Q1 2008 Earnings Call

Company Participants

- Roberto Castello Branco, Director of IR

Other Participants

- Carlos de Alba, Analyst
- Dan Kwiatkowski, Analyst
- Felipe Hirai, Analyst
- Giorgi Do Mingris, Analyst
- Jorge Beristain, Analyst
- Oscar Cabrera, Analyst
- Roger Downey, Analyst
- Sanil Daptardar, Analyst

Presentation

Operator

With us today in Rio de Janeiro is Mr. Roberto Castello Branco, Vale's Director of Investor Relations. First, Mr. Castello Branco will proceed to the presentation and after that, we will open for question and answer session.

Now it's my pleasure to turn the call over to Mr. Castello Branco. Sir, you may now begin.

Roberto Castello Branco {BIO 3193867 <GO>}

Thank you. Good morning, to those who are on this side of the Atlantic. Good afternoon, to those on the other side of the Atlantic. First of all, I would like to tell that unfortunately our Chief Financial Officer, Mr. Fabio Barbosa, will not attend the conference, as he is in China, attending an investor conference.

The title of our 1Q '08 earnings release, Staying Strong in a World of Change, reflects, I think, pretty clearly, what happened in this quarter. We had a very solid performance in the face of a tough environment of currency. And price volatilities and non-cash charges that distorted, a little bit, our real performance.

In terms of production, we did very well. Iron ore production in the First Quarter '08, despite this is a seasonally weak quarter. I would like to emphasize this. But it's reached 74.5 million tons of iron ore, helped by the good performance of Carajas, Brucatu [ph] and the new mine of Fazendao. And in this quarter, we achieved a historical mark because our production in mineral [ph] base over the last -- accumulated over the last 12 months in the First Quarter of 2008 reached more than -- exceeded the 300 million tons mark. The last time we had a historical mark was in the Third Quarter of 2004, when we reached, for the first time, 200 million tons of iron ore.

So we continue to increase our exposure to the cycle and in doing this, we delivered in this quarter three new projects through three new platforms of cash flow and value creation for shareholders. The Fazendao mine in the southeastern system with a capacity to produce 15.8 million tons of iron ore on a run-of-the-mine basis. The third pellet plant of our affiliated joint venture, Samarco, with the capacity to produce 7.6 million tons of pellets, that started operations in April.

And finally a small. But very important project in terms of our marketing strategy for nickel, Dalian, in the north of China, which is going to produce 300 -- has the capacity to produce 300,000 tons per year of finished nickel. Dalian is important because it's a project, which is associated to the Goro nickel project in New Caledonia. Goro is going to produce 60,000 tons of nickel in market, with 78% of nickel content. And so it's going to ship its product to Dalian, where we are going to produce a product with 97% of nickel purity. And to help the flexibility, to play in the Chinese domestic market for stainless steel.

As a consequence of that, we are going to change the profile of sales for the Chinese market that's too concentrated on plating, on the plating market, represents more than 80% of our sales. And we are choosing more towards stainless steel. Because this product produced by Dalian will be focused on the stainless steel industry.

Although China is a very large player in the plating market globally, China represents 50% of the plating market, we're in -- we are a very large player in this market. We have 40% of the sales of market share in the plating market. In the domestic Chinese marketplace, it represents only 20% of the consumption of nickel. So with Dalian, Goro plus Dalian, we'll be exploiting a larger share of the large Chinese market.

In terms of CapEx, we spent this quarter, only $1.7 billion. This is going to accelerate throughout the year. But 77% of our CapEx was focused on growth, project execution plus research and development. We have been investing heavily in mineral exploration around the world, focusing products like copper and coal in South America, Africa and Asia and we are starting to have initial very favorable results.

In terms of projects, we announced, of course, revision of the Onca Puma project, $2.3 billion from the $1.4 billion initially budgeted. This was due to the currency volatility, to the appreciation of the Brazilian real against the U.S. dollar and also to the rising costs as is well known, the mining industry faced a very tough environment in terms of costs because almost everything has price increases, raw materials, equipment, spare parts, contracted service as well.

And Salobo One, it's a project that is being developed that has very good expectations, suffered a revision of a CapEx budget upward by $200 million to $1.20 billion against

$900 million and we are very optimistic about Salobo, about developing after Salobo I, Salobo II. And even, there is a chance for Salobo III having a very large copper operation at Salobo with more than 200,000 tons.

Well in terms of costs, costs in -- cost of goods sold comparing the First Quarter 2008 with the First Quarter of 2007, there was an increase of about $800 million. That's as shown in the slide. Most of this was due to the depreciation of the U.S. dollar against the main currencies that -- composed our costs. I'm talking about the Brazilian real and the Canadian dollar.

And -- but it's important to highlight that even amidst this environment of rising price for inputs, we managed to get $224 million in cost reductions. And talk about this, our efforts are paying off. We, on a quarter-over-quarter basis, our costs per unit of output discounting, of course, it discounting the effect of depreciation and the currency volatility, we managed to obtain cost reductions quarter-after-quarter, with the exception of the Fourth Quarter of 2007.

Yet I would like to emphasize the point that in a tight market environment, one shouldn't -- should not concentrate expectations only in -- only in terms of cash costs per ton. But there are several situations where we have to accept a cost increase. But conditions is for marginal revenues higher than marginal costs. This is the relevant economic decision. If there is an opportunity to increase production. But at a -- but increasing costs. But the additional revenues generated by that decision is going to be much higher than the additional costs, it would be not rational to not make that decision to you, meaning to give up cash flow and profits. It's to be -- it should not be on the very best interest of shareholders.

Of course, we are making a lot of efforts to fight costs. But our main driver is the comparison between marginal revenues with marginal costs. Our operational margins improved relatively to the Fourth Quarter of 2007. For the company as a whole, it went up to 37.2%, up 430 basis points. And across our three main divisions, only the ferrous minerals divisions registered a decrease margins. I want to call your attention that only $17 million of additional revenues arose from the iron ore price increase. The bulk of the iron ore price increase is going to be accrued from the Second Quarter onwards. A major part of our clients moved to the Japanese fiscal year, which starts on April the 1st, for the period relevant for a price change. So only a small part of the price increase is retroactive and a major part will be accrued from the Second Quarter onwards.

Comparing the First Quarter of 2008 with the Fourth Quarter of 2007, our EBITDA registered an increase of approximately $200 million and it was helped by the reduction of SG&A. SG&A in the Fourth Quarter 2007 was very high. It is due to one-off events, like expenses with branding, with the installations of off south side [ph] Brazil, with several provisions and to a seasonal increase of profit sharing provisions. So it decreased by $232 million. There was the contribution of reduction in cost of goods sold, the contribution of an increased sales price and that more than offset the decrease in -- the seasonal decrease in sales volumes.

Comparing EBIT to the EBITDA reached in the First Quarter of 2008, with the one that we obtained in the First Quarter of 2007, it's important to see that if you normalize by the nickel price, the average realized nickel price, we should see an increase, not a decrease, because in the First Quarter of 2007 nickel prices were very high, were -- reached 14 -- nickel average realized price reached $14,400 per ton. It decreased by 29% compared to the First Quarter of 2008. And I should say that one should not expect this very high price to continue over time because it should be very good in a short-term view. But for the medium and long term, it was not as positive as it looks in the short term, because of course, this implies substitution.

Our net earnings decreased by 8.8% compared to the First Quarter 2007. And in 12 months, last 12 months perspective, we have an interruption in our upward trend. It was $12.5 billion in 2007, it decreased to $11.7 billion. And this was the effect of the distortions caused by non-cash charge. There was increase compared to the First Quarter of 2007. We have an increase of $137 million in terms of non-cash charged, due to the so-called monetary variation on the position of net liabilities in U.S. dollars. We have the effect of derivatives and marked-to-market of some instruments.

In terms of derivatives, we have positions in aluminum and copper. We are going to be -- to expire by the end of the year, December 2008. We hedged about -- we still have a hedge about 55% of our aluminum production in terms of copper, only 25% of our production. These hedges were made as ways to protect our cash flow for the acquisition of Inco in 2006. So the acquisition of Inco in 2006.

In terms of nickel, we have a very small part of our production, only 5%. Therefore [ph] is in nickel, the rationale for hedging is due to two factors. First, we have some sales that are made at fixed price and we use derivatives to keep our exposure to the price volatility of nickel. Secondly, we used to buy feed, nickel feed, from third parties at fixed price and so in order to match our positions, used to hedge against price volatility. So these are transitory, non-cash events that, of course, contribute to distort our financial performance in the First Quarter of 2007.

In terms of debt, it's important to highlight that our costs, our average cost of debt, is in a downward trend. We managed to reduce the average cost of debt by 270 basis points over -- in a period of three years. And most recently, you saw due to the actions of LIBOR interest rates, we transformed two swaps, we transformed an additional part of our debt into floating interest rate debt. But now we have 64% of our total debt indexed to the LIBOR and taking advantage of the decrease in LIBOR to reduce the average cost of debt. It's part of our constant of reducing costs and achieving our -- the lowest cost of capital possible in the environment.

For looking to the future, we believe that the cycle, the long cycle, of minerals and metals are gaining momentum. We have seen widespread price rise for several products in different segments for base metals, for steel making raw materials, precious metals and minor metals, such as cobalt. But the longer-term fundamentals remain strong. Demand for minerals and metals continues to increase. Supply growth is facing multiple headwinds, water, power shortage, in addition to the usual problems whether a shortage of skilled labor, equipment, contracted services, environmental permits. This is a problem across the world.

And we believe that the future, the key factors are driving the demand for minerals and metals will be investment in infrastructure by emerging market economies. Not only China. But India and several other even smaller countries, like Vietnam and I would say that even in mature economies, like in the U.S. and Australia, these -- the lack of investment in infrastructure is increasingly recognized as a barrier to economic growth and there are discussions nowadays about the status of the transportation infrastructure in the U.S. that's contributing to a decrease in productivity in an economy that traditionally has moved by high productivity gains. So it's very good for the future of the demand for minerals and metals.

The steel prices are rising across the world for every type of product in every region of the world, reaching all time highs. We present a slide of the crude steel price index, that's reached an all-time high. And the excess demand for steel is generating a very strong pressure on the demand for the steel making raw materials. Iron ore prices were settled recently, as you know. Metallurgical coal contracts for 2008, 2009 year were settled at a price that runs from 205% to 210%. Manganese ferroalloys price reached an all-time high. To give you an example, our average realized price for the First Quarter of 2008 reached $2,100 per ton against $1,000 the First Quarter of last year.

We settled the price for pellets for both for blast furnace pellets with an 86.67% increase over 2007. And for, also for, direct reduction pellets, maintaining the 10% premium over blast furnace pellets and we saw a recovery of the premium of blast furnace pellets ore refines [ph] that is an additional indication of the market tightness for these products.

In terms of pellets, we see a rising trend of consumption around the world. In these four months of the year, we have two new operations, two new from joint ventures, Zhuhai in China that started operations in January. Initially, it's a very small operation with only 1.2 million tons per year. We have a capacity -- we have a stake of 25%. Samarco, as we have mentioned. We have one new pellet plant to be delivered this year, Itabiritos in Brazil, in the southeastern system with a capacity to produce 7 billion tons. In the future, we have Tubarao 8 at the Port of Tubarao. Pending Board approval, we have an investment in Oman, in the Middle East, to take advantage of the growing -- of the growth of Gulf countries that are investing dozens of billions -- hundred billion dollars and we are analyzing investments in -- further investments in the Chinese market to exploit the domestic Chinese market for pellets and also in Malaysia, to establish a distribution center for Southeast Asia.

We foresee routes to [ph] production increasing by 4.7% over the next five years. That should be a slower pace than the first seven years of this decade. But still above trend and much above global GDP growth.

We see the demand for iron ore is still growing fast over the next five years, by almost 11%. Percentage wise, it is -- it reflects a slower pace of growth. But volume wise, we have a very significant amount of iron ore being required from the iron ore industry.

In terms of nickel, despite the existence of, currently, of very high inventories, we believe that the prospects are improving. We have seen the end of what we believe that the end of the stainless steel distorting cycle. The demand for other applications coming from the aerospace, the energy and chemical industry, running steady. And the production of austenitic stainless steel is recovering from the low in the Third Quarter, when the austenitic ratio plunged to 70% from 77% as an average in 2006, now it's approaching 75%.

That's good for the demand for nickel. It means that the substitution pressures have eased. In terms of aluminum, aluminum is a typical case where power shortages are very important with energy price boosting aluminum price. And for the future, we believe there is a very good upside because on the one hand, we are seeing projects for new smelters with a very high CapEx, reached $7,000 to $9,000 range, against $2,000 to $4,000 in the past. And on the other hand, very high operating costs due to the rising costs of energy. So this conflict has to be solved by a decrease in energy price that we think that's unlikely. Or -- and/or an increase in aluminum price to make feasible the development of these projects.

Last. But not least, copper markets represents also very good prospects. Copper price reached an all-time high. This is due to the combination of production disruptions, low inventories and well-known supply constraints that come from lower grades, from the lack of a large pipeline of projects and the potential source of supply growth is -- faces still very significant political risks.

So we do believe that Vale is well positioned with its large world-class, worldwide pipeline. It is very well positioned to take advantage of the long cycle that we still believe will last for several years in the future.

Thank you very much. I will be very happy to take your questions.

Questions And Answers

Operator

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

Q - Roger Downey {BIO 7419641 <GO>}

Good morning, everyone. Good morning, Roberto. Another good set of results from an operational standpoint. But I think cost still has been an area of concern for a lot of people. I think it would be interesting to hear from you some guidance on what we can expect going forward. So what initiatives are in place to further increase -- or further reduce costs rather, despite the fact that surely enough we're going to have another price increase next year, which would offset costs. But just to get some idea on the initiatives there.

And the second thing is on Carajas, with the delays in the licensing there, what can we expect in terms of 2009? Or is it more realistic to start thinking about 2010?

A - Roberto Castello Branco {BIO 3193867 <GO>}

Good morning, Roger, thank you for your questions.

In terms of costs, we launched an initiative to identify inefficiencies to correct them, of course. And do more with less. This is the general guideline. And it is not something that as is usual, let's reduce costs by X-million of billion of dollars. Because there is -- there are no such deficiencies in an environment of rising price for everything, it's just not feasible. The idea is to become leaner, more efficient and we have -- this is a daily activity in our company.

It's like -- so there is nothing that I can tell you that we are going to reach $200 million of cost reductions or $2 billion of cost reductions. There are surprises coming from every side in terms of cost increase. What I can guarantee you is that we are doing our best in terms of reducing inefficiencies.

And again I would like to emphasize please in a tight environment, where there are several disequilibria in several segments of the market, where demand is pressuring supply, the best guideline for decision is to figure out if the marginal revenue is higher than the marginalcost. One should not refrain from increasing production just because your cash costs will increase. But just -- you have to verify if the marginal costs -- if the marginal cost is lower or not than the marginal revenues. Of course, this does not make us to relax about these costs. We have a constant concern about costs. We are investing to reduce them. We are doing our best to reduce them.

In terms of Carajas, we -- growth in our present is that we are concerned about the obtaining of environmental license for the Carajas expansion to 130 million tons per year. It is not -- we are not sure that the project will have a delay. But there is a chance for a delay. We are not sure that we will be able to deliver this project in the second half of 2010. So -- 2009. So there is a risk. But nothing that we can make sure that our production will suffer in 2000 -- in the next year or not. For the time being, we keep our expectations that Carajas will -- Carajas's 130 million tons per year will come on stream in the second half of 2009. And we will keep you informed about this.

Q - Roger Downey {BIO 7419641 <GO>}

Thank you, Roberto. But just a follow-up on the cost side of things. Of course, the First Quarter is traditionally seasonally low in terms of shipments. So in other words, your denominator in terms of tons is lower. Going forward with some of -- some more capacity being added, as you streamline your processes and start operating at full capacity in some of your expansions, should we see a downward pressure on costs, just from the economies of scale?

A - Roberto Castello Branco {BIO 3193867 <GO>}

We'll see this in the longer period of time. For instance, in iron ore, the expansion of our capacity in Carajas over the next five years, for sure, will contribute to reduce operational costs. First, because these are new mines with much lower stripping ratios. And secondly, because Carajas, given the very high iron content, has much lower costs than the southern and southeastern systems.

So we have an impact on the average operational costs for iron ore. In the case of nickel, the same. We'll have new projects come on stream that will contribute to decreased costs. But you should not expect that next quarter will have lower costs due to an increase in sales or so. We will have to see in a more longer-term perspective.

Q - Roger Downey {BIO 7419641 <GO>}

Okay, Roberto. The second question on the non-ferrous derivatives. I think you caught a lot of people by surprise and I think your explanations were very clear. Just going forward, is this something that we should expect will continue despite the fact that you said some of these contracts will expire at the end of the year? Will they be renewed and is this --?

A - Roberto Castello Branco {BIO 3193867 <GO>}

Oh it's --

Q - Roger Downey {BIO 7419641 <GO>}

Yes.

A - Roberto Castello Branco {BIO 3193867 <GO>}

I'm sorry. Roger, it's not -- we have a policy of non-hedging. We hedge against metals price volatility only in special situations like that when we financed the acquisition of Inco. We decided to hedge part of our positions, of our production, of aluminum copper to protect our cash flow, to be sure that we have part of the cash flow will be delivered to pay for the steps of the debt. In the case of nickel, for very specific situations, in a very small scale.

So we do not foresee a renewal of the position in aluminum copper. In nickel, there, as it's a policy to be exposed to the currency volatility and to hedge the positions bought in nickel feed, this is a continuous process. We do not foresee booking a nan [ph] in this use of derivatives for nickel. But again, these are very small positions compared to our total production, it's about 5% of the production.

Operator

(Operator Instructions) Our next question comes from Mr. Felipe Hirai with Merrill Lynch.

Q - Felipe Hirai {BIO 15071781 <GO>}

Hi. Good morning, everyone. Good morning, Roberto. My question is regarding your nickel projects. We saw a major increase in CapEx in Onca Puma so Roberto, could you walk us through the main reasons for such an increase in the Onca Puma project and how these would impact the development of Vermelho?

A - Roberto Castello Branco {BIO 3193867 <GO>}

Well thank you for your questions, Felipe. First, we have an approximate $900 million increase in the CapEx costs for Onca Puma. One-third of it was due to the effect of the Brazilian real appreciation against the U.S. dollar. And $600 million, two-thirds of the cost increase, was due to the usual impact of rising costs for equipment, for contractor services, particularly the assembly of the electromechanical assembly. So it's something that is in line with environment that the mining industry faced. Currency volatility and input price increase.

And it doesn't impact the Vermelho. The Vermelho is still being studied. The project is being built in order to be approved by the Board of Directors and constructed. I would like to highlight that, now our experience with Goro will facilitate a lot the development of the Vermelho in a much easier way, not only the Vermelho. But our projects for the next decade in Indonesia, Pomala, Sorowako II. We have a family of new milled nickel laterite limonite projects to be developed in the future. Including a second phase of Goro that will be developed at a much lower cost than this initial phase, given the infrastructure is already in place and given the experience that we are gaining with the development of the project.

Q - Felipe Hirai {BIO 15071781 <GO>}

Okay. Thank you. And Roberto, just a follow-up question on the increasing CapEx. Could we assume that your $60 billion CapEx program for the next five years, they -- it could actually be higher than that? Or do you think that it's still too early to assume that it could be, instead of $60 billion, it could be $70 billion or even $80 billion?

A - Roberto Castello Branco {BIO 3193867 <GO>}

At this point of time, we are not foreseeing making any change in our CapEx program for the next five years.

Q - Felipe Hirai {BIO 15071781 <GO>}

Okay. Thank you, Roberto.

Operator

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

Q - Jorge Beristain {BIO 17554499 <GO>}

Good morning, Roberto. Two questions. One is what can we -- and more of a strategic question. What can we interpret out of the collapse of the aluminum division now held with inside non-ferrous and the increasing emphasis on your coal business as a standalone operation? That's my first question.

A - Roberto Castello Branco {BIO 3193867 <GO>}

Good morning, Jorge. It's a very interesting question. The aluminum business before the acquisition of the nickel operations were, in terms of the company context at that time, it was relatively large. With the nickel operations, it becomes -- it became relatively small. It's -- it represents only 15% of the revenues of the non-ferrous minerals business. And as aluminum is a non -- is part of the non-ferrous metals, of the base metal business. We decided to include the aluminum operations for -- in the -- into the non-ferrous metals division. So just for the sake of facilitating, of not for any strategic reason, that it doesn't mean that we are downgrading the aluminum business in our general strategy.

Secondly, why coal was separate? Our coal operation is still very small. We are just beginning. We are ramping up our Australian projects. You see it particularly in the case of Carborough Downs. Carborough Downs is an underground mine in Central Queensland. It's still very small. It -- as an underground mine, it produces only 800,000 tons of coal, mostly coking coal and PCI coal. Only with a project that we are starting to implement of long-wall systems, Carborough Downs will be a bigger mine and with much lower costs because underground mines, small underground mines are not economically feasible due to the very high fixed costs, to the ventilation and the safety investment. So we do ramp up to 4.4 million metric tons per year.

So that keeps coal aside, it's different from ferrous minerals, non-ferrous minerals and non-ferrous -- not base metals. And so it will be a division on its own. It's a -- it's still, I would say that still in its infancy, it's again nothing in terms of strategy.

Q - Jorge Beristain {BIO 17554499 <GO>}

Okay. My second question is just related to some of the recent management departures that you've had, particularly Lancaster, I think he was one of the key architects behind the big push you've done in the last several years to spend hundreds of millions of dollars almost per quarter on R&D and exploration. And I was wondering is there anything concrete that we can point to in that plan that's been found in the past few years in terms of a new generation of projects? And what were the reasons behind the recent departures of both Stoliar and Lancaster?

A - Roberto Castello Branco {BIO 3193867 <GO>}

Well yes, well, we regret the departures of both. All good things come to an end and they decided to retire. They have the right to do that. Jose Lancaster built a very good business, a global mineral exploration and multi-commodity mineral exploration program. He did a very good job. He's a very knowledgeable, very competent professional. We -- all of us at Vale admire him. His professional capacity. But one of the good things he had done was to build a very good team of very competent professionals that will have the challenge. But will -- we think that they have the competence, the competences and the motivation to continue the work that Jose Lancaster started.

So things are going on and we have great expectations about the results that we will start to collect in the future.

Operator

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

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

Good morning, everybody. Good morning, Roberto. Two questions. The first one is related to the -- following on on Jorge's question, on was the spike in aluminum production costs only related to the higher spot prices for energy that we saw earlier in the year because of the lower water levels in the reservoirs? That is question number one.

And question number two, Roberto, if I may, on -- as far as the explanation of the higher SG&A costs, it was quoted that out of 52% -- sorry, $43 million increase in selling expenses, $30 million came from the coal division. However, when I look at the revenues that we're reporting in -- for that segment, there were only $72 million. So it seems to be quite a significant level of selling expenses for the revenues that are being generated right now. Thank you.

A - Roberto Castello Branco {BIO 3193867 <GO>}

Well. Good morning, Carlos. Regarding the first question, regarding the cost of aluminum. Hello?

Hello? Hello?

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

Yes.

A - Roberto Castello Branco {BIO 3193867 <GO>}

Yes. I'm sorry. Regarding the first question, with the cost of aluminum, in Brazil we have a very -- we had a very serious spread of a power shortage. So energy price in the spot market had a very significant spike.

The aluminum -- energy price in the spot market, which were very low in December 2007, they were around $10 per megawatt hour. They rose to -- skyrocketed to more than $200 per megawatt hour. And now when this spread disappeared with the start of the rainy season, now one should see energy price in Brazil, in the spot market, the price of -- again, last sold at $10 to $15 per megawatt hour. But if you enter into a contract for one year, you are going to pay a price that's as -- at least as high as $100. And if you enter into a contract for 20 years, you are going to pay at least $70 per ton per megawatt hour.

So in the -- at Vale Sul [ph], that has -- buys part of its energy needs in the spot market, we decided to reduce production instead of keeping it. It was the case for marginal revenues against marginal costs. In this case, marginal costs were higher than marginal revenues. So we decided to reduce production at Vale Sul. At Albrise [ph], there are no problems because Albrise has 100% of its energy needs under a 20-year contract, at a lower price than the current cost -- than the current market price. So we continue to produce.

Of course we have regular maintenance activities, repairing some cells, that's part of the normal activity. We had no problems with that.

So -- and we are still having done increase in the alumina refining because the production of Paragominas is not sufficient yet to meet all the demand for the stage 4 and 5 of Alunorte. So we have to buy bauxite from third parties. It doesn't have the same quality of the Paragominas and Tombitas [ph] bauxite. So it tends to generate a higher cost of refining bauxite in our aluminum refinery. So this is a problem that will be corrected over the next quarters when Paragominas will be sufficient to meet the demand for Alunorte.

Your second question is --

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

Sorry. On the --

A - Roberto Castello Branco {BIO 3193867 <GO>}

SG&A, SG&A. As I was mentioning, we cannot say that our coal operation, given its small size, is a profitable operation that is a star performer. It's -- one should see the -- our coal operation, as I said, in its infancy. So it's an investment in the short term. We are having costs in exchange for having very good returns over the medium and long term. It's a small operation, it's growing. And gradually it will become a profitable operation. We have plans to become a very large player in the coal market. We have projects to be developed in Mozambique and Australia. We look to develop Belvedere. We have prospects at Alan Steel [ph] then Peak Downs in Central Queensland, near Carborough Downs.

We have mineral exploration around the world, in Mongolia, in Angola, in Kazakhstan and other places in the world. In Columbia, as well. And we look forward to become a very large player in the coal market over the long term.

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

Thank you.

Operator

Our next question comes from Mr. Oscar Cabrera with Goldman Sachs.

Q - Oscar Cabrera {BIO 7553392 <GO>}

Hi. Good morning, Roberto. Congratulations on achieving the 300 million ton mark. Looking forward for the next one, which is 450. So the first question, I was very interested in your comments about the austenitic stainless steel production and the ratio. But the question there, Roberto, is do you -- are you seeing -- do you surmise that the increase is because we're seeing an -- starting to restock on stainless steel? Or is it because the high coal prices globally are forcing some of the production in nickel from pig iron production out of the market? Because it becomes uneconomic.

A - Roberto Castello Branco {BIO 3193867 <GO>}

Good morning, Oscar. We are trying hard to accelerate the achievement of this new mark in iron ore production. It's a great challenge. But we promise that we will do it.

Q - Oscar Cabrera {BIO 7553392 <GO>}

I know you will, Roberto.

A - Roberto Castello Branco {BIO 3193867 <GO>}

Thank you for your confidence. And about austenitic ratio. It's much more linked to the volatility and flexibility of the stainless steel industry. In a short-term prospect is relatively easy for the stainless steel industry to move to non-nickel stainless steel, the series 400, the so-called ferritic steel. Or to the series 200, that's low-nickel content stainless steel, then reducing the austenitic ratio.

But this is not a permanent situation because the end-user of the stainless steel products will suffer. So the stainless steel industry is able to do this is a short-term perspective, trying to reduce the -- its costs as a reaction to what you have seen, the very high nickel price that prevailed in the first and the Second Quarter of 2007, reaching an all-time high level in May 16th of 2007, when it reached $54,000 per ton.

But it's natural that now, given the lower nickel price. And given the fact that it's not technically feasible to do -- to promote a permanent substitution, austenitic ratio is gradually moving to its normal level of 75% 77%, 78%.

This is, I think this is, at least to me, it's clear that we should see this movement.

Q - Oscar Cabrera {BIO 7553392 <GO>}

And a bullish sign for the nickel market.

Then the second question, Roberto, it just has got to do more with your strategic positioning right now. It seems that you're very interested in the coal and in the copper market. And the question is, do you, A, plan to develop organically? Or do you, B, go and try and acquire something to take advantage of the extremely tight markets in both commodities?

A - Roberto Castello Branco {BIO 3193867 <GO>}

Well we have a project pipeline, in both products, in copper. We are developing Salobo I, we have -- next we have Salobo II and have raised the possibility of having even an extension of Salobo III, to end up with an operation at Salobo of more than 200,000 tons per year of copper. We have Papomono in Chile. We have Tote [ph] in Canada to increase our copper production a little bit. We have other projects in Brazil, Cristalino. And we are investing in mineral exploration in countries like Peru, Chile, Kazakhstan, Mongolia and to identify in our new copper deposits and to develop them.

In coal, as I mentioned, we have Mozambique, Australia, we have prospects in Columbia, Mongolia and Angola. So we -- our priority is organic growth. But simultaneously, to our efforts in organic growth, keeping an eye to opportunities for acquisitions. For acquisitions that will contribute to create value for our shareholders.

Operator

Our next question comes from Mr. Sanil Datinardar with Sentinel Asset Management.

Q - Sanil Daptardar

Thank you. Roberto, you talked about some 4.7% increase over the next five years. I did not catch what it was you were talking about. Is it the global GDP growth you're talking about that would be trending above trend line levels? Or --?

A - Roberto Castello Branco {BIO 3193867 <GO>}

Well we are talking about crude steel production. We expect it to grow at 4.7% on a global basis and to be a little higher than the global GDP growth. That despite the current environment, despite the recession in the U.S. and gross deceleration in the major developed economies, we believe that for the -- this five-year period, it will continue to grow above trend. Something a little bit below 4% against a long-term trend of 3.5%, being driven by emerging market economies, which is very important for the demand for minerals and metals. Because these are the countries that are in the forefront of structural change. These are the countries who have to invest heavily in infrastructure, in housing and these are the countries that are having some changes like financial deepening and increase in credits to companies and to individuals, especially consumer finance and housing finance.

In our country, in Brazil, we have seen over the last couple of years this very important impact of financial deepening. Spreads in Brazil was very low relatively to GDP. There was an increase more recently due to the expansion of consumer credit and housing credit. So it had a very important impact on the demand for consumer durables, namely cars. And a positive impact on residential construction. And the net result of this is a growing demand for metals, especially steel and aluminum, copper and nickel.

Operator

Our next question comes from Mr. Dan Kwiatkowski with Schroder.

Q - Dan Kwiatkowski {BIO 16655726 <GO>}

Hi. I was just wondering if you could give me a bit of color on the derivative losses? The forwards, are they open forwards? Or is there any cap or collar? When do they roll off, i.e., when are you going to have the big -- when are you actually going to take the cash impact of the derivatives? Thank you very much.

A - Roberto Castello Branco {BIO 3193867 <GO>}

Well thank you, Dan, for your question. It is a very interesting one. We have some open and we have some collars in derivatives. They will be expiring over time. For instance, in this quarter, we mentioned the press release. We had a loss of $75 million that had a cash impact because it was due to the liquidation of contracts. Contracts that we expired and were liquidated at a loss. So we have not only an accounting loss. But we have also a negative cash impact. And they will expire over the years. So by December of 2008, they will be cleared.

Operator

Our next question comes from Mr. Giorgi do Mingris [ph] with HSBC.

Q - Giorgi Do Mingris

Good morning, Roberto. Good morning, everybody. My question is related to the negotiations your competitors are still having with the Chinese customers. I know you can't give any color on what's Vale's opinion on what the possible ramifications might be for 2009, (inaudible) renegotiations. I know it's still early. But given the fact that the situation is pretty difficult right now, I would like to know what Vale thinks. Thank you.

A - Roberto Castello Branco {BIO 3193867 <GO>}

Well Giorgi, our job's done. We negotiated the iron ore fines [ph] price, that's one. We highlighted the price differential for the best iron ore in the world, that's Carajas, with a premium, which became explicit premium. The pellet price negotiation was also very successful, as I mentioned, 83.7% [ph]. And I believe that it's too premature to think about the next negotiation. So the name of the game now is to maximize production and to try to keep costs under control to we can make our production costs of iron ore and pellets more efficient and to resource our products.

So as to the negotiation of our competitors, we -- well, let's see the results. It remains to be seen.

Q - Giorgi Do Mingris

Okay. Thank you.

A - Roberto Castello Branco {BIO 3193867 <GO>}

You're welcome.

Operator

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

A - Roberto Castello Branco {BIO 3193867 <GO>}

Oh, well, I would like to thank you for your attendance of this conference call. It was a very interesting moment for exchanging some ideas, discussing our point of views, trying to respond to your questions. We look forward to seeing you at the next opportunity here with our Chief Financial Officer, Fabio Barbosa, for the next quarter and we wish to have good news for you in the Second Quarter.

Thank you. Have a great weekend, all of you.

Operator

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