Q4 2004 Earnings Call

Company Participants

- Fabio Barbosa, CFO
- Vida Borrit

Other Participants

- Alberto Arias, Analyst
- Andrea Weinberg, Analyst
- Daniel Altman, Analyst
- Gary Lampard, Analyst
- Jorge Beristain, Analyst
- Karem Bovay, Analyst
- Katie Blacklock, Analyst
- Luiz Mann, Analyst

Presentation

Operator

Ladies and gentlemen. thank you for standing by. (Operator Instructions) As a reminder, this conference is being recorded. At this time, I would like to turn the conference over to Ms. (Vida Borrit) of Financial Investor Relations Brazil, which as a reminder is a successor of Thomson Financial Investor Relations Brazil. Please go ahead.

Vida Borrit

Good afternoon, ladies and gentlemen and welcome to CVRD's conference call to discuss 2004 results. I'd like to mention that a slide presentation has also been made available on the company's website site at www.cvrd.com.br during this call.

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 those anticipated in any forward-looking comments as a result of macroeconomic conditions, market risks and other factors.

With us today/this afternoon is Mr. Fabio Barbosa, CVRD's Chief Financial Officer. First, Mr. Barbosa will comment on the 2004 results. Afterwards, management will be available for a question and answer session.

It's now my pleasure to turn the call over to management. Mr. Barbosa, you may now begin.

Fabio Barbosa {BIO 1907620 <GO>}

Good afternoon. Thank you, very much for attending this conference call. We are very happy to be here today with presenting to you what we believe are very, very good results of CVRD in 2004.

Now our discussion today will of course involve some comments on the results themselves. Then we are going to comment on the business outlook for the industry as a whole and our Company as well.

I can anticipate to you that we envisage, or we anticipate, we are forecasting a very good performance in 2005 as well.

In terms of the results, I think a major issue that we are showing today is the fact that the Company has changed in terms of style. We are talking about a Group that altogether generated $8.5 billion in revenues in 2004. That compares with almost $5.5 billion in 2003. So a much bigger Company. Much more efficient Company as you can see by the margins we are showing -- we showed in 2004 and we are certainly continuing to do that in 2005.

Price contributions to 2004 revenue growth amounted to $1.3 billion scattered by the several divisions of the Company showing that in our products, lines of products, we have been able to enjoy the very good momentum of this fact; the price.

In terms of iron ore and pellet shipments, again our operational excellence is highlighted with a new record. We achieved 61.8 million tons in the First Quarter and a total of the year 231 million tons of iron ore and pellets. Even if you do not account for the Caemi addition, you see that our performance was extremely, extremely efficient given the constraints we had this year in 2004.

Our railroads transportation in terms of general cargo, we were able to show the new record in 2004 with 28.7 billion ntk. A growth of around 9.5% compared to 2003. Well above GDP growth rates presented by the Brazilian economy. It was 5.2%. Showing the same trend we have shown in the last 3 or four years.

Our General Cargo business is growing well above the GDP growth rate. Sometimes 4 times above the average growth rate of the GDP in this last 4 or five years. It is a result of identified demand with the addition of our fleet of railcars and locomotives. Of thousands of railcars and hundreds of locomotives in this same period. So we are doing our best to meet our clients' requirements. But we are facing the constraints of the equipment provided by the industry.

In our case, the lead time to get a locomotive, not only for general cargo. But for transporting as well, is around 18 to 24 months. And the railcars, if we order today, we will only get them by the end of the year. So it's a general constraint experienced by the both general cargo services, as well as our (inaudible). At least in the near term.

We are buying this year 123 locomotives that we have already ordered and 5,600 railcars. And we believe that with that we will of course be able to deliver the expansion production that we are aiming at for iron ore and pellets and all the other products that we offer to our clients.

At the same time we will be able to grow further our General Cargo business in 2005. Although not at the same growth rate of -- not at the rate we would like to see considering the demand we have identified.

In terms of our EBIT margin, a new record was achieved in 2004. We reached 38.7% margin for our EBIT margin. It almost doubled in comparison with 2003. So we have a bigger Company and a more efficient Company. It is very important to stress that we were able to add the consolidation of companies in our figures. At the same time there was a sharp improvement in our operational efficiency.

Our costs suffered a little bit in the Fourth Quarter compared to the Third Quarter. I've seen the report and I understand by the reports several of you issued in the last two days there was concern there. But that's why we reported a slide here trying to explain to you in more detail what has happened.

Of course we are facing an environment that everybody is investing in the mining industry. Everybody is investing buying goods and materials in order to increase production because the momentum is extremely good. So there is some inflation there. There is some, in the specifics of the industry. But there is also some inflation in Brazil. There is the effect of the appreciation of the currency, as you all know.

Particularly in the case of research and development. I would like to highlight that in the Fourth Quarter we bought a new bauxite deposit of around $20m. That explains two-thirds of the total increase of our research and development that we have presented from the third to the Fourth Quarter.

In terms of our costs, we have them in more detail on the next page. And you can see that current volatility explains one-third. About one-third of this increased cost, that figure that we are showing. Also we have the effect of the consolidation of Albras in the new energy contract this time. It's a little margin. It's a $33 million effect there. Albras is a large intensive business. It's a primary aluminum. It's reflected -- this cost increase is reflected. They are linked with the aluminum price that went up and reached almost $2,000 recently and has been in very high levels for the last few months.

As you know, energy costs for Albras is linked to the aluminum price at LME. So beyond $1,450, every $100 more of aluminum price represents $1 in addition to the rate of what Albras pays.

On top of that, Albras energy cost is set in Reais. It's a BRL53 per megawatt. The basis from which it is calculated at final cost of the energy of the total. So there is a set of factors inducing increased, major increase in energy particularly in the case of Albras.

Demurrage. Demurrage costs we had an increase of $29 million in the Fourth Quarter. Of course we -- you just saw the record in sales that we achieved in the Fourth Quarter. But we also had some operational problems in the Northern System and also some issues related to the implementation of the ERP. So part of the costs, demurrage costs, associated with the shipments were translated, or were evident only in the Fourth Quarter.

That is a mix. The main determinants were of course the line of ships that -- was the line of ships that we observed in the ports.

With the P&L expenses, there are several factors here. But I would like to highlight at least 1. That we are implementing the compliance program with the Sarbanes-Oxley Act. It's very complex issue for CVRD given the size and diversity of its operations. It does not explain all this increase here. We have salaries. We have other consolidation of companies.

1 of the issues I would like to highlight here is the fact that we implemented a new program that was effective September 1 onwards. A program of compliance to enable us to comply fully with this whole section of Sarbanes-Oxley. And this was not observed in the previous quarters.

Finally, I would like to comment a little bit on the chartering of vessels by Docenave. It's $12 million increase from quarter-to-quarter. But it's in our perception a business that is recovering from the very problematic past we believe. Docenave is now restricted to coastal shipping and in the last year operational performance was much better than in previous years. And it is even showing capacity of paying dividends to CVRD as controlling company. So there will be an adjustment of $12 million in the Fourth Quarter.

Given the circumstances of the industry as a whole and our own position in Brazil, is facing a very -- a much more appreciated currency. The dollar is appreciating against almost all currencies. A major part of our costs are Real denominated.

We have the challenge of keeping our costs in line with expectations of our shareholders. So we launched an Excellence Program dedicated to reduce costs and to improve our productivity. We have been doing that. But now we are intensifying this effort with the current circumstance. So we are, all the pillars of this program is improve the maintenance efforts, improve our operations and be able to execute the most ambitious investment program we have had in the last -- since the beginning of CVRD operations.

So we are aiming at growth irrespective of the cycle. And we are promoting some 'savings'. We are increasing our situation. We are trying to intensify our maintenance program. We are keeping all trucks in operation given the strength of demand. But we are planning for the removal of those equipments as market conditions change.

So we are improving our supply chain. We centralize engineering of CVRD in a single department. That's regards implementation of several projects. So we are enjoying this very good momentum of this cycle of course. But we are not slipping on the good result that we are presenting. We are trying to improve further because we know that we still have some room to increase our efficiency and productivity in our operations.

Despite that of course, we presented very strong results in all lines of business. Ferrous Minerals, EBIT margin reached 42.3% in 2004, Non-Ferrous 41.9%, Aluminum 41.7%, Logistics 21.9% and CVRD as a whole 38.7%. And as I mentioned before, a new record that compares to the almost 30% that we showed in 2003.

In terms of net earnings, again an extraordinary result in 2004. $2.5 billion in net earnings in 2004. A new record in terms of earnings and of course it is a result of the operational excellence. But it was also helped by the appreciation of the currency. Even that the Real is a functional currency, there is a positive effect there, improving our net earnings given this appreciation of the currency. Of the Real. So there is a positive impact there.

But the point I would like to make is that you will certainly notice that we pay more taxes, particularly in the Fourth Quarter. In this point I would like to clarify the issue of the taxes of the Fourth Quarter.

Out of the increase of $172 million observed in the Fourth Quarter there, $137m; almost 80%; was non-recurring events. Was derived from non-recurring events. The events I mention are first the effect of the sale of CSD and this of course the sale was finally concluded in the Fourth Quarter. And according to Brazilian legislation, we had to report the full effect only in the Fourth Quarter. Part of it was reported in the Third Quarter. But there was $10 million effect of this sale of CSD there.

A second aspect is that we promoted a structural change in the way we approach the tax credits okay. They are for instance losses in companies like FCA, our railroad company. But presented losses for several years in a row and those losses were creating, implying in tax credits that of course will remain in the future performance of the Company. But if we make it strong then we believe that it would be more appropriate given the moment of the cycle to be more conservative and more prudent in this area. So this change in approach represented one-off effect of $57m.

The change in legislation related to losses with derivatives represented additional $57m. This is a government determination. A new legislation that was passed in December 2004 determining a new treatment of the losses and derivatives. And this represented $57 million of additional expenditures of tax income. Income taxes in 2004. So it was of course not anticipated by ourselves and we had to adapt to this new position.

But although this non-recurring event, they explain about 80% of our increase, of tax increase from 1 quarter to the other. It's clear that our Company's effective tax rate is increasing. This is something that we should be clear about. It's not of course in the level that you saw in the Fourth Quarter. The Fourth Quarter. Given the nature of the event. But is an increase in the effective rate. Given the size of the operations we achieved, we are now operating in more States with different tax treatment. And effective tax burden in Brazil is increasing. That's a fact. So this is something that we will of course try our best in order to optimize our fiscal position. But there is a trend there that we wanted to share with you.

In terms of EBITDA. Again, for the eleventh consecutive quarter we showed a new record. In 2004, $3.7 billion of EBITDA. That is almost more than double of what the figure showed in 2002. So the Company grew through organic growth. But also grew through the cooperation of consolidation of companies like Caemi, Albras and FCA.

But what message here is that it's much clearer to the market participants that the actual size of our Company, although there is more consolidation there. But we believe that we working in the right direction in order to show the market participants that operators like aluminum are adding value to CVRD's shareholders. They are very good operations. And they were not shown in full according to the US GAAP criteria until 2004. So now the market participants have a more accurate perspective of this actual contribution of this several lines of business that we do have.

And that is still some companies that are outside the picture according to the US GAAP criteria, like our Pelletizing plants, our joint venture with Tubarao, MIN, Valesul and others. So still there is some room for further improvement.

In terms of balance sheet. Well we are strengthening further our balance sheet. Confirming our conservative approach towards the financial indicators of the Company. You see that our interest coverage reached 12.4% in December '04 and our EBITDA gross debt reached 1.1 times. So it's very much comparable with the major players in this industry. We are fighting. We are not fighting. But we are discussing the issue of the investment rate with the rating agencies. And we work further in this direction in 2005 to strengthen further our balance sheet because as you recall, we bought back almost 60% of our PLI bonds due in 2007. Even before knowing about this price increase that was achieved by our negotiators.

Turning to the business outlook. We believe, as we said, that markets will be tighter for longer. We are not talking about a bubble that will burst any time soon in the future. We are talking about the structural changes, secular trends that came to stay in our view.

Although global GDP growth slowed down a little bit in 2004 compared -- in 2005 compared to 2004, we believe that the line for that will continue to prevail. There is no chance, in our view, that China will reduce sharply its growth rate. There is no macroeconomic fundamental that would impair this judgment, in our view. They have very strong position in international reserves. They have inflation under control. They have a very high investment -- aggregate investment rate. A very high domestic savings rate. So it's a balanced economy. It's 1 of the top players in international trade. So it helps everything in place to grow further. There is no reason why it should stop growing, particularly if you consider that as we keep saying all the time we are able to meet you, that China cannot afford stagnation in our view given the history, the culture and the political issues involving that country.

So we believe that China will continue to grow and as we can see in the slide that we reflecting GDP, Chinese industrial production, it keeps growing. It keeps growing. China industrial production is around 13% on a year-on-year basis growth in January/February.

And alumina and iron ore imports. Alumina grew, alumina imports grew by 45% in the first month of the year. In iron ore imports, 24% in the first month of the year. Well if they continue this trend, it means that they would be booking more 50 million tons of iron ore in 2005. That's a major and as you are going to see, our seaborne forecast is around 665 million tons. Meaning that China would absorb the whole growth of the seaborne trade that we are forecasting if they continue to perform as they are right now.

And the next slide is a very interesting chart. That shows the historical trend towards deterioration of terms of trade of commodities against industrialized products was dramatically changed by China. Particularly near the year 2000 and you see clearly that there is a change in the trend that was shown by this -- in this comparison in benefit of commodities and raw materials producers. That is very good news for us. That was we are, we believe in the right spot at the right time. And we have a great investment program ahead of us.

So another important point is that growth in the steel industry is taking place in China. Most of the growth is taking place there. So as we put after almost 25 years of relative stagnation, China is a major driving force of the steel growth, steel industry growth in the last few years. Chinese steel production last year was 272 million tons. More than one-fourth of the world's production. The steel industry grew 8.8% last year. This year we believe that at least 5% would be feasible to achieve in terms of growth of the steel industry and China would be again the major driver. And the import of iron ore in the first two months of the year just confirmed this expectation.

China's growth. The quality or the nature of the growth in the steel industry in China it's enhancing. It's dependent on iron ore and good quality iron ore. And that's again very good news for our products because in order, given the trend of the bias towards blast furnaces production, iron ore producers like CVRD are very well positioned to supply our clients and to provide them with all the solutions they need. And this again makes our market share in China more structural and more permanent than otherwise would be in the absence of this trend.

The next chart shows you that with the price negotiations that we were able to conclude, that we are trying to catch with other metals and other commodities. Iron ore used to be a late cycle product. Now we are trying to, again, to catch up with the market trend in order to allow the implementation for a huge investment program to increase our supply of products to our clients. So it's a very important movement given the market circumstances.

We would like to highlight new trends and mergers in the iron ore market in the last few years, particularly last year. First, a potential long-term contract and this is very important for Chinese suppliers. That used -- that didn't use to have a very long-term approach and they are now moving towards a long-term relationship establishing joint ventures and long-term contracts.

And a spot market was also developed. It's marginal in our view yet. It's nothing that would represent a trap to the major producer in the long-term given the issues of quality, timely delivery of the products and reliability. But it was a powerful indication of the imbalance of the market and it's a reality that is there and you have to live with that.

In the near future, we believe that despite our best efforts and our competitors' efforts, it's not likely that you will see an excess of capacity for the next couple of years. We have growth in demand. Sustained growth in our view, that we will keep this market very tight. There is some demand to be met by marginal players in the spot market. There is room for further growth on our part. And we are, of course, building the added capacity to deal with the supply chain problems. But they are there. This is a reality we cannot deny.

In terms of demand. The outlook is extremely positive. The seaborne trade, again as I mentioned before, should reach 665 million tons and almost 700 million in 2006. And China's share in the total seaborne trade should be consolidated further. And imports of iron ore in China could reach this year 256 million tons. The first two months of the year, are very much in line with this forecast. 288 million in 2006 and 310 million in 2007.

Yesterday we commented that we added 1 more project to our portfolio. You recall that we have been commenting on several projects in Carajas. We discussed about 85 million ton expansion that is part operation in the Third Quarter of 2005. In fact Carajas 85 million tons expansion, will start to be ship loaded. That will be recorded in July. Then Carajas will produce this year around 77 million tons of iron ore and then it will start operation at full capacity from July onwards. Meaning that we will be producing about 87 -- sorry 77 for the whole year.

Then we announced the expansion, a further expansion of Carajas. Carajas is going to reach 100 million tons by 2007. It's a $376 million investment with a very nice rate of return as you see there. That's important to mention. That we are almost doubling Carajas' capacity compared to what it was just two years ago; 2003. That was 56 million tons.

So we are working hard to please our clients and in this investment in Carajas, it's important to mention as well that there will be some additional investment in Logistics that will provide for much more flexibility in our Logistics systems. Our Logistic facilities and more consistent, enabling us to cope with the additional demand of copper, nickel and also further expansion of our Northern System, our iron ore system. Our Carajas production. So it's a very important project that was just approved by our Board last Monday.

In terms of Alumina. Prices hit a new 10 year high this year. As I commented briefly on discussing the energy prices, about $2,000 per ton. A good perspective. Inventories are going down and the weak dollar helps this market.

In terms of Alumina, still a very strong market. Aluminum prices 22% of aluminum prices and a very good perspective for until 2007 at least.

Copper prices reached a 16 year high. Very good momentum. The only greenfield project in 2004 is Sossego. Sossego are able to deliver 73,000 tons of copper content. A very good performance for a plant that is still in the ramp up. So very good perspective.

And finally, I would like to mention that given this very good perspective of the market and I will not discuss every single project we have in our pipeline. There are over 40 and growing. I would like to highlight the fact that we, as reported, are paving the way for long-term growth. We are accelerating our investment in R&D, particularly in other countries. We are trying to develop organic growth opportunities in countries in South America, Africa and Asia. So our growth will depend more and more off other projects in other countries. And that's very good news. We are trying to do our homework, trying to look for opportunities.

They are not that obvious. But important to allow us for interest with in the core market. It is something that is missing in our portfolio like the Moatize Mozambique project enhancing our production in potash.

That we have limited perspective here in Brazil when this new product was very important and that is phosphate. The project in Peru is the second largest deposit, second world largest deposit and we have a perspective of increasing of producing about 3.3 million tons per year. That's a very nice margin according to the first estimates that we do have.

So our long-term trend as we put there. We believe that we will be promoting sustainable profitable growth with diversification and globalization. Meaning that we will increase our footprint worldwide.

Thank you, very much and I will be available for any questions you may have.

Questions And Answers

Operator

Ladies and gentlemen. we will now begin the question and answer session. (Operator Instructions) Our first question comes from Alberto Arias of Goldman Sachs. Please go ahead.

Q - Alberto Arias {BIO 18302585 <GO>}

Yes good morning Fabio and Roberto. Congratulations on the good result. A couple of questions. The first 1 perhaps on the comment you had on the structural changes on these markets and the decision of expanding the iron ore production ahead of what you were anticipating before. Should we read that this is going to change your $3.3 billion CapEx for 2005 given that this project was not approved before? Or was the CapEx already incorporated in your -- this project was incorporated in that project?

And also, when you talk about internal rate of return on Carajas, what kind of pricing assumption are you making on iron ore to estimate that 30% internal rate of return?

A - Fabio Barbosa {BIO 1907620 <GO>}

Okay Alberto, thank you very much for your questions. There should be no change on the first question. Our investment program for this year $3.3b. We already had some small provisions there for the beginning of the project. It's like the expansion to $70 million Alberto. It was already embedded with the expansion of 85 in a sense right. So we expanding 85 now with a shipload and we are working -- we are investing in some aspects of the logistics and the mines that will help us to produce $100m. 100 million tons sorry.

To give an idea. We are investing in expanding our yards, our loading capacity in Carajas. We are adding silos. So we mark this -- we have several investments that go in parallel that are already part of or were attached to a single project like 85. But they will help us to produce 100m.

But as we speak, your question as you asked, we are not increasing the investment program for 2005. It is $3.3 billion is our mark.

As for the internal rate of return, the reference prices well those they vary in 2004. Therefore it was before the price change of 2005.

Q - Alberto Arias {BIO 18302585 <GO>}

So that was the price that you used for 30% internal rate of return?

A - Fabio Barbosa {BIO 1907620 <GO>}

Yes.

Q - Alberto Arias {BIO 18302585 <GO>}

Okay and my second question is just a little bit of elaboration on the tax impact. You mentioned that derivatives was non-recurring tax hit in the First Quarter of $57 million because of a change in legislation at the end of last year. Should we be expecting that the tax rate will be impacted by your --- is it the mark-to-market position that was taxable and is this something that we're going to get every quarter depending on fluctuations of commodity prices? Is this going to at all change any of your hedging policies from now on?

A - Fabio Barbosa {BIO 1907620 <GO>}

Well this is a non-recurring event in our view because we have to adjust for the whole spark of losses accumulated last year. And the tax credits. We did some adjustments. Operational adjustments. For instance, we've transferred part of the derivatives position to offshore companies. So it should not happen again in the same amount, or in this year.

But remember what I mentioned about the general tax effective rate. The effective tax rate of the Company. It should be increasing over time given the size of our operations and the nature of the results we are getting okay.

Q - Alberto Arias {BIO 18302585 <GO>}

All right. Thank you.

A - Fabio Barbosa {BIO 1907620 <GO>}

Thank you, Alberto.

Operator

Thank you for your question Mr. Arias. Our next question comes from Jorge Beristain of Deutsche Ixe. Please go ahead.

Q - Jorge Beristain {BIO 17554499 <GO>}

Hi good morning Fabio. Jorge Beristain with Deutsche Ixe. I just had I guess 2 questions as well. 1 is if you could give us a sense on what is happening with your interest expense line which has in the past few quarters really been increased a lot by these derivative losses and also losses on interest rate forward now we're obviously in a rising interest rate environment. Do you have your own internal projections as to what, if the interest rate line will fall in 2005 given that a lot of these have already been losses on derivatives for the past two years? I guess that's my first question.

A - Fabio Barbosa {BIO 1907620 <GO>}

Okay. Thank you for your question. Well the interest expenses, the net financial expenses increased by roughly $60m. And you were right, derivatives responded, represented $36 million of this total.

It's related with Alberto's question. The fact is that we have derivatives position, particularly aluminum. And we marking a margin for the Company of about 50% of the total production of Albras, for instance. And prices of aluminum have skyrocketed, particularly in the last quarter of the year.

So it's very much related to the fact that we of course locked a much lower price in our derivative position and as prices continue to be strong, we should continue to present these losses in our derivatives position. We are trying to adjust that. But those are long positions you know. Remember where aluminum prices were two years ago. So they are very important to protect. The margin included -- they are a requirement of some of the financiers of Albras, for instance, like BNDES. And we are constrained by the position we have already established.

So on the other side we have some derivative position as well in interest and there the liability is increasing. These losses should be reduced. And we have very marginal losses in our gold production as a byproduct of the copper.

So the bulk of it was associated with -- the increase I mean associated with derivatives.

Another important point is that you saw that we bought back part of the (inaudible) of that total debt. We are reducing the share of floating interest rate in total debt. Increasing the duration of our debt and this is slight advantage, a higher interest payment over time as a structural factor okay. I hope I have answered your question Jorge.

Q - Jorge Beristain {BIO 17554499 <GO>}

Okay. Thanks and a second question is if I may. This is more related to your capital structure. But there has been a lot of recent under-performance of your preferred share class versus the ON share class. And I was wondering if CVRD management is formulating any policy to deal with this large discount in the PN share class?

A - Fabio Barbosa {BIO 1907620 <GO>}

Okay. Our view is that there is no reason for this discount. In our view it's no issue. It's a very cheap investment opportunity for CVRD in our view. There is no reason why PN shares should be traded at this discount. They've got the same dividends. The only difference is that they have no right to appoint, to nominate a Board member. But I believe that for most investors, particularly the institutional investors, this is a no issue there. So we do not understand and we cannot justify this discount. And there is a great opportunity there in our view.

Q - Jorge Beristain {BIO 17554499 <GO>}

Is there any concrete that management can do such as (preventing) tag alongs to the preferred share class or any other thing to close the spread?

A - Fabio Barbosa {BIO 1907620 <GO>}

No Jorge. As you know this is an issue that is way beyond our shoes. This issue is a shareholders' issue. That they should be convinced. They should be endorsing any movement in this direction. But so far there is no change in this issue.

Q - Jorge Beristain {BIO 17554499 <GO>}

Thank you.

A - Fabio Barbosa {BIO 1907620 <GO>}

Thank you, Jorge.

Operator

Thank you for your question Mr. Beristain. Our next question comes from Andrea Weinberg of Merrill Lynch. Please go ahead.

Q - Andrea Weinberg {BIO 6591181 <GO>}

Hi Fabio. Hi Roberto. So 2 quick questions. First, in your Logistics business EBITDA declined $33 million on a quarter-over-quarter basis and revenues were pretty much in line. Could you please explain what led to this significant? My conclusion is that a significant increase in costs in the Logistics business.

A - Fabio Barbosa {BIO 1907620 <GO>}

Sorry Andrea, could you repeat your last part of your question please.

Q - Andrea Weinberg {BIO 6591181 <GO>}

It just seems like the cost structure in your Logistics business increased a lot on a quarter-over-quarter basis. I just wanted to understand why.

A - Fabio Barbosa {BIO 1907620 <GO>}

Well basically that shortening investors that was a major adjustment in December by Docenave. Also we have some provisions for losses that we have to adjust. There is some seasonality there as well. Basically that would be those factors that will have affected the margins. But we are working on that. It's interesting because Docenave generated very good amount of cash. They will be paying dividends. So this is almost new let's say in the last few years at least. Okay.

Q - Andrea Weinberg {BIO 6591181 <GO>}

Okay. The second question will be more some explanation on the rationale behind the fact that you exercised the preemptive rights on the CSN long-term contract. The 54 or 50 million ton contract that you announced two days ago. I just want to understand why you're doing it and if you would do in further contracts as CSN announced to the market?

A - Fabio Barbosa {BIO 1907620 <GO>}

Well this exercise has to do with the rights that we do have. It has to do with the tightness of the market that we are forecasting. We believe that given market circumstances, we had an opportunity there given the intentions of CSN to increase their production. We believe that for exports we have said we would like to supply our clients with more order. We are able with our own production. So in this sense we are not exercising the domestic market as you know and in this particular case we believe that that was the right thing to do given the strength of the demand and the perspective of the market in the long-term.

Q - Andrea Weinberg {BIO 6591181 <GO>}

Okay. Thank you.

A - Fabio Barbosa {BIO 1907620 <GO>}

Thank you.

Operator

Thank you, Ms Weinberg. (Operator Instructions) Our next question comes from Daniel Altman of Bear Stearns. Please go ahead.

Q - Daniel Altman {BIO 1855515 <GO>}

Hi. Good morning. A couple of questions. On taxes you're showing a deferred tax liability in the short-term -- sorry, current liability provision of $433 million as of the end of the year. I'm just wondering when you think that that, or if you think that that will be paid in cash during 2005?

The other question regarding the CSN contract. If their contract was for a customer in Asia, are you obliged to sell to the same customer, or to the same region, or do you have flexibility to take that product and sell it wherever you feel -- wherever you choose?

And kind of an offshoot to that question, they're saying that they can go as high as 25 million tons in the export market. Do you think that number is credible and would you be able to, or would you choose to use your rights all the way up to 25m? Thanks.

A - Fabio Barbosa {BIO 1907620 <GO>}

Well thank you very much for your questions. No issue. We as recorded, we made some provisions for the income tax and part of this particularly in the year will be actually dispersed in 2005. About half of it. Half of this total. Okay. And we, as you are observing, we have very good perspectives for this year as well. So we have limited scope for using interest and shareholders' equity to deduct our tax burden. So we should, again, we should have an increase in the effective tax rate, even on a cash basis. Okay.

On your second question, no we are not restricted to the very client was negotiated the contract to sell the order applying from CSN. We can sell to anyone. So we have much more flexibility and as you know, we have a very strong presence in Asia. And of course we will try to optimize this ore that we are buying in terms of sale and margins.

As for your third question on the expansion of the mine, we have to take a gradual approach there. They have been saying that they would be able to expand it to a certain level. But so far the 1 thing we saw is I believe 3 million tons in 2006 and 5 million tons from then onwards. And it's not easy as you know to increase production overnight. You see if you wanted to, there I just mentioned that if we order a locomotive today, we'll get it in two years. And the same applies to ship loaders, to shovels and other equipment, or mining equipment. Trucks, just look at Caterpillar and Komatsu lines. So it's not simple to increase the production.

And if they decide to do that. And if they decide to export, we'll decide depending on market conditions what will be our approach to deliver. But so far the exercise is first right of refusal. On that contract that was actually discussed, I believe, by what I saw in the press, for several years by CSN with their players. So it may take a lot of -- at least months or years. I don't know to come with another opportunity let's say.

Q - Daniel Altman {BIO 1855515 <GO>}

Okay. Thanks very much.

A - Fabio Barbosa {BIO 1907620 <GO>}

Thank you, Daniel.

Operator

Thank you for your question Mr. Altman. Our next question comes from (Karem Bovay) (ph.) of Lehman Brothers. Please go ahead.

Q - Karem Bovay

Hi, guys. Congratulations. All my questions have been answered.

A - Fabio Barbosa {BIO 1907620 <GO>}

Thank you, very much.

Operator

Our next question comes from Luiz Mann with CSFB.

Q - Luiz Mann {BIO 1963758 <GO>}

Hello everyone. My question is related to your balance sheet structure. When you take into account your net debt position coupled with your comments regarding the iron ore market that is likely to remain very strong. I see your net debt to EBITDA being at a very low level and I would like to hear some comments where do you think these multiples should be to make your balance sheet more efficient considering taxes and considering also the fact that the Company is looking for a upgrade on the debt side, which means lower cost of capital? Thank you.

A - Fabio Barbosa {BIO 1907620 <GO>}

Thank you, Luiz. Well you are right, our figure is a very -- both are number 1 for the net debt/EBITDA. But in our daily management of our financials we use as reference the gross debt due to a more conservative approach that we do use. And in this regard we are showing a figure of 1.1 times gross debt/EBITDA. It is extremely comfortable. It is comparable with a single A or double A figure. A double A or single A company if there was not the sovereign ceiling or the sovereign risk attached to our risk yet.

So our view is that we should strengthen further our balance sheet in order to enhance the possibility of getting the investment grade. We are -- so in this regard 1 should expect further reduction of leverage. The Company, we are reviewing our borrowing program for 2005. That was initially thought to be around $1b. We are reconsidering this figure downwards. And we are also discussing with several first year banks the extension of the committed bank facilities that we signed last year with the $500m. So we hope to improve the profile this year. Remember that was one year to disperse plus one year to repay. We are trying to improve the profile and also to increase the size of this committed facility in order to give more confidence to rating agencies to reconsider our rating. Okay.

Q - Luiz Mann {BIO 1963758 <GO>}

Okay Fabio. Next question is related to recent comments from Bow Steel and TBOG joint venture regarding this new steel plant and the taxes issue. Can you update us on that? Thank you.

A - Fabio Barbosa {BIO 1907620 <GO>}

Thank you. Well the issue is that by the time we discussed this Bow Steel, the project in Sao Luiz set there in 2002. Since then there was a change in legislation that increased taxation of the equipment in about 20%. So this increased the overall cost of the project by $405 -- almost $500m. So we. And this has to do with the import tax and these are continuous taxation of imported equipment as well.

So we presented our proposal to Mr. (Balarchi) last year. At the end of 2004. In which for investments that would have -- that would be targeting exports, that would have at least 80% of the total revenues targeting for markets for exports. In projects like this we would have the exemption of the taxation. That was said. We presented a proposal last year and so far we haven't heard from the government about the possibility. We believe that there is no physical impact because we will be talking about new projects, not old ones. Why? Because we are talking about investments. And I believe that there is -- the idea is welcome. I believe that they are studying because they know that this is a major issue to make more feasible several major projects in Brazil, particularly in the steel industry. Okay.

Q - Luiz Mann {BIO 1963758 <GO>}

Okay Fabio. Thank you, very much.

A - Fabio Barbosa {BIO 1907620 <GO>}

Thank you, Luiz.

Operator

Thank you for your question. Our next question comes from Katie Blacklock of Thames River Capital. Please go ahead.

Q - Katie Blacklock {BIO 17145068 <GO>}

Hello. First of all could you just clarify what exactly is included in the outsourced services line and what's included in the other costs line?

And then the second question is related to personnel expenses. Can you just tell me how many employees you had at the year-end and what kind of wage inflation we can expect to see this year as well as any increases in staff that you are expecting for this year please? Thank you.

A - Fabio Barbosa {BIO 1907620 <GO>}

Thank you, Katie. Well first, outsourced services. The basic issue there is Caemi. Last year you remember we consolidated Caemi for four months only. This year we have 12 months of Caemi and Caemi uses a third party railroad. Its MRS. That's not consolidated in our US GAAP figure. So that's why there is this increase in the outsourced services. Explains most of it. And of course, depreciation of the Real and so on and so forth.

As for payroll, we had addition of several companies last year. Remember FCA. It's our railroad. A general cargo transportation that has almost 3,000 people working for it. We have Caemi consolidation. We have Albras consolidation. So in total our total workforce is around 31,000 by the end of -- it was 31,000 by the end of 2004. And this addition represents about 4,000 people to the 12 months basically in 2004. Okay.

Q - Katie Blacklock {BIO 17145068 <GO>}

So you added 4,000 in 2004. Are you expecting to add any more in 2005, or do you--?

A - Fabio Barbosa {BIO 1907620 <GO>}

Well we are investing a lot Katie. We have a consolidation effect of this addition okay. But we are investing $3.3 billion in production expansion and this represents organic growth and we will add people to our workforce for certain. We need drivers for trucks. We need shovel operators. We need you know locomotive pilots. I don't know how to call them. But we will certainly have people. But remember our concern is the facility and efficiency of our operations. We are working very hard on that. But we are facing some cost pressures related to the appreciation of the Real and overall boom of the whole industry.

Q - Katie Blacklock {BIO 17145068 <GO>}

Okay and just in terms of wage negotiations for this year, do they happen at sort of 1 specific time in the year? Is it in April renegotiation of wages?

A - Fabio Barbosa {BIO 1907620 <GO>}

The wage negotiations take place in July. So this where we should start our discussions with the trade unions. I would like to highlight that in this First Quarter we are going to pay our employees profit sharing bonus and of course will affect the cost of payroll in this very First Quarter of the year.

But other than that, the discussions about wages will start in July.

Q - Katie Blacklock {BIO 17145068 <GO>}

Okay. So the profit share wasn't paid in the Fourth Quarter. That will be paid in the First Quarter?

A - Fabio Barbosa {BIO 1907620 <GO>}

It will be paid in the First Quarter of '04. But there was some provision there in the Fourth Quarter okay.

Q - Katie Blacklock {BIO 17145068 <GO>}

Okay and then sorry, it was just also a clarification on what's included in other costs. Is that demurrage and then the chartering of vessels? Can you just give me a breakdown of what else is in that line?

A - Fabio Barbosa {BIO 1907620 <GO>}

Okay. Katie I will ask Roberto or Daniela or Roberto to call you and go into the very detail of that.

Q - Katie Blacklock {BIO 17145068 <GO>}

Okay. Thank you, very much.

A - Fabio Barbosa {BIO 1907620 <GO>}

Thank you, Katie.

Operator

Thank you for your question Ms Blacklock. (Operator Instructions) Our next question comes from Gary Lampard of Canaccord. Please go ahead.

Q - Gary Lampard {BIO 2019395 <GO>}

Oh hello. I have 2 questions. The first on the Ferro Alloys business. There appears to be very large cost increases from Q3 2004 to Q4. Can you explain those cost increases and also whether or not we can expect that cost base to continue into 2005?

And the second question is on Sossego. Could you give us some more detail there of copper grade? What was the copper grade in the Fourth Quarter 2004 and what are you expecting for 2005?

A - Fabio Barbosa {BIO 1907620 <GO>}

Okay. Thank you, very much. As for the cost increase, we did have some pressures of coke energy and also there was a provision that affected the performance of this segment of business. Basically stock writeoffs. Writeoff of stock of inputs that we had there in our plant.

As for your second question on the Sossego, could you repeat that please?

Q - Gary Lampard {BIO 2019395 <GO>}

Yes. I would like to know what the copper grade was during the Fourth Quarter and what your expectations are for 2005?

A - Fabio Barbosa {BIO 1907620 <GO>}

Well as you know we are in the ramp up process and the copper grade was around 1% in the first -- in the Fourth Quarter. For this year we are facing very important issue that is related to the hardening of the rocks there. So we are working hard to cope with that. That should represent some additional operational cost there this year. But the grade should be around the same that we observed in the last quarter of '04. Even with this difficulty in terms of production, we expect to reach annual production of over 140 tons of copper content this year.

Q - Gary Lampard {BIO 2019395 <GO>}

Okay. Thanks.

A - Fabio Barbosa {BIO 1907620 <GO>}

Thank you, very much.

Operator

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

A - Fabio Barbosa {BIO 1907620 <GO>}

Well I would like to thank you all for the patience of hearing us today and we will be of course available for any further questions you might have. Thank you, very much and I hope to see you soon.

Operator

This does conclude our CVRD conference for today. Thank you, very much for your participation. You may now disconnect.