

BR-L1118 Gerdau Açominas Investment Program
Brazil
Environmental and Social Strategy¹

A. Project and Company Overview

1. *Gerdau Açominas S.A.* (“Gerdau Açominas”, or the “Company”, or the “Borrower”), a company incorporated in Brazil, is the largest steel mill of the Gerdau group of companies (the “Gerdau Group”). The Company is implementing a US\$ 1.5 billion capital expenditure program aimed at increasing its production capacity at the *Ouro Branco* Mill located between the cities of *Ouro Branco* and *Congonhas*, in the State of *Minas Gerais*, Brazil, and about 100 kilometers to the southeast of the state capital, *Belo Horizonte*. As part of this program, the Company is undertaking a US\$ 300 million investment plan that comprises the installation in a area of about 4.2 hectares of: (i) a new continuous slab-casting equipment to produce raw material for flat steel production; (ii) a vacuum degassing unit to improve steel quality; (iii) gantry cranes and ancillary equipment (together the “Investment Plan”); and (iv) water-based cooling towers and water recirculation system. This Investment Plan is being considered for possible support by IDB.
2. The *Ouro Branco* Mill has an annual production capacity of 3.0 million tons of steel per year and the entire area of the property extends over 1000 hectares. The Investment Plan, together with other improvements being made at the plant, will increase its capacity by 50 percent to 4.5 million tons of steel per year. The expansion of the Company’s capacity is focused on meeting the demands of the international market, which accounts for more than 70 percent of its production.
3. The Company is a closed capital company incorporated in Brazil and controlled by Gerdau, which owns 89.36 percent of its total and common shares. The remainder of its common shares is owned by *Metalúrgica Gerdau S.A.* (0.20%), *Santa Felicidade Comércio, Importação e Exportação de Produtos Siderúrgicos Ltda.* (0.16%) and others (10.28%).
4. The Company started operations in 1986, and produces steel billets, slabs, blooms, wire rod and structural profiles, which are sold in over 40 countries, in addition it generates carbon compounds and by-products used in the metal and chemical industries and in road paving. It sells its products to rolling mills and to companies that use slabs, billets, blooms and ingots as raw material for their finishing lines such as shipbuilding, forging and mechanical. It also produces its own finished products such as high quality wire rod and sections.

B. Environmental and Social Compliance Status

5. Brazilian and State of *Minas Gerais* environmental legislation usually foresees three sequential environmental licenses for large projects that are being planned to be installed in a new area: (i) a Preliminary License at planning stage; (ii) an Installation License to initiate construction; and (iii) an Operating License authorizing operation of the facility.

¹ This Environmental and Social Strategy (ESS) is being made available to the public in accordance with the Bank’s Policy on Disclosure of Information. The ESS has been prepared based primarily upon information provided by the project sponsors and does not represent either the Bank’s approval of the project or verification of the completeness or accuracy of the information. The Bank, as part of its due diligence on the feasibility of the project, will assess the environmental and social aspects.

6. However, in case of some expansion projects, such as the ones involved in the Investment Plan, the Preliminary License may not be required. In fact, the Minas Gerais State Environmental Agency (Portuguese acronym - FEAM), responsible for the review and recommendation for the issuance of environmental licenses in the state, decided that the licensing process for the expansion of the Gerdau Açominas would start with the Installation License, as it will be developed in an area inside the mill area, and requested the Company to present an Environmental Control Report (Portuguese acronym - RCA) and an Environmental Management Plan (Portuguese acronym - PCA). Regarding to the Investment Plan, the Company prepared and submitted the applicable RCA and PCA to FEAM at the end of January 2007, the licensing inspection by FEAM was performed in May, and the Installation License is expected to be granted shortly.
7. The Bank will require that the environmental assessment reports (RCA and PCA) related to the Investment Plan be disclosed to the Public according to IDB's OP-102 Disclosure of Information Policy.

C Potential Impacts and Risks and Control Measures

8. The projects integrated in the Investment Plan will be located in the existing steel mill complex, in an area adjacent to the main steel mill buildings. Hence, the potential negative environmental and social impacts and risks associated with ground preparation and overall implementation of the new facilities will be substantially reduced.
9. Gerdau Açominas' facilities are located away from any conservation or indigenous areas, and the land acquisition and preparation process did not require or involve relocation of people. Thus, it appears that the Investment Plan and Gerdau Açominas' facilities and operations will or do not: (i) convert or degrade critical natural habitats or damage critical cultural sites; (ii) significantly convert or degrade natural habitats; (iii) raise any significantly negative indigenous issues; and (iv) generate any resettlement issues. Moreover, as the mill facilities are surrounded by a relatively wide forested buffer zone, there are no sensitive receptors or units nearby and these circumstances contribute to lower considerably the significance of impacts related to air and noise emissions.
10. Potential negative impacts associated with construction of the projects integrated in the Investment Plan will be those typical of works of this nature: (i) dust and noise emissions; (ii) increase in road traffic associated with the supply of construction materials and equipment during installation; and (iii) influx of workers to the region. However, these impacts will be limited in scale and temporary, and can be mitigated with the standard construction environmental management procedures established by the Company. Moreover, the significance of these impacts will be attenuated by the location of the new facilities in an existing industrial complex, as indicated in the paragraphs above.
11. The most relevant potential negative environmental and social impacts associated with the operation of the projects integrated in the Investment Plan will be related to: (i) emissions of particulate matter generated at silos used to store flux materials²; (ii) generation of liquid effluent from periodic purges at the water recirculation system; and (iii) noise emissions. However, the new facilities will be provided with bag filters to retain the particulate matter coming from the silos and press filters to clean the liquid effluent coming from water purges, and, as mentioned, the industrial complex is surrounded by a buffer zone so that the noise

² Flux are substances or minerals, such as lime and fluorite, which are added for the purpose of aiding the removal of impurities and lowering the melting point of raw materials in steel production.

emissions from the new facilities will not represent a significant impact. The new facilities will also generate industrial solid wastes such as metal bits, dust cake from the bag filters and mud from the water purge filtering system; nevertheless, most of these solid wastes will be recycled at the mill facilities and, as consequence, there will be no significant environmental impacts associated with them. Therefore, most of the environmental and social impacts associated with the new facilities will be limited or controlled.

12. Also in relation to the operation of the new facilities, there may be risks to workers in relation to possible accidents (*e.g.*, contact with hot surfaces and moving parts, fires, explosions, spills), as is expected in any typical industrial setting of this nature. However, the Company will adopt health and safety procedures and plans to both reduce the risks and consequences to worker's health and safety, either at normal operation or in relation to accidents.
13. In terms of potential risks, there may exist some limited environmental liabilities associated with Gerdau Aço Minas' existing facilities and operations, which go beyond the Investment Plan that is being considered for financing by IDB. Based upon information provided, the Company management of these risks includes: (i) apparent adequate capacity and commitment to address and manage environmental matters; (ii) the Company has in place an environmental policy and possesses an environmental management system ("EMS") and a health and safety management system. The EMS is ISO-14001 certified since 2004 and regular internal and external audits are performed at the mill facilities. The Company undertakes also activities to monitor water quality, soil quality, source and ambient air quality, and noise levels, in the realm of monitoring plans developed taking into account requirements set for by environmental authorities and/or established by specific technical standards.
14. It should be noted that the more modern process technologies selected to be used in the expansion of the Gerdau Aço Minas mill, *i.e.* new continuous slab-casting equipment and the vacuum degassing unit, will have associated with them a lower environmental impact potential when compared with more traditional technologies. Furthermore, by eliminating old and more energy consuming processes such as ingot pre-heating and ingot rolling, the new continuous slab-casting machine will allow an economy of energy at the mill, notwithstanding the increase in overall production capacity.

D. Environmental and Social Strategy

15. Taking into account the aspects discussed in **Section C** and the requirements outlined in IDB's OP 703 Environment and Safeguards Compliance Policy, the Team proposes that the Project be classified as a Category B operation.
16. The Team also proposes to perform an Environmental and Social Due Diligence ("ESDD") to assess the potential environmental and social viability of the Investment Plan in terms of Bank policies and requirements. Since there are limited impacts related to the Investment Plan, the ESDD will also focus on potential risks related to possible impacts associated with the Company's activities that are not part of the IDB financing. The ESDD will include: (i) review of the proposed Investment Plan to confirm that even the limited environmental, social and health and safety impacts will be properly mitigated; (ii) review of Gerdau Aço Minas' activities and relevant existing facilities to identify possible liabilities (*i.e.*, existing impacts and risks) associated with environmental and social, health and safety, and labor aspects; (iii) assessment of the Company's commitment, capacity, and systems to adequately manage both present and future impacts and risks; and (iv) as applicable, development of an environmental, health and safety action plan to implement any recommended actions identified as part of the ESDD.