EL PASO ELECTRIC CO /TX/
Form 424B2
May 29, 2008

The information in this preliminary prospectus supplement is not complete and may be changed. A registration statement relating to these notes has been filed with the Securities Exchange Commission and is effective. This preliminary prospectus is not an offer to sell these notes and is not soliciting an offer to buy these notes in any state where the offer or sale is not permitted.

SUBJECT TO COMPLETION, DATED MAY 29, 2008

PROSPECTUS SUPPLEMENT TO PROSPECTUS DATED MAY 20, 2008

$

El Paso Electric Company

% Senior Notes due

We will pay interest on the Senior Notes each March 15 and September 15. The first interest payment will be made on September 15, 2008.

We may redeem some or all of the Senior Notes at any time and from time to time at the make-whole redemption price described herein.

The Senior Notes will be our senior unsecured obligations and will rank equally with all our other existing and future senior unsecured debt from time to time outstanding.

Investing in the Senior Notes involves risks. See ‘‘Risk Factors’’ beginning on page S-4.

	Price to Public(1)	Underwriting Discounts and Commissions	Proceeds to El Paso Electric Company (before expenses)
Per Senior Note	%	%	%
Total	$	$	$

(1) Plus accrued interest from , 2008, if settlement occurs after that date.

Delivery of the Senior Notes in book-entry form only will be made on or about , 2008.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus supplement or the prospectus to which it relates is truthful or complete. Any representation to the contrary is a criminal offense.

Credit Suisse

The date of this prospectus supplement is , 2008.

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You should rely only on the information incorporated by reference or provided in this prospectus supplement and the accompanying prospectus. No person has been authorized to give any information or to make any representation other than those set forth or incorporated by reference in this prospectus supplement and the accompanying prospectus and, if given or made, such information or representations must not be relied upon. We are not, and the underwriter is not, making an offer of these securities in any jurisdiction where the offer is not permitted. You should not assume that the information in this prospectus supplement and the accompanying prospectus is accurate as of any date other than the date on the front of this prospectus supplement or that the documents incorporated by reference are accurate as of any date other than the date that those documents were filed by us with the Securities and Exchange Commission.

All references to ‘‘El Paso’’, ‘‘the Company’’, ‘‘we’’, ‘‘us,’’ ‘‘the Registrant,’’ ‘‘our,’’ or similar words are to El Paso Electric and, except as expressly stated or the context otherwise requires, not to any of its subsidiaries.

Summary

The following summary information is qualified in its entirety by the information contained elsewhere in this prospectus supplement and the accompanying prospectus, including the documents we have incorporated by reference, and in the indenture as described under ‘‘Description of the Senior Notes.’’ You should read the prospectus supplement, accompanying prospectus and the documents incorporated by reference in their entirety. This prospectus supplement and the accompanying prospectus contain or incorporate certain forward-looking statements. Forward-looking statements should be read together with the cautionary statements and factors referred to under ‘‘Special Note on Forward-Looking Statements’’ in the accompanying prospectus.

The Company

El Paso Electric Company is a public utility engaged in the generation, transmission and distribution of electricity in an area of approximately 10,000 square miles in west Texas and southern New Mexico. We also serve a wholesale customer in Texas and from time to time a customer in the Republic of Mexico. We own or have significant ownership interests in six electrical generating facilities providing us with a net dependable generating capability of 1,503 MW. For the year ended December 31, 2007, our energy sources consisted of approximately 43% nuclear fuel, 28% natural gas, 7% coal, 22% purchased power and less than 1% generated by wind turbines.

We serve approximately 360,000 residential, commercial, industrial and wholesale customers. We distribute electricity to retail customers principally in El Paso, Texas and Las Cruces, New Mexico (representing approximately 55% and 9%, respectively, of our operating revenues for the year ended December 31, 2007). In addition, our wholesale sales include sales for resale to other electric utilities and power marketers. Our principal industrial and other large customers include United States military installations, including Fort Bliss in Texas and White Sands Missile Range and Holloman Air Force Base in New Mexico, two large universities, and oil, copper refining and steel production facilities.

We were incorporated in Texas in 1901. As of January 31, 2008, we had approximately 1,000 employees, 44% of whom are covered by a collective bargaining agreement.

Our principal offices are located at the Stanton Tower, 100 North Stanton, El Paso, Texas 79901 (telephone 915-543-5711). The Company makes available free of charge through its website, www.epelectric.com, its annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to those reports as soon as reasonably practicable after such material is electronically filed with or furnished to the Securities and Exchange Commission (‘‘SEC’’). Information contained on our website is not part of this prospectus supplement or the accompanying prospectus.

The Offering

Issuer El Paso Electric Company, a Texas corporation.

Securities Offered $ aggregate principal amount of % Senior Notes due .

Maturity March 15, .

Interest Payment Dates March 15 and September 15 of each year, commencing on September 15, 2008.

Interest Rate % per year.

Further Issuances We may issue additional debt securities under the indenture relating to the Senior Notes having the same terms and CUSIP number as the Senior Notes in all respects, except for the issue date and the issue price. Any such additional debt securities will be consolidated with and form a single series with the Senior Notes offered hereby.

In addition to the Senior Notes, we may issue other series of debt securities under the indenture relating to the Senior Notes. There is no limit on the total aggregate principal amount of debt securities that we can issue under the indenture relating to the Senior Notes.

Covenants The Senior Notes will be subject to covenants that will limit our ability to:

- Create liens on our operating property; and
- Consolidate with or merge into, or transfer all or substantially all of our assets to any other party.

These covenants are subject to important exceptions and qualifications that are described under ''Description of Debt Securities — Successor Obligor'' in the accompanying prospectus and under ''Description of the Senior Notes — Limitation on Liens.''

Events of Default The Senior Notes will be subject to the events of default described under ''Description of Debt Securities — Defaults and Remedies'' in the accompanying prospectus.

In addition, it will be an event of default under the Senior Notes if we fail to observe or perform any term, covenant, condition or agreement contained in any agreement or instrument evidencing or governing any indebtedness of the Company in a principal amount in excess of $10,000,000 if the effect of any such failure is to cause such indebtedness to become due prior to its maturity. See ''Description of the Senior Notes — Events of Default.''

Optional Redemption We may redeem the Senior Notes, in whole or in part, at any time and from time to time, at the make-whole redemption price described under ‘‘Description of the Senior Notes — Optional Redemption.’’

Ranking The Senior Notes will be our senior unsecured obligations and will rank equally with all our other existing and future senior unsecured debt, including all other debt securities issued under the indenture relating to the Senior Notes, from time to time outstanding. See ‘‘Description of Debt Securities — Ranking’’ in the accompanying prospectus.

Form and Denomination The Senior Notes will be issued in fully registered form in denominations of $2,000 and in integral multiples of $1,000 thereafter.

DTC Eligibility Senior Notes will be represented by global certificates deposited with, or on behalf of, The Depository Trust Company (DTC) or its nominee. See ‘‘Description of the Senior Notes — Book-Entry System.’’

Same Day Settlement Beneficial interests in the Senior Notes will trade in DTC’s same-day funds settlement system until maturity. Therefore, secondary market trading activity in such interests will be settled in immediately available funds.

Use of Proceeds The net proceeds of this offering are intended to be used for general corporate purposes, which may include funding capital expenditures, repayment of debt and ensuring adequate liquidity. See ‘‘Use of Proceeds.’’

Risk Factors See ‘‘Risk Factors’’ beginning on page S-4 of this prospectus supplement and other information included or incorporated by reference in this prospectus supplement and the accompanying prospectus for a discussion of factors you should carefully consider before investing in the Senior Notes.

Trustee The Bank of New York Trust Company, N.A.

Listing The Senior Notes will not be listed on any national securities exchange.

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Risk Factors

Like other companies in our industry, our consolidated financial results will be impacted by weather, the economy of our service territory, fuel prices, the performance of our customers and the decisions of regulatory agencies. Our common stock price and creditworthiness will be affected by national and international macroeconomic trends, general market conditions and the expectations of the investment community, all of which are largely beyond our control. In addition, the following statements highlight risk factors that may affect our consolidated financial condition and results of operations. This is not intended to be an exhaustive discussion of all such risks, and the statements below must be read together with factors discussed elsewhere in this document and in our other filings with the SEC.

Risks Related to Our Business

Our Costs Could Increase or We Could Experience Reduced Revenues if There Are Problems at the Palo Verde Nuclear Generating Station

A significant percentage of our generating capacity, off-system sales margins, assets and operating expenses is attributable to the Palo Verde Nuclear Generating Station. Our 15.8% interest in each of the three Palo Verde units totals approximately 633 MW of generating capacity. Palo Verde represents approximately 42% of our available net generating capacity and represented approximately 43% of our available energy for the twelve months ended December 31, 2007. Palo Verde comprises 41% of our total net plant-in-service and Palo Verde expenses comprise a significant portion of operation and maintenance expenses. Arizona Public Service Company is the operating agent for Palo Verde, and we have limited ability under the Arizona Nuclear Power Project Participation Agreement to influence operations and costs at Palo Verde. Palo Verde operated at a capacity factor of 78.5% and 70.4% in the twelve months ended December 31, 2007 and 2006, respectively.

The Nuclear Regulatory Commission (‘‘NRC’’) has placed Palo Verde Unit 3 in the ‘‘multiple repetitive degraded cornerstone’’ column of its action matrix which results in an enhanced NRC inspection regimen. We face the risk of additional or unanticipated costs at Palo Verde resulting from (i) increases in operation and maintenance expenses, including additional costs relating to the enhanced NRC oversight; (ii) increases in the cost of uranium; (iii) the replacement of reactor vessel heads at the Palo Verde units; (iv) an extended outage of any of the Palo Verde units; (v) increases in estimates of decommissioning costs; (vi) the storage of radioactive waste, including spent nuclear fuel; (vii) prolonged reductions in generating output; (viii) insolvency of other Palo Verde Participants; and (ix) compliance with the various requirements and regulations governing commercial nuclear generating stations.

Our ability to increase retail base rates in Texas is limited through June 2010. We cannot seek approval to increase our base rates in Texas in the event of increases in non-fuel costs or loss of revenue unless our return on equity falls below the bottom of a defined range which currently is approximately 8.3%. Our rates in New Mexico will be fixed until after the conclusion of the May 2009 rate filing. We cannot assure that revenues will be sufficient to recover any increased costs, including any increased costs in connection with Palo Verde or other operations, whether as a result of inflation, changes in tax laws or regulatory requirements, or other causes.

We May Not Be Able to Recover All of Our Fuel Expenses from Customers

In general, by law, we are entitled to recover our prudently incurred fuel and purchased power expenses from our customers in Texas and New Mexico. The 2007 New Mexico Stipulation provides for energy from the deregulated Palo Verde Unit 3 to be recovered through fuel and purchased power costs based upon the contract cost of capacity and fuel for power purchased under the existing Southwestern Public Service Company (‘‘SPS’’) purchased power

contract. The 2007 New Mexico Stipulation requires the Company to file its Fuel and Purchased Power Cost Adjustment Clause (''FPPCAC'') according to New Mexico Public Regulation Commission (''NMPRC'') rules, at which time any party may propose to change the price of capacity and related energy from Palo Verde Unit 3 after the SPS purchased power contract is terminated September 30, 2009. The fuel expense in

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New Mexico and Texas is subject to reconciliation by the Public Utility Commission of Texas (‘‘Texas Commission’’) and the NMPRC. Prior to the completion of a reconciliation, we record fuel and purchased power costs transactions such that fuel revenues equal fuel and purchased power expense including the repriced energy costs for Palo Verde Unit 3 in New Mexico. In the event that a disallowance occurs during a reconciliation proceeding, the amounts recorded for fuel and purchased power expenses could differ from the amounts we are allowed to collect from our customers and we would incur a loss to the extent of the disallowance.

In New Mexico, the FPPCAC allows us to reflect current fuel and purchased power expenses in the FPPCAC and to adjust for under-recoveries and over-recoveries with a two-month lag. In Texas, fuel costs are recovered through a fixed fuel factor that may be adjusted two times per year. If we materially under-recover fuel costs, we may seek a surcharge to recover those costs at the time of the next fuel factor filing. During periods of significant increases in natural gas prices such as occurred in 2005, the Company realizes a lag in the ability to reflect increases in fuel costs in its fuel recovery mechanisms. As a result, cash flow is impacted due to the lag in payment of fuel costs and collection of fuel costs from customers. At December 31, 2007 and December 31, 2006, the Company had deferred fuel balances of $27.7 million and $32.6 million, respectively. To the extent the fuel and purchased power recovery processes in Texas and New Mexico do not provide for the timely recovery of such costs, we could experience a material negative impact on our cash flow.

Equipment Failures and Other External Factors Can Adversely Affect Our Results

The generation and transmission of electricity require the use of expensive and complex equipment. While we have a maintenance program in place, generating plants are subject to unplanned outages because of equipment failure. We are particularly vulnerable to this due to the advanced age of several of our gas-fired generating units in or near El Paso. In addition, we are seeking to extend the lives of these plants. In the event of unplanned outages, we must acquire power from others at unpredictable costs in order to supply our customers and comply with our contractual agreements. This can materially increase our costs and prevent us from selling excess power at wholesale, thus reducing our profits. In addition, actions of other utilities may adversely affect our ability to use transmission lines to deliver or import power, thus subjecting us to unexpected expenses or to the cost and uncertainty of public policy initiatives. We are particularly vulnerable to this because a significant portion of our available energy (at Palo Verde and the Four Corners Generating Station) is located hundreds of miles from El Paso and Las Cruces and must be delivered to our customers over long distance transmission lines. In addition, Palo Verde’s availability is an important factor in realizing off-system sales margins. These factors, as well as weather, interest rates, economic conditions, fuel prices and price volatility, are largely beyond our control, but may have a material adverse effect on our consolidated earnings, cash flows and financial position.

We May Not Be Able to Recover All Costs of New Generation

We have obtained from the Texas Commission and the NMPRC Certificates of Convenience and Necessity to construct a new generating unit (Newman Unit 5) in El Paso to meet our expected customers’ demand for electricity. We have provided the estimated cost of constructing Newman Unit 5 to the Texas Commission and NMPRC. We have risks associated with completing the construction of Newman Unit 5 on time and within projected costs. In addition, we have risks associated with obtaining financing for Newman Unit 5 at reasonable rates as we expect to issue debt to finance a portion of the plant.

The cost of financing and constructing Newman Unit 5 will be reviewed in future rate cases in both Texas and New Mexico. To the extent that the Texas Commission or NMPRC determines that the costs of construction are not reasonable because of cost overruns, delays or other reasons, we may not be allowed to recover these costs from

customers in base rates.

In addition, if the unit is not completed on time, we may be required to purchase power or operate less efficient generating units to meet customer requirements. Any replacement purchased power or fuel costs will be subject to regulatory review by the Texas Commission and NMPRC. We face financial risks to the extent that recovery is not allowed for any replacement fuel costs resulting from delays in the completion of Newman Unit 5.

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Competition and Deregulation Could Result in a Loss of Customers and Increased Costs

As a result of changes in federal law, our wholesale and large retail customers already have, in varying degrees, alternate sources of power, including co-generation of electric power. Deregulation legislation is in effect in Texas requiring us to separate our transmission and distribution functions, which would remain regulated, from our power generation and energy services businesses, which would operate in a competitive market, in the future. In 2004, the Texas Commission approved a rule delaying retail competition in our Texas service territory. This rule identified various milestones that we must reach before retail competition can begin. The first milestone calls for the development, approval by the Federal Energy Regulatory Commission (‘‘FERC’’), and commencement of independent operation of a regional transmission organization in the area that includes our service territory. This and other milestones are not likely to be achieved for a number of years. There is substantial uncertainty about both the regulatory framework and market conditions that would exist if and when retail competition is implemented in our Texas service territory, and we may incur substantial preparatory, restructuring and other costs that may not ultimately be recoverable. There can be no assurance that deregulation would not adversely affect our future operations, cash flows and financial condition.

We May Not Be Able to Recover All Our Planned Capital Expenditures

Our planned capital expenditures are large relative to our revenues and assets, and our ability to recover those capital expenditures and the timing of which recovery will have a significant impact on our results of operations. Any unexpected cost increases, delays or events that negatively impact our ability to raise capital, such as ratings downgrades or disruptions in the capital markets, or unexpected decisions or delays by the Texas Commission, NMPRC, or FERC in decisions affecting recovery of capital expenditures, could materially impact our financial statements.

Risks Related to the Offering

Increased leverage may harm our financial condition and results of operations.

We may incur additional indebtedness in the future and the Senior Notes do not restrict future incurrence of indebtedness. Any increase in our level of indebtedness will have several important effects on our future operations, including, without limitation:

- we will have additional cash requirements in order to support the payment of interest on our outstanding indebtedness;
- increases in our outstanding indebtedness and leverage will increase our vulnerability to adverse changes in general economic and industry conditions, as well as to competitive pressure; and
- depending on the levels of our outstanding debt, our ability to obtain additional financing for working capital, capital expenditures, general corporate and other purposes may be limited.

Our ability to make payments of principal and interest on our indebtedness depends upon our future performance, which will be subject to general economic conditions, industry cycles and financial, business and other factors affecting our operations, many of which are beyond our control. If we are unable to generate sufficient cash flow from operations in the future to service our debt, we may be required, among other things:

- to seek additional financing in the debt or equity markets;
- to refinance or restructure all or a portion of our indebtedness, including the Senior Notes;
- to sell selected assets;
- to reduce or delay planned capital expenditures; or
- to reduce or delay planned operating and investment expenditures.

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These measures may not be sufficient to enable us to service our debt. In addition, any such financing, refinancing or sale of assets might not be available on economically favorable terms.

Ratings of the Senior Notes may change and affect the market price and marketability of the Senior Notes.

Our long term debt has been rated by Moody's Investors Service, Inc. and Standard & Poor's Ratings Services respectively. Such ratings are limited in scope, and do not address all material risks relating to an investment in the Senior Notes, but rather reflect only the view of each rating agency at the time the rating is issued. Our credit ratings may not remain in effect for any given period of time or such ratings will not be lowered, suspended or withdrawn entirely by the rating agencies, if, in each rating agency's judgment, circumstances so warrant. Our ratings may be lowered in connection with future events. Holders of Senior Notes will have no recourse against us or any other parties in the event of a change in or suspension or withdrawal of such ratings. Any lowering, suspension or withdrawal of such ratings may have an adverse effect on the market price or marketability of the Senior Notes.

The Senior Notes are effectively subordinated to any secured obligations we may have and to the obligations of our subsidiary.

Although the Senior Notes are unsubordinated obligations, they are effectively subordinated to any secured obligations we may have or may incur in the future, to the extent of the assets that serve as security for those obligations. As of the date of this prospectus supplement, we do not currently have any material secured obligations other than that portion of our obligations under our $200,000,000 bank line of credit related to our financing of nuclear fuel purchases, which portion is secured by substantially all of our nuclear fuel assets. In addition, since the Senior Notes are exclusively our obligations and are not guaranteed by our subsidiary, the Senior Notes are also effectively subordinated to all liabilities of our subsidiary, to the extent of its assets, since it is a separate and distinct legal entity with no obligation to pay any amounts due under our indebtedness, including the Senior Notes, or to make any funds available to us, whether by paying dividends or otherwise, so that we can do so. Our subsidiary is not prohibited from incurring additional debt or other liabilities, including senior indebtedness, or from issuing equity interests that have priority over our interests in the subsidiary. If our subsidiary were to incur additional debt or liabilities or to issue equity interests that have priority over our interests in the subsidiary, our ability to pay our obligations on the Senior Notes could be adversely affected.

An active trading market for the Senior Notes may not develop.

There is currently no public market for the Senior Notes, and we do not plan to list the Senior Notes on any national securities exchange. In addition, the liquidity of any trading market in the Senior Notes, and the market price quoted for the Senior Notes, may be adversely affected by changes in the overall market for these Senior Notes, prevailing interest rates and changes in our financial condition, results of operations or prospects. A liquid trading market in the Senior Notes may not develop, which could decrease the amounts you would otherwise receive upon a sale or disposition of the Senior Notes.

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Use of Proceeds

The net proceeds from the sale of the Senior Notes will be approximately $ million after the deduction of the underwriting discount and our expenses. We intend to use the net proceeds from the sale of the Senior Notes for general corporate purposes, which may include funding capital expenditures, repayment of debt and ensuring adequate liquidity.

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Capitalization

The following table sets forth our cash and cash equivalents and consolidated capitalization as of March 31, 2008 on an actual basis and on an as adjusted basis to give effect to the issuance of the Senior Notes offered by this prospectus supplement. This table should be read in conjunction with the financial statements and notes thereto incorporated by reference in this prospectus supplement and the accompanying prospectus.

	As of March 31, 2008	
	Actual	As Adjusted
	(In Thousands)	
Cash and Equivalents	$ 11,725	$
Current Portion of Long-Term Debt and Financing Obligations	19,225	
Short-Term Borrowings	13,000	
Long-Term Debt Net of Current Portion	590,901	
Financing Obligations, Net of Current Portion	76,372	
% Senior Notes offered hereby	—	
Total Debt	699,498	
Total Common Stock Equity	665,716	
Total Capitalization	$ 1,365,214	$

Under the terms of our credit facility, we have the ability to borrow up to $200 million. As of March 31, 2008, we had $108.6 million of indebtedness outstanding under our credit facility, $13.0 million of which was drawn for working capital purposes.

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Description of the Senior Notes

The following description of the particular terms of the Senior Notes supplements, and to the extent inconsistent, replaces, the description in the accompanying prospectus of the general terms and provisions of the debt securities under ‘‘Description of Debt Securities’’ to which description reference is hereby made. Capitalized terms defined in the accompanying prospectus and not defined herein are used herein as therein defined.

General

The following is a summary of the terms of the Senior Notes. The Senior Notes will be issued under an indenture dated as of May 1, 2005 between us and The Bank of New York Trust Company, N.A., as successor to JPMorgan Chase Bank, National Association, as trustee (the ‘‘Trustee’’), a copy of which is incorporated by reference as Exhibit 4.1 to the Registration Statement on Form S-3 of which the accompanying prospectus is a part, as amended by the First Supplemental Indenture dated as of May 19, 2008 between us and the Trustee in substantially the form attached as Exhibit 4.4 to such Registration Statement. The indenture, as amended by the supplemental indenture and as may be further supplemented from time to time, is referred to herein as the ‘‘Indenture.’’ This description is not complete and investors should refer to the Indenture. The Senior Notes will be established under the Indenture pursuant to a securities resolution.

Maturity, Interest, Form and Denomination

The Senior Notes will initially be issued in an amount equal to $ in aggregate principal amount. The Senior Notes will mature on , , unless redeemed prior to that date, and will bear interest at the rate of % per year.

Interest on the Senior Notes will accrue from the date of original issuance and will be payable semi-annually in arrears on March 15 and September 15 of each year commencing on September 15, 2008 to holders of record of the Senior Notes on the preceding March 1 and September 1, respectively. If an interest payment date falls on a day that is not a business day, interest will be payable on the next succeeding business day with the same force and effect as if made on such interest payment date. Interest on the Senior Notes will be calculated on the basis of a 360-day year of twelve 30-day months. The notes will be issued in fully registered form in denominations of $2,000 and in integral multiples of $1,000 thereafter.

Further Issues of the Same Series

We may, from time to time, without the consent of the existing holders of the Senior Notes, issue additional debt securities under the Indenture having the same terms and CUSIP number as the Senior Notes in all respects, except for the issue date and the issue price. Any such additional debt securities will be consolidated with and form a single series with the Senior Notes offered hereby.

In addition to the Senior Notes, we may issue other series of debt securities under the Indenture. There is no limit on the total aggregate principal amount of debt securities that we can issue under the Indenture.

Optional Redemption

The Senior Notes will be redeemable in whole or in part, at our option, at any time and from time to time, at a redemption price equal to the greater of:

(1) 100% of the principal amount of the Senior Notes to be redeemed or

(2) the sum of the present values of the remaining scheduled payments of principal and interest thereon (exclusive of interest accrued to the redemption date) discounted to the redemption date on a semi-annual basis (assuming a 360-day year consisting of twelve 30-day months) at the Treasury Rate as defined below, plus basis points,

plus, in either case, accrued and unpaid interest thereon to the redemption date.

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‘‘Treasury Rate’’ means, with respect to any redemption date, the rate per annum equal to the semiannual equivalent yield to a maturity of the Comparable Treasury Issue, assuming a price for the Comparable Treasury Issue (expressed as a percentage of its principal amount equal to the Comparable Treasury Price for such redemption date). The Treasury Rate will be calculated on the third business day preceding the redemption date.

‘‘Comparable Treasury Issue’’ means the United States Treasury security selected by an Independent Investment Banker as having a maturity comparable to the remaining term of the Senior Notes to be redeemed that would be utilized, at the time of selection and in accordance with customary financial practice, in pricing new issues of corporate debt securities of comparable maturity to the remaining term of such Senior Notes.

‘‘Comparable Treasury Price’’ means, with respect to any redemption date, (1) the average of the Reference Treasury Dealer Quotations for such redemption date, after excluding the highest and lowest such Reference Treasury Dealer Quotations, or (2) if we obtain fewer than four such Reference Treasury Dealer Quotations, the average of all such Quotations.

‘‘Independent Investment Banker’’ means one of the Reference Treasury Dealers that we appoint.

‘‘Reference Treasury Dealers’’ means (1) Credit Suisse Securities (USA) LLC and its respective successors; provided, however, that if any of the foregoing shall cease to be a primary U.S. Government securities dealer (a ‘‘Primary Treasury Dealer’’), we shall substitute another nationally recognized investment banking firm that is a Primary Treasury Dealer, and (2) two other Primary Treasury Dealers selected by us.

‘‘Reference Treasury Dealer Quotations’’ means, with respect to each Reference Treasury Dealer and any redemption date, the average, as determined by us, of the bid and asked prices for the Comparable Treasury Issue (expressed in each case as a percentage of its principal amount) quoted in writing to us by such Reference Treasury Dealer at 5:00 p.m. on the third business day preceding such redemption date.

Notice of any redemption will be mailed at least 30 days but not more than 60 days before the redemption date to each holder of Senior Notes to be redeemed. Any notice of redemption at our option with respect to the Senior Notes may state that such redemption will be conditional upon the occurrence of any event before the redemption date described in such notice, and such notice will be of no force and effect unless all such conditions to the redemption have occurred on or before such redemption date. In the event that such conditions are not met, we will not be required to redeem the Senior Notes.

Unless we default in payment of the redemption price, on and after the redemption date, interest will cease to accrue on the Senior Notes or portions thereof called for redemption.

Limitation on Liens

So long as any Senior Notes are outstanding, we may not create or permit to be created, any mortgage, security interest, pledge, lien or other encumbrance (‘‘Lien’’) of or upon any of our Operating Property (as defined below), whether owned at the date of the Indenture or thereafter acquired, to secure any Debt (as defined below), without effectively securing the Senior Notes (together with, if we shall so determine, any of our other Debt ranking senior to, or equally with, the Senior Notes) equally and ratably with such Debt (but only so long as such Debt is so secured), subject to the following exceptions, one or more of which may apply to any particular Lien.

The foregoing restriction will not apply to:

- Liens to secure Debt incurred without limitation as to amount under the Mortgage;
- Liens to secure Debt existing on the date of the issuance of the Senior Notes; provided that such Debt shall not be increased in amount, except pursuant to our Credit Agreement dated as of April 11, 2006 as amended as of July 12, 2007 among the Company, The Bank of New York Trust Company, National Association, as trustee of the Rio Grande Resources Trust II, the lenders party thereto and JPMorgan Chase Bank, National Association as Administrative Agent and Issuing Bank;

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- Liens on any Operating Property which existed on such property prior to the acquisition thereof by us, to secure Debt assumed by us in connection with such acquisition;
- Liens to secure Debt incurred by the Company in connection with the acquisition or lease by the Company in the ordinary course of business, after the date of the issuance of the Senior Notes, of furniture, fixtures, equipment and other assets not owned by the Company as of the date of issuance of the Senior Notes provided that (a) such Debt shall not be secured by any Operating Property of the Company other than the Operating Property with respect to which such Debt is incurred, and (b) the Lien securing such Debt shall be created within 90 days of the incurrence of such Debt;
- Liens to secure Debt of any entity existing at the time such entity is merged into or consolidated with, or such entity disposes of all or substantially all its properties (or those of a division) to, us;
- Liens to secure Debt incurred to acquire, construct, develop or substantially repair, alter or improve Operating Property or to provide funds for any such purpose or for reimbursement of funds previously expended for any such purpose; provided that such Debt is incurred contemporaneously with, or within 24 months after, such acquisition or the completion of construction, development or substantial repair, alteration or improvement;
- Liens to secure, directly or indirectly, our obligations with respect to debt issued by any Governmental Authority (as defined herein), including debt represented by securities issued by any such Governmental Authority (or providers of credit enhancement with respect to such securities), including, without limitation, our obligations with respect to industrial development, pollution control or similar revenue bonds incurred for the purpose of financing all or any part of the purchase price or the cost of substantially repairing or altering, constructing, developing or substantially improving our Operating Property;
- Liens to secure Debt which has been defeased, including the Senior Notes;
- Liens to secure Debt incurred in connection with an accounts receivable facility and/or contract payments facility or the securitization of any Excepted Assets (as defined below); and
- Liens to secure any extension, renewal or replacement (or successive extensions, renewals or replacements), in whole or in part, of an instrument or agreement creating any Debt referred to in the above clauses.

Also, the foregoing restriction will not apply to Liens, otherwise subject to the foregoing restrictions, to secure Debt of up to an aggregate principal amount (not including Debt secured by Liens permitted by any of the foregoing exceptions) which, immediately following the creation of such Lien, together with all other Debt so secured, does not exceed 15% of Capitalization (as defined below). As of March 31, 2008, our Capitalization, as defined for purposes of this covenant, was approximately $1,352 million.

For purposes of the limitation on liens covenant described above, certain terms are defined as follows:

‘‘Capitalization’’ means the total of all the following items appearing on, or included in, our consolidated balance sheet:

- liabilities for Debt; and
- common stock, preferred stock, hybrid preferred securities, premium on capital stock, capital surplus, capital in excess of par value and retained earnings (however the foregoing may be designated), less, to the extent not otherwise deducted, the cost of shares of

our capital stock held in our treasury.

Subject to the foregoing, Capitalization shall be determined in accordance with generally accepted accounting principles applicable to the type of business in which we are engaged and that are

approved by independent accountants regularly retained by us, and may be determined as of a date not more than sixty (60) days prior to the happening of an event for which such determination is being made.

‘‘Debt’’ means any of our outstanding debt for money borrowed evidenced by notes, debentures, bonds, or other securities, or guarantees of any thereof.

‘‘Excepted Assets’’ means all bills, notes and other instruments, accounts receivable, claims, credits, judgments, demands, general intangibles, licenses and privileges (except franchises and permits), emissions allowances, choses in action, patents, patent applications, patent licenses and other patent rights, trade names, trademarks and all contracts, leases and agreements of whatsoever kind and nature, other than any of the foregoing which are by the express provisions of the Mortgage subjected or required to be subjected to the Lien of the Mortgage.

‘‘Governmental Authority’’ means any federal, state, local or foreign court or governmental agency, authority, instrumentality or regulatory body.

‘‘Mortgage’’ means the General Mortgage Indenture and Deed of Trust dated February 1, 1996 between the Company and U.S. Bank National Association, successor to State Street Bank and Trust Company, as Trustee, as amended, supplemented, substituted or replaced from time to time; provided, however, that any such substitution or replacement will provide for a Lien on substantially all of the Company’s Operating Property subject to exceptions substantially similar to those contained in the previously existing Mortgage.

‘‘Operating Property’’ means, as of any particular time, (i) all of the real, personal and mixed property which is an integral part of or is used or to be used as an integral part of the electric generating, transmission and/or distribution operations of the Company, (ii) any undivided legal interest of the Company in any such property which is jointly owned by the Company and any other person or persons and (iii) franchises and permits owned by the Company in connection with the electric generating, transmission and/or distribution operations of the Company, including, without limitation all of such property which is acquired by the Company after the date hereof; provided, however, that Operating Property shall not be deemed to include Excepted Property (as defined in the Mortgage). See ‘‘Description of First Mortgage Bonds — Mortgaged Property’’ in the accompanying prospectus.

Events of Default

The Senior Notes will be subject to the events of default contained in the indenture as described under ‘‘Description of Debt Securities — Defaults and Remedies’’ in the accompanying prospectus. In addition, pursuant to the securities resolution establishing the terms of the Senior Notes, it will be an event of default under the Senior Notes if the Company fails to observe or perform any term, covenant, condition or agreement contained in any agreement or instrument evidencing or governing any Debt (as defined above) in a principal amount in excess of $10,000,000 if the effect of any such failure is to cause such Debt to become due prior to its stated maturity.

Defeasance

The Senior Notes will be subject to covenant defeasance and legal defeasance pursuant to the terms and conditions set forth in Article 9 of the Indenture. See ‘‘Description of Debt Securities — Legal Defeasance and Covenant Defeasance’’ in the accompanying prospectus.

Concerning the Trustee

The Trustee has provided other services to us in the past and may do so in the future as a part of its regular business.

Book-Entry System

The Senior Notes will be issued in the form of one or more fully registered global securities. The global security will be deposited with the trustee as custodian for DTC and registered in the name of

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Cede & Co., or Cede, as DTC's nominee. Except in the limited circumstances described under ''Global Securities'' in the accompanying prospectus, the Senior Notes will not be issued in definitive certificated form. The global security may be transferred, in whole and not in part, only to another nominee of DTC.

DTC has advised us and the underwriter as follows:

DTC is a limited-purpose trust company organized under the New York Banking Law, a ''banking organization'' under the New York Banking Law, a member of the Federal Reserve System, a ''clearing corporation'' within the meaning of the New York Uniform Commercial Code, and a ''clearing agency'' registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934, as amended. DTC holds securities that its participants deposit with DTC and facilitates the settlement of transactions among its participants in such securities, through electronic computerized book-entry changes in participants' accounts, thereby eliminating the need for physical movement of securities certificates. DTC's participants include securities brokers and dealers (including the Underwriters), banks, trust companies, clearing corporations, and certain other organizations, some of whom (and/or their representatives) own DTC. Access to the DTC system is also available to others, such as banks, brokers, dealers and trust companies that clear through or maintain a custodial relationship with a participant, either directly or indirectly.

Purchases of Senior Notes under the DTC system must be made by or through direct participants, which will receive a credit for the Senior Notes on DTC's records. The ownership of interest of each actual purchaser of Senior Notes (a ''beneficial owner'') is in turn to be recorded on the direct and indirect participants' records. Beneficial owners will not receive written confirmation from DTC of their purchase, but beneficial owners are expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the direct and indirect participant through which the beneficial owner entered into the transaction. Transfers of ownership interests in the Senior Notes are to be accomplished by entries made on the books of participants acting on behalf of beneficial owners. Beneficial owners will not receive certificates representing their ownership interests in the Senior Notes, except in the event that use of the book-entry system for the Senior Notes is discontinued.

To facilitate subsequent transfers, all Senior Notes deposited by participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co. The deposit of Senior Notes with DTC and their registration in the name of Cede & Co. effect no change in beneficial ownership. DTC has no knowledge of the actual beneficial owners of the Senior Notes; DTC's records reflect only the identity of the direct participants to whose accounts such Senior Notes are credited, which may or may not be the beneficial owners. The participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to direct participants, by direct participants to indirect participants, and by direct participants and indirect participants to beneficial owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time.

Neither DTC nor Cede & Co. will consent or vote with respect to the global notes. Under its usual procedures DTC mails an Omnibus Proxy to us as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those direct participants to whose accounts interests in the global notes are credited on the record date (identified in the listing attached to the Omnibus Proxy).

The information in this section concerning DTC and DTC's book-entry system has been obtained from sources that we believe to be reliable (including DTC), but we take no responsibility for the accuracy for such information.

Neither we, the trustee nor the underwriter will have any responsibility or obligation to participants, or the persons for whom they act as nominees, with respect to the accuracy of the records of DTC, its nominee or any direct or indirect participant with respect to any ownership interest in the Senior Notes, or payments to, or the providing of notice to participants or beneficial owners.

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Global Clearance and Settlement Procedures

Initial settlement for the Senior Notes will be made in immediately available funds. Secondary market trading between the DTC participants will occur in the ordinary way in accordance with DTC's rules and will be settled in immediately available funds using DTC's Same-Day Funds Settlement System.

Additional Information

See ''Description of Debt Securities'' in the accompanying prospectus for additional important information about the Senior Notes. That information includes:

- additional information about the terms of the Senior Notes;
- general information about the Indenture and the trustee; and
- a description of the events of default under the Indenture.

See ''Description of First Mortgage Bonds'' in the accompanying prospectus for information about our ability to issue first mortgage bonds under our mortgage.

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Underwriting

Under the terms and subject to the conditions contained in an underwriting agreement dated , 2008, we have agreed to sell to Credit Suisse Securities (USA) LLC $ principal amount of the Senior Notes.

The underwriting agreement provides that Credit Suisse Securities (USA) LLC is obligated to purchase all of the Senior Notes if any are purchased.

Credit Suisse Securities (USA) LLC proposes to offer the Senior Notes initially at the public offering price on the cover page of this prospectus supplement and to selling group members at that price less a selling concession of % of the principal amount per Senior Note. Credit Suisse Securities (USA) LLC and selling group members may allow a discount of % of the principal amount per Senior Note on sales to other broker/dealers. After the initial public offering, Credit Suisse Securities (USA) LLC may change the public offering price and concession and discount to broker/dealers.

We estimate that our out-of-pocket expenses for this offering will be approximately $501,400.

The Senior Notes are a new issue of securities with no established trading market. Credit Suisse Securities (USA) LLC intends to make a secondary market for the Senior Notes. However, it is not obligated to do so and may discontinue making a secondary market for the Senior Notes at any time without notice. No assurance can be given as to how liquid the trading market for the Senior Notes will be.

In connection with the offering, Credit Suisse Securities (USA) LLC may engage in stabilizing transactions, over-allotment transactions and penalty bids.

- Stabilizing transactions permit bids to purchase the Senior Notes so long as the stabilizing bids do not exceed a specified maximum.
- Over-allotment involves sales by an underwriter of Senior Notes in excess of the principal amount of the Senior Notes the underwriter is obligated to purchase, which creates a short position.
- Covering positions involve purchases of the Senior Notes in the open market after the distribution has been completed in order to cover short positions. A short position is more likely to be created if an underwriter is concerned that there may be downward pressure on the price of the Senior Notes in the open market after pricing that could adversely affect investors who purchase in the offering.

These stabilizing transactions and penalty bids may have the effect of raising or maintaining the market price of the Senior Notes or preventing or retarding a decline in the market price of the Senior Notes. As a result the price of the Senior Notes may be higher than the price that might otherwise exist in the open market. These transactions, if commenced, may be discontinued at any time.

We have agreed to indemnify Credit Suisse Securities (USA) LLC against liabilities under the Securities Act of 1933, as amended, or contribute to payments which Credit Suisse Securities (USA) LLC may be required to make in that respect.

Credit Suisse Securities (USA) LLC will make the Senior Notes available for distribution on the Internet through a proprietary Web site and/or a third-party system operated by MarketAxess Corporation, an Internet-based communications technology provider. MarketAxess Corporation is providing the system as a conduit for communications between Credit Suisse Securities (USA) LLC and its customers and is not a party to any transactions. MarketAxess Corporation, a registered broker-dealer, will receive compensation from Credit Suisse Securities (USA) LLC based on transactions conducted through the system. Credit Suisse Securities (USA) LLC will make the Senior Notes available to its customers through the Internet distributions, whether made through a proprietary or third-party system, on the same terms as distributions made through other channels.

In relation to each Member State of the European Economic Area which has implemented the Prospectus Directive (each, a ‘‘Relevant Member State’’), Credit Suisse Securities (USA) LLC will

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represent and agree that with effect from and including the date on which the Prospectus Directive is implemented in that Relevant Member State (the ‘‘Relevant Implementation Date’’) it has not made and will not make an offer of the Senior Notes to the public in that Relevant Member State prior to the publication of a prospectus in relation to the Senior Notes which has been approved by the competent authority in that Relevant Member State or, where appropriate, approved in another Relevant Member State and notified to the competent authority in that Relevant Member State, all in accordance with the Prospectus Directive, except that it may, with effect from and including the Relevant Implementation Date, make an offer of Senior Notes to the public in that Relevant Member State at any time:

(a) to legal entities which are authorized or regulated to operate in the financial markets or, if not so authorized or regulated, whose corporate purpose is solely to invest in securities;

(b) to any legal entity which has two or more of (1) an average of at least 250 employees during the last financial year; (2) a total balance sheet of more than €43,000,000 and (3) an annual net turnover of more than €50,000,000, as shown in its last annual or consolidated accounts;

(c) to fewer than 100 natural or legal persons (other than qualified institutional investors as defined in the Prospectus Directive); or

(d) in any other circumstances which do not require the publication by the Company of a prospectus pursuant to Article 3 of the Prospectus Directive.

An ‘‘offer of Senior Notes to the public’’ in relation to any Senior Notes in any Relevant Member State means the communication in any form and by any means of sufficient information on the terms of the offer and the Senior Notes to be offered so as to enable an investor to decide to purchase or subscribe for the Senior Notes, as the same may be varied in that Member State by any measure implementing the Prospectus Directive. The expression ‘‘Prospectus Directive’’ means Directive 2003/71/EC and includes any relevant implementing measure in each Relevant Member State. References to ‘‘€’’ are to euros.

In addition, Credit Suisse Securities (USA) LLC will represent and agree that:

(a) it has only communicated or caused to be communicated and will only communicate or cause to be communicated an invitation or inducement to engage in investment activity (within the meaning of Section 21 of the Financial Services and Markets Act 2000 (the ‘‘FSMA’’)) received by it in connection with the issue or sale of the Senior Notes in circumstances in which Section 21(1) of the FSMA does not apply to us; and

(b) it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to the Senior Notes in, from or otherwise involving the United Kingdom.

This document is only being distributed to and is only directed at (i) persons who are outside the United Kingdom or (ii) investment professionals falling within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the ‘‘Order’’) or (iii) high net worth entities, and other persons to whom it may lawfully be communicated, falling within Article 49(2)(a) to (d) of the Order (all such persons together being referred to as ‘‘relevant persons’’). The Senior Notes are only available to, and any invitation, offer or agreement to subscribe, purchase or otherwise acquire such Senior Notes will be engaged in only with, relevant persons. Any person who is not a relevant person should not act or rely on this document or any of its contents.

Credit Suisse Securities (USA) LLC and its affiliates have engaged and may in the future engage in commercial banking and investment banking and other transactions with us and our affiliates in the ordinary course of business.

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NOTICE TO CANADIAN RESIDENTS

Resale Restrictions

The distribution of the Senior Notes in Canada is being made only on a private placement basis exempt from the requirement that we prepare and file a prospectus with the securities regulatory authorities in each province where trades of the Senior Notes are made. Any resale of the Senior Notes in Canada must be made under applicable securities laws which will vary depending on the relevant jurisdiction, and which may require resales to be made under available statutory exemptions or under a discretionary exemption granted by the applicable Canadian securities regulatory authority. Purchasers are advised to seek legal advice prior to any resale of the Senior Notes.

Representations of Purchasers

By purchasing the Senior Notes in Canada and accepting a purchase confirmation a purchaser is representing to us and the dealer from whom the purchase confirmation is received that:

- the purchaser is entitled under applicable provincial securities laws to purchase the Senior Notes without the benefit of a prospectus qualified under those securities laws,
- where required by law, that the purchaser is purchasing as principal and not as agent,
- the purchaser has reviewed the text above under Resale Restrictions, and
- the purchaser acknowledges and consents to the provision of specified information concerning its purchase of the Senior Notes to the regulatory authority that by law is entitled to collect the information.

Further details concerning the legal authority for this information is available on request.

Rights of Action – Ontario Purchasers Only

Under Ontario securities legislation, certain purchasers who purchase a security offered by this prospectus during the period of distribution will have a statutory right of action for damages, or while still the owner of the Senior Notes, for rescission against us in the event that this prospectus contains a misrepresentation without regard to whether the purchaser relied on the misrepresentation. The right of action for damages is exercisable not later than the earlier of 180 days from the date the purchaser first had knowledge of the facts giving rise to the cause of action and three years from the date on which payment is made for the Senior Notes. The right of action for rescission is exercisable not later than 180 days from the date on which payment is made for the Senior Notes. If a purchaser elects to exercise the right of action for rescission, the purchaser will have no right of action for damages against us. In no case will the amount recoverable in any action exceed the price at which the Senior Notes were offered to the purchaser and if the purchaser is shown to have purchased the securities with knowledge of the misrepresentation, we will have no liability. In the case of an action for damages, we will not be liable for all or any portion of the damages that are proven to not represent the depreciation in value of the Senior Notes as a result of the misrepresentation relied upon. These rights are in addition to, and without derogation from, any other rights or remedies available at law to an Ontario purchaser. The foregoing is a summary of the rights available to an Ontario purchaser. Ontario purchasers should refer to the complete text of the relevant statutory provisions.

Enforcement of Legal Rights

All of our directors and officers as well as the experts named herein may be located outside of Canada and, as a result, it may not be possible for Canadian purchasers to effect service of process within Canada upon us or those persons. All or a substantial portion of our assets and the assets of those persons may be located outside of Canada and, as a result, it may not be possible to satisfy a judgment against us or those persons in Canada or to enforce a judgment obtained in Canadian courts against us or those persons outside of Canada.

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Taxation and Eligibility for Investment

Canadian purchasers of the Senior Notes should consult their own legal and tax advisors with respect to the tax consequences of an investment in the Senior Notes in their particular circumstances and about the eligibility of the Senior Notes for investment by the purchaser under relevant Canadian legislation.

Validity of the Senior Notes

The validity of the Senior Notes will be passed upon by Clark, Thomas & Winters, Austin, Texas, and Davis Polk & Wardwell, Menlo Park, California. Certain legal matters in connection with the interpretation of federal law and the law of the States of Texas, New Mexico and Arizona will be passed upon by (i) Clark, Thomas & Winters, Austin, Texas, in respect of Texas law only, (ii) Law Offices of Randall W. Childress, P.C., Santa Fe, New Mexico, in respect of New Mexico law, (iii) White & Case LLP, Washington, D.C., in respect of federal energy regulatory matters, and (iv) Perkins Coie Brown & Bain P.A., Phoenix, Arizona, in respect of Arizona law. Milbank, Tweed, Hadley & McCloy LLP, New York, New York, will issue an opinion about certain legal matters with respect to the Senior Notes for Credit Suisse Securities (USA) LLC.

PROSPECTUS

El Paso Electric Company

Debt Securities
First Mortgage Bonds
Common Stock (no par value)
Preferred Stock (no par value)
Warrants
Purchase Contracts
Units

We or selling security holders may offer and sell debt securities, first mortgage bonds, shares of our common stock and preferred stock, warrants, purchase contracts, and units from time to time in one or more offerings. This prospectus describes the general terms of these securities and the general manner in which we or selling security holders will offer them. We will provide the specific terms of these securities in supplements to this prospectus. The prospectus supplements will also describe the specific manner in which these securities will be offered and may also supplement, update or amend information contained in this document. You should read this prospectus and the applicable prospectus supplement before you invest.

We or selling security holders may offer these securities in amounts, at prices and on terms determined at the time of offering. The securities may be sold directly to you, through agents we or the selling security holders select, or through underwriters and dealers we or the selling security holders select. If agents, underwriters or dealers are used to sell these securities, we will name them and describe their compensation in a prospectus supplement.

Our common stock is listed on the New York Stock Exchange under the symbol ‘‘EE.’’ We have not yet determined whether the other securities that may be offered by this prospectus will be listed on any exchange, inter-dealer quotation system or over-the-counter market. If we decide to seek the listing of any such securities upon issuance, the prospectus supplement relating to those securities will disclose the exchange, quotation system or market on which the securities will be listed.

Investing in our securities involves risk. See Risk Factors beginning on page 24 of our annual report on Form 10-K for the year ended December 31, 2007, which is incorporated by reference herein.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The date of this prospectus is May 20, 2008

You should rely only on the information contained in or incorporated by reference in this prospectus. We have not authorized anyone to provide you with different information. We are not making an offer of these securities in any state where the offer is not permitted. You should not assume that the information contained in this prospectus is accurate as of any date other than the date on the front of this prospectus. All references in this prospectus to ‘‘El Paso,’’ ‘‘the Company,’’ ‘‘we,’’ ‘‘us,’’ ‘‘the Registrant,’’ ‘‘our,’’ or similar words are to El Paso Electric Company and, except as exp stated or the context otherwise requires, not to its subsidiary.

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El Paso Electric Company

El Paso Electric Company is a public utility engaged in the generation, transmission and distribution of electricity in an area of approximately 10,000 square miles in west Texas and southern New Mexico. We also serve a wholesale customer in Texas and from time to time a customer in the Republic of Mexico. We own or have significant ownership interests in six electrical generating facilities providing us with a net dependable generating capability of 1,503 megawatts. We serve approximately 360,000 residential, commercial, industrial and wholesale customers. We distribute electricity to retail customers principally in El Paso, Texas and Las Cruces, New Mexico. In addition, our wholesale sales include sales for resale to other electric utilities and power marketers. Our principal industrial and other large customers include United States military installations, including Fort Bliss in Texas and White Sands Missile Range and Holloman Air Force Base in New Mexico, two large universities, and oil, copper refining and steel production facilities.

Our principal offices are located at the Stanton Tower, 100 North Stanton, El Paso, Texas 79901 (telephone 915-543-5711). We were incorporated in Texas in 1901. We maintain a website at www.epelectric.com where general information about us is available. We are not incorporating the contents of the website in this prospectus.

About This Prospectus

This prospectus is part of a registration statement that we filed with the SEC utilizing a ‘‘shelf’’ registration process. Under this shelf process, we or selling security holders may sell any combination of the securities described in this prospectus in one or more offerings. This prospectus provides you with a general description of the securities that we or selling security holders may offer. Each time we sell securities, we will provide a prospectus supplement that will contain specific information about the terms of that offering. The prospectus supplement may also add, update or change information contained in this prospectus. You should read both this prospectus and any prospectus supplement together with any related free writing prospectuses and the additional information described under the heading ‘‘Where You Can Find More Information.’’

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Where You Can Find More Information

We file annual, quarterly and current reports, proxy statements and other information with the SEC. You may read and copy any document that we file at the Public Reference Room of the SEC at 100 F Street, N.E., Washington, D.C. 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. In addition, the SEC maintains an Internet site at http://www.sec.gov, from which interested persons can electronically access our SEC filings, including the registration statement and the exhibits and schedules thereto.

The SEC allows us to ''incorporate by reference'' the information we file with them, which means that we can disclose important information to you by referring you to those documents. The information incorporated by reference is an important part of this prospectus, and information that we file later with the SEC will automatically update and supersede this information. We incorporate by reference the documents listed below and all documents subsequently filed with the SEC pursuant to Section 13(a), 13(c), 14, or 15(d) of the Securities Exchange Act of 1934, as amended, prior to the termination of the offering under this prospectus:

(a) Current Reports on Form 8-K filed February 8, 2008, February 12, 2008, April 7, 2008 and April 30, 2008;

(b) Quarterly Report on Form 10-Q for the period ended March 31, 2008, filed May 7, 2008;

(c) Annual Report on Form 10-K for the year ended December 31, 2007, filed February 29, 2008;

(d) Registration Statement on Form 8-A dated November 26, 2002.

You may request a copy of these filings, at no cost, by writing or telephoning us at the following address:

El Paso Electric Company
Stanton Tower
100 North Stanton
El Paso, Texas 79901
Attn: Investor Relations
(915) 543-5711

Copies of these filings are also available from our website at http://www.epelectric.com.

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Special Note on Forward-Looking Statements

Certain matters discussed in this prospectus or incorporated by reference into this prospectus other than statements of historical information are ''forward-looking statements.'' The Private Securities Litigation Reform Act of 1995 has established that these statements qualify for safe harbors from liability. Forward-looking statements may include words like ''believes,'' ''anticipates,'' ''targets,'' ''expects,'' ''pro forma,'' ''estimates,'' ''intends'' and words of similar mea
Forward-looking statements describe our future plans, objectives, expectations or goals. Such statements address future events and conditions concerning:

- capital expenditures,
- earnings,
- liquidity and capital resources,
- litigation,
- accounting matters,
- possible corporate restructurings, acquisitions and dispositions,
- compliance with debt and other restrictive covenants,
- interest rates and dividends,
- environmental matters,
- nuclear operations, and
- the overall economy of our service area.

These forward-looking statements involve known and unknown risks that may cause our actual results in future periods to differ materially from those expressed in any forward-looking statement. Factors that would cause or contribute to such differences include, but are not limited to, such things as:

- our rates following the end of the Texas Freeze Period ending June 30, 2010,
- our rates in New Mexico, including the impact of the 2007 New Mexico Stipulation,
- any changes in our New Mexico fuel and purchased power adjustment clause after the 2009 continuation filing,
- loss of margins on off-system sales due to changes in wholesale power prices or availability of competitive generation resources,
- ability of our operating partners to maintain plant operations and manage operation and maintenance costs at Palo Verde and Four Corners plants, including additional costs associated with the degraded cornerstone status of Palo Verde,
- reductions in output at generation plants operated by us,
- unscheduled outages, including outages at Palo Verde,
- electric utility

deregulation or re-regulation,

- regulated and competitive markets,
- ongoing municipal, state and federal activities,
- economic and capital market conditions,
- changes in accounting requirements and other accounting matters,
- changing weather trends,
- rates, cost recoveries and other regulatory matters including the ability to recover fuel costs on a timely basis,

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- changes in environmental regulations,
- political, legislative, judicial and regulatory developments,
- the impact of lawsuits filed against us,
- the impact of changes in interest rates,
- changes in, and the assumptions used for, pension and other post-retirement and post-employment benefit liability calculations, as well as actual and assumed investment returns on pension plan assets,
- the impact of changing cost escalation and other assumptions on our nuclear decommissioning liability for the Palo Verde Nuclear Generating Station,
- Texas, New Mexico and electric industry utility service reliability standards,
- homeland security considerations,
- coal, uranium, natural gas, oil and wholesale electricity prices, and
- other circumstances affecting anticipated operations, sales and costs.

These lists are not all-inclusive because it is not possible to predict all factors. A discussion of some of these factors and definitions for certain terms are included in our Annual Report on Form 10-K for the year ended December 31, 2007, which is incorporated by reference in this prospectus. This report should be read in its entirety. No one section of this prospectus or our Annual Report on Form 10-K for the year ended December 31, 2007, which is incorporated by reference in this prospectus, deals with all aspects of the subject matter; these documents should be read in their entireties. Any forward-looking statement speaks only as of the date such statement was made, and we are not obligated to update any forward-looking statement to reflect events or circumstances after the date on which such statement was made except as required by applicable laws or regulations.

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Use of Proceeds

Unless otherwise indicated in a prospectus supplement, the net proceeds from the sale of the offered securities will be used for general corporate purposes, primarily to fund our operations, to finance capital expenditures and from time to time to repurchase outstanding shares of our common stock and to repay debt. The prospectus supplement relating to a particular offering of securities by us will identify the use of proceeds for that offering.

Ratios of Earnings to Fixed Charges

The table below sets forth our ratios of earnings to fixed charges for the periods indicated.

For the Three Months Ended	For the Fiscal Years Ended				
March 31, 2008	December 31, 2007	December 31, 2006	December 31, 2005	December 31, 2004	December 31, 2003
2.7	3.5	3.2	2.2	1.8	1.5

Earnings consist of earnings from continuing operations and fixed charges less capitalized interest. Earnings from continuing operations consist of income from continuing operations before income taxes, extraordinary items and cumulative effects of accounting changes. Fixed charges consist of all interest on indebtedness, amortization of debt discount and expense and the estimated portion of rental expense that represents an interest factor.

We do not calculate ratios of combined fixed charges and preference dividends to earnings at this time because no shares of our preferred stock are issued and outstanding as of the date of this prospectus.

Dividend Policy

Subject to the prior rights and preferences, if any, applicable to any shares of preferred stock that we may issue in the future, holders of our common stock are entitled to receive such dividends (payable in cash, stock or otherwise) as may be declared from time to time by our Board of Directors out of funds legally available for the payment of dividends. We have not declared or paid any cash dividends on our common stock since our emergence from bankruptcy in 1996. We do not anticipate paying any cash dividends in the foreseeable future.

Description of Capital Stock

Our authorized capital stock under our Articles of Incorporation, which we refer to as the Articles, consists of 100,000,000 shares of common stock, no par value, and 2,000,000 shares of preferred stock, no par value. The following description is a brief summary of certain provisions relating to our capital stock contained in the Articles and does not purport to be complete. This description is qualified in its entirety by reference to the Articles.

Common Stock

Our authorized common stock consists of 100,000,000 shares, no par value, of which 64,455,282 shares were issued and 44,718,653 shares were outstanding as of March 31, 2008. Holders of our common stock are entitled to one vote for each share held of record on all matters submitted to a vote of the shareholders. As of March 31, 2008, there were approximately 3,819 registered holders of record of our common stock.

In the event of any voluntary or involuntary liquidation, dissolution or winding-up of us, subject to prior distribution rights of preferred stock, if any, then outstanding, the holders of common stock are entitled to receive all of the remaining assets available for distribution. The Articles do not provide for preemptive or other subscription rights of the holders of common stock. There are no redemption or sinking fund provisions applicable to the common stock. The issued and outstanding shares of common stock are, and any shares of common stock issued will be, fully paid and non-assessable. The common stock is listed on the New York Stock Exchange under the symbol ‘‘EE.’’ The Bank of New York serves as the transfer agent and registrar for our common stock.

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Preferred Stock

Our authorized preferred stock consists of 2,000,000 shares, no par value, of which no shares were issued and outstanding as of March 31, 2008. This prospectus describes certain general terms and provisions of our preferred stock. When we offer to sell a particular series of preferred stock, we will describe the specific terms of the securities in a supplement to this prospectus. The prospectus supplement will also indicate whether the general terms and provisions described in this prospectus apply to the particular series of preferred stock. The preferred stock will be issued under a statement of resolution establishing a series of preferred stock for each series and is also subject to our Articles.

We have summarized below certain terms that would be included in any statement of resolution establishing a series of preferred stock. The summary is not complete. The statement of resolution will be filed with the SEC in connection with an offering of preferred stock.

Under our Articles, our Board of Directors has the authority to:

- create one or more series of preferred stock;
- issue shares of preferred stock in any series up to the maximum number of shares of preferred stock authorized; and
- determine the designations, powers, preferences, rights, qualifications, limitations and restrictions of each series.

Our Board of Directors may issue authorized shares of preferred stock, without further vote or action by the shareholders, unless shareholder action is required by applicable law or by the rules of a stock exchange or quotation system on which any series of our preferred stock may be listed or quoted.

The prospectus supplement will describe the terms of any preferred stock being offered, including:

- the number of shares and designation or title of the shares;
- any date of maturity;
- any dividend rate or rates and the conditions upon which and the times when such dividends are payable;
- any redemption provisions including the conditions and timing of redemption and redemption prices;
- any retirement or sinking fund provisions;
- the preferences of such shares upon our dissolution or distribution of our assets;
- whether the preferred stock is convertible or exchangeable and, if so, the securities or property into which the preferred stock is convertible or exchangeable and the terms and conditions of conversion or exchange;
- any restrictions upon the issuance or reissuance of any other class or series of preferred stock ranking on a parity with or prior to the preferred stock; and
- any other special

rights and protective provisions with respect to the preferred stock, including any voting rights.

Any shares of preferred stock offered will be fully paid and non-assessable. Any shares of preferred stock that are issued will have priority over the common stock with respect to dividend or liquidation rights or both. Our Board of Directors may increase or decrease the number of shares designated for any existing class or series.

The transfer agent for any series of preferred stock will be described in a prospectus supplement.

Certain Antitakeover Effects of Texas Law

We are subject to the provisions of the Texas Business Combination Law, Part 13 of the Texas Business Corporation Act (the TBCA). In general, the law prohibits a Texas ‘‘issuing public

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corporation'' from engaging in a ''business combination'' with an ''affiliated shareholder,'' or an affiliate or associate thereof, for a period of three years after the date of the transaction in which the person became an affiliated shareholder, unless:

- before the date such person becomes an affiliated shareholder, the board of directors of the corporation approves the business combination or the acquisition of shares by which the person becomes an affiliated shareholder; or
- not less than six months after the date such person becomes an affiliated shareholder, the business combination is approved by the affirmative vote of the holders of at least two-thirds of the corporation's outstanding voting shares not beneficially owned by the affiliated shareholder or its affiliates or associates at a meeting of shareholders duly called for that purpose, and not by written consent.

A ''business combination'' includes, among other things, mergers with and asset sales to an affiliated shareholder or its affiliate or associate and other transactions resulting in a financial benefit to the affiliated shareholder. An ''affiliated shareholder'' is a person who, together with affiliates and associates, is the ''beneficial owner'' (or, within three years, was the ''beneficial owner'') of 20% or more of the corporation's then outstanding voting stock. The Texas Business Combination Law could prohibit or delay mergers or other takeovers or change in control attempts with respect to us and, accordingly, may discourage attempts to acquire us even though such a transaction may offer our stockholders the opportunity to sell their stock at a price above the prevailing market price.

Certain Provisions of our Articles and By-laws

In addition to the restrictions of the Texas Business Combination Law, a number of provisions in our Articles and by-laws could have an effect of delaying, deferring, or preventing a change in control of us in the context of a merger, reorganization, tender offer, sale or transfer of substantially all of our assets, or liquidation involving us or our subsidiary.

Our Articles contain specific provisions governing the approval of certain ''business combinations'' with an ''interested shareholder.'' Under our Articles, a business combination may be approved by the affirmative vote of a majority of our shareholders as is required by our Articles and pursuant to the restrictions of the Texas Business Combination Law outlined above, only (1) if it is approved by a majority of disinterested directors at a meeting of the Board of Directors or by unanimous written consent of our Board of Directors in lieu of such meeting; and (2) if the per share aggregate amount of the cash and the fair market value, as defined in our Articles, as of the date of the consummation of the business combination, of consideration other than cash to be received by our shareholders in the proposed business combination is, subject to adjustment, at least equal to the higher of (a) the highest price per share for any share of our common stock paid by the interested shareholder within the two-year period prior to the date of announcement of the business combination or in the transaction in which the interested shareholder became an interested shareholder, whichever is higher; or (b) the higher of the fair market value per share of our common stock on the announcement date or on the date on which the interested shareholder became an interested shareholder. Furthermore, our Articles (1) limit the form of consideration that may be received by the holders of our common stock, (2) grant our Board of Directors the power to determine whether the amount, any adjustments to and the form of the consideration meet the requirements of our Articles, (3) prohibit an interested shareholder from acquiring beneficial ownership of any additional shares of our stock, (4) bar the interested shareholder from receiving any benefit of any financial assistance or tax advantages provided by or for us, and (5) impose certain requirements for notification of our shareholders about the business combination.

If the proposed business combination does not meet the requirements outlined in the paragraph above, then, in addition to the affirmative vote of a majority of our shareholders required by our Articles and in addition to the restrictions of the Texas Business Combination Law, the business combination must be approved by the affirmative vote of the holders of at least 80% of the outstanding shares entitled to vote in the election of directors at the time of the business combination.

A ‘‘business combination’’ includes any merger or consolidation of us or our subsidiary with an interested shareholder or its affiliate, certain sales, leases, exchanges, mortgages, pledges, transfers or

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other dispositions of assets to an interested shareholder or its affiliate, certain issuances or transfers of securities to an interested shareholder or its affiliate, adoption of any plan or proposal for liquidation or dissolution proposed by an ‘‘interested shareholder’’ and certain reclassifications of securities to the benefit of any ‘‘interested shareholder.’’ An ‘‘interested shareholder’’ is any person who beneficially owns 15% or more of the voting power of our outstanding shares; or at any time within the two-year period immediately prior the applicable date was the beneficial owner of 15% or more of the voting power of our outstanding shares.

Our Articles and by-laws provide for a classified Board of Directors and that the number of directors will be fixed by the Board of Directors. Our Board of Directors is divided into three classes, and directors are elected for staggered three-year terms with one class of directors up for election each year. Directors are elected by a plurality of votes cast by holders of shares entitled to vote. No cumulative voting is allowed in the election of directors or for any other purpose. Classified directors may be removed only with cause at a special meeting called expressly for that purpose upon the affirmative vote of at least 80% of all shares entitled to vote. An affirmative vote of at least 80% of shares entitled to vote is required to amend or repeal, or adopt any provision inconsistent with, the provisions of the Articles relating to the election and removal of directors.

Pursuant to our by-laws, the timing of our annual meeting is determined by the Board of Directors. In the absence of a request in writing from a majority of the Board of Directors or from shareholders owning at least 25% of all shares, special meetings of the shareholders may be called only by the chairman of the Board of Directors or the president. Special meetings of the shareholders shall be called by the chairman of the Board of Directors, the president or secretary at the request in writing of a majority of the Board of Directors or at the request in writing of shareholders owning at least 25% of all shares entitled to vote. Shareholders may not take action by written consent without a meeting.

Our Board of Directors could create and issue a series of preferred stock with rights, privileges or restrictions that effectively discriminate against an existing or prospective shareholder as a result of the holder’s beneficially owning or commencing a tender offer for a substantial amount of common stock. One of the effects of authorized but unissued and unreserved shares of capital stock may be to make it more difficult for or discourage an attempt by a potential acquirer to obtain control of us by means of a merger, tender offer, proxy contest or otherwise. This protects the continuity of our management. The issuance of these shares of capital stock may defer or prevent a change in control of us without any further shareholder action.

Description of Debt Securities

This prospectus describes certain general terms and provisions of our debt securities. The debt securities will be issued under the Debt Securities Indenture dated May 1, 2005, entered into between us and The Bank of New York Trust Company, N.A., as successor to JPMorgan Chase Bank, National Association, as trustee (the indenture trustee), as supplemented by the First Supplemental Debt Securities Indenture dated May 19, 2008 (collectively, the indenture), which are incorporated by reference and filed, respectively, as exhibits to the registration statement for these securities that we have filed with the SEC. The indenture has been qualified under the Trust Indenture Act of 1939. When we offer to sell a particular series of debt securities, we will describe the specific terms of the securities in a prospectus supplement.

We have summarized below the material provisions of the indenture and the debt securities or indicated which material provisions will be described in the related prospectus supplement. These descriptions are only summaries, and you should refer to the indenture itself that describes completely the terms and definitions summarized below and contains additional information about the debt securities.

Terms

The indenture does not limit the amount of debt securities that can be issued and provides that the debt securities may be issued from time to time in one or more series pursuant to the terms of

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one or more securities resolutions creating such series. The prospectus supplement will set forth the following terms, as applicable, of the debt securities to be offered:

- the designation, aggregate principal amount, currency or composite currency and denominations;
- if an index formula or other method is used, the method for determining amounts of principal or interest;
- the maturity date and other dates, if any, on which principal will be payable;
- the interest rate (which may be fixed or variable), if any;
- the date or dates from which interest will accrue and on which interest will be payable, and the record dates for the payment of interest;
- the manner of paying principal and interest;
- the place or places where principal and interest will be payable;
- the terms of any mandatory or optional redemption by us or any third party including any sinking fund;
- the terms of any conversion or exchange;
- the terms of any redemption at the option of holders or put by the holders;
- any tax indemnity provisions;
- if the debt securities provide that payments of principal or interest may be made in a currency other than that in which the debt securities are denominated, the manner for determining such payments;
- the portion of principal payable upon acceleration of a discounted debt security (as defined below);
- whether and upon what terms debt securities may be defeased;
- any events of default or covenants in addition to or in lieu of those set forth in the indenture;
- provisions for electronic issuance of debt securities or for debt securities in uncertificated form; and
- any additional provisions or other special terms not inconsistent with the provisions of the indenture, including any terms that may be required or advisable under United States or other applicable laws or regulations, or advisable in connection with the marketing of the debt securities.

Debt securities of any series may be issued as registered debt securities, bearer debt securities, or uncertificated debt securities, and in such denominations as specified in the terms of the series.

In connection with its original issuance, no bearer security will be offered, sold or delivered to any location in the United States, and a bearer security may be delivered in connection with its original issuance only upon presentation of a certificate in a form prescribed by us to comply with United States laws and regulations.

Securities may be issued under the indenture as discounted debt securities to be offered and sold at a discount from the principal amount thereof. Special United States federal income tax and other considerations applicable thereto will be described in the prospectus supplement relating to such discounted debt securities. ‘‘Discounted debt security’’ means a security where the amount of principal due upon acceleration or redemption is less than the stated principal amount.

We are not obligated to issue all debt securities of one series at the same time and, unless otherwise provided in the prospectus supplement, we may reopen a series, without the consent of the holders of the debt securities of that series, for the issuance of additional debt securities of that series.

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Additional debt securities of a particular series will have the same terms and conditions as outstanding debt securities of such series, except for the date of original issuance and the offering price, and will be consolidated with, and form a single series with, such outstanding debt securities.

Ranking

The debt securities will be unsecured and will rank equally with all of our existing and future unsecured senior debt, which includes indebtedness under our pollution control bonds which was approximately $193.1 million as of March 31, 2008, and our 6% Senior Notes due May 15, 2035, which was $400 million as of March 31, 2008. The debt securities will be senior to any existing and future indebtedness which by its terms is made subordinate to the debt securities.

The debt securities are unsecured obligations. Our secured debt is effectively senior to the debt securities to the extent of the value of the assets securing such secured debt. Substantially all of our nuclear fuel assets are subject to liens under our $200,000,000 bank line of credit. As of March 31, 2008 we had borrowed approximately $108.6 million under this line.

Certain Covenants

The indenture contains several customary covenants, including covenants relating to payment of principal and interest, our continued corporate existence and the filing of reports with the SEC and the trustee.

Any additional covenants that may apply to a particular series of debt securities will be described in the prospectus supplement relating thereto. Unless otherwise described in the prospectus supplement, the indenture will not limit the aggregate amount of debt, including secured debt, that we may incur. In addition, unless otherwise described in the prospectus supplement, there will be no provisions in the indenture or the related debt securities that require us to redeem, or permit the holders to cause a redemption of, those debt securities.

Successor Obligor

The indenture provides that, unless otherwise specified in the securities resolution establishing a series of debt securities, we shall not consolidate with or merge into, or transfer all or substantially all of our assets to, any person in any transaction in which we are not the survivor, unless: (1) the person is organized under the laws of the United States or a state thereof and consents to the jurisdiction of the courts of the United States or a state thereof; (2) the person assumes by supplemental indenture all our obligations under the indenture, the debt securities and any coupons; (3) all required approvals of any regulatory body having jurisdiction over the transaction shall have been obtained; and (4) immediately after the transaction, no Default (as defined below) exists. The successor in a permitted transaction shall be substituted for us, and thereafter all our obligations under the indenture, the debt securities and any coupons shall terminate.

Exchange or Transfer of Debt Securities

Registration of transfer or exchange of registered debt securities may be requested upon surrender thereof at any of our agencies maintained for such purpose (the transfer agent) and upon fulfillment of all other requirements of the transfer agent. Registered debt securities may be exchanged for an equal aggregate principal amount of registered debt securities of the same series in such authorized denominations as may be requested upon surrender of the registered debt securities to the transfer agent and upon fulfillment of all other requirements of the transfer agent.

Default and Remedies

Unless the securities resolution establishing the series otherwise provides (in which event the prospectus supplement will so state), an ‘‘Event of Default’’ with respect to a series of debt securities will occur if:

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(1) We default in any payment of interest on any debt securities of such series when the same becomes due and payable and the Default continues for a period of 30 days;

(2) We default in the payment of the principal and premium, if any, of any debt securities of such series when the same becomes due and payable at maturity or upon redemption, acceleration or otherwise;

(3) We default in the payment or satisfaction of any sinking fund obligation with respect to any debt securities of the series as required by the securities resolution establishing such series and the Default continues for a period of 30 days;

(4) We default in the performance of any of our other agreements applicable to the series and the Default continues for 60 days after the notice specified below;

(5) We, pursuant to or within the meaning of any Bankruptcy Law (as defined below):

(A) commence a voluntary case;

(B) consent to the entry of an order for relief against us in an involuntary case;

(C) consent to the appointment of a Custodian for us or for all or substantially all of our property; or

(D) make a general assignment for the benefit of our creditors;

(6) a court of competent jurisdiction enters an order or decree that remains unstayed and in effect for 60 days under any Bankruptcy Law that:

(A) is for relief against us in an involuntary case;

(B) appoints a Custodian for us or for all or substantially all of our property; or

(C) orders the liquidation of the Company; or

(7) there occurs any other Event of Default provided for in the series and specified in the applicable prospectus supplement.

The term ‘‘Bankruptcy Law’’ means Title 11, U.S. Code or any similar federal or state law for the relief of debtors. The term ‘‘Custodian’’ means any receiver, trustee, assignee, liquidator or a similar official under any Bankruptcy Law.

‘‘Default’’ means any event that is, or after notice or passage of time would be, an Event of Default. A Default under subparagraph (4) above is not an Event of Default until the trustee or the holders of at least 25% in principal amount of the series notify us of the Default and we do not cure the Default within the time specified after receipt of the notice.

If a Default occurs and is continuing on a series of debt securities and if the indenture trustee has actual knowledge of such Default, the indenture trustee is required to mail a notice of the Default within 90 days after it occurs to holders of registered debt securities of such series. Except in the case of a Default in payment on a series of debt securities, the indenture trustee may withhold such notice if and so long as the indenture trustee in good faith determines that withholding the notice is in the interest of such holders. The indenture trustee is required to withhold notice of a Default described in subparagraph (4) above until at least 60 days after it occurs. We are required to furnish the indenture trustee, within 120 days after the end of each of our fiscal years, a brief certificate as to our compliance with

all conditions and covenants under the indenture.

Notwithstanding the remedies generally available under the Indenture in the case of an Event of Default, at our election, the sole remedy for an Event of Default relating to the failure to comply with the requirements of Section 314(a)(1) of the Trust Indenture Act and the covenant in the Indenture to file reports with the trustee (''Reporting Obligations'') shall consist exclusively of the right of a holder of debt securities to receive additional interest (''Reporting Interest'') on such debt securities, accruing at an annual rate equal to 0.25% of the principal amount of such debt securities, provided, however, that on the 180th calendar day after commencement of any such Event of Default (unless waived) the

other remedies under the Indenture shall become available. This interest will accrue on all outstanding debt securities from and including the date on which an Event of Default relating to a failure to comply with the Reporting Obligations in the debt securities indenture first occurs to, but not including, the date on which such Event of Default is cured or waived. In the event we do not elect to pay Reporting Interest upon an Event of Default in accordance with this section, the debt securities will be subject to acceleration as provided below.

If we have given a notice of a redemption subject to occurrence of conditions, it is not an Event of Default if any event on which such redemption is so conditioned does not occur and is not waived before the scheduled redemption date.

The indenture does not have a cross-default provision. Thus, unless otherwise provided in the prospectus supplement for a series of debt securities, a default by us or our subsidiary on any other debt would not constitute an Event of Default. An Event of Default by us on any series of debt securities issued under the indenture shall constitute an Event of Default on other series only if it is an Event of Default under subparagraphs (5) or (6) above.

If an Event of Default occurs and is continuing with respect to any series of the debt securities, then the indenture trustee or the holders of 25% or more in aggregate principal amount of the debt securities of such series then outstanding may, and, upon the written request of the holders of a majority in aggregate principal amount of such series then outstanding, the indenture trustee shall, declare the principal amount (or, if the debt securities of that series are discounted debt securities, such portion of the principal amount as may be specified in the terms of that series) of, and all accrued but unpaid interest, if any, on all the outstanding debt securities of such series, to be immediately due and payable. If any Event of Default described in subparagraph (4) above with respect to all series of outstanding debt securities, or any Event of Default described in subparagraph (5) or (6), occurs and is continuing, then the indenture trustee or the holders of 25% or more in aggregate principal amount of all the outstanding debt securities (voting as one class) may, and upon the written request of the holders of a majority in aggregate principal amount of all the outstanding debt securities (voting as one class), the indenture trustee shall, declare the principal amount (or, if any debt securities are discounted debt securities, such portion of the principal amount as may be specified in the terms of such debt securities) of and all accrued but unpaid interest, if any, on all the debt securities to be immediately due and payable. Prior to the acceleration of the maturity of the debt securities of any series (or all series, as the case may be), other than a Default in the payment of the principal of or interest on the series (or all series, as the case may be) and a Default in respect of a provision in the indenture that cannot be amended without the consent of each affected holder of the debt securities, the holders of a majority in aggregate principal amount of the series (or all series of debt securities then outstanding, voting as one class, as the case may be) by notice to the indenture trustee may waive an existing Default on the series (or an existing Default described in subparagraph (4) that relates to all series of the outstanding debt securities or described in subparagraph (5) or (6) and its consequences).

However, the holders of a majority in aggregate principal amount of the debt securities of any series (or of all series, as the case may be) then outstanding may, on behalf of all holders of all debt securities of such series (or of all series, as the case may be), waive the Event of Default by reason of which the principal of the debt securities of such series (or of all series, as the case may be) shall have been so declared to be due and payable and rescind and annul such declaration and its consequences if, at any time after such declaration, (1) all arrears of interest, if any, on all the debt securities of such series (or of all series, as the case may be) and all amounts owed to the indenture trustee and any predecessor indenture trustee and all other amounts payable under the indenture (except the principal of the debt securities of such series (or of all series, as the case may be) that would not be due and payable were it not for such declaration) have been paid and (2) every other Default and Event of Default has been cured or adequate provisions have been made to the reasonable satisfaction of the holders of a majority in aggregate principal amount of the debt securities of such series (or of all series, as the case may be); provided that no such waiver, rescission or annulment shall extend to or affect or impair any rights arising from any subsequent Default or Event of Default.

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The holders of a majority in aggregate principal amount of any series of debt securities may direct the time, method and place of conducting any proceeding for any remedy available to the indenture trustee, or of exercising any trust or power conferred on the indenture trustee, with respect to such series (or all series as the case may be). The indenture trustee, however, may refuse to follow any such direction if it conflicts with law or the indenture, or if the indenture trustee in good faith determines that the action or direction may involve the indenture trustee in personal liability. The indenture trustee may require indemnity satisfactory to it before it enforces the indenture or the debt securities.

A holder of the debt securities of a series may pursue a remedy with respect to the series only if:

(1) the holder gives to the indenture trustee notice of a continuing Event of Default on the series;

(2) the holders of at least 25% in principal amount of the series make a request to the indenture trustee to pursue the remedy;

(3) the holder or holders offer the indenture trustee indemnity satisfactory to it against any loss, liability or expense;

(4) the indenture trustee does not comply with the request within 60 days after receipt of the request and the offer of indemnity; and

(5) during such 60-day period, the holders of a majority in principal amount of the series do not give the indenture trustee a direction inconsistent with such request.

The right of any holder of the debt securities to receive payment of the principal amount or any accrued interest in respect of the debt securities, to convert the debt securities, if such right exists, or to bring suit for the enforcement of such right shall not be impaired or adversely affected without the consent of such holder.

Amendments and Waivers

The indenture and the debt securities or any coupons of the series may be amended, and any default may be waived as follows:

Unless the securities resolution otherwise provides (in which event the applicable prospectus supplement will so state), the indenture, debt securities and any coupons may be amended with the written consent of the holders of a majority in principal amount of the debt securities of all series affected by the amendment voting as one class, and an existing Default on a particular series may be waived with the consent of the holders of a majority in principal amount of the debt securities of the series prior to the acceleration of the maturity of the debt securities of the series. However, without the consent of each security holder affected, (1) no amendment may (a) reduce the amount of debt securities whose holders must consent to an amendment, (b) reduce the interest on or change the time for payment of interest on any debt security, (c) change the fixed maturity of any debt security, (d) reduce the principal of any non-discounted debt security or reduce the amount of the principal of any discounted debt security that would be due on acceleration thereof, (e) change the currency in which the principal or interest on a debt security is payable, (f) make any change that materially adversely affects the right to convert any debt security, or (g) change any provision in the indenture concerning waiver of past Defaults and amendments that require the consent of security holders except to increase the requisite amount of debt securities whose holders must consent to an amendment or waiver or to provide that other provisions of the indenture cannot be amended or waived without the consent of each security holder affected; and (2) unless the securities resolution otherwise provides, neither the indenture trustee nor the holders of a majority in principal amount of a series may waive a Default in the payment of the principal of or interest on the series or a Default in respect of a provision that cannot be amended without the consent of each security holder affected.

Without the consent of any security holder, the indenture, the debt securities, or any coupons may be amended (1) to cure any ambiguity, omission, defect or inconsistency; (2) to provide for assumption of our obligations to security holders in the event of a merger, consolidation or transfer of all or

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substantially all of its assets requiring such assumption; (3) to provide that certain provisions of the indenture shall not apply to a newly issued series of debt securities; (4) to create a series and establish its terms; (5) to provide for a separate indenture trustee for one or more series; or (6) to make any change that does not materially adversely affect the rights of any security holder.

Conversion Rights

Any securities resolution establishing a series of debt securities may provide that the debt securities of a series may be convertible at the option of the holders into or for our common stock or other equity or debt instruments (a conversion right). The securities resolution may establish, among other things, (1) the number or amount of shares of common stock or other equity or debt instruments for which $1,000 aggregate principal amount of the debt securities of the series is convertible, adjusted pursuant to the terms of the indenture and the securities resolution (the conversion rate), and (2) provisions for adjustments to the conversion rate and limitations upon exercise of the conversion right.

Legal Defeasance and Covenant Defeasance

Debt securities of a series may be defeased in accordance with their terms and, unless the securities resolution establishing the terms of the series otherwise provides, as set forth below. We at any time may terminate as to a series all of our obligations (except for certain obligations, including obligations with respect to the defeasance trust and obligations to register the transfer or exchange of a debt security, to replace destroyed, lost or stolen debt securities and coupons and to maintain paying agencies in respect of the debt securities) with respect to the debt securities of the series and any related coupons and the indenture (legal defeasance). We at any time may terminate as to a series our obligations with respect to any restrictive covenants that may be applicable to a particular series (covenant defeasance).

We may exercise our legal defeasance option notwithstanding our prior exercise of our covenant defeasance option. If we exercise our legal defeasance option, a series may not be accelerated because of an Event of Default. If we exercise our covenant defeasance option, a series may not be accelerated by reference to any restrictive covenant that may be applicable to that series.

To exercise either defeasance option as to a series, we must (i) irrevocably deposit in trust (the defeasance trust) with the indenture trustee (or another trustee) money or U.S. Government Obligations, deliver to the indenture trustee a certificate from a nationally recognized firm of independent accountants expressing their opinion that the payments of principal and interest when due on the deposited U.S. Government Obligations, without reinvestment, plus any deposited money, without investment, will provide cash at such times and in such amounts as will be sufficient to pay the principal and interest when due on all debt securities of such series to maturity or redemption, as the case may be, and (ii) comply with certain other conditions. In particular, we must deliver to the indenture trustee an opinion of counsel that the defeasance will not result in recognition of any income, gain or loss to holders of debt securities of such series for federal income tax purposes as a result of the defeasance (and in the case of legal defeasance, such opinion of counsel is based on a ruling of the Internal Revenue Service or other change in applicable federal income tax law) and that the holders will be subject to federal income tax in the same amounts, in the same manner and at the same times as if the defeasance had not occurred.

‘‘U.S. Government Obligations’’ means direct obligations of the United States or an agency or instrumentality of the United States, the payment of which is unconditionally guaranteed by the United States, which, in either case, have the full faith and credit of the United States pledged for payment and which are not callable at the issuer’s option, or certificates representing an ownership interest in such obligations.

Regarding the Trustee

Unless otherwise indicated in a prospectus supplement, the indenture trustee will also act as depository of funds, transfer agent, registrar, paying agent or conversion agent with respect to the debt

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securities. We may remove the indenture trustee with or without cause if we so notify the indenture trustee three months in advance and if no Default exists or occurs during the three-month period. The indenture trustee provides additional unrelated services for us as a depository of funds, registrar, trustee and similar services.

Governing Law

The indenture and the debt securities will be governed by New York law.

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Description of First Mortgage Bonds

This prospectus describes certain general terms and provisions of our first mortgage bonds. The first mortgage bonds will be issued under and secured by the General Mortgage Indenture and Deed of Trust, dated as of February 1, 1996, between us and U.S. Bank National Association, as successor to State Street Bank and Trust Company, as trustee (the mortgage trustee), as supplemented and amended by supplemental indentures. We refer to the original mortgage, as so supplemented and amended, as the mortgage. All of the first mortgage bonds issued or issuable under the mortgage are referred to as the bonds. We have summarized below the material provisions of the mortgage and the bonds or indicated which material provisions will be described in the related prospectus supplement. These descriptions are only summaries, and you should refer to the mortgage itself and the supplemental indentures to the mortgage, which describe completely the terms and definitions summarized below and contain additional information about the bonds. The mortgage has been qualified under the Trust Indenture Act of 1939. When we offer to sell a particular series of first mortgage bonds, we will describe the specific terms in a prospectus supplement.

General

Substantially all of our utility plant is subject to liens under the mortgage. We are subject to certain covenants which will govern any future series of bonds we may issue pursuant to the mortgage.

Terms

When we offer to sell a particular series of bonds, we will describe the specific terms of the bonds in a supplement to the mortgage and a prospectus supplement, which will set forth the following terms, as applicable, of the bonds offered thereby:

- the designation and aggregate principal amount;
- the maturity date and other dates, if any, on which principal will be payable;
- the interest rate (which may be fixed or variable);
- if an index formula or other method is used, the method for determining amounts of principal or interest;
- the date or dates from which interest will accrue and on which interest will be payable, and the record dates for the payment of interest;
- the manner of paying principal and interest;
- the place or places where principal and interest will be payable, where bonds may be surrendered for registration of transfer or exchange, and where notices and demands to or on us may be served;
- the terms of any mandatory or optional redemption or repurchase by us or any third party including any sinking fund or similar fund;
- the terms of any redemption at the option of holders or put by the holders;
- the terms of any conversion or exchange;
- if the principal or

interest on the bonds is to be payable in securities or other property, or in a currency other than that in which bonds are denominated, the manner for determining such payments;

- if an amount other than the principal amount shall be payable upon acceleration of a bond, the calculation of such amount to be due and payable;
- whether the bonds will be issued in book entry or certificated form; and
- any additional provisions or other special terms not inconsistent with the provisions of the mortgage, including any terms that may be required or advisable under United States or other applicable laws or regulations, or advisable in connection with the marketing of the bonds.

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Security

The mortgage constitutes a first mortgage lien on the mortgaged property, subject to permissible encumbrances. The bonds are secured by the mortgaged property on an equal and ratable basis and will rank equally (except as to sinking funds and other similar funds that may be established for the exclusive benefit of a particular series) with all other bonds of any series issued and outstanding under the mortgage.

Mortgaged Property

The mortgaged property is made up of all of our real, personal and mixed property, which is an integral part of, or is used or to be used as an integral part of our electric generating, transmission and distribution operations, our undivided legal interest in any of such property, which is jointly owned with a third party, any franchises and permits owned by us in connection with these operations, and any other property, which is intended at any time to be subject to the lien created by the mortgage, including any after acquired property of the character intended to be mortgaged property and any property scheduled as mortgaged property in the mortgage and any supplemental indentures, subject to the exceptions referred to below, to certain minor leases and easements, permitted liens, exceptions and reservations in the instruments by which we acquired title to our property and the prior lien of the mortgage trustee for compensation, expenses and liability.

Excepted from the lien of the mortgage, among other things, are:

- cash, cash equivalents, accounts receivable, securities not pledged under the mortgage, and certain intangibles including intellectual property;
- goods, merchandise, electricity, gas, steam, water, ice, oil, coal and other materials, products or services generated, manufactured, produced, purchased or acquired by us and held for sale in the ordinary course of business or for use or consumption by us for operations or maintenance, replacement or fixed capital purposes;
- all nuclear fuel, cores and materials and interests therein;
- all supplies and equipment used in connection with our business, books and records; and
- all leases and real or personal property not specifically pledged under the mortgage.

There is further expressly excepted any property of any other corporation that acquires us or into which we merge, which is owned by such corporation prior to the acquisition or merger, or which is acquired by such corporation after the acquisition or merger and is not integrally related to our electric generating, transmission and distribution operations. The mortgage permits our consolidation or merger with, or the conveyance of substantially all of our property to, any other corporation; provided that the successor corporation is a U.S. company that expressly assumes the due and punctual payment of the principal and interest on the bonds outstanding under the mortgage and the due and punctual performance and observance of all covenants, agreements and conditions of the mortgage, and provided that the consolidation or merger does not create any prior lien over the mortgaged property.

Issuance of Additional Bonds

The mortgage provides that we may at any time and from time to time issue additional first mortgage bonds in principal amounts equal to the sum of:

(a) the lesser of:

(i) 75% of the amount of bondable property that has not been used as a basis for the issuance of bonds already issued under the mortgage, and

(ii) 100% of the principal amount of first mortgage bonds or indebtedness subject to prior liens, which bonds or indebtedness have been paid, retired, repurchased, redeemed, cancelled or otherwise discharged by us since February 1, 1996 or are then being paid, retired, repurchased, redeemed, cancelled or otherwise discharged by us, and which have not already been used as a basis for the issuance of bonds under the mortgage, and

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(b) the amount of cash deposited with the mortgage trustee for such purpose.

Additional bonds may not be issued on the basis of property additions subject to a prior lien.

Certain Covenants

The mortgage contains several covenants, including covenants relating to payment of principal and interest, our continued corporate existence and the filing of reports with the SEC and the trustee. Any covenants that may apply to a particular series of debt securities will be described in the prospectus supplement relating thereto.

Release and Substitution of Assets

The mortgage provides that, subject to various limitations, property may be released from the lien of the mortgage if, after such release, the fair value of the remaining property subject to the mortgage equals or exceeds an amount equal to 1331/3% of the aggregate principal amount of outstanding bonds plus the amount of outstanding indebtedness that has a prior lien on such property. The mortgage also permits property to be released from the lien of the mortgage upon the substitution of cash, certain cash equivalents, newly acquired bondable property, or the waiver of the right to issue bonds in the amount of the fair value of such released property.

The mortgage also provides that cash may be released by the mortgage trustee (i) in the case of cash deposited with the mortgage trustee for the issuance of bonds after February 1, 1996, to the extent of 75% of the amount of bondable property that has not been used as a basis for the issuance of bonds already issued under the mortgage, and (ii) in the case of cash deposited with the mortgage trustee for any other reason under the mortgage, to the extent of 100% of the amount of bondable property that has not been used as a basis for the issuance of bonds already issued under the mortgage, and which may be withdrawn in an amount equal to the principal amount of bonds which we have the right to issue based upon the retirement of outstanding bonds or the repayment of indebtedness with a prior lien. Cash may also be used or applied to the payment at maturity or on redemption or repurchase of any outstanding bonds or indebtedness with a prior lien.

Events of Default

An Event of Default under the mortgage includes:

- default in the payment of the principal of, or premium, if any, on any bond when due or default for 60 days in the payment of interest on any bond when due;
- default in compliance with any covenant contained in the mortgage or any supplemental indenture, which is not remedied within 60 days after we or the mortgage trustee receives written notice from the holders of not less than 25% of the outstanding bonds;
- an order or decree by a court of competent jurisdiction that remains in effect for 60 days and (i) that adjudicates us to be bankrupt or insolvent, (ii) that is for the winding up or liquidation of our affairs, (iii) that approves a petition seeking our reorganization or arrangement under bankruptcy law or (iv) that appoints a trustee, liquidator, receiver, assignee, or similar official under bankruptcy law;
- (i) our filing for voluntary bankruptcy, (ii) our consent to filing for relief against us in an involuntary bankruptcy case, (iii) our making

of an assignment for the benefit of creditors, (iv) our consent to the appointment of a trustee, liquidator, receiver, assignee, or similar official under bankruptcy law over us or over a substantial part of the mortgaged property, (v) our filing a petition or answer or consent seeking reorganization or arrangement under bankruptcy law, (vi) our consent to the filing of any such petition and (vii) our filing a petition to take advantage of any law for the relief of debtors; and

- any other event expressly designated as an Event of Default under the terms of the applicable supplemental indenture and disclosed in the applicable prospectus supplement.

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We are required to give the mortgage trustee notice of the occurrence of any Default or Event of Default and to certify to the mortgage trustee within 120 days of the end of each fiscal year that we are not in default. The mortgage trustee is required, within 90 days after the occurrence of any Default or Event of Default, to give to the holders of the bonds notice of all defaults known to the mortgage trustee unless such defaults shall have been cured before the giving of such notice; provided, however, that except in the case of default in the payment of the principal of or interest on any of the bonds, or in the payment or satisfaction of any sinking, improvement, maintenance, replacement or analogous fund installment, the mortgage trustee shall be protected in withholding notice if and so long as the mortgage trustee in good faith determines that the withholding of notice is in the interests of the holders of the bonds.

If any Event of Default occurs and is continuing, the mortgage trustee or the holders of at least 25% in aggregate principal amount of the then outstanding bonds of any series affected by the Event of Default may declare all of the bonds in such series to be immediately due and payable. The holders of not less than a majority in aggregate principal amount of bonds outstanding and affected by an Event of Default may direct the mortgage trustee in the exercise of its power, provided that the mortgage trustee is not required to exercise any of its rights or powers under the mortgage at the request of any holders of bonds unless the holders have offered the mortgage trustee security and indemnity against any loss, liability or expense, to the mortgage trustee's satisfaction. The holders of not less than a majority in aggregate principal amount of bonds outstanding may also waive past defaults other than payment defaults, defaults arising from our creation of prior liens, or defaults that are in violation of other provisions of the indenture. The indenture does not have a cross-default provision. Thus, unless otherwise provided in the prospectus supplement for a series of bonds, a default by us on any other debt would not constitute an Event of Default.

Modification of the Mortgage

The mortgage may be amended or supplemented, and any existing default or compliance with any provision of the mortgage or the bonds may be waived, with the consent of the holders of not less than a majority in principal amount of the then outstanding bonds, unless the rights of one or more but less than all series of bonds would be materially and adversely affected; then, the only consent required shall be the consent of the holders of a majority in principal amount of each such series affected, voting together as a single class.

Notwithstanding the previous paragraph, without the consent of each holder affected, no amendment or waiver may reduce the principal amount of bonds whose holders must consent to an amendment of the bonds or waiver of any Defaults or Events of Default under the bonds, reduce the principal amount due under or change the maturity of any bond, reduce the rate of interest or change the time for payment of interest on any bond, alter any conversion, redemption or repurchase rights with respect to any bond, waive any default in the payment of principal or interest on the bonds, limit the right of a holder of bonds to institute suit for the enforcement of any payment of principal or interest on the bonds, or permit the creation of any prior liens.

Legal Defeasance

Pursuant to the mortgage, bonds that are within one year of their stated maturity may be legally defeased when the mortgage trustee has received from us, an amount of money or U.S. government obligations which will be adequate to pay when due the principal and interest on all outstanding bonds at their maturity or earlier redemption. The mortgage trustee will determine whether the funds deposited are adequate based on the opinion of an accountant, who may be our financial officer, and taking into account any reinvestment and proceeds on such funds. When adequate funds have been deposited with the mortgage trustee, and we have given irrevocable instructions for such funds to be paid to the bondholders, the mortgage trustee may, and at our request will, satisfy and discharge the lien of the mortgage and release to us the mortgaged property.

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Governing Law

The mortgage is governed by New York law, except to the extent that the Trust Indenture Act of 1939 is applicable and except that the perfection, priority and enforcement of the lien of the mortgage is governed by the law of the jurisdiction where any portion of the mortgaged property is located.

Description of Warrants

We may issue warrants to purchase our debt or equity securities or securities of third parties or other rights, including rights to receive payments in cash or securities based on the value, rate or price of one or more specified commodities, currencies, securities or indices, or any combination of the foregoing. Warrants may be issued independently of or together with any other offered securities and may be attached to, or separate from, such securities. Each series of warrants will be issued under a separate warrant agreement to be entered into between us and a warrant agent. The terms of any warrants to be issued and a description of the material provisions of the applicable warrant agreement will be set forth in the applicable prospectus supplement.

The applicable prospectus supplement will describe the following terms of any warrants in respect of which this prospectus is being delivered:

- the title of such warrants;
- the aggregate number of such warrants;
- the price or prices at which such warrants will be issued;
- the currency or currencies in which the price of such warrants will be payable;
- the securities or other rights, including rights to receive payment in cash or securities based on the value, rate or price of one or more specified commodities, currencies, securities or indices, or any combination of the foregoing, purchasable upon exercise of such warrants;
- the price at which and the currency or currencies in which the securities or other rights purchasable upon exercise of such warrants may be purchased;
- the date on which the right to exercise such warrants shall commence and the date on which such right shall expire;
- if applicable, the minimum or maximum amount of such warrants that may be exercised at any one time;
- if applicable, the designation and terms of the securities with which such warrants are issued and the number of such warrants issued with each such security;
- if applicable, the date on and after which such warrants and the related securities will be separately transferable;
- information with respect to book-entry procedures, if any;
- if applicable, a discussion of any material United States federal income tax considerations; and

- any other terms of such warrants, including terms, procedures and limitations relating to the exchange and exercise of such warrants.

Description of Purchase Contracts

We may issue purchase contracts, together with, or separate from, the securities registered hereby, for the purchase or sale of:

- debt or equity securities issued by us or securities of third parties, a basket of such securities, an index or indices of such securities or any combination of the above as specified in the applicable prospectus supplement;
- currencies; or
- commodities.

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Each purchase contract will entitle the holder thereof to purchase or sell, and obligate us to sell or purchase, on specified dates, such securities, currencies or commodities at a specified purchase price, which may be based on a formula, all as set forth in the applicable prospectus supplement. We may, however, satisfy our obligations, if any, with respect to any purchase contract by delivering the cash value of such purchase contract or the cash value of the property otherwise deliverable or, in the case of purchase contracts on underlying currencies, by delivering the underlying currencies, as set forth in the applicable prospectus supplement. The applicable prospectus supplement will also specify the methods by which the holders may purchase or sell such securities, currencies or commodities and any acceleration, cancellation or termination provisions or other provisions relating to the settlement of a purchase contract.

The purchase contracts may require us to make periodic payments to the holders thereof or vice versa, which payments may be deferred to the extent set forth in the applicable prospectus supplement, and those payments may be unsecured or prefunded on some basis. The purchase contracts may require the holders thereof to secure their obligations in a specified manner to be described in the applicable prospectus supplement. Alternatively, purchase contracts may require holders to satisfy their obligations thereunder when the purchase contracts are issued. Our obligation to settle such prepaid purchase contracts on the relevant settlement date may constitute indebtedness. Accordingly, prepaid purchase contracts may be issued under the indenture.

Description of Units

As specified in the applicable prospectus supplement, we may issue units consisting of one or more purchase contracts, warrants, debt securities, first mortgage bonds, shares of preferred stock, shares of common stock or any combination of such securities. The applicable prospectus supplement will describe:

- the terms of the units and of the purchase contracts, warrants, debt securities, first mortgage bonds, preferred stock and common stock comprising the units, including whether and under what circumstances the securities comprising the units may be traded separately;
- a description of the terms of any unit agreement governing the units; and
- a description of the provisions for the payment, settlement, transfer or exchange of the units.

Forms of Securities

Each debt security, bond, warrant and unit will be represented either by a certificate issued in definitive form to a particular investor or by one or more global securities representing the entire issuance of securities. Certificated securities will be issued in definitive form, and global securities will be issued in registered form. Definitive securities name you or your nominee as the owner of the security, and in order to transfer or exchange these securities or to receive payments other than interest or other interim payments, you or your nominee must physically deliver the securities to the trustee, registrar, paying agent or other agent, as applicable. Global securities name a depositary or its nominee as the owner of the debt securities, warrants or units represented by these global securities. The depositary maintains a computerized system that will reflect each investor’s beneficial ownership of the securities through an account maintained by the investor with its broker/dealer, bank, trust company or other representative, as we explain more fully below.

Global Securities

Registered Global Securities. We may issue the registered debt securities, bonds, warrants and units in the form of one or more fully registered global securities that will be deposited with a depositary or its nominee identified in the applicable prospectus supplement and registered in the name of that depositary or nominee. In those cases, one or more registered global securities will be issued in a denomination or aggregate denominations equal to the portion of the aggregate principal or face amount of the securities to be represented by registered global securities. Unless and until it is exchanged in whole for securities in definitive registered form, a registered global security may not be transferred except as a whole by and among the depositary for the registered global security, the nominees of the depositary or any successors of the depositary or those nominees.

If not described below, any specific terms of the depositary arrangement with respect to any securities to be represented by a registered global security will be described in the prospectus supplement relating to those securities. We anticipate that the following provisions will apply to all depositary arrangements.

Ownership of beneficial interests in a registered global security will be limited to persons, called participants, that have accounts with the depositary or persons that may hold interests through participants. Upon the issuance of a registered global security, the depositary will credit, on its book-entry registration and transfer system, the participants' accounts with the respective principal or face amounts of the securities beneficially owned by the participants. Any dealers, underwriters or agents participating in the distribution of the securities will designate the accounts to be credited. Ownership of beneficial interests in a registered global security will be shown on, and the transfer of ownership interests will be effected only through, records maintained by the depositary, with respect to interests of participants, and on the records of participants, with respect to interests of persons holding through participants. The laws of some states may require that some purchasers of securities take physical delivery of these securities in definitive form. These laws may impair your ability to own, transfer or pledge beneficial interests in registered global securities.

So long as the depositary, or its nominee, is the registered owner of a registered global security, that depositary or its nominee, as the case may be, will be considered the sole owner or holder of the securities represented by the registered global security for all purposes under the applicable indenture, warrant agreement, or unit agreement. Except as described below, owners of beneficial interests in a registered global security will not be entitled to have the securities represented by the registered global security registered in their names, will not receive or be entitled to receive physical delivery of the securities in definitive form and will not be considered the owners or holders of the securities under the applicable indenture, warrant agreement or unit agreement. Accordingly, each person owning a beneficial interest in a registered global security must rely on the procedures of the depositary for that registered global security and, if that person is not a participant, on the procedures of the participant through which the person owns its interest, to exercise any rights of a holder under the applicable indenture, warrant agreement or unit agreement. We understand that under existing industry practices, if we request any action of holders or if an owner of a beneficial interest in a registered global security desires to give or take any action that a holder is entitled to give or take under the applicable indenture, warrant agreement or unit agreement, the depositary for the registered global security would authorize the participants holding the relevant beneficial interests to give or take that action, and the participants would authorize beneficial owners owning through them to give or take that action or would otherwise act upon the instructions of beneficial owners holding through them.

Principal, premium, if any, and interest payments on debt securities and bonds, and any payments to holders with respect to warrants or units, represented by a registered global security registered in the name of a depositary or its nominee will be made to the depositary or its nominee, as the case may be, as the registered owner of the registered global security. None of us, the trustees, the warrant agents, the unit agents or any other agent of our, any agent of the trustees or agent of the warrant agents or unit agents will have any responsibility or liability for any aspect of the records relating to payments made on account of beneficial ownership interests in the registered global security or for maintaining, supervising or reviewing any records relating to those beneficial ownership interests.

We expect that the depositary for any of the securities represented by a registered global security, upon receipt of any payment of principal, premium, interest or other distribution of underlying securities or other property to holders on that registered global security, will immediately credit participants' accounts in amounts proportionate to their respective beneficial interests in that registered global security as shown on the records of the depositary. We also expect that payments by participants to owners of beneficial interests in a registered global security held through participants will be governed by standing customer instructions and customary practices, as is now the case with the

securities held for the accounts of customers in bearer form or registered in ‘‘street name,’’ and will be the responsibility of those participants.

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If the depositary for any of these securities represented by a registered global security is at any time unwilling or unable to continue as depositary or ceases to be a clearing agency registered under the Securities Exchange Act of 1934, and a successor depositary registered as a clearing agency under the Securities Exchange Act of 1934 is not appointed by us within 90 days, we will issue securities in definitive form in exchange for the registered global security that had been held by the depositary. Any securities issued in definitive form in exchange for a registered global security will be registered in the name or names that the depositary gives to the relevant trustee, warrant agent, unit agent or other relevant agent of ours or theirs. It is expected that the depositary's instructions will be based upon directions received by the depositary from participants with respect to ownership of beneficial interests in the registered global security that had been held by the depositary.

Plan of Distribution

We or selling security holders may sell the securities being offered under this prospectus in four ways or any combination thereof:

- directly to purchasers;
- through agents;
- through underwriters; and
- through dealers.

If any securities are sold pursuant to this prospectus by any persons other than us, we will, in a prospectus supplement, name the selling security holders, indicate the nature of any relationship such holders have had to us or any of our affiliates during the three years preceding such offering, state the amount of securities of the class owned by such security holder prior to the offering and the amount to be offered for the security holder's account, and state the amount and (if one percent or more) the percentage of the class to be owned by such security holder after completion of the offering.

We or any selling security holder may directly solicit offers to purchase the securities, or agents may be designated to solicit such offers. We will, in the prospectus supplement relating to such offering, name any agent that could be viewed as an underwriter under the Securities Act of 1933 and describe any commissions that we or any selling security holder must pay. Any such agent will be acting on a best efforts basis for the period of its appointment or, if indicated in the applicable prospectus supplement, on a firm commitment basis.

If any underwriters or agents are used in the sale of the securities in respect of which this prospectus is delivered, we and, if applicable, any selling security holder will enter into an underwriting agreement or other agreement with them at the time of sale to them, and we will set forth in the prospectus supplement relating to such offering the names of the underwriters or agents and the terms of the related agreement with them.

If a dealer is used in the sale of the securities in respect of which the prospectus is delivered, we will sell such securities to the dealer, as principal. The dealer may then resell such securities to the public at varying prices to be determined by such dealer at the time of resale.

If indicated in the applicable prospectus supplement, we will authorize underwriters, dealers or agents to solicit offers by certain institutional investors to purchase securities from us pursuant to contracts providing for payment and delivery at a future date. Institutional investors with which these contracts may be made include, among others,

commercial and savings banks, insurance companies, pension funds, investment companies and educational and charitable institutions. In all cases, these purchasers must be approved by us. Unless otherwise set forth in the applicable prospectus supplement, the obligations of any purchaser under any of these contracts will not be subject to any conditions except that:

- the purchase of the securities must not at the time of delivery be prohibited under the laws of any jurisdiction to which that purchaser is subject; and
- if the securities are also being sold to underwriters, we must have sold to these underwriters the securities not subject to delayed delivery.

We may enter into derivative transactions with third parties, or sell securities not covered by this prospectus to third parties in privately negotiated transactions. If the applicable prospectus supplement indicates, in connection with those derivatives, the third parties may sell securities covered by this prospectus and the applicable prospectus supplement, including in short sale transactions. If so, the third parties may use securities pledged by us or borrowed from us or others to settle those sales or to close out any related open borrowings of stock, and may use securities received from us in settlement of those derivatives to close out any related open borrowings of stock. The third parties in such sale transactions will be underwriters and, if not identified in this prospectus, will be identified in the applicable prospectus supplement (or a post-effective amendment).

We may loan or pledge securities to a financial institution or other third party that in turn may sell the securities using this prospectus. Such financial institution or third party may transfer its short position to investors in our securities or in connection with a simultaneous offering of other securities offered by this prospectus.

One or more firms, referred to as ‘‘remarketing firms,’’ may also offer or sell the securities, if the prospectus supplement so indicates, in connection with a remarketing arrangement upon their purchase. Remarketing firms will act as principals for their own accounts or as our agents. These remarketing firms will offer or sell the securities in accordance with the terms of the securities. The prospectus supplement will identify any remarketing firm and the terms of its agreement, if any, with us and will describe the remarketing firm’s compensation. Remarketing firms may be deemed to be underwriters in connection with the securities they remarket.

Remarketing firms, agents, underwriters and dealers may be entitled under agreements which they may enter into with us to indemnification by us and by any selling security holder against certain civil liabilities, including liabilities under the Securities Act, and may be customers of, engage in transactions with or perform services for us in the ordinary course of business.

In order to facilitate the offering of the securities, any underwriters may engage in transactions that stabilize, maintain or otherwise affect the price of the securities or any other securities the prices of which may be used to determine payments on such securities. Specifically, any underwriters may overallot in connection with the offering, creating a short position for their own accounts. In addition, to cover overallotments or to stabilize the price of the securities or of any such other securities, the underwriters may bid for, and purchase, the securities or any such other securities in the open market. Finally, in any offering of the securities through a syndicate of underwriters, the underwriting syndicate may reclaim selling concessions allowed to an underwriter or a dealer for distributing the securities in the offering if the syndicate repurchases previously distributed securities in transactions to cover syndicate short positions, in stabilization transactions or otherwise. Any of these activities may stabilize or maintain the market price of the securities above independent market levels. Any such underwriters are not required to engage in these activities, and may end any of these activities at any time.

Unless otherwise specified in a prospectus supplement, except for our common stock, which is listed on the New York Stock Exchange, the securities will not be listed on a national securities exchange or inter-dealer quotation system. No assurance can be given that any broker-dealer will make a market in any series of the securities, and, in any event, no assurance can be given as to the liquidity of the trading market for any of the securities. The prospectus supplement will state, if known, whether or not any broker-dealer intends to make a market in the securities. If no such determination has been made, the prospectus supplement will so state.

Legal Matters

The validity of the offered securities will be passed upon by Clark, Thomas & Winters, Austin, Texas, and Davis Polk & Wardwell, Menlo Park, California.

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 catastrophe or a failure of our primary systems, we do not yet have an integrated 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.

Risks Relating to our Mining Operations

Our mineral resource estimates are based in interpretations and premises and may materially differ from mineral quantities that we may be able to actually extract.

Our mining resources are estimated quantities of ore and minerals. There are numerous uncertainties inherent in estimating quantities of resources, including many factors beyond our control. Reserve engineering involves estimating deposits of minerals that cannot be measured in an exact manner, and the accuracy of any reserve estimate is a function of the quality of available data, engineering and geological interpretation and judgment. In addition, estimates of different engineers may vary. As a result, no assurance can be given that the amount of mining resources will be extracted or that they can be extracted at commercially viable rates, which could adversely affect the financial situation of the Company.

Moreover, when making determinations about whether to advance any projects to development, Gerdau relies upon estimated calculations as to the mineralized material on its properties. Since Gerdau has not conducted a feasibility study demonstrating proven or probable reserves, estimates of mineralized material presented are less certain than would be the case if the estimates were made in accordance with the SEC-recognized definition of proven and probable reserves. Furthermore, until ore is actually mined and processed, any mineral reserves and

grades of mineralization must be considered as estimates only. These estimates are imprecise and

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depend on geological interpretation and statistical inferences drawn from drilling and sampling analysis, which may prove to be unreliable. We cannot assure that these mineralized material estimates will be accurate or that this mineralized material can be mined or processed profitably and any decision to move forward with development is inherently risky. Further, there can be no assurance that any minerals recovered in small scale tests will be duplicated in large scale tests under on-site conditions or production scale. Any material changes in estimates of mineralized material will affect the economic viability of placing a property into production and such property s return on capital. As a result, the Company s financial condition and results of operations may be adversely affected.

The Company has no proven or probable reserves, and the Company s decision to commence industrial production, in order to supply its steelmaking works as well as sell any surplus volume, is not based on a study demonstrating economical recovery of any mineral reserves and is therefore inherently risky. Any funds spent by the Company on exploration or development could be lost.

The Company has not established any proven or probable mineral reserves at any of its properties. All exploration activities are supported based on mineral resources classified as mineralized materials, as they are not compliant with the definitions established by the SEC of proven or probable reserves. The Company is conducting a comprehensive exploration study to establish, in accordance with SEC definitions, the amount of mineralized material that could be transformed to proven or probable reserves. Thus, part of the volume of mineralized materials informed discussed herein may never reach the development or production stage.

In order to demonstrate the existence of proven or probable reserves, it would be necessary for Company to perform additional exploration to demonstrate the existence of sufficient mineralized material with satisfactory continuity and obtain a positive feasibility study which demonstrates with reasonable certainty that the deposit can be economically and legally extracted and produced. The absence of proven or probable reserves makes it more likely that the Company s properties may cease to be profitable and that the money spent on exploration and development may never be recovered, which could adversely affect the financial condition and results of operations of the Company.

Drilling and production risks could adversely affect the mining process.

Once mineral deposits are discovered, it can take a number of years from the initial phases of drilling until production is possible, during which time the economic feasibility of production may change. Substantial time and expenditures are required to:

- establish mineral reserves through drilling;
- determine appropriate mining and metallurgical processes for optimizing the recovery of metal contained in ore;
- obtain environmental and other licenses;

- construct mining, processing facilities and infrastructure required for greenfield properties; and
- obtain the ore or extract the minerals from the ore.

If a mining project proves not to be economically feasible by the time we are able to profit from it, the Company may incur substantial losses and be obliged to take write-offs. In addition, potential changes or complications involving metallurgical and other technological processes arising during the life of a project may result in delays and cost overruns that may render the project not economically feasible and could adversely affect the financial condition and results of operations of the Company.

The Company has two mining tailing dams and any accident or defect affecting the structural integrity of either of them could affect its image, results of operations, cash flows and financial condition.

Gerdau has two mining tailing dams in the state of Minas Gerais. The Bocaina Dam has been inactive since 2011 and is practically dry, which is a factor that minimizes the risk. It is periodically monitored and its instrumentation data are within the safety limits. Meanwhile, the Alemães Dam is currently operating at its maximum capacity and is regularly monitored. The instrumentation data are within the safety limits.

Both dams are classified as Class C (low risk) in accordance with the National Mining Dam Registry available on the website of the National Department of Mineral Production (DNPM).

Gerdau adopts rigorous standards of engineering control and environmental supervision and conducts an annual Geotechnical Stability Audit to ensure the stability of the two dams. Gerdau has a Mining Dam Emergency Action Plan for each of the dams and both documents are filed at the regulatory agencies, as required by governing law.

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An accident involving a dam could result in serious adverse consequences, including:

- Temporary/permanent shutdown of mining activities and consequently the need to buy iron ore to supply mills;
- Large 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 one or more of these consequences could have a material adverse impact on our results of operations, 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. In December 2011, Moody s assigned the investment grade rating Baa3 for all of Gerdau s ratings. With the deterioration of the Brazilian economy, S&P, Fitch and Moody s downgraded Brazil s sovereign rating. Despite the loss of Brazil s investment grade rating in 2015, the Company maintained its investment grade rating by Fitch and Standard & Poor s. However, the Company lost its investment grade rating by Moody s.

The loss of any 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;

- The Company may be required to adjust the level of funds available for additions to fixed assets; and

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

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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 include covenants relating to the Company s indebtedness ratios, but with distinct characteristics in relation to those 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 Division 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* depreciated against the U.S. dollar by 47.0% in 2015, appreciated by 16.5% in 2016 and depreciated by 1.5% in 2017.

The Company held debt denominated in foreign currency, mainly U.S. dollars, in an aggregate amount of R$13.3 billion at December 31, 2017, representing 81.0% 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. Because the statements made by the head of the FCA are recent in nature, 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 reserve has been established are the following:

- The Company and its subsidiary 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$ 443,137 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$ 309,581 thousands; (ii) PIS and COFINS, substantially related to non-approval of compensation of credits on inputs totaling R$ 438,843, (iii) social security contributions in the total of R$ 76,866 thousands and (iv) other taxes, which updated total amount is currently R$ 370,175 thousands.

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- Subsidiary Gerdau Aços Longos S.A. is a party to an administrative proceeding relating to Withholding Income Tax, in the amount of R$ 122,029 thousands, assessed on the remittance abroad of interest charged on export financings under Export Prepayment or Export Advance Agreements. The Company submitted an administrative claim challenging the tax assessment on January 13, 2017, which was rejected by the Brazilian Federal Revenue Judgment Office (Delegacia de Julgamento da Receita Federal do Brasil), on June 5, 2017, reason for which the Company submitted a voluntary appeal, on July 4, 2017, which is currently pending on the Brazilian Board of Tax Appeals (Conselho Administrativo de Recursos Fiscais CARF , administrative body of the Ministry of Finance of Brazil).

- 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$ 1,488,989 thousands. Said proceedings relate to profits generated abroad, of which (i) R$ 1,317,381 thousands correspond to two proceedings involving Gerdau Internacional Empreendimentos Ltda., of which (i.a.) R$ 951,736 thousands relate to a proceeding that is no longer subject to appeal in CARF and was referred for judicial collection, which collection is being challenged in the competent judicial lower court; and (i.b) R$ 365,645 thousands relate to a voluntary appeal which was partially granted in the lower tribunal of the Brazilian Board of Tax Appeals (Conselho Administrativo de Recursos Fiscais CARF , administrative body of the Ministry of Finance of Brazil), and was subject to special appeal which was partially granted in CARF s superior tribunal with the publication of the judgment on May 25, 2017, and is currently awaiting due diligence by the Internal Revenue Service, as determined by the CARF decision, and new appeals may be filed after the conclusion of such procedure; and (ii) R$ 171,608 thousands correspond to a proceeding involving the Company, whose voluntary appeal in CARF s lower tribunal was dismissed, for which a special appeal was filed, and currently awaits judgment in CARF s superior tribunal.

- 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$ 6,217,810 thousands, of which (i) R$ 4,963,398 thousands 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 administrative 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 Motion to Stay Execution by the subsidiary Gerdau Aços Longos S.A. were initiated, in their respective proceedings, which total the amount of R$ 3,195,379 thousands, and also by the Company, in its respective lawsuit, which amounts to R$ 364,370 thousands; (ii) R$ 600,101 thousands correspond to two proceedings involving Gerdau Aços Longos S.A., whose voluntary appeal is currently pending in CARF s lower tribunal; (iii) R$ 531,138 thousands correspond to two proceeding involving the subsidiary Gerdau Aços Longos S.A., whose voluntary appeal was dismissed in CARF s lower tribunal and having been presented Request for Clarification against those decisions, which are pending of judgment; and (iv) R$ 123,172 thousands correspond to one proceeding involving the Company (as successor of Gerdau Aços Especiais S.A.), whose Request for Clarification, which was filed against a decision that dismissed its Voluntary Appeal, was rejected on December 7, 2017, then the Company became aware of that on December 12, 2017 and it is opposing the appropriate appeal.

Some of the decisions obtained at the CARF related to those proceedings along with other matters involving the Company included in the scope of the so-called Operation Zelotes (the Operation) are being investigated by Brazilian federal authorities including the Judiciary Branch, with the purpose of verifying the occurrence or not of alleged illegal acts.

Considering the involvement of Gerdau s name in press reports concerning the Operation, the Board of Directors decided to engage outside counsel, which report to a Special Committee of the Board, to conduct an investigation to determine, among other things: (i) whether, in light of current knowledge, proper protocol was followed in the relationship of the Company with governmental authorities, including CARF, and in the hiring of firms representing the Company in cases before CARF; (ii) whether such firms have remained within the scope of their work/hiring; (iii) whether the engagement terms for such firms included clauses intended to prevent activity that violates ethical codes or laws currently in force; (iv) whether the engagement terms for such firms included the establishment of sanctions for any violations (whether contractual breaches or otherwise); and (v) if there is any evidence of fraud, deceit, bad faith, or any expression of an intent to commit an illegal act on the part of directors and/or officers of the Company in the relationship of the Company with governmental authorities, including CARF, in the negotiation, signing or carrying out of the aforementioned contracts (the Internal Investigation).

The Internal Investigation is ongoing, and as of the date of the approval of these interim financial statements, the Company believes it is not possible to predict either the duration or the outcome of the Operation or of the Internal Investigation. Additionally, the Company believes that currently there is not enough information to determine whether a provision for losses is required or disclose any contingency.

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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 likely).

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 situation. 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 situation.

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.

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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, North America and Asia. 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 an external legal, which would 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). The internal investigation is ongoing, and the Company is cooperating with the Federal Police. 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.

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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 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*, which have negatively impacted the Brazilian economy and political environment and contributed to a decline in market confidence in Brazil.

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 these *Lava Jato* investigations.

Amidst this background of political and economic uncertainty, President Dilma Rousseff was suspended from office on May 12, 2016, when the Brazilian Senate voted to hold a trial on impeachment charges against her. President Rousseff was replaced by Vice-President Michel Temer, who served as acting President until Ms. Rousseff was permanently removed from office by the Senate on August 31, 2016. President Temer s term of office is set to end in December 2018.

The potential outcome of *Lava Jato* as well as other ongoing corruption-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 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.

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.

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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 BM&FBOVESPA, 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.

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

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. 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.

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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. has 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 attributes an economic value to the joint venture of US$165 million (R$546 million on the transaction date).

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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), with the possibility of receiving up to an additional 45 million (equivalent to R$ 180 million) within five years, depending on future business performance.

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 Indústrias 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.

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

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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 Itaú 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 December 29, 2017, the Company entered into a definitive agreement to sell some of its rebar-producing mills, as well as fabricated rebar units and distribution centers in the United States, to Commercial Metals, for US$600 million (R$2.0 billion on the sale date). The agreement includes mills in Jacksonville (Florida), Knoxville (Tennessee), Rancho Cucamonga (California) and Sayreville (New Jersey). The transaction is subject to authorization from regulatory agencies and typical settlement conditions.

In February 2018, the Company sold its two hydroelectric power plants based in Goias state, in Brazil, for R$835 million, to Kinross Brasil Mineração, a wholly-owned subsidiary of the Canadian mining company Kinross Gold Corporation. The hydroelectric power plants Caçu and Barra dos Coqueiros, which commenced operations in 2010, have a total capacity of 155 MW. The transaction is subject to regulatory clearances and customary closing conditions.

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 2016 (the most recent year for which information is available), 25.7% of the total crude steel production in the world was through mini-mill process and the remaining 74.3% was through the integrated process.

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Crude Steel Production by Process in 2016*

Blast Furnace	Crude Steel Production (in million tonnes)	Production by Process (%) Mini-mill	Integrated
World	**1,627**	**25.7**	**74.3**
China	808	6.4	93.6
Japan	105	22.2	77.8
India	96	57.3	42.7
U.S.A.	78	67.0	33.0
Russia	71	30.8	69.2
S. Korea	69	30.7	69.3
Germany	42	29.9	70.1
Turkey	33	65.9	34.1
Brazil	31	21.1	78.9

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 1,348.1 million tonnes in 2007 to 1,674.7 million tonnes in 2017, for an average annual increase of 2.9%.

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 2.8% from 1,628.5 million tonnes in 2016 to 1,674.7 million tonnes in 2017.

Crude Steel Production (in million tonnes)

Source: World Steel/Monthly 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 831.7 million tonnes, an increase of 2.9% compared to 2016. In 2017, China s share of world steel production was 49.7% of world total crude steel.

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Crude Steel Production by Country in 2017 (million tonnes)

Source: World Steel/Monthly Statistics

Asia produced 1,151.8 million tonnes of crude steel in 2017, an increase of 5.7% compared to 2016, and its share of world steel production amounted to 69.0%. The EU-28 produced 168.7 million tonnes of crude steel in 2017, a increase of 4.1% compared to 2016, representing 10% of the global total. In 2017, crude steel production in North America increased 4.9% when compared to 2016, a total of 116.0 million tonnes. The CIS (Commonwealth of Independent States) showed a stable crude steel production with a total of 102.0 million tonnes in 2017.

The Brazilian Steel Industry

In 2017, Brazil was the world s 9th largest producer of crude steel, with a production of 34.4 million tonnes, a 2.1% share of the world market and 78.7% of the total steel production in South America during the year.

Total sales of Brazilian steel products were 34.4 million tonnes in 2017, 31.3 million tonnes in 2016 and 33.3 million tonnes in 2015, exceeding domestic demand of 19.2 million tonnes in 2017, 18.4 million tonnes in 2016 and 21.3 million tonnes in 2015. In 2017, total steel sales in the domestic market increased 2.3% from 2016, going from 16.5 million tonnes to 16.9 million tonnes.

In 2017, the total of Brazilian steel products sales was 31.6 million tonnes. The breakdown of total sales was 69.1% or 21.8 million tonnes of flat steel products, formed by domestic sales of 10.1 million tonnes and exports of 11.7 million tonnes. The remaining 30.9% or 9.7 million tonnes represented sales of long steel products, which consisted of domestic sales of 6.8 million tonnes and exports of 2.9 million tonnes.

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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 2017, the Brazilian GDP increased by 1.0% and steel consumption increased by 4.3%.

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 2017, Brazilian steel exports totaled 14.6 million tonnes, representing 46.4% 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 9.5 million tonnes in 2017, 8.4 million tonnes in 2016 and 8.7 million tonnes in 2015, representing 64.9%, 64.3% and 63.5% 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 2017, imports represented 12.0% of apparent domestic consumption, an increase compared to 2016, which was mainly due to higher prices in the domestic market compared to the international market.

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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.

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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 2018.

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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, Chile, Colombia, the United States, India, 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 2016, 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 41 steel producing facilities globally.

As of December 31, 2017, Gerdau s total consolidated installed annual capacity, excluding investments in joint ventures and associate companies, was approximately 26.1 million tonnes of crude steel and 21.1 million tonnes of rolled steel products. The Company had total consolidated assets of R$ 50.3 billion, shareholders equity (including non-controlling interests) of R$ 23.9 billion, consolidated net sales of R$ 36.9 billion and a total consolidated net loss (including non-controlling interests) of R$338.7 million for the period ended on December 31, 2017.

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 and Asia. Gerdau currently operates 16 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 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 divisions in North and Latin America (except Brazil) are aimed at their respective local markets.

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The Company manages its Business Divisions as follows:

- **Brazil BD** (Brazil Business Division) - includes operations in Brazil (excluding Special Steel) and iron ore operation in Brazil;

- **North America BD** (North America Business Division) - includes all operations in North America (Canada, United States and Mexico), except special steels, in addition to associate and joint ventures, both of which are located in Mexico;

- **South America BD** (South America Business Division) - includes all operations in South America (Argentina, Chile, Peru, Uruguay and Venezuela), except the operations in Brazil, in addition to the joint venture in the Dominican Republic and Colômbia; and

- **Special Steel BD** (Special Steel Business Division) - includes the special steel operations in Brazil, the United States and India.

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

Shipments

Gerdau S.A. Consolidated Shipments by Business Operations (1) (1,000 tonnes)	**Year ended December 31, 2017**	**2016**	**2015**
TOTAL	**14,938**	**15,558**	**16,970**
Brazil	5,608	6,067	6,457
North America	6,313	5,965	6,232
South America	1,723	2,088	2,222
Special Steel	1,977	2,102	2,621
Eliminations and Adjustments	(683)	(665)	(562)

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

Net Sales

Gerdau S.A. Consolidated Net Sales by Business Divisions (1) (R$ million)	**Year ended December 31,**		
	2017	**2016**	**2015**
TOTAL	**36,918**	**37,652**	**43,581**
Brazil	12,563	11,635	12,977
North America	15,433	15,431	17,312
South America	4,026	4,776	5,477
Special Steel	6,229	6,885	8,882
Eliminations and Adjustments	(1,333)	(1,075)	(1,067)

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

Production

Gerdau S.A. Consolidated annual production (million tonnes)	**Year ended December 31,**		
	2017	**2016**	**2015**
Crude Steel Production	**16,120**	**15,677**	**16,862**
Rolled Steel Production	**14,047**	**13,616**	**14,604**
Iron Ore Production	**7,265**	**8,647**	**7,419**

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Brazil Business Division

Steel information

The Brazil Business Division minimizes delays by delivering its products directly to customers through outsourced companies under Gerdau s supervision. Sales trends in both the domestic and export markets are forecasted monthly. The Brazil Business Division 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 Division, sales volume in 2017 fell by 7.6% compared to 2016, mainly influenced by the 15.6% reduction in exports due to the low profitability caused by higher costs. In the domestic market, the reduction of 2.5% was caused by the slowdown in the construction industry.

In 2017, around 15% of the production sold in Brazil was distributed through Gerdau s 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 Division has annual crude steel installed capacity of 9.2 million tonnes and 7.1 million tonnes of finished steel products.

Iron ore information

Gerdau s 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 Division

The North America Business Division has an annual production capacity of 11.5 million tonnes of crude steel and 8.6 million tonnes of finished steel products. It has a vertically integrated network of 16 steel units for the operation of steel units , scrap recycling facilities, downstream operations and rebar fabrication shops. The North America Business Division s products are generally sold to steel service centers and 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 inventory for the mini-mill operations is recycled steel scrap.

The mills of this business division manufacture and commercialize a wide range of steel products, including steel reinforcement bars (rebar), merchant bars, structural shapes, beams, special sections and coiled wire rod. Some of these products are used by the downstream units to make products with a higher added value, which consists of the fabrication of rebar, railroad spikes, super light beam processing, elevator guide rails, grinding balls, wire mesh and wire drawing.

The downstream strategy is to have production facilities located in close proximity to customers job sites so that quick delivery can be provided to meet their reinforcing steel needs and construction schedules.

In general, sales of finished products to U.S. and Canadian customers are centrally managed by the Tampa sales office. There is also a sales office in Selkirk, Manitoba for managing sales of special sections and one in 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. Fabricated rebar and 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.

In the North America Business Division, 2017 shipments were on the level of 6.5 million tonnes. The increased share of imported products have continued to impact the North American market.

The North America Business Division accounted for 40.4% of overall Gerdau sales volumes. Gerdau s Canadian operations sell a significant portion of their production in the United States.

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South America Business Division

The South America Business Division 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 2.2 million tonnes of crude steel and 1.6 million tonnes of finished steel products. The South American operation accounted for 11.5% of overall Gerdau sales volumes, representing 1.7 million tonnes in 2017, a reduction of 17.5% when compared to 2016. The countries in the South America Business Division are Argentina, Chile, Peru, Venezuela and Uruguay. Gerdau also operates in the markets of Colombia and Dominican Republic through joint ventures.

Special Steel Business Division

The Special Steel Business Division is composed of the operations in Brazil (Charqueadas, Pindamonhangaba and Mogi das Cruzes), in the United States (Fort Smith, Jackson and Monroe) and in India (Tadipatri). This operation produces engineering steel (SBQ), tool steel, rolling mill rolls, large forged and casted engineering pieces. In order to meet the continuous need for innovation, this operation is constantly developing new products, such as high strength steels, clean steel, high temperability steels and steel with improved machining characteristics, among others.

The Special Steel Business Division registered a decrease of 5.9% when compared to 2016, due to the divestment of the units in Spain in 2016. Excluding this factor, shipments increased at the other operations.

In Brazil, Gerdau special steel operations are located in Rio Grande do Sul (Charqueadas) and in São Paulo (Pindamonhangaba and Mogi das Cruzes). The special steel units in Brazil have a combined annual capacity of 1.4 million tonnes of crude steel and 1.9 million tonnes of rolled products. The operation in Brazil has more than 300 customers located mainly in Brazil, although its products are also exported to South America, North America and Europe.

In North America, Gerdau maintains a presence in United States, with three mills located in Jackson (Michigan), Monroe (Michigan) and Fort Smith (Arkansas). The operation also has six downstream operations. The operation has an annual installed capacity of 1.5 million tonnes of crude steel and 1.5 million tonnes of rolled products and has more than 200 customers located mainly in the United States, Canada and Mexico.

In India, the Company has a plant for the production of special steel with capacity of 250 thousand tonnes of crude steel and 300 thousand tonnes of rolled products. The operation is constantly evolving and is achieving better results each year.

There are commercial and operational synergies among the units in this business division.

Exports

In 2017, the international market had two distinct moments, with the first half of the year still affected by the oversupply of steel and low prices at the close of 2016, and the second half impacted by the strong contraction of China s presence in the international market and the consequent increase in prices.

The difference between the scenarios in the first and second halves of the year is clearly seen when we calculate the volumes exported by China during the year. Chinese exports of finished goods in 2017 decreased 30.5% to 75 million tonnes, based on information from specialized publications. In 2016, exports of finished products amounted to 109 million tonnes. Comparing the month of December of each year, in 2017, Chinese exports amounted to 5.7 million tonnes, compared to 7.8 million tonnes in 2016.

In addition to the contraction in China s presence in the international market, 2017 was marked by higher production costs, which in turn supported higher prices. The global shortage in electrodes and in the raw material used to make them, needle coke, interruptions in the supply of metallurgical coal and iron ore in Australia due to adverse weather conditions, reductions in obsolete production capacity in China (induction furnaces) and the recent focus on electric furnaces (pressuring scrap prices) were the main factors explaining the increase in costs. Despite the significant increase in costs, the new price levels reached as from the second half ensured historically high spreads and consequently good profitability for mills around the world, especially in China.

In 2017, Gerdau s Brazilian exports continued to focus on South America, which accounted for 42% of exports, leveraged by supply from the group s companies. The share of exports destined for Africa and the Middle East increased significantly due to the growth in billet exports to these region.

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The following table presents Gerdau s exports by destination for selected periods:

Consolidated Exports of Gerdau Steel in Brazil, by Destination (%)	Fiscal Year ended December 31st, 2017	2016	2015
Total including shipments to subsidiaries (1,000 tonnes)	1.991	2.360	2.173
Africa	6%	3%	14%
Central America	21%	27%	11%
North America	11%	22%	22%
South America	42%	31%	26%
Asia	6%	5%	6%
Europe	11%	12%	15%
Middle East	2%	1%	7%

Gerdau continues to consolidate its client base around the world, which is essential for expanding its exports portfolio and overcoming the challenges in 2018.

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 mill produces hot rolled coils and heavy plate, which are sold in the domestic and export markets. The Company distributes these products through its distribution channel and direct sales, 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.

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Iron Ore

Gerdau operates three mines producing iron ore, all located in the Brazilian state of Minas Gereais (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 synthetizing 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 Division for the periods shown:

	Brazil(1)			North America			South America			Special Steel			Eliminations and Adjustments		
Products	**Rebars, merchant bars, beams, drawn products, billets, blooms, slabs, wire rod, structural shapes, hot rolled coil, heavy plate and iron ore.**			**Rebars, merchant bars, wire rod, light and heavy structural shapes.**			**Rebar, merchant bars and drawn products.**			**Stainless steel, special profiles and wire rod.**					
Year	**2017**	**2016**	**2015**	**2017**	**2016**	**2015**	**2017**	**2016**	**2015**	**2017**	**2016**	**2015**	**2017**	**2016**	**2015**
Net Sales (R$ million)	12,562.7	11,634.9	12,977.3	15,433.4	15,430.8	17,312.2	4,025.7	4,775.6	5,477.2	6,228.5	6,884.7	8,882.1	(1,332.8)	(1,074.3)	(1,067
% of Consolidated Net Sales	34.0%	30.9%	29.8%	41.8%	41.0%	39.7%	10.9%	12.7%	12.6%	16.9%	18.3%	20.4%	-3.6%	-2.9%	-2
Net (Loss) Income (R$ million)	302.3	(36.7)	(671.7)	(956.3)	(2,591.9)	(1,468.1)	154.4	134.2	(154.2)	475.4	162.5	(2,297.3)	(314.5)	(554.1)	(4
% of Consolidated Net (Loss) Income	-89.3%	1.3%	14.6%	282.4%	89.8%	31.9%	-45.6%	-4.7%	3.4%	-140.4%	-5.6%	50.0%	92.9%	19.2%	0

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.

Non-Integrated Process (Mini-Mills)

The Company operates 39 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

The Company operates five integrated mills, of which three are located in Brazil, one in Peru and one in India. The Ouro Branco mill is the largest integrated facility the Company operates. Although it produces steel using a blast furnace, this mill has some of the advantages of a mini-mill since it is located very close to its main suppliers and the ports from which the Company exports most of its production.

The Company s steelmaking process in integrated facilities consists of four basic processes: raw material preparation, pig-iron production, steel production and production of semi-finished products (billets, blooms and slabs). In the primary stage of steel making, sinter (a mixture of iron ore and fluxes), coke and other raw materials are consumed in the blast furnace to produce pig iron.

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Coke acts as both a fuel and a reducing agent in this process. The Company s blast furnaces have installed capacity of 5.9 million tonnes of liquid pig iron per year.

The pig iron produced by the blast furnace is transported by rail to the desulphurization unit to reduce the sulfur content in the steel. After the desulphurization process, the low-sulfur pig-iron is transformed into steel through 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 not require any external source of energy, which is fully supplied by the chemical reactions that occur between the oxygen and the molten pig iron impurities. The LD steelmaking process is presently the most widely used in the world. Some mills further refine the LD converters output with ladle furnaces and degassing processes.

The liquid steel is then sent to the continuous casting equipment, which are solidified in the form of billets, blooms or slabs. These products can be sold directly to customers, be transferred for processing into other Gerdau units or be transformed into rolled finished products in the Company´s own integrated units. Gerdau integrated units in Brazil have rebar, bars and rods, wire rods, structural steel, hot rolled coils and heavy plate rolling mills.

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. These shares provide the guarantee of using 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.

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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, United States and India.

Competitive Position Brazil

The Brazilian steel market is very competitive. In the year ended December 31, 2017, 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 to be the second largest mini-mill steel producer in North America, with annual nominal capacity of 9.3 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, Jacksonville, 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 19.5% 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 60.4%; and, in India the production and commercialization of rolled products began in 2013, and continue to ramp up, providing gradual access in the Indian market.

Business Cyclicality 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

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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 2018, the steel industry will remain challenging and continue to present volatility, but the projection is that steel consumption will grow 1.6% compared to 2017.

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 Division 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, Peru, among other origins with lower expression in volumes, as well as petroleum coke purchased from Petrobrás and charcoal chaff also acquired from other domestic suppliers; (ii) ferroalloys, of which 76% are purchased

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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 Division 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 Division 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 2017, Gerdau consumed more than 12 million tonnes of scrap, which accounted for significant gains from increasingly competitive operating costs.

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 Divisions 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 Division Ferrous scrap is the primary raw material. The availability of the scrap varies in accordance with the level of economic activity, the season of the year and export levels, leading to price fluctuations.

Some mills in the North America Business Division have on-site dedicated scrap processing facilities, including shredder operations that supply a significant portion of their scrap requirements. Given that not all of the scrap it consumes is sourced from its own scrap yards, it purchases residual requirements in the market either directly or through dealers that source and prepare scrap.

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. 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 Division 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 Division 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 Division Scrap availability imprints a unique characteristic on the use of pig iron and sponge iron, which are used in limited amounts only to produce steels with particular characteristics.

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 6.8 million tonnes in 2017, 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 Division 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 Gerdau 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. This makes the plant have significantly lower exposure to the energy market than mini-mills.

The Company, in 2017, 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

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shareholders of DFESA are Gerdau S.A. (51.8%), COPEL Participações S.A (23.0%), Celesc (23.0%), and Statkraft (2.1%).

- Caçu and Barra dos Coqueiros hydroelectric power plants, located in the state of Goiás (Brazil), with total installed capacity of 155MW and started its operations in 2010, with all power made available to the units located in Brazil s Southeast.

- 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 2017, 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 Companía 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 also possess certain product and laboratory certifications . 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 conduct 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.

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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 develop 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 R/3) 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 custumer credit analyses.

The Company s provision for doubtful accounts has been at low levels. On December 31, 2017, provision for doubtful accounts was 4.7% based on gross account receivables per Note 5 to the Consolidated Financial Statements, compared to 5.3% on December 31, 2016 and 4.0% on December 31, 2015. 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 amounts up to approximately US$4.9 billion (R$16 billion as of April 30, 2017), including material damage to installations (US$4.5 billion) and losses of gross revenues (US$432 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, 2018. 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.

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Gerdau Aços Longos S.A. holds the concession for the Caçú and Barra dos Coqueiros hydroelectric plants, which have aggregate installed capacity of 155MW and are located in the southeastern region of the State of Goias between the cities of Caçu and Cachoeira Alta, as per concession contract number 089/2002.

Chopim Energia S.A. (50% direct and 50% through Itaguaí Comércio, Importação e Exportação Ltda.) holds the concession for the São João and Cachoeirinha Energy Complex, which corresponds to the São João and Cachoeirinha hydroelectric plants, which have aggregate installed capacity of 105 MW and are located in the southeastern region of the State of Paraná between the cities of Honório Serpa and Clevelândia, as per concession contract number 016/2002.

Gerdau S.A. holds an interest of 51.82% in the company Dona Francisca Energética S.A. DFESA, which, in consortium with Companhia Estadual de Energia Elétrica CEEE, holds the concession for the Dona Francisca Hydroelectric Plant located between the cities of Agudo and Nova Palma in the State of Rio Grande do Sul, which has installed capacity of 125 MW, as per concession contract 188/1998.

Gerdau Açominas S.A. is authorized to operate the Açominas Thermo Electric Power Plant (103 MW) located in its industrial complex in the city of Ouro Branco, as authorized by Administrative Rule (*Portaria*) 275/MME of February 23, 1984 and subsequent resolutions.

Activities involving the generation of electric power are subject to the rules and regulations of the National Electric Power Agency (ANEEL) and to oversight by the agency. Operating licenses, which are issued by the respective state environmental departments or agencies, are required to operate the hydroelectric plants, which must also comply with the obligations of the respective concession contracts. All projects in which the Company participates are working properly, with valid licenses and no objections to their operations. The exception is Chopim, whose construction has yet to begin.

The commercial operation of ports is subject to authorization by the federal government, as regulated by Federal Law 12,815 of June 5, 2013. Gerdau has two private port terminals outside of Organized Port areas located in Vitória, ES and Salvador, BA, which are known, respectively, as the Praia Mole Private Port and Mixed Use Terminal and the Gerdau Maritime Terminal. The former, with Adhesion Contract 112/2016, was signed on June 30, 2016, with duration of 25 years, with extended successively for equal periods, as provided for by law. There is no specific description of cargoes, with authorization for the handling and/or storage in the TERMINAL of own and third-party cargo destined or originating from water transportation. The latter, with Adhesion Contract 11/2017, was signed on December 7, 2017, with duration of 25 years, with extended successively for equal periods, as provided for by law, authorized to move and store solid bulk and own and third general cargo.

This authorization is subject to oversight by the National Water Transportation Agency (ANTAQ) and, alternatively, by the Special Department of Ports (SEP).

Gerdau s mining explorations in Brazil are subject to the prevailing rules established by the Brazilian Mining Code (*Decreto-Lei nº 227, de 28 de fevereiro de 1967*) and non codified mining legislation, with mining exploration substantiated by mining property rights and titles.

Gerdau acquired the surface of the areas corresponding to the respective mining rights, as well as all other mining property rights and titles, through an Asset Sale and Rights Assignment Agreement entered into between 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 explorations are subject to the limitations imposed by Brazil s Federal Constitution and Mining Code and by the laws and regulations pertaining to exploration activities, which include requirements concerning, among other things, how the mineral deposits are used, workplace health and safety, environmental protection and restoration, pollution prevention and health and safety of local communities where the mines are located. The Brazilian Mining Code also establishes certain requirements for sending notifications and information.

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.

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The new law 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.

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 mineral rights held by Gerdau cover a total of 8,837.19 ha and the period of concessions is until the exhaustion of the deposits, on the condition that we perform legal requirements annually. The table below shows the DNPM processes held by Gerdau:

Mining Rigth DNPM	City	Location	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
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

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C. ORGANIZATIONAL STRUCTURE

The Company s operational structure (including its main operating subsidiaries engaged in steel production) on December 31, 2017 is below:

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The table below lists the significant consolidated subsidiaries of Gerdau on December 31, 2017, 2016 and 2015:

Consolidated company	**Country**		**Equity Interests Total capital (*)**	
		2017	**2016**	**2015**
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.	Brazil	99.36	99.35	99.35
Gerdau Aços Longos S.A. and subsidiary (2)	Brazil	99.12	99.11	99.11
Gerdau Steel Inc.	Canada	100.00	100.00	100.00
Gerdau Holdings Inc. and subsidiary (3)	USA	100.00	100.00	100.00
Paraopeba - Fixed-income investment fund (4) (**)	Brazil	10.69	70.93	65.75
Gerdau Holdings Europa S.A. and subsidiaries	Spain			100.00
Gerdau América Latina Participações S.A.	Brazil		99.12	99.12
Gerdau Chile Inversiones Ltda. and subsidiaries (5)	Chile	99.00	99.00	99.99
Gerdau Aços Especiais S.A.	Brazil		99.55	99.56
Gerdau Hungria Holdings Limited Liability Company and subsidiaries (6)	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
Diaco S.A. and subsidiary (nota 3.4)	Colombia		99.68	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	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	99.96	99.96
Cleary Holdings Corp.	Colombia			100.00
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	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 Metalurgica Gerdau S.A. in the investment fund is 51.11% in 2017, 91.58% in 2016 and 82.64% in 2015.

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

(2) Subsidiary: Gerdau Açominas Overseas Ltd.

(3) Subsidiary: Gerdau MacSteel Inc.

(4) Fixed-income investment fund managed by Banco JP Morgan S.A..

(5) Subsidiaries: Aza Participaciones S.A., Gerdau Aza S.A., Armacero Matco S.A., Aceros Cox Comercial S.A., Salomon Sack S.A..

(6) Subsidiaries: Gerdau Hungria y Cia SRC, Bogey Holding Company Spain S.L.

(7) Subsidiaries: Sidertul 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 and the investment in Dona Francisca Energética S.A, in Brazil, in which the Company holds a 51.82%; and the investment in Gerdau Summit Aços Fundidos e Forjados S.A., in Brazil, in which Gerdau has a 58.73% stake; and the investment in Diaco S.A. in Colombia, which Gerdau has a 49.87% 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:

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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 Division.

Gerdau Ameristeel Corporation Gerdau Ameristeel has an annual capacity of 11.5 million tonnes of crude steel and 8.6 million tonnes of rolled products. The Company is one of the largest producers of long steel in North America. Gerdau Ameristeel subsidiaries are: Gerdau Ameristeel US Inc., Gerdau Reinforcing Steel, Gerdau Ameristeel Sayreville Inc., TAMCO Steel and Chaparral Steel Company.

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.

Gerdau Chile Inversiones Ltda. The company has two units in Chile with a combined annual production capacity of 520,000 tonnes of crude steel and 530,000 tonnes of rolled steel.

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 45% 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 Steel India Private Ltd. This company owns a steel mill in Tadipatri, located in the southern part of Andhra Pradesh state in India. The crude steel capacity of this unit is 250,000 tonnes and 300,000 of rolled steel capacity.

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 assests 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

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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, 2017:

	LOCATION		INSTALLED CAPACITY (1,000 tonnes)				
PLANTS	COUNTRY	STATE	PIG IRON/ SPONGE IRON	CRUDE STEEL	ROLLED PRODUCTS	EQUIPMENT	PRODUCTS
BRAZIL OPERATION			**5,252**	**9,229**	**7,090**		
Açonorte	Brazil	PE		265	242	EAF mini-mill, rolling mill, drawing mill, nail and clamp factory	Rebar, merchant bars, wire rod, drawn products and nails
Barão de Cocais	Brazil	MG	330	330	196	Integrated/blast furnace, LD converter and rolling mill	Merchant bars
Cearense	Brazil	CE		198	161	EAF mini-mill, rolling mill	Rebar and merchant bars
Cosigua	Brazil	RJ		932	1,414	EAF mini-mill, rolling mill, drawing mill, nail and clamp factory	Rebar, merchant bars, wire rod, drawn products and nails
Divinópolis	Brazil	MG	430	570	460	Integrated/blast furnace, EOF converter and rolling mill	Rebar and merchant bars
Guaíra	Brazil	PR		540*		EAF mini-mill	Billet
Riograndense	Brazil	RS		450	495	EAF mini-mill, rolling mill, drawing mill, nail and clamp factory	Rebar, merchant bars, wire rod, drawn products and nails
Usiba	Brazil	BA		495*	397*	Integrated with DRI, EAF mini-mill, rolling mill, drawing mill	Rebar, merchant bars, wire rod and drawn products
São Paulo	Brazil	SP		950	600	EAF mini-mill, rolling mill	Billets, rebars and coil rebar
Contagem	Brazil	MG				Blast furnace	Pig iron
Sete Lagoas	Brazil	MG	132			Blast furnace	Pig iron
Ouro Branco	Brazil	MG	4,360	4,500	3,126	Integrated with blast furnace, LD converter and rolling mills	Billets, blooms, slabs, wire rod, heavy structural shapes and HRC
NORTH AMERICA OPERATION				**11,510**	**8,626**		
Mexico	Mexico			500	400	EAF mini-mill, rolling mill	Rebar, merchant bars and beams
Beaumont	USA	TX		698	655	EAF mini-mill, rolling mill	Wire rod

Cambridge	Canada	ON	330*	278	EAF mini-mill, rolling mill	Rebar, merchant bars
Cartersville	USA	GA	925	610	EAF mini-mill, rolling mill	Merchant bars, structural shapes, beams
Charlotte	USA	NC	468	316	EAF mini-mill, rolling mill	Rebar, merchant bars

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	LOCATION		INSTALLED CAPACITY (1,000 tonnes)				
PLANTS	COUNTRY	STATE	PIG IRON/ SPONGE IRON	CRUDE STEEL	ROLLED PRODUCTS	EQUIPMENT	PRODUCTS
Jackson	USA	TN		764	496	EAF mini-mill, rolling mill	Rebar, merchant bars
Jacksonville	USA	FL		756	549	EAF mini-mill, rolling mill	Rebar, merchant bars
Knoxville	USA	TN		594	597	EAF mini-mill, rolling mill	Rebar
Manitoba - MRM	Canada	MB		394	271	EAF mini-mill, rolling mill	Special sections, merchant bars, rebar
Sayreville	USA	NJ		760	623	EAF mini-mill, rolling mill	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
Rancho Cucamonga	USA	CA		830	469	EAF mini-mill, rolling mill	Rebar
SOUTH AMERICA OPERATION			**400**	**2,240**	**1,626**		
Chile	Chile			520	530	EAF mini-mill, rolling mill	Rebar, merchant bars, wire rod, nails, wire and mesh.
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
SPECIAL STEEL OPERATION			**275**	**3,125**	**3,733**		
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	465	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

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	LOCATION		INSTALLED CAPACITY (1,000 tonnes)				
PLANTS	COUNTRY	STATE	PIG IRON/ SPONGE IRON	CRUDE STEEL	ROLLED PRODUCTS	EQUIPMENT	PRODUCTS
Monroe	USA	MI		600	690	EAF mini-mill, rolling mill and finishing	Special bars and shapes and cold finished bar
India	India	AP	275	250	300	Integrated/blast furnace, converter and rolling mill	Pig iron, billets and rolled bars
GERDAU TOTAL			**5,927**	**26,104**	**21,075**		

*Temporarily not in use.

Mining Assets

Iron ore mines

Gerdau s activities related to iron ore mines began after the acquisition of the mining rights of Grupo Votorantim, located in the municipalities of Ouro Preto (Miguel Burnier district), Itabirito and Barão de Cocais, in 2004. These areas are located within the iron producing region in the state of Minas Gerais, Brazil, which is one of the most prominent mineral provinces in Brazil, as illustrated in the figure below.

Focused on ensuring its iron ore self-sufficiency within the state of Minas Gerais, and searching for the opportunity to add value to its business by the use of its own mineral resources, Gerdau conducted surveys to assess and implement expansions projects of its mining operations until 2014 in order to establish itself as a player in the global iron ore market. However, with the current price of iron ore in the international market, Gerdau decided to focus only on the production of iron ore to self-sufficiency.

Gerdau s mining location

Current iron ore production units are primarily comprised of open pit mines, processing plants, waste piles, tailings dams, and logistics and operational support infrastructure.

Current and future iron ore production units are grouped as follows:

- Miguel Burnier/Dom Bosco Complex: encompasses the mines located in Miguel Burnier, as well as the Dom Bosco mines;
- Várzea do Lopes Complex;
- Gongo Soco. There are no mining activities in this location.

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Location and Access

Miguel Burnier/Dom Bosco Complex

Miguel Burnier and Dom Bosco are located in the municipality of Ouro Preto, in the southwestern portion of the iron producing region in the state of Minas Gerais, Brazil, at approximately 80 km from Belo Horizonte and 5 km from Vila do Pires, on federal highway BR-040. The Dom Bosco Mine is located at approximately 11 km from the Miguel Burnier Mine. Vila do Pires is established off both sides of federal highway BR-040, north from the city of Congonhas. The mines are accessed through a 3 km-long non-paved road from the Miguel Burnier village.

Várzea do Lopes Complex

Várzea do Lopes is located in the Itabirito municipality, in the western portion of the iron producing region in the state of Minas Gerais, Brazil, and is established at approximately 46 km from downtown Belo Horizonte. Access to the mine from Belo Horizonte is through BR-040, in the direction towards Rio de Janeiro. Várzea do Lopes is located at approximately 20 km from Miguel Burnier, in a straight line.

Gongo Soco

Gongo Soco is located in the municipality of Barão de Cocais, in the northwestern portion of the iron producing region in the state of Minas Gerais, Brazil, at approximately 110 km from Belo Horizonte, 8 km from the municipality of Barão de Cocais, and 170 km from Miguel Burnier. Access from Belo Horizonte is through BR-381/262 and MG-436 highways.

The figure below displays the locations of current iron ore production units and main accesses:

Investment Programs

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

Brazil Business Division 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 Division this business division spent R$291.8 million in capital expenditures on fixed assets distributed throughout the units which compose this business division. This amount was mainly spent for the maintenance of the production units.

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South America Business Division 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 division 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 Division the Special Steel units spent R$108.5 million in capital expenditures on fixed assets distributed throughout the units which compose this business division. This amount was mainly spent on the maintenance of the production units.

The disbursements in fixed assets planned for 2018 are estimated at R$1.2 billion, and include productivity and maintenance investments.

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 2017, Gerdau S.A. invested R$264.0 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$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), R$163,806 thousands as of December 31, 2015 (R$27,736 thousands recorded in Current Liabilities and R$136,070 thousands recorded in Non-Current Liabilities), R$116,421 thousands as of December 31,2014 (R$23,025 thousands recorded in Current Liabilities and R$93,396 thousands recorded in Non-Current Liabilities) and R$ 105,663 thousands as of December 31, 2013 (R$15,149 thousands recorded in Current Liabilities and R$90,514 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.

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As of December 31, 2017, the updated present value of the total remaining amount of Brazilian Environment Liabilities was estimated at R$53.2 million. Some of these areas have already been recovered and some areas are still being evaluated.

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 remedies are not precisely known, the Company has estimated the present value of the total remaining costs as of December 31, 2017 at approximately R$ 32 million, 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 exempts 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.

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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 periodic reports under the Securities Exchange Act.

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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 as of December 31, 2017, 2016 and 2015, 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

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 2015, Brazilian GDP decreased by 3.8% (US$1.8 trillion Nominal GDP). Inflation, as measured by the IPCA index, stood at 10.7%. The average CDI rate in the year was 14.1%. The Brazilian *real* depreciated by 47.0% against the U.S. dollar, ending the year at R$3.90 to US$1.00.

In 2016, Brazilian GDP decreased by 3.6% (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% (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.

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 *reais* 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 *reais*, 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 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

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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.

	2017	2016	2015
Actual GDP growth	1.0%	-3.6%	-3.8%
Inflation (IGP-M) (1)	-0.5%	7.2%	10.5%
Inflation (IPCA) (2)	3.0%	6.3%	10.7%
CDI rate (3)	7.0%	13.6%	14.1%
6-month LIBOR	1.8%	1.3%	0.9%
Depreciation (appreciation) in the Brazilian *real* against the U.S. dollar	0.5%	(16.5)%	47.0%
Foreign exchange rate at end of period $1.00	R$ 3.3080	R$ 3.2591	R$ 3.9048
Average foreign exchange rate $1.00 (4)	R$ 3.1928	R$ 3.4833	R$ 3.3399

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 de recovery in the non-residential construction sector were the drivers of the recovery in demand.

In 2015, according to the IMF (International Monetary Fund) the U.S. Real GDP grew by 2.6% (US$18.0 trillion Nominal GDP). Inflation, as measured by the CPI, was 0.1%. The average Fed Funds rate (the interest rate established by the U.S. Federal Reserve) was 0.50%.

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%.

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

	2017	2016	2015
Actual Real GDP growth (1)	2.2%	1.6%	2.6%
Inflation (CPI) (2)	2.1%	1.3%	0.1%
Fed Funds (3)	1.5%	0.75%	0.50%

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, effective 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. In the last few months inflation fell sharply and Brazil Central Bank started a long and intense cycle of interest rate reduction, without jeopardizing the goal of attaining the target of 4.5% for IPCA in 2018.

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 2017 was 1,675 million tonnes, 2.8% higher than in 2016. China s crude steel production in 2017 reached 831.7 million tonnes, an increase of 2.9% over 2016. In 2017, China s share of world steel production was 49.7% of total crude steel. According to worldsteel, world demand for finished steel products decreased by 3.0% in 2015, increased by 1.0% in 2016 and the forecast for 2017 is an increase of 2.9%. For 2018, the forecast calls for growth of 1.6%, since the current scenario is a stabilization of the Chinese economy and recoveries in developed economies continue 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 2017, the price has increased 29.6% when compared to December of 2016, going from $ 398 to $ 515, due to the increase of raw materials prices.

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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 2017, exports were 15.7% lower than 2016 from to 2,360 million tonnes in 2016 to 1,991 in 2017, which represented 35.5% of all shipments by the Company s Brazilian units, in 2016 exports represented 38.9% of total shipments from Brazil operations. This decrease was due to the low profitability caused by higher costs. Export revenue totaled R$3,056 million in 2017 (R$3,066 million in 2016).

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 46.5% of production costs in 2017, while Energy and Reducing Agents, which represents the cost of coal, electricity, oxygen, natural gas and fuel oil, accounted for 15.2%. Personnel totaled 18.4% of production costs and Specific Materials, which includes refractories, electrodes, rolling cylinders, rollers, guides, carburants and lime, were 8.8% of total production costs. The

table below presents the production costs breakdown by business division (BD):

Production Costs Breakdown in 2017 (%)

% of costs	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016
	Consolidated		Brazil BD		North America BD		South America BD		Special Steel BD	
Personnel	18.4	21.6	19.5	21.9	17.8	22.2	13.9	13.8	20.6	24.3
Maintenance	6.0	7.1	5.6	6.7	7.2	8.3	3.6	4.6	5.3	6.3
Depreciation	5.0	6	7.4	8.2	3.5	4.8	3.7	4	5.5	6.6
Metallic Inputs	46.5	41.3	29.6	26.9	55.1	46.9	61.9	59.8	45.6	39.3
Energy and Reducing Agents	15.2	14.3	29.5	27.1	7.2	7.5	11.0	11.2	13.1	12.4
Specific Materials	8.8	9.7	8.5	9.2	9.2	10.3	6.0	6.6	9.9	11.1

Significant events affecting financial performance during 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

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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$ 2.2 billion (designated as hedges) is recognized in the Statement of Comprehensive Income, while the exchange rate on the portion of US$ 0.4 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.

Impairment of assets 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, 2017, 2016 and 2015 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.

Note that the Company sold its units in Spain on June 23, 2016 and in Colombia on June 30, 2017. Due to these divestments, figures for 2016 correspond to five months of operations in Spain, and figures for 2017 correspond to five months of operations in Colombia, thereby affecting comparisons.

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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:

	2017		2016		2015		Variation	Variation
	R$ million	% net sales	R$ million	% net sales	R$ Million	% net sales	2017/ 2016	2016/ 2015
Net sales	36,918	100.0%	37,652	100.0%	43,581	100.0%	(1.9)%	(13.6)%
Cost of Sales	(33.313)	(90.2)%	(34,188)	(90.8)%	(39,290)	(90.2)%	(2.6)%	(13.0)%
Gross profit	3,605	9.8%	3,464	9.2%	4,291	9.8%	4.1%	(19.3)%
Operating expenses:								
Selling expenses	(525)	(1.4)%	(711)	(1.9)%	(785)	(1.8)%	(26.1)%	(9.4)%
General and administrative expenses	(1,130)	(3.1)%	(1,528)	(4.1)%	(1,797)	(4.1)%	(26.1)%	(15.0)%
Other operating income	261	0.7%	242	0.6%	213	0.5%	7.7%	13.6%
Other operating expenses	(169)	(0.5)%	(114)	(0.3)%	(116)	(0.3)%	47.8%	(1.7)%
Impairment of assets	(1,115)	(3.0)%	(2,918)	(7.7)%	(4,996)	(11.5)%	(61.8)%	(41.6)%
Gains and losses on assets held for sale and sales of interest in subsidiaries and associate company	(722)	(2.0)%	(58)	(0.2)%			1,139%	
Reversal of contingent liabilities, net	930	2.5%						
Equity in earnings of unconsolidated companies	(35)	0.1%	(13)	0.0%	(25)	(0.1)%	170.9%	(48.0)%
Net (loss) Income Before Financial Income (Expenses) and Taxes	1,100	(3.0)%	(1,636)	(4.3)%	(3,216)	(7.4)%	(167.2)%	(49.1)%
Financial income	227	0.6%	252	0.7%	378	0.9%	(10.1)%	(33.3)%
Financial expenses	(1,726)	(4.7)%	(2,010)	(5.3)%	(1,780)	(4.1)%	(14.1)%	12.9%
Exchange variations, net	(4)	0.0%	852	2.3%	(1,564)	(3.6)%	(100.5)%	(154.5)%
Reversal of monetary update of contingent liabilities, net	370	1,0%						
Gains and losses on financial instruments, net	(9)	0.0%	(39)	(0.1)%	87	0.2%	(75.7)%	(144.8)%
Income and social contribution taxes	(295)	(0.8)%	(304)	(0.8)%	1,498	3.4%	(2.9)%	(120.3)%
Net income (Loss)	(339)	(0.9)%	(2.886)	(7.7)%	(4.596)	(10.5)%	(88.3)%	(37.2)%

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Year Ended December 31, 2017 Compared with Year Ended December 31, 2016

Net Sales

Net Sales by Business Divisions(*) (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)	
Total	**36,918**	**37,652**	**(1.9)%**

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

Net Sales per tonne by Business Divisions(*) (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,.%
North America	2,445	2,587	(5.5)%
South America	2,336	2,287	2.2%
Special Steel	3,151	3,276	(3.8)%
Consolidated(1)	**2,472**	**2,420**	**2.1%**

(*) 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 Division, 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 Division, 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 of 6,313 thousand tonnes in 2017).

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

In the Special Steel Business Division, 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.

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Cost of Sales and Gross Profit

Net sales, Cost of Sales and Gross Profit(*)		Year ended December 31, 2017	2016	Variation Year ended December 31, 2017/ Year ended December 31, 2016
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$million)	1,566	1,230	27.4%
	Gross margin (%)	*12.5%*	*10.6%*	
North America	Net sales (R$million)	15,433	15,431	0.0%
	Cost of Sales (R$million)	(14,824)	(14,515)	2.1%
	Gross Profit (R$million)	609	916	(33.4)%
	Gross margin (%)	*4.0%*	*5.9%*	
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$million)	502	672	(25.3)%
	Gross margin (%)	*12.5%*	*14.1%*	
Special Steel	Net sales (R$million)	6,229	6,885	(9.5)%
	Cost of Sales (R$million)	(5,301)	(6,239)	(15.0)%
	Gross Profit (R$million)	927	646	43.6%
	Gross margin (%)	*14.9%*	*9.4%*	
Intercompany Eliminations	Net sales (R$million)	(1,333)	(1,075)	
	Cost of Sales (R$million)	1,332	1,074	
	Gross Profit (R$million)	(1)	(1)	
Total	**Net sales (R$million)**	**36,918**	**37,652**	**(2.0)%**
	Cost of Sales (R$million)	**(33,313)**	**(34,188)**	**(2.6)%**
	Gross Profit (R$million)	**3,605**	**3,464**	**4.1%**
	Gross margin (%)	***9.8%***	***9.2%***	

(*) 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 Division, 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 Division, 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 Division, cost of sales decreased 14.1% in 2017 compared to 2016, mainly due to the loss of control that resulted in 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 Division, 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.

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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%
Total	1,655	2,239	-26.1%
Net sales	36,918	37,652	-2.0%
% of net sales	**4.5%**	**5.9%**	

(*) 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 the expectation that certain assets of the Company would not be utilized, as identified by impairment testing. In the fourth quarter of 2017, due to the lack of expectations regarding the future utilization of any asset at any industrial unit, 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 division and R$220,090 thousands in the North America division, due to recoverable values below the carrying values. These losses were determined based on the difference between the carrying value and the recoverable value of these assets, of R$0, which represents the amount 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 divisions. 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 divisions 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

Operating Income (Loss) before Financial Result and Taxes went from a loss of R$1,636.4 million in the fiscal year ended December 31, 2016 to a gain of R$1,100.1 million in 2017. The variation was mainly due to lower asset impairment losses, higher losses from operations with subsidiaries, the reversal of net contingent 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

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

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

The net financial result went from a negative result of R$945.3 million in 2016 to a negative result of R$1,143.3 million in 2017. The higher negative financial result 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.

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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 negative in R$295.4 million in 2017, compared to negative 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 Division, 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 Division 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 Division 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 Division 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.

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Year Ended December 31, 2016 Compared with Year Ended December 31, 2015

Net Sales

Net Sales by Business Divisions(*) (R$ million)	Year ended December 31, 2016	Year ended December 31, 2015	Variation Year ended December 31, 2016/ Year ended December 31, 2015
Brazil	11,635	12,977	(10.3)%
North America	15,431	17,312	(10.9)%
South America	4,776	5,477	(12.8)%
Special Steel	6,885	8,882	(22.5)%
Intercompany Eliminations	(1,075)	(1,067)	
Total	**37,652**	**43,581**	**(13.6)%**

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

Net Sales per tonne by Business Divisions(*) (R$/tonne)	Year ended December 31, 2016	Year ended December 31, 2015	Variation Year ended December 31, 2016/ Year ended December 31, 2015
Brazil	1,918	2,010	(4.6)%
North America	2,587	2,778	(6.9)%
South America	2,287	2,465	(7.2)%
Special Steel	3,276	3,389	(3.3)%
Consolidated(1)	**2,420**	**2,568**	**(5.8)%**

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

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

In 2016, consolidated net sales decreased 13.6% compared to 2015, due to the decline in shipments in all Business Divisions and a decrease of net sales per tonne mainly in the North America Business Division (-6.9%).

In the Brazil Business Division, the 10.3% decline in net sales in 2016 compared to 2015 was mainly due to a less favorable market mix, with lower shipments in the domestic market (from 4,284 thousand tonnes in 2015 to 3,707 thousand tonnes in 2016), which was partially offset by

higher shipments to the export market (from 2,173 thousand tonnes in 2015 to 2,360 thousand tonnes in 2016). In addition, there was a decrease in net sales per tonne exported (-11.1%). In the domestic market, the reduction in shipments was due to a lower level of activity in the construction and industrial sectors as a result of the economic recession in Brazil. The Brazilian GDP decreased 3.6% in 2016. On the other hand, exports increased due to opportunities in the international market.

In the North America Business Division, net sales in 2016 decreased 10.9% compared to 2015 due to the reduction in net sales per tonne (-6.9%) and lower shipments (-4.3%) in the period, reflecting the constant pressure from imported in the region, even with the continued solid demand from the non-residential construction sector.

In the South America Business Division, net sales in 2016 decreased 12.8% compared to 2015, due to contraction in shipments, from 2,222 thousand tonnes in 2015 to 2,088 thousand tonnes in 2016 and the effect from exchange variation of the countries where Gerdau has operations.

In the Special Steel Business Division, net sales decreased 22.5% in 2016 compared to 2015, mainly due to the divestitures of the units in Spain and lower shipments in Brazil resulting in a reduction of 19.8% in consolidated shipments of this Business Division (from 2,621 thousand tonnes in 2015 to 2,102 thousand tonnes in 2016).

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Cost of Sales and Gross Profit

Net sales, Cost of Sales and Gross Profit(*)		**Year ended December 31, 2016**	**2015**	**Variation Year ended December 31, 2016/ Year ended December 31, 2015**
Brazil	Net sales (R$million)	11,635	12,977	(10.3)%
	Cost of Sales (R$million)	(10,405)	(11,433)	(9.0)%
	Gross Profit (R$million)	1,230	1,544	(20.3)%
	Gross margin (%)	*10.6%*	*11.9%*	
North America	Net sales (R$million)	15,431	17,312	(10.9)%
	Cost of Sales (R$million)	(14,515)	(15,800)	(8.1)%
	Gross Profit (R$million)	916	1,512	(39.4)%
	Gross margin (%)	*5.9%*	*8.7%*	
South America	Net sales (R$million)	4,776	5,477	(12.8)%
	Cost of Sales (R$million)	(4,103)	(4,800)	(14.5)%
	Gross Profit (R$million)	672	677	(0.6)%
	Gross margin (%)	*14.1%*	*12.4%*	
Special Steel	Net sales (R$million)	6,885	8,882	(22.5)%
	Cost of Sales (R$million)	(6,239)	(8,333)	(25.1)%
	Gross Profit (R$million)	646	549	17.7%
	Gross margin (%)	*9.4%*	*6.2%*	
Intercompany Eliminations	Net sales (R$million)	(1,075)	(1,067)	
	Cost of Sales (R$million)	1,074	1,076	
	Gross Profit (R$million)	(1)	9	
Total	**Net sales (R$million)**	**37,652**	**43,581**	**(13.6)%**
	Cost of Sales (R$million)	**(34,188)**	**(39,290)**	**(13.0)%**
	Gross Profit (R$million)	**3,464**	**4,291**	**(19.3)%**
	Gross margin (%)	***9.2%***	***9.8%***	

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

In 2016, cost of sales decreased 13.0% from 2015, mainly due to sales volume reduction of 8.3%, as well as lower raw materials cost. Gross margin decreased slightly from 9.8% in 2015 to 9.2% in 2016, due to poor performance of North America and Brazil Business Divisions, partially compensated by Special Steel Business Division.

In the Brazil Business Division, cost of sales decreased 9.0% in 2016 compared to 2015, mainly due to lower shipments (-6.0%). The larger reduction in net sales (-10.3%) compared to the cost of sales (-9.0%), resulted in a reduction of gross margin, from 11.9% in 2015 to 10.6% in 2016.

In the North America Business Division, cost of sales in 2016 decreased 8.1% compared to 2015 due to shipments reduction (-4.3%) and lower scrap price in the comparison period. The larger reduction in net sales (-10.9%) than the decrease in cost of sales (-8.1%), resulted in a reduction of gross margin, from 8.7% in 2015 to 5.9% in 2016.

In the South America Business Division, cost of sales decreased 14.5% in 2016 compared to 2015, due to the shipments reduction (-6.0%), lower raw materials cost, as well as the exchange rate effect. Gross margin improved, going from 12.4% in 2015 to 14.1% in 2016, due to stronger reduction in cost of sales (-14.5%) compared to net sales (-12.8%).

In the Special Steel Business Division, the 25.1% decrease in cost of sales was due to the sale of the Spain units and lower shipments in the Brazilian units. The Spain units historically had the lowest profitability of this Business Division, as a result, gross margin improved from 6.2% in 2015 to 9.4% in 2016. In addition, the performance in the United States and India improved.

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Selling, General and Administrative Expenses

Operating Expenses(*) (R$ million)	2016	2015	Variation Year ended December 31, 2016/ Year ended December 31, 2015
Selling expenses	711	785	-9.4%
General and administrative expenses	1,528	1,797	-15.0%
Total	2,239	2,582	-13.3%
Net sales	37,652	43,581	-13.6%
% of net sales	**5.9%**	**5.9%**	

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

The 9.5% reduction in consolidated selling expenses was due to lower shipments in 2016 (-8.3%). Consolidated general and administrative expenses decreased 15.0% from 2015 to 2016, which demonstrates the Company s efforts to streamline these expenses, despite the depreciation of 4.3% of the exchange variation on operations abroad. In 2016, selling, general and administrative expenses as a ratio of net sales was 5.9%, which was stable as compared to 2015.

Impairment of assets

In 2016, the line losses from asset impairments amounted to R$ 2,917.9 million, which is related to the impairment of goodwill and the expectation that certain assets of the Company would not be utilized, as identified by impairment testing. In the fourth quarter of 2016, the Company assessed the impairment of goodwill of its segments. Tests identified losses from goodwill impairment of R$ 2,678.6 million in the North America Business Division. The other segments did not present losses from asset impairments on goodwill in the tests conducted in 2016. Furthermore, in the fourth quarter of 2016, the tests conducted of other long-lived assets identified losses from the impairment of fixed assets of R$ 239.3 million, of which R$ 138.8 million was attributable to the South America Business Division and R$100.6 million was attributable to the North America Business Division, due to recoverable amounts below the the carrying amount.

Operating Income (Loss) before Financial Result and Taxes

Operating Income (Loss) before Financial Result and Taxes went from a loss of R$ 3,215.5 million in the fiscal year ended December 31, 2015 to a loss of R$ 1,636.4 million in 2016. This variation was mainly due to lower losses from asset impairments in 2016 and to the decline in selling, general and administrative expenses, despite the contraction in gross profit in comparison to 2015.

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)	**2016**	**2015**	**Variation Year ended December 31, 2016/ Year ended December 31, 2015**
Financial income	252	378	-33.3%
Financial expenses	(2,010)	(1,780)	12.9%
Exchange variation, net	852	(1,564)	-154.5%
Gains and Losses on financial instruments, net	(39)	87	-144,8%
Total	**(945)**	**(2,879)**	**-67.2%**

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

The net financial result went from a negative result of R$ 2,878.9 million in 2015 to a negative result of R$ 945.3 million in 2016. The lower negative financial result mainly reflects the higher positive exchange variation on liabilities contracted in U.S. dollars (appreciation of the Brazilian *real* against the U.S. dollar of 16.5% in 2016, compared to depreciation of 47.0% in 2015), despite the higher financial expenses.

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In accordance with IFRS, the Company designated the bulk 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$2.7 billion (US$2.5 billion related to the 10/30 Year Bonds and US$0.2 billion related to other financing operations) was recognized in the statement of comprehensive income, while the exchange variation on the portion of US$1.0 billion was recognized in financial result and was neutralized by the line Income Tax.

Income and Social Contribution Taxes

Income and social contribution taxes was negative R$ 304.3 million in 2016, compared to positive R$ 1,498.4 million in 2015. This variation was due to the deferred income tax and social contribution on positive net investment hedge in 2015 and on negative net investment hedge in 2016.

Net Income (loss)

Consolidated net loss went from R$ 4,596.0 million in 2015 to R$ 2,885.9 million in 2016. This variation was mainly due to lower losses from asset impairments in 2016 and to the decline in selling, general and administrative expenses, despite the contraction in gross profit as compared to 2015.

In the Brazil Business Division, the net loss was R$ 37 million in 2016, compared to a net loss of R$ 672 million in 2015. This variation was mainly due to losses from asset impairment of R$ 835 million in 2015.

The North America Business Division posted a net loss of R$ 2,592 million in 2016, compared to a net loss of R$ 1,468 million in 2015. This variation was mainly due to the losses from asset impairment of R$ 2,779 million recorded in 2016 being greater than the amount of R$ 1,882 million recorded in 2015. Gross profit also decreased, from R$ 1,512 million in 2015 to R$ 916 million in 2016.

In 2016, the South America Business Division posted net income of R$ 134 million, compared to a net loss of R$ 154 million in 2015. This variation was mainly due to the losses from asset impairment of R$ 139 million registered in 2016 being lesser than the amount of R$ 354 million registered in 2015.

In 2016, the Special Steel Business Division posted net income of R$ 163 million, compared to a net loss of R$ 2,297 million in 2015. This variation was mainly due to losses from asset impairment of R$ 1,925 million in 2015.

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 variables 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 variables 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;
- business combination, including valuation of assets acquired and liabilities, and
- impairment test of assets with definite and indefinite useful life.

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Deferred Income and Social Contribution Taxes

The liability method of accounting (according to the concept described in IAS 12) for income taxes is used for deferred income and social contribution taxes arising from temporary differences between the book value of assets and liabilities and their tax bases. 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.

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 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.

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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.

Business Combination, Valuation of Assets Acquired and Liabilities Assumed in Business Combinations

During the last several years the Company has made certain business combinations. The Company allocates the cost of the acquired entity to the assets acquired and liabilities assumed based on their fair value estimated on the date of acquisition. Any difference between the cost of the acquired entity and the fair value of the assets acquired and liabilities assumed is recorded as goodwill. The Company exercises significant judgment in the process of identifying tangible and intangible assets and liabilities, valuing these assets and liabilities, and estimating their remaining useful life. The valuation of these assets and liabilities is based on assumptions and criteria that, in some cases, include estimates of future discounted cash flow at the appropriate rates. The use of valuation assumptions includes discounted cash flow estimates and discount rates and may result in estimated values that are different from the assets acquired and liabilities assumed.

The Company does not believe there is a reasonable likelihood that there will be a material change in the future estimates or assumptions used to complete the purchase price allocation and estimate the fair value of acquired assets and liabilities. However, if actual results are not consistent with estimates and assumptions considered, the Company may be exposed to losses that could be material.

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 company is remeasured at fair value at acquisition date (at the date the Company acquires control) and the resulting gain or loss, if any, is recognized in profit or loss. Amounts related to the acquired company which were recognized in Other comprehensive income before the acquisition date, are reclassified to income, where such treatment would be appropriate in case this interest was sold.

Acquisitions in which control is obtained initially

Acquisitions of subsidiaries and businesses are accounted for under the acquisition method. The cost of the acquisition is measured at the aggregate of the fair values (at the date of exchange) of assets given and liabilities incurred or assumed and equity instruments issued by the Group in exchange for control. 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.

Under the previous version of the Standard, contingent consideration was recognized at the acquisition date only if payment of the contingent consideration was probable and it could be measured reliably; any subsequent adjustments to the contingent consideration are recognized against goodwill. Under the revised Standard, contingent consideration is measured at fair value at the acquisition date; subsequent adjustments to the consideration are recognized against goodwill only to the extent that they arise from better information about the fair value at the acquisition date, and they occur within the provisional period (a maximum of 12 months from the acquisition date). All other subsequent adjustments are recognized in profit or loss.

Increases/decreases in non-controlling interests

In prior years, in the absence of specific requirements in IFRS, increases in interests in existing subsidiaries were treated in the same manner as the acquisition of subsidiaries, with goodwill or a bargain purchase gain being recognized where appropriate.

The impact of decreases in interests in subsidiaries that did not involve loss of control (being the difference between the consideration received and the carrying amount of the share of net assets disposed of) are recognized in profit or loss. Under the revised standards, all increases or decreases in such interests are accounted for within equity, with no impact in goodwill or profit or loss.

Subsequent purchases after the Company has obtained control are treated as the acquisitions of shares from non-controlling shareholders: the identifiable assets and liabilities of the entity are not subject to a further revaluation and the positive or negative

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difference between the cost of such subsequent acquisitions and the net value of the additional proportion of the company is accounted for within equity.

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.

The Company does not believe there is a reasonable likelihood that there will be a material change in the future estimates or assumptions used to complete the purchase price allocation and estimate the fair value of acquired assets and liabilities. However, if actual results are not consistent with estimates and assumptions considered, the Company may be exposed to losses that could be material.

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.

The Company evaluates the recoverability of goodwill on investments 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 are assessed based on the analysis of facts or circumstances that may indicate the need to perform the impairment test and are performed annually in December, or being anticipated whenever changes in events or circumstances indicate that the goodwill and other long-lived assets may be impaired.

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 thousands, of which R$ 45,279 thousands in the Brazil segment and R$ 220,090 thousands 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). In 2016, due to the interruption of certain activities as result of significant changes in the economy of the region where these units are located and the lack of expectation of future use of some assets of these industrial plants, tests performed on other long-lived assets identified impairment losses on property, plant and equipment in the amount of R$ 239,329 thousands, of which R$ 138,765 thousands in the South America segment and R$ 100,564 thousands 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 in the amount of R$ 138,543 thousands, which represents their value in use (higher between the fair value net of disposal expenses and their value in use).

In the fourth quarter of 2017, the Company evaluated the recoverability of the goodwill allocated to its segments. Based on the aforementioned events, notably the increase 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 thousands for the North America segment. In 2016, the tests identified an impairment loss of goodwill in the amount of R$ 2,678,582 thousands for the North American segment caused by the deterioration of the economic conditions reflected by the decrease of the EBITDA margin at that time.

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 2017 test were: a) North America: 3% (3% in December 2016); b) Special Steel: 3% (3% in December 2016); c) South America: 3% (3% in December 2016); and d) Brazil: 3% (3% in December 2016).

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: 13.6% (13.1% in December 2016); b) Special Steel: 13.1% (14.0% in December 2016); c) South America: 14.7% (14.6% in December 2016); and d) Brazil: 15.2% (14.9% in December 2016).

Discounted cash flows are compared to the book value of each segment and result in the recoverable amount as shown below: a) North America: below the book value of R$ 849 million (below the book value of R$ 2,679 million in 2016); b) South America: exceeded the book value by R$ 437 million (exceeded the book value by R$ 724 million in 2016); c) Special Steel: exceeded the book value by R$ 3,989 million (exceeded the book value by R$ 1,601 million in 2016); and d) Brazil: exceeded the book value by R$ 1,747 million (exceeding the book value by R$ 1,225 million in 2016).

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: below book value of R$ 506 million (below the book value by R$ 872 million in 2016); b) Special Steel: exceeded book value by R$ 3,422 million (exceeded the book value by R$ 1,170 million in 2016); c) South America: exceeded book value by R$ 265 million (below the book value by R$ 486 million in 2016); and d) Brazil: exceeded the book value by R$ 999 million (exceeded the book value by R$ 425 million in 2016).

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: below the book value by R$ 310 million (below the book value by R$ 661 million in 2016); b) Special Steel: exceeded the book value by R$ 3,596 million (exceeded the book value by R$ 1,301 million in 2016); c) South America: exceeded the book value by R$ 318 million (exceeded the book value by R$ 561 million in 2016); and d) Brazil: exceeded the book value by R$ 1,254 million (exceeded the book value by R$ 673 million in 2016).

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

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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 2017.

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

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Cash Flow

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

		For the year ended on			
	December, 31, 2017	December, 31, 2016	December, 31, 2015	Variation 2017x2016	Variation 2016x2015
Cash flows from operating activities					
Net income (loss) for the year	(338,667)	(2,885,929)	(4,595,986)	-88.3%	-37.2%
Adjustments to reconcile net income for the year to net cash provided by operating activities					
Depreciation and amortization	2,092,551	2,535,955	2,607,909	-17.5%	-2.8%
Impairment of Assets	1,114,807	2,917,911	4,996,240	-61.8%	-41.6%
Equity in earnings of unconsolidated companies	34,597	12,771	24,502	170.9%	-47.9%
Exchange variation, net	4,057	(851,635)	1,564,017	-100.5%	-154.5%
Losses (Gains) on financial instruments, net	9,441	38,930	(87,085)	-75.7%	-144.7%
Post-employment benefits	192,724	229,767	233,287	-16.1%	-1.5%
Stock based remuneration	35,576	46,683	48,589	-23.8%	-3.9%
Income tax	295,391	304,314	(1,498,422)	-2.9%	-120.3%
Gains on disposal of property, plant and equipment	(69,510)	(43,340)	(3,971)	60.4%	991.4%
Gains and losses on assets held for sale and sales of interest in subsidiaries and associate company	721,682	58,223			
Allowance for doubtful accounts	18,342	68,781	127,701	-73.3%	-46.1%
Provision for tax, labor and civil claims	(110,281)	347,882	323,314	-131.7%	7.6%
Reversal of contingent liabilities, net	(929,711)				
Interest income on investments	(75,387)	(107,980)	(153,631)	-30.2%	-29.7%
Interest expense on loans	1,323,448	1,540,797	1,471,526	-14.1%	4.7%
Reversal of monetary update of contingent liabilities, net	(369,819)				
Interest on loans with related parties	(95)	2,457	(2,712)	-103.9%	-190.6%
(Reversal) Provision for net realisable value adjustment in inventory	(20,195)	(31,492)	17,536	-35.9%	-279.6%
	3,928,951	4,184,095	5,072,814	-6.1%	-17.5%
Changes in assets and liabilities					
(Increase) Decrease in trade accounts receivable	(54,690)	64,805	1,219,605	-184.4%	-94.7%
(Increase) Decrease in inventories	(1,269,455)	794,591	1,977,361	-259.8%	-59.8%
Increase (Decrease) in trade accounts payable	800,164	110,466	(768,627)	624.4%	-114.4%
Increase in other receivables	(371,745)	(275,938)	(270,391)	34.7%	2.1%
Decrease in other payables	(56,909)	(287,487)	(509,227)	-80.2%	-43.5%
Dividends from joint ventures	40,644	124,495	52,769	-67.4%	135.9%
Purchases of trading securities	(2,390,104)	(880,436)	(1,958,522)	171.5%	-55.0%
Proceeds from maturities and sales of trading securities	2,905,411	1,089,972	3,929,971	166.6%	-72.3%
Cash provided by operating activities	3,532,267	4,924,563	8,745,753	-28.3%	-43.7%
Interest paid on loans and financing	(1,330,116)	(1,240,165)	(946,041)	7.3%	31.1%
Income and social contribution taxes paid	(126,023)	(168,032)	(637,394)	-25.0%	-73.6%

Net cash provided by operating activities	2,076,128	3,516,366	7,162,318	-41.0%	-50.9%
Cash flows from investing activities					
Purchases of property, plant and equipment	(873,329)	(1,323,891)	(2,324,718)	-34.0%	-43.1%
Proceeds from sales of property, plant and equipment, investments and other intangibles	554,457	308,694	90,942	79.6%	239.4%
Purchases of other intangibles	(37,939)	(54,044)	(126,428)	-29.8%	-57.3%
Payment for business acquisitions, net of cash of acquired entities			(20,929)		
Capital increase in jointly-controlled entity	(178,670)		(40,524)		
Net cash used in investing activities	(535,481)	(1,069,241)	(2,421,657)	-49.9%	-55.8%
Cash flows from financing activities					
Purchase of treasury shares		(95,343)	(189,071)	-100.0%	-49.6%
Dividends and interest on capital paid	(86,386)	(85,962)	(358,226)	0.5%	-76.0%
Proceeds from loans and financing	3,265,860	2,455,371	3,042,783	33.0%	-19.3%
Repayment of loans and financing	(7,241,401)	(4,605,406)	(5,028,386)	57.2%	-8.4%
Intercompany loans, net	5,797	(6,492)	30,126	-189.3%	-121.5%
Increase in controlling interest in subsidiaries			(339,068)		
Net cash used in financing activities	(4,056,130)	(2,337,832)	(2,841,842)	73.5%	-17.7%
Exchange variation on cash and cash equivalents	7,438	(693,990)	699,290	-101.1%	-199.2%
(Decrease) Increase in cash and cash equivalents	(2,508,045)	(584,697)	2,598,109	328.9%	-122.5%
Cash and cash equivalents at beginning of year	5,063,383	5,648,080	3,049,971	-10.4%	85.2%
Cash and cash equivalents at end of year	2,555,338	5,063,383	5,648,080	-49.5%	-10.4%

Cash and cash equivalents totaled R$2,555.3 million, R$5,063.4 million and R$5,648.1 million on December 31, 2017, 2016 and 2015, respectively, as analyzed below:

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Net cash provided by operating activities

Net cash from operating activities amounted to R$2,076.1 million, R$3,516.4 million and R$7,162.3 million in the fiscal years ended December 31, 2017, 2016 and 2015, respectively.

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 Divisions, mainly in the Brazil BD, due to the higher production in the period and higher raw material costs.

In 2016, net cash from operating activities declined 50.9% compared to 2015, mainly due to the lower use of working capital and to the lower redemptions of financial investments. In working capital, the decrease of R$64.8 million in trade accounts receivable, decrease of R$794.6 million in inventories and an increase of R$ 110.5 million in trade accounts payable had a net positive effect of R$969.9 million on the Company s cash from operating activities in 2016. In 2015, this net positive effect on cash was R$2,428.3 million, due to the decrease of R$1,219.6 million in trade accounts receivable, decrease of R$1,977.4 million in inventories and decrease of R$768.6 million in accounts payable. The main factor leading to the net positive effect of R$969.9 million on the Company s cash from operations in 2016 was the decrease in inventories, especially at the North America Business Division. This resulted from the adjustment of inventories to the lower shipments, which were affected by continued pressure from imported goods in the region, despite the continued solid demand from the non-residential construction industry. The cash generated by the redemption of financial investments was used to amortize the Company s short-term and long-term liabilities.

Cash conversion cycle

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 and working capital(2) 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).

In 2016, as a result of the decrease in working capital(1) (-26.4%) coupled with the decrease in net sales (-17.8%) in the last three months of 2016 compared to the last three months of 2015, the cash conversion cycle(2) and working capital decreased from 84 days in 2015 to 75 days in 2016 (from 40 outstanding sales days in 2015 to 37 days in 2016, 76 outstanding inventory days in 2015 to 66 in 2016 and 31 outstanding payable days in 2015 to 29 days in 2016).

Net cash used in investing activities

Net cash used in investing activities decreased 49.9%, from R$1,069.2 million at the year ended December 31, 2016 to R$ 535.5 million in 2017, 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 investing activities decreased 55.8%, from R$2,421.7 million in 2015 to R$1,069.2 million in 2016, mainly due to lower capital expenditure (addition to fixed assets) and to the proceeds from the divestment of the special steel units in Spain, a long steel mill in Colombia, metallurgical coke mills in Colombia, the 30% interest in Corporación Centroamericana del Acero S.A. and manufacturing units and land in the United States.

Net cash used in financing activities

Net cash from financing activities went from the use of R$2,337.8 million in the fiscal year ended December 31, 2016 to the use of R$4,056.1 million in 2017. 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.

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(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.

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Net cash from financing activities went from the use of R$ 2,841.8 million in the fiscal year ended December 31, 2015 to the use of R$ 2,337.8 million in 2016. This variation was mainly due to the use of R$ 339.1 million for the acquisition of additional interests.

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, 2017, 2016 and 2015 (in thousands of Brazilian *reais*):

	2017	2016	2015
SHORT TERM:	**2,004,341**	**4,458,220**	**2,387,237**
Total short-term debt	2,004,341	4,458,220	2,387,237
Debentures			
LONG TERM:	**14,505,243**	**16,125,013**	**24,073,620**
Total long-term debt	**14,457,315**	**15,959,590**	**23,826,758**
Debentures	**47,928**	**165,423**	**246,862**
TOTAL DEBT:	**16,509,584**	**20,583,233**	**26,460,857**
Total cash and cash equivalents and short-term investments	**3,376,856**	**6,087,794**	**6,918,840**
In R$	386,441	1,609,145	2,289,407
Companies abroad	2,990,414	4,478,649	4,629,433
NET DEBT(1)	**13,132,728**	**14,495,439**	**19,542,017**

(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.

Total debt was R$16,509 million, R$20,593 million and R$26,461 million in the fiscal years ended December 31, 2017, 2016 and 2015, respectively. The R$4.1 billion decrease between December 2016 and December 2017 was mainly due to the amortization of the 2017 Bonds and other working capital and fixed assets financings. The reduction in the cash position of R$2.7 million between December 2016 and December 2017 was mainly due to the amortization of financings of working capital and fixed assets. As of December 31, 2017, 88.6% of cash was held by Gerdau companies abroad and denominated mainly in U.S. dollars. Net debt (net debt is a non-GAAP metric defined as short-term and long-term debt plus debentures less cash and cash equivalents and less short-term investments, which is broadly used by investors to measure a company s debt position) decreased 7.5%, from R$14,495 million in 2016 to R$13,133 million in 2017, due to the decline in total debt. The R$5.9 billion decrease between December 2015 and December 2016 was mainly due to the effects from exchange variation during 2016 (appreciation of 16.5% of the Brazilian *real* against the U.S. dollar in 2016), in addition to the amortization of financings of working capital and fixed assets. The reduction in the cash position of R$831 million between December 2015 and December 2016 was mainly due the

amortization of financings of working capital and fixed assets in 2016, in addition to the effects from exchange variation on the reconversion of balances at subsidiaries abroad. As of December 31, 2016, 73.6% of cash was held by Gerdau companies abroad and denominated mainly in U.S. dollars.Net debt (net debt is a non-GAAP metric defined as short- and long-term debt plus debentures less short- and long-term investments and cash and cash equivalents, which is broadly used by investors to measure a company s debt position) decreased 25.8%, from R$19,542 million in 2015 to R$ 14,495 million in 2016, due to the decline in total debt.

Of the total debt on December 31, 2017, short term debt corresponded to 12.1% and long-term debt to 87.9% (on December 31, 2016, 21.7% was short-term debt and 78.3% was long-term debt, and on December 31, 2015, 9.0% was short-term debt and 91.0% was long-term debt).

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As of December 31, 2017, short-term debt was R$2,004 million, representing a decrease of 55.0% in relation to 2016, due to the R$2.7 billion in 2017 Bonds, which were settled in October 2017. As of December 31, 2016, short-term debt was R$4,458 million, representing an increase of 86.8% in relation to 2015, due to the R$2.7 billion in 2017 Bonds becoming due in October 2017.

As of December 31, 2017, long-term debt was R$ 14,505 million, representing a decline of 10.0% in relation to 2016, due to the amortization of financings of working capital and fixed assets. As of December 31, 2016, long-term debt was R$16,125 million, representing a decline of 33.0% in relation to 2015, due to the effects from exchange variation on foreign-denominated debt over the course of 2016, in addition to the amortization of financings of working capital and fixed assets.

As of December 31, 2017, the maturity profile of the Company s long-term debt with financial institutions, including debentures, was as follows:

Gerdau S.A. Consolidated Long-Term Amortization	**(R$ thousands)**
2019	873,274
2020	3,158,211
2021	1,730,177
2022	147,715
2023 and After	8,547,938
Total	**14,457,315**

Financial Agreements

Below are the material financial agreements outstanding at year end 2017:

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 English Export Credit Agency (ECA), with the banks Deutsche Bank AG, London Branch, HSBC Limited, Tokyo Branch, Citibank Europe plc and BNP Paribas. On December 31, 2017, the outstanding balance of this facility was US$125.8 million (R$416.1 million).

Bonds

The Company, through its subsidiaries Gerdau Holdings Inc. and Gerdau Trade Inc., concluded in each of 2009, 2010, 2013, 2014 and 2017, the issuance of bonds with maturities of 10 and 30 years (collectively, the Ten/Thirty Years Bonds). The following companies guaranteed these transactions: Gerdau S.A., Gerdau Açominas S.A. and Gerdau Aços Longos S.A. On December 31, 2017, the outstanding balance of these bonds was R$11.6 billion.

NCEs

The Company and its subsidiaries Gerdau Açominas S.A. and Gerdau Aços Longos S.A. issued Export Credit Notes in the total amount of R$1.2 billion with Banco do Brasil. On December 31, 2017 the total outstanding amount of these facilities was R$935 million.

EXIM PSI BNDES

During 2016, the Company raised R$ 670.3 million through the BNDES Program EXIM PSI, with a term of two years.

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 of five years; the Company guarantees this transaction.

BBVA Credit Agreement

In December 2015, the associate company 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 of five years. The outstanding amount of this facility was US$126.3 million as of December 31, 2017 (R$417.8 million) and the Company guarantees this transaction.

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Syndicated Loan

In December, 2016 the associate company 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, 2017 the outstanding amount was US$340.3 million (R$1.1 billion) and the Company guarantees this transaction.

All loans contracted under the FINAME/BNDES program, totaling R$110.4 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 under IFRS of Gerdau S.A., are related to 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, 2017, such ratio calculated was 3.5.

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, 2017, such ratio calculated was 3.0.

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, 2017, the current ratio was 2.3.

Credit Lines

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 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, 2017, the outstanding amount was R$450.5 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$270.3 million as of December 31, 2017.

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, 2017, the outstanding loans under this line totaled US$54 million (R$ 178.6 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

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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 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, designated as a cash flow hedge, contract whereby it receives a variable interest rate based on LIBOR in US dollars and pays a fixed interest rate based on the local currency. The counterparties to these transactions are financial institutions with low credit risk.

			Notional value		Amount receivable		Amount payable	
Contracts	**Position**		**2017**	**2016**	**2017**	**2016**	**2017**	**2016**
Forward								
Maturity at 2017		long in USD		US$ 84.8 million		734		(6,584)
Maturity at 2017		short in USD		US$ 15.0 million		1,823		
Cross currency swap								
Maturity at 2017	receivable under the swap	Libor 6M + 2.25%						
	payable under the swap	INR 11.02%		US$ 25.0 million		5,684		

Maturity at 2018	receivable under the swap	Libor 6M + 2%							
	payable under the swap	INR 10.17%	US$	40.0 million	US$	40.0 million	4,710	(1,267)	
Total fair value of financial instruments							12,951	(1,267)	(6,584)

The effects of financial instruments are classified as follow:

	2017	2016
Unrealized gains on financial instruments		
Current assets		2,557
Non-current assets		10,394
		12,951
Unrealized losses on financial instruments		
Current liabilities		(6,584)
Non-current liabilities	(1,267)	
	(1,267)	(6,584)

	2017	2016
Net Income		
Gains on financial instruments	9,666	33,753
Losses on financial instruments	(19,107)	(72,683)
	(9,441)	(38,930)
Other comprehensive income		
Gains (Losses) on financial instruments	(11,364)	212
	(11,364)	212

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.

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Capital Expenditures

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 Division 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 Division this business division spent R$291.8 million in capital expenditures on fixed assets distributed throughout the units which compose this business division. This amount was mainly spent on maintenance of the production units.

South America Business Division 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 division 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 Division 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 division. 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 Division 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 Division this business division spent R$227.4 million in capital expenditures on fixed assets, which were distributed throughout the units which compose this business division. This amount was mainly spent on maintenance of the production units.

South America Business Division 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 division 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.

Special Steel Business Division 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 division. This amount was mainly spent on maintenance of the production units.

2015 Capital Expenditures

In fiscal year 2015, capital expenditures on fixed assets was R$2,324.7 million. 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 Division a total of R$1,091.2 million was invested in this operation in capital expenditures. The main highlight was the installation work of flat steel rolling mill (heavy plates) at the Ouro Branco mill.

North America Business Division this business division spent R$346.9 million in capital expenditures on fixed assets, which were distributed throughout the units which compose this business division. This amount was mainly spent on maintenance of the production units.

South America Business Division in 2015, the South American units spent R$443.6 million in capital expenditures, on fixed assets distributed among the countries in which the units from this business division are located. Part of this investment is being

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used to build a new melt shop in Argentina, which will have a capacity of 650,000 tonnes of steel per year and will start production on March of 2017.

Special Steel Business Division the special steel units spent R$442.9 million in capital expenditures on fixed assets, which were distributed throughout the units which compose this business division. This amount was mainly spent for the 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, and also have additional product and laboratory certifications. In general, the 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 conduct planned visits, where some are randomly selected and some are scheduled, to its customers to check on the quality of the delivered products in order to guarantee 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.

Gerdau works continuously to monitor and anticipate the needs of its customers. For this, has research and development centers in Brazil and the United States used to meet the market demands for special steel, especially for the automotive industry. The Company invested in Technological Innovation projects and research and development the amount of R$ 117.9 million in 2015, R$ 23.1 million in 2016 and R$ 28.5 million in 2017.

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 2018, 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 4% in 2018. 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 3.7% growth in long steel consumption in the United States in 2018, considering the main steel-consuming segments (non-residential construction, manufacturing, oil and gas). On March 8, 2018, Trump signed into law a 25% steel import tariff, effective in 15 days, designed to combat the 30-35mt of U.S. steel imports, and help the US steel industry increase its utilization rate to 80%. Canada and Mexico will be excluded from the initial tariffs and the proclamations include

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a broader provision which will allow other countries to request an exemption. The Company exects this tariff to be positive for Gerdau operations in North America.

In special steels, Brazil s automotive industry should register strong growth in sales to the 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 2017. The automotive industry in India continues to grow year after year, with the potential for growth continuing in the coming periods.

Moreover, South America s other economies are expected to post positive growth of varying rates in 2017, influencing the region s apparent steel consumption.

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 Bank of America, in the amount of US$ 30 million (R$ 88,607 thousands as of December 31, 2017).

The Company provides a guarantee for the line of credit of its joint venture Diaco S.A., with Citibank, in the amount of US$ 40 million (R$ 128,019 thousands as of December 31, 2017).

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$ 165,637 thousands as of December 31, 2017).

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$ 1,125,655 thousands as of December 31, 2017).

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$ 417,958 thousands as of December 31, 2017).

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 US$ 130,164 thousands (R$ 6,550 thousands as of December 31, 2017).

F. DISCLOSURE OF CONTRACTUAL OBLIGATIONS

The following table sets forth the Company s contractual obligations on December 31, 2017 (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	3,179,954	3,179,954			
Short-term debt obligations (1)	1,749,805	1,749,805			
Long-term debt obligations (1)	14,457,315		4,031,485	1,877,892	8,547,938
Debentures (1)	47,928		5,761	22,710	19,457
Interest payments	6,913,427	945,178	1,624,284	1,020,919	3,323,046
Unrealized losses on financial instruments	1,267		1,267		
Obligations with FIDC	1,135,077			1,135,077	
Operating lease obligations (2)	318,587	72,614	112,393	72,101	61,479
Capital expenditures (3)	439,551	439,551			
Unconditional purchase obligations (4)	1,916,731	1,089,731	827,000		
Pension funding obligations (5)	115,022	102,346	3,393	3,057	6,226
Total	**30,274,664**	**7,579,179**	**6,605,583**	**4,131,756**	**11,958,146**

(1) Total amounts are included in the December 31, 2017 consolidated balance sheet. See Note 13 - Loans and Financing and Note 14 - Debentures in the Consolidated Financial Statements.

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(2) Includes minimum lease payment obligations for equipment and real property leases in effect as of December 31, 2017.

(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, 2017, the corresponding liability has not yet been recorded in its financial statements.

(4) The majority of other purchase obligations are for inventory and operating supplies and expenses used in the ordinary course of business.

(5) 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:

Chairman

Claudio Johannpeter

Members

André Bier Gerdau Johannpeter

Richard Chagas Gerdau Johannpeter

Affonso Celso Pastore

Aod Cunha de Moraes Junior

Fernando Fontes Iunes

Chief Executive Officer (CEO):

Gustavo Werneck da Cunha

Vice-Presidents:

Francisco Deppermann Fortes

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

Harley Lorentz Scardoelli

Officers:

André Brickmann Areno

Cesar Obino da Rosa Peres

Fernando Pessanha Santos

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 (Canada), Executive Development at Penn State (United States) and Advanced Management Program at Harvard (United States).

• Experience: He has worked at Gerdau since 1982. In 2007, he was elected Chief Operating Officer (COO), a position he held until August 2012. In December 2017, he left his executive position at Executive Committee representing the Brazil Long Steel Business Operation and the Global Processes: Engineering and Industrial, Compliance and Environment, Health and Safety. On January 2018 he joined the (i) Board Chairman of Gerdau S.A., (ii) member of the Compensation Committee, (iii) member of the People Committee, (iv) member of the Governance Committee, (v) member of the Finance Committee, (vi) member of the Strategy Committee, (vii) Board Chairman of Metalúrgica Gerdau SA, a listed company, holding company of Gerdau S.A., (viii) Board

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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).

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) Board Member of Gerdau S.A., (ii) member of the Compensation Committee, (iii) member of the People Committee, (iv) member of the Governance Committee, (v) member of the Finance Committee, (vi) member of the Strategy Committee, (vii) Board Member of Metalúrgica Gerdau SA, a listed company, holding company of Gerdau S.A., (viii) Board Member of Seiva SA - Florestas e Indústrias, a company that is part of Gerdau s economic group. He also severs as a member of the Executive Committee 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.

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. On January 2018, he joined a (i) Board Member of Gerdau S.A., (ii) Governance Committee, (iii) member of the Finance Committee, (iv) member of the Strategy Committee.

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 SA and Metalúrgica Gerdau SA, listed company, holding of Gerdau SA whose the activity is the manufacture of general steel products since February 2002 and also a member of the Corporate Governance Committee and member of the Compensation and Succession Committee of Gerdau SA; (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 food products 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 worked as an economist, analyst and economic adviser, writing articles, reports and studies. He participated in national and international seminars, and has given lecture on topics related to the Brazilian and World Economies. Since June 2013, he has served as the President of the Center for Public Policy Debates (CDPP).

FERNANDO FONTES IUNES (born in 1962)

• Education: Degree in Civil Engineering from the Faculdade de Engenharia da Universidade Mackenzie and obtained the title of MS and PhD from the University of London (UK).

• Experience: Fernando was a Senior Advisor, Partner and Executive Director, responsible for the Global Investment Banking 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., where he was Director responsible for the areas of Capital Markets 2003-2010, Itaú Banco de Investimento S.A., where he served as Executive Officer from 2001 to 2003, Banco BBA Creditantalt S.A. and Creditanstalt in New York in 1994. During that period, Fernando participated in some of the largest and most important capital markets transactions, mergers, acquisitions and reorganizations held in Latin America. Fernando also worked on the Infrastructure and Urban Development Department, Policy, Research and External Affairs at the World Bank in Washington. He was a professor of the Instituto Brasileiro de Mercado de Capitais

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- IBMEC (Insper). Currently, Fernando is a senior fellow at Harvard University in the 2017 Advanced Leadership Initiative in Cambridge, United States. On September 28, 2015, he joined the Board of Directors of Gerdau S.A.

GUSTAVO WERNECK DA CUNHA (born in 1973)

• Education: Degree in Mechanical Engineer 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 a (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 (GAB). In December 2017, he left the Executive Officer GAB position and on January 2018, he joined the position of 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. On September, 2015 Harley Lorentz Scardoelli became a member of 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 the companies Gerdau S.A., Metalúrgica Gerdau S.A. and Seiva S.A. Florestas e Indústrias. Member of the Financial. Currently he hold the same position.

FRANCISCO DEPPERMANN FORTES (born in 1963)

• Education: Degree in Metallurgical Engineering from Universidade Federal do Rio Grande do Sul (UFRGS) in 1985 and a master s degree in Business Administration from the same University in 2001. In 2008, he completed the Gerdau Business Program and in 2010, he attended the Stanford Executive Program at Stanford University in the United States. In 2017 completed his coaching training at the Ecosocial Escola de Coaches.

• Experience: He started his career in 1984 as an intern in the Engineering area at Gerdau being, subsequently, hired as Technical Advisor in this same area. In 1992, after a period in which he studied and worked in Germany, he took the responsibility for coordinating the area of Management Systems of Aços Especiais Piratini, until 2000, also he accumulated the responsibility for the Human Resources of the unit. In 2001 he served as Manager of the Management System Area of Integrated Regional Unit of Long Steel Brazil. In 2003 he was transferred to the city of Porto Alegre where he started coordinating the global implementation and structuring of Gerdau Business System and Total Safety System, where he was promoted to Director of Management Systems in 2004. In January, 2006, he was promoted to the position of Executive Director of Gerdau Riograndense and Guaíra and in 2007 he was promoted to the position of Corporate Director of Human Resources, the position in which he added, over time, the processes of Organizational Development, Management Systems, Environment, Health and Safety, Management and Innovation, Shared Services, Business Security and Information Technology. Since 2011, he is Vice President and member of the Executive Committee of Gerdau S.A.. Since April 1st, 2015 he has served as a member of the Executive Committee of Gerdau SA, Metalurgica Gerdau SA and Seiva S.A. Currently is Vice President of Human Resources, Information Technology and Corporate Process of Engineer, Safety and Environment, he is also a member of Compensation Committee and People Committee.

FLADIMIR BATISTA LOPES GALTO (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 the Stanford University (California).

• Experience: Has 37 years of professional experience, being 30 years at Gerdau. For the last 10 years, he has been Global Procurement Officer, Commercial Gerdau s Executive Officer and currently is the (i) Executive Officer of Special Steel Brazil (GSB) and responsible for Gerdau Summit (Joint Venture) and Special Steel India Operations (ii) board member Gerdau Previdência. He was a member of the Steel Institute Brazil from 2016 to 2017.

MARCOS EDUARDO FARACO WAHRHAFTIG (born in 1972)

• Education: Degree in Mechanical Engineering from the Universidade Federal do Paraná (UFPR), with a MBA from Manchester Business School (UK) and has studied Corporate Finance at FGV/ ISAE.

• Experience: 23 years of experience, with 14 years in Gerdau. In the last 5 years he has held Commercial Officer of Special Steel Brazil (GSB), Corporate Commercial Officer and Commercial Officer of Gerdau Brazil Steel (GAB). Currently holds the positions of (i) Executive Director Brazil, Argentina and Uruguay, (ii), member of the board of the Instituto Aço Brasil (Brazilian Steel Institute), (iii) President of the CBCA Brazilian Institute for Steel Construction, (iv) member of the board of FIESP/ Concic -

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Superior Council of the Federation of Industries of the State of São Paulo, civil construction committee (v) member of the board of Abramat Brazilian Association of Construction Material Producers.

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 MBA in Strategic Marketing at Universidade Federal de Pernambuco in Recife-PE.

• Experience: Has more than 26 years of experience in Gerdau, holding positions of Comercial Gerdau units Manager, Civil Construction National Sales Manager, Distribution National Sales Manager and Logistics Officer. He 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 holds the position of Comercial 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 30 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, he held the position of Sales and Marketing General Manager at the Gerdau operation in Colombia from 2013 to 2014, and was later promoted to Executive Officer of Gerdau Colombia Operation where he remained until the end of 2016. Currently holds Commercial Officer of Gerdau Aços Brasil (GAB).

FERNANDO PESSANHA SANTOS (born in 1976)

• Education: Graduated in Mechanical Engineering from the Universidade do Estado do Rio de Janeiro (UERJ-RJ), he has completed his academic training with the Negotiation Courses at Fundação Getúlio Vargas (São Paulo), Logistics at Universidade de São Paulo (USP - São Paulo) and Gerdau Business Program at IBMEC with international modules at INSEAD (France), Duke (United States) and HKUST (China).

• Experience: Has more than 20 years of experience in the industrial sector, being 18 years at Gerdau on Supply, Metals, Logistics, Forestry, Sales of Non-Steel Products and Raw Materials Areas. He served as a MRS Logística

board member in 2016 and has been a member of the World Steel Raw Material Committee since 2015. Currently holds the position of Raw Materials & Procurement Officer.

ANDRÉ BRICKMANN ARENO (born in 1974)

• Education: Degree in Law from Faculdade de Direito da Universidade de São Paulo (FADUSP), completed his academic training with the Master of Laws (LLM) in Trade Regulation at New York University (United States of America) and Master of Business Administration (MBA) at INSPER - Instituto de Ensino e Pesquisa (Brasil).

• Experience: He is a lawyer registered at the Ordem dos Advogados do Brasil Seccional São Paulo (OAB-SP) and a member of the New York State Bar. He has over 10 years of experience at Gerdau. Currently holds the positions of (i) Gerdau SA s Legal Officer, (ii) member of Gerdau SA s Risk Committee (iii) member of Gerdau SA s Disclosure Committee and (iv) Legal Officer of Metalúrgica Gerdau S.A., a publicly listed company and the holding company of Gerdau S.A.

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.

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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 2017, the Directors and Executive officers of Gerdau were paid a total of R$ 54.9 million in total remuneration as salary, variable remuneration, benefits, social charges, and termination. The variable remuneration of directors is determined based on Gerdau s financial results and individual performance evaluation. Fiscal Council members are not eligible for variable renumeration.

Gerdau 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 2017, Gerdau s contribution to the Gerdau Plan with respect to the executive officers amounted to R$1.2 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, Gerdau 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:

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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 begun. 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	580.054	505.648	253.171	1.077.060	816.489	615.739	1.183.845	953.657	624.020	889.577	828.278
Exercised Options	580.054	485.497	253.171	25.272	0	0	16.494	1.825	2.953	4.560	3.378
Cancelled Options	0	0	0	0	0	0	0	320.162	390.658	496.641	258.267
Balance Options	0	0	0	0	0	0	0	0	0	0	198.000
Options converted to Restricted Share	0	20.151	0	1.051.788	816.489	615.739	1.167.351	631.670	230.409	388.376	368.633

Grant Price:	R$ 16,50	R$ 18,36	R$ 9,65	R$ 4,29	R$ 11,12
Grant Date:	1-set-13	1-jan-14	1-jan-15	1-jan-16	1-jan-17
Vesting Date:	1-mar-18	1-mar-19	1-mar-20	1-mar-21	1-mar-21
Expiration Date:	0-jan-00	0-jan-00	0-jan-00	0-jan-00	0-jan-00
Total Restricted Share (Conversion)	2.746.821	0	0	0	0
Exercised Restricted Share (Conversion)	2.669.101	0	0	0	0
Cancelled Restricted Share (Conversion)	0	0	0	0	0
Balance Restricte Share (Conversion)	77.720	0	0	0	0
Grant Restricted Share	0	192.453	344.717	1.497.333	642.340
Exercised Restricted Share	0	120.457	152.901	316.530	0
Cancelled Restricted Share	0	0	0	18.476	0
Balance Restricte Share	0	71.996	191.816	1.162.327	642.340
Grant Performance Share	0	739.568	1.421.727	2.078.967	923.233
Grant Performance Share - Performance Adjustment					0
Exercised Performance Share	0	80.786	881.801	0	0
Cancelled Performance Share	0	373.114	28.683	0	0
Balance Performance Share	0	285.668	511.243	2.078.967	923.233

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 (Bovespa) 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 three levels and has maintained the existing governing bodies: the Board of Directors, the Executive Committee 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, 2017, the members of the Board of Directors, whose terms of office expire on April 30, 2018, are:

Chairman

Claudio Johannpeter (1), (2), (3), (4) and (5)

Members

André Bier Gerdau Johannpeter (1), (2), (3), (4) and (5)

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)

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(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:

Guilherme Chagas Gerdau Johannpeter (1), (2), (3), (4) and (5)

Gustavo Werneck da Cunha (1), (2), (4) e (5)

The Committees created to support the Board of Directors are:

*Compensation Committee: e*valuate 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-Presidents:

Francisco Deppermann Fortes

Vice-President, Chief Financial officer (CFO) and Investor Relations Officer:
Harley Lorentz Scardoelli

Officers:

André Brickmann Areno

Cesar Obino da Rosa Peres

Fernando Pessanha Santos

Fladimir Batista Lopes Gauto

Marcos Eduardo Faraco Wahrhaftig

Mauro de Paula

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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 Divisions.

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.

Advisory Board

At the Extraordinary and Ordinary General Meeting of April 29, 2015, given that the changes in the Company s Bylaws were approved, the Board of Directors installed and elected the Advisory Board (Conselho Consultivo) that began its duties on May 1, 2015.

The Advisory Board is responsible for issuing an opinion on the matters submitted thereto by the Board of Directors.

Chairman:

Jorge Gerdau Johannpeter

Members:

Germano Hugo Gerdau Johannpeter

Klaus Gerdau Johannpeter

Frederico Carlos Gerdau Johannpeter

JORGE GERDAU JOHANNPETER (born in 1936)

• Education: Degree in Law from the Universidade Federal do Rio Grande do Sul (UFRGS) in 1961.

• Experience: In May 2015, he became the Chairman of the Advisory Board of Gerdau S.A. and Metalúrgica Gerdau S.A. He has worked at Gerdau since 1954. He became an Executive Officer in 1971 and was appointed as a member of the Board of Directors in 1973. From 2002, after the implementation of new corporate governance structure, until December 2006, Jorge Johannpeter also held the position of Chief Executive Officer (CEO). From 1983 to April 2015, he served as Chairman of the Board of Directors of Gerdau S.A. and its parent company Metalurgica Gerdau S.A., a publicly listed company and Gerdau s holding company, whose core business is the manufacturing of steel products in general; and Seiva S.A. - Florestas e Indústrias, a company that is part of the same group as Gerdau S.A. and whose main activity is the participation in the capital of other companies. On January 2, 2007, Jorge Gerdau Johannpeter retired from the Gerdau Executive Committee and, since then and until April 2015, he served exclusively as a member of the Board of Directors as its President.

• Other activities: Member of the Economic and Social Development Council (CDES) of the Brazilian Government. Founded of the Gaucho Quality and Productivity Program (PGQP) and Brazil Competitive Movement (MBC). He is a member of the International Quality Academy, of the Brazilian Quality Academy and member of the board of the National Quality Foundation (FNQ). In the areas of education and culture, he leads the governing board of the All for Education Movement and of the Ibere Camargo Foundation, he is also member of the board of Volunteer Partners.

FREDERICO CARLOS GERDAU JOHANNPETER (born in 1942)

• Education: Degree in Business Administration from the Universidade Federal do Rio Grande do Sul (UFRGS) and has a master s degree in Business, Finance, Costs and Investments from the University of Cologne, Germany.

• Experience: In May 2015, he became a member of the Advisory Board of Gerdau S.A. and Metalurgica Gerdau S.A. He has worked at Gerdau since 1961. He became an Executive Officer in 1971, and from 1973 to 2002, served as a member of the Board of Directors. In 2002, under the new corporate governance structure, he became Vice-Chairman of the Executive Committee of Gerdau S.A., a position he held until December 2006. From January 2007 until April 2015, he served as Vice Chairman of the Board of Directors of Gerdau S.A., its parent company Metalurgica Gerdau S.A. and Seiva S.A. - Florestas e Indústrias.

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GERMANO HUGO GERDAU JOHANNPETER (born in 1932)

• Education: Degree in Business Administration from the Fundação Getúlio Vargas.

• Professional experience: In May 2015, he became a member of the Advisory Board of Gerdau S.A. and Metalúrgica Gerdau S.A. He has worked at Gerdau in since 1951. He became an Executive Officer in 1971, and from 1973 to 2015, he served as a member of the Board of Directors. From 2002 until April 2015, he served as Vice-Chairman of the Board of Directors of Gerdau S.A., Metalúrgica Gerdau S.A. and Seiva S.A. - Florestas e Indústrias.

KLAUS GERDAU JOHANNPETER (born in 1935)

• Education: Degree in Civil, Electrical and Mechanical Engineering for the Universidade Federal do Rio Grande do Sul (UFRGS) in 1958.

• Professional experience: In May 2015, he became a member of the Advisory Board of Gerdau S.A. and Metalúrgica Gerdau S.A. He has worked for Gerdau since 1954. He became an Executive Officer in 1971 and from 1973 to 2015, he served as a member of the Board of Directors. Until his retirement from the Executive Committee in 2007, he was the main coordinator of the technical development of Gerdau s industrial operations. From 2002 until April 2015, he served as Vice-Chairman of the Board of Directors of Gerdau S.A., Metalúrgica Gerdau S.A., and Seiva S.A. - Florestas e Indústrias. In addition, he has been the Chairman of the Gerdau Institute, the governing body of Gerdau s social projects, since it was founded in 2005.

Board of Auditors

Under Brazilian Corporate Law, the board of auditors (*Conselho Fiscal*) is a shareholder nominated audit board and an independent corporate body of 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 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

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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 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, since April 29, 2015.

Name	Birthday	Member Position	Year First Elected
Bolívar Charneski	08/22/1950	Effective	2011
Geraldo Toffanello	10/12/1950	Effective	2014
Carlos Roberto Schröder	02/19/1940	Effective	2015
Herculano Aníbal Alves	27/02/1953	Effective	2017
Celene Carvalho de Jesus	10/07/1955	Effective	2017
Tarcicio Beuren	15/11/1953	Alternate	2017
Artur Cesar Brenner Peixoto	09/29/1942	Alternate	2014
Roberto Pacheco Walcher	21/11/1956	Alternate	2017
Paulo Roberto Batista Machado	16/07/1977	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 at PricewaterhouseCoopers in Atlanta, GA, USA.

• Experience: Founder and partner since 1988 of Charneski Contadores Associados (up to 2009, Charneski Auditores & Consultores), a company settled in Porto Alegre (RS), where he was technically responsible for

independent auditing and consulting services. Since 2009 dedicates to advising companies and organizations in the fields of Governance, Boards, Management, Accounting and Board of Auditors Board of Auditors member (assigned as Financial Expert for SOX purposes) of Gerdau S.A. since 2011. Board of Auditors Board of Auditors member of Metalúrgica Gerdau S.A., since 2017. 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 in the national level. Board of Auditors Board of Auditorsmember of Grendene SA from 2011 to 2013. He was also a Board of Auditors Board of Auditorsmember of Forjas Taurus SA from 1998 to 2007. He is also the author of articles about business and economic scenarios, corporate governance, management, accounting and tax.

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, and was 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

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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 and later served as Accounting Director a position he held until retiring in 2012, when retired. Since 2013, he has been a member of the Board of Auditors for several companies, and he is currently a member of the Board of Auditorss 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 Vice President of Volunteer Partners.

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) Metalurgica Gerdau SA, from 1973 to 1976 as Chief Accountant; (Iv) Companhia Siderurgica da Guanabara - Cosigua, former name of Gerdau SA 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 Siderurgica Guaira SA, from 1983 to 1989 as Administrative and Accounting Director; (vii) Usina Siderúrgica da Bahia SA - Usiba, 1989-1996, as Executive Director; (viii) Siderrúrgica Açonorte SA, Usina Siderúrgica da Bahia SA - Usiba and Usina Siderúrgica Cearense SA, from 1996 to 1998, as Executive Director. Currently, he is a Board of Auditors member of Metalurgica Gerdau SA and Gerdau SA.

HERCULANO ANÍBAL ALVES (born in 1953)

• Education: Degree in Economics by PUC/SP with a post-graduation in Financial Management and a Master degree in Finance and Investments at EAESP-FGV. Also holds a Governance, Risk and Compliance Certificate by Risk University KPMG, a Portfolio Manager Certification by CVM and ANBIMA (CGA).

• Experience: Worked in the financial market, as investment director, variable income manager and credit analyst at BRAM - Bradesco Asset Management, at ABN AMRO Bank, Unibanco and Banco Bozzano Simonsen, and in the administrative and financial area of the bus company Vila Carrão was Board member of Marfrig Brasil Foods (2015 - Nov / 16), was member of the Board of Auditors of the Private Equity Technology Fund of GP (2001-05), was member of the Board of Auditors of the Liquidity of Bradesco Templeton (1998 -01) and partner of Araxá Investimentos de (2015 - 2017).He is currently (i) Board Member and Member of the Statutory Audit Committee of Tim Brasil (since 2015); (ii) Member of the Board of Auditors of Cielo (since 2015), (iii) Member of the Board of Auditors of Grendene (since 2015); (iv) Member of the Board of Auditors of Gerdau SA (since 2017); (v) Substitute member in the Private Equity Fund of 2Bcapital and (vi) Partner of Barigui Gestão de Recursos (since Nov / 17).

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 Braília (2001 - 2002) and Postgraduate in Managerial Accounting from FGV - Fundação Gatúlio 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 on the Board of Auditors of Gerdau S.A. since May 2017.

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D. EMPLOYEES

Work Force	Brazil	Other Countries	Total
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

Extended Work Force*	Brazil	Other Countries	Total
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

*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, 2017, the Company employed 28,612 at its industrial units, excluding joint ventures, 49% of this total is based in Brazil and the remainder in South America, North America and India, which have 4,566, 9.210, and 798 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. 38% 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 maintain good relations with employees. To maintain such a good working environment, the Company provides development and training opportunities, team-building programs and transparent management system. Compensation programs are designed to meet employee s financial interests with those of Gerdau shareholders.

E. STOCK OWNERSHIP

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 January 31, 2017.

Shareholder	**Common Shares (with voting rights)**	**%**	**Preferred Shares (with restricted voting rights)**	**%**
Claudio Johannpeter			313,030	0.03
André Bier Gerdau Johannpeter			509,011	0.04
Richard Chagas Gerdau Johannpeter			21,419	0.00
Affonso Celso Patore			31,669	0.00
Fernando Fontes Iunes			3,690	0.00
Aod Cunha				
Harley Lorentz Scardoelli			16,521	0.00
Francisco Deppermann Fortes			60,215	0.00
Gustavo Werneck da Cunha			5,956	0.00
Andre Brickmann Areno			6,982	0.00
Cesar Obino da Rosa Peres			937	0.00
Marcos Eduardo Faraco Wahrhaftig				
Fladimir Batista Lopes Gauto				
Mauro de Paula				
Fernando Pessanha Santos			4,091	0.00
TOTAL			**973,521**	**0.80**

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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 and 2016 awards (all Gerdau S.A. preferred shares) to each director and executive officer until January 31, 2017.

	Stock Options				Restricted Share Units				Performance Share Units			
Names	**Grant**	**Exercised**	**Cancelled**	**Balance**	**Grant**	**Exercised**	**Cancelled**	**Balance**	**Grant with performance adjustment**	**Exercised**	**Cancelled**	**Balance**
Jorge Gerdau Johannpeter	**320.386**	**0**	**320.386**	**0**	**634.776**	**634.776**	**0**	**0**	**463.850**	**335.814**	**128.036**	**0**
Germano H G Johannpeter	**191.881**	**0**	**191.881**	**0**	**544.672**	**544.672**	**0**	**0**	**226.236**	**163.847**	**62.389**	**0**
Klaus Gerdau Johannpeter	**191.881**	**0**	**191.881**	**0**	**544.672**	**544.672**	**0**	**0**	**226.236**	**163.847**	**62.389**	**0**
Frederico C G Johannpeter	**281.485**	**0**	**281.485**	**0**	**607.488**	**607.488**	**0**	**0**	**391.180**	**283.216**	**107.964**	**0**
Claudio Johannpeter	**185.976**	**0**	**147.225**	**38.751**	**996.203**	**275.931**	**0**	**720.272**	**1.312.535**	**0**	**0**	**1.312.535**
Affonso Celso Pastore	**28.929**	**0**	**20.559**	**8.370**	**90.457**	**46.739**	**7.558**	**36.160**	**48.049**	**0**	**653**	**47.396**
Andre Bier Johannpeter	**231.158**	**0**	**154.412**	**76.746**	**1.179.677**	**314.980**	**0**	**864.697**	**1.595.647**	**0**	**0**	**1.595.647**
Expedite Luz	**41.319**	**0**	**41.319**	**0**	**94.876**	**87.318**	**7.558**	**0**	**56.229**	**15.863**	**40.366**	**0**
Francisco D Fortes	**33.027**	**0**	**18.387**	**14.640**	**162.532**	**50.039**	**0**	**112.493**	**209.130**	**0**	**0**	**209.130**
Guilherme Gerdau Johannpeter	**109.759**	**12.716**	**49.496**	**47.547**	**304.206**	**81.186**	**0**	**223.020**	**394.593**	**0**	**0**	**394.593**
Harley Lorentz Scardoelli	**16.987**	**0**	**11.653**	**5.334**	**92.026**	**22.388**	**0**	**69.638**	**123.209**	**0**	**0**	**123.209**
Fernando Fontes Iunes	**0**	**0**	**0**	**0**	**32.170**	**4.644**	**0**	**27.526**	**0**	**0**	**0**	**0**
Richard Gerdau Johannpeter	**0**	**0**	**0**	**0**	**35.530**	**5.316**	**3.360**	**26.854**	**0**	**0**	**0**	**0**
Gustavo Werneck da Cunha	**0**	**0**	**0**	**0**	**46.802**	**17.811**	**0**	**28.991**	**49.000**	**0**	**0**	**49.000**
Fladimir Batista Lopes Gauto	**19.394**	**0**	**12.782**	**6.612**	**57.578**	**21.030**	**0**	**36.548**	**67.601**	**0**	**0**	**67.601**
Total	**1.652.182**	**12.716**	**1.441.466**	**198.000**	**5.423.664**	**3.258.989**	**18.476**	**2.146.199**	**5.163.495**	**962.587**	**401.797**	**3.799.111**

The information of 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, 2018, 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, 2018, 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.	554,636,718	96.69	98,733,314	8.62
Blackrock INC.			57,457,132	5.0
Members of the board of directors and executive officers as a group (9 members)			973,521	0.80

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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 96.69% 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, 2018 there were 283,331,178 ADRs outstanding, representing 24.7% 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.

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The Company s transactions with related parties are presented below:

			Original Amount				Outstanding Amount	
Item	INTRA-GROUP AGREEMENTS Purpose of the Agreement	Relationship with issuer	In thousands of R$	Date	Maturity or Deadline	Termination or extinction conditions	December 31, 2017	Largest amount during the period covered
1	Guarantee granted to Gerdau Corsa S.A.P.I. de C.V. in financing from Bank of America in the amount of up to US$30,000,000.00 at the date of the agreement.	Jointly-controlled entity	97,968	07/15/2016	Jul-18	Settlement of the agreement	88,607	97,967
2	Guarantee for company Diaco S.A., in a loan with Citibank in the amount of up to US$40 million on the agreement s date.	Jointly-controlled entity	137,700	08/03/2015	Aug-18	Settlement of the agreement	128,019	128,019
3	Bank guarantee granted to Banco de la Nación regarding the financing of Sipar Aceros SA s Melt Shop in the amount of US$105,000,000.00.	Subsidiary	229,808	10/04/2013	Sep-18	Settlement of the agreement	20,020	332,682
4	Guarantee granted to Gerdau Steel India Ltd., in financing to the Bank of Tokyo in the amount of up to INR 2,505,600,000.00, equivalent to US$40,000,000.00 at the date of the agreement.	Subsidiary	92,996	09/06/2013	Sep-18	Settlement of the agreement	132,320	132,328
5	Guarantee granted to Siderúrgica Zuliana, C.A., in financing from Citibank up to US$15,000,000.00 at the date of the agreement.	Subsidiary	50,010	12/13/2016	Dec-18	Settlement of the agreement	33,080	47,526
6	Guarantee granted to Chilean entities Armacero and Salomon Sack in bilateral loans, in the total amount of US$65 million, equivalent in Chilean pesos.	Subsidiary	214,793	12/21/2017	Dec-18	Maturity	226,700	226,700
7	Guarantee granted to Gerdau Aços Longos SA in an agreement to purchase and sell electricity with Companhia de São Paulo, CESP, in the current amount of R$7,007,262.85.	Subsidiary	7,007	11/30/2016	Dec-18	Settlement of the agreement	7,007	7,007
8	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	Jan-19	Settlement of the agreement	165,637	183,134
9	Guarantee granted to the Gerdau Steel India, in financing with Citibank regarding working capital loan, in the amount of up to US$1,500,000.00 equivalent in INR.	Subsidiary	5,363	02/20/2015	Feb-19	Settlement of the agreement	155,370	155,370
10	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	19,153	28,041
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	Subsidiary	2,188,125	11/24/2009	Jan-20	Settlement of the agreement	1,711,649	1,828,528

	remuneration.							
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	206,972	303,859
13	Guarantee for company Gerdau Açominas S.A. in a loan with NCE Banco do Brasil in the amount of up to R$430 million on the agreement s date.	Subsidiary	430,000	03/19/2014	Feb-20	Settlement of the agreement	344,000	344,000
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	535,000	585,000
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.	Subsidiaryand Jointly-controlled entity		10/27/2015	Oct-20	Maturity	178,200	428,000
17	Guarantee for company Gerdau Corsa S.AP.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-20	Settlement of the agreement	417,958	462,109
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	12,521	18,165
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	1,570,546	3,395,619
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	416,099	457,718
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	34,226	41,175
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	1,125,655	1,244,564
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	1,792,291	1,792,399
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	3,031,974	3,032,157
25	Gerdau S.A. usually trades its own debentures on behalf of Gerdau Açominas S.A.. These transactions	Subsidiary			Aug-24	Maturity	586,950	586,950

	are carried out at the present unit price of the paper, which pays the CDI variation.							
26	Guarantee granted to Gerdau Aços Longos S.A. in financing from the BNDES in the amount of up to R$543,413,000.00 at the date of the agreement.	Subsidiary	543,413	07/08/2008	Oct-24	Settlement of the agreement	270,318	297,830
27	Gerdau S.A. usually trades its own debentures for the parent owners. These transactions are carried out at the present unit price of the paper, which pays the CDI variation.	Subsidiary			Nov-24	Maturity	348	31,510
28	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	6,550	6,550
29	Guarantee for company Gerdau Aços Longos S.A. in a loan with BBRB Pró DF II.	Subsidiary	12,834	08/05/2009	Dec-30	Settlement of the agreement	12,216	12,216
30	Co-guarantee for Gerdau Ameristeel US Inc. in the 30-year Bond issued in May/2007 in an amount of US$51 million.	Subsidiary	46,460	05/01/2007	May-37	Settlement of the agreement	76,084	76,089
31	Co-guarantee for Gerdau 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	168,708	168,718
32	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	1,654,000	1,654,100
33	Guarantee received from the company Indac Ind. Adm. E Com. S.A. for debentures from the7°, 8°, 9° and 11° issuances, with no restriction of amounts and dates. Remuneration rate of 0.95% on the due amount.	Parent company			Undetermined	Maturity	26,551	100,836
34	Gerdau S.A. has accounts receivable derived from sales to subsidiaries (Gerdau Aços Longos S.A. and Gerdau Aços Especiais S.A. (Incorporated by Gerdau S.A.)) Sales in the period amounted to R$1,421.	Subsidiaries			Undetermined	Maturity	14,779	14,779
35	Gerdau S.A. has accounts payable derived from purchases of subsidiaries (Gerdau Aços Longos S.A., Gerdau Aços Especiais S.A. (Incorporated by Gerdau S.A.) and Gerdau Açominas S.A.). Purchases in the period amounted to R$24,211.	Subsidiaries			Undetermined	Maturity	30,387	30,387
36	Current account (assets balance) with Gerdau Açominas S.A. Pays the monthly variation of the CDI.	Subsidiary		12/01/2014	Undetermined	No maturity	2,714	2,714
37	Current account (assets balance) with Gerdau Aços Longos S.A. Pays the monthly variation of the CDI.	Subsidiary		07/31/2005	Undetermined	No maturity	2,601	2,601
38	Current account (liability balance) with Gerdau Trade Inc. Pays the contracted charges plus exchange variance.	Subsidiary		09/17/2010	Undetermined	No maturity	6,093,327	6,155,589
39	Renting agreement of commercial room of area of 840 m2 of building placed on Av. Farrapos, 1811 - Porto Alegre/RS, Lessor: Gerdau Aços Longos S.A. Lessee: Grupo	Parent company	50	01/01/2013	Undetermined	Maturity	67	67

Gerdau Empreendimentos Ltda:
Amount per month R$57 thousand.

C. INTERESTS OF EXPERTS AND COUNSEL

Not applicable.

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ITEM 8. FINANCIAL INFORMATION

A. CONSOLIDATED STATEMENTS AND OTHER FINANCIAL INFORMATION

The Company s financial statements are included in Item 18.

Legal Proceedings

General

Like other Brazilian companies, Gerdau and its subsidiaries are party 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 counsel, 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 ultimate resolution will not have a significant effect on its consolidated financial position as of December 31, 2017.

The most significant legal and administrative disputes are detailed below, as well as the amount disclosed for each dispute as of December 31, 2017, unless otherwise stated. For further information on the reserve for contingencies, see Note 17 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, 2017, 2016 and 2015 (in thousands of reais):

Claims

	Reserve for Contingencies			Judicial Deposits		
	2017	**2016**	**2015**	**2017**	**2016**	**2015**
Tax	258	1,830	1,570	1,883	1,717	1,521
Labor	517	359	288	129	107	82
Other	53	51	47	39	38	100
Total	828	2,240	1,905	2,051	1,862	1,703

As a result of the reversal of the accounting provision described below (tax provisions), relating to the discussion of the inclusion of ICMS in the PIS and COFINS calculation basis, and recognition of other accounting provisions for the year ended December 31, 2017, the Company recorded the amounts of R$ 929 million in the line of Reversion of contingent liabilities, net (Operating Result) and R$ 370 million, in the line

of Reversion to update contingent 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 basis of calculation of contributions to 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 realization of said deposits.

On March 15, 2017, the Federal Supreme Court (STF) analyzed a lawsuit related to this matter, and by 6 votes to 4, the following decision was taken: The ICMS does not compose the calculation basis for PIS incidence purposes and COFINS. The decision taken 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 to clarify, 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 base 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, from that decision.

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The Company emphasizes, however, that, in view of the possibility that the STF may consider the requirements for application of modulation to the case as presented, the application of such an instrument results in limiting the effects of the decision already rendered, according to paragraph 59 of IAS 37. According to the terms of the modulation, as defined by the STF, such revaluation may result in the need to establish new provisions on this theme in the future.

The balance of judicial deposits recorded on 12/31/2017, in the amount of R$1,692 million, referring to the same discussion on the inclusion of ICMS in the PIS and COFINS calculation base, awaits the procedural closure of the actions in the judiciary to be returned to the Company.

During the year ended 12/31/2017, the Company adhered to the installment program of the State of Minas Gerais (Brazil), including amounts already substantially provisioned for ICMS.

The other tax provisions comprise:

- R$3 million related to Tax on Circulation of Goods and Services (*Imposto sobre a circulação de Mercadorias e Serviços ICMS*), the majority of which is related to credit rights involving the Finance Secretariat and the State Courts.

- R$39 million related to discussions on Social Contribution Tax on Profits (*Contribuição Social sobre o Lucro CSLL*) and Income Tax (*Imposto de Renda Pessoa Jurídica IRPJ*).

- 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 the RTE charge as of a tax nature and, as such, incompatible with the 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 Instances of the Federal Justice. The Company has made a full deposit in court for the amount of the disputed charge.

- R$164 million related to (i) compensation of Contribution to the Social Integration Plan (*Contribuição ao Programa de Integração Social PIS*) and Social Security Financing Contribution (*Contribuição para o Financiamento da Seguridade Social COFINS*) credits, and (ii) taxation of those Contributions over income in excess of sales.

- R$42 million related to other taxes, discussed in cases, for which the probability of loss is more likely than not.

After taking into account the opinions of our legal advisors and 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 reserves 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 Tax on Circulation of Goods and Services (*Imposto sobre a circulação de Mercadorias e Serviços ICMS*) state VAT discussions, which essentially relate to tax credit and rate differences, and aggregately amount to R$443 million.

- The Company and certain of its subsidiaries in Brazil are parties to claims related to: (i) Tax on Industrialized Products (IPI), substantially related to IPI credit on inputs, whose claims total the updated amount of R$309 million; of Social Integration PIS and Contribution for Social Security Financing COFINS, substantially related to non-approval of offsetting of credits on inputs totaling R$439 million, (iii) social security contributions in the total of R$77 million and (iv) other taxes, which updated total amount is currently R$370 million.

- Subsidiary Gerdau Aços Longos S.A. is a party to an administrative proceeding relating to Withholding Income Tax, in the amount of R$122 million, charged on interest remitted abroad, related to export financing formalized through Pre-Settlement Agreements (PPE) or Early Payment of Exports (SAR). The company filed an appeal on January 13, 2017, which was rejected by the Brazilian Federal Revenue Service, on June 5, 2017, which is why the Company filed a Voluntary Appeal on July 4, and is currently awaiting trial in the first instance of CARF.

- The Company and its subsidiary Gerdau Internacional Empreendimentos Ltda. are parties to administrative and legal proceedings related to Corporate Income Tax (IRPJ) and Social Contribution on Net Income (CSLL), in the updated amount of R$1,489 million. These lawsuits relate to profits generated abroad, of which: (i) R$1,317 million correspond to two lawsuits of the subsidiary Gerdau Internacional Empreendimentos Ltda., Of which (a) R$952 million correspond to a lawsuit whose administrative discussion already ended and are currently in tax enforcement, in relation to which the

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Company filed motion to stay execution that are pending judgment in the first instance and (b) R$365 million corresponds to a lawsuit in which the Company had its Voluntary Appeal partially provided for by the Company, in the first instance of the Administrative Council of Tax Appeals (CARF), and was submitted to a Special Appeal, which was partially provided by the Higher Fiscal Revenue Chamber of the CARF (CSRF), in a decision published on May 25, 2017, and is currently awaiting due diligence by the Internal Revenue Service, as determined by the CARF decision, and new appeals may be filed after the conclusion of such procedure; and (ii) R$172 million corresponds to a lawsuit filed by the Company, which had its Voluntary Appeal judged at the first instance of CARF, which was dismissed, which is why it was submitted to a Special Appeal, which is pending judgment by the Superior Chamber of Tax Appeals.

- 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$ 6,217,810 thousands, of which (i) R$ 4,963,398 thousands 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 tax enforcement; the Companies offers a judicial guarantee using a liability insurance policy, for judicial discussions on Motion to Stay Execution by the subsidiary Gerdau Aços Longos S.A. in their respective proceedings, which total the amount of R$ 3,195,379 thousands, and also by the Company, in its respective lawsuit, which amounts to R$ 364,370 thousands; the motions to stay execution are pending judgment in the first instance; (ii) R$ 600,101 thousands correspond to two proceedings involving Gerdau Aços Longos S.A., whose voluntary appeal is currently pending in CARF s lower tribunal; (iii) R$ 531,138 thousands correspond to two proceeding involving the subsidiary Gerdau Aços Longos S.A., whose voluntary appeal was dismissed in CARF s lower tribunal and having been presented Request for Clarification against those decisions, which are pending of judgment; and (iv) R$ 123,172 thousands correspond to one proceeding involving the Company (as successor of Gerdau Aços Especiais S.A.), whose Request for Clarification, which was filed against a decision that dismissed its Voluntary Appeal, was rejected on December 7, 2017, then the Company became aware of that on December 12, 2017 and it is opposing the appropriate appeal.

Some of the decisions obtained at the CARF, along with other matters involving the Company, are included in the scope of the so-called Operation Zelotes (the Operation) being conducted by Brazilian federal authorities including the Judiciary Branch, for the purpose of verifying the occurrence of alleged illegal acts.

Considering the involvement of Gerdau s name in press reports concerning the Operation, the Board of Directors decided to engage outside counsel, reporting to a Special Committee of the Board, to conduct an investigation to determine, among other things: (i) whether, in light of current knowledge, proper protocol was followed in the relationship of the Company with governmental authorities, including CARF, and in the hiring of firms representing the Company in cases before CARF; (ii) whether such firms have remained within the scope of their work/hiring; (iii) whether the engagement terms for such firms included clauses intended to prevent activity that violates ethical codes or laws currently in force; (iv) whether the engagement terms for such firms included the establishment of sanctions for any violations (whether contractual breaches or otherwise); and (v) if there is any evidence of fraud, deceit, bad faith, or any expression of an intent to commit an illegal act on the part of directors and/or officers of the Company in the relationship of the Company with governmental authorities, including CARF, in the negotiation, signing or carrying out of the aforementioned contracts (the Internal Investigation).

The Internal Investigation is ongoing, and the Company, as of the date of the approval of the Company s Financial Statements, believes it is not possible to predict either the duration or the outcome of the Operation or of the Internal Investigation. Additionally, the Company believes that

currently there is not enough information to determine whether a provision for losses is required or to disclose any contingency.

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 above mentioned proceedings, were strictly legal, and, therefore, the likelihood of loss with respect to said proceedings is possible (but not likely).

Labor Provisions

The Company is also defending against labor proceedings, for which there is a provision as of December 31, 2017 of R$517 million. None of these processes refers to significant amounts individually, and the lawsuits mainly involve labor claims for overtime, nighttime 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, 2017, represented R$129 million.

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Other Provisions

The Company is also involved in lawsuits arising from the ordinary course of its operations and reserves R$ 53 million for these actions. Deposits in guaranteed accounts related to these contingencies as of December 31, 2017 amount to almost R $ 39 million. Other contingent liabilities with remote possibility of losses, 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 was filed, alleging that Gerdau S.A. and other long steel producers in Brazil share customers, thus violating antitrust legislation. After investigations carried out by the Economic Law Department (SDE), 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 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 accounting 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 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 actions and both are found in recursal degree.

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 reversed.

Other Civil Litigation

The Company and its subsidiaries are parties to other civil claims that together have an amount of approximately R$191 million. For these claims, no accounting provision was made, since these were considered as possible losses, based on the opinion of its legal advisors.

Securities Class Action

On May 26, 2016, a securities class action complaint was filed in the United States District Court for the Southern District of New York against Gerdau and certain executives and former executives of the Company by purchasers of American Depositary Receipts (ADRs) of the Company that trade on the New York Stock Exchange. On August 9, 2016, the court appointed the Policemen s Annuity and Benefit Fund of Chicago as

lead plaintiff. On October 31, 2016, lead plaintiff filed an amended complaint under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 on behalf of a purported class of purchasers of Gerdau ADRs between April 23, 2012 and May 16, 2016. Among other things, the amended complaint alleged that the Company and certain executives had engaged in a bribery scheme involving members of the Brazilian Board of Tax Appeals (CARF), which had purportedly resulted in the nonpayment of approximately US$ 429 million in taxes and resulted in defendants statements in Gerdau s securities filings about Gerdau s business, operations, and prospects being false and misleading and/or lacking a reasonable basis. The amended complaint did not specify an amount of alleged damages, and it also included claims pertaining to the transaction relating to the acquisition of equity interests described in note (c) below. On January 17, 2017, the Company filed a motion to dismiss, but before its review by the Court, the parties asked for a stay of the proceedings, so that they could engage in a mediation process. As a result of the mediation process. On July 5, 2017 lead plaintiff and the defendants reached a settlement, in the amount of US$ 15 million, which was approved by the Court on October 20, 2017. As a result, the action was dismissed, with prejudice, as against lead plaintiff and the class of purchasers of Gerdau ADRs. The amount of the settlement was substantially covered by insurance. The settlement does not acknowledge any liability by the defendants and, in the opinion of the Company and its legal advisors, was the best alternative to eliminate the uncertainties, burdens and costs to be incurred if the dispute were to continue.

Administrative proceeding Brazilian Securities Comission (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

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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, 2017, in accordance with Brazilian GAAP, Gerdau S.A. s legal reserve amounted to R$ 628.2 million or 3.3 % 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 Common 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 common 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 common 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 ADRs 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 ADRs. 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 ADRs 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 ADRs, are not subject to Brazilian withholding tax.

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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 common 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.

Buyback Program

On January 8, 2018, the Board of Directors authorized the Company to buyback its shares within a period of up to 3 months from the date of authorization, with a limit 10,000,000 preferred shares (GGBR4) or American Depositary Receipts ADRs (GGB), representing in aggregate approximately 0.96% of the preferred shares comprising the free-float, which on November 30th, 2017 totaled 1,040,867,403 shares. The repurchased shares will serve the following purposes: (i) to meet the needs of the Long-Term Incentive Program of the Company and its subsidiaries, (ii) to be held in treasury, (iii) to be canceled or (iv) to be subsequently sold on the market.

ITEM 9. THE OFFER AND LISTING

A. OFFER AND LISTING DETAILS

Price Information

Preferred Stock

The following table presents high and low market prices in Brazilian *reais* for Gerdau S.A. preferred stock (GGBR4) listed on the São Paulo Stock Exchange (BOVESPA) for the periods shown, as well as the high and low market prices in U.S. dollars for the same period.

Closing Price GGBR4 Annual Basis (adjusted for dividends and events)

	Brazilian reais per Share		U.S. dollars per Share	
Year	**High**	**Low**	**High**	**Low**
2013	18.06	11.12	8.85	4.96
2014	17.27	7.84	7.22	2.92
2015	10.89	4.52	3.73	1.15
2016	14.62	3.27	4.31	0.79
2017	13.67	9.00	4.42	2.67

Source: Bloomberg

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Closing Price GGBR4 Quarterly Basis (adjusted for dividends and events)

Year	Brazilian reais per Share High	Brazilian reais per Share Low	U.S. dollars per Share High	U.S. dollars per Share Low
2016				
1Q	6.71	3.27	1.85	0.79
2Q	8.31	5.55	2.35	1.54
3Q	10.29	5.97	3.18	1.79
4Q	14.62	8.84	4.31	2.72
2017				
1Q	13.67	10.7	4.42	3.30
2Q	10.9	9.00	3.50	2.67
3Q	12.91	10.28	4.16	3.11
4Q	12.49	9.95	3.77	3.01

Source: Bloomberg

Closing Price GGBR4 Monthly Basis (adjusted for dividends and events)

Year	Brazilian reais per Share High	Brazilian reais per Share Low	U.S. dollars per Share High	U.S. dollars per Share Low
2017				
January	13.02	10.84	4.08	3.30
February	13.67	12.23	4.42	3.93
March	13.35	10.70	4.29	3.41
April	10.90	9.30	3.50	2.96
May	10.35	9.00	3.35	2.67
June	10.28	9.02	3.11	2.71
July	11.14	10.28	3.51	3.11
August	11.85	10.56	3.77	3.39
September	12.91	10.86	4.16	3.41
October	12.05	10.70	3.71	3.34
November	11.10	9.95	3.43	3.01
December	12.49	11.05	3.77	3.38
2018				
January	15.00	12.95	4.75	3.98
February	17.03	13.74	5.26	4.18
March, 29	15.65	15.07	4.74	4.56

Source: Bloomberg

The common and preferred stock are both traded in the market, but only the common stock has voting rights. According to the Company s bylaws, however, specific rights are guaranteed to the non-voting preferred shares. See Gerdau s bylaws, which are provided as an exhibit of this document.

American Depositary Receipts

The following table presents high and low market prices for Gerdau S.A. s American Depositary Receipts (ADRs) traded on the New York Stock Exchange (NYSE) for the periods shown:

Closing Price GGB Annual Basis (adjusted for dividends and events)

	U.S. dollars per Share	
Year	**High**	**Low**
2013	9.01	5.04
2014	7.26	2.89
2015	3.70	1.16
2016	4.28	0.80
2017	4.36	2.65

Source: Bloomberg

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Closing Price GGB Quarterly Basis (adjusted for dividends and events)

Year	U.S. dollars per Share High	Low
2016		
1Q	1.81	0.80
2Q	2.34	1.53
3Q	3.14	1.75
4Q	4.28	2.68
2017		
1Q	4.36	3.37
2Q	3.53	2.65
3Q	4.08	3.02
4Q	3.74	3.00

Source: Bloomberg

Closing Price GGB Monthly Basis (adjusted for dividends and events)

Year	U.S. dollars per Share High	Low
2017		
January	4.05	3.14
February	4.36	3.83
March	4.24	3.37
April	3.50	2.92
May	3.30	2.65
June	3.08	2.65
July	3.48	3.05
August	3.71	3.31
September	4.08	3.38
October	3.69	3.31
November	3.36	3.00
December	3.74	3.32
2018		
January	4.69	3.94
February	5.25	4.13
March, 29	4.71	4.53

Source: Bloomberg

Common Stock

The following table presents high and low market prices in Brazilian *reais* for Gerdau S.A. common stock (GGBR3) listed on the São Paulo Stock Exchange (BOVESPA) for the periods shown, as well as the high and low market prices in U.S. dollars for the same period.

Closing Price GGBR3 Annual Basis (adjusted for dividends and events)

	Brazilian reais per Share		U.S. dollars per Share	
Year	**High**	**Low**	**High**	**Low**
2013	15.52	10.03	7.64	4.49
2014	14.09	6.69	5.95	2.49
2015	8.23	3.33	3,03	0.83
2016	10.09	2.46	2,98	0.60
2017	12.88	7.67	4.14	2.34

Source: Bloomberg

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Closing Price GGBR3 Quarterly Basis (adjusted for dividends and events)

	Brazilian reais per Share		U.S. dollars per Share	
Year	**High**	**Low**	**High**	**Low**
2016				
1Q	4.85	2.46	1.35	0.60
2Q	5.85	3.90	1.65	1.09
3Q	7.29	4.32	2.25	1.29
4Q	10.09	6.43	2.98	1.98
2017				
1Q	12.23	7.67	3.94	2.34
2Q	10.63	8.95	3.41	2.65
3Q	12.88	10.16	4.14	3.07
4Q	11.99	9.42	3.69	2.90

Source: Bloomberg

Closing Price GGBR3 Monthly Basis (adjusted for dividends and events)

	Brazilian reais per Share		U.S. dollars per Share	
Year	**High**	**Low**	**High**	**Low**
2017				
January	9.34	7.67	2.89	2.34
February	9.45	8.69	3.07	2.76
March	12.23	9.15	3.94	2.95
April	10.63	9.07	3.41	2.89
May	10.15	8.95	3.28	2.65
June	10.16	8.97	3.07	2.69
July	11.1	10.16	3.50	3.07
August	11.77	10.51	3.74	3.37
September	12.88	10.75	4.14	3.38
October	11.99	10.6	3.69	3.31
November	10.92	9.54	3.34	2.91
December	10.55	9.42	3.18	2.90
2018				
January	12.88	10.88	4.01	3.34
February	13.83	11.79	4.27	3.64
March, 29	13.15	12.74	3.98	3.86

Source: Bloomberg

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 Depositary Corporation (Companhia Brasileira de Liquidação e Custódia) responsible for the settlement, clearing and depositary 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

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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 BOVESPA 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 BOVESPA. 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 BM&FBOVESPA which became effective on May 10, 2011. As of the effective date aforementioned, therefore, the companies listed on Level 1segment of BM&FBOVESPA 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 BM&FBOVESPA 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;

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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 Gerdau 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 BOVESPA or on the Brazilian over-the-counter markets (Brazilian OTC). The shares of a publicly held company, including Gerdau 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 BOVESPA, 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 BOVESPA may be suspended in anticipation of a material announcement. Trading may also be suspended at the initiative of the BOVESPA 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 N. 1,634, of May 6, 2016, as amended. This registration process is undertaken by the investor s legal representative in Brazil.

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 common 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, Gerdau shares are traded on two other stock exchanges:

New York Stock Exchange

On March 10, 1999, Gerdau S.A. obtained registration for the issuance of Level II ADRs, which began trading on the New York Stock Exchange the same day. Under the GGB symbol, these Level II ADRs have been traded in virtually every session since the first trading day. In 2017, 2.0 billion ADRs were traded, a figure 16.3% lower than in 2016, representing a trading volume of $7.0 billion, equivalent to a daily average of $27.7 million.

Latibex Madrid Stock Exchange

Since December 2, 2002, Gerdau 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 Gerdau 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.

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B. MEMORANDUM AND ARTICLES OF ASSOCIATION

Gerdau s bylaws have been registered with the Public Registry of the State of Rio de Janeiro (Junta Comercial do Rio de Janeiro) under company number (NIRE) 33.3.0003226-6.

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 December 29, 2017, as follows:

- Article 2: The Company, which shall be in existence for an undefined duration, has as its principal object, a) the participation in the capital of other companies with activities related to manufacture and sale of steel and/or metal products, some of its plants being integrated with ports, including activities of research, extraction, manufacturing, and sales of ores, the elaboration, execution and management of forestation and reforestation projects, as well as the sale, export or import of goods, the production of vegetable charcoal from its forests, the transport of goods that it has produced and its activities as a port operator, in accordance with the terms of Law No. 8,630 of February 25, 1993; e b) the exploration of the industry and the trade of steel products, rolled steel, drawn products and steel and iron articles, steel and other metals, including the representation, import and export of goods related to its industrial and commercial activities, technical assistance and service provision.

Objects and Purposes

According to the consolidated by-laws of the Company, its objects and purposes are described in the article 2, as stated below:

Article 2: The Company, which shall be in existence for an undefined duration, has as its principal object, a) the participation in the capital of other companies with activities related to manufacture and sale of steel and/or metal products, some of its plants being integrated with ports, including activities of research, extraction, manufacturing, and sales of ores, the elaboration, execution and management of forestation and reforestation projects, as well as the sale, export or import of goods, the production of vegetable charcoal from its forests, the transport of goods that it has produced and its activities as a port operator, in accordance with the terms of Law No. 8,630 of February 25, 1993; e b) the exploration of the industry and the trade of steel products, rolled steel, drawn products and steel and iron articles, steel and other metals, including the representation, import and export of goods related to its industrial and commercial activities, technical assistance and service provision.

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 (BM&FBOVESPA).

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, Section154, 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 j of the bylaws).

With regard to borrowing powers exercisable by the directors , the bylaws state that:

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- 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, § 7º: 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

Gerdau s 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 Gerdau´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.

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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.

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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 hall 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 the 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

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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 is 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. Gerdau 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. and Gerdau Trade Inc., concluded in each of 2009, 2010, 2013, 2014 and 2017, the issuance of bonds with maturities of 10 and 30 years (collectively, the Ten/Thirty Years Bonds). The following companies guaranteed these transactions: Gerdau S.A., Gerdau Açominas S.A. and Gerdau Aços Longos S.A. On December 31, 2017, the outstanding balance of these bonds was R$11.9 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, 2017, the outstanding loans under this line totaled US$54 million (R$178.6 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, 2017 the outstanding amount was R$ 450.5 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

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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$270.3 million as of December 31, 2017.

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 BOVESPA. 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 ADRs have been approved under the applicable law by the Central Bank and the CVM, the proceeds from the sale of the ADRs by ADR holders outside Brazil are free of Brazilian foreign investment controls and holders of the ADRs 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 ADRs (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 ADRs into foreign currency and remit the proceeds abroad. Subject to the provisions set forth in Annex V Regulations, holders of preferred ADRs may exchange such ADRs 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 ADRs 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.

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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 ADRs.

Restrictions on the remittance of foreign capital overseas could hinder or prevent the Custodian, as custodian for the Preferred Shares represented by Preferred ADRs, or holders who have exchanged Preferred ADRs 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 ADRs 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 ADRs.

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 .

ITEM 10. ADDITIONAL INFORMATION

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 ADRs. 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 ADRs 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 ADRs 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 voting shares of the Company. Prospective purchasers of common shares, preferred shares or ADRs 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 ADRs. 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 ADRs and any related documents will be performed in accordance with its terms.

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Brazilian Tax Considerations

The following discussion summarizes the main Brazilian tax consequences of the acquisition, ownership and disposition of common shares, preferred shares or ADRs 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 ADRs, are currently exempt from income tax in Brazil, as provided by art. 10 of Federal Law no. 9,249, of December 26, 1995.

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.

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).

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 ADRs are concerned, although the matter is not entirely clear, arguably the gains realized by a Non-Resident Holder on the disposition of ADRs are not taxed in Brazil, based on the argument that ADRs 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 ADRs 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 ADRs by a Non-Resident Holder will be subject to withholding

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income tax in Brazil, according to the rules described below.

In general, gains realized on the disposition of common or preferred shares (or ADRs, 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 ADRs, 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. Until December 31, 2016, this rate was 15%, as per Article 21 of Federal Law no. 8,981, of January 20, 1995. Federal Law no. 13,259, of March 16, 2016, amended said Federal Law no. 8,981/95 and, as of January 1, 2017, rendered capital gains realized by resident individuals 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).

The rules contained in Federal Law no. 13,259/16 are also applicable on the disposition of common or preferred shares (or ADRs, in case they are deemed assets located in Brazil) that is not carried out on a Brazilian stock exchange. Such increase, however, shall have no impact as regards transactions carried out (i) on the Brazilian stock exchange, as well as (ii) by a Non-Resident Holder resident or domiciled in a Tax

Favorable Jurisdiction (whether or not on the Brazilian stock exchange).

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 ADRs, 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 ADRs, 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.

Any exercise of preemptive rights relating to the common or preferred shares or ADRs 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 ADRs will be subject to Brazilian income tax according to the same rules described above.

A Non-Resident Holder of ADRs may cancel such ADRs 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 ADRs are not deemed assets located in Brazil .

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The deposit of common or preferred shares by a Non-Resident Holder in exchange for ADRs 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 ADRs, 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

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 ADRs, 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

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ADRs.

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 ADRs by a U.S. holder (as defined below) holding such shares or ADRs 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 ADR, 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 Company s voting stock, investors that hold the Preferred Shares or Preferred ADRs 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 ADR 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 ADR 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 ADR, 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 ADR 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 ADRs.

Nature of Preferred ADRs 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 ADRs 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 ADR 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 ADRs will be the same for Preferred Shares in the Company, and exchanges of Preferred Shares for Preferred ADRs, and Preferred ADRs 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 ADRs, 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

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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 ADR, 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 ADR, 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 Depositary 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 Depositary 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 Depositary 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 ADRs 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 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.

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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 ADRs. 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 apply. 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

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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 common stock.

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. The Company s filings are also available to the public through the Internet at Gerdau s website at 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. 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.

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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 derivate 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, 2017, 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$ 129,209 thousands and R$ 79,088 thousands after the effects arising from the changes in the net investment hedge described in note 15.g - (R$ 253,294 thousands and R$ 177,711 thousands as of December 31, 2016, 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$ 54,908 thousands as of December 31, 2017 (R$ 63,416 thousands as of December 31, 2016) 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.

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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, 2017, totals R$ 369,176 thousands (R$ 376,517 thousands as of December 31, 2016) and the variation in the price of raw materials and other inputs totals R$ 234,239 thousands as of December 31, 2017 (R$ 228,637 thousands as of December 31, 2016). 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 ADRs, which began trading on the New York Stock Exchange the same day. Under the GGB symbol, these Level II ADRs 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 ADRs, 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 ADR facility. There are

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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 2017, the depositary reimbursed the Company in the amount of R$ 6.1 million (equivalent to US$ 1.9 million considering the average quotation in 2017).

The depositary collects its fees for delivery and surrender of ADRs directly from investors depositing shares or surrendering ADRs 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 ADR holders may be required to pay or incur are the following:

Depository Service	**Fee payable by ADR holder**
Transferring, splitting or grouping receipts	$1.50 per transfer of ADRs
Depositary services	$0.05 or less per ADR
Withdrawal or deposit/issuance and cancellations of shares underlying ADRs	$5.00 or less per 100 ADRs
Cash distributions	$0.05 or less per ADR

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, 2017, 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 Legal Director, Andre Areno, 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.

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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, 2017, 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, 2017.

KPMG Auditores Independentes, 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.

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).

The Company did not grant any waiver from the Code provisions in the last fiscal year.

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ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The following table provides information on fees billed to Gerdau 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 year ended December 31, 2017 and PricewaterhouseCoopers Auditores Independentes for the year ended December 31, 2016:

	2017	2016
Audit fees	8,751	14,368
Audit-related fees		290
All other fees	715	74
Total	**9,466**	**14,732**

Audit fees are related to professional services rendered in the auditing of Gerdau s Consolidated Financial Statements, quarterly reviews of Gerdau 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 Gerdau and of Gerdau 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 consulting 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 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 .

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The Board of Auditors members are elected at the Ordinary Shareholders Meeting for one-year terms. They are eligible for reelection. In Gerdau 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

During the calendar year of 2017 the Company did not purchase any shares of its own issuance.

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, Gerdau 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 303.A.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

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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**

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Reports of independent registered public accounting firms	F-2
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Consolidated statements of comprehensive income for the years ended December 31, 2017, 2016 and 2015	F-8
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(b) **List of Exhibits**

1.01	Bylaws of Gerdau S.A.*******
2.(a)(1)	Corporate Governance Level 1 BOVESPA**
2.(a)(2)	Deposit Agreement dated July 1, 2013, among the Company, the JPMORGAN CHASE BANK, N.A., as Depositary and all holders from time to time of American Depositary Receipts issued thereunder. *
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	Gerdau SA Equity Incentive Plan, Equity Ownership Plan and Long-Term Incentive Plan (for Gerdau Ameristeel)***
4.02	Gerdau Special Steel North America Equity Incentive Plan****
11.01	Code of Ethics*****
12.01	Certification of the Chief Executive Officer under Item 15
12.02	Certification of the Chief Financial Officer under Item 15
13.01	Certification pursuant to 18 U.S.C. Section 1350
13.02	Certification pursuant to 18 U.S.C. Section 1350
23.01	Consent of KPMG Auditores Independentes
23.02	Consent of PricewaterhouseCoopers Auditores Independentes
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

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* Incorporated by reference to the Company s Registration Statement on Form F-6 (File No. 333-189475), filed with the Securities and Exchange Commission on June 20, 2013.

**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

*** 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.

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***** 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.

****** 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.

******* 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 March 24, 2014.

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.

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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
Dated: April 2, 2018	Title:	Chief Financial Officer

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GERDAU S.A.

Consolidated financial statements

as of December 31, 2017 and 2016

and for each of the three years in the period

ended December 31, 2017

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

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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, 2017, the related consolidated statements of income, comprehensive income, changes in equity, and cash flows for the year ended December 31, 2017, 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, 2017, 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, 2017, and the results of its operations and its cash flows for the year ended December 31, 2017, 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, 2017, 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.

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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.

/s/ KPMG Auditores Independentes

We have served as the Company s auditor since 2017.

Porto Alegre, Brazil
April 2, 2018

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Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of

Gerdau S.A.

In our opinion, the accompanying consolidated balance sheet as of December 31, 2016 and the related consolidated statements of income/(loss), of comprehensive income/(loss), of changes in equity and of cash flows for each of the two years in the period ended December 31, 2016 present fairly, in all material respects, the financial position of Gerdau S.A. and its subsidiaries as of December 31, 2016, and the results of their operations and their cash flows for each of the two years in the period 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 audits. We conducted our audits 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 audits provide a reasonable basis for our opinion.

/s/PricewaterhouseCoopers Auditores Independentes

Porto Alegre, Brazil, March 14, 2017

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GERDAU S.A.

CONSOLIDATED BALANCE SHEETS

as of December 31, 2017 and 2016

In thousands of Brazilian reais (R$)

	Note	2017	2016
CURRENT ASSETS			
Cash and cash equivalents	4	2,555,338	5,063,383
Short-term investments			
Held for Trading	4	821,518	1,024,411
Trade accounts receivable - net	5	2,798,420	3,576,699
Inventories	6	6,701,404	6,332,730
Tax credits	7	402,429	504,429
Income and social contribution taxes recoverable		487,633	623,636
Unrealized gains on financial instruments	15		2,557
Assets held for sale	3.4	3,745,634	
Other current assets		469,737	668,895
		17,982,113	17,796,740
NON-CURRENT ASSETS			
Tax credits	7	30,841	56,703
Deferred income taxes	8	3,054,393	3,407,230
Unrealized gains on financial instruments	15		10,394
Related parties	18	51,839	57,541
Judicial deposits	17	2,051,181	1,861,784
Other non-current assets		542,973	447,260
Prepaid pension cost	19	1,149	56,797
Investments in associates and jointly-controlled entities	9	1,280,299	798,844
Goodwill	11	7,891,142	9,470,016
Other Intangibles	12	972,089	1,319,941
Property, plant and equipment, net	10	16,443,742	19,351,891
		32,319,648	36,838,401
TOTAL ASSETS		50,301,761	54,635,141

The accompanying notes are an integral part of these Consolidated Financial Statements.

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GERDAU S.A.

CONSOLIDATED BALANCE SHEETS

as of December 31, 2017 and 2016

In thousands of Brazilian reais (R$)

	Note	2017	2016
CURRENT LIABILITIES			
Trade accounts payable		3,179,954	2,743,818
Short-term debt	13	2,004,341	4,458,220
Taxes payable	16	284,101	341,190
Income and social contribution taxes payable		70,242	74,458
Payroll and related liabilities		443,859	464,494
Employee benefits	19	253	409
Environmental liabilities	20	21,928	17,737
Unrealized losses on financial instruments	15		6,584
Liabilities held for sale	3.4	1,084,032	
Other current liabilities		625,410	514,599
		7,714,120	8,621,509
NON-CURRENT LIABILITIES			
Long-term debt	13	14,457,315	15,959,590
Debentures	14	47,928	165,423
Deferred income taxes	8	82,686	395,436
Unrealized losses on financial instruments	15	1,267	
Provision for tax, civil and labor liabilities	17	827,883	2,239,226
Environmental liabilities	20	63,263	66,069
Employee benefits	19	1,424,611	1,504,394
Obligations with FIDC	21	1,135,077	1,007,259
Other non-current liabilities		653,670	401,582
		18,693,700	21,738,979
EQUITY	22		
Capital		19,249,181	19,249,181
Treasury stocks		(76,085)	(98,746)
Capital reserves		11,597	11,597
Retained earnings		3,315,374	3,763,207
Operations with non-controlling interests		(2,870,831)	(2,873,335)
Other reserves		4,015,965	3,976,232
EQUITY ATTRIBUTABLE TO THE EQUITY HOLDERS OF THE PARENT		23,645,201	24,028,136
NON-CONTROLLING INTERESTS		248,740	246,517
EQUITY		23,893,941	24,274,653
TOTAL LIABILITIES AND EQUITY		50,301,761	54,635,141

The accompanying notes are an integral part of these Consolidated Financial Statements.

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GERDAU S.A.

CONSOLIDATED STATEMENTS OF INCOME

for the years ended December 31, 2017, 2016 and 2015

In thousands of Brazilian reais (R$), except for per share data

	Note	2017	2016	2015
NET SALES	24	36,917,619	37,651,667	43,581,241
Cost of sales	29	(33,312,995)	(34,187,941)	(39,290,526)
GROSS PROFIT		3,604,624	3,463,726	4,290,715
Selling expenses	29	(524,965)	(710,766)	(785,002)
General and administrative expenses	29	(1,129,943)	(1,528,262)	(1,797,483)
Other operating income	29	260,618	242,077	213,431
Other operating expenses	29	(168,887)	(114,230)	(116,431)
Impairment of assets	28	(1,114,807)	(2,917,911)	(4,996,240)
Gains and losses on assets held for sale and sales of interest in subsidiaries and associate company	3.4	(721,682)	(58,223)	
Reversal of contingent liabilities, net	17	929,711		
Equity in earnings of unconsolidated companies	9	(34,597)	(12,771)	(24,502)
INCOME (LOSS) BEFORE FINANCIAL INCOME (EXPENSES) AND TAXES		1,100,072	(1,636,360)	(3,215,512)
Financial income	30	226,615	252,045	378,402
Financial expenses	30	(1,726,284)	(2,010,005)	(1,780,366)
Exchange variations, net	30	(4,057)	851,635	(1,564,017)
Reversal of monetary update of contingent liabilities, net	17	369,819		
Gains and losses on financial instruments, net	30	(9,441)	(38,930)	87,085
INCOME (LOSS) BEFORE TAXES		(43,276)	(2,581,615)	(6,094,408)
Current	8	(313,758)	(110,511)	(158,450)
Deferred	8	18,367	(193,803)	1,656,872
Income and social contribution taxes		(295,391)	(304,314)	1,498,422
NET INCOME (LOSS)		(338,667)	(2,885,929)	(4,595,986)
ATTRIBUTABLE TO:				
Owners of the parent		(359,360)	(2,890,811)	(4,551,438)
Non-controlling interests		20,693	4,882	(44,548)
		(338,667)	(2,885,929)	(4,595,986)
Basic earnings/(loss) per share - preferred and common - (R$)	23	(0.21)	(1.70)	(2.69)
Diluted earnings/(loss) per share - preferred and common - (R$)	23	(0.21)	(1.70)	(2.69)

The accompanying notes are an integral part of these Consolidated Financial Statements.

GERDAU S.A.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME/(LOSS)

for the years ended December 31, 2017, 2016 and 2015

In thousands of Brazilian reais (R$)

	2017	2016	2015
Net income (loss) for the year	**(338,667)**	**(2,885,929)**	**(4,595,986)**
Items that may be reclassified subsequently to profit or loss			
Other comprehensive income from associates and jointly-controlled entities	(16,745)	(251,195)	417,961
Cumulative translation adjustment	409,280	(5,036,586)	8,835,306
Recycling of cumulative translation adjustment to net income	(76,430)	(1,237,175)	
Unrealized (Losses) Gains on net investment hedge	(148,560)	1,679,312	(3,613,178)
Cash flow hedges			
Unrealized (Losses) Gains	(11,364)	212	17,283
	156,181	(4,845,432)	5,657,372
Items that will not be reclassified subsequently to profit or loss			
Remeasurement on defined benefit pension plan	(115,880)	(42,181)	32,962
	(115,880)	**(42,181)**	**32,962**
Other comprehensive income (loss), net of tax	**40,301**	**(4,887,613)**	**5,690,334**
Total comprehensive income (loss) for the year, net of tax	**(298,366)**	**(7,773,542)**	**1,094,348**
Total comprehensive income/(loss) attributable to:			
Owners of the parent	(325,260)	(7,743,624)	1,035,164
Non-controlling interests	26,894	(29,918)	59,184
	(298,366)	**(7,773,542)**	**1,094,348**

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.

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GERDAU S.A.

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

for the years ended December 31, 2017, 2016 and 2015

in thousands of Brazilian reais (R$)

	Attributed to parent company s interest											
					Retained earnings						Other reserves	
	Capital	Treasury stocks	Capital Reserve	Legal reserve	Tax Incentives Reserve	Investments and working capital reserve	Retained earnings	Operations with non-controlling interests	Gains and losses on net investment hedge	Gains and losses on financial instruments	Cumulative translation adjustment	Pens
Balance as of January 1, 2015 (Note 22)	19,249,181	(233,142)	11,597	628,228	611,531	10,475,045		(1,732,962)	(2,472,853)	(923)	5,874,714	
2015 Changes in Equity												
Net loss							(4,551,438)					
Other comprehensive income (loss) recognized in the year									(3,610,435)	17,007	9,147,164	
Total comprehensive income (loss) recognized in the year							(4,551,438)		(3,610,435)	17,007	9,147,164	
Supplementary dividend						944						
Stock option expenses recognized in the year												
Treasury stocks		(186,033)										
Stock option exercised during the year		35,812				(3,275)						
Effects of interest changes in subsidiaries								(1,144,526)				
Absorption of net loss proposed to the shareholders						(4,551,438)	4,551,438					
Dividends/interest on capital						(252,976)						
Balance as of December 31, 2015 (Note 22)	19,249,181	(383,363)	11,597	628,228	611,531	5,668,300		(2,877,488)	(6,083,288)	16,084	15,021,878	
2016 Changes in Equity												
Net loss							(2,890,811)					
Other comprehensive income (loss) recognized in the year									1,678,852	239	(6,489,813)	

Total comprehensive income (loss) recognized in the year							(2,890,811)		1,678,852	239	(6,489,813)
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)					
Balance as of December 31, 2016 (Note 22)	19,249,181	(98,746)	11,597	628,228	611,531	2,523,448		(2,873,335)	(4,404,436)	16,323	8,532,065
2017 Changes in Equity											
Net loss							(359,360)				
Other comprehensive income (loss) recognized in the year									(148,548)	(11,351)	309,385
Total comprehensive income (loss) recognized in the year							(359,360)		(148,548)	(11,351)	309,385
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			
Absorption of net loss proposed to the shareholders						(359,360)	359,360				
Dividends/interest on capital						(85,462)					
Balance as of December 31, 2017 (Note 22)	19,249,181	(76,085)	11,597	628,228	611,531	2,075,615		(2,870,831)	(4,552,984)	4,972	8,841,450

The accompanying notes are an integral part of these Consolidated Financial Statements.

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GERDAU S.A.

CONSOLIDATED STATEMENTS OF CASH FLOWS

for the years ended December 31, 2017, 2016 and 2015

In thousands of Brazilian reais (R$)

	Note	2017	2016	2015
Cash flows from operating activities				
Net income (loss) for the year		(338,667)	(2,885,929)	(4,595,986)
Adjustments to reconcile net income for the year to net cash provided by operating activities				
Depreciation and amortization	29	2,092,551	2,535,955	2,607,909
Impairment of Assets	28	1,114,807	2,917,911	4,996,240
Equity in earnings of unconsolidated companies	9	34,597	12,771	24,502
Exchange variation, net	30	4,057	(851,635)	1,564,017
Losses (Gains) on financial instruments, net	30	9,441	38,930	(87,085)
Post-employment benefits		192,724	229,767	233,287
Stock based remuneration		35,576	46,683	48,589
Income tax	8	295,391	304,314	(1,498,422)
Gains on disposal of property, plant and equipment		(69,510)	(43,340)	(3,971)
Gains and losses on assets held for sale and sales of interest in subsidiaries and associate company	3.4	721,682	58,223	
Allowance for doubtful accounts	5	18,342	68,781	127,701
Provision for tax, labor and civil claims	17	(110,281)	347,882	323,314
Reversal of contingent liabilities, net	17	(929,711)		
Interest income on investments		(75,387)	(107,980)	(153,631)
Interest expense on loans	30	1,323,448	1,540,797	1,471,526
Reversal of monetary update of contingent liabilities, net	17	(369,819)		
Interest on loans with related parties	18	(95)	2,457	(2,712)
(Reversal) Provision for net realisable value adjustment in inventory	6	(20,195)	(31,492)	17,536
		3,928,951	4,184,095	5,072,814
Changes in assets and liabilities				
(Increase) Decrease in trade accounts receivable		(54,690)	64,805	1,219,605
(Increase) Decrease in inventories		(1,269,455)	794,591	1,977,361
Increase (Decrease) in trade accounts payable		800,164	110,466	(768,627)
Increase in other receivables		(371,745)	(275,938)	(270,391)
Decrease in other payables		(56,909)	(287,487)	(509,227)
Dividends from joint ventures		40,644	124,495	52,769
Purchases of trading securities		(2,390,104)	(880,436)	(1,958,522)
Proceeds from maturities and sales of trading securities		2,905,411	1,089,972	3,929,971
Cash provided by operating activities		3,532,267	4,924,563	8,745,753
Interest paid on loans and financing		(1,330,116)	(1,240,165)	(946,041)
Income and social contribution taxes paid		(126,023)	(168,032)	(637,394)
Net cash provided by operating activities		2,076,128	3,516,366	7,162,318
Cash flows from investing activities				
Purchases of property, plant and equipment	10	(873,329)	(1,323,891)	(2,324,718)
		554,457	308,694	90,942

Proceeds from sales of property, plant and equipment, investments and other intangibles				
Purchases of other intangibles	12	(37,939)	(54,044)	(126,428)
Payment for business acquisitions, net of cash of acquired entities				(20,929)
Capital increase in jointly-controlled entity		(178,670)		(40,524)
Net cash used in investing activities		(535,481)	(1,069,241)	(2,421,657)
Cash flows from financing activities				
Purchase of treasury shares			(95,343)	(189,071)
Dividends and interest on capital paid		(86,386)	(85,962)	(358,226)
Proceeds from loans and financing		3,265,860	2,455,371	3,042,783
Repayment of loans and financing		(7,241,401)	(4,605,406)	(5,028,386)
Intercompany loans, net		5,797	(6,492)	30,126
Increase in controlling interest in subsidiaries				(339,068)
Net cash used in financing activities		(4,056,130)	(2,337,832)	(2,841,842)
Exchange variation on cash and cash equivalents		7,438	(693,990)	699,290
(Decrease) Increase in cash and cash equivalents		(2,508,045)	(584,697)	2,598,109
Cash and cash equivalents at beginning of year		5,063,383	5,648,080	3,049,971
Cash and cash equivalents at end of year		2,555,338	5,063,383	5,648,080

The accompanying notes are an integral part of these Consolidated Financial Statements.

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NOTE 1 - GENERAL INFORMATION

Gerdau S.A. is a publicly traded corporation *(sociedade anônima)* with its corporate domicile in the city of Rio de Janeiro, 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 April 2, 2018.

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 for December 31, 2017.

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 method of accounting.

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 investees. 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.

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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 Reais (R$), which is the functional and reporting currency of the Company.

b) Transactions and Balances

For purposes of the Consolidated Financial Statements, the balances of each subsidiary of the Company are translated into Brazilian reais, which is the functional currency of the Company and the reporting currency of its Consolidated Financial Statements.

c) Group Companies

Income and loss from operations and financial position of all subsidiaries included in the Consolidated Financial Statements, along with equity method of accounting, 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; and

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 derived from the changes in assets, liabilities and income and expenses translated, as detailed above.

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 at the measurement currency unit at 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 (Bolívar Forte) to Real considers the local exchange rate known as SIMADI (*Sistema Marginal de Divisas*), which is used in conversions from Bolívar Forte to American Dollar as a reference to local currency translation into Real. This rate is equivalent to 1,011.19 Bolívar Forte to each 1 Real as of December 31, 2017 (206.61 Bolivar Forte to each 1 Real as of December 31, 2016).

2.3 - Financial Assets

The Company measures its derivative financial instruments based on their fair value on the balance sheet date, being the most relevant evidence of fair value the quotations obtained from market participants. The fair value recognized in its Consolidated Financial Statements may not necessarily represent the amount of cash that the Company would receive or pay, as applicable, if the Company would have settled the transactions on the balance sheet date.

The Company classifies its financial assets, upon initial recognition, in the following categories: financial assets at fair value through profit or loss, loans and receivables and available for sale (when applicable). The classification depends on the objective for which the financial assets where acquired, as detailed in Note 15.

a) Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss are financial assets held for trading and include Bank Deposit Certificates and marketable securities. Financial assets at fair value through profit or loss are initially recognized at fair value and the transaction costs are expensed immediately in the income statement.

b) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. The Company s loans and receivables comprise Accounts receivable and other receivables , Cash and cash equivalents and Judicial deposits . They are presented as current assets, except for those with maturities greater than 12 months after the end of the reporting period, which are classified as non-current assets.

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c) Derivative financial instruments and hedging activities

Derivatives are initially recognized at fair value on the date a derivative contract is entered into and are, subsequently, remeasured to their fair value. The method of recognizing the resulting gain or loss depends on whether the derivative is designated or not as a hedging instrument and for which hedge accounting has been adopted. If this is the case, the method also depends on the nature of the item being hedged as well as the effectiveness of the hedging relationship. As described in note 15, the Company applies hedge accounting.

d) Derivatives at fair value through profit or loss

Certain derivative instruments do not qualify for hedge accounting. Changes in the fair value of these derivative instruments are recognized immediately in the income statement under Gains and losses on financial instruments, net .

e) Cash and Cash Equivalents

Cash and cash equivalents include cash, bank accounts and highly liquid investments with original maturities of 90 days or less with insignificant risk of changes in fair value and are stated at cost plus accrued interest, when applicable.

f) Short-term Investments

Held for trading securities are stated at fair value and recognized through profit and loss (held for trading), since the purpose of the investment is to earn short-term gains. Interest, monetary corrections, and exchange variation, when applicable, as well as changes in fair value are recognized in the income statement when incurred.

g) Trade Accounts Receivable

Trade accounts receivable are stated at amortized cost and accounts receivable from foreign customers are translated based on the exchange rates in effect at the balance sheet date. The allowance for doubtful accounts is determined based on a risk assessment, which considers historical losses, the individual situation of each customer and the situation of the economic group to which they belong, available collateral and guarantees and the opinion of legal counsel. The allowance is considered sufficient to cover any losses incurred on uncollectible receivables. Information on the breakdown of current and past-due trade accounts receivable and the related allowance for doubtful accounts is provided in note 5.

The Company s maximum exposure to credit risk is its balance of trade accounts receivable, net of allowance for doubtful accounts. The credit quality of the current trade accounts receivable is considered proper and the amount of the effective risk of eventual losses in trade accounts receivable is presented as allowance for doubtful accounts.

h) Impairment of Financial Assets

Financial assets are assessed at each balance sheet date for evidence of impairment. They are considered impaired when there is evidence that one or more events have occurred after the initial recognition of the financial asset and such event or events had a negative impact on the estimated future cash flows of the investment. The criteria used to determine whether there is evidence of an impairment loss include, among other factors: (i) significant financial difficulty of the issuer or debtor, and (ii) domestic or local economic conditions that correlate with defaults on the assets in portfolio.

2.4 Inventories

Inventories are measured at the lower of historical average 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 in accordance with IAS 29, less depreciation, except for land, which is not depreciated. The Company monthly capitalizes 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

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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 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 of the net 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, whenever evidence is available that the investment may be impaired.

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

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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 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 believes that there is no 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) Classification as Debt or Equity

Debt or equity instruments are classified based on the substance of the contractual terms of the instruments.

b) Short and Long-Term Debt

They are stated net of transaction costs, and are subsequently measured at the amortized cost using the effective interest method.

c) Equity Instruments

An equity instrument is based on a contract that evidences a residual interest in the assets of an entity after deducting its liabilities.

d) 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 hedge s inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items. When a cash flow hedge instrument is sold, terminated, expires or is exercised, the hedge is discontinued prospectively, however the cumulative unrealized gains and losses remains registered in comprehensive income when the hedged item is registered in the statement of income. When a transaction is no longer expected to occur, the cumulative gains and losses are immediately reclassified to the income statement. In the net investment hedge the amount registered is reclassified to the income statement when the hedged investment is disposed of. Additionally, changes in the fair value of financial instruments not designated for hedge are registered as Gain and losses on financial instruments, net, in the income statement.

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.

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 full 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 are 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 contingencies, and provision for losses, 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.

The Company only recognizes a provision on tax issues if a past event leads to a present obligation. The Company determines whether a present obligation exists at the reporting date by taking into consideration all available evidence, including, for example, the opinion of legal advisors. The Company also considers whether it is probable that there will be an outflow of assets and a reliable estimate can be made of the amount of the obligation.

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 and reviewed by management, 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, actuarial calculations consider 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. requires dividends of not less than 30% of the annual net income; 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.

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2.15 Revenue Recognition

Net sales are presented net of taxes and discounts. Taxes on sales are recognized when sales are invoiced and discounts on sales are estimated and recognized upon sale. Revenues from sales of products are recognized when the sales amount can be reliably measured, the Company no longer has control over the goods sold or any other responsibility attributable to its ownership, the costs incurred or that will be incurred related to the transaction can be reliably measured, it is more likely than not that the economic benefits will be received by the Company, and the risks and benefits of the products have been fully transferred to the buyer. 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 Estimates

In the preparation of the Consolidated Financial Statements estimates are required 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), recoverable amount of deferred income taxes (note 8), 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 valuation 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, which also includes previous amounts recognized in Other comprehensive income, are reclassified to profit or loss, which considers same treatment as 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.

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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 under IAS 28 or IAS 39.

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, United States and India).

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 diluted earnings per share has been based on weighted average number of shares outstanding after adjustment for the effects of all dilutive potential ordinary shares. Instruments with dilutive potential effects are represented by the share-based payments discussed in note 25.

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. The reclassification of assets and liabilities to assets held for sale and liabilities held for sale is a non-cash transaction and it does not affect the Consolidated Statements of Cash Flows.

2.23 - New IFRS and Interpretations of the IFRIC (International Financial Reporting Interpretations Committee)

Some new IASB accounting standards and IFRIC interpretations were issued and/or reviewed and have their mandatory adoption for the year 2018 and/or after.

• IFRS 9 - Financial Instruments. It replaces IAS 39 and it is effective for years beginning on or after January 1, 2018. IFRS 9 contains a new approach to the classification and measurement of financial assets that should reflect the business model and expectation of cash flow used by the Company in the management of its financial assets. Financial assets will be classified into three categories, which are: (i) measured at amortized cost; (ii) fair value through other comprehensive income; and (iii) fair value through profit or loss. The standard eliminates the categories in IAS 39: held to maturity , loans and receivables and available for sale . IFRS 9 replaces the losses incurred model with a prospective expected credit loss model. This change will require a judgment on how the change or expectation of change in economic factors affects the expected credit losses, which will be determined on the basis of weighted probabilities. The Company s financial assets represented by cash and cash equivalents, trade accounts receivable and other assets have not presented an increase in credit risk and there is also no expectation of an increase in credit risk as of December 31, 2017 and no significant increase in the provision for expected losses in relation to Provision for credit risk. The impacts arising from IFRS 9 on the Company s equity at January 1, 2018 are immaterial, and any differences in the carrying amounts of financial assets and financial liabilities resulting from the adoption of IFRS 9 will be recognized in retained earnings at January 1, 2018.

• IFRS 15 - Revenue from Contracts with Customers and subsequently the issuance of document for clarification on this standard.

IFRS 15 provides a comprehensive framework for determining whether, when and by what amount a revenue should be recorded. This pronouncement replaces IAS 18 - Revenues and IAS 11 - Construction Contracts and will be effective for fiscal years beginning on or after January 1, 2018. IFRS 15 provides more detail for revenue recognition, stating that it should be recorded when the performance obligation is met, ie when the control of the goods or services of a particular transaction is transferred to the customer and establishing, also, more detail in the disclosures. Revenues are currently recognized when the products are delivered to the customer,

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and the performance obligation is fulfilled at that time. Revenue is recognized at this time as long as revenue and costs can be measured reliably, receipt of the consideration is probable and there is no continuous involvement of management with the products. In accordance with IFRS 15, revenue must be recognized when the customer obtains control of the products. Based on this, the Company does not expect a significant impact on its Financial Statements by the adoption of IFRS 15. Additionally, based on the Company s assessment, the fair value and sales prices and conditions agreed with the clients (such as discounts and shipping costs) are broadly similar, the Company does not expect the application of IFRS 15 to result in material differences in recognition and measurement of revenue. For the purposes of the transition requirements the company intends to apply the retrospectively method with the cumulative effect of initially applying this standard recognized as an adjustment to the opening balance of retained earnings at January 1, 2018. No adjustment is expected at the transition date.

• IFRS 16 - Lease. Establishes aspects of recognition, measurement and disclosure of leases. This standard is effective for fiscal years beginning on or after January 1, 2019. The Company is in initial evaluation process of impacts on its financial statements of the adoption of the standard, however, no material impacts are expected considering the relevance of current lease contracts.

• Amendments to IFRS 2 - Classification and Measurement of Share-based Payment Transactions. It addresses changes in some paragraphs to better clarify the application of the standard. This change in the standard is effective for years beginning on or after January 1, 2018 and it will not have material impact in the Company s Financial Statements.

• 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 is evaluating the impacts on its Financial Statements, however, no material impact is expected in the Company s Financial Statements.

NOTE 3 - CONSOLIDATED FINANCIAL STATEMENTS

3.1 - Subsidiaries

Listed below are the significant consolidated subsidiaries, as follows:

			Equity Interests Total capital (*)	
Consolidated company	**Country**	**2017**	**2016**	**2015**
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.	Brazil	99.36	99.35	99.35
Gerdau Aços Longos S.A. and subsidiary (2)	Brazil	99.12	99.11	99.11
Gerdau Steel Inc.	Canada	100.00	100.00	100.00
Gerdau Holdings Inc. and subsidiary (3)	USA	100.00	100.00	100.00
Paraopeba - Fixed-income investment fund (4) (**)	Brazil	10.69	70.93	65.75
Gerdau Holdings Europa S.A. and subsidiaries	Spain			100.00
Gerdau América Latina Participações S.A.	Brazil		99.12	99.12
Gerdau Chile Inversiones Ltda. and subsidiaries (5)	Chile	99.00	99.00	99.99
Gerdau Aços Especiais S.A.	Brazil		99.55	99.56
Gerdau Hungria Holdings Limited Liability Company and subsidiaries (6)	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
Diaco S.A. and subsidiary (note 3.4)	Colombia		99.68	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	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	99.96	99.96
Cleary Holdings Corp.	Colombia			100.00
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	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 Metalurgica Gerdau S.A. in the investment fund is 51.11% in 2017, 91.58% in 2016 and 82.64% in 2015.

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

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TAMCO Steel, Chaparral Steel Company.

(2) Subsidiary: Gerdau Açominas Overseas Ltd.

(3) Subsidiary: Gerdau MacSteel Inc.

(4) Fixed-income investment fund managed by Banco JP Morgan S.A..

(5) Subsidiaries: Aza Participaciones S.A., Gerdau Aza S.A., Armacero Matco S.A., Aceros Cox Comercial S.A., Salomon Sack S.A..

(6) Subsidiaries: Gerdau Hungria y Cia SRC, Bogey Holding Company Spain S.L.

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

(8) Subsidiary: Siderco S.A.

3.2 Joint ventures

Listed below are the interests in joint ventures:

			Equity Interests Total capital(*)	
Joint ventures	**Country**	**2017**	**2016**	**2015**
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.	45.00	45.00	45.00
Gerdau Summit Aços Fundidos e Forjados S.A.	Brazil	58.73		
Diaco S.A.	Colombia	49.87		

(*)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.

On January 5, 2017, Gerdau S.A. subscribed capital stock in Gerdau Summit Aços Fundidos e Forjados S.A. through the contribution of some of its assests and liabilities, which were valued by specialized independent valuation firm. On January 31, 2017, the Extraordinary General Meeting of Gerdau Summit Aços Fundidos e Forjados S.A. was held, where Sumitomo Corporation and The Japan Steel Works, Ltd. subscribed capital stock in this company, and a joint control agreement was signed among the partners. Accordingly, Gerdau Summit Aços Fundidos e Forjados S.A. will have accounting treatment of a joint venture in the Financial Statements of Gerdau S.A., with a 58.73% interest and will not have a significant impact on the Company s total Assets.

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, with an annual installed steel capacity of 674 thousand tons. The transaction attributed an economic value to the joint venture of US$ 165 million (equivalent to R$ 546 million). The transaction is aligned with the process to optimize Company s assets with focus on profitability and deleveraging and allowed the Company to reduce its indebtedness and working capital levels in the amounts of R$ 226 million and R$ 175 million, respectively. Due to this transaction, Diaco started to have accounting treatment of joint venture in Consolidated Financial Statements with a 49.87% interest.

The summarized financial information of the joint venture, accounted for under the equity method, is shown as follows:

	Joint ventures	
	2017	**2016**
Net income	(91,553)	(126,723)
Total comprehensive income	(91,553)	(126,723)

3.3 Associate companies

Listed below are the interests in associate companies:

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Associate companies	Country	Equity interests Total capital (*) 2017	2016	2015
Dona Francisca Energética S.A.	Brazil	51.82	51.82	51.82
Corsa Controladora, S.A. de C.V. and subsidiaries	Mexico	49.00	49.00	49.00
Corporación Centroamericana del Acero S.A. and subsidiaries	Guatemala			30.00

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

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 as follows:

	Associate Companies 2017	2016
Net income	26,099	141,023
Total comprehensive income	26,099	141,023

3.4 Gains and losses on assets held for sale and sales of interest in subsidiaries and associate company

I) Subsidiaries, Associate company and Joint ventures

In 2017, as a result of the operation described in note 3.2, the Company received US$ 44.7 million in cash (equivalent to R$ 147.9 million) and recognized an expense of R$ 72.5 million in the line gains and losses on assets held for sale and sales of interest in subsidiaries and associate company in its Statement of Income, mainly due to the adjustment to fair value of the remaining interest in accordance to IFRS.

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. As a result of the transaction, the Company have receivables amounting to 28.9 million and 32.5 million (equivalent to R$ 121 million and R$ 112 million) as of December 31, 2017 and 2016, respectively and registered an expense of R$ 105 million in the gains and losses on assets held for sale and sales of interest in subsidiaries and associate company in its Consolidated Statements

of Income.

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 these transactions, the Company have receivables amounting to US$ 16 million and US$ 79 million (equivalent to R$ 52 million and R$ 257 million) as of December 31, 2017 and 2016, respectively and registered a gain of R$ 47 million in the gains and losses on assets held for sale and sales of interest in subsidiaries and associate company in its Consolidated Statements of Income.

The sale of these operations in Spain, Guatemala and Colombia is aligned with Gerdau s objective of focusing on its most profitable assets and allowed the Company to reduce its debt and working capital levels in 2016 in the amount of R$ 291 million and R$ 438 million, respectively.

II) Assets and liabilities held for sale

On October 10, 2017, the Company signed a contract for the sale of 100% of its operation in Chile to the Chilean family groups Matco e Ingeniería e Inversiones. The assets included in the sale are long steel industrial units with annual installed steel capacity of 520 thousand tons, presented within the South America segment. The economic value of the transaction corresponds to US$ 154 million (equivalent to R$ 509 million). The closing of the transaction still depends on the approval of the Chilean competition authority, which is expected to occur in 2018. This movement is aligned with the Company s asset optimization process, focusing on profitability and reducing its financial leverage. The Company started to present assets and liabilities of these units separately from other operations, in specific lines of the balance sheet of assets held for sale and liabilities held for sale.

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On December 29, 2017, the Company entered into a definitive agreement to sell some of the rebar-producing mills, as well as steel cutting and bending units and distribution centers in the United States to Commercial Metals for US$ 600 million (equivalent to R$ 1,985 million), subject to usual adjustments to the acquisition value. The agreement includes the Jacksonville (Florida) , Knoxville (Tennessee), Rancho Cucamonga (California) and Sayreville (New Jersey), with a combined production capacity of 2.5 million short tons per year, as well as rebar processing and distribution units in the United States, presented within the North America segment. The transaction is subject to regulatory approvals and the usual closing conditions, which should occur before the end of 2018. This transaction represents a milestone in the Company s strategy to reduce its indebtedness and focus on opportunities with greater returns in the markets in which it operates. The Company started to present the assets and liabilities of these units separately from other operations, in specific lines of the balance sheet of assets held for sale and liabilities held for sale. Additionally, as a result of the measurement of the net assets classified as held for sale by the lower of their book value and their fair value less costs to sell, the Company recognized an expense net of tax in the amount of R$ 649.2 million in the line of gains and losses on assets held for sale and sales of interest in subsidiaries and associate company in its Consolidated Statements of Income.

3.5 Total cash paid for business combinations

Companies / interest acquired	2017	2016	2015
Business Combination			
Armacero Industrial y Comercial S.A.			20,929
			20,929
Interest increase in subsidiaries			
Gerdau Aços Longos S.A., Gerdau Açominas S.A., Gerdau Aços Especiais S.A. and Gerdau América Latina Participações S.A.			339,068
			339,068

NOTE 4 CASH AND CASH EQUIVALENTS, AND SHORT AND LONG-TERM INVESTMENTS

	2017	2016
Cash	10,439	9,412
Banks and immediately available investments	2,544,899	5,053,971
Cash and cash equivalents	2,555,338	5,063,383

	2017	2016
Held for trading	821,518	1,024,411
Short-term investments	821,518	1,024,411

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

	2017	2016
Trade accounts receivable - in Brazil	1,265,431	1,251,739
Trade accounts receivable - exports from Brazil	139,162	265,252
Trade accounts receivable - foreign subsidiaries	1,525,466	2,259,014
(-) Allowance for doubtful accounts	(131,639)	(199,306)
	2,798,420	3,576,699

Accounts receivable by aging are as follows:

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	2017	2016
Current	2,234,723	2,917,073
Past-due:		
Up to 30 days	467,901	506,780
From 31 to 60 days	96,852	128,715
From 61 to 90 days	17,636	37,559
From 91 to 180 days	27,841	53,460
From 181 to 360 days	22,985	66,444
Above 360 days	62,121	65,974
(-) Allowance for doubtful accounts	(131,639)	(199,306)
	2,798,420	3,576,699

The changes in the allowance for doubtful accounts are as follows:

Balance as of January 1, 2015	(98,814)
Provisions for bad debt during the year	(133,868)
Recoveries in the year	6,167
Write-offs	41,392
Exchange variation	(138)
Balance as of December 31, 2015	(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 (note 3.4)	1,487
Assets held for sale (note 3.4)	11,207
Exchange variation	(276)
Balance as of December 31, 2017	(131,639)

NOTE 6 - INVENTORIES

	2017	2016
Finished products	3,026,556	2,987,785
Work in progress	1,302,152	1,201,327
Raw materials	1,703,013	1,487,971
Storeroom supplies	298,100	430,731
Imports in transit	375,139	253,729
(-) Allowance for adjustments to net realizable value	(3,556)	(28,813)
	6,701,404	6,332,730

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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:

Balance as of January 1, 2015	(66,363)
Provision for the year	(54,987)
Reversal of adjustments to net realizable value	37,451
Exchange rate variation	(17,222)
Balance as of December 31, 2015	(101,121)
Provision for the year	(62,899)
Reversal of adjustments to net realizable value	94,391
Loss of contro 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 (note 3.4)	392
Assets held for sale (note 3.4)	881
Exchange rate variation	3,789
Balance as of December 31, 2017	(3,556)

NOTE 7 TAX CREDITS

	2017	2016
Current		
ICMS (state VAT)	155,096	130,718
Social security financing	91,229	173,453
Financing of social integration program	20,242	35,135
IPI (federal VAT)	59,982	48,751
IVA (value-added tax)	48,139	85,674
Others	27,741	30,698
	402,429	504,429
Non-current		
ICMS (state VAT)	26,135	50,757
Social security financing	360	2,294
Financing of social integration program and Others	4,346	3,652
	30,841	56,703
	433,270	561,132

The estimates of realization of non-current tax credits are as follows:

	2017	2016
2018		33,840
2019	18,017	14,334
2020	7,062	8,529
2021 on	5,762	
	30,841	56,703

NOTE 8 - INCOME AND SOCIAL CONTRIBUTION TAXES

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

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December 31, 2017, 2016 and 2015. The foreign subsidiaries of the Company are subject to taxation at rates ranging between 22.6% and 35.0%, 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:

	2017	2016	2015
Income (loss) before income taxes	(43,276)	(2,581,615)	(6,094,408)
Statutory tax rates	34%	34%	34%
Income and social contribution taxes at statutory rates	14,714	877,749	2,072,099
Tax adjustment with respect to:			
- Difference in tax rates in foreign companies	(183,787)	(1,162,174)	(222,553)
- Equity in earnings of unconsolidated companies	(11,763)	(4,342)	(8,331)
- Interest on equity*	113	(162)	63,407
- Tax credits and incentives	23,185	18,494	19,459
- Tax deductible goodwill recorded in statutory books		36,469	233,029
- No recognition of deferred tax assets		(40,279)	(387,668)
- Capital Gain**	(98,290)		
- Write-down of deferred tax asset***			(284,014)
- Other permanent differences, net	(39,563)	(30,069)	12,994
Income and social contribution taxes	(295,391)	(304,314)	1,498,422
Current	(313,758)	(110,511)	(158,450)
Deferred	18,367	(193,803)	1,656,872

(*) 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. This expense is not recognized for financial reporting purposes and thus it does not impact accounting profit.

(**) The merger of Gerdau Aços Especiais S.A. and Gerdau América Latina Part. S.A. at Gerdau S.A., generated a taxable capital gain.

(***) The Company assessed the recoverability of certain deferred income tax assets and, due to the lack of expected utilization of these assets because of the adjustment of the long-term investment plan in one of its foreign subsidiaries and registered a write-down of R$ 284,014 in 2015.

b) Breakdown and changes in deferred income and social contribution tax assets and liabilities at statutory tax rates:

	Balance as of January 1, 2015	Recognized in income	Comprehensive Income	Balance as of December 31, 2015

Tax loss carryforward	1,003,441	(259,976)	144,515	887,980
Social contribution tax losses	148,827	42,811		191,638
Provision for tax, civil and labor liabilities	527,731	110,318	1,517	639,566
Benefits granted to employees	431,328	(25,694)	144,231	549,865
Other temporary differences	210,609	247,458	(76,076)	381,991
Deferred exchange variance*	874,742	1,292,709	(9,302)	2,158,149
Provision for losses	54,938	95,596	1,144	151,678
Difference between book value and tax base of assets acquired in business combinations	(1,628,973)	153,650	(92,557)	(1,567,880)
	1,622,643	1,656,872	113,472	3,392,987
Non-current assets	2,567,189			4,307,462
Non-current liabilities	(944,546)			(914,475)

* Corresponds to deferred taxes over foreign exchange gains and loss which certain subsidiaries elected to tax on a cash basis

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	Balance as of December 31, 2015	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
Difference between book value and tax base of assets acquired in business combinations	(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

	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
Difference between book value and tax base of assets acquired in business combinations	(1,077,430)	613,339	(51,606)	18,163	(497,534)
	3,011,794	18,367	2,056	(60,510)	2,971,707
Non-current assets	3,407,230				3,054,393
Non-current liabilities	(395,436)				(82,686)

* 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 carryforwards 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	
	2017	**2016**
2017		512,422
2018	326,356	391,384
2019	198,590	364,030
2020	400,597	535,937
2021	369,857	499,984
2022 on	1,758,993	1,103,473
	3,054,393	3,407,230

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	Liabilities	
	2017	**2016**
2017		(2,283)
2018	(2,680)	(89,052)
2019	(6,116)	(56,006)
2020	(6,498)	(154,664)
2021	(4,745)	(14,496)
2022 on	(62,647)	(78,935)
	(82,686)	(395,436)

d) Tax Assets not booked:

Due to the lack of opportunity to use tax losses and negative basis of social contribution in some companies in Brazil, the Company has not recorded a portion of tax assets of R$ 312,741 (R$ 317,889 as of December 31, 2016), which do not have an expiration date. The subsidiaries abroad had R$ 360,152 (R$ 349,072 as of December 31, 2016) of tax credits on capital losses for 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$ 1,137,548 (R$ 857,215 as of December 31, 2016), which expire at various dates between 2018 and 2037.

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NOTE 9 INVESTMENTS

			Joint ventures					Associate companies
	Joint ventures North America	**Gerdau Corsa S.A.P.I. de C.V.**	**Gerdau Metaldom Corp.**	**Gerdau Summit Aços Fundidos e Forjados S.A. (note 3.2)**	**Diaco S.A.**	**Dona Francisca Energética S.A.**	**Armacero Ind. Com. Ltda.**	**Corsa Controladora S.A. de C.V.**
Balance as of January 1, 2015	40,152	109,930	364,281			124,211	20,251	298,409
Equity in earnings	14,432	(88,690)	38,485			11,725	(1,933)	(7,574
Cumulative Translation Adjustment	11,265	27,021	173,079				2,611	68,733
Capital increase		40,524						
Impairment of assets								
Control acquisition							(20,929)	
Dividends/Interest on equity	(5,116)					(46,341)		
Balance as of December 31, 2015	60,733	88,785	575,845			89,595		359,568
Equity in earnings	13,533	(96,306)	16,362			17,780		12,155
Cumulative Translation Adjustment	(9,492)	(11,748)	(88,051)					(105,420
Effect of selling of subsidiary (note 3.4)								
Dividends/Interest on equity	(8,282)		(99,634)			(16,579)		
Balance as of December 31, 2016	56,492	(19,269)	404,522			90,796		266,303
Equity in earnings	5,725	(110,773)	33,505	15,460	8,048	19,971		(6,533
Cumulative Translation Adjustment	5,081	(33,078)	(7,606)		1,346			17,512
Capital increase		178,670		184,187				
Joint venture creation (note 3.2)					145,084			
Contingent price complement						65,500		
Dividends/Interest on equity	(14,050)					(26,594)		
Balance as of December 31, 2017	53,248	15,550	430,421	199,647	154,478	149,673		277,282

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NOTE 10 PROPERTY, PLANT AND EQUIPMENT

a) Summary of changes in property, plant and equipment:

	Land and buildings	Machines, equipment, and installations	Data electronic equipment	Property, plant and equipment under construction	Other	Total
Cost of the property, plant, and equipment						
Balances as of January 1, 2015	9,083,765	28,434,074	755,455	4,065,627	1,296,613	43,635,534
Additions	2,150	238,060	8,194	2,000,515	75,799	2,324,718
Capitalized interest				213,476		213,476
Business Combination	30,693	10,767	503	1,784	10,853	54,600
Transfers	462,812	1,475,130	40,512	(1,999,840)	21,386	
Disposals	(69,777)	(142,936)	(20,166)	(103,959)	(29,769)	(366,607)
Impairment	(60,952)	(1,501,293)		(543,726)		(2,105,971)
Foreign exchange effect	1,394,111	4,102,898	154,768	434,999	95,603	6,182,379
Balances as of December 31, 2015	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 (note 28)	(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 (note 3.4)	(119,928)	(900,840)	(16,426)	(1,382)	(53,129)	(1,091,705)
Impairment (note 28)	(10,063)	(255,293)			(13)	(265,369)
Assets held for sale (note 3.4)	(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

	Land and buildings	Machines, equipment, and installations	Data electronic equipment	Property, plant and equipment under construction	Other	Total
Accumulated depreciation						
Balances as of January 1, 2015	(3,618,197)	(16,825,332)	(664,783)		(395,433)	(21,503,745)
Depreciation, amortization and depletion	(323,824)	(1,842,158)	(48,195)		(96,391)	(2,310,568)
Transfers	8,815	(9,071)	360		(104)	
Disposals	26,846	175,405	15,512		28,844	246,607
Foreign exchange effect	(481,359)	(2,913,862)	(130,514)		(60,362)	(3,586,097)
Balances as of December 31, 2015	(4,387,719)	(21,415,018)	(827,620)		(523,446)	(27,153,803)
Depreciation, amortization and depletion	(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 (note 3.4)	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, amortization and depletion	(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 (note 3.4)	28,691	589,951	12,627		41,117	672,386
Assets held for sale (note 3.4)	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)
Net property, plant and equipment						
Balances as of December 31, 2015	6,455,083	11,201,682	111,646	4,068,876	947,039	22,784,326
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

The average rate of capitalized interest in 2017 was 6.6% (6.6% in 2016 and 6.4% in 2015).

The following useful lives are used to calculate depreciation, amortization, and depletion:

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	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$ 609,116 as of December 31, 2017 (R$ 632,376 and R$ 823,650 as of December 31, 2016 and 2015, respectively).

c) Impairment of property, plant and equipment At December 31, 2017, the carrying amount of items of property, plant and equipment for which an impairment loss has been recognized up to current year is R$ 118,348 for land, buildings and construction (R$ 112,438 as of December 31, 2016), R$ 783,183 for machines, equipment and installations (R$ 642,592 as of December 31, 2016), R$ 543,726 for Property, plant and equipment under construction (R$ 543,726 as of December 31, 2016). The loss of control of Diaco S.A. has been reflected in the results above (See Note 3.4).

NOTE 11 GOODWILL

The changes in goodwill are as follows:

	Goodwill	Accumulated impairment losses	Goodwill after Impairment losses
Balance as of January 1, 2015	12,834,998	(278,594)	12,556,404
(+/-) Foreign exchange effect	5,264,188	(167,679)	5,096,509
(-) Impairment (note 28)		(2,528,483)	(2,528,483)
Balance as of December 31, 2015	18,099,186	(2,974,756)	15,124,430
(+/-) Foreign exchange effect	(2,645,368)	63,516	(2,581,852)
(-) Impairment (note 28)		(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 (note 28)		(849,438)	(849,438)
(-) Assets held for sale (note 3.4)	(801,967)		(801,967)
Balance as of December 31, 2017	14,500,381	(6,609,239)	7,891,142

The amounts of goodwill by segment are as follows:

	2017	2016	2015

Brazil	373,135	380,644	519,327
Special Steel	2,487,364	2,508,056	3,409,429
North America	5,030,643	6,581,316	11,195,674
	7,891,142	9,470,016	15,124,430

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:

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	Supplier relationships	Software development	Customer contracts and relationships	Others	Total
Balance as of January 1, 2015	56,654	688,061	749,027	53,356	1,547,098
Foreign exchange effect		123,167	327,424	14,375	464,966
Acquisition		118,933		7,495	126,428
Disposal		(1,182)		(4,208)	(5,390)
Amortization	(9,083)	(120,497)	(164,968)	(2,793)	(297,341)
Balance as of December 31, 2015	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 (note 3.4)		(37,512)	(25,396)	(17,700)	(80,608)
Balance as of December 31, 2017	32,786	490,829	440,774	7,700	972,089
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:

	2017	2016	2015
Brazil	351,578	412,134	459,383
Special Steel	152,640	219,878	357,435
South America	1,863	7,606	13,507
North America	466,008	680,323	1,005,436
	972,089	1,319,941	1,835,761

NOTE 13 LOANS AND FINANCING

Loans and financing are as follows:

	Annual charges (*)	2017	2016
Working capital	7.36%	2,739,258	3,468,490
Financing of property, plant and equipment and others	8.58%	2,108,216	2,855,860
Ten/Thirty Year Bonds	5.84%	11,614,182	14,093,460
Total Loans and Financing		16,461,656	20,417,810
Current		2,004,341	4,458,220
Non-current		14,457,315	15,959,590
Principal amount of loans and Financing		16,207,120	20,049,854
Interest accrued of loans and Financing		254,536	367,956

Total Loans and Financing	16,461,656	20,417,810

(*) Weighted average effective interest costs on December 31, 2017.

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).

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Summary of loans and financing by currency:

	2017	2016
Brazilian Real (BRL)	2,710,308	3,228,759
U.S. Dollar (USD)	13,333,669	16,487,116
Other currencies	417,679	701,935
	16,461,656	20,417,810

The amortization schedules of long term loans and financing are as follows:

	2017	2016
2018		1,679,416
2019	873,274	875,319
2020	3,158,211	3,261,435
2021	1,730,177	3,500,937
2022	147,715	150,916
2023 on	8,547,938	6,491,567
	14,457,315	15,959,590

a) Main funding in 2017

In October 2017, Gerdau SA, through its subsidiary Gerdau Trade Inc., completed the issuance of a 10-year Bond in the amount of US$ 650 million with a coupon of 4.875% per annum. The proceeds were used to repurchase the Bonds maturing in 2021 and 2020, issued by Gerdau Trade Inc. and Gerdau Holdings Inc., respectively.

b) Monitoring Index

Only operations with BNDES contemplate monitoring of the Company s indebtedness indexes established in the agreement. In a possible breakdown of the indicator in the annual measurement, the Company would enter into a healing period and a subsequent renegotiation of guarantees, therefore, not being configured as the possibility of a default event. The Company is in compliance with contractual obligations and no default events occurred at December 31, 2017, 2016 and 2015.

c) Guarantees

All loans contracted under the FINAME/BNDES program, totaling R$ 110.4 million on December 31, 2017, 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, 2017, the outstanding balance of this credit facility was R$ 402.5 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 (R$ 2,646.4 million as of December 31, 2017) revolving credit line to provide liquidity to its subsidiaries. The line is divided into two tranches, of which US$ 200 million (R$ 661.6 million as of December 31, 2017) is allocated to North American subsidiaries and US$ 600 million (R$ 2,028.0 million as of December 31, 2017) to subsidiaries in Latin America, including Brazil. The companies Gerdau SA, Gerdau Açominas SA and Gerdau Aços Longos SA provide a guarantee and the operation expires in October 2020. As of December 31, 2017, the amount disbursed in this line was US$ 54 million (R$ 178.6 million as of December, 31, 2017).

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NOTE 14 DEBENTURES

Issuance	General Meeting	Quantity as of December 31, 2017 Issued	Held in treasury	Maturity	2017	2016
3rd- A and B	May 27,1982	144,000	136,259	06/01/2021	21,377	44,292
7th	July 14, 1982	68,400	63,587	07/01/2022	1,333	35,942
8th	November 11, 1982	179,964	168,242	05/02/2023	14,557	57,191
9th	June 10, 1983	125,640	124,203	09/01/2024	4,900	10,731
11th - A and B	June 29, 1990	150,000	147,561	06/01/2020	5,761	17,267
14th	August 26, 2014	20,000	10,174	08/30/2024		
Total Consolidated					47,928	165,423
Non-current					47,928	165,423

The amortization schedules of long term are as follows:

	2017	2016
2020	5,761	17,267
2021	21,377	44,292
2022	14,557	57,191
2023 on	6,233	46,673
	47,928	165,423

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 9.93% and 14.00% as of December 31, 2017 and December 31, 2016, respectively.

The Company has guarantees provided by parent entity for debentures of the 7ª, 8ª, 9ª and 11ª 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 cash and cash equivalents, short-term investments, trade accounts receivable, trade accounts payable, Loans and financing, debentures, related-party transactions, unrealized gains on derivatives, unrealized losses on derivatives, Judicial deposits, 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) Fair value the fair value of the aforementioned financial instruments is as follows:

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	2017		2016	
	Book value	Fair value	Book value	Fair value
Assets				
Cash and cash equivalents	2,555,338	2,555,338	5,063,383	5,063,383
Short-term investments	821,518	821,518	1,024,411	1,024,411
Trade accounts receivable	2,798,420	2,798,420	3,576,699	3,576,699
Related parties	51,839	51,839	57,541	57,541
Unrealized gains on derivatives			12,951	12,951
Judicial deposits	2,051,181	2,051,181	1,861,784	1,861,784
Other current assets	469,737	469,737	668,895	668,895
Other non-current assets	542,973	542,973	447,260	447,260
Liabilities				
Trade accounts payable	3,179,954	3,179,954	2,743,818	2,743,818
Loans and Financing	16,461,656	17,102,512	20,417,810	20,716,266
Debentures	47,928	47,928	165,423	165,423
Unrealized losses on financial instruments	1,267	1,267	6,584	6,584
FIDC Obligation	1,135,077	1,135,077	1,007,259	1,007,259
Other current liabilities	625,410	625,410	514,599	514,599
Other non-current liabilities	653,670	653,670	401,582	401,582

The fair values of Loans and Financing are based on market assumptions, 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 enter into derivative financial instruments 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 the financial position of customers, establishing a credit limit and constantly monitoring their balances. 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. 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.

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

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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, based on economic and financial conditions, aiming 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. In the long-term, the Company seeks to remain between the parameters below, admitting specific short-term variations:

WACC	between 10% to 13% a year
Net debt/EBITDA	less than or equal to 2.5 times
Net Financial Expenses Coverage Ratio	greater than 5.5 times
Debt/Equity Ratio	less than or equal to 60%

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.

			2017		
Contractual obligations	**Total**	**Less than 1 year**	**1-3 years**	**4-5 years**	**More than 5 years**
Trade accounts payable	3,179,954	3,179,954			
Loans and financings	24,470,750	3,191,793	6,060,186	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
	30,125,256	**6,998,424**	**6,079,924**	**3,208,433**	**13,838,475**

			2016		
Contractual obligations	**Total**	**Less than 1 year**	**1-3 years**	**4-5 years**	**More than 5 years**
Trade accounts payable	2,743,818	2,743,818			
Loans and financings	29,258,030	5,940,222	4,818,322	8,443,080	10,056,406
Debentures	277,879			93,488	184,391
Unrealized losses on financial instruments	6,584	6,584			
Obligations with FIDC	1,007,259				1,007,259
Other current liabilities	514,599	514,599			
Other non-current liabilities	401,582		11,081		390,501
	34,209,751	**9,205,223**	**4,829,403**	**8,536,568**	**11,638,557**

Sensitivity analysis:

The Company performed a sensitivity analysis, which can be summarized as follows:

Impacts on Statements of Income

Impacts on Statements of Income

Assumptions	Percentage of change	2017	2016
Foreign currency sensitivity analysis	5%	129,209	253,294
Interest rate sensitivity analysis	10 bps	54,908	63,416
Sensitivity analysis of changes in prices of products sold	1%	369,176	376,517
Sensitivity analysis of changes in raw material and commodity prices	1%	234,239	228,637
Sensitivity analysis of interest rate and foreign currency swaps	10 bps/5%	6,479	9,870
Sensitivity analysis of NDF (Non Deliverable Forwards)	5%	1,480	15,816

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Foreign currency sensitivity analysis: As of December 31, 2017, 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$ 129,209 and R$ 79,088 after the effects arising from the changes in the net investment hedge described in note 15.f - (R$ 253,294 and R$ 177,711 as of December 31, 2016, 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$ 54,908 as of December 31, 2017 (R$ 63,416 as of December 31, 2016) 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 sales 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, 2017, totals R$ 369,176 (R$ 376,517 as of December 31, 2016) and the variation in the price of raw materials and other inputs totals R$ 234,239 as of December 31, 2017 (R$ 228,637 as of December 31, 2016). 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 fair value of swaps. These variations represent an income or expense of R$ 6,479 (R$ 9,870 as of December 31, 2016). 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 Chilean Peso, and its effects on the fair value of these derivatives. A 5% increase in the US Dollar against the Chilean Peso represents an income of R$ 1,480 (R$ 15,816 as of December 31, 2016), and a 5% reduction of the US Dollar against the Chilean Peso represents an expense of the same amount. The US Dollar / Chilean Peso forward contracts had the objective of hedging the liability position 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:

2017 **Assets**	**Loans and receivables**	**Assets at fair value with gains and losses recognized in income**	**Total**
Cash and cash equivalents	2,555,338		2,555,338
Short-term investments		821,518	821,518
Trade accounts receivable	2,798,420		2,798,420
Related parties	51,839		51,839
Judicial deposits	2,051,181		2,051,181
Other current assets	469,737		469,737
Other non-current assets	462,735	80,238	542,973
Total	8,389,250	901,756	9,291,006
Financial income	177,466	87,242	264,708

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Liabilities	Liabilities at fair value with gains and losses recognized in income	Other financial liabilities at amortized cost	Total
Trade accounts payable		3,179,954	3,179,954
Loans and financings		16,461,656	16,461,656
Debentures		47,928	47,928
FIDC Obligation		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
Total	1,267	22,103,695	22,104,962
Financial income (expenses)	(12,503)	(1,395,553)	(1,408,056)

2016 Assets	Loans and receivables	Assets at fair value with gains and losses recognized in income	Assets at fair value with gains and losses recognized in shareholder s equity	Total
Cash and cash equivalents	5,063,383			5,063,383
Short-term investments		1,024,411		1,024,411
Unrealized gains on financial instruments			12,951	12,951
Trade accounts receivable	3,576,699			3,576,699
Related parties	57,541			57,541
Judicial deposits	1,861,784			1,861,784
Other current assets	668,895			668,895
Other non-current assets	380,211	67,049		447,260
Total	11,608,513	1,091,460	12,951	12,712,924
Financial income	100,150	300,123		400,273

Liabilities	Liabilities at fair value with gains and losses recognized in income	Other financial liabilities at amortized cost	Total
Trade accounts payable		2,743,818	2,743,818
Loans and financings		20,417,810	20,417,810
Debentures		165,423	165,423
FIDC Obligation		1,007,259	1,007,259
Other current liabilities		514,599	514,599
Other non-current liabilities		401,582	401,582
Unrealized losses on financial instruments	6,584		6,584
Total	6,584	25,250,491	25,257,075
Financial income (expenses)	(58,068)	(1,287,460)	(1,345,528)

As of December 31, 2017, 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

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the fair value of these transactions. All derivative financial instruments are recognized at fair value in the Consolidated Financial Statements of the Company.

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.

The derivative transactions may include: interest rate swaps, cross currency swaps and currency forward contracts.

Forward Contracts in US Dollar

The Company has entered into NDFs (Non Deliverable Forward) in order to mitigate the exchange variance risk on liabilities denominated in foreign currencies, mainly US dollar. The counterparties of these transactions are financial institutions with a low credit risk.

Swap Contracts

The Company entered into cross currency swaps, designated as a cash flow hedge, in which it receives a variable interest rate based on LIBOR in US dollars and pays a fixed interest rate based on local currency. The counterparties to these transactions are financial institutions with low credit risk.

The derivatives instruments can be summarized and categorized as follows:

		Notional value		Amount receivable		Amount payable	
Contracts	**Position**	**2017**	**2016**	**2017**	**2016**	**2017**	**2016**
Forward							
Maturity at 2017	purchase in US$		US$ 84.8 million		734		(6,584)

Maturity at 2017		sell in US$			US$	15.0 million	1,823		
Cross currency swap									
Maturity in 2017	receivable under the swap	Libor 6M + 2.25%							
	payable under the swap	INR 11.02%			US$	25.0 million	5,684		
Maturity in 2019	receivable under the swap	Libor 6M +2%							
	payable under the swap	INR 10.17%	US$	40.0 million	US$	40.0 million	4,710	(1,267)	
Total fair value of financial instruments							12,951	(1,267)	(6,584)

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Prospective and retrospective tests demonstrated the effectiveness of these instruments.

	2017	2016
Unrealized gains on financial instruments		
Current assets		2,557
Non-current assets		10,394
		12,951
Unrealized losses on financial instruments		
Current liabilities		(6,584)
Non-current liabilities	(1,267)	
	(1,267)	(6,584)

	2017	2016
Net Income		
Gains on financial instruments	9,666	33,753
Losses on financial instruments	(19,107)	(72,683)
	(9,441)	(38,930)
Other comprehensive income		
(Losses) Gains on financial instruments	(11,364)	212
	(11,364)	212

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$ 2.2 billion (designated as hedges) is recognized in the Statement of Comprehensive Income, while the exchange rate on the portion of US$ 0.4 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$ 148,560 for the year ended on December 31, 2017 (gain of R$ 1,679,312 on December 31, 2016).

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 oscillations in the exchange rate. This objective is consistent with the Company s risk management strategy. Prospective and retrospective tests need demonstrate the effectiveness of these instruments.

g) Measurement of fair value:

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. 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 all the terms 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.

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As of December 31, 2017, the Company had some assets for 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, 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)**	
	2017	**2016**	**2017**	**2016**	**2017**	**2016**
Current assets						
Cash and cash equivalents	2,555,338	5,063,383			2,555,338	5,063,383
Short-term investments - Held for Trading	821,518	1,024,411	238,008	458,639	583,510	565,772
Trade Accounts receivable	2,798,420	3,576,699			2,798,420	3,576,699
Unrealized gains on financial instruments		2,557				2,557
Other current assets	469,737	668,895			469,737	668,895
Non-current assets						
Related parties	51,839	57,541			51,839	57,541
Unrealized gains on financial instruments		10,394				10,394
Judicial deposits	2,051,181	1,861,784			2,051,181	1,861,784
Other non-current assets	542,973	447,260			542,973	447,260
	9,291,006	12,712,924	238,008	458,639	9,052,998	12,254,285
Current liabilities						
Trade accounts payable	3,179,954	2,743,818			3,179,954	2,743,818
Short-term debt	2,004,341	4,458,220			2,004,341	4,458,220
Unrealized losses on financial instruments		6,584				6,584
Other current liabilities	625,410	514,599			625,410	514,599
Non-current liabilities						
Long-term debt	14,457,315	15,959,590			14,457,315	15,959,590
Debentures	47,928	165,423			47,928	165,423
Unrealized losses on financial instruments	1,267				1,267	
Obligations with FIDC	1,135,077	1,007,259			1,135,077	1,007,259
Other non-current liabilities	653,670	401,582			653,670	401,582
	22,104,962	25,257,075			22,104,962	25,257,075

h) Changes in liabilities from Cash flow from financing activities:

As required by IAS 7, the Company demonstrates below the changes in the liabilities of cash flow from financing activities, from its Statement of Cash Flows:

		Cash transactions		**Non cash transactions**		
	Balances as of January 1, 2015	**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**	**Balances as of December 31, 2015**
Related parties, net	(80,920)	30,126		(2,712)		(53,506)
Debt, Debentures and Losses/Gains on financial instruments, net	19,488,733	(1,985,603)	(946,041)	1,471,526	8,388,641	26,417,256

		Cash transactions		**Non cash transactions**		
	Balances as of December 31, 2015	**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**	**Balances as of December 31, 2016**
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

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		Cash transactions		Non cash transactions		
	Balances as of December 31, 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	Balances as of December 31, 2017
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

NOTE 16 TAXES PAYABLE

	2017	2016
Payroll charges	75,752	89,763
ICMS (state VAT)	37,444	43,915
COFINS (tax on revenue)	5,411	8,470
IPI (federal VAT)	17,305	13,864
IVA (value-added tax) and others	148,189	185,178
	284,101	341,190

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 are 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

	2017	2016
a) Tax provisions		
ICMS (state VAT)	2,821	67,942
Corporate Income Tax and Social Contribution Tax	39,256	37,376
Emergency Capacity Charge and Extraordinary Rate Adjustment	9,278	8,852
Financing of social integration program and Social security financing	163,981	1,678,778

Other tax provisions and Social security contributions	42,285	36,823
b) Labor provisions	517,329	358,901
c) Civil provisions	52,933	50,554
	827,883	2,239,226

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 item Reversal of contingent liabilities, net (Operating Result), and R$ 369,819, on the item Reversal of monetary update of contingent 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. The balances recorded as of December 31, 2016 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.

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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 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.

Pursuant to paragraph 14 of IAS 37 - 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 (sitting *en banc*) 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 accounting practices adopted in Brazil and the 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 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, pursuant to paragraph 59 of IAS 37. 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, 2017, in the amount of R$ 1,691,596, 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.

During the year ended on December 31, 2017, the Company adhered to the installment program of the state of Minas Gerais, including amounts already provisioned regarding ICMS.

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 involve individually significant amounts and corresponds mainly to overtime pay, health hazard premium, and hazardous duty premium, 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, 2017 the amount shown as provision liabilities.

The changes in the tax, labor and civil provisions are shown below:

	2017	**2016**
Balance at the beginning of the year	2,239,226	1,904,730
(+) Additions	527,543	313,246
(+) Monetary correction	(419,567)	178,661
(-) Reversal of accrued amounts	(1,517,787)	(144,025)
(+) Foreign exchange effect on provisions in foreign currency	(201)	(3,235)
(-) Effect of selling of subsidiary		(10,151)
(-) Loss of control by joint venture creation (note 3.4)	(1,331)	
Balance at the end of the year	827,883	2,239,226

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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.

a) Tax contingencies

a.1) The Company and its subsidiary 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$ 443,137.

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$ 309,581; (ii) PIS and COFINS, substantially related to non-approval of compensation of credits on inputs totaling R$ 438,843, (iii) social security contributions in the total of R$ 76,866 and (iv) other taxes , whose updated total amount is currently R$ 370,175.

a.3) Subsidiary Gerdau Aços Longos S.A. is a party to an administrative proceeding relating to Withholding Income Tax, in the amount of R$ 122,029, assessed on the remittance abroad of interest charged on export financings under Export Prepayment or Export Advance Agreements. The Company submitted an administrative claim challenging the tax assessment on January 13, 2017, which was rejected by the Brazilian Federal Revenue Judgment Office (Delegacia de Julgamento da Receita Federal do Brasil), on June 5, 2017, reason for which the Company submitted a voluntary appeal, on July 4, 2017, which is currently pending on the Brazilian Board of Tax Appeals (Conselho Administrativo de Recursos Fiscais CARF , administrative body of the Ministry of Finance of Brazil).

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$ 1,488,989. Such proceedings relate to profits generated abroad, of which (i) R$ 1,317,381 correspond to two proceedings involving Gerdau Internacional Empreendimentos Ltda., of which (i.a.) R$ 951,736 relate to a proceeding that is no longer subject to appeal in CARF and was referred for judicial collection, which collection is being challenged in the competent judicial lower court; and (i.b) R$ 365,645 relate to a voluntary appeal which was partially granted in the lower tribunal of the Brazilian Board of Tax Appeals (Conselho Administrativo de Recursos Fiscais CARF , administrative body of the Ministry of Finance of Brazil), and was subject to special appeal which was partially granted in CARF s superior tribunal with the publication of the judgment on May 25, 2017, and is currently awaiting due diligence by the Internal Revenue Service, as determined by the CARF decision, and new appeals may be filed after the conclusion of such procedure; and (ii) R$

171,608 correspond to a proceeding involving the Company, whose voluntary appeal in CARF s lower tribunal was dismissed, for which a special appeal was filed, and currently awaits judgment in CARF s superior tribunal.

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$ 6,217,810, of which (i) R$ 4,963,398 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 administrative 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 by the subsidiary Gerdau Aços Longos S.A. were initiated, in their respective proceedings, which total the amount of R$ 3,195,379, and also by the Company, in its respective lawsuit, which amounts to R$ 364,370; (ii) R$ 600,101 correspond to two proceedings involving Gerdau Aços Longos S.A., whose voluntary appeal is currently pending in CARF s lower tribunal; (iii) R$ 531,138 correspond to two proceeding involving the subsidiary Gerdau Aços Longos S.A., whose voluntary appeal was dismissed in CARF s lower tribunal and having been presented Embargo de Declaration against those decisions, which are pending of judgment; and (iv) R$ 123,172 correspond to one proceeding involving the Company (as successor of Gerdau Aços Especiais S.A.), which had its Declarations of Appeal, filed against a decision that dismissed its Voluntary Appeal, rejected on December 7, 2017, whose decision the Company became aware on December 19, 2017, to oppose the appropriate appeal.

Some of the decisions obtained at the CARF related to those proceedings along with other matters involving the Company included in the scope of the so-called Operation Zelotes (Operation) are being investigated by Brazilian federal authorities including the Judiciary Branch, with the purpose of verifying the occurrence or not of alleged illegal acts.

Considering the involvement of Gerdau s name in press reports concerning the Operation, the Board of Directors decided to engage outside counsel, which report to a Special Committee of the Board, to conduct an investigation to determine, among other things: (i) whether, in light of current knowledge, proper protocol was followed in the relationship of the Company with governmental authorities, including CARF, and in the hiring of firms representing the Company in cases in CARF; (ii) whether such firms have

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remained within the scope of their work/hiring; (iii) whether the engagement terms for such firms included clauses intended to prevent activity that violates ethical codes or laws currently in force; (iv) whether the engagement terms for such firms included the establishment of sanctions for any violations (whether contractual breaches or otherwise); and (v) if there is any evidence of fraud, deceit, bad faith, or any expression of an intent to commit an illegal act on the part of directors and/or officers of the Company in the relationship of the Company with governmental authorities, including CARF, in the negotiation, signing or carrying out of the aforementioned contracts (Internal Investigation).

The Internal Investigation is ongoing, and as of the date of the approval of these financial statements, the Company believes it is not possible to predict either the duration or the outcome of the Operation or of the Internal Investigation. Additionally, the Company believes that currently there is not enough information to determine whether a provision for losses is required or disclose any contingency.

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 likely).

b) Civil contingencies

b.1) 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, 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.

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$ 191,112. For these demands, no accounting provision was recorded, since they were considered as possible losses, based on the opinion of its legal advisors.

b.3) On May 26, 2016, a securities class action was filed in the United States District Court for the Southern District of New York against Gerdau and certain executives and former executives of the Company by purchasers of American Depositary Receipts (ADRs) of the Company that trade on the New York Stock Exchange. On August 9, 2016, the court appointed the Policemen s Annuity and Benefit Fund of Chicago as lead plaintiff. On October 31, 2016, lead plaintiff filed an amended under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 on behalf of a purported class of purchasers of Gerdau ADRs between April 23, 2012 and May 16, 2016. Among other things, the amended complaint alleged that the Company and certain executives had engaged in a bribery scheme involving members of the Brazilian Board of Tax Appeals (CARF), which had purportedly resulted in the nonpayment of approximately US$ 429 million in taxes and resulted in defendants statements in Gerdau s securities filings about Gerdau s business, operations, and prospects being false and misleading and/or lacking a reasonable basis. The amended complaint did not specify an amount of alleged damages, and it also included claims pertaining to the transaction relating to the acquisition of equity interests described in note (c) below. On January 17, 2017, the Company filed a motion to dismiss, but before its review by the Court, the parties asked for a stay of the proceedings, so that they could engage in a mediation process. As a result of the mediation process. On July 5, 2017 lead plaintiff and the defendants reached a settlement, in the amount of US$ 15 million, which was approved by the Court on October 20, 2017. As a result, the action was dismissed, with prejudice, as against lead plaintiff and the class of purchasers of Gerdau ADRs. The amount of the settlement was substantially covered by insurance. The settlement does not acknowledge any liability by the defendants and, in the opinion of the Company and its legal advisors, was the best alternative to eliminate the uncertainties, burdens and costs to be incurred if the dispute were to continue.

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c) Administrative proceeding Brazilian Securities Comission (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 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:

	2017	**2016**
Tax	1,883,562	1,716,996
Labor	128,849	107,191
Civil	38,770	37,597
	2,051,181	1,861,784

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 superior 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.

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NOTE 18 - RELATED-PARTY TRANSACTIONS

a) Intercompany loans

	2017	2016
Assets		
Joint venture		
Gerdau Corsa SAPI de C.V.	7	48
Others		
Fundação Gerdau	51,832	57,493
	51,839	57,541

	2017	2016	2015
Net financial income	95	(2,457)	2,712

b) Operations with related parties

During the years ended December 31, 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$ 630,190 as of December 31, 2017 (R$ 421,415 as of December 31, 2016) and purchases in the amount of R$ 121,618 as of December 31, 2017 (R$ 141,275 as of December 31, 2016). The net amount totals R$ 508,572 as of December 31, 2017 (R$ 280,140 as of December 31, 2016).

During the years ended December 31, 2017 and 2016, the Company and its subsidiaries made transactions with controlling shareholders, directly or indirectly, mainly 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$ 689 (R$ 4,732 as of December 31, 2016). Additionally, the Company recorded income of R$ 801 (R$ 1,001 as of December 31, 2016), derived from rental agreement.

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Guarantees granted

Related Party	Relationship	Object	Original Amount	Maturity	2017	2016
GTL Trade Finance Inc.	Subsidiary	*10-year Bond*	1,744,000	Oct/17		2,577,296
GTL Trade Finance Inc.	Subsidiary	*30-year Bond*	1,118,000	Apr/44	1,654,000	1,629,550
Diaco S.A.	Joint-venture	Financing Agreements	137,700	Aug/18	128,019	397,238
Armacero-Matco S.A., Salomon Sack S.A.	Subsidiary	Financing Agreements	214,793	Dec/18	226,700	
Gerdau Holding Inc.	Subsidiary	*10-year Bond*	2,188,125	Jan/20	1,711,649	1,801,389
Gerdau Trade Inc.	Subsidiary	10-year Bond	2,117,750	Jan/21	1,570,546	3,345,222
Gerdau Corsa S.A.P.I. de C.V.	Joint-venture	*Financing Agreements*	1,973,313	Jul/18 - Dec/21	1,797,856	2,061,260
Gerdau Summit Aços Fundidos e Forjados S.A.	Joint-venture	*Financing Agreements*	130,164	Aug/25	6,550	
GTL Trade Finance Inc., Gerdau Holdings Inc.	Subsidiary	10-year Bond	2,606,346	Apr/24	3,031,974	2,987,154
Sipar Aceros S.A.	Subsidiary	Financing Agreements	436,959	Sep/18 - Sep/21	85,920	434,706
Gerdau Trade Inc.	Subsidiary	10-year Bond	1,501,275	Apr/23	1,792,291	1,832,625
Gerdau Steel India Ltd.	Subsidiary	Financing Agreements	98,359	Sep/18 - Feb/19	287,690	354,585
Gerdau Steel India Ltd.	Subsidiary	Financing Agreements		Indetermined		55,130
Comercial Gerdau Bolivia	Subsidiary	Financing Agreements		nov/17		13,036
Gerdau Açominas S.A.	Subsidiary	Financing Agreements	2,960,203	Jan/20 - Feb/21	2,158,271	2,627,205
Gerdau Ameristeel US. Inc.	Subsidiary	Bond 25 yers	103,596	Oct/37	168,708	166,214
Gerdau Ameristeel US. Inc.	Subsidiary	Bond 30 yers	46,460	May/37	76,084	74,959
Gerdau Aços Longos S.A.	Subsidiary	Financing Agreements	556,247	Oct/24 - Dec/30	282,534	318,784
Gerdau Aços Longos S.A.	Subsidiary	Financing Agreements	7,007	Dec/18	7,007	304,194
Siderurgica Zuliana, C.A.	Subsidiary	Financing Agreements	50,010	Dec/18	33,080	65,182
Gerdau Ameristeel Corporation; Gerdau Ameristeel US Inc.; Gerdau Macsteel Inc.; Comercial Gerdau Bolivia S.A.; Gerdau Aza S.A.; Gerdau Metaldom S.A.; Sipar Aceros S.A.; Gerdau Hungria Holdings LLC; Aceros Corsa S.A. de C.V.; Gerdau Corsa S.A.P.I de C.V.; Gerdau GTL México S.A. de C.V.; Sidertul S.A. de C.V.; Steelchem Trading Corporation; Empresa Siderúrgica Del Perú S.A.A.; Gerdau Hungria Y CIA, S.R.C and Gerdau Laisa S.A.	Subsidiary and Joint-venture	Financing Agreements		Oct/20	178,200	635,525
Gerdau Aços Especiais S.A.	Subsidiary	Financing Agreements	70,000	feb/20		63,000

c) Debentures

Debentures are held by direct or indirect shareholders in the amount of R$ 348 as of December 31, 2017 (R$ 33,438 as of December 31, 2016), which corresponds to 63 debentures (5,964 as of December 31, 2016).

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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$ 33,942 during 2017 (R$ 33,686 in 2016). In 2017, contributions to management s defined contribution pension plans totaled R$ 1,327 (R$ 1,359 in 2016).

Stock options granted to management are as follows:

	2017	
	Number of shares	Weighted exercise price R$
Balance as of January 1, 2015	1,564,341	19.53
Options Forfeited	(1,130,091)	19.56
Others	112,420	
Balance as of December 31, 2015	546,670	18.36
Options Forfeited	(148,491)	20.49
Balance as of December 31, 2016	398,179	16.64
Options Forfeited	(217,819)	15.11
Balance as of December 31, 2017	180,360	17.91

At the end of the year, the Restricted Shares resulting from the conversion process within the key management were:

	2017	2016
Available at beginning of the year	4,831,999	1,669,557
Granted	1,353,930	3,399,729
Exercised	(240,619)	(237,287)
Forfeited		
Available at the end of the year	5,945,310	4,831,999

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$ 14,609 during 2017 (R$ 14,095 and R$ 10,999 during 2016 and 2015, respectively).

Additionally, for the year ended December 31, 2017, the compensation for the members of the Advisory Board was R$ 0 (R$ 1,958 in 2016 and R$ 1,129 in 2015, being the amount of 2015 the compensation of the Advisory Board as from its creation in May/15).

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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, 2017 are as follows:

	2017	2016
Plan assets - Defined contribution pension plan	1,149	1,490
Plan assets - Defined benefit pension plan		55,307
Total assets	1,149	56,797
Actuarial liabilities - Defined benefit pension plan	1,084,758	1,144,080
Acturial liabilities - Post-employment health care benefit	316,230	305,447
Retirement and termination benefit liabilities	23,876	55,276
Total liabilities	1,424,864	1,504,803
Current	253	409
Non-current	1,424,611	1,504,394

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 Gerdau - 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).

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	(19,286)	15,457

The accumulated amount recognized in other Comprehensive Income for employee benefits is R$ (1,227,722) as of December 31, 2017 (R$ (1,111,842) as of December 31, 2016).

Defined Benefit Pension Plan

The current expenses of the defined benefit pension plans are as follows:

	2017	2016	2015
Cost of current service	60,595	57,619	121,962
Interest expense	90,381	199,389	226,406
Return on plan assets	(64,128)	(186,856)	(216,005)
Past service cost	1,082	2,788	(151,685)
Curtailment			(4,510)
Settlement	(566)	609	
Interest cost on unrecoverable surplus	21,211	22,916	23,515
Net pension cost	108,575	96,465	(317)

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The reconciliations of assets and liabilities of the plans are as follows:

	2017	2016
Present value of defined benefit obligation	(4,314,592)	(4,174,653)
Fair value of plan assets	3,456,613	3,292,890
Asset ceiling restrictions on recognition of net funded assets	(226,779)	(207,010)
Net	(1,084,758)	(1,088,773)
Plan assets		55,307
Defined benefit obligation	(1,084,758)	(1,144,080)

Changes in plan assets and actuarial liabilities were as follows:

	2017	2016	2015
Variation of the plan obligations			
Obligation at the begining of the year	4,174,653	4,739,299	3,791,670
Cost of service	60,595	57,619	121,962
Interest expense	195,557	199,389	226,406
Payments of the benefits	(335,471)	(317,505)	(398,778)
Past service cost	1,082	2,788	(114,899)
Curtailment			(41,296)
Settlement	(52,035)	609	
Acturial remeasurements	235,549	186,905	(202,749)
Liabilities held for sale (note 3.4)	(101,794)		
Exchange Variance	136,456	(694,451)	1,356,983
Obligation at the end of the year	4,314,592	4,174,653	4,739,299

	2017	2016	2015
Variation of the plan assets			
Fair value of the plan assets at the begining of the year	3,292,890	3,865,411	3,319,133
Return of the plan assets	169,304	186,857	216,005
Contributions from sponsors	111,450	(47,574)	(14,986)
Curtailment			(5,248)
Settlement	(51,469)	(6,710)	
Payments of benefits	(335,471)	(317,505)	(398,778)
Remeasurement	232,214	109,153	(235,275)
Assets held for sale (note 3.4)	(73,127)		
Exchange Variance	110,822	(496,742)	984,560
Fair value of plan assets at the end of the year	3,456,613	3,292,890	3,865,411

The fair value of plan assets include shares of the Company in the amount of R$ 3,558 as of December 31, 2017 (R$ 1,895 as of December 31, 2016).

Amounts recognized as actuarial gains and losses in the Statement of Comprehensive Income are as follows:

	2017	2016	2015
Remeasurements	(232,214)	(109,153)	235,275
Actuarial Remeasurements	235,549	186,905	(202,749)
Restriction recognized in Other Comprehensive Income	(1,696)	3,065	(44,453)
Remeasurements recognized in Other Comprehensive Income	1,639	80,817	(11,927)

The historical actuarial remeasurements are as follows:

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	2017	2016	2015	2014	2013
Present value of defined benefit obligation	(4,314,592)	(4,174,653)	(4,739,299)	(3,791,670)	(3,113,818)
Fair value of the plan assets	3,456,613	3,292,890	3,865,411	3,319,133	3,081,582
Surplus (Deficit)	(857,979)	(881,763)	(873,888)	(472,537)	(32,236)
Experience adjustments on plan liabilities (Gain)	235,549	186,905	(202,749)	466,829	(272,767)
Experience adjustments on plan assets (Gain)	(232,214)	(109,153)	235,275	(69,748)	33,417

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:

	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%

	2016	
	Brazilian Plans	American Plans
Fixed income	97.0%	45.8%
Variable income		48.5%
Others	3.0%	5.7%
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 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.

The tables below show a summary of the assumptions used to calculate the defined benefit plans in 2017 and 2016, respectively:

	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 service and salary level/null	Based on age and/or the service

	2016	
	Brazilian Plan	North America Plan
Average discount rate	10.87%	3.75% - 4.25%
Rate of increase in compensation	Not applicable	3.25%
Mortality table	RP-2000	CPM-2014 and RP-2014
Mortality table of disabled	AT-2000 per sex	Rates by age
Rate of rotation	Based on service and salary level/null	Based on age and/or the service

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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$ 132,399 in 2017 (R$ 143,561 in 2016).

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.

The net periodic costs of post-employment health care benefits are as follows:

	2017	2016	2015
Current service cost	4,441	4,481	5,935
Interests expense	12,162	15,494	18,981
Past service cost	5,769	(75,787)	
Net cost pension benefit	22,372	(55,812)	24,916

The funded status of the post-employment health benefits plans is as follows:

	2017	2016
Present value of obligations	(316,364)	(305,447)
Total net liabilities	(316,364)	(305,447)

Changes in plan assets and actuarial liabilities were as follows:

	2017	2016	2015
Change in benefit obligation			
Benefit obligation at beginning of the year	305,447	446,842	351,538
Cost of service	4,441	4,481	5,935
Interest expense	12,162	15,494	18,981
Past service cost	5,769	(75,787)	
Contributions from participants	1,556	2,212	2,206
Payment of benefits	(14,230)	(14,799)	(17,245)
Remeasurements	(14,452)	(3,673)	(45,884)

Exchange variations	15,671	(69,323)	131,311
Benefit obligation at the end of the year	316,364	305,447	446,842

	2017	2016	2015
Change in plan assets			
Contributions from sponsors	12,572	12,463	14,733
Contributions from participants	1,556	2,212	2,206
Payments of benefits	(14,128)	(14,675)	(16,939)
Fair value of plan assets at end of the year			

The historical actuarial gains and losses of the plans are as follows:

	2017	2016	2015	2014	2013
Present value of defined benefit obligation	(316,364)	(305,488)	(446,843)	(351,538)	(369,086)
Deficit	(316,364)	(305,488)	(446,843)	(351,538)	(369,086)
Experience adjustments on plan liabilities	(14,452)	(3,673)	(45,884)	42,345	(20,980)

The amounts recognized as actuarial gains and losses in other comprehensive income are as follows:

	2017	2016	2015
Losses on actuarial obligation	14,452	(3,673)	(45,884)
Actuarial losses recognized in Equity	14,452	(3,673)	(45,884)

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The accounting assumptions adopted for post-employment health benefits are as follows:

	2017	2016
Average discount rate	3.25% - 3.50%	3.75% - 4.25%
Health treatment - rate assumed next year	6.88% - 7.60%	6.40% - 6.80%
Health treatment - Assumed rate of decline in the cost to achieve in the years of 2026 to 2041	4.00% - 4.50%	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	92	(765)
Effect over benefit plan obligations	37,871	(47,434)

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$ 23,876 as of December 31, 2017 (R$ 55,276 as of December 31, 2016).

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 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 a result of the final investigations and the determination of the actual environmental impact. The balances of the provisions are as follows:

	2017	2016
Provision for environmental liabilities	85,191	83,806
Current	21,928	17,737
Non-current	63,263	66,069

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 (FIDC), 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 connection with 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$ 1,135,077 as of December 31, 2017 (R$ 1,007,259 on December 31, 2016) 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.

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Reconciliations of common and preferred outstanding shares are presented below:

	2017		2016		2015	
	Common shares	**Preferred shares**	**Common shares**	**Preferred shares**	**Common shares**	**Preferred shares**
Balance at beginning of the year	571,929,945	1,137,018,570	571,929,945	1,114,744,538	571,929,945	1,132,613,562
Acquisition of Treasury shares				(10,000,000)		(19,923,200)
Exercise of stock options		308,614		2,274,032		2,054,176
Transfer of shares				30,000,000		
Balance at the end of the year	571,929,945	1,137,327,184	571,929,945	1,137,018,570	571,929,945	1,114,744,538

At December 31, 2017, 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 2017			
Shareholders	**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 2016			
Shareholders	**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

			Shareholders 2015			
Shareholders	**Common**	**%**	**Pref.**	**%**	**Total**	**%**
Metalúrgica Gerdau S.A.*	449,712,654	78.4	252,841,484	22.1	702,554,138	40.9
Brazilian institutional investors	49,834,446	8.7	73,686,224	6.4	123,530,670	7.2
Foreign institutional investors	13,881,226	2.4	632,717,431	55.2	646,598,657	37.6
Other shareholders	58,501,619	10.2	155,489,399	13.6	213,991,018	12.4
Treasury stock	1,697,538	0.3	31,286,707	2.7	32,984,245	1.9
	573,627,483	100.0	1,146,031,245	100.0	1,719,658,728	100.0

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* Metalurgica 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.

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b) Treasury stocks

Changes in treasury stocks are as follows:

	2017			
	Common shares	**R$**	**Preferred shares**	**R$**
Opening balance	1,697,538	557	9,012,675	98,189
Exercise of stock options			(308,614)	(22,661)
Closing balance	1,697,538	557	8,704,061	75,528

	2016			
	Common shares	**R$**	**Preferred shares**	**R$**
Opening balance	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)
Closing balance	1,697,538	557	9,012,675	98,189

	2015			
	Common shares	**R$**	**Preferred shares**	**R$**
Opening balance	1,697,538	557	13,417,683	232,585
Repurchases			19,923,200	186,033
Exercise of stock options			(2,054,176)	(35,812)
Closing balance	1,697,538	557	31,286,707	382,806

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$ 8.68 during 2017 (R$ 10.89 and R$ 12.24 during the years ended on December 31, 2016 and 2015, respectively).

c) Capital reserves consists of premium on issuance of shares.

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 distribution purposes.

II) Tax incentives reserve under Brazilian Corporate Law, the Company may transfer to this account part of net income resulting from government grants 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.

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The effects of changes in percentage of ownership in subsidiaries for the years presented are composed of:

	December 31, 2017		
	Attributed to parent company s interest	Non-controlling interests	Total
(ii) Other changes		(21,698)	(21,698)
Effects of interest changes in subsidiaries		(21,698)	(21,698)

	December 31, 2016		
	Attributed to parent company s interest	Non-controlling interests	Total
(ii) Other changes		(6,405)	(6,405)
Effects of interest changes in subsidiaries		(6,405)	(6,405)

	December 31, 2015		
	Attributed to parent company s interest	Non-controlling interests	Total
(i) Acquisition of non-controlling interests		(837,437)	(837,437)
(ii) Other changes		12,726	12,726
Effects of interest changes in subsidiaries		(824,711)	(824,711)

(i) Acquisition of non-controlling interests in some Brazilian subsidiaries; (ii) 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 calculated interest on shareholders´ capital for the year ended on December 31, 2015, 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$ 63,074 in 2015.

The dividends credited during the year totaled R$ 85,462, distributed on profits obtained in the first nine months of 2017. As a result of the net loss in 2017, management will propose to the Annual Shareholders Meeting that this amount be considered as distributed using the balance of the Investments and Working Capital Reserve, as shown below:

	2017	2016	2015
Net loss	(359,360)	(2,890,811)	(4,551,438)
Absorption of net loss by investments and working capital reserve	359,360	2,890,811	4,551,438

Dividends and interest on capital in the years

Period	Nature	R$ /share	Outstanding shares (thousands)	Credit	Payment	2017	2016	2015
1st quarter	Interest							101,200
2nd quarter	Dividends	0.02	1,709,205	8/21/2017	9/1/2017	34,184	51,225	
2nd quarter	Interest							84,318
3rd quarter	Interest							
3rd quarter	Dividends	0.03	1,709,267	11/21/2017	12/1/2017	51,278	34,152	67,458
4th quarter	Dividends							
Interest and Dividends						85,462	85,377	252,976
Credit per share (R$)						0.05	0.05	0.15

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NOTE 23 EARNINGS PER SHARE (EPS)

In accordance with IAS 33, Earnings per Share, the following tables reconcile net income to the amounts used to calculate basic and diluted earnings per share.

Basic

	2017		
	Common	**Preferred**	**Total**
	(in thousands, except share and per share data)		
Basic numerator			
Allocated net income (loss) available to common and preferred shareholders	(120,267)	(239,093)	(359,360)
Basic denominator			
Weighted-average outstanding shares, after deducting the average tresuary shares	571,929,945	1,137,012,265	
Earnings per share (in R$) Basic	(0.21)	(0.21)	

	2016		
	Common	**Preferred**	**Total**
	(in thousands, except share and per share data)		
Basic numerator			
Allocated net income (loss) available to common and preferred shareholders	(969,954)	(1,920,857)	(2,890,811)
Basic denominator			
Weighted-average outstanding shares, after deducting the average tresuary shares	571,929,945	1,132,626,373	
Earnings per share (in R$) Basic	(1.70)	(1.70)	

	2015		
	Common	**Preferred**	**Total**
	(in thousands, except share and per share data)		
Basic numerator			
Allocated net income (loss) available to common and preferred shareholders	(1,541,242)	(3,010,196)	(4,551,438)
Basic denominator			
Weighted-average outstanding shares, after deducting the average tresuary shares	571,929,945	1,117,034,926	
Earnings per share (in R$) Basic	(2.69)	(2.69)	

Due to the net loss in the years of 2017, 2016 and 2015, the Company is considering for these 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.

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NOTE 24 NET SALES REVENUE

The net sales revenues for the year are composed of:

	2017	2016	2015
Gross sales	42,156,553	42,935,022	48,701,895
Taxes on sales	(2,956,896)	(2,765,957)	(3,184,879)
Discounts	(2,282,038)	(2,517,398)	(1,935,775)
Net sales	36,917,619	37,651,667	43,581,241

NOTE 25 - LONG-TERM INCENTIVE PLANS

a) Restricted Shares and Performance Shares Summary:

Balance on January 1, 2015	**10,086,234**
Granted	9,098,389
Forfeited	(2,717,724)
Exercised	(3,941,643)
Balance on December 31, 2015	**12,525,256**
Granted	13,357,922
Forfeited	(3,046,593)
Exercised	(2,403,094)
Balance on December 31, 2016	**20,433,491**
Granted	3,170,952
Forfeited	(1,901,782)
Exercised	(2,727,577)
Balance on December 31, 2017	**18,975,084**

In 2017, the Company approved changes to the long-term incentive plan allowing the use of multiple forms of share-based compensation and changing the grace period of each grant to three years. In 2017 Restricted Shares and Performance Shares were granted.

b) Stock Options Plan:

	2017		2016		2015	
	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	569,115	16.64	1,074,246	18.36	2,448,973	19.53

Options Exercised					(25,210)	19.56
Options Forfeited	(276,724)	15.11	(505,131)	20.49	(1,349,517)	20.98
Available at the end of the year	292,391	17.91	569,115	16.64	1,074,246	18.36

The average market price of the share in the year ended December 31, 2017 was R$ 11.19 (R$ 7.68 and R$ 7.70 in the years ended on December 31, 2016 and 2015, respectively).

As of December 31, 2017 the Company has a total of 8,704,061 preferred shares in treasury. These shares may be used for serving this plan. The exercise of the options before the grace period end was due to retirement or death.

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Exercise price	Quantity	Average period of grace (in years)	Average exercise price R$	Number exercisable at December 31, 2017*
R$ 14.39	40,873	1.2	13.89	40,873
R$ 10.58 to R$ 29.12	251,518	5.0	18.56	16,795
	292,391			57,668

*The total of options vested that are exercisable on December 31, 2017 is 57,668 (57,678 and 127,899 on December 31, 2016 and 2015).

During the years ended December 31, 2017, 2016 and 2015, the long-term incentive plans costs recognized in income for all equity settled awards were R$ 25,403, R$ 38,023 and R$ 39,657, respectively.

The Company recognizes costs of employee compensation based on the fair value of the options granted, considering their fair value on the date of granting. The Company uses the Black-Scholes model for determining the fair value of the options. There were no options granted for this plan in 2017.

c) Other Plans North America

In February 2010, the Board of Directors approved, to the North American subsidiary, the adoption of the Equity Incentive Plan (the EIP). Awards under the EIP may take the form of stock options, SARs, deferred share units (DSUs), restricted share units (RSUs), performance share units (PSUs), and/or other share-based awards. Except for stock options, which must be settled in common shares, awards may be settled in cash or common shares as determined by the Company at the time of grant.

For the portion of any award which is payable in options or SARs, the exercise price of the options or SARs will be no less than the fair market value of a common share on the date of the award. The vesting period for all awards (including RSUs, DSUs and PSUs) is determined by the Company at the time of grant. Options and SARs have a maximum term of 10 years.

In 2016, a grant of approximately US$ 9.9 million (R$ 34.5 million) was granted to EIP participants. The Company issued 2,846,835 RSUs and 3,820,894 PSUs, which will be accrued through the vesting period of 5 years.

In 2015, an award of approximately US$ 13.9 million (R$ 46.4 million) was granted to participants under the EIP. The Company issued 3,833,542 RSUs, and 1,792,456 PSUs under this plan. This award has being accrued over the vesting period of 5 years.

In connection with the adoption of the EIP, the Company terminated the existing long-term incentive plan (LTIP), and no further awards will be granted under the LTIP. All outstanding awards under the LTIP will remain outstanding until either exercised, forfeited or they expire. On

December 31, 2017, there were 535,543 SARs and 40,873 stock options outstanding under the LTIP. These awards have been accrued over the vesting period of 4 years.

As of December 31, 2017 and December 31, 2016, the outstanding liability for share-based payment transactions included in other non-current liabilities of the subsidiaries in North America was US$ 9 thousand (R$ 29.8) and US$ 10 thousand (R$ 32.6), respectively.

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NOTE 26 SEGMENT REPORTING

	Business Segments 2017					
	Brazil Operation	North America Operation	South America Operation	Special Steels Operation	Eliminations and Adjustments	Consolidated
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)
Gains and losses on assets held for sale and sales of interest in subsidiaries and associate company					(721,682)	(721,682)
Reversal of contingent liabilities, net					929,711	929,711
Equity in earnings of unconsolidated companies		(111,581)	41,554	15,460	19,970	(34,597)
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					
	Brazil Operation	North America Operation	South America Operation	Special Steels Operation	Eliminations and Adjustments	Consolidated
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)
Gains and losses on assets held for sale and sales of interest in 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

			Business Segments 2015			
	Brazil Operation	**North America Operation**	**South America Operation**	**Special Steels Operation**	**Eliminations and Adjustments**	**Consolidated**
Net sales	12,977,327	17,312,166	5,477,228	8,882,071	(1,067,551)	43,581,241
Cost of sales	(11,433,115)	(15,800,270)	(4,800,063)	(8,333,189)	1,076,111	(39,290,526)
Gross profit	1,544,212	1,511,896	677,165	548,882	8,560	4,290,715
Selling, general and administrative expenses	(821,152)	(814,393)	(313,521)	(371,481)	(261,938)	(2,582,485)
Other operating income (expenses)	3,638	18,379	2,985	21,791	50,207	97,000
Impairment of assets	(834,665)	(1,882,239)	(354,468)	(1,924,868)		(4,996,240)
Equity in earnings of unconsolidated companies		(72,774)	36,550		11,722	(24,502)
Operational (Loss) income before financial income (expenses) and taxes	(107,967)	(1,239,131)	48,711	(1,725,676)	(191,449)	(3,215,512)
Financial result, net	(624,526)	(234,183)	(98,557)	(288,021)	(1,633,609)	(2,878,896)
Income (Loss) before taxes	(732,493)	(1,473,314)	(49,846)	(2,013,697)	(1,825,058)	(6,094,408)
Income and social contribution taxes	60,804	5,196	(104,308)	(283,633)	1,820,363	1,498,422
Net income (Loss)	(671,689)	(1,468,118)	(154,154)	(2,297,330)	(4,695)	(4,595,986)
Supplemental information:						
Net sales between segments	817,494	121,292	685	128,080		1,067,551
Depreciation/amortization	928,861	836,660	192,014	650,374		2,607,909
Investments in associates and jointly-controlled entities		725,356	575,845	2,082	89,599	1,392,882
Total assets	20,791,119	27,324,285	7,046,438	17,077,208	(2,144,341)	70,094,709
Total liabilities	12,831,815	7,214,899	2,451,835	9,369,552	6,256,225	38,124,326

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.

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The column of eliminations and adjustments includes the elimination of sales between segments, corporate expenses, gains and losses on assets held for sale and sales of interest in subsidiaries and associate company, reversal of contingent liabilities, net, reversal of monetary update of contingent liabilities, net 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:

	Brazil 2017	Latin America (1) 2017	North America (2) 2017	Europe/Asia 2017	Geographic Area Consolidated 2017
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

	Brazil 2016	Latin America (1) 2016	North America (2) 2016	Europe/Asia 2016	Consolidated 2016
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

	Brazil 2015	Latin America (1) 2015	North America (2) 2015	Europe/Asia 2015	Consolidated 2015
Net sales	14,033,792	6,653,980	19,813,519	3,079,950	43,581,241
Total assets	22,803,505	9,327,457	36,048,019	1,915,728	70,094,709

(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	2017	2016
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).	57,062,113	60,924,807
Business Interruption	Net income plus fixed expenses	6,464,512	8,354,147
Civil Liability	Industrial operations	535,896	527,974

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 annually in December, or being anticipated whenever changes in events or circumstances indicate that the goodwill and other long-lived assets may be impaired.

To determine the recoverable amount of each business segment, the Company uses the discounted cash flow method, using as basis, financial and economic projections for each segment. 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.

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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.

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, where the increase in the pre-tax discount rate was 0.5% compared to 2016.

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 (R$ 2,917,911 in 2016), of which R$ 265,369 (R$ 239,329 in 2016) as a result of the impairment test of other long-lived assets (note 28.1) and R$ 849,438 (R$ 2,678,582 in 2016) as a result of the goodwill impairment test (note 28.2).

28.1 Other assets Impairment test

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). In 2016, due to the interruption of certain activities as result of significant changes in the economy of the region where these units are located and the lack of expectation of future use of some assets of these industrial plants, tests performed on other long-lived assets identified impairment losses on property, plant and equipment in the amount of R$ 239,329, of which R$ 138,765 in the South America segment and R$ 100,564 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 in the amount of R$ 138,543, 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 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. In 2016, the tests identified an impairment loss of goodwill in the amount of R$ 2,678,582 for the North American segment caused by the deterioration of the economic conditions reflected by the decrease of the EBITDA margin at that time.

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 2017 test were: a) North America: 3% (3% in December 2016); b) Special Steel: 3% (3% in December 2016); c) South America: 3% (3% in December 2016); and d) Brazil: 3% (3% in December 2016).

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: 13.6% (13.1% in December 2016); b) Special Steel: 13.1% (14.0% in December 2016); c) South America: 14.7% (14.6% in December 2016); and d) Brazil 15.2%: (14.9% in December 2016).

Discounted cash flows are compared to the book value of each segment and result in the recoverable amount as shown below: a) North America: below the book value of R$ 849 million (below the book value of R$ 2,679 million in 2016); b) South America: exceeded the book value by R$ 437 million (exceeded the book value by R$ 724 million in 2016); c) Special Steel: exceeded the book value by R$ 3,989 million (exceeded the book value by R$ 1,601 million in 2016); and d) Brazil: exceeded the book value by R$ 1,747 million (exceeded the book value by R$ 1,225 million in 2016).

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.

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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: below book value of R$ 506 million (below the book value by R$ 872 million in 2016); b) Special Steel: exceeded book value by R$ 3,422 million (exceeded the book value by R$ 1,170 million in 2016); c) South America: exceeded book value by R$ 265 million (exceeded the book value by R$ 486 million in 2016); and d) Brazil: exceeded the book value by R$ 999 million (exceeded the book value by R$ 425 million in 2016).

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: below the book value by R$ 310 million (below the book value by R$ 661 million in 2016); b) Special Steel: exceeded the book value by R$ 3,596 million (exceeded the book value by R$ 1,301 million in 2016); c) South America: exceeded the book value by R$ 318 million (exceeded the book value by R$ 561 million in 2016); and d) Brazil: exceeded the book value by R$ 1,254 million (exceeded the book value by R$ 673 million in 2016).

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. The expenses classified by nature is as follows:

	2017	**2016**	**2015**
Depreciation and amortization	(2,092,551)	(2,535,955)	(2,607,909)
Labor expenses	(5,514,721)	(6,508,834)	(7,018,129)
Raw material and consumption material	(23,423,950)	(22,863,693)	(27,126,417)
Freight	(2,281,773)	(2,279,459)	(2,538,071)
Impairment of assets	(1,114,807)	(2,917,911)	(4,996,240)
Gains and losses on assets held for sale and sales of interest in subsidiaries and associate company	(721,682)	(58,223)	
Reversal of contingent liabilities, net	929,711		
Other expenses/income, net	(1,563,177)	(2,111,181)	(2,485,485)
	(35,782,950)	(39,275,256)	(46,772,251)
Classified as:			
Cost of sales	(33,312,995)	(34,187,941)	(39,290,526)
Selling expenses	(524,965)	(710,766)	(785,002)
General and administrative expenses	(1,129,943)	(1,528,262)	(1,797,483)
Other operating income	260,618	242,077	213,431
Other operating expenses	(168,887)	(114,230)	(116,431)
Impairment of assets	(1,114,807)	(2,917,911)	(4,996,240)
Gains and losses on assets held for sale and sales of interest in subsidiaries and associate company	(721,682)	(58,223)	

Reversal of contingent liabilities, net	929,711		
	(35,782,950)	(39,275,256)	(46,772,251)

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NOTE 30 FINANCIAL INCOME

	2017	2016	2015
Income from short-term investments	85,153	142,965	270,742
Interest income and other financial income	141,462	109,080	107,660
Financial Income	226,615	252,045	378,402
Interest on debt	(1,323,448)	(1,540,797)	(1,471,526)
Monetary variation and other financial expenses	(402,836)	(469,208)	(308,840)
Financial Expenses	(1,726,284)	(2,010,005)	(1,780,366)
Exchange Variation, net	(4,057)	851,635	(1,564,017)
Reversal of monetary update of contingent liabilities, net	369,819		
Gains and losses on financial instruments, net	(9,441)	(38,930)	87,085
Financial result, net	**(1,143,348)**	**(945,255)**	**(2,878,896)**

NOTE 31 SUBSEQUENT EVENTS

I) On January 8, 2018, the Company s Board of Directors authorized the Company to acquire shares of its own issuance, within a period of up to 3 months from the date of the authorization, of up to 10,000,000 preferred shares (GGBR4) or American Depositary Receipts (ADRs). This authorization has the purpose to support the Long-Term Incentive Plan of the Company and its subsidiaries, keeping in Treasury, cancelling or further selling in the market. The acquisition will be supported by retained earnings, being the Board responsible for defining the number of shares and the opportunity of each operation. On January 17, 2018 the share repurchase program was completed.

II) On January 31, 2018, the Company announced a definitive sale agreement for its wire rod mill located in Beaumont, Texas, as well as two processing units for Optimus Steel LLC for US$ 92.5 million (equivalent to R$ 292.5 million), subject to usual adjustments in the acquisition value. The agreement includes the Company s Beaumont, Texas-based mill and Beaumont Wire Products and Carrollton Wire Products. The mill has a melt shop with the capacity to produce approximately 700,000 short tons of steel per year and is capable of rolling wire rod and rebar in roll. On April 2, 2018, the Company informed, through a notice to the market, that this sale was completed.

III) On February 14, 2018, the Company announced 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, inaugurated in 2010, have a total installed capacity of 155 MW. The transaction is subject to regulatory approvals and the usual closing conditions.

IV) On February 26, 2018, the Company proposed payment of dividend on account of pre-existing profit reserves, which will be calculated and credited to the positions held by the shareholders on March 3, 2018, in the amount of R$ 51,0 million (R$ 0.03 per common and preferred share), with payment expected for March 21, 2018, which was submitted and approved by the Board of Directors on February 27, 2018.

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