Q1 2006 Earnings Call

Company Participants

- Fabio Barbosa, CFO
- Gabriel Stoliar, EVP, Strategic Planning and Control
- Murilo Ferreiras, Executive Director, Business Development

Other Participants

- Andrea Weinberg, Analyst
- Daniel Altman, Analyst
- Edmo Chagas, Analyst
- Jorge Beristain, Analyst
- Katie Blacklock, Analyst
- Oscar Cabrera, Analyst
- Paolo Di Sora, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. Thank you for standing by and welcome to the CVRD's conference call to discuss First Quarter 2006 earnings results. If you do not have a copy of the relevant press release, it is available at the company's website at www.cvrd.com.br at the Investors Relations link.

(Operator Instructions) As a reminder, this conference is being recorded. And the replay will be available until May 22 of 2006. To access the replay please dial 55-11-4613-4532, access code 398. The file will also be available at the Company's website at www.cvrd.com.br at the Investors Relations 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, www.cvrd.com.br Investors Relations section, or at www.trnewfwird.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 any of macroeconomic conditions, market risks and other factors.

With us today in Rio de Janeiro is Mr. Fabio Barbosa, CVRD's Chief Financial Officer. 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. Sir, you may begin.

Fabio Barbosa {BIO 1907620 <GO>}

Thank you, very much. Good afternoon, ladies and gentlemen. It's a pleasure to be with you today. We have with us here two colleagues of ours, Mr. Gabriel Stoliar, our Executive Director in charge of our Strategic Planning and Control and also Mr. Murilo Ferreiras, our Executive Director in charge of New Business Development.

If I can start our discussion today with the presentation. And we have two sections. The first we comment on our First Quarter results. And I will ask my colleagues here to make some specific comment in some areas I think would be interesting for everybody. And finally, we will comment on what we see on various scenarios underlining for the industry and (mining efforts).

Let us start with the performance in our First Quarter of '06. We delivered two production records in the First Quarter of '06, Alumina, 728,000 tons of Alumina in the First Quarter, already reflecting the good path of our minority expansion stage 435. Potash, 185,000 tons also reflecting the expansion of our alumina capacity to 850,000 tons from almost 600,000 tons previously.

A point that you might like to highlight is the fact that iron ore production for the first time we were able to overcome the seasonality, the very heavy rainy season that disturbed our operation. But despite that, in terms of production, we were able to deliver a slightly 100,000 tons more, or produce 100,000 tons more in the First Quarter of '06 compared to the Fourth Quarter of '05. That's usually -- it's much stronger, as you can see, in the chart that should be before you now.

Our revenues growth reached almost 50% on a year-on-year basis and price of course we managed to increase our production. But prices reflecting the cycle that we are living through right now. But it netted a major contribution with over $1 billion in total compared to the same period of last year.

These are the results in terms of EBITDA. Our EBITDA in the First Quarter of '05 was $993m. In the First Quarter of '06 it was $1,629b. A major change in dimension of our Company that was an advantage, a major, a large part by the strong contribution of prices. Of course, that was slightly (consolidated) by the sharp appreciation of the Real that took us $233 million in terms of all of the impact of EBITDA in terms of prices.

Another important aspect is that -- and this was an issue of some concern in the last discussion that we had was regarding costs. By that, in the last conference call we mentioned that we now feel cost pressures were easing. And the trend would be something like that, not the margin of cost pressures. And that's precisely what we observed in the First Quarter of '06.

We saw the cost of goods sold decline from $1.8 billion to $1.7b. Even adjusted for volumes, you will see that there was an important reduction there. And at this stage, I would like to ask my colleague Gabriel Stoliar to comment a little bit on some cost reduction initiatives that we adopted in our Company. Gabriel, please.

Gabriel Stoliar {BIO 1712096 <GO>}

Good afternoon, everybody. The idea here is that we have been for quite a while investing in programs that intend to reduce costs and increase efficiency in the Company. But of course, with the market very heated, the focus is to mainly be on granting quantities and therefore, benefiting from this heated market.

Now, we are going to put a lot of focus on a combination of excellence and cost reduction because we believe, as we are already getting some very significant cost reduction in terms of unit costs, that all of this work can be fully linked to the Company's budget. And the Company will be able to get very clear plans from the operational areas towards implementing operational excellences. And therefore getting the cost reductions.

This will cover not just the operations in which the size -- the operations themselves will focus a lot on alternation and linking the alternation systems with the ERP. But also that would also cover corporate costs and SG&A and CapEx expenditure. So that we intend to have this concept of operational excellence covering all of the operations of the Company.

We of course expect that all these excellent plans that would translate into value targets to be achieved along the time. We will of course obtain some quick wins that we expect that will be expressed already in 2006 results from now on.

Fabio Barbosa {BIO 1907620 <GO>}

Gabriel will of course be available for the Q&A session just after this initial presentation. But with this effort that we are starting to put in place and the strong performance on the revenue side, the fact that we managed to achieve a very impressive number for our (inaudible) and also our EBIT margin that reached 40% in the First Quarter of '06. And in terms of net earnings we presented, for the fourth consecutive quarter a figure above $1b. So it's an impressive performance. And again, just consolidating a change of dimension of size that our Company achieved in the last few years.

Then the very next chart in front of you with the performance of our EBITDA. That just three years ago, or four years ago was $1.5 billion for the First Quarter of '02 and for the last 12 months ended in March of 2002. And now in the First Quarter of '06 this figure reached $7.176b. So it's a better performance of course, benefiting from the very good momentum of the industry as a whole. But as you all know, our Company was able to outperform our peers in this period.

In terms of our balance sheet, we managed to implement an aggressive investment program but at the same time, we managed to keep our balance sheet on a very sound strategy. So total debt reached $6.1 billion in March because we borrowed most of our borrowing program in the First Quarter of '06. But net debt was $4.4b.

Total debt to EBITDA was below 1. It was 0.84. A very sound figure. And at the same time, the interest coverage almost doubled. The indicator for this therefore in 2005 was 27 times at this stage. Total debt enterprise value reduced, actually, from one year ago from an average of 10.3. And we managed to increase sharply the average debt life to almost 8.2 years from 6.7 years. That was already a great figure in March 2005.

And as I mentioned, we were able to keep this very sound balance sheet despite even that we have already an aggressive CapEx program. And as you can see on the next page, we delivered in the last four years 16 major projects that are very much behind the transformation of our Company. Projects that, together with our assets, implied a return on invested capital averaging 33.7% per year since 2002. It's an impressive figure and the latest one was precisely Alunorte Stages 4 and 5. That has had an impressive ramp-up. I would like to have Murilo Ferreiras to comment on this issue. Please, Murilo.

Murilo Ferreiras

Good afternoon, everybody. We are really very happy with the impressive ramp-up of the Alunorte refinery. As you know, most of the refinery is planned at least three or four months in order to reach the full capacity in terms of an annual basis. And in this expansion of Alunorte Line 4 with 20 days and we overcome our own effort in the line of 5 and we reach the full capacity in just 12 days.

So really, we are very impressed with these numbers with our team. The commitment to improve substantially our operations and what can I can tell you is that we intended to start to reserve also a bauxite from Paragominas. The project is on time, on budget, regardless of this cost that is increasing so substantially.

Of course, we have to exclude the effect of the exchange rate variation. But those projects, the Alunorte expansion, number two and the Paragominas that we will start the operation in the end of this year, what we can tell you is that we are very happy that the numbers that we are (faced).

Fabio Barbosa {BIO 1907620 <GO>}

(inaudible), our promise also was the important issue of energy costs. We in our chart here show that we managed to increase through our investments the sum of the investments that we just commented that were being built in the last two years. For instance, (Airmores) (inaudible) Capim Branco. Our part last year that allowed us to increase the share of CVRD generation from 8.7 to 18.7% in total consumption of the Company.

And also we have been able, as a cost control measure, we have been able to access more energy through the free market, increasing or mitigating partially the negative effect of the higher costs that we are observing in our energy supply.

Turning to the general scenario of our industry. The very type of expansion explains our field. It's a benign environment for the industry and (inaudible) in particular. In fact, the curve of the expansion cycle is the longest since 1970 as it is put there. And we have been serving markets for some time ago that we believe that we are leading a circular trend, a structural change that the figures that we are collecting therefore form this view.

The global economic expansion again growing above 4% for the fourth consecutive year, as we've put there. And the major driver of this has been the Chinese economy continues to show very strong performance. Chinese GDP growth reached 10.2% in the First Quarter of '06, very marginally in line with our own forecast. And I remember at the beginning of the year our forecast this year was considered somehow optimistic but it is very much in line the figure that we just achieved, the 10.2%.

And the good news is that it's not only China that is performing well. But also a new force is coming into play. That's precisely India. We do believe that the Indian economy will be a major force that will affect sharply the fundamentals of the mining metals market.

In fact, you see there in the chart that the common material growth rates of the steel industry, China has increased sharply in the last five years than in 2005 compared to the 10 years then in 2000, indicating very much in line with our expectations which is the strong growth performance of the Indian economy, associated with the very -- which is a focus on the development of the steel industry domestically.

That will represent, in our view, a major potential disturbance in the supply and demand balance of the iron ore seaborne trade, as India is responsible for almost 25% of the Chinese imports of iron ore. So it's interesting to note that the marginal growth rate of India ore exports was China has been sharply reduced this First Quarter of '06. So we do believe that there's much more to come. And not only iron ore but also how the minerals and metals should be affected by this strong performance.

In terms of the global economy as a whole, we see an environment in which growth is happening everywhere. A more balanced industrial production growth is observed there in the chart about the manufacturing industry that we put there. And is of course, together with this positive environment, steel prices are recovering sharply across the board.

So Asia, Europe and North America, they are simply reflecting the trend of the aggregate demand on a worldwide basis. And they are pointing north, which is natural and is very much in line with our expectations. Although they have been surprising us with the intensity of the price increases that we are observing.

The Chinese FAI investment continues to grow at a very steady pace, not slowing down whatsoever, almost 30% growth. Even with the sharp increase in interest rates, the situation continues to be very similar to what it was at the end of the year. So growth is happening actually on the ground and Chinese iron ore imports are growing fast as well. As we put there, an all-time high figure was observed in March '06. In the First Quarter, they imported 28% more than the First Quarter of '05.

If; the next slide; they replicate the same growth rate for the rest of the year and we are not forecasting that. But if they replicate, it will represent almost 80 million tons more of iron ore imports this year.

At the same time, Chinese iron ore inventories are on a downward trend, as you can see there in the next chart, in which we compare the monthly pig iron production with the iron ore inventories. So from time to time we have commented about the size of this (inaudible) and then what we argue is that the production had increased. And now we are showing to a chart that's decided the downward trend is stuck. Inventories are not an indication of the strength of the market.

And the spot iron ore prices remain well above benchmark prices. They are above $19 per ton, or $18.30 per ton, above the benchmark price. Comparing this with the FOB price and this is just a comparison. This will be a premium on an FOB basis of roughly 45% on the benchmark price. So it shows you that the market remains extremely strong and there is no sign of deterioration whatsoever.

Turning now to the aluminum market, I would like Murilo to make some comments on the fundamentals of the market, how he sees the pricing and the inventories of aluminum and alumina as well.

Murilo Ferreiras

I think that again we are seeing some structural changing and it's unlikely to see any kind of reducing in the short-term at least. What you are seeing is that most of the commodities they are adjusting with the new scenario and the aluminum is not so different.

What we needed is much more in terms of power. Power is very important to raw materials to produce aluminum as we needed also alumina. And alumina is very expensive. We had just two new refineries with the exception of China into the world and we are paying now for the rest of when they decide not to invest so much in the alumina.

And we needed to follow the market. But what we are seeing is that in terms of adjustment, we needed to see the long-term forecast for commodity price as a rule in the new scenario.

Fabio Barbosa {BIO 1907620 <GO>}

Okay. So with that note, I'll just inform that alumina has (inaudible) prices now, it's 22%, 23% on a spot basis. We do sell some alumina spot at 10 to 15% of our total production available. And the aluminum price reaching a record level for the last 10 years at least, almost ($228).

And finally, copper prices, that I guess this chart, as you will see there, is now obsolete because this week the copper prices reached $8,000 per ton, or Â£3 and $3.62 and past our record. So it's an impressive figure in our more (inaudible). Most of the domestic comments, we didn't -- to be very frank with you, we didn't think that we could see such a price level.

So with that comment, we conclude the first part of our discussion today. And myself, Mario and Gabriel will be available for any questions you may have. Thank you, very much.

Questions And Answers

Operator

(Operator Instructions) Our first question comes from Andrea Weinberg with Merrill Lynch. Please go ahead.

Q - Andrea Weinberg {BIO 6591181 <GO>}

Hello, Fabio, Gabriel, Murilo. A quick question maybe for Fabio and Gabriel. On the cost initiatives, on the cost cutting initiatives that you're taking, do you have any idea of how much this could imply in cost savings on a yearly basis?

And the second question will be that you have been showing in your presentations that the lead time for delivery of equipment, trucks, tires, etc, is actually longer than what you have shown in previous presentations. And some of your competitors have been recently stating that the shortage of labor equipment and carriers is actually bigger this year than what it was last year. Are you experiencing any delays on your project development that you expect. And if you are experiencing delays, how long the delays are?

A - Fabio Barbosa {BIO 1907620 <GO>}

Gabriel?

A - Gabriel Stoliar {BIO 1712096 <GO>}

Yes, let me try to explain because we're not in a position to commit ourselves to targets or to cost reduction targets today. The idea is that we are working, or rather benchmarking, standardizing and like using the best directives, the best operational directives. It's about the Company's operations. And we foresee that in this year's strategic planning process, which includes the budget process, will add up, linking most of these action plans to cost reductions that will be fixed and introduced in the budget.

And as I said before, there are many things that are coming out of this work that will prove to be quick wins. And therefore the results will be strong in this year's results. For example, we see that there are many third party contracts, because of a matter of words which are being, because of the very heated market, signed at higher prices. And there is room to consolidate, integrate, optimize these contracts. And obtain some gains.

Also, some of these contracts, especially in services, they tend to transform variable into fixed costs and we need to invert this. And lastly, for instance, working capital is something that can also be reduced. There is a lot of room regarding optimization in inventories, etc (inaudible) things to be obtained there also.

About the difficulties that we are facing that you mentioned, like for instance getting tires for the trucks and for the tractors. And these types of things, they are still there, in the market. We have to buy eventually, trucks, tractors, equipment in one country, tires in other countries. And that creates some difficulties.

But of course, this is the type of thing that in the very first moment, you have more difficulty along the time, you get in touch with different suppliers, you arrange ways of reducing the lead times for the delivery of this equipment and parts. And we are managing to reduce the problem, although we have to accept that we still face. And will continue to face a separate problem. But not just us, all of the industry, because thank God on the other hand, the market is very heated up. And all of the cost increases add up on the other hand. And price increases that more than compensate that. But of course, in terms of operational excellence, we need to improve our performance.

Q - Andrea Weinberg {BIO 6591181 <GO>}

Okay, thank you.

Operator

Thank you for your question Miss Weinberg. Our next question comes from Jorge Beristain from Deutsche Bank. Please go ahead.

Q - Jorge Beristain {BIO 17554499 <GO>}

Hello, my question as well is about cost control and I just need to understand, we have noticed that your SG&A, or your general operating expenses have gone up quite a bit, quarter-on-quarter. And has there been any reallocation from an accounting view, perhaps in contract services, to move them out of the costs of goods sold line and into the operating expense line? That's my first question.

A - Fabio Barbosa {BIO 1907620 <GO>}

Thank you, Jorge. There is no change in accounting figures. That's the number.

Q - Jorge Beristain {BIO 17554499 <GO>}

Okay. My second question has to do with the rate of production that we're seeing in iron ore. Do you believe that things will normalize again in the -- or more specifically, I guess, the sales of iron ore into the Second Quarter? Have you gotten through these land invasion issues and issues of the protests along the rail lines?

A - Fabio Barbosa {BIO 1907620 <GO>}

Good news. In fact, we face not only that but a much heavier rainy season that we were used to. So the fact that we, even with all these problems have been able to show a very strong production figure indicates that our efforts about all this to keep up with the market requirements. Our expectation is to try to offset, at least partially, what we lost in the First Quarter in terms of production, although it will not be a (new) effect.

I have a picture that we have taken two weeks ago, I believe in our port, Ponta da Madeira Port and this is impressive. Simply, we show a picture of the yard that's supposed to have iron ore there waiting to be loaded in the ship. And there is no iron ore at all in the port, in our yard there. So the fact that we are operating, I would say, on an adjusted time basis. And if we lose production it's very hard to compensate this lost production in the future quarters. That's what we will try to do. But it's not an easy task (inaudible).

Q - Jorge Beristain {BIO 17554499 <GO>}

Thanks. So you're standing by your full year stated goals of tonnage so far for the 2006?

A - Fabio Barbosa {BIO 1907620 <GO>}

Yes, we haven't changed it yet.

Q - Jorge Beristain {BIO 17554499 <GO>}

Thank you.

A - Fabio Barbosa {BIO 1907620 <GO>}

Thank you.

Operator

Thank you for your question, Mr. Beristain. Our next question comes from Daniel Altman from Bear Stearns. Please go ahead.

Q - Daniel Altman {BIO 1855515 <GO>}

Hello, thanks very much. First question is there are a couple of very high profile mining assets that are openly for sale, Inco and Southern Copper, just to name two. I wonder if you can give us a sense of what your thought process is in terms of organic versus acquisition, if it's changed at all given current asset prices. And whether you're taking a look at either of these two assets today?

And then the second question is again CSN yesterday talked about, or I guess confirmed that things were on track to get to 40 million tons of ore in the First Quarter of '08, which is not that far away. I'm just wondering if your work in the field, if you're hearing from customers about an acceptance of this ore, if they've come to you, if CSN has come to you with additional contracts for you to take, or not? Thanks.

A - Fabio Barbosa {BIO 1907620 <GO>}

Thank you, Daniel. On the strategic approach, we do have here, as you well know, organic growth is our priority. And our first priority as we believe that's the best way to seek growth. We haven't changed a bit on that. And given this very excited market that we see today, we haven't changed our minds because we do believe that organic growth is the best way.

Of course, as we always comment, we are always analyzing alternatives. And I'm not saying that we analyze these specific two alternatives that you are indicating here, simply making a generic comment, a conceptual comment. We always look, or we always analyze potential alternatives for CVRD. But our focus is organic growth.

On the second issue, the CSN, frankly, Daniel, I have some difficulties in answering that because we have been hearing for some time, for some time now that production expansion that they have talked about. But we don't, at least that we can notice, a major change. We didn't see the additional production come at least -- we had no additional plans established as a target. I don't know.

40 million tons by the First Quarter of '08, I don't know if -- it's not, in our view, a relevant amount, an additional amount in the market. It should not affect the market. And if and when it happens, we'll give due consideration to this potential â€" again potential supply. And analyze that according to our commercial needs. But according, of course, with the rights we have under contract with CSN. But let's see first if it actually happens.

Q - Daniel Altman {BIO 1855515 <GO>}

Are you still expecting to receive in the order of 3 million tons from them in the second half of this year?

A - Fabio Barbosa {BIO 1907620 <GO>}

We didn't get a ton so far. So we didn't get a single ton. So I'm not sure. We are not confident on that.

Q - Daniel Altman {BIO 1855515 <GO>}

Okay, thanks very much.

A - Fabio Barbosa {BIO 1907620 <GO>}

Yes.

Operator

Our next question comes from Mr. Paolo Di Sora with Itau.

Q - Paolo Di Sora {BIO 3285292 <GO>}

Hello, I have two questions. The first question is regarding the Pellet business. We have seen quite a strong drop in your pellet sales for the year, for the First Quarter. So could you give us a guidance of what's your expectation on pellet sales for 2006 and going forward?

And my second question is on Logistics. We have also seen flat volumes, year-over-year in your Logistics performance. Could you give us a guidance of what's the plan on your Logistics business in terms of transport volumes going forward?

A - Fabio Barbosa {BIO 1907620 <GO>}

Hello. Thank you, Paolo. Thank you for your question and the pellets, we -- in fact, we have seen a much more dynamic growth rate in Asia in the steel-making industry. And this explains what we did in terms of reallocating our clients to that market.

However, as we also pointed out in this presentation, growth in Germany -- on a strong, on a strong pace in Europe which is a large consumer of pellets. So I'm not saying that we think we will recover fully all the reduction that we have (inaudible). We actually expect some resumption or some recovery of this market by the year-end as the world economy is growing fast and all the regions across the world are growing on a very steady path. And Asia is like Asia always. So a very good scenario ahead of us. And we expect some reaction there.

As for Logistics, we did have a very -- a performance that was affected by the (performance of the glass furnace). But mainly due to the performance of the steel sector. Of course, we had a problem with CSN (Brasonas) that hadn't resumed operations as yet. And I would say the other thing is, important clients for our general Pellet business will be -- if they actually resumed operations of the glass furnace on June 15 as they stated, we may have some recovery there during the year.

And we will know that very soon. By June we will know that if they were able to resume because it's a very important cargo for (inaudible) and coal. So this -- and of course iron ore as well. But the fact is that we don't know. Let's hope that they actually resume operations on June 15 as they established. But other than that, we see now what is happening right now. It was a performance less impressive than we would like to see and the appreciation of the exchange rate is affecting sales of producers and actually we should expect a more modest growth from now on.

Q - Paolo Di Sora {BIO 3285292 <GO>}

Okay, thank you.

Operator

Our next question comes from Katie Blacklock with Thames River Capital. Please go ahead.

Q - Katie Blacklock {BIO 17145068 <GO>}

Hello. My question was on the copper division. And there are obviously operational problems that led to much lower volumes in the First Quarter. Now, I know in the press release you talked about regaining the annualized rate of 120,000 but can you give us some guidance for what you expect for volumes for the full year this year?

And then my second question is just on the personnel costs. There was a sharp rise, year-on-year, in personnel costs. Can you tell me whether that was actual salaries going up or an increase in personnel, or what kind of combination of the two that was? Thank you.

A - Fabio Barbosa {BIO 1907620 <GO>}

Thank you, Katie. Well, on copper, we indicated our expectation about resuming production at the trend of 120,000 tons of copper content. And this is actually happening. The production has increased in the last few weeks. And we are running at a very, very strong rate. But of course we were deeply affected by the poor performance of the First Quarter of '05. So we may be operating at a trend of 120. But the final year could be slightly less than that. Okay?

Q - Katie Blacklock {BIO 17145068 <GO>}

So for the Second Quarter you would expect a (inaudible)?

A - Fabio Barbosa {BIO 1907620 <GO>}

A much stronger performance.

Q - Katie Blacklock {BIO 17145068 <GO>}

Than 120. And that would be an annualized rate of 120 in the Second Quarter already?

A - Fabio Barbosa {BIO 1907620 <GO>}

It's likely. It's likely to happen to see that. So far, fortunately we were able to fix the deal, the deal there. There was -- it had a problem with the engine. We were able to fix lost production, weaker production in the First Quarter. We don't expect it to happen again because it's a single, or a peculiar event. So we are improving our operations and we hope to present much better results in the Second Quarter.

As for personnel that you asked, on a U.S. GAAP basis we increased by almost 15% our total number of employees. We have about 32,500 employees in the First Quarter of December '05. And December '06 this number was about 38,000 people. More than that --

Q - Katie Blacklock {BIO 17145068 <GO>}

Sorry, that was 38,000 in the First Quarter of this year?

A - Fabio Barbosa {BIO 1907620 <GO>}

Yes.

Q - Katie Blacklock {BIO 17145068 <GO>}

Okay.

A - Fabio Barbosa {BIO 1907620 <GO>}

In December '05, December of '05, okay. But there is not yet a stable figure for the First Quarter, okay? And at the same time, we had a salary adjustment of 6.5% last year, combined with appreciation of the Real, okay, of 18% or so in the last 12 months. And finally, we paid a figure, the viable compensation, the profit sharing in total in the First Quarter of '06. And the last year it was partly paid in the last quarter of '04. So that makes up for the difference, okay?

Q - Katie Blacklock {BIO 17145068 <GO>}

Okay.

A - Fabio Barbosa {BIO 1907620 <GO>}

Thank you, Katie.

Q - Katie Blacklock {BIO 17145068 <GO>}

Thank you.

Operator

Our next question comes from Oscar Cabrera from Goldman Sachs. Please go ahead.

Q - Oscar Cabrera {BIO 7553392 <GO>}

Hello. Good morning. Good afternoon, gentlemen. Just a question with regards to your iron ore supply chain. Supply chains around the world have been impacted by cost pressures and in the past presentations you've mentioned the fact that you'd like to get your capacity utilization down to 95%. I'm just wondering if this figure was to be put into your budget would you be able to meet your target of 300 million tons in 2007? That's the first question.

The second question is just if you can remind me what percentage of your sales in alumina go to the spot market. Thanks.

A - Fabio Barbosa {BIO 1907620 <GO>}

Okay. On the first issue, Oscar, we never said that we want to bring our capacity utilization down to 95. We said that the industry -- we have been saying that the industry has operated for more than two decades in the line of capacity of around 7% of the total production. This was the level that the industry operated since 1980 until recently.

What we have been saying is that we need some spare capacity, yes, to build, to create, to increase our capacity up to a point that will reach some idle capacity. But that has not been the case despite our efforts. The number that in 2000 and when our production was 134 million tons in 2005, in (5) our production was 224m. We grew (1BHD) in the iron ore division in five years. And now we are set to increase our production by 2007 to reach 300 million tons. And this continues to be our target.

I will ask Murilo to answer on the point of alumina.

A - Murilo Ferreiras

We have two different sorts of material in the spot market. The first one is our (inaudible) in Alunorte. And the second one, in case of having some surplus in Alunorte. As I point out, we are doing much better in Alunorte. And we expect to have some material to sell. And we have also in CVRD our commitment to deliver material to Albras to (Copesul) and to different customers. But in the end, what we are forecasting is to have in the range of 18% of our stake to sell in the spot market.

Q - Oscar Cabrera {BIO 7553392 <GO>}

Thank you.

Operator

Thank you for your question. Our next question comes from Edmo Chagas from UBS. Please go ahead.

Q - Edmo Chagas {BIO 1786085 <GO>}

Yes, hello. Good morning. I have two questions. The first one is related to your working capital requirements. According to your cash-flow statement you have an increase in working capital for about $788 million in the First Quarter. How much of that working capital do you expect to recover going forward for the year, given your cost reduction efforts and the operation as well?

And second question is related. Could you remind us how much of the production of alumina is still tied up to those hedge contracts that generated some losses in the First Quarter?

A - Fabio Barbosa {BIO 1907620 <GO>}

Murilo will answer this.

A - Murilo Ferreiras

About alumina what I can tell you is that on average, 2006 we are hedging in roughly 12%. Of course, much more in the first half of 2006 than the second half. In average, it will be roughly 12%.

A - Fabio Barbosa {BIO 1907620 <GO>}

And as for your question on working capital, that's decided the initiative that Gabriel and myself will be working together to deal with. In fact, this is the result of the priority to reach additional production in order to meet our clients' needs. And this means that in order to have operational security, let's say, in order to ensure that we would be able to prevent any interruption of production, we may have overlooked or exaggerated an acquisition of parts and components that are in our inventories now that in normal circumstances would not be.

So we have to reduce this component and as I will fully endorse what Murilo just said. We are not able to put a target, quantitative target right now, because we are actually working at full capacity and we have to check what are the parts and components that will be necessary to work with. And we are not able to give a precise figure. But it is our major priority. And you are right indicating for this.

Q - Edmo Chagas {BIO 1786085 <GO>}

Okay. But you're still comfortable that a part of that working capital increase may be recovered through 2006?

A - Fabio Barbosa {BIO 1907620 <GO>}

Oh yes, definitely.

Q - Edmo Chagas {BIO 1786085 <GO>}

Okay, thank you.

Operator

Thank you for your question. Our next question comes from Jorge Beristain from Deutsche Bank. Please go ahead.

Q - Jorge Beristain {BIO 17554499 <GO>}

Yes. Good morning. I wanted a few follow-up questions. One is on the iron ore price negotiations. Obviously things have become very public lately with CVRD officials again being quoted in the press recently as saying that they might even exceed the initial 24% ask. Could you confirm if this in fact is a true statement?

A - Fabio Barbosa {BIO 1907620 <GO>}

Well what, Jorge, what we said. And it was just the case yesterday in a press conference, to answer your question, is that when we established or indicated our compromise solution for the negotiations, considering the level of the spot and considering the extent of the market, that we would be accepting a 24.6% price increase as a compromise solution.

We had different conditions from those that were there today. That's what we've said. And I think there was some more appreciation of the Real hurting on our part directly, as you can see, in our figures. And just until prices recovered, since iron ore imports strengthened. And the world economy is growing faster. So its capacity is compared to the level that we could observe by the time we issued our idea.

Its cost increased and it just made a logical statement saying that the conditions are different now from what they were before. And yes, it's possible to reconsider output, the figure that was initially discussed with it.

Q - Jorge Beristain {BIO 17554499 <GO>}

Okay, my second question is given that the iron ore negotiations are running so late this Second Quarter, even if you were to settle the prices, theoretically, tomorrow, would it be possible to book any of the price increases in your actual Second Quarter results, or is it now coming too late in the quarter from an accounting point of view to reflect any of the price hike? And my question comes mainly from the point of view of comparing 2Q '06 to 2Q '05 where you did in fact book the price increase plus the retroactive price increase. And I'm just trying to understand how your numbers might look if this negotiation drags on a little further?

A - Fabio Barbosa {BIO 1907620 <GO>}

Okay, Jorge, as a rule, when we have a price increase, as we are expecting, we book the price increase according to the signature of the amendment to contract with our price. So we don't -- we never book before the actual document is ready, okay? So if in our idea, we reach an agreement today or tomorrow, the actual booking of the contents will depend on the speed with which we are able to sign these amendments, as we did last year. Okay, remember that we had some marginal effect in the Third Quarter of '05 and due to this time difference there. Okay?

Q - Jorge Beristain {BIO 17554499 <GO>}

Okay. And sorry, if I could get just one more question in. Related to your costs, your guidance has historically been for a 1% change in the Real. You experienced about a $20 million loss of EBITDA, say, in the case of an appreciation. Just comparing the year-on-year numbers in the second -- sorry, in the First Quarter, you mentioned that roughly $200 million worth of the increase in costs of goods sold came from the real appreciation, which was 17%, point to point, on average. But applying this rule of thumb to the full year basis would imply cost inflation much closer to $800 million or essentially, $40 million of EBITDA for every 1% change in the Real. I just wanted to ask if as the Real appreciates more, are you perhaps now facing an even stronger negative correlation to the Real at these levels?

A - Fabio Barbosa {BIO 1907620 <GO>}

Sorry, there is a component of structural change there, given the changes in the various tariffs of the Real. And of course, the total composition in Reais may have changed a little bit. And this could yield some change in the rule of thumb that you refer to. But I am confident that our work together with Gabriel, we will be able to address this concern and to bring this closer again to this rule of thumb.

It's not a target again, it's just a reference that we are giving. But what we observed is the result of the cost pressures and the changes in the ways, the total ways, of course, of Real costs in the total costs of the company. So in other words, we will address this. But we want -- we wouldn't like to give you, at this moment, at this stage, any specific figure, okay?

Q - Jorge Beristain {BIO 17554499 <GO>}

Thank you.

A - Fabio Barbosa {BIO 1907620 <GO>}

Thank you.

Operator

Thank you for your question. Our next question comes from Daniel Altman with Bear Stearns. Please go ahead.

Q - Daniel Altman {BIO 1855515 <GO>}

Thanks. On your ferrous metals, Ferrous Minerals division in the First Quarter, your margins were down a little over 300 basis points. Was any of that because of the railway blockages. And do you think that you can beat that 45% margin in the First Quarter, the Second Quarter or is -- was most of the decline in the margin more of a structural increase in costs?

A - Fabio Barbosa {BIO 1907620 <GO>}

Daniel, I would say that it was a combination of a very heavy rainy season that affected our production there in the Northern System. And of course, the blockade of the railroad. That affected our production in the Southern System as well. But the main issue there was the rainy season at the Northern System. This is the one that affected sharply operations. And it's seasonal. And it's an issue today at this time that it rains much more in the First Quarter of '06 than it used to rain in the First Quarter of '05 or '03. That's what happened. And that affected, of course, our costs there.

Q - Daniel Altman {BIO 1855515 <GO>}

Okay. And then the other question is. And sorry to ask really difficult to answer questions. But when you talk about another quote that's come up in the press is that one option for CVRD would be to circumvent the contract market, or go away from the contract market and sell more spot sales. Is that a strategy and I know it's not a formal strategy but is this something that if you're unable to reach a deal with the Chinese, would you still go back to your traditional customers in Europe and Japan and say you're welcome to take the contract price of this and just make China a spot market customer, or are you thinking everybody becomes a spot market customer if you can't get a benchmark price with China?

A - Fabio Barbosa {BIO 1907620 <GO>}

Daniel, I'll be very straightforward. I believe that we will be able to reach a successful agreement we've outlined and this will happen. We are in a learning process, I would say, ourselves, our clients and this is part of our -- the better changes that are taking place. We are confident that we'll be able to show -- we'll be able to reach a reasonable agreement because we do believe in market fundamentals. So the market fundamentals are clear and they will eventually prevail.

And at the end of the day, our obsession is to create and generate shareholder value. So we will be always seeking the best alternative for our shareholders, okay. Thank you, very much.

Q - Daniel Altman {BIO 1855515 <GO>}

Thank you.

Operator

Thank you for your question. 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>}

Well, I would just like to thank you all for attending this conference. And also my colleagues Gabriel and Murilo for being here with us today. And all the staff of the Investors Relations and Policy Department. As usual, we are available for any other questions you may have related to this Company and its figures. Thank you, very much.

Operator

That does conclude our CVRD's 2006 Investment Plan conference for today. Thank you, very much for your participation. You may now disconnect.