Q3 2008 Earnings Call

Company Participants

- Fabio Barbosa, CFO
- Roger Agnelli, CEO

Other Participants

- Andy Minder, Analyst
- Carlos de Alba, Analyst
- Felipe Hirai, Analyst
- Jorge Beristain, Analyst
- Marcelo Aguiar, Analyst
- Marcelo Brisac, Analyst
- Rodolfo De Angele, Analyst
- Samuel Taptart, Analyst
- Terry Ortslan, Analyst
- Victoria Santaella, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. Thank you for standing by and welcome to Vale's Conference Call to discuss Third Quarter 2008 earnings 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 Investors link. 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 Instructions) 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 risk. And other factors.

With us today in Rio de Janeiro is Mr. Fabio Barbosa, Vale's Chief Financial Officer and Mr. Roberto Castello Branco, Vale's Investor Relations Officer. First, Mr. Fabio Barbosa will proceed to the presentation. And after that, we will open up for question and answers.

It is now my pleasure to turn the conference over to Mr. Fabio Barbosa. Sir, you may now begin.

Fabio Barbosa {BIO 21197136 <GO>}

Thank you, very much. I'd just like to inform you all that our CEO Mr. Roger Agnelli is here with us today and he'll participate of the whole conference call. Thank you, very much, Roger, for your presence here with us.

Roger Agnelli {BIO 14016988 <GO>}

My pleasure.

Fabio Barbosa {BIO 21197136 <GO>}

So, let's start with the first picture of our results in the Third Quarter of '09 -- '08, sorry -- was a very good performance, operational performance. We have a record in the output production of iron ore, pellets, nickel, bauxite, alumina, aluminum, cobalt and thermal coal. Our shipments also in a record high for iron ore and pellets, copper, alumina, cobalt. And thermal coal.

Revenues reached $12.1 billion, our EBIT $5.5 billion, EBITDA $6.4 billion. So a tremendous operational performance that was also associated with the recognition, an award that Vale got this very week of being considered the most admired company in Brazil. That's very good and show how responsible socially speaking we are in the environment that we operate.

A brief word on our risk management policy. First of all, the basic concept is that our trading desk is not a profit center. Its -- our policy's very conservative. We have our policy focused on mitigating cash flow volatility. So, this is what drives our policy, our risk management policy.

And we have no leverage in our operations. And as of September, the overall position of our derivatives, mark-to-market basis, was $32.6 million, was a positive $32.6 million or less than 0.1% of our last 12 months' revenue. So, this is an important message considering what was observed unfortunately in the last several weeks on Vale.

If you look at our release, you'll see a very detailed explanation about our risk management policy and the use of derivatives and also a note on our financial statements by request of our CVM or SEC in which we produce a very detailed explanation about our derivatives and policy. So, this request was made by CVM last Friday and Vale was able to comply fully. And yesterday, we released the results already with this addition requested by CVM. So very important news there.

So, we are given that now we face a new global scenario. So, the picture of the world that we know until September '09 changed in October. It's a brave new world out there in this last quarter. We -- what we saw until September, it's something that is there in the past now. We have to face the reality of a new world. And for that, Vale is very well poised to explore growth options in this much more illiquid world.

We have a very powerful cash flow, very large cash holdings that was derived from our capital increase that we promoted our offering in July. Most of the cash that we have today is derived from these operations, $12 billion.

And now, we have $15.3 billion. We also, as you may recall, we set up a long-term credit facility with institutions like BNDS in Brazil, Jabik [ph] and Nexa [ph] in Japan. And finally, we have $2 billion in committed facilities for our short-term liquidity needs.

So, on the top of that, we have a very well-structured debt profile. Our total debt-EBITDA was reached a new low with one time EBITDA in the Third Quarter of '08. And this -- we are talking here gross debt. I would like to mention that. Gross debt-EBITDA reached one time EBITDA, a very low level considering what we have today.

And the average maturity of our debt stays in a very comfortable 9.3 years level. So, it's a very comfortable position. Next year, we have $380 million in amortizations in our debt. So, this is the very, very comfortable debt profile. At the same time, the cost -- the average debt cost is around 5.8%, which at current levels it's a very -- prevailing markets, it's a very comfortable position as well.

Well, this new world we are talking about, it's a new world with -- that shows through this PMI that we put there in page seven a very sharp deceleration of industrial production. And this is part of this new reality and the PMI as a lead indicator is anticipating what is yet to come.

So, we should be aware that this will be a very difficult environment over the next several months. And the indication that we have is that we should expect weakening in the demand for minerals and metals over the next several months.

The world economy has changed as we put there. There is less liquidity. We observed world losses around the world. Trillions of dollars of wealth were -- disappeared, simply disappeared. And we should expect a slower growth path for the world economy. Although, with the divergence that we mentioned now released between emerging market economies and developed economies that should continue and should widen actually.

So, high cost producers will face a very difficult environment. And the lack of funding liquidity will most likely hamper the future growth of supply and what in a way would contribute to market re-balancing sooner rather than later.

The Chinese demand is weaker right now, much weaker. There are some cuts in steel production in October and we do expect production in general in China to rebound in the first half of '09. In fact, the Chinese demand for iron ore had been slowing due to, as we put there, a combination of several factors.

First, we have a snowstorm. And then soon after that, we had the earthquake that in fact provoked a major disruption in the logistics and the feeding of the several regions of the country in terms of raw materials.

So, this caused a major disruption out there. And then, we had the Olympic games and Paralympic restrictions, where the areas around Beijing, we had a sharp reduction in industrial activity. And there was, of course, the effect of the slow external demand for Chinese steel that also affected the dynamics of demand for iron ore there.

And finally, the negative effects of the domestic credit tightness in China, affecting particularly the property sector. As you can see in slide 10 -- in chart 10 -- this credit tightening promoted by the Chinese government had the effect of slowing sharply the loans to construction that almost didn't grow in August. And the total loans also are growing a much lower pace. So, this is the result of credit tightening over the most dynamic sector of the industry -- the Chinese economy.

And it had a major impact on the steel consumption, as you can see in page 11, where the construction itself represents -- the property represents about 24% of the total fixed asset investment, second only to manufacturing.

And then, we have construction that is a major concern to consumers of steel affected and measures related to deal with the excess of activity that was observed by the Chinese economy in the late 2007, early 2008. Inflation is down now. But the result of this tightness was -- in credit -- was a major deceleration in the construction the -- with obvious effects on the steel consumption.

However, we believe that the long-term fundamentals are strong. We do believe that there will be there some sort of deflation in the housing. The affordability of buying new homes should increase over the medium to long term. Urbanization and rising income are key drivers. And those are structural elements that will not change.

They'll continue to be there. We are in a pause that could take several months. But the growth process, the development process of Chinese economy will be certainly resumed. And now, we have to wait until the effects of the measures taken by the Chinese government have an impact on the short-term indicators.

In fact, the long term, we continue to have a -- to hold a very positive view about the long term. But in the short term, things are much harder, although the Chinese government implemented a very comprehensive package of stabilization of the demand with trying to avoid an excessive appreciation of the RMB.

There was some monetary policy easing. There was softening of credit controls and tax incentives, again, in place. So, it's -- they're trying to deal with the short-term hardships in this way.

Of course, one cannot ignore the difficulties represented by this crisis in the world economy. But the long-term fundamentals are there. We have, in our case, we have been working to enhance our growth options in the long term. We are better positioned now to weather the down cycle.

We have been preparing the Company along this years to work in a less favorable environment. And the fact is that today we enjoy a financial strength that is second to no company in our segment, I would say, world-class assets and a long and attractive pipeline -- project pipeline.

We implemented, as you could appreciate in our last few quarters releases, cost-cutting measures that should have an effect. We established a strategic alliance with suppliers of parts, equipment. And engineering services. Of course, in this new world, we will have -- should have a stronger US dollar and this would affect in a way positively our long-term costs.

We will certainly -- we have to look at our production plans and make some adjustments, as Roger will comment. And unlike previous years, as we put there, we have no large iron ore project coming on stream in 2009 and 2010. And finally, the nickel project's going in Onca Puma. We always have the option to extend the duration of the ramp up in order to deal with market circumstances.

With that, I will pass the floor to Roger to make his comments about the scenario and the perspective of our Company. Roger, please?

Roger Agnelli {BIO 14016988 <GO>}

Well, thank you very much, Fabio. Good afternoon, everybody. It's a pleasure to be here with you. I don't have a lot of things to add to what Fabio mentioned. The point is the balance sheet is out there, no surprise.

The Company is still working to reduce costs. I think we managed very well the cost of reduction for these nine months of '08. We are going to continue to work to reduce more our costs. Of course, right now we have in our favor the real depreciation, which is very good for us because our expense issue or our cost is in reals denominated.

If we had the year of '08 ending in September, I think we should be very happy because we reached all the records. The results, the earnings is bigger than last year already. We worked very hard to have all the finance for our projects.

And we have all the needs that -- we have all the money that we need to continue to finish our projects. I think this is the major step that we are going to have next year is to finalize all the projects that we have already started. Of course, the ramp up of those projects will be according to the market conditions.

Second, to start new projects, of course, we are -- we have the ability to choose the best timing to do that. And we work carefully to push more investments ahead. Of course, we are concerned about the oversupply of different materials in the market right now. And we will be very careful to add more volume in the market.

So, I don't have any additional comments -- to just say that no surprise, the results are good. The year of '08 is very, very sound for us. We are in a very good situation right now and we have all the options open for us. If we wanted to speed up investments, we can do. We have money, we have credit lines to do that. If we wanted to slow down a little bit, we can do that. If we wanted to continue to analyze possible acquisitions, we have the ability to do that.

This is not our priority. As always, I'm saying this kind of thing. I -- this is not our priority. But certainly in the future, we are going to see a lot of depreciated assets that we can analyze if fits to our strategy or not. If it adds value to -- for our shareholders, we are ready to move. The point is we are in a very good situation to face the challenged world that we have in front of us.

For the future, what I can say -- let's be quiet for awhile. We are not pressed or we are not forced to sell our product at any price. Of course, some of our competitors are selling at a very low price right now. This is the adjustment that the market is forcing those guys to do that. We are in a very good situation. We can hold a little bit.

We can wait a little bit to clarify the situation, clarify how deep is going to be the recession. There is no doubt that we are going to have at least for the next six, seven, 10 months a very deep recession. But we don't know how long this is going to take to rebound.

That's it. I think we don't have anything else to say, just to answer your questions if you may have.

Fabio Barbosa {BIO 21197136 <GO>}

Okay. Thank you, very much, Roger.

Questions And Answers

Operator

Excuse me. Ladies and gentlemen, we will now begin the question-and-answer session. (Operator Instructions) Our first question comes from Rodolfo De Angele with J.P. Morgan.

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

Hi. Good morning, everyone. Just my question is about iron ore. Could you just be a little bit more specific as to what do you expect to see in terms of volumes for the next quarters and beginning of next year? Are you already getting the sense that volumes are down by any percentage terms? Any light you can give us on what is the situation on the iron ore side would be great.

A - Roger Agnelli {BIO 14016988 <GO>}

Rodolfo, to make any comment right now is danger. What we can say is that in September, we shipped all our production without any problem in plenty of time. October, I think we are on budget or maybe a little bit lower in terms of volume. For November, I feel that we are going to face really a crunch in the market. But will not be a disaster. And of course, we have the ability to reduce production in some mines that we are not very competitive.

For next year, I feel -- my feeling is that we are going to see at least more -- three months or four months very, very complicated. After all, I think we are going to rebound. The -- what is causing that is because in the first half of '08, Chinese and some of other steel mills, they bought a lot of stock.

They bought a lot of material. And if you go to China, you see a mountain -- mountains and mountains of iron ore that is -- it has been consuming. I think it's going to take more, two or three months, to normalize or to have a levering in terms of demand and supply.

But I can tell you it's really hard to see the next six months. At least, I should say that we are prepared to face this next three months is very complicated. This is the situation right now in the market. There is -- there's a stocking process going on.

We needed to wait a little bit to see where is the real demand. Some of our clients are cutting production right now. This is globally -- this is a worldwide situation right now. Everybody's a little bit scared about the lack of demand. But it's not going to take so long to reverse.

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

Okay. Roger, thank you. I'll leave my follow-up question for later. Thank you, again. Thanks.

A - Roger Agnelli {BIO 14016988 <GO>}

Thank you.

Operator

Excuse me. Our next question comes from Mr. Marcelo Aguiar with Goldman Sachs.

Q - Marcelo Aguiar {BIO 3721791 <GO>}

Hi, gentlemen. Congratulations on the results, definitely a new world. Can you comment a little bit? I mean, according to our calculation here on the back of your results, I mean, your iron ore cost, it increased if I'm not wrong 17% quarter-on-quarter. Can you elaborate about this cost increase and what we could expect in terms of cash cost for iron ore in the following quarters?

A - Roger Agnelli {BIO 14016988 <GO>}

Okay. Thank you, Marcelo. This is -- I think one of the major drivers was energy costs. It was -- it's increased this month. And also, the demurrage -- we had a very tight shipment program in September as part of this old world. So, September was business as usual. So, we faced some demurrage cost.

And the effect of the exchange rate, the acceleration of the depreciation took place only the last few weeks of September. So, the average -- if you look at the average exchange rate throughout the Third Quarter, it's almost the same of the Second Quarter, 166, 167 respectively. So, there was no effect there. So, moving forward, if exchange rate remains as it is currently, we should expect, all things remaining the same, a reduction in cost associated with the exchange rate.

Q - Marcelo Aguiar {BIO 3721791 <GO>}

Okay. Thank you. I'm going to go back to the queue.

A - Roger Agnelli {BIO 14016988 <GO>}

Thank you.

Operator

Excuse me. Our next question comes from Mr. Jorge Beristain with Deutsche Bank.

Q - Jorge Beristain {BIO 17554499 <GO>}

Hi. Good morning, Fabio. I guess my question is -- could you give us more color as to what is happening on the ground in China? We're all aware that China has a massive amount of self supply. And given where spot market transactions are being recorded currently in the $65 to $70 range, can you comment if your --

A - Fabio Barbosa {BIO 21197136 <GO>}

Okay.

Q - Jorge Beristain {BIO 17554499 <GO>}

-- clients are now starting to feel the pinch of some of their suppliers essentially going out of business or ceasing to supply product at these price points?

A - Fabio Barbosa {BIO 21197136 <GO>}

Yes, Jorge, what's happening today is that, as you pointed out, spot prices are below the benchmark prices, considering what was your comment -- that there was -- there are a lot of inventories out there.

They are trying to -- and inventories that were bought -- let's say were built with a freight cost of $100 per ton and in a different situation. So, there's a difficult time there because not only prices came down. But liquidity is no longer there. So -- and freight costs are now at $12 per ton, even $10 per ton.

So, this made -- this, of course, is a result of a major deceleration in steel production. There was cut -- there has been cut in production of steel and in some cases up to 30% in steel production cuts. So, demand is for raw materials decline sharply, considering these adjustments for the situation that's out there. A lot of inventories and a lot of downward pressure considering the credit crunch and the very slowdown of the demand associated with all the elements that we commented there.

So, the scenario that we see in this Fourth Quarter is strong deceleration of the Chinese demand. And that should, of course, affect our shipments, as Roger also indicated. We are below budget in October. In November, we have a difficult month, although, again, we have a very strong position. But we will have a very difficult November and maybe even December.

So this deceleration, of course, is concrete. And the government, the Chinese government is also observing that and trying to figure out ways to foster more growth, given that this deceleration is not in the intensity maybe they would be expecting, considering all the elements of the Chinese economic and social development.

Q - Jorge Beristain {BIO 17554499 <GO>}

Thank you. And my second question, if I may, is maybe more directed to Roger. But frankly, I was a little surprised that in the environment that we're in Vale came out with an increase of about 30% on its planned CapEx budget to around $14 billion.

And I would just like to understand what the real sensitivities are there to the actual slowdown that we're actually now living. In other words, how concrete do you believe that $14 billion budget to be and at what point could we start to see signs that perhaps Vale may push back some of these projects or reign in that growth?

A - Roger Agnelli {BIO 14016988 <GO>}

Well, certainly the $14 billion investment for next year right now is concrete. Of course, we have the possibility to slow down a little bit and inflate [ph] the start of the implementation of some of those projects. The point is we haven't been investing in a very strong past.

And we needed to finalize some of the biggest investments that we are implementing right now, including Goro, including Onca Puma, includes some of iron ore projects and pelletizing plants, like Fabelito Zema Zerai [ph]. So, we are going to finish everything. In terms of ramp up of those new investments, those new production plants or mines, of course, we are accommodated according to the market.

For the beginning of some projects, of course, we are going to analyze next year. I should say that all the investments that we have right now in our pipeline are very efficient, are very good, even if we compare to the current market capitalization of some of our competitors. I think those investments are in a better situation than old assets. So, they are very good assets.

Just to give an idea, I feel that the project in Peru that we started three or four more months ago, we are going to push this back on track. It's a phosphate mine and the market is still very good. We wanted to increase our presence in this market, in fertilizers or material for fertilizers. So, we are going to keep invest in this project. Most of these projects, I think I feel that we needed to increase our presence in coal business. So, we are going to go ahead with this project.

If we analyze Serasu [ph] iron ore project, it's going to take like three, four years to finish the project. Maybe we can finish the project in five years or in six years. But it's very important for us, even considering the quality of the ore and the cost of the mine. That is going to be much below than the average cost that we have today. So, if we finish this investment, we will be in a much stronger position to compete in any scenario in the market.

The project in railways, in logistics -- we needed to open capacity or to increase our capacity of transportation for the further -- for the future projects that we wanted to implement in the Carajas area. So of course, the logistic projects we are continuing to invest.

So, I should say that much -- the biggest part of the investment is concrete. Of course, for 2010, we can reduce significantly the investment for the year 2010. But 2009, I feel that we are going to continue to implement all those projects.

Q - Jorge Beristain {BIO 17554499 <GO>}

Thank you.

Operator

Excuse me. Our next question comes from Mr. Marcelo Brisac with Itau Securities.

Q - Marcelo Brisac {BIO 15348244 <GO>}

Hi. Good morning, gentlemen.

A - Roger Agnelli {BIO 14016988 <GO>}

Good morning.

Q - Marcelo Brisac {BIO 15348244 <GO>}

A quick comment here on taxes -- your effective tax rate was extremely low this quarter. Actually, I have no listings [ph] connected (inaudible) there. So, just wondering what happened, the effects -- if (inaudible) exactly why your tax rate was so low. Thank you.

A - Fabio Barbosa {BIO 21197136 <GO>}

Okay. Well, it was a combination of elements. First, in our Brazilian taxation, the effects of the monetary correction associated exchange rate, they are not taxed. There's a major element there. So, we have more -- we have a lot of assets abroad and denominated in dollars.

So, there is no taxation because it's simply a changing in the currency. But it affects the result. Also, we have the contribution of the interest on shareholders' equity that we announced. We are paying now this month of October $1.6 billion. And we have a deduction associated with that.

We also observed a reduction in the tax rate in Indonesia. And then we reverted provision for the income tax there. And this accounted for about $154 million. Then finally, the charges associated with the devaluation of the currency over the debt denominated in US dollars, this is fully deductible on the tax base.

So, as there was a major depreciation of the real, there was an expenditure, accrual expenditure there associated with this. The depreciation debt was fully deductible from our result and this combination of elements caused our tax rate -- this abnormal low tax rate I would say.

This is something that you should not expect to happen again. It was a combination of elements that one should not extrapolate for the future because our tax rate is about the same and should continue to be the same around the long-term tax rate around 20%. So, this was an absolutely exceptional, one-off result.

Q - Marcelo Brisac {BIO 15348244 <GO>}

Perfect. So, just to clarify that -- so the impact of the revaluation of the debt that creates an expense that is tax deductible?

A - Fabio Barbosa {BIO 21197136 <GO>}

Yes.

Q - Marcelo Brisac {BIO 15348244 <GO>}

On the other hand, the revaluation of the assets is nontaxable?

A - Fabio Barbosa {BIO 21197136 <GO>}

Yes, that's right. That's right.

Q - Marcelo Brisac {BIO 15348244 <GO>}

Okay. Thank you, very much.

A - Fabio Barbosa {BIO 21197136 <GO>}

Thank you.

Operator

Excuse me, our next question comes from Mr. Felipe Hirai with Merrill Lynch.

A - Roger Agnelli {BIO 14016988 <GO>}

Felipe, are you there?

Q - Felipe Hirai {BIO 15071781 <GO>}

Hello? Can you hear me now?

A - Fabio Barbosa {BIO 21197136 <GO>}

Yes.

Q - Felipe Hirai {BIO 15071781 <GO>}

Hi. Good morning, everyone. So, thanks for the presentation, it was very helpful and I think one of the best from the last few quarters. I -- my question is related still to -- I don't know -- I think that now it's what really matters for Vale. So, I wonder if you could help us think on how we should be looking at the iron ore market for 2009 in terms of prices.

What's going to happen with the index that your tradings were pushing, how we should think about freight prices, about now it seems that the supply and demand right now makes -- they are in favor for the steel makers. So, just if you could help us understand how we should think about iron ore prices next year. Thank you.

A - Roger Agnelli {BIO 14016988 <GO>}

We continue to prefer the benchmark system. I think today there is no doubt that it is good for the industry because avoids a lot of volatility in the market. And in the last quarter, you are going to see that this is the best way to negotiate with our clients.

Index brings a lot of volatility and a lot of distortions, et cetera, et cetera. I -- clearly, I don't understand why the Australians, they like the index or they like this kind of thing. It's their problem. The point is we are continuing to deliver iron ore to China, to Japan, to Korea, to Europe at the long-term contract at the benchmark system.

So, I think we are in a much better situation right now compared to the spot market. If they are selling at the spot market, I don't know. But of course, they are -- they have been hurting by the price right now.

For next year, it's a completely new negotiation. We will be -- stick to the benchmark system to have one price for iron ore. The Carajas quality is going to be the benchmark again. And life is actually the same. So, we don't see big change in the system, even though, of course, we needed to adopt the benchmark system to a new reality because the world is completely different right now.

Q - Felipe Hirai {BIO 15071781 <GO>}

Okay. Thank you.

Operator

Excuse me, ladies and gentlemen, please restrict your questions to one at a time. Our next question comes from Ms. Victoria Santaella with Santander.

Q - Victoria Santaella {BIO 1521297 <GO>}

Good morning, gentlemen. My question is regarding the general philosophy of the Company facing our global recession. What has changed versus the previous crises we saw in '98 and 2002, where companies were not that consolidated and the sacrifices were via prices?

What are you foreseeing that is going to change this time, maybe more adjustments in volume in order to support prices? I want to hear how are you preparing for that and if you can also give us any following on this question, any updates on your negotiations of increasing prices in China at 12%.

A - Roger Agnelli {BIO 14016988 <GO>}

Well, in terms of market, I think the market today is completely different than it was in 2002. First of all, all the mines have been facing a cost increase because this is the nature of the business. When you go deeper, when you increase your production, your cost goes up. So, I think we don't -- it's impossible to compare 2002 with 2007, 2008.

For next year, there's a lot of unknown recession [ph]. No efficient competitors came to the market. I think they will be the first to leave the market. A lot of dreams were sold in the market that a lot of new material is going to reach the market that I don't believe that they will continue to push that -- those investments ahead because the cost of investment is very high. There is a credit crunch right now in the world. And they are not prepared to realize all this investment.

So, I think naturally the market is going to be adjusted. Supply and demand, we believe that in medium term, long term, the trend is positive -- is still positive. Don't forget that the beginning of '08, the end of '07, what we had was abnormal behavior in the market. The price went up sharply due to the exchange rate, the dollar depreciation, due to the growth rate in the economy, mainly there in China because they were finalizing the infrastructure for the Olympic Games.

So right now, I think this is not normal. It's completely abnormal, the behavior in the market right now. The competitors or some companies are facing problems to price their products because the price today is affected by liquidity crash. So, if they need money, they needed to sell it in the price. So, this is not sustainable either.

So for next year, let's wait a little bit. Let's be quiet. Let's be conservative. Let's see what's going to happen. My perception is that we will not have sustainable oversupply in the market. This is for sure because the cost is very high. The price -- the current prices are below the cost -- the average cost of the industry. So, a lot of no efficient producers will be completely out of the market in -- I should say in a few months, certainly in a few months.

Q - Victoria Santaella {BIO 1521297 <GO>}

Thank you.

A - Roger Agnelli {BIO 14016988 <GO>}

Okay. Sorry. There is another question she had for us. The price negotiations for next year -- sorry.

Q - Victoria Santaella {BIO 1521297 <GO>}

The 12% that you guys were pursuing last month.

A - Roger Agnelli {BIO 14016988 <GO>}

Okay. The 12%, let's talk a little bit about that. First, we had -- I watched in Japan, in Korea, in Taiwan, in China, in last May, last April, May and we mentioned that we set the price. We increased the price by 71% [ph] at that time.

And we said that if they could reach an agreement with the Australian with a price higher than our price, we would like to see something for us. And they accepted to pay a premium for the Australians. And they reached an agreement there. And then, we asked for a quality price increase.

And some companies or some clients -- the major clients in Japan and Korea, in Taiwan accepted the price. That was in July, August of '08. Right after that, the markets changed completely. And what is going -- what's happening today is that the Chinese, they wanted to have the Australian price renegotiated. Today, they don't want to pay the premium that they agreed to pay a few months ago. And they are refusing to accept our price right now.

And of course, we are not in a hurry because a lot of traders, a lot of local miners, they need to sell their product. So, let's leave them sell first. Then next year, we are going to renegotiate the price again. We have a completely different environment. What I should say that we are not delivering, we are not shipping iron ore without the 12% price increase.

Q - Victoria Santaella {BIO 1521297 <GO>}

Thank you, very much.

Operator

Excuse me. Our next question comes from Mr. Terry Ortslan with TSO & Associates.

Q - Terry Ortslan {BIO 1785453 <GO>}

Thank you, very much. Terry Ortslan. I share your views on China. Just came back yesterday, as a matter of fact. And they seem to have a timing horizon which a bit more than a couple of months or a couple of quarters. But nevertheless, let's assume that.

But my question to you is CVR -- as Vale being a leader in many commodities, iron ore and nickel, can we expect that you're going to show some discipline to the industry whereby by cutbacks and managing the supply you can control the inventories a bit more and bring these into the industry -- including nickel business, as a matter of fact that you have implied in your presentation about Onca Puma and on the Goro? Thank you.

A - Roger Agnelli {BIO 14016988 <GO>}

Yes, in the term -- nickel market, I think what we are facing there the major oversupply in the market for short term or medium term. And we are cutting production. Indonesia, for example, we turned off all the power plants, the oil or the term of our plants. And we are running right now only with the hydropower plants, where the cost is much lower. So, we are cutting at least 20% production there in Indonesia.

In China, we are working right now with 35% of our capacity. And we don't want to increase capacity because to sell at any price is not reasonable. In Canada, we would like to keep the mines producing or operating at the maximum capacity because there we have the lowest cost in the nickel business. So of course, we are going to follow discipline in the market. And we will not sell at any price. If it's necessary, we are going to cut production. No doubt about that.

In terms of iron ore, we had at least 30 million tons that is completed out of our average cost in some mines that the ore is not good in terms of quality. And we are reducing production right now in those mines mainly here in the south system. But we are keeping production there in Carajas.

Of course, we are not buying iron ore from third parties. Right now, we canceled completely the acquisition of those iron ore. And we are reorganizing the Company to face the lowest cost production possible. This is for the next three, four, five months. So, we are not really pressed by debt or working capital. So, we can be -- we will be very disciplined.

Q - Terry Ortslan {BIO 1785453 <GO>}

I'm very pleased to hear that. Can you just elaborate on the Onca Puma and the Goro ramp up the way you implied in your presentation in terms of the next scenario you have for the ramp up schedule? Thank you, very much.

A - Roger Agnelli {BIO 14016988 <GO>}

We are discussing right now the ramp up of Onca Puma and Goro. Let's talk a little bit about Onca Puma. Onca Puma was expected to produce 7,000 tons of nickel next year. And the step up was expected to start in March or April. We are going to postpone a little bit from March to August or September or maybe October.

And our expectation is to produce 4,000 tons of nickel. So, we are turning on the furnaces and we will keep production at the minimal level. The same thing to Goro. Goro, we are going to turn on the furnace until the end of '08, maybe January of next year. And we are going to work at the minimum production level.

Q - Terry Ortslan {BIO 1785453 <GO>}

Okay. Thank you, very much for your help.

Operator

Our next question comes from Mr. Samuel Taptart [ph] with Sentinel Asset Management.

Q - Samuel Taptart

Thanks. On the iron ore side, you talked about significant inventories in China. How long do you think that it may take for those inventories to get depleted? You talked about basically you had been saying in last minute conference calls about your high-quality iron or basically that's beneficial for Chinese blast furnaces.

And you haven't talked anything on that today, in fact that you are going to push more high-quality iron ore in Chinese mills rather than the low quality, which they currently have probably on inventories there, where you can get higher prices for iron ore in 2009, 2010 period. Is that still the philosophy? Or has that philosophy has changed now on the downside? Can you just talk about that on the two factors?

A - Roger Agnelli {BIO 14016988 <GO>}

I think the first issue is -- today, the scrap price is $200 per ton, which is very, very, very low. And of course, the steel mills, they prefer to melt the scrap than iron ore. So, if they're reducing production right now, what they needed to do is to reduce efficiency of the blast furnace.

So, they will consume more low-quality ore. But this is temporary. I feel that in three, four months, the stock or the inventories that they have there in China will be consumed. But they needed to have, of course, high-quality iron ore to blend.

In Europe, they wanted to keep their big blast furnaces at maximum capacity because it's not easy to shut down big blast furnaces. So, if it's working, they need to keep at maximum production at a maximum efficiency.

What we needed to do here is to see how big is going to be the adjustment in steel production. Then, we will have -- we'll have all the options open to face a new reality in the steel market. The point is -- in the United States, the situation is not good. In Europe, some of our clients are cutting production because there is a lack of working capital. There is a lack of finance right now. So, they are obliged to shut down some blast furnaces.

So, let's wait a little bit to accommodate, to see things as the normal situation. Of course, the level of production will be lower than was in the first half of '08. No doubt about that. And we are going to adjust our production to this new reality.

Q - Samuel Taptart

And on the pricing on -- in 2009, 2010, of course, you cannot talk about that. But you were contemplating to push high-quality iron ore. And do you think that in this scenario you may be able to get higher prices for the high-quality iron ore? Or you don't think that it is not likely now?

A - Roger Agnelli {BIO 14016988 <GO>}

Since the clients accept to have a different price resulting to freight, I think we deserve to have a premium for the high-quality ore. No doubt about that. And we are going to be -- stick to this policy because high-quality iron ore is good for the environment because the CO_2 emission is lower, because the consumption of energy is lower, the quality of the steel is better.

So, we need it and we would like to have that. Why that? Because they are subject to differences in the pricing in Australia. And right now, if we consider the current freight price, I think there is no big difference between our standard [center feed] and the Australian ore.

Q - Samuel Taptart

Okay. Great. Thank you.

Operator

Our next question comes from Mr. Carlos de Alba with Morgan Stanley.

Q - Carlos de Alba {BIO 15072819 <GO>}

Hello. Good morning, Roger. Good morning, Fabio. Question is the first one. Has the strategic importance of corporate aluminum and coal changed with this down market? Or are those still the three most important avenues that Vale has to grow in coming years?

A - Roger Agnelli {BIO 14016988 <GO>}

Corporate in coal is certainly a market that we would like to increase our presence. We believe that long term is good. To implement new projects is going to take like four years to finish the investments. And at that time, I believe that the market is going to be much better than it is currently.

In aluminum, of course, the problem is energy cost and energy cost is very high. So, we needed to analyze carefully. I think we have room to develop the business. But it's very intensive in capital. The return in terms of years is longer. So, this is not really our priority to develop aluminum smelters. Only if we find out places that we can count on a cheap or very low cost energy.

For alumina, I feel that we can go a little bit ahead. Of course, the timing or the speed is going to be reduced. But we are not going to reduce the speed in terms of copper project implementation like Soloco. We will go at full stream ahead because it's going to take like four years to finish the project. In coal, Mozambique is very, very, very competitive mine. And we are going to keep the same speed that we assume in the very beginning of the project.

Q - Carlos de Alba {BIO 15072819 <GO>}

Thank you. And just follow up -- is there any updated guidance, Fabio, in terms of the volume that we should expect for the year?

A - Fabio Barbosa {BIO 21197136 <GO>}

No, I think it's too early comment on that, Carlos. Things are evolving, developing markets are very volatile. We are not in position to give any indication at this stage.

Q - Carlos de Alba {BIO 15072819 <GO>}

Thank you, gentlemen.

Operator

Our last question comes from Mr. Ben Folk [ph] with Marble Bar.

Q - Andy Minder

Hi. Good afternoon. It's Andy Minder [ph] from Marble Bar Asset Management. Could you please give us some thoughts on the cash cost? But I realize that prices are falling. But at the same time, energy costs, fuel costs are also declining. Can you give us some idea as to after the real adjustment, what kind of cost declines we should be expecting in Q4 versus Q3? Thanks.

A - Fabio Barbosa {BIO 21197136 <GO>}

Well, I think the major element there, as you can appreciate, markets have been extremely volatile. So, we have a reduction -- sharp reduction in oil prices that may or may not be translated in cost reductions here in Brazil for instance and in other places in which we have operations. There's a major question mark here, at least in Brazil, where we have the bulk of our operations here.

Also, the exchange rate and not only the real. But also the Canadian dollar, the Australian dollar, the strengthening of the dollar should affect positively, all things remaining the same, the cost structure of several operations worldwide. So again, today, to guess what would be the average exchange rate for the Fourth Quarter is literally a several billion dollars question.

So -- but the trend, the appreciation of the US dollar is there. And one should expect, all things remaining the same, a reduction in costs associated with that and the exposure, even the exposure that we have to several different currencies in our costs.

A - Roger Agnelli {BIO 14016988 <GO>}

And Marble, there is another thing that we can add to that is the fact that a lot of our suppliers -- services suppliers or equipment suppliers -- they are facing some cancels in terms of orders. A lot of mining, a lot of other companies, they put orders in the beginning of the year. And they are canceling those orders.

So, a lot of our suppliers are coming to us and say, "Hey, would you like to have the equipment right now? Or would you like to hire us to do something for you? And we can give you a discount," because they are losing work right now. So, it's too premature to say or to put guidance of cost reduction. But of course, money right now is king and we have the money.

Operator

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

A - Fabio Barbosa {BIO 21197136 <GO>}

I'll leave that to Mr. Roger Agnelli, our CEO.

A - Roger Agnelli {BIO 14016988 <GO>}

Yes, what I'd like to say is that we like work hard. We love work hard. And we are continuing to work harder to give or to bring the best return to our shareholders. I feel that we are going to have a lot of opportunities to cost reduction. I think we are going to have a lot of opportunities to support our clients.

That is going to be necessary to do that. And our view is always long term. And I feel very comfortable to say that we are in a very strong and very good position right now to keep growing or to keep going on. Thank you, very much for everybody for the audience. Bye-bye.

Operator

That does conclude our Vale's Third Quarter 2008 Earnings Conference for today. Thank you, very much for your participation and have a good day.

FINAL

Bloomberg Transcript