Q2 2003 Earnings Call

Company Participants

- Fabio Barbosa, CFO

Other Participants

- Daniel Altman, Analyst
- Disel Konia, IR
- Katy Blacklock, Analyst
- Marcelo Kayath, Analyst
- Unidentified Participant, Analyst

Presentation

Operator

Ladies and gentlemen, thank you for standing by. At this time, all lines are in a listen-only mode. Later there will be a question-and-answer session. Instructions will be given at that time. If you should require assistance during the call, please press '*' '0.' As a reminder, this conference is being recorded.

At this time, I would like to turn the conference over to Mr. Disel Konia [ph] from Crompton [ph] Financial. Please go ahead, Sir.

Disel Konia

Good morning, ladies and gentlemen and thanks for standing by and welcome to CVRD's Conference Call to discuss Second Quarter 2003 Results. I'm Disel Konia [ph] from Crompton [ph] Financial Investor Relations. I would like to mention, that a slide presentation is also been made available during this call on the company website at www.cvrd.com.br.

Before proceeding, let me mention that forward-looking statements are being made under the safe harbor of the Securities Litigation Reform Act of 1996. Actual performance could differ materially from those anticipated in any forward-looking comments as the result of macroeconomic conditions, market risks. And other factors.

During this presentation, we may refer to various non-GAAP financial measures. So please visit the Investor Relations section of the company's website, www.cvrd.com.br for a reconciliation of these non-GAAP financial measures to the most directly comparable GAAP measures. With us today from Rio de Janeiro this morning, is Mr. Fabio Barbosa, CVRD's Chief Financial Officer.

First Mr. Barbosa will comment on the Second Quarter 2003 results. Afterwards, management will be available for a question-and-answer session. It's now my pleasure to turn the call over to CVRD's management. Mr. Barbosa, you may now begin.

Fabio Barbosa {BIO 21197136 <GO>}

Thank you, very much. Good afternoon, ladies and gentlemen and thank you all for attending this conference on our Second Quarter results. This presentation is divided into sections. First, some highlights on our performance; then we will comment on our latest operations in the fund raising and finally macro economies and business outlook.

Let's start with the Second Quarter '03 highlights and I would like to mention there is very strong performance in our top lines; 14.5% year-over-year and also in our net earnings line, $470 million year-over-year in addition to what was observed in the Second Quarter of '02 when there was (inaudible) loss of $14m [ph].

The company continues to present a very strong cash, a very good sales performance, although limited by a capacity limit. We do have and we do face and we are speeding up investments and increasing capacity mainly in the Northern System.

At the same time, we managed to keep our discipline capital exchanges expenditures in total for this is same at about $647m [ph]. And finally, there is very good performance impact in gas generation and volumes and in performance in sales allowed us to show our commitment to our shareholders by paying additional dividends to the ones that we anticipated when we announced the minimum dividend payment for 2003.

Turning to more detailed view of our sales and EBITDA, in the Second Quarter of '03, our gross revenues reached $1.2 billion and in terms of products iron ore and pellets responded for 61.5% [ph] of our total revenues.

The aluminum chain as a whole 15.4% [ph]; already reflecting the start off of the aluminum markets (inaudible) recently. Logistics, 11.2%, manganese and Ferro-alloys have a good performance 7.3%, Kaolin and potash 3.9 and a decline in gold share total revenues due to the exhaustion of our mines and also the reduction in production in (inaudible) Brazilian.

In terms of market, 33.2% of our revenues were now in the Brazilian market and the main market abroad, it's a 30.9% for total revenues. This as a whole is about 21% -- 21.7% in the second most important region. US -- was more pleasant [ph] of over 3.4% [ph] and a very comfortable 10.8%. So, we continued to show a very nice diversification in geographical terms in our total revenue.

As far as any of those figures, we reached the Second Quarter -- the level of $490 million with (inaudible) representing 81% of the total EBITDA, logistic 11.8% and aluminum 5.5%, a very strong performance in the Second Quarter.

The whole sales performance could be seen through the volumes we sold (inaudible) 41.5 million tons with a slight increase compared to the Second Quarter of '02, both major reduction reflecting what I just commented on the (inaudible) connected by (inaudible).

(Inaudible) we have extraordinary performance in the shipments for the first time of Manganese (inaudible) to our Chinese clients, Ferro-alloys 10.75%, a very good performance as well.

Aluminum, a large (inaudible) here reflected the consolidation of Alunorte that has started only in the Third Quarter of 2002. And also the expansion of Alunorte plants, the alumina refinery that we started was last March.

As far as aluminum's (inaudible) reflects much more seasonal adjustment on shipments as much it presented to you in our review and the fact that our Alunorte plant is working in a very strong trend. Potash, last year we had -- event list that we did not have this year.

So, we reduced our (inaudible) last year. And today apparently in our potash mine we are working a full capacity that is 600,000 tons per year and (inaudible) we have more (inaudible). So that explains the fall in volumes compared to the Second Quarter of 2002.

Kaolin had very good performance as well reflecting our efforts in developing new markets for products and very good performance in our logistic business in general cargo with new quarterly record driven by our business.

Therefore, the operational performance we can see that using the adjusted EBIT margin we are showing a improving performance over the prices in First Quarter of '02. And we recorded 31.2% as EBIT margin and we reached the Second Quarter of '03 33.2% of EBIT margin in spite of the sharp depreciation [ph] of the Reals in the first half of '03.

When we look at our performance compared to years, we're also doing extremely well. In fact, yesterday we had (inaudible) record market debt capitalization with a total of $19.8b [ph] as market cap. Of course we are keeping track of the performance of the mining and metal industry as a whole. But maybe we are somewhat outperforming some of the major players in this sector.

Clearly, on the (inaudible) we showed a strong performance in several others competitors in the sector with a total of $810 million net earnings for the first half of '03, well above (inaudible) $621m [ph].

During this last 18 months, we have shown a very strong and consistent translation [ph] and we can see in this slide what (inaudible) of the less (inaudible) such as this EBITDA, is an extending growth of our EBITDA figures this year. Even if we adjust for the Alunorte effect, we would have an increase of about more than $300 million in the last several months.

It is very important, a very strong performance in terms of EBITDA and (inaudible) and so such as good performance in terms of market, market share. Iron ores and pellets, our shipments were constrained by mining and logistics as fast as we move.

We are working hard on that (inaudible) to succeed. We are (inaudible) mainly under the mining in order to deal with a very strong market demand. In fact, in the First Quarter we still had some (inaudible) which was utilized. But they were no longer available in the First Quarter. But also we, we faced some shipments delays and we are confident that the second half of this should be a recorded without any loss in terms of sale.

As for railroad (inaudible), as I mentioned before, we made several records in all the operations. But I would like to highlight FCA that show the performance of 2.6 billion net tonne kilometers in the Second Quarter of '03 as compared to the 2.2 billion net tonne kilometers in the Second Quarter of '02.

This is the fully dedicated general cargo's railroad without (inaudible) Carajas (inaudible) also showed strong, very strong performance in General Cargo, also reaching quarterly records [all time] records in the Second Quarter '03.

Our investments are in line with our regional forecast although slightly below our initial figure we thought. But we are (inaudible) to expand our (inaudible) iron ore mainly with a new mine (inaudible) produce in 2005 and 2008 respectively.

We will have a shorter-term increase in Carajas with 40 million in the First Quarter of '04 and we will certainly increase our (inaudible) help us to feel what we anticipate and seems to be a very strong market for the iron ore (inaudible) bauxite and alumina are being started right now. This was stable project in this quarter and we spent about $120 million in the first half of '03 and it is right on schedule to be operating by the second half of 2004.

For ports [ph], we expect to conclude the investment [ph] in the Third Quarter of '05 and this would be a (inaudible) driven back (inaudible) a very strong demand that we already seeing in the market but we are not able to meet to the limits we have (inaudible). I would like to mention that our (inaudible) pellets plants (inaudible) commissioning in full from 2004 due to some problem in relocation of the (inaudible) where the plants will operate. (Inaudible) for the Third Quarter of '03.

Another important comment is that we've announced last Wednesday an additional payment of $250 million in dividends (inaudible) shareholders. This represents $0.65 per share in addition to the $1.04 we announced in January.

I'd like to stress that when we announced the new dividend policy and then when we announced the minimum dividend payments, we said that we should look at the performance of the company over time and see how the cash flow will develop and if we felt appropriate, we would propose to the board an additional payment.

I'm very happy to say that we implemented fully, as announced the dividend policy and with the additional dividend reflecting what has been in our view a very strong performance of the company.

So, with this payment, the total dividend payment this year will amount to $650 million and this is well above the level observed in 2002 with $600 million and with that payment the dividend per share this year will total $1.69 that compares very nicely with the average dividend per share in the period 1999-2002; that was $1.57. The average dividend yield in this same year 1999-2002 was 7%.

So, to consolidate our reputation as a broad [ph] dividend payers [ph] and at the same time we managed to keep a very sound balance sheet, that is very important for us. And our total debt-to-EBITDA the ratio that was 2.57 times by June 30th, 2002 was reduced to 1.74 times EBITDA in June 30th, 2003. This figures will not include the recent transaction, that we financed [ph] as a performance right now.

We actually for the whole year, we borrowed slightly over $1 billion so far and we think that is later is appropriate for our cash flow and I'd like to highlight too the lesser transactions; one, $250 million notes 10-year maturity securitization receivable of iron ores and pellets with a very low yield to maturity of 4.48, a duration of 5.38 years, a very good operation in our view.

It was guaranteed by MBIA Insurance Corporation with AAA rating, which has been the quality of (inaudible). Second, (inaudible) we issued new note $300m, (inaudible) also 10-years maturity. CVRD was the first Brazilian company to pack the market with a 10-years note, unsecured note.

It was also the first private company to issue a bond below the sovereign cost. In other words, we managed to issue our $300 million bond of 9.25 and the sovereign with the same time was trading at 12.60% per year. So, this was a discount to our reference. We used the reference for Brazilian company at 3.33% [ph] per year.

Also this transaction was personal [ph], because Moody's gave us three notches above the sovereign rating and we were rated Ba2 and this is very important for us to for the success of the transaction that had the duration of 6.77 years at once [ph].

We were very happy with this conclusion because in this wherever we have issued this bond, markets were extremely volatile and, particularly Brazil was penalized by market perceptions. And we managed to keep the pricing for our bond at the same level we saw it at the beginning of the week.

And we have an over booking and we had more aggressively [ph] on the debt side, to know the CVRD's operations and how CVRD performed. So, it was very important for us. And we also believed that from debt side these answers would not only buy bonds but also shares, that's the concession we got of some of the business we made.

So, with those transactions, we managed to increase average maturity and duration of our debt at what we would say a relatively low cost, of course it would improve a little bit further in the future. CEES [ph] 2003 is trading through the Brazilian sovereign, now that has been in steady fashion. In some days, the discounts for the sovereigns reached 400 basis points and right now -- just the other day, it was 320 basis point approximately.

Finally, turning to the market dynamics and business outlook, it seems like the business environment where we think it is started to improve with the global GDP, although globally it had a lower rate than its long-term trend showing very positive signs particularly in the U.S. economy with a stronger, well anticipated by the markets -- stronger figure for the U.S. GDP with 2.4% growth on a annual basis.

Also, the impact of SARS on Chinese economy was very limited and in the first-half, China moved by 8.2% in case of GDP. And we are expecting that at year-end it should reach 77% GDP growth. And the fact is that when those prices are already factoring the change in the expected [ph] regarding world outlook.

Worldwide ore demand continues to be on the rising trend that based on our expansions we began our expansion in Carajas very timely.

And we see no signs of dissolution [ph] there and we think that what it could fairly do probably balance in the iron ore market and should remain throughout 2004, that's our perception as yet and this perception is enhanced by the continuous strength of the cost of freight differentials that continues to increase indicating that the excess of the rent [ph] remain and there is no signs at all of dissolution as you see in the chart when we put together.

China, of course, is the main driver in this market. And here we've put some very interesting field showing the increasing share of imported iron ore and total Chinese consumption, (inaudible) the increasing in average as he pointed reflecting the size of what we expected in terms of improving the quality of production of the fuel industry in China, reflecting the state of development we are through right now.

We are working hard where we are trying to be (inaudible) our iron ore production anticipating in 2004 the Carajas expansion, that will match the expansion of our Ponta da Madeira of III Pier, that will increase our shipping capacity from 56 million to 74 million tons per year by the First Quarter of '04.

Carajas expansion should be completed by then and with a total capacity of 70 million tons per year and as far this is all consistent. We are expecting for 2004 a net increase of 2 million tons a year, already considering the exploration [ph] of Capanema mine in Southern System.

As for the prospects, we continue with our estimate of total (inaudible)-550 million tons for 2003, a net increase of 35 million tons compared to 2002. And as I mentioned before, the currency balance should remain throughout 2004 as we see it.

In terms of our shipments, we then changed our dictation [ph], we still think we show a modest increase in our shipments in 2003 with some acceleration of all the shipments in the second half of 2003 compared to the first half. For the long term, our estimated (inaudible) continues to grow in line with the long term GDP world growth 6.6%.

As for alumina, the process continues to be very bright in our view with consumption growing faster than production. And China again is a major factor there. Spot prices stabilized in the range of $280 and maybe and $300 per ton, it is well above what used to be in 2002 and this represents about 20% of the revenue prices that compares to the 11% of the revenue prices in 2002 (inaudible) 2002.

It's very strong in the market and it is performing very strong. And it should continue in this position over the next 18 months. Although the announced additional capacity should reduce the pressure, in our view the markets will continue to be relatively tight. So, creating huge opportunities for CVRD in this final expansion of ALUNORTE.

As for logistics expansion, as you saw in our release, logistics had a very strong performance not only in the Second Quarter but also in the First Quarter of 2003. We are developing new business.

We are providing services for the (inaudible) industry with intermodal [ph] consultation are showing high growth rates with the perspective enhanced by total shipping business and we've managed to have to show a very strong performance in spite of the delay in the arrival of locomotives and car rails we brought this year. So, there was basically a very strong productivity increase in our logistic business during the first half of the year.

Finally, just on some pro forma information what would be the consolidation of cahyani [ph] showing the importance of this acquisition for CVRD. Our expectation is that cahyani [ph] consolidation will start in the Third Quarter of '03 and with this consolidation if we have it since the very start of the year, we would have a total (inaudible) of iron ore balance of 101.7 million tons, sorry 101.7 million tons of iron ore imbalance.

Our sales to China represented 14.6 million tons gaining 537,000 tons. And our adjusted EBITDA would be in $1.67m, total debt, a very small increase compared to (inaudible) about jus3.3 it would be $3.6b.

So, it was a very important acquisition for CVRD. In our view, we are not sure if the markets have already priced as there are two aspects of (inaudible) waiting [for other information and decision] and the closing of the transaction should take place in the next few weeks.

Thank you, very much and there will be myself, my colleague Gabriel Stoliar. And Robert [ph] (inaudible) in Brazil. We are here available for any questions you might have. Thank you, very much.

Questions And Answers

Operator

Ladies and gentlemen, we will now begin the question-and-answer session. Our first question comes from Mr. Marcelo Kayath with Credit Suisse First Boston.

Q - Marcelo Kayath {BIO 2169773 <GO>}

Hey, Fabio, how are you? My question is about a slide 11, where you are talking about the constraint in iron ore and pellets. In the short, would you give us some more information about what you expect for the third and the Fourth Quarters in terms of volumes because I know that you are constrained but you are talking about Gongo Soco coming back into full production in the second half of the year.

You have taken some emergency measures along the Northern and the Southern System. So how constrained are you in the second half of the year?

Are we likely to see just the 36-37 million tons of iron ore shipments as you are showing in slide 11 or can we see may be a bit more in the second half of the year and the same thing applies 2004 i.e., are you limited just to the expansion in Carajas or are there other things that you can do to remove other bottlenecks and increase the supply of iron ore in 2004? Thank you.

A - Fabio Barbosa {BIO 21197136 <GO>}

Thank you, Marcelo for your questions. We actually we expect a stronger performance in the second half of the year. We -- not only we would see more regular shipment that's not a problem of demand I would like to highlight there but I think the size of the shipments was such that indicated this change. But we are also bringing in some new equipments.

So although (inaudible) to speed up the process in the Northern System mainly. But also in the Southern System in the first half of the year, as you recall, you mentioned it we had this Gongo Soco problem that was addressed and Gongo Soco now has resumed full operations so we should expect more from that.

But first half of the year we also had the race volume [ph] that interrupted the entire unit for two days, affecting logistics and mining. And we should not have this repeated given the regular weather in Brazil. So altogether, we should expect a stronger performance in terms of volume in the second half.

Q - Marcelo Kayath {BIO 2169773 <GO>}

Fabio, when you say stronger volumes, are you talking about additional availability of 1 million or 2 million that is going out for 37m; 38 million tons of iron ore shipments, are we talking about something more like 40 million tons?

A - Fabio Barbosa {BIO 21197136 <GO>}

I would say that for the year as a whole. We could expect an increase over 2002 of about 3%.

Q - Marcelo Kayath {BIO 2169773 <GO>}

That's for iron ore plus pellets?

A - Fabio Barbosa {BIO 21197136 <GO>}

Yes, iron ore and pellets, yes.

Q - Marcelo Kayath {BIO 2169773 <GO>}

How about 2004, Fabio, can you give us a hint if there are other things the CVRD can do besides the 3 million tons in the Southern System and the 50 million tons in Carajas?

A - Fabio Barbosa {BIO 21197136 <GO>}

Those are 14m [ph] tons in Carajas and 3 million tons in the Southern System and that's what we are planning for 2004. So, roughly we should have additional 30 million tons compared to the level we are going to observe in 2003.

Q - Marcelo Kayath {BIO 2169773 <GO>}

Next question is that with warranty increasing at some point you are going to have an expansion of margins especially because you already incurred into the expenses to generate additional volume and we have not seen the expansion of margins yet. In the Third Quarter you have an artificial impact of the price increase, the invoices will be adjusted.

But going forward on a more forward basis for Fourth Quarter 2004, when should we expect to see the kind of expansion of margins that we are hoping for given your expansion of volumes in the second half of the year and [all through] 2004. Is this really a 2004 story in terms of margins or could we expect something in the Fourth Quarter already on the more sustainable basis?

A - Fabio Barbosa {BIO 21197136 <GO>}

I have a different view. I think that as we move and the company has a profile of revenues and expenditures in which it is very much affected by fluctuation of the exchange rate or in this case we saw this was half depreciation of the Real against the U.S. dollars. We had some specific additional costs such as few orders [ph].

But all in all I think that in the long-term we are implementing as we try to put together this phase [ph], these is several cost reduction measures that you cannot precisely measure right now but you are starting to see some results in our information.

But in terms of the operations, if you take out the Illinois [ph] effect that's consolidated for the first time U.S. GAAP in the Third Quarter, you will see that we have actually a reduction in our cost of production and compared to the first part of '03, in spite of depreciation of the Real we had an improvement in our EBITDA margin.

So, our new project, as you mentioned, they are very cost effective and we think that this should basically consolidate a good performance in our margins [ph] that we don't see at all. As if. And (inaudible) as our average taxation.

Q - Marcelo Kayath {BIO 2169773 <GO>}

That's good. That's helpful. Thanks a lot.

A - Fabio Barbosa {BIO 21197136 <GO>}

Thank you, very much.

Operator

Our next question comes from Ms. Katy Blacklock [ph] with Stanes [ph] Capital.

Q - Katy Blacklock

Hello. I have just a question on the expansion on the iron ore side. Previously you have said that you would expect third party [iron ore] to peak to 212 million metric tons. And I think you are accelerating the expansion at the Carajas. Can we expect that (inaudible) to be lower than that in 2004?

A - Fabio Barbosa {BIO 21197136 <GO>}

I would not guarantee that as now, because we bought this first half [five points] only in the terms of third party [iron ores]. And this figure should be repeated in the second half of the year. And as the market continues to show very strong performance we may have to continue to buy third parties iron ore and even increase it depending on markets performance.

The good thing of that is that we have some flexibility in adjusting for any major change of the market acquisitions that we are not anticipating by reducing acquisitions in the future. But actually this is not what we are forecasting right now. So we should keep buying this during the second half and also in 2004 to deal with market demand.

Q - Katy Blacklock

So as things stand, given the expansion that you are expecting for 2004 and the market that you are anticipating for 2004, would you still expect to [rise the] 212 million metric tons of purchased iron ore in 2004?

A - Fabio Barbosa {BIO 21197136 <GO>}

That's correct.

Q - Katy Blacklock

Okay. And just one more question, which is regarding the price increase in pallets in the Second Quarter. Looking at the ore revenue per ton, it looks as though there was some price increase that went during [ph] the Second Quarter. I do understand that most of that will come through in the Third Quarter.

But on the pallet side prices looked as though they stayed flat, I mean it's around $30-31 in the First Quarter and the Second Quarter. Can you give me any reasons for that differentiation between the ore and pallet?

A - Fabio Barbosa {BIO 21197136 <GO>}

Well, thank you. In the case of pellets, the price adjustment was agreed upon few weeks later then in the case of iron ore. If I am not mistaken, two or three weeks later. So there is no price effect yet in our information in the press release.

I would like to comment [ph] it and we'll use your question for that, that of the total pricing fees that we agreed with our client. Out of total of about $70 million in fact in the first half of the year, we accounted for only $25m. So, we had to delays in agreement in contract with our appliance. So it should be seen only the third and Fourth Quarter of 2003.

Q - Katy Blacklock

Okay, thank you.

Operator

Our next question comes from Mr. (inaudible) with (inaudible).

Q - Unidentified Participant

Good morning. I have a question two related with pellets performance. During the Second Quarter, I would like to understand what's happening with your pellets operations and how each commodity is demanding less pellets or the kind of growth on specific on pellets should we expect in the second half of the year.

And the second question is that you are projecting an additional 70 million tons for next year, which should give an increase of roughly 10% in your volumes, in your capacity, are you expecting to sell this full 70 million tones already in 2004?

A - Fabio Barbosa {BIO 21197136 <GO>}

Thank you, Paul [ph] for your question and as for the pellets, this is basically a shipment and schedule and it doesn't reflect the size of the markets. There is no signs of any kind of the manhunt [ph] problem of demand or the leg of demand to the very contrary, because the demand continue to be well above our capacity to deal with that.

So, it should be just a regular rise during the second half of the year. And as for the second question on the 70m, actually this is what we are anticipating as what we could provide to the market.

Actually, the market -- it is the deformed right now, although it is showing -- much more room than what we are having been able to provide in terms of supply. All our competitors are working towards expansion, additional expansions of capacity and we think that the level of 70 million is appropriate to the level we anticipate of demand for 2004.

I would like to add that this year, demands was so strong that the we are recurring to more usual supplier, moderate supplier (inaudible) with Canada, in Sweden, countries like Uzbekistan, Kazakhstan, Chile. And Peru. So, there is room for growth not only because we expect the Chinese demand to continue to grow in 2004. But also replacing these marginal supplier.

Q - Unidentified Participant

That's so helpful. Thank you.

Operator

Our next question comes from with Mr. Daniel Altman with Bear Stearns.

Q - Daniel Altman {BIO 1855515 <GO>}

Hi, this is Daniel from Bear Stearns. Can you hear me okay?.

A - Fabio Barbosa {BIO 21197136 <GO>}

Now we can hear you.

Q - Daniel Altman {BIO 1855515 <GO>}

Okay, I personally had a call from home, it is kind of mess here.

A - Fabio Barbosa {BIO 21197136 <GO>}

That's how life lies, we have there.

Q - Daniel Altman {BIO 1855515 <GO>}

I just had two questions and I missed the last one. So I apologize if there is any repetition. But I noticed that in both of your comments on the iron ore sector and also the alumina sector, you gave guidance through the end of 2004 roughly 18 months.

I'm wondering if that's because, that's kind as far as you want to stick, you are not going to (inaudible) which is part of the reasonable, or did you see something in 2005 makes you think that by 2005 you may see a reversal of the supply demand trend in both iron ore and alumina.

A - Fabio Barbosa {BIO 21197136 <GO>}

Well then I think (inaudible). No, it is not some, let's say a new adjustments we simply I say it was -- we see as more likely to have until 2004 and then you know, we are a very conservative company in all aspects.

So, we studied the market, we saw estimates made by several analysts of the market and what we mentioned in our presentation was if you debt would be the average of our view and especially view on the future developments of the marketer who offer the go with that.

As for 2005, we already have in the past indicated that in the case of our aluminum, for instance , in the alumina business, we should have a more balanced market by 2005 with a reduction in the advantage of aluminum and reduction in the advantage of alumina and reduction in balance of the aluminum market as for 2005 onwards.

That appears to be very much what we think it would happen in the future but China, as we commented during the presentation continues to be a very nice starting factor in this trend. It works for all the matters in general and in particular in our case to develop iron ore and alumina, the aluminum markets and just the Second Quarter we had our first shipment of ultra-fine manganese.

So, as we stop our guidance in 2004 is not because we are expecting and anticipating the reversal. But it's the timing we feel we are more comfortable to comment on.

Q - Daniel Altman {BIO 1855515 <GO>}

Okay. Thanks and just one another question on CAEMI, very strong volumes based on recording. I am wondering if you think those numbers are sustainable what do you think is the fair annualized volume contribution from CAEMI, out there in 2004?

A - Fabio Barbosa {BIO 21197136 <GO>}

CAEMI, has shown a very strong performance this first half of the year and it should continue in the same way in the second half or even generate to show stronger performance in terms of sales and this could reach about $36 million tons by year-end. So, we have very strong performance with (inaudible) of the investments we made in the last few years.

Q - Daniel Altman {BIO 1855515 <GO>}

Okay. Thanks again very much.

A - Fabio Barbosa {BIO 21197136 <GO>}

Thank you.

Operator

Our last question comes from Ms. Katy Blacklock [ph] with Stanes [ph] Capital.

Q - Katy Blacklock

Hi, I am sorry to bother you again. I just have a question on the cash flow statement. First of all, can you give me some background as to what the guarantees and deposits refer to and also the loan and advances receivables? And can you also give me some guidance as to how you will see the CAEMI purchase reflected in the cash flow statement? I understand that the results will be consolidated until the Third Quarter but has the payment not already been made?

A - Fabio Barbosa {BIO 21197136 <GO>}

Okay. Thank you, very much and could you repeat the first question please.

Q - Katy Blacklock

Yes, the first question, just referring to -- two categories in the cash flow statement and I do understand what they refer to, the first is loan and advances receivable and the second is guarantees and deposits. I just wondered if these items had something to do with your affiliate companies or some --

A - Fabio Barbosa {BIO 21197136 <GO>}

Okay.

Q - Katy Blacklock

The reason it came to my attention was because they had moved some $7 million U.S. in the First Quarter to a $152 million in the Second Quarter from the guarantees and deposits.

A - Fabio Barbosa {BIO 21197136 <GO>}

Okay. Thank you, very much. Let's start with CAEMI, the closing of CAEMI will happen next few weeks and we should consolidate in our U.S. debt figures. (Inaudible) we should not consolidate it from the very start of the quarter, because it has to -- the transaction was not yet concluded.

Q - Katy Blacklock

And the actual payment will be --

A - Fabio Barbosa {BIO 21197136 <GO>}

The actual payment will be --

Q - Katy Blacklock

Reflected in the cash flow in the Third Quarter as well. In fact --

A - Fabio Barbosa {BIO 21197136 <GO>}

The Third Quarter for sure.

Q - Katy Blacklock

under the control --

A - Fabio Barbosa {BIO 21197136 <GO>}

Guarantees and deposit. It has to do with the income tax deposit. We are contesting position of our Internal Revenue Service. And regarding some tax payment. But according to the Brazilian law you have to make (inaudible) payment on deposit that continues to belong to us.

But it is a judicial cost deposit that will be blocked by the (inaudible) due. We settled the issue with the IRS or the court. So, in the Second Quarter there was deposit of around $100 million for this purpose.

Q - Katy Blacklock

Okay and the dispute with the IRS is regarding that something like detailed or -

A - Fabio Barbosa {BIO 21197136 <GO>}

It refers to the recent understanding for the IRS that we should not deduct more than 30% of our previous year's law sales we had in our balance sheet instead of some 100% deductions we were allowed on due few months ago -- that's in relation with that. And, they have a very strong case I must be frank with you.

Q - Katy Blacklock

Okay

A - Fabio Barbosa {BIO 21197136 <GO>}

Thank you.

Q - Katy Blacklock

Great, thank you very much.

Operator

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

A - Fabio Barbosa {BIO 21197136 <GO>}

I would like again to thank you all for attending this conference. And I would like to highlight how we appreciate the way you've been following our company and analyzing our company. And we will be available to any further questions you may have.

Operator

Vale Do Rio Doce conference call has been interrupted for technical reasons please hold on and we will soon resume the conference call. That does conclude our Vale Do Rio Doce conference of today. Thank you, very much for your participation you may now disconnect.