition date).

In May 2007, Gerdau acquired an interest of 30% in Multisteel Business Holdings Corp., a holding of Industrias Nacionales, C. por A. ( INCA ), a company located in Santo Domingo, Dominican Republic, that produces rolled products. This partnership allowed Gerdau to access the Caribbean market. The total cost of the acquisition was US\$ 42.9 million (R\$ 82.0 million on the acquisition date). In July 2007, Gerdau acquired an additional interest of 19% in Multisteel Business Holdings Corp., bringing its total interest in the Company to 49%. The total cost of this second acquisition was US\$ 72.0 million (R\$ 135.2 million on the acquisition date). In October 2014, Gerdau and Complejo Metalúrgico Dominicano S.A. confirmed the merger of operations of its companies Industrias Nacionales and METALDOM, becoming denominated Gerdau Metaldom. This merger is aimed at more efficiency and competitiveness in the Caribbean and Central America region and assures the supply of steel products for construction sector in the Dominican Republic.

In June 2007, Gerdau acquired 100% of the capital stock of Siderúrgica Zuliana C.A., a Venezuelan company operating a steel mill in the city of Ojeda, Venezuela. The total cost of the acquisition was US\$ 92.5 million (R\$ 176.2 million on the acquisition date).

In the same month, Gerdau and the Kalyani Group from India initiated an agreement to establish a joint ventures for an investment in Tadipatri, India. The joint venture included an interest of 45% in Kalyani Gerdau Steel Ltd. The agreement provides for shared control of the joint venture, and the purchase price was US\$ 73.0 million (R\$ 127.3 million on the acquisition date). In May 2008, Gerdau announced the conclusion of this acquisition. In July 2012, the Company obtained control of Kalyani Gerdau Steel Ltds (KGS), which the Company had an interest of 91.28% as of the control acquisition date. In 2012, until the date Gerdau acquired control over KGS, Gerdau made capital increases in KGS, which resulted in an increase of its shareholder interest, going from 80.57% in December 31, 2011 to 91.28%.

In September 2007, Gerdau concluded the acquisition of Chaparral Steel Company, increasing Gerdau's portfolio of products and including a comprehensive line of structural steel products. The total cost of the acquisition was US\$ 4.2 billion (R\$ 7.8 billion on the acquisition date), plus the assumption of certain liabilities.

## Edgar Filing: GERDAU S.A. - Form 20-F

In October 2007, Gerdau executed a letter of intent for the acquisition of a 49% interest in the capital stock of the holding company Corsa Controladora, S.A. de C.V., headquartered in Mexico City, Mexico. The holding company owns 100% of the capital stock of Aceros Corsa, S.A. de C.V. and its distributors. The acquisition price was US\$ 110.7 million (R\$ 186.3 million on the acquisition date). In February 2008, the Company announced the conclusion of this acquisition.

In November 2007, Gerdau entered into a binding agreement for the acquisition of the steel company MacSteel from Quanex Corporation. MacSteel operates three mini-mills located in Jackson, Michigan; Monroe, Michigan; and Fort Smith, Arkansas. The Company also operates six downstream operations in the states of Michigan, Ohio, Indiana and Wisconsin. The purchase price for this acquisition was US\$1.5 billion (R\$2.4 billion on the acquisition date) in addition to the assumption of their debts and some liabilities. Gerdau concluded the acquisition in April 2008.

In June 2008, the parent company Metalúrgica Gerdau S.A. acquired a 29% stake of voting and total capital in Aços Villares S.A. from BNDESPAR for R\$ 1.3 billion. As a payment, Metalúrgica Gerdau S.A. issued debentures to be exchanged for Gerdau S.A.'s common shares. In December 2009 the Company's stake in Aços Villares S.A. owned through its subsidiary Corporación

Table of Contents

Sidenor S.A. was transferred to direct control of Gerdau S.A., for US\$ 218 million (R\$ 384 million on the acquisition date), which then owned a total 59% stake in Aços Villares S.A. On December 30, 2010, Gerdau S.A. and Aços Villares S.A. shareholders approved the merger into Gerdau S.A. of Aços Villares S.A. The transaction was carried out through a share exchange, whereby the shareholders of Aços Villares S.A. received one share in Gerdau S.A. for each lot of twenty-four shares held. The new shares were credited on February 10, 2011. As a result of the transaction, Aços Villares S.A. was delisted from the Brazilian stock exchange.

On August 30, 2010, Gerdau S.A. concluded the acquisition of all outstanding common shares issued by Gerdau Ameristeel that it did not yet hold either directly or indirectly, for US\$ 11.00 per share in cash, corresponding to a total of US\$ 1.6 billion (R\$ 2.8 billion). With the acquisition, Gerdau Ameristeel was delisted from the New York and Toronto stock exchanges.

On July 14, 2015 the Company approved the acquisition of the minority interests described below, in the following companies: Gerdau Aços Longos S.A. (4.77%), Gerdau Açominas S.A. (3.50%), Gerdau Aços Especiais S.A. (2.39%) and Gerdau América Latina Participações S.A. (4.90%), with its counterparts Itau Unibanco S.A. and ArcelorMittal Netherlands BV. The acquisitions of these interests, in a total amount of R\$1,986 million, allowed Gerdau to hold more than 99% of the total capital of each of the subsidiaries. On August 10, 2015, the CVM requested clarification from Gerdau and the Company, referring to the statements of a shareholder concerning the transaction for the acquisition of minority stakes in subsidiaries by Gerdau. The shareholder alleged a potential conflict of interest in the transaction. In response, the Company has identified to the CVM that the referenced acquisition had exclusively commercial merits, was properly and unanimously approved by the Board of Directors of Gerdau and that the terms and conditions for the acquisition took into account a long term market perspective.

On March 30, 2018, the Company concluded the sale of its wire-rod production unit located in Beaumont, Texas and of the processing units, Beaumont Wire Products and Carrollton Wire Products, to Optimus Steel LLC for US\$ 99.5 million (equivalent to R\$ 330.7 million). The mill has a melt shop with annual steel production capacity of approximately 700,000 short tons and has the capacity to produce wire-rods and rebar.

On June 29, 2018, the Company concluded the sale of 100% of the shares of Aza Participações SpA and its subsidiaries, Gerdau AZA SA, Aceros Cox SA, Armacero - Matco SA and Salomon Sack S.A. through Gerdau Chile Inversiones Limitada, an indirect subsidiary of Gerdau S.A., to a group of Chilean investors formed by Ingeniería e Inversiones Limitada, Inversiones Reyosan SpA, Los Andes S.A. de Inversiones and Matco Cables SpA. This sale included three production plants with an annual installed capacity of 520,000 tonnes of recycled long steel and its distribution network in Chile. The transaction value corresponds to US\$ 154.1 million (equivalent to R\$ 594.2 million on the date of the conclusion of the sale).

On July 31, 2018, the Company concluded the sale of its two hydropower plants in Goiás for R\$ 835 million to Kinross Brasil Mineração, a wholly-owned subsidiary of the mining company Kinross Gold Corporation. The plants Caçu and Barra dos Coqueiros, inaugurated in 2010, have aggregate installed capacity of 155 MW.

On September 14, 2018, the Company announced to the market that the Brazilian antitrust authority known as CADE approved, without restrictions, the creation of a new company to manage and promote a loyalty program for Brazil's retail construction industry, called Juntos Somos +, jointly with Votorantim Cimentos and Grupo Tigre. The initiative functions like a benefits program for stores and respective vendors, with the aim of improving service to end customers and to construction industry professionals. Votorantim Cimentos, founder of the program in 2015, will have a 45% stake, while Gerdau and Grupo Tigre each have 27.5%.

On October 31, 2018, the Company concluded the sale of its interest in Gerdau Hungria KFT Y CIA Sociedad Regular Colectiva, a subsidiary of the Company located in Spain and the holder of 98.89% of the shares of Gerdau Steel India Ltd., to Blue Coral Investment Holdings Pte. Ltd and Mountainpeak Investment Holdings Ltd. This sale comprises 100% of its operations and assets in India, including the special steels industrial unit located in Tadipatri, with annual installed capacity of 250 thousand tonnes of crude steel and 300 thousand tonnes of rolled steel. The transaction value corresponds to US\$ 120 million (equivalent to R\$ 490.2 million on the signing date of the agreement).

On November 5, 2018, the Company concluded the sale to Commercial Metals Company (CMC) of four U.S. rebar mills and rebar fabrication locations. The sale includes the steel mills in Jacksonville, FL, Knoxville, TN, Rancho Cucamonga, CA, and Sayreville, NJ, as well as all of Gerdau's U.S. rebar fabrication facilities. The transaction value is US\$ 600 million (equivalent to R\$ 2,222.9 million) as well as working capital adjustments.

## **B. BUSINESS OVERVIEW**

### **Steel Industry**

The world steel industry is composed of hundreds of steel producing facilities and is divided into two major categories based on the production method utilized: integrated steel mills and non-integrated steel mills, sometimes referred to as mini-mills. Integrated steel mills normally produce steel from iron oxide, which is extracted from iron ore melted in blast furnaces, and refine the iron into steel, mainly through the use of basic oxygen furnaces or, more rarely, electric arc furnaces. Non-integrated steel mills produce steel by melting in electric arc furnaces scrap steel, which occasionally is complemented by other metals such as direct-reduced iron or hot-compressed iron. According to World Steel, in 2017 (the most recent year for which information is available), 28.0% of the total crude steel production in the world was through mini-mill process and the remaining 72.0% was through the integrated process.



Table of Contents**Crude Steel Production by Process in 2017\***

<b>Blast Furnace</b>	<b>Crude Steel Production (in million tonnes)</b>	<b>Production by Process (%)</b>	
		<b>Mini-mill</b>	<b>Integrated</b>
<b>World</b>	<b>1,688</b>	<b>28.0</b>	<b>71.5</b>
China	832	9.0	91.0
Japan	105	24.2	75.8
India	101	56.8	43.2
U.S.A.	82	68.4	31.6
Russia	71	30.8	66.9
S. Korea	71	32.9	67.1
Germany	44	28.8	71.2
Turkey	37	69.2	30.8
Brazil	34	21.0	77.6

---

Source: World Steel/World Steel In Figures

\*Most recent year for which information available

Over the past 10 years, according to World Steel, total annual crude steel production has grown from 1,343 million tonnes in 2008 to a forecast of 1,789 million tonnes in 2018, for an average annual increase of 33.17%.

The main factor responsible for the increase in the demand for steel products has been China. Since 1993, China has become the world's largest steel market and currently consumes as much as the United States and Europe combined.

Over the past year, total annual crude steel production increased by 4.50% from 1,712 million tonnes in 2017 to 1,789 million tonnes in 2018.

**Crude Steel Production (in million tonnes)**

Source: World Steel/Annually Statistics

China is rebalancing its economy to move more towards a consumer-driven economy. GDP growth was aligned with the government expectation and despite the injection of credit into the construction and infrastructure sectors, the country showed a reduction in steel consumption for the third year in a row. In 2016, China's crude steel production was 928.2 million tonnes, an increase of 12% compared to 2015. In 2017, China's share of world steel production was 52% of world total crude steel.

Table of Contents

**Crude Steel Production by Country in 2018 - forecast (million tonnes)**

Source: World Steel/Annually Statistics

Asia produced 1,257.9 million tonnes of crude steel in 2018, an increase of 5.5% compared to 2017, and its share of world steel production amounted to 42.3%. The EU-28 produced 168.0 million tonnes of crude steel in 2018, a reduction of 0.3% compared to 2017, representing 9.4% of the global total. In 2018, crude steel production in North America increased 4.1% when compared to 2017, a total of 120.5 million tonnes. The CIS (Commonwealth of Independent States) showed a stable crude steel production with a total of 101.0 million tonnes in 2018.

***The Brazilian Steel Industry***

According World Steel Association, in 2018 Brazil was the world's 9th largest producer of crude steel, with a production of 34.7 million tonnes, a 2.0% share of the world market and 78.4% of the total steel production in South America during the year.

Total sales of Brazilian steel products were 34.7 million tonnes in 2018, 34.3 million tonnes in 2017 and 31.3 million tonnes in 2016, exceeding domestic demand of 20.6 million tonnes in 2018, 19.2 million tonnes in 2017 and 18.4 million tonnes in 2016. In 2018, total steel sales in the

domestic market increased 8.2% from 2017, going from 16.9 million tonnes to 18.3 million tonnes.

In 2018, the total of Brazilian steel products sales was 32.4 million tonnes. The breakdown of total sales was 69.6% or 22.5 million tonnes of flat steel products, formed by domestic sales of 11.2 million tonnes and exports of 11.4 million tonnes. The remaining 30.4% or 9.8 million tonnes represented sales of long steel products, which consisted of domestic sales of 7.1 million tonnes and exports of 2.7 million tonnes.

Table of Contents

**Breakdown of Total Sales of Brazilian Steel Products (million tonnes)**

Source: Instituto Aço Brasil

*Domestic demand* Historically, the Brazilian steel industry has been affected by significant variations in domestic steel demand. Although domestic consumption varies in accordance with Gross Domestic Product (GDP), variations in steel consumption tend to be more accentuated than changes in the level of economic growth. In 2018, the Brazilian GDP increased by 1.0% and steel consumption increased by 7.3%.

*Exports and imports* Over the past 20 years, the Brazilian steel industry has been characterized by a structural need for exports. The Brazilian steel market has undergone periods of excess capacity, cyclical demand and intense competition in recent years. Demand for finished steel products has lagged total supply (total production plus imports).

In 2018, Brazilian steel exports totaled 14.1 million tonnes, representing 43.5% of total sales (domestic sales plus exports). Brazil has performed an important role in the world export market, principally as an exporter of semi-finished products (slabs, blooms and billets) for industrial use or for re-rolling into finished products. Brazilian exports of semi-finished products totaled 9.6 million tonnes in 2018, 9.4 million tonnes in 2017 and 7.8 million tonnes in 2016, representing 67.8%, 64.0% and 58.1% of Brazil's total exports of steel products, respectively.

***Brazilian Production and Apparent Demand for Steel Products (million tonnes)***

Source: Instituto Aço Brasil

Brazil used to be a small importer of steel products. Considering the reduction in the international steel prices during 2010, the appreciation of the Brazilian *real* against the U.S. dollar and the decrease in demand for steel products in developed countries, the Brazilian levels of imports increased from 2.3 million tonnes in 2009 to 5.9 million tonnes in 2010 (excluding the imports made by the steel mills to avoid double counting), representing 22.0% of apparent domestic consumption. In 2015, imports were 3.2 million tonnes, decreased to 1.9 million tonnes in 2016 and increased to 2.3 million tonnes in 2017. In 2018, imports represented 12.0% of apparent domestic consumption, an increase compared to 2017, which was mainly due to higher prices in the domestic market compared to the international market.

Table of Contents

*Raw materials* One of Brazil's major competitive advantages is the low cost of its raw materials. Brazil has an abundance of high quality iron ore. Various integrated producers are located in the state of Minas Gerais, where some of the world's biggest iron ore mines are located. The cost of iron ore from small miners in Brazil is very competitive if compared to the cost of iron ore in China, for example.

In Brazil, most of the scrap metal consumed by steel mills comes from Brazil's southeast and south regions. Mill suppliers deliver scrap metal obtained from obsolete products and industrial scrap directly to the steel mills.

Brazil is a major producer of pig iron. Most of the pig iron used in the steel industry comes from the state of Minas Gerais and the Carajás region, where it is produced by various small and midsized producers. The price of pig iron follows domestic and international markets, with charcoal and iron ore the main components of its cost formation.

*North American Steel Industry*

The global steel industry is highly cyclical and competitive due to the large number of steel producers, the dependence upon cyclical end markets and the high volatility of raw material and energy prices. The North American steel industry is currently facing a variety of challenges, including volatile pricing, high fixed costs and low priced imports. The future success of North American steel producers is dependent upon numerous factors, including general economic conditions, levels and prices of steel imports and the strength of the U.S. dollar.

*Crude Steel Production by North American Countries (million tonnes)*

Source: World Steel/Monthly Statistics

Beginning in mid-2000 and continuing through 2002, the North American steel industry experienced a severe downward cycle due to excess global production capacity, high import levels at low prices, including prices that were below the combined costs of production and shipping, and weak general economic conditions. These forces resulted in lower domestic steel prices and significant domestic capacity closures. Prices for many steel products reached 10-year lows in late 2001. As a result of these conditions, over 20 U.S. steel companies have sought protection under Chapter 11 of the United States Bankruptcy Code since the beginning of 2000.

In response to these conditions, in March 2002, Former President George W. Bush imposed a series of tariffs and quotas on certain imported steel products under Section 201 of the Trade Act of 1974. These measures were intended to give the domestic steel industry an opportunity to strengthen its competitive position through restructuring and consolidation. On November 10, 2003, the World Trade Organization ( WTO ) Appellate Body issued a ruling that upheld an initial WTO panel ruling that declared the Section 201 tariffs on steel imports to be in violation of WTO rules concerning safeguard measures. On December 4, 2003, Former President Bush signed a proclamation terminating the steel safeguard tariffs, and announced that the tariffs had achieved their purpose and changed economic circumstances indicated it was time to terminate them. International trade negotiations, such as the ongoing Organization for Economic Cooperation and Development steel subsidy agreement negotiations and the WTO Doha Round negotiations, may affect future international trade rules with respect to trade in steel products. More recently, in a White House signing ceremony on March 8, 2018, President Donald Trump announced he was imposing import tariffs of 25% on steel and 10% on aluminum. After invoking a rarely-used Cold War-era law last year, Commerce Secretary Wilbur Ross concluded imports were a threat, and he recommended the imposition of these new restrictions covering an estimated \$46.1 billion of imports, or about 2% of total U.S. goods imports in 2017.



Table of Contents

The North American steel industry has experienced a significant amount of consolidation in the last decade. Bankrupt steel companies, once overburdened with underfunded pension, healthcare and other legacy costs, were relieved of obligations and purchased by other steel producers. This consolidation, including the purchases of the assets of LTV Corporation, Bethlehem Steel Corporation, Trico Steel Co. LLC and National Steel Corporation, has created a lower operating cost structure for the resulting entities and a less fragmented industry. In the bar sector in 2002, the combination of Gerdau North America and Co-Steel in October 2002 and Nucor Corporation's acquisition of Birmingham Steel Corporation in February 2002 significantly consolidated the market. Gerdau's acquisition of the North Star Steel assets from Cargill in November 2004, Sheffield Steel Corporation in 2006 and Chaparral Steel Company in September 2007, have further contributed to this consolidation trend. Since the beginning of 2007, Tata Iron and Steel Co. Ltd. acquired Corus Group PLC, SSAB Svenskt Staal AB acquired Ipsco Inc., Essar Global Ltd. acquired Algoma Steel Inc., United States Steel Corporation acquired Stelco Inc., and Arcelormittal Inc. acquired Bayou Steel Corporation.

The steel industry demonstrated strong performance through the middle of 2006, resulting from the increased global demand for steel related products and a continuing consolidation trend among steel producers. Beginning in the fall of 2008, the steel industry began feeling the negative effects of the severe economic downturn brought on by the credit crisis. The economic downturn continued through 2009 and has resulted in a significant reduction in the production and shipment of steel products in North America, as well as reduced exports of steel products from the United States to other parts of the world. Since the beginning of 2010, the economy in North America has been showing signs of upturn, contributing to a gradual recovery in the steel industry, with an important improvement in the non-residential and automotive sector. The Company believes that this trend should continue throughout 2019.

**Company Profile**

Gerdau S.A. is mainly dedicated to the production and commercialization of steel products in general, through its mills located in Argentina, Brazil, Canada, Colombia, the United States, Mexico, Peru, the Dominican Republic, Uruguay and Venezuela.

Gerdau is the leading manufacturer of long steel in North and South America. Gerdau believes it is one of the major global suppliers of special steel for the automotive industry. In Brazil, Gerdau also produces flat steel and iron ore, activities that are expanding Gerdau's product mix and the competitiveness of its operations. In addition, Gerdau believes it is one of Latin America's biggest recycler and, worldwide, transforms millions of tonnes of scrap metal into steel every year, reinforcing its commitment to sustainable development in the regions where it operates. Gerdau's shares are listed on the New York, São Paulo and Madrid stock exchanges.

Gerdau holds significant market share in the steel industries of almost all countries where it operates and was classified by World Steel Association as the world's 18th largest steel producer based on its consolidated crude steel production in 2017, the most recent year for which information is available.

Gerdau operates steel mills that produce steel by direct iron-ore reduction (DRI) in blast furnaces and in electric arc furnaces (EAF). In Brazil it operates three integrated steel mills, including its largest mill, Ouro Branco, located in the state of Minas Gerais. Gerdau currently has a total of 39 steel producing facilities globally.

As of December 31, 2018, Gerdau's total consolidated installed annual capacity, excluding investments in joint ventures and associates companies, was approximately 20.3 million tonnes of crude steel and 16.8 million tonnes of rolled steel products. The Company had total consolidated assets of R\$ 51.3 billion, shareholders' equity (including non-controlling interests) of R\$ 25.9 billion, consolidated net sales of R\$ 46.2 billion and a total consolidated net income (including non-controlling interests) of R\$ 2,326.4 million for the period ended on December 31,

2018.

Gerdau offers a wide array of steel products, which can be manufactured according to the customer's specifications. The product mix includes crude steel (slabs, blooms and billets) sold to rolling mills, finished products for the construction industry such as rebars, wire rods, structural, hot rolled coils and heavy plates; finished products for consumer goods industry such as commercial bars, light shapes and mesh wire and products for farming and agriculture such as poles, smooth wire and barbed wire. Gerdau also produces special steel products, normally with a certain degree of customization, utilizing advanced technology, for the manufacture of tools and machinery, chains, locks and springs, mainly for the automotive and mechanical industries.

A significant portion of Gerdau's steel production assets are located outside Brazil, particularly in the United States and Canada, as well as in Latin America. Gerdau currently operates 14 steel production units in the United States, Canada and Mexico, and believes that it is one of the market leaders in North America in terms of production of certain long steel products, such as rebars, wire rods, commercial bars and beams.

Gerdau's operating strategy is based on the acquisition and/or construction of steel mills located close to its customers and sources of the raw materials required for steel production, such as scrap metal, pig iron and iron ore. For this reason, most of its

Table of Contents

production has historically been geared toward supplying the local markets in which it has production operations. However, Gerdau also exports a substantial portion of its production to other countries.

Through its subsidiaries and affiliates, Gerdau also engages in other activities related to the production and sale of steel products, including the following: reforestation; electric power generation projects; iron ore and pig iron production; as well as fab shops and downstream operations.

**Operations**

The Company sells its products to a diversified list of customers for use in the construction, manufacturing and agricultural industries. Shipments by the Company's Brazilian operations include both domestic and export sales. Most of the shipments by the Company's business segments in North and Latin America (except Brazil) are aimed at their respective local markets.

Table of Contents

The Company manages its Business Segments as follows:

- **Brazil Business Segment** - includes operations in Brazil (excluding Special Steel) and iron ore operation in Brazil;
- **North America Business Segment** - includes all operations in North America (Canada, United States and Mexico), except special steels, in addition to associate and joint venture, both of which are located in Mexico;
- **South America Business Segment** - includes all operations in South America (Argentina, Peru, Uruguay and Venezuela), except the operations in Brazil, in addition to the joint ventures in the Dominican Republic and Colômbia; and
- **Special Steel Business Segment** - includes the special steel operations in Brazil and the United States.

The following tables present the Company's consolidated shipments in tonnage and net sales by Business Segment for the periods indicated:

Shipments**Gerdau S.A. Consolidated****Shipments by Business****Segments (1)****(1,000 tonnes)**

	<b>Year ended December 31,</b>		
	<b>2018</b>	<b>2017</b>	<b>2016</b>
<b>TOTAL</b>	<b>14,560</b>	<b>14,938</b>	<b>15,558</b>
Brazil	5,535	5,608	6,067
North America	6,085	6,313	5,965
South America	1,307	1,723	2,088
Special Steel	2,111	1,977	2,102
Eliminations and Adjustments	(479)	(683)	(665)

(1) The information does not include data from associate and joint ventures.

Net Sales

Gerdau S.A. Consolidated Net Sales by Business Segments (1) (R\$ million)	Year ended December 31,		
	2018	2017	2016
<b>TOTAL</b>	<b>46,159</b>	<b>36,918</b>	<b>37,652</b>
Brazil	15,745	12,563	11,635
North America	19,927	15,433	15,431
South America	3,801	4,026	4,776
Special Steel	8,159	6,229	6,885
Eliminations and Adjustments	(1,473)	(1,333)	(1,075)

---

(1) The information does not include data from associate and joint ventures.

**Production**

Gerdau S.A. Consolidated annual production (1) (million tonnes)	Year ended December 31,		
	2018	2017	2016
Crude Steel Production	<b>15,344</b>	<b>16,120</b>	<b>15,677</b>
Rolled Steel Production	<b>13,749</b>	<b>14,047</b>	<b>13,616</b>
Iron Ore Production	<b>7,317</b>	<b>7,265</b>	<b>8,647</b>

---

(1) The information does not include data from associate and joint ventures.

Table of Contents

***Brazil Business Segment***

*Steel information*

The Brazil Business Segment minimizes delays by delivering its products directly to customers through outsourced companies under Gerdaus supervision. Sales trends in both the domestic and export markets are forecasted monthly. The Brazil Business Segment uses a proprietary information system to stay up-to-date on market developments so that it can respond swiftly to fluctuations in demand. Gerdau considers its flexibility in shifting between markets (Brazilian and export markets) and its ability to monitor and optimize inventory levels for most of its products in accordance with changing demand as key factors to its success.

In the Brazil Business Segment, steel shipments decreased slightly in 2018 compared to 2017, due to the decline in exports. On the other hand, shipments in the domestic market grew, driven by demand from the retail construction and manufacturing industries.

In 2018, around 15% of the production sold in Brazil was distributed through Gerdaus distribution channel, with stores throughout Brazil and downstream facilities serving a significant number of customers. Another important distribution channel is the independent distributors network, formed by points of sales to which Gerdau sells its products, giving it comprehensive national coverage. Sales through its distribution network and to final industrial and construction consumers are made by Gerdau employees and authorized sales representatives working on commission. This Business Segment has annual crude steel installed capacity of 8.2 million tonnes and 6.7 million tonnes of finished steel products.

*Iron ore information*

Gerdaus mineral assets were incorporated to its business through the acquisition of lands and mining rights of Grupo Votorantim, in 2004, encompassing the Miguel Burnier, Várzea do Lopes, and Gongo Soco compounds, located in the iron producing region in the state of Minas Gerais, Brazil. From 2004 to 2010, several geological surveys (drilling and superficial geological mapping) were conducted in order to obtain further information on the acquired resources.

***North America Business Segment***

The North America Business Segment has annual production capacity of 8.1 million tonnes of crude steel and 5.9 million tonnes of finished steel products. It has a vertically integrated network of 10 steel units, scrap recycling facilities and downstream operations. North America Business Segment's products are generally sold to steel service centers, steel fabricators or directly to original equipment manufacturers for use in a variety of industries, including construction, automotive, mining, cellular and electrical transmission, metal construction fabrication and equipment fabrication. Most of the raw material feed stock for the mini-mill operations is recycled steel scrap.

The mills of this business operation manufacture and commercialize a wide range of steel products, including steel reinforcement bars (rebar), merchant bars, structural shapes, beams and special sections. Some of these products are used by the downstream units to make products with a

higher value-add, which consists of railroad spikes, super light beam processing, elevator guide rails and grinding balls.

Sales of finished products to U.S. and Canadian customers are centrally managed by sales office in Tampa, Florida. There is also a sales office in Selkirk, Manitoba for managing sales of special sections and one in Midlothian, Texas for managing sales of structural and merchant bar products. Metallurgical service representatives at the mills provide technical support to the sales group. Sales of the super light beam products are managed by sales representatives located at their respective facilities. Elevator guide rails are generally sold through a bidding process in which employees at Gerdau's facilities work closely with customers to tailor product requirements, shipping schedules and prices.

The North America Business Segment 2018 shipments were on the level of 6.1 million tonnes. The North America Segment accounted for 43.2% of overall Gerdau sales volumes.

Table of Contents

***South America Business Segment***

The South America Business Segment comprises of five steel facilities, retail facilities, fab shops (including joint ventures and associate companies) and scrap processing facilities. The entire operation is focused on the respective domestic markets of each country, operating mini-mills facilities with annual manufacturing capacity of 1.7 million tonnes of crude steel and 1.0 million tonnes of finished steel products. The South American Business Segment accounted for 9.0% of overall Gerdau sales volumes, representing 1.3 million tonnes in 2018, a reduction of 24.1% when compared to 2017. The countries in the South America Business Segment are Argentina, Peru, Venezuela and Uruguay. Gerdau also operates in the markets of Colombia and Dominican Republic through joint ventures.

***Special Steel Business Segment***

The Special Steel Business Segment consists of the operations in Brazil (Charqueadas, Pindamonhangaba and Mogi das Cruzes) and the United States (Fort Smith, Jackson and Monroe). The segment produces special steels for engineering steel, tool steel and forged bars. To meet the needs of more demanding markets, this segment is constantly developing new products, such as high-resistance steels, clean steel, high temper steel, good machinability steel, among others.

In Brazil, Gerdau special steel units are located in the states of Rio Grande do Sul (Charqueadas) and São Paulo (Pindamonhangaba and Mogi das Cruzes). The special steel units in Brazil have aggregate annual production capacity of 1.4 million tonnes of crude steel and 1.8 million tonnes of rolled steel. The operation has over 300 clients that are located primarily in Brazil. However, it also exports products, primarily to South America, North America and Europe.

In North America, the Special Steel Segment is present in the United States, with three units located in Jackson (Michigan), Monroe (Michigan) and Fort Smith (Arkansas). The company also operates a downstream unit in Huntington (Indiana). The segment has annual installed production capacity of 1.4 million tonnes of crude steel and 1.5 million tonnes of rolled steel products, with a portfolio of more than 200 clients located mainly in the United States, Canada and Mexico.

The plants of this business segment have commercial and operational synergies.

***Exports***

In 2018, two factors marked the dynamics of the international steel market: the continued reduction in Chinese supply to the international market due to its domestic demand, despite the 6% growth in annual production in 2017 and 2018 (record 928 million tonnes), and the protectionist measures in major consumer markets, whose effects on prices became clearer in the last quarter of the year.



## Edgar Filing: GERDAU S.A. - Form 20-F

In the first half of the year, prices remained healthy, as expected, with no downward pressure given China's weak presence in the market. In the second half of the year, the intensification of world trade protectionism and the political-economic discussions between China and the United States ended up pressuring prices and sparking pessimism in the market. Chinese exports of finished goods in 2018 decreased 8.1% to 69 million tonnes, according to specialized publications. In 2017, exports of finished products amounted to 75 million tonnes.

In addition to the continuous reduction in China's presence in the international market, 2018 was marked by the intensification of protectionist trade measures. Examples include the consolidation of Section 232 in the United States, the temporary protectionist measures in the European Union and, on a broader spectrum, the trade war between China and the United States, whose effects were amplified in the last quarter of 2018.

In 2018, Gerdau's Brazilian exports continued to focus on South and Central Americas, which accounted for 78% of exports, leveraged by supply from the group's companies and joint ventures.

The following table presents Gerdau's Brazilian exports by destination for select periods:

Table of Contents**Consolidated Exports of Gerdau****Brazil Business Segment, by**

Destination (%)	Fiscal Year ended December 31,				
	2018	2017	2016	2015	2014
<b>Total including shipments to subsidiaries (1,000 tonnes)</b>	<b>1,585</b>	<b>1,991</b>	<b>2,360</b>	<b>2,173</b>	<b>1,043</b>
Africa		6%	3%	14%	
Central America	31%	21%	27%	11%	4%
North America	7%	11%	22%	22%	46%
South America	47%	42%	31%	26%	37%
Asia	6%	6%	5%	6%	6%
Europe	9%	11%	12%	15%	6%
Middle East		2%	1%	7%	

Gerdau remains focused on serving strategic markets that contribute results to its operation, analyzing the impacts and opportunities arising from the volatile international political-economic scenario and consolidating the presence of its entire product portfolio in these markets in 2019.

**Products**

The Company supplies its customers with a wide range of products, including steel products and iron ore:

***Semi-finished products (Billets, Blooms and Slabs)***

The semi-finished products (billets, blooms and slabs) have relatively low added value compared to other steel products. Billets are bars from square sections of long steel that serve as inputs for the production of wire rod, rebars and merchant bars. They represent an important part of the products from the Ouro Branco mill. Blooms are used to manufacture products such as springs, forged parts, heavy structural shapes and seamless tubes. Slabs are used in the steel industry for the rolling of a broad range of flat rolled products, and mainly used to produce hot and cold rolled coils, heavy slabs, profiles and heavy plates.

The semi-finished products are produced using continuous casting and, in the case of blooms and billets there is subsequent rolling process.

***Common Long Rolled Products***

Common long rolled products represent a major portion of the Company's production. The Company's main long rolled products include rebars, wire rods, merchant bars, light shapes and profiles, which are used mainly by the construction and manufacturing industries.

***Drawn Products***

Drawn products include barbed and barbless fence wire, galvanized wire, fences, concrete reinforcing wire mesh, nails and clamps. These products are not exported and are usually sold to the manufacturing, construction and agricultural industries.

***Special Steel Products***

Special steel requires advanced manufacturing processes because they have specific physical and metallurgical characteristics for applications with high mechanical demands. This steel is a key product for the automotive industry, as it is used in auto parts, light and heavy vehicles and agricultural machinery. Special steels also serve other relevant markets, such as oil and gas, wind energy, machinery and equipment, mining and rail, among others.

***Flat Products***

The Ouro Branco unit produces cast slabs, which are rolled into flat products, such as hot-rolled steel coils and heavy plates. Gerdau also produces hot-rolled coils, which are sold in the domestic market, and heavy plates, which are sold in the domestic and export markets. The Company, through its distribution channel and direct sales, distributes these hot-rolled coils and heavy plates and resells flat steel products manufactured by other Brazilian steel products, which adds more value through additional processing at flat steel service centers.

Table of Contents**Iron Ore**

Gerdau operates three mines producing iron ore, all located in the Brazilian state of Minas Gerais (Várzea do Lopes, Miguel Burnier and Gongo Soco). The mines produce the following: sinter feed (featuring low content of contaminants and good metallurgical properties, enabling its use as a base material); pellet feed/concentrated (superior quality enabling its use as a chemical balancer in the synthesizing process, while being also adequate for pelletizing, blast furnace quality - low loss by calcination PPC); hematite fines (small scale production, used as input in Gerdau's furnaces); and granulated (high quality, used chiefly for own consumption at the Ouro Branco Mill).

The following table presents the main products and the contributions to net revenue and net income by Business Segment for the periods shown (consolidated):

Products	Brazil(1) Rebars, merchant bars, beams, drawn products, billets, blooms, slabs, wire rod, structural shapes, hot rolled coil, heavy plate and iron ore.			North America Rebars, merchant bars, wire rod, light and heavy structural shapes.			South America Rebar, merchant bars and drawn products.			Special Steel Stainless steel, special profiles and wire rod.			Eliminations and Adjustments		
	2018	2017	2016	2018	2017	2016	2018	2017	2016	2018	2017	2016	2018	2017	2016
Net Sales (R\$ million)	15,745.2	12,562.7	11,634.9	19,927.4	15,433.4	15,430.8	3,801.2	4,025.7	4,775.6	8,158.6	6,228.5	6,884.7	(1,472.9)	(1,332.8)	(1,074.2)
% of Consolidated Net Sales	34.1%	34.0%	30.9%	43.2%	41.8%	41.0%	8.2%	10.9%	12.7%	17.7%	16.9%	18.3%	-3.2%	-3.6%	-2.1%
Net (Loss) Income (R\$ million)	1,247.6	302.3	(36.7)	834.0	(956.3)	(2,591.9)	269.8	154.4	134.2	630.2	475.4	162.5	(655.2)	(314.5)	(554.2)
% of Consolidated Net (Loss) Income	53.6%	-89.3%	1.3%	35.8%	282.4%	89.8%	11.6%	-45.6%	-4.7%	27.1%	-140.4%	-5.6%	-28.2%	92.9%	19.1%

**Production Process**

In Brazil, the Company has a decentralized production process, using both mini-mills and integrated facilities. In general, the Company has used the mini-mill model to produce steel products outside of Brazil.

**Semi-integrated Process (Mini-mills)**

The Company operates 27 mini-mills worldwide. Mini-mills are equipped primarily with electric arc furnaces that can melt steel scrap and produce steel product at the required specifications requested by customers. After loading the furnace with a preset mixture of raw material (i.e., steel scrap, pig iron and sponge iron), electric power is applied in accordance with a computer controlled melting profile. The Company's mini-mill production process generally consists of the following steps: obtaining raw material, melting, casting, rolling and drawing. The basic

difference between this process and the integrated mill production process described below is in the first processing phase, i.e., the steelmaking process. Mini-mills are smaller plants than integrated facilities and the Company believes they provide certain advantages over integrated mills, including:

- lower capital costs,
- lower operational risks due to the low concentration of capital and installed capacity in a single production plant,
- proximity of production facilities to raw-material sources,
- proximity to local markets and easier adjustment of production levels, and
- more effective managerial structure due to the relative simplicity of the production process.

#### *Integrated Process*

Gerdau operates four integrated mills, three of which are located in Brazil and one in Peru. The Ouro Branco Mill is the largest integrated facility operated by the Company. It produces steel from pig iron from the blast furnace and has some of the advantages of a mini-mill, since it is located near key suppliers as well as the ports from which Gerdau exports most of its production.

Gerdau's steel manufacturing process at integrated units consists of four basic stages: preparation of raw materials, production of pig iron, production of steel and production of semi-finished steel products (billets, blooms and slabs). In the primary stage of steelmaking, sinter (a mixture of iron ore and limestone), coke and other raw materials are consumed in the blast furnace to produce pig iron. Coke acts as both fuel and a reducing agent in this process. Gerdau's blast furnaces have aggregate installed capacity of approximately 5.9 million tonnes of molten pig iron per year.

The pig iron produced is transported by rail to the desulphurization unit to reduce the steel's sulfur content. After the desulphurization process, the low-sulfur pig iron is transformed into steel using LD-type oxygen converters. The LD steelmaking process utilizes molten pig iron and scrap to produce steel by blowing oxygen over the metallic charge inside the converters. The process does

Table of Contents

not require any external source of energy, which is fully supplied by the chemical reactions occurring between oxygen and the impurities in the molten pig iron. The LD steelmaking process is currently the most widely used in the world. Some mills further refine the LD converters' output with ladle furnaces and outgassing process.

Liquid steel is then sent to the continuous casting equipment, where it is solidified into billets, blooms or slabs. These products may be sold to clients directly, be transferred to other Gerdau Units for transformation or be used in the production of finished rolled steel products at the integrated units. Gerdau's integrated units in Brazil have rolling mills for rebars, bars and profiles, wire-rod, structural shapes, hot-rolled coils and heavy plates.

**Logistics**

Gerdau sells its products through independent distributors, direct sales from the mills and its retail network.

Logistics costs are an important component of most steel businesses and represent a significant factor in maintaining competitive prices in the domestic and export markets. The Gerdau mills are strategically located in various different geographic regions. The Company believes that the proximity of its mills to raw material sources and important consumer markets gives it a competitive advantage in serving customers and obtaining raw materials at competitive costs. This represents an important competitive advantage in inbound and outbound logistics.

To adequate and reduce logistic costs, Gerdau uses specific solutions, directed to different types of transportation modes (road, rail, sea and cabotage), terminals, technology and equipment. Gerdau continuously seeks to improve its performance to receive raw materials, and to deliver products to its customers or ports of destination. Accordingly, Gerdau develops and maintain long-term relationships with logistic suppliers specialized in delivering raw materials and steel products.

In 1996 Gerdau acquired an interest in MRS Logística, one of the most important rail companies in Brazil, which operates connecting the states of São Paulo, Rio de Janeiro and Minas Gerais, which are Brazil's main economic centers, and also reaches the main ports of the country in this region. This interest assures the availability of this mode to transport raw materials (scrap and pig iron) as well as final products.

Gerdau uses a variety of ports to deliver products from the entire Brazilian coastline. The majority of exports are shipped from the Praia Mole Private Steel Terminal in Vitoria, Espírito Santo.

Overseas, Gerdau owns a private port terminal in Chimbote (Peru), where the Company has a steel mill, used to deliver inputs, raw material and products for the operation.

**Competition**

The steel market is divided into manufacturers of long steel products, flat steel products and special steel.

The Company operates in the long steel market, which is the most important market for Gerdau, by supplying to the following customer segments: (i) construction, to which it supplies rebars, merchant bars, nails and meshes; (ii) manufacturing, to which it supplies products for machinery, agricultural equipment, tools and other industrial products; and (iii) other markets, to which it supplies wires and posts for agricultural installations and reforestation projects. In North America, the Company also supplies customers with special sections, including elevator guide rails and super light beams. The Company also provides its customers with higher value-added products at rebar and wire rod fabrication facilities.

The Company operates in the flat steel market through its Ouro Branco mill that produces slabs, which are used to roll flat products such as hot and cold rolled steel coils and heavy plates. Gerdau also produces hot-rolled coils, which are sold in the domestic and export markets. The Company distributes these hot-rolled coils and also resells flat steel products manufactured by other Brazilian steel producers to which it adds further value through additional processing at its flat steel service centers.

Table of Contents

The Company produces special and stainless steel used in tools and machinery, chains, fasteners, railroad spikes, special coil steel, grader blades, smelter bars, light rails, super light I-beams, elevator guide rails and other products that are made on demand for the Company's customers at its special steel units in Brazil and United States.

***Competitive Position Brazil***

The Brazilian steel market is very competitive. In the year ended December 31, 2018, ArcelorMittal Brasil and the Company were the two largest Brazilian crude steel producers, according to the Brazilian Steel Institute (IABr - Instituto Aço Brasil).

World common long rolled steel demand is met principally by steel mini-mills and, to a much lesser extent, by integrated steel producers. In the Brazilian market, no single company competes against the Company across its entire product range. The Company has been facing some competition from long steel products imports, mainly coming from Turkey, with more extension from 2010. The Company believes that the diversification of its products, the solution developed by its fab shops units and the decentralization of its business provide a competitive edge over its major competitors.

In the domestic market, Gerdau is almost an exclusive supplier of blooms and billets to well-defined and loyal customers that have been purchasing from it regularly for over 15 years. Intense competition exists between the Company and ArcelorMittal in the slab and wire rod markets. With respect to the rebar market, competition in the Brazilian domestic market has increased in recent years due to two new entrants (Simec and Silat) and Companhia Siderurgica Nacional (CSN), which started rebar production.

***Competitive Position Outside Brazil***

Outside Brazil, notably in North America, the Company has increased its market share through acquisitions, and believes it is the second largest mini-mill steel producer in North America, with annual nominal capacity of 8.9 million tonnes of crude steel and 6.9 million tonnes of rolled products.

Gerdau's geographic market in North America encompasses primarily the United States and Canada. The Company faces substantial competition in the sale of each of its products from numerous competitors in its markets. Rebar, merchant bars and structural shapes are commodity steel products for which pricing is the primary competitive factor. Due to the high cost of freight relative to the value of steel products, competition from non-regional producers is somewhat limited. Proximity of product inventories to customers, combined with competitive freight costs and low-cost manufacturing processes, are key to maintaining margins on rebar and merchant bar products. Rebar deliveries are generally concentrated within a 350-mile radius of the mini-mills and merchant bar deliveries are generally concentrated within a 500-mile radius. Some products produced by the Selkirk, Midlothian, Jackson, Cartersville and Petersburg mini-mills are shipped greater distances, including overseas.

The Company's principal competitors include Commercial Metals Company (CMC), Nucor Corporation, Steel Dynamics Inc., and ArcelorMittal Inc.



In South America, each country has a specific competitive position that depends on conditions in their respective markets. Most compete domestically and face significant competition from imports. More than 70% of shipments from Gerdau's South American Operation originate from Chile, Peru and Colombia. In this market, the main barriers faced by Gerdau sales are freight and transportation costs and the availability of imports. The main products sold in the South American market are the constructions, mechanic, agriculture and mining markets.

Currently, the Company believes the special steel operations in United States are approximately 19.8% of the special steel market; in Brazil, Gerdau's special steel units are combined the biggest player in that market, with a stake of approximately 60.6%.

### **Business Cyclicity and Seasonality**

The steel industry is highly cyclical. Consequently, the Company is exposed to fluctuations in the demand for steel goods that in turn cause fluctuations in the prices of these goods. Furthermore, since the production capacity of Brazil's steel industry exceeds its demand, it is dependent on export markets. The demand for steel goods and consequently the financial conditions and results of operations of steel producers, including the Company, are generally affected by fluctuations in the world economy and in particular the performance of the manufacturing, construction and automotive industries. Since 2003, the good performance of the world economy, especially in developing economies, such as China, has led to strong demand for steel goods, which contributed to historically high prices for Gerdau's steel goods. However, with the financial crisis that emerged in mid-2008, these prices have become unsupportable, especially given the expansion in world installed production capacity and the recent softening of demand. In

Table of Contents

the second quarter of 2008 and especially in early 2009, the United States and other European economies showed strong signs of a slowdown, which in turn affected many other countries. Over the past few years, developing economies have shown signs of a gradual recovery, while developed economies still present a challenging demand scenario. The Company believes that, in 2019, the steel industry will remain challenging and continue to present volatility, but the projection is that steel consumption will grow 1.4% compared to 2018.

In Gerdau's Brazilian and South American operations, shipments in the second and third quarters of the year tend to be stronger than in the first and fourth quarters, given the reduction in construction activity. In Gerdau's North American operations, demand is influenced by winter conditions, when consumption of electricity and other energy sources (i.e., natural gas) for heating increases and may be exacerbated by adverse weather conditions, contributing to increased costs and decreased construction activity, and in turn leading to lower shipments.

**Information on the Extent of the Company's Dependence**

The Company is not dependent on industrial, commercial or financial agreements (including agreements with clients and suppliers) or on new production processes that are material to its business or profitability. The Company also has a policy of diversifying its suppliers, which enables it to replace suppliers without affecting its operations in the event of failure to comply with the agreements, except in the case of its energy and natural gas supply.

In addition to the government regulations that apply to its industry in general, the Company is not subject to any specific regulation that materially or adversely affect its business.

In the case of a power outage, there are no alternative supply options available at most Gerdau mills due to the high volume and tension required for the operation of these plants. Some Gerdau small plants may choose, as an alternative, to use generators to compensate for the energy shortage. Moreover, the Ouro Branco mill generates 70% of its power needs internally using gases generated in the steel-making process.

In case of a lack of natural gas, the equipment could be adjusted to use diesel and LPG.

Gerdau's operations are spread across various geographic regions, which provides a risk diversification of any electricity or natural gas supply problems in Brazil.

The distribution of electric power and natural gas is a regulated monopoly in most countries, which leads the distributor to be the only supplier in each geographic region. In some countries, regulations allow for a choice of electrical power or natural gas commodity supplier, allowing Gerdau to diversify its supply agreement portfolio.

**Production Inputs**

*Price volatility*

Gerdau's production processes are based mainly on the mini-mill concept, with mills equipped with electric arc furnaces that can melt ferrous scrap and produce steel products at the required specifications. The main raw material used at these mills is ferrous scrap, which at some plants is blended with pig iron. The component proportions of this mixture may change in accordance with prices and availability in order to optimize raw material costs. Iron, iron ore (used in blast furnaces) and ferroalloys are also important.

Although international ferrous scrap prices suffer high influence by the U.S. domestic market (since the United States is the largest scrap exporter), the price of ferrous scrap in Brazil varies from region to region and is influenced by demand and transportation costs.

*Brazil and Special Steel Business Segment* The Company's Brazilian mills use scrap and pig iron purchased from local suppliers. Due to the nature of the raw materials used in its processes, Gerdau has contracts with scrap generators, especially scrap from industrial sources, for its mini-mills in Brazil, acquiring scrap as necessary for the mills' needs. Scrap for the Brazilian Operation is priced in Brazilian reais, thus input prices are not directly affected by currency fluctuations.

Due to its size, the Ouro Branco mill has developed over the last few years a strategy to diversify its raw materials, which are supplied through various types of contracts and from multiple sources, which include: (i) coking coals imported from Colombia, United States, Canada, Russia, Australia and Peru as well as petroleum coke purchased from Petrobrás and charcoal chaff also acquired from other domestic suppliers; (ii) ferroalloys, of which 78% are purchased

Table of Contents

in the domestic market; and (iii) iron ore, which is mainly produced from its own mines and partially supplied by mining companies, most of them strategically located close to the plant.

*North America Business Segment* The main input used by the Company's mills in North America is ferrous scrap, and has consistently obtained adequate supplies of raw materials, not depending on a smaller number of suppliers. Due to the fact that the United States are one of the largest scrap exporters in the world, the prices of this raw-material, in this country, may fluctuate according to supply and demand in the world's scrap market.

*South America Business Segment* The main input used by the Company's mills in South America is ferrous scrap. This operation is exposed to market fluctuations, varying its prices according to each local market.

***Ferrous Scrap***

There are two broad categories of ferrous scrap: (i) obsolete scrap, which is steel from various sources, ranging from cans to car bodies and white goods; and (ii) industrial scrap, which is composed of scrap from manufacturing processes, essentially steel bushings and flashings, steel turnings and even scrap generated by production processes at steel producers, such as Gerdau. In Brazil, the use of scrap in electric arc furnaces varies between scrap from obsolescence and industrial scrap. Special Steel mills mainly use industrial scrap.

In 2018, Gerdau consumed more than 12 million tonnes of scrap. Because ferrous scrap is one of its main raw materials in steel production, Gerdau is dedicated to improving its supply chain in various countries, aiming to develop and integrate micro and small suppliers into the Company's business. In Brazil, the main part of the scrap consumed by the Company comes from small scrap collectors who sell all their material to Gerdau, which provides a direct supply at more competitive costs for the Company. In North America, although smaller, the number is still significant, ensuring the competitiveness of the business in the region.

*Brazil and Special Steel Business Segments* The price of steel scrap in Brazil varies by region and reflects local supply, demand and transportation costs. The Southeast is the country's most industrialized region and generates the highest volume of scrap. Due to the high concentration of players in this region, competition is more intense.

Gerdau has six scrap shredders, including a mega-shredder at the Cosigua mill in Rio de Janeiro, with capacity to process scrap in volumes superior to 200 carcasses of vehicles per hour.

*North America Business Segment* The main input used by the Company's mills in North America is ferrous scrap, and it has consistently obtained adequate supplies of raw materials, not depending on a smaller number of suppliers. Due to the fact that the United States are one of the largest scrap exporters in the world, the prices of this raw-material, in this country, may fluctuate according to supply and demand in the world's scrap market.

In North America, all production units are semi-integrated mills or mini-mills, in which results of operations are closely related to the cost of ferrous scrap and its substitutes, which are the main input of mini-mills. Ferrous scrap prices are relatively higher during the winter months in the north hemisphere due to the impact of climate on collection and supply. More than half of North America's products are currently produced in electric arc furnaces with the use of ferrous scrap. Prices of ferrous scrap are subject to market forces beyond the Company's control, including demand from the United States and international steel producers, freight costs and speculation.

*South America Business Segment* The price of scrap in South America varies widely from country to country in accordance with supply, demand and transportation cost.

***Pig Iron and Sponge Iron***

*Brazil Business Segment* Brazil is an exporter of pig iron. Most of Brazil's pig iron is produced in the state of Minas Gerais by a number of small producers. Pig iron is a drop-in substitute for scrap and in Brazil it is an important component of the metal mix used to make steel in the mills. The price of pig iron follows domestic and international demand, and its cost production is basically composed by reducers and minerals.

*North America Business Segment* The availability of scrap plays an important role for operations in North America. Sponge iron and pig iron are used in limited quantities only for the production of steels with particular characteristics.

Table of Contents

***Iron Ore***

Iron ore is the main input used to produce pig iron at Gerdau's blast furnace mills located in the state of Minas Gerais, southeastern Brazil. The pig iron is used in the melt shops together with scrap, to produce steel.

Iron ore is purchased in its natural form as lump ore, pellet feed or sinter feed, or agglomerated as pellets. The lump ore and pellets are loaded directly into the blast furnace, while the sinter feed and pellet feed need to be agglomerated in the sinter plant and then loaded into the blast furnace, to produce pig iron. The production of 1.0 tonne of pig iron requires about 1.6 tonnes of iron ore.

Iron ore consumption in Gerdau mills in Brazil amounted to 7.8 million tonnes in 2018, partially supplied by mining companies adjacent to the steel plants and partially supplied by Gerdau's mines.

***Other Inputs***

In addition to scrap, pig iron, sponge iron and iron ore, Gerdau's operations use other inputs to produce steel such as ferroalloys, electrodes, furnace refracting materials, oxygen, nitrogen and other industrial gases and limestone, albeit in smaller amounts. Additional inputs associated with the production of pig iron are thermal-reducer, which is used in blast furnace mills, and natural gas, which is used at the DRI unit.

The Ouro Branco mill's significant raw materials and inputs also include solid fuels, comprising the metallurgical coal, used in the production of coke and also for the blast furnace pulverized injecting, this last one providing increase in productivity and consequently reduction in the final cost of pig iron. Besides the metallurgical coal, the Company also uses the anthracite, solid fuel used in the production of sinter. The gas resulting from the production of coke and pig iron are reused for generation of thermal energy that can be converted in electric energy for the mill.

The North American operations also use additional inputs. Various domestic and foreign companies supply other important raw materials or operating supplies required for the business, including refractory materials, ferroalloys and graphite electrodes that are available in the national and international market. Gerdau North America Business Segment has obtained adequate quantities of these raw materials and supplies at competitive market prices. The Company is not dependent on any one supplier as a source for any particular material and believes there are adequate alternative suppliers available in the marketplace if the need to replace an existing one arises.

***Energy Requirements***

Steel production is a process that consumes large amounts of electricity, especially in electric arc mills. Electricity represents an important role in the production process, along with natural gas, which is used mainly in furnaces to re-heat billets in rolled steel production.

In Brazil, electricity is currently supplied to the Company's industrial units under two types of contracts:

- Contracts in the Regulated Contractual Environment in which the Company is a Captive Consumer are used at the following units: Usiba and Açonorte. These involve state-owned companies or holders of government concessions. In these contracts, prices are defined by the National Electric Power Agency (ANEEL).
- Contracts executed in the Free Market Environment, in which Gerdaul is a Free Consumer, are used by the following units: Araçariguama, Charqueadas, Cosigua, Cearense, Ouro Branco, Divinópolis, Barão de Cocais, Riograndense, São José dos Campos, Cumbica, Cotia, Pindamonhangaba, Mogi das Cruzes and Miguel Burnier. The load of these units is served by a portfolio of contracts and by self-generation. The power supply contracts are entered into directly with generation and/or distributing companies at prices that are pre-defined and adjusted in accordance with conditions pre-established by the parties. The transmission and distribution rates are regulated and revised annually by ANEEL. The Ouro Branco mill generates internally approximately 70% of its energy needs, using the gases produced during the steelmaking process. As a result, this makes the plant has significantly lower exposure to the energy market than mini-mills.

The Company, in 2018, held the following power generation concessions in Brazil:

- Dona Francisca Energética S.A. (DFESA) operates a hydroelectric power plant with nominal capacity of 125 MW located between Nova Palma and Agudo, Rio Grande do Sul State (Brazil). Its corporate purpose is to operate, maintain and maximize use of the energy potential of the Dona Francisca Hydroelectric Plant. DFESA participates in a consortium (Consórcio Dona Francisca) with the state power utility Companhia Estadual de Energia Elétrica (CEEE). The

Table of Contents

shareholders of DFESA are Gerdau S.A. (51.82%), COPEL Participações S.A (23.03%), Celesc (23.03%), and Statkraft (2.12%).

- Gerdau also holds the concession to implement São João Cachoeirinha Hydroelectric Plant Complex located in Paraná state. The complex will have a total installed capacity of 105 MW. It is currently waiting for the granting of the environmental licenses.

The terms of the aforementioned generation concession agreements are for 35 years as of the signature of the agreement. As such: UHE Dona Francisca expires in 2033 and UHEs Caçu and Barra dos Coqueiros and UHEs São João - Cachoeirinha expire in 2037.

The supply of natural gas to all Brazilian units is regulated and performed under long-term contracts. The Barão de Cocais and Divinópolis units do not have access to natural gas supplies.

In the United States, there are essentially two types of electricity markets: regulated and deregulated. In the regulated market, contracts are approved by Public Utility commissions and are subject to an approved rate of return. These regulated tariffs are specific to local distributors and generally reflect the average fuel costs of the distributor. In deregulated markets, the price of electricity is set by the marginal resource and fluctuates with demand. Natural gas in the United States is completely deregulated. The U.S. energy market is benefiting from the increased exploration of shale gas, which is driving down prices of both electricity and natural gas.

In Uruguay, electricity is purchased under agreements that are renewed automatically on an annual basis from the state-owned utility UTE. Natural gas is purchased from Montevideo Gas with prices set by the Argentinean export tariff agreement (fuel oil as substitute). During 2018, the plant operated mostly on fuel oil, due to competitive reasons.

In Peru, the Company has a current electricity contract until December 2025. The plant receives CNG (Compressed Natural Gas) by trucks and then is decompressed and distributed through internal pipeline to production processes.

Argentina uses natural gas (liquefied petroleum gas) as a substitute. The natural gas purchase agreement was renewed for another year. In 2008, Gerdau Sipar entered into a long-term agreement to supply the new mill's power requirements.

In Mexico, electricity is purchased under agreements regulated by the state-owned utility Compañía Federal de Electricidad (CFE) and bilateral contracts with private companies. The natural gas agreements are annually and automatically renewed. Electricity and natural gas prices are indexed and adjusted monthly based on the NYMEX prices indices.

**Technology and Quality Management**



All Gerdau mills have a Quality Management System supported by a wide array of quality control tools. Product development projects are headed by specialists who use quality tools such as Six Sigma, a set of statistical methods for improving the assessment of process variables, and the concept of Quality Function Deployment, a methodology through which technicians can identify and implement the customer requirements.

Given this level of quality management, mills are ISO 9001 or ISO TS 16949 certified, and certain products receive laboratory certification as required. In general, production, technical services and quality teams are responsible for developing new products to meet customer and market needs.

Gerdau uses a Quality Management System developed in house that applies tests for product design, manufacturing processes and final-product specifications. A specially trained team and modern technologies also exist to assure the manufactured product high standards of quality. Gerdau's technical specialists do planned visits, some are randomly selected and some are scheduled visits, to its customers to check on the quality of the delivered products in order to guarantee the final user satisfaction for products purchased indirectly.

Due to the specialized nature of its business, the Gerdau special steel mills are constantly investing in technological upgrading and in research and development. These mills are active in the automotive segment and maintain a technology department (Research and Development) responsible for new products and the optimization of existing processes.

International machinery manufacturers and steel technology companies supply most of the sophisticated production equipment that Gerdau uses. These suppliers generally sign technology transfer agreements with the purchaser and provide extensive technical support and staff training for the installation and commissioning of the equipment. Gerdau has technology transfer and benchmarking agreements with worldwide recognized performance companies.

Table of Contents

As is common with mini-mill steelmakers, Gerdau usually acquires technology in the market rather than develops new technology through intensive process research and development, since steelmaking technology is readily available for purchase.

The Company is not dependent on patents or licenses or new manufacturing processes that are material to its business. See item Information on the Extent of the Company's Dependence for further details.

**Sales Terms and Credit Policy**

The Company's Brazilian sales are usually made on a 21/28-day settlement CIF (Cost, Insurance and Freight) basis. Comercial Gerdau, the retail arm of Gerdau in Brazil, sells on an approximately 34 day settlement basis, mainly CIF. Brazilian customers are subject to a credit approval process. The concession of credit limits is controlled by a corporate-level system (ECC) that can be accessed by all sales channels. The credit and collection department is responsible for evaluating, determining and monitoring credit in accordance with the credit limit policy. This policy includes the active participation of staff from the various sales channels. At Comercial Gerdau, in particular, the criteria for retail sales also include practices such as the use of credit card services. Gerdau exports are guaranteed via letters of credit and/or pre-payment before the product is shipped. Exports to Gerdau's subsidiaries may be sold on credit at market interest rates.

Gerdau North American credit terms to customers are generally based on customary market conditions and practices. The Company's North American business is seasonal, with orders in the second and third quarters tending to be stronger than those in the first and fourth quarters, primarily due to weather-related slowdowns in the construction industry.

The Company's Special Steel operations in the United States and Brazil have their own credit departments for customer credit analyses.

The Company's provision for doubtful accounts has been at low levels. On December 31, 2018, provision for doubtful accounts was 4.7% based on gross account receivables per Note 5 to the Consolidated Financial Statements, compared to 4.5% on December 31, 2017 and 5.3% on December 31, 2016. Gerdau has improved its credit approval controls and enhanced the reliability of its sales process through the use of risk indicators and internal controls.

**Insurance**

The Company maintains insurance coverage in amounts that it believes suitable to cover the main risks of its operating activities. The Company has purchased insurance for its integrated mill Ouro Branco to insure against operating losses, which covers assets of approximately US\$ 5 billion (R\$19 billion as of April 30, 2018), including material damage to installations (US\$4.6 billion) and losses of gross revenues (US\$471 million), such as halts in production due to business interruptions caused by accidents for a period up to twelve months. The Company's current insurance policy relating to the Ouro Branco mill remains effective until April 30, 2019. The Company's mini-mills are also covered under insurance policies which insure against certain operational losses resulting from business interruptions.

**Trade Investigations and Government Protectionism**

Over the past several years, exports of steel products from various companies and countries, including Brazil, have been subject to antidumping, countervailing duties and other trade-related investigations in importing countries. Most of these investigations resulted in duties limiting the investigated companies' ability to access such import markets. Until now, however, these investigations have not had a significant impact on the Company's export volumes.

**Material effects of government regulation on the Company's activities**

The Company's steel production activities are not subject to special authorizations other than the licenses and permits typical to the industry. The Company maintains a good relationship with the government agencies responsible for issuing common authorizations and does not have any history of problems in obtaining them.

Gerdau's mining operation in Brazil are subject to the rules of the Brazilian Mining Code and its regulation (Decree-Law 227, of February 28, 1967 and Decree 9,406, of June 12, 2018) and to the applicable mining legislation, with mining exploration governed by Mining Property Rights and Concessions.

Gerdau acquired the surface of the properties located in the polygon of the respective mining rights, as well as all other Mining Property Rights and Concessions, under an Agreement for the Sale of Assets and Assignment of Rights entered into by and between

Table of Contents

Gerdau Açominas S.A. and Companhia Paraibunas de Metais, Siderúrgica Barra Mansa S.A., Votorantim Metais Ltda., and Votorantim International Holding N.V., on May 19, 2004.

The Company's mining exploration activities are subject to the conditions and limitations imposed by the Federal Constitution of Brazil, the Brazilian Mining Code and related laws and regulations, which include requirements connected to, among other factors, how mineral deposits are used, occupational safety and health, environmental protection and restoration, pollution prevention and the health and safety of the local communities where the mines are located. The Brazilian Mining Code also establishes some requirements for the submission of notifications and information.

Companies authorized to economically explore mineral resources are required to pay royalties to the Federal Government, which distributes most of them to States and Municipalities. On July 26, 2017, Provisional Presidential Decree 789/17 was published, which was later converted into Federal Law 13,540/17, amending Federal Laws 7,990/89 and 8,001/90, which provide for the Financial Compensation for Exploration of Mineral Resources (CFEM). The structure for the charging of royalties was changed to the following:

1) TRIGGERING EVENT: the exploration of mineral resources will trigger the payment of CFEM upon:

- the first sale of mineral asset (already mined mineral substance after its processing, if applicable);
- the sale at auction, in the case of mineral assets acquired via judicial sale;
- the first acquisition of mineral assets extracted under the system of mining permission (*lavra garimpeira*);
- the consumption of mineral asset (use of mineral assets in a process that entails obtaining a new type of ore or its transformation into another product type).

2) CALCULATION BASE

- in the case of sales, calculated based on gross sales revenue, less any taxes levied, with deductions for freight and insurance expenses prohibited;

- in the case of consumption, calculated based on the current price of the mineral asset in the market or the price reference, as defined by the regulatory agency of the mining sector. Since iron ore does not appear in the absolute list of the National Mineral Production Department (DNPM) Ordinance 239/2018, it is subject to the current price calculation base when transformed into another type of product, such as pig iron.
- in the case of exports, even for transactions in the free market (sales to third parties/unrelated third parties) and exports to companies not located in tax havens, the calculation base is the greater of the price reference defined by the Federal Revenue Department (PECEX method) and the export value;
- in the case of mineral assets acquired via judicial sale, calculated based on the value of the sale at auction;
- in the case of extraction under the system of mining permission (*lavra garimpeira*), calculated based on the value of the first acquisition of the mineral asset;

Financial compensation (CFEM) may or may not have to be paid on sales among companies of the same business group; Federal Law 13,540/17 does not establish any criteria for such.

For mineral assets shipped to another establishment of the same owner, for subsequent sale, even if subject to processing, the calculation base is the price charged in the final sale.

3) RATES: effective 11/1/2017

a) Rates of mineral substances:

<b>RATE (VETOED)</b>	<b>MINERAL SUBSTANCE (VETOED)</b>
one percent (1%)	Rocks, sand, gravel, red clay and other mineral substances intended for immediate use in construction; ornamental rocks; mineral and thermal water
one point five percent (1.5%)	Gold
two percent (2%)	Diamond and other mineral substances
three percent (3%)	Bauxite, manganese, niobium and rock salt
three point five percent (3.5%)	Iron, subject to letters <i>b</i> and <i>c</i> of this Appendix

Table of Contents

For iron ore, the rate is fixed at 3.5%, which represents an increase compared to the previous rate, which was fixed at 2%. In this case, upon a justified need, the regulatory entity of the mining sector could exceptionally reduce the iron compensation rate from 3.5% to as low as 2% in order to not adversely affect the economic feasibility of deposits with low performance and profitability due to the iron content, production scale, payment of taxes and number of employees.

On December 26, 2017, Federal Law 13,575 was sanctioned, which created the National Mining Agency (ANM), eliminated the National Department of Mineral Production (DNPM), amended federal laws 11,046 of December 27, 2004, and 10,826 of December 22, 2003, and revoked Federal Law 8,876 of May 2, 1994, and the provisions of Decree-Law 227 of February 28, 1967 (Mining code). This law derives from Provisional Presidential Decree 791/2017 issued by the Ministry of Mines and Energy (MME) and submitted to the joint commission of the Senate in mid-2017 for approval. The wording of the federal law was published in the federal register *Diário Oficial da União* (DOU) on December 27, 2017, Issue: 247, Section 1, Pages 1 to 4.

It eliminates the National Department of Mineral Production (DNPM) and creates the National Mining Agency (ANM), a government agency linked to the Ministry of Mines and Energy responsible for promoting mineral exploration and developing the industry.

The Rate for Inspection of Mining Activities (TFAM), which the Executive Branch intended to create along with ANM, was not approved by the National Congress.

Gerdau holds environmental licenses for commercial operation of the mines located in the cities of Miguel Burnier, Várzea do Lopes and Gongo Soco in the Brazilian state of Minas Gerais.

The mining rights held by Gerdau cover 8,837.19 hectares, and the concessions are valid until the mining deposits are exhausted, provided the legal requirements are fulfilled annually. The table below lists the DNPM processes referring to the mining rights held by Gerdau:

DNPM Process	City	Location / Mine / Project	State
1.978/1935	BARÃO DE COCAIS	GONGO SOCO	MG
724/1942	OURO PRETO / OURO BRANCO	MORRO GABRIEL	MG
4.575/1935	OURO PRETO	MIGUEL BURNIER	MG
3.613/1948	OURO PRETO	MIGUEL BURNIER	MG
5.303/1948	OURO PRETO	MIGUEL BURNIER	MG
5.514/1956	OURO PRETO	MIGUEL BURNIER	MG
5.975/1956	OURO PRETO	MIGUEL BURNIER	MG
6.549/1950	OURO PRETO	MIGUEL BURNIER	MG
930.600/2009	OURO PRETO	GM MIGUEL BURNIER	MG
3.583/1957	ITABIRITO / MOEDA	VÁRZEA DO LOPES	MG
3.584/1957	ITABIRITO	VÁRZEA DO LOPES	MG
3.585/1957	ITABIRITO	VÁRZEA DO LOPES	MG
8.141/1958	ITABIRITO	VÁRZEA DO LOPES	MG
6.255/1960	ITABIRITO	VÁRZEA DO LOPES	MG
317/1961	ITABIRITO	VÁRZEA DO LOPES	MG
5.945/1961	ITABIRITO	VÁRZEA DO LOPES	MG
932.705/2011	ITABIRITO	GM VÁRZEA DO LOPES	MG

Edgar Filing: GERDAU S.A. - Form 20-F

833.209/2006	OURO PRETO / OURO BRANCO	DOM BOSCO	MG
832.090/2005	OURO PRETO / OURO BRANCO	DOM BOSCO	MG
832.044/2006	OURO BRANCO	DOM BOSCO	MG
830.158/2007	OURO PRETO	DOM BOSCO	MG
830.159/2007	OURO PRETO	DOM BOSCO	MG
830.160/2007	OURO PRETO	DOM BOSCO	MG
831.640/2003	OURO PRETO	DOM BOSCO	MG
830.475/2007	OURO PRETO	DOM BOSCO	MG
832.620/2006	OURO PRETO	MIGUEL BURNIER	MG
830.798/2013	OURO PRETO	MIGUEL BURNIER	MG
832.377/2014	OURO PRETO	MIGUEL BURNIER	MG
832.375/2014	OURO PRETO	MIGUEL BURNIER	MG
833.018/2015	ITABIRITO	VÁRZEA DO LOPES	MG
832.625/2016	ITABIRITO	VÁRZEA DO LOPES	MG

Table of Contents

**c. ORGANIZATIONAL STRUCTURE**

The Company's operational structure (including its main operating subsidiaries engaged in steel production) on December 31, 2018 is below:



Edgar Filing: GERDAU S.A. - Form 20-F

Table of Contents

The table below lists the significant consolidated subsidiaries of Gerdau on December 31, 2018, 2017 and 2016:

Consolidated company	Country	Equity Interests Total capital (*)		
		2018	2017	2016
Gerdau GTL Spain S.L.	Spain	100.00	100.00	100.00
Gerdau Internacional Empreendimentos Ltda. - Grupo Gerdau	Brazil	100.00	100.00	100.00
Gerdau Ameristeel Corporation and subsidiaries (1)	USA/Canada	100.00	100.00	100.00
Gerdau Açominas S.A. and subsidiary (2)	Brazil	99.83	99.36	99.35
Gerdau Aços Longos S.A. and subsidiary (3)	Brazil	99.78	99.12	99.11
Gerdau Steel Inc.	Canada	100.00	100.00	100.00
Gerdau Holdings Inc. and subsidiary (4)	USA	100.00	100.00	100.00
Paraopeba - Fixed-income investment fund (5) (**)	Brazil	91.40	10.69	70.93
Gerdau América Latina Participações S.A.	Brazil			99.12
Aza Participaciones S.A.	Chile		100.00	100.00
Gerdau Aços Especiais S.A.	Brazil			99.55
Gerdau Hungria Holdings Limited Liability Company	Hungary	100.00	100.00	100.00
GTL Equity Investments Corp.	British Virgin Islands	100.00	100.00	100.00
Empresa Siderúrgica del Perú S.A.A. - Siderperú	Peru	90.03	90.03	90.03
Diacó S.A. and subsidiary (6)	Colombia			99.68
Gerdau GTL México, S.A. de C.V. and subsidiaries (7)	Mexico	100.00	100.00	100.00
Seiva S.A. - Florestas e Indústrias	Brazil	97.73	97.73	97.73
Itaguai Com. Imp. e Exp. Ltda.	Brazil			100.00
Gerdau Laisa S.A.	Uruguai	100.00	100.00	100.00
Sipar Gerdau Inversiones S.A.	Argentina	99.99	99.99	99.99
Sipar Aceros S.A. and subsidiary (8)	Argentina	99.98	99.98	99.96
Sizuca - Siderúrgica Zuliana, C. A.	Venezuela	100.00	100.00	100.00
GTL Trade Finance Inc.	British Virgin Islands	100.00	100.00	100.00
Gerdau Trade Inc.	British Virgin Islands	100.00	100.00	100.00
Gerdau Steel India Ltd.	India		98.90	98.90

(\*) The voting capital is substantially equal to the total capital. The interests reported represent the ownership percentage held directly and indirectly in the subsidiary.

(\*\*) The percentage of participation including interest of the parent company Metalúrgica Gerdau S.A. in the investment fund is 98.60% in 2018, 51.11% in 2017 and 91.58% in 2016.

(1) Subsidiaries: Gerdau Ameristeel US Inc., Gerdau Ameristeel Sayreville Inc., Chaparral Steel Company.

(2) Subsidiary: G2L Logística Ltda.

(3) Subsidiary: Gerdau Açominas Overseas Ltd.

(4) Subsidiary: Gerdau MacSteel Inc.

(5) Fixed-income investment fund managed by Bank JP Morgan S.A..

(6) Subsidiary: Cyrgo S.A.

(7) Subsidiary: Sidertel S.A. de C.V. and GTL Servicios Administrativos México, S.A. de C.V..

(8) Subsidiary: Siderco S.A.

The Company's investments in Bradley Steel Processor and MRM Guide Rail in North America, in which Gerdau Ameristeel holds a 50% stake in the total capital, the investments in Gerdau Metaldom Corp. in the Dominican Republic in which the Company owns a 45% stake, the investment in Corsa Controladora, S.A. de C.V. in Mexico, in which Gerdau has a 49% stake, the investment in Corsa Controladora, S.A.P.I de C.V. in Mexico, in which Gerdau has a 50% stake, the investment in Dona Francisca Energética S.A. in Brazil, in which the Company holds a 51.82%, investment in Gerdau Summit Aços Fundidos e Forjados S.A., in Brazil, in which Gerdau has a 58.73% stake, the investment in Diaco S.A. in Colombia, which Gerdau has a 49.87%, and the investment in Juntos Somos Mais Fidelização S.A., in Brazil, in which Gerdau has a 27.50% stake are accounted in the Company's financial statements using the equity method (for further information, see Note 3 Consolidated Financial Statements).

The operating companies that are fully consolidated or accounted according to the equity method in the financial statements of Gerdau S.A. are described below:

Table of Contents

*Gerdau Aços Longos S.A.* This company produces common long steel and has nine mills distributed throughout Brazil and an annual installed capacity of 4.7 million tonnes of crude steel. This company also sells general steel products and has steel distribution centers located throughout Brazil.

*Gerdau Açominas S.A.* Gerdau Açominas owns the mill located in the state of Minas Gerais, Brazil. The Ouro Branco mill is Gerdau's largest unit, with an annual installed capacity of 4.5 million tonnes of crude steel, accounting for 48.8% of Gerdau's crude steel output in the Brazil Business Segment.

*Gerdau Ameristeel Corporation* Gerdau Ameristeel has an annual capacity of 7.4 million tonnes of crude steel and 5.3 million tonnes of rolled products. The Company is one of the largest producers of long steel in North America.

*Gerdau MacSteel Inc.* This company is the largest special steel producer in U.S., has three units and a combined annual production capacity of 1.5 million tonnes of crude steel and 1.5 million tonnes of rolled products.

*Gerdau Laisa S.A.* In 1980, the Company acquired the Laisa mini-mill in Uruguay. Gerdau Laisa is the one of largest long steel producers in Uruguay and has annual installed capacity of 100,000 tonnes of crude steel and 90,000 tonnes of rolled products.

*Sipar Gerdau Inversiones S.A.* Sipar Gerdau Inversiones, through its operational subsidiary Sipar Aceros S.A., entered the Argentinean market in December 1997 and has annual installed capacity of 650,000 tonnes of crude steel and 263,000 tonnes of rolled products.

*Empresa Siderúrgica del Perú S.A.A.* Acquired in 2006, this company is a long steel producer with annual installed capacity of 720,000 tonnes of crude steel and 573,000 tonnes of rolled steel.

*Gerdau GTL México, S.A. de C.V.* The subsidiary of this company is a long steel producer located in the metropolitan area of Mexico City with annual installed capacity of 500,000 tonnes of crude steel and 400,000 tonnes of rolled products.

*Sizuca - Siderúrgica Zuliana, C. A.* In June 2007, Gerdau acquired Sizuca - Siderúrgica Zuliana, which is located in Ciudad Ojeda, Venezuela. Sizuca owns a mini-mill that produces concrete reinforcement bars. Sizuca has an annual installed capacity of 250,000 tonnes of crude steel and 170,000 tonnes of rolled products.

*Corsa Controladora, S.A. de C.V.* In 2008, the Company acquired a 49% stake in Corsa Controladora, S.A. de C.V. (Mexico). Corsa Controladora owns 100% of the capital of Aceros Corsa, S.A. de C.V. and its distributors. Located in the metropolitan area of Mexico City, Corsa is a mini-mill that produces long steel (light merchant bars).

*Multisteel Business Holdings* In 2014, the Company completed the merger of its associate Multisteel Business Holdings Corp. with the Dominican company Metaldom, originating the joint venture Gerdau Metaldom Corp., which will produce long and flat steel for the areas of civil construction, industrial and agricultural, and also scrap processing operations and PVC pipes, with over one million tons/year of installed capacity. As a result of the merger, the Company has contributed its interest of 79.97% on the associate Multisteel Business Holdings Corp. into the newly formed entity Gerdau Metaldom, in exchange of 50% interest on Gerdau Metaldom Corp. This transaction was recorded on fair value basis, which was substantially equivalent to the book value of the previous investment.

*Gerdau Summit Aços Fundidos e Forjados S.A.* - Gerdau Summit Aços Fundidos e Forjados S.A. - On January 5, 2017, the Gerdau S.A. subscribed capital stock in Gerdau Summit Aços Fundidos e Forjados S.A. through the contribution of some of its assets and liabilities, which were valued by specialized independent evaluation firm. Gerdau Summit Aços Fundidos e Forjados S.A. have accounting treatment of a joint venture in the Financial Statements of Gerdau S.A., with a 58.73% interest.

*Diaco S.A.* - On June 30, 2017, the Company concluded the operation to create a joint venture, based on the sale of 50% interest in Diaco S.A., in Colombia, to Putney Capital Management. The new company's assets are Gerdau's long-steel industrial units in

Table of Contents

Colombia, with an annual installed steel capacity of 674 thousand tons. Due to this transaction, Diaco started to have accounting treatment of joint venture in Consolidated Financial Statements with a 49.87% interest.

**D. PROPERTY, PLANT AND EQUIPMENT****Facilities**

Gerdau's principal properties are for the production of steel, rolled products and drawn products. The following is a list of the locations, capacities and types of facilities, as well as the types of products manufactured at December 31, 2018:

PLANTS BRAZIL OPERATION	LOCATION		INSTALLED CAPACITY (1,000 tonnes)			EQUIPMENT	PRODUCTS
	COUNTRY	STATE	PIG IRON/ SPONGE IRON	CRUDE STEEL	ROLLED PRODUCTS		
Açonorte			5,252	9,229	7,090	EAF mini-mill, rolling mill, drawing mill, nail and clamp factory	Rebar, merchant bars, wire rod, drawn products and nails
Barão de Cocais	Brazil	PE		265	242	Integrated/blast furnace, LD converter and rolling mill	Merchant bars
Cearense	Brazil	MG	330	330	196	EAF mini-mill, rolling mill	Rebar and merchant bars
Cosigua	Brazil	CE		198	161	EAF mini-mill, rolling mill, drawing mill, nail and clamp factory	Rebar, merchant bars, wire rod, drawn products and nails
Divinópolis	Brazil	RJ		932	1,414	Integrated/blast furnace, EOF converter and rolling mill	Rebar and merchant bars
Guáira	Brazil	MG	430	570	460	EAF mini-mill	Billet
Riograndense	Brazil	PR		540*		EAF mini-mill, rolling mill, drawing mill, nail and clamp factory	Rebar, merchant bars, wire rod, drawn products and nails
Usiba	Brazil	RS		450	495	Integrated with DRI, EAF mini-mill, rolling mill, drawing mill	Rebar, merchant bars, wire rod and drawn products
São Paulo	Brazil	BA		495*	397*	EAF mini-mill, rolling mill	Billets, rebars and coil rebar
Contagem	Brazil	SP		950	600	Blast furnace	Pig iron

Edgar Filing: GERDAU S.A. - Form 20-F

Sete Lagoas	Brazil	MG	132			Blast furnace	Pig iron
Ouro Branco						Integrated with blast furnace, LD converter and rolling mills	Billets, blooms, slabs, wire rod, heavy structural shapes and HRC
	Brazil	MG	4,360	4,500	3,126		
<b>NORTH AMERICA OPERATION</b>				<b>7,872</b>	<b>5,733</b>		
Mexico						EAF mini-mill, rolling mill	Rebar, merchant bars and beams
	Mexico			500	400		
Cambridge						EAF mini-mill, rolling mill	Rebar, merchant bars
	Canada	ON		330*	278		
Cartersville						EAF mini-mill, rolling mill	Merchant bars, structural shapes, beams
	USA	GA		925	610		
Charlotte						EAF mini-mill, rolling mill	Rebar, merchant bars
	USA	NC		468	316		

Table of Contents

PLANTS	LOCATION		INSTALLED CAPACITY (1,000 tonnes)			EQUIPMENT	PRODUCTS
	COUNTRY	STATE	PIG IRON/ SPONGE IRON	CRUDE STEEL	ROLLED PRODUCTS		
Jackson	USA	TN		764	496	EAF mini-mill, rolling mill	Rebar, merchant bars
Manitoba - MRM	Canada	MB		394	271	EAF mini-mill, rolling mill	Special sections, merchant bars, rebar
St. Paul	USA	MN		502	455	EAF mini-mill, rolling mill	Rebar, merchant bars, special bars (SBQ) and round bars
Whitby	Canada	ON		949	775	EAF mini-mill, rolling mill	Structural shapes, rebar, merchant bars
Wilton	USA	IA		322	245	EAF mini-mill, rolling mill	Rebar and merchant bars
Midlothian	USA	TX		1,753	1,411	EAF mini-mill, rolling mill	Rebar, merchant bars and beams
Petersburg	USA	VA		965	476	EAF mini-mill, rolling mill	Merchant bars and beams
<b>SOUTH AMERICA OPERATION</b>			<b>400</b>	<b>1,720</b>	<b>1,096</b>		
Uruguay	Uruguay			100	90	EAF mini-mill, rolling mill	Rebar, merchant bars and mesh
Argentina	Argentina			650	263	EAF mini-mill, rolling mill, drawing mill	Rebar, merchant bars and mesh
Peru	Peru		400	720	573	Blast Furnace, EAF mini-mill, rolling mill	Rebar and merchant bars
Venezuela	Venezuela			250	170	EAF mini-mill, rolling mill	Rebar
<b>SPECIAL STEEL OPERATION</b>				<b>2,875</b>	<b>3,583</b>		
Pindamonhangaba	Brazil	SP		620	1,188	EAF mini-mill, rolling mill, finishing and foundry	Bars, wires, wire rod, finished and rolled bar, rolling mill rolls.
Mogi das Cruzes	Brazil	SP		375	264	EAF mini-mill, rolling mill and finishing	Bars, special profiles
Charqueadas	Brazil	RS		430	615	EAF mini-mill, rolling mill and finishing	Bars, special profiles, wires, wire rod, cold finished bar
Fort Smith	USA	AR		550	550	EAF mini-mill, rolling mill and finishing	Special bars and shapes and cold finished bar
Jackson	USA	MI		300	276	EAF mini-mill, rolling mill and finishing	Special bars and shapes and cold finished bar





Table of Contents

PLANTS	LOCATION		INSTALLED CAPACITY (1,000 tonnes)				EQUIPMENT	PRODUCTS
	COUNTRY	STATE	PIG IRON/ SPONGE IRON	CRUDE STEEL	ROLLED PRODUCTS	PRODUCTS		
Monroe	USA	MI		600	690	EAF mini-mill, rolling mill and finishing	Special bars and shapes and cold finished bar	
<b>GERDAU TOTAL</b>			<b>5,652</b>	<b>21696</b>	<b>17,502</b>			

---

\*Temporarily not in use.

Table of Contents

**Mining Assets**

*Iron ore mines*

Gerdau's activities related to the iron ore mines began after acquiring the mining rights from the Votorantim Group, in the cities of Ouro Preto (district of Miguel Burnier), Itabirito and Barão de Cocais, in 2004. These areas are located in the Iron Quadrilateral region of Minas Gerais state, in Brazil, one of the country's most prominent mineral regions, as shown in the following figure.

Focusing on guaranteeing its iron ore self-sufficiency in Minas Gerais state and seeking opportunities to add value to the business by using its own mineral resources, Gerdau conducted studies up to 2014 to assess and implement projects for expanding its mining operations in order to become a player in the global iron ore market. However, given the current price of iron ore in the international market, Gerdau decided to focus only on iron ore production for achieving self-sufficiency.

*Location of Gerdau's mining operations*

## Edgar Filing: GERDAU S.A. - Form 20-F

The current and future iron ore production units encompass mainly open-pit mines, processing mills, waste piles, waste areas and logistics and operational support infrastructure.

The current iron ore production units are the following:

- Miguel Burnier/Dom Bosco Complex: includes the mines located in Miguel Burnier and in Dom Bosco;
- Várzea do Lopes Complex;
- Gongo Soco. There are no mining activities at this location.

### *Location and Access*

#### **Miguel Burnier/Dom Bosco Complex**

Miguel Burnier and Dom Bosco are located in the city of Ouro Preto, in the southwestern region of the Iron Quadrilateral region of Minas Gerais, in Brazil, around 80 km from Belo Horizonte and 5 km from Vila do Pires, on Highway BR-040. The Dom Bosco

Table of Contents

Mine is located approximately 11 km from the Miguel Burnier Mine. Vila do Pires is situated on both sides of Highway BR-040, in the northern region of the city of Congonhas. Access to the mines is via a three-kilometer unpaved road starting in the villa of Miguel Burnier.

**Várzea do Lopes Complex**

Várzea do Lopes is located in the city of Itabirito, in the Iron Quadrilateral region of Minas Gerais, in Brazil, approximately 46 km from downtown Belo Horizonte. Access to the mine is from Belo Horizonte via Highway BR-040, heading towards Rio de Janeiro. Várzea do Lopes is located approximately 20 km from Miguel Burnier, in a straight line.

**Gongo Soco**

Gongo Soco is located in the city of Barão de Cocais, in the northwestern region of the Iron Quadrilateral of Minas Gerais, in Brazil, around 8 km from the city of Barão de Cocais and 170 km away from Miguel Burnier. Access from Belo Horizonte is via highways BR-381/262 and MG-436.

The image below shows the location of the current and future iron ore production units and their main access routes:

## Investment Programs

Investments in Property, Plant and Equipment (Capex) amounted to R\$ 1.2 billion in 2018, which was allocated to productivity gains and maintenance. Of the total capex in the year, 47% was allocated to the Brazil Business Segment, 33% to the North America Business Segment, 16% to the Special Steel Business Segment and 4% to the South America Business Segment.

## Investments 2019-21

As an evolution of the Company's governance process, Gerdau is announcing its capex plan for the next three years (2019-2021), which amounted to R\$ 7.1 billion, broken down into three categories:

- **General maintenance:** focused on improving the operational excellence and increasing useful lives of existing assets.
- **Ouro Branco (Minas Gerais, Brasil) Maintenance:** series of initiatives related to planned stoppage of the mill's modernization in 2022. In 2019, there will be a 60-day scheduled stoppage on Blast Furnace 1 in Ouro Branco mill, and in 2020 and 2021, there will be a series of gradual improvements. During this period, strategic inventories will be built to ensure normal supply to clients.
- **Technological expansion and updating:** investments to expand installed capacity and to update technology in product lines with higher profitability potential. The execution of these investments will be flexible, since they will be realized as the expectations of the market developments and of free cash flow generation for the period are confirmed, always ensuring compliance with the financial policy of maintaining a Net Debt/EBITDA ratio of between 1x and 1.5x.

Table of Contents

**Environmental Issues**

Gerdau S.A is currently in compliance with environmental regulations. The Company also believes that there are no environmental issues that could affect the use of its fixed assets.

In 2018, Gerdau S.A. invested R\$254.0 million in the improvement of its eco-efficiency practices and in technologies for the protection of the air, water and soil.

***Environmental Regulations***

In all of the countries in which the Company operates, it is subject to federal, state and municipal environmental laws and regulations governing air emissions, wastewater discharges and solid and hazardous waste handling and disposal. Its manufacturing facilities have been operating under the applicable environmental rules. The respective permits and licenses require the satisfaction of various performance standards, which are monitored by regulatory authorities. The Company employs a staff of experts to manage all phases of its environmental programs and uses outside experts where needed. The Company works to assure that its operations maintain compliance in all material respects with the applicable environmental laws, regulations, permits and licenses currently in effect. When Gerdau acquires new plants, it conducts an assessment of potential environmental issues and prepares a work plan in compliance with the local authorities.

In most countries, both federal and state governments have the power to enact environmental protection laws and issue regulations under such laws. In addition to those rules, the Company is also subject to municipal environmental laws and regulations. Under such laws, individuals or legal entities whose conduct or activities cause harm to the environment are usually subject to criminal and administrative sanctions, as well as any costs to repair the actual damages resulting from such harm.

Individuals are subject to penalties and sanctions that range from fines to imprisonment and for legal entities the suspension or interruption of its operations and prohibition to enter into any contracts with government agencies.

Government environmental protection agencies may also impose administrative sanctions on individuals and entities that fail to comply with environmental laws and regulations that include:

- fines;
  
- partial or total suspension of operations;

- obligations to provide compensation for recovery works and environmental projects;
- forfeiture of or restrictions on tax incentives and benefits;
- closing of establishments or enterprises; and
- forfeiture or suspension of participation in credit lines with official credit agencies.

The steel industry uses and generates substances that may damage the environment. The Company's management performs frequent surveys with the purpose of identifying potentially impacted areas and records based on best cost estimate the amounts estimated for investigation, treatment and cleaning of potentially affected sites, totaling R\$ 132,646 thousands as of December 31, 2018 (R\$ 60,419 thousands recorded in Current Liabilities and R\$ 72,227 thousands recorded in Non-Current Liabilities), R\$85,191 thousands as of December 31, 2017 (R\$21,928 thousands recorded in Current Liabilities and R\$63,263 thousands recorded in Non-Current Liabilities) R\$83,806 thousands as of December 31, 2016 (R\$17,737 thousands recorded in Current Liabilities and R\$66,069 thousands recorded in Non-Current Liabilities). The Company used estimates and assumptions to determine the amounts involved, which can vary in the future, due to the final investigations and the determination of the actual environmental impact. See also Note 20 Environmental Liabilities.

Table of Contents

As of December 31, 2018, the present value of the total remaining amount of Brazilian Environmental Liabilities was estimated at R\$71.1 million related to Brazilian subsidiaries.

Gerdau Ameristeel and Macsteel estimate clean-up costs based on a review of the anticipated remedial activities to be undertaken at each of their respective known contaminated sites. Although the ultimate costs associated with such remediation are not precisely known, the Company has estimated the present value of the total remaining costs as of December 31, 2018 at approximately R\$ 61.6 million in US subsidiaries, with these costs recorded as a liability in its financial statements.

***Brazilian Environmental Legislation***

The Company's activities are subject to wide-sweeping Brazilian environmental legislation at the federal, state and municipal levels that govern, among other aspects, the dumping of effluents, atmospheric emissions and the handling and final disposal of dangerous waste, as well as the obligation to obtain operating licenses for the installation and operation of potentially polluting activities.

Brazilian environmental legislation provides for the imposition of criminal and administrative penalties on natural persons and legal entities that commit environmental crimes or infractions, as well as for the obligation to repair the environmental damage caused. Although the Company has never suffered any environmental penalties that could have a relevant impact on its business, potential environmental crimes or infractions could subject the Company to penalties that include:

- fines that at the administrative level could reach as high as R\$ 50 million, depending on the violator's economic capacity and past record, as well as the severity of the facts and prior history, with the amounts potentially doubled or tripled in the case of repeat offenders;
- suspension of or interference in the activities of the respective enterprise; and
- loss of benefits, such as the suspension of government financing and the inability to qualify for public bidding processes and tax breaks.

In addition, strict liability is applicable to environmental crimes for both natural persons and legal entities. Environmental legislation also provides for disregarding the legal status of a company's controlling shareholder whenever such status represents an impediment to receiving restitution for environmental damages.

In the civil sphere, environmental damage results in joint and several liability as well as strict liability. This means that the obligation to repair the environmental damage may affect all those directly or indirectly involved, regardless of any proof of who is to blame. As a result, the hiring



of third parties to intervene in its operations to perform such services as final disposal of solid waste does not exempt the Company from liability for any environmental damage that may occur.

***North American Environmental Legislation***

The Company is required to comply with a complex and evolving body of Environmental, Health and Safety Laws (EHS Laws) concerning, among other things, air emissions, discharges to soil, surface water and groundwater, noise control, the generation, handling, storage, transportation and disposal of toxic and hazardous substances and waste, the clean-up of contamination, indoor air quality and worker health and safety. These EHS Laws vary by location and can fall within federal, provincial, state or municipal jurisdictions.

Most EHS Laws are of general application but result in significant obligations in practice for the steel sector. For example, the Company is required to comply with a variety of EHS Laws that restrict emissions of air pollutants, such as lead, particulate matter and mercury. Because the Company's manufacturing facilities emit significant quantities of air emissions, compliance with these laws does require the Company to make investments in pollution control equipment and to report to the relevant government authority if any air emissions limits are exceeded. The government authorities typically monitor compliance with these limits and use a variety of tools to enforce them, including administrative orders to control, prevent or stop a certain activity; administrative penalties for violating certain EHS Laws; and regulatory prosecutions, which can result in significant fines and (in rare cases) imprisonment. The Company is also required to comply with a similar regime with respect to its wastewater. EHS Laws restrict the type and amount of pollutants that Company facilities can discharge into receiving bodies of waters, such as rivers, lakes and oceans, and into municipal sanitary and storm sewers. Government authorities can enforce these restrictions using the same variety of tools noted above.

Table of Contents

The Company has installed pollution control equipment at its manufacturing facilities to address these emissions and discharge limits, and has an environmental management system in place designed to reduce the risk of non-compliance.

***Environmental Permits***

According to Brazilian environmental legislation, the proper functioning of activities considered effectively or potentially polluting or that in some way could cause environmental damage requires environmental licenses. This procedure is necessary for both the activity's initial installation and operating phases as well as for its expansion phases, and these licenses must be renewed periodically.

The Brazilian Institute for the Environment and Renewable Resources (IBAMA) has jurisdiction to issue licenses for projects with national or regional environmental impacts. In all other cases, the state environmental agencies have jurisdiction and, in the case of local impact, the municipal agencies have jurisdiction.

Environmental licensing of activities with significant environmental impacts is subject to a Prior Environmental Impact Study and respective Environmental Impact Report (EIA/RIMA), as well as the implementation of measures to mitigate and compensate for the environmental impact of the project.

The environmental licensing process includes the issuance of three licenses: Pre-License (LP), Installation License (LI) and Operational License (LO). These licenses are issued in accordance with each phase of project implementation, and maintaining their validity requires compliance with the requirements established by the environmental licensing agency. The failure to obtain an environmental license, regardless of whether or not the activity is actually harming the environment, is considered an environmental crime and an administrative infraction, subjecting the violator to administrative fines, at the federal level (subject to being doubled or tripled in the case of repeat violations), and the suspension of operations. The Operational License (LO) must be renewed periodically.

The Company's operations currently comply with all legal requirements related to environmental licenses. However, any delay or refusal on the part of environmental licensing agencies to issue or renew these licenses, as well as any difficulty on its part to meet the requirements established by these environmental agencies during the course of the environmental licensing process, could jeopardize or even impair the installation, operation and expansion of new and current projects.

***Areas of permanent forest preservation and legal reserves***

Some activities of the Company, mainly those involving reforestation to produce thermal-reducer used in its industrial units, are subject to the Brazilian Forest Code.

The Code determines that certain areas, because of their importance for preserving the environment and water resources, be considered permanent preservation areas (APP). These include areas adjacent to rivers or natural or artificial reservoirs, and hilltops and hillside properties

with an incline steeper than 45°. At Gerdau's forest units, permanent preservation areas are an integral part of the business and are protected in compliance with the law.

Moreover, depending on the region where the property is located, the Code requires rural land owners to restore and preserve between 20%, 35% or 80% of areas containing native vegetation. The maintenance of these percentages of native vegetation is important because it guarantees the preservation of the local natural vegetation, perpetuating the genetic resources and the biodiversity of each Brazilian biome. Gerdau maintains its Legal Reserve areas preserved and in accordance with governing legislation.

**ITEM 4A. UNRESOLVED SEC STAFF COMMENTS**

The Company has no unresolved comments from the staff of the U.S. Securities and Exchange Commission with respect to its annual report under the Securities Exchange Act.

Table of Contents

**ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS**

The following discussion of the Company's financial condition and results of operations should be read in conjunction with the Company's audited Consolidated Financial Statements of financial position as of December 31, 2018 and 2017 and for each year in the three year period ended December 31, 2018, included in this Annual Report that have been prepared in accordance with International Financial Reporting Standards (IFRS) as well as with the information presented under "Presentation of Financial and Other Information" and "Selected Financial and Other Information of Gerdau".

The following discussion contains forward-looking statements that are based on management's current expectations, estimates and projections and that involve risks and uncertainties. The Company's actual results may differ materially from those discussed in the forward-looking statements as a result of various factors, including those described in the sections "Forward-Looking Statements" and "Risk Factors".

The primary factors affecting the Company's results of operations include:

- Economic and political conditions in the countries in which Gerdau operates, especially Brazil and the U.S.;
- The fluctuations in the exchange rate between the Brazilian *real* and the U.S. dollar;
- The cyclical nature of supply and demand for steel products both inside and outside of Brazil, including the prices for steel products;
- The Company's level of exports; and
- The Company's production costs.

**Brazilian Economic Conditions**

## Edgar Filing: GERDAU S.A. - Form 20-F

The Company's results and financial position depend largely on the situation of the Brazilian economy, most notably economic growth and its impact on steel demand, financing costs, the availability of financing and the exchange rates between Brazilian and foreign currencies.

Since 2003, the Brazilian economy has become more stable, with significant improvement in the main indicators. The continuity of the macroeconomic policies focused on tax matters, the inflation-targeting system, the adoption of a floating foreign exchange rate, the increase in foreign investment and compliance with international financial agreements, including the full repayment of debt with the International Monetary Fund, contributed to the improved economic conditions in Brazil.

In 2016, Brazilian GDP decreased by 3.6% (equivalent to US\$1.8 trillion Nominal GDP). Inflation, as measured by the IPCA index, stood at 6.3%. The average CDI rate in the year was 13.6%. The Brazilian *real* appreciated by 17.0% against the U.S. dollar, ending the year at R\$3.26 to \$1.00.

In 2017, Brazilian GDP increased by 1.0% (equivalent to US\$ 2.0 trillion Nominal GDP). Inflation, as measured by the IPCA index, stood at 3.0%. The average CDI rate in the year was 7.0%. The Brazilian *real* depreciated by 1.5% against the U.S. dollar, ending the year at R\$3.31 to \$1.00.

In 2018, Brazilian GDP increased by 1.1% (equivalent to US\$ 1.9 trillion Nominal GDP). Inflation, as measured by the IPCA index, stood at 3.7%. The average CDI rate in the year was 6.5%. The Brazilian *real* depreciated by 1.5% against the U.S. dollar, ending the year at R\$3.87 to \$1.00.

The recession appears to be nearing its end, but recovery is expected to be gradual. See the discussion below under "Trend Information".

Moreover, a significant portion of the Company's debt denominated in Brazilian *reals* is subject to interest at the CDI and TJLP rates, which are affected by many factors including inflation in Brazil. Another portion of the Company's debt, denominated in Brazilian *reals*, is indexed to general-inflation indexes, generally the IGP-M index. Therefore, higher inflation may result in increases in the Company's financial expenses and debt service obligations.

The interest rates that the Company usually pays depend on a variety of factors such as; movements on the interest rates, which can be driven by inflation; ratings given by the credit rating agencies that assess the Company; as well as the Company's debt securities that are traded in the secondary market, as bonds. The Company's debt obligations with floating interest rates, exposes the Company

Table of Contents

to market risks from changes in the CDI rate, IGP-M index and LIBOR. To reduce its exposure to interest rate risk, the Company seeks from time to time to enter into hedging arrangements to mitigate fluctuations in these rates, such as LIBOR.

The table below presents GDP growth, inflation, interest rates and the foreign exchange rate between the U.S. dollar and the Brazilian *real* for the periods shown.

		2018		2017		2016
Actual GDP growth		1.1%		1.0%		(3.6)%
Inflation (IGP-M) (1)		7.6%		(0.5)%		7.2%
Inflation (IPCA) (2)		3.7%		3.0%		6.3%
CDI rate (3)		6.4%		7.0%		13.6%
6-month LIBOR		2.9%		1.8%		1.3%
Depreciation (appreciation) in the Brazilian <i>real</i> against the U.S. dollar		17.1%		0.5%		(16.5)%
Foreign exchange rate at end of period	\$1.00	R\$ 3.8748	R\$	3.3080	R\$	3.2591
Average foreign exchange rate	\$1.00 (4)	R\$ 3.6831	R\$	3.1928	R\$	3.4833

Sources: Getúlio Vargas Foundation, Central Bank of Brazil and Bloomberg

- (1) Inflation as measured by the General Market Price index (IGP-M) published by the Getúlio Vargas Foundation (FGV).
- (2) Inflation as measured by the Board Consumer Price Index (IPCA) measured by Brazilian Institute of Geography and Statistics (IBGE).
- (3) The CDI rate is equivalent to the average fixed rate of interbank deposits recorded during the day in Brazil (annualized monthly cumulative figure at end of period).
- (4) Average of the foreign exchange rates, according to the Brazilian Central Bank, on the last day of each month in the period indicated.

### U.S. Economic Conditions

In view of the size of the Company's operations in the United States, U.S. economic conditions have a significant effect on the Company's results, particularly with regard to U.S. economic growth and the related effects on steel demand, financing costs and the availability of credit.

In the United States, Real GDP began to fall in the third quarter of 2008 (down 2.7% annualized) before falling at a 5.4% annual rate in the fourth quarter of 2008 as uncertainty and tight credit conditions led companies to preserve cash, leading to a drawdown in inventories throughout the supply chain. Inventory reduction continued on a much wider scale in the first quarter of 2009, accounting for about one-half of the 6.4% drop in annualized Real GDP. The second quarter of 2009 saw demand begin to stabilize, with Real GDP falling at a 0.7% pace as domestic demand and inventories bottomed out. Supported by the Cash for Clunkers program, which drove a sharp rise in auto sales, and first-time homebuyer incentives, which supported improved housing starts, Real GDP in the United States grew by 5.7% in the fourth quarter of 2009, as re-stocking of inventories outweighed the continued negative impact of rising unemployment on consumption. Throughout the last three years, the United States economy kept showing a gradual recovery, with an increase in the demand for steel products. The improvements in the automotive sector and the recovery in the non-residential construction sector were the drivers of the recovery in demand.

In 2016, according to the IMF (International Monetary Fund) the U.S. Real GDP grew by 1.6% (US\$ 18.6 trillion Nominal GDP). Inflation, as measured by the CPI, was 1.3%. The average Fed Funds rate (the interest rate established by the U.S. Federal Reserve) was 0.75%.

In 2017, according to the IMF (International Monetary Fund) the U.S. Real GDP grew by 2.2% (US\$ 19.4 trillion Nominal GDP). Inflation, as measured by the CPI, was 2.1%. The average Fed Funds rate (the interest rate established by the U.S. Federal Reserve) was 1.5%.

In 2018, according to the IMF (International Monetary Fund) the U.S. Real GDP grew by 2.3%. Inflation, as measured by the CPI, was 1.9%. The average Fed Funds rate (the interest rate established by the U.S. Federal Reserve) was 2.5%.

Table of Contents

The table below presents actual U.S. Real GDP growth, inflation and interest rates for the periods indicated.

	2018	2017	2016
Actual Real GDP growth (1)	2.3%	2.2%	1.6%
Inflation (CPI) (2)	1.9%	2.1%	1.3%
Fed Funds (3)	2.5%	1.5%	0.75%

Sources: International Monetary Fund and Federal Reserve Statistical Release

(1) Real GDP growth (annual percent change) published by the International Monetary Fund (IMF).

(2) Consumer price index, average of consumer prices (annual percent change) published by the International Monetary Fund (IMF). The CPI is a survey of consumer prices for all urban consumers.

(3) Fed Funds corresponds to the interest rate set by the U.S. Federal Reserve.

### Impact of Inflation and Fluctuations in Exchange Rates

Gerdau's results and its financial position are largely dependent on the state of the Brazilian economy, notably (i) economic growth and its impact on steel demand, (ii) financing costs and the availability of financing, and (iii) the rates of exchange between the Brazilian *real* and foreign currencies.

For many years, Brazil experienced high inflation rates that progressively eroded the purchasing power of the vast majority of the population. During periods of high inflation, salaries and wages tend to fall because the frequency and size of salary and wage adjustments for inflation usually do not offset the actual rate of inflation.

A portion of Gerdau's trade accounts receivable, trade accounts payable and debt is denominated in currencies other than the respective functional currencies of each subsidiary. The functional currency of the Brazilian operating subsidiaries is the Brazilian *real*. Brazilian subsidiaries have some of their assets and liabilities denominated in foreign currencies, mainly the U.S. dollar.

The foreign exchange effect on translation of foreign subsidiaries is recorded directly in shareholders' equity. Foreign exchange gains and losses on transactions, including the exchange gains and losses on some non-*real* denominated debt of the subsidiaries in Brazil are recognized in the statement of income. However, gains and losses from debts contracted for acquisition of overseas investments are designated as a hedge of net investment in foreign subsidiaries, and are also recorded directly in shareholders' equity. The operations of Gerdau in Brazil have both liabilities and assets denominated in foreign currency, with the amount of assets exceeding the amount of liabilities. The effect of the valuation of the Brazilian *real* versus other currencies (mainly the U.S. dollar) has a net positive effect in our shareholders' equity.

### The cyclical nature of supply and demand for steel products including the prices of steel products



The prices of steel products are generally sensitive to changes in world and local demand, which in turn are affected by economic conditions in the world and in the specific country. The prices of steel products are also linked to available installed capacity. Most of the Company's long rolled steel products, including rebars, merchant bars and common wire rods, are classified as commodities. However, a significant portion of the Company's long rolled products, such as special steel, wire products and drawn products, are not considered commodities due to differences in shape, chemical composition, quality and specifications, with all of these factors affecting prices. Accordingly, there is no uniform pricing for these products.

According to World Steel Association, world crude steel production in 2018 was 1,789 million tonnes, 4.5% higher than in 2017. China's crude steel production in 2017 reached 928 million tonnes, an increase of 12% over 2016. In 2018, China's share of world steel production was 52% of total crude steel. According to World Steel, world demand for finished steel products increased by 1.0% in 2016, 2.6% in 2017 and 3.0% in 2018. For 2019, the forecast calls for growth of 1.4%, since the current scenario is a stabilization of the Chinese economy and recoveries in developed economies continuing to advance.

International steel prices have experienced ups and downs throughout the period from the fourth quarter of 2007 and through the fourth quarter of 2009, when the average price per tonne of CIS (Commonwealth of Independent States) export billet at Black Sea/Baltic Sea was \$512 in the fourth quarter of 2007, skyrocketing to \$1,205 in June 2008, slumping to \$295 in March 2009 and reaching \$415 at the end of 2009. This swing in the steel price was mainly caused by the turmoil in the world economy and the surplus supply of steel products in a scenario of lower demand. In December 2018, the price increased 29.6% when compared to December of 2017, going from \$ 398 to \$ 515, due to the increase of raw materials prices.

Table of Contents

The average price per tonne of the CIS (Commonwealth of Independent States) export billet at the Black Sea/Baltic Sea is used as a reference for the international price, and it is possible to see its evolution in the chart below:

*Average Price of CIS Export Billet at Black Sea/Baltic Sea (\$ per Tonne)*

Sources: Metal Bulletin and Steel Business Briefing

*Export levels* during periods of lower domestic demand for the Company's products, the Company actively pursues export opportunities for its excess production in order to maintain capacity utilization rates and shipments. During periods of higher domestic demand for its products, export sales volumes may decline as the Company focuses on satisfying domestic demand. Gerdau exports products from Brazil to customers in other continents with whom we have long-established commercial relations. In 2018, exports were 20.4% lower than 2017 from 1,991 million tonnes in 2017 to 1,585 in 2018, which represented 28.6% of all shipments by the Company's Brazilian units, in 2017 exports represented 35.5% of total shipments from Brazil operations. This decrease was due to the truck drivers' strike in Brazil in May and the scheduled maintenance stoppage on Blast Furnace 2 in Ouro Branco, Minas Gerais. Export revenue totaled R\$3,425 million in 2018 (R\$3,056 million in 2017).

*Production costs* raw materials account for the highest percentage of the Company's production costs. Metallic inputs, which includes scrap, pig iron, iron ore, coke and metallic alloys, represented approximately 49.4% of production costs in 2018, while Energy and Reducing Agents, which represents the cost of coal, electricity, oxygen, natural gas and fuel oil, accounted for 14.3%. Personnel totaled 16.2% of production costs and Specific Materials, which includes

refractories, electrodes, rolling cylinders, rollers, guides, carburants and lime, were 10.5% of total production costs. The table below presents the production costs breakdown by business segment(BD):

**Production Costs Breakdown in 2018 (%)**

% of costs	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017
	Consolidated		Brazil Business Segment		North America Business Segment		South America Business Segment		Special Steel Business Segment	
Personnel	17.4	18.4	17.2	19.5	17.7	17.8	12.2	13.9	19.2	20.6
Maintenance	6.3	6.0	5.3	5.6	8.0	7.2	4.0	3.6	4.9	5.3
Depreciation	3.7	5.0	5.3	7.4	2.5	3.5	2.0	3.7	4.3	5.5
Metallic Inputs	46.6	46.5	31.7	29.6	53.5	55.1	68.7	61.9	48.7	45.6
Energy and Reducing Agents	15.2	15.2	31.1	29.5	6.7	7.2	7.7	11.0	8.8	13.1
Specific Materials	10.9	8.8	9.4	8.5	11.6	9.2	5.4	6.0	14.3	9.9

**Significant events affecting financial performance during 2018 and 2017**

*Exchange rate* In accordance with IFRS, the Company has designated a portion of its debt denominated in foreign currency and contracted by companies in Brazil as a hedge for a portion of the net investments in foreign subsidiaries. As a result, the effects from exchange variation gains or losses on the portion of debt designated for hedge accounting are also recognized in shareholders' equity. The subsidiaries that issued the debt are not subject to income taxes and as such there is no income tax effect on the exchange gains and losses on the debt. However, the subsidiaries have loaned the proceeds to other entities in Brazil with terms

Table of Contents

identical to those of the Ten Year Bonds. The payable by the subsidiaries in Brazil to the foreign subsidiaries denominated in US dollars generates exchange gains (losses) that are taxable and results in income tax recognized in the income statement, while these exchange variances are eliminated in consolidation with the offsetting exchange gains (losses) recognized by the foreign subsidiaries.

Starting from April 1, 2012, with the objective of eliminating the tax effect from the exchange variance of these debts, the Company designated part of its debt in foreign currency as a hedge for a portion of the investments in subsidiaries located outside Brazil. As a result, the exchange variation generated on the operations of Ten/Thirty Years Bonds in the amount of US\$ 1.8 billion (equivalent to R\$ 7.0 billion) (designated as hedges) is recognized in the Statement of Comprehensive Income, while the exchange rate on the portion of US\$ 0.3 billion (equivalent to R\$ 1.2 billion) (not designated as hedges) is recognized in income. Additionally, the Company opted to designate as hedge of the net investment financing operations held by the subsidiary Gerdau Açominas SA, in the amount of US\$ 0.1 billion (equivalent to R\$ 0.4 billion), which were made in order to provide part of the funds to purchase these investments abroad.

*Impairment of assets* In 2017, the Company performed the impairment test for goodwill and other long-lived assets, in which impairment losses were recognized in the amount of R\$ 1,114,807 thousand, of which R\$ 265,369 thousand as a result of the impairment test of other long-lived assets (see note 28.1 of the Consolidated Financial Statements) and R\$ 849,438 thousand as a result of the goodwill impairment test (see note 28.2 of the Consolidated Financial Statements).

**Results of Operations**

The following presentation of the Company's operating results for the years ended December 31, 2018, 2017 and 2016 is based on the Company's Consolidated Financial Statements prepared in accordance with the International Financial Reporting Standards (IFRS) included in this Annual Report. References to increases or decreases in any year or period are made in relation to the corresponding prior year or period, except where stated otherwise.

Table of Contents

The table below presents information for various income statements items and are expressed in both reais and as a percentage of net sales for each of the respective years:

**GERDAU S.A.****CONSOLIDATED STATEMENTS OF INCOME**

In thousands of Brazilian reais (R\$)

	For the year ended on		For the year ended on		Net Increase Horizontal Analysis		Horizontal Analysis	
	December 31, 2018	Net Increase (Decrease) 2018	December 31, 2017	Net Increase (Decrease) 2017	December 31, 2016	Net Increase (Decrease) 2016	2018x2017	2017x2016
<b>NET SALES</b>	46,159,478		36,917,619		37,651,667		25.0%	-1.9%
Cost of sales	(40,010,100)	-86.7%	(33,312,995)	-90.2%	(34,187,941)	-90.8%	20.1%	-2.6%
<b>GROSS PROFIT</b>	6,149,378	13.3%	3,604,624	9.8%	3,463,726	9.2%	70.6%	4.1%
Selling expenses	(570,431)	-1.2%	(524,965)	-1.4%	(710,766)	-1.9%	8.7%	-26.1%
Impairment loss on trade receivables	(9,914)	0.0%		0.0%				
General and administrative expenses	(1,082,449)	-2.3%	(1,129,943)	-3.1%	(1,528,262)	-4.1%	-4.2%	-26.1%
Other operating income	235,421	0.5%	260,618	0.7%	242,077	0.6%	-9.7%	7.7%
Other operating expenses	(270,413)	-0.6%	(168,887)	-0.5%	(114,230)	-0.3%	60.1%	47.8%
Impairment of non-financial assets			(1,114,807)	-3.0%	(2,917,911)	-7.7%		-61.8%
Gains and losses on assets held for sale and sales of interest in subsidiaries	(414,507)	-0.9%	(721,682)	-2.0%	(58,223)	-0.2%	-42.6%	1139.5%
Reversal of provision for tax liabilities, net			929,711	2.5%				
Equity method investees	10,141	0.0%	(34,597)	-0.1%	(12,771)	0.0%	-129.3%	170.9%
<b>INCOME (LOSS) BEFORE FINANCIAL INCOME (EXPENSES) AND TAXES</b>	4,047,226	8.8%	1,100,072	3.0%	(1,636,360)	-4.3%	267.9%	-167.2%
Financial income	204,000	0.4%	226,615	0.6%	252,045	0.7%	-10.0%	-10.1%
Financial expenses	(1,579,341)	-3.4%	(1,726,284)	-4.7%	(2,010,005)	-5.3%	-8.5%	-14.1%
Bonds Repurchases	(223,925)	-0.5%		0.0%				

Edgar Filing: GERDAU S.A. - Form 20-F

expenses								
Exchange variations, net	(322,621)	-0.7%	(4,057)	0.0%	851,635	2.3%	7852.2%	-100.5%
Reversal of interest on provision for tax liabilities, net			369,819	1.0%				
Gains and losses on derivative financial instruments, net	32,092	0.1%	(9,441)	0.0%	(38,930)	-0.1%	-439.9%	-75.7%
<b>INCOME (LOSS) BEFORE TAXES</b>	2,157,431	4.7%	(43,276)	-0.1%	(2,581,615)	-6.9%	-5085.3%	-98.3%
Current	(629,209)	-1.4%	(313,758)	-0.8%	(110,511)	-0.3%	100.5%	183.9%
Deferred	798,160	1.7%	18,367	0.0%	(193,803)	-0.5%	4245.6%	-109.5%
Income and social contribution taxes	168,951	0.4%	(295,391)	-0.8%	(304,314)	-0.8%	-157.2%	-2.9%
<b>NET INCOME (LOSS)</b>	2,326,382	5.0%	(338,667)	-0.9%	(2,885,929)	-7.7%	-786.9%	-88.3%

Table of Contents**Year Ended December 31, 2018 Compared with Year Ended December 31, 2017***Net Sales*

Net Sales by Business Segments(*) (R\$ million)	Year ended December 31, 2018	Year ended December 31, 2017	Variation Year ended December 31, 2018/ Year ended December 31, 2017
Brazil	15,745	12,563	25.3%
North America	19,927	15,433	29.1%
South America	3,801	4,026	(5.6)%
Special Steel	8,159	6,229	31.0)%
Intercompany Eliminations	(1,473)	(1,333)	
<b>Total</b>	<b>46,159</b>	<b>36,918</b>	<b>25.0%</b>

---

(\*) The information does not include data from associate and joint ventures.

Net Sales per tonne by Business Segments(*) (R\$/tonne)	Year ended December 31, 2018	Year ended December 31, 2017	Variation Year ended December 31, 2018/ Year ended December 31, 2017
Brazil	2,844	2,240	27%
North America	3,275	2,445	34%
South America	2,909	2,336	25%
Special Steel	3,864	3,151	23%
<b>Consolidated(1)</b>	<b>3,170</b>	<b>2,472</b>	<b>28%</b>

---

(\*) The information does not include data from associate and joint ventures.

(1) The information does not include iron ore volumes.

Consolidated net sales increased in 2018 in relation to 2017, due to the increase in net sales per tonne sold at all BDs, which was influenced by higher international prices.

At the Brazil Business Segment, the increase in net sales in 2018 compared to 2017 is explained by the increases in sales price per tonne sold in the both the domestic and export markets, which were influenced by the higher prices per tonne sold.

At the North America Business Segment, net sales increased in 2018 compared to 2017, due to the increase in sales price per tonne sold, which was influenced by better prices in the export market in the period, despite the reduction in shipments due to the loss of control, resulting in the deconsolidation of rebar and wire rod assets in the region.

At the South America Business Segment, the increase in net sales in 2018 compared to 2017 was influenced by higher prices in the export market.

At the Special Steel Business Segment, net sales increased in 2018 compared to 2017, due to the increases in shipments and in net sales per tonne sold.



Table of Contents*Cost of Sales and Gross Profit*

Brazil	Net sales (R\$million)	<b>15,745</b>	12,563	25.3%
	Cost of Sales (R\$million)	<b>(13,044)</b>	(10,996)	18.6%
	Gross Profit (R\$million)	<b>2,701</b>	1,566	72.5%
	<i>Gross margin (%)**</i>	<b>17.2%</b>	<i>12.5%</i>	
South America	Net sales (R\$million)	<b>3,801</b>	4,026	-5.6%
	Cost of Sales (R\$million)	<b>(3,231)</b>	(3,523)	-8.3%
	Gross Profit (R\$million)	<b>570</b>	502	13.5%
	<i>Gross margin (%)**</i>	<b>15.0%</b>	<i>12.5%</i>	
Intercompany Eliminations	Net sales (R\$million)	<b>(1,473)</b>	(1,333)	
	Cost of Sales (R\$million)	<b>1,495</b>	1,332	
	Gross Profit (R\$million)	<b>22</b>	(1)	

(\*) The information does not include data from the associate and joint ventures.

(\*\*) Gross Profit divided by Net Sales.

Cost of goods sold increased in relation to 2017, given the changes in cost per tonne sold at all Business Segments, which was influenced by the higher prices of inputs in general.

At the Brazil Business Segment, cost of sales increased 18.6% in 2018 compared to 2017, driven by higher prices of inputs in general (metals increased their share of production costs from 29.6% in 2017 to 33.4% in 2018). Gross margin increased in 2018 compared to 2017, since the increase in net revenue per tonne sold (+27.0%) outpaced the increase in costs per tonne sold.

At the North America Business Segment, cost of sales increased 22.5% in 2018 compared to 2017, driven by higher prices of inputs in general (metals increased their share of production costs from 43.4% in 2017 to 44.4% in 2018). The improvement in gross margin was due to the better metal spread in the period, which was supported by favorable economic growth for the construction and manufacturing industries.

At the South America Business Segment, cost of sales decreased 8.3% in 2018 compared to 2017, mainly due to the loss of control, resulting in the deconsolidation of the Colombia and Chile operations. Gross margin expanded in 2018 compared to 2017, since the increase in net sales per tonne sold outpaced the increase in cost per tonne sold, which was influenced by higher international prices.

At the Special Steel Business Segment, the 33.3% increase in cost of goods sold in 2018 compared to 2017 is explained by the higher prices of inputs in general, especially electrodes, scrap and metal alloys (specific materials increased their share of production costs from 9.9% in 2017 to 13.0% in 2018). Gross margin decreased in 2018 compared to 2017, since the increase in costs per tonne sold outpaced the increase in net sales per tonne sold due to the adverse effects in the second half of 2018 from economic slowdown in Argentina, which affected Brazil's auto industry, which is an important client of our special steel operations in that

Table of Contents

country, as well as cost pressures, with increases in the prices of higher-quality scrap and electrodes, which are important cost components in this operation.

*Selling, General and Administrative Expenses*

Operating Expenses (R\$ million)	2018	2017	Variation Year ended December 31, 2018/ Year ended December 31, 2017
Selling expenses and Impairment loss on trade receivables	580	525	10.5%
General and administrative expenses	1,082	1,130	-4.2%
<b>Total</b>	<b>1,662</b>	<b>1,655</b>	<b>0.4%</b>
Net sales	46,159	36,918	25.0%
<b>% of net sales</b>	<b>3.6%</b>	<b>4.5%</b>	

Selling, general and administrative expenses remained stable in 2018 compared to 2017, reflecting the Company's ongoing efforts to streamline operations and to implement the digital innovation over the past few years, and corresponded to 3.6% of net sales in 2018, which is the lowest percentage ever.

*Operating Income (Loss) before Financial Income (Expenses) net and Taxes*

Income before Financial Income and Taxes was R\$ 4,047.2 million in 2018, compared to an income of R\$1,100.0 million, 2017. The increase was mainly due to the 70.6% growth in gross profit driven by the increases commodity steel prices and the reduced of losses from asset impairment in 2018.

*Financial Income, Financial Expenses, Exchange Variations, net and Gains and Losses on financial instruments, net*

Financial Income, Financial Expenses, Exchange Variations, net and Gain and Losses on derivatives, net (R\$ million)	2018	2017	Variation Year ended December 31, 2018/ Year ended December 31, 2017
Financial income	204	227	-10.1%
Financial expenses	(1,579)	(1,726)	-8.5%
Bonds Repurchases expenses	(224)		-100.0%
Exchange variation, net	(323)	(4)	7975.0%
Reversal of interest on provision for tax liabilities, net		369	
Gains and Losses on financial instruments, net	32	(9)	
<b>Total</b>	<b>(1,890)</b>	<b>(1,143)</b>	<b>83.2%</b>

The net financial expense was R\$ 1,889.8 million in 2018, compared to an expense of R\$ 1,143.3 million in 2017. The increase in expenses was mainly due to the net effects from exchange variation on liabilities contracted in U.S. dollar (average depreciation of the Brazilian real against

the U.S. dollar of 15% in the comparative period).

Table of Contents*Income and Social Contribution Taxes*

Income and social contribution taxes were a tax benefit of R\$ 168.9 million in 2018, compared to an expense of R\$ 295.4 million in 2017. The change from expense to benefit in the income and social contribution balance for the year 2018 compared to 2017 was mainly due to the tax effect on the exchange variation in 2018 (depreciation of the Real against the US dollar was 17.1%).

**Year Ended December 31, 2017 Compared with Year Ended December 31, 2016***Net Sales*

Net Sales by Business Segments(*) (R\$ million)	Year ended December 31, 2017	Year ended December 31, 2016	Variation Year ended December 31, 2017/ Year ended December 31, 2016
Brazil	12,563	11,635	8.0%
North America	15,433	15,431	0.0%
South America	4,026	4,776	(15.7)%
Special Steel	6,229	6,885	(9.5)%
Intercompany Eliminations	(1,333)	(1,075)	
<b>Total</b>	<b>36,918</b>	<b>37,652</b>	<b>(1.9)%</b>

(\*) The information does not include data from associate and joint ventures.

Net Sales per tonne by Business Segments(*) (R\$/tonne)	Year ended December 31, 2017	Year ended December 31, 2016	Variation Year ended December 31, 2017/ Year ended December 31, 2016
Brazil	2,240	1,918	16,8%
North America	2,445	2,587	(5.5)%
South America	2,336	2,287	2.1%
Special Steel	3,151	3,276	(3.8)%
<b>Consolidated(1)</b>	<b>2,472</b>	<b>2,420</b>	<b>2.1%</b>

(\*) The information does not include data from associate and joint ventures.

(1) The information does not include iron ore volumes.

In 2017, consolidated net sales decreased 1.9% in relation to 2016, due to the lower shipments.

In the Brazil Business Segment, the 8.0% increase in net sales in 2017 compared to 2016 was due to the higher net sales per tonne, despite the decline in shipments (from 6,068 thousand tonnes in 2016 to 5,068 thousand tonnes in 2017).

In the North America Business Segment, net sales remained stable in 2017 compared to 2016, due to the 5.5% reduction in net sales per tonne sold in Brazilian real, which was affected by exchange variation (8.3% appreciation in the average price of the Brazilian *real* against the U.S. dollar), despite the 5.8% increase in shipments in the period (from 5,965 thousand tonnes in 2016 to 6,313 thousand tonnes in 2017).

In the South America Business Segment, net sales decreased 15.7% in 2017 compared to 2016, mainly due to the loss of control resulting in the deconsolidation of the operation in Colombia, whose shipments through May 2017 amounted to 121 thousand tonnes.

In the Special Steel Business Segment, the 9.5% decrease in net sales in 2017 compared to 2016 was mainly due to the divestment of the units in Spain, whose shipments through May 2016 came to 341 thousand tonnes. Sales in the remaining (after the sale of Spain) special steel business units increased by 12.3% compared to prior year.

Table of Contents*Cost of Sales and Gross Profit*

Brazil	Net sales (R\$million)	12,563	11,635	8.0%
	Cost of Sales (R\$million)	(10,996)	(10,405)	5.7%
	Gross Profit (R\$million)	1,566	1,230	27.4%
	<i>Gross margin (%)</i>	<i>12.5%</i>	<i>10.6%</i>	
South America	Net sales (R\$million)	4,026	4,776	(15.7)%
	Cost of Sales (R\$million)	(3,523)	(4,103)	(14.1)%
	Gross Profit (R\$million)	502	672	(25.3)%
	<i>Gross margin (%)</i>	<i>12.5%</i>	<i>14.1%</i>	
Intercompany Eliminations	Net sales (R\$million)	(1,333)	(1,075)	
	Cost of Sales (R\$million)	1,332	1,074	
	Gross Profit (R\$million)	(1)	(1)	

(\*) The information does not include data from the associate and joint ventures.

In 2017, cost of sales decreased 2.6% compared to 2016, due to the lower shipments. Gross margin increased slightly, supported by the better performance of the Brazil and Special Steel BDs, which offset the weaker performance of the North America and South America BDs in the comparison periods.

In the Brazil Business Segment, cost of sales increased 5.7% in 2017 compared to 2016, driven by higher raw material costs (metallic materials increased their share of production costs from 26.9% in 2016 to 29.6% in 2017). Gross margin increased in 2017 compared to 2016, due to the increase in net sales per tonne sold (16.8%) outpacing the increase in raw material costs.

In the North America Business Segment, cost of sales increased 2.1% in 2017 compared to 2016, due to higher shipments (5.8%) and higher raw material costs (metallic materials increased their share of production costs from 46.9% in 2016 to 55.1% in 2017), despite the impact from exchange variation (8.3% appreciation in the average price of the Brazilian *real* against the U.S. dollar). The decline in gross margin is explained by the intense competition in domestic market, where the growth in net sales in U.S. dollar did not accompany the increase in costs.

In the South America Business Segment, cost of sales decreased 14.1% in 2017 compared to 2016, mainly due to the loss of control, resulting in the deconsolidation of the operation in Colombia. The reduction in gross margin is explained by the weaker performance of the operations in Argentina and Venezuela.

In the Special Steel Business Segment, the 15% decrease in cost of sales in 2017 compared to 2016 is mainly due to the divestment of the units in Spain. The higher gross margin in 2017 compared to 2016 was due to the stronger performance of the units in the United States and Brazil, in addition to the divestment of the units in Spain, which were the least profitable operations of this BD.



Table of Contents*Selling, General and Administrative Expenses*

Operating Expenses(*) (R\$ million)	2017	2016	Variation Year ended
			December 31, 2017/ Year ended December 31, 2016
Selling expenses	525	711	-26.2%
General and administrative expenses	1,130	1,528	-26.1%
<b>Total</b>	<b>1,655</b>	<b>2,239</b>	<b>-26.1%</b>
Net sales	36,918	37,652	-2.0%
<b>% of net sales</b>	<b>4.5%</b>	<b>5.9%</b>	

(\*) The information does not include data from the associate and joint ventures.

The 26.2% reduction in consolidated selling expenses and 26.1% reduction in general and administrative expenses reflected the Company's efforts to streamline these expenses, as well as the 4.0% decrease in shipments. Consequently, selling, general and administrative expenses as a percentage of net sales stood at 4.5% in 2017, down from 5.9% in 2016.

*Impairment of assets*

In 2017, the line losses from asset impairments amounted to R\$1,114.8 million, which is related to the impairment of goodwill and lack of expectation of future use of some assets in some industrial plants, as identified by impairment testing. In the fourth quarter of 2017, due to the lack of expectation of future use of some assets in some industrial plants, the tests conducted of other long-lived assets identified losses from the impairment of fixed assets of R\$265,369 thousands, of which R\$45,279 thousands was in the Brazil segment and R\$220,090 thousands in the North America segment, due to recoverable values below the carrying values. These losses were determined based on the difference between the carrying amount and the recoverable value of these assets, of R\$0, which represents the value in use (the greater of fair value net of expenses to sell and their value in use). Also, in the fourth quarter of 2017, the Company assessed the impairment of goodwill of its segments. Based primarily on the increase in the discount rate, the tests identified losses from asset impairments on goodwill of R\$849,438 thousands in the North America BD. The other business segments did not present losses from asset impairments on goodwill in the tests conducted in 2017. Additional information is presented in Note 28 of the Consolidated Financial Statements contained herein.

*Operating Income (Loss) before Financial Income (Expenses) net and Taxes*

In 2017, the operating Income (Loss) before Financial Result and Taxes was a gain of R\$1,100.1 million, when compared to a loss of R\$1,636.4 million in the fiscal year ended December 31, 2016. The variation was mainly due to lower asset impairment losses, higher losses from operations with subsidiaries, the reversal of net provision for tax liabilities and the reduction in selling, general and administrative expenses in 2017 compared to 2016. Additional information is presented in Notes 3.4, 17, 28 and 29 of the Consolidated Financial Statements contained herein.

*Financial Income, Financial Expenses, Exchange Variations, net and Gains and Losses on financial instruments, net*

<b>Financial Income, Financial Expenses, Exchange Variations, net and Gain and Losses on derivatives, net (R\$ million)</b>	<b>2017</b>	<b>2016</b>	<b>Variation Year ended December 31, 2017/ Year ended December 31, 2016</b>
Financial income	227	252	-10.0%
Financial expenses	(1,726)	(2,010)	-14.1%
Exchange variation, net	(4)	852	-288.6%
Reversal of interest on provision for tax liabilities, net	369		100.0%
Gains and Losses on financial instruments, net	(9)	(39)	-75.9%
<b>Total</b>	<b>(1,143)</b>	<b>(945)</b>	<b>20.9%</b>

The net financial result went from a net expenses of R\$945.3 million in 2016 to a net expenses of R\$1,143.3 million in 2017. The increase in financial expenses mainly reflects the net exchange variation on liabilities contracted in U.S. dollar (depreciation in the closing price of the Brazilian *real* against the U.S. dollar of 1.5% in 2017, compared to appreciation of 16.5% in 2016), despite the lower financial expenses (-14.1%) in the comparison period.

Table of Contents

Note that the Company designated part of its debt in foreign currency as a hedge for a portion of the investments in subsidiaries located abroad. As a result, the exchange variation on the amount of US\$2.3 billion (US\$2.1 billion related to the 10/30 Year Bonds and US\$0.2 billion related to other financing operations) was recognized in the statement of income, while the exchange variation on the portion of US\$0.5 billion was recognized in financial result and was compensated by the line Income and Social Contribution Taxes.

***Income and Social Contribution Taxes***

Income and social contribution taxes were an expense of R\$295.4 million in 2017, compared to an expense of R\$304.3 million in 2016. This variation was primarily due to the lower income tax rates at certain companies abroad.

***Net Income (loss)***

Consolidated net loss went from R\$2,885.9 million in 2016 to R\$338.7 million in 2017. The variation was mainly due to the operating income in 2017, compared to the operating loss recorded in 2016, and to the lower negative financial result in 2017.

In the Brazil Business Segment, net income was R\$302.3 million in 2017, compared to a net loss of R\$36.7 million in 2016. The variation was due to the higher operating income, which increased from R\$553.5 million in 2016 to R\$969.9 million in 2017.

The North America Business Segment generated a net loss of R\$956.3 million in 2017, compared to a net loss of R\$2,591.9 million in 2016. This variation was mainly due to the losses from asset impairment of R\$1,069.5 million in 2017, which was lower than the amount of R\$2,779.1 million registered in 2016.

In 2017, the South America Business Segment generated net income of R\$154.4 million, compared to net income of R\$134.2 million in 2016. This improvement was mainly due to the losses from asset impairment of R\$138.8 million in 2016.

In 2017, the Special Steel Business Segment generated net income of R\$475.4 million, compared to net income of R\$162.5 million in 2016. The variation was due to the higher gross profit (+43.6%) in the period.

**Critical Accounting Policies**

Critical accounting policies are those that are (a) important to present the financial position and results of operations or (b) require management's most difficult, subjective or complex judgments, often as a result of the need to make estimates that impact matters that are inherently uncertain. As the number of estimates and assumptions affecting the possible future resolution of the uncertainties increases, those judgments become even

more subjective and complex. In the preparation of the Consolidated Financial Statements, the Company has relied on estimates and assumptions derived from historical experience and various other factors that it deems reasonable and relevant. Although these estimates and assumptions are reviewed by the Company in the normal course of business, the presentation of its financial position and results of operations often requires making judgments regarding the effects of inherently uncertain matters on the carrying value of its assets and liabilities. Actual results may differ from estimates based on different variables, assumptions or conditions. In order to provide an understanding of how the Company forms its judgments about future events, including the variables and assumptions underlying the estimates, comments have been included that relate to each critical accounting policy described below:

- deferred income and social contribution taxes;
  
- pension and post-employment benefits;
  
- provisions;
  
- loss of control of a subsidiary, and
  
- impairment test of assets with definite and indefinite useful life.

Table of Contents

***Deferred Income and Social Contribution Taxes***

The amount of the deferred income and social contribution tax asset is revised at each Consolidated Financial Statement date and reduced by the amount that is no longer probable of being realized based on future taxable income. Deferred income and social contribution tax assets and liabilities are calculated using tax rates applicable to taxable income in the years in which those temporary differences are expected to be realized. Future taxable income may be higher or lower than estimates made when determining whether it is necessary to record a tax asset and the amount to be recorded.

The realization of deferred tax assets for tax loss carryforwards are supported by projections of taxable income based on technical feasibility studies submitted annually to the Company's Board of Directors. These studies consider historical profitability of the Company and its subsidiaries and expectation of continuous profitability and estimated the recovery of deferred tax assets over future years. The other tax credits arising from temporary differences, mainly tax contingencies, and provision for losses, were recognized according to their estimate of realization, and are consistent with recoverability described above.

***Pension and Post-Employment Benefits***

Actuarial gains and losses are recorded in the period in which they are originated and are recorded in the statement of comprehensive income.

The Company recognizes its obligations related to employee benefit plans and related costs, net of plan assets, in accordance with the following practices:

i) The cost of pension and other post-employment benefits provided to employees is actuarially determined using the projected unit of credit method and management's best estimate of expected investment performance for funded plans, salary increase, retirement age of employees and expected health care costs. The discount rate used for determining future benefit obligations is an estimate of the interest rate in effect at the balance sheet date on high-quality fixed-income investments with maturities that match the expected maturity of obligations.

ii) Pension plan assets are stated at fair value.

iii) Gain and losses related to the curtailment and settlement of the defined benefit plans are recognized when the curtailment or settlement occurs and they are based on actuarial evaluation done by independent actuaries.

In accounting for pension and post-retirement benefits, several statistical and other factors that attempt to anticipate future events are used to calculate plan expenses and liabilities. These factors include discount rate assumptions, return on plan assets, future increases in health care

costs, and rate of future compensation increases. In addition, actuarial computations include other factors whose measurement involves judgment such as withdrawal, turnover, and mortality rates. The actuarial assumptions used by the Company may differ materially from actual results in future periods due to changing market and economic conditions, regulatory events, judicial rulings, higher or lower withdrawal rates, or longer or shorter participant life spans.

*Provisions*

The significant judgment is related to recognition and measurement of provisions. The Company recognizes provisions for liabilities and probable losses that have been incurred when it has a present obligation as a result of past events, it is probable that the Company will be required to settle the obligation and a reliable estimate of the amount of the obligation can be made. If the effect of the time value of money is material, provisions are discounted using a current pre-tax rate that reflects, where appropriate, the risks specific to the liability. Provisions for tax, civil and labor liabilities are presented in Note 17 of the Consolidated Financial Statements contained herein.

The Company records provisions for environmental liabilities based on best estimates of potential clean-up and remediation costs for known environmental sites. The Company has a team of professionals to manage all phases of its environmental programs. These professionals develop estimates of liabilities at these sites based on projected and known remediation costs. This analysis requires the Company to make significant estimates and changes in facts and circumstances, which may result in material changes to environmental provisions.

Table of Contents

The steel industry uses and generates substances that may damage the environment. The Company's management performs frequent surveys with the purpose of identifying potentially impacted areas and records as current liabilities and non-current liabilities in the account "Environmental liabilities", based on best cost estimate, the amounts estimated for investigation, treatment and cleaning of potentially affected sites. The Company used assumptions and estimates for determining the estimated amount, which may vary in the future depending on the final investigations and determination of the actual environmental impact.

The Company is compliant with all the applicable environmental regulations in the countries where they operate.

*Loss of control of a subsidiary*

When control of a subsidiary is lost as a result of a transaction, event or other circumstance, the revised Standard requires that the Company derecognizes all assets, liabilities and non-controlling interests at their carrying amount. Any retained interest in the former subsidiary is recognized at its fair value at the date that control is lost. This fair value is reflected in the calculation of the gain or loss on disposal attributable to the parent, and becomes the initial carrying amount for subsequent accounting for the retained interest.

*Impairment Test of Assets with definite and indefinite useful life*

There are specific rules to assess the impairment of long-lived assets, especially property, plant and equipment, goodwill and other intangible assets. On the date of each Financial Statement, the Company performs an analysis to determine if there is evidence that the carrying amount of long-lived assets is impaired. If such evidence is identified, the recoverable amount of the assets is estimated by the Company.

The recoverable amount of an asset is determined as the higher of: (a) its fair value less estimated costs of sale and (b) its value in use. The value in use is measured based on discounted cash flows (before taxes) derived from the continuous use of the asset until the end of its useful life.

Regardless of whether or not there is any indication that the carrying amount of the asset may not be recovered, the balances of goodwill arising from business combinations and assets with indefinite useful lives are tested for impairment at least once a year, in December.

When the residual carrying value of the asset exceeds its recoverable amount, the Company recognizes a reduction in this asset's book balance. The reduction in recoverable amount must be recorded in income for the year.

Except for the impairment of goodwill, a reversal of previously recorded impairment losses is allowed. Reversal in these circumstances is limited up to the amount of depreciated balance of the asset at the date of the reversal, determined as if the impairment had not been recorded.

## Edgar Filing: GERDAU S.A. - Form 20-F

The Company evaluates the recoverability of goodwill at least annually and uses accepted market practices, including discounted cash flow for units with goodwill allocated and comparing the book value with the recoverable amount of the assets.

The impairment test of these assets (assets other than goodwill) are assessed based on the analysis of facts and circumstances to perform the impairment test annually in December, or being anticipated whenever changes in events or circumstances indicate that the goodwill and other long-lived assets may be impaired.



Table of Contents

The Company performs goodwill impairment tests for all of its operating segments, which represent the lowest level at which goodwill is monitored by management based on projections for discounted cash flows and that take into consideration the following assumptions: cost of capital, growth rate and adjustments used for perpetual cash flows, methodology for determining working capital, investment plans and long-term economic-financial forecasts.

The period for projecting the cash flows for the goodwill impairment test was five years. The assumptions used to determine the value in use based on the discounted cash flow method include analysis prepared in dollars, such as: projected cash flows based on management estimates for future cash flows, exchange rates, discount rates and growth rates on perpetuity. The cash flow projections already reflect a more challenging competitive scenario than projected in previous years, resulting from a deterioration in the steel consuming markets and overcapacity in the industry, as well as macroeconomic challenges in certain markets in which the Company operates. The perpetuity was calculated considering stable operating margins, levels of working capital and investments. The perpetuity growth rates considered in the 2018 test were: a) North America: 3% (3% in December 2017); b) Special Steel: 3% (3% in December 2017); c) South America: 3% (3% in December 2017); and d) Brazil: 3% (3% in December 2017).

The pre-tax discount rates used were determined taking into consideration market information available on the date of performing the impairment test. The Company adopted distinct rates for each business segment tested with the purpose of reflecting the differences among the markets in which each segment operates, as well as the risks associate to each of them. The pre-tax discount rates used were: a) North America: 13.8% (13.6% in December 2017); b) Special Steel: 14.7% (13.1% in December 2017); c) South America: 17.1% (14.7% in December 2017); and d) Brazil: 16.4% (15.2% in December 2017).

Discounted cash flows are compared to the book value of each segment and result in the recoverable amount as shown below: a) North America: exceeded the book value of R\$ 2,157 million (below the book value of R\$ 849 million in 2017); b) South America: exceeded the book value by R\$ 730 million (exceeded the book value by R\$ 437 million in 2017); c) Special Steel: exceeded the book value by R\$ 3,019 million (exceeded the book value by R\$ 3,989 million in 2017); and d) Brazil: exceeded the book value by R\$ 3,924 million (exceeding the book value by R\$ 1,747 million in 2017).

The Company performed a sensitivity analysis in the assumptions of discount rate and perpetuity growth rate, due to the potential impact in the discounted cash flows.

An increase of 0.5 % in the discount rate of each segment's cash flow would result in a recoverable amount below the book value and / or that exceeded the book value as shown below: a) North America: exceeded book value of R\$ 1,474 million (below the book value by R\$ 506 million in 2017); b) Special Steel: exceeded book value by R\$ 2,483 million (exceeded the book value by R\$ 3,422 million in 2017); c) South America: exceeded book value by R\$ 593 million (exceeded the book value by R\$ 265 million in 2017); and d) Brazil: exceeded the book value by R\$ 3,048 million (exceeded the book value by R\$ 999 million in 2017).

On the other hand, a decrease of 0.5 % in the perpetuity growth rate of the cash flow of each business segment would result in a recoverable amount below the book value and / or that exceeded the book value as shown below: a) North America: exceeded the book value by R\$ 1,672 million (below the book value by R\$ 310 million in 2017); b) Special Steel: exceeded the book value by R\$ 2,645 million (exceeded the book value by R\$ 3,596 million in 2017); c) South America: exceeded the book value by R\$ 640 million (exceeded the book value by R\$ 318 million in 2017); and d) Brazil: exceeded the book value by R\$ 3,318 million (exceeded the book value by R\$ 1,254 million in 2017).

The Company will maintain over the next year its constant monitoring of the steel market in order to identify any deterioration, significant drop in demand from steel consuming sectors (notably automotive and construction), stoppage of industrial plants or activities relevant changes in the economy or financial market that result in increased perception of risk or reduction of liquidity and refinancing capacity. Although the projections made by the Company provide a more challenging scenario than that in recent years, the events mentioned above, if manifested in a greater intensity than that anticipated in the assumptions made by management, may lead the Company to revise its projections of value in use and eventually result in impairment losses.

Goodwill that forms part of the carrying amount of an investment in an associate or in a joint venture entity is not separately recognized and it is not tested for impairment separately. Instead, the entire carrying amount of the investment in an associate or in a joint venture is tested for impairment as a single asset, by comparing its recoverable amount (higher of value in use and fair value less costs to sell) with its carrying amount. An impairment loss recognized in those circumstances is not allocated to any asset, including

Table of Contents

goodwill that forms part of the carrying amount of the investment in the associate or joint venture. Accordingly, any reversal of that impairment loss is recognized to the extent that the recoverable amount of the investment subsequently increases.

The recoverability review process is subjective and requires significant judgments through analysis performed. The determination of fair value for the Company's operating segments, based on projected cash flows, may be negatively impacted if the economic global recovery happens slower than what management expected during the preparation of financial statements in December 2018.

Additional information related to impairment of goodwill and other long lived assets are described at Note 28 of the Consolidated Financial Statements contained herein.

Table of Contents**Cash Flow**

The table below presents information for the cash flow of the respective years:

**GERDAU S.A.****CONSOLIDATED STATEMENTS OF CASH FLOWS**

In thousands of Brazilian reais (R\$)

	December 31, 2018	For the year ended on December 31, 2017	December 31, 2016	Net Increase (Decrease) % 2018x2017	Net Increase (Decrease) % 2017x2016
<b>Cash flows from operating activities</b>					
Net income (loss) for the year	2,326,382	(338,667)	(2,885,929)	-786.9%	-88.3%
Adjustments to reconcile net income for the year to net cash provided by operating activities					
Depreciation and amortization	1,891,814	2,092,551	2,535,955	-9.6%	-17.5%
Impairment of Assets		1,114,807	2,917,911	-100.0%	-61.8%
Equity in earnings of unconsolidated companies	(10,141)	34,597	12,771	-129.3%	170.9%
Exchange variation, net	322,621	4,057	(851,635)	7852.2%	-100.5%
Losses (Gains) on financial instruments, net	(32,092)	9,441	38,930	-439.9%	-75.7%
Post-employment benefits	189,603	192,724	229,767	-1.6%	-16.1%
Stock based compensation	41,186	35,576	46,683	15.8%	-23.8%
Income tax	(168,951)	295,391	304,314	-157.2%	-2.9%
Gains on disposal of property, plant and equipment	(41,109)	(69,510)	(43,340)	-40.9%	60.4%
Results in operations with subsidiaries	414,507	721,682	58,223	-42.6%	1139.5%
Impairment loss on trade receivables	9,914	18,342	68,781	-45.9%	-73.3%
Provision for tax, labor and civil claims	(56,409)	(110,281)	347,882	-48.8%	-131.7%
Reversal of contingent liabilities, net		(929,711)		-100.0%	
Interest income on short-term investments	(49,745)	(75,387)	(107,980)	-34.0%	-30.2%
Interest expense on loans	1,177,686	1,323,448	1,540,797	-11.0%	-14.1%
Reversal of monetary update of contingent liabilities, net		(369,819)		-100.0%	
Interest on loans with related parties	(545)	(95)	2,457	473.7%	-103.9%
Provision (Reversal) for net realisable value adjustment in inventory	8,228	(20,195)	(31,492)	-140.7%	-35.9%
	6,022,949	3,928,951	4,184,095	53.3%	-6.1%
<b>Changes in assets and liabilities</b>					
	71,631	(54,690)	64,805	-231.0%	-184.4%

Edgar Filing: GERDAU S.A. - Form 20-F

Decrease (Increase) in trade accounts receivable					
(Increase) Decrease in inventories	(2,427,473)	(1,269,455)	794,591	91.2%	-259.8%
Increase in trade accounts payable	900,388	800,164	110,466	12.5%	624.4%
Decrease (Increase) in other receivables	(118,988)	(371,745)	(275,938)	-68.0%	34.7%
Decrease in other payables	(1,160,626)	(56,909)	(287,487)	1939.4%	-80.2%
Dividends from jointly-controlled entities	55,357	40,644	124,495	36.2%	-67.4%
Purchases of trading securities	(1,512,123)	(2,390,104)	(880,436)	-36.7%	171.5%
Proceeds from maturities and sales of trading securities	1,629,595	2,905,411	1,089,972	-43.9%	166.6%
<b>Cash provided by operating activities</b>	<b>3,460,710</b>	<b>3,532,267</b>	<b>4,924,563</b>	<b>-2.0%</b>	<b>-28.3%</b>
Interest paid on loans and financing	(1,162,364)	(1,330,116)	(1,240,165)	-12.6%	7.3%
Income and social contribution taxes paid	(298,663)	(126,023)	(168,032)	137.0%	-25.0%
<b>Net cash provided by operating activities</b>	<b>1,999,683</b>	<b>2,076,128</b>	<b>3,516,366</b>	<b>-3.7%</b>	<b>-41.0%</b>
<b>Cash flows from investing activities</b>					
Purchases of property, plant and equipment	(1,194,934)	(873,329)	(1,323,891)	36.8%	-34.0%
Proceeds from sales of property, plant and equipment, investments and other intangibles	4,021,251	554,457	308,694	625.3%	79.6%
Purchases of other intangibles	(67,388)	(37,939)	(54,044)	77.6%	-29.8%
Advance for future investment in equity interest	(375,456)				
Capital increase in jointly-controlled entity		(178,670)			
<b>Net cash provided (used) in investing activities</b>	<b>2,383,473</b>	<b>(535,481)</b>	<b>(1,069,241)</b>	<b>-545.1%</b>	<b>-49.9%</b>
<b>Cash flows from financing activities</b>					
Purchase of treasury shares	(243,396)		(95,343)		-100.0%
Dividends and interest on capital paid	(599,099)	(86,386)	(85,962)	593.5%	0.5%
Increase on financial debts	2,560,789	3,265,860	2,455,371	-21.6%	33.0%
Payments of financial debts	(6,000,433)	(7,241,401)	(4,605,406)	-17.1%	57.2%
Intercompany loans, net	25,755	5,797	(6,492)	344.3%	-189.3%
<b>Net cash used in financing activities</b>	<b>(4,256,384)</b>	<b>(4,056,130)</b>	<b>(2,337,832)</b>	<b>4.9%</b>	<b>73.5%</b>
Exchange variation on cash and cash equivalents	208,034	7,438	(693,990)	2696.9%	-101.1%
Increase (Decrease) in cash and cash equivalents	334,806	(2,508,045)	(584,697)	-113.3%	328.9%
Cash and cash equivalents at beginning of year	2,555,338	5,063,383	5,648,080	-49.5%	-10.4%
<b>Cash and cash equivalents at end of year</b>	<b>2,890,144</b>	<b>2,555,338</b>	<b>5,063,383</b>	<b>13.1%</b>	<b>-49.5%</b>

Cash and cash equivalents totaled R\$2,890.1 million, R\$2,555.3 million and R\$5,063.4 million on December 31, 2018, 2017 and 2016, respectively, as analyzed below:



Table of Contents

*Net cash provided by operating activities*

Net cash from operating activities amounted to R\$ 1,999.7 million, R\$2,076.1 million and R\$3,516.4 million in the fiscal years ended December 31, 2018, 2017 and 2016, respectively.

In 2018 net cash from operating activities decreased by 3.7% compared to 2017, substantially due to working capital consumption in 2018, higher than consumption in 2017. In working capital, the net between reduction of R \$ 71.6 million in customers, an increase of R \$ 2,427.5 million in inventories and an increase of R \$ 900.4 million in accounts payable, negatively impacted the Company's operating activities by R \$ 1,445.5 million in 2018. The main factor for the negative impact of R \$ 1,445.5 million on the Company's operating cash position in 2018 was the increase in inventories, mainly in Brazilian, North American and Special Steel Business Segments and higher raw material costs.

In 2017, net cash from operating activities declined 41.0% compared to 2016, substantially due to the consumption of working capital in 2017, compared to the decrease of working capital(1) of 2016. In working capital(1), the increase of R\$54.7 million in trade accounts receivable, increase of R\$1,269.5 million in inventories and decrease of R\$ 800.2 million in trade accounts payable had a net negative effect of R\$524.0 million on the Company's cash from operating activities in 2017. In 2016, this net positive effect on cash was R\$969.8 million, due to the decrease of R\$64.8 million in trade accounts receivable, decrease of R\$794.6 million in inventories and increase of R\$110.5 million in accounts payable. The negative effect of R\$524.0 million on the Company's operating cash in 2017 is mainly explained by the increase in inventories in all Business Segments, mainly in the Brazil Business Segment, due to the higher production in the period and higher raw material costs.

*Cash conversion cycle*

In 2018, as a result of the reduction in working capital (-23.6%), compared to the reduction of net revenue (-19.5%) in the last three months of 2018 in relation to the last three months of 2017, the cash conversion cycle(2) and working capital(1) increased from 70 days in 2017 to 72 days in 2018 (from 34 days of accounts receivable from customers in 2017 to 28 days in 2018, 69 days from inventories in 2017 to 80 in 2018 and from 33 days from suppliers in 2017 to 36 days in 2018).

In 2017, as a result of the increase in working capital(1) (+6.3%) in comparison with the increase in net sales (+13.9%) in the last three months of 2017 compared to the last three months of 2016, the cash conversion cycle(2) and working capital(1) decreased from 75 days in 2016 to 70 days in 2017 (from 37 outstanding sales days in 2016 to 34 days in 2017, 66 outstanding inventory days in 2016 to 69 in 2017 and 29 outstanding payable days in 2016 to 33 days in 2017).

*Net cash used in investing activities*

Net cash used in investing activities was positive in R\$2,383.5 million in 2018, when compared to a negative result of R\$ 535.5 million in 2017. This increase was due to the cash received from the disposal of investments related to the sale of wire rod assets in Beaumont in the North America Business Segment, the sale of the Chilean unit in the South America Business

Segment, the sale of the Caçu and Barra dos Coqueiros hydroelectric plants in Goiás, Brazil, the sale of the unit in India, in Special Steel Business Segment and the sale of rebar assets in the United States, in the North America Business Segment

Net cash used in investing activities was R\$ 535.5 million in 2017, representing a decrease of 49.9%(R\$1,069.2 million at the year ended December 31, 2016) this decrease was due to the lower capital expenditure (addition to fixed assets) and to the higher cash proceeds from the divestment of the special steel units in Spain, of a long steel mill in Colombia, of metallurgical coke production units in Colombia, of the 30% interest in Corporación Centroamericana del Acero S.A. and of manufacturing units and land in the United States.

*Net cash used in financing activities*

Net cash provided by financing activities was a use of R\$ 4,256.4 million in 2018, when compared to a use of R \$ 4,056.1 million in the year ended December 31, 2017. This variation was mainly due to the fact that in 2018 there was a greater payment of dividends and interest on own capital, due to the higher net income of the Company, in addition to the purchase of shares in treasury.

Net cash from financing activities was R\$ 4,056.1 million in 2017, when compared to a use of R\$2,337.8 million in the fiscal year ended December 31, 2016. This variation is mainly due to the higher payments of loans and financing, reflecting the Company's strategy to reduce its debt level and debt indicators.



Table of Contents

(1) *Working capital*: trade accounts receivable, plus inventories, less suppliers (based on the balance of each account at the end of the year).

(2) *Cash conversion cycle*: working capital, divided by net sales (in last three months), multiplied by 90.

**Indebtedness**

The Company's debt is used to finance investments in fixed assets, including the modernization and technological upgrade of its plants and the expansion of installed capacity, as well as for working capital, acquisitions and, depending on market conditions, short-term financial investments.

The following table profiles the Company's debt in the years ended December 31, 2018, 2017 and 2016 (in thousands of Brazilian *reais*):

	2018	2017	2016
<b>SHORT TERM:</b>	<b>1,824,938</b>	<b>2,004,341</b>	<b>4,458,220</b>
<b>Total short-term debt</b>	<b>1,822,183</b>	2,004,341	4,458,220
<b>Debentures</b>	<b>2,755</b>		
<b>LONG TERM:</b>	<b>13,081,776</b>	<b>14,505,243</b>	<b>16,125,013</b>
<b>Total long-term debt</b>	<b>11,545,658</b>	<b>14,457,315</b>	<b>15,959,590</b>
<b>Debentures</b>	<b>1,536,118</b>	<b>47,928</b>	<b>165,423</b>
<b>TOTAL DEBT:</b>	<b>14,906,714</b>	<b>16,509,584</b>	<b>20,583,233</b>
<b>Total cash and cash equivalents and short-term investments</b>	<b>3,349,614</b>	<b>3,376,856</b>	<b>6,087,794</b>
In R\$	1,306,349	386,441	1,609,145
Companies abroad	2,043,265	2,990,414	4,478,649
<b>NET DEBT(1)</b>	<b>11,557,100</b>	<b>13,132,728</b>	<b>14,495,439</b>

(1) The calculation of net debt is made by subtracting cash and cash equivalents and short-term investments from total debt. Net debt is not a GAAP measure recognized under IFRS and should not be considered in isolation from other financial measures. Other companies may calculate net debt differently and therefore this presentation of net debt may not be comparable to other similarly titled measures used by other companies. The Company uses net debt as indicator of indebtedness in its financial management.

Total debt was R\$ 14,907 million, R\$ 16,509 million and R\$ 20,593 million in the fiscal years ended December 31, 2018, 2017 and 2016, respectively. On December, 2018, gross debt was 12.2% short term and 87.8% long term. Broken down by currency, 26.2% of gross debt was denominated in Brazilian real, 73.3% in U.S. dollar and 0.5% in other currencies. For comparison purposes, on December, 2017, 80.8% of gross debt was denominated in U.S. dollar, which demonstrates the Company's strategy to reduce its exposure to the dollar and consequently better align the currency profile of its debt with that of its cash generation. On December 31st, 2018, 61.0% of cash was held by Gerdaу companies abroad and denominated mainly in U.S. dollar.

In November 2018, the Company carried out the 15th issue of debentures of Gerdau S.A. in the amount of R\$ 1.5 billion and repurchased US\$ 1 billion (equivalent to R\$ 3.9 billion) in bonds (distributed among bonds coming due in 2020, 2021, 2023 and 2024) with the aim of reducing its gross debt, restructuring and rebalancing its debt maturity schedule and reducing its exposure in U.S. dollar.

In December, 2018, the nominal weighted average cost of gross debt was 6.7%, or 6.8% for the portion denominated in Brazilian real, 5.7% plus exchange variation for the portion denominated in U.S. dollar contracted by companies in Brazil and 10.7% for the portion contracted by subsidiaries abroad. On December, 2018, the average gross debt term was 7.0 years.

The Board of Directors established as the Company's financial policy the implementation and maintenance in the long term of the following parameters:

- Maximum Net Debt/EBITDA ratio of between 1x and 1.5x;
- Average debt term of over six years;
- Maximum Gross Debt of R\$ 12 billion.

Table of Contents

These parameters are intended to enable the Company to pursue a balanced financial condition while successfully executing an investment plan to meet the market's demands and the industry's challenges.

As of December 31, 2018, the maturity profile of the Company's long-term debt with financial institutions, including debentures, was as follows:

<b>Gerdau S.A. Consolidated</b>	
<b>Long-Term Amortization</b>	<b>(R\$ thousands)</b>
2020	2,259.674
2021	1,217.916
2022	1,622.593
2023	1,217.189
2024	2,446.834
2025 and After	4,317.571
<b>Total</b>	<b>13,081.776</b>

**Financial Agreements**

Below are the material financial agreements outstanding at year end 2018:

***UKEF UK Export Finance***

In June 2011, the subsidiary Gerdau Açominas S.A. entered into a financing agreement covered by ECGD (Export Credits Guarantee Department), the UK Export Finance (UKEF), with the banks Deutsche Bank AG, London Branch, HSBC Limited, Tokyo Branch, Citibank Europe plc and BNP Paribas. On December 31, 2018, the outstanding balance of this facility was US\$ 100.6 million (R\$ 390 million).

***Bonds***

The Company, through its subsidiaries Gerdau Holdings Inc., GTL Trade Inc. and Gerdau Trade Inc., issued bonds due in 2020, 2021, 2023, 2024, 2027 and 2044. The following companies guaranteed these transactions: Gerdau S.A., Gerdau Açominas S.A. and Gerdau Aços Longos S.A. On December 31, 2018, the outstanding balance of these bonds was R\$ 10 billion.

***Debenture***

The Company concluded in 2018 the issuance of debentures with maturity of 4 years. On December 31, 2018, the outstanding balance of these debentures was R\$ 1.5 billion.

*NCEs*

The Company and its subsidiary Gerdau Açominas S.A. issued Export Credit Notes with final maturity in 2019 and 2020. On December 31, 2018 the total outstanding amount of these facilities was R\$ 1,135 million.

*4131 Citi*

In October 2015, the subsidiary Gerdau Açominas S.A. entered into a 4131 loan agreement in the amount of R\$ 656.2 million, with a term for five years; the Company guarantees this transaction.

In April 2018, the subsidiaries Gerdau Açominas S.A. and Gerdau Aços Longos S.A. entered into a 4131 loan agreements in the total amount of R\$ 400 million with a term for 1 year; the Company guarantees these transactions.

*BBVA Credit Agreement*

In December 2015, the joint-venture Gerdau Corsa SAPI de C.V. entered into a loan agreement with BBVA in the amount of US\$ 150 million, denominated in Mexican Pesos, with a term for five years. The outstanding amount of this facility was US\$ 127 million as of December 31, 2018 (R\$ 492.2 million) and the Company guarantees this transaction.

Table of Contents

***Syndicated Loan***

In December, 2016 the joint-venture Gerdau Corsa SAPI de C.V. entered into a syndicated senior unsecured term loan in the amount of US\$ 330 million, denominated in Mexican pesos. As of December 31, 2018 the outstanding amount was US\$ 342.1 million (R\$ 1.3 billion) and the Company guarantees this transaction.

***BNDES***

All loans contracted under the FINAME/BNDES program, totaling R\$ 90.5 million, on the balance sheet date are secured by the assets being financed.

***Indebtedness Ratios***

All ratios described below, calculated based on the Consolidated Financial Statements in accordance with IFRS of Gerdau S.A., are related to the BNDES (*Banco Nacional de Desenvolvimento Econômico e Social*) financings. In the event of a failure to satisfy the annual tests, Gerdau S.A. would have a grace period and a subsequent renegotiation of the security for the financing, and an event of default would not occur.

*Net Interest Coverage Ratio* measures the net interest expense payment capacity in relation to EBITDA (Earnings before Interest, Taxes, Depreciation and Amortization and Impairment of assets) and gains and losses on assets held for sale and sales of interest in subsidiaries and associate company. The ratio in the agreement requires that the EBITDA for the last 12 months should represent at least 2 times of the interest expense of the same period. As of December 31, 2018, such ratio calculated was 5.5.

*Net Leverage Ratio* measures the level of net debt in relation to EBITDA (Earnings before Interest, Taxes, Depreciation and Amortization and Impairment of assets) and gains and losses on assets held for sale and sales of interest in subsidiaries and associate company. The agreed ratio requires that the net debt should not surpass 4 times the EBITDA for the last 12 months. As of December 31, 2018, such ratio calculated was 1.9.

*Current Ratio* measures the company's ability to fulfill its short term obligations. The contractual terms require that the ratio of Current Assets divided by Current Liabilities must be Greater than 0.8. As of December 31, 2018, the current ratio was 2.1.

## Credit Lines

In June 2009, certain subsidiaries of the Company (Gerdau Açominas S.A., Gerdau Aços Longos S.A. and Gerdau S.A.) entered into a credit facility agreement with BNDES in the total amount of R\$ 1.5 billion, bearing an interest rate of TJLP + 2.16% per annum when drawn. On December 31, 2018, the outstanding amount was R\$ 253.7 million.

In December 2012 the subsidiary Gerdau Açominas S.A. obtained a committed credit line with BNDES in the total amount of R\$ 776.6 million for the Plate and Steckel Mill project. The funds are provided as the subsidiary carries out its own investment plans and submit to BNDES the evidences of completion. The interest rate for this credit line is determined at the time of each disbursement and is the sum of TJLP and exchange rate + 2.16% per annum. The outstanding balance of this transaction was R\$ 117.6 million as of December 31, 2018.

In October 2017, the Company concluded the roll-over and reduction of its senior unsecured working capital facility in the amount of US\$ 800 million (equivalent to R\$ 3,100 million). The facility is divided into two tranches: US\$ 200 million (equivalent to R\$ 775 million) for Gerdau's North American subsidiaries and US\$ 600 million (equivalent to R\$ 2,325 million) for Gerdau's Latin American subsidiaries. On December 31, 2018, the outstanding loans under this line totaled US\$ 50 million (R\$ 194 million).

## *Derivatives, Off-Balance Sheet Arrangements and Contractual Obligations*

For more details see Item 5-E OFF-BALANCE SHEET ARRANGEMENTS .

## Derivatives

*Risk management objectives and strategies:* The Company understands that it is subject to different market risks, such as fluctuations in exchange rates, interest rates and commodity prices. In order to carry out its strategy for profitable growth, the Company implements risk management strategies with the objective of mitigating such market risks.

The Company's objective when entering into derivative transactions is always related to mitigation of market risks as stated in our policies and guidelines. All outstanding derivative financial instruments are monthly reviewed by the **Financial Risk**

Table of Contents

Management Committee, which validates the fair value of such financial instruments. All gains and losses in derivative financial instruments are recognized by its fair value in the Consolidated Financial Statements of the Company.

*Policy for use of derivatives:* according to internal policy, the financial result must arise from the generation of cash from its business and not gains from the financial market. The Company uses derivatives and other financial instruments to reduce the impact of market risks on its financial assets and liabilities or future cash flows and earnings. Gerdau has established policies to assess market risks and to approve the use of derivative financial instruments transactions related to those risks. The Company enters into derivative financial instruments to manage the above mentioned market risks and never for speculative purposes.

*Policy for determining fair value:* the fair value of the derivative financial instruments is determined using models and other valuation techniques, which involve future prices and curves discounted to present value as of the calculation date. Amounts are gross before taxes. Due to changes in market rates, these amounts can change up to the maturity or in situations of early settlement of transactions.

The derivative financial instruments may include: interest rate swaps, cross currency swaps, currency options contracts and currency forward contracts.

*Dollar forward contracts:* the Company entered into NDF operations (Non Deliverable Forward) in order to mitigate the foreign exchange risk on assets and liabilities denominated in foreign currencies, mainly U.S. dollar. The counterparties of these transactions are financial institutions with low credit risk.

*Swap Contracts:* the Company entered into cross currency swap, contract whereby it receives a variable interest rate based on LIBOR in US dollars and pays a variable interest rate based on the local currency, and into interest rate swap, contract whereby it receives a fixed interest rate and pays a variable interest rate based on local currency. The counterparties to these transactions are financial institutions with low credit risk.

The effects of financial instruments are classified as follow:

Contracts	Position	Notional value		Amount receivable		Amount payable	
		2018	2017	2018	2017	2018	2017
<b>Forward</b>							
Maturity at 2019		US\$19.2					
	purchase in US\$	million				(4,069)	
Maturity at 2019		US\$18.3					
	sell in US\$	million		462		(1,176)	

**Cross currency swap**

Maturity in 2018	INR 10.17%	US\$40.0 million	(1,267)
Maturity in 2019	CDI 111.50%	R\$230.5 million	30,249

**Swap of interest rate**

Maturity in 2020	CDI 111.50%	R\$50.0 million	2,706
------------------	-------------	-----------------	-------

**Total fair value of financial instruments**

33,417	(5,245)	(1,267)
--------	---------	---------

The effects of financial instruments are classified as follow:

	2018	2017
<b>Unrealized gains on financial instruments</b>		
Current assets	30,711	
Non-current assets	2,706	
	33,417	
<b>Unrealized losses on financial instruments</b>		
Current liabilities	(5,245)	
Non-current liabilities		(1,267)
		(1,267)

	2018	2017
<b>Net Income</b>		
Gains on financial instruments	49,576	9,666
Losses on financial instruments	(17,484)	(19,107)
	32,092	(9,441)
<b>Other comprehensive income</b>		
Gains (Losses) on financial instruments	11,947	(11,364)
	11,947	(11,364)

For further information regarding swap contracts (interest rate swap and cross currency swap) refer to Note 15 Financial Instruments, item e) Operations with Derivative Financial Instruments.



Table of Contents

**Capital Expenditures**

**2018 Capital Expenditures**

In fiscal year 2018, capital expenditure on fixed assets was R\$1.2 billion. Of this amount, 46.9% was allocated to operations in Brazil and the remaining 53.1% was allocated to operations in the other countries in which Gerdau operates.

*Brazil Business Segment* a total of R\$559.8 million was invested in this operation for capital expenditures. The main highlight was the improvement of productivity and increase of useful lives of the units.

*North America Business Segment* this business segment spent R\$388.0 million in capital expenditures on fixed assets distributed throughout the units which compose this business segment. This amount was mainly spent on increase of useful lives of the production units.

*South America Business Segment* in 2018, the South American units spent R\$52.9 million in capital expenditures on fixed assets distributed among the countries in which the units from this business segment are located.

*Special Steel Business Segment* the special steel units spent R\$ 194.0 million for capital expenditure on fixed assets, which were distributed throughout the units which compose this business segment. This amount was mainly spent on increase of useful lives of the production units.

**2017 Capital Expenditures**

In fiscal year 2017, capital expenditure on fixed assets was R\$873.3 million. Of this amount, 40.0% was allocated to operations in Brazil and the remaining 60.0% was allocated to operations in the other countries in which Gerdau operates.

*Brazil Business Segment* a total of R\$346.9 million was invested in this operation for capital expenditures. The main highlight was the improvement of productivity and maintenance of the units.

*North America Business Segment* this business segment spent R\$291.8 million in capital expenditures on fixed assets distributed throughout the units which compose this business segment. This amount was mainly spent on maintenance of the production units.

*South America Business Segment* in 2017, the South American units spent R\$123.6 million in capital expenditures on fixed assets distributed among the countries in which the units from this business segment are located. Part of this investment is being used to build a new melt shop in Argentina, which have a capacity of 650,000 tonnes of steel per year that started operation 2017.

*Special Steel Business Segment* the special steel units spent R\$ 108.5 million for capital expenditure on fixed assets, which were distributed throughout the units which compose this business segment. This amount was mainly spent on maintenance of the production units.

#### **2016 Capital Expenditures**

In fiscal year 2016, capital expenditures on fixed assets was R\$1,323.9 million. Of this amount, 46.0% was allocated to operations in Brazil and the remaining 54.0% was allocated to operations in the other countries in which Gerdau operates.

*Brazil Business Segment* a total of R\$608.5 million was invested in this operation for capital expenditures. The main highlight was the installation work of flat steel rolling mill (heavy plates) at the Ouro Branco mill, which commenced production at the end of July 2016.

*North America Business Segment* this segment spent R\$227.4 million in capital expenditures on fixed assets, which were distributed throughout the units which compose this business segment. This amount was mainly spent on maintenance of the production units.

*South America Business Segment* in 2016, the South American units spent R\$347.0 million in capital expenditures, on fixed assets distributed among the countries in which the units from this business segment are located. Part of this investment is being used to build a new melt shop in Argentina, which will have a capacity of 650,000 tonnes of steel per year and which started operating in 2017.

Table of Contents

*Special Steel Business Segment* the special steel units spent R\$140.9 million in capital expenditures on fixed assets, which were distributed throughout the units which compose this business segment. This amount was mainly spent on maintenance of the production units.

**C. RESEARCH AND DEVELOPMENT, PATENTS AND LICENCES, ETC.**

All Gerdau mills have a Quality Management System supported by a wide array of quality control tools. Product development projects are headed by specialists who use quality tools such as Six Sigma, a set of statistical methods for improving the assessment of process variables, and the concept of Quality Function Deployment, a methodology through which technicians can identify and implement the customer requirements.

Given this level of quality management, mills are ISO 9001 or ISO TS 16949 certified, as well as a sort of certification of products and laboratories, according to demands. In general, production, technical services and quality teams are responsible for developing new products to meet customer and market needs.

Gerdau uses a Quality Management System developed in house that applies tests for product design, manufacturing processes and final-product specifications. A specially trained team and modern technologies also exist to assure the manufactured product high standards of quality. Gerdau's technical specialists do planned visits, some are randomly selected and some are scheduled visits, to its customers to check on the quality of the delivered products in order to guarantee the final user satisfaction for products purchased indirectly.

Due to the specialized nature of its business, the Gerdau special steel mills are constantly investing in technological upgrading and in research and development. These mills are active in the automotive segment and maintain a technology department (Research and Development) responsible for new products and the optimization of existing processes.

International machinery manufacturers and steel technology companies supply most of the sophisticated production equipment that Gerdau uses. These suppliers generally sign technology transfer agreements with the purchaser and provide extensive technical support and staff training for the installation and commissioning of the equipment. Gerdau has technology transfer and benchmarking agreements with worldwide recognized performance companies.

As is common with mini-mill steelmakers, Gerdau usually acquires technology in the market rather than develops new technology through intensive process research and development, since steelmaking technology is readily available for purchase.

The Company is not dependent on patents or licenses or new manufacturing processes that are material to its business. See item Information on the Extent of the Company's Dependence for further details.

**D. TREND INFORMATION**

The outlook for the world steel industry continues to call for weak consumption growth and overcapacity. In the markets in which we operate, the developed economies present positive prospects.

The Brazilian economy should continue to improve in 2019, with an ongoing recovery in industrial production and, at a slower pace, in construction. According to the Brazilian Steel Institute, internal demand for steel should grow 6.2% in 2019. Gerdau is prepared to serve any potential growth in Brazilian demand, but, until then, we will continue to focus on exporting part of our production.

In North America, market studies point to 1.3% growth in long steel consumption in the United States in 2019, considering the main steel-consuming segments (non-residential construction, manufacturing, oil and gas).

In special steels, Brazil's automotive industry should present strong growth in sales to both the local and export markets. If these market expectations are confirmed, the industry could return to a production level of around 3 million units in Brazil, according to the National Association of Vehicle Manufacturers (Anfavea). In the U.S. automotive industry, demand should remain strong, but at a slower pace than at the peak in 2018.

Moreover, South America's other economies are expected to post positive growth, according to IMF, in 2019, especially for Peru and Colombia, influencing the region's apparent steel consumption. According to IMF, Argentina is a point of attention in this region considering the perspective of economic recession for this year.

Table of Contents**E. OFF-BALANCE SHEET ARRANGEMENTS**

The Company does not have any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on its financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources other than the ones described below.

The Company provides a guarantee for the line of credit of its joint venture Gerdau Corsa SAPI de C.V., with Sumitomo, in the amount of US\$ 75 million (R\$ 116,296 thousands as of December 31, 2018).

The Company provides a guarantee for the line of credit of its joint venture Gerdau Corsa SAPI de C.V., with local banks, in the amount of US\$ 330 million (R\$ 1,325,480 thousands as of December 31, 2018).

The Company provides a guarantee for the line of credit of its joint venture Gerdau Corsa SAPI de C.V., with BBVA, in the amount of US\$ 150 million (R\$ 492,153 thousands as of December 31, 2018).

The Company provides a guarantee for the line of credit of its joint venture Gerdau Summit Aços Fundidos e Forjados S.A., with BNDES, in the amount of up to R\$ 130,164 thousands (R\$ 41,571 thousands as of December 31, 2018).

**F. DISCLOSURE OF CONTRACTUAL OBLIGATIONS**

The following table sets forth the Company's contractual obligations on December 31, 2018 (in thousands of reais).

Contractual obligations (R\$ thousands)	Total	Less than 1 year	Payments due by period		
			1-3 years	4-5 years	More than 5 years
Trade accounts payable	4,119,057	4,119,057			
Short-term debt obligations (1)	1,632,799	1,632,799			
Long-term debt obligations (1)	11,545,658		3,453,003	1,330,599	6,762,056
Debentures (1)	1,536,118		24,587	1,509,182	2,349
Interest payments	6,706,294	853,889	1,414,032	997,866	3,440,507
Unrealized losses on financial instruments	5,245	5,245			
Obligations with FIDC	938,526		827,137	111,389	
Operating lease obligations (2)	219,404	56,836	83,010	52,655	26,903
Capital expenditures (3)	619,968	619,968			
Pension funding obligations (4)	258,941	246,246	3,344	2,989	6,362
<b>Total</b>	<b>27,582,010</b>	<b>7,534,040</b>	<b>5,805,113</b>	<b>4,004,680</b>	<b>10,238,177</b>

---

(1) Total amounts are included in the December 31, 2018 consolidated balance sheet. See Note 13 - Loans and Financing and Note 14 - Debentures in the Consolidated Financial Statements.

Table of Contents

(2) Includes minimum lease payment obligations for equipment and real state leases in effect as of December 31, 2018.

(3) Purchase obligations for capital expenditures are related to capital projects. The full amount relates to capital project agreements where Gerdau has irrevocably committed with suppliers to acquire equipment. As the equipment had not been received by December 31, 2018, the corresponding liability has not yet been recorded in its financial statements.

(4) Pension funding obligations are included as per actuarial computations made by third party actuaries and reviewed by management.

**G. SAFE HARBOR**

See the disclaimer with respect to Forward-Looking Statements.

**ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES**

**The Directors and Senior Management of the Company as of the date hereof are as follows:**

The summary of the structures of the Board of Directors and of Board of Executive Officers are:

BOARD OF DIRECTORS

*Chairman*

Claudio Johannpeter

*Members*

André Bier Gerdau Johannpeter

Guilherme Chagas Gerdau Johannpeter

Richard Chagas Gerdau Johannpeter

Affonso Celso Pastore

Aod Cunha de Moraes Junior

Fernando Fontes Iunes

BOARD OF EXECUTIVE OFFICERS

*Chief Executive Officer (CEO):*

Gustavo Werneck da Cunha

*Executive Vice-President, Chief Financial officer (CFO) and Investor Relations Officer:*

Harley Lorentz Scardoelli

*Officers:*

Cesar Obino da Rosa Peres

Fladimir Batista Lopes Gauto

Marcos Eduardo Faraco Wahrhaftig

Mauro de Paula

**CLAUDIO JOHANNPETER (born in 1963)**

- Education: Degree in Metallurgical Engineering from the Universidade Federal do Rio Grande do Sul (UFRGS). He completed courses in Operations Management at University of London (UK), Executive Development at Penn State (United States) and Advanced Management Program at Harvard (United States).

- Experience: He has worked at Gerdau for over 36 years and held the position of Chief Operating Officer (COO) from January 2017 to August 2012. In December 2017, he left his executive position on the Executive Committee representing the Brazil Long Steel Business Operation and the Global Processes: Engineering and Industrial, Health and Safety. On January 2018 he joined the (i) Board as Chairman of Gerdau S.A. and its committees, (ii) joined as Board Chairman of Metalúrgica Gerdau S.A.,, (iii) joined as Board Chairman of Seiva SA - Florestas e Indústrias, a company that is part of Gerdau's economic group. He is also an advisor at IEDI (Institute of Studies for Industrial Development).





Table of Contents

**ANDRÉ BIER GERDAU JOHANNPETER (born in 1963)**

- Education: Degree in Business Administration from the Pontifícia Universidade Católica do Rio Grande do Sul (PUC RS). Studied General Business Administration at the University of Toronto (Canada), Marketing at the Ashridge Business School (UK), and Advanced Management at the Wharton School, University of Pennsylvania (United States).

- Experience: He has worked at Gerdau for over 30 years and held the position of Chief Executive Officer (CEO) from January 2007 to December 2017. In December 2017, he left his executive position and on January 2018 he joined (i) as Board Member of Gerdau S.A. and its committees, (ii) as Board Member of Metalúrgica Gerdau S.A., (iii) Board Member of Seiva SA - Florestas e Indústrias. He also serves as President of the Worldsteel Association, member of the Board of Directors of Instituto Aço Brasil (Brazilian Steel Institute), member of the Board of Directors of Alacero (Latin American Steel Association), member of the Strategic Superior Council of the Federation of Industries of São Paulo - FIESP and of the Economy Council of the Federation of Industries of Rio Grande do Sul - FIERGS.

**GUILHERME CHAGAS GERDAU JOHANNPETER (born in 1971)**

- Education: Degree in Law from the Unisinos in 1995 and has a Marketing and Finance MBA from Kellogg School of Management, Illinois (United States).

- Experience: He has worked at Gerdau for over 34 years and held the position of Executive Vice President

on the Gerdau Executive Committee (CEG), coordinating the Special Steel Business Operation and the Gerdau 2022 Project Strategy from April 2014 to December 2017. In January 2018 he became a (i) Board Member of Gerdau S.A. and its committees, (ii) Board Member of Metalúrgica Gerdau S.A., (iii) Board Member of Seiva SA - Florestas e Indústrias, a. Member of the Executive Committee of Alacero and Board Member of Amcham São Paulo (American Chamber of Commerce for Brazil)..

**RICHARD CHAGAS GERDAU JOHANNPETER (born in 1974)**

- Education: Degree in Law and Social Sciences from the Universidade Federal do Rio Grande do Sul (UFRGS) and has an MBA from the Stanford Graduate School of Business (United States);

- Experience: He began his career as an intern in 1993 in the production area of Riograndense Mill. In 1995, he was hired as a salesman of Civil Construction Steel Area and was promoted in 1996 to Administration Manager, also passing through Sales and Marketing of the same area. In 1997, he was transferred to the financial area at Gerdau as Technical Advisor, and later was transferred to São Paulo as Metallic Purchase Manager. In 2003, he returned to Porto Alegre to be Technical Advisor in Banco Gerdau. In 2005, he resigned his position to attend an MBA program in United States, returning in 2007 as Investment Manager for Brazil and foreign operations. In 2010, he became the

Investment Director of the holding company that controls Metalúrgica Gerdau S.A. Currently, he is a (i) Board Member of Gerdau S.A. and its committees, and (ii) Board Member of Metalúrgica Gerdau S.A.

**AFFONSO CELSO PASTORE (born in 1939)**

- Education: Degree in Economics from the University of São Paulo and has a PhD in Economics from the same university.
- Experience: He was Treasury Secretary of São Paulo State and President of the Central Bank of Brazil. He is (i) an Independent Member of the Board of Directors of Gerdau S.A. and Metalúrgica Gerdau S.A., and also a member of the Corporate Governance Committee and member of the Compensation and Succession Committee of Gerdau S.A.; (ii) Member of the Board of Directors of M. Dias Branco SA - Industria e Comércio de Alimentos, listed company whose activity is the manufacturing and trade of food products and wheat derivatives, especially biscuits, crackers, pasta and wheat flour since July 2010. He was member of the Board of Directors of Even Construtora e Incorporadora SA, listed company whose activity is the construction of buildings since February 2010 until April 2013; member of the Board of Directors of Klabin Segal SA, a company whose activity is promotion, construction and real estate developments of any kind, own or third party from May 2006 until May 2008 and Engevix Engenharia SA, leading company whose activity is elaborate studies, projects and integration and project management in Energy, Industry and Infrastructure areas, from March 2008 until August 2009. Pastore is the founder partner of AC Pastore & Associados SS Ltda, a consulting company, specializing in economics analysis of the Brazilian and International Economy. In addition, in the last 5 years he has worked as an economist, analyst and economic adviser, writing articles, reports and studies. He has participated in national and international seminars, and has given lectures on topics related to the Brazilian and World Economies. Since June 2013 he has been the President of the Center for Public Policy Debates (CDPP).

Table of Contents

**FERNANDO FONTES IUNES (born in 1962)**

- Education: Degree in Civil Engineering from the Faculdade de Engenharia da Universidade Mackenzie and obtained an MS and PhD from the University of London (UK).
- Experience: He was a Partner and Executive Director, responsible for the Global Investment Bank of Banco Itaú BBA SA from 2010 to 2015, during which helped to establish a leading platform for Investment Banking in Latin America, with operations in Brazil, Argentina, Chile, Colombia, Peru and Mexico. Previously he held various positions in Banco Itaú BBA S.A., in Brazil and in the U.S. During that period, he participated in some of the largest and most important capital markets transactions, mergers, acquisitions and reorganizations undertaken in Latin America. In 2016 and 2017 he was a fellow at Harvard University in the Advanced Leadership Initiative Program in Cambridge, USA. He was also part of the 2017 Fall Term Teaching Team of the course Exercising Leadership: The Politics of Change of Harvard Kennedy School. Currently he is Board Member of Gerdau S.A., Board Member of Metalurgica Gerdau S.A. and Board Member of M. Dias Branco S.A.

**AOD CUNHA DE MORAES JUNIOR (born in 1968)**

- Education: Degree in Economics, Federal University of Rio Grande do Sul (1986 - 1989); Master's Degree in Economics, Federal University of Rio Grande do Sul (1990-1994); Ph.D. in Economics, Federal University of Rio Grande do Sul (UFRGS 1999 - 2013); Post doctor and Visiting Researcher in Economics at Columbia University (NY/US 2009); Executive Leadership Course at Harvard Business School (Boston/US 2015);
- Experience: Economic Advisor to the Governor of Rio Grande do Sul State (1994-1998); President of Economics and Statistics Foundation of State of Rio Grande do Sul (2003-2006); Secretary of Finance of Rio Grande do Sul State (2007-2009); Chairman of Rio Grande do Sul State Bank, Banrisul (2007-2009); Senior Economist Advisor at World Bank (2010); Executive Director J.P Morgan Bank at the Corporate Bank and Corporate and Investment Bank areas, member of J. P. Morgan's Global Public Sector Group (2011-2014); Partner of BTG Pactual, based in SP (2014-2016); Board Member of Banco Pan (2015-2016); Currently, he is (i) Board Member of Bank Agibank (since 2018); (ii) Board Member of VIBRA Group (since 2017); (iii) Board Member of Metalúrgica Gerdau S.A. (since 2017); (iv) Board Member of Gerdau S.A. (since 2017); (v) Board Member of Atiaia Energia (Cornelio Brennan Group) (from 2019).

**GUSTAVO WERNECK DA CUNHA (born in 1973)**

- Education: Degree in Mechanical Engineering from the Universidade Federal de Minas Gerais (UFMG - Brazil). Studied Project Management at Fundação Getúlio Vargas (Brazil), General Business Administration at INSPER Business School (Brazil), Leading Change and Organizational Renewal at Harvard Business School (United States) and Advanced Corporate Finance at London Business School (UK).

- Experience: He has worked at Gerdau for 13 years. In the last 5 years, he has held the positions of (i) Industrial Officer of Gerdau Special Steel, (ii) Industrial Officer of Gerdau India, (iii) Gerdau Corporate Officer of Information Technology and (iv) Executive Officer of Gerdau Brazil Steel . In January 2018, he became Chief Executive Officer (CEO) of Gerdau S.A., Metalurgica S.A. and Seiva S.A. Florestas e Industrias. He also serves as board member of the Instituto Aço Brasil (Brazilian Steel Institute).

**HARLEY LORENTZ SCARDOELLI (born in 1963)**

- Education: Degree in Civil Engineering from the Universidade Federal do Rio Grande do Sul (UFRGS), graduated in Business Administration from the Pontifícia Universidade Católica do Rio Grande do Sul, and holds a CFA certification.

- Experience: He began his career at Gerdau in May 1988, where he has worked for Gerdau s operations in Canada, United States, Spain and Brazil. In September, 2015, he became a member of the Executive Committee and was elected Vice President and CFO responsible for Finance, Planning, Accounting and Tax. He also holds the position of Investor Relations Officer of Gerdau S.A., Metalúrgica Gerdau S.A. and Seiva S.A. Florestas e Indústrias. Member of the Financial Committee and Strategy Committee of Gerdau S.A.

**FLADIMIR BATISTA LOPES GAUTO (born in 1962)**

- Education: Degree in Accounting from the Pontifícia Universidade Católica do Rio Grande do Sul (PUC-RS), he has completed his academic training with a postgraduate degree in Business Management from Fundação Getúlio Vargas (FGV-SP) and has a specialization in Advanced Marketing from Stanford University (California).

- Experience: Has 38 years of professional experience, 31 years of which at Gerdau. For the last 10 years, he has been Global Procurement Director, Commercial Gerdau s Executive Director and currently is the (i) Executive Director of Special Steel Brazil and responsible for Gerdau Summit (Joint Venture), and (ii) board member of Gerdau Previdência. He was a member of the Steel Institute Brazil from 2016 to 2017.

Table of Contents

**MARCOS EDUARDO FARACO WAHRHAFTIG (born in 1972)**

- Education: Degree in Mechanical Engineering from the Universidade Federal do Paraná (UFPR), with an MBA from Manchester Business School (UK) and has studied Corporate Finance at FGV/ ISAE.
- Experience: 24 years of experience, with 15 years in Gerdau. In the last 5 years he has held positions as Commercial Officer of Special Steel Brazil (GSB), Corporate Commercial Officer and Commercial Officer of Gerdau Brazil Steel (GAB). Currently holds the position of Executive Director Brazil, Argentina and Uruguay. Also he is (i) Vice-president of the board of the Instituto Aço Brasil (Brazilian Steel Institute), (ii) President of the CBCA Brazilian Institute for Steel Construction, (iii) member of the board of FIESP/ Concic - Superior Council of the Federation of Industries of the State of São Paulo, civil construction committee, (iv) member of the board of Abramatt Brazilian Association of Construction Material Producers and (v) member of the board of FIEMG - Strategic Council, Federation of Industries of the State of Minas Gerais.

**MAURO DE PAULA (born in 1962)**

- Education: Graduated in Economics from the Faculdade Don Bosco in Resende-RJ and completed his academic training with Foreign Trade Course at IBET in Rio de Janeiro-RJ and Master in Business Administration - MBA in Strategic Marketing at Universidade Federal de Pernambuco in Recife-PE.
- Experience: Has more than 27 years of experience in Gerdau, holding positions of Commercial Gerdau units Manager, Civil Construction National Sales Manager, Distribution National Sales Manager and Logistics Officer. He has served as Counselor of the company MRS Logística from 2015 to 2016 and Member of the Board of Directors of INDA - National Institute of Steel Distributors from 2016 to Jun/2017. Currently serves as Commercial Gerdau Executive Officer.

**CESAR OBINO DA ROSA PERES (born in 1962)**

- Education: Graduated in Business Administration from the Faculdade de Ciências Econômicas, Contábeis e Administração Prof. de Plácido e Silva in Curitiba-PR, he has completed his academic training with a specialization course in Business Administration at Universidade Presbiteriana MACKENZIE in São Paulo-SP.
- Experience: Has more than 31 years of experience at Gerdau. He held the position of Sales and Marketing Manager at the Gerdau operation in Mexico from 2010 to 2012. In addition, held the position of Sales and Marketing General Manager at the Gerdau operation in Colombia from 2013 to 2014, later was promoted to Executive Director of Gerdau Colombia Operation where he remained until the end of 2016. Currently serves as Commercial Officer of Gerdau Aços Brasil (GAB).

**Family Relationships**

Jorge Gerdau Johannpeter, Germano Hugo Gerdau Johannpeter, Klaus Gerdau Johannpeter and Frederico Carlos Gerdau Johannpeter are brothers. André Bier Gerdau Johannpeter is Jorge Gerdau Johannpeter's son, Claudio Johannpeter is Klaus Gerdau Johannpeter's son, and Guilherme Chagas Gerdau Johannpeter and Richard Chagas Gerdau Johannpeter are sons of Frederico Carlos Gerdau Johannpeter. Guilherme Chagas Gerdau Johannpeter and Richard Chagas Gerdau Johannpeter are brothers.

**Arrangements**

Gerdau has no agreement of any kind with shareholders, clients, suppliers or other parties with respect to the election of its officers or directors. Except as described in this document, there are no pending legal proceedings to which any Board Member, Executive Officer or Advisory Council is a party against the Company. Apart from statutory severance benefits, none of the Board Members, Executive Officers or Advisory Council is entitled to any contractual benefits upon termination of employment.

Table of Contents

**B. COMPENSATION**

The employees' compensation system is divided into two portions: a fixed salary and a variable pay linked to performance.

The fixed portion of the compensation is constantly monitored and compared to market benchmarks in order to maintain parity with the good market practices as adopted by other companies. The variable portion of the compensation package is tied to annual goals. These goals are measured against standards clearly specified that are intended to support and motivate overachievement of individual and teams results.

The human resources policy states and recognizes co-workers as being strategic to the business.

The Company conducts evaluations based on several different methodologies, including competence mapping, to track the managerial skills of its executives. Competence mapping aims to identify the degree of alignment of executives with the Company's strategies and business management and to monitor individual development.

In 2018, the Directors and Executive officers of Gerdaul were paid a total of R\$ 50.3 million in total remuneration as salary, variable remuneration, benefits, social charges, and termination. The variable remuneration of directors is determined based on Gerdaul's financial results and individual performance evaluation. Fiscal Council members are not eligible for variable remuneration.

Gerdaul Group sponsors Pension Plans for its subsidiaries in Brazil and abroad. About 7% of participants are in the Defined Benefit plans and 93% in a Defined Contribution plan.

During 2018, Gerdaul's contribution to the Gerdaul Plan with respect to the executive officers amounted to R\$1.6 million to the Defined Contribution Plan. This sum includes only that portion of contributions for executives who do not currently receive retirement benefits. These benefits are in no way different from those offered to the other employees of the Company.

On April 30, 2003, Gerdaul's shareholders approved a new compensation program for strategic employees in the Company known as the Long Term Incentive Program. This program foresees the grant of options of the Company's Preferred Shares, on an annual basis, representing 20% of the annual base salary of each executive and, for the Directors and Executive Offices, an additional entrance bonus equivalent to 30% of the annual salary which latter was eliminated as of April 28, 2005. From 2005 on, in order to align their potential total compensation to market measures, the Board members were granted a number of shares representing 120% of their base salary. This modification of the long term incentive program was approved by the Compensation and Succession Committee in February 2006. In 2007, the Compensation and Succession Committee approved a change in the grant to the Chief Executive Officer (CEO) and the Chief Operating Officer (COO) to the equivalent of 50% of their annual base salaries. In order to align the potential total compensation to market measures, the Compensation and Succession Committee approved respectively in 2012 and in 2013, to the Chief Executive Officer (CEO) and to the Chief Operating Officer (COO) a change to the grant to 75% and then to 120% of their annual base salaries and to the Vice-Presidents to 30% and then to 40%. In order to align the potential total compensation to market, the Compensation and Succession Committee approved a change to 2018 in the grant to the Chief Executive Officer (CEO) to the equivalent of 150% of his annual base salary, Board Members up to 100% and VP's to 50%.



The intent of such Program to attract and assure the long-term commitment of executives by allowing them to share in the growth of the Company, thereby enhancing the sense of participation in the business. (See Item 10. Additional Information B. Memorandum and Articles of Association).

To meet the effort of aligning globally both the compensation programs and the business needs, the Human Resources team, supported by the HAY Group Consultancy, an expert in compensation related matters, reviewed the Long Term Compensation Program in order to tie a significant part of this compensation to a long term financial metric, in this case the ROCE (Return on Capital Employed), which was submitted to and approved by the Gerdau Compensation and Succession Committee during the meeting held on April 28, 2010. The Chief Executive Officer (CEO and Director positions will have part of their Long Term Compensation tied to ROCE (Return on Capital Employed) calculated on a yearly basis by comparing the actual ROCE against the one foreseen in the Strategic Plan.

In a shareholders meeting, held on September 19, 2013, changes to the Program were approved to better support the fulfillment of long term goals. These changes consisted of the inclusion of new vehicles such as Restricted Shares, Performance Shares, Differed Shares and also allowed participants to convert voluntarily until November 17, 2013, their Stock Options or Share Appreciation Rights to Restricted Shares, through a calculation methodology that assured that there would be equivalent fair value.

The fair value calculation was determined by a specialized external consultancy and the trinomial evaluation method was used. The Restricted Shares resulting from the conversion will be exercised in five equal instalments on the following schedule:

Table of Contents

December 9, 2013, March 20, 2015, March 20, 2016, March 20, 2017 and March 20, 2018. The Compensation and Succession Committee has approved all stock option grants since the program began. Share figures have been retroactively adjusted for all periods to reflect the bonus issue of one share for each share held in April 2004, the bonus issue of one share for every two shares held in April 2005, the bonus issue of one share for every two shares held in April 2006 and the bonus issue of one share for each share held in June 2008.

The Long Term Incentive grants distributed to the Board of Directors and Executive Committee are as follows (see Consolidated Financial Statements Note 24 for a complete summary of the stock option plans):

Exercise Price:	R\$ 6,78	R\$ 10,58	R\$ 10,58	R\$ 12,86	R\$ 17,50	R\$ 26,19	R\$ 14,91	R\$ 29,12	R\$ 22,61	R\$ 14,42	R\$ 18,58
Grant Date:	30-dez-03	30-dez-04	30-dez-04	30-dez-05	30-dez-06	30-dez-07	30-dez-08	30-dez-09	30-dez-10	30-dez-11	30-dez-12
Vesting Date:	2-jan-09	2-jan-10	2-jan-08	2-jan-11	2-jan-12	2-jan-13	2-jan-14	2-jan-15	2-jan-16	2-jan-17	2-jan-18
Expiration Date:	30-dez-13	30-dez-14	30-dez-14	30-dez-15	30-dez-16	30-dez-17	30-dez-18	30-dez-19	30-dez-20	30-dez-21	30-dez-22
Total Options Granted to Directors and Executive Officers											
	36.162	37.157	10.420	34.268	51.466	79.070	190.176	153.666	253.248	275.718	317.167
Exercised Options	36.162	17.694	10.420	16.012	0	0	16.494	1.825	2.953	4.560	3.378
Cancelled Options	0	0	0	0	0	0	0	52.195	199.022	178.661	187.558
Balance Options	0	0	0	0	0	0	0	0	0	0	0
Options converted to Restricted Share											
	0	19.463	0	18.256	51.466	79.070	173.682	99.646	51.273	92.497	126.231
Grant Price:											
	R\$ 16,50	R\$ 18,36	R\$ 9,65	R\$ 4,29	R\$ 11,12	R\$ 13,22	R\$ 18,58				
Grant Date:	1-set-13	1-jan-14	1-jan-15	1-jan-16	1-jan-17	1-jan-18	30-dez-12				
Vesting Date:	1-mar-18	1-mar-19	1-mar-20	1-mar-21	1-mar-21	1-mar-22	31-mar-14				
Expiration Date:	31-mar-18	31-mar-19	31-mar-20	31-mar-21	31-mar-21	31-mar-22	31-mar-18				
Total Restricted Share (Conversion)											
	403.884	0	0	0	0	0					
Exercised Restricted Share (Conversion)											
	403.884	0	0	0	0	0					
Cancelled Restricted Share (Conversion)											
	0	0	0	0	0	0					
Balance Restricted Share (Conversion)											
	0	0	0	0	0	0					
Grant Restricted Share	0	174.736	309.118	1.430.534	628.888	778.011					
Exercised Restricted Share	0	139.789	185.471	572.214	0	0					
Cancelled Restricted Share	0	0	0	10.918	0	0					
Balance Restricted Share	0	34.947	123.647	847.402	628.888	778.011					
Grant Performance Share	0	278.441	495.381	2.024.936	903.054	261.493					
Grant Performance Share - Performance Adjustment											
					0	0					
Exercised Performance Share	0	0	0	0	0	0					
Cancelled Performance Share	0	653	0	0	0	0					
Balance Performance Share	0	277.788	495.381	2.024.936	903.054	261.493					

**C. BOARD PRACTICES**

Gerdau has a historical commitment to good corporate governance practices and to strengthening the stock markets, which is why it takes part in Level 1 of the São Paulo Stock Exchange (nowadays named as B3) Differentiated Corporate Governance program (since 2001 in the case of Gerdau S.A. and since 2003 for Metalúrgica Gerdau S.A.).

Furthermore, Gerdau S.A and Metalúrgica Gerdau S.A also have an information disclosure policy that defines the criteria guiding investor relations, including the announcement of relevant acts and facts. The aim is to maintain a fast and efficient flow of data while respecting the rules of secrecy and confidentiality. This policy covers controlling shareholders, officers and managers, members of the Board of Directors and Board of Auditors and any organizations or persons with technical or consultative functions which, as a result of their responsibilities, function or position, have access to information concerning the Gerdau Companies.

The structure is composed of two levels and has maintained the existing governing bodies: the Board of Directors and the Board of Officers.

**Board of Directors:** The Board of Directors is responsible for determining the broad direction of the Gerdau's business. The Board may have up to eleven (11) members; currently there are three independent Board members. The Board has five (5) Committees: Compensation, People, Corporate Governance, Finance and Strategy. According to the Ordinary General Shareholders Meeting, held on April 20, 2018, the members of the Board of Directors, whose terms of office expire on April 30, 2019, are:

*Chairman*

Claudio Johannpeter (1), (2), (3), (4) and (5)

Table of Contents

***Vice Presidents***

André Bier Gerdau Johannpeter (1), (2), (3), (4) and (5)

Guilherme Chagas Gerdau Johannpeter (1), (2), (3) (4) and (5)

***Members***

Richard Chagas Gerdau Johannpeter (3), (4) and (5)

Affonso Celso Pastore (1) and (3)

Aod Cunha de Moraes Junior (3) and (4)

Fernando Fontes Iunes (1), (3) and (4)

Table of Contents

---

(1) Member of the Compensation Committee

(2) Member of the People Committee

(3) Member of the Corporate Governance Committee

(4) Member of the Finance Committee

(5) Member of the Strategy Committee

Other Committee members:

Gustavo Werneck da Cunha (1), (2), (4) e (5)

The Committees created to support the Board of Directors are:

*Compensation Committee:* evaluate compensation plans, benefits and pensions of directors and strategic executives; review of general wage increases; general definition of global values of variable remuneration and grant of stock options; review of compensation policies; participate in the evaluation process of the main executives of the Company.

*People Committee:* recommend policies for selection, retention and succession of directors and strategic executives of the Company; review and monitoring of the training programs for strategic managers and executives, suggesting alternatives to their professional development; review general HR strategies.

*Corporate Governance Committee:* responsible for, among other functions, keeping the members updated about the trends and benchmarks of Corporate Governance; evaluating the recommendations of the agents of capital markets and financial and specialized agencies, to recommend to the Board principles and guidelines of Corporate Governance; reviewing and commenting on the information relating to Corporate Governance contained in the official documents of the Company for dissemination to the market and evaluating the performance of the Board as a whole.

*Finance Committee:* responsible for supporting the Board in financial matters, including follow-up of the financial results of the Company, debt and leverage levels and targets, liquidity position and cash flows, capital structure, capital allocation, stock price and financial market trends, review of the financial and hedging policies of the Company.

*Strategy Committee:* responsible for supporting the Board in the formulation of general policy guidelines of the Company; providing recommendations to the Board regarding policies and guidelines of business by product line and market; providing opinion on the investment program presented annually and recommend its approval; opining on proposed mergers and acquisitions, monitoring the political environment, economic and social from the perspective of the Gerdau s business, as well as trends in the steel industry and evaluating the impacts of the development on the Company s business, among other activities.

**Board of Executive Officers:** Statutory Board whose members are responsible for the representation of the company and performance of the acts needed for the company s standard operations. The members of the Statutory Board of Executive Officers are:

*Chief Executive Officer (CEO):*

Gustavo Werneck da Cunha

*Vice-President, Chief Financial officer (CFO) and Investor Relations Officer:*

Harley Lorentz Scardoelli

*Officers:*

Cesar Obino da Rosa Peres

Fladimir Batista Lopes Gauto

Marcos Eduardo Faraco Wahrhaftig

Mauro de Paula

Table of Contents

Other Committees created to Support the Management: In order to provide support to the Management several committees were created and are responsible for advising on specific matters, such as the Risk Committee and the Disclosure Committee.

**Corporate Structure:** Gerdau's corporate structure evolved to help the business by adding value in three ways: being guardian of the governance and brand, image and values; optimizing the efficiency of Gerdau's activities through optimization of scale and leveraging capabilities to deliver value above what individual businesses could generate autonomously. The Governance Guardian areas, such as Finance and Planning; Accounting; Com., Public Affairs, Gerdau Institute; Legal, Compliance, Corp. Security; Internal Audit and Environment, Health and Safety, protects shareholders' interests and manages relevant risks to long-term sustainability. The Scale Optimizer areas, such as Information Technology; Procurement; Shared Services and Gerdau International Trade, optimize resources and achieve economies of scale. The Advantage Accelerators areas, such as Metallics; Marketing and Sales; Industrial, Engineering; People; Innovation and Management System, exploit Gerdau's differentiating capabilities in the Business Segments.

All members of the Board of Directors and the Board of Executive Officers are elected for one-year terms, with re-election or re-appointment permitted. Members of the Board of Directors are appointed at the Ordinary General Meeting of Shareholders while members of the Board of Executive Officers are elected at meetings of the Board of Directors.

**Board of Auditors**

Under Brazilian Corporate Law, the Board of Auditors ( *Conselho Fiscal* ) is a shareholder nominated audit board and an independent corporate body from the board of directors, management and the company's external auditors. The board of auditors has not typically been equivalent to or comparable with a U.S. audit committee; its primary responsibility has been to monitor management's activities, review the financial statements, and report its findings to the shareholders.

Pursuant to an exemption under Section 10A-3 of the SEC rules concerning the audit committees of listed companies, a foreign private issuer (such as the Company) does not need to have a separate audit committee composed of independent members if it has a Board of Auditors established and selected pursuant to its home country's legal or listing provisions expressly requiring or permitting such a board and if such a board meets certain requirements. Pursuant to this exemption, a board of auditors can exercise the required duties and responsibilities of an U.S. audit committee to the extent permissible under Brazilian Corporate Law. To comply with the SEC rules, the Board of Auditors must meet the following standards: it must be separate from the full board of directors, its members must not be elected by management, no executive officer may be a member, and Brazilian law must set forth standards for the independence of the members. In order to qualify for exemption, the Board of Auditors must, to the extent permitted by Brazilian law:

- be responsible for the appointment, retention, compensation and oversight of the external auditors (including the resolution of disagreements between management and the external auditors regarding financial reporting);

- be responsible for establishing procedures for the receipt, retention and treatment of complaints regarding accounting, internal accounting controls or auditing matters, and procedures for the confidential, anonymous submission by employees of concerns regarding questionable accounting or auditing matters;
- have the authority to engage independent counsel and other advisors as deemed necessary, to carry out its duties; and
- receive appropriate funding from the Company for payment of compensation to the external auditors, for any advisors and ordinary administrative expenses.

As a foreign private issuer, the Company decided to modify its Board of Auditors to comply with the exemption requirements. Accordingly, the Ordinary General Meeting of Shareholders held on April 28, 2005 amended the Company's by-laws to modify the duties of the Board of Auditors and the Board of Directors, and, on the same date, approved the delegation of certain additional responsibilities to the Board of Auditors. The Board of Auditors operates pursuant to a charter ( *Regimento Interno* ) that contemplates the activities described above to the extent permitted by Brazilian Law and is compliant with the requirements of the Sarbanes-Oxley Act, the pertinent regulations, and the requirements of the New York Stock Exchange and the Board of Auditors.

Because Brazilian Corporate Law does not permit the Board of Directors to delegate responsibility for the appointment, retention and compensation of the external auditors and does not provide the Board of Directors or the Board of Auditors with the authority to resolve disagreements between management and the external auditors regarding financial reporting, the Board of Auditors cannot fulfill these functions. Therefore, in addition to its oversight responsibilities, the Board of Auditors may only make recommendations to the



Table of Contents

Board of Directors with respect to the appointment, retention and compensation of the external auditors. Likewise, the board of auditors may only make recommendations to management and the Board of Directors with regard to the resolution of disagreements between management and the external auditors. This limited scope of authority is a key difference between the board of auditors and the customary authority of an audit committee as a full committee of the board of directors.

Under Brazilian Corporate Law, members of the Board of Auditors of a company are not allowed to be members of the Board of Directors, hold executive office, or be employed in any other position within that of the company or its subsidiaries or controlled companies. In addition, a member of the Board of Auditors cannot be spouse or relative of any member of the company's management. The Brazilian Corporate Law requires that members of the Board of Auditors receive a remuneration at least 10% of the average amount paid to each executive officer; and, also, that a Board of Auditors be composed of a minimum of three and a maximum of five members and their respective alternates.

As part of the adaptation of its Board of Auditors to the regulations, the Company has installed a permanent (standing) Board of Auditors currently composed of five members and their alternates who are elected at the Ordinary General Meeting of Shareholders with term of office to run until the next Ordinary General Meeting of Shareholders following their election, reelection being permitted. Under Brazilian Corporate Law, holders of Preferred Shares have the right to elect through a separate vote, one member of the Board of Auditors to represent their interests. Likewise, minority groups of shareholders with voting shares also have the right to elect one member of the board of auditors through a separate vote. However, irrespective of circumstances, the common shareholders have the right to elect the majority of the members of the board of auditors. Set forth below are the names, ages and positions of the members of the Company's Board of Auditors and their respective alternates, elected at the last Company's Ordinary General Meeting of Shareholders:

Name	Birthday	Member Position	Year First Elected
Bolívar Charneski	08/22/1950	Effective	2011
Geraldo Toffanello	10/12/1950	Effective	2014
Carlos Roberto Cafareli	27/02/1953	Effective	2017
Carlos Roberto Schröder	02/19/1940	Alternate	2015
Artur Cesar Brenner Peixoto	09/29/1942	Alternate	2014
Celene Carvalho de Jesus	10/07/1955	Alternate	2017

The Shareholder's Ordinary Meeting has determined that Bolívar Charneski is an audit committee financial expert within the meaning of the rules adopted by the SEC concerning the disclosure of financial experts. Each member of the Board of Auditors has acquired significant financial experience and exposure to accounting and financial issues.

**BOLÍVAR CHARNESKI (born in 1950)**

- Education: Degree in Accounting in 1974 and participant in a professional exchange program in PricewaterhouseCoopers, in Atlanta, GA USA.
- Experience: Founder and partner since 1988 of Charneski Contadores Associados (up to 2009, Charneski Auditores & Consultores), a company based in Porto Alegre (RS), where he was technically responsible for independent auditing and consulting services. Since 2009 dedicates himself to advising companies and organizations in the fields of Governance, Boards, Management, Accounting and Tax. Board member certified by Instituto IBGC Instituto Brasileiro de Governança Corporativa (Brazilian Corporate Governance Institute), where he acted as a

member of the Coordination Committee of the South Chapter. Advisory Board Member of family-owned companies. He was acting Partner (1st elected in Brazil) of Price Waterhouse (1971-1988), where he was also one of the founders of the Accounting and Audit Commission. Former director in various management terms of the IBRACON Instituto dos Auditores Independentes do Brasil (Brazilian Institute of Independent Auditors), having presided over the 6th Regional Section and serving twice as Director of IBRACON at the national level. Board of Auditors member of Grendene SA from 2011 to 2013. Board of Auditors member of Forjas Taurus SA from 1998 to 2007. Author of articles about business and economic scenarios, corporate governance, management, accounting and tax. Currently he is (i) Board of Auditors member (designated as Financial Expert for SOX purposes since 2011) of Gerdau S.A and (ii) Board of Auditors member of Metalúrgica Gerdau S.A.

Table of Contents

**GERALDO TOFFANELLO (born in 1950)**

- Education: Degree in accounting from Faculdade Porto-Alegrense de Ciências Contábeis e Administrativas and Postgraduate education in Accounting from the Universidade Federal do Rio Grande do Sul (UFRGS).
- Experience: He started his career at Gerdau in 1970, as tax bookkeeping assistant, promoted later to manager of the Tax Accounting area. He also served as manager of Accounting and Bookkeeping in Sapucaia do Sul. In 1980, he was transferred to Gerdau Açonorte, as the Accountant responsible for the northeast region companies, being promoted to Accounting Manager of this regional office in 1981. In 1983, he returned to Gerdau in Porto Alegre/RS to work at the Accounting department and also at the holding company. In 1984, he was promoted to General Manager of Accounting and Internal Audit, serving in the corporate areas of these two processes. In 1988, he was promoted to Accounting Director, a position he held until retiring in 2012. Since 2013, he has been a member of the Board of Auditors of several companies, and he is currently member of the Board of Auditors of Gerdau S.A, Metalúrgica Gerdau S.A and Ultrapar S.A. He is Founding Partner of Empresa Luzes do Mundo Ltda. He works with social entities, being a Board Member of Casa Menino Jesus de Praga and Board Member of Volunteer Partners.

**CARLOS ROBERTO CAFARELI (born in 1956)**

- Education: Holds a degree in Business Administration from the Pontifical Catholic University of Curitiba, (PUC-PR, 1985). Completed his academic training with an MBA degree in General Basic Training for Senior Executives (IBMEC, 1998). Also earned an MBA degree in Finance (IBMEC, 2010).
- Experience: Has more than 30 years of experience in Banco do Brasil, occupying positions of Superintendent and Director. Was the Board Member of TAESA - Transmissora Aliança de Energia Elétrica S.A., from 2010 to 2017. Head of Middle Market and Corporate at Banco do Brasil from 2009 to 2014. Director of Operational Assets Restructuring at Banco do Brasil from 2014 to 2016. Chief Executive Officer of Brasidental from 2016 to 2018. Currently, he is Board of Auditors member of Gerdau S.A.

**ARTUR CESAR BRENNER PEIXOTO (born in 1942)**

- Education: Graduated in Mining Engineering.
- Experience: Director of Cia. de Telecomunicações Cotelgos, Telegoiás, in Goiania, Goiás (1969 -1970); Director of DHB - Direções Hidráulicas do Brasil S.A. (1971 - 1972); Gerdau Diversifications Advisor (1972 - 1974); Director in Grupo Arthur Lange (1975 - 1978); Managing Director of Effem Produtos Alimentícios Ltda. - M & M Mars Group (1979 - 1984); Holdings Director of Gerdau (1984-2002). From 2003 to 2012, he was partner of Adviser Asset Management, a company operating in Securities Portfolio Management and Securities and Investment Clubs Management, which currently is responsible for the relationship with clients and investors. In addition, he is a Board of Auditors substitute member of Metalúrgica Gerdau S.A. and a Board of Auditors substitute member of Gerdau S.A.

**CARLOS ROBERTO SCHRODER (born in 1940)**

- Education: Degree in Accounting from the Universidade Federal do Rio Grande do Sul (UFRGS) in 1968.
- Experience: He worked in the following companies: (i) Petróleo Brasileiro SA - PETROBRAS, a listed company whose main activity is the prospecting, extraction, refining, processing, trade and transport of oil from wells, shale and other rocks, its derivatives, natural gas and other fluid hydrocarbons, as Head of Cost Sector from 1966 to 1971; (ii) Siderúrgica Riograndense SA, from 1971 to 1973 as Assistant at Cost Department, and from 1973 to 1976 as Chief Accountant; (iii) Metalúrgica Gerdau S.A., from 1973 to 1976 as Chief Accountant; (iv) Companhia Siderúrgica da Guanabara - Cosigua, former name of Gerdau S.A. from 1977 to 1981 as Accounting Manager; (v) Gerdau Group and Siderúrgica Laisa SA - Uruguay from 1981 to 1983 as Accounting Manager; (vi) Siderúrgica Riograndense SA and Siderúrgica Guaira SA, from 1983 to 1989 as Administrative and Accounting Director; (vii) Usina Siderúrgica da Bahia SA - Usiba, 1989-1996, as Executive Director; (viii) Siderúrgica Açonorte SA, Usina Siderúrgica da Bahia SA - Usiba and Usina Siderúrgica Cearense SA, from 1996 to 1998, as Executive Director. Currently, he is Board of Auditors substitute member of Metalúrgica Gerdau S.A. and Board of Auditors substitute member of Gerdau S.A..

**CELENE CARVALHO DE JESUS (born in 1955)**

- Education: Graduated in Accounting Sciences from UniCEUB - Centro Universitário de Brasília (1977 - 1982), with MBA in Financial Institutions Management from Universidade Católica de Brasília (2001 - 2002) and Postgraduate in Managerial Accounting from FGV - Fundação Getúlio Vargas (1989).
- Experience: Executive Manager/Accountant of PREVI - Caixa de Previdência dos Funcionários do Banco do Brasil (2002 - 2007) and Senior Analyst at the Accounting Department of Banco do Brasil (1999 - 2002). She was a member of the Board of Directors of FIAGO Participações - in Clearance sale (2016). She acted as effective member of Auditing Committee of Banco do Brasil (2008 - 2012). She served as Member of Board of Auditors of CPFL Energia (2013 - 2016), Cooperforte (2007), Cemig (2007 and 2008), Embraer (2003 - 2005), Embratel Participações (2006), PREVI (1996 - 1998) and Sociedade de Transportes Coletivos de Brasília (1995/1996). She is a Fiscal Counselor certified by Instituto Brasileiro de Governança Corporativa - IBGC. She has served as Board of Auditors substitute member of Gerdau S.A. since May 2018.

Table of Contents**D. EMPLOYEES**

<b>Work Force</b>	<b>Brazil</b>	<b>Other Countries</b>	<b>Total</b>
2011	23.516	19.304	42.820
2012	22.658	19.211	41.869
2013	22.278	19.337	41.615
2014	20.169	19.892	40.061
2015	16.495	18.650	35.145
2016	14.960	15.054	30.014
2017	14.038	14.574	28.612
2018	14.811	9.731	24.542

<b>Extended Work Force*</b>	<b>Brazil</b>	<b>Other Countries</b>	<b>Total</b>
2011	7.734	3.799	11.186
2012	8.147	3.303	11.450
2013	7.637	4.128	11.765
2014	6.583	4.201	10.784
2015	5.406	3.461	8.867
2016	4.992	2.970	7.962
2017	5.544	2.701	8.245
2018	6.192	1.487	7.679

---

\*Outsourced corresponds to employees of third-party service providers of Gerdau which provide, as employees of those providers, services directly to Gerdau in areas that are not the core business of Gerdau.

As of December 31, 2018, the Company employed 24,542 at its industrial units, excluding joint ventures; 60% of this total is based in Brazil and the remainder in South America and North America, which have 3,700 and 6,301 employees, respectively.

As labor unions in Brazil and other countries in Latin America and Europe are organized on a regional basis, the Company has no nationwide agreements with its employees. 39% of Gerdau employees are unionized.

Gerdau maintains good working conditions at its mills and consequently has what it believes to be a comparatively low employee turnover rate.

Gerdau maintains good relations with employees. To maintain such a good working environment, the Company provides development and training opportunities, team-building programs and a transparent management system. Compensation programs are designed to match employee's financial interests with those of Gerdau shareholders.

**E. STOCK OWNERSHIP**

Edgar Filing: GERDAU S.A. - Form 20-F

The following table shows the individual holdings of shares in preferred and common stock in Gerdau S.A. for each director and executive officer as of December 31, 2018.

Shareholder	Common Shares (with voting rights)	%	Preferred Shares (with restricted voting rights)	%
Claudio Johannpeter			100	0.00
André Bier Gerdau Johannpeter			100	0.00
Richard Chagas Gerdau Johannpeter				
Affonso Celso Patore			42,394	0.00
Fernando Fontes Iunes			7,056	0.00
Aod Cunha				
Harley Lorentz Scardoelli			26,473	0.00
Gustavo Werneck da Cunha				
Cesar Obino da Rosa Peres				
Marcos Eduardo Faraco Wahrhaftig				
Fladimir Batista Lopes Gauto			7,096	
Mauro de Paula				
<b>TOTAL</b>			<b>83,219</b>	<b>0.00</b>

Table of Contents

The Company has different employee stock option plans for each of its subsidiaries. See NOTE 25 Long-Term Incentive Plans in its Consolidated Financial Statements included herein for further details.

The following table shows the remaining vested options, the restricted shares resulted from the stock option conversion and 2013, 2014, 2015, 2016, 2017 and 2018 awards (all Gerdaul S.A. preferred shares) to each director and executive officer until January 31, 2018.

Names	Stock Options				Restricted Share Units				Performance Share Units			
	Grant	Exercised	Cancelled	Balance	Grant	Exercised	Cancelled	Balance	Grant with performance adjustment	Exercised	Cancelled	Balance
Claudio Johannpeter	185.976	0	185.976	0	1.200.507	435.578	0	764.929	1.312.535	0	0	1.312.535
Andre Bier Johannpeter	231.158	0	231.158	0	1.363.550	503.585	0	859.965	1.595.647	0	0	1.595.647
Guilherme Gerdaul Johannpeter	109.759	12.716	97.043	0	488.080	119.783	0	368.297	394.593	0	0	394.593
Richard Gerdaul Johannpeter	0	0	0	0	43.438	10.632	3.360	29.446	0	0	0	0
Aod Cunha de Moraes Júnior	0	0	0	0	7.908	0	0	7.908	0	0	0	0
Affonso Celso Pastore	28.929	0	28.929	0	98.365	63.040	7.558	27.767	48.049	0	653	47.396
Fernando Fontes Lunes	0	0	0	0	40.078	9.288	0	30.790	0	0	0	0
Gustavo Werneck da Cunha	0	0	0	0	169.286	25.423	0	143.863	232.726	0	0	232.726
Harley Lorentz Scardoelli	16.987	0	16.987	0	118.619	36.117	0	82.502	163.100	0	0	163.100
Fladimir Batista Lopes Gauto	19.394	0	19.394	0	64.427	30.817	0	33.610	77.875	0	0	77.875
Marcos Eduardo Faraco Wahrhaftig	13.687	0	13.687	0	48.861	21.929	0	26.932	59.119	0	0	59.119
Cesar Obino da Rosa Peres	0	0	0	0	47.698	28.180	0	19.517	44.208	0	0	44.208
Mauro de Paula	0	0	0	0	34.355	16.986	0	17.369	35.455	0	0	35.455
<b>Total</b>	<b>605.890</b>	<b>12.716</b>	<b>593.174</b>	<b>0</b>	<b>3.725.171</b>	<b>1.301.357</b>	<b>10.918</b>	<b>2.412.896</b>	<b>3.963.305</b>	<b>0</b>	<b>653</b>	<b>3.962.652</b>

Information concerning exercise price, grant date, vesting date and expiration date are available in the stock option table in Item 6.B Compensation.

The Extraordinary Shareholders Meeting held on September 19, 2013 approved the amendment to the Preferred Stock Option Plan, allowing participants to convert their Stock Options already granted but not yet exercised into Restricted Shares, in which restriction in this case is the vesting period. Said conversion was based on the fair value of the option calculated by an independent consulting firm. Bloomberg was contracted to perform the equivalence calculation.

## ITEM 7.

**MAJOR SHAREHOLDERS AND RELATED-PARTY TRANSACTIONS****A. MAJOR SHAREHOLDERS**

As of January 31, 2019, Gerdau S.A. had 571,929,945 common shares and 1,127,341,350 non-voting preferred shares outstanding (excluding treasury stock). Of the two classes of stock traded in the market, only the common stock carries voting rights. Under the terms of the Company's bylaws, however, specific rights are assured to the non-voting preferred stock. See the bylaws of Gerdau S.A. attached to this Annual Report.

The table below presents certain information as of January 31, 2019, regarding (i) any person known to the Company as the owner of more than 5% of Gerdau S.A.'s outstanding common stock, (ii) any person known to the Company as the owner of more than 5% of Gerdau S.A.'s outstanding preferred stock, and (iii) the total amount of the common and preferred stock owned by the members of the board of directors and executive officers of the Gerdau S.A. as a group.

Shareholder	Common Shares	%	Preferred Shares	%
Metalúrgica Gerdau S.A.	557,898,901	97.26%	95,469,722	8.33
JP MORGAN CHASE BANK			255,176,166	14.84
Members of the board of directors and executive officers as a group (9 members)			83,019	0.01



Table of Contents

Metalúrgica Gerdau S.A. is a holding company that directly and indirectly controls all Gerdau companies in Brazil and abroad. Metalúrgica Gerdau and its subsidiaries hold 97.26% of the voting capital stock of Gerdau S.A. and thus have the ability to control the Company's Board of Directors as well as its management and operations.

On January 31, 2019 there were 255,176,166 ADSs outstanding, representing 14.84% of Gerdau S.A. preferred shares and the number of record holders were 39.

**B. RELATED-PARTY TRANSACTIONS**

The Company's transactions with related parties consist of (i) loans, (ii) commercial operations and (iii) the payment of guarantees to some controlling companies. See Note 18 to the Consolidated Financial Statements (Related Party Transactions) for further information.

(i) Gerdau S.A. maintains loans with some of its subsidiaries and other affiliates through loan contracts, which are repaid under conditions similar to those prevailing in the open market. Loan agreements between Brazilian companies are adjusted by the monthly variation in the CDI (interbank deposit rate). The agreements with foreign companies are adjusted by contracted charges plus foreign exchange variation, when applicable.

(ii) Commercial operations between Gerdau S.A. and its subsidiaries or related parties basically consist of transactions involving the purchase and sale of inputs and products. These transactions are carried out under the terms and conditions established in the contract between the parties and under prevailing market conditions. The commercial operations include payments relating to loan guarantees.

(iii) The Company holds marketable securities in investment funds managed by a bank. These marketable securities comprise time deposits and debentures issued by major Brazilian banks and treasury bills issued by the Brazilian government.

(iv) The Company pays a fee of 0.95% per year for debt guaranteed by a controlling related-party company.

Table of Contents

The Company's transactions with related parties are presented below:

Item	INTRA-GROUP AGREEMENTS Purpose of the Agreement	Relationship with issuer	Original Amount		Maturity or Deadline	Termination or extinction conditions	Outstanding Amount	
			In thousands of R\$	Date			December 31, 2018	Largest amount during the period covered
1	Guarantee granted to Gerdau Aços Longos SA in an agreement to purchase and sell electricity with EDP.	Subsidiary	1,037	07/03/2018	Jan-19	Settlement of the agreement	1,037	1,037
2	Guarantee granted to Gerdau Corsa S.A.P.I. de C.V., obtained a financing from Sumitomo in the amount of up to MXN 990,750,000,000.00, equivalent to US\$ 75,000,000.00 at the date of the agreement.	Jointly-controlled entity	176,145	03/13/2014	Mar-19	Settlement of the agreement	116,296	209,931
3	The Company is the guarantor of subsidiary Gerdau Açominas S.A. in a loan with Banco do Brasil in the amount of R\$ 400 million.	Subsidiary	1,300,000	04/28/2013	Apr-19	Settlement of the agreement	400,000	400,000
4	The Company is the guarantor of subsidiary Gerdau Açominas S.A. in a financing working capital with Citibank in the amount of R\$ 169,500,000.00.	Subsidiary	169,500	04/16/2018	Apr-19	Settlement of the agreement	169,500	169,500
5	The Company is the guarantor of subsidiary Gerdau Aços Longos S.A. in a financing working capital with Citibank in the amount of R\$ 230,500,000.00.	Subsidiary	230,500	04/16/2018	Apr-19	Settlement of the agreement	230,500	230,500
6	Guarantee granted to the company Sipar Aceros S.A., in financing with BBVA, in the amount of US\$ 34,000,000.00 equivalent in ARS.	Subsidiary	83,241	10/30/2014	Sep-19	Settlement of the agreement	5,929	15,895
7	Guarantee granted to Gerdau Aços Longos S.A. in an agreement for the distribution of electric power with the Operador Nacional do Sistema Elétrico, ONS.	Subsidiary	2,485	11/06/2018	Nov-19	Settlement of the agreement	2,485	2,485
8	Guarantee granted to Gerdau Aços Longos S.A. in an agreement for the distribution of electric power with the Operador Nacional do Sistema Elétrico, ONS.	Subsidiary	6,926	11/06/2018	Nov-19	Settlement of the agreement	6,926	6,926
9	Guarantee granted to Gerdau Aços Longos SA in an agreement to purchase and sell electricity with Companhia de São Paulo, CESP.	Subsidiary	15,284	11/29/2018	Dec-19	Settlement of the agreement	15,284	15,284
10	Guarantee granted to Gerdau Aços Longos SA in an agreement to purchase and sell electricity with LIGHT Energia.	Subsidiary	491	12/20/2018	Dec-19	Settlement of the agreement	491	491
11	Co-guarantee for Gerdau Holdings Inc. in the 10-year Bond issued in November/2009 in an amount of up to US\$ 1,25 billion. No remuneration.	Subsidiary	2,188,125	11/24/2009	Jan-20	Settlement of the agreement	834,454	2,041,172
12	Guarantee for company Gerdau Açominas S.A. in a loan with BNDES in the amount of up to R\$ 776,616,380.00 on the agreement's date.	Subsidiary	776,616	12/04/2012	Jan-20	Settlement of the agreement	117,942	182,393
13	Guarantee for company Gerdau Açominas S.A. in a loan with NCE	Subsidiary	430,000	03/19/2014	Feb-20	Settlement of the agreement	258,000	258,000

Edgar Filing: GERDAU S.A. - Form 20-F

	Banco do Brasil in the amount of up to R\$ 430 million on the agreement's date.							
14	The Company is the guarantor of subsidiary Gerdau Açominas S.A. in a loan with Banco do Brasil in the amount of R\$ 660 million.	Subsidiary	660,000	09/24/2013	Aug-20	Settlement of the agreement	435,000	535,000
15	The Company is the guarantor of subsidiary Gerdau Açominas S.A. in a financing working capital with Citibank in the amount of R\$ 656,200,000.00 for a period of 5 years.	Subsidiary	656,200	10/30/2015	Oct-20	Settlement of the agreement	656,200	656,200
16	Guarantee granted to subsidiaries and joint ventures in revolving credit lines of up to US\$ 800,000,000.00 with maturity in October/2020.	Subsidiary and Jointly-controlled entity		10/27/2015	Oct-20	Maturity	198,619	382,333
17	Guarantee for company Gerdau Corsa S.A.P.I de C.V. in a loan with BBVA in the amount of US\$ 150 million equivalent to MXN.	Jointly-controlled entity	580,665	12/14/2015	Dec-22	Settlement of the agreement	492,153	581,642
18	The Company is the guarantor of subsidiary Sipar Aceros S.A., in a financing granted by Banco Patagônia in the amount of US\$ 21,023,641.08 equivalent in ARS.	Subsidiary	81,575	10/30/2015	Dec-20	Settlement of the agreement	4,837	10,674
19	Co-guarantee for Gerdau Trade Inc. in the 10-year Bond issued in 2010 in an amount of up to US\$ 1,25 billion	Subsidiary	2,117,750	10/01/2010	Jan-21	Settlement of the agreement	1,070,599	1,884,924
20	Guarantee for Gerdau Açominas S.A. in financings and the opening of a letter of credit for expansion projects and the acquisition of equipment in an amount of up to US\$ 291,959 thousand. No remuneration.	Subsidiary	437,387	06/16/2011	Feb-21	Settlement of the agreement	389,959	436,526
21	Guarantee granted to the company Sipar Aceros S.A., in financing with BBVA, in the amount of US\$ 13,063,357.28 equivalent in ARS.	Subsidiary	42,335	09/21/2016	Sep-21	Settlement of the agreement	17,001	30,606
22	Co-guarantee granted to Gerdau Corsa S.A.P.I. de C.V., borrower of local credit line, in the amount of US\$ 330,000,000.00, equivalent in MXN.	Jointly-controlled entity	1,118,535	12/07/2016	Dec-21	Settlement of the agreement	1,325,480	1,426,680
23	Co-guarantee for Gerdau Trade Inc. in the 10-year Bond issued in April/2013 in an amount of up to US\$ 750,000,000.00.	Subsidiary	1,501,275	04/15/2013	Apr-23	Settlement of the agreement	1,200,308	2,169,333
24	Co-guarantee for GTL Trade Finance Inc. and Gerdau Holdings Inc. in the 10-year Bond issued in April/2014 in an amount of up to US\$ 1,165,629,000.00. No remuneration.	Subsidiary	2,606,346	04/10/2014	Apr-24	Settlement of the agreement	2,427,186	3,669,807
25	Gerdau S.A. usually trades its own debentures on behalf of Seiva S.A. Florestas e Indústrias. These transactions are carried out at the present unit price of the paper, which pays the CDI variation.	Subsidiary			Aug-24	Maturity	42,755	42,755
26	Guarantee granted to Gerdau Summit Aços Fundidos e Forjados S.A. in financing from the BNDES in the amount of up to R\$ 130,164,000.00 at the date of the agreement.	Jointly-controlled entity	130,164	09/21/2017	Aug-25	Maturity	41,571	41,571
27	Co-guarantee for Gerdau Trade Inc. in the 10-year Bond issued in October/2017 in an amount of up to US\$ 650,000,000.00.	Subsidiary	2,129,985	10/12/2017	Oct-27	Settlement of the agreement	2,518,620	2,602,535
28		Subsidiary	12,834	08/05/2009	Dec-30		12,216	12,216

Edgar Filing: GERDAU S.A. - Form 20-F

	Guarantee for company Gerdaul Aços Longos S.A. in a loan with BBRB Pró DF II.					Settlement of the agreement		
29	Co-guarantee for Gerdaul Ameristeel US Inc. in the 25-year Bond issued in October/2012 in an amount of US\$ 51 million.	Subsidiary	103,596	10/18/2012	Oct-37	Settlement of the agreement	197,615	204,199
30	Co-guarantee for GTL Trade Finance Inc. in the 30-years Bond issued in April/2014 in an amount of US\$ 500 million. No remuneration.	Subsidiary	1,118,000	04/16/2014	Apr-44	Settlement of the agreement	1,937,400	2,001,950
31	Guarantee received from the company Indac Ind. Adm. E Com. S.A. for debentures from the 7 <sup>o</sup> , 8 <sup>o</sup> , 9 <sup>o</sup> and 11 <sup>o</sup> issuances, with no restriction of amounts and dates. Remuneration rate of 0.95% on the due amount.	Parent company			Undetermined	Maturity	17,246	26,551
32	Gerdaul S.A. has accounts receivable derived from sales to subsidiaries (Sipar Aceros S.A., Gerdaul Aços Longos S.A. e Empresa Siderúrgica Del Peru S.A.A.) Sales in the period amounted to R\$ 8,582.	Subsidiary and Jointly-controlled entity			Undetermined	Maturity	32,876	32,876
33	Gerdaul S.A. has accounts payable derived from purchases of subsidiaries (Gerdaul Aços Longos S.A. and Gerdaul Açominas S.A.). Purchases in the period amounted to R\$ 24,735.	Subsidiaries			Undetermined	Maturity	6,856	46,454
34	Current account (assets balance) with Gerdaul Açominas S.A. Pays the monthly variation of the CDI.	Subsidiary		12/01/2014	Undetermined	No maturity	386	7,186
35	Current account (liability balance) with Gerdaul Aços Longos S.A. Pays the monthly variation of the CDI.	Subsidiary		07/31/2005	Undetermined	No maturity	4,090	4,090
36	Current account (liability balance) with Gerdaul Trade Inc. Pays the contracted charges plus exchange variance.	Subsidiary		09/17/2010	Undetermined	No maturity	6,717,259	6,974,279
37	Renting agreement of commercial room of area of 840 m2 of building placed on Av. Farrapos, 1811 - Porto Alegre/RS, Lessor: Gerdaul Aços Longos S.A. Lessee: Grupo Gerdaul Empreendimentos Ltda: Amount per month R\$ 60 thousand.	Parent company	50	01/01/2013	Undetermined	Maturity	60	60

C. INTERESTS OF EXPERTS AND COUNSEL

Not applicable.

Table of Contents**ITEM 8. FINANCIAL INFORMATION****A. CONSOLIDATED STATEMENTS AND OTHER FINANCIAL INFORMATION**

The Company's financial statements are included in Item 18.

**Judicial and Administrative / Arbitral Proceedings****General**

Like other Brazilian companies, Gerdau and its subsidiaries are parties to proceedings with respect to tax, labor and civil matters, most of them arising in the regular course of business. Based on advice from legal advisors, management believes that the reserve for provisions is sufficient to meet probable and reasonably estimable losses in the event of unfavorable rulings, and that the final proceedings will not have a significant effect on its consolidated financial position at December 31, 2018.

The most significant legal and administrative disputes are detailed below. For further information on the tax, civil and labor claims and contingent assets, see Notes to the consolidated financial statements.

The following table summarizes the balances of provisions recorded for tax, civil and labor liabilities and related judicial deposits as of December 31, 2018, 2017 and 2016 (in thousands of reais):

**Claims**

	Reserve for Contingencies			Judicial Deposits		
	2018	2017	2016	2018	2017	2016
Tax	268,009	257,621	1,829,771	1,964,120	1,883,562	1,716,996
Labor	449,350	517,329	358,901	128,173	128,849	107,191
Civil	52,946	52,933	50,554	45,537	38,770	37,597

As a result of the net reversal of the accounting provision described below (tax provisions), relating to the discussion of the inclusion of Tax on Circulation of Goods and Services ( *Imposto sobre a Circulação de Mercadorias e Serviços* - ICMS) a type of State VAT in the calculation bases of the Contribution to the Social Integration Plan ( *Contribuição ao Programa de Integração Social* - PIS) and the Contribution for the Financing of Social Security ( *Contribuição para o*

*Financiamento da Seguridade Social* (COFINS), and recognition of other accounting provisions for the year ended 12/31/2017, the Company recorded the amounts of R\$ 929 million in the line of Reversal of provision for tax liabilities, net (Operating Result) and R\$ 370 million, in the line of Reversal of interest on provision for tax liabilities, net (Financial Result), in its Consolidated Income Statement.

#### **Tax Provisions**

The Company and its subsidiaries are parties to lawsuits related to the exclusion of ICMS from the bases of calculation of PIS and COFINS, for which judicial deposits and accounting provisions of the amounts under discussion have been updated, in both cases, by the SELIC rate. The balances recorded as of December 31, 2016 refer to the unsettled amounts of PIS and COFINS since 2009, whose liability was fully suspended, due to the posting of said deposits.

On March 15, 2017, the Federal Supreme Court ( *Supremo Tribunal Federal* - STF) analyzed a lawsuit related to this matter, and by 6 votes to 4, the following decision was taken: The ICMS shall not be included in the calculation bases of PIS and COFINS. The decision handed down by the STF, in principle, takes effect in all the judicial proceedings in progress, due to its general repercussion. However, after the publication of the judgment on 10/2/2017, the Attorney of the National Treasury filed a motion for clarification ( *embargos de declaração* ), claiming that the decision of the Supreme Court was silent on certain points, and requested a modulation of the effects of the decision, which may limit the production of its effects to taxpayers.

Pursuant to paragraph 14 of CPC 25 and IAS 37 - Provisions, Contingent Liabilities and Contingent Assets, a provision is recognized only when it is probable that an outflow of resources that incorporates economic benefits to settle the obligation will be required, among other requirements. On March 31, 2017, the Company, based on (i) the conclusion of said judgment by the STF Plenary in Extraordinary Appeal No. 574,706 / RG with general repercussion, which ruled that the inclusion of ICMS in the calculation bases of PIS and COFINS was unconstitutional, and (ii) in accounting practices adopted in Brazil and international financial reporting standards (IFRS), reversed the aforementioned accounting provision. The Company's decision is supported by the position of its legal advisors who, when reassessing the likelihood of loss in the ongoing lawsuits related to the matter, concluded that the likelihood of loss, as to the merits judgment in said lawsuits, became remote, as from that decision.

Table of Contents

The Company emphasizes, however, that, in view of the possibility that the STF considers that the requirements for application of modulation to the case as present, and that the application of such an instrument results in limiting the effects of the decision already rendered, there may be a need for reassessing the likelihood of loss associated with said lawsuits, according to paragraph 59 of IAS 37. Depending on the terms of the modulation, as defined by the STF, such reassessment may result in the need for establishing new provisions on this matter in the future.

The balance of judicial deposits recorded on 12/31/2018, in the amount of R\$ 1,763 million, referring to deposits posted until June, 2017, in connection with the same discussion on the inclusion of ICMS in the PIS and COFINS calculation bases, awaits the closure of the proceedings in the judiciary to be withdrawn by the Company.

The other tax provisions comprise:

- R\$ 3 million related to ICMS, the majority of which is related to credit rights involving the Finance Secretariat and the State Courts.
  
- R\$ 17 million related to discussions on Social Security Contributions ( *contribuições previdenciárias* ) levied on the company's total payroll amount.
  
- R\$ 9 million related to the Extraordinary Tariff Recomposition ( *Recomposição Tarifária Extraordinária* RTE), which is a charge included in the electric energy bills. The Company understands that RTE is a tax in nature and, as such, incompatible with the Brazilian National Tax System. For this reason, the constitutionality of this charge is being challenged in court. The lawsuits are outstanding before the First and Second Levels of the Federal Justice. The Company has made a full deposit in court for the amount of the disputed charge.
  
- R\$ 204 million related to (i) offsetting of PIS and COFINS credits, and (ii) taxation of those Contributions over revenues in excess of sales.
  
- R\$ 33 million related to other taxes, discussed in cases, for which the probability of loss is more likely than not.

Considering the opinion of our legal advisors and the assessment by management, the likelihood of loss in connection with the lawsuits and proceedings listed below is deemed possible (but not probable), and, according to the accounting principles currently in force, no accounting provision were made in connection with said proceedings.

- The Company and its subsidiaries, Gerdau Aços Longos S.A. and Gerdau Açominas S.A. are parties in legal proceedings related to ICMS discussions, which essentially relate to tax credit and rate differences, and in aggregate amounting to R\$ 613 million.
  
- The Company and certain of its subsidiaries in Brazil are parties to claims related to: (i) Tax on Industrialized Products ( *Imposto sobre Produtos Industrializados* IPI), substantially related to credit on inputs, whose claims total the updated amount of R\$ 341 million; (ii) PIS and COFINS, substantially related to non-approval of offsetting of credits on inputs totaling R\$ 968 million, (iii) social security contributions in the total of R\$ 88 million and (iv) other taxes, whose updated total amount is currently R\$ 642 million.
  
- The Company and its subsidiary Gerdau Aços Longos S.A. are parties to three administrative proceedings relating to Withholding Income Tax, in the amount of R\$ 411 million, charged on interest remitted abroad, related to export financing formalized through Pre-Settlement Export Agreements ( *Pré-Pagamento de Exportações* PPE) or Early Payment of Exports ( *Recebimento Antecipado de Exportações* RAE), of which: (i) R\$ 125 million correspond to a proceeding initiated by Gerdau Aços Longos S.A., whose appeal was rejected by The Appeals Administrative Council ( *Conselho Administrativo de Recursos Fiscais* CARF) by a casting vote ( *voto de qualidade* ), as per the decision published on 09/03/2018, against which the Company filed a motion for clarification disposition of which is pending; (ii) R\$ 133 million correspond to a proceeding initiated by Gerdau Aços Longos S.A., whose defense was rejected by a first-level decision, against which the company filed a voluntary appeal on 08/28/2018 disposition of which is pending; (iii) R\$ 153 million correspond to a proceeding initiated by the Company, whose defense was rejected by a first-level decision, against which the Company filed a voluntary appeal on 08/31/2018 disposition of which is pending.
  
- The Company (as successor due to the merger with Gerdau Aços Especiais S.A.) and its subsidiary Gerdau Internacional Empreendimentos Ltda. are parties to administrative and legal proceedings related to Corporate Income Tax ( *Imposto de Renda da Pessoa Jurídica* IRPJ) and Social Contribution on Net Profits ( *Contribuição Social sobre o Lucro Líquido* CSLL), in the updated amount of R\$ 1,201 million. These lawsuits relate to profits generated abroad, of which: (i) R\$ 1,023 million correspond to two lawsuits of the subsidiary Gerdau Internacional Empreendimentos Ltda., of which (i.a) R\$ 989 million correspond to a lawsuit



Table of Contents

whose administrative discussion has already ended and is currently subject to a tax foreclosure, against which said company filed a motion to stay execution ( *embargos à execução* ), the judgment of which is still pending and (i.b) R\$ 34.5 million are the remainder of a R\$ 372 million tax assessment which was partially confirmed by the Superior Chamber of Tax Appeals of the CARF ( *Câmara Superior de Recursos Fiscais*

CSRF), in a decision published on 05/25/2017, and currently awaits redistribution of the case for retrial by CARF, as determined by the CSRF decision, for analysis of matters not previously analyzed; and (ii) R\$ 177 million corresponds to a lawsuit filed by the Company, whose appeal was rejected by CARF, and whose special appeal is still pending judgment by the CSRF.

- The Company (as successor due to the merger with Gerdau Aços Especiais S.A.) and its subsidiaries Gerdau Aços Longos S.A. and Gerdau Açominas S.A. are parties to administrative proceedings related to the deductibility of goodwill, generated pursuant to articles 7 and 8 of Law no. 9,532 / 97, of the bases of calculation of IRPJ and CSLL, resulting from the corporate reorganization carried out in 2004/2005. The updated total amount of the assessments is R\$ 7,063 million, of which: (i) R\$ 5,129 million correspond to four lawsuits filed by the Company and the subsidiaries Gerdau Aços Longos S.A. and Gerdau Açominas S.A., whose administrative discussion has already been closed and are currently in the process of judicial collection; the companies have already offered judicial guarantees, in the form of a precautionary measure, through Insurance-Guarantee policies, and initiated judicial proceedings by means of motions to stay execution. The motion presented by the Company (as successor due to the merger with Gerdau Aços Especiais S.A.) on 05/17/2018 was upheld by a first-level decision (therefore cancelling the tax foreclosure), against which the Attorney of the National Treasury filed an appeal disposition of which is still pending (by the Federal Regional Court of the 4<sup>th</sup> Circuit); (ii) R\$ 630 million correspond to a proceeding filed by the subsidiary Gerdau Aços Longos S.A., whose appeal was partially granted by CARF (the Company will be subsequently notified in order to take whatever actions it may deem necessary); (iii) R\$ 256 million correspond to a proceeding filed by the subsidiary Gerdau Aços Longos S.A., whose appeal was rejected by CARF, whose special appeal was partially granted on 07/06/2018, and whose interlocutory appeal ( *agravo regimental* ) is still pending judgment; (iv) R\$ 297 million correspond to a proceeding filed by the subsidiary Gerdau Aços Longos S.A., whose appeal was rejected, for which reason the Company presented a special appeal disposition of which is still pending (the company currently awaits for the collection of the debt related to the portion of the appeal that the Court decided not to rule on); (v) R\$ 128 million correspond to a proceeding filed by the Company (as successor due to the merger with Gerdau Aços Especiais S.A.), whose appeal was rejected by CARF, for which reason the Company presented a special appeal that was partially granted, and whose interlocutory appeal ( *agravo regimental* ) is still pending judgment; (vi) R\$ 101 million correspond to a proceeding filed by the Company (as successor due to the merger with Gerdau Aços Especiais S.A.), whose defense was rejected by a first-level decision it was notified of on 09/17/2018, against which the Company filed an appeal disposition of which is pending; and (vii) R\$ 523 million correspond to a proceeding filed by the subsidiary Gerdau Aços Longos S.A., whose defense was rejected by a first-level decision it was notified of on 11/27/2018, against which the company filed an appeal disposition of which is pending.

The Company's legal tax advisors have confirmed that the procedures adopted by the Company with respect to the tax treatment of profits abroad and the deductibility of goodwill, which generated the abovementioned proceedings, were strictly legal, and, therefore, the likelihood of loss with respect to said proceedings is possible (but not likely).

Some of the decisions obtained at the level of CARF related to those proceedings along with other matters involving the Company included in the scope of the so-called Operation Zelotes are being investigated by Brazilian federal authorities including the Judiciary Branch, with the purpose of verifying the occurrence, or not, of alleged illegal acts. The Company was providing information requested by the U.S. Securities and Exchange Commission (SEC). The Company has since been informed by the SEC's staff that it has closed its inquiry and therefore is not seeking any further information from the Company regarding these matters.

The Company believes it is not possible at this time to predict the term or outcome of the proceedings in Brazil, and that there currently is not enough information to determine whether a provision for losses is required or any additional disclosures.

**Labor Provisions**

The Company is also defending labor proceedings, for which there is a provision as of December 31, 2018 of R\$ 451 million. None of these processes refers to significant amounts individually, and the lawsuits involve, mainly, labor claims for overtime, nighttime additional, hours *in itinere*, unhealthy and hazardous conditions, indemnity for occupational accidents, occupational disease and moral damages, among others. The balance of judicial deposits related to labor contingencies, as of December 31, 2018, represented R\$ 128 million.

**Other Provisions**

The Company is also involved in lawsuits arising from the ordinary course of its operations and has reserved R\$ 53 million for these proceedings. Deposits in guaranteed accounts related to these contingencies as of December 31, 2018 amount to almost R\$

Table of Contents

45 million. Other contingent liabilities with remote possibility of loss, involving uncertainties related to their occurrence, and therefore not included in the contingency reserve, are comprised of:

***Antitrust Proceedings***

A lawsuit arising from the request by two civil construction unions in the state of São Paulo alleging that Gerdau S.A. and other long steel producers in Brazil share customers among themselves, thus, violating the antitrust legislation. After investigations carried out by the Economic Law Department ( *Secretaria de Direito Econômico* SDE), the final opinion was that a cartel exists. The lawsuit was therefore forwarded to the Administrative Council for Economic Defense ( *Conselho Administrativo de Defesa Econômica* CADE) for judgment, which resulted in a fine to the Company and other long steel producers an amount equivalent to 7% of gross revenues in the year before the Administrative Proceeding was commenced, excluding taxes (fine of R\$ 245 million, updated by the judicial accounting on August 01, 2013 to R\$ 418 million)

Two lawsuits challenge the investigation conducted by the Competition Defense System and its merits judgment, whose grounds are procedural irregularities, especially the production of evidence, based on an economic study, to prove the lack of a cartel. The suspension of the effects of CADE's decision was granted by the Court, upon offer of bank guarantee letter. Sentences were handed down for the dismissal of the proceedings and both are at the level of appeals.

As regards the first lawsuit, filed in 2003, that challenges procedural irregularities, the Federal Regional Court of the 1st Circuit rendered an unfavorable decision to the Company. Against said decision, the Company presented appeals directed to the Superior Court of Justice and the STF, disposition of which on admissibility is still pending. As regards the second lawsuit, filed in 2006, that challenges the validity of the judgment made by CADE, the Federal Regional Court of the 1st Circuit rendered an unfavorable decision to the Company. Due to a procedural irregularity and omissions found on the respective decision, the Company filed a motion for clarification, disposition of which is still pending. Regardless of the outcome of these appeals, the Company will continue to seek appropriate legal remedy for the defense of its rights.

The Company denies having been engaged in any type of anti-competitive conduct and believes based on information available, including the opinion of its legal counsel, that it is possible that the decision will be reverted.

***Other Civil Litigation***

The Company and its subsidiaries are parties to other civil claims that together have an amount of approximately R\$ 234 million. For these claims, no accounting provision was made, since these were considered as possible losses, based on the opinion of its legal advisors.

***Administrative proceeding Brazilian Securities Commission (CVM)***

On July 14, 2015, the Company acquired non-controlling interests in the following companies: Gerdau Aços Longos S.A. (4.77%), Gerdau Açominas S.A. (3.50%), Gerdau Aços Especiais S.A. (2.39%) and Gerdau América Latina Participações S.A. (4.90%), having as a counterparty Itaú Unibanco S.A. and ArcelorMittal Netherlands BV. This transaction was approved by the Board of Directors of Gerdau S.A. by unanimous vote of the directors on July 13, 2015, based on the market opportunity and the analysis that the prices were appropriate considering: economic evaluations conducted by independent report, the financial instruments used, the payment terms, capturing value through a more concentrated cash flow and long-term vision for the Company. The Company, in compliance with CVM requests for clarification on the acquisition, disclosed that the decision to its acquisition had exclusively

Table of Contents

business merit and was duly considered and unanimously approved by the Board of Directors. The terms and conditions for the acquisition considered long-term market prospects. On October 21, 2016, Metalúrgica Gerdau S.A. and certain directors and former directors of Gerdau S.A. filed a defense in the administrative proceeding brought by CVM on the acquisition of non-controlling interests in the subsidiaries, against allegations that the operation was not justified. There is no estimate for a final decision of the matter. Metalúrgica Gerdau S.A. believes that, currently, there is not enough information to disclose or determine if a provision for losses is required.

**No Material Effect**

Management believes that any losses arising from other contingencies will not materially affect the results of operations or the Company's consolidated financial position. However, there is no guarantee that a final court order will be favorable in any of these or other proceedings, as well as any material adverse effects on the Company's consolidated financial position, results or future cash flows.

**Dividend Distribution Policy**

Brazilian Corporate Law generally requires the by-laws of each Brazilian corporation to specify a minimum percentage of the profits for each fiscal year that must be distributed to shareholders as dividends. The law requires a minimum payout of 25% of adjusted net income. Under the Company's bylaws, this percentage has been fixed at no less than 30% of the adjusted net income (according the section 19 of the Company's bylaws) for distribution each fiscal year.

Dividends for a given fiscal year are payable from (i) retained earnings from prior periods and (ii) after-tax income for the same period, after the allocation of income to the legal reserve and to other reserves ( Adjusted Net Income ). In order to convert the dividends paid by the Company from *reais* into U.S. dollars, the institution providing the Company with custodial services ( Custodian ) uses the relevant commercial market exchange rate on the date that these dividends are made available to shareholders in Brazil. Under Brazilian Corporate Law, a Brazilian company is required to maintain a legal reserve, to which it must allocate 5% of net income determined in accordance with the law for each fiscal year until such reserve reaches an amount equal to 20% of the company's paid-in capital. On December 31, 2018, in accordance with Brazilian GAAP, Gerdau S.A.'s legal reserve amounted to R\$ 743.4 million or 3.9% of total paid-in capital of R\$ 19,249.1 million.

According to Law 9,457, holders of preferred shares in a Brazilian corporation are entitled to dividends at least 10% greater than the dividends paid on Ordinary Shares, unless one of three exceptions described in the law holds. Gerdau S.A.'s executive directors presented a proposal at the 2002 shareholders' meeting, to grant to both ordinary and preferred shares 100% tag-along rights. Shareholders approved this measure and the right was extended to all shareholders, even though the new Brazilian Corporate Law only requires that such rights be granted to the common minority shareholders (and only for 80% of the consideration paid to the controlling shareholders).

Under the amendments to the Brazilian Corporate Law, by extending the tag along rights to minority shareholders, the Company no longer needs to comply with the requirement to pay an additional 10% premium on dividends paid to preferred shareholders. Following the approval and implementation of the amendments to the Company's bylaws to provide for the tag-along rights as described above, the Company now pays the stated minimum dividend of 30% of adjusted net profit (according the section 19 of the Company's articles of association) to all shareholders, from January 1, 2002 dividends paid to preferred shareholders no longer being subject to a minimum 10% premium over those paid to holders of ordinary shares.

As a general requirement, shareholders who are non-residents of Brazil must have their Brazilian company investments registered with the Central Bank in order to be eligible for conversion into foreign currency of dividends, sales proceeds or other amounts related to their shares for remittance outside Brazil. Preferred shares underlying the ADSs will be held in Brazil by the Custodian as agent for the Depositary Bank (the Depositary ). The holder of preferred shares will be the registered holder recorded in the preferred shares register.

Payments of cash dividends and distributions, if any, are made in Brazilian currency to the Custodian, on behalf of the Depositary, which will then convert such proceeds into U.S. dollars and deliver the same U.S. dollars to the Depositary for distribution to holders of ADSs. If the Custodian is unable to convert the Brazilian currency received as dividends into U.S. dollars immediately, the amount of U.S. dollars payable to holders of ADSs may be adversely affected by any devaluation or depreciation of the Brazilian currency relative to the U.S. dollar that may occur before such dividends are converted and remitted. Dividends in lieu of the preferred shares paid to holders who are not resident in Brazil, including holders of ADSs, are not subject to Brazilian withholding tax.

Table of Contents

*Interest on Capital Stock*

Law 9,249 of December 1995, provides that a company may, at its sole discretion, pay interest on capital stock in addition to, or instead of, dividends. A Brazilian corporation is entitled to pay its shareholders interest on capital stock up to the limit of an amount computed as the TJLP (Long-Term Interest Rate) rate of return on its interest on capital stock or 50% of the net income (according BR GAAP) for the fiscal year, whichever is the lower. The payment of interest as described herein is subject to a 15% withholding income tax. See Item 10. Additional Information - Taxation.

*Dividend Policy*

The Company currently intends to pay dividends on its outstanding preferred shares at its mandatory distribution rates for any particular fiscal year, subject to any determination by the Board of Directors that such distributions would be inadvisable in view of the Company's financial condition. On March 31, 2003, the Board of Directors approved a new policy for paying dividends and interest on capital stock on a quarterly basis.

Since 1999, dividends have been paid to holders of the Company's ordinary and preferred shares in *reais* and in U.S. dollars translated from *reais* at the commercial exchange rate on the date of payment. Relevant amounts are described in Item 3 - Key Information - Selected Financial Data.

**B. SIGNIFICANT CHANGES**

No significant changes to report.

**ITEM 9. THE OFFER AND LISTING**

**A. OFFER AND LISTING DETAILS**

Not required.

**B. DISTRIBUTION PLAN**

Not required.

**C. MARKETS**

**São Paulo Stock Exchange - Brasil**

***Trading on the BOVESPA***

The São Paulo Stock Exchange (BOVESPA) is the only stock trade center in Brazil and Latin America's largest stock exchange. Until August, 2007, BOVESPA was a non-profit association owned by its member brokerage firms and trading on the BOVESPA was limited to these member brokerage firms and a limited number of authorized nonmembers. On August 28, 2007, BOVESPA was subject to a corporate restructuring process that resulted in the creation of BOVESPA Holding S.A., a public corporation which had, as fully-owned subsidiaries, the São Paulo Stock Exchange S.A. (Bolsa de Valores de São Paulo S.A. - BVSP) responsible for the operations by the stock exchange and the organized over-the-counter markets and the Brazilian Clearing and Depository Corporation (Companhia Brasileira de Liquidação e Custódia) responsible for the settlement, clearing and depository services. Such corporate restructuring has consolidated a demutualization process, thereby causing the access to the trading and other services rendered by the BOVESPA not conditioned to a stock ownership. On May 8, 2008, BOVESPA was subject to another corporate restructuring process that resulted in the creation of BM&F BOVESPA S.A. - Bolsa de Valores, Mercadorias e



Table of Contents

Futuros, a public corporation which merged the operations of BOVESPA Holding S.A. and BM&F S.A. On November 28, 2008, Brazilian Clearing and Depositary Corporation (Companhia Brasileira de Liquidação e Custódia), fully-owned subsidiary of BM&F BOVESPA S.A., was merged into BM&F BOVESPA S.A.

The BOVESPA's trading is conducted between 10:00 a.m. and 5:00 p.m. on the BOVESPA automated system. There is also trading on the so-called After-Market, a system that allows for evening trading through an electronic trading system. Trades are made by entering orders in the Mega Bolsa electronic trading system, created and operated by BOVESPA. The price variations are limited to 2% (above or below) the closing quote of the day.

In order to better control volatility, the BOVESPA adopts a circuit breaker system pursuant to which trading sessions may be suspended for a period of 30 minutes or one hour whenever the index of the BOVESPA falls below the limits of 10% or 15%, respectively, in relation to the index registered in the previous trading session. If any circuit breaker takes place during the day, trading sessions thereafter may be suspended by a period of time to be determined as per BOVESPA's own discretion whenever the index of the BOVESPA falls below the limit of 20% in relation to the index registered in the trading session of the day before.

Since March 17, 2003, market making activities have been allowed on the BOVESPA. The CVM (Comissão de Valores Mobiliários) and the BOVESPA have discretionary authority to suspend trading in shares of a particular issuer under certain circumstances. Trading of securities listed on the BOVESPA may be effected off the stock exchange market under certain circumstances, although such trading is very limited.

Settlement of transactions is effected three business days after the trade date without adjustment of the purchase price for inflation. The seller is ordinarily required to deliver the shares to the exchange on the second business day following the trade date.

Trading on the BOVESPA by non-residents of Brazil is subject to certain limitations under Brazilian foreign investment legislation. See specific regulation for foreign investments in Brazil.

**Corporate Governance Practices in Brazil**

In 2000, the B3 introduced three special listing segments, known as Level 1 and 2 of Differentiated Corporate Governance Practices and the *Novo Mercado*, aimed at encouraging Brazilian companies to follow good corporate governance practices and higher levels of transparency, as required by Brazilian Corporate Law. The listing segments were designed for the trading of shares issued by companies voluntarily undertaking to abide by corporate governance practices and disclosure requirements in addition to those already imposed by Brazilian law. These rules generally increase shareholders' rights and enhance the quality of information provided to shareholders.

The Company is listed on the Level 1 segment of the B3. To become a Level 1 company, in addition to the obligations imposed by current Brazilian law, an issuer must agree to (i) ensure that shares of the issuer representing at least 25% of its total capital are effectively available for trading; (ii) adopt offering procedures that favor widespread ownership of shares whenever making a public offering; (iii) comply with minimum quarterly disclosure standards, including cash flow statements; (iv) follow stricter disclosure policies with respect to transactions made by controlling shareholders, directors and officers; (v) disclose the terms of the transactions with related parties; (vi) make a schedule of corporate

events available to shareholders; and (vii) at least once a year, hold public meetings with analysts and investors.

On March 21, 2011, CVM approved the new text of the Corporate Governance Level 1 Listing Rules of B3 which became effective on May 10, 2011. As of the effective date aforementioned, therefore, the companies listed on Level 1 segment of B3 are subject to what has been laid out in the Corporate Governance Level 1 Listing Rules, in accordance with the changes.

In order to be adapted to the changes to the Listing Rules, the companies listed in Level 1 segment must adopt, in addition to the rules, aforementioned, the following provisions within the terms informed below:

- a) Inclusion in the company bylaws of the mandatory minimum clauses set out by B3 no later than: (i) the first Extraordinary General Meeting held 90 (ninety) days after the new Rules entered into force; or (ii) the date on which the company holds its general meeting to approve the financial statements; what happens first.
  
- b) The preparation and publication of the Policy on Trading Securities and the Code of Conduct, which should occur within the deadline of one year as from the date on which the new Listing Rules came into force;

Table of Contents

c) Compliance, as from May 10, 2014, with the rule contained in item 4.3 of the new Corporate Governance Level 1 Listing Rules, which consists of a prohibition on the accumulation in a Company of the position of Chairman of the Board of Directors and Chief Executive Officer or lead executive by the same person.

**Regulation of the Brazilian Securities Market**

The Brazilian securities markets are regulated by the CVM, which has authority over stock exchanges and the securities markets generally, and by the Brazilian Central Bank, which has, among other powers, licensing authority over brokerage firms and regulates foreign investment and foreign exchange transactions. The Brazilian securities market is governed by the Brazilian Securities Law (Law N. 6,385 of December 7, 1976, as amended) and the Brazilian Corporate Law (Law N. 6,404 of December 15, 1976, as amended).

Law 11,638, of December 28, 2007, and Law N. 11,941, of May 27, 2009 (which resulted from the conversion into law of Provisional Decree (MP) N. 449, of December 3, 2008), amended a number of provisions of Law N. 6,385/76 and Law N. 6,404/76, related to accounting rules and financial statements of Brazilian corporations. The new changes aim to bring Brazilian accounting rules/financial statements closer to international standards.

Under the Brazilian Corporate Law, a company is either publicly held, such as Gerdaul S.A., or closely held. All publicly held companies must apply for registration with the CVM and are subject to ongoing reporting requirements. A publicly held company may have its securities traded either on the B3 or on the Brazilian over-the-counter markets (Brazilian OTC). The shares of a publicly held company, including Gerdaul S.A., may also be traded privately subject to certain limitations established in CVM regulations.

CVM has issued Instruction N. 480, dated December 7, 2009, that provides for the requirements for the registration of publicly held companies and companies that intend to trade securities in regulated securities markets. CVM Instruction N. 480/09 significantly modified the reporting requirements applicable to publicly held companies and set forth the obligation to such companies to file annually with CVM a Reference Form ( Formulário de Referência ) containing all of the company's relevant information and to update the information contained therein as soon as any relevant changes occur.

In addition to such reporting requirements, the occurrence of certain events also requires disclosure of information to the CVM, the B3, or even the public. These include (i) the direct or indirect acquisition by an investor of at least 5% (five percent) of any class or type of shares representing the share capital of a publicly held company, (ii) the sale of shares representing the transfer of control of a publicly held company and (iii) the occurrence of a material event to the corporation. On March 5, 2002, the CVM issued Instruction N. 361, which regulates tender offers if one of the following events occurs: (i) delisting of companies; (ii) an increase in the equity interest of the controlling shareholder; or (iii) the transfer of control of a public held company.

The Brazilian OTC market consists of direct trades between individuals in which a financial institution registered with the CVM serves as intermediary. No special application, other than registration with the CVM, is necessary for securities of a publicly held company to be traded on the Brazilian OTC. The CVM must be notified of all trades carried out on the Brazilian OTC by the company's respective intermediaries. The trading of a company's securities on the B3 may be suspended in anticipation of a material announcement. Trading may also be suspended at the initiative of the B3 or the CVM on the basis of a belief that a company has provided inadequate information regarding a material event, has not provided an adequate response to the inquiries by the CVM or the stock exchange, or for other reasons.

The laws and regulations regarding the Brazilian Securities Market provide for disclosure requirements, restrictions on insider trading and price manipulation, and protection of minority shareholders. Although many changes and improvements have been introduced, the Brazilian securities markets are not as highly regulated and supervised as the U.S. securities markets or those in certain other jurisdictions.

#### **Regulation of Foreign Investment in Brazil**

Foreign investors may either register their investments in the Company's shares as a foreign direct investment under Law N. 4,131/62 and CMN (*Conselho Monetário Nacional*) Resolution N. 3,844/10 or as a portfolio investment under CMN Resolution N. 4,373/14 and CVM Instruction N. 325/00, both as amended. Foreign investors, regardless of whether their investments are made as foreign direct investments or portfolio investments, must be enrolled with the RFB (*Receita Federal do Brasil*, the Brazilian internal revenue service) pursuant to its Regulatory Instruction No.1,863, as of December 27, 2018. This registration process is undertaken by the investor's legal representative in Brazil.

Table of Contents

Law N. 4,131/62 and CMN Resolution N. 3,844/10 provide that, after a foreign direct investment is made, an application for its registration with the Central Bank must be submitted by the investee and the non-resident investor, through its independent representatives in Brazil, within 30 days. The registration of the foreign direct investment with the Central Bank allows the foreign investor to remit abroad resources classifiable as capital return, resulting either from: (i) the transfer of corporate interests to Brazilian residents, (ii) capital reduction, or (iii) the liquidation of a company, as well as funds classified as dividends, profits or interest on shareholders' equity. Foreign investors with foreign direct investments may also divest those investments through private transactions or transactions conducted through the stock exchange or the over-the-counter market. See *Taxation - Brazilian Tax Considerations* for information regarding the taxation of such transactions.

There are no restrictions on ownership of the Company's shares by individuals or legal entities domiciled outside Brazil. With certain limited exceptions, under CMN Resolution N. 4,373/14 investors are permitted to carry out any type of transaction in the Brazilian financial and capital markets involving a security traded on a stock, futures or organized over-the-counter markets. Investments and remittances outside of Brazil of gains, dividends, profits or other payments for ordinary and preferred shares are made through the exchange market. See *Exchange Controls* for further information regarding non-Brazilian holders who qualify under CMN Resolution N. 4,373/14.

Securities and other financial assets held by non-Brazilian investors pursuant to CMN Resolution N. 4,373/14 must be registered or maintained in deposit accounts or under the custody of an entity duly licensed by the Central Bank or the CVM. In addition, securities trading is restricted to transactions carried out in the stock exchanges or through organized over-the-counter markets licensed by the CVM, except for transfers resulting from a corporate reorganization, or occurring upon the death of an investor by operation of law or will.

**Trading on Exchanges outside Brazil**

In addition to the BOVESPA, Gerdaу shares are traded on two other stock exchanges:

***New York Stock Exchange***

On March 10, 1999, Gerdaу S.A. obtained registration for the issuance of Level II ADSs, which began trading on the New York Stock Exchange the same day. Under the GGB symbol, these Level II ADSs have been traded in virtually every session since the first trading day. In 2018, 2.8 billion ADRs were traded, a figure 44.9% higher than in 2017, representing a trading volume of \$12.3 billion, equivalent to a daily average of \$49.2 million.

***Latibex - Madrid Stock Exchange***

Since December 2, 2002, Gerdaу S.A.'s preferred shares have been traded on the Latibex, the segment of the Madrid Stock Exchange devoted to Latin American companies traded in Euros. Following approval by the CVM and the Brazilian Central Bank, this date marked the beginning of the Depositary Receipts (DR) Program for preferred shares issued by the Company in Spain. The shares are traded in Spain under the symbol XGGB in the form of DRs, each corresponding to one preferred share. This participation in the Latibex boosted the Company's visibility in the European market. In 2017, a total of 1.1 million Gerdaу preferred shares were traded on the Madrid Stock Exchange (Latibex), a figure 35.6%

higher than in 2016, representing a trading volume of \$3.7 million, equivalent to a daily average of \$30 thousand.

**ITEM 10. ADDITIONAL INFORMATION**

**A. SHARE CAPITAL**

Not applicable.

Table of Contents

**B. MEMORANDUM AND ARTICLES OF ASSOCIATION**

Gerdau's bylaws have been registered with the Public Registry of the State of São Paulo (Junta Comercial de São Paulo) under company number (NIRE) 35.3.0052069-6.

The consolidated by-laws are incorporated by reference hereto as Exhibit 1.1.

The last amendment of the Company's by-laws was made on April 20, 2018.

*Summary of Special Conditions Relating to Directors and Officers*

Although the bylaws do not specifically address this matter, the Company, its directors and officers are obliged to adhere the provisions of Law 6.404/76 (Corporate Law), which regulates corporations in Brazil, and also observes the rules of the Brazilian Stock Exchange Commission (CVM) and the São Paulo Stock Exchange (B3).

In general terms, Section 153 of the Brazilian Corporate Law establishes that in exercising his/her duties, a company director or officer shall employ the care and diligence, which a person normally employs in the administration of his/her own affairs.

In addition, Section 154, paragraph 2 of the Brazilian Corporate Law, states that directors and officers shall not: a) perform an act of liberality at the expense of the company; b) borrow money or property from the company or use company's property, services or credits for his/her own advantage or for the advantage of any entity in which he/she/any third party has an interest, without the prior approval of a general shareholders meeting or the board of directors; c) by virtue of his/her position, receive any type of direct or indirect personal benefit unless according to the Company's bylaws or a general shareholders meeting.

Finally, Section 156 of the Brazilian Corporate Law states that: An administrator (member of the board of directors and executive officers) shall not take part in any corporate transaction in which he/she has an interest which conflicts with an interest of the corporation, nor in the decisions made by the other officers on the matter.

Regarding the decision on director's compensation, the bylaws of the Company state that the shareholders are in charge of defining the global remuneration of the administrators (member of the board of directors and executive officers) and the board of directors is in charge of fixing the individual remuneration of directors and officers (article 6, letter m and n of the bylaws).

With regard to borrowing powers exercisable by the directors, the bylaws state that:





Table of Contents

- Article 6, letter u : The Board of Directors should set on a periodic basis, value criteria, time of duration, extension of effects, etc., for which certain company acts, including loans by and to the Company, may only be effected by one or more Executive Officers or after prior authorization by the Executive Committee;
  
- Article 6, § 7°: The Board may decide to create specific committees linked to itself, which shall include one or more of its members, with or without the participation of Executive Officers, Company employees or contracted third-parties with the aim of coordinating or orienting certain corporate processes or operations.

*Rights, preferences and restrictions attaching to each class of the shares*

Gerdaus capital stock is divided into common and preferred shares.

*Rights to dividends*

All common and preferred shares enjoy the same rights to dividends, which are established by the Company's bylaws as a minimum mandatory percentage of 30% of net income, with the following adjustments:

- a) the addition to the following amounts:
- amounts arising during the fiscal year from the reversal of previous contingency reserves;
  
  - amounts resulting from the realization, during the fiscal year, of profits that have previously been transferred to the unrealized profit reserve line;
  
  - amounts arising from the realization during the fiscal year of increases in the value of assets, as a result of new valuations, recorded as revaluation reserve.
- b) the subtraction of amounts assigned during the fiscal year for the constitution of legal reserves, the reserve for contingencies, the unrealized profit reserve and the tax incentive reserve.

For additional information, please see the item Dividend Policy above.

### **Voting rights**

According to Gerdaú's bylaws, the common shares have voting rights and the preferred shares have no voting rights although the holders of preferred share are entitle to attend to shareholders meetings and to participate in the discussions.

Note, however, that the Company's bylaws state, in Article 19, Paragraph 11, that the preferred shares shall acquire the right to vote if the Company, for three consecutive fiscal years, fails to pay the minimum dividends to which they are entitled, a right that the shares will hold until the first subsequent payment of dividends that the Company makes.

Shareholders representing the majority of a) holders of preferred shares without voting rights (or with restricted voting rights) representing 10% of the total capital stock; and b) holders of at least 15% of the voting capital stocks; shall have the right to elect and remove from office a member and his substitute from the board of directors, in a separate election at the general meeting, being excluded from such election the majority shareholder.

If neither the holders of shares with voting rights nor the holders of preferred shares without voting rights or with restricted voting rights are sufficient to achieve the quorum above, they shall be allowed to aggregate their shares in order to jointly elect a member and his substitute for the board of directors, in this case considering the quorum of 10% of the capital.

Shareholders representing at least one-tenth of the voting capital may also request that the election of directors be subject to cumulative voting, if present this request to the company up to 48 hours prior to the general shareholders meeting.

Notwithstanding the provisions aforementioned, the controlling shareholders shall always have the right to elect the majority of the members of the board of directors of a Brazilian company.

Based upon section 161, paragraph 4 of the Brazilian Corporate Law, the holders of preferred shares without voting rights or with restricted voting rights shall be entitled to elect one member of the board of auditors and his alternate in a separate election. The minority shareholders shall have the same right, provided that they jointly represent ten per cent or more of the voting shares.

Table of Contents

***Rights to the reimbursement of capital***

The preferred shares enjoy preference in the reimbursement of capital, up to the value of their respective interest in the capital stock, in the event of the Company's dissolution, after which the common shares are reimbursed up to the value of their respective fractional participation in the capital stock, with the remaining balance distributed on equal conditions among the holders of the common and preferred shares.

***Liability to further capital calls and Shareholders owning a substantial number of shares***

There are no specific provisions in the bylaws of liability to further capital calls by the Company or provisions discriminating against any existing or prospective holder of such securities as a result of such shareholder owning a substantial number of shares.

***Changes to the rights***

The Brazilian Corporate Law states, in its Section 109, that neither the bylaws nor a general meeting may deprive a shareholder of the right:

- a) to participate in the corporate profits;
- b) to participate in the assets of the corporation in the case of liquidation;
- c) to supervise the management of the corporate business as provided for in the Corporate Law;
- d) of first refusal in the subscription of shares, founders' shares convertible into shares, debentures convertible into shares and subscription bonuses, and
- e) to withdraw from the corporation in the cases provided for in the Corporate Law.

Furthermore, Section 16, sole paragraph of the Brazilian Corporate Law set forth that, unless expressly provided for, an amendment to that part of the bylaws which regulates the different classes of shares shall require the approval of the shareholders of all shares thereby affected.

On the same hand, Section 136, paragraph 1 of the Brazilian Corporate Law states that any changes in the preferences or rights of the preferred shares, or the creation of a class of shares having priority in relation to the existing preferred shares, unless the change is authorized by our bylaws, would require the approval of the preferred shareholders in a special shareholders meeting, in addition to approval by the majority of the holders of the outstanding voting shares.

*Annual general meetings and extraordinary general meetings of shareholders*

The call for the annual general meeting and extraordinary general meeting of Gerdau shall be made by a notice published on at least three occasions in the Valor Econômico, Rio de Janeiro edition, Valor Econômico, São Paulo edition, and Diário Oficial do Estado do Rio de Janeiro. The notice shall contain, in addition to the place, date and time of the general meeting, the agenda and, in the case of an amendment to the bylaws, an indication of the subject-matter.

The first call of the general meeting shall occur fifteen (15) days in advance, and the second call eight (8) days in advance.

Apart from the exceptions provided by law, the opening of a general meeting shall occur on first call with the presence of shareholders representing at least one-quarter of the voting capital; and on the second call, with any number.

The investors attending a general meeting shall produce proof of their shareholder status. According to Gerdau's bylaws, the Company may require, within a period established in the notice of calling, the depositing of proof of ownership of shares, submitted by the financial institution acting as depositary for the same shares, as well as to suspend, for the same period, transfer and stock split services.

A shareholder may be represented at a general meeting by a proxy, appointed less than one year before, who shall be a shareholder, a corporation officer, a lawyer or a financial institution. A condominium shall be represented by its investment fund officer.

Table of Contents

A request for the appointment of a proxy, made by post or by public notice, shall satisfy the following requirements:

- a) contain all information necessary to exercise the requested vote;
- b) entitle the shareholder to vote against a resolution by appointing another proxy to exercise the said vote;
- c) be addressed to all shareholders whose addresses are kept by the corporation.

Subject to the requirements aforementioned, any shareholder whose shares with or without voting rights represent one-half percent or more of the capital shall be entitled to request a list of the addresses of the shareholders

The legal representative of a shareholder shall receive an authorization to attend general meetings.

***Limitations on the rights of non-residents and foreign shareholders to own securities***

There are no limitations on the rights to own securities by non-residents or foreign shareholder set forth in the bylaws of Gerdau S.A. The Brazilian Corporate Law neither establishes limitation. Note that some procedures shall be observed by the foreign companies for the remittance of funds (see Item 10.D, below).

A shareholder resident or domiciled abroad must maintain a representative in Brazil empowered to accept service of process in proceedings brought against him under this law.

***Change in control of the company***

Brazilian Corporate Law states that the direct or indirect transfer of control of a publicly held corporation can only be effective under the condition that the purchaser agrees to conduct a public offer to acquire the voting shares owned by the remaining shareholders.

Our bylaws attribute to all shares the right to be included in any public offering involving the transfer of control, guaranteeing the same price paid per share with voting rights that are part of the controlling block.

***Disclosure of shareholders ownership***

With regard to the disclosure of ownership, shareholders shall observe the rule 358 enacted by the Brazilian Exchange Commission, which sets forth that:

*Article 12. The direct or indirect controlling shareholders and the shareholders that elected members of the Board of Directors and the Board of Auditors, as well as any person or company or group of people acting together or representing the same interest that have either direct or indirect participation corresponding to 5% (five percent) or more in type or class of shares representing the capital of a publicly held company, shall send to the company the following information:*

*I - the announcers' name and qualification, indicating their National Register of Legal Persons or the Register of Natural Persons;*

*II - objective of the participation and quantity envisaged, if it is the case, including a declaration of the buyer that purchases will not alter the composition of the control or administrative structures of the company;*

*III - number of shares, subscription bonus, as well as rights to subscribe to shares and options to buy shares, by sort and type, already held, directly or indirectly, by the assignor or linked person.*

*IV - number of convertible debentures into shares, already held, directly or indirectly, by the assignor or linked person, explaining the quantity of shares intended to be converted, by sort and type;*

*V - indication of any agreement or contract regulating the right to vote or purchase and sale securities issued by the company; and*

Table of Contents

VI if the shareholder has its residence or domicile abroad, the name or social denomination and the Brazilian Tax Payer Number of its attorney or legal representative in the country, in compliance with section 119 of law 6.404 of 1976.

*Paragraph 1. Individuals or groups of individuals representing a common interest are also under the obligation to disclose the same information, given they are shareholders holding shares of equal or higher stockholdings percentages stated in this article, every time this participation increases 5% (five per cent) of the sort or type of representative share of the company's share capital.*

*Paragraph 2. The obligations provided for in the caput and paragraph 1 are also extended to the acquisition of any rights over shares and further securities stated there.*

*Paragraph 3. The communication referred to in the caput shall be performed immediately after the mentioned participation is accomplished.*

*Paragraph 4. The people mentioned in the caput of this article shall also communicate the alienation or extinction of shares and other securities mentioned in this article, or of rights over them, every time the participation of the owner in type or class of the securities mentioned reaches 5% (five percent) of the total of such type or class, and every time such participation is reduced by 5% (five percent) of the total in type or class.*

*Paragraph 5. In cases when the acquisition results or has been carried out with the objective of changing the control's composition or the governance structure of the company, as in case when the acquisition generates the obligation of making a public offer, according to the applicable regulation, the acquirer must promote the disclosure, at least, in the same communication channels regularly adopted by the company, in compliance with section 3, paragraph 4, of a notice with the information predicted in line I to V of this article caput.*

*Paragraph 6. The Investor Relations Director is responsible for transmitting the information, as soon as they are received by the company, to CVM and, if applicable, to the stock exchange or organized over-the-counter market entities in which the company trades its shares, as update the IAN form in the correspondent field.*

**Conditions more stringent governing changes in the capital than is required by law**

There are no conditions imposed by the bylaws more stringent than is required by Law governing changes in the capital.

**C. MATERIAL CONTRACTS**

For information concerning material contracts regarding the acquisition of assets, see Item 4 Company Information, Item 5 Operating and Financial Review and Prospects and Item 8 Financial Information. Gerda S.A. has entered into financial agreements in order to finance its

expansion projects and improve its debt profile. Although some of these contracts entail significant amounts, none exceed 10% of the Company's consolidated total assets. The most significant financial agreements are described below, with the Company agreeing to provide a copy of the debt instruments described herein to the Securities and Exchange Commission upon request.

**Bonds** The Company, through its subsidiaries Gerdau Holdings Inc., GTL Trade Finance Inc. and Gerdau Trade Inc., has issued bonds due on 2020, 2021, 2023, 2024, 2027 and 2044. The following companies guaranteed these transactions: Gerdau S.A., Gerdau Açominas S.A. and Gerdau Aços Longos S.A. On December 31, 2018, the outstanding balance of these bonds was R\$ 10 billion.

**Debenture** The Company concluded in 2018, the issuance of debentures with maturity of 4 years. On December 31, 2018, the outstanding balance of these debentures was R\$ 1.5 billion.

**GGWCF** In October 2017, the Company concluded the roll-over and reduction of its senior unsecured working capital facility in the amount of US\$ 800 million. The facility is divided into two tranches: US\$ 200 million for Gerdau's North American subsidiaries and US\$ 600 million for Gerdau's Latin American subsidiaries. On December 31, 2018, the outstanding loans under this line totaled US\$ 50 million (R\$ 194 million).

**BNDES** In June 2009, certain subsidiaries of the Company (Gerdau Açominas S.A., Gerdau Aços Longos S.A., Gerdau Aços Especiais S.A. and Gerdau S.A.) entered into a credit line with BNDES in the total amount of R\$ 1.5 billion, bearing an interest rate of TJLP + 2.16% per annum when drawn. On December 31, 2018 the outstanding amount was R\$ 253.7 million.

In December 2012, the subsidiary Gerdau Açominas S.A. obtained a committed credit line with BNDES in the total amount of R\$776.6 million for the Plate and Steckel Mill project. The funds are disbursed as the subsidiary carries out its own investment



Table of Contents

plans and submit to BNDES evidence of completion. The interest rate for this credit line is determined at the time of each disbursement and is composed by TJLP and exchange rate + 2.16% a year. The outstanding balance of this transaction was R\$117.6 million million as of December 31, 2018.

**D. EXCHANGE CONTROLS**

There are no restrictions on ownership or voting of the Company's paid-in capital by individuals or legal entities domiciled outside Brazil. The right to convert dividend payments and proceeds from the sale of the Company's paid-in capital into foreign currency and to remit such amounts outside Brazil is subject to restrictions under foreign investment legislation which generally require, among other things, the prior registration of the relevant investment with the Central Bank.

In Brazil, a mechanism is available to foreign investors interested in trading directly on the B3. Until March 2000, this mechanism was known as Annex IV Regulations, in reference to the Annex IV of CMN Resolution N. 1,289/87 ( Annex IV Regulations ). Currently, this mechanism is regulated by CMN Resolution N. 4,373/14 and CVM Instruction N. 560/15.

CMN Resolution N. 4,373/14, which took effect on March 30, 2014, establishes rules for foreign investments in Brazilian equities. Such rules allow foreign investors to invest in almost all types of financial asset and to engage in almost all transactions available in the Brazilian financial and capital markets, provided that certain requirements are fulfilled.

Pursuant to CMN Resolution N. 4,373/14, foreign investors are defined as individuals, legal entities, mutual funds and other collective investments resident, domiciled or headquartered abroad. CMN Resolution N. 4,373/14 prohibits the offshore transfer or assignment of title to the securities.

Pursuant to CMN Resolution N. 4,373/14, foreign investors must: (i) appoint at least one representative in Brazil with powers to perform actions relating to the foreign investment; (ii) obtain registration as a foreign investor with the CVM; (iii) appoint an authorized custodian in Brazil for its investment and (iv) register the foreign investment with the Central Bank. The securities and other financial assets held by the foreign investor pursuant to CMN Resolution N. 4,373/14 must be registered or maintained in deposit accounts or under the custody of an entity duly licensed by the Central Bank or by the CVM or be registered in registration, clearing and custody systems authorized by the Central Bank or by the CVM. In addition, securities trading are restricted to transactions carried out on exchanges or organized over-the-counter markets licensed by the CVM. All investments made by a foreign investor under CMN Resolution N. 4,373/14 will be subject to electronic registration with the Central Bank.

CMN Resolution N. 4,373/14, that revoked CMN Resolution N. 1,927/92 of the National Monetary Council (which was the Amended and Restated Annex V to CMN Resolution N. 1,289/87), provides for the issuance of depositary receipts in foreign markets in respect of shares of Brazilian issuers. Since ADSs have been approved under the applicable law by the Central Bank and the CVM, the proceeds from the sale of the ADSs by ADS holders outside Brazil are free of Brazilian foreign investment controls and holders of the ADSs will be subject to a specific tax treatment. According to CMN Resolution N. 4,373/14, are subject to concurrent exchange operations or international transfers in Brazilian Reais, without effective delivery of resources and whether prior authorization of the Central Bank of Brazil, the application of non-resident investor through the mechanism of Depositary Receipts may be transferred to other foreign investments mechanisms, with due regard to the conditions set forth by the Central Bank and by the CVM.

Since July 1, 2013, JPMorgan Chase Bank is the Depositary for the Preferred ADSs ( Depositary ) and Itaú Unibanco S.A. ( Custodian ) on behalf of the Depositary. Pursuant to the registration, the Custodian and the Depositary are able to convert dividends and other distributions with respect to the Preferred Shares represented by Preferred ADSs into foreign currency and remit the proceeds abroad. Subject to the provisions set forth in Annex V Regulations, holders of preferred ADSs may exchange such ADSs for the underlying Preferred Shares. In this event, such a holder will be entitled to continue to rely on the Depositary's registration of foreign investment for only five business days after such exchange, after which time, the same holder must seek its own registration with the Central Bank.

The Registered Capital for Preferred Shares that are withdrawn upon surrender of Preferred ADSs will be the U.S. dollar equivalent to (i) the average price of the Preferred Shares on the BOVESPA on the day of withdrawal, or (ii) if no Preferred Shares were sold on such day, the average price of Preferred Shares that were sold in the fifteen trading sessions immediately preceding the same withdrawal. The U.S. dollar value of the Preferred Shares is determined on the basis of the average Foreign Exchange rates quoted by the Central Bank on the same date (or, if the average price of Preferred Shares is determined under clause (ii) of the preceding sentence, the average of such average quoted rates on the same fifteen dates used to determine the average price of the Preferred Shares). A non-Brazilian holder of Preferred Shares may experience delays in effecting the registration of Registered Capital, which may delay remittances abroad. Such a delay may adversely affect the amount, in U.S. dollars, received by the non-Brazilian holder.

Table of Contents

Thereafter, unless the Preferred Shares are held pursuant to CMN Resolution N. 4,373/14 or to Law N. 4,131/62 by a foreign investor, the same holder may not be able to convert into foreign currency and remit the proceeds outside Brazil from the disposal of, or distributions with respect to, such Preferred Shares, and will generally be subject to less favorable Brazilian tax treatment than a holder of Preferred ADSs.

Restrictions on the remittance of foreign capital overseas could hinder or prevent the Custodian, as custodian for the Preferred Shares represented by Preferred ADSs, or holders who have exchanged Preferred ADSs for Preferred Shares, from converting dividends, distributions or the proceeds from any sale of Preferred Shares into U.S. dollars and remitting such U.S. dollars abroad. Holders of Preferred ADSs could be adversely affected by delays in, or refusal to grant any required government approval for conversions of Brazilian currency payments and remittances abroad of the Preferred Shares underlying the Preferred ADSs.

**Exchange Rates**

Before March 2005, there were two legal foreign exchange markets in Brazil, the commercial market and the floating market. The difference between these two markets was the type of transaction that could be performed through each market.

On March 4, 2005, through CMN Resolution N. 3,265 (revoked and replaced by CMN Resolution N. 3,568, of May 29, 2008), CMN introduced a single foreign exchange market and abolished the legal differences between the referred Commercial and Floating Markets. Among the modifications to foreign exchange market rules is a greater freedom to remit funds abroad through the foreign exchange market. On the other hand, the so-called CC5-Accounts, which are bank accounts in *reais* held in Brazil by foreign entities, may no longer be used to transfer funds on behalf of third parties.

On March 24, 2010, the CMN approved Resolution No. 3,844, adopting a series of measures to consolidate and simplify the Brazilian foreign exchange regulations. These changes are expected to reduce the effective cost of foreign exchange transactions and the related administrative expenses for both the public and private sectors as well as to provide more legal certainty to the parties to such transaction.

In the past, the Central Bank has intervened occasionally to control unstable movements in foreign exchange rates. We cannot predict whether the Central Bank or the Brazilian government will continue to let the *real* float freely or will intervene in the exchange rate market through the return of a currency band system or otherwise. The *real* may depreciate or appreciate against the U.S. dollar.

The current exchange rates from U.S Dollar to Brazilian Reais are demonstrated in the table of item 3.A, Exchange rates between the United States Dollar and Brazilian Reais .

**E. TAXATION**

The following summary contains a description of the main Brazilian and U.S. federal income tax consequences of the purchase, ownership and disposition of common shares, preferred shares and ADSs. It does not purport to be a comprehensive description of all tax considerations that

may be relevant to a decision to purchase these securities. In particular, this summary deals only with holders of common shares, preferred shares or ADSs as capital assets (generally, property held for investment) and does not address the tax treatment of a holder that may be subject to special tax rules, like a bank, an insurance company, a dealer in securities, a person that will hold common shares, preferred shares or ADSs in a hedging transaction or as a position in a straddle, conversion transaction or other integrated transaction for tax purposes, a person that has a functional currency other than the U.S. dollar, a person liable for alternative minimum tax, a partnership (or other entity treated as a partnership for U.S. federal income tax purposes) or a person that owns or is treated as owning 10% or more of the total combined voting power of the Company's voting stock or 10% or more of the total value of the Company's stock. Prospective purchasers of common shares, preferred shares or ADSs should consult their own tax advisors as to the personal tax consequences of their investment, which may vary for investors in different tax situations. The summary is based upon tax laws of Brazil and the United States and applicable regulations, judicial decisions and administrative pronouncements as in effect on the date hereof. Such authorities are subject to change or new interpretations, possibly with retroactive effect. Although there is no income tax treaty between Brazil and the United States at this time, the tax authorities of the two countries have had discussions that may culminate in a treaty. No assurance can be given, however, as to whether or when a treaty will enter into force or how it will affect the U.S. holders of common shares, preferred shares or ADSs. This summary is also based upon the representations of the Depositary (as defined below) and on the assumption that each obligation in the Deposit Agreement relating to the ADSs and any related documents will be performed in accordance with its terms.

Table of Contents

**Brazilian Tax Considerations**

The following discussion summarizes the main Brazilian tax consequences of the acquisition, ownership and disposition of common shares, preferred shares or ADSs by a holder that is not resident or domiciled in Brazil for purposes of Brazilian taxation ( Non-Resident Holder ).

The following is a general discussion only. It does not specifically address all of the Brazilian tax considerations applicable to any particular Non-Resident Holder. The discussion does not address the effects of any tax treaties or reciprocity of tax treatment entered into by Brazil and other countries. This discussion also does not address any tax consequences under the laws of any state or municipality of Brazil.

*Income tax*

*Dividends*

Dividends derived from profits generated on or after January 1, 1996, paid by a Brazilian corporation such as our company, including stock dividends and other dividends paid to a Non-Resident Holder of common shares, preferred shares or ADSs, are currently exempt from income tax in Brazil, as provided by art. 10 of Federal Law no. 9,249, of December 26, 1995.

Despite the fact that this exemption is currently in force, news released by the press claim that the government that recently took office intends to revoke the mentioned tax exemption and thus levy income tax on dividends paid by Brazilian companies, a measure that would be followed by a reduction of the overall income tax burden borne by said companies. The Brazilian authorities have not yet made a binding statement on the matter, either through the enactment of a provisional measure, or through a draft bill submitted to the Brazilian National Congress. For this reason, it is not yet possible to anticipate the exact terms of the intended taxation. In any case, in order to become effective, such changes in the Brazilian tax legislation would have to be discussed and approved by the Brazilian National Congress, and would only become effective as of January 1, 2020, at the earliest.

*Interest Attributable to Shareholders Equity*

As from the enactment of Federal Law no. 9,249/95, a Brazilian corporation, such as our company, is allowed to make distributions to shareholders of interest on shareholders equity and to treat such payments as a deductible expense for purposes of calculating Brazilian corporate income tax and social contribution on net profits, as far as the limits described below are observed.

## Edgar Filing: GERDAU S.A. - Form 20-F

For tax purposes, this interest is calculated over the net equity accounts of the corporation and is limited to the daily *pro rata* variation of the Brazilian long-term interest rate (*Taxa de Juros de Longo Prazo* - TJLP), as determined by the Brazilian Central Bank from time to time, and the amount of the deduction cannot exceed the greater of:

- 50% of net income (after the deduction of social contribution on net profits and before taking into account the provision for corporate income tax and the amounts attributable to interest on shareholders' equity) for the period in respect of which the payment is made; and
- 50% of the sum of retained profits and profit reserves as of the date of the beginning of the period in respect of which the payment is made.

Such payments of interest on shareholders' equity made to a Non-Resident Holder are generally subject to withholding income tax at the rate of 15%, being such rate increased to 25% if the Non-Resident Holder is resident or domiciled in a Tax Favorable Jurisdiction (please refer to Tax Favorable Jurisdictions for a definition of this concept).

Payments of interest on shareholders' equity may be included, at their net value, as part of any mandatory dividend. To the extent a payment of interest on shareholders' equity is so included, the corporation is required to distribute to shareholders an additional amount to ensure that the net amount received by such shareholders, after payment of the applicable withholding income tax, plus the amount of declared dividends, is at least equal to the mandatory dividend (gross-up method).

Although the Brazilian legislation currently in force allows payments of interest on shareholders' equity, news released by the press claim that the government that recently took office intends to revoke such incentive, a measure that would be followed by a reduction of the overall income tax burden borne by said companies, as mentioned above.

In any event, since no rules have been enacted (or no binding statements have been made) on the matter, there is no immediate prospect that any said kind of change in the Brazilian tax legislation enters into force.

Table of Contents

*Capital Gains*

According to Federal Law no. 10,833, of December 29, 2003, gains deriving from the transfer of assets located in Brazil by a Non-Resident Holder, whether to another non-Brazilian resident or to a Brazilian resident, may be subject to withholding income tax in Brazil.

With respect to a disposition of common or preferred shares, as these are assets considered to be located in Brazil, the Non-Resident Holder will be subject to withholding income tax on the realized gains, according to the rules described below.

As far as ADSs are concerned, although the matter is not entirely clear, arguably the gains realized by a Non-Resident Holder on the disposition of ADSs are not taxed in Brazil, based on the argument that ADSs are not assets located in Brazil for purposes of Article 26 of Federal Law no. 10,833/03. We cannot assure you, however, that Brazilian tax authorities or Brazilian tax courts will agree with this interpretation. Accordingly, in the event that ADSs are deemed to be assets located in Brazil for purposes of Article 26 of Federal Law no. 10,833/03, gains realized on a disposition of ADSs by a Non-Resident Holder will be subject to withholding income tax in Brazil, according to the rules described below.

In general, gains realized on the disposition of common or preferred shares (or ADSs, in case they are deemed to be assets located in Brazil ) correspond to the positive difference between the amount realized on the disposition, and the cost of acquisition of the shares disposed of, measured in Brazilian reais (without any correction for inflation), in line with the views expressed by the Brazilian tax authorities on the matter (*see, e.g.*, Normative Ruling no. 1,455, issued on March 06, 2014). There are grounds, however, for maintaining that the gains realized should be calculated taking into consideration the cost of the relevant investments in foreign currency, as so registered before the Brazilian Central Bank. Notwithstanding, no assurance can be provided as to whether such arguments will prevail in the Brazilian administrative and/or judicial courts.

The rules related to whether or not withholding income tax must be levied on such gains will vary depending on the domicile of the Non-Resident Holder, the type of registration of the investment that must be made by the Non-Resident Holder before the Brazilian Central Bank, and how the disposition is carried out.

Gains realized on a disposition of common or preferred shares carried out on the Brazilian stock exchange are:

- exempt from income tax when assessed by a Non-Resident Holder that (1) has invested in Brazil under the rules set forth by the Brazilian Central Bank Qualified Portfolio Investor (in particular the National Monetary Council Resolution no. 4,373, of September 29, 2014) and (2) is not domiciled or resident in a Tax Favorable Jurisdiction. Please refer to Tax Favorable Jurisdictions for a definition of this concept; or

- subject to income tax at a rate of 15% in any other case, including a case of gains assessed by a Non-Resident Holder that is not a Qualified Portfolio Investor, and of a Non-Resident Holder that is domiciled or resident in a Tax Favorable Jurisdiction. In these cases, a withholding income tax of 0.005% on the sale value will be applicable and can be later offset against income tax due on any capital gain realized on the transaction.

Gains realized by a Non-Resident Holder on a disposition of common or preferred shares (or ADSs, in case they are deemed assets located in Brazil ) that is not carried out on a Brazilian stock exchange are subject to income tax at the same rate applicable to resident individuals. As from January 1, 2017, in accordance with Article 21 of Federal Law no. 8,981, of January 20, 1995, as amended by Federal Law no. 13,259, of March 16, 2016, capital gains realized by resident individuals are taxable at progressive rates in brackets that vary from 15% to 22,5%, depending upon the amount of gain realized on the transaction, being: (i) 15% on gains realized up to R\$ 5 million; (ii) 17,5% on gains exceeding R\$ 5 million but not R\$ 10 million; (iii) 20% on gains exceeding R\$ 10 million but not R\$ 30 million; and (iv) 22,5% on gains exceeding R\$ 30 million. In case, however, the Non-Resident Holder is resident or domiciled in a Tax Favorable Jurisdiction, the gains it realize on the disposition of said assets will be taxable at the fixed rate of 25% (please refer to Tax Favorable Jurisdictions below for a definition of this concept).

Gains related to transactions carried out outside the Brazilian stock exchanges, but on a Brazilian non-organized over-the-counter market with intermediation, are also subject to the withholding income tax of 0.005%, which can be offset against income tax due on any capital gain realized on the transaction.

In the event of a redemption of common or preferred shares (or ADSs, in case they are deemed to be assets located in Brazil ) or of a capital reduction by a Brazilian corporation, such as our company, the positive difference between the amount received by the Non-Resident Holder and the acquisition cost of the respective common or preferred shares (or ADSs, in case they are deemed to be assets located in Brazil ) will be treated as a capital gain derived from a disposition that is not carried out on a Brazilian stock exchange market, and therefore will be subject to income tax at a rates described in the previous paragraphs.



Table of Contents

Any exercise of preemptive rights relating to the common or preferred shares or ADSs will not be subject to Brazilian income tax. Gains realized by a Non-Resident Holder on the disposition of preemptive rights relating to common shares, preferred shares or ADSs will be subject to Brazilian income tax according to the same rules described above.

A Non-Resident Holder of ADSs may cancel such ADSs and exchange them for common or preferred shares. Income tax may not be levied on such exchange, as long as the appropriate rules are complied with in connection with the registration of the investment before the Brazilian Central Bank, and as long as ADSs are not deemed assets located in Brazil .

The deposit of common or preferred shares by a Non-Resident Holder in exchange for ADSs may trigger Brazilian income tax on the capital gain presumably realized, in accordance with the rates mentioned above. There are grounds to maintain, however, that such transaction should not trigger Brazilian income tax, provided that the appropriate rules are complied with in connection with the registration of the transaction before the Brazilian Central Bank.

There can be no assurance that the current favorable tax treatment granted to Qualified Portfolio Investors will continue in the future.

***Tax Favorable Jurisdictions***

The concept of Tax Favorable Jurisdiction is defined by Federal Law 9,430, of December 27, 1996, and included the countries or locations (1) that do not impose income tax, (2) where the maximum income tax rate is lower than 20% (such percentage may be reduced or restored by the Executive branch) or (3) whose laws do not allow access to information regarding the shareholding composition of legal entities, their ownership, or the identity of the beneficial owners of earnings attributable to non-residents. Normative Ruling no. 1,037, of June 04, 2010, as amended, expressly lists the countries or locations that fit into such definition.

The same Federal Law no. 9,430/96, as amended by Federal Law no. 11,727, of June 23, 2008, also sets forth the concept of Privileged Tax Regimes ; said regimes are also expressly listed by Normative Ruling no. 1,037/10. Notwithstanding, the mentioned concept does not seem relevant for purposes of determining the tax treatment applicable to investments made by Non-Resident Holders of common shares, preferred shares and ADSs, although one cannot completely disregard the risk that tax authorities argue otherwise.

Ordinance ( *Portaria* ) no. 488, issued by the Brazilian Ministry of Finance on November 28, 2014, lowered the tax threshold at which countries or locations are deemed to be Tax Favorable Jurisdictions (see item (2), above), from 20% to 17%.

***Tax on Foreign Exchange Transactions***

## Edgar Filing: GERDAU S.A. - Form 20-F

Brazilian law imposes a Tax on Foreign Exchange Transactions ( IOF/FX ) due on the liquidation of foreign exchange agreements related to the conversion of Brazilian *reais* into foreign currency and on the conversion of foreign currency into Brazilian *reais*.

Currently, as a general rule, IOF/FX is levied at the rate of 0.38%. There are, however, a number of exceptions to such general rule (as provided by Article 15-B of Decree no. 6,306, of December 14, 2007, as amended).

Foreign exchange transactions for the inflow of funds into Brazil in connection with investments made by foreign investors in the Brazilian financial and capital markets are currently subject to IOF/FX at a zero percent rate.

Foreign exchange transactions for the outflow of funds in connection with the return of investments made in the Brazilian financial and capital markets are also subject to IOF/FX at a zero percent rate. The same rate applies on the outflow of funds in connection with payments of dividends and interest on shareholders' equity made by Brazilian companies.

The Brazilian government is permitted to increase the rate of the IOF/FX at any time up to 25%. However, any increase in rates will only apply to transactions carried out after this increase in rates enters into force.

### *Tax on Transactions Related to Bonds and Securities*

Brazilian law imposes a Tax on Transactions Related to Bonds and Securities ( IOF/Bonds ) due on transactions involving bonds and securities, including those carried out on a Brazilian stock exchange. Currently, IOF/Bonds is levied at the rate of 0% in most transactions involving common or preferred shares, including the transfer of shares traded in Brazilian stock exchanges with the specific purpose of enabling the issuance of depositary receipts to be traded outside Brazil.

The Brazilian government is allowed to increase the rate of the IOF/Bonds at any time up to 1.5% per day of the transaction amount. However, any increase in rates may only apply to transactions carried out after this increase in rates enters into force.

### *Other Brazilian Taxes*

There are no specific Federal Brazilian inheritance, gift or succession taxes applicable to the ownership, transfer or disposition of common or preferred shares or ADSs, except for gift and inheritance taxes that may be imposed by Brazilian states. There are no Brazilian stamp, issue, registration, or similar taxes or duties payable by holders of common or preferred shares or ADSs.

Table of Contents

ADSs.

**United States Tax Considerations**

*U.S. Federal Income Tax Considerations*

The following discussion summarizes the principal U.S. federal income tax considerations relating to the purchase, ownership and disposition of Preferred Shares or Preferred ADSs by a U.S. holder (as defined below) holding such shares or ADSs as capital assets (generally, property held for investment). This summary is based on the Internal Revenue Code of 1986, as amended (the Code), Treasury regulations, administrative pronouncements of the U.S. Internal Revenue Service (the IRS) and judicial decisions, all as in effect on the date hereof, and all of which are subject to change (possibly with retroactive effect) and to differing interpretations.. This summary does not the federal tax laws other than those pertaining to U.S. federal income taxation (such as estate or gift tax laws), nor does it address any aspects of U.S. state or local or non-U.S. taxation. U.S. holders are urged to consult their own tax advisers regarding such matters.

This summary does not purport to address all material U.S. federal income tax consequences that may be relevant to a U.S. holder of a Preferred Share or Preferred ADS, and does not take into account the specific circumstances of any particular investors, some of which (such as tax-exempt entities, banks or other financial institutions, insurance companies, broker-dealers, traders in securities that elect to use a mark-to-market method of accounting for their securities holdings, regulated investment companies, real estate investment trusts, U.S. expatriates, investors liable for the alternative minimum tax, partnerships and other pass-through entities, investors that own or are treated as owning 10% or more of the total combined voting power of the Company's voting stock or 10% or more of the total value of the Company's stock, investors that hold the Preferred Shares or Preferred ADSs as part of a straddle, hedge, conversion or constructive sale transaction or other integrated transaction, and U.S. holders whose functional currency is not the U.S. dollar) may be subject to special tax rules.

As used herein, a U.S. holder is a beneficial owner of a Preferred Share or Preferred ADS that is, for U.S. federal income tax purposes, (i) a citizen or resident alien individual of the United States, (ii) a corporation (or an entity taxable as a corporation) created or organized under the laws of the United States, any State thereof or the District of Columbia, (iii) an estate, the income of which is subject to U.S. federal income tax without regard to its source, or (iv) a trust if (1) a court within the United States is able to exercise primary supervision over the administration of the trust, and one or more U.S. persons have the authority to control all substantial decisions of the trust, or (2) the trust has a valid election in effect under applicable Treasury regulations to be treated as a U.S. person. For purposes of this discussion, a non-U.S. holder is a beneficial owner of a Preferred Share or Preferred ADS that is not a U.S. holder or a partnership.

If a partnership (including for this purpose any entity treated as a partnership for U.S. federal income tax purposes) is a beneficial owner of a Preferred Share or Preferred ADS, the U.S. federal income tax treatment of a partner in the partnership generally will depend on the status of the partner and the activities of the partnership. A holder of a Preferred Share or Preferred ADS that is a partnership and partners in that partnership are urged to consult their own tax advisers regarding the U.S. federal income tax consequences of the purchase, ownership and disposition of Preferred Shares or Preferred ADSs.

*Nature of Preferred ADSs for U.S. Federal Income Tax Purposes*

The following summary assumes that the representations contained in the deposit agreement among us, The Bank of New York Mellon, as depositary, and the holders and beneficial owners from time to time of ADSs issued thereunder are true and that the obligations in the deposit agreement and any related agreement will be complied with in accordance with their terms. In general, for U.S. federal income tax purposes, a holder of a Preferred ADS will be treated as the owner of the underlying Preferred Shares. Accordingly, except as specifically noted below, the tax consequences discussed below with respect to Preferred ADSs will be the same for Preferred Shares in the Company, and exchanges of Preferred Shares for Preferred ADSs, and Preferred ADSs for Preferred Shares, generally will not be subject to U.S. federal income tax.

For purposes of the following summary, any reference to Preferred Shares shall be understood to also include reference to the Preferred ADSs, unless otherwise noted.

***Taxation of Distributions***

*U.S. holders*

In general, subject to the passive foreign investment company ( PFIC ) rules discussed below, a distribution on a Preferred Share will constitute a dividend for U.S. federal income tax purposes to the extent that it is made from the Company's current or accumulated earnings and profits as determined under U.S. federal income tax principles (regardless of whether it is considered a

Table of Contents

dividend for Brazilian income tax purposes). If a distribution exceeds the amount of the Company's current and accumulated earnings and profits, it will be treated as a non-taxable reduction of basis to the extent of the U.S. holder's tax basis in the Preferred Share on which it is paid, and to the extent it exceeds that basis it will be treated as capital gain. The Company does not intend to calculate its earnings and profits under U.S. federal income tax principles. Therefore, a U.S. holder should expect that a distribution on a Preferred Share generally will be treated as a dividend even if that distribution would otherwise be treated as a non-taxable return of capital or as capital gain under the rules described above.

The gross amount of any dividend on a Preferred Share (which will include the amount of any Brazilian taxes withheld, if any) generally will be subject to U.S. federal income tax as foreign source dividend income and will not be eligible for the corporate dividends received deduction. In the case of a Preferred Share, but not a Preferred ADS, the amount of a dividend paid in Brazilian currency will be its value in U.S. dollars based on the prevailing spot market exchange rate in effect on the day that the U.S. holder receives the dividend. In the case of a dividend received in respect of a Preferred ADS, the amount of a dividend paid in Brazilian currency will be its value in U.S. dollars based on the prevailing spot market exchange rate in effect on the date the Depository receives it, whether or not the dividend is converted into U.S. dollars. A U.S. holder will have a tax basis in any distributed Brazilian currency equal to its U.S. dollar amount on the date of receipt, and any gain or loss realized on a subsequent conversion or other disposition of the Brazilian currency generally will be treated as U.S. source ordinary income or loss. If dividends paid in Brazilian currency are converted into U.S. dollars on the date they are received by a U.S. holder or the Depository or its agent, as the case may be, the U.S. holder generally should not be required to recognize foreign currency gain or loss in respect of the dividend income. U.S. holders are urged to consult their own tax advisers regarding the treatment of any foreign currency gain or loss if any Brazilian currency received by the U.S. holder or the Depository or its agent is not converted into U.S. dollars on the date of receipt.

Subject to certain exceptions for hedged positions, any dividend that a non-corporate U.S. holder receives on a Preferred Share generally will be subject to a maximum Federal income tax rate of 20% if the dividend is a qualified dividend. A dividend on a Preferred Share will be a qualified dividend if (i) the Preferred Shares are readily tradable on an established securities market in the United States, (ii) the U.S. holder meets the holding period requirement for the Preferred Share (generally more than 60 days during the 121-day period that begins 60 days before the ex-dividend date), and (iii) the Company was not, in the year prior to the year the dividend was paid, and is not, in the year the dividend is paid, a passive foreign investment company (PFIC).

The Preferred ADSs are listed on the New York Stock Exchange and will qualify as readily tradable on an established securities market in the United States so long as they are so listed. Based on existing guidance, it is not entirely clear whether a dividend on a preferred share will be treated as a qualified dividend, because the preferred shares themselves are not listed on a U.S. exchange. As discussed below under PFIC Rules, the Company does not believe that it was a PFIC for U.S. federal income tax purposes for its 2017 taxable year, nor does it anticipate being classified as a PFIC in its current taxable year or future taxable years. Given that the determination of PFIC status involves the application of complex tax rules, and that it is based on the nature of the Company's income and assets from time to time, no assurances can be provided that the Company will not be considered a PFIC for the current (or any past or future) taxable year.

The U.S. Treasury Department has announced its intention to promulgate detailed rules pursuant to which holders of stock of non-U.S. corporations, and intermediaries through whom the stock is held, will be permitted to rely on certifications from issuers to establish that dividends are treated as qualified dividends. Because those detailed procedures have not yet been issued, it is not clear whether the Company will be able to comply with them. Special limitations on foreign tax credits apply to dividends subject to the reduced rate of tax for qualified dividends. U.S. holders of Preferred Shares are urged to consult their own tax advisers regarding the availability of the reduced dividend tax rate in the light of their own particular circumstances.

Any Brazilian withholding tax will be treated as a foreign income tax eligible for credit against a U.S. holder's U.S. federal income tax liability, subject to generally applicable limitations under U.S. federal income tax law. For purposes of computing those limitations separately for specific categories of income, a dividend generally will constitute foreign source passive category income or, in the case of certain holders, general category income. A U.S. holder will be denied a foreign tax credit with respect to Brazilian income tax withheld from dividends received with

## Edgar Filing: GERDAU S.A. - Form 20-F

respect to the underlying Preferred Shares to the extent the U.S. holder has not held the Preferred Shares for at least 16 days of the 31-day period beginning on the date which is 15 days before the ex-dividend date or to the extent the U.S. holder is under an obligation to make related payments with respect to substantially similar or related property. Any days during which a U.S. holder has substantially diminished its risk of loss on the Preferred Shares are not counted toward meeting the 16-day holding period required by the statute. Alternatively, any Brazilian withholding tax may be taken as a deduction against taxable income, provided the U.S. holder takes a deduction and not a credit for all foreign income taxes paid or accrued in the same taxable year. The rules relating to the determination of the foreign tax credit are complex, and U.S. holders are urged to consult with their own tax advisers to determine whether and to what extent they will be entitled to foreign tax credits as well as with respect to the determination of the foreign tax credit limitation.

Table of Contents

U.S. holders should be aware that the IRS has expressed concern that parties by whom ADSs are held or to whom they are transferred may be taking actions that are inconsistent with the claiming of foreign tax credits by U.S. holders of ADSs. Accordingly, the discussion above regarding the credibility of Brazilian withholding taxes could be affected by future actions that may be taken by the IRS.

***Non-U.S. holders***

A dividend paid to a non-U.S. holder on a Preferred Share will not be subject to U.S. federal income tax unless the dividend is effectively connected with the conduct of trade or business by the non-U.S. holder within the United States (and, if an applicable income tax treaty so provides, is attributable to a permanent establishment or fixed base the non-U.S. holder maintains in the United States). A non-U.S. holder generally will be subject to tax on an effectively connected dividend in the same manner as a U.S. holder. A corporate non-U.S. holder may also be subject under certain circumstances to an additional branch profits tax, the rate of which may be reduced pursuant to an applicable income tax treaty.

***Taxation of Capital Gains***

*U.S. holders*

Subject to the PFIC rules discussed below, on a sale or other taxable disposition of a Preferred Share, a U.S. holder will recognize capital gain or loss in an amount equal to the difference between the U.S. holder's adjusted basis in the Preferred Share and the amount realized on the sale or other taxable disposition, each determined in U.S. dollars. Such capital gain or loss will be long-term capital gain or loss if at the time of the sale or other taxable disposition the Preferred Share has been held for more than one year. In general, any adjusted net capital gain of a non-corporate U.S. holder is subject to a maximum Federal income tax rate of 20%. The deductibility of capital losses is subject to limitations.

Any gain a U.S. holder recognizes generally will be U.S. source income for U.S. foreign tax credit purposes, and, subject to certain exceptions, any loss will generally be a U.S. source loss. If a Brazilian tax is withheld on a sale or other disposition of a Preferred Share, the amount realized will include the gross amount of the proceeds of that sale or other disposition before deduction of the Brazilian tax. The generally applicable limitations under U.S. federal income tax law on crediting foreign income taxes generally precludes a U.S. holder from obtaining a foreign tax credit for any Brazilian income tax withheld on a sale of a Preferred Share. Alternatively, any Brazilian withholding tax may be taken as a deduction against taxable income, provided the U.S. holder takes a deduction and not a credit for all foreign income taxes paid or accrued in the same taxable year. The rules relating to the determination of the foreign tax credit are complex, and U.S. holders are urged to consult with their own tax advisers regarding the application of such rules.

*Non-U.S. holders*

A non-U.S. holder will not be subject to U.S. federal income tax on a gain recognized on a sale or other disposition of a Preferred Share unless (i) the gain is effectively connected with the conduct of trade or business by the non-U.S. holder within the United States (and, if an applicable income tax treaty so provides, is attributable to a permanent establishment or fixed base the non-U.S. holder maintains in the United States), or (ii) in the case of a non-U.S. holder who is an individual, the holder is present in the United States for 183 or more days in the taxable year of the

sale or other taxable disposition and certain other conditions are met. Any effectively connected gain of a corporate non-U.S. holder may also be subject under certain circumstances to an additional branch profits tax, the rate of which may be reduced pursuant to an applicable income tax treaty.

***PFIC Rules***

A special set of U.S. federal income tax rules applies to a foreign corporation that is a PFIC for U.S. federal income tax purposes. Based on the Company's audited financial statements and relevant market and shareholder data, as well as the Company's current and projected income, assets and activities, the Company believes it was not a PFIC for U.S. federal income tax purposes for its 2017 taxable year, nor does it anticipate being classified as a PFIC in its current taxable year or future taxable years. However, because the determination of whether the Company is a PFIC is based upon the composition of its income and assets from time to time, and because there are uncertainties in the application of the relevant rules, it is possible that the Company will become a PFIC in a future taxable year (and no assurance can be provided that the Company will not be considered a PFIC for its current (or any past) taxable year).

If the Preferred Shares were shares of a PFIC for any taxable year, U.S. holders (including certain indirect U.S. holders) will generally be subject to adverse tax consequences, including the possible imposition of ordinary income treatment for gains or excess distributions (generally a distribution in excess of 125% of the average distributions received during the past three years or, if shorter, the U.S. holder's holding period) that would otherwise be taxed as capital gains or dividends, along with an interest charge on gains or excess distributions allocable to prior years in the U.S. holder's holding period during which the Company was determined to be a PFIC. If the Company is deemed to be a PFIC for a taxable year, dividends on a Preferred Share would not constitute qualified



Table of Contents

dividends subject to preferential rates of U.S. federal income taxation. In addition, if the Company is deemed to be a PFIC for a taxable year, U.S. holders would be subject to increased reporting requirements. U.S. holders are urged to consult their own tax advisers regarding the application of the PFIC rules.

***Medicare Tax***

A U.S. holder that is an individual or estate, or a trust that does not fall into a special class of trusts that is exempt from such tax, will be subject to a 3.8% tax on the lesser of (1) the United States holder's net investment income (or undistributed net investment income in the case of estates and trusts) for the relevant taxable year and (2) the excess of the United States holder's modified adjusted gross income for the taxable year over a certain threshold (which in the case of individuals will be between \$125,000 and \$250,000, depending on the individual's circumstances). A holder's net investment income will generally include its dividend income and its net gains from the disposition of the Preferred Shares, unless such dividend income or net gains are derived in the ordinary course of the conduct of a trade or business (other than a trade or business that consists of certain passive or trading activities). If you are a U.S. holder that is an individual, estate or trust, you are urged to consult your own tax advisor regarding the applicability of this Medicare tax to your income and gains in respect of your investment in our Preferred Shares.

***Information Reporting and Backup Withholding***

Under U.S. federal income tax law and the Treasury regulations, certain categories of U.S. holders must file information returns with respect to their investment in, or involvement in, a foreign corporation. For example, U.S. holders that hold certain specified foreign financial assets in excess of \$50,000 are subject to U.S. return disclosure obligations (and related penalties). The definition of specified foreign financial assets includes not only financial accounts maintained in foreign financial institutions, but also, unless held in accounts maintained by a financial institution, any stock or security issued by a non-U.S. person, any financial instrument or contract held for investment that has an issuer or counterparty other than a U.S. person and any interest in a foreign entity. U.S. holders may be subject to these reporting requirements unless their Preferred Shares are held in an account at a domestic financial institution. Penalties for failure to file certain of these information returns are substantial. U.S. holders should consult with their own tax advisers regarding the requirements of filing information returns, and, if applicable, filing obligations relating to the PFIC rules.

Dividends paid on, and proceeds from the sale or other taxable disposition of, a Preferred Share to a U.S. holder generally may be subject to information reporting requirements and may be subject to backup withholding (currently at the rate of 24%) unless the U.S. holder provides an accurate taxpayer identification number or otherwise demonstrates that it is exempt. The amount of any backup withholding collected from a payment to a U.S. holder will be allowed as a credit against the U.S. holder's U.S. federal income tax liability and may entitle the U.S. holder to a refund, provided that certain required information is timely submitted to the IRS. A non-U.S. holder generally will be exempt from these information reporting requirements and backup withholding tax but may be required to comply with certain certification and identification procedures in order to establish its eligibility for exemption.

**F. DIVIDENDS AND PAYING AGENTS**

Not applicable.

**G. STATEMENT BY EXPERTS**

Not applicable.

**H. DOCUMENTS ON DISPLAY**

The Company makes its filings in electronic form under the EDGAR filing system of the U.S. Securities and Exchange Commission and XBRL - eXtensible Business Reporting Language. Its filings are available through the EDGAR system and XBRL at [www.sec.gov](http://www.sec.gov). The Company's filings are also available to the public through the Internet at Gerdau's website at [www.gerdau.com](http://www.gerdau.com). Such filings and other information on its website are not incorporated by reference in this Annual Report. Interested parties may request a copy of this filing, and any other report, at no cost, by writing to the Company at the following address: Av. das Nações Unidas, 8501/ 8th floor São Paulo-SP 05425-070 Brazil or calling 55-11-3394 6300 or by e-mail at [inform@gerdau.com.br](mailto:inform@gerdau.com.br). In compliance with New York Stock Exchange Corporate Governance Rule 303A.11, the Company provides on its website a summary of the differences between its corporate governance practices and those of U.S. domestic companies under the New York Stock Exchange listing standards.

Table of Contents

**I. SUBSIDIARY INFORMATION**

Not applicable.

**ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES REGARDING MARKET RISK**

Gerdau is exposed to various market risks, which involve the fluctuation of exchange rates and interest rates. The Company uses derivatives and other financial instruments to reduce the impact of such risks on its financial assets and liabilities or future cash flows and earnings. Gerdau has established policies to assess market risks and to approve the use of derivative financial instruments transactions related to those risks. The Company enters into derivative financial instruments to manage the above mentioned market risks and never for speculative purposes.

**Foreign Exchange Rate Risk**

This risk is related to the possibility of fluctuations in exchange rates affecting the value of the Company's financial assets and liabilities or future cash flows and earnings. The Company assesses its exposure to such risk by measuring the difference between the value of its assets and the value of its liabilities in foreign currency. The Company understands that its receivables originated from exports, its cash and cash equivalents denominated in foreign currencies and its investments abroad are more than equivalent to its liabilities denominated in foreign currency. Since the management of these exposures occurs at each operation level, if there is a mismatch between assets and liabilities denominated in foreign currency, the Company may employ derivative financial instruments in order to mitigate the effect of exchange rate fluctuations.

*Foreign currency sensitivity analysis*

As of December 31, 2018, the Company is mainly exposed to variations between the Real and the Dollar. The sensitivity analysis carried out by the Company considers the effects of a 5% increase or reduction between the Real and the Dollar in its non-hedged debt, in order to represent the impact on its Statements of Income. In this analysis, if the Real appreciates against the Dollar, this would represent a gain of R\$ 113,445 thousands (R\$ 129,209 thousands as of December 31, 2017, respectively). If the Real depreciates against the Dollar this would represent an expense of the same value. Due to the investment hedge, the variations are minimized when the exchange variation accounts and income tax are analyzed.

The net amounts of trade accounts receivable and trade accounts payable denominated in foreign currency do not represent any relevant risk in the case of any fluctuation of exchange rates.

**Interest rate risk**

This risk is related to the possibility of fluctuations in interest rates affecting the value of the Company's financial assets and liabilities or future cash flows and earnings. The Company assesses its exposure to such risk by (i) comparing financial assets and liabilities denominated in fixed and floating interest rates and (ii) monitoring the movements in interest rates, such as LIBOR and CDI. Therefore, the Company may enter into an interest rate swap in order to mitigate this risk.

***Interest rate sensitivity analysis***

The interest rate sensitivity analysis made by the Company considers the effects of an increase or reduction of 10 basis point (bps) on the average interest rate applicable to the floating part of its debt. The calculated impact, considering this variation in the interest rate totals R\$ 55,959 thousands as of December 31, 2018 (R\$ 54,908 thousands as of December 31, 2017) and would impact the Financial expenses account in the Consolidated Statements of Income. The specific interest rates to which the Company is exposed are related to the loans, financing, and debentures presented in Notes 13 and 14, and are mainly comprised by Libor and CDI Interbank Deposit Certificate.

**Commodity prices risk**

This risk is related to the possibility of fluctuations in prices of products sold by the Company or in prices of raw material and other inputs used in the production process. Since the Company operates in a commodity market, its sales revenues and cost of sales may be affected by changes in the international prices of the products it sells or the raw materials it purchases. In order to minimize this risk, the Company constantly monitors the price variations in the domestic and international markets.

Table of Contents

The sensitivity analysis made by the Company considers the effects of an increase or of a reduction of 1% on both prices. The impact measured considering this variation in the price of products sold, considering the revenues and costs of the year ended on December 31, 2018, totals R\$ 461,595 thousands (R\$ 369,176 thousands as of December 31, 2017) and the variation in the price of raw materials and other inputs totals R\$ 296,234 thousands as of December 31, 2018 (R\$ 234,239 thousands as of December 31, 2017). The impact in the price of products sold and raw materials would be recorded in the accounts Net Sales and Cost of Sales, respectively, in the Consolidated Statements of Income. The Company does not expect to be more vulnerable to a change in one or more specific product or raw material.

**Credit risk**

This risk arises from the possibility of the Company not receiving amounts arising from sales to customers or investments made with financial institutions. In order to minimize this risk, the Company has adopted the procedure of analyzing in detail the financial position of their customers, establishing a credit limit and constantly monitoring their balances. In relation to cash investments, the Company invests solely in financial institutions with low credit risk, as assessed by rating agencies. In addition, each financial institution has a maximum limit for investment, determined by the Company's Credit Committee.

**Capital management risk**

This risk comes from the Company's choice in adopting a financing structure for its operations. The Company manages its capital structure, which consists of a ratio between the financial debts and its own capital (Equity) based on internal policies and benchmarks. The KPIs (Key Performance Indicators) related to the objective Capital Structure Management are: WACC (Weighted Average Cost of Capital), Net Debt/EBITDA, Net Financial Expenses Coverage Ratio, and Indebtedness/Equity Ratio. The Net Debt is composed of the outstanding principal of the debt, less cash, cash equivalents and short-term investments (notes 4, 13 and 14). The total capitalization is formed by Total Debt (composed by the outstanding principal of the debt) and equity (note 22). The Company may change its capital structure, as economic and financial conditions to optimize its financial leverage and its debt management. At the same time, the Company seeks to improve its ROCE (Return on Capital Employed) by implementing a working capital management and an efficient program of capital expenditures.

**Liquidity risk**

The Company's management policy of indebtedness and cash on hand is based on using the committed lines and the currently available credit lines with or without a guarantee in export receivables for maintaining adequate levels of short, medium, and long-term liquidity.

**ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES**

**A. DEBT SECURITIES**

Not applicable.

**B. WARRANTS AND RIGHTS**

Not applicable.

**C. OTHER SECURITIES**

Not applicable.

**D. AMERICAN DEPOSITARY SHARES**

On March 10, 1999, Gerdau S.A. obtained registration for the issuance of Level II ADSs, which began trading on the New York Stock Exchange the same day. Under the GGB symbol, these Level II ADSs are equivalent to one preferred share of Gerdau S.A (GGBR4).

J.P. Morgan Chase Bank, as depositary, has agreed to reimburse the Company for expenses it incurs that are related to the maintenance of the ADS program. The depositary has agreed to reimburse the Company for its continuing and annual stock exchange listing fees. It has also agreed to pay the standard out-of-pocket maintenance costs for the ADSs, and to reimburse the Company annually for certain investor relations programs or special promotional activities. In certain instances, the depositary has agreed to provide additional payments to the Company based on any applicable performance indicators relating to the ADS facility. There are

Table of Contents

limits on the amount of expenses for which the depositary will reimburse the Company, but the amount of reimbursement available to the Company is not necessarily tied to the amount of fees the depositary collects from investors. During calendar year 2018, the depositary reimbursed the Company in the amount of USD 3.25mm gross (\$2,275,000 net of withholding taxes).

The depositary collects its fees for delivery and surrender of ADSs directly from investors depositing shares or surrendering ADSs for the purpose of withdrawal or from intermediaries acting for them. The depositary collects fees for making distributions to investors by deducting those fees from the amounts distributed or by selling a portion of distributable property to pay the fees. The depositary may collect its annual fee for depositary services by deduction from cash distributions or by directly billing investors or by charging the book-entry system accounts of participants acting for them.

The fees that ADS holders may be required to pay or incur are the following:

<b>Depository Service</b>	<b>Fee payable by ADS holder</b>
Transferring, splitting or grouping receipts	\$1.50 per transfer of ADSs
Depository services	\$0.05 or less per ADS
Withdrawal or deposit/issuance and cancellations of shares underlying ADSs	\$5.00 or less per 100 ADSs
Cash distributions	\$0.05 or less per ADS

**PART II****ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES**

Not applicable.

**ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS**

Not applicable.

**ITEM 15. CONTROLS AND PROCEDURES**

**Disclosure control and procedures**

The Company has established disclosure controls and procedures to ensure that the information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act of 1934 as amended (the Exchange Act ) is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms. And such information is accumulated and made known to the officers who certify the Company's financial reports and to other members of senior management and the Disclosure Committee as appropriate to allow timely decisions regarding required disclosure.

A control system, no matter how well designed and operated, can only provide reasonable, not absolute, assurance that the objectives of the control system will be met. Based on their evaluation as of December 31, 2018, the Chief Executive Officer and the Chief Financial Officer of the Company have concluded that the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) are effective at a reasonable assurance level.

The Disclosure Committee is composed of the Chief Executive Officer, Gustavo Werneck, the Chief Financial Officer and Executive Vice President, Harley Lorentz Scardoelli, the Accounting Director, Clemir Uhlein and the Corporate Communication & Public Affairs Director, Renato Gasparetto Junior. This Committee oversees and reviews all materials for which there is a legal disclosure requirement, together with all data required to support the documents mentioned above. This committee meets at regular intervals in order to review all data.

There have been no significant changes in the Company's internal controls or in other factors that could significantly affect these controls subsequent to the date of their most recent evaluation.

Please see Exhibits 12.01 and 12.02 for the certifications required by this Item



Table of Contents

**Management's Annual Report on Internal Controls over Financial Reporting**

The management of Gerdau S.A. is responsible for establishing and maintaining adequate internal control over Financial Reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934. The internal controls are designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management has documented and evaluated the effectiveness of the internal control over Financial Reporting of the Company as of December 31, 2018, in accordance with the criteria established in the Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission ( COSO ). Based on the above evaluation, management has concluded that the Company maintained effective internal control over financial reporting as of December 31, 2018.

KPMG Auditores Independientes, an independent registered certified public accounting firm, has audited and issued their report on the Consolidated Financial Statements of the Company and the effectiveness of the Company's internal controls over financial reporting, which appears herein.

**ITEM 16. [RESERVED]**

**ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT**

The Shareholder's General Meeting has determined that Bolívar Charneski, a member of its Board of Auditors, is a financial expert and independent within the meaning of the SEC rules applicable to disclosure of such expertise.

**ITEM 16B. CODE OF ETHICS**

In 2011, Gerdau S.A. integrated its three previous codes - Gerdau Ethical Guidelines, Gerdau Ameristeel's Code of Ethics and Business Conduct and Gerdau Ameristeel Code of Ethics for Senior Executives into one single Code of Ethics applicable to all of Gerdau's business units around the world and periodically revised to improve suitability, adequacy and effectiveness as appropriate.

The provisions of the Code are thus binding on Gerdau's Chief Executive Officer, Chief Financial Officer, Chief Accounting Officer, Compliance Officer and other persons performing similar functions.

## Edgar Filing: GERDAU S.A. - Form 20-F

The Code of Ethics is focused on the ethics and compliance issues most important to a publicly-held company and meets all applicable legal requirements.

The code is organized according to the Company's values which are: (a) Be the Customer's choice, (b) Safety above all, (c) Respected, engaged and fulfilled Employees, (d) Pursuing excellence with simplicity, (e) Focus on results, (f) Integrity with all stakeholders and, (g) Economic, social and environmental sustainability.

The code instructs all employees to follow a number of steps when reporting suspected breaches or violations with no fear of demotion, reprisal or retaliation. The company has implemented an Ethics Helpline to which all employees and third parties may refer in the case of any violations of the code, assuring confidentiality, anonymity and two-way communication for any needed follow-up.

The purpose and the contents of the current Code of Ethics have been made public to all employees and board of directors and have been the object of periodically in-company training. For third parties there is a Code of Ethics with the same content, but in a language for its employees.

In the same manner as the three previous codes mentioned in the first paragraph, the actual Code of Ethics meets the definition contemplated by applicable SEC and New York Stock Exchange rules, covering wrongdoing related to business conduct, conflicts of interest, disclosure in reports and other documents, as well as compliance with legislation.

The Gerdau Code of Ethics is filed herewith as exhibit 11.01 and also may be accessed through our Internet website ([www.gerdau.com](http://www.gerdau.com)).

The Company did not grant any waiver from the Code provisions in the last fiscal year.

Table of Contents**ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

The following table provides information on fees billed to Gerdaul for professional services rendered by the external auditors responsible for auditing the financial statements included in this Annual Report (in thousands of Brazilian Reais) which were KPMG for the years ended on December 31, 2018 and December 31, 2017:

	2018	2017
Audit fees	7,068	8,751
Audit-related fees		
All other fees	36	715
<b>Total</b>	<b>7,104</b>	<b>9,466</b>

Audit fees are related to professional services rendered in the auditing of Gerdaul's Consolidated Financial Statements, quarterly reviews of Gerdaul's Consolidated Financial Statements and statutory audits and interim reviews of certain of the Company's subsidiaries and affiliates as required by the appropriate legislation. Those amounts also include fees related to the audit of internal controls over financial reporting of Gerdaul and of Gerdaul Ameristeel.

Audit-related fees are for assurance and related services, such as due diligence services traditionally performed by an external auditor related to acquisitions, as well as compliance services on accounting standards and transactions.

Other fees are mainly related to services provided to subsidiaries relating to tax compliance and tax services.

**ITEM 16D. EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES**

On April 28, 2005, the Company elected its Board of Auditors duly adapted to ensure compliance with the Sarbanes-Oxley Act requirements and exemptions from the listing standards. The Board of Auditors ( Conselho Fiscal ) has been operating in accordance with Brazilian Corporate Law 6,404/76, since April 2000. The customary role of this board is to monitor and verify the actions of company directors and executive officers and the compliance with their legal duties, providing opinions and official statements on the annual management report and the proposals of members of the Board of Directors, denouncing errors or fraud, calling meetings whenever necessary and analyzing financial statements. In establishing a permanent Board of Auditors, the Company has availed itself of paragraph (c)(3) of Rule 10A-3 of the U.S. Securities Exchange Act of 1934, as amended, which provides a general exemption from the audit committee requirements for a foreign private issuer (such as the Company) with a board of auditors, subject to certain requirements which continue to be applicable under Rule 10A-3.

NYSE rules require that listed companies have an audit committee that (i) is composed of a minimum of three independent directors who are all financially literate, (ii) meets the SEC rules regarding audit committees for listed companies, (iii) has at least one member who has accounting or financial management expertise and (iv) is governed by a written charter addressing the committee's required purpose and detailing its required responsibilities. However, as a foreign private issuer, the Company needs only to comply with the requirement that the audit committee, or Board of Auditors in its case, meet the SEC rules regarding audit committees for listed companies. The Brazilian Corporate Law requires companies to have a non-permanent Board of Auditors composed of three to five members who are elected by the shareholders at the Ordinary

## Edgar Filing: GERDAU S.A. - Form 20-F

General Meeting of Shareholders. The Board of Auditors operates independently from management and from a company's external auditors. Its main function is to monitor the activities of the management of the company, examine the financial statements of each fiscal year and provide a formal report to its shareholders.

The Company has a permanent Board of Auditors that consists of three but up to five members and three but up to five alternates and which has ordinary meetings every two months. The members of the Gerdau S.A.'s Board of Auditors are all financially literate and one member has accounting expertise that qualifies him as an audit committee financial expert. Gerdau S.A. believes that its Board of Auditors, as modified, meets the requirements for the exemption available to foreign private issuers under the SEC rules regarding audit committees of listed companies. In addition, the Board of Auditors operates under a written charter and which the Gerdau S.A. believes meets the NYSE's requirements for audit committee charters. The Board of Auditors is not the equivalent of, or wholly comparable to, a U.S. audit committee. Among other differences, it is not required to meet the standards of independence established in Rule 10A-3 and is not fully empowered to act on matters that are required by Rule 10A-3 to be within the scope of an audit committee's authority. Nonetheless, with the duties that have been provided to the Board of Auditors to the extent permitted by Brazilian law, Gerdau S.A. believes that its current corporate governance system, taken as a whole, including the ability of the Board of Auditors to consult internal and external experts, is fully equivalent to a system having an audit committee functioning as a committee of its Board of Directors. For a further discussion of its Board of Auditors, see Item 6C. Board Practices - Board of Auditors .

Table of Contents

The Board of Auditors members are elected at the Ordinary Shareholders Meeting for one-year terms. They are eligible for reelection. In Gerda S.A. the Board of Auditors consists of five members and five alternates. As required by Brazilian law, members of the Board of Auditors must have college graduation or held office for at least three years as business administrators or as members of boards of auditors. The Board of Auditors, at the request of any of its members, may ask the external auditors to provide explanations or information and to investigate specific facts.

**ITEM 16E. PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS**

On December, 12, 2018 Gerda S.A. announced to the market that it has concluded the acquisition by the Company of shares of its own issue.

Purposes: (i) to meet the needs of the Long-Term Incentive Program of the Company and its subsidiaries, (ii) held in treasury, (iii) cancellation or (iv) subsequent sale on the market.

The acquisitions were carried out supported from its existing profit reserves, with the Executive Committee responsible for establishing the number of shares and the opportune moment for each transaction.

Number of shares acquired: 6,000,000 preferred shares (GGBR4), representing in aggregate approximately 0.57% of the preferred shares comprising the free-float, which on October 31, 2018 totaled 1,048,257,933 shares.

**ITEM 16F. CHANGE IN REGISTRANT S CERTIFYING ACCOUNTANT.**

Not applicable.

**ITEM 16G. CORPORATE GOVERNANCE**

Under the Corporate Governance Rules of the New York Stock Exchange, currently in effect, Gerda S.A. is required to disclose any significant ways in which its corporate governance practices differ from those required to be followed by domestic companies under NYSE listing standard. These significant differences are summarized below.

The Company is permitted to follow practice in Brazil in lieu of the provisions of the Corporate Governance Rules, except that it is required to avail itself of an appropriate exemption to the requirement to have a qualifying audit committee under Section 303A.06 of the Rules and its Chief Executive Officer is obligated, under Section 303A.12(b), to promptly notify the NYSE in writing after any of its executive officers becomes aware of any material non-compliance with any applicable provisions of the Corporate Governance Rules.

**Majority of Independent Directors:** Under NYSE Rule 303A.01 domestic listed companies must have a majority of independent directors. The Company does not have a similar requirement under Brazilian practice and does not have a majority of independent directors serving on its board of directors, even though the majority of the members are non-management directors.

**Separate meetings of non-management directors:** Under NYSE Rule 303A.03, the non-management directors of each domestic listed company must meet at regularly scheduled executive sessions without management. Gerdau does not have a similar requirement under Brazilian practice, but non-management directors meet separately once a year to assess management performance.

**Nominating/corporate governance committee:** Under NYSE Rule 303A.04, a domestic listed company must have a nominating/corporate governance committee composed entirely of independent directors. While the Company is not required to have such a committee under Brazilian law, it has a Corporate Governance Committee that is composed by a majority of independent directors. The purpose of this Committee is to provide its views to the board in respect of the best practices in Corporate Governance.

**Compensation Committee:** Under NYSE Rule 303A.05, a domestic listed company must have a compensation committee composed entirely of independent directors. Gerdau is not required to have such a committee under Brazilian practice. It has established a Remuneration and Succession Committee to advise the full Board on employee and executive compensation and recruitment, incentive-compensation plans and related matters, but such committee does not have a separate charter and is composed by a majority of independent directors. Its full Board of Directors otherwise is directly responsible for employee and executive compensation and recruitment, incentive-compensation and related matters.

**Audit Committee:** Under NYSE Rule 303A.06 and the requirements of Rule 10A-3 of the Securities and Exchange Commission, domestic listed companies are required to have an audit committee consisting entirely of independent directors that otherwise complies with Rule 10A-3. In addition, the audit committee must have a written charter that addresses the matters outlined in NYSE Rule 303A.06(c), has an internal audit function and otherwise fulfills the requirements of the NYSE and Rule 10A-3. There is no requirement for an audit committee under Brazilian law and there are features of Brazilian law that require adaptation of the independent audit committee rule to local practice, as permitted by NYSE Rule 303A.06 and Rule 10A-3. Gerdau has a board of auditors (conselho fiscal) that currently performs certain of the functions prescribed for the audit committee, although the scope of its duties is not entirely compatible with the requirements of U.S. law and the NYSE rules. The Company has adapted its corporate governance practices and the functions of the board of auditors (with certain limitations due to Brazilian corporate law that qualify for an exemption as authorized by the SEC) to assure compliance with the requirements of the NYSE Rule and Rule 10A-3. See Item 6C.- Board Practices-Board of Auditors and Item 16D.- Exemption from the Listing Standards for Audit Committees.

**Equity Compensation Plans:** Under NYSE Rule 303A.08, shareholders must be given the opportunity to vote on all equity-compensation plans and material revisions thereto, with certain limited exemptions as described in the Rule. The General

Table of Contents

Shareholders' meeting held on April 30, 2003 approved the establishment by the Board of a stock option plan for executives. Any material changes to such plan, or a new or different plan if established, would require the favorable vote of holders of the common shares of the Company. Holders of preferred shares, including holders of Gerdau's ADSs, would not have the opportunity to vote on such a plan or any revisions thereto.

**Corporate governance guidelines:** Under NYSE Rule 303A.09, domestic listed companies must adopt and disclose their corporate governance guidelines. Gerdau does not have a similar requirement under Brazilian law, although it does establish operating principles for its executive management and it observes the requirements of Instruction 358 of the Brazilian Securities Commission (CVM) concerning trading in its shares. In addition, it has adhered to the Level I listing standards of the BOVESPA.

**Code of Business Conduct and Ethics:** Under NYSE Rule 303A.10, domestic listed companies must adopt and disclose a code of business conduct and ethics for directors, officers and employees and promptly disclose any waivers of the code for directors or executive officers. Gerdau has a similar requirement under Brazilian law and it has adopted a code of ethics that applies to its directors, officers and employees. For more information regarding the Code of Ethics please see Item 16B. Code of Ethics.

Further information concerning Gerdau's corporate governance practices and applicable Brazilian law is available on the Company's website, in its submissions to the U.S. Securities and Exchange Commission. The Company has also voluntarily adhered to the Level I listing standards of the Sao Paulo Stock Exchange (BOVESPA) on which its shares are traded, which impose heightened standards of disclosure, transparency and corporate governance on Gerdau.

**ITEM 16H. MINE SAFETY DISCLOSURE**

Not applicable as none of our mines are located in the United States and, therefore, not subject to the Federal Mine Safety and Health Act of 1977 or the Mine Safety and Health Administration.

**PART III**

**ITEM 17. FINANCIAL STATEMENTS**

The Company has responded to Item 18 in lieu of responding to this item.



**ITEM 18. FINANCIAL STATEMENTS**

Reference is made to Item 19 for a list of all financial statements filed as part of this Annual Report.

**ITEM 19. FINANCIAL STATEMENTS AND EXHIBITS**

(a) **Financial Statements**

	<b>Page</b>
<u>Reports of independent registered public accounting firms</u>	F-2
<u>Consolidated balance sheets on December 31, 2018 and 2017</u>	F-5
<u>Consolidated statements of income for the years ended December 31, 2018, 2017 and 2016</u>	F-7
<u>Consolidated statements of comprehensive income for the years ended December 31, 2018, 2017 and 2016</u>	F-8
<u>Consolidated statements of changes in equity for the years ended December 31, 2018, 2017 and 2016</u>	F-9
<u>Consolidated statement of cash flow for the years ended December 31, 2018, 2017 and 2016</u>	F-10
<u>Notes to consolidated financial statements for the years ended December 31, 2018, 2017 and 2016</u>	F-11

Table of Contents

**(b) List of Exhibits**

1.01	<u>Bylaws of Gerdau S.A.±</u>
2.(a)(1)	<u>Corporate Governance Level 1 BOVESPA**</u>
2.(a)(2)	<u>Further Amended and Restated Deposit Agreement dated as of March 22, 2019, among the Company, JPMorgan Chase Bank, N.A., as Depositary and all holders from time to time of American Depositary Receipts issued thereunder. *</u>
2(b)(1)	The Company agrees to furnish to the Commission upon its request any instrument relating to long-term debt issued by the Company or any subsidiary where the total amount of securities authorized under that instrument does not exceed 10% of the Company's consolidated assets.
4.01	<u>Gerdau S.A. Equity Incentive Plan, Equity Ownership Plan and Long-Term Incentive Plan (for Gerdau Ameristeel)***</u>
4.02	<u>Gerdau Special Steel North America Equity Incentive Plan****</u>
11.01	<u>Code of Ethics*****</u>
12.01	<u>Certification of the Chief Executive Officer under Item 15±</u>
12.02	<u>Certification of the Chief Financial Officer under Item 15±</u>
13.01	<u>Certification pursuant to 18 U.S.C. Section 1350 ±</u>
13.02	<u>Certification pursuant to 18 U.S.C. Section 1350 ±</u>
23.01	<u>Consent of KPMG Auditores Independentes±</u>
23.02	<u>Consent of PricewaterhouseCoopers Auditores Independentes±</u>
101.INS	XBRL Instance Document
101.SCH	XBRL Schema Document
101.CAL	XBRL Calculation Linkbase Document
101.DEF	XBRL Definition Linkbase Document
101.LAB	XBRL Labels Linkbase Document
101.PRE	XBRL Presentation Linkbase Document

---

\* Incorporated by reference to the Company's Registration Statement on Form F-6 (File No. 333-230439), filed with the Securities and Exchange Commission on March 22, 2019.

\*\*Incorporated by reference to Exhibit 2(a)(1) to the Company's Annual Report on Form 20-F (File No. 001-14878), filed with the Securities and Exchange Commission on April 23, 2012

Edgar Filing: GERDAU S.A. - Form 20-F

\*\*\* Incorporated by reference to the Company's Registration Statement on Form S-8 (File No. 333-171217) filed with the Securities and Exchange Commission on December 16, 2010.

\*\*\*\* Incorporated by reference to the Company's Registration Statement on Form S-8 (File No. 333-179182) filed with the Securities and Exchange Commission on January 26, 2012.

Table of Contents

\*\*\*\*\* Incorporated by reference to Exhibit 11.01 to the Company's Annual Report on Form 20-F (File No. 001-14878), filed with the Securities and Exchange Commission on April 23, 2012.

± Filed herewith.

This certification will not be deemed filed for purposes of Section 18 of the Act (15 U.S.C. 78r), or otherwise subject to the liability of that section. Such certification will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the Registrant specifically incorporates it by reference.

Table of Contents

**SIGNATURES**

The registrant hereby certifies that it meets all of the requirements for filing Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

**GERDAU S.A.**

By: /s/ Gustavo Werneck da Cunha  
Name: Gustavo Werneck da Cunha  
Title: Chief Executive Officer

By: /s/ Harley Lorentz Scardoelli  
Name: Harley Lorentz Scardoelli  
Title: Chief Financial Officer

Dated: March 28, 2019

Table of Contents

**GERDAU S.A.**

Consolidated financial statements

as of December 31, 2018 and 2017

and for each of the three years in the period

ended December 31, 2018

prepared in accordance with International Financial Reporting Standards ( IFRS ) as issued by the International Accounting Standards Board IASB

and Reports of Independent Registered Public Accounting Firms

Table of Contents

**Report of Independent Registered Public Accounting Firm**

To the Stockholders and Board of Directors  
Gerdau S.A.

*Opinions on the Consolidated Financial Statements and Internal Control Over Financial Reporting*

We have audited the accompanying consolidated balance sheets of Gerdau S.A. and subsidiaries (the Company) as of December 31, 2018 and 2017, the related consolidated statements of income, comprehensive income, changes in equity, and cash flows for each of the years in the two-year period ended December 31, 2018, and the related notes (collectively, the consolidated financial statements). We also have audited the Company's internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and 2017, and the results of its operations and its cash flows for each of the years in the two-year period ended December 31, 2018, in conformity with International Financial Reporting Standards as issued by the International Accounting Standards Board. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2018 based on criteria established in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

**Basis for Opinions**

The Company's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Controls over Financial Reporting appearing under Item 15 of the Company's Annual Report on Form 20-F. Our responsibility is to express an opinion on the Company's consolidated financial statements and an opinion on the Company's internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the consolidated financial statements included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation

of the consolidated financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

#### Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.



Table of Contents

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

We have served as the Company's auditor since 2017.

KPMG Auditores Independentes

Porto Alegre, Brazil  
March 28, 2019

F-3

---

Table of Contents

**Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Stockholders of

Gerdau S.A.

In our opinion, the accompanying consolidated statements of income/(loss), of comprehensive income/(loss), of changes in equity and of cash flows for the year ended December 31, 2016 present fairly, in all material respects, the results of operations and cash flows of Gerdau S.A. and its subsidiaries for the year ended December 31, 2016 in conformity with International Financial Reporting Standards as issued by the International Accounting Standards Board. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit of these financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provide a reasonable basis for our opinion.

/s/PricewaterhouseCoopers Auditores Independentes

Porto Alegre, Brazil, March 14, 2017

Table of Contents

**GERDAU S.A.**  
**CONSOLIDATED BALANCE SHEETS**  
**as of December 31, 2018 and 2017**  
**In thousands of Brazilian reais (R\$)**

	Note	2018	2017
<b>CURRENT ASSETS</b>			
Cash and cash equivalents	4	2,890,144	2,555,338
Short-term investments	4	459,470	821,518
Trade accounts receivable - net	5	3,201,656	2,798,420
Inventories	6	9,167,689	6,701,404
Tax credits	7	527,428	402,429
Income and social contribution taxes recoverable		445,561	487,633
Unrealized gains on financial instruments	15	30,711	
Assets held for sale			3,745,634
Other current assets		780,423	469,737
		17,503,082	17,982,113
<b>NON-CURRENT ASSETS</b>			
Tax credits	7	32,065	30,841
Deferred income taxes	8	3,874,054	3,054,393
Unrealized gains on financial instruments	15	2,706	
Related parties	18	27,939	51,839
Judicial deposits	17	2,135,414	2,051,181
Other non-current assets		449,592	542,973
Prepaid pension cost	19	17,952	1,149
Advance for future investment in joint venture		375,456	
Investments in associates and joint ventures	9	1,367,802	1,280,299
Goodwill	11	9,112,390	7,891,142
Other Intangibles	12	836,096	972,089
Property, plant and equipment, net	10	15,546,481	16,443,742
		33,777,947	32,319,648
<b>TOTAL ASSETS</b>		<b>51,281,029</b>	<b>50,301,761</b>

The accompanying notes are an integral part of these Consolidated Financial Statements.

Table of Contents

**GERDAU S.A.**  
**CONSOLIDATED BALANCE SHEETS**  
**as of December 31, 2018 and 2017**  
**In thousands of Brazilian reais (R\$)**

	Note	2018	2017
<b>CURRENT LIABILITIES</b>			
Trade accounts payable		4,119,057	3,179,954
Short-term debt	13	1,822,183	2,004,341
Debentures		2,755	
Taxes payable	16	351,545	284,101
Income and social contribution taxes payable		395,682	70,242
Payroll and related liabilities		588,627	443,859
Dividends payable		169,616	
Employee benefits	19	157	253
Environmental liabilities	20	60,419	21,928
Unrealized losses on financial instruments	15	5,245	
Liabilities held for sale			1,084,032
Other current liabilities		988,967	625,410
		8,504,253	7,714,120
<b>NON-CURRENT LIABILITIES</b>			
Long-term debt	13	11,545,658	14,457,315
Debentures	14	1,536,118	47,928
Related parties	18	1,350	
Deferred income taxes	8	118,368	82,686
Unrealized losses on financial instruments	15		1,267
Provision for tax, civil and labor liabilities	17	770,305	827,883
Environmental liabilities	20	72,228	63,263
Employee benefits	19	1,356,560	1,424,611
Obligations with FIDC	21	938,526	1,135,077
Other non-current liabilities		499,092	653,670
		16,838,205	18,693,700
<b>EQUITY</b>			
	22		
Capital		19,249,181	19,249,181
Treasury stocks		(280,426)	(76,085)
Capital reserves		11,597	11,597
Retained earnings		4,806,089	3,315,374
Transactions with non-controlling interests without change of control		(2,870,825)	(2,870,831)
Other reserves		4,814,988	4,015,965
EQUITY ATTRIBUTABLE TO THE EQUITY HOLDERS OF THE PARENT		25,730,604	23,645,201
<b>NON-CONTROLLING INTERESTS</b>			
		207,967	248,740
<b>EQUITY</b>			
		25,938,571	23,893,941
<b>TOTAL LIABILITIES AND EQUITY</b>			
		51,281,029	50,301,761

The accompanying notes are an integral part of these Consolidated Financial Statements.



Table of Contents

## GERDAU S.A.

## CONSOLIDATED STATEMENTS OF INCOME/(LOSS)

for the years ended December 31, 2018, 2017 and 2016

In thousands of Brazilian reais (R\$)

	Note	2018	2017	2016
<b>NET SALES</b>	24	46,159,478	36,917,619	37,651,667
Cost of sales	29	(40,010,100)	(33,312,995)	(34,187,941)
<b>GROSS PROFIT</b>		6,149,378	3,604,624	3,463,726
Selling expenses	29	(570,431)	(524,965)	(710,766)
Impairment loss on trade receivables	29	(9,914)		
General and administrative expenses	29	(1,082,449)	(1,129,943)	(1,528,262)
Other operating income	29	235,421	260,618	242,077
Other operating expenses	29	(270,413)	(168,887)	(114,230)
Impairment of non-financial assets	28		(1,114,807)	(2,917,911)
Gains and losses on assets held for sale and sales of interest in subsidiaries	3.4	(414,507)	(721,682)	(58,223)
Reversal of provision for tax liabilities, net	17		929,711	
Equity method investees	9	10,141	(34,597)	(12,771)
<b>INCOME (LOSS) BEFORE FINANCIAL INCOME (EXPENSES) AND TAXES</b>		4,047,226	1,100,072	(1,636,360)
Financial income	30	204,000	226,615	252,045
Financial expenses	30	(1,579,341)	(1,726,284)	(2,010,005)
Bonds Repurchases expenses	30	(223,925)		
Exchange variations, net	30	(322,621)	(4,057)	851,635
Reversal of interest on provision for tax liabilities, net	17		369,819	
Gains and losses on derivative financial instruments, net	30	32,092	(9,441)	(38,930)
<b>INCOME (LOSS) BEFORE TAXES</b>		2,157,431	(43,276)	(2,581,615)
Current	8	(629,209)	(313,758)	(110,511)
Deferred	8	798,160	18,367	(193,803)
Income and social contribution taxes		168,951	(295,391)	(304,314)
<b>NET INCOME (LOSS)</b>		2,326,382	(338,667)	(2,885,929)
<b>ATTRIBUTABLE TO:</b>				
Owners of the parent		2,303,868	(359,360)	(2,890,811)
Non-controlling interests		22,514	20,693	4,882
		2,326,382	(338,667)	(2,885,929)
Basic earnings/(loss) per share - preferred and common - (R\$)	23	1.35	(0.21)	(1.70)
Diluted earnings/(loss) per share - preferred and common - (R\$)	23	1.34	(0.21)	(1.70)

The accompanying notes are an integral part of these Consolidated Financial Statements.

F-7

---

Table of Contents

**GERDAU S.A.**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME/(LOSS)**  
**for the years ended December 31, 2018, 2017 and 2016**  
**In thousands of Brazilian reais (R\$)**

	2018	2017	2016
<b>Net income (loss) for the year</b>	<b>2,326,382</b>	<b>(338,667)</b>	<b>(2,885,929)</b>
<b>Items that may be reclassified subsequently to profit or loss</b>			
Other comprehensive income from associates and joint ventures	125,719	(16,745)	(251,195)
Cumulative translation adjustment	2,399,725	409,280	(5,036,586)
Recycling of cumulative translation adjustment to net income	(811,276)	(76,430)	(1,237,175)
Unrealized (Losses) Gains on net investment hedge	(1,491,534)	(148,560)	1,679,312
Cash flow hedges			
Unrealized Gains (Losses) on Financial Instruments, net of tax	11,947	(11,364)	212
	234,581	156,181	(4,845,432)
<b>Items that will not be reclassified subsequently to profit or loss</b>			
Remeasurement of defined benefit pension plan, net of tax	152,345	(115,880)	(42,181)
	152,345	(115,880)	(42,181)
<b>Other comprehensive income (loss), net of tax</b>	<b>386,926</b>	<b>40,301</b>	<b>(4,887,613)</b>
<b>Total comprehensive income (loss) for the year, net of tax</b>	<b>2,713,308</b>	<b>(298,366)</b>	<b>(7,773,542)</b>
<b>Total comprehensive income/(loss) attributable to:</b>			
Owners of the parent	2,668,728	(325,260)	(7,743,624)
Non-controlling interests	44,580	26,894	(29,918)
	<b>2,713,308</b>	<b>(298,366)</b>	<b>(7,773,542)</b>

The items in the statement of comprehensive income/(loss) are presented net of taxes, where applicable. The tax effects of these items are presented in note 8.

The accompanying notes are an integral part of these Consolidated Financial Statements.



Table of Contents**GERDAU S.A.****CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY**

for the years ended December 31, 2018, 2017 and 2016

in thousands of Brazilian reais (R\$)

	Retained earnings						Attributed to parent company's interest			Gains and losses on financial instruments
	Capital	Treasury stocks	Capital Reserve	Legal reserve	Tax Incentives Reserve	Investments and working capital reserve	Retained earnings	Transactions with non-controlling interests without change of control	Gains and losses on net investment hedge	
<b>Balance as of January 1, 2016</b>	19,249,181	(383,363)	11,597	628,228	611,531	5,668,300		(2,877,488)	(6,083,288)	
<b>2016 Changes in Equity</b>										
Net loss							(2,890,811)			
Other comprehensive income (loss) recognized in the year									1,678,852	
Total comprehensive income (loss) recognized in the year							(2,890,811)		1,678,852	
Stock option expenses recognized in the year										
Treasury stocks		(95,343)								
Stock option exercised during the year		10,461					(4,965)			
Assignment of preferred shares		369,499					(163,699)			
Effects of interest changes in subsidiaries								4,153		
Destination of net income proposed to the shareholders										
Absorption of net loss proposed to the shareholders							(2,890,811)	2,890,811		
Dividends/interest on capital							(85,377)			
<b>Balance as of December 31, 2016 (Note 22)</b>	19,249,181	(98,746)	11,597	628,228	611,531	2,523,448		(2,873,335)	(4,404,436)	
<b>2017 Changes in Equity</b>										
Net loss							(359,360)			
Other comprehensive income (loss)									(148,548)	

Edgar Filing: GERDAU S.A. - Form 20-F

recognized in the year									
Total comprehensive income (loss) recognized in the year							(359,360)		(148,548)
Stock option expenses recognized in the year									
Stock option exercised during the year	22,661						(3,011)		
Effects of interest changes in subsidiaries								2,504	
Destination of net income proposed to the shareholders									
Absorption of net loss proposed to the shareholders							(359,360)	359,360	
Dividends/interest on capital							(85,462)		
<b>Balance as of December 31, 2017 (Note 22)</b>	19,249,181	(76,085)	11,597	628,228	611,531	2,075,615		(2,870,831)	(4,552,984)
Effects of IFRS 9 adoption, net of taxes									
<b>Adjusted Balance as of January 1, 2018 (Note 22)</b>	19,249,181	(76,085)	11,597	628,228	611,531	2,075,615		(2,870,831)	(4,552,984)
<b>2018 Changes in Equity</b>									
Net income							2,303,868		
Other comprehensive income (loss) recognized in the year									(1,491,274)
Total comprehensive income (loss) recognized in the year							2,303,868		(1,491,274)
Assignment of preferred shares	11,622						7,362		
Stock option expenses recognized in the year									
Treasury stocks	(243,396)								
Effects of IAS29 adoption in the subsidiary of Argentina									
Stock option exercised during the year	27,433						(4,156)		
Effects of interest changes in subsidiaries								6	
Complementary Dividends							(51,020)		
Destination of net income proposed									

Edgar Filing: GERDAU S.A. - Form 20-F

to the									
shareholders									
Legal reserve					115,193			(115,193)	
Tax incentives									
reserve					17,051			(17,051)	
Investments and									
working capital									
reserve						1,406,285		(1,406,285)	
Dividends/interest									
on capital								(765,339)	
<b>Balance as of</b>									
<b>December 31,</b>									
<b>2018 (Note 22)</b>	19,249,181	(280,426)	11,597	743,421	628,582	3,434,086		(2,870,825)	(6,044,258)

The accompanying notes are an integral part of these Consolidated Financial Statements.

Table of Contents**GERDAU S.A.****CONSOLIDATED STATEMENTS OF CASH FLOWS**

for the years ended December 31, 2018, 2017 and 2016

In thousands of Brazilian reais (R\$)

	Note	2018	2017	2016
<b>Cash flows from operating activities</b>				
Net income (loss) for the year		2,326,382	(338,667)	(2,885,929)
Adjustments to reconcile net income for the year to net cash provided by operating activities				
Depreciation and amortization	29	1,891,814	2,092,551	2,535,955
Impairment of Assets	28		1,114,807	2,917,911
Equity method investees	9	(10,141)	34,597	12,771
Exchange variation, net	30	322,621	4,057	(851,635)
(Gains) Losses on financial instruments, net	30	(32,092)	9,441	38,930
Post-employment benefits		189,603	192,724	229,767
Stock based compensation		41,186	35,576	46,683
Income tax	8	(168,951)	295,391	304,314
Gains on disposal of property, plant and equipment		(41,109)	(69,510)	(43,340)
Results in operations with subsidiaries	3.4	414,507	721,682	58,223
Impairment loss on trade receivables	5	9,914	18,342	68,781
Provision for tax, labor and civil claims	17	(56,409)	(110,281)	347,882
Reversal of contingent liabilities, net	17		(929,711)	
Interest income on short-term investments		(49,745)	(75,387)	(107,980)
Interest expense on loans	30	1,177,686	1,323,448	1,540,797
Reversal of monetary update of contingent liabilities, net	17		(369,819)	
Interest on loans with related parties	18	(545)	(95)	2,457
Provision (Reversal) for net realisable value adjustment in inventory	6	8,228	(20,195)	(31,492)
		6,022,949	3,928,951	4,184,095
<b>Changes in assets and liabilities</b>				
Decrease (Increase) in trade accounts receivable		71,631	(54,690)	64,805
(Increase) Decrease in inventories		(2,427,473)	(1,269,455)	794,591
Increase in trade accounts payable		900,388	800,164	110,466
Increase in other receivables		(118,988)	(371,745)	(275,938)
Decrease in other payables		(1,160,626)	(56,909)	(287,487)
Dividends from joint ventures		55,357	40,644	124,495
Purchases of trading securities		(1,512,123)	(2,390,104)	(880,436)
Proceeds from maturities and sales of trading securities		1,629,595	2,905,411	1,089,972
<b>Cash provided by operating activities</b>		3,460,710	3,532,267	4,924,563
Interest paid on loans and financing		(1,162,364)	(1,330,116)	(1,240,165)
Income and social contribution taxes paid		(298,663)	(126,023)	(168,032)
<b>Net cash provided by operating activities</b>		1,999,683	2,076,128	3,516,366
<b>Cash flows from investing activities</b>				
Purchases of property, plant and equipment	10	(1,194,934)	(873,329)	(1,323,891)
Proceeds from sales of property, plant and equipment, investments and other intangibles		4,021,251	554,457	308,694
Purchases of other intangibles	12	(67,388)	(37,939)	(54,044)
Advance for future investment in joint venture		(375,456)		

Edgar Filing: GERDAU S.A. - Form 20-F

Capital increase in joint venture		(178,670)	
<b>Net cash provided (used) in investing activities</b>	2,383,473	(535,481)	(1,069,241)
<b>Cash flows from financing activities</b>			
Purchase of treasury shares	(243,396)		(95,343)
Dividends and interest on capital paid	(599,099)	(86,386)	(85,962)
Proceeds from loans and financing	2,560,789	3,265,860	2,455,371
Repayment of loans and financing	(6,000,433)	(7,241,401)	(4,605,406)
Intercompany loans, net	25,755	5,797	(6,492)
<b>Net cash used in financing activities</b>	(4,256,384)	(4,056,130)	(2,337,832)
Exchange variation on cash and cash equivalents	208,034	7,438	(693,990)
Increase (Decrease) in cash and cash equivalents	334,806	(2,508,045)	(584,697)
Cash and cash equivalents at beginning of year	2,555,338	5,063,383	5,648,080
<b>Cash and cash equivalents at end of year</b>	2,890,144	2,555,338	5,063,383

The accompanying notes are an integral part of these Consolidated Financial Statements.

Table of Contents

**NOTE 1 - GENERAL INFORMATION**

Gerdau S.A. is a publicly traded corporation (*sociedade anônima*) with its corporate domicile in the city of São Paulo, Brazil. Gerdau S.A. and subsidiaries (collectively referred to as the Company) is a leading producer of long steel in the Americas and one of the largest suppliers of special steel in the world. In Brazil, the Company also produces flat steel and iron ore, activities which expanded the product mix and made its operations even more competitive. The Company believes it is the largest recycler in Latin America and around the world it transforms each year millions of tons of scrap into steel, reinforcing its commitment to sustainable development of the regions where it operates. Gerdau is listed on the São Paulo, New York and Madrid stock exchanges.

The Consolidated Financial Statements of Gerdau S.A. and subsidiaries were approved by the Board of Directors on March 28, 2019.

**NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING PRACTICES**

**2.1 - Basis of Presentation**

The Company's Consolidated Financial Statements have been prepared in accordance and are in compliance with the International Financial Reporting Standards (IFRS) issued by *International Accounting Standards Board* (IASB).

The preparation of the Consolidated Financial Statements in accordance with IFRS requires Management to make accounting estimates. The areas that involve judgment or use of estimates relevant to the Consolidated Financial Statements are stated in Note 2.17. The Consolidated Financial Statements have been prepared using historical cost as its basis, except for the valuation of certain financial instruments, which are measured at fair value.

The Company adopted all applicable standards and revisions of standards and interpretations issued by the IASB or the IFRS Interpretations Committee that are effective as of December 31, 2018.

**a) Investments in Subsidiaries**

The Company's consolidated financial statements include the financial statements of Gerdau S.A. and all its subsidiaries. The Company controls an entity when it is exposed or has the right to variable returns arising from their involvement with the entity and has the ability to affect those returns due to the power exercised over the entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Company. They are deconsolidated from the date that control ceases.

Third parties' interests in equity and net income of subsidiaries are reported separately in the consolidated balance sheet and in the consolidated statement of income, respectively, under the account "Non-controlling interests".

For business combinations, the assets, liabilities, and contingent liabilities of a subsidiary are reported at their respective fair value on the date of acquisition. Any excess of the acquisition cost over the fair value of the identifiable net assets acquired is recorded as goodwill. When the acquisition cost is less than the fair value of the net assets identified, the difference is recorded as a gain in the statement of income for the year in which the acquisition took place. The non-controlling interests are presented based on the proportion of the fair value of the identified assets and liabilities acquired. Intercompany transactions and balances are eliminated in the consolidation process. Gains or losses resulting from transactions among consolidated entities of the Company are also eliminated.

#### **b) Investments in Joint ventures and Associate companies**

Joint ventures are those in which the control is held jointly by the Company and one or more partners. An associate company is one in which the Company exercises significant influence, but over which it does not have control. Investments in joint ventures and associate companies are recorded under the equity accounting method.

#### **c) Equity Method**

According to this method, investments are recognized in the consolidated balance sheet at acquisition cost and are adjusted subsequently based on the Company's share in the earnings and in other changes in the net assets of the Associates and Joint Ventures. The balances of the investments can also be reduced due to impairment losses. Furthermore, dividends received from these companies are recorded as reductions in the value of the investments.

Table of Contents

**2.2 Foreign Currency Translation**

**a) Functional and Reporting Currency**

The functional currency of an entity is the currency of the primary economic environment where it operates. The Consolidated Financial Statements are presented in Brazilian Reais (R\$), which is the functional and reporting currency of the Company. All balances were rounded to the nearest thousand, unless otherwise stated.

**b) Transactions and Balances**

For purposes of the Consolidated Financial Statements, the balances of each subsidiary of the Company are converted into Brazilian reais, which is the functional currency of the Company and the reporting currency of its Consolidated Financial Statements, at the exchange rates at the dates of the transactions.

**c) Group Companies**

The results of operations and financial position of all subsidiaries included in the consolidated financial statements, along with equity investments, which have functional currencies different from the Company's reporting currency are translated into the reporting currency as follows:

- i) Asset and liability balances are translated at the exchange rate in effect at the balance sheet date;
- ii) Income and expenses are translated using the average monthly exchange rates for the year;
- iii) Translation gains and losses resulting from the above methodology are recognized in Equity, in the Statement of Comprehensive Income, in the account named Other reserves - Cumulative translation adjustment ; and
- iv) The amounts presented in the cash flow are extracted from the converted changes in assets, liabilities and results.

**d) Hyperinflation in Venezuela**



Venezuela is considered a hyperinflationary economy and, for this reason, the financial statements of the Company's subsidiary located in this country have been adjusted so that the amounts are stated in the measurement currency unit as of the end of the year, which considers the effects measured by the IPC - *Índice de Preços ao Consumidor* (Consumer Price Index) of Venezuela. The exchange rate used to translate the Venezuela subsidiary financial statements from local currency (Sovereign Bolivar in 2018 and Strong Bolivar in 2017) to Real considers the local exchange rate known as SIMADI (*Sistema Marginal de Divisas*), which is used in conversions from Strong Bolivar to American Dollar as a reference to local currency translation into Real. This rate is equivalent to 164.70 Sovereign Bolivars each 1 Real as of December 31, 2018 (1,011.19 Strong Bolivar to each 1 Real as of December 31, 2017).

#### **d) Hyperinflation in Argentina**

In July 2018, considering that the accumulated inflation in the last three years in Argentina was over 100%, the application of the Financial Reporting in Hyperinflationary Economies (IAS 29) is now required. In accordance with IAS 29, non-monetary assets and liabilities, Equity and the statement of income of subsidiaries operating in highly inflationary economies are adjusted by the change in the Consumer price index of the currency. As a result of that, the Company applied the concepts of IAS 29 to its subsidiaries in Argentina. The non-monetary assets and liabilities recorded at historical cost and the Equity of the subsidiaries in Argentina were updated for inflation. The statements of income for the year ended on 2017, and the respective balance sheets of the subsidiaries in Argentina, were not restated.

The impacts of hyperinflation resulting from changes in general purchasing power up to June, 30 2018 were reported as equity adjustment and the impacts of changes in general purchasing power as from July 1, 2018 were reported as financial result in the statements of income of the Company. As a result of the above effects as of December 31, 2018, the Company recognized R\$ 507,887 in its equity, net of tax effects, and in its consolidated statements of income, the amounts of R\$ (38,105) in the financial result, and R\$ (29,455) in the net income of the year.

### **2.3 - Financial Assets**

At initial recognition, a financial asset is classified as measured at amortized cost, at fair value through profit or loss or at fair value through other comprehensive income. Financial assets are not reclassified subsequent to initial recognition, unless the Company changes the business model for the management of financial assets. The Company performs an evaluation of the business model objective in which a financial asset is held in the portfolio because this better reflects the way in which the business is managed.

Table of Contents

**a) Financial assets at amortized cost**

These assets are measured subsequently to initial recognition at the amortized cost using the effective interest method. The amortized cost is reduced by impairment losses. Interest income, foreign exchange gains and losses and impairment are recognized directly in income. Any gain or loss on derecognition is recognized on statement of income.

**b) Financial assets measured at fair value through profit or loss**

These assets are measured subsequently to initial recognition at the fair value. The net result, including interest, is recognized directly in income.

**c) Financial assets measured at fair value through other comprehensive income**

These assets are measured subsequently to initial recognition at fair value. Interest income calculated using the effective interest method, exchange gains and losses and impairment are recognized in the statement of income. Other net results are recognized in other comprehensive income. In derecognition, the accumulated result in other comprehensive income is reclassified to the statement of income.

**d) Impairment of financial assets**

The Company measures the allowance for doubtful accounts in an amount equal to the Expected credit loss. In determining whether the credit risk of a financial asset has increased significantly since the initial recognition and in estimating the expected credit losses, the Company considers reasonable and supportable information that is relevant and available without undue cost or effort. This includes quantitative and qualitative information and analysis, based on the Company's historical experience, credit assessment and considering forward-looking information. The provision for credit risks was calculated based on the credit risk analysis, which includes the historical losses, the individual situation of the clients, the situation of the economic group to which they belong, the real guarantees for the debts and the evaluation of the legal advisors and is considered sufficient to cover possible losses on amounts receivable, in addition to a prospective assessment that takes into account the change or expectation of change in economic factors that affect expected credit losses, which will be determined based on probabilities weighted. The Company presents the impairment of the financial assets (Provision for credit risk) in the Statement of Income and in the line of Impairment loss on trade receivables.

**e) Derecognition**

The Company derecognizes a financial asset when expire the contractual rights of the cash flows of the asset, or when the Company transfers the contractual rights of that cash flows in a transaction in which substantially all the risks and benefits of the financial asset are transferred or in which the Company neither transfers nor maintains substantially all the risks and benefits of the financial asset and also does not retain control over the financial asset.

**f) Compensation**

Financial assets and liabilities are offset and the net amount presented in the balance sheet when, and only when, the Company currently has a legally enforceable right to offset the amounts and intends to settle them on a net basis or to realize the asset and settle the liability simultaneously.

**g) Financial Instruments Accounting Policy applicable as from January 1st, 2018**

A financial asset is measured at amortized cost if it meets both of the following conditions and is not designated as measured at fair value through profit or loss: it is maintained within a business model whose objective is to maintain financial assets to receive contractual cash flows; and its contractual terms generate, at specific dates, cash flows that are related only to payment of principal and interest on the outstanding principal amount.

A debt instrument is measured at fair value through other comprehensive income if it meets both of the following conditions and is not designated as measured at fair value through profit or loss: it is maintained within a business model whose objective is achieved both by receipt of contractual cash flows and sale of financial assets; and its contractual terms generate, on specific dates, cash flows that are only payments of principal and interest on the outstanding principal amount. In the initial recognition of an investment in an equity instrument that is not held for trading, the Company may irrevocably choose to present subsequent changes in the fair value of the investment in other comprehensive income. This choice is made investment by investment.

Table of Contents

The Company performs an evaluation of the business model objective in which a financial asset is held in the portfolio because this better reflects the way in which the business is managed and the information is provided to Management. The information considered includes: the policies and objectives stipulated for the portfolio and the practical operation of those policies. They include the question of whether Management's strategy focuses on obtaining contractual interest income, maintaining a certain interest rate profile, matching the duration of financial assets with the duration of related liabilities or expected outflows of cash, or the realization of cash flows through the sale of assets; how the performance of the portfolio is evaluated and reported to the Company's Management; the risks that affect the performance of the business model (and the financial asset held in that business model) and the manner in which those risks are managed; the frequency, volume and timing of sales of financial assets in prior periods, the reasons for such sales and their expectations about future sales.

**h) Evaluation on whether contractual cash flows are only payments of principal and interest**

For the purposes of this valuation, the principal is defined as the fair value of the financial asset at the initial recognition. Interest is defined as a consideration for the time value of money and for the credit risk associated with the principal amount outstanding over a given period of time and for the other underlying risks and costs of borrowing (e.g. liquidity risk and costs administrative costs), as well as a profit margin.

The Company considers the contractual terms of the instrument to assess whether contractual cash flows are only principal and interest payments. This includes assessing whether the financial asset contains a contractual term that could change the timing or value of the contractual cash flows so that it would not meet that condition. In making this assessment, the Company considers: contingent events that modify the value or the time of cash flows; terms that may adjust the contractual rate, including variable rates; the prepayment and the extension of the term; and terms that limit the Company's access to cash flows of specific assets (for example, based on the performance of an asset).

The prepayment is consistent with the principal and interest payments criterion if the prepayment amount represents, for the most part, unpaid principal and interest amounts on the outstanding principal amount - which may include additional compensation the early termination of the contract.

**i) Financial assets Accounting Policy applicable before January 1st, 2018**

The Company classified the financial assets in the following categories: loans and receivables; financial assets measured at fair value through profit or loss. Financial assets classified as loans and receivables used amortized cost by the effective interest method as a measurement, and financial assets measured at fair value through profit or loss were measured at fair value and changes in fair value, including interest or dividend income, and were recognized in profit or loss.

**2.4 Inventories**

Inventories are measured at the lower of historical cost of acquisition or production and net realizable value. The acquisition and production costs include transportation, storage and non-recoverable taxes.

Net realizable value is the estimated sale price in the ordinary course of business less the estimated costs of completion and selling expenses directly related. Information regarding the allowance for adjustments to net realizable value is presented in note 6.

## **2.5 - Property, Plant and Equipment**

Property, plant and equipment are stated at historical cost, monetarily adjusted when applicable, less depreciation, except for land, which is not depreciated. The Company recognizes monthly to the construction costs of qualified assets, which are assets that, necessarily, require a substantial period of time to be finished for its intended use, the borrowing costs as part of the acquisition cost of the property, plant and equipment under construction based on the following capitalization criteria: (a) the capitalization period begins when the property, plant and equipment item is under construction in process and the capitalization of borrowing costs ceases when the asset is available for use; (b) borrowing costs are capitalized considering the weighted average rate of loans existing on the capitalization date or a specific rate, in the case of loans for the acquisition of property, plant and equipment; (c) borrowing costs capitalized do not exceed the interest expenses during the capitalization period; and (d) capitalized borrowing costs are depreciated considering the same criteria and useful life determined for the property, plant and equipment item to which it was capitalized.

Depreciation is calculated under the straight-line method at rates that take into consideration the estimated useful life of the asset, its level of utilization and the estimated residual value of the asset at the end of its useful life. The estimated residual value and useful life of the assets are reviewed and adjusted, if necessary, at each year-end. Subsequent costs are added to the carrying amount of property, plant and equipment or recognized as a specific item, as appropriate, only if the economic benefits associated to these items are

Table of Contents

probable and the amounts can be reliably measured. The carrying amount of replaced items is written-off. Other repairs and maintenance are recognized directly in income when incurred.

Mining exploration rights are classified as Land and Buildings in the Property, plant and equipment account. Exploration expenditures are recognized as expenses until the feasibility of mining activity is established and thereafter subsequent costs are capitalized. Costs for the development of new iron ore reserves or to expand the capacity of operating mines are capitalized and amortized based on the amount of iron ore extracted. Stripping costs (costs associated with removal of waste and other residual materials) incurred during the development phase of a mine, before production phase, are registered as part of the depreciable cost of asset. Subsequently, these costs are depreciated over the useful life of the mine. Spending on waste removal, after the start of production of the mine, are treated as production costs. Depletion of mines is calculated based on the amount of ore extracted.

The net book value of property, plant and equipment items is immediately impaired to its recoverable amount when the residual balance exceeds the recoverable amount.

## **2.6 Goodwill**

Goodwill represents the excess of the acquisition cost over the fair value net of the assets acquired, liabilities assumed and identifiable contingent liabilities of a subsidiary, joint venture, or associate company, at the respective acquisition date.

Goodwill is recorded as an asset and recorded under Goodwill account. Goodwill is not amortized and is subject to impairment tests annually or whenever there are indications of potential impairment. Any impairment loss is recorded as an expense in the income statement and cannot be reversed. Goodwill is allocated to the operating segments, which represents the lowest level at which goodwill is monitored by management.

Goodwill that forms part of the carrying amount of an investment in an associate or a joint venture is not separately recognized. The entire carrying amount of the investment in associate or joint venture is tested for impairment as a single asset, by comparing its recoverable amount (higher of value in use and fair value less costs to sell) with its carrying amount, including impairment indicators described in IFRS 9.

When a subsidiary, joint venture or associate is sold, goodwill is included in the determination of gains and losses on disposal.

## **2.7 Other Intangible Assets**

Other intangible assets are stated at acquisition cost, less accumulated amortization and impairment losses, when applicable. Intangible assets consist mainly of assets which represent the capacity to generate economic benefits from companies acquired based on relationships with customers and suppliers, software and others. Intangible assets with definite useful lives are amortized taking into consideration their actual use or a method that reflects their consumption of economic benefits. The net book value of intangible assets is impaired immediately

to its recoverable value when the residual balance exceeds the recoverable amount (note 2.8).

Intangible assets acquired in a business combination are recorded at fair value, less accumulated amortization and impairment losses, when applicable. Intangible assets that have a defined useful life are amortized over their useful lives using an amortization method that reflects the economic benefit of the intangible asset and is recorded in the cost of sales account. The intangible relationship with customers and suppliers is amortized based on an accelerated method that considers the expected future economic benefit provided over time by these new acquired customers and suppliers.

The Company reviews the amortization period and amortization method for its intangible assets with definite useful lives at the end of each year.

## **2.8 Provision for Impairment of Assets and Reversal of Impairment**

At each balance sheet date, the Company performs an assessment to determine whether there is evidence that the carrying amount of long-lived assets might be impaired. If such evidence is identified, the recoverable amount of the assets is estimated by the Company. The recoverable amount of an asset is determined as the higher of: (a) its fair value less estimated costs to selling and (b) its value in use. The value in use is measured based on discounted cash flows (before taxes) derived from the continuous use of the asset until the end of its estimated useful life. Regardless of whether or not there is any indication that the carrying amount of the asset may be impaired, the balances of goodwill arising from business combinations and intangible assets with indefinite useful lives are tested for impairment at least once a year in December.

When the carrying amount of the asset exceeds its recoverable amount, the Company recognizes a reduction in the book value of the asset (Impairment). The reduction to the recoverable amount of the asset is recorded as an expense. Except for an impairment of goodwill, a reversal of a previously recorded impairment loss is required. Reversal in these circumstances is limited to the amount of

Table of Contents

the depreciated balance of the asset at the time of the reversal, determined as if the impairment had not been recorded, as discussed in note 28.1.

The Company does not believe there is a reasonable likelihood that may occur a material change in the estimates or assumptions used to calculate long-lived asset impairment losses. However, if actual results are not consistent with estimates and assumptions used in estimating future cash flows and asset fair values, the Company may be exposed to losses that could be material.

## **2.9 Financial Liabilities and Equity Instruments**

### **a) Financial liabilities**

Financial liabilities are classified as amortized cost or at fair value through profit or loss. A financial liability is classified as fair value through profit or loss if it is classified as held for trading, it is a derivative or it is designated as such at initial recognition. Financial liabilities measured at fair value through profit or loss are measured at fair value and the net result, including interest, is recognized in the income statement. Other financial liabilities are subsequently measured at amortized cost using the effective interest method. Interest expense, exchange gains and losses are recognized in income.

### **b) Derecognition**

The Company derecognizes a financial liability when its contractual obligation is withdrawn, canceled or expires. The Company also derecognizes a financial liability when the terms are modified and the cash flows of the modified liability are substantially different, in which case a new financial liability based on the modified terms is recognized at fair value. In the derecognition of a financial liability, the difference between the carrying amount extinguished and the consideration paid (including any non-cash assets transferred or liabilities assumed) is recognized in the income statement.

### **c) Derivative Instruments and hedging**

The Company enters into derivative financial instruments mainly to manage its exposure to fluctuation in interest rates and exchange rates. The Company measures its derivative financial instruments, based on quotations obtained from market participants, at fair value at the balance sheet date.

Changes in the fair value of a derivative that is highly effective and that is designated and qualifies as a cash flow hedge or a net investment hedge are recorded in the statement of comprehensive income.



The Company assesses, both at the beginning of hedge coverage and on an ongoing basis, whether the derivatives used in hedge transactions are highly effective in offsetting changes in the fair value or cash flows of hedged items. When a cash flow hedge instrument is sold, terminated, expired or exercised, the hedge is discontinued prospectively, but the cumulative unrealized gain or loss is recognized in the comprehensive income statement. The cumulative gain and loss is transferred from the comprehensive income and recognized in the income statement when the hedged transaction is recognized in the statement of income. When no more than one transaction is expected to occur, the accumulated gain or loss is immediately transferred to the income statement. In cases of net investment hedges, the amount recorded in the statement of comprehensive income is written off and recognized in the statement of income when the disposal of the hedged investment occurs. In addition, changes in the fair value of financial instruments not characterized as hedges are recognized in the line of (Loss) Gains on financial instruments, net, in the statement of income.

**d) Equity instruments**

The equity component is initially recognized by the difference between the fair value of the compound financial instrument as a whole and the fair value of the liability component. Any directly attributable transaction costs are allocated to the liability and equity components in proportion to their initial carrying amounts.

**2.10 Current and Deferred Income and Social Contribution Taxes**

Current income and social contribution tax expense is calculated in conformity with enacted tax rate in effect at the balance sheet date in the countries where the Company's subsidiaries, associates and joint venture operate and generate taxable income. Management periodically evaluates positions taken in relation to tax matters which are subject to interpretation and recognizes a provision when there is an expectation of payment of income tax and social contribution in accordance with the tax bases. The expense for income tax and social contribution taxes comprises current and deferred taxes. Current tax and deferred tax are recognized in income unless they are recognized for a business combination, or for items directly recognized in equity through other comprehensive income.

Table of Contents

Current tax is the estimated tax payable or receivable on the taxable income or loss for the year, at the tax rates effective at the balance sheet date. Deferred income tax and social contribution are recognized in its total on the differences generated between assets and liabilities recognized for tax purposes and corresponding to amounts recognized in the Financial Statements. However, deferred income and social contribution taxes are not recognized arising from the initial recognition of assets and liabilities in a transaction other than a business combination and that do not affect the tax basis. Income and social contribution taxes are determined based on tax rates (and laws) effective at the balance sheet date and applicable when the respective income and social contribution taxes is paid. Deferred income and social contribution tax assets are recognized only to the extent that it is probable that there will be taxable income for which the temporary differences can be used and tax losses can be compensated.

Deferred tax assets recorded for tax loss carryforwards are supported by projections of taxable income based on technical feasibility studies submitted annually to the Board of Directors of the Company and its subsidiaries, when applicable. These studies consider historical profitability of the Company and its subsidiaries, expectations of continuous profitability and estimates of the recovery of deferred tax assets over future years. Other deferred tax assets arising from temporary differences, mainly tax provision, are recognized according to their estimate of realization. Deferred income tax and social contribution assets are reviewed at each reporting date and will be reduced to the extent that their realization is not more likely than not based on future taxable income.

## **2.11 Employee Benefits**

The Company has several employee benefit plans including pension and retirement plans, health care benefits, profit sharing, bonus, and share-based payment, as well as other retirement and termination benefits. The main benefit plans granted to the Company's employees are described at notes 19 and 25.

The actuarial obligations related to the pension and retirement benefits and the actuarial obligations related to the health care plans are recorded based on actuarial calculations performed every year by independent actuaries, using the projected unit credit method, net of the plan assets, when applicable, and the related costs are recognized over the employees' service period. Any employee benefit plan surpluses are also recognized up to the probable amount of reduction in future contributions by the Company.

Actuarial remeasurement arising from adjustments and changes in actuarial assumptions of the pension and retirement benefit plans and actuarial obligations related to the health care plan are recognized directly in the Statement of Comprehensive Income as described in Note 19.

In accounting for pension and post-retirement benefits, several statistical and other factors that attempt to anticipate future events are used to calculate plan expenses and liabilities. These factors include discount rate assumptions, return on plan assets, future increases in health care costs, and rate of future compensation increases. In addition, the Company and its actuarial uses other factors whose measurement involves judgment are used such as withdrawal, turnover, and mortality rates. The actuarial assumptions used by the Company may differ materially from actual results in future periods due to changing market and economic conditions, regulatory events, judicial rulings, higher or lower withdrawal rates, or longer or shorter participant life spans.

## **2.12 - Other Current and Non-current Assets and Liabilities**

Other current and non-current assets and liabilities are recorded at their realizable amounts (assets) and at their known or estimated amounts plus accrued charges and monetary adjustments (liabilities), when applicable.

### **2.13 Related-Party Transactions**

Loan agreements between the entities in Brazil and abroad are adjusted by contractual financial charges plus foreign exchange variation, when applicable. These contracts have an expiration date, with the possibility of extension of time by agreement between the parties. Sales and purchases of raw materials and products are made under terms and conditions contractually established between the parties.

### **2.14 Dividends and Interest on equity**

Dividend payments are recognized as liabilities at the time dividends are approved by the shareholders of Gerdau S.A. The bylaws of Gerdau S.A. required dividends of not less than 30% of the annual net income adjusted by 5% representing the constitution of legal reserve, and the constitution of tax incentives reserve; therefore, Gerdau S.A. records a liability at year-end for the minimum dividend amount that has not yet been paid during the year up to the limit of the mandatory minimum dividend described above.

Table of Contents

**2.15 Revenue Recognition**

Net sales are presented net of taxes and discounts. Revenues from sales of products are recognized to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The related costs of freight are included in cost of sales.

**2.16 - Investments in Environmental Protection and Environmental liabilities**

Environmental costs that relate to current operations are expensed or capitalized as appropriate. Environmental costs that relate to an existing condition caused by past operations, and which do not contribute to current or future revenue generation or cost reduction are recorded as expense. Liabilities are recorded when environmental assessments or remedial efforts are probable and the cost can be reasonably estimated based on discussions with the environmental authorities and other assumptions relevant to the nature and extent of the remediation that may be required. The ultimate cost to the Company is dependent upon factors beyond its control such as the scope and methodology of the remedial action requirements to be established by environmental and public health authorities, new laws or government regulations, rapidly changing technology and the outcome of any potential related litigation. Environmental liabilities are adjusted to present value when the aggregate amount of the obligation and the amount and timing of cash disbursements are established or can be reliably estimated.

**2.17 - Use of Judgements and Estimates**

The preparation of the Consolidated Financial Statements requires estimates to record certain assets, liabilities and other transactions. To make these estimates, Management uses the best information available on the date of preparation of the Consolidated Financial Statements and the experience of past and/or current events, also considering assumptions related to future events. As such, the Consolidated Financial Statements include estimates with respect to the recoverable amount of long-lived assets (note 28), with respect to the need and the amount of provisions for tax, civil and labor liabilities (note 17), estimates in selecting interest rates, return on assets, mortality tables and expectations for salary increases (note 19), and long-term incentive plans through the selection of the evaluation model and rates (note 25). Actual results could differ from those estimates.

**2.18 - Business Combinations for the Financial Statements**

**a) Step-acquisitions in which control is obtained**

When a business combination is achieved in stages, the interest previously held by the Company in the acquired entity is remeasured at fair value at acquisition date (i.e. the date when the Company acquires the control) and the resulting gain or loss, if any, is recognized in profit or loss. Amounts related to the Company's interest in the acquired company before the acquisition date, and that were recognized in Other comprehensive income, are reclassified to profit or loss, where such treatment would be appropriate if that interest were disposed of.

**b) Acquisitions in which control is obtained initially**

Acquisitions of businesses are accounted for under the acquisition method. The cost of the acquisition is measured at the fair values (at the date of the transaction) of the assets transferred, liabilities incurred or assumed and equity instruments issued by the Company in exchange for control of the acquired business entity. The acquiree's identifiable assets, liabilities and contingent liabilities are recognized at their fair values at the acquisition date. The interest of non-controlling shareholders in the acquiree is initially measured at the non-controlling shareholders' proportion of the net fair value of the assets, liabilities and contingent liabilities recognized. Expenses related to the acquisition are recognized in the income statement when incurred.

**c) Increases/decreases in non-controlling interests**

Subsequent purchases, after the Company has obtained control, are treated as acquisitions of shares from non-controlling shareholders: the identifiable assets and liabilities of the acquired entity are not subject to a further revaluation and the positive or negative difference between the cost of such subsequent acquisitions and the net value of the additional proportion of the company is accounted for within equity.

**d) Loss of control of a subsidiary**

When control of a subsidiary is lost as a result of a transaction, event or other circumstance, the Company derecognizes all assets, liabilities and non-controlling interests at their carrying amount. Any retained interest in the former subsidiary is recognized at its fair value at the date that control is lost. This fair value is reflected in the calculation of the gain or loss on disposal attributable to the parent, and becomes the initial carrying amount for subsequent accounting for the retained interest.

Table of Contents

**2.19 Segment Information**

The bodies responsible for making operational decisions, allocating resources and evaluating performance include the Board of Executive Officers and the Board of Directors. The information presented to the senior management with the respective performance of each segment is derived from the records kept in accordance with accounting practices, with some reallocations between the segments.

The Company's segments are as follows: Brazil Operations (includes operations of steel and iron ore in Brazil, except Special Steel), North America Operations (includes all operations in North America, including the joint venture in Mexico and associate company in Mexico, with the exception of Special Steel), South America Operations (includes all operations in South America, except Brazil and includes the Joint venture in Dominican Republic and Colombia) and Special Steel Operations (including special steel operations in Brazil and in the United States and the joint venture in Brazil).

**2.20 Earnings per Share**

The tables presented in note 23 reconcile net income to the amounts used to calculate basic and diluted earnings per share. The Company has no instruments considered antidilutive that should be excluded from the calculation of diluted EPS.

The calculation of basic EPS has been based on the profit attributable to shareholders and weighted-average number of shares outstanding. The calculation of diluted EPS has been based on the profit attributable to shareholders and weighted-average number of shares outstanding after adjustment for the effects of all dilutive potential shares. The average market value of the Company's shares for the purpose of calculating the dilutive effect of share options was based on quoted market prices for the year during which the options were outstanding.

**2.21 Long-term incentive plans**

The Company settles the stock options plans by delivering its own shares, which are held in treasury until the exercise of the options by the employees. Additionally, the Company has also granted the following long-term incentive plans: Stock Options, Restricted Shares, Share Appreciation Rights and Performance Shares, as presented in note 25.

**2.22 Assets and liabilities held for sale**

The Company presents assets and liabilities of entities held for sale in specific lines of the Balance Sheet, denominated Assets held for sale and Liabilities held for sale, respectively, until the closing of the sale operation, which is expected to be completed in up to one year from the date of classification as held for sale. The Company measures the net assets classified as held for sale at the lower of their carrying amount and fair value less costs to sell.

**2.23 - New IFRS and Interpretations of the IFRIC (International Financial Reporting Interpretations Committee)**

The Company adopted IFRS 15 - Revenue from Contracts with Customers and IFRS 9 - Financial Instruments, as from January 1, 2018.

a) IFRS 15 - Revenue from contract with customers. IFRS 15 establishes a comprehensive framework for determining whether, when, and by how much revenue is recognized. The Company adopted IFRS 15 using the cumulative effect method, however, this adoption did not generate any change in amounts previously recognized as revenue, given the non-significant of the change in the standard for the Company. As a result, the information presented for the years 2017 and 2016 have not been restated and, therefore, the information for the years of 2017 and 2016 continue to be presented as disclosed in accordance with IAS 18 and related interpretations. Revenues are currently recognized when products are delivered to the customer and the performance obligation is met.

b) IFRS 9 - Financial instruments. IFRS 9 establishes requirements for recognizing and measuring financial assets, financial liabilities and certain contracts for the purchase or sale of non-financial items. This standard replaces IAS 39 - Financial Instruments: Recognition and Measurement.

In relation to the classification and measurement of financial assets and liabilities, IFRS 9 largely retains the requirements in IAS 39 for the classification and measurement of financial liabilities, however, it eliminates the following categories of IAS 39 for financial assets: held to maturity, loans and receivables and available for sale.

The adoption of IFRS 9 did not have a significant effect on the Company's accounting policies related to financial liabilities and derivative financial instruments. The impact of IFRS 9 on the Classification and Measurement of Financial Assets is described below. According to IFRS 9, at the initial recognition, a financial asset is classified in the following measurement categories: at amortized

Table of Contents

cost or at fair value through other comprehensive income or at fair value through profit or loss. The classification of financial assets under IFRS 9 is based on the business model in which a financial asset is managed and its characteristics of contractual cash flows.

The following accounting policies apply to the subsequent measurement of financial assets:

- *Financial assets at fair value through profit or loss*: these assets are subsequently measured at fair value. Net income, including interest, is recognized directly in income.

- *Financial assets at amortized cost*: these assets are measured subsequently to the amortized cost using the effective interest method. The amortized cost is reduced by impairment losses. Interest income, foreign exchange gains and losses and impairment are recognized directly in income. Any gain or loss on derecognition is recognized in profit or loss.

- *Financial assets measured at fair value through other comprehensive income*: these assets are subsequently measured at fair value. Interest income calculated using the effective interest method, exchange gains and losses and impairment are recognized in the income statement. Other net income is recognized in other comprehensive income. In derecognition, the accumulated result in other comprehensive income is reclassified to the income statement.

The following table sets forth the original measurement categories in IAS 39 and the new measurement categories of IFRS 9 for each class of financial assets and liabilities of the Company:

			Balance as of December 31, 2017 according to IAS 39	Balance as of January 1, 2018 according to IFRS 9
	Original classification according to IAS 39	New classification according to IFRS 9		
Cash and cash equivalents	Loans and receivables	Financial assets at fair value through profit or loss	2,555,338	2,555,338
Short-term investments	Assets at fair value with gains and losses recognized in income	Financial assets at fair value through profit or loss	821,518	821,518
Trade accounts receivable - net	Loans and receivables	Financial assets at amortized cost	2,798,420	2,750,357
Related parties	Loans and receivables	Financial assets at amortized cost	51,839	51,839
Other current assets	Loans and receivables	Financial assets at amortized cost	469,737	469,737
Other non-current assets	Loans and receivables	Financial assets at amortized cost	462,735	462,735
Other non-current assets	Assets at fair value with gains and losses recognized in income	Financial assets at fair value through profit or loss	80,238	80,238
<b>Total of financial assets</b>			<b>7,239,825</b>	<b>7,191,762</b>
Trade accounts payable	Other financial liabilities at amortized cost	Financial liabilities at amortized cost	3,179,954	3,179,954
Short-term debt	Other financial liabilities at amortized cost	Financial liabilities at amortized cost	16,461,656	16,461,656



Edgar Filing: GERDAU S.A. - Form 20-F

Debentures	Other financial liabilities at amortized cost	Financial liabilities at amortized cost	47,928	47,928
Unrealized losses on financial instruments	Liabilities at market value with gains and losses recognized in income	Financial liabilities at fair value through profit or loss	1,267	1,267
Obligations with FIDC	Other financial liabilities at amortized cost	Financial liabilities at amortized cost	1,135,077	1,135,077
Other current liabilities	Other financial liabilities at amortized cost	Financial liabilities at amortized cost	625,410	625,410
Other non-current liabilities	Other financial liabilities at amortized cost	Financial liabilities at amortized cost	653,670	653,670
<b>Total of financial liabilities</b>			<b>22,104,962</b>	<b>22,104,962</b>

The change in the classification of cash and cash equivalents from Loans and receivables in accordance with IAS 39 for Financial Assets at fair value through profit or loss in accordance with IFRS 9 was based on the Company's business model. Note 15.d discloses the measurement categories of IFRS 9 for each class of financial assets and liabilities of the Company on January 1, 2018 and December 31, 2018.

In relation to the Impairment of Financial Assets, IFRS 9 replaces the "loss incurred" model of IAS 39 by an expected credit loss model. The new impairment model applies to financial assets measured at amortized cost. Under IFRS 9, credit losses are recognized earlier than under IAS 39.

The Company measures the provision for loss in an amount equal to the Expected credit loss for life. In determining whether the credit risk of a financial asset has increased significantly since the initial recognition and in estimating the expected credit losses, the Company considers reasonable and bearable information that is relevant and available without undue cost or effort. This includes quantitative and qualitative information and analysis, based on the Company's historical experience, credit assessment and considering forward-looking information. The provision for credit risks was calculated based on the credit risk analysis, which includes historical losses, the individual situation of the clients, the situation of the economic group to which they belong, the real guarantees for debits and the evaluation of the consultants and is considered sufficient to cover possible losses on amounts receivable, in addition to a prospective assessment that takes into account the change or expectation of change in economic factors that affect the expected credit losses, which will be determined based on probabilities weighted. The provision for credit risk considers the maturity date of the accounts receivable securities, where the Company uses different percentages according to the maturity period, in order to measure the probability of loss, increasing the percentage of the provision of credit risk as the accounts receivable mature longer.

Due to the transition methods chosen by the Company in the application of this standard, the comparative information of these financial statements was not restated to reflect the requirements of the new standards.

The impacts of the adoption of IFRS 9 on January 1, 2018 due to the effect of expected credit losses were R\$ (32,387), net of taxes.

Table of Contents

When the entity applies this standard for the first time, it may choose whether its accounting policy continues to apply the hedge accounting requirements of IAS 39 instead of IFRS 9. In this case, the Company chose to continue applying the requirements of IAS 39.

c) In addition, the IASB issued/revised some IFRS standards, which have adoption in 2019 or after, and the Company presents below the evaluation of the impacts of adopting these standards in its Financial Statements:

- Issuance of IFRS 16 - Lease. - Issuance of IFRS 16 - Lease. This standard is effective for years beginning on or after January 1, 2019 and introduces a single model for accounting for leases in the balance sheet for lessees. A lessee recognizes a right of use asset that represents its right to use the leased asset and a lease liability that represents its obligation to make lease payments. Exemptions are available for short term leases and low value items. This standard replaces existing lease standards, including IAS 17 - Leasing Operations and IFRIC 4, SIC 15 and SIC 27 - Complementary Aspects of Leasing Operations. The Company will recognize as from 2019 new assets and liabilities for its operating leases. The nature of the expenses related to these leases will change because the Company will recognize a depreciation of right of use assets and financial expense on lease obligations. The Company recognized until 2018 an operating lease expense during the lease term. No significant impact is expected on the Company's financial leases.

The new standard provides practical expedient whose election is optional. The Company adopted the following practical expedient:

- 1) It will not reassess whether the contract is or contains lease at the initial application date, instead will apply IAS 17 to contracts that were previously identified as a lease using IAS 17 and IFRIC 4;
- 2) It will not separate non-lease components from leasing components by considering them as a single lease component;
- 3) It will not register contracts with a term exceeding 12 months, which on the date of transition, will end within 12 months of the date of initial application;
- 4) It will not register contracts of low value, according to policy defined by the Company;
- 5) It will exclude initial direct costs of measuring the right to use asset on the date of initial application;
- 6) It will make use of judgement in determining the term of the lease, if the contract contains options to extend or terminate the lease, among others; and

7) It will apply a single discount rate to the lease portfolio with fairly similar characteristics (such as similar remaining lease term, similar classes of underlying assets in a similar economic environment).

Variable elements of payments related to leases (such as a lease of machinery and/or equipment with parts of payments based on asset productivity) are not included in the liability calculation and are recorded as operating expense. The discount rates used by the Company were obtained according to market conditions. The Company does not expect significant changes in the leasing activities in the period comprising the issuance of these financial statements and the date of initial application. Based on the information currently available, the Company estimates that it will recognize a lease liability and a right of use asset in the amount of R\$ 996,873 on January 1, 2019; this estimate takes into account reasonable assumptions available to the Company and may vary in the initial adoption. The Company intends to apply a retrospective approach modified on January 1, 2019, with the accounting of the effects of adjustments directly on the opening balance of net equity without updating the comparative information, as well as applying the standard for all contracts entered before January 1, 2019 that were identified as leases in accordance with IAS 17 and IFRIC 4. Until the date of these financial statements, the Company is developing processes and controls to meet the new requirements.

- **IFRIC 23 Uncertainty over Income Tax Treatments.** Establishes aspects of recognition and measurement of the IAS 12 when there are uncertainties about the treatment of income tax related to tax assets or liabilities and current or deferred taxes, based on taxable income, tax losses, taxable bases, unused tax losses, unused tax credits and tax rates. This interpretation is effective for fiscal years beginning on or after January 1, 2019. The Company does not expect material impact in its Financial Statements.

- **Amendment of IAS 19 - Changes in the plan in cases of curtailment or settlement.** Clarifies aspects of measurement and recognition in the result of the effects of curtailments and settlements in employee benefit plans. This change in the standard is effective for years beginning on or after January 1, 2019. The Company does not expect significant impacts on possible future events of curtailments and settlements in employee benefit plans.

- **Amendment of IFRS 3 - Definition of business.** Clarifies aspects for the definition of business, in order to clarify when a transaction must have accounting treatment of business combination or acquisition of assets. This change in the standard is effective for years beginning on or after January 1, 2020. The Company does not expect significant impacts on possible future events of business combinations or acquisition of assets.

- **Amendment of IAS 1 and IAS 8 - Definition of materiality** Clarifies definition of materiality to the framework of the accounting standard where this concept is applicable. These changes are effective for years beginning on or after January 1, 2020. The Company does not expect material impacts on its Financial Statements.

Table of Contents**NOTE 3 - CONSOLIDATED FINANCIAL STATEMENTS****3.1 - Subsidiaries**

Listed below are the significant consolidated subsidiaries, as follows:

Consolidated company	Country	2018	Equity Interests Total capital (*)	
			2017	2016
Gerdau GTL Spain S.L.	Spain	100.00	100.00	100.00
Gerdau Internacional Empreendimentos Ltda. - Grupo Gerdau	Brazil	100.00	100.00	100.00
Gerdau Ameristeel Corporation and subsidiaries (1)	USA/Canada	100.00	100.00	100.00
Gerdau Açominas S.A. and subsidiary (2)	Brazil	99.83	99.36	99.35
Gerdau Aços Longos S.A. and subsidiary (3)	Brazil	99.78	99.12	99.11
Gerdau Steel Inc.	Canada	100.00	100.00	100.00
Gerdau Holdings Inc. and subsidiary (4)	USA	100.00	100.00	100.00
Paraopeba - Fixed-income investment fund (5) (**)	Brazil	91.40	10.69	70.93
Gerdau América Latina Participações S.A.	Brazil			99.12
Aza Participaciones S.A. (note 3.4)	Chile		100.00	100.00
Gerdau Aços Especiais S.A.	Brazil			99.55
Gerdau Hungria Holdings Limited Liability Company	Hungary	100.00	100.00	100.00
GTL Equity Investments Corp.	British Virgin Islands	100.00	100.00	100.00
Empresa Siderúrgica del Perú S.A.A. - Siderperú	Peru	90.03	90.03	90.03
Diacó S.A. and subsidiary (6)	Colombia			99.68
Gerdau GTL México, S.A. de C.V. and subsidiaries (7)	Mexico	100.00	100.00	100.00
Seiva S.A. - Florestas e Indústrias	Brazil	97.73	97.73	97.73
Itaguaí Com. Imp. e Exp. Ltda.	Brazil			100.00
Gerdau Laisa S.A.	Uruguai	100.00	100.00	100.00
Sipar Gerdau Inversiones S.A.	Argentina	99.99	99.99	99.99
Sipar Aceros S.A. and subsidiary (8)	Argentina	99.98	99.98	99.96
Sizuca - Siderúrgica Zuliana, C. A.	Venezuela	100.00	100.00	100.00
GTL Trade Finance Inc.	British Virgin Islands	100.00	100.00	100.00
Gerdau Trade Inc.	British Virgin Islands	100.00	100.00	100.00
Gerdau Steel India Ltd. (note 3.4)	India		98.90	98.90

(\*) The voting capital is substantially equal to the total capital. The interests reported represent the ownership percentage held directly and indirectly in the subsidiary.

(\*\*) The percentage of participation including interest of the parent company Metalúrgica Gerdau S.A. in the investment fund is 98.60% in 2018, 51.11% in 2017 and 91.58% in 2016.

(1) Subsidiaries: Gerdau Ameristeel US Inc., Gerdau Ameristeel Sayreville Inc., Chaparral Steel Company.

- (2) Subsidiary: G2L Logistica Ltda.
- (3) Subsidiary: Gerdau Açominas Overseas Ltd.
- (4) Subsidiary: Gerdau MacSteel Inc.
- (5) Fixed-income investment fund managed by Bank JP Morgan S.A..
- (6) Subsidiary: Cyrgo S.A.
- (7) Subsidiary: Sidertul S.A. de C.V. and GTL Servicios Administrativos México, S.A. de C.V..
- (8) Subsidiary: Siderco S.A.

Table of Contents**3.2 Joint ventures**

Listed below are the interests in joint ventures:

Joint ventures	Country	2018	Equity Interests Total capital(*)	
			2017	2016
Bradley Steel Processors	Canada	50.00	50.00	50.00
MRM Guide Rail	Canada	50.00	50.00	50.00
Gerdau Corsa S.A.P.I. de CV	Mexico	50.00	50.00	50.00
Gerdau Metaldom Corp.	Dominican Rep.	50.00	45.00	45.00
Gerdau Summit Aços Fundidos e Forjados S.A.	Brazil	58.73	58.73	
Diacó S.A.	Colombia	49.87	49.87	
Juntos Somos Mais Fidelização S.A.	Brazil	27.50		

(\*)The voting capital is substantially equal to the total capital. The interests reported represent the ownership percentage held directly and indirectly held in the joint venture.

The summarized financial information of these joint ventures, accounted for under the equity method, is shown on a combined basis as follows:

	2018	Joint ventures	
		2017	2016
Net income (loss)	(16,403)	(91,553)	(126,723)
Total comprehensive income (loss)	(16,403)	(91,553)	(126,723)

**3.3 Associate companies**

Listed below are the interests in associate companies:

Associate companies	Country	2018	Equity interests Total capital (*)	
			2017	2016
Dona Francisca Energética S.A.	Brazil	51.82	51.82	51.82
Corsa Controladora, S.A. de C.V.	Mexico	49.00	49.00	49.00

(\*)The voting capital is substantially equal to the total capital. The interests reported represent the ownership percentage held directly and indirectly.

## Edgar Filing: GERDAU S.A. - Form 20-F

Although the Company owns more than 50% of Dona Francisca Energética S.A., it does not consolidate the financial statements of this associate because of the veto rights granted to minority shareholders that prevent the Company from controlling the decisions in conducting the associate's business.

The summarized financial information of the associate companies, accounted for under the equity method, is shown on a combined basis as follows:

	Associate Companies		
	2018	2017	2016
Net income	31,806	26,099	141,023
Total comprehensive income	31,806	26,099	141,023

### 3.4 Gains and losses on assets held for sale and sales of interest in subsidiaries

On March 30, 2018, the Company completed the sale of its wire rod mill located in Beaumont, Texas, and the Beaumont Wire Products and Carrollton Wire Products processing units for Optimus Steel LLC for US\$ 99.5 million (equivalent to R\$ 330.7 million). The mill has a melt shop capable of rolling wire rod and rebar in roll.

On June 29, 2018, the Company concluded the sale of 100% of the shares of Aza Participações SpA and its subsidiaries, Gerdau AZA SA; Aceros Cox SA; Armacero - Matco SA; and Salomon Sack S.A., for the group of Chilean investors formed by Ingeniería e

Table of Contents

Inversiones Limitada; Inversiones Reyosan SpA; Los Andes SA de Inversiones and Matco Cables SpA. This sale includes three production plants of long recycled steel per year and its distribution network in Chile, which were presented until the conclusion of the sale within the South American segment. The transaction value attributed corresponds to US\$ 154.1 million (equivalent to R\$594.2 million on the date of the conclusion of the sale).

On July 31, 2018, the Company concluded the sale of its two hydroelectric plants in Goiás for R\$ 835 million to Kinross Brasil Mineração, a wholly owned subsidiary of Kinross Gold Corporation. The Caçu and Barra dos Coqueiros plants were inaugurated in 2010.

On October 31, 2018, the Company concluded the sale of its participation interest in Gerdau Hungria KFT Y CIA Sociedad Regular Colectiva, a subsidiary of the Company located in Spain and owner of 98,89% of Gerdau Steel India Ltd. shares, to Blue Coral Investment Holdings Pte. Ltd and Mountainpeak Investment Holdings Ltd.. The transaction perimeter involves 100% of the operations and assets in India, including the special steels industrial unit located in Tadipatri. The enterprise value of the transaction corresponds to US\$ 120 million (equivalent to R\$ 490.2 million on the signing date of the agreement). The transaction will enable Gerdau to focus more on managing its strategic assets in the Americas, where its key markets, Brazil and the United States, are located.

On November 5, 2018, the Company concluded the sale of its four rebar-producing mills, as well as steel cutting and bending units and distribution centers in the United States to Commercial Metals. The agreement includes the Jacksonville (Florida) , Knoxville (Tennessee), Rancho Cucamonga (California) and Sayreville (New Jersey), as well as all of Gerdau's U.S. rebar fabrication facilities, presented within the North America segment up to the conclusion of the sale. The enterprise value of the transaction is US\$ 600 million (equivalent to R\$ 2,222.9 million) as well as working capital adjustments.

On June 30, 2017, the Company concluded the operation to create a joint venture, based on the sale of 50% interest in Diaco S.A., in Colombia, to Putney Capital Management, which is already partner in its operation in the Dominican Republic. The new company's assets are Gerdau's long-steel industrial units in Colombia. The transaction attributed an economic value to the joint venture of US\$ 165 million (equivalent to R\$ 546 million). Due to this transaction, Diaco started to have accounting treatment of joint venture in Consolidated Financial Statements with a 49.87% interest.

In the second quarter of 2016, the Company completed the sale of its special steel producer Gerdau Holdings Europa S.A. in Spain to Clerbil SL, an investment group with international experience formed by local executives of the Company. The enterprise value of the transaction was 155 million (equivalent to R\$ 621 million) and the sale agreement provides the possibility of receiving an additional up to 45 million (equivalent to R\$ 180 million) in the end of five years, depending on the future performance of the business.

In the fourth quarter of 2016, the Company sold its interest in the associate company Corporación Centroamericana del Acero S.A. in Guatemala to the current controlling shareholders of this company for US\$ 70 million (equivalent to R\$ 222.7 million at the sale date) and its subsidiary Cleary Holdings Corp. coke producer and coking coal reserves holder in Colombia to Trinity Capital S.A.S. jointly with local executives, for US\$ 30.2 million (equivalent to R\$ 102.6 million at the selling date).

As a result of the transactions above, the Company recognized an expense of R\$ 414.5 million in the line of Gains and losses on assets held for sale and sales of interest in subsidiaries (expense of R\$ 721.7 million as of December 31, 2017 and expense of R\$ 58.2 million as of December 31, 2016) in its Income Statement.





Table of Contents**NOTE 4 CASH AND CASH EQUIVALENTS, AND SHORT AND LONG-TERM INVESTMENTS**

	<b>2018</b>	<b>2017</b>
Cash	6,800	10,439
Banks and immediately available investments	2,883,344	2,544,899
Cash and cash equivalents	2,890,144	2,555,338

	<b>2018</b>	<b>2017</b>
Held for trading	459,470	821,518
Short-term investments	459,470	821,518

Immediately available investments include investments with maturity up to 90 days, immediate liquidity and low risk of fair value variation.

Held for trading securities include Bank Deposit Certificates and marketable securities, which are stated at their fair value. Income generated by these investments is recorded as financial income.

**NOTE 5 TRADE ACCOUNTS RECEIVABLE**

	<b>2018</b>	<b>2017</b>
Trade accounts receivable - in Brazil	1,056,625	1,265,431
Trade accounts receivable - exports from Brazil	373,593	139,162
Trade accounts receivable - outside of Brazil	1,929,595	1,525,466
(-) Impairment loss on trade receivables	(158,157)	(131,639)
	3,201,656	2,798,420

Accounts receivable by aging are as follows:

	<b>2018</b>	<b>2017</b>
Current	2,362,408	2,234,723
Past-due:		
Up to 30 days	792,569	467,901
From 31 to 60 days	63,294	96,852
From 61 to 90 days	10,133	17,636
From 91 to 180 days	22,261	27,841
From 181 to 360 days	26,003	22,985
Above 360 days	83,145	62,121
(-) Impairment loss on trade receivables	(158,157)	(131,639)
	3,201,656	2,798,420

The Company's maximum exposure to credit risk, net of allowance for doubtful accounts, is the amount of accounts receivable. The credit quality of accounts receivable to maturity is considered adequate, and the value of the effective risk of possible losses on accounts receivable

from customers is presented as allowance for doubtful accounts.

The changes in the allowance for doubtful accounts are as follows:

F-25

---

Table of Contents

Balance as of January 1, 2016	(185,261)
Provisions for bad debt during the year	(85,661)
Recoveries in the year	16,880
Write-offs	37,679
Loss of control by selling of subsidiary (note 3.4)	17,594
Exchange variation	(537)
Balance as of December 31, 2016	(199,306)
Provisions for bad debt during the year	(98,476)
Recoveries in the year	80,134
Write-offs	73,591
Loss of control by joint venture creation	1,487
Assets held for sale	11,207
Exchange variation	(276)
Balance as of December 31, 2017	(131,639)
Provisions for bad debt during the year	(111,900)
Recoveries in the year	101,986
Write-offs	39,943
Exchange variation	(5,136)
Effects of IFRS 9 adoption	(48,063)
Assets held for sale	(3,348)
Balance as of December 31, 2018	(158,157)

**NOTE 6 - INVENTORIES**

	<b>2018</b>	<b>2017</b>
Finished products	3,985,964	3,026,556
Work in progress	1,688,794	1,302,152
Raw materials	2,296,074	1,703,013
Storeroom supplies	784,517	298,100
Imports in transit	426,044	375,139
(-) Allowance for adjustments to net realizable value	(13,704)	(3,556)
	9,167,689	6,701,404

The allowance for adjustment to net realizable value of inventories, on which the provision and write-offs are registered with impact on cost of sales, is as follows:

Table of Contents

Balance as of January 1, 2016	(101,121)
Provision for the year	(62,899)
Reversal of adjustments to net realizable value	94,391
Loss of control by selling of subsidiary	30,105
Exchange rate variation	10,711
Balance as of December 31, 2016	(28,813)
Provision for the year	(26,545)
Reversal of adjustments to net realizable value	46,740
Loss of control by joint venture creation	392
Assets held for sale	881
Exchange rate variation	3,789
Balance as of December 31, 2017	(3,556)
Provision for the year	(11,943)
Reversal of adjustments to net realizable value	3,715
Exchange rate variation	(871)
Assets held for sale	(1,049)
Balance as of December 31, 2018	(13,704)

**NOTE 7 TAX CREDITS**

	2018	2017
<b>Current</b>		
ICMS (state VAT)	291,027	155,096
Social security financing	95,700	91,229
Financing of social integration program	23,473	20,242
IPI (federal VAT)	44,312	59,982
IVA (value-added tax)	32,967	48,139
Others	39,949	27,741
	527,428	402,429
<b>Non-current</b>		
ICMS (state VAT)	27,527	26,135
Social security financing	1,980	360
Financing of social integration program and Others	2,558	4,346
	32,065	30,841
	559,493	433,270

The estimates of realization of non-current tax credits are as follows:

	2018	2017
2019		18,017
2020	15,025	7,062
2021	10,846	5,762
2022 on	6,194	
	32,065	30,841

**NOTE 8 - INCOME AND SOCIAL CONTRIBUTION TAXES**

Edgar Filing: GERDAU S.A. - Form 20-F

In Brazil, income taxes include federal income tax (IR) and social contribution (CS), which represents an additional federal income tax. The statutory rates for income tax and social contribution are 25% and 9%, respectively, and are applicable for the years ended

F-27

---

Table of Contents

December 31, 2018, 2017 and 2016. The foreign subsidiaries of the Company are subject to taxation at rates ranging between 22.6% and 34.0%, without considering there are subsidiaries abroad with zero tax rate, which have mainly financial activities. The differences between the Brazilian tax rates and the rates of other countries are presented under Difference in tax rates in foreign companies in the reconciliation of income tax and social contribution below.

**a) Reconciliations of income and social contribution taxes at statutory rates to amounts presented in the Statement of Income are as follows:**

	2018	2017	2016
Income (loss) before income taxes	2,157,431	(43,276)	(2,581,615)
Statutory tax rates	34%	34%	34%
Income and social contribution taxes at statutory rates	(733,527)	14,714	877,749
Tax adjustment with respect to:			
- Difference in tax rates in foreign companies	663,116	(183,787)	(1,162,174)
- Equity in earnings of unconsolidated companies	3,448	(11,763)	(4,342)
- Interest on equity*	128,418	113	(162)
- Tax credits and incentives	9,531	23,185	18,494
- Recognition of previously unrecognized tax losses	47,545		(40,279)
- Capital Gain**		(98,290)	
- Other permanent differences, net	50,420	(39,563)	6,400
Income and social contribution taxes	168,951	(295,391)	(304,314)
Current	(629,209)	(313,758)	(110,511)
Deferred	798,160	18,367	(193,803)

(\*) Brazilian Law 9,249/95 provides that a company may, at its sole discretion, consider dividends distributions to shareholders to be considered as interest on own capital subject to specific limitations - which has the effect of a taxable deduction in the determination of income tax and social contribution. The limitation is the greater of (i) shareholders equity multiplied by the TJLP (Long Term Interest Rate) rate or (ii) 50% of the net income in the fiscal year.

(\*\*) The merger of Gerda Aços Especiais S.A. and Gerda América Latina Part. S.A. at Gerda S.A., generated a taxable capital gain.

**b) Breakdown and changes in deferred income and social contribution tax assets and liabilities at statutory tax rates:**

	Balance as of January 1, 2016	Recognized in income	Effect of selling of subsidiary and others	Comprehensive Income	Balance as of December 31, 2016
Tax loss carryforward	887,980	327,743	(263,297)	(78,069)	874,357
Social contribution tax losses	191,638	120,254			311,892
Provision for tax, civil and labor liabilities	639,566	118,526	(2,671)	(223)	755,198
Benefits granted to employees	549,865	(67,133)	34,982	(85,177)	432,537
Other temporary differences	381,991	(21,985)	20,776	(30,020)	350,762
Deferred exchange variance*	2,158,149	(907,690)		1,083	1,251,542
Provision for losses	151,678	(34,059)	(4,671)	(12)	112,936

Edgar Filing: GERDAU S.A. - Form 20-F

Fair value adjustments on businesses acquired	(1,567,880)	270,541	2,984	216,925	(1,077,430)
	3,392,987	(193,803)	(211,897)	24,507	3,011,794
Non-current assets	4,307,462				3,407,230
Non-current liabilities	(914,475)				(395,436)

---

\* Corresponds to deferred taxes over foreign exchange gains and loss which certain subsidiaries elected to tax on a cash basis



Table of Contents

	Balance as of December 31, 2016	Recognized in income	Effect of selling of subsidiary and Others	Comprehensive Income	Balance as of December 31, 2017
Tax loss carryforward	874,357	157,402	(22,362)	(35,759)	973,638
Social contribution tax losses	311,892	58,963	(15,073)		355,782
Provision for tax, civil and labor liabilities	755,198	(479,836)	101		275,463
Benefits granted to employees	432,537	(48,466)	(9,363)	(91,905)	282,803
Other temporary differences	350,762	(81,627)	92,174	48,991	410,300
Deferred exchange variance*	1,251,542	(199,200)	8,185		1,060,527
Provision for losses	112,936	(2,208)			110,728
Fair value adjustments on businesses acquired	(1,077,430)	613,339	(51,606)	18,163	(497,534)
	3,011,794	18,367	2,056	(60,510)	2,971,707
<b>Non-current assets</b>	<b>3,407,230</b>				<b>3,054,393</b>
<b>Non-current liabilities</b>	<b>(395,436)</b>				<b>(82,686)</b>

\* Corresponds to deferred taxes over foreign exchange gains and loss which certain subsidiaries elected to tax on a cash basis

	Balance as of December 31, 2017	Recognized in income	Others	Comprehensive Income	Balance as of December 31, 2018
Tax loss carryforward	973,638	341,664	36,445	(11,814)	1,339,933
Social contribution tax losses	355,782	(18,524)			337,258
Provision for tax, civil and labor liabilities	275,463	(5,214)	168		270,417
Benefits granted to employees	282,803	(16,564)	67,184	(46,929)	286,494
Other temporary differences	410,300	93,094	17,177	5,247	525,818
Deferred exchange variance*	1,060,527	223,850			1,284,377
Provision for losses	110,728	(33,165)	(12)	6,286	83,837
Fair value adjustments on businesses acquired	(497,534)	213,019	(89,859)	1,926	(372,448)
	2,971,707	798,160	31,103	(45,284)	3,755,686
<b>Non-current assets</b>	<b>3,054,393</b>				<b>3,874,054</b>
<b>Non-current liabilities</b>	<b>(82,686)</b>				<b>(118,368)</b>

\* Corresponds to deferred taxes over foreign exchange gains and loss which certain subsidiaries elected to tax on a cash basis

The recoverability analysis of deferred tax balances related to tax loss carryforward and social contribution tax losses performed by the Company are based on its business plans and aligned with other projections and analysis performed by the Company as, for example, the impairment of assets tests.

**c) Estimated recovery and reversal of income and social contribution tax assets and liabilities are as follows:**

	Assets	
	2018	2017
2018		326,356

Edgar Filing: GERDAU S.A. - Form 20-F

2019	609,546	198,590
2020	585,047	400,597
2021	338,896	369,857
2022	306,130	168,125
2023 after	2,034,435	1,590,868
	3,874,054	3,054,393

F-29

---

Table of Contents

	Liabilities	
	2018	2017
2018		(2,680)
2019	(18,055)	(6,116)
2020	(25,144)	(6,498)
2021	(13,548)	(4,745)
2022	(14,009)	(18,514)
2023 after	(47,612)	(44,133)
	(118,368)	(82,686)

**d) Unrecognized deferred income tax assets:**

Deferred tax assets have not been recognised in respect of the following items, because it is not probable that future taxable profit will be available against which the Company can use the benefits therefrom in some companies in Brazil. The Company has not recorded a portion of tax assets of R\$ 265,403 (R\$ 312,741 as of December 31, 2017), which do not have an expiration date. The subsidiaries abroad had R\$ 398,364 (R\$ 360,152 as of December 31, 2017) of tax credits on capital losses which deferred tax assets have not been booked and which expire between 2029 and 2035 and also several tax losses of state credits in the amount of R\$ 795,775 (R\$ 1,137,548 as of December 31, 2017), which expire at various dates between 2019 and 2038.

Table of Contents**NOTE 9 INVESTMENTS IN ASSOCIATES AND JOINT VENTURES**

	<b>Investments in North America</b>	<b>Investments in South America</b>	<b>Investments in Special Steel</b>	<b>Others</b>	<b>Total</b>
Balance as of January 1, 2016	509,086	792,117		91,679	1,392,882
Equity in earnings	(70,618)	40,067		17,780	(12,771)
Cumulative Translation Adjustment	(126,660)	(124,185)		(350)	(251,195)
Effect of selling of subsidiary		(203,843)		(1,734)	(205,577)
Dividends/Interest on equity	(8,282)	(99,634)		(16,579)	(124,495)
Balance as of December 31, 2016	303,526	404,522		90,796	798,844
Equity in earnings	(111,581)	41,553	15,460	19,971	(34,597)
Cumulative Translation Adjustment	(10,485)	(6,260)			(16,745)
Capital increase	178,670		184,187		362,857
Joint venture creation		145,084			145,084
Contingent price complement				65,500	65,500
Dividends/Interest on equity	(14,050)			(26,594)	(40,644)
Balance as of December 31, 2017	346,080	584,899	199,647	149,673	1,280,299
Equity in earnings	(77,909)	51,648	15,629	20,773	10,141
Cumulative Translation Adjustment	33,101	96,045	(1,377)	(2,050)	125,719
Capital increase				7,000	7,000
Dividends/Interest on equity		(31,359)		(23,998)	(55,357)
Balance as of December 31, 2018	301,272	701,233	213,899	151,398	1,367,802

**a) Advance for future investment in joint venture**

The Company made an advance for future investment in equity interest in the amount of R\$ 375,456 in the joint venture Gerdau Corsa S.A.P.I. of C.V ..

Table of Contents**NOTE 10 PROPERTY, PLANT AND EQUIPMENT****a) Summary of changes in property, plant and equipment:**

<b>Cost of the property, plant, and equipment</b>	<b>Land and buildings</b>	<b>Machines, equipment, and installations</b>	<b>Data electronic equipment</b>	<b>Property, plant and equipment under construction</b>	<b>Other</b>	<b>Total</b>
Balances as of January 01, 2016	10,842,802	32,616,700	939,266	4,068,876	1,470,485	49,938,129
Additions	35,238	93,290	2,126	1,117,317	75,920	1,323,891
Capitalized interest				187,375		187,375
Transfers	584,575	2,665,898	74,804	(3,314,746)	(10,531)	
Disposals	(81,256)	(271,104)	(60,542)	(1,550)	(46,888)	(461,340)
Effect of selling of subsidiary	(1,011,492)	(1,726,440)	(112,319)	(53,630)	(52,281)	(2,956,162)
Impairment	(52,071)	(183,788)	(228)		(3,242)	(239,329)
Foreign exchange effect	(834,043)	(2,560,676)	(81,033)	(240,994)	(74,219)	(3,790,965)
Balances as of December 31, 2016	9,483,753	30,633,880	762,074	1,762,648	1,359,244	44,001,599
Additions	2,028	124,136	1,770	687,019	58,376	873,329
Capitalized interest				44,260		44,260
Transfers	700,318	716,685	19,340	(1,440,183)	3,840	
Disposals	(157,625)	(232,771)	(12,963)	(60,151)	(49,962)	(513,472)
Loss of control by selling of subsidiary	(119,928)	(900,840)	(16,426)	(1,382)	(53,129)	(1,091,705)
Impairment	(10,063)	(255,293)			(13)	(265,369)
Transfer to assets held for sale	(1,013,466)	(2,734,923)	(53,315)	(107,677)	(171,404)	(4,080,785)
Foreign exchange effect	200,681	665,730	11,158	66,146	28,745	972,460
Balances as of December 31, 2017	9,085,698	28,016,604	711,638	950,680	1,175,697	39,940,317
Additions	13,739	66,764	11,811	983,519	119,101	1,194,934
Capitalized interest				23,999		23,999
Transfers	140,334	802,664	457	(949,888)	6,433	
Disposals	(45,290)	(285,860)	(5,641)	(3,352)	(9,606)	(349,749)
Transfer to assets held for sale	(784,464)	(749,425)	(14,914)	(49,579)	(300,618)	(1,899,000)
Effects of IAS 29 adoption		699,724				699,724
Foreign exchange effect	290,732	1,058,527	49,727	65,868	(2,895)	1,461,959
Balances as of December 31, 2018	8,700,749	29,608,998	753,078	1,021,247	988,112	41,072,184

<b>Accumulated depreciation</b>	<b>Land and buildings</b>	<b>Machines, equipment, and installations</b>	<b>Data electronic equipment</b>	<b>Property, plant and equipment under construction</b>	<b>Other</b>	<b>Total</b>
Balances as of January 01, 2016	(4,387,719)	(21,415,018)	(827,620)		(523,446)	(27,153,803)
Depreciation	(334,365)	(1,738,759)	(44,437)		(100,259)	(2,217,820)
Transfers	(12,015)	(2,368)	968		13,415	
Disposals	14,696	243,429	56,466		31,589	346,180
Loss of control by selling of subsidiary	524,209	1,515,886	95,809		37,965	2,173,869
Foreign exchange effect	296,523	1,792,251	69,172		43,920	2,201,866
Balances as of December 31, 2016	(3,898,671)	(19,604,579)	(649,642)		(496,816)	(24,649,708)
Depreciation	(343,373)	(1,361,561)	(40,915)		(61,506)	(1,807,355)
Transfers	(38,467)	25,886	(400)		12,981	
Disposals	67,598	218,590	12,790		43,067	342,045
Loss of control by selling of subsidiary	28,691	589,951	12,627		41,117	672,386
Transfer to assets held for sale	370,727	1,989,917	54,275		95,350	2,510,269
Foreign exchange effect	(101,528)	(435,040)	(10,969)		(16,675)	(564,212)
Balances as of December 31, 2017	(3,915,023)	(18,576,836)	(622,234)		(382,482)	(23,496,575)
Depreciation	(291,315)	(1,128,138)	(34,814)		(130,611)	(1,584,878)
Transfers	18,341	5,234	158		(23,733)	
Disposals	29,944	258,609	2,609		7,970	299,132
Transfer to assets held for sale	105,787	286,204	11,667		234,271	637,929

Edgar Filing: GERDAU S.A. - Form 20-F

Effects of IAS 29 adoption		(265,654)			(265,654)	
Foreign exchange effect	(129,539)	(946,240)	(44,332)	4,454	(1,115,657)	
Balances as of December 31, 2018	(4,181,805)	(20,366,821)	(686,946)	(290,131)	(25,525,703)	

**Net property, plant and equipment**

Balances as of December 31, 2016	5,585,082	11,029,301	112,432	1,762,648	862,428	19,351,891
Balances as of December 31, 2017	5,170,675	9,439,768	89,404	950,680	793,215	16,443,742
Balances as of December 31, 2018	4,518,944	9,242,177	66,132	1,021,247	697,981	15,546,481

The average rate of capitalized interest in 2018 was 5.7% (6.6% in 2017 and 6.6% in 2016).

The following useful lives are used to calculate depreciation:

Table of Contents

	Useful lives of property, plant and equipment
Buildings	20 to 33 years
Machines, equipment, and installations	10 to 20 years
Furniture and fixture	5 to 10 years
Vehicles	3 to 5 years
Data electronic equipment	2.5 to 6 years

b) **Guarantees** property, plant and equipment have been pledged as collateral for loans and financing in the amount of R\$ 90,463 as of December 31, 2018 (R\$ 609,116 and R\$ 632,376 as of December 31, 2017 and 2016, respectively).

c) **Impairment of property, plant and equipment** At December 31, 2018, the carrying amount of items of property, plant and equipment for which an impairment loss has been recognized up to current year is R\$ 126,790 for land, buildings and construction (R\$ 118,348 as of December 31, 2017), R\$ 569,303 for machines, equipment and installations (R\$ 783,183 as of December 31, 2017), R\$ 543,726 for Property, plant and equipment under construction (R\$ 543,726 as of December 31, 2017). According to note 3.4, the Company deconsolidated subsidiaries and the amounts above contemplate these effects.

**NOTE 11 GOODWILL**

The changes in goodwill are as follows:

	Goodwill	Accumulated impairment losses	Goodwill after Impairment losses
Balance as of January 1, 2016	18,099,186	(2,974,756)	15,124,430
(+/-) Foreign exchange effect	(2,645,368)	63,516	(2,581,852)
(-) Impairment		(2,678,582)	(2,678,582)
(-) Effect of selling of subsidiary	(393,980)		(393,980)
Balance as of December 31, 2016	15,059,838	(5,589,822)	9,470,016
(+/-) Foreign exchange effect	242,510	(169,979)	72,531
(-) Impairment		(849,438)	(849,438)
(-) Transfer to assets held for sale	(801,967)		(801,967)
Balance as of December 31, 2017	14,500,381	(6,609,239)	7,891,142
(+/-) Foreign exchange effect	2,283,577	(1,062,329)	1,221,248
Balance as of December 31, 2018	16,783,958	(7,671,568)	9,112,390

The amounts of goodwill by segment are as follows:

	2018	2017	2016
Brazil	373,135	373,135	380,644
Special Steel	2,854,888	2,487,364	2,508,056
North America	5,884,367	5,030,643	6,581,316

9,112,390

7,891,142

9,470,016

**NOTE 12 INTANGIBLE ASSETS**

Intangible assets consist mainly of relationships recognized upon business combinations and software development, with application in the management of the business:

F-33

---



Table of Contents

	Supplier relationships	Software development	Customer contracts and relationships	Others	Total
Balance as of January 01, 2016	47,571	808,482	911,483	68,225	1,835,761
Foreign exchange effect		(60,464)	(140,812)	(7,509)	(208,785)
Acquisition		40,643		13,401	54,044
Disposal		(2,145)		(13,050)	(15,195)
Amortization	(7,845)	(149,911)	(155,063)	(5,316)	(318,135)
(-) Effect of selling of subsidiary				(27,749)	(27,749)
Balance as of December 31, 2016	39,726	636,605	615,608	28,002	1,319,941
Foreign exchange effect		2,947	3,835	884	7,666
Acquisition		37,939			37,939
Disposal			(27,652)		(27,652)
Amortization	(6,940)	(149,150)	(125,621)	(3,486)	(285,197)
(-) Assets held for sale		(37,512)	(25,396)	(17,700)	(80,608)
Balance as of December 31, 2017	32,786	490,829	440,774	7,700	972,089
Foreign exchange effect		28,598	77,593	1,243	107,434
Acquisition		67,388			67,388
Disposal		(3,791)	(88)		(3,879)
Amortization	(6,067)	(167,384)	(130,980)	(2,505)	(306,936)
Balance as of December 31, 2018	26,719	415,640	387,299	6,438	836,096
Estimated useful lives	5 to 20 years	7 years	5 to 20 years	5 years	

The composition of other intangible assets by segment is as follows:

	2018	2017	2016
Brazil	295,107	351,578	412,134
Special Steel	136,910	152,640	219,878
South America	1,441	1,863	7,606
North America	402,638	466,008	680,323
	836,096	972,089	1,319,941

**NOTE 13 LOANS AND FINANCING**

Loans and financing are as follows:

	Annual charges (*)	2018	2017
Working capital	6.78%	2,424,246	2,739,258
Financing of property, plant and equipment and others	14.28%	1,205,281	2,108,216
Ten/Thirty Year Bonds	5.81%	9,738,314	11,614,182
Total Loans and Financing		13,367,841	16,461,656
Current		1,822,183	2,004,341
Non-current		11,545,658	14,457,315
Principal amount of loans and Financing		13,178,457	16,207,120
Interest accrued of loans and Financing		189,384	254,536
Total of Debts		13,367,841	16,461,656

---

(\*) Weighted average effective interest costs on December 31, 2018, which in a consolidated basis represent total of 6.66%.

Loans and financing denominated in Brazilian reais are indexed to the TJLP (long-term interest rate, CDI (Interbank Deposit Certificate), or by the IGP-M (general market price index) and IPCA (Amplified Consumer Price).

Table of Contents

Summary of loans and financing by currency:

	2018	2017
Brazilian Real (BRL)	2,361,610	2,710,308
U.S. Dollar (USD)	10,924,355	13,333,669
Other currencies	81,876	417,679
	13,367,841	16,461,656

The amortization schedules of long term loans and financing are as follows:

	2018	2017
2019		873,274
2020	2,253,958	3,158,211
2021	1,199,045	1,730,177
2022	121,490	147,715
2023	1,209,109	1,296,597
2024 after	6,762,056	7,251,341
	11,545,658	14,457,315

**a) Main funding in 2018**

In March 2018, the subsidiary Gerdau Açominas obtained a loan of R\$ 400 million from Banco do Brasil, maturing on April 28, 2019 and clause of export verification obligations.

In April 2018, the subsidiaries Gerdau Açominas S.A. and Gerdau Aços Longos S.A. obtained a loan of R\$ 400 million from Citibank S.A. with guarantee from Gerdau S.A. and maturing on April 15, 2019.

**b) Monitoring Index**

Only operations with BNDES contemplate monitoring of the Company's indebtedness indexes (covenants) established in the agreement. In a possible breakdown of the indicator in the annual measurement, the Company would enter into a remediation period and a subsequent renegotiation of guarantees, and it is not an event of a default.

**c) Guarantees**

All loans contracted under the FINAME/BNDES program, totaling R\$ 90.5 million on December 31, 2018, are guaranteed by the assets being financed.

**d) Credit Lines**

In June 2009, the Company and some of its subsidiaries in Brazil, obtained a pre-approved credit line with BNDES in the total amount of R\$ 1.5 billion to be used for the revamp and modernization of several areas, an increase in the production capacity of certain product lines, investment in logistics and energy generation, and also environmental and sustainability projects. The funds are made available at the time each subsidiary starts its specific investment and presents to BNDES the evidence of the investment made. The interest rate for this credit line is determined at the time of each disbursement, and is composed by indexes linked to of TJLP + 2.16% p.a. As of December 31, 2018, the outstanding balance of this credit facility was R\$ 253.7 million.

In October 2017, the Company completed the renewal and reduction of the volume of the Senior Unsecured Global Working Capital Credit Agreement, a US\$ 800 million (equivalent to R\$ 3,100 million) revolving credit line to provide liquidity to its subsidiaries. The line is divided into two tranches, of which US\$ 200 million (equivalent to R\$ 775 million) is allocated to North American subsidiaries and US\$ 600 million (equivalent to R\$ 2,325 million) to subsidiaries in Latin America, including Brazil. The companies Gerdau S.A., Gerdau Açominas SA and Gerdau Aços Longos SA provide a guarantee and the operation expires in October 2020. As of December 31, 2018, the amount disbursed in this line was US\$ 50 million (R\$ 193.7 million as of December, 31, 2018).

Table of Contents**NOTE 14 DEBENTURES**

Issuance	General Meeting	Quantity as of December 31, 2018		Maturity	2018	2017
		Issued	Held in treasury			
3rd- A and B	May 27, 1982	144,000	141,144	06/01/2021	18,871	21,377
7th	July 14, 1982	68,400	68,271	07/01/2022	1,102	1,333
8th	November 11, 1982	179,964	178,516	05/02/2023	8,080	14,557
9th	June 10, 1983	125,640	125,365	09/01/2024	2,349	4,900
11th - A and B	June 29, 1990	150,000	149,294	06/01/2020	5,716	5,761
15th	November 09, 2018	1,500,000		11/21/2022	1,502,755	
<b>Total Consolidated</b>					<b>1,538,873</b>	<b>47,928</b>
Current					2,755	
Non-current					1,536,118	47,928

The amortization schedules of long term are as follows:

	2018	2017
2020	5,716	5,761
2021	18,871	21,377
2022	1,501,102	1,333
2023	8,080	14,557
2024 on	2,349	4,900
	1,536,118	47,928

**15<sup>a</sup> Issuance of Debentures:** The Board of Directors Meeting held on November 9, 2018 approved the 15<sup>th</sup> issuance of Simple Debentures and non-convertible into shares, in a Single Series. The value of the Issuance, subscribed and paid-in, was R\$ 1.5 billion, represented by 1,500,000 debentures, with a par value of R\$ 1,000.00, and the net proceeds were used to reinforce cash, with the objective of meet ordinary management business.

Debentures are denominated in Brazilian reais, they are not convertible into shares and have variable interest at a percentage of the CDI (Interbank Deposit Rate). The nominal annual interest rate was 6.42% and 9.93% as of December 31, 2018 and December 31, 2017, respectively.

The Company has guarantees provided by parent entity for debentures of the 7<sup>a</sup>, 8<sup>a</sup>, 9<sup>a</sup> and 11<sup>a</sup> issuances.

**NOTE 15 - FINANCIAL INSTRUMENTS**

a) **General considerations** - Gerdau S.A. and its subsidiaries enter into transactions with financial instruments whose risks are managed by means of strategies and exposure limit controls. All financial instruments are recorded in the accounting books and presented as short-term investments, loans and financing, debentures, related-party transactions, unrealized gains on derivatives, unrealized losses on derivatives, obligations with FIDC, other current assets, other non-current assets, other current liabilities and other non-current liabilities.

The Company has derivatives and non-derivative instruments, such as the hedge for some operations under hedge accounting. These operations are non-speculative in nature and are intended to protect the company against exchange rate fluctuations on foreign currency loans and against interest rate fluctuations.

b) **Market value** the market value of the aforementioned financial instruments is as follows:

Table of Contents

	2018		2017	
	Book value	Fair value	Book value	Fair value
<b>Assets</b>				
Short-term investments	459,470	459,470	821,518	821,518
Related parties	27,939	27,939	51,839	51,839
Unrealized gains on derivatives	33,417	33,417		
Other current assets	780,423	780,423	469,737	469,737
Other non-current assets	449,592	449,592	542,973	542,973
<b>Liabilities</b>				
Loans and Financing	13,367,841	13,533,306	16,461,656	17,102,512
Debentures	1,538,873	1,538,873	47,928	47,928
Related parties	1,350	1,350		
Unrealized losses on financial instruments	5,245	5,245	1,267	1,267
Obligations with FIDC	938,526	938,526	1,135,077	1,135,077
Other current liabilities	988,967	988,967	625,410	625,410
Other non-current liabilities	499,092	499,092	653,670	653,670

The fair values of Loans and Financing are based on market premises, which may take into consideration discounted cash flows using equivalent market rates and credit rating. All other financial instruments, which are recognized in the Consolidated Financial Statements at their carrying amount, are substantially similar to those that would be obtained if they were traded in the market. However, because there is no active market for these instruments, differences could exist if they were settled in advance. The fair value hierarchy of the financial instruments above are presented in Note 15.g.

**c) Risk factors that could affect the Company's and its subsidiaries' businesses:**

**Price risk of commodities:** this risk is related to the possibility of changes in prices of the products sold by the Company or in prices of raw materials and other inputs used in the productive process. Since the Company operates in a commodity market, net sales and cost of sales may be affected by changes in the international prices of their products or materials. In order to minimize this risk, the Company constantly monitors the price variations in the domestic and international markets.

**Interest rate risk:** this risk arises from the possibility of losses (or gains) due to fluctuations in interest rates applied to the Company's financial liabilities or assets and future cash flows and income. The Company evaluates its exposure to these risks: (i) comparing financial assets and liabilities denominated at fixed and floating interest rates and (ii) monitoring the variations of interest rates like Libor and CDI. Accordingly, the Company may enter into interest rate swaps in order to reduce this risk.

**Exchange rate risk:** this risk is related to the possibility of fluctuations in exchange rates affecting the amounts of financial assets or liabilities or of future cash flows and income. The Company assesses its exposure to the exchange rate by measuring the difference between the amount of its assets and liabilities in foreign currency. The Company understands that the accounts receivables originated from exports, its cash and cash equivalents denominated in foreign currencies and its investments abroad are more than equivalent to its liabilities denominated in foreign

currency. Since the management of these exposures occurs at each operation level, if there is a mismatch between assets and liabilities denominated in foreign currency, the Company may employ derivative financial instruments in order to mitigate the effect of exchange rate fluctuations.

**Credit risk:** this risk arises from the possibility of the company not receiving amounts arising from sales to customers or investments made with financial institutions. In order to minimize this risk, the company adopt the procedure of analyzing in details of the financial position of their customers, establishing a credit limit and constantly monitoring their balances. If customers are classified by an independent agency, these ratings are used. If an independent assessment is not available, the Company s credit area provides a credit rating assessment, taking into consideration its financial position, past experience and other factors. Regarding cash investments, the Company invests solely in financial institutions with low credit risk, as assessed by rating agencies. In addition, each financial institution has a maximum limit for investment, determined by the Company s Credit Committee.

**Capital management risk:** this risk comes from the Company s choice in adopting a financing structure for its operations. The Company manages its capital structure, which consists of a ratio between the financial debts and its own capital (Equity) based on internal policies and benchmarks. The level of financial leverage is defined by the Net Debt to Adjusted EBITDA indicator. Net Debt consists of debt reduced by cash, cash equivalents and financial investments (notes 4, 13 and 14). Another recently added key indicator is the maximum Gross Debt value that works with the objective of limiting indebtedness at different times in the financial cycle. The Company can change its capital structure, according to economic-financial conditions, in order to optimize its financial



Table of Contents

leverage and its debt management. At the same time, the Company seeks to improve its ROCE (Return on Capital Employed) through the implementation of working capital management and an efficient investment program in property, plant and equipment. In the long term, the Company seeks to remain within the parameters below, admitting occasional variations in the short term:

Net debt/Adjusted EBITDA	From 1.0 to 1.5 times
Gross debt limit	R\$12 billion
Average maturity	more than 6 years

These key indicators are used to monitor objectives described above and may not necessarily be used as indicators for other purposes, such as impairment tests.

**Liquidity risk:** the Company's management policy of indebtedness and cash on hand is based on using the committed lines and the currently available credit lines with or without a guarantee in export receivables for maintaining adequate levels of short, medium, and long-term liquidity. The maturity of long-term loans and financing, and debentures are presented in Notes 13 and 14, respectively.

Contractual obligations	Total	Less than 1 year	2018		
			1-3 years	4-5 years	More than 5 years
Trade accounts payable	4,335,054	4,335,054			
Loans and financings	20,613,734	2,817,346	5,053,827	2,509,962	10,232,599
Debentures	1,940,474	104,995	231,817	1,600,632	3,030
Unrealized losses on financial instruments	5,245	5,245			
Obligations with FIDC	938,526		827,137	111,389	
Other current liabilities	988,967	988,967			
Other non-current liabilities	499,092		13,295		485,797
	<b>29,321,092</b>	<b>8,251,607</b>	<b>6,126,076</b>	<b>4,221,983</b>	<b>10,721,426</b>

Contractual obligations	Total	Less than 1 year	2017		
			1-3 years	4-5 years	More than 5 years
Trade accounts payable	3,179,954	3,179,954			
Loans and financings	24,470,751	3,191,793	6,060,187	3,168,144	12,050,627
Debentures	59,128		6,528	40,289	12,311
Unrealized losses on financial instruments	1,267	1,267			
Obligations with FIDC	1,135,077				1,135,077
Other current liabilities	625,410	625,410			
Other non-current liabilities	653,670		13,209		640,461
	<b>30,125,257</b>	<b>6,998,424</b>	<b>6,079,924</b>	<b>3,208,433</b>	<b>13,838,476</b>

**Sensitivity analysis:**

The Company performed a sensitivity analysis, which can be summarized as follows (assuming that other variables remain constant):

**Impacts on Statements of Income**

<b>Assumptions</b>	<b>Percentage of change</b>	<b>2018</b>	<b>2017</b>
Foreign currency sensitivity analysis	5%	113,445	129,209
Interest rate sensitivity analysis	10 bps	55,959	54,908
Sensitivity analysis of changes in prices of products sold	1%	461,595	369,176
Sensitivity analysis of changes in raw material and commodity prices	1%	296,234	234,239
Sensitivity analysis of interest rate and foreign currency swaps	10 bps/5%	11,073	6,479
Sensitivity analysis of Swap of interest rate	50bps	476	
Sensitivity analysis of NDF (Non Deliverable Forwards)	5%	7,063	1,480

**Foreign currency sensitivity analysis:** As of December 31, 2018, the Company is mainly exposed to variations between the Real and the Dollar. The sensitivity analysis carried out by the Company considers the effects of a 5% increase or reduction between the Real and the Dollar in its non-hedged debt. In this analysis, if the Real appreciates against the Dollar, this would represent a gain of R\$ 113,445 and R\$ 74,457 after the effects arising from the changes in the net investment hedge described in note 15.g - (R\$ 129,209)

Table of Contents

and R\$ 79,088 as of December 31, 2017, respectively). If the Real depreciates against the Dollar this would represent an expense of the same value. Due to the investment hedge, the variations are minimized when the exchange variation accounts and income tax are analyzed.

The net amounts of trade accounts receivable and trade accounts payable denominated in foreign currency do not represent any relevant risk in the case of any fluctuation of exchange rates.

**Interest rate sensitivity analysis:** The interest rate sensitivity analysis made by the Company considers the effects of an increase or reduction of 10 basis point (bps) on the average interest rate applicable to the floating part of its debt. The calculated impact, considering this variation in the interest rate totals R\$ 55,959 as of December 31, 2018 (R\$ 54,908 as of December 31, 2017) and would impact the Financial expenses account in the Consolidated Statements of Income. The specific interest rates to which the Company is exposed are related to the loans, financing, and debentures presented in Notes 13 and 14, and are mainly comprised by Libor and CDI Interbank Deposit Certificate.

**Sensitivity analysis of changes in sales price of products and price of raw materials and other inputs used in production:** the Company is exposed to changes in the price of its products. This exposure is associated with the fluctuation of the sale price of the Company's products and the price of raw materials and other inputs used in the production process, mainly for operating in a commodity market. The sensitivity analysis made by the Company considers the effects of an increase or of a reduction of 1% on both prices. The impact measured considering this variation in the price of products sold, considering the revenues and costs of the year ended on December 31, 2018, totals R\$ 461,595 (R\$ 369,176 as of December 31, 2017) and the variation in the price of raw materials and other inputs totals R\$ 296,334 as of December 31, 2018 (R\$ 234,239 as of December 31, 2017). The impact in the price of products sold and raw materials would be recorded in the accounts Net Sales and Cost of Sales, respectively, in the Consolidated Statements of Income. The Company does not expect to be more vulnerable to a change in one or more specific product or raw material.

**Sensitivity analysis of interest rate and foreign currency swaps:** the Company has exposure to interest rate swaps for some of its loans and financing. The sensitivity analysis calculated by the Company considers the effects of either an increase or a decrease of 10 bps in the interest curve and of 5% in the exchange rate, and its impacts in the swaps mark to market for Cross Currency Swap operations, and 50 bps on the interest curve for Pre x DI operations. These variations represent an income or expense of R\$ 11,549 (R\$ 6,479 as of December 31, 2017). These effects would be recognized in the statement of comprehensive income. The interest rate swaps to which the Company is exposed to are presented in note 15.e.

**Sensitivity analysis of forward contracts in US Dollar:** the Company has exposure to forward contracts for some of its assets and liabilities. The sensitivity analysis carried out by the Company considers the effects of a 5% increase or reduction of the US Dollar against the Argentinian Peso, and its effects on fair value of these derivatives. A 5% increase in the US Dollar against the Argentinian Peso represents an income of R\$ 7,063 (income or expense of R\$ 1,480 as of December 31, 2017, considering that in this position we had operations of the Dollar against Real and Argentinian Peso), and a 5% reduction of the US Dollar against the Real and Argentinian Peso represents an expense of the same

amount. The US Dollar / Real and US Dollar / Argentinian Peso forward contracts had the objective of hedging the asset and liability positions in US Dollar and the fair value effects of these contracts were recorded in the Consolidated Income Statement. The forward contracts in US Dollars that the Company is exposed are presented in Note 15.e.

**d) Financial Instruments per Category**

Summary of the financial instruments per category:

<b>2018 Assets</b>	<b>Financial asset at amortized cost</b>	<b>Financial asset at fair value through profit or loss</b>	<b>Financial asset at fair value through other comprehensive income</b>	<b>Total</b>
Short-term investments		459,470		459,470
Unrealized gains on financial instruments			33,417	33,417
Related parties	27,939			27,939
Other current assets	780,423			780,423
Other non-current assets	449,592			449,592
<b>Total</b>	<b>1,257,954</b>	<b>459,470</b>	<b>33,417</b>	<b>1,750,841</b>
Financial income	629,750	115,081		744,831

Table of Contents

<b>Liabilities</b>	<b>Financial liability at fair value through profit or loss</b>	<b>Financial liability at amortized cost</b>	<b>Total</b>
Loans and financings		13,367,841	13,367,841
Debentures		1,538,873	1,538,873
Related parties		1,350	1,350
Obligations with FIDC		938,526	938,526
Other current liabilities		988,967	988,967
Other non-current liabilities		499,092	499,092
Unrealized losses on financial instruments	5,245		5,245
<b>Total</b>	<b>5,245</b>	<b>17,334,649</b>	<b>17,339,894</b>
Financial income (expenses)	(17,484)	(2,617,142)	(2,634,626)

<b>2017 Assets</b>	<b>Loans and receivables</b>	<b>Assets at fair value with gains and losses recognized in income</b>	<b>Total</b>
Short-term investments		821,518	821,518
Related parties	51,839		51,839
Other current assets	469,737		469,737
Other non-current assets	462,735	80,238	542,973
<b>Total</b>	<b>984,311</b>	<b>901,756</b>	<b>1,886,067</b>
Financial income	177,466	87,242	264,708

<b>Liabilities</b>	<b>Liabilities at market value with gains and losses recognized in income</b>	<b>Other financial liabilities at amortized cost</b>	<b>Total</b>
Loans and financings		16,461,656	16,461,656
Debentures		47,928	47,928
Obligations with FIDC		1,135,077	1,135,077
Other current liabilities		625,410	625,410
Other non-current liabilities		653,670	653,670
Unrealized losses on financial instruments	1,267		1,267
<b>Total</b>	<b>1,267</b>	<b>18,923,741</b>	<b>18,925,008</b>
Financial income (expenses)	(12,503)	(1,395,553)	(1,408,056)

As of December 31, 2018, the Company has derivative financial instruments such as interest rate swaps and forward contracts in US Dollar. Part of these instruments is classified as cash flow hedges and their effectiveness can be measured, having their unrealized losses and/or gains classified directly in Other Comprehensive Income. The other derivative financial instruments have their realized and unrealized losses and/or gains presented in the account Gains and losses on derivatives, net in the Consolidated Statement of Income.

#### e) Operations with derivative financial instruments

**Risk management objectives and strategies:** In order to execute its strategy of sustainable growth, the Company implements risk management strategies in order to mitigate market risks.

The objective of derivative transactions is always related to mitigating market risks as stated in our policies and guidelines. The monitoring of the effects of these transactions is performed monthly by the Financial Risk Management Committee, which validates the mark to market of these transactions. All derivative financial instruments are recognized at fair value in the Consolidated Financial Statements of the Company.

Table of Contents

**Policy for use of derivatives:** The Company is exposed to various market risks, including changes in exchange rates, commodities prices and interest rates. The Company uses derivatives and other financial instruments to reduce the impact of such risks on the fair value of its assets and liabilities or in future cash flows and income. The Company has established policies to evaluate the market risks and to approve the use of derivative transactions related to these risks. The Company enters into derivative financial instruments solely to manage the market risks mentioned above and never for speculative purposes. Derivative financial instruments are used only when they have a related position (asset or liability exposure) resulting from business operations, investments and financing.

**Policy for determining fair value:** the fair value of derivative financial instruments is determined using models and other valuation techniques, including future prices and market curves.

Derivative transactions may include: interest rate and/or currency swaps, currency futures contracts and currency options contracts.

**Swap Contracts**

The Company has contracted Cross Currency Swaps operations, whether or not qualified as cash flow hedge, through which it receives a variable interest rate based on Libor and/or a fixed US dollar rate and pays a fixed interest rate or floating currency based on the local currency. The company also contracted the Pre x DI swap operation, through which it receives a fixed interest rate and pays a floating interest rate, both in local currency. The counterparties to these operations are financial institutions with low credit risk.

The derivatives instruments can be summarized and categorized as follows:

Contracts	Position	Notional value		Amount receivable		Amount payable	
		2018	2017	2018	2017	2018	2017
<b>Forward</b>							
Maturity at 2019	purchase in US\$	US\$19.2 million				(4,069)	
Maturity at 2019	sell in US\$	US\$18.3 million		462		(1,176)	
<b>Cross currency swap</b>							
Maturity in 2018	INR 10.17%		US\$40.0 million				(1,267)
Maturity in 2019	CDI 111.50%	R\$230.5 million		30,249			
<b>Swap of interest rate</b>							
Maturity in 2020	CDI 111.50%	R\$50.0 million		2,706			
<b>Total fair value of financial instruments</b>					33,417	(5,245)	(1,267)

Table of Contents

Prospective and retrospective tests demonstrated the effectiveness of these instruments.

	2018	2017
<b>Unrealized gains on financial instruments</b>		
Current assets	30,711	
Non-current assets	2,706	
	33,417	
<b>Unrealized losses on financial instruments</b>		
Current liabilities	(5,245)	
Non-current liabilities		(1,267)
		(1,267)
	2018	2017
<b>Net Income</b>		
Gains on financial instruments	49,576	9,666
Losses on financial instruments	(17,484)	(19,107)
	32,092	(9,441)
<b>Other comprehensive income</b>		
Gains (Losses) on financial instruments	11,947	(11,364)
	11,947	(11,364)

**f) Net investment hedge**

The Company designated as hedge of part of its net investments in subsidiaries abroad the operations of Ten/Thirty Years Bonds. As a consequence, the effect of exchange rate changes on these debts has been recognized in the Statement of Comprehensive Income.

The exchange variation generated on the operations of Ten/Thirty Years Bonds in the amount of US\$ 1.8 billion (designated as hedges) is recognized in the Statement of Comprehensive Income, while the exchange rate on the portion of US\$ 0.3 billion (not designated as hedges) is recognized in income. Additionally, the Company opted to designate as hedge of the net investment financing operations held by the subsidiary Gerdau Açominas SA, in the amount of US\$ 0.1 billion, which were made in order to provide part of the funds to purchase these investments abroad.

Based on the standards related to this subject, the Company demonstrated effectiveness of the hedge as of its designation dates and demonstrated the high effectiveness of the hedge from the contracting of each debt for the acquisition of these companies abroad, whose effects were measured and recognized directly in the Statement of Comprehensive Income as an unrealized loss, net of taxes, in the amount R\$ 1,491,534 for the year ended on December 31, 2018 (loss of R\$ 148,560 on December 31, 2017).

The objective of the hedge is to protect, during the existence of the debt, the amount of part of the Company's investment in the subsidiaries abroad mentioned above against positive and negative changes in the exchange rate. This objective is consistent with the Company's risk management strategy. Prospective and retrospective tests demonstrated the effectiveness of these instruments.



**g) Measurement of fair value:**

The IFRS defines fair value as the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. The standard also establishes a three level hierarchy for the fair value, which prioritizes information when measuring the fair value by the company, to maximize the use of observable information and minimize the use of non-observable information. This IFRS describes the three levels of information to be used to measure fair value:

Level 1 - quoted prices (unadjusted) in active markets for identical assets and liabilities.

Level 2 - Inputs other than quoted prices included in Level 1 available, where (unadjusted) quoted prices are for similar assets and liabilities in non-active markets, or other data that is available or may be corroborated by market data for substantially the full term of the asset or liability.

Level 3 - Inputs for the asset or liability that are not based on observable market data, because market activity is insignificant or does not exist.

Table of Contents

As of December 31, 2018, the Company had some assets which the fair value measurement is required on a recurring basis. These assets include investments in private securities and derivative instruments.

Financial assets and liabilities of the Company, measured at fair value on a recurring basis and subject to disclosure requirements of IFRS 7 as of December 31, 2018 and December 31, 2017, are as follows:

	Fair Value Measurements at Reporting Date Using					
			Quoted Prices Active Markets for Identical Assets (Level 1)		Quoted Prices in Non-Active Markets for Similar Assets (Level 2)	
	2018	2017	2018	2017	2018	2017
<b>Current assets</b>						
Short-term investments	459,470	821,518	114,027	238,008	345,443	583,510
Unrealized gains on financial instruments	30,711				30,711	
Other current assets	780,423	469,737			780,423	469,737
<b>Non-current assets</b>						
Related parties	27,939	51,839			27,939	51,839
Unrealized gains on financial instruments	2,706				2,706	
Other non-current assets	449,592	542,973			449,592	542,973
	1,750,841	1,886,067	114,027	238,008	1,636,814	1,648,059
<b>Current liabilities</b>						
Short-term debt	1,822,183	2,004,341			1,822,183	2,004,341
Unrealized losses on financial instruments	5,245				5,245	
Other current liabilities	988,967	625,410			988,967	625,410
<b>Non-current liabilities</b>						
Long-term debt	11,545,658	14,457,315			11,545,658	14,457,315
Debentures	1,538,873	47,928			1,538,873	47,928
Related parties	1,350				1,350	
Unrealized losses on financial instruments		1,267				1,267
Obligations with FIDC	938,526	1,135,077			938,526	1,135,077
Other non-current liabilities	499,092	653,670			499,092	653,670
	17,339,894	18,925,008			17,339,894	18,925,008

**h) Changes in liabilities from Cash flow from financing activities:**

As required by IAS 7, the Company has summarized below the changes in the liabilities of cash flow from financing activities, from its Statement of Cash Flows:

Cash transactions

Non cash transactions

Edgar Filing: GERDAU S.A. - Form 20-F

	<b>Balances as of December 31, 2017</b>	<b>Proceeds/(Repayment) from financing activities</b>	<b>Interest paid on loans and financing</b>	<b>Interest expense on loans and Interest on loans with related parties</b>	<b>Exchange variation, operations with subsidiaries and associate company and others</b>	<b>Balances as of December 31, 2018</b>
Related parties, net	(51,839)	25,755		(545)	40	(26,589)
Debt, Debentures and Losses/Gains on financial instruments, net	16,510,851	(3,439,644)	(1,162,364)	1,177,686	1,825,430	14,911,959

	<b>Cash transactions</b>			<b>Non cash transactions</b>		
	<b>Balances as of December 31, 2016</b>	<b>Proceeds/(Repayment) from financing activities</b>	<b>Interest paid on loans and financing</b>	<b>Interest expense on loans and Interest on loans with related parties</b>	<b>Exchange variation, operations with subsidiaries and associate company and others</b>	<b>Balances as of December 31, 2017</b>
Related parties, net	(57,541)	5,797		(95)		(51,839)
Debt, Debentures and Losses/Gains on financial instruments, net	20,576,866	(3,975,541)	(1,330,116)	1,323,448	(83,806)	16,510,851

Table of Contents

	Cash transactions			Non cash transactions		Balances as of December 31, 2016
	Balances as of January 1, 2016	Proceeds/(Repayment) from financing activities	Interest paid on loans and financing	Interest expense on loans and Interest on loans with related parties	Exchange variation, operations with subsidiaries and associate company and others	
Related parties, net	(53,506)	(6,492)		2,457		(57,541)
Debt, Debentures and Losses/Gains on financial instruments, net	26,417,256	(2,150,035)	(1,240,165)	1,540,797	(3,990,987)	20,576,866

**NOTE 16 TAXES PAYABLE**

	2018	2017
Payroll charges	58,907	75,752
ICMS (state VAT)	25,385	37,444
COFINS (tax on revenue)	2,162	5,411
IPI (federal VAT)	14,372	17,305
IVA (value-added tax) and others	250,719	148,189
	351,545	284,101

**NOTE 17 TAX, CIVIL AND LABOR CLAIMS AND CONTINGENT ASSETS**

The Company and its subsidiaries are party in judicial and administrative proceedings involving labor, civil and tax matters. Based on the opinion of its legal advisors, Management believes that the provisions recorded for these judicial and administrative proceedings is sufficient to cover probable and reasonably estimable losses from unfavorable court decisions, and that the final decisions will not have significant effects on the financial position, operational results and liquidity of the Company and its subsidiaries.

For claims whose expected loss is considered probable, the provisions have been recorded considering the judgment of the Management of the Company with the assistance of its legal advisors and the provisions are considered sufficient to cover expected probable losses. The balances of the provisions are as follows:

**I) Provisions**

	2018	2017
a) Tax provisions	268,009	257,621
b) Labor provisions	449,350	517,329
c) Civil provisions	52,946	52,933
	770,305	827,883

As the net result of the reversal of the accounting provision described below (tax provisions), related to the discussion of the exclusion of the ICMS ( Imposto sobre a circulação de Mercadorias e Serviços ICMS State VAT) from the tax base for contributions to PIS ( Contribuição ao Programa de Integração Social - PIS) and COFINS ( Contribuição para o Financiamento da Seguridade Social - COFINS), and the recognition of other accounting provisions for the year ended on December 31, 2017, the Company recorded the amounts of R\$ 929,711 on the line Reversal of provision for tax liabilities, net (Operating Result), and R\$ 369,819, on the line Reversal of interest on provision for tax liabilities, net (Financial Income), in its Consolidated Statements of Income.

**a) Tax Provisions**

The Company and its subsidiaries are parties to lawsuits related to the exclusion of the ICMS from the tax base for contributions to PIS and COFINS, with respect to which the Company made judicial deposits and accounting provisions, which in turn were updated in accordance with the SELIC rate, which were referred to the unpaid amounts of PIS and COFINS since 2009, because the collection of which was fully suspended, due to the mentioned judicial deposits.

On March 15, 2017, the Brazilian Federal Supreme Court (STF Supremo Tribunal Federal) ruled on a claim related to this matter, and by 6 votes to 4, concluded: The ICMS does not comprise the tax base for PIS and COFINS assessment purposes . The STF decision, in principle, affects all of the judicial proceedings in progress, due to its general repercussion. However, after the publication

Table of Contents

of the decision on October 02, 2017, the Attorney of the National Treasury filed an appeal, claiming that the decision of the Supreme Court was silent on certain points, and requested a modulation of the decision effects, which may limit its effects to the taxpayers.

Provisions, Contingent Liabilities and Contingent Assets, a provision is recognized only when it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, among other requirements. On March 31, 2017 the Company, based on (i) the conclusion of this judgment by the STF in Extraordinary Appeal No. 574,706/RG with general repercussion, which ruled that the inclusion of the ICMS in the PIS and COFINS calculation tax base was unconstitutional, and (ii) the International Financial Reporting Standards (IFRS), reversed the aforementioned accounting provision, through the recognition of R\$ 929,711 in the line Reversal of contingent liabilities, net (Operational result) and R\$ 369,819 in the line Reversal of monetary update of contingent liabilities, net (Financial Result), in its income statement. The Company's decision is supported by the position of its legal advisors who, when reassessing the likelihood of loss in the ongoing lawsuits related to the matter, concluded that the probability of loss, as to the merits of these lawsuits, became remote as of the date of the enactment of this decision.

The Company emphasizes, however, that in view of the possibility that the STF may understand that the modulation mechanism necessarily applies to its decision, and that the application of such a mechanism could limit the effects of the same, a revaluation of the risk of loss associated with the aforementioned lawsuits may be required. Accordingly, depending on the terms of the modulation, as defined by the STF, such revaluation may result in the need to record new provisions in connection with this matter in the future.

The balance of judicial deposits as of December 31, 2018, in the amount of R\$ 1,763,085, referring to the same discussion on the inclusion of the ICMS in the tax base of PIS and COFINS, awaits termination of the relevant lawsuits before the Brazilian courts in order to be returned to the Company.

The other tax provisions refer substantially to the discussions regarding the offset of PIS credits and the incidence of PIS and COFINS on other revenues.

**b) Labor Provisions**

The Company and its subsidiaries are party to labor claims. None of these claims involves individually significant amounts and corresponds mainly to overtime pay, additional night work, hours in itinere, health hazard premium, and hazardous duty premium, indemnity for occupational accidents, occupational illness and moral damages, among others.

**c) Civil Provisions**

The Company and its subsidiaries are also a party to civil lawsuits arising in the normal course of its business, which totaled as of December 31, 2018 the amount shown as provision liabilities.

Edgar Filing: GERDAU S.A. - Form 20-F

The changes in the tax, labor and civil provisions are shown below:

	2018	2017	2016
Balance at the beginning of the year	827,883	2,239,226	1,904,730
(+) Additions	177,684	527,543	313,246
(+) Monetary correction	85,626	77,257	178,661
(-) Reversal of contingent liabilities		(929,711)	
(-) Reversal of monetary update of contingent liabilities		(369,819)	
(-) Reversal of accrued amounts	(319,719)	(715,081)	(144,025)
(+) Foreign exchange effect on provisions in foreign currency	(1,169)	(201)	(3,235)
(-) Loss of control of subsidiary		(1,331)	(10,151)
Balance at the end of the year	770,305	827,883	2,239,226

**II) Contingent liabilities for which provisions were not recorded**

Considering the opinion of legal advisors and management's assessment, contingencies listed below have chance of loss considered as possible (but not likely) and due to this classification, accruals have not been made in accordance with IFRS.

Table of Contents

**a) Tax contingencies**

**a.1)** The Company and its subsidiaries Gerdau Aços Longos S.A. and Gerdau Açominas S.A., have other lawsuits related to the ICMS (state VAT) which are mostly related to credit rights and rate differences, whose demands totaled R\$ 613,642.

**a.2)** The Company and certain of its subsidiaries in Brazil are parties to claims related to: (i) Imposto sobre Produtos Industrializados - IPI, substantially related to IPI credit on inputs, whose demands total the updated amount of R\$ 341,659; (ii) PIS and COFINS, substantially related to non-approval of compensation of credits on inputs totaling R\$ 968,047, (iii) social security contributions in the total of R\$ 88,374 and (iv) other taxes, whose updated total amount is currently R\$ 641,782.

**a.3)** The Company and its subsidiary Gerdau Aços Longos SA are parties to three administrative proceedings related to Withholding Income Tax, levied on interest remitted abroad, linked to export financing formalized through Prepayment of Exports Agreements (PPE) or Prepayment of Exports (RAE), in the updated amount of R\$ 410,893, of which: (i) R\$ 125,365 corresponds to a lawsuit of the subsidiary Gerdau Aços Longos, which had its Voluntary Appeal judged at the first instance of the Administrative Council of Tax Appeals (CARF), which was dismissed by the quality vote, by means of the judgment published on September 3, 2018, in the face of which the Company objected Embargoes of Declaration, which awaits judgment;; (ii) R\$ 132,643 corresponds to a lawsuit filed by the subsidiary Gerdau Aços Longos, which was challenged and dismissed and filed a Voluntary Appeal at the first instance of CARF, on August 28, 2018, which is pending of judgment; and; (iii) R\$ 152,885, corresponds to a lawsuit filed by the Company, which was challenged and dismissed and filed a Voluntary Appeal at the first instance of CARF, on August 31, 2018, which is pending of judgment.

**a.4)** The Company (as successor of Gerdau Aços Especiais S.A.) and its subsidiary Gerdau Internacional Empreendimentos Ltda. are parties to administrative and judicial proceedings relating to IRPJ Corporate Income Tax and CSLL Social Contribution Tax, in the current amount of R\$ 1,200,672. Such proceedings relate to profits generated abroad, of which (i) R\$ 1,023,337 correspond to two lawsuits of the subsidiary Gerdau Internacional Empreendimentos Ltda., of which (i.a) R\$ 988,819 correspond to a lawsuit whose administrative discussion has already been closed and are currently in Fiscal Execution, in relation to which the Company filed Execution Embargoes, which are pending of judgment by the first instance and (i.b) R\$ 34,518 are remaining from a notice originally of R\$ 372,213 and correspond to a suit partially provided by the Superior Court of Tax Appeals (CSRF), in a decision published on May 25, 2017 and has already become final; currently the process is awaiting proceedings by the first instance of the Administrative Council of Tax Appeals (CARF), for analysis of matters not previously analyzed, as determined by the CSRF decision; and (ii) R \$ 177,335 corresponds to a lawsuit filed by the Company, which had its Voluntary Appeal adjudicated by the first instance of CARF, which was dismissed, reason why a Special Appeal was filed with the Superior Court of Tax Appeals (CSRF), known in part and pending of judgment.



a.5) The Company (as successor of Gerdau Aços Especiais S.A.) and its subsidiaries Gerdau Aços Longos S.A. and Gerdau Açominas S.A. are parties to administrative proceedings relating to the disallowance of the deductibility of goodwill generated in accordance with Article 7 and 8 of Law 9,532/97 as a result of a corporate restructuring carried out in 2004/2005 from the tax base of the Corporate Income tax - IRPJ and Social Contribution on Net Income - CSLL. The total updated amount of the proceedings is R\$ 7,062,878, of which (i) R\$ 5,128,470 correspond to four proceedings involving the Company and its subsidiaries Gerdau Aços Longos S.A. and Gerdau Açominas S.A., for which administrative discussions already ended and are currently in the judicial collection stage; and the Companies obtained injunctive relief to permit it to offer a judicial guarantee using a liability insurance policy, for judicial discussions on Embargoes to Execution in the respective proceedings, and in the Embargoes to Execution filed by the Company (as successor of Gerdau Aços Especiais S.A.), on May 17, 2018, a judgment was rendered dismissing the fiscal launch, in the face of which the National Treasury filed an appeal, which is pending of judgment in the Federal Regional Court of the 4<sup>th</sup> Region; (ii) R\$ 629,753 correspond to a lawsuit filed by the subsidiary Gerdau Aços Longos SA, which had its Voluntary Appeal judged at the first instance of CARF on September 18, 2018, which was given partial relief and it is pending of publication of the judgment, in the light of which the Company will take the appropriate measures; (iii) R\$ 255,531 correspond to a lawsuit filed by the subsidiary Gerdau Aços Longos SA, which had a Voluntary Appeal rejected by the first instance of CARF, which is why a Special Appeal was filed in the CSRF, which was partially dispatched by an order of which it became aware on July 6, 2018 and in the face of which it filed Regimental Grievance, which is awaiting judgment; (iv) R\$ 297,033 correspond to a lawsuit filed by the subsidiary Gerdau Aços Longos SA, which had its Voluntary Appeal rejected, reason for which was filed a Special Appeal, which was given partial follow-up; currently, the company awaits judgment of its Special Appeal in so far as it is known and awaits collection of the amounts corresponding to the part in which its Special Appeal was not known, in order to adopt the appropriate judicial measures; (v) R\$ 128,404 correspond to a lawsuit filed by the Company (as successor to Gerdau Aços Especiais SA), which had its Voluntary Appeal rejected by the first instance of CARF, which is why a Special Appeal was filed, by an order of which it became aware on September 12, 2018 and in the face of which it filed a regimental grievance that awaits judgment; (vi) R\$ 100,686 corresponds to a lawsuit filed by the Company (as successor to Gerdau Aços Especiais SA), which was rejected as unfounded, by decision of which it became aware on September 17, 2018 and in the face of which it filed Voluntary Appeal in the first instance of CARF, currently pending of judgment; and (vii) R\$ 522,731 correspond to a lawsuit filed by the subsidiary Gerdau Aços Longos S.A., which was challenged as unfounded, by decision of which it became aware on November 27, 2018 and in the face of which it filed a Voluntary Appeal at the first instance of CARF, which is currently pending of judgment.

Table of Contents

The Company, supported by the advice of its legal counsel, understands that the procedures adopted by the Company with respect to the tax treatment of profits abroad and the deductibility of goodwill were strictly legal, and, therefore, the likelihood of loss with respect to said proceedings is possible (but not likely).

In connection with the so-called Operation Zelotes and other matters, Brazilian federal authorities and the judiciary branch are investigating certain issues relating to CARF proceedings, as well as specific political contributions made by the Company, with the purpose of determining whether the Company engaged in any illegal conduct. The Company previously disclosed that, in addition to its interactions with Brazilian authorities, the Company was providing information requested by the U.S. Securities and Exchange Commission (SEC). The Company has since been informed by the SEC's staff that it has closed its inquiry and therefore is not seeking any further information from the Company regarding these matters.

The Company believes it is not possible at this time to predict the term or outcome of the proceedings in Brazil, and that there currently is not enough information to determine whether a provision for losses is required or any additional disclosures.

Furthermore, as previously disclosed, the Company retained outside counsel, reporting to a Special Committee of the Board of Directors, to investigate certain matters relating to CARF proceedings and ultimately political donations by Company entities. That investigation by outside counsel has now been concluded and its results have been reported to the Board of Directors and the SEC.

**b) Civil contingencies**

**b.1)** A lawsuit arising from the request by two civil construction unions in the state of São Paulo alleging that Gerdaul S.A. and other long steel producers in Brazil share customers, thus, violating the antitrust legislation. After investigations carried out by the Economic Law Department (SDE - Secretaria de Direito Econômico), the final opinion was that a cartel exists. The lawsuit was therefore forwarded to the Administrative Council for Economic Defense (CADE) for judgment, which resulted in a fine to the Company and other long steel producers, on September 23, 2005, an amount equivalent to 7% of gross revenues in the year before the Administrative Proceeding was commenced, excluding taxes (fine of R\$ 245,070, updated by the judicial accountant on August 01, 2013 to R\$ 417,820).

Two lawsuits challenge the investigation conducted by the Competition Defense System and its merits judgment, whose grounds are procedural irregularities, especially the production of evidence, based on an economic study, to prove the inexistence of a cartel. The Court, upon offer of bank guarantee letter, granted the suspension of the effects of CADE's decision. Sentences were handed down for the dismissal of the actions and both are found in appeal phase.

With respect to the first lawsuit, filed in 2003, in which irregularities are questioned in the administrative proceeding, the Federal Regional Court of the first Region rendered an unfavorable decision to the Company. Against this decision, appeals were directed to the Superior Court of Justice and to the Federal Supreme Court, which are still awaiting admissibility analysis by the Court. With regard to the second lawsuit, filed in 2006, in which the nullity of the CADE judgment is questioned, the Federal Regional Court of the first Region issued a recent unfavorable decision to the Company. Due to procedural defect and omission in the respective judgment, there were opposing Embargoes of Declaration,

which are still awaiting judgment by the Federal Regional Court of the first Region. Regardless of the result of its resources, the Company will continue to seek all legal remedies to defend its rights. The Company denies having been engaged in any type of anti-competitive conduct and believes based on information available, including the opinion of its legal counsel, that it is possible that the decision will be reverted.

b.2) The Company and its subsidiaries are parties to other demands of a civil nature that collectively have a discussion amount of approximately R\$ 234,626. For these demands, no accounting provision was recorded, since they were considered as possible losses, based on the opinion of its legal advisors.

**c) Administrative proceeding Brazilian Securities Commission (CVM)**

On July 14, 2015, the Company acquired non-controlling interests in the following companies: Gerdau Aços Longos S.A. (4.77%), Gerdau Açominas S.A. (3.50%), Gerdau Aços Especiais S.A. (2.39%) and Gerdau América Latina Participações S.A. (4.90%), having as counterparties Itaú Unibanco S.A. and ArcelorMittal Netherlands BV. This transaction was approved by the Board of Directors of Gerdau S.A. by unanimous vote of the directors on July 13, 2015, based on the market opportunity and the analysis that the prices were appropriate considering: economic evaluations conducted by independent report, the financial instruments used, the payment terms, capturing value through a more concentrated cash flow and long-term vision for the Company. The Company, in compliance with CVM requests for the clarification on the acquisition, disclosed that the decision to its acquisition had exclusively business purpose and was duly considered and unanimously approved by the Board of Directors. The terms and conditions for the acquisition

Table of Contents

considered long-term market prospects. On October 21, 2016, Metalúrgica Gerdau S.A. and certain directors and former directors of Gerdau S.A. filed a defense for the administrative proceeding brought by CVM on the acquisition of non-controlling interests in the subsidiaries, in the sense that the operation was businesslike justified, as above stated. There is no estimate for a final decision of the matter. Metalúrgica Gerdau S.A. believes that, currently, there is not enough information to disclose or determine if a provision for losses is required.

**III) Judicial deposits**

The Company has judicial deposits related to tax, labor and civil lawsuits as listed below:

	2018	2017
Tax	1,963,859	1,883,562
Labor	126,620	128,849
Civil	44,935	38,770
	2,135,414	2,051,181

**IV) Contingent Asset - Eletrobrás Compulsory Loan Centrais Elétricas Brasileiras S.A. (Eletrobrás)**

The Compulsory Loan, instituted by the Brazilian government in order to expand and improve the energy sector of the country was charged and collected from industrial consumers with monthly consumption equal or greater than to 2000kwh through the electricity bills issued by the electric power distribution companies, was converted into credits to the taxpayers based on the annual value of these contributions made between 1977 and 1993. The legislation sets a maximum 20 years period to return the compulsory loan to the taxpayers, providing Eletrobrás the possibility of anticipating this return through the conversion of those loans in shares of its own issuance. Prior to the conversion of the credits into shares, those credits were monetary corrected through an indexer and quantifier, called Standard Unit (SU). However, the compulsory loan was charged to the companies in their monthly electricity bills, consolidated during the year, and only indexed by the SU in January of the following year, resulting in a lack of monthly monetary correction during the years of collection, as well as interest. This procedure imputed to taxpayers considerable financial losses, particularly during the periods when the monthly inflation rates stood at high levels.

In order to claim the appropriate interest and monetary correction subtracted by the methodology applied by Eletrobrás, the Company (understood to be legally entities existing at the time and that later became part of Gerdau S.A.) filed lawsuits claiming credits resulting from differences on the monetary correction of principal, interest, moratory and other accessory amounts owed by Eletrobrás due to the compulsory loans, totaling approximately R\$ 1,260 million. Recently, particularly in 2015, processes involving representative amounts were definitively judged by the Superior Court of Justice - STJ favorable to the Company so that no further appeals against such decisions apply ( final judgment ). For claims with a final judgment, it yet remains the enforcement of ruling (or execution phase) where the actual amounts to be settled will finally be calculated.

Obtaining favorable decisions represented by the final judgment mentioned above, suggests that an inflow of economic benefits may occur in the future. However, there are still substantial uncertainties on the timing, the way and the amount to be realized so that it is not yet practicable to reasonably determine that the realization of the gain arising from these decisions has reached a level of virtually certain and that the Company has control over such assets, which implies that such gains are not recorded until such conditions are demonstrably present.



Table of Contents**NOTE 18 - RELATED-PARTY TRANSACTIONS****a) Intercompany loans**

	2018	2017
<b>Assets</b>		
<b>Joint venture</b>		
Gerdau Corsa SAPI de C.V.	72	7
<b>Others</b>		
Fundação Gerdau	27,867	51,832
	27,939	51,839
<b>Liabilities</b>		
<b>Joint venture</b>		
Diaco S.A.	(1,350)	
	(1,350)	

	2018	2017	2016
Net financial income	545	95	(2,457)

**b) Operations with related parties**

During the years ended December 31, 2018, 2017 and 2016, the Company, through its subsidiaries, entered into commercial operations with some of its associate companies and joint ventures including sales of R\$ 1,382,584 as of December 31, 2018 (R\$ 630,190 and R\$ 421,415 as of December 31, 2017 and 2016, respectively) and purchases in the amount of R\$ 129,513 as of December 31, 2018 (R\$ 121,618 and R\$ 141,275 as of December 31, 2017 and 2016, respectively). The net amount totals R\$ 1,253,071 as of December 31, 2018 (R\$ 508,572 and R\$ 280,140 as of December 31, 2017 and 2016, respectively).

During the years ended December 31, 2018, 2017 and 2016, the Company and its subsidiaries made transactions with controlling shareholders, directly or indirectly, mainly of guarantees provided by the controlling in guarantees of debentures, on which the Company pays a fee of 0.95 % p.a. on the amount guaranteed. The effect of these transactions was an expense of R\$ 194 (R\$ 689 and R\$ 4,732 as of December 31, 2017 and 2016, respectively). Additionally, the Company recorded income of R\$ 445 (R\$ 801 and R\$ 1,001 as of December 31, 2017 and 2016, respectively), derived from rental agreement.

**Guarantees granted**

Related Party	Relationship	Object	Original Amount	Maturity	2018	2017	2016
Diaco S.A.	Joint-venture		137,700	Aug/18		128,019	

		Financing Agreements					
Gerdau Corsa S.A.P.I. de C.V.	Joint-venture	<i>Financing Agreements</i>	1,875,345	Jan/19 - Dec/21	1,933,929	1,797,856	2,016,260
Gerdau Summit Aços Fundidos e Forjados S.A.	Joint-venture	<i>Financing Agreements</i>	130,164	Aug/25	41,571	6,550	
Gerdau Metaldom S.A.; Aceros Corsa S.A. de C.V. and Gerdau Corsa S.A.P.I de C.V.;	Subsidiary and Joint-venture	<i>Financing Agreements</i>		Oct/20	198,619	178,200	

### c) **Debentures**

Debentures are held by direct or indirect shareholders in the amount of R\$ 0 as of December 31, 2018 (R\$ 348 as of December 31, 2017), which corresponds to 0 debentures (63 as of December 31, 2017).

### d) **Price and interest**

Loan agreements between Brazilian companies carry interest based on the CDI (Interbank Deposit Certificate) and Libor rate plus exchange variance, when applicable. Sales of products and purchases of inputs are made under terms and conditions agreed between the parties.

### e) **Key Management compensation**

The cost of the key management salaries, variable compensation and benefits was R\$ 50,310 during 2018 (R\$ 38,510 in 2017). In 2018, contributions to management's defined contribution pension plans totaled R\$ 1,595 (R\$ 1,158 in 2017).

Table of Contents

Stock options granted to management are as follows:

	<b>2018</b>	
	<b>Number of shares</b>	<b>Weighted exercise price R\$</b>
Available at beginning of the year	198,000	18.19
Options Cancelled	(198,000)	18.62
Available at the end of the year		

At the end of the year, the Restricted Shares resulting from the conversion process within the key management were:

	<b>2018</b>	<b>2017</b>
Available at beginning of the year	5,945,310	4,831,999
Granted	1,255,286	1,353,930
Exercised	(511,333)	(240,619)
Shares adjustment	(313,716)	
Available at the end of the year	6,375,547	5,945,310

Additional information on the long-term incentive plan are presented in Note 25.

The cost of long-term incentive plans recognized in income and attributable to key management (members of Board of Directors and executive officers) totaled R\$ 23,189 during 2018 (R\$ 10,451 and R\$ 14,095 during 2017 and 2016, respectively).

**NOTE 19 EMPLOYEE BENEFITS**

Total assets and liabilities of all types of employee benefits granted by the Company and its subsidiaries as of December 31, 2018 are as follows:

	<b>2018</b>	<b>2017</b>
Plan assets - Defined contribution pension plan	17,952	1,149
Total assets	17,952	1,149
Actuarial liabilities - Defined benefit pension plan	1,057,846	1,084,758
Actuarial liabilities - Post-employment health care benefit	272,369	316,230
Retirement and termination benefit liabilities	26,502	23,876
Total liabilities	1,356,717	1,424,864
Current	157	253
Non-current	1,356,560	1,424,611



a) **Post-employment defined benefit pension plan**

The Company's Canadian and US subsidiaries sponsor defined benefit plans (Canadian Plan and American Plan), collectively referred to as the North-American Plans, that cover substantially all their employees and provide supplemental benefits to employees during retirement.

Additionally, the Company and its subsidiaries in Brazil sponsored a defined benefit pension plan (Brazilian plans), which are managed through Gerda - Sociedade de Previdência Privada, a closed supplementary pension entity. In 2010, it was approved the settlement of a defined benefit plan, in which the participants had the rights for the benefit settled. All participants of those plans, which are now settled, were able to: (i) choose to adhere to a new defined contribution plan, when it was authorized to transfer the amount related to the individual mathematical reserve from the settled plan for the new plan and add amounts to this reserve through future contributions and sponsors, plus the resources profitability; or (ii) do not transfer the reserve and maintain the benefit settled in the defined benefit plan, adjusted by the INPC (National Index of Consumer Prices).

Table of Contents

The assumptions adopted for pension plans can have a significant effect on the amounts disclosed and recorded for these plans. Due to the migration process and the closing of the Brazilian pension plans in 2010, the Company is not calculating the potential effects of changes in discount rates and expected return rate on assets for these plans. The potential effects of changes to the North-American Plans on the Consolidated Statement of Income are presented below:

	1% Increase	1% Decrease
Discount rate	(14,689)	10,346

The accumulated amount recognized in other Comprehensive Income for employee benefits is R\$ (1,075,377) as of December 31, 2018 (R\$ (1,227,722) as of December 31, 2017).

**Defined Benefit Pension Plan**

The current expenses of the defined benefit pension plans are as follows:

	2018	2017	2016
Cost of current service	60,803	60,595	57,619
Interest expense	82,513	90,381	199,389
Return on plan assets	(59,692)	(64,128)	(186,856)
Past service cost	7,065	1,082	2,788
Settlement	3,220	(566)	609
Interest cost on unrecoverable surplus	20,023	21,211	22,916
Net pension cost	113,932	108,575	96,465

The reconciliations of assets and liabilities of the plans are as follows:

	2018	2017
Present value of defined benefit obligation	(4,391,251)	(4,314,592)
Fair value of plan assets	3,568,934	3,456,613
Asset ceiling restrictions on recognition of net funded assets	(235,532)	(226,779)
Net	(1,057,849)	(1,084,758)
Plan assets		
Defined benefit obligation	(1,057,849)	(1,084,758)

Changes in plan assets and actuarial liabilities were as follows:

	2018	2017	2016
<b>Variation of the plan obligations</b>			
Obligation at the beginning of the year	4,314,592	4,174,653	4,739,299
Cost of service	60,803	60,595	57,619

Edgar Filing: GERDAU S.A. - Form 20-F

Interest expense	188,729	195,557	199,389
Payments of the benefits	(318,198)	(335,471)	(317,505)
Past service cost	7,065	1,082	2,788
Supplementary amounts of the plan	17,078		
Settlement	(61,369)	(52,035)	609
Acturial remeasurements	(370,083)	235,549	186,905
Liabilities held for sale		(101,794)	
Exchange Variance	552,634	136,456	(694,451)
Obligation at the end of the year	4,391,251	4,314,592	4,174,653

F-51

---

Table of Contents

	2018	2017	2016
<b>Variation of the plan assets</b>			
Fair value of the plan assets at the beginning of the year	3,456,613	3,292,890	3,865,411
Return of the plan assets	165,908	169,304	186,857
Contributions from sponsors	197,828	111,450	(47,574)
Settlement	(64,868)	(51,469)	(6,710)
Payments of benefits	(318,198)	(335,471)	(317,505)
Remeasurement	(253,301)	232,214	109,153
Assets held for sale		(73,127)	
Exchange Variance	384,952	110,822	(496,742)
Fair value of plan assets at the end of the year	3,568,934	3,456,613	3,292,890

The fair value of plan assets include shares of the Company in the amount of R\$ 3,427 as of December 31, 2018 (R\$ 3,558 as of December 31, 2017).

Amounts recognized as actuarial gains and losses in the Statement of Comprehensive Income are as follows:

	2018	2017	2016
Remeasurements	253,301	(232,214)	(109,153)
Actuarial Remeasurements	(370,083)	235,549	186,905
Restriction recognized in Other Comprehensive Income	(43,197)	(1,696)	3,065
Remeasurements recognized in Other Comprehensive Income	(159,979)	1,639	80,817

The historical actuarial remeasurements are as follows:

	2018	2017	2016	2015	2014
Present value of defined benefit obligation	(4,391,251)	(4,314,592)	(4,174,653)	(4,739,299)	(3,791,670)
Fair value of the plan assets	3,568,934	3,456,613	3,292,890	3,865,411	3,319,133
Surplus (Deficit)	(822,317)	(857,979)	(881,763)	(873,888)	(472,537)
Experience adjustments on plan liabilities (Gain)	(370,083)	235,549	186,905	(202,749)	466,829
Experience adjustments on plan assets (Gain)	253,301	(232,214)	(109,153)	235,275	(69,748)

Actuarial remeasurements are recognized in the period in which they occur and are recorded directly in comprehensive income.

The allocations for plan assets are presented below:

	2018	
	Brazilian Plans	American Plans
Fixed income	98.0%	58.1%
Variable income		36.5%
Others	2.0%	5.4%
Total	100.0%	100.0%

	2017	
	Brazilian Plans	American Plans
Fixed income	98.0%	48.3%
Variable income		45.0%
Others	2.0%	6.7%
Total	100.0%	100.0%

The investment strategy for the Brazilian Plan is based on a long-term macroeconomic scenario. This scenario assumes a reduction in Brazil's sovereign risk, moderate economic growth, stable levels of inflation, exchange rates and moderate interest rates.

The Canadian and American subsidiaries have an Investment Committee that defines the investment policy for the defined benefit plans. The primary investment objective is to ensure the security of benefits that were accrued under the plans, providing an adequately funded asset pool which is separated and independent of the Company. To reach this objective, the fund must invest in a

Table of Contents

manner that adheres to safeguards and diversification to which a prudent investor of pension funds would normally adhere. These subsidiaries retain specialized consultants that advice and support Investment Committee decisions and recommendations.

The asset mix policy considers the principles of diversification and long-term investment goals, as well as liquidity requirements. To do this, the target allocation ranges between 50% in shares, 40% in debt securities and 10% in alternative securities, and for Brazilian Plan it is close to 100% in fixed income.

The tables below show a summary of the assumptions used to calculate the defined benefit plans in 2018 and 2017, respectively:

	2018	
	Brazilian Plan	North America Plan
Average discount rate	9.10%	3.50% - 4.25%
Rate of increase in compensation	Not applicable	3.00%
Mortality table	AT-2000 per sex	RP-2006 and MP-2018
Mortality table of disabled	AT-2000 per sex	RP-2006 and MP-2018
Rate of rotation	Based on plan background	Based on age and/or the service

	2017	
	Brazilian Plan	North America Plan
Average discount rate	9.84%	3.25% - 4.25%
Rate of increase in compensation	Not applicable	3.00%
Mortality table	AT-2000 per sex	RP-2006 and MP-2017
Mortality table of disabled	AT-2000 per sex	RP-2006 and MP-2017
Rate of rotation	Based on plan background	Based on age and/or the service

#### b) **Post-employment defined contribution pension plan**

The Company and its subsidiaries in Brazil, in the United States and in Canada maintain a defined contribution plan to which contributions are made by the sponsor in proportion to the contributions made by its participating employees. The total cost of these plans was R\$ 123,225 in 2018 (R\$ 132,399 in 2017).

#### c) **Post-employment health care benefit plan**

The North American plans include, in addition to pension benefits, specific health care benefits for employees who retire after a certain age and with a certain number of years of service. The Americans and Canadian subsidiaries have the right to change or eliminate these benefits, and the contributions are actuarially calculated.

Edgar Filing: GERDAU S.A. - Form 20-F

The net periodic costs of post-employment health care benefits are as follows:

	<b>2018</b>	<b>2017</b>	<b>2016</b>
Current service cost	4,144	4,441	4,481
Interests expense	11,082	12,162	15,494
Past service cost	(40,740)	5,769	(75,787)
Net cost pension benefit	(25,514)	22,372	(55,812)

The funded status of the post-employment health benefits plans is as follows:

	<b>2018</b>	<b>2017</b>
Present value of obligations	(272,959)	(316,364)
Total net liabilities	(272,959)	(316,364)

Changes in plan assets and actuarial liabilities were as follows:

Table of Contents

	2018	2017	2016
<b>Change in benefit obligation</b>			
Benefit obligation at beginning of the year	316,364	305,447	446,842
Cost of service	4,144	4,441	4,481
Interest expense	11,082	12,162	15,494
Past service cost	(40,740)	5,769	(75,787)
Contributions from participants	1,496	1,556	2,212
Payment of benefits	(18,655)	(14,230)	(14,799)
Remeasurements	(40,841)	(14,452)	(3,673)
Exchange variations	40,109	15,671	(69,323)
Benefit obligation at the end of the year	272,959	316,364	305,447

	2018	2017	2016
<b>Change in plan assets</b>			
Contributions from sponsors	17,159	12,572	12,463
Contributions from participants	1,496	1,556	2,212
Payments of benefits	(18,655)	(14,128)	(14,675)
Fair value of plan assets at end of the year			

The historical actuarial gains and losses of the plans are as follows:

	2018	2017	2016	2015	2014
Present value of defined benefit obligation	(272,959)	(316,364)	(305,447)	(446,843)	(351,538)
Deficit	(272,959)	(316,364)	(305,447)	(446,843)	(351,538)
Experience adjustments on plan liabilities	(40,841)	(14,452)	(3,673)	(45,884)	42,345

The amounts recognized as actuarial gains and losses in other comprehensive income are as follows:

	2018	2017	2016
Losses on actuarial obligation	(40,841)	(14,452)	(3,673)
Actuarial losses recognized in Equity	(40,841)	(14,452)	(3,673)

The accounting assumptions adopted for post-employment health benefits are as follows:

	2018	2017
Average discount rate	3.75% - 4.25%	3.25% - 3.50%
Health treatment - rate assumed next year	6.60% - 6.75%	6.88% - 7.60%
Health treatment - Assumed rate of decline in the cost to achieve in the years of 2026 to 2041	4.00% - 4.40%	4.00% - 4.50%

The assumptions adopted for post-employment health benefits have a significant effect on the amounts disclosed and recorded for post-employment health benefits plans. The change of one point percentage on discount rates would have the following effects:



	1% Increase	1% Decrease
Effect over total service costs and interest costs	2,051	(1,612)
Effect over benefit plan obligations	27,517	(22,743)

**d) Other retirement and termination benefits**

The benefits of this plan provide a compensation supplement up to retirement date, cost of living allowance, and other benefits as a result of termination and retirement of the employees. The Company estimates that the total obligation for these benefits was R\$ 26,502 as of December 31, 2018 (R\$ 23,876 as of December 31, 2017).

**NOTE 20 ENVIRONMENTAL LIABILITIES**

The steel industry uses and generates substances that may damage the environment. The Company and its subsidiaries believe they are compliant with all the applicable environmental regulations in the countries where they operate. The Company's management performs frequent analysis with the purpose of identifying potentially impacted areas and a liability is recorded based on the best

Table of Contents

estimate of costs for investigation, treatment and cleaning of potentially affected sites. The Company uses estimates and assumptions to determine the amounts involved, which may change in the future, as result of the final investigations and the determination of the actual environmental impact. The balances of the provisions are as follows:

	2018	2017
Provision for environmental liabilities	132,647	85,191
Current	60,419	21,928
Non-current	72,228	63,263

**NOTE 21 - OBLIGATIONS WITH FIDC - INVESTMENT FUND IN CREDIT RIGHTS**

Part of the assets resulting from the favorable judgments of credits with Eletrobras mentioned in Note 17 iv, were used to set up a Non Standardized Credit Right Investment Fund, constituted and duly authorized to operate by the Securities and Exchange Commission of Brazil ( FIDC NP Barzel ), whose fair value at the FIDC Inception date was R\$ 800 million. On July 14, 2015, the single quota of that FIDC was sold in the acquisition of minority interests transaction in subsidiaries of Gerdau S.A.

The Company assures the FIDC, through the transfer agreement price adjustments clause, minimum return on the transferred amount of the credits rights on the lawsuits. However, where the amounts received in the lawsuits exceed the transferred amount, monetarily adjusted, the Company will be entitled to a percentage of that gain. Additionally, the Company has the right of first offer to repurchase those receivables in the event of sale by the Fund, in accordance to the contract subscribed, and has the amount of R\$ 938,526 as of December 31, 2018 (R\$ 1,135,077 as of December 31, 2017) recognized in the account Obligations with FIDC .

**NOTE 22 EQUITY****a) Capital**

The Board of Directors may, without need to change the bylaws, issue new shares (authorized capital), including the capitalization of profits and reserves up to the authorized limit of 1,500,000,000 common shares and 3,000,000,000 preferred shares, all without nominal value. In the case of capital increase through subscription of new shares, the right of preference shall be exercised in up to 30 days, except in the case of a public offering, when the limit is not less than 10 days.

Reconciliations of common and preferred outstanding shares are presented below:

	2018		2017		2016	
	Common shares	Preferred shares	Common shares	Preferred shares	Common shares	Preferred shares
Balance at beginning of the year	571,929,945	1,137,327,184	571,929,945	1,137,018,570	571,929,945	1,114,744,538

Edgar Filing: GERDAU S.A. - Form 20-F

Acquisition of Treasury shares		(16,000,000)				(10,000,000)
Exercise of stock options		1,597,235		308,614		2,274,032
Transfer of shares		1,309,336				30,000,000
Balance at the end of the year	571,929,945	1,124,233,755	571,929,945	1,137,327,184	571,929,945	1,137,018,570

As of December 31, 2018, 573,627,483 common shares and 1,146,031,245 preferred shares are subscribed and paid up, with a total capital of R\$ 19,249,181 (net of share issuance costs). Ownership of the shares is presented below:

Shareholders	Shareholders 2018					
	Common	%	Pref.	%	Total	%
Metalúrgica Gerdau S.A.*	557,898,901	97.3	95,469,922	8.3	653,368,823	38.0
Brazilian institutional investors	2,383,207	0.4	224,073,547	19.6	226,456,754	13.2
Foreign institutional investors	4,836,488	0.8	410,387,290	35.8	415,223,778	24.1
Other shareholders	6,811,349	1.2	394,302,996	34.4	401,114,345	23.3
Treasury stock	1,697,538	0.3	21,797,490	1.9	23,495,028	1.4
	573,627,483	100.0	1,146,031,245	100.0	1,719,658,728	100.0

Table of Contents

Shareholders	Shareholders 2017					
	Common	%	Pref.	%	Total	%
Metalúrgica Gerdau S.A.*	557,898,901	97.3	95,471,131	8.3	653,370,032	38.0
Brazilian institutional investors	254,785	0.0	155,227,424	13.5	155,482,209	9.0
Foreign institutional investors	7,254,556	1.3	708,109,387	61.8	715,363,943	41.6
Other shareholders	6,521,703	1.1	178,519,242	15.6	185,040,945	10.8
Treasury stock	1,697,538	0.3	8,704,061	0.8	10,401,599	0.6
	573,627,483	100.0	1,146,031,245	100.0	1,719,658,728	100.0

Shareholders	Shareholders 2016					
	Common	%	Pref.	%	Total	%
Metalúrgica Gerdau S.A.*	449,712,654	78.4	202,806,626	17.7	652,519,280	37.9
Brazilian institutional investors	41,883,032	7.3	92,721,295	8.1	134,604,327	7.8
Foreign institutional investors	11,122,498	1.9	705,652,715	61.5	716,775,213	41.8
Other shareholders	69,211,761	12.1	135,837,934	11.9	205,049,695	11.9
Treasury stock	1,697,538	0.3	9,012,675	0.8	10,710,213	0.6
	573,627,483	100.0	1,146,031,245	100.0	1,719,658,728	100.0

\* Metalúrgica Gerdau S.A. is the controlling shareholder and Stichting Gerdau Johanpeter is the ultimate controlling shareholder of the Company.

Preferred shares do not have voting rights and cannot be redeemed but have the same rights as common shares in the distribution of dividends and also priority in the capital distribution in case of liquidation of the Company.

**b) Treasury stocks**

Changes in treasury stocks are as follows:

	2018			
	Common shares	R\$	Preferred shares	R\$
<b>Opening balance</b>	1,697,538	557	8,704,061	75,528
Repurchases			16,000,000	243,396
Exercise of stock options			(1,597,235)	(27,433)
Transfer of shares			(1,309,336)	(11,622)
<b>Closing balance</b>	1,697,538	557	21,797,490	279,869

	2017			
	Common shares	R\$	Preferred shares	R\$
<b>Opening balance</b>	1,697,538	557	9,012,675	98,189
Exercise of stock options			(308,614)	(22,661)
<b>Closing balance</b>	1,697,538	557	8,704,061	75,528

	2016			
	Common shares	R\$	Preferred shares	R\$
<b>Opening balance</b>	1,697,538	557	31,286,707	382,806
Repurchases			10,000,000	95,343
Exercise of stock options			(2,274,032)	(10,461)
Transfer of shares			(30,000,000)	(369,499)
<b>Closing balance</b>	1,697,538	557	9,012,675	98,189

These shares are held in treasury for subsequent cancellation, selling in the market or to be granted under the long-term incentive plan of the Company. The average acquisition cost of these shares was R\$ 12.84 during 2017 (R\$ 8.68 and R\$ 10.89 during the years ended on December 31, 2017 and 2016, respectively).

c) **Capital reserves** consists of premium on issuance of shares.

Table of Contents**d) Retained earnings**

**I) Legal reserves** - under Brazilian Corporate Law, the Company must transfer 5% of the annual net income determined on its statutory books in accordance with Brazilian accounting practices to the legal reserve until this reserve equals 20% of the paid-in capital. The legal reserve can be utilized to increase capital or to absorb losses, but cannot be used for dividend purposes.

**II) Tax incentives reserve** - under Brazilian Corporate Law, the Company may transfer to this account part of net income resulting from government benefits which can be excluded from the basis for dividend calculation.

**III) Investments and working capital reserve** - consists of earnings not distributed to shareholders and includes the reserves required by the Company's by-laws. The Board of Directors may propose to the shareholders the transfer of at least 5% of the profit for each year determined in its statutory books in accordance with accounting practices adopted in Brazil to this reserve. Amount can be allocated to the reserve only after the minimum dividend requirements have been met and its balance cannot exceed the amount of paid-in capital. The reserve can be used to absorb losses, if necessary, for capitalization, for payment of dividends or for the repurchase of shares.

**e) Operations with non-controlling interests** - Corresponds to amounts recognized in equity from changes in non-controlling interests.

The effects of interest changes in subsidiaries for the years presented are composed of:

	December 31, 2018	
	Attributed to parent company's interest	Non-controlling interests
		Total
(i) Other changes		(85,483)
Effects of interest changes in subsidiaries		(85,483)

	December 31, 2017	
	Attributed to parent company's interest	Non-controlling interests
		Total
(i) Other changes		(21,698)
Effects of interest changes in subsidiaries		(21,698)

	December 31, 2016	
	Attributed to parent company's interest	Non-controlling interests
		Total
(i) Other changes		(6,405)

Effects of interest changes in subsidiaries

(6,405)

(6,405)

---

(i) Other changes in subsidiaries without losing control, which may include among others, capital increases, other acquisitions of interests and dilutions of any nature.

**f) Other reserves** - Include: gains and losses on available for sale securities, gains and losses on net investment hedge, gains and losses on derivatives accounted as cash flow hedge, cumulative translation adjustments and expenses recorded for stock option plans.

**g) Dividends and interest on capital** - the shareholders have a right to receive a minimum annual mandatory dividend equal to 30% of adjusted net income as determined in its corporate records prepared in accordance with the accounting practices adopted in Brazil. The Company calculates interest on shareholders' capital in accordance with the terms established by Law 9249/95. The corresponding amount was recorded as a financial expense for tax purposes. For presentation purposes, this amount was recorded as dividends and did not affect net income. The related tax benefit from the reduction in income tax and social contribution on net income was R\$ 127,311 in 2018.

Table of Contents

	2018	2017	2016
Net income (loss)	2,303,868	(359,360)	(2,890,811)
Constitution of legal reserve	(115,193)		
Constitution of the tax incentives reserve	(17,051)		
Net income (loss) before dividends and interest on capital	2,171,624	(359,360)	(2,890,811)
Dividends and interest on capital	(765,339)		
Net income (loss) before constitution of investments and working capital reserve	1,406,285	(359,360)	(2,890,811)
Constitution of investments and working capital reserve	(1,406,285)		
Absorption of net loss by investments and working capital reserve		359,360	2,890,811

The dividends and interest for the year 2018 amounted to R\$ 765,339, as shown below:

Period	Nature	R\$/share	Dividends and interest on capital in the years			2018	2017	2016
			Outstanding shares (thousands)	Credit	Payment			
1st quarter	Interest	0.08	1,701,894	05/21/2018	06/01/2018	136,152		
2nd quarter	Interest	0.14	1,702,095	08/21/2018	08/31/2018	238,293		
2nd quarter	Dividends						34,184	51,225
3rd quarter	Dividends	0.13	1,702,138	11/21/2018	12/03/2018	221,278	51,278	34,152
4th quarter	Dividends	0.10	1,696,164	03/06/2019	03/18/2019	169,616	51,020	
Interest and Dividends						765,339	136,482	85,377
Credit per share (R\$)						0.45	0.08	0.05

**NOTE 23 EARNINGS (LOSS) PER SHARE (EPS)**

The following tables reconcile net income to the amounts used to calculate basic and diluted earnings per share.

**Basic**

	Common	2018 Preferred	Total
	(in thousands, except share and per share data)		
<b>Basic numerator</b>			
Allocated net income (loss) available to common and preferred shareholders	774,279	1,529,589	2,303,868
<b>Basic denominator</b>			
Weighted-average outstanding shares, after deducting the average treasury shares	571,929,945	1,129,851,598	
Earnings per share (in R\$) Basic	1.35	1.35	



Edgar Filing: GERDAU S.A. - Form 20-F

	Common	2017 Preferred	Total
	(in thousands, except share and per share data)		
<b>Basic numerator</b>			
Allocated net income (loss) available to common and preferred shareholders	(120,267)	(239,093)	(359,360)
<b>Basic denominator</b>			
Weighted-average outstanding shares, after deducting the average treasury shares	571,929,945	1,137,012,265	
Loss per share (in R\$) Basic	(0.21)	(0.21)	

F-58

Table of Contents

	Common	2016 Preferred	Total
	(in thousands, except share and per share data)		
<b>Basic numerator</b>			
Allocated net income (loss) available to common and preferred shareholders	(969,954)	(1,920,857)	(2,890,811)
<b>Basic denominator</b>			
Weighted-average outstanding shares, after deducting the average treasury shares	571,929,945	1,132,626,373	
Loss per share (in R\$) Basic	(1.70)	(1.70)	

**Diluted**

	2018
<b>Diluted numerator</b>	
<b>Allocated net income available to Common and Preferred shareholders</b>	
Net income allocated to preferred shareholders	1,529,589
Add:	
Adjustment to net income allocated to preferred shareholders in respect to the potential increase in number of preferred shares outstanding, as a result of options granted to acquire stock of Gerdau.	6,515
	1,536,104
Net income allocated to common shareholders	774,279
Less:	
Adjustment to net income allocated to preferred shareholders in respect to the potential increase in number of preferred shares outstanding, as a result of options granted to acquire stock of Gerdau.	(6,515)
	767,764
<b>Diluted denominator</b>	
<b>Weighted - average number of shares outstanding</b>	
Common Shares	571,929,945
Preferred Shares	
Weighted-average number of preferred shares outstanding	1,129,851,598
Potential increase in number of preferred shares outstanding in respect of stock option plan	14,440,860
Total	1,144,292,458
Earnings per share Diluted (Common and Preferred Shares)	1.34

Due to the net loss in the years of 2017 and 2016, the Company is considering for these two years the same basic and diluted loss, without considering the effects on the diluted calculation of the potential increase in preferred shares as a result of the long-term incentive plans.

Table of Contents**NOTE 24 NET SALES**

The net sales revenues for the year are composed of:

	<b>2018</b>	<b>2017</b>	<b>2016</b>
Gross sales	51,861,423	42,156,553	42,935,022
Taxes on sales	(3,793,516)	(2,956,896)	(2,765,957)
Discounts	(1,908,429)	(2,282,038)	(2,517,398)
Net sales	46,159,478	36,917,619	37,651,667

**NOTE 25 - LONG-TERM INCENTIVE PLANS****a) Restricted Shares and Performance Shares Summary:**

<b>Balance on January 1, 2016</b>	<b>12,525,256</b>
Granted	13,357,922
Cancelled	(3,046,593)
Exercised	(2,403,094)
<b>Balance on December 31, 2016</b>	<b>20,433,491</b>
Granted	3,170,952
Cancelled	(1,901,782)
Exercised	(2,727,577)
<b>Balance on December 31, 2017</b>	<b>18,975,084</b>
Granted	2,411,345
Cancelled	(3,150,635)
Exercised	(3,974,293)
<b>Balance on December 31, 2018</b>	<b>14,261,501</b>

The Company recognizes the cost of the long-term incentive plan through Restricted Shares and Performance Shares based on the fair value of the options granted on the grant date during the vesting period of each grant. The grace period for the year is 3 years for grants made as from 2017 and 5 years for grants made up to 2016. The costs with long-term incentive plans recognized in the income statement on December 31, 2018 were R\$ 41,186 (R\$ 25,403 on December 31, 2017).

As of December 31, 2018 the Company has a total of 21,797,490 preferred shares in treasury and, according to note 22, these shares may be used for serving this plan.

**b) Stock Options Plan:**

Edgar Filing: GERDAU S.A. - Form 20-F

	2018		2017		2016	
	Number of shares	Average exercise price in the year R\$	Number of shares	Average exercise price in the year R\$	Number of shares	Average exercise price in the year R\$
Available at beginning of the year	292,391	17.91	569,115	16.64	1,074,246	18.36
Options Exercised	(33,499)	14.86				
Options Forfeited	(243,412)	18.62	(276,724)	15.11	(505,131)	20.49
Available at the end of the year	15,480	16.72	292,391	17.91	569,115	16.64

The average market price of the share in the year ended December 31, 2018 was R\$ 15.70 (R\$ 11.19 and R\$ 11.68 in the years ended on December 31, 2017 and 2016, respectively).

Exercise price	Quantity	Average period of grace (in years)	Average exercise price R\$	Number exercisable at December 31, 2018*
R\$ 16.86	10,754	0.2	15.90	10,754
R\$ 18.58	4,726	4.0	18.58	4,726
	15,480			15,480

Table of Contents

\*The total of options vested that are exercisable on December 31, 2018 is 15,480 (57,668 and 57,678 on December 31, 2017 and 2016).

**NOTE 26 SEGMENT REPORTING**

	<b>Business Segments</b>					<b>Consolidated</b>
	<b>2018</b>					
	<b>Brazil Operation</b>	<b>North America Operation</b>	<b>South America Operation</b>	<b>Special Steels Operation</b>	<b>Eliminations and Adjustments</b>	
Net sales	15,745,161	19,927,390	3,801,210	8,158,626	(1,472,909)	46,159,478
Cost of sales	(13,044,433)	(18,164,834)	(3,230,952)	(7,064,608)	1,494,727	(40,010,100)
Gross profit	2,700,728	1,762,556	570,258	1,094,018	21,818	6,149,378
Selling, general and administrative expenses	(564,031)	(607,581)	(136,707)	(186,037)	(168,438)	(1,662,794)
Other operating income (expenses)	(33,814)	19,114	(11,421)	10,081	(18,952)	(34,992)
Results in operations with subsidiaries and associate company					(414,507)	(414,507)
Equity in earnings of unconsolidated companies	(1,700)	(77,872)	51,648	15,629	22,436	10,141
Operational (Loss) income before financial income (expenses) and taxes	2,101,183	1,096,217	473,778	933,691	(557,643)	4,047,226
Financial result, net	(442,966)	(37,351)	(117,270)	(112,109)	(1,180,099)	(1,889,795)
Income (Loss) before taxes	1,658,217	1,058,866	356,508	821,582	(1,737,742)	2,157,431
Income and social contribution taxes	(410,651)	(224,897)	(86,667)	(191,386)	1,082,552	168,951
Net income (Loss)	1,247,566	833,969	269,841	630,196	(655,190)	2,326,382
Supplemental information:						
Net sales between segments	1,280,770	84,335	4,988	102,816		1,472,909
Depreciation/amortization	951,826	511,154	88,537	340,297		1,891,814
Investments in associates and jointly-controlled entities	3,250	301,271	701,233	213,899	148,149	1,367,802
Total assets	17,473,039	14,659,926	4,421,487	8,825,830	5,900,747	51,281,029
Total liabilities	8,072,380	4,935,210	1,053,007	1,736,085	9,545,776	25,342,458

	<b>Business Segments</b>					<b>Consolidated</b>
	<b>2017</b>					
	<b>Brazil Operation</b>	<b>North America Operation</b>	<b>South America Operation</b>	<b>Special Steels Operation</b>	<b>Eliminations and Adjustments</b>	
Net sales	12,562,727	15,433,380	4,025,736	6,228,543	(1,332,767)	36,917,619
Cost of sales	(10,996,383)	(14,823,590)	(3,523,394)	(5,301,172)	1,331,544	(33,312,995)
Gross profit	1,566,344	609,790	502,342	927,371	(1,223)	3,604,624
Selling, general and administrative expenses	(539,613)	(569,696)	(202,862)	(166,656)	(176,081)	(1,654,908)
Other operating income (expenses)	(11,513)	29,113	11,260	14,989	47,882	91,731
Impairment of assets	(45,279)	(1,069,528)				(1,114,807)
Results in operations with subsidiaries and associate company					(721,682)	(721,682)
Reversal of contingent liabilities, net		(111,581)	41,554	15,460	929,711	929,711
					19,970	(34,597)

Edgar Filing: GERDAU S.A. - Form 20-F

Equity in earnings of unconsolidated companies						
Operational (Loss) income before financial income (expenses) and taxes	969,939	(1,111,902)	352,294	791,164	98,577	1,100,072
Financial result, net	(564,397)	(46,184)	(74,301)	(122,837)	(335,629)	(1,143,348)
Income (Loss) before taxes	405,542	(1,158,086)	277,993	668,327	(237,052)	(43,276)
Income and social contribution taxes	(103,263)	201,807	(123,552)	(192,902)	(77,481)	(295,391)
Net income (Loss)	302,279	(956,279)	154,441	475,425	(314,533)	(338,667)
Supplemental information:						
Net sales between segments	1,216,526	59,478	6,490	50,273		1,332,767
Depreciation/amortization	909,333	684,121	155,038	344,059		2,092,551
Investments in associates and jointly-controlled entities		346,080	584,898	199,647	149,674	1,280,299
Total assets	17,051,262	14,872,755	5,208,265	8,834,041	4,335,438	50,301,761
Total liabilities	9,592,948	3,315,546	1,711,963	2,753,091	9,034,272	26,407,820

	Business Segments 2016					Consolidated
	Brazil Operation	North America Operation	South America Operation	Special Steels Operation	Eliminations and Adjustments	
Net sales	11,634,862	15,430,814	4,775,598	6,884,733	(1,074,340)	37,651,667
Cost of sales	(10,405,078)	(14,514,789)	(4,103,231)	(6,238,749)	1,073,906	(34,187,941)
Gross profit	1,229,784	916,025	672,367	645,984	(434)	3,463,726
Selling, general and administrative expenses	(678,369)	(778,218)	(253,177)	(284,962)	(244,302)	(2,239,028)
Other operating income (expenses)	2,111	26,223	41,396	14,166	43,951	127,847
Impairment of assets		(2,779,146)	(138,765)			(2,917,911)
Results in operations with subsidiaries and associate company					(58,223)	(58,223)
Equity in earnings of unconsolidated companies		(46,917)	16,366		17,780	(12,771)
Operational (Loss) income before financial income (expenses) and taxes	553,526	(2,662,033)	338,187	375,188	(241,228)	(1,636,360)
Financial result, net	(603,373)	(63,654)	(96,822)	(148,313)	(33,093)	(945,255)
Income (Loss) before taxes	(49,847)	(2,725,687)	241,365	226,875	(274,321)	(2,581,615)
Income and social contribution taxes	13,140	133,818	(107,124)	(64,348)	(279,800)	(304,314)
Net income (Loss)	(36,707)	(2,591,869)	134,241	162,527	(554,121)	(2,885,929)
Supplemental information:						
Net sales between segments	885,050	90,267	6,386	92,637		1,074,340
Depreciation/amortization	952,848	874,299	182,672	526,136		2,535,955
Investments in associates and jointly-controlled entities		303,526	404,522		90,796	798,844
Total assets	18,672,770	16,459,784	5,582,926	11,970,202	1,949,459	54,635,141
Total liabilities	10,761,705	3,407,444	1,651,590	6,519,255	8,020,494	30,360,488

Table of Contents

The main products sold in each segment are:

Brazil Operations: rebar, bars, shapes, drawn products, billets, blooms, slabs, wire rod, structural shapes and iron ore.

North America Operations: rebar, bars, wire rod, light and heavy structural shapes.

South America Operations: rebar, bars and drawn products.

Special Steel Operations: stainless steel, round, square and flat bars, wire rod.

The column of eliminations and adjustments includes the elimination of sales between segments in the context of the Consolidated Financial Statements.

The Company's geographic information with revenues classified according to the geographical region where the products were shipped is as follows:

	<b>Brazil 2018</b>	<b>Latin America (1) 2018</b>	<b>North America (2) 2018</b>	<b>Europe/Asia 2018</b>	<b>Geographic Area Consolidated 2018</b>
Net sales	17,284,473	4,785,281	23,524,381	565,343	46,159,478
Total assets	26,283,287	5,251,637	19,746,105		51,281,029

	<b>Brazil 2017</b>	<b>Latin America (1) 2017</b>	<b>North America (2) 2017</b>	<b>Europe/Asia 2017</b>	<b>Consolidated 2017</b>
Net sales	13,450,378	4,769,526	18,142,218	555,497	36,917,619
Total assets	23,872,075	6,009,394	19,629,950	790,342	50,301,761

	<b>Brazil 2016</b>	<b>Latin America (1) 2016</b>	<b>North America (2) 2016</b>	<b>Europe/Asia 2016</b>	<b>Consolidated 2016</b>
Net sales	12,229,582	5,828,564	17,917,485	1,676,036	37,651,667
Total assets	24,266,983	6,159,387	23,463,447	745,324	54,635,141

---

(1) Does not include operations of Brazil

(2) Does not include operations of Mexico

IFRS requires the Company to disclose revenue per product unless the information is not available and the cost to obtain it would be excessive. Management does not consider this information useful for its decision making process, because it would aggregate sales in different markets and in different currencies, subject to the effects of changes in exchange rates. Furthermore, the trends of steel consumption and the price dynamics of each product or group of products in different countries and different markets within these countries are poorly correlated and, as a result, the information would not be useful and would not serve to conclude about historical trends. Considering this scenario and considering that the information of revenue by product is not maintained by the Company on a consolidated basis and the cost to obtain the revenue per product

information would be excessive compared to the benefits of the information, the Company does not present revenue by product.

#### NOTE 27 INSURANCE

The subsidiaries have insurance coverage determined by management with the assistance of specialists' advice, taking into consideration the nature and the level of risk, in amounts that cover significant losses on their assets and/or liabilities. The main types of insurance are as follows:

Type	Scope	2018	2017
Equity	Inventories and property, plant and equipment items are insured against fire, electrical damage, explosion, machine breakage and overflow (leakage of material in fusion state).	64,676,890	57,062,113
Business Interruption	Net income plus fixed expenses	6,610,851	6,464,512
Civil Liability	Industrial operations	627,718	535,896

#### NOTE 28 IMPAIRMENT OF ASSETS

The Company performs tests for impairment of assets, notably goodwill and other long-lived assets, based on projections of discounted cash flows, which take into account assumptions such as: cost of capital, growth rate and adjustments applied to flows in perpetuity, methodology for working capital determination, investment plans, and long-term economic-financial forecasts. The impairment test of these assets are assessed based on the analysis of facts or circumstances that may indicate the need to perform the impairment test and are performed at least annually, for groups of cash generating units containing goodwill, in December, or whenever changes in events or circumstances indicate that the goodwill and other long-lived assets may be impaired.



Table of Contents

To determine the recoverable amount of each cash generating unit, the Company uses the discounted cash flow method, using as basis, financial and economic projections for each one. The projections are prepared by taking into consideration observed changes in the economic scenario in the market where the Company operates, as well as assumptions with respect to future results and the historical profitability of each segment.

The Company maintains its monitoring of the steel market in order to identify any deterioration, significant drop in demand from steel consuming sectors (notably automotive and construction), stoppage of industrial plants or relevant changes in the economy or financial market that result in increased perception of risk or reduction of liquidity and refinancing capacity.

In 2018, no impairment losses were recognized for goodwill and other long-lived assets.

During the fourth quarter of 2017, the Company identified an increase in the pre-tax discount rate at a higher intensity than that contemplated in the quarterly monitoring conducted during the year in the North America segment. As a result, the Company performed the impairment test for goodwill and other long-lived assets, in which impairment losses were recognized in the amount of R\$ 1,114,807, of which R\$ 265,369 as a result of the impairment test of other long-lived assets (note 28.1) and R\$ 849,438 as a result of the goodwill impairment test (note 28.2).

**28.1 Other assets Impairment test**

In 2018, no impairment losses were recognized for other long-lived assets.

In the fourth quarter of 2017, due to the lack of expectation of future use of some assets in some industrial plants, tests performed on other long-lived assets identified impairment losses in property, plant and equipment in the amount of R\$ 265,369, of which R\$ 45,279 in the Brazil segment and R\$ 220,090 in the North America segment, resulting from a recoverable amount below the book value. These losses were determined based on the difference between the book value and the recoverable amount of these assets, which represents their value in use (higher between the fair value net of disposal expenses and their value in use).

The pre-tax discount rates used for this test are the same as presented in note 28.2 of the goodwill impairment test.

**28.2 Goodwill impairment test**

The Company has four operating segments, which represents the lowest level in which goodwill is monitored by the Company. In 2018, no impairment losses were recognized for goodwill.

## Edgar Filing: GERDAU S.A. - Form 20-F

In the fourth quarter of 2017, the Company evaluated the recoverability of the goodwill of its segments. Based on the aforementioned events, notably the increment in the pre tax discount rate in the North America segment, the analyzes carried out identified a loss due to non-recoverability of goodwill in the amount of R\$ 849,438 for the North America segment.

The period for projecting the cash flows for the goodwill impairment test was five years. The assumptions used to determine the value in use based on the discounted cash flow method include analysis prepared in dollars, such as: projected cash flows based on management estimates for future cash flows, exchange rates, discount rates and growth rates on perpetuity. The cash flow projections already reflect a more challenging competitive scenario than projected in previous years, resulting from a deterioration in the steel consuming markets and overcapacity in the industry, as well as macroeconomic challenges in some geographies in which the Company operates. The perpetuity was calculated considering stable operating margins, levels of working capital and investments. The perpetuity growth rates considered in the 2018 test were: a) North America: 3% (3% in December 2017); b) Special Steel: 3% (3% in December 2017); c) South America: 3% (3% in December 2017); and d) Brazil: 3% (3% in December 2017).

The pre-tax discount rates used were determined taking into consideration market information available on the date of performing the impairment test. The Company adopted distinct rates for each business segment tested with the purpose of reflecting the differences among the markets in which each segment operates, as well as the risks associated to each of them. The pre-tax discount rates used were: a) North America: 13.8% (13.6% in December 2017); b) Special Steel: 14.7% (13.1% in December 2017); c) South America: 17.1% (14.7% in December 2017); and d) Brazil 16.4%: (15.2% in December 2017).

Discounted cash flows are compared to the book value of each segment and result in the recoverable amount as shown below: a) North America: exceeded the book value by R\$ 2,157 million (below the book value by R\$ 849 million in 2017); b) South America: exceeded the book value by R\$ 730 million (exceeded the book value by R\$ 437 million in 2017); c) Special Steel: exceeded the book value by R\$ 3,019 million (exceeded the book value by R\$ 3,989 million in 2017); and d) Brazil: exceeded the book value by R\$ 3,924 million (exceeded the book value by R\$ 1,747 million in 2017).

The Company performed a sensitivity analysis in the assumptions of discount rate and perpetuity growth rate, due to the potential impact in the discounted cash flows.

Table of Contents

An increase of 0.5 percentage points in the discount rate of each segment's cash flow would result in a recoverable amount below the book value and / or that exceeded the book value as shown below: a) North America: exceeded book value by R\$ 1,474 million (below the book value by R\$ 506 million in 2017); b) Special Steel: exceeded book value by R\$ 2,483 million (exceeded the book value by R\$ 3,422 million in 2017); c) South America: exceeded book value by R\$ 593 million (exceeded the book value by R\$ 265 million in 2017); and d) Brazil: exceeded the book value by R\$ 3,048 million (exceeded the book value by R\$ 999 million in 2017).

On the other hand, a decrease of 0.5 percentage points in the perpetuity growth rate of the cash flow of each business segment would result in a recoverable amount below the book value and / or that exceeded the book value as shown below: a) North America: exceeded the book value by R\$ 1,672 million (below the book value by R\$ 310 million in 2017); b) Special Steel: exceeded the book value by R\$ 2,645 million (exceeded the book value by R\$ 3,596 million in 2017); c) South America: exceeded the book value by R\$ 640 million (exceeded the book value by R\$ 318 million in 2017); and d) Brazil: exceeded the book value by R\$ 3,318 million (exceeded the book value by R\$ 1,254 million in 2017).

The Company will maintain over the next year its constant monitoring of the steel market in order to identify any deterioration, significant drop in demand from steel consuming sectors (notably automotive and construction), stoppage of industrial plants or activities relevant changes in the economy or financial market that result in increased perception of risk or reduction of liquidity and refinancing capacity. Although the projections made by the Company provide a more challenging scenario than that in recent years, the events mentioned above, if manifested in a greater intensity than that anticipated in the assumptions made by management, may lead the Company to revise its projections of value in use and eventually result in impairment losses.

**NOTE 29 EXPENSES BY NATURE**

The Company opted to present its Consolidated Income Statement by function. As required by IAS 1, the expenses classified by nature is as follows:

	<b>2018</b>	<b>2017</b>	<b>2016</b>
Depreciation and amortization	(1,891,814)	(2,092,551)	(2,535,955)
Labor expenses	(5,724,352)	(5,514,721)	(6,508,834)
Raw material and consumption material	(29,623,418)	(23,423,950)	(22,863,693)
Freight	(2,770,516)	(2,281,773)	(2,279,459)
Impairment of assets		(1,114,807)	(2,917,911)
Gains and losses on assets held for sale and sales of interest in subsidiaries	(414,507)	(721,682)	(58,223)
Reversal of provision for tax liabilities, net		929,711	
Other expenses/income, net	(1,697,786)	(1,563,177)	(2,111,181)
	(42,122,393)	(35,782,950)	(39,275,256)
Classified as:			
Cost of sales	(40,010,100)	(33,312,995)	(34,187,941)
Selling expenses	(570,431)	(524,965)	(710,766)
Allowance for doubtful accounts	(9,914)		
General and administrative expenses	(1,082,449)	(1,129,943)	(1,528,262)
Other operating income	235,421	260,618	242,077
Other operating expenses	(270,413)	(168,887)	(114,230)
Impairment of assets		(1,114,807)	(2,917,911)
Gains and losses on assets held for sale and sales of interest in subsidiaries	(414,507)	(721,682)	(58,223)
Reversal of provision for tax liabilities, net		929,711	

(42,122,393) (35,782,950) (39,275,256)

**NOTE 30 FINANCIAL INCOME**

	2018	2017	2016
Income from short-term investments	68,721	85,153	142,965
Interest income and other financial income	135,279	141,462	109,080
Financial Income	204,000	226,615	252,045
Interest on debt	(1,177,686)	(1,323,448)	(1,540,797)
Monetary variation and other financial expenses	(401,655)	(402,836)	(469,208)
Financial Expenses	(1,579,341)	(1,726,284)	(2,010,005)
Bonds repurchases	(223,925)		
Exchange Variation, net	(322,621)	(4,057)	851,635
Reversal of interest on provision for tax liabilities, net		369,819	
Gains and losses on derivative financial instruments, net	32,092	(9,441)	(38,930)
Financial result, net	(1,889,795)	(1,143,348)	(945,255)

\*\*\*\*\*