Q1 2010 Earnings Call

Company Participants

- Fabio Barbosa, CFO
- Jose Carlos Martins, Executive Officer for Ferrous Minerals
- Tito Martins, Executive Officer Non

Other Participants

- Felipe Hirai, Analyst
- Leonardo Correa, Analyst
- Marcos Assumpcao, Analyst
- Rene Clewag, Analyst
- Rodolfo de Angele, Analyst
- Rodrigo Barros, Analyst
- Tony Rizzuto, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. Thank you for standing by and welcome to Vale's Conference Call to discuss First Quarter 2010 Results. If you do not have a copy of the relevant press release, it is available at the Company's Website at www.vale.com at the Investor's link. (Operator Instructions). As a reminder, this conference is being recorded.

To access a replay, please dial 55 11 46 88 6312; the access code 46525. The file will also be available at the Company's website at www.vale.com at the Investor section.

This conference call and the slide presentation are being transmitted via internet as well. You can access the webcast by logging on to the Company's website at www.vale.com, Investor section, or at www.prnewswire.com.br.

Before proceeding, let me mention that forward-looking statements are being made under the Safe Harbor of the Securities Litigation Reform Act of 1996. Actual performance could differ materially from that anticipated in any forward-looking comments and as a result of macroeconomic conditions, market risks, and other factors.

With us today are Mr. Fabio Barbosa, Chief Financial Officer; Mr. Jose Carlos Martins, Executive Officer for Ferrous Minerals; and Mr. Tito Martins, Executive Officer for Non-ferrous Minerals.

First, Mr. Barbosa will proceed to the presentation, and after that we will open for questions and answers. It is now my pleasure to turn the call over to Mr. Barbosa. Please sir, you may now begin.

Fabio Barbosa {BIO 1907620 <GO>}

Good morning, ladies and gentlemen. Thank you very much for attending this conference. It's a pleasure to be here with you today.

Let's start our discussion in this conference call by saying that what we saw in the First Quarter of the year just confirmed our expectations about the future for our Company and our industry and markets in general.

We saw a very positive development and very much in line with what we discussed in the previous earnings release and throughout particularly the second half of 2009. So recovery is underway and we are happy to see that we are right, including by the fact of preserving our growth capacity, our investments throughout the most difficult period as to the world economy in the last 80 years.

So our agenda today; we are going to talk about some-- a few variables in our First Quarter release and then a very important topic; how we are dealing with the structural change that is taking place, particularly in the iron ore market. Then we will comment on how we see the world economy evolving and finally a few comments on how we are addressing this very bright scenario in terms of our strategy and managing the tools to promote growth and value creation.

Starting with the First Quarter release; we had a very sound performance. Operating revenues grew by 4.7%, adjusted EBIT margin by almost 1400 basis points, EBITDA 33% and net earnings 5.6% growth; so very positive performance, clearly stating what we said about the recovery of the economy, not only the absolute numbers but the very quality of the results sharply improved in the First Quarter of 2010 with the predominance of operating income in the explaining the performance of net earnings, another evidence of this strong operational performance that we had.

At the same time, our EBITDA was favored by a very clear effect of prices, prices associated with the very development that we commented on just now. And also cost reduction was a very important element in explaining the variation of EBITDA from the Fourth Quarter of '09 to 2010.

Some seasonally lower R&D expenses and exchange rate would explain the remaining effects. Counter-balanced by lower dividends and sales volumes that we observed in the First Quarter compared to the Fourth Quarter, given the seasonality also related to the production-- particularly in the Northern region and the rainy season.

And costs, as I said, was a major achievement in our view. We had $354 million of actual cost savings. We said in the Fourth Quarter release that there were some non-recurring elements explaining the sharp increase in costs observed then, but also on the top of the lack of those elements in the First Quarter, we also had the important contribution of cost savings to drive down total cost to $4.4 billion; down from almost $5 billion in the Fourth Quarter of '09.

Turning to the second session; let's talk about the structural change that is taking place, in particular in the iron ore market. This is of course a direct result of the shift of geographies and the new players that came to the market, particularly in the last decade, in this very decade; we are talking about China. So if in the past Japan was the major driver of the establishment of new prices and new supply-demand arrangement, now we see that China is also playing a role of a transformational player in the iron ore market.

Then we see that today, most of the seaborne and almost 70% of the seaborne is driven by China. So it's a massive change in this market and of course in line with this change of player, there are also changes in the way things are done the way things are discussed. And the very resurgence of the very increase of the relevance of spot iron ore in total group of seaborne; it's an important element of this discussion.

And with that, I would like to turn the floor to Martin to comment about this transformation and how he sees the new arrangement taking place.

Jose Carlos Martins {BIO 1715332 <GO>}

Good morning, everybody. Good afternoon. First of all, Fabio already explained that China is now a driving factor behind the iron ore demand in the world; 70% of the seaborne is now driven by China.

And the second consequence is that the spot inside China is a very important factor. So the combination of a huge increase in the demand from China and also the huge increase of seaborne-- the huge increase of spot market prices in the iron ore in China; is driving the market now.

In the past, we never had the (liquids) market to drive the price of iron ore and now we have. So I think that is the main change which is going on in the last three or four years. This fact is increasing and has now reached the point that we cannot live with the system we are used to live in the past.

Vale always defends the benchmark system. We always support the benchmark system. But we learned in the last crisis that the benchmark system does not work anymore. Part of our customers in China decided to buy in the spot.

Outside China, we have a lot of different behaviors; but one way or another, disregarding the contract or commitments, some customers postponed their purchasing in order to get a better price after the new benchmark was set. Some of the customers didn't treat us what we call in a fair way because if the customers-- iron ore is only used to produce steel, so we recognize this fact so when the customer is not producing-- so he can reduce the purchasing of iron ore from us. But they have to do it in a fair way.

And Vale learned during this crisis that we were the most affected iron ore company. Although we defend the system, we were affected by the system negatively.

So our commitment to benchmarking is over and we now want to move to a pricing system that has more of a relationship with the market that now is there.

In the past, we didn't have kind of a spot market reference, but now we have. So if you have-- if the size is big enough to give it liquidity, to give it transparency and also to avoid the manipulation, so that's very reasonable for us to use this market as a reference. And so that's what we are doing.

We are now-- we have for this quarter 100% of our sales under the new system which is based on an average of the market price. We have, besides that, we have one month for the customer to see where the price will be for the next quarter. We also have a reference for the quality, so we have-- how to price the VIU, value-in-use of our ore and also establish a kind of band. If the price stays inside that band, we keep the same price. So we're not telling that the prices have to be fixed-- for only for three months. If we don't have a big variation in the average price, the price could be the same forever as long as the average stays inside that band.

So we consider the difference between-- we consider not only quality difference but also proximity; the customer that's closer to the iron ore will pay less on a CFR basis. So I think the system we designed and we are negotiating with our customers has some very good characteristics inside him and I think it's fair.

Another point that we look in the system is transparency. The system we can look at the prices; I think today you can see every day several sources of spot prices in China. You can look at the sites. You can look at the newspapers. You have a lot of publications that have these prices. So the prices are very transparent and we are completely open to negotiate different indexes or baskets of index and different averages; so whatever the customers can agree with us, we are open to give--freedom to negotiate the average and to negotiate the indexes and a basket of index.

We can also negotiate the band. So there is a freedom for negotiations. So we are not imposing our system. But we want a system that avoids discussions and avoids every year disputes; we want to have a more proactive and more beneficial relationship with our customers. And every year discuss if the price will increase-- 60% or 70% or going down 30%, 40% or 50%. There's always a question of dispute between customers.

In the past, the benchmark system variation was 2%-3%-5%-10%; so now we are going to a period that the market is changing so fast that we need a system that can have what we call flexibility, but just faster to the market conditions. And we believe that after we have more time with this new system, customers will feel more comfortable with that.

We can avoid a lot of discussions like with this big difference between spot and benchmark, people trying to buy at benchmark prices to sell in the spot business to make a lot of money. So all of these discussions that brought not only economic aspects to the business we want to avoid. And we think that this system that we are discussing with our customers now will help in this way.

Fabio Barbosa {BIO 1907620 <GO>}

If you want more details on these new arrangements that we are discussing, we have in our earnings release a detailed description of what we are discussing with our clients.

Moving to the prospects of the economy; what we see is that a manufacturing boom is underway and of course the industrial production increasing-- it's a major driver of additional demand for minerals and metals. We have the PMI back to record levels and the global industrial production also resuming a very steady growth path, meaning that more demand is out there for minerals and metals, in particular. But not only minerals and metals; the world economy as a whole should grow this year in the range of 3.5% to 4%.

And so this is part of this process in which emerging market economies are of course a major driver, but counting on a very clear recovery of the U.S. economy.

Global carbon steel output, if you see on slide 17, it's back to the peak level before the crisis in June 2008. Of course there's a major change in composition with China assuming a larger share, but the fact is that from the standpoint of steel production growth and steel production, we are back to where we were just before the collapse of Lehman Brothers.

And the very positive environment is of course favoring price formation of iron ore and we see there in slide 18 that one of the latest figures we had-- iron ore a ton at $176, according to Platts IODEX index at 62%. This is a very important comment; Martin has just reminded me about this because another indication of the strength of the market is the varied cost attribute about to the 1% of the differential. That is showing a very high level compared to what we observed throughout 2009. Now it's estimated to be around $5.50 per ton-- sorry per 1% per ton.

So if we are talking about Carajas at 67%, we are talking about $27.50 more on the top of the price that we are seeing here, just to give you a reference of what Martin said about the early news.

We also believe that this is nonsense talking about deceleration in the Chinese economy. This economy has shown its resilience over time and what we see today is an increased importance of domestic demand in the much more selective macro-economic stabilization set of measures.

So instead of what we saw in 2007-2008 when credit was curtailed across the board, what now as we put in our release-- we have a clear target for the measures that are being adopted whereas speculative buying of homes, for instance, being curbed and the developing of new supply of lower-income, lower-end houses are being stimulated by the government.

So it's a much more (inaudible) smart approach and this should not represent any threat in our view to the future growth prospects of China. To the contrary; what we see is a growing importance of domestic demand, in total GDP and this should further reduce the vulnerability of the economy moving forward to fluctuations in the developed world, particularly in Europe where of course the continent has a major challenge ahead of it.

So the result is that prices are reflecting the strength of the market with as we saw in the Platts IODEX 62%. And we don't see any meaningful change in the supply of iron ore, right, Martins, we don't see in China at this stage even with this price incentive that is right there.

Jose Carlos Martins {BIO 1715332 <GO>}

Yes; I think the main competition could come from local ore. And it seems they are reaching their limit as far as iron ore content, as far as environmental difficulties that they have there; so it seems that the local production cannot grow as fast as local big iron production is growing.

Fabio Barbosa {BIO 1907620 <GO>}

So supply there is restricted and demand very strong; so the result has been shown by market indicator there, as you can appreciate by the last few slides.

Turning to the stainless steel, I would like to ask our colleague Tito Martins to comment on the industry-- the nickel industry and the demand. Tito, could you please?

Tito Martins {BIO 3374920 <GO>}

Yes Fabio, thank you. As you can see in slide 21, we are seeing a recovery in the stainless steel market. As was said before, most of the metal markets are returning to growth. We see a very strong demand coming from China.

In terms of nickel consumption, we are not sure about the levels of the stocks of nickel in the Chinese market but we know that if the situation remains as it is today, we should see a more stable level for nickel prices.

If we look at the slide 22, prices are back to what they were in mid 2008, showing that the demand is strong. As a consequence of the demand in China, we can see also some movement in the U.S. and less in Europe. But in any case, our customers, they've been much more concerned about the supply of nickel in the world and we are confident that demand should be more stable along the next year.

But specifically about our production I think it's important to mention that you will not see it in our numbers, but we've managing to return to the production in the Canadian operations mostly Sudbury in Newfoundland and Labrador. And on the Second Quarter we should be able to show in our numbers the results of this return. We have already managed in the last quarter to produce more than 6,300 tons of nickel content in

Sudbury, reflecting actually almost-- less than three months of production because we started the furnace in Sudbury at the end of January.

So we are committed to supply to our customers and we think that the market is actually eager to see our products coming back. Back to you, Fabio.

Fabio Barbosa {BIO 1907620 <GO>}

Okay. Thank you. To finalize this initial discussion, let's talk a little bit about strategy and how we have been managing the several tools to reach growth and value creation. And as you can see in slide 23, discipline in capital allocation is of essence of our strategy. So we have a multi-lane road to value creation, as we put there, through existing assets and new assets. So we have been exploring all of them in a way that we believe is very efficient, given the results that we are delivering to our shareholders and have been delivering to our shareholders in the last several years.

So as part of our development of new assets, for instance we have-- or the existing assets sorry-- we had the expansion of Carajas, the additional 20 million tons; a very creative project that was devised by Martin's team and we managed to-- by adjusting the original project, to double the expected result of our original additional (inaudible) and the result-- this is the only major project that we had coming on stream this year and at a very low CapEx cost of $29 per ton.

It's a very important achievement and on top of that it's environmentally friendly as you can appreciate by what I say that.

And on the other side, on the acquisition of assets, I would like Martins to comment a little bit on Simandou. That's a major important acquisition that we just announced and Martins was the chief negotiator and the strategist behind this very important acquisition for Vale. Martins, could you comment on Simandou very briefly please?

Jose Carlos Martins {BIO 1715332 <GO>}

Yes, Simandou is a project that was always on our radar. So Vale arrived a little bit later at that area. Competitors were there many years before, so it took some time from us to put our foot there. And finally we got the opportunity to do it.

Simandou is one of the largest resources of iron ore in the world, high quality; similar to Carajas; also quality and quantity-wise. So for Vale, it was always our dream to be there and we came a little bit later but we have the opportunity to reach this agreement with BSGR, so now we are there and our plan is to foster as fast as possible, production in that area.

As you probably know, we have a lot of resources in Brazil and we are developing it. But the situation here is taking more time because-- to get the approvals environmentally speaking it takes a long time. And we believe that in Simandou we can move faster in the development. This is a project that will affect not only Guinea but also Liberia because we have the rights to ship the ore through the Liberia corridor.

We are negotiating with the Liberian government also the rights to use the existing railway but also the rights to build a new track and a new port in order to optimize the volumes looking forward. We expect that by 2012 to be producing ore there, something between 10 million and 15 million tons; but the project will reach 50 million tons in 2014 and could produce even more if we find enough resource to it.

So we've put a lot of-- we are going to put a lot of efforts in Simandou, and by doing that we can guarantee that we can reach the 450 million tons that we designed to be producing by 2014.

Fabio made some comments about the new 10/20 million tons project in Carajas. And that project was designed to cope with the delay-- the project for 30 million tons in Carajas; because for the 30 million tons we didn't get the permits and so we have to find a way to increase production in the existing piece. Then we came up with 10 million tons project that we increased to 20 million tons.

And what we learned with this project now, makes us very comfortable for us to increase also the 30 million tons project to 40; because we are adopting the same system which is to process iron ore in a dry way instead of through washing and all of the stuff that requires a lot of water and a lot of area for the dumps.

So by looking for solutions relating to the permits, we came up with a lot of solutions that increased the possibility of increasing production and we also-- our idea is to bring the same principle to Simandou in order to avoid the environmental consequences and also to speed up the whole process.

Simandou is only four hours from Brazil by flight, so we are in a very strong position to leverage from our people in Brazil because even for a production system based on fly-in/fly-out; it will be much easier for Vale to do it than everybody else. We are very close to that region and this is another advantage that we have by doing that there.

We know the kind of ore. We have been experiencing new technologies for producing ore and we are closer to Simandou which will reduce the risk of implementation a lot. So we are very confident in this project that will bring more consistency in our production and we'll give to our customers a new production system that can increase even the reliability of our deliveries to the market.

Fabio Barbosa {BIO 1907620 <GO>}

So we see; we have organic growth-- that additional 20 as Martins explained, the acquisition Simandou, and then we have the portfolio asset management through which we are aiming at unlocking asset value, improved capital allocation and focus our efforts in larger businesses.

And with that, I'd like to turn to Tito; that is in charge with the aluminum business and was the chief negotiator of the deal with Norsk; Tito, could you comment on the following two slides, please?

Tito Martins {BIO 3374920 <GO>}

Thank you, Fabio. It's very simple and I think most of the analysts have already made some comments about what we announced last Sunday. Basically, Vale owns very good reserves, very important reserves of bauxite in Brazil. We have the expertise and the knowledge about aluminum production.

Alunorte became the most important aluminum plant in the world, with the implementation of the last phase. And of course we have some constraints about energy costs. So our future in the aluminum business is directly linked to the possibility to integrate our assets to assets on a more competitive level of cost of energy.

So it was natural to join Hydro into this transaction. Hydro has technology and expertise in aluminum production; and at the same time at a very competitive cost of energy. So we combined the assets and this new organization, new Hydro. Vale is not leaving the business. It remains with a 22% stake in the new company; enjoying the potential upside of this integration.

And the total transaction amounted to something around $5.3 billion when we consider the cash that will be received and also the debt that we'll overtake by Hydro.

We decided to hold the 40% stake in MRN, given the agreements we have in the company right now. But we actually enjoy various benefits from this MRN production which is considered one of the benchmarks in the world.

And of course with this we will have time to focus on business that we actually can enjoy more profitability where we are based right now. And Fabio wants to mention--

Fabio Barbosa {BIO 1907620 <GO>}

Just to stress that this aluminum deal will make feasible our growth through integration with Norsk. So Norsk brings in what we lack which is competitive energy cost, so this deal has a lot of synergy. And through integration, will make feasible growth in the business in Brazil that was not feasible or doable considering the prevailing energy costs.

And as Tito mentioned, of course this deal is part of our overall portfolio management, and just last quarter we announced our acquisition for Fosfertil assets.

So in sum, we have been extremely active in exploring all of the tools to promote growth and value creation in our Company. Thank you very much and with that we close our initial remarks.

Questions And Answers

Operator

(Operator Instructions) Our first question comes from Mr. Felipe Hirai from Bank of America/Merrill Lynch.

Q - Felipe Hirai {BIO 15071781 <GO>}

Hello, hi. Good morning. I have one. Thanks for the clarification on the new iron ore pricing. I have two questions here. The first one is related to your production-- sorry your Carajas Serra Sul project because you're talking about now doing the 450 million tons by developing the Simandou asset and maybe not Carajas. So I just would like to understand how -- the importance of the Carajas Serra Sul in the order of importance here. And also if you decide to go ahead with both projects at the same time, if you think that there is going to be demand for a 50 million ton project in Simandou and a 90 million ton project in Serra Sul by 2014?

My second question is also related to Simandou; if you could give us some more details on the project, mainly related to costs, the CapEx that you would have to spend there and also some of the legal aspects of the ownership of the concession, given that Rio Tinto used to be the owner and that they might challenge the ownership of the concession. Thank you.

A - Fabio Barbosa {BIO 1907620 <GO>}

Martins, could you please?

A - Jose Carlos Martins {BIO 1715332 <GO>}

Okay, Felipe; a lot of questions. So starting with the Simandou and Serra Sul; our intention is to move with both projects. But you probably know, we have a delay already for the Serra Sul project. It's a huge project; it's a greenfield project and so we are facing difficulties in getting all of the approvals. We are going to get it, but it will take much more time than we first realized.

So Simandou will give us flexibility to start producing sooner there because the conditions for producing sooner are there in the (inaudible) area. So and then we can move later and adjust to according to what we are doing we are doing in Serra Sul also.

So I think both projects you go forward, but the timing schedule could change a little bit according to the licenses that we can get.

And also we have many other projects in the southern system that can be delayed a little bit; so Simandou will give us big flexibility for us as far as the permit is concerned. We-- in the case of for instance the Carajas 30 million tons project, we are now more than two years late. We have a delay more than two years because of the licensing.

So for Serra Sul, we already have a more than one year delay. So in case of Simandou, that will give us a lot of flexibility and then we can adjust later our investment, our CapEx, according to the market situation. We don't intend to create overcapacity in the market, and I don't think we needed to do it. But I think it will have a new area for producing and a new environment, even in terms of environmental concerns, will help us to guarantee that in 2014 we can get 450 million tons, which will be what the market will need and reasonably with the same CapEx. We don't intend to invest more and to create overcapacity; but to have some strategic freedom to develop other areas.

So that is the main point.

A - Fabio Barbosa {BIO 1907620 <GO>}

Do you want to talk about the demand-- the inelasticity of demand for high-quality ore?

A - Jose Carlos Martins {BIO 1715332 <GO>}

Yes, because we know that we don't have good ore in the world; what you have is reasonable ore, so more and more production will come from this reasonable ore. And for use the reasonable ore-- they needed to use a good ore. So demand for high-quality ore will always be there.

During this crisis, we didn't reduce a ton of production of Carajas for instance. We have to reduce a lot of production in the southern system and the southeast system, but in the north we keep the Carajas running at full capacity without reduction. So demand for good ore will be there because more and more people are producing bad ore.

So in that situation, unless you have a big change in technology in the steel industry that moves from existing blast furnace to another kind of reduction system, the preeminence of good ore will be there and we see it-- by the way we are pricing out the VIU more than $20 above the normal ore. So we don't see big problems in producing and shipping high-quality ore going forward.

A - Fabio Barbosa {BIO 1907620 <GO>}

And Martins, he also asked about the pace on the projects in Simandou and the legal issues that could be associated with it.

A - Jose Carlos Martins {BIO 1715332 <GO>}

As far as the project, our intention is to produce, as I told you 50 million tons there. For mining investment, this is really-- we can see investment around the $2 billion in the mining (inaudible) and the remaining will be on the logistic system and also in the compensations because to get ore through Liberia, we have to compensate the Guinea government and make some investments in existing railways there for people usage and small cargo usage.

So the total investment in there, looking as of today, would be above $5 billion. But we needed to work more on it to make all the engineering in order to give a better figure for you.

As far as the legal ownership is concerned, we took all of the precautions. As you probably know, we wouldn't have to make an investment like that without knowing all of the legal aspects, and we are not concerned with any bad development on this regard. We took all the precautions and we have all the measures in place to go forward with this without any big problems as far as legal aspects are concerned.

A - Fabio Barbosa {BIO 1907620 <GO>}

Thank you, Martins.

Q - Felipe Hirai {BIO 15071781 <GO>}

Okay. Thank you.

Operator

Excuse me; our next question comes from Mr. Rodolfo de Angele from JPMorgan.

Q - Rodolfo de Angele {BIO 1541593 <GO>}

Hi. Good morning. I have a question on the pricing mechanism. I wonder if you could comment on how it will work for pellets. I think it is the same type of index pricing. And if it's especially-- you mentioned, Martins, that one of the virtues of the new system is transparency. If we take the index-- or the Platts index or whatever index you're using today, what would be the price increases for both iron ore and pellets in the Second Quarter compared to what was the contract price last year?

A - Jose Carlos Martins {BIO 1715332 <GO>}

Well as far as pellets, we have a premium above (the fines), okay; as we are used to doing in the past. And unfortunately we have to negotiate customer by customer and that's what we did and we got an agreement based on that. And I think that the price for pellets will be more-- we'll charge more than the fine price because the conditions in the pellet market is even more dynamic than the condition in the normal ore.

For this quarter, we reached an agreement with customers to charge around $50 per ton of premium for pellets. So that's what we are doing. But I don't know what will be next quarter, because as I told you, the dynamics in the pellet market is bigger than the normal fine if you have direct competition with the scrap, with the solid (inaudible); so other sources of iron units.

So as you remember last year, you have to reduce the price of pellets below the price of lump ore, so there is a completely different market for pellets and a little bit different market dynamics. But for this quarter, what we got is something around $50.

Q - Rodolfo de Angele {BIO 1541593 <GO>}

Thank you.

Operator

Excuse me; our next question comes from Mr. Rodrigo Barros from Deutsche Bank.

Q - Rodrigo Barros {BIO 5851294 <GO>}

Good morning, gentlemen. My first question is now on the pricing mechanism for the First Quarter. Since it's one month delayed and mostly based on Platts, if you do a roughly calculation based on the past two months' Platts index and the maximum futures, it would suggest that for fines we would have another let's say 31% or 32% price increase in the Third Quarter. My first question is, if these calculations matter -- what Vale thinks for the market in the Third Quarter for fines?

A - Fabio Barbosa {BIO 1907620 <GO>}

Rodrigo, this is your call. Let's wait for the Second Quarter results and we'll let you know.

Q - Rodrigo Barros {BIO 5851294 <GO>}

Okay, perfect. And my second question is regarding the freight. I want to know if you can update us on what you're doing in terms of freight, in terms of hedging your volumes, (conversion ships) and what would be ultimately the target size of Vale's fleet to ship iron ore to China?

A - Fabio Barbosa {BIO 1907620 <GO>}

Martins, could you comment?

A - Jose Carlos Martins {BIO 1715332 <GO>}

Yes. This is a very important part of our strategy because the freight is a source of arbitration in the market. So in the past, when you have the benchmark, amended spot price in China; the freight always made the balance between the spot and the benchmark. So that was the situation before.

Now that we are going to a more flexible mechanism and that we are pricing based on CFR price in China back to Brazil; so freight is very important in our strategy. What we have been telling people about our shipping strategy; we are going to have as much shipped as we need in order to keep the freight differential as low as possible, which means that as close to the freight as to the spot freight is to the replacement cost, that will be the best for Vale; and we happen to have a fleet that can support it.

We now have-- we bought a lot of ships now. We have more than 20 ships being built for us. We bought a lot of existing ships. We have now a big fleet of ships that we own and we also signed long-term contracts with a lot of ship owners to work for us.

And for the time being, this strategy is working because the pressure on freight rate is very low and we believe that in the future the pressure will be even lower when we get these new vessels entering in the market. We have more than 20 being built now and from the end of this year we are going to start to get the average of three or four months, a new big ship coming.

So again, the fleet will be as big as necessary to keep the freight differential as low as possible. And also we have another important issue is that to get on a quality basis, the VIU enough money to eliminate the freight differential. So one side-- we want to have the freight differential as low as possible. And the other side we want to get a premium for our products that offset this disadvantage against our competitors that are nearby the Asia market.

So that's what I can tell you about our shipping strategy.

Q - Rodrigo Barros {BIO 5851294 <GO>}

Thank you.

Operator

Excuse me; our next question comes from Mr. Leonardo Correa from Barclays Capital.

Q - Leonardo Correa {BIO 16441222 <GO>}

Hello. Good morning. Thank you for the call. My first question is regarding the potential tax regime in Australia for the miners that are being discussed. I just wanted to hear your thoughts on the potential impact this measure could have on the iron ore industry going forward and also about the risks for higher taxes or royalties in Brazil. So please, if Martins can comment on this, that would be great.

And also my second question is regarding iron ore volumes. We saw that shipments in this quarter were impacted by the heavy rainfall and maintenance work at (Ponto do Madero); so just to get a sense if these issues, mainly important issues have been solved in the Second Quarter; because given that we saw (Sussex) data out for April which were weaker; just to get a sense on how the evolution for the Second Quarter iron ore volumes have been playing out. Those are the questions, please.

A - Fabio Barbosa {BIO 1907620 <GO>}

As for the tax, Martins, I don't know if you want to comment, but it was a surprise to markets, the way it was put; not only the way, but the dimension. This implies extortion in the industry of course and we have to analyze very careful the extension and the dimension of the final outcome that will be discussed in the Australian Congress.

But Martins, I don't know if you want to make an additional comment on that?

A - Jose Carlos Martins {BIO 1715332 <GO>}

I think although this will affect the Australians, I think it's an undesirable solution because these kinds of things give space for the same behavior in other countries. So I think the last tax we have in the industry, the better we'll be. And we hope that this tax system in Australia has to be discussed, has to be passed through the Congress and so it will take a long way until it reaches the market. Because as far as I know, the system we are entering in July 2012; and I hope until July 2012 there will be a lot of changes to make it more reasonable.

We have some operations in Australia also and all the mining industry in Australia will be affected; not only iron ore. So we see it as undesirable.

A - Fabio Barbosa {BIO 1907620 <GO>}

Okay. And as for the Second Quarter problems--

A - Jose Carlos Martins {BIO 1715332 <GO>}

As for the production problem, we have, first, the rainy season was stronger than usual. Second, we haven't been helping out production after we cut a lot of production last year. We shut down a lot of mines. So it took some time to bring all of these in production. And also we have the rainy season. And also we have a big accident in Ponto do Madera where we lost some conveyors and the Port had stopped operating for almost four days. So all of these problems together reduced our volumes; but we believe that in the next quarter we can get a much better performance and as far as our production is concerned, we are in condition to reach this year our full capacity as we planned.

A - Fabio Barbosa {BIO 1907620 <GO>}

Thank you.

Operator

Excuse me; our next question comes from Mr. Marcos Assumpcao from Itau.

Q - Marcos Assumpcao {BIO 7474402 <GO>}

Hi. Good morning, everyone. First question is for Martins. If you could comment a little bit on the supply-demand drivers that are impacting-- that should impact the spot prices in the second half; how you're seeing them right now? You already commented on some of them. You mentioned that the Chinese demand should remain strong and also on the supply side how you don't believe that the Chinese will be able to increase a lot of their domestic supply. I would ask if you could comment a little bit on the other factors like India and the rest of the world demand, India supply and the rest of the world demand and how you're seeing this evolving going forward.

A - Jose Carlos Martins {BIO 1715332 <GO>}

I think we'll have some factors increasing supply but other factors also increasing demand. If you look in the western world, you have a stronger recovery; even in some countries in Eastern Europe you have some recovery. So less and less opportunity ore is available in the market. What I call opportunity ore is the ore that two years ago was devoted to the local markets and during the crisis this ore went to the other markets-- even the States or Canada increased their exports of iron ore during this tough period. And as their economies are recovering and their industrial production is growing, more and more of the ore is coming in their countries. So this is a factor that is helping the market to be more bullish.

Another factor is we don't have too many projects coming on stream. It seems that FMG reached their full capacity. They're not showing capacity to go above this level; CSN also. So the main projects that entered in the market in the last two years seem to be reaching their full capacity.

And if you look at the big three; they are also operating at full capacity now and I think the only additional ore that will come to the market is from Vale because last year we shipped below 250 million tons which is below our normal capacity. So I think the biggest quantity of ore that will come into the market will come from Vale.

In China you have the situation of the local ore that I also explained before and in India if you look in the next three months, you have the month on India which will reduce normally their shipments. And the India market is growing; still production is growing in India and more and more the ore will be (inaudible) to the local market.

So if you took all of these points, I would say to you that the market will continue to be very tight in the next six months. I do not see any (easy) in the market looking in the next six months.

A - Fabio Barbosa {BIO 1907620 <GO>}

Thank you.

Operator

Excuse me; our next question comes from Mr. Tony Rizzuto from Dahlman Rose.

Q - Tony Rizzuto {BIO 1490590 <GO>}

Thank you very much. Hi, gentlemen. I've got two questions-- the first question, just to follow up a little bit further on the pricing mechanism; thanks very much for all of the detail you've provided so far. But if you could give us an idea; you may have mentioned something about grade; I had some issues with the call audibility earlier; but if you could give us an idea of the magnitude of the premium for the grade and impurities; lack of impurities-- I'd like to understand that better.

And you indicated there's talk about a band mechanism. I'd like to learn a little bit more about that as well.

A - Jose Carlos Martins {BIO 1715332 <GO>}

Well the quality issue is that for each 1% additional iron ore content in the iron ore, the market now is paying between $5 and $6 per ton. So normally the market price is based on 62% iron ore and for instance, Carajas's iron ore which is 66%, we are getting between $20 to $24 additional price based on quality. That is the situation.

The band is another mechanism. We established a band of 5%. If the average market price stays into the band in the next quarter, we don't have a price change; only if the price variation goes above 5%. So that is the mechanism we agreed with our customers.

A - Fabio Barbosa {BIO 1907620 <GO>}

Thank you.

Q - Tony Rizzuto {BIO 1490590 <GO>}

Jose, also about the impurities as well; does that work in a similar way?

A - Jose Carlos Martins {BIO 1715332 <GO>}

Yes, because when you increase the iron ore content, on the other way around you are reducing impurities; so the more iron ore content you have in the ore, the less impurity you have. So that's how it works. It's an automatic mechanism. But there is one point that we didn't factor in our price yet which is the low phosphorous content; because the low phosphorous content that we have in our ore, much lower than the average in the market, is another source of value for customers.

But it's more difficult to price it because it is not so transparent. And sometimes it has to be fixed customer by customer, according to their product range-- the steel product they have-- that where the phosphorous content will have a big impact.

Q - Tony Rizzuto {BIO 1490590 <GO>}

Excellent. Thank you very much.

Operator

Excuse me; our next question comes from Mr. (Rene Clewag) from UBS.

Q - Rene Clewag

Good morning, gentlemen. Maybe we could continue on the theme that we just touched on in terms of the contaminants. When you're talking about capturing the value in use premium, where are we in terms of having that recognized in contracts? And should we assume that the current market indication of a $5.50 premium is something that we should expect you to start capturing on Carajas volumes in the Second Quarter, or is this still a work in progress in terms of discussions with clients?

And the other point would be just in relation to Simandou. Have you got an indication of what sort of alumina content you're expecting there?

A - Jose Carlos Martins {BIO 1715332 <GO>}

Look, as far as the price system; this VIU system is already in place. For the Second Quarter on, our price should be based on the quality of our ore, so we are already getting this price quality differential in our pricing.

And as far as Simandou ore is concerned, the ore there is very similar of Carajas ore so the quality 66%; some areas go up to 67%; so it's very, very similar to Carajas and will be priced accordingly, the same way as we price Carajas now.

A - Fabio Barbosa {BIO 1907620 <GO>}

Thank you very much.

Operator

Thank you. This concludes today's question-and-answer session. Mr. Barbosa, at this time you may proceed with your closing statement, sir.

A - Fabio Barbosa {BIO 1907620 <GO>}

I would just like to thank my colleagues, Tito and Jose Carlos Martins for participating here and of course thank you, all, for attending this conference. And as usual, we'll be available for any further questions you may have. Thank you, all very much.

Operator

Thank you. That does conclude our Vale's First-Quarter 2010 Results Conference Call for today. Thank you very much for your participation, and have a good day.