Q1 2007 Earnings Call

Company Participants

- Eduardo Bartolomeo, Director
- Fabio Barbosa, CFO
- Jose Carlos Martins, Director
- Jose Lancaster, Director
- Leonardo Moretzsohn, CFO

Other Participants

- Felipe Hirai, Analyst
- Harry Natter, Analyst
- Jim Lennon, Analyst
- Jorge Beristain, Analyst
- Oscar Cabrera, Analyst
- Roger Downey, Analyst

Presentation

Operator

Before proceeding, let me mention that forward-looking statements are being made under the safe harbor of the Security Litigation Reform Act of 1996. Actual performance could differ materially from that anticipated in any forward-looking comments as a result of macro economic conditions, market risk and other factors.

With us today in Rio de Janeiro is Mr. Fabio Barbosa, CVRD's Chief Financial Officer. And, in Canada, Mr. Leonardo Moretzsohn, CVRD Inco'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 21197136 <GO>}

Thank you very much. Good afternoon, ladies and gentlemen. I would like to mention that we have Jose Carlos Martins, who is in Carajas today. He's also attending this conference directly from Carajas. And here in Rio de Janeiro, we have Jose Lancaster, Executive Director for Non-Ferrous. And also Eduardo Bartolomeo, Executive Director in charge of Logistics. So let's start with the agenda we have today. First, the results of the First Quarter of '07.

We are very happy with the results that we managed to achieve, despite the difficulties that we observed in the weather conditions, particularly in the iron ore business in Brazil. Despite that, we were able to post very strong numbers in terms of sales with several records, as you can see in slide number 5. With iron ore and pellets almost 35%, of course, we have the effect of the Sao Luis pellet plant production disruptionlast year. But this pellet number shows-- it confirms our views about the very strong market that we are facing; actually, another good thing in terms of pellets compared to actual capacity of production.

Finished nickel; also a very strong number; 10.8%. Copper almost 29% with increasing production in Sossego. And that recovered from the levels it achieved last year. Carlos could comment a little bit later on that. Alumina; 39% at 700,000 metric tons with the full effect of the expansion. Aluminum, with the consolidation of Valesul, 20%-- almost 20%. Potash; good numbers on sales, although potash was not that brilliant. But in sales we were able to capture the good momentum of the market with 161,000 metric tons with the investments that we had accumulated (inaudible). And cobalt; also 19.3%. And general cargo; 4.4% increase against the same period last year.

In terms of margins, I would highlight the very strong performance in Non-Ferrous Minerals that we were able to achieve, 52.2% in EBIT margin, above Ferrous Minerals' margins, 50.9%. As you may have noticed, in the case of Ferrous Minerals, we didn't have almost any effect of the price increase that we negotiated last year in the First Quarter. I believe that the number-- the precise number of the price effect in the First Quarter was $18 million. So the bulk of the price increase that we achieved with our clients will be posted in the third quarter of the year.

So I would like to highlight that Ferrous Minerals, in a way, is not reflecting the actual current prices that are present in the iron ore business. Aluminum, while it is slightly lower than 2006, is still very strong compared to 2005. Prices are higher. Of course, costs are also increasing. But we managed to keep a very strong margin. Logistics; 28.3%. And the average of the Company, 49.2%; a very strong performance compared to both 2005 and 2006.

Net earnings, $8.8 billion the last 12 months, the fifth year of upward trend. It's a very strong performance. The same goes for EBITDA performance. It's 20 consecutive quarters of EBITDA growth. Now you see a much more diversified profile with Non; Ferrous for the first time. So that in the Ferrous business is an historical quarter for the Company, considering what it used to be until the Third Quarter of last year. So 47.1% in the so-called Non-Ferrous. Ferrous; 42.8%. And EBITDA in the last 12 months; $12.5 billion.

The next page indicates a distribution of the contributions of prices, volumes and cost reductions that we managed to achieve in order to reach this EBITDA figure of $4.2 billion, roughly, not adjusting for the inventories charge. That is a non-cash component. If we do not consider it, you'll see that prices were the major driver, together with the cost reductions, to achieve this higher level of EBITDA that you see there.

In terms of our cost of goods sold, also, our efforts are starting to pay. Of course, we would like to see a much more significant, meaningful number. But I believe that it's a clear indication that our efforts are starting to bear fruits, with the cost reduction of $72 million explaining a major part of the cost of goods sold variation on a quarter-to-quarter basis.

On our financial side, we made a lot of announcements the last few days. We paid fully the bridge loan; $2.25 billion. And we also renewed our revolving credit facility. And we improved further our financial profile with a reduction in leverage, the total debt that we're talking; $1.88 billion. And we increase again our average maturity with a virtually stable cost of debt for the total CVRD Group.

The results we have achieved in return on invested capital; well above the average of the last two years; and, particularly in this quarter, 53.4%, despite the sharp increase of the capital invested that we have been observing compared, for instance, to 2003. So 2003, our total capital there was $5.4 billion. And now we are talking above seven times higher level with a return that's much higher as well. So we were able to deliver very strong results, despite the sharp increase in our capital invested.

Now turning to the new growth platforms and how we see our Company performing in the long term. We just revised our CapEx program for 2007 to $7.4 billion. We are still reviewing our numbers and our projects. And I believe that, given the strength of the market that we anticipate, that we could even review further this number if necessary for 2007, if the market continues to perform as it is and if we find the right project. We are performing those studies right now. And particularly in the iron ore business, we may have some additional news. We are studying additional projects, particularly in iron ore. In the case of Non-Ferrous, you saw the new investment level for Goro.

And at this stage, I would like to ask Lancaster to comment on Goro. What were the major changes that we implemented there not only in terms of the level of investment-- that increased to $938 million-- but also in terms of execution and strategy.

Jose Lancaster {BIO 7335880 <GO>}

Basically, when we acquired Inco, we ran through a thorough review of the project. Our focus was on the risk management and political, environmental, technological and operating factors. We also use what is part of our culture, which is a thorough work with the communities. I think the relationships with the people of Caledonia have improved significantly, using our experiences from Carajas.

We made some key technical changes, things to do with manganese and the rejects of the mine and some engineering changes. And we have a brand new team which is focused on discipline and execution. The budget now of Gora is about $3.2 billion. And we believe we are on the right track to finish the project by the end of 2008.

Goro, as most of you people know, is a fantastic project. It has reserves of about 120 million tons of material at a grade of 1.5% nickel. This does not fully reflect the size of the project. There's over 500 million tons of resources. It has a superior position in Asia. So it permits us to supply the Chinese market and Asian markets in general. It is a low quartile-- it's first quartile nickel cost of production, which is a very interesting thing to have these days. And it has a CapEx of $3.2 billion at this stage to produce 60,000 tons of nickel and 4,600 tons of cobalt.

For Onca Puma, which is the other nickel project, this is a success story. We bought it from Canico and have been able of starting the project on schedule. It is going extremely well. It's actually slightly ahead of schedule. We are keeping the budgets very tightly. It's a budget of about $1.4 billion to produce about 58,000 tons of nickel. It is another very fantastic resource, with 7 or 8 million tons of 1.8% for production of ferronickel. And the good surprise that we're having is there is a top layer in the saprolite deposit which is a significant resource for hydrometallurgical. So we believe that in the future we will be able of increasing capacity at Onca Puma. Again, it's a first quartile cost of production nickel (inaudible).

Fabio Barbosa {BIO 21197136 <GO>}

Thank you, Lancaster. Now turning to the iron ore business and, particularly, what is showing and indicated in slide 18. That is the spot freight spread increased sharply in the last few years, particularly in the last (inaudible) years. And together with this increasing spread, we also observed an increase in the volatility of this spread, meaning that there are other factors affecting the price formation of this particular market. In fact, the level of freight costs today indicate that ship owners capture a major chunk of the value chain of our business.

At this point, I would like to ask Eduardo Bartolomeo and Martins that's already on the line to comment on this new strategy of ours by developing our dedicated shuttle service between Brazil and China. Eduardo and Martins, could you please comment?

Eduardo Bartolomeo {BIO 15365202 <GO>}

As Fabio already explained, we had a big increase and the way we tackle it. We believe we've made some significant steps during the First Quarter in developing the dedicated shuttle service between Brazil and China through very large carriers. We announced recently the Bergesen contract for four big ships around 388,000 tons. Add to that another 300,000 tons with NYK.

And besides, already we had done with our three ships that we sent into China and then reviewed it to serve to us. Plus a tanker. Add to that-- all that adds up to a capacity of shuttling to China about 10 million tons of iron ore. That's the way we think we should tackle the problem because it's the way that we get (inaudible) scale. And of course, we just developed it, as Fabio said. At that moment, I think Martins is going to add because it's an iron ore strategy that we are helping him to serve better the customer in China.

Jose Carlos Martins {BIO 1715332 <GO>}

Thanks, Eduardo. Our idea is to complement the shuttle between Brazil and China with remote blending of iron ore in China to sell locally to take advantage of high prices in China. So the idea is to combine shipment capacity with blending capacity in China in some port to sell iron ore locally at the same price you have in the domestic markets. So that is being more cost competitive. We can to some extent take some advantage of the price difference that now is captured by the ship owners. So a big part of this price that Chinese (inaudible) are paying now goes to the ship owners. Now the cost of shipment is bigger than the price of the iron ore. So the idea is not to be only more competitive but also to take some advantage of this.

Fabio Barbosa {BIO 21197136 <GO>}

Okay, Martins. Thank you. Martins, we commented before on the very strong demand and some additional study that you are performing in terms of additional projects. Can you comment also on that?

Jose Carlos Martins {BIO 1715332 <GO>}

Yes. We are now considering to anticipate all our projects, mainly in the Carajas area. The idea is to double production of Carajas up to 2011. So we are going to anticipate all our projects, not only in the existing north ridge. But also we are going to open up the south ridge. We are working very fast on it. There is a lot of constraint relating to equipment, relating to engineering companies-- a lot of difficulties in doing that. But we really believe that we needed to do it because the market continues to be very strong. And we are facing a lot of difficulties to cope with the growing demand, mainly from China.

But it's not only China. The growth in China is now replicating in other countries. We can see even Japan growing and other Asian countries growing very fast. Latin America is growing slow. Even in Europe, we see a very good moment for steel production and iron ore construction.

So the whole picture is very good. And for this reason we are considering (inaudible) all our plans in order to double Carajas capacity to 200 million tons per year by 2011 and total (inaudible) capacity of 450 million tons by 2011. It will be a big, vast, huge investment. But we are confident that we can do it and also do believe it. So we don't want to let our customers in that situation that they don't get the iron ore they need. So we are going to answer in a massive investment in order to increase our capacity very fast and in huge volume.

Fabio Barbosa {BIO 21197136 <GO>}

That's the same approach we are taking in the case of nickel. As you just saw last week, we announced a major increase in our investment in Goro and our Non-Ferrous business. So we have-- we take this long term approach towards our customers. We want to supply the material they want in the long term. And, in this context, we are investing heavily. We are investing more. And we are, in some cases, as Martins indicated-- we are anticipating investments because we see the cycle continuing to show very strong signs of growth as we'll comment in the next section.

In fact, the global economy remains on track for continued robust growth, as indicated there. For the next 18 months or so, 4.5% growth. And this I may-- I could say that is a conservative indication of future global GDP growth. But it's the one that we are using right now. We see very strong signs of industrial production sites as is seen by the performance of the global PMI that achieved the highest level in the last seven months. The same goes for the ISM, showing that it's a more generalized phenomenon. Growth is there on the ground and should continue. And that's very much behind our decision to anticipate and identify our investment efforts.

And in the case of the seaborne trade, as you see in slide 25, we are indicating that the seaborne trade should reach by the end of the decade almost 1 billion tons per annum. So it's a major increase compared to what we are observing right now. It's 725 million tons for 2006 and 790 million tons expected for 2007. So growth should continue at a very fast pace. You see the indications of growth in this new industry in China that Martins referred to; but not only in China but also in different markets around the world.

In the case of the nickel market, I would like to ask Leonardo Moretzsohn to comment, considering that inventories level is very low and demand continues to be very strong, despite the rise in the supply of nickel pig iron that, in our view, has a positive effect by mitigating the natural friction that we have now due to this cost of the material and allow us some time to put our production in place to meet our clients' requirements. But Leonardo, could you please comment a little bit on the nickel market right now?

Leonardo Moretzsohn {BIO 15216920 <GO>}

Yes. Good afternoon, everybody. As mentioned by Fabio, we are facing (inaudible) nickel market; a very tight market. Demand in Asia remains very strong. And inventories are at a very low level. To increase our production in nickel, it's needed and we share the same statement of CVRD-- we are making a lot of effort to fulfill the demands from our clients, especially in Asia and China, where the demand is growing in not only China but also in the other countries as well. We can see some decrease in the nickel DDI. But I think it's a positive effect for the market because there is new nickel for the users-- for the consumers.

And we can see some substitution, especially in the plating industry. But this is also-- this substitution is also challenging because, in many cases, the substitute material costs are also very high. So we're still positive that the demand is still there. And we are doing the best efforts possible to give the right stuff to the market. Speeding up our investments here. Goro was mentioned already; but also here in Canada, in the entire region. We are investing more in a new mine, Totem. But also (inaudible) that we have approved new investments (inaudible) to have more production in place in the short term.

Fabio Barbosa {BIO 21197136 <GO>}

Okay. And just to conclude this first part of this conference, a brief comment on aluminum prices. It continues to sustain very nice levels, about $2,900 per ton. And we may have a partial surprise there, considering that we are expecting some acceleration of the global industrial production growth.

And copper (inaudible). It's resuming its growth trend in terms of prices, particularly with the recent increase in Chinese imports. So we've reached again the level of $8,000 per ton.

So now we'll end our first part here. And we are available, all of us, for questions you may have. Thank you very much.

Questions And Answers

Operator

(Operator Instructions) Our first question comes from Mr. Roger Downey with Credit Suisse.

Q - Roger Downey {BIO 7419641 <GO>}

Congratulations on a very strong quarter. Very solid results, despite the production setback with all the rain we had here in Brazil. A couple of questions, if I may, first of all, with regards to the expansion. Quite a phenomenal amount of new capacity that you're adding there by 2011. Can we already expect for CVRD to be producing at the full 450 million tons in 2011, or will that take a couple of years to ramp up? The second question more regarding nickel.

I'd like to hear your views on some of the new technology that is surfacing around the industry, especially reported by Bosco with nickel substitutes in stainless steel production. And also, if I may congratulate you guys on the cost cutting initiatives that have certainly filtered through to this quarter's results. And if we may get some guidance on what we can see in the next few quarters--

A - Fabio Barbosa {BIO 21197136 <GO>}

Thank you very much. We will ask Martins to answer the first question on the extra capacity in 2011.

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

Roger, the idea is to be producing by December 2010-- to be producing 35 million tons per month, which will be 420 million tons of iron ore. That's our target. As I have told you, we are facing a lot of difficulties relating to the work, the engineering, equipment and things like that. But our plan-- also, the environmental license is really a nightmare these days in Brazil. But our plan is to be producing by December 2010 35 million tons per month, which will be 420 million tons on a yearly basis. And, by the end of 2011, to be producing 450 million tons.

The idea is to add 150 tons of additional capacity by end of 2011. As you probably know, the bulk of our investment will be in Carajas area, where we have high quality iron ore, unbeatable by world standards and not easy (inaudible) iron ore also. So the very question is mainly relating to get all the permits and to get all the equipment and all the engineering placed in order to be there like I told you because the iron ore is there. We have enough resources of high quality. So the task will be mainly in the engineering area, to get the permits and to do everything done by 2010. We plan to be, in December 2010, already reaching this 420 million tons of iron ore. As you probably know, huge investments will be done in the Logistics system.

The bulk of the investments will be railway and import. I'll say Eduardo is also there also to comment on that. But two-thirds of the investment will be done in the Logistic area because now we are fully-- we are operating full capacity on the Logistics side. So that will be the big chunk. In the mining, we think that the challenge is not so big. But for sure, to get all the approvals, all the permits will be a huge amount of investment. So I think that will be the big challenge. But I would like Eduardo to comment a little bit about the Logistics challenge that we have had in order to move 450 million tons from the inner part of the country to the seaside and to ship it all over the world.

A - Eduardo Bartolomeo {BIO 15365202 <GO>}

Okay. I think, as Martins said, this is a huge task. We saw in Carajas-- I have just seen Carajas a doubling of the capacity during the last four or five years. That took all the expansion, the longer trains we said the last time. We're operating now with half of the model. We're just finishing that step. And we're starting to double the track in some places. That's one of the key investments that are going to be made, on the track.

Besides that, we can neither forget the ports. The ports are going to receive a lot of investments or so. Ponta da Madeira is going to have a fourth dock there. And also, as already mentioned, the channel to go through to the see or wherever our clients are. So it's a huge task. We are preparing to that. We are facing that already in the last four years. And we are taking some (inaudible), anticipating the treatment, either locals or (inaudible) port, to get there on time and on budget, as we have to do it to serve our clients.

A - Fabio Barbosa {BIO 21197136 <GO>}

At this stage, I would like to ask Leonardo Moretzsohn to comment on the positive developments.

A - Leonardo Moretzsohn {BIO 15216920 <GO>}

Of course, at this nickel price level, increased demand for substitution must be expected not only in stainless steel application but also in all stainless applications as well. We have already seen some substitution in plating, the (inaudible) plating segment, which was the most visibly impacted in 2006. And there are some, of course, huge efforts in R&D development for substitution.

However, in our view here, there are still some challenges ahead for this new development. For instance, if I can perhaps sum for you the specific attributes of nickel in 300 series panelists also challenged to produce 200 and 400 (inaudible) series. The long lead time it costs for consumers to change standards and production equipment, as well, gives a lot of challenge, besides the one I already have mentioned, which is the cost of the material for substitution is also high. Those are my comments in this field. But we have to give the right answer and come up with more production in the short run.

Q - Roger Downey {BIO 7419641 <GO>}

Fabio, if you could just give us some guidance on what we can expect from further cost cutting in the next few quarters. And also, back to Martins, if I can, we're expecting, according to your slide here, about 255 million tons of growth in seaborne trade. CVRD is going to capture 150 million tons of that. What's your view? That certainly means capturing a lot more market share.

A - Fabio Barbosa {BIO 21197136 <GO>}

On the first part, Roger, we continue to make our efforts here to control costs. It's not easy because the real appreciated sharply the First Quarter against our expectation and market analysts' expectation last year. We have some good news on the fuel side. But, on the other side, some labor costs increased and other costs increased, partially offsetting. So it's a major effort that is in place. And we would like rather to show results instead of providing guidance of a precise figure. Let's show the results and then comment on them. I will also ask Martins to comment on the second part of your question.

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

The idea is not to increase the market share. The idea is to capture some market-- some domestic Chinese markets. We have a comprehensive advantage towards Chinese markets. Nowadays, Chinese mines are selling iron ore at a price of over $100 per ton. We really believe that we have the cost. And we have the structure to deliver iron ore in China at a much lower price than that.

So besides keeping or increasing slightly our market share in China in the seaborne markets, the idea is to capture part of the domestic Chinese iron ore market produced by local mines. These local mines are very small, lower competitive. And as the local currency strengthens, we think that we are competitive and we will be even more. So there is a huge market to be captured in China if you compete directly with the local producers. And the only way to compete directly with the local producers is to move our iron ore from Brazil to China, to blend locally and to sell locally.

We already established a company in China to sell iron ore locally. The (inaudible) in China is already established. So we have a comprehensive advantage (inaudible) China. And we intend to keep our market share in the seaborne or increase is slightly because we have the quality to do it; to get this additional market share. But our main target is to sell more in China. It's to bring some market that now is locally-- that is, inland markets to the seaborne market. That's the idea behind our plan.

Q - Roger Downey {BIO 7419641 <GO>}

Thank you very much. That's brilliant. Congratulations, once again, gentlemen.

Operator

Thank you for your question. (Operator Instructions) Our next question comes from Felipe Hirai with Merrill Lynch. Please go ahead.

Q - Felipe Hirai {BIO 15071781 <GO>}

I too have a question on the expansion of Carajas and the other mines. First, could you give us a rough idea of what could be the total CapEx of these projections and to do all this expansion? And also, if you could comment a little bit on the breakdown of what would be in Carajas. Out of the 200 million tons of production, what would come from the northern region. And how much would come from the southern region? And my last question is regarding coal. If you could just give us a brief update on what your expectations are on the development of the recent acquisition in Australia and the coal project in Africa, in Moatize. Thank you.

A - Fabio Barbosa {BIO 21197136 <GO>}

On the CapEx costs, we are finalizing the studies. Martins is right now in Carajas, where the bulk of the additional production should come from. So I'll not try to measure any figure right now. But Martins, could you comment on the additional production capacity; the northern range or the southern range? How would it work?

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

The bulk of the investment will be in the Carajas area, because, there, we're killing less per ton because we don't need to process the iron ore like we did in the southern region. So from the 150 million tons that we intend to add in our final capacity by 2011, 100 million will be in Carajas. And 50 million will be in the southern system. So that's the idea relating to the (inaudible).

Related to the CapEx, we are just working on it, we needed to say, to a large extent. But we think that, in the next two or three months, we can have the final figures. Then we can present to the market. As you probably know, the investment will be huge because we needed to invest also in the Logistics system. We have to increase capacity in all of the corridors that we have (inaudible). So it's not only a time-up-front, brownfield project. A lot of greenfield projects will be developed to reach this zone of production by 2011.

Q - Felipe Hirai {BIO 15071781 <GO>}

Actually, Martins, my question was regarding Carajas. How much would come from Serra Norte. And how much would come from Serra Su out of the 200 million tons?

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

The idea is to increase in the Serra Norte 35 million tons and, in the south ridge, 65 million tons. So that will be 100 million tons in total.

A - Fabio Barbosa {BIO 21197136 <GO>}

Lancaster, could you comment on the coal question?

A - Jose Lancaster {BIO 7335880 <GO>}

We just concluded the acquisition of the Australian assets on April 20. We are presently building a business plan for the growth of these operations in Australia. It is going pretty well at this point. The plan is to increase production to about 12 million tons of coal from Australia, of which probably in the order of 65% will be CVRD's share. In terms of Moatize, we are finalizing-- we have an environmental permit in place already. We are finalizing the mining license. We are very, very intensely doing our detailed engineering. And we expect to have the start of construction in the second semester of this year. And we're finalizing, also, the logistical arrangements there in Mozambique.

Operator

Thank you for your question. Our next question comes from Jorge Beristain with Deutsche Bank.

Q - Jorge Beristain {BIO 17554499 <GO>}

Fabio, I guess my first question is for you. And again, congratulations on a pretty strong quarter. If you could just described conceptually what is CVRD's policy now towards hedging, both on a currency and a metals mix basis, as it would seem that things relatively worked out for you this quarter due to your currency mix? If you could maybe comment on that first--

A - Fabio Barbosa {BIO 21197136 <GO>}

Okay. The currency-- the basic arrangement that we put in place was the swap before debentures issued in domestic markets. We (inaudible) five and seven years. And we were able to swap it at an average cost of dollar plus 5.6% per year. So this was done. With that, I would say that roughly 95% or more of our total debt now is dollar-denominated. It's very nice in our total flows. We do have some exposure to the real, as you can see by the effect of the depreciation on our costs. But we are working on that to reduce the net exposure to this particular currency. Other matters. We put in place also some protection for our prices-- our revenues in copper and aluminum, a small part of-- a major part (inaudible) of the copper produced out of Sossego.

So we are able to protect a very interesting range of prices. Right now, we are rather in an unusual position that this price (inaudible) copper and also in aluminum. It's literally at the same level that we were able to lock two months ago. So in some weeks, we are losing some money on a mark to market basis. Some weeks, we make some money out of the derivatives. But the objective was not this. The objective was to protect our cash flow volatility against the volatility of natural prices. In this connection, both currency swap and hedging of copper and aluminum has been very effective.

Q - Jorge Beristain {BIO 17554499 <GO>}

Okay. My second question is just specifically on the nickel business. We did see your cash costs per pound rise roughly $0.60 quarter on quarter, I believe, from around $3 to $3.60. You mentioned in the press release that some of this was due to higher profit sharing, which, I assume, you came to some kind of an agreement with your workers to settle the potential strike. And could we just get an idea of how much more you're going to capture quarter on quarter as nickel prices are averaging roughly $4 higher? How much of that could be given away in higher profit sharing or other cost inflation in the nickel business?

A - Fabio Barbosa {BIO 21197136 <GO>}

Leonardo, could you comment on Jorge's question, please?

A - Leonardo Moretzsohn {BIO 15216920 <GO>}

This is-- we had a cost increase this First Quarter. But this profit sharing is just part of it. We also have-- as you know, we are buying nickel from third parties (inaudible) not only the intermediate products but also final products as well. So due to the nickel price, our purchased tonnage was higher. So this has a large impact in costs as well. We also have to understand that, as we had some weather problems in Brazil, we faced some weather problems in Indonesia as well. We had a lack of rain. And then we have to increase up to-- more or less 30% in our diesel consumption in Indonesia, PTI, which also had impact in our cost.

Regarding this profit sharing, it was part of our employees are receiving bonuses based on the nickel price. So this is the fact. So if the price remains like that, we can face additional situations in the second and Third Quarter and, as well, the year. This impact is because part of them are receiving bonuses based on the price.

A - Fabio Barbosa {BIO 21197136 <GO>}

And just to complement, we also had less byproduct credits in this quarter compared to the previous quarter. But it's related to the nickel production.

A - Leonardo Moretzsohn {BIO 15216920 <GO>}

That's right, Fabio. Agreed.

Q - Jorge Beristain {BIO 17554499 <GO>}

Thank you.

Operator

Thank you for your question. Our next question comes from Jim Lennon with Macquarie Bank. Please go ahead.

Q - Jim Lennon {BIO 1643077 <GO>}

I think some of my questions have already been answered. But I wanted to ask a question about the shipping costs of the iron ore from Brazil to China. We know the spot freight rates have recently gone above $50 a ton. But could you give some indication-- of your roughly 100 million tons that you sell to China this year, how much of that do you think is exposed to the spot freight market relative to steel mills taking longer term freight arrangements at lower prices? I just want to get a sense of the increase in steelmaking costs as a result of this freight movement. That's one thing.

Secondly, when you mentioned that you want to take some market share from the smaller mines in China, I assume that you may, in future, sell on an R&B delivered basis to some mills in China as opposed to an FOB basis. Are you implying, maybe, that in order to compete with the domestic mines, you sell on a similar type of pricing basis rather than on the traditional FOB basis?

A - Fabio Barbosa {BIO 21197136 <GO>}

Martins, I think those questions are for you.

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

Okay. Related to China is one of the most exposed market to this high priced cost. Here, 60% of our sales to China is being transported on a spot basis freight price. Because China is growing so fast, every additional ton normally goes to China on a spot basis. You have some big customers, like (inaudible), that have long term contracts with freight on the range of $8 to $12 per ton. But for the additional tonnage that they need, they have to go through the spot market. This is only smaller customers, as they buy iron ore from different sources. They buy locally, they buy from India. And they buy from us. So they prefer to buy in the spot market because they don't want long term commitments with freight.

So these things are (inaudible) now because, as Fabio told you before, we have imbalance between the transportation from east to west and west to east, which will keep freight rates from Brazil to Asia in high levels. So because of this situation, all of the customers are looking for long term contracts. And we are working on that in order to facilitate-- for them to get long term contracts with ship owners. So we create-- we are giving-- we are signing 25 years contract with some customers because they want to have a 25-year contract with the ship owner. So we are working very close with our customers to help them to reduce their freight costs.

Above that, these local markets for iron ore will be there. And there will be also opportunity for us to get part of the market. Nowadays, we are not participating in it. We don't sell in this spot market in China, where you have mainly Chinese ore and Indian ore. It makes the biggest part of this market. Our idea is to move iron ore from Brazil to there based on long term contracts, based on these vessels that we are now contracting. So we are going to deliver this iron ore in China at a very low price compared with the local price.

So we have the opportunity to arbitrate the difference between local prices and our price. If the market is good, we can charge more. If the market is not good, we can get market share. We've had to be there. We intend to be presenting in China, like, a virtual mine, moving iron ore from Brazil to their ports, blending there and selling this iron ore to the local customers. We made a deep analysis of this market. And only if we go to three ports in China, we can reach out (inaudible). Tsingtao-- we can access a market of iron ore in order of 100 million tons that we are not now selling at all on it. So there is a huge opportunity there if you are able to really deliver iron ore at a very low price.

We have no idea to change the way we are selling iron ore. We sell FOB to big customers in Brazil. And we are continuing to sell. And for sure, we have to be very careful in pricing locally. But we are fully-- we are certain that we can price locally at the higher price that we sell to our long term customers that we have in China. So we can have it; these two price differences. And we consider that we are able to manage it. It's obviously filling one in another because we are going to operate in China like being a Chinese company in a Chinese market. That's probably for this increasing in our orders. (inaudible).

Q - Jorge Beristain {BIO 17554499 <GO>}

Brilliant. Thank you.

Operator

Thank you for your question. Our next question comes from Oscar Cabrera with Goldman Sachs.

Q - Oscar Cabrera {BIO 7553392 <GO>}

Congratulations on the strong results. The first question is; your operations in nickel. Basically, you had about 10,000 tons of purchased concentrate. And I guess, the gap with production in Indonesia-- it's sort of like partly explains that. But are you seeing different grades or issues with Voisey's Bay? I guess the question goes-- the question I want you to address is the following. Do you expect this production for the rest of the year to eliminate most of these concentrate purchases? And are you facing any structural issues in terms of just the mining sequencing at Voisey's?

A - Fabio Barbosa {BIO 21197136 <GO>}

Leonardo, could you answer that?

A - Leonardo Moretzsohn {BIO 15216920 <GO>}

Yes. We are buying concentrate from third sources to fulfill our customers' needs. This will continue this year. But we intend to replace those tonnages by increasing our own production. This is going to happen by the end of this year or beginning of next year. So this year, we want to stop to continuously buy concentrate from third parties-- which is today, compared to the last year, a lower volume.

We've got in Voisey's-- I think, on the contrary, the production there is very good. Very high content of nickel in the concentrate also. Very high content of copper, as well, in the concentrate. So we don't see any major problem or any problem at all in Voisey's Bay production. So the ramp up went very well. And they are producing above the plan. So no major issue at all in Voisey's Bay.

Q - Oscar Cabrera {BIO 7553392 <GO>}

I'd just like to follow up on that, if I can. So basically, the shortage in production is coming from Indonesia, really?

A - Leonardo Moretzsohn {BIO 15216920 <GO>}

Oh, no. We have a shortage of production from Indonesia; but, also, this quarter, we have an issue in the Ontario operations in February regarding the copper and nickel separation. But the volume is there. It's in the process. And we are going to catch up in the second and Third Quarter. This is just a temporary issue. We are not foreseeing any disruption in our production plan for this year.

Q - Oscar Cabrera {BIO 7553392 <GO>}

Okay. Thanks very much. Now, if I can just ask a second question with regards to the expansions, if Martins could just remind us what type of greenfield development capital expenditures and brownfield development capital expenditures you're seeing in the industry currently-- and, if we're thinking about expanding the northern system to those levels, what type of inflationary pressures-- what type of inflation numbers are you guys considering for these type of projects?

A - Fabio Barbosa {BIO 21197136 <GO>}

As Martins mentioned, we are finalizing (inaudible). And we have a strategy in place. We want to expand and we will expand our production. But it's too premature to indicate anything at this stage.

Q - Oscar Cabrera {BIO 7553392 <GO>}

Okay. Thank you.

Operator

Thank you for your question. Our next question comes from Harry Natter with Lehman Brothers. Please go ahead.

Q - Harry Natter

I have a question for you, a couple of questions, really, primarily relating to your balance sheet. One, given that debt increased from the end of the year. And I know a large part of it was largely temporary due to the payment of the dividend, as well as the financing of the acquisition of AMCI, can you give us an update of where total debt stands as of today pro forma for not only financing both those transactions out of operating cash flow but also the final $2.25 billion payment under your bridge facility?

Then, my second question is again related to credit quality. Where do you stand right now with respect to talking to the rating agencies? And can you give us a sense for a what your target credit metrics may be. And b where would you like to see your ratings over the course of the next year; one to two years.

A - Fabio Barbosa {BIO 21197136 <GO>}

We don't have the final numbers for the April figure because April we had a lot of events. We paid fully that bridge loan with $2.25 billion. We dispersed was $855 million in dividends. And also, we paid for AMCI, $656 million. And also, we have the current disbursements for our CapEx program that was just increased to $7.3 billion. So I don't have the-- even on a pro forma basis. But certainly, I could say to you that the total debt (inaudible) by the end of June would be lower than-- we expect it to be lower than the level that we indicated at the end of March.

As for the rating agencies, myself and (inaudible), we are visiting the rating agencies at the end of this month in New York. The idea is to update them on the latest developments in our quarter, as we regularly do every six months. Just to give you an idea, we had a very, very strong dialog with them just before the announcement of our new CapEx program, for instance. We informed them about it beforehand in order to allow them to have more time to analyze the numbers. So we are going to visit them there. And I believe that this dialog is very important to keep them updated on our developments of our Company.

And as our expectation, we do believe that we addressed very important concerns they had in the past about CVRD credit, concerns that are related to the diversification of our geography and diversification of our exposure to a single industry. With the acquisition of Inco, it is evident in our numbers since the end of 2006. And now the First Quarter of '07, that we actually delivered what we promised. So in a way, markets already reassessed our credit rating as being even better than the multiples that they are applying to our cash flows. This is clear in the evolution of our market cap.

And I believe there is still some room for further improvement in our rating, as, more and more, we recover from the old structure of a single product in a single geography, coming to a more global profile, in line with the other major players in this industry. So we do expect to be in the same league they are. And I would say that we are not there yet. But we hope to get there very soon. I'm not sure if it's possible next year. But we'll work very hard for you.

Q - Harry Natter

That's great. And in terms of target leverage metrics, is there anything we can look to from the fixed income side in terms of total debt to EBITDA; where you would like to get to?

A - Fabio Barbosa {BIO 21197136 <GO>}

We would like to get back to the level that we had before the acquisition of Inco. That's around 0.8 total debt/EBITDA ratio. We are running at a very sound level in terms of EBITDA and cash flow generation. So it's possible that you get there sooner rather than later.

Q - Harry Natter

Great. Thank you very much.

Operator

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

A - Fabio Barbosa {BIO 21197136 <GO>}

I'd like to thank our colleagues for attending this conference with me and, also, all of you that are also on this conference. And of course, as usual, we will be available for any further questions that you may have. Thank you very much.

Operator

This does conclude our Companhia Vale do Rio Doce First Quarter 2007 earnings conference call for today. Thank you very much for your participation.