Q1 2004 Earnings Call

Company Participants

- Eduardo Hoffman, IR
- Fabio Barbosa, CFO
- Thomas Carson, Unidentified Speaker

Other Participants

- Alberto Arias, Analyst
- Andres Perez, Analyst
- Daniel Altman, Analyst
- Fritz Von Carp, Analyst
- Ivan Sabell, Analyst
- Pablo Orisoira, Analyst
- Rafael Bederman, Analyst

Presentation

Operator

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

Thomas Carson {BIO 17738572 <GO>}

Good afternoon, ladies and gentlemen and welcome to CVRD's Conference Call to discuss the First Quarter 2004 results. I would like to mention that a slide presentation has also been made available during this call at the company's 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 that anticipated in any forward-looking comments due to macroeconomic conditions, market risks and other factors.

With us today in Rio de Janeiro is Mr. Fabio Barbosa, CVRD's Chief Financial Officer. First Mr. Barbosa will comment on the First 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 the management. Mr. Barbosa, you may now begin.

Fabio Barbosa {BIO 1907620 <GO>}

Thank you, very much. Good afternoon, ladies and gentlemen. It is a pleasure to be with you today. We will comment on the First Quarter results for CVRD then we will talk a little bit about China. I think this is a hot issue right now. Finally, we will end this presentation with some comments on our projects for 2004 and beyond.

For performance, we believe, that we had a great performance this quarter. Revenue growth reached 46.1%. And this was, of course, partly due to the price changes of that increase that we managed to get these three months. But also by larger volumes we were able to sell. So, showing the strength of our operational performance.

Overall, it was 28.7% more in volume. Sales (inaudible) 76%, (inaudible) 163% to name a few. This figure shows the strength of our performance in the First Quarter and why we achieved these very good results we announced two days ago.

As for iron ore and pellets, we do have our growth constrained by (inaudible) but I would say that even with this limitation we posted very good results, almost 53 million tons in iron ore and pellets, that compares to the First Quarter of 2003 of 42.5 million tons. So over 10 million tons more of sales on a quarter-to-quarter basis.

In terms of our sales revenue distribution, yes, the iron ore pellets and the manganese sales (inaudible) is responsible for 7% of total revenues.

Aluminum, the aluminum chain is a growing business. We managed to get the revenues 13.9% and could grow even more with the consolidation of (inaudible) taking place in 2002 and then the expansion that resulted that the aluminum chain would be more visible.

And the future expansion of a stage four and five will help in the same direction, coupled with the (inaudible) expansion of MIN [ph] in the future (inaudible). So, the aluminum chain tends to grow. It tends to grow in our overall gross revenues. Logistics, general cargo, 11.3%. Kaolin and potash 4.9%.

On the next page, if you turn to the next page, it will show a very good performance in terms of our EBIT margin. Jumping from the results that we posted last quarter in which we had several one-off adjustments, as you know.

Then, I would say, we turned back to our normal usual margin as you can see by the figures there. Our EBIT margin turned into 32.9%. Of course, there is a major effort in terms of cost control as most of you recorded in several reports. And, of course, the prices helped in the same direction.

If you turn to the next page, you will see that was mentioned there across the board is excellent operating performance and sales reached 36.9% against 32.6% in the Fourth Quarter. There is mild change compared to the First Quarter of 2003, it relates to the relatively appreciated exchange rate in this quarter compared to last year and also the consolidation of Caemi.

Good margins in logistics, general cargo improving sharply from the Fourth Quarter of 2003 in which we was made against several one-off adjustments and not as much as in the First Quarter of 2003 due to, again, the exchange rate. That is why we have a very positive effect last year and this year there is not strong enough exchange rate to have virtually unchanged.

Aluminum. The price tag and also the increase in the scale of operations have helped us to achieve these very positive results and EBIT margins reached 24.5%.

Coming back to the logistic segment of our business with the specifically FCA performance, we are implementing several structural measures to improve its overall performance, the operational performance. And also to improve its operational safety. We are aiming at doubling cargo transportation up to 20 billion net tons per kilometer by 2006 from 10 billion net tons per kilometer in 2003. This is feasible.

This year we are buying locomotives and almost 2,000 new rail cars to put on our tracks there, in FCA. And this will help increase our productivity by 46%, as you see there from almost 1400 net tons per kilometer per hp by horsepower in 2003, to 2000 in 2006.

Finally, we are working on reducing the fuel consumption by 6% in this very year of 2004. And given the recent oil prices this is a very timely measure.

In terms of earnings performance, we continue to be very well placed. For companies reporting quarterly, we were the top company in terms of earnings, $405m, well above (inaudible) with $355m. So, a very good performance and helped, of course, by a very strong cash generation.

If you turn to the next page, our EBITDA reached a record level of $685 million and for the eighth consecutive quarter it showed a positive growth rate. It was a very impressive performance. Of course, again, you had the positives impact of prices but we have also shown discipline in our cost sense. We were helped as well by the consolidation of new companies, Caemi and FCA.

FCA posting a positive EBITDA, the First Quarter is small but positive. So $373 million a very strong performance. The bulk of this EBITDA generation was in the sales of minerals division 74%, almost 3/4 of total EBITDA generated in this area. Logistics, contributed with almost 11%. And the aluminum chain 12.1%.

I would also like to comment on our financial structure and again to highlight this strengthening that continues, the continuous strengthening of our balance sheet. In fact, in the First Quarter of 2003, EBITDA interest coverage was further improved reaching almost 11.7 times compared to 11.5 times that was reported by the end of 2003.

There is a total debt enterprise value showing a small increase in leverage from almost 16 to 18 points but this was mostly due to the reduction of the market share of the company the last few weeks of the quarter.

In terms of our total debt to EBITDA ratio, again, another reduction from 1.89 to 1.79 for the strengthening of our balance sheet. That is coupled with the improved profile for debt. Our average life, the average life of all debts was less than three years by the end of 2002. And now it has reached 6.3 years.

So, a major improvement in average life duration of our debt reducing with financing risk, market risk of our debt and at the same time, we took a very good window of opportunity. We enjoyed this and we managed to increase our average debt life without increasing the cost, the overall cost, of our debt. This is very important measure.

Finally, we also managed to sign contracts with major institutions, The National Institutions, First Year Institutions that made available to CVRD $500 million in committed credit line facility. This is a very important step in our target of becoming an investment grade company.

We are only two margins away from this level. We are rated currently BA2 and we have been implementing several important measures consistent with this objective. I have mentioned the reduced leverage of the company. We are operating below two times EBITDA, total EBITDA and a ratio below two.

We also, as I commented before, improved sharply the profile for debt in terms of duration and average life. We are discussing with Deutsche Bank the change in the regulatory framework that would allow net exporters like CVRD to keep hard currencies offshore without the obligation of the tax rating. It is all the hard currency it generates.

And finally, we have further mitigated the perceived transfer rates through the contracts with those banks that I just mentioned, with the signing of the contracts of our committed credit line facility.

This was a very important step, $500 million at a very low cost with a commitment fee of 50 basis points for $400 million then 100 basis points for $100 million that is made available for almost three years. Again, this is the only Brazilian company we know that has this sort of credit available and will certainly enhance the improved recent discussions about our company.

Turning to the next section, we will comment a little bit on China and our exposure to China and this growth potential. I would like to start by putting the recent Chinese growth in perspective. If you turn to the next page, page 18 in this presentation. You will see that Chinese growth history is not a new phenomenon, in terms of other Asian countries. It is very similar in its duration and its strength.

So, if you take, according to IMF data, if you take the Chinese growth and compare it with Taiwan, Singapore and Korea for the last 30 or 25 years, you see that what is happening to China is very similar to those other countries. Meaning that they will continue our expectation of continues growth in China is based on the actual experience based on other countries in the same region, the same pattern of growth.

China is also a metals showing similar to Japan, metals in terms of economic growth but on a much larger scale. The population in China is 1.4 billion people. There is much growth with that and as a less developed country it must grow with the certain buyers towards these metals and materials in general produced by companies like CVRD. So, they are demanding.

They are important players in the growth of consumption of all-important raw materials, iron ore 8%, aluminum 19%, copper 19%, (inaudible) 32% and nickel, yes 9%. But could grow in the future. (Inaudible) are responsible for 29% of the total imports of steel to the world. It is a very important player and should not be ignored and we see no signs of major change in the performance in the near future.

As you see, on the next page, showing the consumption of steel per capita in China is far behind major players in Asia, Korea, Taiwan, Singapore and Japan showing there is a lot more to come in terms of growth. We have no doubt that this will be the best. Overall it will be more moderate than the previous decade but it will continue to be a very strong growth rate.

In (inaudible), including all the companies we have when we have a share on that, including San Marco [ph] for instance we have been growing faster, our sales to China are growing faster than the Chinese imports are growing very fast themselves, 34%. And our sales are growing by 34% average minimum rate, while the Chinese imports between 1999 and 2003 grew by 28%. So, we managed to increase our market share in this very important market through the several components of our Groups.

We are also exploring new opportunity to increase stakes in China, particular in terms of manganese and aluminum. We still have a much lower share in those markets than the share we have in the iron ore market for instance. So, we believe, that more room to grow this specific product as we are able to produce more.

Also, to put in perspective the relative importance of China in our revenues, of course China is important, as a country it is the largest client we do have. But it represents 10% of our gross revenues. We believe that the (inaudible) distribution of our gross revenues is very good. So, we have several countries in Europe 31%, China 10%, Japan 5.6% and the market 30.8%.

In terms of iron ore and pellets, China demand represents 16.3% and if you take out the domestic market, you see that it is very similar to the seabord trade, (inaudible) for the totals. This is the share of total export, 2.3% this is the share of China in total. So, it is an exposure consistent with the trends and the demand of China showing in this market.

We have launched additional strong links with leading agents to make this a good year. Not only through long-term contracts but also with joint ventures in several of our (inaudible). This was the case with Japan. We have a (inaudible). We (inaudible). (Inaudible) Korea. In Korea we have another pelletizing plant (inaudible).

And now in China we are developing a very strong relationship that grows with the long-term contract but also with joint ventures as you see in our relationship with (inaudible) Steel. In fact, we have a long-term contract to sell over 220 million tons of iron ore until 2016 and we are developing an export (inaudible). We will be partners of Bar [ph] Steel in this investment that is the largest investment of a Chinese company overseas.

So, a very important demonstration of confidence in CVRD by their part and also in our country. Our role in this venture will be as a minority shareholder and exclusive provider of iron ore and pellets, representing about 6 million tons per year in the first stage of the project. So, very important growth in China. This Chinese project with CVRD and Bar [ph] Steel.

In terms of the future of Chinese iron ore imports, we are working with a more moderate growth rate for the import until 2007, around 12% per year, much lower than the one shown in the years 1999 to 2003 that is 28.1%. As for the (inaudible) trade, we are also working with a figure that is 4.7%, much lower than 6.9% of sales in the same period from 1999 to 2003. This could prove to be conservative if the First Quarter figures of the Chinese imports prevail for the rest of the year.

By the way, in conversation with our office in Shanghai, they see no sign of deterioration at all in their demands for our iron ore and iron ore in general. So, demand continues to be extremely strong and they are looking for more and asking if we do not have more what is the availability.

Our sales to China are supported by long-term contracts and, if you turn to page 27, you see what will be our shipment under the current long-term contracts we have signed with them, jumping from 32 or 33 million tons this year to about 65 million tons by the end of 2010 not considering Caemi, they both have a very strong presence in the Chinese market.

Still in China, we believe, that the measures adopted by the Chinese Government, they are appropriate. They were in the right direction. It was a prudent approach.

We believe, that what was happening here was a speculative process fueled by (inaudible) and in this regard they are addressing the issues correctly and this should prevent implementation of slow return projects and to preserve growth prospects of China as we are foreseeing. But, again, we do not think that the Chinese demand for iron ore will diminish and, we believe, that the market as a whole will be very tight until the end of 2006.

Finally, just a brief on the deals in our growth portfolio. We have announced and we are implementing projects that will increase our total capacity by 73 million tons per year by the end of 2007, several green-field and brown field projects. Carajas is now up to 70 million tons per year. We have already invested in the second expansion to 85 million tons that should be fully operational in 2006.

In Tapira [ph] we are investing to increase its capacity by 3 million tons per year and we have three new projects that (inaudible) (inaudible) expansion down, (inaudible) with two stages. The second stage (inaudible) could reach 50 million tons by 2007. (Inaudible) in the first stage 12 million tons and it could reach also 24 million tons (inaudible) if necessary. Carajas could also be expanded further to 100 million tons if the right investments are approved.

So, what we are showing here is that we have the flexibility to increase our production. We are implementing all those projects and if the (inaudible) of course we will review upwards those projections and that we can invest more to ensure the adequate supply of our iron ore in the market.

In terms of bauxite and alumina we see the authorization of (inaudible) pipeline that is part of the Paragominos [ph] project. This is a very important green light. As for the Alumina stage (inaudible) we are already investing in its implementation. What I would like to highlight here is the very effective CapEx per ton.

We are talking about in the case of Paragominos [ph] which is pipeline approved, we are able to deliver a project that is about $60 per ton, 20% lower than all the recent projects in bauxite.

It is a very efficient project. In the case of (inaudible), it is (inaudible) we hope to deliver. They are very much in line with a stage three expansion even at the lower course of 324. But, anyway it will be much lower than the average of our competitors [non fuel expansion] at $460 per ton.

Finally, we have the Sossego project with very good timing. We are very happy with this project. The plant is running very well. It is the only (inaudible) copper project in the world to come on stream in 2004. We would like to stress that a few years ago, there was a lot of skepticism about it. First our capacity to be in this copper segment and second about capacity to implement this project.

So, we are very happy to announce that this project is ready and will be fully operational maximum July 2004. And, as you may know, we are certainly have investors too that will have the Sossego project as its main event coupled with business (inaudible) port facilities that were just expanded.

With that, I close this presentation. I thank you for your patience. And I will be here to try to answer your questions. Thank you, very much.

Questions And Answers

Operator

(Operator Instructions) Our first question comes from Mr. Alberto Arias with Goldman Sachs.

Q - Alberto Arias {BIO 18302585 <GO>}

Good morning, gentlemen. I was wondering if you have done any kind of sensitivity with regards to Chinese corporate in order to see how far would Chinese growth would have to decline before you have an impact in some of your projects for Iron Ore and Alumina and copper if that is the case?

A - Fabio Barbosa {BIO 1907620 <GO>}

Thank you, Alberto. If I understand you are in China right?

Q - Alberto Arias {BIO 18302585 <GO>}

That is right. It is very late here.

A - Fabio Barbosa {BIO 1907620 <GO>}

So, good night, good evening. Thank you for your question Alberto. We are working with a more moderate growth rate for the Chinese growth 7.8% this year, 7% less next year and a gradual convergence towards more regular growth rates like 4.5% to 5%.

As you saw, in our presentation, even with this more moderate growth the contracts we have signed with our clients are showing us a demand to reach only for CVRD 55 million tons per year starting, I believe, in 2008. So, this confidence combined with the bias towards or the metals intensive growth given the stage of the development of China should ensure a very steady demand for raw materials in general, in particular Iron Ore.

So, I believe, the risk we are running is to be again short of ore to provide all the demand that is put in there. We are working with (inaudible). Even with (inaudible) we already have over bookings. We have clients demanding well above their regular contracts given the very strong demand we are facing right now in China, as you can see in person there.

A - Eduardo Hoffman

in dealing with the situations of excess demand. In 1993 there was an investment boom led only by the state and the GDP growth rates reached 13%. In October 1994 inflation rates sky rocketed to 28% and then a stabilization program was put in place so we reached a more normal growth rate by 1995 of 9% per year.

They have managed well the Asian financial crisis in 1997 and 1998 and the growth recession of 2001. We believe, that the restrictions put in place by the PPOC [ph] the State Council, The State Environmental Protection Agency, is focused much more on marginal players that have contributed to heavy pollution that are buying at a very high price in the stock market and have low financial capacity that represents risks involved for the major commercial banks.

They do not want to accumulate no performance lows. So, as Fabio highlighted, our relationship is with the strongest steel makers in the country that have a good financial capacity, low financial risk for the banks and our sales are supported by long-term contracts. So, we believe that there are risks, of course. But risks are minimized by all these factors.

A - Fabio Barbosa {BIO 1907620 <GO>}

Alberto, just to conclude, we have about 20 clients in China. There are over 450 steel makers there. So, we are, let's say, in a way, just beginning. I believe, there will be some consolidation in the segment there but we are operating with what we believe could be the winners of the consolidation process that will certainly take place in the future.

Operator

Our next question comes from Mr. Ivan Sabell from CSFB.

Q - Ivan Sabell

Hi gentlemen. My first question is with regards to the price increase in iron ore. I just want to clarify if CVRD already granted the price increase for all of the non-Asian clients, I mean all the Brazilian and European clients, I know that as a (inaudible) Asian corner but other than that I was just wondering if there could be additional upside because the Asian clients to additional price increases to either European or other countries' clients. So this is my first question.

The second question regarding the cost reduction, I just wanted to know the feeling from management, if there is more room for further cost reduction, where that could be done and in which kind of segment and which kind of business. So those are my two questions. Thank you.

A - Fabio Barbosa {BIO 1907620 <GO>}

Thank you for your questions and welcome. For the price increase, we have the bulk of our European clients, I would say, fully accounted for our already announced figures. I would say 90% of the total sect was already included here.

But the bulk of the price increase will come in the Second Quarter with the residual 10% of the First Quarter plus our Asian clients and other clients that came into the Second Quarter of the calendar year. So, I believe that the impacts would be slightly stronger in the Second Quarter than in the First Quarter.

The second question on cost reduction, there is always room for cost reduction. We are working very hard on that. As you know, last year we made a major effort in terms of maintenance, removing backlog that should imply in more efficient equipment, more scale of operation and also some cost reduction associated with that. We also discounted one-time adjustments in the Fourth Quarter but we are trying (inaudible) this year.

We believe that they should not be fully replicated in 2004. We commented on the measures adopted by FCA that should imply better operational performance, basically through cost reductions and finally we are seeing trends to devalue the exchange rate compared to what the level prevailed in the First Quarter. That should represent in dollar terms an additional cost reduction if things remain as they are.

Q - Ivan Sabell

Okay, very helpful. Thank you, very much.

Operator

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

Q - Daniel Altman {BIO 1855515 <GO>}

Hi. Good morning. Two questions. First of all, if you can comment on the (inaudible) business. The spot prices for alumina obviously shot up in the First Quarter. We did not really see that in your numbers. What percentage of your sales from alumina are to the spot market?

A - Fabio Barbosa {BIO 1907620 <GO>}

Sorry Daniel can you repeat please.

Q - Daniel Altman {BIO 1855515 <GO>}

I am just wondering, given that you have been running Elinorche [ph] above its nominal capacity I would have thought that you would have more volumes to sell on the stock market for Alumina. I was just wondering if you can tell us in the First Quarter how much of your volumes were contract to the shareholders versus the stock market?

Second question is, regarding FCA in the Fourth Quarter you showed, obviously, a very large EBITDA loss at FCA, it seemed like the First Quarter it had only a minor impact on the logistics business. Where there any structural changes? You mentioned lower labor costs. But where there any structural changes in the way you report FCA that would account for such a dramatic turnaround just from one quarter to the next? Thank you.

A - Fabio Barbosa {BIO 1907620 <GO>}

Daniel, thank you for your questions. On the (inaudible) we have a very small volume in the stock market. So we are trying to understand the question about the higher volume.

But we are dedicating the most we can to the low sell point at this time with our clients. It was over our nominal capacity was since last year, if you notice particularly the third and Fourth Quarter we were already operating in the nominal capacity we had for Alumina so there is no net increase in the stock market operations there.

And for FCA what, to the second question, we had no structural measures. We mentioned that should have a more long-term effect, we reduced our payroll there. But also we promoted a price increase in the tariffs of our service and general cargo. So, this is reals combined with the stability of the exchange rate helped us on the revenue side to improve the performance of our revenue.

Q - Daniel Altman {BIO 1855515 <GO>}

Okay, thanks very much.

A - Fabio Barbosa {BIO 1907620 <GO>}

Thank you.

Operator

(Operator Instructions) Our next question comes from Mr. Andres Perez with Morgan Stanley.

Q - Andres Perez {BIO 18609546 <GO>}

Hi. Good morning. Two questions, the first is on the decline that we saw in outsourced services. One of the items mentioned was discounts given to Caemi related to rail services at MRS. If you could just expand upon this a little bit. How sustainable is this? Are these lower charges from MRS? It was my understanding that rail costs are actually going up a bit in Brazil.

My second question was, we have been hearing that there has been a bit of an inventory build in China both in iron ore and steel. Plus it seems that freight rates are coming down a bit. What do you think this indicates in terms of overall demand?

A - Fabio Barbosa {BIO 1907620 <GO>}

Okay Andres. Thank you for the questions. In the case of MRS, contrary to what happened in FCA we had a price reduction through a bonus that was granted to the clients, particularly the shareholders there that is associated with the performance of the company. So, we had a very good performance of MRS in the year 2003. So, the company was able to reduce the cost it charged to its clients.

But it was the captive client like MBR and other companies that used that railroad. So, this was (inaudible) by price reduction promoted by MRS. Also, as we mentioned in our report, we also had the interruption of the railroad for two or three days due to accidents. We are paid less for the services also due to this reduction in volumes.

On the second question on inventory (inaudible), we have not seen any sign of debt in terms of iron ore. Again, they were right the freight rates are coming down a little bit. But this, I believe, does not mean that freight rate reduction implies that what was happening with the speculative demand I mentioned before, it means that clients that do not have long terms contracts are (inaudible).

The (inaudible) that they are trying to get the ore to China at any cost buying from anywhere and transporting in any ships available, that was what was inflating the freight cost or in line with the availability of credit they had to speculate with this raw material.

With the measures put in by the Chinese authorities there should be a natural reduction in all this sort of movement here. So, the freight rates could reduce a little bit but the fundamentals of this level will not remain. So, they could come down for a very speculative level, they could have been in the recent past. But they should continue to reflect the excitement of the iron ore market.

And, again, in terms of inventory building of iron ore, we have no information or implication whatsoever that this is happening in China. To this very contrary, our clients are demanding more and more iron ore that we are not able to deliver due to capacity constraints.

A - Eduardo Hoffman

Andres, the freight rate decline was supply driven as we have said several times last year. It was predicted that a (inaudible) steep increase this year would put some pressure on freight rates. As a matter of fact, a (inaudible) is increasing by more than 6% and this has an impact on the supply of freight and causing a price decline. Additionally, as we have said, investment in ports in Brazil, in Australia.

And even in China are making the effect of supply of maritime transportation to increase. And, of course, it has an additional impact on freight rates. We had also a temporary impact on the demand of freight caused by the Australian cyclone that forced the iron ore players in Australia to declare force majeure to postpone shipments. This also caused a temporary situation of excess supply in the (inaudible) of maritime freight.

Q - Andres Perez {BIO 18609546 <GO>}

Okay, thank you.

Operator

Our next question comes from Mr. Fritz von Carp with Sage Asset Management.

Q - Fritz Von Carp {BIO 1872800 <GO>}

Hello, gentlemen. If you will allow me to ask a question about your view of the steel market. It just seems to me that there are some questions about steel capacity growing in China. At what rate and at what quality, I suppose if anybody wanted to make steel in China they would have to come to you first for the ore or maybe one of your competitors.

I was just wondering if your figures for iron ore growth represent a maximum on the rate at which Chinese steel production can grow and whether how do related to that do you see China becoming an important steel importer net in the next 5 or 10 years?

A - Fabio Barbosa {BIO 1907620 <GO>}

Thank you for your three questions. What we have been observing of the growth in the Chinese steel production continues to be very, very strong. I believe that the First Quarter shows an increase of 26% compared with the same period last year. There was production (inaudible) as we put on our report it was over 28.7% increase compared to the same period last year.

Even without China it grew almost 4%. So, it is a very favorable environment for steel producers everywhere. But China is a peculiar particular case given it has a very high consumption associated with the level of development it has shown. You saw in our presentation that China is in a stage of development well behind the top Asian players in terms of economic and social development.

So, I see consumption of 150 kilos per capita is very low compared to almost 600 that other Asian countries are demanding. There is no reason why China should not show the same level over the next few decades let’s say.

So, our perspective is a very strong growth in the long term although it could be at a lower rate. It could be more modest growth instead of double-digit growth rate we could see a sustainable growth rate at around 5%. The steel industry should average GDP growth.

Operator

Excuse me CVRD's conference call has been interrupted for technical reasons. Please hold on and we will soon return the conference call. Thank you. Mr. Fabio Barbosa please go ahead.

A - Fabio Barbosa {BIO 1907620 <GO>}

What we were commenting on the growth rate of China that even in a more moderate fashion, it should continue to show a very impressive performance at around 5% per year or so. The Chinese economy is $1.6 trillion dollars. It is a huge economy already.

As a very good balance of payment position, it is extremely competitive and it should continue to grow in the same levels similar to these that I commented before. The steel industry in particular will be associated with this growth showing elasticity of demand higher than when compared to GDP growth rate, in our view.

Then we believe that we will have a lot of room to grow further in that market and that we will be able to deliver and to provide our Chinese clients with the necessary ore to support this growth. Inshore our pipeline of plan of investment and my comments of the potential increase in production even compared with the very aggressive figures we have showed there we have increased our production by 73 million tons.

But this figure could easily add 100 if you double the growth of the capacity and if you increase Carajas capacity to 100 million tons per year from the 85 that could be operated from 2006 onwards. So, (inaudible) of course we as the global leaders in the iron ore market will be consulted by the Chinese players in that market, in the steel industry in China. We will be their partners as we have been with several of them.

We have some 20 clients right now. We believe that this sector will be very important to (inaudible) few years due to some consolidation being very likely. And we would be happy to provide them with our support according to the limitations we have in terms of our production as well of course an extensive consultation in the single market.

Q - Fritz Von Carp {BIO 1872800 <GO>}

Thank you.

Operator

Our next question comes from Mr. Pablo Orisoira [ph] with (inaudible).

Q - Pablo Orisoira

Hi, gentlemen. Congratulations for the strong results in the First Quarter. My question is first regarding CAPEX for the year. I know that you have been having problems with some environmental licenses in two of your projects and I would like to see if you are revising the awards you CAPEX for the year considering that the First Quarter CAPEX was way below the average expected for the year.

A - Fabio Barbosa {BIO 1907620 <GO>}

Thank you for your compliments Pablo. Thank you for the question. On the CAPEX, we (inaudible) $1.8 billion this is our forecast. You are right to say that there are some problems related to our investment in terms of regulatory framework, the license for (inaudible) for instance was recently achieved. It was granted.

To give an idea (inaudible) the power plant that is ready for almost five months is not operating yet because we had a license and then I don't know how to translate that, Minestario Publico, it is an arm of justice. They (inaudible) provisional measures to avoid the (inaudible) so it was not completed.

The license for the pipeline was also delayed a little bit. But I would say that the $350 million or so that we spent in the First Quarter is about 20% of the expected year figure of $1.8 billion and this small delay could be recovered as the year goes by.

Recently when we thought the figure was a mere estimate for the figures for investment CAPEX program for the purpose of adjusting inventory out there in the program, they are very much in line with our projections in the beginning of the year. So, that is scheduled $1.8b.

Q - Pablo Orisoira

My second question is regarding your primary aluminum production in Obres [ph]. There was a reduction on volumes this quarter and I know you completed a negotiation (inaudible) your prices recently. So, I would like to have a sense of which kind of volume should we expect for the operation going forward, can (inaudible) any increase in production at Obres [ph] considering this attractive energy price you could get?

A - Fabio Barbosa {BIO 1907620 <GO>}

Okay Pablo. The reduction in production in the First Quarter was due to adjustment on that plant, operational adjustments because when we have this shortage of energy in 2001 and 2002 the equipment, the unit we turn it on and then the life of this was shortened.

Then we have to stop a little bit this First Quarter in order to repair and to replace that. So, that cause of reduction is a reduction which should be assuming normal levels from the Second Quarter onwards. This is already in progress. So, we believe we may reach by year-end a total production of 450,000 tons.

Q - Pablo Orisoira

And regarding any studies on expansion?

A - Fabio Barbosa {BIO 1907620 <GO>}

No studies on expansion. The contract with (inaudible) covers only our current needs. In order to think about an expansion, we should be attracted to a much more competitive energy (inaudible) of course our branch contract is under circumstances is a very efficient one, it is a very good deal, very good agreement for both sides.

Thinking of a new plan, we will have to consider there are alternatives worldwide and we have been contacted by several different countries offering very special conditions to invest in this sort of (inaudible) materials. So, we have to consider a much broader picture.

Q - Pablo Orisoira

Okay thanks.

A - Fabio Barbosa {BIO 1907620 <GO>}

Thank you.

Operator

Our last question comes from Mr. Rafael Bederman from BBVA.

Q - Rafael Bederman

Good afternoon, gentlemen. My question, I do not know if this was already mentioned this. But my question regards on the problems you had in the Carajas railway on the MRS. I would like to know how much of the reduction on iron ore volumes. You mentioned to us 2.6 million the reduction but how much of it was because of the accidents and how much was because of seasonal effects?

Also, if you could give some indications in terms of the Cofince [ph] tax, the sales tax bracket increased from the Fourth Quarter to the First Quarter. I would like to know if this is the Confince [ph] tax or if the increase of the Cofince [ph] tax impacts exporters like you do? That is basically it.

A - Fabio Barbosa {BIO 1907620 <GO>}

Thank you, Rafael for those questions. The first, the accident in Carajas was more important to extent. I believe, that was the final figure was about 1 million tons, 1.2 million tons of iron ore that we lost in terms of production.

The other costs were due to seasonality of the railway season that affects our production as you know. So, we were saying the other day it is the weakest quarter of the year in terms of production, in terms of the company performance as a whole. So, I would say half-and-half would be a fair estimate for that.

As for the tax factors, as you may have noticed, we made an observation that we paid retroactive (inaudible) tax and (inaudible) that was due to the local government of (inaudible) and if I am not mistaken the total amount paid was R$18m. So this could explain this change in taxes that you observed.

Q - Rafael Bederman

But the accident at the Carajas plant I suppose it has been a while since I do not look at CVRD. But when I used to look at it I have never seen this happening. Is this reason because the demand is too high and you are working at your top capacity and anything could cause a problem? My question in a sense is are there increasing risks of having production problems or if this was a one off, a very extraordinary event.

A - Fabio Barbosa {BIO 1907620 <GO>}

It is probably an extraordinary event. Carajas has a record in terms of performance, operational performance. And that was unfortunate because it happened in conjunction with the rainy season. But there is no indication that we are running much higher risk of accident in the past. To the very contrary, we are enhancing our operational procedures, stage to procedures, in order to avoid that.

A - Eduardo Hoffman

Carajas has been (inaudible) more resistant last year a decrease in 50% in terms of incidents, railroad incidents last year. It is considered one of the safest railroads in the world.

Q - Rafael Bederman

Thank you, gentlemen.

A - Fabio Barbosa {BIO 1907620 <GO>}

Thank you.

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>}

I would like to thank you all for attending this conference. Myself and our team here at CVRD will be available to clarify any further questions you may have. Thank you, very much. And until next time.

Operator

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