Q4 2005 Earnings Call

Company Participants

- Fabio Barbosa, CFO
- Jose Carlos Martins, Executive Director, Non-Ferrous Division
- Roger Agnelli, CEO

Other Participants

- Alberto Arias, Analyst
- Andrea Weinberg, Analyst
- Andres Perez, Analyst
- Daniel Altman, Analyst
- Ivan Fadel, Analyst
- Leo Larkin, Analyst
- Paolo Di Sora, Analyst
- Raphael Ellis, Analyst
- Rodrigo Barros, Analyst
- Sam Gosch, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. Thank you for standing by. Welcome to the CVRD's conference call to discuss fiscal year 2005 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 Investor Relations link.

(Operator Instructions) As a reminder, this conference is being recorded. And the replay will be available until March 16, 2006. To access the replay, please dial 551146134532, access code 212. The file will also be available at the Company's website at www.cvrd.com.br at the Investor Relations section. This conference call and the slide presentation are being transmitted by Internet as well. You can access the webcast by logging onto the Company's website, www.cvrd.com.br Investor Relations section. It is also available at www.PR newswire.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 1995. 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 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 conference call over to Mr. Barbosa. Sir, you may now begin.

Fabio Barbosa {BIO 21197136 <GO>}

Thank you, very much. Good afternoon, ladies and gentlemen. We have a nice surprise for you. Here with us today is Mr. Roger Agnelli, our CEO, that will make initial statements regarding our 2005 results and how we see the market from now on. Please Mr. Agnelli, the floor is yours.

Roger Agnelli {BIO 14016988 <GO>}

Okay. Good morning. Good afternoon, good evening if we have any (inaudible) have people in Europe and the United States and Brazil. It is our pleasure to be here with you.

Yesterday we announced our results from 2005. I would like to make some comments about last year's performance because last year was a very tough year in terms of operational point of view. The Company was working in a very stressful environment because the clients were requiring a lot of shipment and a lot of product. We had problems with supply. Of course, our suppliers weren't prepared to ship their products or their equipment in the right schedule for our investment here in Brazil. So we had a problem with supply. We had a problem with Real appreciation last year. That affected our cost.

At the same time, the Company beat all the records in all sectors or in all our segments and was in terms of operational was really a very stressful year. But, at the end of the year, I could say that we did well. I think the Company overcome all the restrictions. And we invest heavily in logistics. I think all or the major struggle that we had in our operations we were able to overcome.

2006, we are beginning the year with this bottleneck completely soft. I think we will have a more easy year in terms of operational point of view. Of course, it is our concern to keep taking care of the costs. We needed to. We're dealing with our supplies with our service supplier to increase productivity, increase efficiency in order to reduce the cost of some investments that we had faced last year. We are trying to improve our performance in terms of productivity in terms of efficiency. Last year we invested heavily in training programs for our employees. This year we are keeping investing in training programs in Brazil, outside of Brazil in management programs.

So, in terms of the Company itself, I think we're doing very well.

In terms of market point of view, last year was a very light year. The demand was very strong. The supply we were not able to fulfill all our requests in terms of shipments. For

2006 my perception is that the year will be the same as last year. So the demand is still very very strong in terms of supply.

We are increasing our production. We are able to fulfill all our long-term projects. But the demand and supply equation is not stable yet. I think we need at least more, 18 or at least 24 months to match the demand. Of course, we are right now negotiating the price with our clients. The environment is very calm. It is very, I should say, normal. Of course, the bias of our clients, they don't want to see an operating increase. But they recognize that the market is very strong. Of course, we're looking for a price increase.

The Chinese, they want to be listed in terms of their consumption. Yesterday or the day before yesterday the Chinese government announced that they wanted to put a cap in the price, the (inaudible) price until April. For us nothing is changing because we have long-term contracts. And our contracts in Asia due in April 1. So all the contracts, the new mining year is started -- in Asia is started in April 1. So, until then, we have all the contracts from April 1 on. Of course, the new reality or the new price will be in place.

So nothing changes. Of course, my understanding is that the Chinese government just is trying to regulate or trying to reduce the impact of the stock market and the price negotiations for this year. That is why they are announcing until April that they have decided to have these restrictions. So, in my point of view, the negotiation is going well. I believe that everybody understanding that the market -- these two markets are recovering a little bit right now. That the trade for price, for the iron ore price is up. The problem is, how much?

Of course, we don't want to put our clients in a situation that is not realistic with the market's current market conditions. We're driven by long-term view and market conditions. We believe that to keep growing or keep investing heavily as we are investing we needed to have appropriated or at least a reasonable price to remunerate our investment. So I think the arguments that we have are very strong. The price they are listening. We're taking our time in terms of negotiation. And the Chinese they are very patient. And so I think we are finishing the negotiations. But I don't see any change in the environment or in the negotiations environment.

So I'm quite optimistic that 2006 we needed to work hard to make a better year than 2005. We needed to work hard, we needed to have our team, our employees really committed with our proposal of our targets. And I believe that we will be able to deliver it very nice at least reasonable results for 2006.

Fabio Barbosa right now will take care of you. If you have any questions later, I will be able to answer to you. Thanks very much for your patience.

Fabio Barbosa {BIO 21197136 <GO>}

Thank you, very much, ladies and gentlemen. for listening. And now our CEO will have to leave for a few moments. He will try to be back in time to be part of this conference.

However, we do have with us today as well Mr. Jose Carlos Martins, our Executive Director of Non-Ferrous Division.

So let's go very quickly through the presentation to allow more room for the Q&A session. So, in the first session, the (inaudible) is cruising at high speed. And that is the size of what we have been doing. In 2005, the third consecutive year of record sales performance. Iron ore and pellets of 255 million tons, 7.4% increased. Primarily aluminum foil 147,000 or (.4%) increase. (inaudible) railroad, general cargo and (inaudible) handling services, the same.

In terms of the change of revenues, sales volume represented $936 million, an impressive contribution by our production increase. Considering all the constraints that Roger mentioned to you, iron ore, of course, a major impact, $753 million, about 22 million tons more delivered shipment in 2005.

We also managed to achieve some financial records in terms of revenues. Clearly the Company changed its size, its dimensions. So the gross revenues line reached $13.4 billion, 58.1% increase over the previous year. Adjusted EBIT $5.4 billion, 73.9% increase our EBIT margin, which 42.5%, our EBITDA $6.5 billion. And all in the quarter of the Fourth Quarter of '05. The total EBITDA in the Fourth Quarter was similar to the (inaudible) served in 2002 for the whole year. Just to give a dimension of the change that took place in the Company in 2005. A combination of volumes and prices, of course, reflecting the good momentum of the industry.

Finally, our net income reaching $4.8 billion, 88% increase, due to this very strong operational performance. Our price environment appreciation of the Real contributed a little bit this for this result. And the return on equity is 40.4%, a very strong performance.

So we have been showing our increasing trend. And the net earnings figure is increasing steadily, at least in the Fourth Quarter of '03. And our adjusted EBIT margin is also reflecting the scarcity generated by the long cycle that we are leaving right now. This is our perception. So, at these margins, it is indicating that in order to supply all the demand that is being in the market, it is impressive, it is imperative to provide the right stickling to the market participants. And so we're increasing our margin because we have an increased scarcity of raw materials of all the product that we sell. And this is just a reflection of that despite the increase in costs that we have been observing the last few months, few years.

So, in terms of EBITDA, our total EBITDA was $6.5 billion in 2005, ferrous minerals 82.5%. Copper varying slightly that the higher diversification of our portfolio. In fact, there was a barometric change in price as that combined with the major increase in volumes that determines this recovery of the share of ferrous division in terms of EBITDA or cash flow generation of the company. In all those good figures that we are showing, they also are accompanied by a very interesting synergy that we point out in the next chart, in which we show the evolution of the return on the invested capital in the last five years. And at the same time, we point out that our (inaudible) damage cost of capital has been sharply reduced by at least 300 basis points. And still we believe there is room for further improvement there. So this combination, this is a very powerful combination and, in fact, in our view explains a lot of the evolution of our market capitalization in the last few years. A higher return on invested capital combined with a much lower cost of capital.

On the shipments of iron ore and pellets, again despite all the constraints, in the Fourth Quarter of '05 a new record was achieved -- 67.7 million tons. If we have all our systems operating in full capacity everyday, it is a major fight to bring additional production. And we have been surfaced in delivering despite all the difficulties, all the lack of delivery of equipment, the disruption in machines, we have been able to ship -- we were able to ship in the Fourth Quarter of 2005 67.7 million tons of iron ore and pellets with a new record for both components, iron ore and pellets.

Of course, as Roger also quoted, we are facing some cost increase. If we look at the composition of our cost of goods sold in the Fourth Quarter of '05, you will see that about half of the cost increase was derived from price increase and input. And 25% or so depreciation of the Real. And 47 -- or the other 25%, the increasing volume. So the Real depreciation is playing a role. But the bulk of the changing cost is being driven by prices.

In terms of the EBITDA, volumes have been the main driver of the increase in our EBITDA on a quarterly basis. A slight increase of $46 million and volumes represented $91 million. So, of course, again the depreciation of the Real is playing its role. They are reducing the total positive effect in EBITDA.

We also like to highlight at this stage, which we are announcing (inaudible) results on the financial operation side, that we also intensified our efforts in terms of our corporate social responsibility. It is in our view a key point to support our long-term competitiveness. And we do operate in a complex (inaudible) and a complex society. So we spent $60 million a year in environmental protection and about $70 million in social actions in several fields. And we believe we strongly believe that these are strategic to ensure a smooth operation long-term for our company. We have to be well perceived by the community, by the society. We must have a positive perception about our role in terms of developing the areas in which we operate.

Another point, of course, there is, as regarding safety in our Railroad operations. And as in the next chart, we show a sharp reduction in accidents. But millions of trains kilometers in all our operations. In Carajas, from 12 to 5 and (inaudible) from 34 to 9. And FCA is a more complex railroad from 86 to 29.

Turning to the second part of our presentation today, we are going to comment a little bit on how we see what is our outlook for the markets in the next few years or so. We do believe that we are in this long cycle as we commented before. It is nothing short lived. It is something that will stay for a few years in a row yet. We see current growth in the world economies (inaudible). Of course, some hiccups here and there may be occur. But nothing that will change the growth there of the world economy in our view.

So for this year, we expect similar growth rates for the world economies to the one observed in 2005, about 4%. But a difference from previous years. Now we are observing a stronger contribution of the other engines as we put it. In fact, Japan domestic demand and consumption and investment for domestic consumption is increasing. So this is an extremely positive scenario. And we also we are already seeing discussions about tightening of monetary policy in Japan. That is extremely positive. Of course, we have some short-term volatility there. But just perceived that a few years ago the problem was the other way around. Deflation was the major threat to the development of the Japanese economy. And now we're talking about a possibility of changing monetary standards by the Bank of Japan. So this is impressive.

The other aspect is that Europe also is showing more stronger signs of growth. So the U.S. should continue to show a strong performance. Of course, we have some adjustment due to the Katrina effect in the Fourth Quarter of '05. But we do believe that the growth in 2006 will be strong and very widely distributed in terms of geography.

The Chinese coming to the Asian market, the Chinese GDP should continue in our view. There is nothing in our view that would prevent them in terms of growth. We are expecting even higher growth rate for 2006 compared to 2005. That was about 10%. We have a slightly higher growth expected for the Chinese GDPs, around 10.5%. And then the Chinese, of course, should continue to grow around very high figures in between 8 and 10%.

There is no change in our perception about the Chinese fundamentals. We see no reason why they would not grow as we mentioned before. A strong balance statement position. A strong market for non-syndicators. And more than that, the need and willingness to pursue a very fast organization rate. So this is something that has profound impact in terms of the balance between supply and demand, particularly in the raw materials industry. So (technical difficulty)--.

And the next slide shows that the trend continues. The imports of iron ore in January of 2006 by China were the highest ever in nominal terms, about 26 million tons. But according to our seasonally adjusted figure, it will be around 29 million tons. So it is an all-time high. And this, in our view, only shows the strength continues. And they are very -- it is a very good performance for the month of January as we put it.

And on the next page, we show that iron ore (inaudible) compared to the monthly figure in production has been declining almost steadily and reaching 2000 in the fall of 2005, .95, down 30% from the levels of June '04. So clearly if we look at the nominal inventories, we don't have a clear picture of what is actually taking place. What we have been telling you for some time is production increased a lot. But they keep staying -- some players keeps saying that inventory of 33, 35 million tons is a high-level. Compared to what has been produced, actually what we observed is a decline of the (inaudible) inventories available before.

In terms of our production, the iron ore production grew at 50% per annum from 2005 to -- from 2001 to 2005. And it is expected to reach 300 million tons in 2006.

This is very important. It shows that our commitment to our clients is extremely strong. We increased our production first from 2000 by 100 million tons in 2005. And in two years time, we're adding 66 million tons more. So in order to do that, it is imperative to have the right signaling by the markets. So CVRD must have the right stimulus, the right incentive to put all this production in place. Because, as we observed, there are inflation costs that have been lagging in terms of our availability of equipment. And it is not an easy environment. In order to deliver all that, we must have the right signaling in place. And we believe that that will be the case. Our capacity expansions should be absorbed by the growth in demand that we are anticipating. And also the need, the much-needed spare capacity that we must create, that we have none at the current time. So we need to create some spare capacity. Martins is working very hard on that.

And also there is the issue of the substitution of some stock market sales that in our view is important room for further growth in the market, individual market in the future. I will comment a little bit more on that in a few minutes.

According to our estimates, the Seaboard trade should reach 730 million tons in 2006. And the Chinese demand should be around 325 million tons, a growth of about 50 million tons in 2006 and with more modest growth rates in 2007 and 2008. But, with this, would that be the potential growth rate of our shipments there? We don't think so. Because we believe that, particularly in the case of the spot market, there are opportunities there for major players like ourselves. So, if you look at the spot market, the main corrector is that the (inaudible) indicators that they are showing -- the stock markets are showing higher prices. They have much more volatility better then the regular market. The quality of the material delivered under the conditions of the spot market are clearly (inaudible). And more important than that for operations that require predictability like a blast furnace, the uncertainty of frequency of shipments is a method of concern.

So we do have some room for further presence in this market. And then I will just just quote something that I just read in the news, that there is a comment that this newspaper, Hindustan Times, in India that the Minister for Steel there will have recommended that suspension of the supply of iron ore for China given the very strong domestic demand in India. So this is the sort of situation that we are facing. And if you look at the total spot market and supply by mostly Indian players in 2005, about 70 million tons of the spot market of the total consumption of iron ore in 2005 was provided for by Indian producers.

So if this is true and here the same news said that the minister will have suggested to reduce the supply of iron ore from Korea and Japan as well, this would have a major effect in terms of the steel margin. I am not saying that this is the case; I'm just reading what I just saw in the news because these last few days have been flooded by several (inaudible) news accounts in the market. So we would like to indicate that the fundamentals of the market remain very very strong and could be even stronger from a raw materials standpoint in the future.

In our view, again, mineral and metal prices are expected to remain well above historical levels due to the demand strength. And now we have the very interesting combination of a lot of development funds being brought to the market or this market due to the perspectives of value creation there in the future. We have higher risks of supply disruption supplied by the full capacity operations. This is something that we want to account for. The other day we had Indians blocking our railroads. And this affected our production.

So if the rainy season is heavier than usual, this will affect our shipments. And if there is a conveyor belt that is not working properly, we will have a problem in our production and this sort of asset that we do have. We have grown the (inaudible) inventories as we put there. And the industry of equipment is not able to deliver all the equipment that we needed.

So, with that, I will close my initial statement. And again, as I said, our colleague, Jose Carlos Martins, the Executive Director in charge of Non-Ferrous Division and in charge of the price negotiation this year, to address all your questions. Thank you, very much.

Questions And Answers

Operator

(Operator Instructions) Ivan Fadel, Credit Suisse.

Q - Ivan Fadel {BIO 4827533 <GO>}

My first question is related to the pellet market. How do you see demand going forward if there's any weakness in the demand from pellets that you're feeling right now, or you believe that it is going to be strong for the following year in 2006 especially and onwards?

A - Fabio Barbosa {BIO 21197136 <GO>}

Here is Martins speaking, okay?

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

Good morning, America. Good morning, Europeans. Good afternoon. And Brazilians. Good afternoon, also.

Speaking about the pellet market, normally in the period of price negotiations, we will have normally a weaker market for pellets. It is not because the customers are canceling orders. But because they are postponing orders. They are postponing the delivery. And we think that it is part of the negotiation process.

CVRD is the main iron ore producer and has a main role in the negotiation process. So we normally see a little bit more of this weaker situation during the period of negotiation. It happens similarly in the years in the former negotiations. But we did not see any structural changes in the marketplace. We are keeping our investments in new pellet plants. And we really believe that this market will grow both the iron ore market in the future.

Q - Ivan Fadel {BIO 4827533 <GO>}

Do you know -- I was just looking at the breakdown of your iron ore and pellet sales. And there was a sharp decrease for Italy. Is there any specific issue on that, or it is normal?

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

It is because we in Italy our main customer is one of our shareholders, it is a partner of us in Kobrasco, okay? So it is you/us taking more pellets than is on production with us. And they reduce a little bit this year because of the increase in our center plant capacity. But we don't see any structural change on it. I think it is part of the moment that we are living in.

Q - Ivan Fadel {BIO 4827533 <GO>}

And just the second question, I was just looking at slide 22, the estimates of production for 2006 and 2007. I'm just trying to match that with the already announced projects for iron ore. So if I add all the projects announced, (inaudible) 85 and 100, Brucutu Phase I and II, Itabira mines, Fazendao and Fabrica, I get to a level of around 68 million being added. So does that mean that there are more projects, or you believe that all of those projects that I mentioned already will be full steam in 2006?

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

Our estimate, our best estimate currently is increasing production. And I just wanted to see there with all those projects information. So 30 million tons in addition to the production of 2005.

A - Fabio Barbosa {BIO 21197136 <GO>}

And because we have some mines that are finishing or exhausting the resource. So we have it both situation and new capacity coming onstream. And also some mines that are finishing their production period.

Operator

Rodrigo Barros, Unibanco.

Q - Rodrigo Barros {BIO 5851294 <GO>}

First, regarding the -- I don't know -- demand. At first I understand there was being a lot of confusion or lack of agreement on what would actually be the demand of iron ore. And I guess (inaudible) said that without this, they could not even talk about prices. And then last week (inaudible) Association issued very interesting news showing 13% in the estimates of internal demand in China for steel and consequently for iron ore.

I wonder my question is, how to negotiate with Chinese when during negotiations all the news we get that they say that the market is weak and their own association predicts 13% in domestic demand. What kind of -- how to reach a consensus in that kind of environment?

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

Well, I think one thing that we needed to state very clearly, we are selling every form of iron ore that we are producing. We don't have any stock in our inventory in our ports. Every ton that we produce we are delivering. And I can tell you the Chinese are taking the majority of this capacity, the capacity increase.

We're not used to negotiate price to the press. But the more they talk to the press, I think the more the case is in our favor because they are demanding more iron ore. And we're selling all the iron ore they need. I don't know what will be the production in China next year, how many I don't know they will buy effectively, how they are producing internally. We have our projections. And Fabio presented this. We expect 50 million additional tons being imported by China next year. And we have the orders for that, okay?

We have everyday our Chinese guy walks in my door asking for more iron ore. So we needed to increase our capacity. Fabio told you about the situation relating to equipment, contractors, parts and also the costs related to that. And surely we need an additional price increase to continue to deliver iron ore. CVRD is the most reliable supplier of iron ore. We have been increasing capacity fast. It continues to grow 10% a year. Our production in January, we increase it; February, we increase it. Every month we produce a little bit more. And every ton that we produce, we're selling.

So the negotiations are based on this, okay? We don't go to the press. We're not looking for diminutive measures to cool down the market or things like that. What we're doing is doing what we needed to do to increase production, to develop new projects and to supply demand. So that is what we're doing. And negotiations in my opinion is developing very well. It is tougher this year than last year. But you have it to convey that you have to see that this year.

Last year we had a big move in the marketplace. One of those suppliers changed a big volume from one customer to the other. So, at that time, it just creates attention in the market that favorite of very fast negotiation. This year we don't have a situation like that. So.

But we -- in fact, we have a negotiation that went through even May to reach an agreement. And I really believe that we are going to reach an agreement before the new year is past. So we're not looking so much at this kind of information that we see in the press everyday. And we are attending to the negotiations that we have with our customers. And I can tell you, they are developing very well. And we think under our perspectives, that is going in a way that we can reach an agreement sooner than later.

Q - Rodrigo Barros {BIO 5851294 <GO>}

Okay and my second question regarding negotiations, is freight rates and exchange rates this year being an issue of discussion -- the difference between spot and freight rates?

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

Could you -- (multiple speakers)

Q - Rodrigo Barros {BIO 5851294 <GO>}

Sure. So one of the issues that I believe is important, the negotiation is the savings that can be achieved if you have a five-year contract of a freight (inaudible) rather than buying freight in the sport market would be $25 I guess from Brazil to China. Is that issue -- is that argument important in the negotiations, or is something that -- (multiple speakers) for the customers?

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

Well, CVRD has a long-term policy to sell FOB price. The freight part of the cost is our customer's question. They have it, too. If you look Europeans, if you look at the Japanese, they buy their freights long-term. And they have very important savings by doing that. The Chinese, because of that, they are -- it is the Chinese corrective they prefer you see that they buy iron ore in the spot markets. And they buy a lot of freight in spot base.

So I think for the Chinese considering that they will continue to be dependent on imports, I think that the Chinese needed to move to contract freight long-term. I think this will help them to reduce their cost. But I cannot influence their policy. It is something the Chinese have to do. And that the Chinese steel industry is very fragmented. The biggest Chinese steelmaker produces 7% of the total production.

So it is very difficult to see if they can move for a long-term contract. Probably they would have to be a little bit more consolidated as a company in order to move this way. But in my opinion. And you raised an interesting question, is a very important way that the Chinese could reduce the delivered cost for iron ore by contracting long-term freights and bigger vessels become. But it is up to them. We do not intend to change our policy to sell FOB rate. We don't intend it to be to buy the risk of the freights. Okay? This is customer policy, not CVRD policy.

Operator

Andrea Weinberg, Merrill Lynch.

Q - Andrea Weinberg {BIO 6591181 <GO>}

Congratulations on the results. Let me go through my first question. And it is related to taxes. We saw a major reduction in taxes. Actually your effective tax rate for the year was 14%. I just wanted to understand from the effect of the tax planning on Caemi, how much of that is reoccurring. And how much of that is going to lower CVRD taxes going forward?

A - Fabio Barbosa {BIO 21197136 <GO>}

Well, we don't believe this will be a meaningful and recurrent effect. Actually we think that for the whole group it is a minor effect, considering the size -- the relative size of Caemi compared to our overall revenues and structure. So we have in this specific asides the restructuring of our Caemi companies abroad, we have the effect of QCM that was not taxed. And it was a major $126 million effect and is also contributed when you look at the overall figures to reduce the effective tax rate.

Also, don't forget that we also have the appreciation of the Real contributed to increase the impact of incentives and the interest on shareholders equity. So it is a combination. But we don't see it as a major issue going forward.

Q - Andrea Weinberg {BIO 6591181 <GO>}

Okay. Second question quickly, you have been talking, Jose Carlos Martins and yourself about the CapEx and how much price you need to continue investing on your iron ore projects. I just wanted to understand because your CapEx that you announced, $4.6 billion, what is your foreign exchange rate that you assume on the 4.6 because it is probably closer to 2.5 and we're at 2.10 or 2.15. I just wanted to understand how much of the CapEx will increase at a Real of 2.10?

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

Well, we're not assuming that the Real of 2.7 the long-term exchange rate for the Real. QC, you see this particular week, we have served a lot of volatility in the financial market. And the Real two minutes ago was 218 or 217, something like that.

So it is too early assume. But this will be the determined exchange rates or the average exchange rate for the year. But, of course, as you know, a major part of our investments are Real denominated. So they are slightly under 80%. So this would have an effect compared to the 250 that was initially bought. So this could increase the total cost for our CapEx. And this is an important consideration given the (inaudible) negotiations that are taking place right now.

So we are making all the efforts to bring to the market 30 million tons in additional capacity this year and 35 million tons more in 2007. So the Real has been an issue in terms of CapEx for us. And as we -- even if there is not 210 but it is below 250, it will increase a little bit the cost of our CapEx. But I don't know if, Martins, you want to comment a little bit on this?

Yes, it is not a question of our iron ore capacity, okay? On a market basis, the new prices has to reflect the replacement costs of new capacity. Because if you look at the industry, you have a lot of talks about new mines. But where? We saw a lot of movement in Australia also. But when you look, their capacity is near $100 per ton of capacity. Because you have it to go for further mines. You have it to build infrastructure. Also, you have it to benefit the iron ore because of the best resources are already under exploration.

So the question is not only the present situation of Brazil, the currency and the equipment prices and so and so. But we have it to look at the whole iron ore industry. And look for new projects, for new capacity, bringing to a stream what to be the capacity. And I can tell you the numbers I saw is near $100 per ton for the production capacity. We don't have too many brownfield opportunities. So we think the CapEx, the price of that reflects this marginal cost of the new capacity all over the world. And that is the point that has to be considered. Besides there is a present situation of our specific project that we're conducting.

A - Roger Agnelli {BIO 14016988 <GO>}

This is an important point. When we look at the (inaudible) effort that is being made by the several players, our competitive advantage remains. There was an inflationary cost for the whole industry. But our CapEx (inaudible). Even with the sharper appreciation of the Real, it is still the most competitive in the industry. That is something that we should keep in mind.

And the other aspect is that it is precisely -- this is part of the long cycle, this inflation and cost of equipment. And so that increases. Our CapEx cost is also operational cost across the board in these units.

Operator

Daniel Altman, Bear Stearns.

Q - Daniel Altman {BIO 1855515 <GO>}

The first question is on iron ore. There is a quote this morning I guess from Roger Agnelli saying that both sides may be left a little bit unhappy from this process. I wonder if you can maybe define, if not the number, at least the thought that went into that comment?

Similarly on iron ore, if you do reach a point where the Chinese just refuse to budge from, say, a rollover of prices, what recourse does CVRD have in terms of would you ever consider reducing your sales to China or reducing your output? What type of recourse could you have if they negotiate in that way?

And then the second question is on cost. Fabio, I guess a couple of months ago you were starting to I think introduce the idea that maybe cost pressures were starting to flatten out or abate. And I wonder that is still your view, if you believe that cost in the next couple of quarters will be similar to the Fourth Quarter or whether you see them up or down? Thanks.

A - Roger Agnelli {BIO 14016988 <GO>}

Okay. Thank you, very much for those three questions. On the comment made by Jose, I was (inaudible) there, the question was it is safe to say that a good deal is spoke conceptually. Okay? A good deal in which you're dealing with clients requires long-term clients should be warned that both parties are not totally happy. This is the meaning of what he would say, that both parties would conceive, would in order to reach a mutually satisfactory agreement. That was his comment. That is the concept of his comment. So no news there.

And, as for the negotiations, we would not have, as Martins said, we don't participate or we don't discuss our negotiation strategy publicly. We discuss our ideas with our clients. And then when we reach an agreement, we formed a market. But we would not like to make any comment at this stage, regarding what they show alternatives for situations that are not presented.

In your second issue, yes, I commented on the flattening, of course. We do still believe that there was -- there is a trend of reducing the marginal increase of cost over time. Just consider that, for instance, it is fuel. Fuel costs increased by almost 50% last year in dollar terms. This is something we would not expect to happen in 2006.

Also, we are trying to reduce our energy costs for several measures that we have put in the report, as you saw, in order to reduce -- to balance a little bit the negative impact that the (inaudible) have in the overall figure.

We are expanding our operations. So we're going to hire more people. We're going to generate more jobs. So the payroll account should increase. And also, salaries are higher. But I don't see as a whole that we should expect additional cost increase that has been growing at a rate that is higher than the one of 2005. There was a sharp appreciation of the Real in 2005. There was the whole evidence of the deflation in equipment prices in other components. There was an energy price increase. So I don't believe that we should expect growth rates, of course, remain at high levels.

Operator

Andres Perez, Morgan Stanley.

Q - Andres Perez {BIO 18609546 <GO>}

Just following up on my colleagues' many questions, if you could go into -- (inaudible) mentioned that you are looking into improving efficiencies at CVRD and helping to reduce costs. Maybe if you could go over what some of those efficiency improvements that you're looking into? Essentially beyond any further strengthening in the Real, if we look at outsourced services or any other cost inputs, what items do you think you can directly have a hand in helping to limit the increase?

And my second question is, just if you can give us an update on how the proceedings with CSN is going? I know that it is still an appeal if you can give us a timeline as to when you think that might be resolved?

A - Roger Agnelli {BIO 14016988 <GO>}

Okay. I will let Martins answer the issue of cost because he is responsible for the largest division in our company. He could comment on what he is doing to reduce cost more properly?

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

Yes, I think the cost reduction effort is mainly based on a plant efficiency base. We have a large program to increase equipment (inaudible). You know, the very nature of the mining industry, the economies of scale are not so big because the system of equipment you used efficiencies and excavators and draining machines. And so you don't have a big effect of economies of scale. So what you need is to improve efficiency of the equipment. Then you can produce more with the same expenses so then you will reduce cost.

We have a particular program for cost reduction on maintenance. Maintenance is a big part of our costs. And we are working very hard in order to reduce it. And efficient overall is also another big effort.

Besides that our policy to hedge our energy costs by developing sources of lower cost of energy than market price. But the main fact for us, the main target we have is based on equipment efficiency. We think that we can improve efficiency now and keep it at least 10% over the present level. And so you can have a cost reduction almost of the same size.

So that is our main target now. Besides that, you have a problem of negotiation process with the suppliers. The moment is not so good for price negotiation with suppliers. We have a lot of inputs that are in short supply -- conveyor belt, for instance. And tires for trucks and even parts for equipment because steel price is up and copper price is up and aluminum price is up. So the moment for cost reduction based on price negotiation with suppliers is not so easy.

So our focus is mainly on equipment, utilization and a maintenance cost as a whole. We are renewing our fleet. We are putting outside the lower efficient equipment that we have in place. So that is what we are doing.

Also, another point of cost reduction is efficient support, which at the end is the same point, to increase operation in the parts. And by doing that, we're able to reduce the)Moorish). Last year we had a very strong reduction in this cost. And for Brazil we also have a very bold plan to reduce the Moorish cost. This is very important because it reduces the cost not only for us but for the customers also and then can improve the competitiveness of our product.

A - Fabio Barbosa {BIO 21197136 <GO>}

Okay. What was your second question again?

Q - Andres Perez {BIO 18609546 <GO>}

If you could just give us an update on how the proceedings of CSN are going on on Casa de Pedra, when you think this issue might be resolved?

A - Roger Agnelli {BIO 14016988 <GO>}

The legal issue.

A - Fabio Barbosa {BIO 21197136 <GO>}

Yes, the (inaudible) issue. There was a provision of -- there was a conscious decision that the year 2005 -- the year 2005. And in our view, there was something that was not adequate in a decision that was taken regarding the proceedings of (inaudible). And we went to the courts. And we were granted with the provision of decision that interrupts the clock, let's say. Until we have final decision of the justice regarding that (multiple speakers) time is not running.

There is, of course, the issue of the final right of CVRD regarding this new contract that was signed. There is a value there. And we still have to win. The proceedings have resumed. We still have to discuss what would be the value for this action in our view.

But there is no reason why CSN should not be investing in its own operations at the Casa de Pedra mine because the contract is working as before. That is the content of the legal decision. So we just have the first refusal right. If they want to expand their production, they are allowed to do that. And we will exercise our rights according to our needs. And that is it. We are not impending -- we're not preventing them from doing whatever they feel like to do regarding the investment of the expansion. If the expansion is not in place, it's not because (inaudible) is interrupting or blocking or preventing them from doing that. And we are eager to get the first shipment of our (multiple speakers) 5 million tons of iron ore according to the contract that we signed with them. And so far we have not seen a gram of this shipment. But we are eager and anxious to get this additional iron ore to be delivered to our clients this year according to what was established in our contract. So business as usual. We are free to pursue the divestment plan as they have ever been in this connection.

Operator

(Sam Gosch), SAC Capital.

Q - Sam Gosch

Thanks for hosting this call. Daniel Altman already asked my first question. So I will just rephrase it a little bit. If you walk away from this year's negotiations with an outcome you're not totally happy with, would you consider scaling back some of your longer-term expansion plans as a supply-side response to sort of a new environment?

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

As I told you before, I'm completely confident that we are going to reach a reasonable agreement with our customers. I don't see anything, anything in the scenario that will prevent us to reach an agreement. I can tell you the majority of our customers understand that some increase will have to come. And we are now discussing how much.

So I did not see -- I don't see any possibility of not reaching an agreement. Okay? I don't believe that anything could happen that will prevent us to reach an agreement. We have been discussing negotiating with customers for so many years this benchmark system. And if we don't reach, someone will reach an agreement. That is the way it was all the time. If we're not able to reach an agreement, the Australians will be able or the Africans will be able, someone will reach an agreement. That is the way things are. And I don't think this will change.

Q - Sam Gosch

Okay. And I just had a follow-up question. On your production plans for 2006, you have a 13% increase in iron ore shipments projected, which will go into the contract market. And my question was on the alumina side, your new production which is coming on there, is that going to be sold on a contract basis or in the spot market?

A - Fabio Barbosa {BIO 21197136 <GO>}

Well, the bulk would be sold -- actually it is already under contract. I would say that we will keep the share of 80 to 85% under contract and 15 to 20% in spot market.

Q - Sam Gosch

Okay. And for the contract portion, could you just comment, is it like a three-year contract at what percentage of LME?

A - Fabio Barbosa {BIO 21197136 <GO>}

It ranges from three to 10 years.

Q - Sam Gosch

And what percentage of LME is at contract?

A - Fabio Barbosa {BIO 21197136 <GO>}

It depends on the duration of the contract. But it is meaningfully above the old average of 2.5%. It is close to 13.5. So certainly the rate of 13.5 to 14.5.

Operator

Paolo Di Sora, Banco Itau.

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

I have a question regarding the supply demand environment going forward. I saw Jose mentioning that he expects the market to remain tight at least for the next 18 to 20 months. So if you guys could please give guidance of when you expect the market to be and before -- if you have any expectation about meeting to long-term iron ore price in a new environmental more East supply demand?

A - Roger Agnelli {BIO 14016988 <GO>}

Well, I will comment a little bit. And then Martins could complement. You know, back there in 2002, early 2002, we expected the iron ore market to be balanced by early 2005. And we missed that by a large volume of tons. So, by that time, we did not have the deal that there was this what we see today as a long cycle actually happening (inaudible).

So, of course, we also shared the view that trees don't reach the sky. So we should not expect growth rates in China to remain as high as they were in the recent past. Although there is a second structural player that many affect the market, which is precisely the Indians. India is a major player in Seaboard. I would advise by reducing its supply ore by the coming on net importer in the Seaboard trade as the growth rates catch up with those of China.

So we believe that there will be -- we are working according to our best estimates of future growth between 2005 and 2008 of 6.5% for the world, China reducing by 2/3 its growth rate, the growth rate of imports of iron ore observed in the previous five years through 2005 and the rest of the world growing just 1.6% moderately. But it is still growing. The Seaboard trade should reach 850 million tons by 2008.

So, as we see on the one side, the one side very very strong demand driven by China and maybe a disruption in the supply/demand balance of India in the future and of the (inaudible) scenario worldwide. And the supply-side, a laggard supply response due to the constrains of the equipment industry. And there's a very unavailability of people and room to increase our production further. So Roger's comments should be seen in the context of at least a couple of years more of tight markets.

Your other question was?

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

No, just one question. The second question I have is regarding the corporate governance. I think many investors are discussing which kind of premier discounts CVRD should trade vis-a-vis its peers. And one thing that is a major issue is the two classes of shares. So I would like to know how much the management is questioning with the board in order to eventually improve the corporate governance on the company by having just a single price on shares?

A - Fabio Barbosa {BIO 21197136 <GO>}

This is way beyond my shoes. I understand your point. And I will convey your point to those who have the power to decide on this issue. Okay? I hope you understand.

Operator

Alberto Arias, Goldman Sachs.

Q - Alberto Arias {BIO 18302585 <GO>}

A couple of questions. The first one is on copper. In your announcement, your press release, you talk about (inaudible) not being able to meet design capacity even in the year 2006. If you could please elaborate a bit more in terms of the technical aspects that are driving these. And is this having any major additional concerns in the project development pipeline that you have on the copper and nickel industries?

A - Fabio Barbosa {BIO 21197136 <GO>}

Thank you for the question. Well, the issue of copper, it is part of our learning process. Last year we found out that the heart of (inaudible) was much higher than the one we expected in our activities steady. There was a geological mistake that cost us a lot in terms of timing and production compared to what we and the various methods the company converted and got and the expectations so there was time.

What I mean is that it is natural to have problems like this in the ramp-up process. But we underestimated those difficulties when we indicated that the ramp up cost was not or that even during the ramp-up cost we could reach the nominal capacity of 140,000 tons per year.

Following this problem with the hardness of the rock that affected our fixed costs. And this is part of the reason why we believe that the pressures to increase cost in 2003 will be easy a little bit. The drilling machines, we did not find them on the shelf. We have to order them. We also ordered used ones to go through the total requirements of the drilling process. And the hardness of the rock also affected the crusher or the productivity of the crusher.

So for this year (multiple speakers) Martins has been reminding me -- there was a problem with the supplier. I won't mention a name. But there was a problem with the quality of the equipment supply. So we changed just a few weeks ago. There is still (inaudible) of the pressure. In order to deal with the much harder material that we were drilling and the business, of course, implies a reduction in the potential production compared to what was originally thought.

So answering your questions, we are facing issues that are normal to happen in a ramp-up process. It is part of our learning process. We do believe that copper production this year will be higher than the level of 2005, although lower than the nominal capacity of the plant. That should be fully operational next year.

Q - Alberto Arias {BIO 18302585 <GO>}

Okay. And a follow-up question just following on that point, we see that your product development pipeline is even more aggressive on even more technically challenging projects like nickel, nickel laterite core bodies, the need of pressure acid leach technology which has created major problems technically in very prestigious nickel companies. Should we be concerned that some of the problems, technical issues, geologic mistakes that we have seen in Sossego could potentially happen in some of your new projects, or are you putting some kind of contingency plan or reevaluation of all your copper and nickel projects to make sure this that does not happen again?

A - Fabio Barbosa {BIO 21197136 <GO>}

I believe that we did have a geological sort of problem that we should not expect to have in the latter right deposit of nickel. (inaudible) better. But it is something that we do not expect. Although we learned some lessons from this experience. And you can be sure that I believe that if you looked at our indications of production for the nickel projects, you would see that we have a much more cautious ramp-up embedded in the figures that we have indicated.

So I don't believe that you will see the same type of issues there. But, at the same time, we will be much more cautious in proceeding with this project. We don't fear the technological challenges that we have ahead.

Operator

Leo Larkin, Standard & Poor's.

Q - Leo Larkin {BIO 1756825 <GO>}

Could you give us guidance on DD&A for 2006?

A - Fabio Barbosa {BIO 21197136 <GO>}

Could you explain that a bit? (multiple speakers) Oh, depreciation, okay. Well, we should -- sorry. I was looking at something else. We are incorporating a very large project this year. We are incorporating Brucutu. It is a project that -- the total investment is around $1 billion. We are incorporating Alunorte expansion in states four and five. We have one hydra plant that is being also added to the total assets of the company. Let's say, the expansion in Carajas.

(multiple speakers) Yes, it is about $2 billion at least in terms of asset base. That should be combined with the appreciation of the Real that has an effect. So in order to look at our overall figure, you have to adjust for that.

Q - Leo Larkin {BIO 1756825 <GO>}

Okay. So in our models, we should be using 2 billion?

A - Fabio Barbosa {BIO 21197136 <GO>}

Sorry?

Q - Leo Larkin {BIO 1756825 <GO>}

For modeling purposes, we should be --?

A - Fabio Barbosa {BIO 21197136 <GO>}

2 billion is additional assets. Yes, I think that is a good figure. I will check on that. And if it is different from what we are indicating, I can inform you. It could be slightly higher, slightly higher.

Operator

(Raphael Ellis), Deutsche Bank.

Q - Raphael Ellis

I just wanted to see where can we get detail on the balance sheet, where can we see it opened up. And basically what I need is the breakdown in debt, short-term and long-term. And also details on the different debt instruments as it stands right now?

A - Fabio Barbosa {BIO 21197136 <GO>}

Well, I am assuming that they will send detailed information about that. But roughly 95% is U.S. dollar-denominated long-term debt, is about that. But she will send it to you.

Operator

That does conclude today's question and answer session. Mr. Barbosa, at this time, you may proceed with your closing statements.

A - Fabio Barbosa {BIO 21197136 <GO>}

Well, thank you very much for attending this conference. I hope you liked it. Myself and Martins and all (inaudible) will be available for any further questions you might have. Thank you, very much for your attention.

Operator

That does conclude our Companhia Vale do Rio Doce 2006 investment plan conference for today. Thank you, very much for your participation. You may now disconnect your lines.