Q4 2003 Earnings Call

Company Participants

- Eduardo Hoffman, Investor Relations
- Fabio Barbosa, CFO
- Unidentified Company Representative, Unknown

Other Participants

- Alberto Arias, Analyst
- Assi Da Silva, Analyst
- Daniel Altman, Analyst
- Jorge Beristain, Analyst
- Marcelo Kayath, Analyst
- Rafael Bederman, Analyst
- Scott Piper, Analyst
- Sebastian Luparia, Analyst
- Sherman Charl, Analyst
- Thomas Mello E Souza, Analyst

Presentation

Eduardo Hoffman

Good afternoon, ladies and gentlemen. Welcome to CVRD's conference call to discuss the 2003 results. I would like to mention that a slide presentation has also been made available on the company's website at www.cvrd.com.br during this call.

Before proceeding, let me mention that forward-looking statements are being made under the safe harbor of the security litigation reform act of 1996. Actual performance could differ materially from those anticipated in any forward-looking comments as a result of macroeconomic conditions, market risks and other factors.

With us today in Rio de Janeiro this afternoon is Mr. Fabio Barbosa, CVRD's Chief Financial Officer. First Mr. Barbosa will comment on the 2003 results. Afterwards, management will be available for a question and answer session. It is now pleasure to turn the call over to management. Mr. Barbosa, you may now commence.

Fabio Barbosa {BIO 21197136 <GO>}

Thank you, very much. Good afternoon, ladies and gentlemen. Thank you for attending this conference. In our presentation today we will comment on our 2003 results and also we will comment a little bit on the business outlook as we see it.

In terms of our performance in 2003, we have to put it in perspective. We had major challenges to overcome: a dramatic global demand growth in our segment minerals and metals; limited capacity; and asset operation at record production levels, trying to maximize our performance. We managed at CVRD to anticipate our expansion in Carajas that was scheduled to be operating only 2005. And this was only possible due to the operation of our third pier in our Ponta da Madeira maritime terminal.

We believe we had an excellent performance in 2003, with an all-time high top-line, $5.5b, 29.5% growth, essentially driven by larger volumes. About two-thirds of this growth in our gross revenues was due to higher volumes and higher prices that we managed here.

Our net earnings also achieved a record high with $1.548b, an increase of 127.6% over last year's results. And a record operational EBIT: 1.6b, an additional result of 15.1%, although with lower margins in 2003 compared to 2002. And I will comment on that later on.

We had, on a comparative basis, a very good earnings performance. Our market cap, as of December 31st, was $21.8b. And our goal being the fifth largest mining company in this segment, we managed to post the third largest net earnings figure of $1.548b. That compares very nicely with Anglo American (inaudible) results.

Turning to our EBIT margin decline, it is important to mention that we had the effects of the consolidation of Caemi and FCA. This explains about 40% of the deterioration of our margins last year. In fact, CVRD has been, for some time now, the most efficient mining company in this segment. And as we acquired and consolidated Caemi, Caemi has a lower margin than CVRD's on a structural basis.

Caemi, for instance, does not have its own railroad. It has indirect ownership. Sorry, I think, in MRS. But it has to pay market prices for the transportation of its iron ore. And CVRD has Vitoria a Minas. So there is structural difference there in margins between CVRD and Caemi.

FCA is also the bulk of all general cargo business. And as you saw in our release last year, had a negative EBITDA contribution. We had $24 million in total decline of the EBITDA due to FCA. This is due to the concession costs. Concession costs represent about $45 million per (inaudible).

In fact there is a methodological discussion about the adequacy of this treatment, because, in fact, it's like a financing rented the owner of the assets, as indicated, the national treasury. But, anyway, the fact is that the concession costs represent part of our total (inaudible) in FCA. Then there is the negative contribution for our margin.

Also, we had asset impairment 16% out of the total reduction in the margin of 2003 compared to 2002. We had asset impairment due to the write-off of some pre-operational expenditure of our pelletizing plant in Sao Luis. And also some other provisions for PPSA: $5m. An indicator [ph] for our pelletizing plant, it was $12m.

Finally, back to provisions. We had made some provisions for the ICMS payment. We are discussing with some state governors some issues they raised in terms of the criteria of payment of ICMS. And as we saw (inaudible), discussions took place basically in the Fourth Quarter. We thought it would be appropriate to make these provisions in order to avoid surprises in the future.

Of course all our operational performance was affected by the combination of a more appreciated exchange rate. And fuel costs that increased by 43% last year. It is a very important component of our costs. We have also payroll increases due to the nominal adjustment of 17% that was presented [ph] to our employees.

And this, combined with the appreciation of the exchange rate in the second half, generated an increase in dollar terms of the payroll. So that explains the bulk â€" all those factors combined explain the bulk of the difference in margins. And we are working very hard, trying to deal with those issues in 2004.

In terms of EBITDA, we reached a record level in 2003 with $2.130b. That compares to the $1.780 billion in 2002. It is even higher than the figure in the First Quarter of 03 that was $2b.

Caemi's contribution in total in 2003 was $88m. And a negative contribution of FCA of $28m. So, that's a $60 million net contribution. So a very good performance in terms of cash generation, even taking out the effects of the new companies that we consolidated in 2003.

In terms of sales revenues, in adjusted EBITDA, the $5.5 billion in terms of product, about 69% was generated in our various divisions manganese, ferro-alloys, iron ore and pellets. I would like to highlight the rising importance of the aluminum trade 15.4%. And logistics; general cargo; 10.9% of revenues. Growth is almost disappearing with 0.4%. Kaolin and potash 4.7%. Both products tend to grow in the future, due to the expansion of our potash plant. And also due to the consolidation of Cadan, together with the PPSA.

In terms of markets, the domestic market is 30.7%. China is our largest client at 10.5%. Europe, as a region, 32%. Japan, 7.6%. Other countries in Asia, 4.5%. The US there is more (inaudible), 3.4%. In terms of the adjusted EBITDA, out of the $2.1b, more than three-quarters was generated by the ferrous mineral division; aluminum, 9.3% and logistics, 8.5%.

In terms of our return on invested capital, we reached 30.6%. It's well above market average and the last five years' average of 21.7%. Our CapEx budget in 2004, as we announced, is to reach $1.8b. We have a Group CapEx of $1.2 billion this year, in terms of focus on iron ore, bauxite, the aluminum chain, copper, finalizing our Sossego project.

And starting our own 118 project investment; potash, the expansion of Taquari-Vassouras up to $850,000 [and port capacity expansions], in order to deal with those demands for additional transportation power [ph] given the very strong market. And a $78 million investment in mineral exploration worldwide.

In terms of the main products coming on-stream in 2004, I would like to highlight Carajas. The expansion that is already in place. We are running a 70 million tons per year production chain. The 40 million tons capacity was possible due to the investment and in our Ponta da Madeira port, as I mentioned before. Their effective CapEx was $10.28 per ton, including all the investment in mine plant, railroad equipment and ports. It is already in operation, as I mentioned.

And Sossego projects. The first of our five projects in the pipeline was a 455,000 tons of copper concentrate being produced, equivalent to 140,000 tons of copper. And three tons of gold. CapEx cost about 80% of the average of the industry. The very fact it was [ph] the cash cost of $0.30 per ton was very good in terms of the cost [per ton] of the industry.

And very good timing. It is the only way to bring the project on-stream in 2004. And the very good timing. It's the only Greenfield copper project on-stream in 2004. And the largest up to 2007. We are expecting it to be fully operational in July 2004, although we are working hard to even try to anticipate it a little bit.

Turning to our balance sheet, I would like to highlight this significant improvement in our financial structure that can be observed by the leverage of the company. Total debt enterprise value was further reduced from 25.1% in 2002 to almost 16% in 2003. Adjusted debt with interest coverage reached a record high of 11.5 times. I would like to point out the fact that the company managed to issue a 30-year bond in early January.

With that transaction and the transactions that took place last year, we managed to increase the average maturities of our debt to about six and a half years. It is more than the double of what it was by the end of 2002. It is a major achievement. This is combined with a very low total debt of adjusted EBITDA at about the same level it was in 2002 of 1.89, considering that invested about $2 billion last year.

And we also paid to our shareholders $675 million in dividends. This shows the strong capability of our company in terms of generating cash. And combining a very aggressive CapEx program with a very sound balance sheet and a very attractive remuneration to our shareholders.

This was partly due to the very strong performance in terms of sales volumes, as you see in this presentation. In iron ore we reached a record high, 186.3 million tons in 2003. Also, we had increased in manganese ore 33%. It was not a record. But it was a major increase. Ferro-alloys, 5.5%, a record. Alumina as well, 168%. This was possible due to the expansion of Alunorte this year, and also the 12-month consolidation of Alunorte, compared to a six-month consolidation in 2002.

Primary aluminum, 7.1%. This growth was possible due to operational improvements that were implemented in our plant there. We didn't invest, we created capacity. Bauxite the expansion of MRN, 30.8%, a new record. Potash we managed to increase our production, although in terms of sales we had a reduction because we didn't have, in 2003, the same investment that we had in 2002. That is why we are posting a reduction in terms of sales volume, although we had an extraordinary operational performance there.

Sales of kaolin 98.2%. Of course we have the effect of cut-down there, the consolidation. But I would like to highlight the improvement and the performance of PPSA. PPSA, we jumped from a production of 330,000 tons in 2002, to 423,000 tons in 2003. This was achieved through a major commercial effort of our team there, opening new markets for PPSA that has a nominal capacity of 600,000 tons per year. So we have a lot more to do. But we are improving the performance of these assets all the time.

A new record also in our general cargo transportation railroads, 26.3 million net tons per kilometer, an. additional 5.1%, a new record. And ports, 16.4%. In terms of iron ore and pellets, our growth was still constrained by capacity. But we actually showed important growth last year.

Even if we take out the Caemi effect, we reached, on a US GAAP basis, of 172 million tons in 2003. That compares with 164 million tons in 2002. So, in spite of our very strong constraints, we managed to increase productivity of our capacity, productivity of our assets. And produce to sell 8 million tons more than in 2002, not considering Caemi's contribution.

That's why we managed to keep our leadership in the global iron ore market with our 33% of the seaborne trade. That grew by more than 10% last year. It is important to mention that we lost a little bit of market share. If you compare with the figures of 2002, that was 34%.

But this was due to the very strong growth of the seaborne trade. 10.3% above the average capacity of both systems. In terms of the manganese, we consolidated our position as the second player in this market, behind BHP Billington. 11% of the total seaborne manganese ore trade.

In terms of logistics performance, our figures show that we continue to be decoupled of Brazil's GDP growth rate. In fact the only constraint we have now to grow is the availability of rolling equipment in our railroads, because the demand is already identified and we keep growing as we manage to get railcars and locomotives.

In terms of the business outlook that we see, there is a structural imbalance, a disequilibrium in demand and supply in the minerals and metal segment. In our view, this won't be corrected in the short term because the industry, over the last four or five years, under-invested. In our view, the structural change in demand is determined by the Chinese growth. We do not think it is temporary.

The Chinese, in the circle of trends, in the circle of performance, in a sense that there is a lot of room for growth there, in terms of the needs of the people and the stage of development. And there may be some bottlenecks here and there. But they cannot afford stagnation. In our view, they will do everything they are capable of to keep a very strong growth rate.

Although we do not think that we will remain as high as in the last couple of years. But we are not counting on a hard landing for the Chinese economy. We believe there will be a gradual convergence of Chinese growth rate towards more Asian levels of 4.5-5% average growth rate per year. That would be very reasonable, in our view.

We have the fortunate combination of strong Chinese growth and growth in the major economies around the world. The US economy is growing much stronger. Even Europe and Japan are showing very positive signs of growth, ensuring that the demand will be there for us for at least for the next couple of years. So there are very good prospects for a company like CVRD that has not only very good and large mineral deposits. But projects already defined in our pipeline.

In terms of the global steel consumption due to the Chinese (inaudible), in our view this will continue to grow. In 2004, the expected growth rate is 5.8%. In China we will possess about two-thirds of this growth in 2004. So, a very positive scenario. And by 2007, total steel consumption should reach 1.41 billion tons of steel.

In terms of freight rates, I believe that most of you know our econometric model for the freight rate differentials, which are a very powerful lead indicator of price adjustments of iron ore. This chart shows that prices, cost of freight differentials remain very high. So this indicates there is an excess of demand and pressure on demand side. And the absolute constraint on the supply side to increase the (inaudible).

Although with higher freight costs, we believe we will continue to be extremely competitive in Asia. In fact, if we had more ore today, as you all know, we would be selling. But we face, in fact, a restriction constraint in our capacity. Already we are operating in Carajas 70 million tons. We are working in our (inaudible) system to increase an additional 4 million tons this year. We are buying from third parties more of 6 million tons of iron ore this year in order to deal with this increase in demand.

In terms of the global seaborne trade, we expect the growth to be 7.1%, down from 10.3% in 2003. But well above the average of 90s, which was around 3. And even close to the average of 99-2003 it was 6.9%. This may prove to be a conservative estimate, given the performance of the Chinese imports in the beginning of the year.

In the first two months, the Chinese imports amounted to 32 million tons. So we may be talking about the Chinese imports reaching more than 190 million tons, if they continue to perform as they are right now. So this figure of 175 for the Chinese imports and 575 million tons for the global seaborne trade may well be very conservative figure. And even the share of China in the total seaborne trade could prove also conservative in very (inaudible).

World aluminum demand is expected to increase by 7.5 million tons in the next five years. Additional demand of alumina of 17 million tons. This means that the imbalance in the market should continue for the next few years. That is very good news for us. We are very well positioned in the aluminum chain to meet this demand.

Sales of copper. Our Sossego project couldn't come in a better timing, with reduced inventories and corporate prices at very high levels, reaching almost $3,000 per ton. And, as you see in this chart on page 28, our forecast is that for the next four years, including 2004, there will be advances in the corporate market. And that's good news for our pipeline of investment.

In terms of the short-term outlook for logistics, we see again that there is no correlation whatsoever with the GDP growth. That is important to stress. The permanent that we see now for our logistics, our general cargo business, is precisely [ph] the abilities of our rolling equipment.

As long as we manage to put them on track, they will be generating EBITDA immediately. In the two years 2003 and 2004 we are buying 139 locomotives and 3,600 wagons for general cargo transportation, a very good additional capacity, although not yet sufficient to meet all the demands already identified.

That will be all. And myself, my colleagues here Roberto Castello Branco, Daniela and Marco [ph] will be available for any questions you may have. Thank you, very much.

Questions And Answers

Operator

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

Q - Marcelo Kayath {BIO 2169773 <GO>}

How are you? I have two questions here. The first one is that, Fabio, you made very clear that the capacity constraints are making it hard for you to keep up with demand. And you are incurring additional expenses because of that. That is clear from the results.

I think, in 2004, I think you have indicated that things will improve with new capacity. You are investing de-bottlenecking, etc. Can you give us a sense of the timing of the improvements and when you expect things to get better, in terms of de-bottlenecking and the new capacity kicking in? Thank you.

A - Fabio Barbosa {BIO 21197136 <GO>}

Thank you, Marcelo, for the question. Well, I believe that this will be a year-long effort. In fact, it has started already with the Ponta da Madeira port capacity increase. We are working in our Tubarao port, also to increase the capacity there. And to reduce demurrage costs. We are working in a cost structure of FCA. We reduced the consumption of fuel last year.

We are also working this year to reduce the cycle of the trips of the trains in order to reduce costs. In Caemi, we are starting, hopefully very soon, the investment in operation capacity there. We are just waiting for the license, the governmental license. And we are reviewing the freight costs of our coastal shipping in order to deal with the very strong market we are seeing now, among other measures.

We are price-takers in a period of few [ph], as you know. And we are working with other suppliers, in order to have an alternative. We are, today, very concentrated in a single supplier, we are trying to create alternatives for that. We are also working, in terms of energy, to try to obtain alternative supply of energy to our operations.

We are thinking of some short-term options to buy energy, enjoying the very good position on the buying side now for energy. Energy costs rose by $30 million last year. We may see a reduction this year with the operation of (inaudible) and also these options we are promoting. So it is a company-wide effort that should be gradually over time in this year of 2004.

Q - Marcelo Kayath {BIO 2169773 <GO>}

Fabio, any guidance as to -- let me rephrase that. On page eight, slide number eight, of the presentation, you said that 155 bps of operational performance were dragged by these occurrences in 2003. Can you give us any guidance of how much you expect margins to improve?

Not only because of the price increase in iron ore. But also because of these efforts that you've just described. What can we expect?

A - Fabio Barbosa {BIO 21197136 <GO>}

I believe that's something that â€” all these assets we mentioned to you are projects should be addressed by the company this year. We must improve our operational performance. We must try to find alternatives. We were, somehow, hurt by the exchange rate that should (inaudible) performance last year.

I believe that this combination of cost reduction and price that would be in place effective January 1st for our European clients. And April 1st for our Asian clients, we will show the effects already in the First Quarter of 03. But it is a year-long effect, as I mentioned before.

Q - Marcelo Kayath {BIO 2169773 <GO>}

Okay, Fabio, that is the first issue. The second issue is, as you pointed out on slide 25, you're expecting a 40 million ton increase in seaborne iron ore trade. And, as you said, China alone is already showing an additional 40 million tons increase, just based on the first two months of the year.

Now, your additional supply from Carajas when exactly that kicks in? You know, at what rate during the year? And if seaborne trade is conservative, as you said, if we have surprises on the upside, how much do you think it can capture of this upside?

A - Fabio Barbosa {BIO 21197136 <GO>}

On your first question, Carajas is already operational 70 million basis. It is already there. To answer your second question, if you recall last year, Marcelo, we started the year forecasting growth of 4-5 million tons in our own production and we managed to meet 8 million tons. Not 8, sorry, 12 million tons. So we managed, through operational improvements productivity gains.

But although with some additional cost, we managed to capture a significant part of this additional seaborne trade that was there. We are starting this year. We are forecasting production combined CVRD, Caemi and third parties of around 220 million tons, for the total CVRD group. That compares with 173.2 million tons of production last year of this same set. Okay?

Q - Marcelo Kayath {BIO 2169773 <GO>}

Okay. That's great. Thanks a lot.

Operator

Our next question comes from Sebastian Luparia from JP Morgan.

Q - Sebastian Luparia {BIO 1556310 <GO>}

Good afternoon, Fabio. A couple of questions to follow up on the recent (inaudible) margin decline. In the quarter you reported several non-recurring charges. What guidance are you announcing for the coming quarters? Are we to expect anything else on the back of this full consolidation of Caemi that should affect the results in the coming quarters?

A - Fabio Barbosa {BIO 21197136 <GO>}

Thank you for the question, Sebastian. The fact is that Caemi and FCA have lower margins than CVRD. We have to work hard there, in Caemi mainly, to put it closer to our group margins. I believe that this new investment in Capao Xavier would help. But Caemi has a structural deficiency that is the fact that it doesn't have its own railroad.

Although it gets some part of what it pays back through the equity, it's not a full off-setting of what it pays for the freight costs there. So there is a structural aspect that should be addressed. It will not be addressed in the short term, let's put it this way. Out of the other costs, we may have room for additional improvements there.

But we believe that Caemi's margins, as we commented before, will continue to be slightly lower than CVRD's on the long term. FCA -- the main issue in FCA is the issue of the concession costs. This is what makes all the difference. If you look at the margins of our Vitoria a Minas railroad, you see that the margin there is over 60%, because it doesn't have the concession costs.

And the volumes transported there, as long as the iron ore is there, is much higher. So, FCA, it is an issue that we are addressing. We are expecting to see a positive contribution of FCA to the EBITDA. It is also very hard, in terms of cost-cutting, in order to present a good result there. But we have to work very hard there.

Q - Sebastian Luparia {BIO 1556310 <GO>}

Thank you, Fabio. My follow up question is on your share price. If you look to the ONPN [ph], the spread is at historically high levels. What is your view on that? How close do we look to that? And then, in the past, it was mentioned that you might consider the possibility that you will [take a long ride for shareholders now]. Can you give us an update on that?

A - Fabio Barbosa {BIO 21197136 <GO>}

Certainly I do not understand very well the spread with the ONPN. In our view there is no fundamental reason to support that form over the last few months. As for the take a long ride, this is a shareholders' decision. And it is up to them. We believe that every manager that contributes to improve corporate governance and to improve the comfort of our shareholders is welcome. But this is completely up to them.

Q - Sebastian Luparia {BIO 1556310 <GO>}

Thank you, very much.

Operator

The next question comes from Mr. Alberto Arias from Goldman Sachs.

Q - Alberto Arias {BIO 18302585 <GO>}

Good afternoon, gentlemen. A couple of questions. The first one is with regards to trans-oceanic shipping rates. In the past we've seen that you â€" hold on, that you are not affected by trans-oceanic rates because most of your sales are in FOB basis.

However, in your press release you were talking about the significant increase in fixed freight rates as adding cost of goods sold in last year by $50m. If you could please explain a little bit further what is the impact of this higher transoceanic shipping rates on your cost structure?

A - Fabio Barbosa {BIO 21197136 <GO>}

Thank you, Alberto for your question. But this freight cost that we have mentioned in our press release refers to the cost per shipping business, not to the iron ore transportation that, as you mentioned is, in our case, FOB at the port. So it is not our cost. Okay?

Q - Alberto Arias {BIO 18302585 <GO>}

Because it says here, significant increase in sea freight rates. When it says sea, I was imagining it was because of --

A - Fabio Barbosa {BIO 21197136 <GO>}

It is the cost of shipping business.

Q - Alberto Arias {BIO 18302585 <GO>}

Okay, perfect. With regards to the purchase of iron ore from third parties, did I get that number right? That you are going to increase your purchases by 6 million metric tons this year, related to last year?

A - Fabio Barbosa {BIO 21197136 <GO>}

6.6 million tons. We bought in 2003 9.2 million tons. And we are going to buy in 2004, according to all plans, at least 16.8 million tons. This year we don't have the Capanema mines in operation. So we have to increase the third party's acquisition. And as I commented before, we are working very hard to increase further our production by increasing the productivity of our current assets.

Q - Alberto Arias {BIO 18302585 <GO>}

I have a final follow up question with regards to the whole southern system. In the past you have been trying to extract synergies from Soteco [ph], the operations with MDR, your southern system from Italy. Where are you in that process of extracting all the operating synergies that you were expecting? How much more room for improvements do you see out of the selling system consolidation?

A - Fabio Barbosa {BIO 21197136 <GO>}

In the case of MDR, as you know, it belongs to a company that is a listed [ph] company. So the synergies we can have there is only through maybe combining procurement procedures and issues like that. Otherwise, as we have a different set of shareholders in both companies, we must work according to the legal requirements. We cannot transfer costs or benefits from one company to the other.

We are very strict on that. And we continue to be, in order to preserve both shareholders' interests. In the case of Soteeco, we have the incorporation of Soteco by the end of August. We already started to collect some synergies, in terms of payroll. We brought to the company about 1,600 new employees. But the average wage cost was much lower. We did not bring managers, for instance.

Soteeco is now fully integrated in our procurement system. Also, in terms of (inaudible), from the positive effects, now we have only one company, CVRD. And that makes all the (inaudible) production belonging to CVRD does have to incur in the cap [ph] gain taxes we have here in Brazil. So this is part of, I would say the bulk of the growth of synergies we get in Soteco.

Operator

Our next question comes from Mr. Scott Piper[ph] with Morgan Stanley.

Q - Scott Piper {BIO 1962169 <GO>}

I have two questions. I was wondering if you could update us about the status about potentially consolidating Albras. Secondly, I was wondering if you could give us a little more detail on FCA. You mentioned a negative 23 million of EBITDA contribution, primarily a function of concession costs.

But you also said that you see that turning round in 04. Can you just explain the nature of the concession costs? And how, in 2004, that will lead to what efforts you're doing to lead to a positive contribution in FCA?

A - Fabio Barbosa {BIO 21197136 <GO>}

Scott, thank you for your questions. As for Albras, as you know, we have 53% or so of the cap [ph] of the company. According to the shareholders agreement, the first condition to consolidate a new (inaudible) is there. But we have a shareholders' agreement that provides equal rights to Japanese shareholders now. So we are discussing with our lawyers and auditors to see what is the extension of those equal rights.

In light of the recent discussions, I am more optimistic than before regarding this issue. We are having meetings with both parties in the next couple of weeks. But we still do not have a final position. Although we are more positive now than we were before on this possibility. That's what I can say to you right now.

In terms of the FCA, FCA was a railroad that belonged to Rede Ferroviario Federal. In its privatization, what the government did was to leave the asset to a private owner on a 30-year basis. So every year, FCA pays around $40-45 million for this lease of the assets. The assets belong to the federal government. The FCA has the right of use of those assets by paying annually $45 million per year or so.

What we are trying to figure out, Scott, is some adjustment in the asset structure of FCA or by taking over this concession and renegotiating it with the federal government with a new consideration, or paying it in advance. We are considering several alternatives, because this is simply an accounting figure. Actually, it doesn't reflect.

It is like, if you considered, if it was called a loan, if we are repaying a loan interest or debt service, it would not affect your EBIT. It's like you have paid an asset for 30 years. But instead of calling it a loan you call it a concession. The financial nature is the same. It is like a loan. But it is not considered like that. As we are conservative, we are deducting the EBIT off this cost.

That is why it produces a negative EBITDA, it produced a negative EBITDA last year. But with several cost reduction measures, even without the restructuring measure, our strategic plan is forecasting a slightly positive performance this year. That's what we have now. So, we (inaudible) and managed to improve on a structural basis this capital structure, we may have even better results. But that has started right now.

Q - Scott Piper {BIO 1962169 <GO>}

Thank you.

Operator

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

Q - Jorge Beristain {BIO 17554499 <GO>}

Hi Fabio, its Jorge Beristain with Deutsche Ixe. I just had two questions. One was, if you could again, go back to that slide number eight, quantify how much of these costs you believe are recurring and which are non-recurring?

What I am trying to get at, for example, is an issue like demurrage, which you have buried in our operational performance. It cost you $9 million in the Fourth Quarter. But with new capacity coming on-stream, is that something that will essentially go away, quarter over quarter? That's kind of my first question.

A - Fabio Barbosa {BIO 21197136 <GO>}

Thank you, Jorge. Yes, you are right. We are expecting a reduction in demurrage cost, due to this operational improvement, the capacity expansion in our logistics assets.

I would mention also that the asset impairment and tax provisions, they are chiefly once and for all. We are not expecting as yet any additional provisions there. And as for Caemi and FCA, we have commented already, there is a difference in margins that is structural, a good part of it. But there is also some temporary effect that we are trying to address.

Q - Jorge Beristain {BIO 17554499 <GO>}

Another similar question is, for example, with regards to labor, we did notice a very sharp increase both year over year and quarter over quarter in your labor expense. Is any part of this seasonal and related, say, to the payment of a Christmas bonus to employees, or maybe overtime as a result of you running your operations flat out. And something that would normalize moving into the First Quarter?

A - Fabio Barbosa {BIO 21197136 <GO>}

Again, you are right. The fact is that for the Christmas bonus we made the provisions after the conclusion of the negotiation with our labor force, by the end of September, if I am not mistaken. It was formalized by this time. Then we made the provision for the payment in December. That cost us $11m. This combined Christmas bonus with the nominal increase of 17% resulted in this $11 million increase in payroll.

What we should do this year is to improve the procedures in order to remove the effects over the year, in order to avoid that. We couldn't do it before because this nominal adjustment was defined in July. But this year we will try to smooth [ph] this a little bit in order to avoid these sharp changes.

Q - Jorge Beristain {BIO 17554499 <GO>}

Great. My second question was just related to the actual press release on page 16, you do put a table detailing the interest expense. And there was quite a large charge of $43 million under 'other' in the Fourth Quarter, which contributed to your full-year total of about, I think, 86 million in that category. Could you just explain what these other financial charges are? Sorry, it was 89 for the full year and 43 of that I've put in the Fourth Quarter and that's on page 16.

A - Fabio Barbosa {BIO 21197136 <GO>}

Page 16. Interest payments? Just a moment please. We paid the bonds. We paid the bonds in December. That should be the final coupon. Let me see. It was a 200 million bond that was due in December and we paid. I will check it for you. But I believe that is it.

Q - Jorge Beristain {BIO 17554499 <GO>}

Thank you.

Operator

Our next question comes from Mr. Sherman Charl [ph] with Chandler Capital [ph].

Q - Sherman Charl

Hi, Fabio. Not to beat a dead horse. But I want to come back to the cost numbers and try to get a sense of how much of the deterioration in the margins in 03 is recurring versus is non-recurring.

A - Fabio Barbosa {BIO 21197136 <GO>}

I believe that we could consider the FCA consolidation at least for the short term as a permanent effect. As for Caemi, we believe at least that the reduction in margins, in Caemi's EBIT margin, as we put there in the chart, was due to from 25.8 to 19.5 was due to non cash, non recurring factors.

So I believe that this should improve over the year, together with the measures as I mentioned before in terms of new investment. FCA, again, it will take a long time and effort to improve it.

Part of impairment [ph] was, once and for all, (inaudible). We had pre-operational expanding expenditures and we had to write it off. And PPSA we capitalized the company in the First Quarter and we had to adjust its assets according to SEC requirements.

Tax revisions it's a non-recurrent in a sense. We deal with 14 states. And every year you have discussions with states [or the other]. But it is a recurrent because it is a major deal. We cannot believe that the government (inaudible) but we have to make with provisions, in order to avoid surprises in the future.

I don't have a precise figure here for what is non-recurrent and recurrent. But the bulk of this reduction was non-recurrent. The majority of this set is non-recurrent. In the case Caemi with accounting procedures as improved. They are just FCA concession costs. But there is some reduction in margins, on a structural basis, due to the structural performance of Caemi and FCA mainly.

Q - Sherman Charl

Thank you, very much. My second question is related to the Chinese iron ore market. I'm curious as to hear what your thoughts are. And what your people are finding as to what local Chinese iron ore pricing and availability might be? In other words, how would the pricing for iron ore be for imported versus domestic supply?

A - Fabio Barbosa {BIO 21197136 <GO>}

I believe that the first two months showed that the Chinese imports continued to be very strong. They are trying to improve further their product mix there. And the iron ore imports are growing faster there than steel production. So that is a powerful indicator that higher quality imported ore is required, or is going into China.

Of course in the casting iron ore business and the iron ore production, several Chinese players are looking for, even for a paradox alternative, considering even the possibility of using lower quality ore that could be bought around the world, even in Brazil.

We have some information that some traders are trying to (inaudible) smaller miners ore that is piled here or there with lower quality that in a different market condition would not be available, or would not be sellable.

And they are looking for that. The same may be happening in their domestic production, in China. Although the Chinese iron ore has a lower quality than ours, there are other players, including the Australians. So even these classes of ore, it may be economical to use a lower quality ore. There is some information about spot prices for pellets around $80 per ton. So there is a clear imbalance in the market and they will try to find alternatives.

A - Unidentified Company Representative

I'm looking at the Chinese steel industry. We can classify it in two groups. There are the low-technology steel mills. For them, they are conscious about the CIF iron ore price. And there is another group that is made by the high-technology steel mills, the more modern steel mills that are much more interested in the quality of the iron ore.

We see the Chinese steel industry in the process of restructuring and urbanization as more steel mills become more modern. There are more technological advances. They need more high Fe, low silica iron ore. So there is a potential for growing in the end for CVRD iron ore in China.

Then we see our share in the Chinese market increasing as we have more iron ore to sell to them. Right now, we are short of iron ore. According to the information of our Shanghai op, we should have more 10 million tons of iron ore this year for sale. It was a bold [ph] view. But unfortunately, even increasing our capacity, we continue to be short of supply.

Q - Sherman Charl

Thank you, very much.

Operator

The next question comes from Mr. Assi da Silva [ph] from Axion International Investors [ph].

Q - Assi Da Silva

Good afternoon. Two questions. The first one was, whether you were willing to tell us what your margins are on the third party iron ore that you source? The second question is on the alumina side.

Your Fourth Quarter, you managed to get something like $197 per ton, whether there is a lag in the price you realized, because the current price is up near $450 a ton? And if there is a lag, how much of it? Three months, six months?

A - Fabio Barbosa {BIO 21197136 <GO>}

Thank you for your questions. First, on the third parties, we have a lower margin there. About 25-30% lower than the regular production of ours. In terms of the alumina, the difference you see in the prices that we actually observed and the current prices, is precisely because 85-90% of our production is sold through local contracts.

In this case, the longer the contracts you have, the lower the percentage of the (inaudible) prices you get in those contracts. It's a trade-off. Just as one share of the alumina we produce is sold and enjoys [ph] this very strong market of alumina right now.

Q - Assi Da Silva

Just to clarify, your margins on the third party is 25-30% lower than your own source?

A - Fabio Barbosa {BIO 21197136 <GO>}

Yes.

Q - Assi Da Silva

Thank you.

Operator

Our next question comes from Mr. Rafael Bederman [ph] from BBVA.

Q - Rafael Bederman

Hi, Fabio. Congratulations for the results. I have a doubt regarding Albras. The contract of electricity. I mean, there were some years that you were thinking of acquiring electricity on the (inaudible) spot market. If you could give me some guidance on what is the prospect and the long-term timing for such contract? And if you could give us some guidance in terms of the impact of increase of transportation costs in the competitiveness of CVRD in relation to the Australian mines?

A - Fabio Barbosa {BIO 21197136 <GO>}

Thank you, Rafael. On your first question, what we have is our long-term contract Albras with Electronorte is coming to an end next May. Albras consumes about 750 megawatts per hour. It's a very large consumer. So far, we didn't manage to reach an agreement with Electronorte. Currently we have brokered a contract (inaudible) from $15 depending on what we are talking.

It is about this range that is very much in line with the costs several electric (inaudible) industries around the world get, in order to produce, in order to (inaudible) production. So (inaudible) alternative.

With this auction, we are trying to buy in the market, I believe, for (inaudible) energy to supply Albras, in order to give more time to negotiate with Electronorte. We hope we reach an agreement. But if it is not possible we will look for alternatives, or alternative suppliers, or other companies that we could reach long-term contracts with them on a regional basis for the characteristics of our business.

It is regrettable that in a country like ours that a major role in this market that (inaudible) because we have, for instance, the bauxite. All CVRD has 11% of the world reserves of bauxite, high quality bauxite. We could be even more aggressive in our investment. And even consider additional investment in aluminum smelters here in Brazil if we did have energy at competitive prices.

But what we see is there is a long-term contract that has been discussed for almost two years is coming to an end. And we don't have any perspective of renewal as yet. So we have to look for alternatives. That is what we are doing with this auction.

In terms of the transportation costs, I believe that, if you are referring to the freight costs, again we are a CVRD operator on an FOB basis. And we are not affected by the freight costs increase, due to the high quality of our ore.

So, our differential, with our competitors, is the fact that we are able to provide almost tailor-made solutions to our clients. We are able to deliver with reliability very high quality ore for our clients in Asia. And we have therefore more than five (inaudible).

Q - Rafael Bederman

Thank you, Fabio.

Operator

The next question comes from Marcelo Aguiar with Merrill Lynch.

Q - Thomas Mello E Souza {BIO 1514965 <GO>}

It's actually Thomas here. Good afternoon. I have a question on the demand/supply picture for iron ore. As you both said, the demand should grow maybe 40 million tons plus. I want to see what CVRD feels in terms of supply growth for this year. And maybe next. If you could give us what the year on year expectation, especially for 2005, given that this year, in terms of pricing and demand, is already a done deal?

A - Fabio Barbosa {BIO 21197136 <GO>}

Thomas, thank you very much for your questions. We are working with this almost 40 million tons increase, although the first figures from China show a different trend, a stronger performance than we were anticipating. In our case, we are trying to increase our capacity.

In 2005 we will be producing in Fabrica Nord? 10 million tons more in 2005. We are trying to speed up other projects. In 2004, the total production of our assets combined, as I mentioned before, should be around 220 million tons.

Q - Thomas Mello E Souza {BIO 1514965 <GO>}

But what I mean is from a global perspective. It seems like 2004 -

A - Fabio Barbosa {BIO 21197136 <GO>}

Sorry. For 2004, 575 may prove to be conservative, as I commented before, if China continues to perform as it is right now. For 2005, I believe that a 5% increase, in line with the growth rate of the last five years, the average at least, is a reasonable figure to work with. Although everything will depend on Chinese performance.

Q - Thomas Mello E Souza {BIO 1514965 <GO>}

But do you believe it's correct to say that 2005 could be as tight as 2004 from a demand/supply -

A - Fabio Barbosa {BIO 21197136 <GO>}

I believe that. Ourselves, we are adding capacity with Fabrica Nord. We are trying to anticipate some more investment in order to deal with the demand in order to recover our market share that we reduced last year. So it will be a very tight market. It will continue to be a very tight market. Again, China is (inaudible) on the upside.

A - Unidentified Company Representative

Unless there is a sharp slowdown in China, the iron ore, alumina and other markets will continue to stay in a very tight situation until 2007.

Q - Thomas Mello E Souza {BIO 1514965 <GO>}

Thank you, very much.

Operator

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

Q - Daniel Altman {BIO 1855515 <GO>}

Just a couple of questions. On the iron ore production forecast that you gave, can you give us â€“ instead of production in terms of shipments, what you think your forecast is, both for iron ore and pellets? The second question is, your third party purchases go from nine to 15, according to your guidance. I'm wondering, where is this extra 6 million coming from?

Is this expanded capacity at some of the southern system mines? Or is this increasing from CSN? Where do you find an extra 6m? The last question is on alumina. How are you able to run so far above the nominal capacity at Alunorte? And is that a sustainable level? We have seen it now for two quarters. Is that sustainable in 2004?

A - Fabio Barbosa {BIO 21197136 <GO>}

Daniel, thank you very much for your questions. On the pellets, we should have an increase of 2.4 million tons this year, due to the production of some of this (inaudible). Last year we had 3.6 million tons in production. It started actual operations in the middle of the year, full operations.

Then this year we had a 12-month effect of 2.4 million tons. Also, we are counting on some operational improvements in our palletizing plant in Tuberao. We may get some additional production there, in terms of pellets. Nothing very meaningful right now. But it is a very imbalanced market. It will be very well received by our clients, I can assure you of that.

As for the we are discussing with our board. We will reach a decision very soon. On the duplication of our Fabrica pelletizing plant. It's actually not really a duplication, because the current unit there produces 4.5 million tons per year. And the new plant should produce 6 million tons per year. So that's our current plans for the pellets.

For the 6 million tons of third party, since last year we have signed long-term contracts with the major producers there in Minas Gerais state. So actually this $15 million did not come as a surprise for them. In fact, they don't lose contracts. They are now capable of expanding their own capacity to provide us with this additional ore. Those are contracts that range from three to six years. Though we didn't sign any contracts with CSN, we already have a contract with them on first refusal rights.

As for the alumina, you are right. We are doing very well in our Alunorte plant. It is fully operational. It is beating records every quarter. The nominal capacity is $2.4m. But we may be operating slightly above the figure, given not only the very strong market. But also the varied [ph] performance of the equipment.

Q - Daniel Altman {BIO 1855515 <GO>}

Great. Again, just to tie up the number, in terms of your guidance for iron ore and pellets, when you say 220m, you are referring to production? What would be a number for shipments?

A - Fabio Barbosa {BIO 21197136 <GO>}

We are not including pellets. Its production plus third parties, okay? 220 million of iron ore. We are not including pellets here.

Q - Daniel Altman {BIO 1855515 <GO>}

But some of that production is then sent to the pelletizing plant.

A - Fabio Barbosa {BIO 21197136 <GO>}

Sorry, could you repeat?

Q - Daniel Altman {BIO 1855515 <GO>}

Does the 220 include iron ore that is then sent back to the --

A - Fabio Barbosa {BIO 21197136 <GO>}

Yes, yes. Okay?

Q - Daniel Altman {BIO 1855515 <GO>}

So total shipment of iron ore do you have a projection on that?

A - Fabio Barbosa {BIO 21197136 <GO>}

We may be talking 230 for the total of the company. If you take 30m, we are maybe talking about 200 million or so.

Q - Daniel Altman {BIO 1855515 <GO>}

Thank you, very much.

Operator

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

A - Fabio Barbosa {BIO 21197136 <GO>}

I would like to thank you all for attending this conference. As usual, myself and our team here will be available for any further questions you may have. Thank you, very much. And (inaudible) our First Quarter conference.