

# Q3 2004 Earnings Call

## Company Participants

- Fabio Barbosa, CFO
- Thomas Carston, IR

## Other Participants

- Alberto Arias, Analyst
- Andrea Weinberg, Analyst
- Art Winston, Analyst
- Daniel Altman, Analyst
- Ivan Fadel, Analyst
- Raphael Biderman, Analyst

## Presentation

### Operator

(Operator Instructions) At this time, I would like to turn the conference over to Thomas Carston, of Thomson Financial Investor Relations. Please go ahead, sir.

### Thomas Carston

Good afternoon, ladies and gentlemen. Welcome to the CVRD conference call to discuss the Third Quarter 2004 results. I'd like to mention that a slide presentation has also been made available during this call on the company's website, at [www.cvr.com.br](http://www.cvr.com.br).

Before proceeding, let me also mention that forward-looking statements are being made under the safe harbor of the Private Securities Litigation Reform Act of 1995. Actual performance could differ materially from that anticipated in any forward-looking comments, as a result of macro economic conditions, market risks. And other factors.

With us this afternoon in Rio is Mr. Fabio Barbosa, CVRD's Chief Financial Officer. Mr. Barbosa will comment on the Third Quarter 2004 results. And afterwards, management will be available for a question and answer session. It is now my pleasure to turn the call over to him. Mr. Barbosa, you may now begin.

### Fabio Barbosa {BIO 1907620 <GO>}

Good afternoon, ladies and gentlemen. It's a pleasure to be with you today. We will comment on the Third Quarter results and we also have some other information to provide to you. Today's presentation is divided in three sections, first, some highlights of our performance, then we will comment in more detail our results. And then some perspectives for our business in the near future.

In terms of our performance in the Third Quarter, we believe that it was actually an outstanding one. We broke new records. We posted a very strong cash-flow generation. And I believe that this only consolidates the perception that the company is on the right track.

At the same time, the fundamentals of the market have been extremely good. And as we have put it in our presentation, we believe that the current cycle is one of the strongest since the late 19th Century was growing very fast. And then after this boom, the late 19th Century, we have, just after the Second World War, the reconstruction effort in Europe, based in Europe and Japan.

So China is, I would say, this economy the road that is; there are two major players and the best have performed. And so it is a very good momentum for our business as a whole.

At the same time, the company, we believe we have a good strategy execution. So we are able to capture most of the value that there is in this current position. Our disciplined capital management that has been our mark the last few years and we'll continue to be very disciplined in terms of investment decisions, as you have been following.

And finally, a very powerful cash-flow generation, combined with sound and prudent financial policies, that allows us to have a very healthy balance sheet.

Coming to our performance itself in the next section, you see that in the Third Quarter, sales continued to show a very strong growth pattern. Iron Ore and Pellets, we reached \$60.4 million in the Third Quarter. And in the first nine months of the year, we almost reach 170 million tons. So a remarkable performance.

In almost all our lines of business there, Manganese and Ferro Alloys, had a very good performance as well, in joining the very positive momentum of the market. It's a very price for Ferro Alloys for instance. Bauxite, Alumina and Aluminum, it was a performance that was also in line with our expectations, or slightly above.

Copper concentrates for the First Quarter, we had a full effect of the production of copper, although as we have seen in the run-up process, below the maximum capacity of the long-term.

Potash, we have a good performance considering that we are in the effort of expanding our capacity to 850,000 tons by mid 2005 and this process, investment process, brings some disruptions in the production in that line.

Clearly, almost 900,000 tons for the first nine months of the year, we are consolidating our position as one of the three largest players in the paving business in the world. Then Logistics, Railroads and Ports was a very strong performance, as I will detail.

In terms of our gross revenues, we reached in the first nine months \$6b. If I'm not mistaken, this is the total revenues for the full 2003. And we still have, as you know, three months to go.

In terms of products, we have, in the Ferrous division, iron ore pellets, manganese and Ferro Alloys, about 68% of the total revenues. Aluminum changed about 15%. Logistics was about 11%, Copper and Potash and others about 6%. So this is an increasingly diversified revenue for fire [ph].

In terms of geography, we had in Asia about one fourth of our total revenues. Of course, China is a new country, individual country is the largest market for CVRD. Europe as a region has the largest market share in terms of output or revenues. It's almost 32%. Brazil, including the sale of pellets, pelletizing [ph] plants, 28%.

In terms of our main business, it's iron ore and pellets, again, we consolidated our growth at 60.4 tons in the First Quarter of 2004. It's by far the record of our history and almost 169 million tons in the first nine months of 2004.

The comparison with 2003 in the first nine months should reflect also the consolidation with kaolin that we started to do in the Third Quarter of 03. But starting in December. So there is some portion thereof the consolidation but it's clear that our very strong performance is even with the deduction of these effects.

In terms of our Logistics business, our general cargo, the performance was very good as well, with almost 8 billion net tons of kilometers in the Third Quarter of 04. And the accumulated figure for 04 is almost 22 billion net tons per kilometer, a growth of about 10% compared to last year. And this particular case in general cargo, as we have been commenting to in the last few years, the constraint here is not on the demand side.

This business has been growing about 10% per year in the last four years. And is well above the GDP growth rate. The constraint here is the availability of equipment. So we are buying this year, we've about 3,300 rail cars and about 88 locomotives in 2004, to add capacity to transport iron ore. And other cargoes for third parties.

And next year, our intention is to order to buy about 6,000 rail cars and 120 locomotives, both new and used, because we don't have locomotives available. We are actually trying to find locomotives to complete our fleet given the very strong demand, not only in iron ore. But also in our general cargo services.

In terms of the EBIT, a new record was reached, \$886m. And the margin was slightly lower than the Second Quarter. But that's a remarkable performance in every way. It's a record that we achieved by then. But then we had some appreciation of the real. And some costs that are due to our structure. So we have about 41% of EBIT margin.

But overall, our operational performance has been extremely good. If we compare what happened in the first nine months of 04 in the Ferrous Minerals division, the EBIT margin was 500 basis points over what happened in 2003, in the whole of 2003, in spite of the appreciation of the currencies, as I mentioned to you before.

Logistics has improved. It is about 200 basis points in terms of EBIT performance. And the Aluminum here, it of course reflects in the consolidation of Docenave [ph] that is also enjoying a very good market momentum, as you all know.

In terms of earnings performance, in spite of there being among the companies that we bought quarterly this second, that is in this chart there, that is in our presentation, by September 30, 2004, our market gap was around \$25b, \$4 billion behind Alcoa. And we were the second one. And then, in terms of net earnings, we were by far the top performer with \$943m.

Even if you take out the extraordinary gains of CSD sales, you will see that our performance was more than the double of the second performer that was Phelps Stores, according to our indications there. So very good earnings performance, indicating our capacity to capture the value to our shareholders of the very sound and positive scenario that we are observing right now in terms of the fundamentals of our market.

In terms of EBITDA, for three quarters in a row we showed growth. And now we've reached the mark of about \$3.3b, \$3.289 billion in the last 12 months. And it's a remarkable performance if we consider that just two years ago; this is in the Third Quarter of 02, it was about half of the current figure posted in our statements. So about \$3.3b. That's a very strong performance by any sort of parameter.

At the same time, we are growing size. We are becoming more diversified. And pursuing very good opportunities to grow in other business areas like the Non-Ferrous and Logistics. And

Alumina of course. By the First Quarter of 02, our EBITDA was \$397 million and now we posted \$1.007b. It's two and a half times the EBITDA figure of just two and a half years ago.

But in this period, Ferrous Minerals became less important. It's of course very important with 72% of the total EBITDA generated. And a very good margin, as I've just commented with you.

But Aluminum changed, as we are not only able to consolidate our norchi [ph] end of plasma [ph] figures but also the very good performance of the companies of Drydand [ph] in the north and the growth of Alunorte with expansion of the third [ph] stage reaching 2.4 billion tons of nominal capacity. Enobrasa [ph] had a marginal increase of its nominal capacity. So very good performance on the Aluminum chain.

Logistics, with a growth; it's important to draw your attention that Logistics, general cargo here only that we are commenting on, in spite of the growth of EBITDA, Logistics not only managed to keep its share but increased it a little bit to 10%. So showing the very good performance that was possible to achieve in this segment of business.

Of course, we still have a lot to do in this area in terms of improving its margins. But I would say that it's becoming more and more evident, important in this line of business in our portfolio.

In terms of investments, our CapEx reached almost \$1.3b. And here I'd like to emphasize what was written in our report, is that we are using preliminary data because we are in the process of implementing the Enterprise Resource Planning. So this data may be adjusted. But anyway, today it indicates that we are very much in line with our annual figure of \$1.8 billion until December.

And we delivered this year four major projects, the third pier in Ponta de Madeira Port, Carajas, the 70 million tons. Actually, it's running now at a 73 million tons trend in this last three months; Candonga Power Plant. And Sossego Mine. And the other, the copper mine that started operations in June.

The other projects are very much on track, on the expansions in Iron Ore, Fabrica Nova, Carajas, Brucutu, Fazendao and Itabira. And the Aluminum chain, Alunorte Stage 4 and 5 and Paragominas I are doing well. Potash, we are almost concluding this and the expansion is expected to be operating by the second half of 2005.

And Aimores and Capim Branco I and II are more or less early next year, maybe, operating already. And Capim Branco I and II in 2006, here the same business CapEx of \$472m.

This very aggressive CapEx program is combined with very good return on investor's capital, as you can see in the next chart, with the first nine months of 04, the return reached 35.2%.

It's a very good rate by any standards. And allows us to pay this very good cash-flow generation from [buying with this performance] allows us to pay what we think are very good dividends to our shareholders. In 2004, we paid the equivalent of \$0.68 per share. And the dividend growth is remarkable; 2003 compared to 2002, 12.1% and 2004 against 2003, 15.7%.

Again, we believe that we have a unique dividend policy in Latin America. And very few companies are able to announce, in the beginning of the year, what would be the minimum payment to our shareholders. We have been doing that for two years in a row now. Last year, we announced \$400 million and then we ended up paying \$675m. This year we announced 550, \$550m.

And we ended up paying about \$800m. So this is possible due to the nature, the very sound cash-flow generation that allows us to combine the aggressive CapEx program with nice dividend

payments. And a very sound balance sheet, as you can see by the indicators that we show in the next chart.

A further improvement in our financials was achieved in the Third Quarter with the last 12 months EBITDA being able to grow by about 13 times the short-term interest payment. So it's almost double what it was about two years ago, or three years ago when it reached 7.6 times. And on top of that, EBITDA reached an all-time low, 1.3 times, given our very strong performance in terms of EBITDA in the last few months.

Turning now to the outlook for our business. And how we see our performance in the near future, we believe that again, we are living a benign scenario, a very benign environment with this world GDP growth reaching 5% per year now, converging to some 4.5% this year.

The global purchase manager index, PMI is showing a very, very strong position as well, well above 50. GDP growth, as I mentioned before, this year, 4.5%, 2005, 4%. And then 2006, around a long-term trend of 3.6%, meaning that the strong demand should continue in the next couple of years or so.

In the case of China, all indicators are showing us what could be a soft landing by the Chinese standards [ph]. They keep growing on a very strong rate, compared to Western standards but it's in a more moderate fashion compared with what it was a few months ago. So fixed asset investments growth rate was sharply reduced as well as growth in bank credit, given the market controls that were established a few months ago.

But in our view, China should post a very high growth rate, 9% this year. And our forecast for the next couple of years is 7.5% and 7% respectively. So more moderate growth but still a very strong performance of the world driver in this [meaning of the macro market].

In terms of steel consumption, the world steel consumption, again, driven by China, should show a very strong performance next year, 5.1%. And China should grow at 10%, more than 10%, in terms of these indicators, showing that additional demand for iron ore will be there. And this is reflected in the growth of the seaborne freight that is expected to reach 630 million tons next year.

We revised our estimate for this year, seaborne, to 595. And China imported 151 million tons of iron ore in the first nine months of 2004. And it's most likely is to achieve total imports of 195 million tons this year. That's almost 50 million tons more than what was imported in 2003.

And just for the sake of comparison, 14 years ago, 1990, China imported 14 million tons only. So it's actually a remarkable performance. And next year, China imports should reach 225 million tons if they grow their imports only by 30 million tons.

In terms of the Aluminum businesses, the Aluminum chain, inventories kept declining in the last few months. And prices are reflecting the very strong demand, growing at almost 10% per year. And prices reaching \$1,800 per ton. We believe that the global deficit should remain for 2005. It is estimated at 700,000 this year. And 400,000 for 2005.

Then for Alumina, after some correction, price correction after the percentage of LME price reaching almost 30%; that is a sharp correction; it went down to about 18%. And now it's back to 22%, 23%. And in spite of this correction, we believe that the market will continue to be tight.

In Copper, you will see in the chart that we present to you that total inventories are in a very low level. And in spite of the increasing supply of some other players. But the fact is that in this market, it should continue to be tight for the near future. So, as we put there, the low inventory level gives support to next year, prices to remain as attractive as they have been in the last few months.

That's what I had to say to you in this first part. And I'll be of course available for any questions you may have. Thank you, very much.

## Questions And Answers

### Operator

(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. Congratulations on the good results. The first question is with the market conditions of Iron Ore and your cash-flows, I would assume that you're trying to optimize production as much as possible. Could you give us some guidance in terms of the volumes of production of CVRD that you're expecting for 2004 and 2005, just to get a sense of what the result of that optimization process?

#### **A - Fabio Barbosa** {BIO 1907620 <GO>}

Okay, thank you for your question. We, in terms of our production, the next year; this year, in the US GAAP consolidation criteria, we should reach total sales of \$205m, or \$220m, sorry. And production of about 205 million tons of Iron Ore and Pellets. For next year, it's reasonable to expect growth of about 10% of this total, about 20 million tons of additional volume of Iron Ore and Pellets.

#### **Q - Alberto Arias** {BIO 18302585 <GO>}

Would that include the purchase from third parties?

#### **A - Fabio Barbosa** {BIO 1907620 <GO>}

No, that would be only our production.

#### **Q - Alberto Arias** {BIO 18302585 <GO>}

Okay, great. And a follow-up question, with regards to the trip that we had on July to Carajas, there was some talk about potentially expanding Carajas to 100 million metric tons. And I think it's not been approved by the board. But if you could tell us, when is the board going to be considering that original expansion to 100 million metric tons in Carajas?

#### **A - Fabio Barbosa** {BIO 1907620 <GO>}

That should be in the next few weeks of that, either this month or the following month. So I would say that that's a decision that we will take in the very short-term.

#### **Q - Alberto Arias** {BIO 18302585 <GO>}

Okay, great, thank you.

#### **A - Fabio Barbosa** {BIO 1907620 <GO>}

Thank you.

### Operator

Thank you for your question, Mr. Arias. Our next question comes from Daniel Altman of Bear Stearns.

**Q - Daniel Altman** {BIO 1855515 <GO>}

Hi. Good morning, two questions please. First, there's been a lot of announcements coming out of Australia, I guess, SMG in particular, also in Brazil, CSN, regarding further advancement in their expansion projects for Iron Ore. I'm wondering, how seriously do you take this new competition.

And if, in your internal supply and demand forecasts, which I guess governs your new project announcements for Iron Ore expansions, are you considering both of these companies as potentially new competitors starting in 06/07?

My second question is just regarding the Logistics business. You mentioned that you're achieving 10% growth and that was less than demand. So a supply constraint. I'm wondering if in 2005, if you can grow the business at a higher rate given the increased investment that you've made in new equipment? Thanks.

**A - Fabio Barbosa** {BIO 1907620 <GO>}

Thank you, very much, Daniel. Your first question, of course you've been seeing a lot of announcements of investments. Some of them may go ahead. Some of them will not. There are a lot of constraints, expending capacity for the major players. And these are for the potential newcomers to this market.

Ourselves, we are working very hard to expand our capacity and we have several projects that could leave our total capacity lifted up to 100 million tons from the current 200 million tons that we have. So we would be producing around 300 million tons in the next few years.

So this is the size of CVRD's productions. So the new players you've commented here, there is a very small fraction of additional capacity that they could bring in the market, in our view, if they managed to invest there.

In the case of CSN, they have already clients for the Iron Ore they sell. They produce around 50 million tons. And if they expand their capacity, they will be considering the seaborne trade, a very marginal increase. Despite this, the CSN expansion should represent a very marginal increase in this total market.

As for Fortescue [ph] it's about the same. It's a different scale. But it's about the same rationale. And of course, there is the major interrogation [ph] market guidance what will be the CapEx cost of these investments.

Turning to your second question on Logistics, we have been getting the rail cars and locomotives gradually over the year. So we, on a 12 month basis, if we are not buying any equipment, new equipment, we should show some growth next year. But we're not going to have the continuous additions to our fleet but also the fact of the previous investments in the growth of our Logistics business over the next few years.

So again, you are right. We should grow a little bit more next year because we are compared to the basis that we are right now, given the gradual increase of our rolling stock and the fact that we have repaired demand for our Logistics service. In fact, we are facing problems, a selection problem, to define who is going to get our services because there is no room for everybody.

The country is growing, exports are growing, reaching record levels as well. And so our problem is a selection one. And we are working very hard to add capacity. But we are facing the constraints of the supply chain.

**Q - Daniel Altman** {BIO 1855515 <GO>}

Okay, thank you very much.

**A - Fabio Barbosa** {BIO 1907620 <GO>}

Thank you.

**Operator**

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

**Q - Andrea Weinberg** {BIO 6591181 <GO>}

Thanks. Hi, Fabio Barbosa. Good morning. And congratulations on the results. The first question is actually on the Logistics business again. But on FCA specifically. It seems like you've invested a lot of money since you acquired FCA and I just wanted to have an idea of the returns on your investments on FCA because when you look at the results of FCA specifically, the EBITDA and the results there seem to be still very low.

And the second question will be actually in the Aluminum business. It seems to me that the average realized price per ton that you got in Alumina was a lot higher this quarter. I wanted to know what percentage of Alumina you sell in the spot market. So you're realizing higher prices there.

**A - Fabio Barbosa** {BIO 1907620 <GO>}

Well, thank you very much for your questions. On FCA, we are investing a lot in terms of adding rolling stock. We are also investing in terms of improving track conditions and trying to improve its overall efficiency. The rationale behind our acquisition of FCA was not one of only in terms of a cash-flow perspective but also in terms of the maximization of our asset performance considering that we are in the Iron Ore business. And the Iron Ore business requires very efficient logistics.

So we have cargoes that are transferred from FCA to Vitoria-Minas and that represents gains to Vitoria-Minas but it's not fully shared with FCA given the operational constraint we do have. So I believe that in order to assess the return of the investment in (inaudible) we should consider it in an integrated basis.

Our Iron Ore business as a whole, it's the logistics that support the Iron Ore business plus total shipping, plus ports, in order to have a better idea of the performance of the business, because if you're thinking of isolated aspects you may not have this picture of what's happening there.

In terms of Alumina, yes, we keep selling a little bit of Alumina in the spot market and it's now around 15% of our total sales. It's 10% to 15% of the usual range.

**Q - Andrea Weinberg** {BIO 6591181 <GO>}

Okay, thank you.

**A - Fabio Barbosa** {BIO 1907620 <GO>}

Thank you, Andrea.

**Operator**

Our next question comes from Mr. Raphael Biderman, of BBVA.

**Q - Raphael Biderman** {BIO 1529743 <GO>}



Good morning, also Alberto. Good morning Fabio, congratulations for the results. I have also two questions on the Aluminum and railway division. I just need some clarification if you can.

On the railway division, on the Third Quarter, revenues from railway of the controlling company under Brazilian GAAP showed a much lower growth, quarter-on-quarter than in the Second Quarter. The Second Quarter, there was a very huge growth of 20% and in the Third Quarter it was of the order of 5% or 6%. Of course, there could be seasonal reasons but year-over-year, the growth also showed a deceleration.

Also, I want to understand, I mean, on the quarter-on-quarter comparison, there could be seasonal effects. But considering that demand is way above the capacity of supply of railway services, is the reason of the deceleration really seasonal, or it's an issue regarding that there was less railway expansion coming on-stream in the Third Quarter, or the wagons that you put in operation in the Third Quarter were more directed to Iron Ore, to Carajas?

And also, what I would like to understand on that is what is the potential of growth in the future for railway revenues, I mean, if you give a guidance. I mean, considering those expansions that were not yet done in 2004 of the wagons. And considering these ones you announced for 2005, what can I consider in terms of guidance of how much this revenue item can grow?

In terms of Aluminum, Fabio, if you consolidate the EBITDA on the Brazilian GAAP of the Aluminum operations, in the Third Quarter comparing to the Second Quarter, there was a drop of 4% in the EBITDA of these operations. And I see that prices are going very high in the period. I would like to know, there is a kind of dis-contract [ph] which has a lagging effect to the spot price. I would like to understand if it was that.

There was also some reduction on production in Albras in sales volume of Albras. I would like to know how much of the growth that was already accrued on Aluminum prices was not yet factored on the performance of the Aluminum operations, because the EBITDA was down, quarter-on-quarter. And how is the timing of that to be realized?

#### **A - Fabio Barbosa** {BIO 1907620 <GO>}

Okay, Raphael, thank you for your questions. Let me try to answer the first one on the Logistics. We have a seasonal pattern in the general cargo business. If you look at our chart on Page 10, I believe, of the presentation that's available to you, you will see that the Second Quarter, in terms of absolute growth, is the strongest one.

Then, there is a marginal growth; not margin. But a less, a lower growth rate on the second to the Third Quarter. This is the pattern, because in the Second Quarter we have the harvest that pushes our results in terms of general cargo.

But for the next few years, you should consider the additions of rolling stock that I mentioned to you this year. We have already, as I mentioned before, 2700 rail cars, additional rail cars to what we had in the beginning of the year. And 78 -- 71 locomotives.

Our target is to reach 3,300 rail cars in addition to our fleet this year for general cargo and Iron Ore. It's two thirds onto our division there. And the equipment, the growth rate seems to depend very much on the regularity of the arrival of the rolling stock that we are able to get. So next year, we are going to order 6,000 rail cars and 120 locomotives.

Of course, they will not arrive on January 1. But we are trying to speed up the process in order to catch above what, for instance, we see here, the seasonality of the harvest. So that's what I can tell you from where we stand right now.

In terms of your question on the Aluminum, I think that the slight changes you showed there are much more for the Aluminum for itself. It's much more related to shipment schedules than other aspects. So it's just a ship or two that did not go in the quarter but we entered the very next week of the quarter. So it's a very small change that is explained by logistic aspects, I would say. And your other question regarding Aluminum was; sorry?

**Q - Raphael Biderman** {BIO 1529743 <GO>}

It was regarding prices. I mean, if the contract prices of all the operations in the Aluminum division from Belsay [ph] to Aluminum, how much is the lag of the actual effective market price to spot price and how much, if there is further upside on the effective realized prices of the Aluminum operations? Was it just this lag effect?

**A - Fabio Barbosa** {BIO 1907620 <GO>}

Well, they usually are in a three months range. It's of course, we have in the state of Aluminum, the bulk of our production is sold through long-term contracts. And they have a reference price at three months LME price. So this is, I would say it's in this range would be the lag between the absolute price in the market and the effect on our revenues. Okay?

**Q - Raphael Biderman** {BIO 1529743 <GO>}

Okay, thank you very much, Fabio.

**A - Fabio Barbosa** {BIO 1907620 <GO>}

Thank you, Raphael.

**Operator**

Our next question comes from Mr. Ivan Fadel with CSFB.

**Q - Ivan Fadel** {BIO 4827533 <GO>}

Hello. Good morning, Fabio, the first question is that could you please break down the 05 expected growth in Iron Ore production, as you mentioned the 20 million tons for 05, additionally, in terms of region and mine. And will there be also any depletion or mine closure in 05? Thank you.

**A - Fabio Barbosa** {BIO 1907620 <GO>}

Thank you for your questions. Well, we should be operating Carajas next year at 78 million tons. That's our expectation. And we'll have a shipload in the Ponta de Madeira Port. That will start operations in the Third Quarter of 05, actually increasing the capacity of the port to 85 million tons by the Third Quarter of 05.

So in terms of production, I would say it is 40%, 8 million tons in the Northern System and 12 million tons in the Southern System. And then we have mainly Fabrica Nova units that will be operating at 10 million tons per year in 2005. And the others are small additions in the Southern System that will complete the 20 million tons I just mentioned to you.

**Q - Ivan Fadel** {BIO 4827533 <GO>}

Let me see if I got that straight. So it will be 12 million tons net from the South System. And plus 18 million tons from North, which is basically increasing Carajas to 78. So you think you're able to go from 70 which used to be this Carajas capacity to 78 without putting the operations at risk at all?

**A - Fabio Barbosa** {BIO 1907620 <GO>}

No, well, of course, we are operating with a very stretched system. But we are confident that we are able to perform at this level. So we believe that we'll be able to deliver the additional 20 million tons in 2005.

**Q - Ivan Fadel** {BIO 4827533 <GO>}

Okay, great, thank you and then just another quick question. We saw some recent news on the Baosteel project that CVRD is going together with them. So could you just provide us with information of when the construction will start?

**A - Fabio Barbosa** {BIO 1907620 <GO>}

Well, it should start very shortly. We are trying to conclude the feasibility. There was some initial preliminary figures. It was due in September and actually had a first draft of the feasibility study. But we wanted to discuss some figures that are showed there.

There was some increase in cost due to the very, let's say, casually; there was some price increase due to costs of equipment associated with these new prices, for instance, in the appreciation of the real. So we have to refine a little bit the figures in order to have a clear view of the investment. So this would be concluded by the end of this year, we hope, or early next year. And construction should start right away.

**Q - Ivan Fadel** {BIO 4827533 <GO>}

Okay, thank you very much, very helpful. Thanks.

**A - Fabio Barbosa** {BIO 1907620 <GO>}

Thank you.

**Operator**

Our next question comes from Alberto Arias of Goldman Sachs. Please go ahead.

**Q - Alberto Arias** {BIO 18302585 <GO>}

Yes, a follow-up question, following on the steel project with Baosteel. You're about to start construction. Can we get any sense of what percentage participation is CVRD considering, given that I would imagine that you're so close to starting building the plant that there should be a sense of what is the economic interest we are going to see out of CVRD?

**A - Fabio Barbosa** {BIO 1907620 <GO>}

Well, you are right on that. You should. But those are complex discussions that we are having with our partners, Baosteel. And now. So the funding structure that we are discussing with the MDS and the other players that are also interested in the project.

But I would say that we would take the stake that would be necessary to go forward with this project, up to 50% but it could be lower in a different arrangement that we will define very shortly.

**Q - Alberto Arias** {BIO 18302585 <GO>}

Okay. If you could give us an update of your project development pipeline, you have been saying recently about studies of the different copper projects and some of them also are getting close. Is there any new development that is worth highlighting and if you could also please include any potential update on your exploration drilling in Mongolia, with which your team was very excited a few months ago?

**A - Fabio Barbosa** {BIO 1907620 <GO>}

Well, on your first question, the next project is in line with these 119 targets and it should be discussed with our board before year end. That's our expectation. And then it should be implemented, if approved by our board, in the next two years or so. It's our next project. They are still discussing alternatives for the other projects but there is no change since the last time we've met.

In terms of your question about Mongolia, there is also no news there. We keep working, trying to find if there is a good alternative to invest there. But so far, no news.

**Q - Alberto Arias** {BIO 18302585 <GO>}

All right, okay, thanks.

**A - Fabio Barbosa** {BIO 1907620 <GO>}

Thank you, Alberto.

## Operator

Thank you for your question, Mr. Arias. Our next question comes from Art Winston of Pila [ph] Advisor. Please go ahead.

**Q - Art Winston** {BIO 1431017 <GO>}

Thank you for a great quarter. The fluctuations in these financial expenses and these taxes are pretty great from quarter-to-quarter. And could you give us any sense of what to anticipate, at least qualitative and what direction on these taxes, in these social taxes. And the interest expense, say, in the next six to nine months?

**A - Fabio Barbosa** {BIO 1907620 <GO>}

Okay, thank you for your questions, Art. And the financial expenses, they are a combination of our net exposure to the exchange rate, given our functional currency is the real. So we have an exposure to US dollars. And the exchange rate is a floating one in Brazil. So this is the volatility associated with the financial expenses. And that explains most of the financial expenses.

And it should continue to be as volatile as the exchange rate in Brazil, because we have no plans to change our exposure to the US dollar in terms of our debt, given the conditions we have managed to achieve in the international capital market. This year to date, for instance, our 30 year bond was using 7.98% per year US. So it's below 8%. And for a company like CVRD, it's a remarkable achievement.

So we should see it backing [ph] the international capital market as both of our financing. So the net exposure should continue. And hence [ph] the volatility of the financial expense.

As for the taxes, as we did have a very good performance in the Third Quarter. And for the full year, we had this very good performance in 2004 so far, in nine months. And this reflects additional tax payments. And the tax optimization mechanism of the shareholders' equity, it only happens for formal purposes.

And in October, with the formal approval, with the approval of the board of the dividend payment of the remuneration of our shareholders in the last month. So we were not able to account for the deduction that is allowed for this payment we realized in the recent [ph] shareholders' equity.

So this figure of the Third Quarter is somehow inflated. It does not reflect the long-term trend, given this peculiarity of the legislation in Brazil regarding interest on equity. We could not declare beforehand as we did last year. Last year, we declared an additional payment in August.

And this we benefited from the additional payment, the tax effect, right on the Third Quarter of 03. This year, we declared formally, we announced in the Third Quarter. But we formally approved it in the Fourth Quarter. That's why the tax figure is inflated compared to its long-term share.

In our view, in spite of this comment, as the company is performing very well as it has been in this last few years and it has been growing in the last few years, the effective tax rate should increase marginally. That's our view. There is nothing that will harm our capacity to deliver very good results.

But we should consider that the tax rate, effective tax rate, as we diversify more, as we grow, as we increase our operations in other countries, it should increase on average but nothing again, nothing that will harm our capacity to deliver very good results to our shareholders.

**Q - Art Winston** {BIO 1431017 <GO>}

Thank you for those answers.

**A - Fabio Barbosa** {BIO 1907620 <GO>}

Thank you.

**Operator**

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

**Q - Daniel Altman** {BIO 1855515 <GO>}

Hi, just regarding your subsidiary, Caemi, if you annualize their volumes in the Third Quarter as around 48 million tons, that's quite a bit higher than their guidance or anyone else's guidance. I'm wondering if you have a projection for the 2005 volumes just for Caemi? Thanks.

**A - Fabio Barbosa** {BIO 1907620 <GO>}

Thank you, Daniel. Well, in fact Caemi had a very strong performance. But as you know, we have some seasonal effects there as well. We should not annualize it and project it for 2005. This year, the production in Caemi will be some 5% above our original estimates. It could reach 41 to 42 million tons.

And next year, as [capacity there] it would be operating in full capacity and it only started operating in the Second Quarter of this year. We could reach, let's say, 45, 44 or 45 million tons in 2005. That's our best guess as yet. But we didn't conclude yet the project for next year.

**Q - Daniel Altman** {BIO 1855515 <GO>}

Okay. And should there be a difference between their production number and their sales number? Are they (inaudible)?

**A - Fabio Barbosa** {BIO 1907620 <GO>}

Sure, Dan, it should not be any relevant difference as they do not operate or by some third parties as we do, for instance.

**Q - Daniel Altman** {BIO 1855515 <GO>}

Okay, thanks very much.

**A - Fabio Barbosa** {BIO 1907620 <GO>}

Thank you, Daniel.

## 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'd just like to thank you very much and say that we will be starting our fifth [ph] global monthly road show next week and in which we will visit our shareholders worldwide in order to update them more closely of our latest performance. Thank you, very much for your attention and patience. And myself and our team here will be available for any further questions that you might have. Thank you.

## Operator

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

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