Q2 2009 Earnings Call

Company Participants

- Fabio Barbosa, CFO
- Jose Carlos Martins, Director
- Tito Martins, Director

Other Participants

- Colin Dealba, Analyst
- Felipe Leal, Analyst
- Ivan Fadel, Analyst
- Jorge Beristain, Analyst
- Leonardo Correa, Analyst
- Marcos Asuncion, Analyst
- Owen Flanagan, Analyst
- Rodolfo Angele, Analyst
- Terence Ortslan, Analyst

Presentation

Operator

Welcome to Vale's conference call to discuss Second Quarter 2009 results. If you do not have a copy of the relevant press release it's available at the company's website at www.vale.com, at the investor section. At this time, all participants are in a listen-only mode. Later we will conduct a question-and-answer session and instructions will be given at that time.

(Operator Instruction). As a reminder, this conference is being recorded. The replay will be available until August 5th, 2009. To access the replay, please dial 55-11-4688-6312, access code 999. 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 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 with the presentation. After that we will open for questions and answers. It is now my pleasure to turn the call over to Mr. Barbosa. Sir, you may begin.

Fabio Barbosa {BIO 1907620 <GO>}

Thank you very much. Good morning. Pleasure to be here with you today.

Let us start off our comments today by saying that by the same token that we commented, in the Fourth Quarter, during the announcement of the Third Quarter results, that the Third Quarter was part of a world that didn't exist any more as the world had changed dramatically. I would say that we could say about the same regarding the development in the first half of 2009. Of course, the adjustment continued during the first half in the world economy, and companies, of course, companies results reflected this reality of adjustment, and as I will comment with you later in this presentation, we have several reasons to believe that the worst is over and we are in a new stage of development of the world economy and our industry in particular.

So the Second Quarter results, they do reflect a from this old world that we are commenting to new world of recovery. Our operating revenues were limited to $5.1 billion, adjusted EBIT of $976 million, EBIT margin limited to 19.7%, and our EBITDA reached $1.7 billion. Of course, we are not quiet waiting for the improvement of the environment. We are working very hard. Several initiatives to push further down our cost structure. And if you took a look at our release, you will notice that we had results across the board in our cost structure, of course, we were affected by the appreciation of the US dollar. That's another indication of the relative strength of the market. The appreciation of the real, sorry, relative strength of the commodity market. But it's clear in the figure, if you look, that in every single item we have meaningful effort in terms of cost reduction.

We have some highlights here in this presentation, and I would like to invite my colleague, Tito Martins, to comment what is going on in the nickel business and what he's doing to improve remarkably the development. Tito, could you comment on that.

Tito Martins {BIO 3374920 <GO>}

Okay. Good morning, everybody. We've been trying hard along the last six months to -- in terms of the nickel business, to set some restructuring program. What we are trying to do is to set up a new way to work from a geographical approach, our operations in Canada and other operations, nickel business around the world to a more functional approach. What I mean by that is, we decide to put the operating team together, and run business from one operating center in Sudbury. Before that, most of the Vale operations were run independently. So this will combine and generate synergies through services contracts and a maintenance systems, IP systems, everything that's related to the operation.

So we're expecting to see along in 2009 results coming from these combination of, based on the new structure. We have already managed to achieve some reductions in managerial positions, around 20%, with this new structure, we're expecting to have some gains in synergies. We would be able to have technical people working different sides to provide service for two different sides throughout the world. Of course, we are also working, renegotiating some service contracts, and at the same time, we're expecting to achieve some cost reductions through a renegotiations with the suppliers and maintenance contracts. Fabio?

Fabio Barbosa {BIO 1907620 <GO>}

And the global sourcing, as well, is applying to you, right, Tito.

Tito Martins {BIO 3374920 <GO>}

Right, applies to everybody. Reduction in all the contracts that are being -- put in place right now.

Fabio Barbosa {BIO 1907620 <GO>}

So this is a very important item of cost structure, and we manage diversify sources of suppliers, so this should mean a very important cost savings over time. And the results, we believe they are impressive, as you cannot serve in chart number 7. We manage to present further cost savings of $186 million. Of course, we increase the volumes and the appreciation of the real exchange rate in particular. An enormous effort. it is clear that we are working very hard to get the results on the ground. And this is clearly shown by the unit costs that we observe in chart number 8, and we see that for the Second Quarter in a row we have meaningful results to be presented, both in nickel and iron ore, iron ore more intensely in the First Quarter. So this is another very important result. $1.3 billion in cost savings. It is nearly the -- it's close to 80% of our EBITDA in the Second Quarter. To give you a dimension of the effort that is being put in place. Of course, the EBITDA reflected the market conditions, and it was primarily determined its reduction was primarily determined by the price decreases. Despite very important contributions by sales volumes and cost savings and also dividends. But unfortunately, we had this market circumstances, and the numbers are reflecting that.

More specifically, the driver of the drop was due to its importance and the very fact that was the most relevant item in cash generation in the first half was the item of price reduction. We applied it retroactively to the First Quarter to part of our sales, and an important message here. All sales from now on, independently of the achieving agreements on prices, they should -- the prices that we are accounting for in the Second Quarter consider that all adjustments have been already made. It means that there should be no more retroactive adjustment relative to the benchmark pricing that we apply independently of the negotiations that, of course, may continue for some clients, as Martins will explain. It means that this effect, unpredictable effect, is no longer expected, considering the market circumstances, and what we just did in terms of adjustment.

So in the case of iron ore, we have this effect, this important effect in price changes, and in the non ferrous business we have a sharp recovery of average prices. And this is indicated by the contribution, $269 million. At this point it is very important to mention that Vale cut production in the Fourth Quarter of 2008, and the first -- and kept production well below its nominal first half because it believed that it was very important to contribute for the rebalancing of the market, and we believe we are being successful in this regard. At the same time, we specified our sales effort in the nickel business, so we sold much less -- much more nickel in the Second Quarter of 2009, 17% more, than we sold in the First Quarter of 2009. This is, of course, a result of the market developments, but also our marketing strategy, as we can see in chart number 11, the prices for commodities, including nickel, recovered -- the numbers indicate very, very sharp recovery of prices, and in this regard, our sales efforts were very timely.

And the non ferrous minerals as a whole, EBIT margin that was negative, it was sharply recovered to reach a positive figure. Very modest, yes, but a positive figure of 0.2% in the Second Quarter. The major challenge that we have today is to reconcile our quest for growth as we do believe that long term is very promising, and we believe in investing for the future demand is create value for our shareholders. And in this regard, we invested $5.2 billion in the first half of 2009. And I would like to call your attention that we have almost $10 billion invested in projects on the ground that are not generating any cash at this stage. That certainly will contribute when the operation starts to enhance further capacity to create -- to generate cash in the long term. We have, of course, a very strong sound financial position with the liquid assets, low risk portfolio and long-term credit lines, as we all know, and considering the position that we are in the down cycle, we are in a very comfortable position in terms of leverage. We saw a total debt of EBITDA limited to 1.5 times.

Now, I'd like to talk about the future of this new world that we are already starting to see with several signs of strength of the world economy, and particularly in our industry. Global industrial production has started to recover, it's clear, and more than that, there is indication the new order ratio is clearly showing that there's more expansion to come. And our business is connected with industrial production figures. So this is good news, and we see chart number 14 a clear improvement of the situation, and if you are able to -- see the red line, the PMI orders inventory indicating further strength of industrial production is due to the actual figures observed in the Second Quarter. And this recovery is being led by emerging markets. More compared to developed economies to produce a faster recovery of the world economy, but they are very intensive in consumption of minerals and metals, and they are driving market to better position. Of course, the developed economies are also improving compared to the situation, the critical situation they faced in the Fourth Quarter of 2008, and the first half of 2009, but there is a clear path of recovery, considering several packages delivered in the most important economies of the world, emerging economies.

So this is having an effect on the industrial production of the developed economies, as we can see in chart 16, and there is a clear convergence toward better performance in the second half of 2009, compared to the -- what we observed in the first half of 2009. As for China, Chinese GDP is rebounding after two quarters. According to the numbers that we collect, the GDP growth, the marginal GDP growth in the Second Quarter of 2009 was almost 15%. Of course, we don't believe that the GDP growth in China will remain such for the year, at 15%, but it's a clear indication that the stimulus package in China and the recovery of economy, the economies presenting a very strong performance this year, and in chart 18, we have another indication which is the Chinese real-estate sector. We have floor space increasing by 51% in the end of the Second Quarter, , and the floor space started, 12% growth. So very solid numbers that are behind, in a way, given the importance of the Chinese real estate to the demand for steel, behind a major part of their recovery of the global carbon steel output. At this point, I would like to invite Martins to comment on sector and the perspective.

Jose Carlos Martins {BIO 1715332 <GO>}

Well. Good morning, everybody. Let's start with the slide number 20, where we can see that steel production start recovery.

Fabio Barbosa {BIO 1907620 <GO>}

19.

Jose Carlos Martins {BIO 1715332 <GO>}

In this year, later this year.

Fabio Barbosa {BIO 1907620 <GO>}

19.

Jose Carlos Martins {BIO 1715332 <GO>}

Sorry. It's chart 19. So we can see that steel production is started recovering worldwide, not only China, and also mainly in Europe, which is very important to see in the chart 20, the recovery in Europe. For Vale, Europe is important, as our sales in Europe used to be higher than our sales in China. And during this crisis, our sales in China and Europe dropped to almost 80%, although steel production in Europe, it went down 50%. European markets decreased a lot in terms of -- because of de-stocking, heavy de-stocking, some uses of their own lines for some customers, and also in some market increase in scrap usage. All of these three points that happened during the first half of this year is now changing, coming back to the older pattern. So the recovery in European steel markets is very important to the recovery of sales of iron ore.

Prices for steel are also going up as we can see from bill lets and hot rolled and coils in every market. Price of steel is a product of demand and also steel production. So the steel production moved after the price increased. This phenomenon is already happening with many steel makers. We started the blast furnace operations, not only in Europe, but also in the States, and even in Brazil we can see a lot of announcements of blast furnaces restarting production. So all of this is bringing a good impact in our prospect for sales. As will you probably know, our sales are mainly based on FOB. basis, and now we see a lot of customers nominating vessels for the next quarter. This is a very good prospect for shipments from iron ore.

Another interesting chart to show you is the chart number 22, which is the iron ore price on the spot. As we can see, yesterday China reached 92.50, sought seems that the market is very tight, and demand for iron ore very strong in China. And one of the reasons is that as other markets are recovering, like Europe, Japan, Korea, other markets outside China is recovering, some shipments that are used to go to China are now moving to other places. So this is bringing some kind of feeling of shortness in the Chinese market.

What we can see in chart 23 is our efforts to increase our sales, because considering our high dependence on European markets and also in Brazilian markets, the drop in those markets left us without any other choice than trying to sell more in China, and we make a lot of efforts to increase our sales in China, and besides that, a lot of efforts in shipping, because we have to hire a lot of ships. 70% of our sales to China were made on a CNF basis. So we have to hire those ships. Being a company that are used to sell 100% of its sales in FOB basis to move it to a CNF basis was a tremendous effort in our company and our structure, and we needed to understand that we are 45 days from China, so we have to hire the ships to send the ore and sell later, and as the market in China was very dynamic in the spot area, you can imagine all the pressure we have to send the ore 45 days ahead.

We don't know what will be the price and what will be the customer. So we did it, and we are very proud now to say that we, even in this very difficult moment, we are able to increase our sales to China, almost 40% above our traditional level. I think if I may say, one of the best points of our performance in this quarter was what we reached in China, by changing the way we sell, by changing the way we ship, changing our portfolio of customers, so it was a big transformation, and I think Vale made a very strong demonstration of our capacity to change when we face different market circumstances.

Implementation of our CNF sales has been very instrumental in enhancing our competitivity in China. Vie view the low-cost portfolio freight. We are less and less dependent on spot freight. We are highly long-term freight contracts, long-term ships to work for us. We also are building a fleet of more than 20 vessels now being built in China that will be starting delivery in 2011. So we are going to be in a very much -- in a very stronger position from now on, because we start this game without having a ship, without having a contract, and having to sell bigger part of our sales CNF basis. But the six months we build a very strong portfolio of ship contracts and we bought many ships also to work for us. So we are minimizing our exposure to spot freight prices, and we are increasing reliance on our own fleet, based on long-term contracts and own ships. And these are very important point we reached during this half, and we are now much better positioned going forward.

We see the recovery global demand for iron ore increasing. The de-stocking process is finished, and none of our customers have iron ore in their stockyards, so they needed to by in order to produce what they are producing. In the first half, they were using, they start to produce. Now they have to buy to produce. If they don't increase their production, they to have buy much more than they did in the first half. And Vale is in a situation, the only big player that has capacity available. So the old increase in the iron ore market will be captured by Vale, because we cap our capacity impact. As we can see by our cost efforts, that we did a lot in the first half, but we kept our structure to produce up to 300 million tons of iron ore if it was needed. So now we have this capacity available, and as we increase the sales, our unit costs will be much lower, because we are going to dilute fixed costs. In the mining industry, fixed costs is a big part of the total costs. As we see in the first half, we sold 212 million tons --

Fabio Barbosa {BIO 1907620 <GO>}

Annualized.

Jose Carlos Martins {BIO 1715332 <GO>}

Annualized. 212 million tons of iron ore, and our capacity is 300. So we have near 80 million tons capacity available to fill the market if it was needed. For sure, our dependence on Chinese market increased, but I don't think it's bad news, I think it's good news, because it should depend on the market that is buying is good news, to depend on a market that is not buying is bad news, like happened in Europe in the first half. We have huge market share in Europe, and the market was very weak. So then we face a lot of troubles because of that.

So I think the dependence in the Chinese market for iron ore is a very good point. As far as pellets are concerned, pellets are mainly used when you need the high productivity. Considering the low capacity utilization in the steel industry, pellet is one of the most affected products in our portfolio. All the steel makers decided to use more cylinders in their burning, so they stopped buying pellets. I think in this point of the crisis, if you consider that we have 13 pellet plants, considering the three pellet plants that we have with San Marco, only three of them were operating, and then at this point, since we made this adjustment in price to reflect a better economic balance with the other forms of iron ore, sales of pellets start increasing, and now we have only three pellet plants idle. All the others are in operation or starting to resume operation. So we think that for pellets, second half will be a much better performance. So the next point I think --

Fabio Barbosa {BIO 1907620 <GO>}

Tito, could you comment on the last, then the ore.

Tito Martins {BIO 3374920 <GO>}

Of course. As you can see from July 27, we are seeing a recovery in the stainless steel production, and much of that was driven by the Chinese market. When you see the numbers from the first half of 2009, and we compare with the first half in 2008, we had a very steep increase in demand in China, 70% rose compared with, for example, 2008, and when you compare the Second Quarter of 2009, over the Second Quarter of 2008, we are talking about 139% increase in demand. We estimate the Chinese stainless production set a new quarterly record on Q2 2009, and we're talking about mark to around 2.1 million tons of stainless steel.

So what's happening outside China? China is the main driver, but we are also seeing some signs from different geographies. Europe and US, Japan, Korea, Brazil, some countries in Asia, they are showing some recovery already, and we have to bear in mind that 70% of the total consumption of nickel in the world is outside China. So when we see those signs, we become more optimistic about a more stable market in the second half. Some important comments, we are seeing the stainless steel growing, demand is growing, but we are also seeing some good signs from other nickel markets, like plating and boilers some recovery has been observed in the batteries in the electronic markets, and also in the automotives.

Because of all of that as you can see in slide 28, nickel prices went up, maybe in the last eight weeks, and looking at the scrap market, the tightness of the scrap market and the consumption of the level of output in the 300 series in nickel, we can see that the market is consuming more and more nickel. So we tend to believe that forecasts for the second half for sure, they should be better than the first half. I think that's it.

Fabio Barbosa {BIO 1907620 <GO>}

Thank you very much. We are ready to take the questions that you may have. Thank you.

Questions And Answers

Operator

Ladies and gentlemen. we will now begin the question-and-answer session. (Operator Instructions) Please restrict your questions to one at a time. Thank you. Our first question comes from Felipe Leal from Banc of America.

Q - Felipe Leal {BIO 2015017 <GO>}

Fabio, one thing you didn't comment was the interest you were having in the fertilizer business, could you comment on the strategic value of this business and how do you think that you could eventually -- if you could eventually consider any bigger position in the sector?

A - Fabio Barbosa {BIO 1907620 <GO>}

Well we have been saying for some time now, and believe that several quarters that fertilizers very important and interesting line of business for Vale. It's mining, Brazil in particular, it's a natural consumer of fertilizers, but not only that, in Americas, there's a whole lot there. They are very well poised in terms of deposit and resources. And it's part of the mining business. We have operation in (inaudible; heavy accent_ and we have several projects in our pipeline, and in the last year, we concluded the negotiations, and in the First Quarter of this year we acquired very interesting assets from Rio Tinto, Rio Colorado deposit in Argentina, and as you know, deposit in Canada. Our ambition is to develop other projects that we have in our pipeline and to become a major player in this sector, and; we can't become a major player in this sector without any further acquisition. And as we commented, by the time that -- there's some rumors in the press, we said that we are always looking for opportunities in all lines of business that have to do with Vale. But our focus is organic growth.

Q - Felipe Leal {BIO 2015017 <GO>}

Okay. Thank you.

Operator

Our next question comes from Mr. (Marcos Asuncion with Echoa Securities.)

Q - Marcos Asuncion

Good morning, everyone. One comment was to explore a little bit the Chinese iron ore market. First question is, you sold 36 million tons, record volume to China, and 25 million tons out of this were on a cnf basis. So I just would like to confirm that the remainder 11 million tons sold in chin nay were done probably on a bench mark basis, and also if you expect any changes regarding this mix, which was almost 70% of volumes on a CNF basis and 30% on a potentially close to benchmark prices.

A - Fabio Barbosa {BIO 1907620 <GO>}

67% of our sales in China were based on CNF Basis, and the remaining FOB was based on benchmark, the remaining prices are fully benchmarked prices. From now on, you have to consider that the Chinese are looking to trade in this spot market, and the -- over the benchmark level. So we immediately saw a trend to nominate vessels and to try to buy more based on the contract, based on the benchmark prices. So something that we are managing for the best of interest of our company and you are -- but clearly the Chinese are now moving faster to the benchmark level, to the contractor level, and this trend is not only with Vale but is happening with the other producers, and probably that is one of the reasons that less shipments are sending to spot, and so this creates some kind of shortage in the spot because of the suppliers are now selling more FOB contractual basis. I think that will be a trend.

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

And just to compliment, if I may, very clear indication of certain imbalance of the market, because they implied the FOB price is more attractive than the CNF spot price. I'm not forecasting anything. I'm just concluding by the numbers that we are observing currently in the Chinese market.

A - Fabio Barbosa {BIO 1907620 <GO>}

And also, a point to be considered clearly, I don't know the latter, but there will be a cap in the spot price in China, which will be the level, because you have more local production. As the price goes up, more local production will be brought to the market. So I think the market is now testing what will be the best balance between import and local production, and what price level that we will happen.

Q - Marcos Asuncion

Thank you.

A - Fabio Barbosa {BIO 1907620 <GO>}

Okay.

Operator

Our next question comes from Mr. Rodolfo Angele with JPMorgan.

Q - Rodolfo Angele {BIO 1541593 <GO>}

Hi. Good morning. My question is regarding freight and your strategy now that you're selling a lot in CNF basis here. Could you please comment a little bit more on how much in terms of volumes you have already freight contracted, what's the range the cost that you are seeing there, in terms of your own fleet, do you have any idea that you could give us in terms of how much capacity that you have in place right now?

A - Fabio Barbosa {BIO 1907620 <GO>}

This is a very sensitive question, because everything we say in this respect could have impact on the level of freight price. So what I can tell you is, we are prepared to ship every ton we produce. If you have a market, if you have customers. And freight will not be a problem for us, like we have beginning of this year, we let a lot of iron ore behind because we didn't have competitive freight for it. So we are preparing ourselves now to deliver every ton we have, despite what is going on with the spot markets for freight. And you may consider that to reach a position like that, we have to have a big portion of our sales based on CNF basis, and we have a big portion of our sales with our own fleet, so we are managing this issue according to market conditions, and according with the situation. This will be from now own a very sensitive issue for Vale. So unfortunately I cannot disclose to you how much iron ore we have, but I can tell you we are in a very comfortable position, based on that.

Q - Rodolfo Angele {BIO 1541593 <GO>}

Thank you.

Operator

Our next question comes from Mr. Ivan Fadel with Credit Suisse.

Q - Ivan Fadel {BIO 4827533 <GO>}

Hello, everyone. My question is regarding recent statements to try to limit iron ore import license to China, spot market, and if implemented, what could be the impact for Vale in your views. I see that in one hand, it can create lower supply, that could increase spot prices further, but as Fabio and Martins were saying, it could also start to create more markets for domestic production there, that could supply the market at higher prices, and maybe reduce a little bit volumes from exporters to that region. So how can this issue impact Vale in your views if implemented? Thank you.

A - Fabio Barbosa {BIO 1907620 <GO>}

Well this is a $1 billion question. But I think we needed to wait to see what they will decide. I think China is becoming more and more important in the iron ore business, more and more important to the whole economy, so I think it's not only iron ore, but other commodities, other nations. So economically speaking, China is becoming more and more important, and the question of if we will have more market oriented season or not is not up to us to conclude, but we really believe that as time goes by, more and more of the decisions will be done based on market situation. So that's what we can expect, based on that. But we had no idea from this present situation.

Q - Ivan Fadel {BIO 4827533 <GO>}

Right. To follow up, you touched the point of the market's decision, we're seeing, as you said, many blast furnaces now he reigniting in Japan, Europe, and Brazil, as you mentioned in the presentation, and also we've seen some signals from recent news wire news that they were seeing demand in China leveling out a little bit. So it's clearly good for iron ore that blast furnaces are reigniting for the short term likely means more demand. But my question, from your side, if you're still seeing final demand for steel, where will that steel go to and if you're seeing that already in your recent numbers.

A - Fabio Barbosa {BIO 1907620 <GO>}

You have better signals in the economy side, okay, as -- during this period, from September on, we have, I would say, a kind of overshooting in the iron ore market. In all of the markets, because of the de-stocking process. We never saw in the iron economy a de-stocking like that in iron ore, but steel, cars, appliances. So a lot of construction is being sold and not new ones being started. So de-stocking everywhere, because there was a credit crunch and people had to free money from their inventories so what we are seeing is coming back to the level, to the underlying levels because production was always there, but now we are replenishing inventories, and this will bring additional demand also.

So we think that we have big growth in these two or three months, and then probably we are going to level off afterwards, and -- but it will be in a much higher point than we were in the first half, and as China is concerned, they are investment package is fully working. You have a lot of investments going on in the country, and they are buying more steel, but also, we can see some -- I would say overflowing in this. I think after this period we are going to be stable in a higher level of demand and also prices a little bit higher than where they used to be. So I think we are moving to a new level, and I would say in a better level for producers.

Q - Ivan Fadel {BIO 4827533 <GO>}

Thank you.

Operator

Our next question comes from Mr. (Owen Flanagan with Akem Asset Management.)

Q - Owen Flanagan

Hi, my question relates to what guidance you can give us on iron ore sales volume and praises for the rest of this year. You said how you think second half of the year could potentially be a very different environment from the first half. Can you share with us some numbers of the kind of sales volume you think are achievable? If we look at the first and Second Quarter you saw pretty much 50 million tons of iron ore in both quarters, and in the Second Quarter, obviously, your production was higher than that, 58 million tons. Is it possible in the third and Fourth Quarter that would you have sales volume equal to that level of production?

A - Fabio Barbosa {BIO 1907620 <GO>}

Well Mr. Flanagan, all indications that we provide in our presentation is that there is a recovery process on the ground. We believe that the second half of 2009 could yield better result in the standpoint of market strength, from market performance, industry performance, the world economy should be much better, and that's the scenario that we are working with, but unfortunately, we do not provide any specific guidance about sales volumes or prices that we expect. We'll provide this information after the end of the quarter, and disseminate this information for everybody interested in the numbers of our company.

Q - Owen Flanagan

Okay. Could I just ask one other question about prices in the Second Quarter? Your realized price in the Second Quarter was $47, which is below even the level of prices that you have on slide 22. Can you tell us why there's that differential between spot prices and your realized prices?

A - Fabio Barbosa {BIO 1907620 <GO>}

This price that you have there, it's index that -- it's an index that involves several materials that are not necessarily the same that we sell. Martins, could you comment on that?

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

You have to consider that the spot price is delivered in China. So our price realization is less freight.

A - Fabio Barbosa {BIO 1907620 <GO>}

FOB.

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

FOB, So the difference is based because our prices -- the price we deliver and our results is FOB, and the spot is delivered price in China. So there is a difference freight and also quality and you have --

A - Fabio Barbosa {BIO 1907620 <GO>}

Some contracts were based on benchmark, some contracts were based on spot. So it's a lot of different reasons for this difference, but the main one is spot is CNF price, and our price is FOB.

Q - Owen Flanagan

Thank you.

Operator

Ladies and gentlemen. as a reminder, please limit your questions to one. Thank you. Our next question comes from Mr. Jorge Beristain with Deutsche Bank.

Q - Jorge Beristain {BIO 17554499 <GO>}

Hi, Tito and Fabio. I only get one question so I better make it count. I wanted to understand what in Vale's mind does a rising CNF price mean in China. In other words, if you're currently selling at rough numbers $50 FOB Brazil, but now the advantage is clearly with spot at 90, and say freight out to China 30, could you be realizing $60 at your port for a CNF sale. So I just wanted to understand, would you be in a position in the second half to capture that differential and actually generate more EBITDA per ton if you continue to sell primarily on a CNF basis in China? Or are the contracts set up in a way that the client would capture that benefit.

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

That could be possible. We have two difference to capture. One is the difference between spot and benchmark, and that will depend if spot market to be open for foreign companies to participate in. And another difference, if you can get lower freight than the spot, we can capture the difference. So if it's we can't capture a better price, but I can't elaborate how much.

Q - Jorge Beristain {BIO 17554499 <GO>}

Okay. Thank you.

A - Fabio Barbosa {BIO 1907620 <GO>}

Thank you.

Operator

Our next question comes from Mr. Leonardo Correa with Barclays Capital.

Q - Leonardo Correa {BIO 16441222 <GO>}

Hi. Good morning and thank you for the call. I would like to explore the cost side a little further. We've seen that although overall costs were negatively impacted by currency movements and the cost of vital capacity. We noted that your cash cost specifically in the iron ore business decreased, so just to get a sense of how you see the evolution of cash costs in the iron ore business going forward, given that FX appreciation might continue which would weigh negatively on your results, but, on the other hand, you have impact, positive impact of ramping up capacity. So just to get a sense of how you see the evolution of cash costs in the iron ore business specifically, please.

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

We cut a lot of costs from the system, and these costs were mainly fixed costs, but as you said, we produce much less than our capacity, in second half as we are helping out production we are sending probably much more than we sold. This fixed cost will be diluted. I cannot make any kind of statement on how much, but it's clear that our costs will be down in the second half, on a unit basis.

Q - Leonardo Correa {BIO 16441222 <GO>}

Okay. Thank you.

Operator

Our next question comes from Mr. Terence Ortslan with TSO Associates.

Q - Terence Ortslan {BIO 1785453 <GO>}

You mentioned that half your pellet capacity is shut down and you said that as of Second Quarter the only upgrade would be half your rate. I didn't hear if you guys said you would be turning demand in the second half of this year, and secondly, on the projects themselves, could you give an update on the major projects?

A - Fabio Barbosa {BIO 1907620 <GO>}

Well the pelletizing plant, if I understood correctly, our plan is to -- we have about five plants in operation right now. We believe that depending on market circumstances, two more could be brought on, this is our idea. As for the goal of project we are expecting to start in this quarter, and it is progressing according to plan and I believe Tito could have additional comments on that.

A - Tito Martins {BIO 3374920 <GO>}

The only thing -- we had a minor delay because of the dispute that happened in April, but we have already managed to be on the schedule. So the first autoclave should be starting by beginning of September, so we should have product by the October, first week of November. Ramp-up will take at least one year, so we're going to have one autoclave in production in 2009, the second will come by December, and the third one at the beginning of the next year.

Q - Terence Ortslan {BIO 1785453 <GO>}

Thank you. Last 30 said, because there was a cut off in the line. You said your first -- Hello? Operator?

A - Fabio Barbosa {BIO 1907620 <GO>}

Yes.

Q - Terence Ortslan {BIO 1785453 <GO>}

After the first autoclave, got cut off the liner, everybody got cut off the line, and also maybe you want to talk about the commercial date of the Goro, if it's change or not, and maybe repeat what you said after the first autoclave in the first month or so.

A - Fabio Barbosa {BIO 1907620 <GO>}

Tito, could you take that?

A - Tito Martins {BIO 3374920 <GO>}

No major change. The other thing tee -- Start the production of the first autoclave by the end of the semester, and we had to move it. In terms of -- but we expect them to have commercial terms by the middle of the first semester of 2010.

Q - Terence Ortslan {BIO 1785453 <GO>}

Thank you very much.

Operator

Our next question comes from Mr. (Colin Dealba) with Morgan Stanley.

Q - Colin Dealba

Thank you very much, gentlemen. Could you give us an update on the situation in Canada and how big are your inventory in order to keep selling your products if the strike extends for a few more months. Thank you.

A - Tito Martins {BIO 3374920 <GO>}

We're in the third week of the strike. The situation has not changed yet. Three weeks ago, when the unions decided to go for the strike, we had made our proposal, put our proposal on the table, they decided to not extract it. We haven't done anything, haven't back to the discussions we had. I cannot elaborate much about what's going to happen, we don't know how long it's going to last with the strike. We have kept our original speech about it, which is everything that was proposed was based on the affordability of our business locally.

We do have major obligations about sustaining capital environmental investments. So we want to keep the profitability of our business in Sudbury and our main concern is to enhance our reduction and our presence in our operations locally in Sudbury. In terms of the inventories, we are fine with the number, but if you look back at the production along the first semester, despite the drop in the market, we tried to keep a certain level production in order to cope with the market conditions the second half. That's what I can tell you right now.

Q - Colin Dealba

Thank you.

Operator

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

A - Fabio Barbosa {BIO 1907620 <GO>}

Thank you, all, very much, and as usual, we all will be available for any further questions that you may have. Thank you very much.

Operator

Vale's Second Quarter 2009 earnings conference call is over for today. Thank you very much, for your participation, and have a good day.