Fuwei Films (Holdings), Co. Ltd.
Form 20-F
April 06, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 20-F

(Mark One)

¨ **REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934**

OR

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2016

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from ________________ to ____________________

OR

¨ **SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

OR

Date of event requiring this shell company report _______________

Commission file number: 001-33176

Fuwei Films (Holdings) Co., Ltd.

(Exact name of Registrant as specified in its charter)

(Translation of Registrant's name into English)

Cayman Islands

(Jurisdiction of incorporation or organization)

No. 387 Dongming Road

Weifang Shandong

People's Republic of China, Postal Code: 261061

(Address of principal executive offices)

Yong Jiang

Tel: +86 133 615 59266

fuweiir@fuweifilms.com

(Name, Telephone, E-mail and/or Facsimile number and Address of Company Contact Person)

Securities registered or to be registered pursuant to Section 12(b) of the Act.

Title of each class	Name of each exchange on which registered
Ordinary Shares	NASDAQ Capital Market

Securities registered or to be registered pursuant to Section 12(g) of the Act. None

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act. None

As of December 31, 2016, there were 3,265,837 ordinary shares outstanding.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

¨ Yes x No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

¨ Yes x No

Note - Checking the box will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from their obligations under those Sections.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

x Yes ¨ No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of “accelerated filer and large accelerated filer” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer x

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP x	International Financial Reporting Standards as issued by the International Accounting Standards Board	¨Other¨

If "Other" has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow:

¨ Item 17 ¨ Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

¨ Yes x No

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SPECIAL NOTE ON FORWARD-LOOKING STATEMENTS

This Annual Report contains many statements that are “forward-looking” and uses forward-looking terminology such as “anticipate,” “believe,” “expect,” “estimate,” “future,” “intend,” “may,” “ought to,” “plan,” “should,” “will,” negatives of such similar statements. You should not place undue reliance on any forward-looking statement due to its inherent risk and uncertainties, both general and specific. Although we believe the assumptions on which the forward-looking statements are based are reasonable and within the bounds of our knowledge of our business and operations as of the date of this annual report, any or all of those assumptions could prove to be inaccurate. As a result, the forward-looking statements based on those assumptions could also be incorrect. The forward-looking statements in this Annual Report include, without limitation, statements relating to:

- our goals and strategies;
- our future business development, results of operations and financial condition;
- our ability to protect our intellectual property rights;
- expected growth of and changes in the PRC BOPET film industry and in the demand for BOPET film products;
- projected revenues, profits, earnings and other estimated financial information;
- our ability to maintain and strengthen our position as a leading provider of BOPET film products in China;
- our ability to maintain strong relationships with our customers and suppliers;
- our planned use of proceeds;
- effect of competition in China and demand for and price of our products and services; and
- PRC governmental policies regarding our industry.

The forward-looking statements included in this Annual Report are subject to risks, uncertainties and assumptions about our businesses and business environments. These statements reflect our current views with respect to future events and are not a guarantee of our future performance. Actual results of our operations may differ materially from information contained in the forward-looking statements as a result of risk factors some of which are described under “Risk Factors” and elsewhere in this Annual Report. Risks, uncertainties and assumptions include, among other things:

- competition in the BOPET film industry;
- growth of, and risks inherent in, the BOPET film industry in China;
- unpredictable impact on the company’s revenue by price movements of crude oil in recent years;
- uncertainty in our export due to trade protectionism around the world;
- uncertainty as to future profitability and our ability to obtain adequate financing for our planned capital expenditure requirements;
- uncertainty in our ability to develop and manufacture high value-added products for the new production line (thick film) to win in the competition;
- uncertainty as to our ability to continuously develop new BOPET film products and keep up with changes in BOPET film technology;
- risks associated with possible defects and errors in our products;
- uncertainty as to our ability to protect and enforce our intellectual property rights;

- uncertainty as to our ability to attract and retain qualified executives and personnel;
- uncertainty as to our ability to attract and retain experienced financial reporting staff familiar with U.S. GAAP;
- uncertainty in acquiring raw materials on time and on acceptable terms;
- adverse effect on our business caused by adjustment of economic structure regulations of the Chinese government;
- adverse effect on our business caused by the uncertainty in economic recovery of major developed countries; and
- adverse effect on our business caused by extreme climate changes.

These risks, uncertainties and assumptions are not exhaustive. Other sections of this Annual Report include additional factors which could adversely impact our business and financial performance. The forward-looking statements contained in this Annual Report speak only as of the date of this annual report or, if obtained from third-party studies or reports, the date of the corresponding study or report, and are expressly qualified in their entirety by the cautionary statements in this Annual Report. Since we operate in an emerging and evolving environment and new risk factors and uncertainties emerge from time to time, you should not rely upon forward-looking statements as predictions of future events. Except as otherwise required by the securities laws of the United States, we undertake no obligation to update or revise any forward-looking statements to reflect events or circumstances after the date of this Annual Report or to reflect the occurrence of unanticipated events.

INTRODUCTION

This annual report on Form 20-F includes our audited consolidated financial statements as of December 31, 2016 and 2015 and for the years ended December 31, 2016, 2015 and 2014.

Our ordinary shares are listed on the Nasdaq Capital Market, or NASDAQ, under the symbol “FFHL”.

Except as otherwise required and for purposes of this Annual Report only:

- “Fuwei”, “Company”, “us”, “our” or “we” refer to Fuwei Films (Holdings) Co., Ltd. The term “you” refers to holders of our ordinary shares.
- “China” or “PRC” and the “Chinese government” refer to the People’s Republic of China and its government.
- All references to “Renminbi,” or “RMB” are to the legal currency of China, all references to “U.S. dollars,” “dollars,” “$” or “US$” are to the legal currency of the United States and all references to “Hong Kong dollars” or “HK$” are to the legal currency of Hong Kong. Any discrepancies in any table between totals and sums of the amounts listed are due to rounding.
- “BOPET” refers to the Biaxially Oriented Polyester Film.

CURRENCIES AND EXCHANGE RATES

We publish our financial statements in Chinese Yuan (“Renminbi” or “RMB”). In this annual report on Form 20-F, references to “U.S. dollars” or “$” are to the currency of the United States and references to “RMB” are to the currency of China.

Solely for your convenience, certain RMB amounts in this annual report have been translated into U.S. dollars. The rate of translation is based on the noon buying rate for Chinese Yuan in New York City as certified for custom purposes by the Federal Reserve Bank of New York on the various dates specified where the translations are set forth in this annual report. References to the “noon buying rate” in this annual report refer to this rate. These translations should not be taken as assurances that the RMB amounts actually represent these U.S. dollar amounts or that they were or could have been converted in U.S. dollars at the rate indicated or at any other rate. The noon buying rate was US $1.00 = RMB6.9430 on December 31, 2016.

The following table sets forth various information concerning exchange rates between the Renminbi and the U.S. dollar for the periods indicated. These rates are provided solely for your convenience and are not necessarily the exchange rates that we used in this Annual Report or will use in the preparation of our other periodic reports or any other information to be provided to you. The source of these rates is the Federal Reserve Bank of New York.

	Average	**High**	**Low**	**Period-end**
2011(1)	6.4630	6.6364	6.2939	6.2939
2012(1)	6.3088	6.3879	6.2221	6.2301
2013(1)	6.1478	6.2438	6.0537	6.0537
2014(1)	6.1620	6.2591	6.0402	6.2046
2015(1)	6.2827	6.4896	6.1870	6.4778
2016(1)	6.6400	6.9580	6.4480	6.9430
November 2016(2)	6.8402	6.9195	6.7534	6.8837
December 2016(2)	6.9198	6.9580	6.8771	6.9430
January 2017(2)	6.8907	6.9575	6.8360	6.8768
February 2017(2)	6.8694	6.8821	6.8517	6.8665
March 2017(2)	6.8940	6.9132	6.8687	6.8832

(1) Annual averages are calculated by averaging the rates on the last business day of each month during the relevant period.

(2) Monthly average is calculated by averaging the daily rates during the relevant period.

PART I

Item 1. Identity of Directors, Senior Management and Advisers

Not applicable.

Item 2. Offer Statistics and Expected Timetable

Not applicable.

Item 3. Key Information

A. Selected financial data.

The following selected financial data should be read in conjunction with Item 5 - the "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the Financial Statements and Notes thereto included elsewhere in this Annual Report.

The following selected historical statement of income data for the years ended December 31, 2016, 2015 and 2014 and the selected historical balance sheet data as of December 31, 2016 and 2015 have been derived from the Company's audited consolidated financial statements included in this Annual Report beginning on page F-1. The following selected historical statement of income data for the years ended December 31, 2013 and 2012, and the selected historical balance sheet data as of December 31, 2014, 2013 and 2012 have been derived from the Company's audited financial statements not included in this Annual Report. The audited financial statements are prepared and presented in accordance with United States generally accepted accounting principles, or U.S. GAAP.

Certain factors that affect the comparability of the information set forth in the following table are described in the "Management's Discussion and Analysis of Financial Condition and Results of Operations," and the Financial Statements and related notes thereto included elsewhere in this Annual Report.

	For the year ended December 31,					
	2016		2015	2014	2013	2012
(in thousands, except per share data)	RMB	US$	RMB	RMB	RMB	RMB
Statement of Operations Data:						
Revenues	253,926	36,573	248,862	284,464	304,950	372,866
Gross (loss) profit	17,736	2,555	(4)	(17,153)	(15,425)	(3,107)
Operating (loss) income	(42,239)	(6,083)	(61,186)	(60,692)	(64,394)	(63,984)
Interest expense	(7,865)	(1,133)	(8,333)	(12,486)	(10,094)	-

(Loss) Income before income taxes	(49,166)	(7,081)	(62,068)	(72,084)	(68,959)	(62,164)
Net (loss) income attributable to the Company	(54,483)	(7,847)	(69,065)	(71,327)	(58,971)	(54,427)
(Loss) Earnings per share						
Basic	(16.68)	(2.40)	(5.29)	(5.46)	(4.51)	(4.17)
Diluted	(16.68)	(2.40)	(5.29)	(5.46)	(4.51)	(4.17)
Weighted average number ordinary shares, Basic and diluted						
Basic	3,265,837	3,265,837	13,062,500	13,062,500	13,062,500	13,062,500
Diluted	3,265,837	3,265,837	13,062,500	13,062,500	13,062,500	13,062,500

	Year Ended December 31, 2016		2015	2014	2013	2012
(in thousands)	RMB	US$	RMB	RMB	RMB	RMB
Balance Sheet Data:						
Cash and cash equivalents	13,343	1,922	14,355	9,020	11,578	5,006
Accounts and bills receivable, net	29,453	4,242	10,046	9,867	8,373	21,587
Inventories	25,153	3,623	29,574	24,034	38,454	34,291
Total current assets	155,101	22,340	124,602	120,084	134,613	123,915
Property, plant and equipment, net	410,654	59,146	431,021	482,534	524,777	233,335
Total assets	593,437	85,473	603,771	672,945	732,047	747,550
Short-term bank loans	60,000	8,642	-	-	105,000	110,000
Total current liabilities	325,229	46,843	276,201	272,057	250,200	201,922
Total shareholders' equity	265,211	38,198	319,698	388,913	460,307	519,234

Shandong Fuwei was entitled to preferential tax treatment at an EIT rate of 15% for the years ended December 31, 2011, 2012 and 2013 due to its status as a High-and-New Tech Enterprise since December 2009. In 2014, Shandong Fuwei failed to be designated as such and it became subject to a standard enterprise income tax at a rate of 25% in 2014 and 2015. In 2016, Shandong Fuwei was designated as a High-and-New Tech Enterprise and as a result, it is entitled to preferential tax treatment at an EIT rate of 15% for the years ended December 31, 2016, 2017 and 2018. Net income and basic and diluted earnings per share would be reduced by the following amounts, if Shandong Fuwei was not entitled to a reduced EIT rate for the years 2013, 2012 and 2011:

	Year Ended December 31,			
(In thousands, except per share data)	2013		2012	2011
	RMB	US$	RMB	RMB
Net income	-	-	-	(2,499)
Earnings per share				
- basic	-	-	-	(0.19)
- diluted	-	-	-	(0.19)

The 2016 RMB amounts included in the above selected financial data have been translated into U.S. dollars at the rate of US $1.00 = RMB6.9430, which was the noon buying rate for U.S. dollars in effect on December 31, 2016 in the City of New York for cable transfer in RMB per U.S. dollar as certified for custom purposes by the Federal Reserve Bank. No representation is made that the RMB amounts could have been, or could be, converted into U.S. dollars at that rate or at any other certain rate on December 31, 2016, or on any other date.

Exchange Rate Information

On July 21, 2005 the Chinese government changed its policy of pegging the value of the Renminbi to the U.S. dollar. This revaluation of the Renminbi was based on a conversion of Renminbi into United States dollars at an exchange rate of US$1.00=RMB8.11. Under the new policy, the Renminbi will be permitted to fluctuate within a band against a basket of certain foreign currencies. On December 31, 2016, this change in policy resulted in an approximately 14.4% appreciation in the value of the Renminbi against the U.S. dollar compared to 2005. The Company generates its revenue in the PRC in Renminbi and its overseas sales and U.S. dollars cash deposits are subject to foreign currency translations which will impact net income (loss).

B. Capitalization and indebtedness.

Not applicable.

C. Reasons for the offer and use of proceeds.

Not applicable.

D. Risk factors.

The following matters and other additional risks not presently known to us or that we deem immaterial, may have a material adverse effect on our business, financial condition, liquidity, results of operations or prospects or otherwise. Reference to a cautionary statement in the context of a forward-looking statement or statements shall be deemed to be a statement that any one or more of the following factors may cause actual results to differ materially from those in such forward-looking statement or statements.

(a) Risks Associated with Our Business

Our business may be adversely affected by the exchange rate fluctuation of RMB against the U.S. dollar and trade protection measures in place by several countries against exports of BOPET films from China.

Our business operation may be adversely affected due to appreciation of RMB against the U.S. dollar, and more stringent trade protection measures in place such as antidumping investigations conducted by several countries against exports of BOPET films originated from China.

A sharp fluctuation in the demand for raw materials may have a negative impact on our operations if we are unable to pass on all increases in cost of raw materials to our customers on a timely basis.

The total cost of raw materials made up approximately 67.4%, 66.4% and 67.8% of our production cost in 2016, 2015 and 2014, respectively. The main raw materials used in our production of BOPET film are polyethylene terephthalate (or PET) resin and additives, which respectively made up approximately 77.7% and 22.3% of our total cost of raw materials in the past three years on average.

The prices of PET resin and additives are, to a certain extent, affected by the price movement of crude oil. Currently the PET resin is mainly used as a raw material in China's textile industry. Therefore, the market prices of PET resin will fluctuate due to changes in supply and demand conditions in that industry. Any sudden shortage of supply or significant increase in demand of PET resin and additives may result in higher market prices and thereby increase our cost of sales.

In 2017, it is expected that there will be a continued capacity expansion within China. The further growing oversupply plus price fluctuations of raw materials may continuously have an adverse impact on the results of our operations. Currently, we have no hedging transactions in place with respect to PET resin or any other petroleum product.

Rising Competition caused by soaring capacity of BOPET films may materially affect our operations and financial conditions.

We operate in a highly competitive and rapidly evolving field, and new developments are expected to continue at a rapid pace. Competitors may succeed by expanding their capacity or succeed in developing products that are more efficient, easier to use or less expensive than those which have been or are being developed by us or that would render our technology and products obsolete and non-competitive. Any of these actions by our competitors could adversely affect our sales.

In addition, several companies are developing similar and substitute products to address the same packaging field that we are targeting. These competitors may have greater financial and technical resources, productivity, marketing capabilities and facilities, cost-efficiency and human resources, or they may have a better quality of products, service, and shorter lead time. The competition from these competitors may adversely affect our business.

An increase in competition could result in slow increase in demand, selling price reductions or loss of our market share, which could have an adverse material impact on our operations and financial condition, or result in substantial losses to the Company.

The existing manufacturers and new entrants have been expanding their production capacity of the BOPET films since the second half of 2010, which have resulted in substantial increase in production of BOPET films from 2011 to 2016. As a result, the market supply in 2017 will continuously increase more than demand. This will have an adverse impact on our sales and operation. In the event that we are unable to compete successfully or retain effective control over the pricing of our products, our profit margins might decrease.

In addition, China has gradually lowered import tariffs after its entry into the World Trade Organization in December 2001. Aiming at the huge market for high value-added films in China, manufacturers from developed countries, including Japan and South Korea started investing in China and some of these facilities had been put into production. This may lead to increased competition from foreign companies in our industry, some of which are significantly larger and financially stronger than us. If we fail to compete effectively with these companies in the future, our current business and future growth potential would be adversely affected.

We may be subject to inventory risks that would negatively impact our operating results.

The possible price decline of our inventory may adversely affect the Company’s operation. The fluctuation of the market prices of our raw material inventory and end product inventory will also adversely affect the value of our inventory.

A significant portion of our revenue is derived from the flexible packaging industry in the PRC; our revenue might be adversely impacted if the flexible packaging industry is adversely affected.

A significant portion of our revenue is currently derived from the production and sale of BOPET films. Our BOPET films are mainly used in the flexible packaging industry for consumer products such as tobacco packaging, alcoholic beverages, food, cosmetics and so on. The demand for our BOPET films is therefore affected by the demand for flexible packaging.

Since the second half of 2011, the sales and prices of our products has been declining significantly as a result of increased supply over demand in China and declined demand from overseas markets. If such situation continues in the future, such as the continued slowdown of the market demand or the increase of the demand continues to be less than that of the supply, it could continue to have an adverse impact on our financial condition and operation of our business.

We rely on key managerial and technical personnel and failure to attract or retain such personnel may compromise our ability to perform our strategies and then to develop new products and to effectively carry on our research and development and other efforts.

Our success to date has been largely attributable to the contributions of key management and experienced personnel, with whom we have entered into service agreements. The loss of their services might impede the achievements of our strategies and development objectives and might damage the close business relationship we currently enjoy with some of our major customers. Our continued success is dependent, to a large extent, on our ability to attract or retain the services of these key personnel. Our future success will also depend on our continued ability to attract and retain highly motivated and qualified personnel. The rapid growth of the economy in China has caused intense competition to attract and retain qualified personnel. Considering the deficiency in the legal environment in China, we cannot assure you that we will be able to retain our key personnel or that we will be able to attract, train or retain qualified personnel in the future.

If our R & D team cannot effectively develop new products, or promote the market process, or we are unable to afford to continue to maintain this team or are not able to hire eligible and talented personnel, our ability to conduct research and development, and our operation results and market competitiveness may be adversely affected.

Marketability of any of our new products is uncertain and low acceptance levels of any of our new products will adversely affect our revenue and profitability.

The development of our products is based on complex technology, and requires significant time and expertise in order to meet industry standards and customers' specifications. Although we have developed some products that meet customers' requirements in the past, there is no assurance that any of our research and development efforts will necessarily lead to any new or enhanced products or generate expected market share to justify commercialization. We must continually improve our current products and develop competitive new products to address the requirements of our customers. If our new products are unable to gain market acceptance, we would not be able to generate future revenue from our investment in research and development. In such event, we would be unable to increase our market share and achieve and sustain profitability. Our failure to further refine our technology and develop and introduce new products attractive to the market could cause our products to become uncompetitive or obsolete, which could reduce our market share and cause our sales to decline.

It is difficult to anticipate whether and when our new production line can develop and manufacture high value-added films; this may have an adverse impact on us and we may not be able to reduce our losses.

The total investment in our new production line was approximately US$51 million. We have commenced the R & D of the high value-added products (such as films for TFT-LCD screens) to be manufactured by this line, however, we are uncertain as to whether the products can be developed as scheduled or recognized by customers.

The new production line has been approved to produce common thick films ranging from thickness of 38μm to 250μm, however, it is difficult to anticipate when the new production line can develop high-value-added films.

In addition, the sales prices of our commodity thick films are far less than our costs due to more supply than demand in such a tough market. As a result, the new production line may not be profitable in the short term and may be faced with more losses.

The circumstances under which we acquired ownership of our main productive assets may jeopardize our ability to continue as an operating business.

On September 24, 2004, the People's Court of Weifang declared Shandong Neo-Luck bankrupt due to its financial difficulties. Shandong Neo-Luck pledged its main assets for the operation of the DMT production line to Weifang Commercial Bank before its bankruptcy.

The pledged DMT production line was auctioned on October 22, 2004 by the Shandong Neo-Luck Clearance Committee. DMT subsequently sought monetary damages from Shandong Neo-Luck for approximately US$1.25 million plus interest relating to a claim of partial non-payment for the DMT production line by way of application of the ICC arbitration and the hearing was held in Geneva in November 2007. Fuwei Shandong joined these discussions later as an interested party and in order to support a resolution of the pending dispute and to achieve resolution of certain outstanding service and spare part issues. All parties entered into a Settlement Agreement in March 2008 and the arbitration was withdrawn by the ICC. Under the Service Agreement entered into in connection with the Settlement Agreement, Shandong Fuwei would pay an amount of US$180,000 in two installments with respect to service and spare parts. The Company made its first payment in April 2008. As of December 31, 2016, Shandong Fuwei had paid US$135,000 and still has US$45,000 left unpaid.

Under the Settlement Agreement, the Neoluck Group was obligated to pay an amount equal to US$900,000 in RMB by delivery of a bank draft to DMT. In April 2008, the Neoluck Group had not performed its obligation under the Settlement Agreement, and, the Neoluck Group and DMT entered into a Supplemental Agreement pursuant to which the Neoluck Group would pay the amount owed to DMT in two installments. The Neoluck Group paid the first installment equal to US$450,000 in April 2008. As agreed between Neoluck Group and DMT, the remaining US$450,000 was to be paid in installments by the end of December 2008. As of December 31, 2016, Neoluck Group had paid US$320,000 and still had US$130,000 outstanding to DMT.

Substantially all of our operating assets were acquired through two auction proceedings under relevant PRC law. We acquired the Brückner production line in 2003 as a result of a foreclosure proceeding enforcing an effective court judgment and the DMT production in 2004 as a result of a commercial auction from a consigner who obtained such assets through a bankruptcy proceeding. In the opinion of our PRC counsel, Concord & Partners, these proceedings are both valid under Chinese auction and bankruptcy law based on certain factual assumptions. Our PRC counsel's opinion solely relates to the legal procedure of the auctions and is based upon certain factual assumptions, our written representations and written reports of the auction company and other related parties. There can be no assurance that relevant authorities or creditors of the predecessor owner of these assets will not challenge the effectiveness of these asset transfers based upon the facts and circumstances of these transfers, despite the existence of independent appraisals, and other facts and circumstances of the auctions that cannot be verified by our PRC counsel. Taking into consideration the facts known by our PRC counsel related to the auction of the Brückner production line and the significant difference in the price paid for the DMT production line at the two bankruptcy auctions involved in our purchase of that asset and, assuming the representations and reports received by our PRC counsel are true and correct in all material respects, our PRC counsel is of the opinion that the auctions of the Brückner and DMT production lines were valid under PRC law and the possibility of the creditors of Shandong Neo-Luck successfully exercising recourse or claiming repayment with respect to our assets purchased in the bankruptcy proceeding should be remote. However, should any such challenge be brought in China (or elsewhere) and prevail, we may incur substantial liabilities and be required to pay substantial damages as a result of acquiring these assets and this could materially affect our ability to continue our operation.

We have, in the past, experienced and may, from time to time, experience negative working capital. We also face risks associated with debt financing (including exposure to variation in interest rates).

As of December 31, 2016, we had a long-term loan of RMB3.3 million (US$0.475 million). We have pledged part of our property, plant and lease prepayments as security for indebtedness of a credit line amounting to RMB45.0 million (US$6.48 million) and RMB45.0 million granted by SPD bank and Bank of Weifang, respectively. In the event that we default on all expired indebtedness, our lenders could foreclose on our assets. In the event that our assets are foreclosed upon, we will not be able to continue to operate our business.

Our obligations under our existing loans have been mainly met through the cash flow from our operations and our financing activities. We are subject to risks normally associated with debt financing, including the risk of significant increases in interest rates and the risk that our cash flow will be insufficient to meet required payment of principal and interest. We may also underestimate our capital requirements and other expenditures or overestimate our future cash flows. In such event, we may consider additional bank loans, issuing bonds, or other forms of financing to satisfy our capital requirements. If any of the aforesaid events occur and we are unable for any reason to raise additional capital, debt or other financing to meet our working capital requirements, our business, operating results, liquidity and financial position will be adversely affected. In addition, if we do not obtain financing or have negative working capital, there is a possibility that we may not be able to perform our contracts with our suppliers as a result of our inability to pay them back. The foregoing factors may have an adverse effect on our operation.

We may lose our competitive advantage and our operations may suffer if we fail to prevent the loss or misappropriation of, or disputes over, our intellectual property.

As of December 31, 2016, we have received 16 patents from the PRC authorities. All these patents are related to our products and production processes. We may not be able to successfully obtain the approvals of the PRC authorities for the pending patent applications. In addition to the patents, proprietary techniques including processes, ingredients and technologies are important to our business as they enable us to maintain our competitive advantage over our competitors. Furthermore, third parties may assert claims to our proprietary processes, ingredients and technologies.

Our ability to compete in our markets and to achieve future revenue growth will depend, in significant measure, on our ability to protect our proprietary technology and operate without infringing upon the intellectual property rights of others. The legal regime in China for the protection of intellectual property rights is still at its early stage of development. Intellectual property protection became a national effort in China in 1979 when China adopted its first statute on the protection of trademarks. Since then, China has adopted its Patent Law, Trademark Law and Copyright Law and promulgated related regulations, such as the Regulation on Computer Software Protection, Regulation on the Protection of Layout Designs of Integrated Circuits and Regulation on Internet Domain Names. China has also acceded to various international treaties and conventions in this area, such as the Paris Convention for the Protection of Industrial Property, Patent Cooperation Treaty, Madrid Agreement and its Protocol Concerning the International Registration of Marks. In addition, when China became a party to the World Trade Organization in 2001, China amended many of its laws and regulations to comply with the Agreement on Trade-Related Aspects of Intellectual Property Rights. Despite many laws and regulations promulgated and other efforts made by China over the years with a view to tightening up its regulation and protection of intellectual property rights, the enforcement of such laws and regulations in China has not achieved the level in developed countries. Both the administrative agencies and the court system in China are not well-equipped to deal with violations or handle the nuances and complexities between compliant technological innovation and non-compliant infringement.

We rely on trade secrets and registered patents and trademarks to protect our intellectual property. We have also entered into confidentiality agreements with our management and employees relating to our confidential proprietary information. However, the protection of our intellectual properties may be compromised as a result of:

- departure of any of our management member(s) or employee(s) in possession of our confidential proprietary information;
- breach by such resigned management member(s) or employee(s) of his or her confidentiality and non-disclosure undertaking to us;
- expiration of the protection period of our registered patents or trademarks;
- infringement by others of our proprietary technology and intellectual property rights; or
- refusal by relevant regulatory authorities to approve our patent or trademark applications.

Any of these events or occurrences may reduce or eliminate any competitive advantage we have developed, causing us to lose sales or otherwise harm our business. There is no assurance that the measures that we have put into place to protect our intellectual property rights will be sufficient. As the number of patents, trademarks, copyrights and other intellectual property rights in our industry increases, and as the coverage of these rights and the functionality of the products in the market further overlaps, we believe that business entities in our industry may face more frequent infringement claims. Litigation to enforce our intellectual property rights could result in substantial costs and may not be successful. If we are not able to successfully defend our intellectual property rights, we might lose the rights to technology that we need to conduct and develop our business. This may seriously harm our business, operating results and financial condition, and enable our competitors to use our intellectual property to compete against us.

Furthermore, if third parties claim that our products infringe their patents or other intellectual property rights, we might be required to devote substantial resources to defend against such claims. If we fail to defend against such infringement claims, we may be required to pay damages, modify our products or suspend the production and sale of such products. We cannot guarantee that we will be able to modify our products on commercially reasonable terms.

We may incur capital expenditures in the future in connection with our growth plans and therefore may require additional financing.

To expand our business, we will need to increase our products mix and capacity, which will require substantial capital expenditures especially enough working capital for the continued operation of our new production line. Such expenditures are likely to be incurred in advance of any increase in sales. We cannot assure you that our revenue will increase after such capital expenditures are incurred. Any failure to increase our revenue after incurring capital expenditures to expand production capacity will reduce our profitability.

In addition, we may need to obtain additional debt or equity financing to fund our capital expenditures. Additional equity financing may result in dilution to existing shareholders' return. Additional debt financing may be required which, if obtained, may:

- limit our ability to pay dividends or require us to seek consents for the payment of dividends;
- increase our vulnerability to general adverse economic and industry conditions;
- limit our ability to pursue our growth plan;
- require us to dedicate a substantial portion of our cash flow from operations to payment for our debt, thereby reducing availability of our cash flow to fund capital expenditures, working capital and other general corporate purposes;
- limit our flexibility in planning for, or reacting to, changes in our business and our industry; and/or
- not assure that we will be able to obtain the additional financing on terms that are acceptable to us, if at all.

A disruption in the supply of utilities, or fire or other calamity at our manufacturing plant would disrupt production of our products and adversely affect our sales.

Our BOPET films are manufactured solely at our production facilities located in Weifang City in the PRC. Any disruption in the supply of utilities, in particular, electricity, water or gas supply or any outbreak of fire, flood or other calamity resulting in significant damage at our facilities would severely affect our production of BOPET film and, as a result, we could incur substantial loss of equipment and properties.

While we maintain insurance policies covering losses in respect of damage to our properties, machinery and inventories of raw materials and products, we cannot assure you that our insurance would be sufficient to cover all of our potential losses.

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We have limited experience in operating outside mainland China, and failure to achieve our overseas expansion strategy may have an adverse effect on our business growth in the future.

Our future growth depends, to a considerable extent, on our ability to develop both the domestic and overseas markets. We are currently exploring new business opportunities outside mainland China for our BOPET film products. Our primary overseas customers are from Europe, Asia and North America. However, we have limited experience in operating outside mainland China, and limited experience with foreign regulatory environments and market practices. As a result, we cannot guarantee that we will be able to penetrate any overseas market. Failure in the development of overseas market may have an adverse effect on our business growth in the future.

We have encountered anti-dumping investigations in South Korea and the United States, and our overseas expansion strategy in our future business growth may be adversely affected.

Since 2007, the manufacturers in China, India and other countries have encountered anti-dumping investigations conducted by South Korea and the United States.

The Korean Trading Committee (KTC) announced the final results for anti-dumping investigations for enterprises in China and India on August 27, 2008. We finally received the anti-dumping duties (ADD) rate of 5.67% which is much lower than the average rate of 23.60% for other enterprises in China. On June 22, 2011, Ministry of Strategy and Finance, Republic of Korea, initiated a sunset review concerning the continued imposition of an anti-dumping duty on imports of the BOPET Films originating from China and India. The rate for Shandong Fuwei, the subsidiary of Fuwei Films was set at 11.72%, higher than one of its counterparts at 5.87%. Punitive duties of 25.32% will be imposed on the PET films manufactured by six Chinese firms. The rate for the remaining Chinese manufacturers was set at 23.61%. The anti-dumping duties imposed on the Company’s exported biaxially oriented polyethylene-terephthalate (BOPET) films to South Korea will be extended for three more years beginning on May 25, 2012.

On January 15, 2015, the Ministry of Strategy and Finance, Republic of Korea, initiated a sunset review concerning the continued imposition of an anti-dumping duty on imports of Polyethylene Terephthalate originating from China and India. Eight Chinese exporters, including Fuwei Films, are required to participate in this review. On January 13, 2016, the Ministry of Strategy and Finance announced that the rate for Shandong Fuwei, the subsidiary of Fuwei Films, was set at 12.92% and it will be extended for three more years beginning on January 13, 2016.

The US Department of Commerce conducted the anti-dumping investigation in October 2007 covering exporters in China, Brazil, Thailand and the United Arab Emirates. 41 exporters in China were under investigation. In October 2008, the anti-dumping judgments were announced. Although we received the lowest ADD rate of 3.49% among five exporters that received a duty, our export to the United States, to a certain extent, was still adversely affected by paying the ADD.

On January 23, 2010, the US Department of Commerce ("USDOC") began a first round annual review of Chinese BOPET exporters. Fuwei received the lowest anti-dumping duty (ADD) rate of 30.91% in this administrative review conducted by the USDOC, while the ADD rate of other four Chinese companies reviewed by the USDOC is more than 36.93%. In accordance with relevant laws and regulations in the US, the ADD rate of final results will retroactively apply to those US companies which imported Chinese-exported BOPET films, including Fuwei Films USA, LLC, during the period of first review, so these US importers are obligated to pay a supplementary antidumping duty at this ADD rate. In March 2011, we submitted comments to the USDOC regarding perceived ministerial errors made in calculating the ADD applicable to us. As a result of a Court challenge brought by Fuwei, in January 2013, the USDOC found that Fuwei did not dump goods in the United States market for the period from November 6, 2008 to October 31, 2009. The USDOC, after recalculating the rate, found that the level of dumping was "de minimis." A rate which is de minimis is treated by the USDOC as a finding of zero. The final results of the second round annual review were announced in March 2012, according to which, an ADD rate of 8.48% was imposed on Fuwei Films which is slightly higher than the lowest antidumping duty rate of 8.42% of all the Chinese exporters being reviewed.

On December 30, 2011, USDOC commenced its third routine annual review of BOPET films originated from China. In order to gain an opportunity to continue exporting to the United States, Fuwei Films, although not a mandatory respondent, will actively respond to the review to the extent permitted by law and will continue to seek the low rate which should properly apply to its exports to the United States. In June 2013, the final results of the third round annual review were issued and an ADD rate of 12.80% was imposed on Fuwei Films. The preliminary results of the fourth round annual review were announced in December 2013, according to which, an ADD rate of 31.77% was imposed on Fuwei Films. In June 2014, the final results of the fourth round annual review were announced and Fuwei Films was imposed on an ADD rate of 31.24%. There was no export to the United States for the year of 2014. The preliminary results of the fifth round annual review were announced in December 2014, which determined that Fuwei Films did not have any reviewable transactions during the fifth round annual review and no rate was assigned to it. On December 23, 2014, the USDOC initiated the sixth round annual review. In February 2015, Fuwei Films filed a No Shipment Certification with USDOC as the Company had no export to U.S. during the sixth round annual review. The domestic industry has withdrawn the request for the seventh round annual review for the years 2015 and 2016 and as a result, the administrative review with respect to Fuwei will be rescinded and no changes will be made to the deposit rate.

In addition, if other countries or regions, such as the European Union, take trade protection measures against China's BOPET film or downstream industries, our business may be adversely affected.

Changes in Applicable PRC Taxes may be adversely affect the Company.

On October 18, 2010, the State Council issued a notice that the city maintenance and construction tax as well as educational surcharges shall be extended from Chinese companies to foreign-funded enterprises and citizens. Beginning December 1, 2010, Interim Regulations on City Maintenance and Construction Tax of the People's Republic of China and Decision of the State Council on Amending the Interim Provisions on the Collection of Educational Surcharges shall be applicable to foreign-funded enterprises, foreign enterprises and foreign citizens, which mean they will no longer be exempt from such taxes. In accordance with the regulations, since December 1, 2010, our subsidiary - Shandong Fuwei - became a taxpayer of city maintenance and construction tax as well as educational surcharges which shall be based on value-added tax, the consumption tax and business tax which currently stands at 12%. In July 2011, according to the new rules promulgated by the local government in China, Shandong Fuwei shall contribute to a fund for local water conservation projects since July 1, 2011 which is based on the actual value-added tax, consumption tax and business tax with a rate of 1%. In August 2014, the local government promulgated a new regulation that adjusted the standard of urban land use tax, according to which the tax amount for Shandong Fuwei increased from RMB8 per square meter to RMB14 per square meter commencing July 1, 2014. In addition, the tax amount was further adjusted from RMB14 per square meter to RMB13 per square meter effective December 2016. If the Chinese government changes its tax policies or adds new types of taxes in the future, our business may be adversely affected.

China's actions to save energy and reduce emissions may adversely affect our business, by subjecting us to significant new costs and restrictions on our operations.

Recently the Chinese government has tightened its control over energy saving and emission reduction. The Chinese government intends to reduce energy consumption for gross domestic products and water consumption for industrial added value. Certain of our manufacturing plants that use significant amounts of energy, including electricity and gas, are likely to be affected by this plan. Therefore, our operation might be influenced by the energy saving and emission reduction measures of the Chinese government. Regulations for restricting greenhouse gas emission may increase the prices of the electricity we purchase, increase costs for our use of natural gas, potentially restrict access to or the use of natural gas, require us to purchase allowances to offset our emissions or result in an overall increase in our costs of raw materials, any of which could increase costs and negatively affect our business operations or financial results.

The current labor law changes in the PRC may have an adverse impact on our business and profitability.

The Company is of the view that the amended Labor Law of the People's Republic of China (the "PRC"), which took effect on January 1, 2008 and contains certain heightened requirements with respect to employment law, does not constitute a material risk to the Company. The amended Labor Law contains new provisions which protect the interests of the employees, including provisions which stipulate that an employer shall enter into labor contracts with its employees and pay social welfare insurance which may increase our human resources costs. In addition, the amended Labor Law also states that upon expiry of the labor contract, under some circumstances, an employer shall compensate an employee of the employer who does not renew the labor contract, which may increase our operating expenses. However, to the best of the Company's knowledge, Shandong Fuwei constantly abides by the Labor Law of PRC, as amended, and therefore we does not believe the labor law provisions and any changes will have any material impact on its business or profitability. However, the Labor Law changes in the PRC in the future may have an adverse impact on our business and profitability.

Our primary source of funds for dividends and other distributions from our operating subsidiary in China is subject to various legal and contractual restrictions and uncertainties, and our ability to pay dividends or make other distributions to our shareholders are negatively affected by those restrictions and uncertainties.

We are a holding company established in the Cayman Islands and conduct our core business operations through our principal operating subsidiary, Shandong Fuwei, in China. As a result, our profits available for distribution to our shareholders are dependent on the profits available for distribution from Shandong Fuwei. If Shandong Fuwei incurs debt on its own behalf, the debt instruments may restrict its ability to pay dividends or make other distributions, which in turn would limit our ability to pay dividends of our ordinary shares. Under the current PRC laws, because we are incorporated in the Cayman Islands, our PRC subsidiary, Shandong Fuwei, is regarded as a wholly foreign-owned enterprise in China. For dividends paid by foreign invested enterprises, the PRC laws permit payment of dividends only out of net income as determined in accordance with PRC accounting standards and regulations. Determination of net income under PRC accounting standards and regulations may differ from determination under U.S. GAAP in significant respects, such as the use of different principles for recognition of revenues and expenses. In addition, distribution of additional equity interests by our PRC subsidiary, Shandong Fuwei, to us (which is credited as fully paid through capitalizing its undistributed profits) requires additional approval of the PRC government. Under the PRC laws, Shandong Fuwei, a wholly foreign-owned enterprise, is required to set aside a portion of its net income each year to fund designated statutory reserve funds. These reserves are not distributable as cash dividends. As a result, our primary internal source of funds of dividend payments from Shandong Fuwei is subject to these and other legal and contractual restrictions and uncertainties, which in turn may limit or impair our ability to pay dividends to our shareholders. Moreover, any allotment of funds from us to Shandong Fuwei, either as a shareholder loan or as an increase in registered capital, is subject to registration with or approval by PRC governmental authorities. These limitations on the flow of funds between us and Shandong Fuwei could restrict our ability to act in response to changing market conditions.

Investor confidence and the market price of our shares may be adversely impacted if we are unable to issue an unqualified opinion on the adequacy of our internal controls over our financial reporting beginning as of December 31, 2016, as required by Section 404 of the U.S. Sarbanes-Oxley Act of 2002.

As a public company, we are required by section 404 of the Sarbanes-Oxley Act 2002 to include a report by management on our internal controls over financial reporting that contains our management's assessment of the effectiveness of our internal controls in our annual report on Form 20-F. Based on our evaluation, our principal executive officer and principal financial officer previously concluded as of December 31, 2010, our internal controls over financial reporting were effective as of such date. However, in connection with the review of our Annual Report on Form 20-F by the Securities and Exchange Commission and subsequent reconsideration of the conclusion regarding effectiveness originally expressed therein, our principal executive officer and principal financial officer have now revised their conclusions and believe that as of the Evaluation Date, our internal controls over financial reporting were ineffective as of December 31, 2010 and that such internal controls exhibited a "material weakness," or a deficiency, or combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of our annual or interim financial statements will not be prevented or detected on a timely basis. The material weaknesses identified resulted from inadequate technical accounting staff with knowledge of and experience with US generally accepted accounting principles, pursuant to which we prepare our consolidated financial statements, to support stand-alone external financial reporting under public company or SEC requirements. The report of management contained in this Annual Report on Form 20-F also reflects the determination of the reviewing officers that as of December 31, 2011, 2012, 2013, 2014, 2015 and 2016, we continued to have a material weakness in our internal controls over financial reporting.

We are in the process of developing and implementing a remedial plan to address the deficiencies in the areas of personnel with knowledge of and experience with US generally accepted accounting principles, including recruiting a full-time reporting employee with U.S. GAAP experience and conducting training in U.S. GAAP principles for all the financial reporting staff of the Company. However, additional measures may be necessary, and the measures we expect to take to improve our internal controls may not be sufficient to address the issues identified, to ensure that our internal controls are effective or to ensure that such material weakness or other material weaknesses would not result in a material misstatement of our annual or interim financial statements. In addition, other material weaknesses or significant deficiencies may be identified in the future. If we are unable to correct deficiencies in internal controls in a timely manner, our ability to record, process, summarize and report financial information accurately and within the time periods specified in the rules and forms of the SEC will be adversely affected. This failure could negatively affect the market price and trading liquidity of our common stock, cause investors to lose confidence in our reported financial information, subject us to civil and criminal investigations and penalties, and generally materially and adversely impact our business and financial condition.

(b) Risks Relating to Business Operations in China

Changes in China's political and economic policies and conditions could cause a substantial decline in the demand for our products and services.

Currently, we derive substantially most of our revenues from mainland China. We anticipate that mainland China will continue to be our primary production and sales base in the near future. In addition, currently, substantially all of our assets are located in China and most of our services are performed in China. In 2016, 2015 and 2014, sales to our customers in the PRC accounted for approximately 83.5%, 78.0% and 84.9%, respectively, of our total revenue. Accordingly, any significant slowdown in the PRC economy or decline in demand for our products from our customers in the PRC will have an adverse effect on our business, financial condition and results of our operations. Furthermore, any unfavorable changes in the social and political conditions of the PRC may also adversely affect our business and operations.

Since the adoption of the "open door policy" in 1978 and the "socialist market economy" in 1992, the PRC government has been reforming and is expected to continue to reform its economic and political systems. Any changes in the political and economic policy of the PRC government may lead to changes in the laws and regulations or the interpretation of the same, as well as changes in the foreign exchange regulations, taxation and import and export restrictions, which may in turn adversely affect our financial performance. While the current policy of the PRC government seems to be one of imposing economic reform policies to encourage foreign investments and greater economic decentralization, there is no assurance that such a policy will continue to prevail in the future. We cannot make any assurances that our operations would not be adversely affected should there be any policy changes.

The financial policies, such as bank reserve ratio and deposit and loan interest rates, are subject to adjustment in accordance with the economic development. These policy changes may adversely affect our business.

A Chinese entity has substantial influence over our company and its interest may not be aligned with the interests of other holders of our ordinary shares.

Hongkong Ruishang International Trade Co., Ltd. ("Hongkong Ruishang"), beneficially owns approximately 52.90% of our outstanding share capital. Hongkong Ruishang has substantial influence over our business, including decisions regarding mergers, consolidations and the sale of all or substantially all of our assets, election of directors and other significant corporate actions. This concentration of ownership may discourage, delay or prevent a change in control of our company, which could deprive our shareholders of an opportunity to receive a premium for their shares as part of a sale of our company and might reduce the price of our ordinary shares. Alternatively, our controlling shareholder may cause a merger, consolidation or change of control transaction even if it is opposed by other shareholders.

In addition, Mr. Xiusheng Wang, who is the chairman of the board of directors of Hongkong Ruishang is also the Chairman of the board of directors of Shandong SNTON Group Co., Ltd. (the "SNTON Group") which has a wholly owned subsidiary, Shandong SNTON Optical Materials Technology Co., Ltd. ("SNTON Optical"), a company in the BOPET industry. Furthermore, Mr. Benjie Dong, who was appointed as our Chief Financial Officer effective April 1, 2016 to fill the vacancy caused by resignation of Mr. Xiuyong Zhang, is also the director and vice president of SNTON Group. Majority of our products, customers and market orientation may be the same as SNTON Optical and as a result, the marketing strategy may conflict with the interests of other holders of our ordinary shares.

The discontinuation of any preferential tax treatments or other incentives currently available to us in the PRC could materially and adversely affect our business, financial condition and results of operations.

Our subsidiary, Shandong Fuwei, was converted into a wholly foreign owned enterprise in January 2005 and could enjoy certain special or preferential tax treatments regarding enterprise income tax in accordance with the "Income Tax Law of the PRC for Enterprises with Foreign Investment and Foreign Enterprises" at that time. Accordingly, at that time, it was entitled to tax concessions whereby the profit for the first two financial years beginning with the first profit-making year (after setting off tax losses carried forward from prior years) was exempt from income tax in the PRC and the profit for each of the subsequent three financial years was taxed at 50% of the prevailing tax rates set by the relevant tax authorities. Shandong Fuwei was designated as a High-and-New Tech Enterprise in December 2008 and was recertified in October 2011 and enjoys a favorable enterprise income tax rate of 15%. If there are any future changes in PRC tax laws, rules and regulations or Shandong Fuwei will not be designated as a High-and-New Tech Enterprise, Shandong Fuwei will no longer enjoy the preferential tax treatment. In December 2014, Shandong Fuwei failed to be designated as a High-and-New Tech Enterprise. As a result, Shandong Fuwei is now subject to a 25% standard enterprise income tax rate since from 2014. In 2016, Shandong Fuwei was designated as a High-and-New Tech Enterprise and as a result, it is entitled to preferential tax treatment at an EIT rate of 15% for the years ended December 31, 2016, 2017 and 2018.

On March 16, 2007, the National People's Congress of the PRC passed the Enterprise Income Tax Law of the People's Republic of China, which took effect on January 1, 2008. In accordance with the law, a unified enterprise income tax rate of 25% and unified tax deduction standards were applied equally to both domestic-invested enterprises and foreign-invested enterprises. Enterprises established prior to March 16, 2007 eligible for preferential tax treatment in accordance with the currently prevailing tax laws and administrative regulations would, under the regulations of the State Council, gradually become subject to the new tax rate over a five-year transition period starting from the date of effectiveness of the law. We expect details of the transitional arrangement for the five-year period from January 1, 2008 to December 31, 2012 applicable to enterprises established prior to March 16, 2007, such as Shandong Fuwei, to be set out in more detailed implementing rules to be adopted in the future. In addition, certain qualifying "High Technology Enterprises" may still benefit from a preferential tax rate of 15% under the new tax law if they meet the definition of "Government Advocated High Technology Enterprise" to be set forth in the more detailed implementing rules when they become adopted. Shandong Fuwei was designated as a High-and-New Tech Enterprise in December 2008 and will retain its status as a high-tech enterprise for three years commencing from 2011 enjoying a favorable corporate tax rate during the term from January 1, 2011 to December 31, 2013 pursuant to the income law Enterprise Income Tax Law. In 2016, Shandong Fuwei was designated as a High-and-New Tech Enterprise and as a result, it is entitled to preferential tax treatment at an EIT rate of 15% for the years ended December 31, 2016, 2017 and 2018.

In accordance with a notice issued by the PRC government in October, 2010, since December 1, 2010, Shandong Fuwei, our subsidiary, will become a taxpayer of city maintenance and construction tax as well as educational surcharges which shall be based on value-added tax, the consumption tax and business tax which currently stand at 12%. In July 2011, according to the new rules promulgated by the local government in China, Shandong Fuwei shall contribute to a fund for local water conservation projects since July 1, 2011 which is based on the actual value-added tax, consumption tax and business tax with a rate of 1%. The policy changes may have an adverse impact on our net profit.

We are subject to environmental laws and regulations in the PRC.

We are subject to environmental laws and regulations in the PRC. Any failure by us to comply fully with such laws and regulations will result in us being subject to penalties and fines or being required to pay damages. Any change in the regulations may require us to acquire equipment or incur additional capital expenditure or costs in order to comply with such regulations. Our profits will be adversely affected if we are unable to pass on such additional costs to our customers.

In recent years, there have been many newly-built residential buildings in close proximity to our factory. In March 2014 and November 2015, due to the noise caused by our production, Shandong Fuwei was fined RMB10,000 and RMB20,000, respectively, and was required to rectify and reform within a definite time. The complaints from nearby residents about the noise caused by our production may require us to take measures to lower noise, which will lead to additional cost to us. In the event that we are forced to suspend our production to take improvement measures, our operations and earnings may be adversely affected.

Changes in foreign exchange regulations in China may affect our ability to pay dividends in foreign currencies.

We currently receive most of our operating revenues in Renminbi. Currently, Renminbi is not a freely convertible currency and the restrictions on currency exchanges in China may limit our ability to use revenues generated in Renminbi to fund our business activities outside China or to make dividends or other payments in U.S. dollars. The PRC government strictly regulates conversion of Renminbi into foreign currencies. Over the years, the PRC government has significantly reduced its control over routine foreign exchange transactions under current accounts, including trade- and service-related foreign exchange transactions, foreign debt service and payment of dividends. In accordance with the existing foreign exchange regulations in China, our PRC subsidiary, Shandong Fuwei, is able to pay dividends in foreign currencies, without prior approval from the PRC State Administration of Foreign Exchange, or SAFE, by complying with certain procedural requirements. The PRC government may, however, at its discretion, restrict access in the future to foreign currencies for current account transactions and prohibit us from converting our Renminbi-denominated earnings into foreign currencies. If this occurs, our PRC subsidiary may not be able to pay us dividends in foreign currency without prior approval from SAFE. In addition, conversion of Renminbi for most capital account items, including direct investments, is still subject to government approval in China and companies are required to open and maintain separate foreign exchange accounts for capital account items. This restriction may limit our ability to invest earnings of Shandong Fuwei.

Fluctuation in the value of Renminbi could adversely affect our overseas sales and import of raw materials and the value of, and dividends payable on, our shares in foreign currency terms.

The value of Renminbi is subject to various factors and depends to a large extent on China's domestic and international economic, financial and political developments, as well as the currency's supply and demand in the local market. From 1994, the conversion of Renminbi into foreign currencies, including the U.S. dollar, was based on exchange rates set and published daily by the People's Bank of China, the PRC central bank, based on the previous day's interbank foreign exchange market rates in China and exchange rates on the world financial markets. The official exchange rate for the conversion of Renminbi into U.S. dollars remained stable until Renminbi was revalued in July 2005 and allowed to fluctuate by reference to a basket of foreign currencies, including the U.S. dollar. Under the new policy, Renminbi is permitted to fluctuate within a band against a basket of foreign currencies. This change in policy resulted initially in an approximately 2.0% appreciation in the value of Renminbi against the U.S. dollar. The Chinese government may adopt a substantially more liberalized currency policy, which could result in a further and more significant fluctuation in the value of Renminbi against the U.S. dollar. Since our income and profits are denominated in Renminbi, fluctuation in the value of Renminbi could adversely affect our overseas sales and import of raw materials and further negatively affect our revenue and net income. Any appreciation of Renminbi would increase the value of, and any dividends payable on, our shares in foreign currency terms. Conversely, any depreciation of Renminbi would decrease the value of, and any dividends payable on, our shares in foreign currency terms.

The uncertain legal environment in China could limit the legal protections available to you.

The PRC legal system is a civil law system based on written statutes. Unlike the common law system, the civil law system is a system in which decided legal cases have little precedential value. In the late 1970s, the PRC government began to promulgate a comprehensive system of laws and regulations to provide general guidance on economic and business practices in China and to regulate foreign investment. Our PRC subsidiary, Shandong Fuwei, is a wholly foreign-owned enterprise and is subject to laws and regulations applicable to foreign investment in China in general and laws and regulations applicable to wholly foreign-owned enterprises in particular. China has made significant progress in the promulgation of laws and regulations dealing with economic matters such as corporate organization and governance, foreign investment, commerce, taxation and trade. However, the promulgation of new laws, changes of existing laws and abrogation of local regulations by national laws may have a negative impact on our business and prospects. In addition, as these laws, regulations and legal requirements are relatively recent and because of the limited volume of published cases and their non-binding nature, the interpretation and enforcement of these laws, regulations and legal requirements involve significant uncertainties. These uncertainties could limit the legal protections available to foreign investors, including you. For example, it is not clear if a PRC court would enforce in China a foreign court decision brought by you against us in shareholders' derivative actions. Moreover, the enforceability of contracts in China, especially with the government, is relatively uncertain. If counterparties repudiated our contracts or defaulted on their obligations, we may not have adequate remedies. Such uncertainties or inability to enforce our contracts could materially and adversely affect our revenues and earnings.

Outbreak of viruses such as SARS, H1N1 or other epidemics could materially and adversely affect our overall operations and results of operations.

From March to July 2003, mainland China, Hong Kong, Taiwan and some other areas in Asia experienced an outbreak of a new and contagious form of atypical pneumonia known as severe acute respiratory syndrome, or SARS. A recurrent outbreak, or an outbreak of a similarly contagious disease, such as the H1N1 avian flu, could potentially disrupt our operations to the extent that any one of our employees is suspected of having the infection or that any of our facilities is identified as a possible source of spreading the virus or disease. We may be required to quarantine employees who are suspected of having an infection. We may also be required to disinfect our facilities and therefore suffer a suspension of production of indefinite duration. Any quarantine or suspension of production at any of our facilities will adversely affect our overall operations. In addition, any such outbreak will likely restrict the level of economic activities in the affected areas, which could lead to a substantial decrease in our revenues accompanied by an increase in our costs.

Regulations relating to offshore investment activities by PRC residents may limit our ability to acquire PRC companies and adversely affect our business and prospects.

The Chinese State Administration of Foreign Exchange ("SAFE") has promulgated several regulations, including the Notice on Relevant Issues Concerning Foreign Exchange Administration for Domestic Residents' Financing and Roundtrip Investment through Offshore Special Purpose Vehicles, or Circular 75, effective on November 1, 2005 and its implementation rules. These regulations require PRC residents and PRC corporate entities to register with local branches of SAFE in connection with their direct or indirect offshore investment activities. These regulations are applicable to our shareholders who are PRC corporate entities and may be applicable to any offshore acquisitions that we make in the future. Under these foreign exchange regulations, PRC residents who make, or have prior to the implementation of these foreign exchange regulations made, direct or indirect investments in offshore special purpose vehicles, or SPVs, will be required to register such investments with SAFE or its local branches. In addition, any PRC corporate entities who is a direct or indirect shareholder of an SPV, is required to update its filed registration with the local branch of SAFE with respect to that SPV, to reflect any material change.

Circular of the State Administration of Foreign Exchange on Printing and Distributing on the Operating Rules for the Administration of Foreign Exchange with Respect to the Financing and Round-tripping Investment of Domestic Residents via Overseas Special Purpose Companies ("Circular 19") was promulgated by SAFE on May 20, 2011 and came into effect on July 1, 2011. Circular 19 further clarifies the administration principles of Circular 75 and the relevant issues in its application and simplifies operating procedures. To a certain extent, Circular 19 will benefit the offshore investment and round-tripping investment.

Provisions on the Merger and Acquisition of Domestic Enterprises by Foreign Investors (Revised in 2009) ("Circular 6") was promulgated by Ministry of Commerce and came into effect on June 22, 2009. According to Circular 6, where a domestic company sets up a company with special purpose abroad, it shall apply to the Ministry of Commerce for going through the examination and approval formalities. When merging or acquiring related domestic companies in the name of the companies in foreign countries legally established or controlled by them, the domestic companies, enterprises or natural persons shall report to the Ministry of Commerce for approval.

Item 4. Information on the Company

Overview

We were formed as a Cayman Islands corporation in August 2004 under the name "Neo-Luck Plastic Holdings Co., Ltd." and changed our name to "Fuwei Films (Holdings) Co., Ltd." in April 2005. Our corporate headquarters, principal place of business, production and ancillary facilities occupy an area of approximately 74,251 square meters at No. 387 Dongming Road, Weifang Shandong 261061, People's Republic of China. Our agent for service in the United States is CT Corporation System located at 111 Eighth Avenue, NY, NY 10011.

We develop, manufacture and distribute high quality plastic film using the biaxially- oriented stretch technique, otherwise known as BOPET film (biaxially-oriented polyethylene terephthalate). The film is light-weight, non-toxic, odorless, transparent, glossy, temperature and moisture-resistant, making it suitable for many forms of flexible packaging, printing, laminating, aluminum-plating and other applications. In addition, it retains high dielectric strength and volume resistance even at high temperatures, which are essential qualities for electrical and electronic uses. Our BOPET film is widely used in consumer based packaging (such as food, pharmaceutical, cosmetics, tobacco and alcohol industries), imaging (such as printing plates and microfilms), electronics and electrical industries (such as wire and cable wrap, capacitors and motor insulation), as well as in magnetic products (such as audio and video tapes). We market our products under our brand name of "Fuwei Films". Our main products are as below:

- Printing base film used in printing and lamination;
- Stamping foil base film and transfer base films used for packaging of luxury items of cigarettes and alcohol to increase the aesthetic presentation of the item and improving environmental performance;
- Metallized film or aluminum plating base film used for vacuum aluminum plating for flexible plastic lamination;
- High-gloss film used for aesthetically enhanced packaging purposes;
- Heat-sealable film used for construction, printing and making heat sealable bags;
- Laser holographic base film used as anti-counterfeit film for food, medicine, cosmetics, cigarettes and alcohol packaging;
- Dry film is generally used in circuit boards (PCB & FPC) production, and sometimes used for nameplate and crafts etching;
- Heat shrinkable film is widely used for special-shaped packaging for beverage and cosmetics; and
- Chemically treated film used to enhance properties including barrier resistance, printing properties and electrostatic resistance.

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Since our establishment, a significant portion of our revenues has been derived from the sales of BOPET film, particularly our printing film, stamping film, transfer film and chemical pretreated film, high-gloss film, heat sealable film, dry film, and heat shrinkable film and so on.

We operate three production lines and have had one trial production line as of December 31, 2016. The first line is a Brückner 6.3 m (in width) production line with an annual design capacity of 13,000 metric tons of BOPET film. The second line is a DMT production line which is three-layer co-extruded with 6.7 m (in width), and has an annual design capacity of 16,100 metric tons of BOPET film. We also have a Mitsubishi trial production line which has an annual design capacity of 1,500 metric tons. The new production line has been put into trial operation at the end of January 2013. The commissioning of this production line was delayed due to the former major shareholders' ownership transfer in early 2011. This production line will manufacture high-performance electric insulation film, base film for solar backsheet and TFT-LCD optical film with an annual design capacity of 23,000 metric tons and thickness between 38 and 250μm. As of September 2013, our third production line has been approved. A sample diffusion film (a type of TFT-LCD optical film) was preliminarily accepted by four customers after being delivered to these four customers for testing. We are supplying small batches of products according to one of the four customer's purchase order. In addition, a sample base film for solar backsheets has been delivered to a customer for initial testing. We received an initial feedback from this customer and we are improving according to the feedback. It could not satisfy the requirements of continued operation for the third production line due to lack of purchase orders. The third production line has not been started up ever since April 2015. As of December 31, 2016, our manufacturing operations had a total annual design capacity of 53,600 metric tons based upon 7,200 production hours per annum.

Our top five customers in the year ended December 31, 2016 were Eternal Electronic Material (Guangzhou) Co., Ltd., Yunnan Dexin Zhiye Co., Ltd., Eternal Photo Electronic Materials (Guangzhou) Co., Ltd., Hololens Technology Co., Ltd., and Celplast Metallized Products Limited. None of our customers accounted for more than 10% of our total revenues in any such year. We sell most of our BOPET film products to customers in the flexible packaging industry in the PRC in the coastal region of China. In addition, we expect to continue to expand our product portfolio to exploit opportunities in different market sectors, such as electronics industries. In 2016, 2015 and 2014, our sales to our overseas customers constituted approximately 16.5%, 22.0% and 15.1% of our total revenue, respectively.

On April 23, 2009, Fuwei Films USA, LLC was set up in South Carolina and co-invested by Fuwei Films (Holdings) Co., Ltd. and Newell Finance Management Co., Ltd. Fuwei Films USA, LLC has a registered capital of US$10,000 and total investment amount of US$100,000. Fuwei Films (Holdings) Co., Ltd. and Newell Finance Management Co., Ltd. own 60% and 40% of the total shares of Fuwei Films USA, LLC, respectively. In December 2016, Fuwei Films USA, LLC was dissolved.

Competitive Strengths

We believe that our competitive strengths have enabled us over the years to meet the needs of our customers and become a leading provider of BOPET film products in China. We also believe that our strengths will continue to help us grow in the BOPET film industry in both China and internationally. Our principal strengths include the following:

We have the capability to expand our product range and markets by introducing new products required by customers.

We believe that our experience in the industry and personnel will enable us to continue to provide new BOPET film products required by customers, and we have already developed a series of new products. Our R&D team comprises of 6 full-time research personnel in total.

We have an established brand name and are recognized for our product quality in the PRC.

Our products are marketed under our brand name, “Fuwei Films”. We believe that this brand name is well known in the BOPET film market in the PRC and, although our selling prices sometimes exceed those of our competitors, our products have achieved significant market acceptance because of its high quality and our superior customer service. In January 2011, Fuwei Films was recognized as “Shandong Famous Brand”. In January, 2014, Fuwei Films was awarded once more as “Shandong Famous Brand” for an additional five years after being reviewed.

We manufacture high quality products that can be customized for our clients.

We implement and enforce stringent quality controls on our production process and products. As part of our production process, we formulate different blends of PET resins and additives to produce film with specific properties for our customers based on their requirements. In addition, we have developed a special production process and we believe using these formulas will produce products that will meet our customers’ requirements in quality.

We have an experienced management team with extensive industry experience.

Our management team has extensive management experience and most of them have many years of experience in the R&D, manufacturing and marketing of BOPET films.

We can continually renovate or update our production lines according to the market trends and our R & D facilities are advanced in the PRC.

Our first production line was German made and manufactured by Brückner and the second was made by DMT in France. The third production line was made by Linduer Dornoer GmbH in Germany. We continually renovate or update these production lines according to the market trends to enable these lines to produce competitive and premium products. We have a trial production line for R & D, which enables our R & D capability to take lead in the industry.

Awards and Certifications

Our subsidiary, Shandong Fuwei, has received the following awards and certificates, each of which, we believe, is an indication of our achievements, the quality of our products and makes us more attractive to our potential customers and therefore a more competitive company both in the local and international markets:

Date	Award/Certificate	Issuing Authority
September 2004(1)	ISO 9001:2000 Certificate	China Certification Center for Quality Mark
July 2006(2)	ISO 14001 Certificate	SGS
December 2007 (3)	Key High-Tech Enterprise of the National Torch Program	Ministry of Science and Technology
December 2008 (4)	High-and-New Tech Enterprise	Shandong Department of Science and Technology, National and Local Taxation Bureau of Shandong Province, and Shandong Province Financial Bureau
May 2009	“Advanced Enterprise of Chinese plastic industry”	China Plastic and Packaging Association

August 2009	Technological Innovation Award	Shandong Province enterprise technological innovation promotion association
June 2010[(5)]	A-Category taxpayer	The National Taxation Bureau and the Local Taxation Bureau of Shandong Province
October 2010 [(6)]	Shandong Engineering Technology Research Center	Department of Science & Technology of Shandong Province
January 2011 [(7), (8)]	Award for Cooperative and Innovative Manufacturing, Study and Research of SME	SME Productivity Promotion Center of Shandong Province
January 2011	First Award of Private SME Innovation of Shandong Province	SME Innovative Committee of Technological Promotion of Shandong Province

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January 2011	Award of Tax Contribution of the Year of 2010	Weifang Municipal Finance Bureau
January 2011 [(9)]	"Fuwei Films" was awarded as Famous Shandong Brand	Shandong Provincial Quality Supervision Bureau
February 2011 [(10)]	Scientific Innovative Enterprise of Shandong Province	Department of Science & Technology of Shandong Province
October 2011	Creditable Private Enterprise of Weifang 2011	Weifang SME Advocacy Office
October 2011[(3)]	Key High-Tech Enterprise of the National Torch Program	Ministry of Science and Technology
October 2011[(4)]	High-and-New Tech Enterprise	Shandong Department of Science and Technology, National and Local Taxation Bureau of Shandong Province, and Shandong Province Financial Bureau
December 2011	Award for Enhanced Productivity	SME Productivity Promotion Center of Shandong Province
December 2011[(11)]	Famous Brand	SME Productivity Promotion Center of Shandong Province
February 2012[(11)]	Outstanding Brand of Plastic Packaging Industry in China in 2011 and 2012	China Packaging Federation
June 2012[(12)]	OHSAS 18001:2007 Occupational Health and Safety Management Systems	SGS
December 2012	Reliable Enterprise of Weifang	Weifang Administration for Industry & Commerce
December 2012	Best Employer of Weifang	Weifang Enterprise Confederation
March 2013[(11)]	Private Economy Famous Brand of Shandong Province	Private Economy Brand Promotion Center of Shandong Province, SME Productivity Promotion Center of Shandong Province
March 2013	Award for Enhanced Productivity in 2012	SME Technology Innovation Promotion Association of Shandong Province, SME Productivity Promotion Center of Shandong Province
March 2013[(7), (8)]	Award for Cooperative and Innovative Manufacturing, Study and Research of SME	SME Technology Innovation Promotion Association of Shandong Province, SME Productivity Promotion Center

for the Year of 2012	of Shandong Province

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March 2013	First Award of Private SME Innovation of Shandong Province for the Year of 2012	SME Technology Innovation Promotion Association of Shandong Province, SME Productivity Promotion Center of Shandong Province
April 2013	2012 Human Resources and Social Security Credibility Demonstration Enterprise	Weifang Municipal Human Resources and Social Security Bureau
May 2013(5)	AA-Category taxpayer	The National Taxation Bureau and the Local Taxation Bureau of Shandong Province
July 2013(11)	the Most Competitive Brand in the Market of Shandong Province	Shandong Province Economic and Information Technology Committee
August 2013(13)	The Third Award of Patent for BOPET and Manufacturing in Weifang City	Weifang Municipal Government
October 2013	The Most Significant Innovation Awarded for Dry Film Resist	Weifang Enterprises Confederation, Weifang Enterprisers Association.
January 2014(9)	"Fuwei Films" was awarded as Famous Shandong Brand	Shandong Provincial Quality Supervision Bureau
January 2014(14)	Five -Star Enterprise in Statistical Work	Shandong Provincial Bureau of Statistics
January 2015(15) (16)	Advanced Work Unit in Making National Standard for BOPET Film One of the Top Ten Outstanding Enterprises in 2014 for All products in Shandong Famous Trademark in Shandong Province High-and-New Tech Enterprise	China Packaging Federation Shandong Provincial Plastic Association Shandong Provincial Administration for Industry & Commerce Shandong Department of Science and Technology, National and Local Taxation Bureau of Shandong Province, and Shandong Province Financial Bureau

(1) ISO 9000 certification has become an international reference for quality management requirements in business-to-business dealings. This certification enables us to compete on many more markets around the world and provides our customers with assurances about our quality, safety and reliability.

(2) After strict examination and approval by SGS, Fuwei Films (Shandong) Co., Ltd. has successfully passed the ISO14001 Environmental Administration System in July 2006.

(3) Fuwei Films (Shandong) Co., Ltd. was awarded as Key High-Tech Enterprise of the National Torch Program in December 2007 and October 2011. This title is recertified every two years.

(4) In December 2008 and October 2011, Fuwei Films was awarded as High-and-New Tech Enterprises by Shandong Department of Science and Technology, National and Local Taxation Bureau of Shandong Province, as well as from the Shandong Province Finance Bureau.

(5) The A-Category is the top of the four ratings for corporate taxpayers in China. Candidates eligible for the category are reviewed and designated by the authorities every two years.

(6) This center is mainly engaged in the research and development of polyester new materials and high-tech products. Currently, it has made more than ten R&D achievements and plays a positive leading role in the development of BOPET industry.

(7) Fuwei Films starts technological cooperation with Chinese colleges and hires South Korean experts to research and develop new products, techniques and process.

(8) Fuwei Films has already developed and applied more than ten kinds of new products, including laser anti-counterfeit film, chemical pretreated film, heat-sealable film, dry film and heat shrinkable film. All these have been widely used in production.

(9) The brand of “Fuwei Films” has been honored as famous brand resulting in visibility, credibility, reputation and continued growth.

(10) Under the fierce competition, Fuwei Films is encouraged by the government to develop new products.

(11) All these awards show that our established brand name “Fuwei Films” are recognized for our product quality in the PRC.

(12) OHSAS 18001 is an internationally recognized assessment specification for occupational health and safety management systems. OHSAS promotes a safe and healthy working environment by providing a framework that allows organizations to reduce the potential for accidents and improve overall performance. We believe this distinction will not only insure a safe environment for our workers, it will also be attractive to global companies looking for BOPET suppliers in China.

(13) We have been focusing on R&D as a key differentiator to enable us a competitive advantage in the market.

(14) The statistical work refers to the collecting, sorting and analyzing work of social economic phenomenon. It is a kind of social investigation activities.

(15) Fuwei participates in and plays an active role in making National Standard of BOPET film.

(16) Shandong Fuwei was designated as a High-and-New Tech Enterprise in 2016 and as a result, it is entitled to preferential tax treatment at an EIT rate of 15% for the years ended December 31, 2016, 2017 and 2018.

Business Prospects

In 2016, we continued to be adversely affected by enhanced competition and increased supply over demand in China's BOPET market as well as the oversea market. Anti-dumping measures taken by USA and South Korea caused a decrease in orders from international markets, in addition to the decrease in the price of main raw materials. The foregoing factors have contributed to significant decrease in sales prices, which resulted in reduced total revenue compared with the revenue of 2014.

We have identified BOPET thick film, which is mainly used in the electronics, electrical, solar energy and other industries, as a key market segment for potential growth. The thick film rapidly grows with the development of the above-mentioned industry. Currently, giants including Mitsubishi Plastics, Inc., SKC, Inc. and China Lucky Film Corporation invested in and built production lines in China, which will bring fiercer competition to us.

Business Development Strategies

As a primary part of our business strategy, we will speed up the R&D of high value-added products for the new production line for thick films. We believe that we have the ability to increase our sales and expand our markets. We will continue to improve our products by developing new functions and applications of the BOPET films and enhancing our products mix. Meanwhile, we will continue to secure opportunities to develop new domestic and overseas customers. We believe that expanding the overseas business is a key part of our business strategy. So we will continue to focus on the development of the BOPET industry and look for the opportunities for merger and acquisition.

Our future plans include: Accelerating the R&D of high value-added products for the new production line for thick films

We completed the construction of a new production line capable of producing BOPET film that is between 38 to 250μm in our current premises in Weifang City, PRC. The BOPET film production using this new production line is targeted at industrial use, including TFT-LCD screen films. We expect to penetrate into the electrical, electronics, solar energy and other industries with this new BOPET film. Such industries for high-end and special usage currently rely on expensive imports. The total investment of the new production line is estimated to be US$51 million. The third production line started its trial operation at the end of January 2013 and officially started its operation in September 2013. A sample diffusion film (a type of TFT-LCD optical film) was preliminarily accepted by four customers after being delivered to them for testing. We supplied small batches of products according to one of the four customer's purchase order. In addition, a sample base film for solar backsheets was delivered to a customer for initial testing and we received an initial feedback from this customer and are adjusting the formulas accordingly. The third production line has not been able to continue its production since April 2015 due to lack of purchase orders.

In addition, we have started the R&D for our thick films to be manufactured by this production line including base film for solar backsheet and so on. However, due to the intense competition in the market, we believe that upon commencing production, the third production line may not be profitable in a short term, or bring about losses.

Expansion into overseas markets

We believe that the overseas markets hold significant potential for future growth. We believe that our venture into the overseas markets which began in 2004 has been successful. Although we are not focused on any particular overseas market, we have identified Europe, Asia and North America as our primary overseas markets.

Our overseas sales were affected by the anti-dumping investigations conducted by South Korea and the United States against BOPET manufacturers originated from China, India and other countries and the fluctuation of Renminbi. However, we still believe there is a great potential in overseas BOPET market. Therefore, we will continue to carry out the marketing in the overseas market to attract new clients and sell our specialty films.

Investment in research and development

As one of our key strategies, we continue to invest substantially in R&D area. We have constructed a trial production line for research and development of new products, which also saves experimental cost. We also intend to expand our R&D team by hiring more senior research personnel from both China and foreign countries. We attach great importance to intellectual property. To date, 16 patents have been granted.

Our Products and Services

We are principally engaged in the manufacture and distribution of BOPET film. As of December 31, 2016, we produced BOPET films from the three production lines and one trial production line, with an aggregate annual design capacity of 53,600 metric tons with thicknesses varying between 6 - 250μm.

BOPET is a high quality plastic film manufactured using the biaxially-oriented stretch (transverse and machine direction) technique. Our advanced production process improves the physical properties of the plastic film such as its tensile strength, resistance to impact, resistance to tearing and malleability. The high dimensional stability of the film over a wide range of humidity and temperature fulfills the basic requirements for flexible packaging. The film is light-weight, non-toxic, odorless, transparent, glossy, moisture-resistant, and retains high barrier resistance, making it suitable for many forms of flexible packaging, printing, laminating, aluminum-plating and other processes. In addition, it retains high dielectric strength and volume resistance even at high temperatures, which are essential qualities for electrical and electronic uses. The three-layer co-extruded structure enables us to develop high-quality BOPET products.

BOPET film has been widely used in the flexible packaging (such as food, pharmaceutical, cosmetics, cigarettes, alcohol), imaging (such as printing plates and microfilms), and electronics and electrical (such as wire and cable wrap, capacitors and motor insulation). Due to its unique qualities, it has become a popular choice as a flexible packaging material in these industries in recent years.

We market our products under our brand name “Fuwei Films”. Our operations are based primarily in Shandong Province, PRC, where we manufacture our products for sale to customers engaged in flexible packaging businesses and electronics industry in the PRC, in particular the coastal region. We also export our products to end-users and distributors mainly in Europe, Asia and North America.

Our BOPET film is mainly used in the flexible packaging industry for consumer products such as those relating to processed foods, pharmaceutical products, cosmetics, tobacco and alcohol. Our products may be sub-divided into five main categories constituting the following percentages of our total revenue for each of the twelve months ended 2016, 2015 and 2014:

Category	2016	2015	2014
Stamping and transfer film	37.8%	41.6%	41.7%
Printing film	8.0 %	11.9%	11.6%
Metallized film	2.9 %	3.6 %	2.2 %
Specialty film	37.8%	29.7%	28.0%
Base film for other applications	13.5%	13.2%	16.5%

The above categorizes BOPET film products by application.

Stamping and transfer film

This is a film that displays excellent thermal stability and tensile strength and is used in metallized film and laser stamping foil and transfer.

Printing film

This is a high transparency film that is corona treated on one side to provide excellent adhesion to ink. This is primarily used in printing and lamination.

Metallized film

This is an aluminum plating base film that displays good thermal stability and tensile strength and provides good adhesion between film and aluminum layer. This is applied to flexible plastic lamination.

Specialty film

We mainly produce the following types of specialty film:

- High-gloss film: Film with high levels of reflection approaching a mirror-like surface, used for aesthetically-enhanced packaging purposes;
- Heat-sealable film: Film with a three layer structure. The heat-sealable film is primarily used in construction, printing and making heat sealable bags;
- Dry film: Generally used in circuit boards (PCB & FPC) production, and sometimes used for nameplate and crafts etching;
- Heat shrinkable film is widely used for special-shaped packaging for beverage and cosmetics; and
- Chemically treated film used to enhance properties including barrier resistance, printing properties and electrostatic resistance.

Base film for other applications

Base films for other application are ordinary commodity polyester films with applications other than for the usages mentioned above.

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Production

As of December 31, 2016, we operate three production lines and have had one trial production line. The first line is a Brückner 6.3 m (in width) production line with an annual design capacity of 13,000 metric tons of BOPET film. The second line is a DMT production line which is three-layer co-extruded with 6.7 m (in width), and has an annual design capacity of 16,100 metric tons of BOPET film. We also have a Mitsubishi trial production line which has an annual design capacity of 1,500 metric tons. The third production line started its trial operation at the end of January 2013. This production line will manufacture high-performance electric insulation film, base film for solar backsheet and TFT-LCD optical film with an annual design capacity of 23,000 metric tons and thickness between 38 and 250µm. It officially started its operation in September 2013. A sample diffusion film (a type of TFT-LCD optical film) was preliminarily accepted by four customers after being delivered to them for testing. We supplied small batches of products according to one of the four customer's purchase order. In addition, a sample base film for solar backsheets was delivered to a customer for initial testing and we received an initial feedback from this customer and are adjusting the formulas accordingly. The third production line has not been able to continue its production since April 2015 due to lack of purchase orders.

As of December 31, 2016, our manufacturing operations had a total annual design capacity of 53,600 metric tons based upon 7,200 production hours per annum.

BOPET film is manufactured from polyethylene terephthalate (PET) resin. BOPET film is produced by melting the granulated PET resin and extruding it into a flat sheet. This sheet is stretched to 3.0 to 3.6 times its original length, and then horizontally from 3.0 to 3.6 times its width, before being heat-set and finally wound into reels. The orientation process (stretching during the application of heat) gives the film its mechanical strength, barrier and optical properties (clarity and gloss). The main steps of our manufacturing process involve:

Dosing and Mixing

PET resin is dosed and mixed with relevant additives to give it its desired characteristics. In the case of the production three-layer co-extruded BOPET film, the materials are dosed and mixed separately for each of the core and outer layers.

Extrusion/Co-extrusion

The mixed material is melted and plasticized to achieve the required homogenous state with the requisite characteristics and then it is filtered and transported to the die unit. Our DMT production line has one main extruder and two auxiliary extruders to allow us to produce multiple-layer co-extruded BOPET film.

Die Casting

The respective mixed materials are extruded from the die unit which produces a flat layered cast sheet and casted on the chill roll which is cooled by the pinning system.

Machine Direction Orientation (vertical stretching)

The cast sheet is then heated and stretched by machine direction before annealing the cast sheet, which is a process of heat-setting so as to control the shrinkage of the sheet after the vertical stretching.

Transversal Direction Orientation (horizontal stretching)

After the machine direction stretching, the cast sheet is horizontally stretched before annealing again.

Pull Roll Station

The stretched sheet is trimmed and measured for thickness. For the production of base film for printing, the surface is treated by corona treatment. Corona treatment is the process which enables the BOPET film to become receptive to printing. At the pull roll station, continuous feedback on the thickness of the BOPET film is also relayed back to the die unit which therefore ensures consistency in the thickness of the BOPET film.

Winder

The final BOPET film is then wound up into metal rolls in the mill roll by the winder.

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Slitter

The wound BOPET film is then unwound from the metal rolls, divided to the requisite width and length, and wound again into paper or plastic core for delivery to customers.

Inventory Management

Our warehousing facilities are located in the Shandong Province, PRC. Our warehouses are guarded by security personnel and loss of our inventory is covered under our insurance policies. As of December 31, 2016, our total inventories amounted to approximately RMB25.2 million and our raw materials, work-in-progress, finished goods and spare parts (including consumables) made up approximately 47.7%, 4.3%, 26.4% and 21.6% of our inventories, respectively.

To ensure an accurate inventory record and to monitor our inventory aging, we conduct monthly stock counts. We usually maintain raw materials which can be used for one or two weeks of production. Typically, we start manufacturing such goods upon our receipt of orders from our customers.

Our inventory turnover periods (in days) for 2016, 2015 and 2014 were 42.3, 39.3 and 37.8, respectively. Inventory turnover is calculated as 365 days times inventory at period/year end date divided by cost of sales in respect of the financial period/year.

In 2016, there were no provisions for inventory obsolescence and inventory written off. As of December 31, 2016, we accrued RMB4.8 million for inventory falling price reserves.

Manufacturing Facilities and Utilization Rates

As of December 31, 2016, the following production lines are in operation:

Production Line	Design Capacity	Estimated Remaining Life Span

Brückner Production Line	13,000 tons per annum	Approximately 0 years
DMT Production Line	16,100 tons per annum	Approximately 2 years
Dornier Production Line	23,000 tons per annum	Approximately 12 years
Trial Production Line	1,500 tons per annum	Approximately 3 years

The design capacity as given by the manufacturer is determined based on the assumption of the production of a specific mix of BOPET films of varying thicknesses. Our Brückner, DMT and Dornier production lines and the trial production line have been in use since 2003, 2004, 2013 and 2009, respectively. The production lines are depreciated on the straight-line method over their respective estimated useful lives.

Our approximate annual production volumes and the average annual utilization rates for our facilities for 2016, 2015 and 2014, based on our estimated operational production capacities were as follows.

	Approximate Annual Production Volume (tons)			Average Annual Utilization Rate (%)		
Production Line	2016	2015	2014	2016	2015	2014
Brückner Production Line	11,131	10,487	9,076	85.6 %	80.7 %	69.8 %
DMT Production Line	13,406	13,051	12,480	83.3 %	81.1 %	77.5 %
Dornier Production Line	-	293	2,155	-	1.3 %	9.4 %
Trial Production Line	9	210	291	0.6 %	14.0 %	19.4 %

The third production line has not been able to continue its production since April 2015 due to lack of purchase orders.

There are currently no regulatory requirements that may materially affect the utilization rates of our property, plant and equipment. However, certain of the fixed assets relating to our production lines have been mortgaged in respect of certain of our bank loans as described under “Properties” for further details.

Quality Control

The quality and reliability of our products are essential for our continued success. We adopt strict measures for quality control in the entire production process of all our products, from the purchase and selection of raw materials, to each stage of the manufacturing processes and to the final inspection of end products. Our quality control procedures were certified for ISO 9001:2000 compliance in September 2004 and the review of it is conducted every three years.

As of December 31, 2016, our product inspection and quality control department comprised of 21 employees. We have one manager, 16 quality inspectors, 2 procurement inspector and 2 after-sale personnel. Members of our quality control departments have had relevant training in the area of quality control in accordance with ISO 9001:2000 procedures. Our product inspection and quality control department ensure that our production process, raw materials and end products are of the quality to our customers' satisfaction.

Raw Materials

We adopt and adhere to a set of quality inspection procedures and internal controls for the procurement, selection and quality checks of raw materials. Different types of checks are utilized for different categories of raw materials. Our suppliers are also required to meet our internal qualification criteria such as the quality and pricing of their suppliers, their ability to meet our requirements and timely delivery. We conduct batch inspections for raw materials delivered to us before they are accepted and stored in our warehouses. Defective materials are returned to our suppliers for necessary corrective action to ensure that no defected materials are used for production.

Production Process

We have established standard operational procedures and implementation rules for each stage of the production process to ensure that our products comply with and adhere to our stringent quality control standards and that our productivity is optimized. We only permit employees who have undergone and completed the relevant training to work on our production lines. At each stage of the production process, our inspectors check and ensure that our production process complies with our quality standards, while our quality control department monitors and ensures that our products-in-process and final products comply with our internal and international standards of quality control by carrying out random sampling of the products.

Finished Products

To ensure that our products fulfill our quality criteria established by our product inspection and quality control department, our products undergo final quality inspection upon production, labeling and packaging. Our product inspection and quality control department continues to monitor and ensure that our products are properly handled and stored in our warehouses. Prior to delivery to our customers, our products are inspected one final time to ensure that they are in good condition and not damaged.

Maintenance

Our maintenance engineers regularly maintain and repair our machinery and equipment to ensure that they are in good working order and functioning properly. We also conduct periodic maintenance of all our machinery on a rotation basis. On an average basis, we replace our filter disks every 20-30 days and this replacement process takes about six to eight hours during which we will conduct routine maintenance. And each year we will conduct one comprehensive maintenance project for each production line which will cost five to ten days varying according to different maintenance projects. We believe that due to our stringent maintenance policies, our equipment is still in good condition. Our average downtime for 2016 (primarily for maintenance) was 3.9% of our overall production time.

New Products

Through years of R&D endeavors, we have introduced a variety of BOPET film products. The following are some of the new products for which commercial production has begun:

Product	**Achievement**
Chemical pretreated film	Our film is pretreated in-line and coated, which results in a strong adhesion to ink and aluminum.
Heat-sealable film	Heat-sealable film is a three layers co-extruded Biaxially oriented polyester film with an amorphous polyester heat seal layer. Available with corona treatment on the non-seal side to give improved adhesion to typical packaging inks and metallizing. Not only can it provide permanent seals to itself for package bag, but also to APET, CPET, PETG and others. Heat-sealable film can be aluminized, printed and composite with other films. It is applied to packaging for food, construction and other applications.
Heat sealable film for steel	To improve the heat-sealable strength between the film and steel and adjust the stretchable capability so as to be more suitable for steel's heat sealing. Mainly used for protection and decoration of colorful armor plate for home appliances.
High-gloss film	By using special raw chips and process, provides very high gloss, uniform thickness, good mechanical properties, and surface smoothness. It can be used under -70~200°C for packaging food, cigarettes, alcohol and laser embossing, holographic anti-fake and metallic yarn and others.
DFR base film	Generally used in circuit boards (PCB & FPC) production, sometimes used for nameplate and crafts etching.
Heat shrinkable film	To change the heat shrinkage rate by enlarging the draw ratio. It is mainly used for PET beverage bottle shrinkable tags. Heat shrinkable film uses PET structure which is the substitute of PVC shrinkable tags, which is also in line with the requirements of environmental protection and recyclable.
Smooth heat sealable film	Excellent smoothness widely used in packaging of mosquito-repellent incense.
Anti-static film	Featuring low static electricity with surface resistance below 10^{10} /sqm applied to printing and packaging which require films with excellent anti-static properties.
Reinforced coated printing film Metal-adhesion improved filmUvioresistant film	Excellent adhesion to UV ink and UV gloss oil suitable for high-end printing. To improve the peel strength after metallized sealing. Mainly used for liquid packages. To prolong the time of yellowing resistance and hence increase the film duration of use.
Heat-sealable film used for FRP	Increase duration of use of heat-sealable film used for FRP

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Our expenditure on research and development in 2016, 2015 and 2014 were as follows (in thousands):

	Year Ended December 31, 2016 RMB		Year Ended December 31, 2015 RMB		Year Ended December 31, 2014 RMB	
Research and Development Expenses	3,577	(1)	3,619	(2)	8,00	(3)

(1) & (2) & (3) In addition to the above-mentioned expenses in 2016, 2015 and 2014 of RMB3,577, RMB3,619 and RMB8,005, respectively, the R&D capital expenditure was RMB453, RMB258 and RMB1,363, respectively.

We view research and development as an essential part of our business. We believe that higher investment in the equipment of our R&D center and in the development of new products and upgrading of existing products will enhance our ability to compete.

Sales, Marketing and Key Customers

As of December 31, 2016, our sales department comprised of 11 employees in the domestic sales division, 4 employees in the overseas sales division and 2 for sales support. Our sales department is responsible for market penetration such as cultivating new customers and businesses, and market development such as developing existing accounts through better service support and customer relationship. Our marketing department is responsible for market research, development and promotion. Our management is actively involved in overseeing and supervising our sales and marketing activities and often visits our clients together with the sales personnel. They have established and maintained close business relationship with our key customers.

Customers and Markets

Over the past years, we have established good working relationships with our customers in the flexible packaging industry. Our products are mainly used in the packaging of consumer products such as those relating to processed foods, pharmaceutical products, cosmetics, tobacco and alcohol. In addition, we maintain good relationship with major dry films customers in Mainland China.

The majority of our domestic customers are located in the coastal region of the PRC. Our overseas customers are mostly based in Europe, Asia, North America and others. In 2016, sales from our domestic and overseas customers constituted approximately 83.5% and 16.5% of our annual revenue respectively.

The following are our top five customers and their respective percentages of contribution to our total revenue for each of the years ended December 31, 2016, 2015 and 2014:

	Percentage of Total Revenue (%)		
	2016	2015	2014
Eternal Electronic Material (Guangzhou) Co., Ltd.	6.6	8.2	9.0
Yunnan Dexin Zhiye Co., Ltd.	3.9	4.3	2.7
Eternal Photo Electronic Materials (Guangzhou) Co., Ltd.	3.3	3.0	3.1
Hololens Technology Co., Ltd.	2.9	1.4	0.2
Celplast Metallized Products Limited	2.7	2.6	0.5

None of our customers accounted for more than 10% of our total revenue in any of the previous three years.

None of our directors or principal shareholders or any of their affiliates has any interest, direct or indirect, in any of our customers listed above.

Sales

Because of our broad range of product offerings and customers, our sales and marketing efforts are generally specific to particular types of product, customer or geographic region. Most of our products are sold by our own direct sales force. These salespeople, including our management, maintain close relationships with our customers by paying visits to our customers from time to time to understand their needs, and to obtain their feedback and suggestions. Our sales personnel provide technical support to our customers when required. We also regularly invite our existing and potential customers to our manufacturing facilities for visits as we believe that such visits enable our customers to better understand our production processes and operations and also enhance our customers' confidence in us.

We adopt a risk assessment model to our customer credit management system, and we offer different credit terms to our customers based on criteria such as working relationship, payment history, creditworthiness and their financial position. We offer our domestic customers credit terms of up to 30 - 45 days. Our international sales are settled through telegraphic transfer and letters of credit, which generally have payment terms of between 30 and 60 days. However, in 2016, more than 50% of transactions were paid by cash in delivery.

We offer a basic salary and commission package for our sales personnel. The scale for the commission payable is dependent on a number of factors such as sales targets completion, debt collection and marketing cost allocation.

Customer Service

We place great emphasis on good, fast and effective pre-sales and after-sales customer support services. As such, all our sales personnel have undergone stringent training and have sufficient knowledge and understanding of our products. Our sales personnel are responsible for coordinating and providing after-sales services which include following through with our customers' orders, maintaining relationships with our customers, handling complaints effectively, ensuring that our customers' needs are met and understanding the future needs of our customers. Our quality department gives support to our customer service, and is responsible for explaining questions related to our products usage from customers. If there are complaints as to our product quality, they are responsible for receiving and settling complaints on our customers' site.

We accept returned defective products from customers or compensate our customers for the losses incurred from our defective products. For 2016, our losses due to returned products from our customers were approximately 1.0% of our total sales.

Marketing

We have the following marketing channels:

- we regularly attend trade fairs and exhibitions as we believe that they serve as a good platform for us to exhibit our new products and expand our sales network. In addition, participation in seminars, fairs and exhibitions provides us with opportunities to network with our potential and existing customers and allows us to obtain up-to-date information on new products, market trends and consumer demand;
- referrals from existing customers as well as business associates to generate sales opportunities; and

- promotion through our corporate website. Information on our products and services are also found on our corporate website which allows us to reach out to potential domestic and overseas customers.

Our marketing personnel also conduct PRC domestic and overseas market surveys and research. The statistics, findings and information obtained from such surveys and research are then passed on to our management and production department for their analysis on the demand for and supply of our products, which allows them to make adjustments to our production and sales targets as well as our marketing strategies.

Suppliers and Raw Materials

Suppliers

We purchase raw materials according to the relevant technical specifications and production requirements. We select our suppliers based on the following considerations and/or methods:

- the consistency of the quality of raw materials supplied and any relevant certifications;
- our inspection of the supplier’s quality control system;
- positive feedback from the supplier’s other customers;
- pricing of raw materials;
- timely delivery of raw materials;
- the supplier’s financial position and viability;

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- the service provided by the supplier;
- qualifying suppliers by sample testing and batch purchasing of their raw materials; and
- annual evaluation and review of our suppliers.

The following are the suppliers that supplied 10% or more of our purchases of raw materials and supplies for each of the years ended December 31, 2016, 2015 and 2014:

		Percentage of total purchases (%)		
Supply		2016	2015	2014
Sinopec Yizheng Chemical Fibre Company Limited	PET resin and Additive	60.3	52.0	60.0

We purchase the majority of our PET resin from Sinopec Yizheng as the quality of its supply of PET resin consistently meets our requirements. We currently have an annual supply agreement with Sinopec Yizheng pursuant to which Sinopec Yizheng has agreed to supply us fixed quantities of PET resin monthly at the prevailing market prices. Such supply agreement is renewable annually. We have not entered into any long-term supply contracts with any other supplier. Our purchases of raw materials are on a cash basis. There are a number of suppliers of PET resin at home and abroad that can consistently meet our quality and quantity requirements on a timely basis.

None of our directors or principal shareholders or any of their affiliates has any interest, direct or indirect, in any of our major suppliers mentioned above.

Raw Materials

The main raw materials that we purchase from our suppliers are as follows:

	Percentage of each category within main raw material purchase s (%)			
Main Raw Material	2016	2015	2014	Country
PET resin	77.0	75.5	80.0	PRC
Additives	23.0	24.5	20.0	PRC

The market prices of PET resin and additives may fluctuate due to changes in supply and demand conditions. Any sudden shortage of supply or significant increase in demand of PET resin and additives may result in higher market prices and thereby increase our costs of sales. The prices of PET resin and additives are, to a certain extent, affected by the price movement of crude oil. The average price for PET resin in 2016 decrease by 4.4% compared to that in 2015.

As we are unable to predict the price movements of such raw materials and to minimize the impact of such price fluctuations on our cost, we generally purchase such raw materials in quantities sufficient for our production process for approximately one or two weeks. Based on orders from our customers, we may increase or reduce the inventory of our raw materials.

Competition

We face intense competition in the PRC plastic film industry. We believe that there are currently many plastic film manufacturers in the PRC and we expect further entrants into this market in the future. Among the flexible packaging industries, in particular those involving packaging of processed food and pharmaceutical products, the primary types of plastic films in the packaging products include BOPET, Biaxially oriented polyester (BOPP); and Biaxially oriented polyamide (BOPA).

The following table gives a general comparison of the key differences in the technical specifications and usage of the above types of plastic films.

Comparison of BOPP Film, BOPET Film and BOPA Film(1)

Features	**BOPP**	**BOPET**	**BOPA**
Water vapor barrier	Excellent	Fair	Poor
Gas barrier properties	Poor	Excellent	Excellent
Break down voltage	Poor	Excellent	Excellent
Machine-ability	Fair	Excellent	Excellent
Print-ability	Fair	Excellent	Fair
Suitability for Metallizing	Poor	Excellent	Fair
Density (gm/cc)	Low (0.91)	High (1.39)	Medium (1.15)
Tensile strength	Poor	Excellent	Excellent

(1) This comparison is based on the book of Biaxially Oriented Plastics Film, edited by Yanping Yin and published by China Chemical Press in August 1999. The Company did not notice updated technical specifications subsequently as of December 31, 2016.

We believe that we are one of the few BOPET film manufacturers in the PRC with research and development capabilities.

We believe that the major competitive factors in our industry include:

- research and development capability;
- quality and reliability of products;
- technical/manufacturing capability;
- industrial reputation; and
- production cost and sales prices.

We believe that our major competitors in BOPET manufacturing are currently:

· Dupont Hongji Films Foshan Co., Ltd.;
· Yihua Toray Polyester Film Co., Ltd.; and
· Ningbo Shunsu Film Co., Ltd.

We believe that we have established a good reputation and management track record as a manufacturer of BOPET film and are able to offer quality products.

C. Organizational structure.

The following table set forth the details of our subsidiaries as at the date of this Annual Report:

Name	**Country of Incorporation**	**Ownerships Interests**	**Direct Parent**
Fuwei Films (Shandong) Co., Ltd.	Weifang Shandong, China	100% wholly owned by Direct Parent	Fuwei Films (BVI) Co., Ltd.
Fuwei Films (BVI) Co., Ltd.	British Virgin Islands	100% wholly owned by Direct Parent	Fuwei Films (Holdings) Co., Ltd.

D. Property, plant and equipment.

Our corporate headquarters and production and ancillary facilities occupy an area of approximately 74,251 square meters in Weifang City, Shandong Province. The land at our facilities is covered by land use rights held by us. The land use rights for the land upon which our buildings and facilities are located have terms of 50 years, the earliest of which expires in November 2050. All of our research and development, manufacturing, warehousing and administrative functions are conducted at our corporate headquarters. The total gross floor area of production and other facilities owned by us is approximately 46,196 square meters. We own all the buildings and facilities on the premises. Part of our land use rights, plant, office buildings have been mortgaged to one bank in the PRC. As of December 31, 2016, the mortgaged floor area of facilities and land use right to the bank is 46,196 square meters and 74,251 square meters, respectively. The total net value of mortgaged property is RMB57.1 million.

Item 4A. Unresolved Staff Comments

None.

Item 5. Operating and Financial Review and Prospects

MANAGEMENT'S DISCUSSION AND

ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following discussion and analysis of our financial condition and results of operations in conjunction with our consolidated financial statements included in this Annual Report beginning on page F-1. The consolidated financial statements have been prepared in accordance with U.S. GAAP. The following discussion and analysis contain forward-looking statements that involve risks and uncertainties.

Overview

We develop, manufacture and distribute high quality plastic film using the biaxially oriented stretch technique, otherwise known as BOPET film. Since the establishment of the Company, a substantial portion of our revenues has been derived from the sales of BOPET film. We sell majority of our BOPET film products to domestic customers in China with minority of them sold to Europe, Asia, North America and other overseas markets.

Our Corporate Structure and Operating History

The diagram below illustrates our corporate structure:

Shandong Fuwei, our PRC operating subsidiary, was formed on January 28, 2003, as a Sino-foreign equity joint venture under the name Weifang Fuwei Plastic Co., Ltd. In July 2003, this company began production of BOPET film, initially renting the necessary fixed assets from Shandong Neo-Luck, a company involved in BOPET film production in which Mr. Xiaoming Wang, our current executive officer, served as executive officer at the time.

Shandong Fuwei subsequently acquired these fixed assets through two auction proceedings, the first in October of 2003 and the second in December 2004. At the first auction proceeding in October 2003, Shandong Fuwei acquired assets related to the Brückner production line that it had been renting from Shandong Neo-Luck. This line had been previously mortgaged by Shandong Neo-Luck to Bank of China, Weifang city branch as security for several loans extended to Shandong Neo-Luck's affiliates. When these loans went into default, Bank of China brought a series of legal actions in Weifang Municipal People's Court that resulted in the assets securing the loans being sold at a public auction. Following its successful bid at an auction on October 9, 2003, Shandong Fuwei acquired the Brückner production line and facilities (with an appraised value of approximately RMB169 million) for RMB156 million.

In November 2003, Shandong Fuwei's shares were sold to Shenghong Group Co., Ltd. ("Shenghong Group") and Shandong Baorui for an aggregate consideration of RMB98.2 million. Tongju Zhou, a former director of the Company, and Duo Wang each indirectly own 50% of Easebright Investments Limited ("Easebright"), one of our principal shareholders, and are both officers and directors of Shandong Baorui. Jun Yin and Duo Wang own 17.5% and 4.6%, respectively, of Shandong Baorui. In 2004, Messrs. Zhou and Wang, along with Jun Yin established several offshore holding companies in the British Virgin Islands and the Cayman Islands to acquire and hold these shares. In October 2004, Fuwei (BVI) entered into a sale and purchase agreement with Shenghong Group and Shandong Baorui pursuant to which Fuwei (BVI) acquired the respective equity interest of Shenghong Group and Shandong Baorui in Shandong Fuwei for an aggregate consideration of RMB91 million. Shandong Fuwei thereafter became a wholly-owned subsidiary of Fuwei (BVI) and was converted into a wholly-foreign owned enterprise pursuant to PRC law.

As a result of its ongoing financial difficulties, Shandong Neo-Luck was declared bankrupt by the Weifang Municipal People's Court in the PRC on September 24, 2004. Prior to the bankruptcy, Shandong Neo-Luck's then major operating asset, the DMT production line, had been pledged by Shandong Neo-Luck to Weifang City Commercial Bank. When Shandong Neo-Luck was declared bankrupt, the Shandong Branch of Bank of China seized the production line by order of the Qingdao Intermediate People's Court and the Qingdao Southern District People's Court while the Weifang Branch of Bank of Communications did so through Weifang Intermediate People's Court. As such, the effectiveness of the pledge in favor of Weifang City Commercial Bank was under dispute. Subsequently, pursuant to the decision from Weifang Intermediate People's Court, Weifang City Commercial Bank ranked senior in terms of the right of claims.

The pledged DMT production line was put up for public auction by the Shandong Neo-Luck Liquidation committee on October 22, 2004. In view of the above complexities, the auction was deemed to be tremendously risky at that time, and therefore, our PRC operating subsidiary did not directly participate in the first auction, which began with a bid price of approximately RMB53 million by reference to an independent valuation performed on a forced sale basis. However, due to the potential tremendous risk involved, the auction had been withdrawn twice and the starting bid price had been further reduced to approximately RMB34 million and was finally purchased by Beijing Baorui, a company indirectly controlled by Shandong Baorui. When the DMT production line was put for public auction by Beijing Baorui three months later, our PRC operating subsidiary purchased it for approximately RMB119 million, which was supported by an independent valuation performed on a going concern basis. We understood that acquiring the DMT production line from Beijing Baorui through the first auction would be an effective way to minimize the risk associated with the uncertainties arising from the bankruptcy of Shandong Neo-Luck. The price difference of approximately RMB85 million represented a risk premium paid to Beijing Baorui, which bore the ultimate risks of recourse from creditors of Shandong Neo-Luck.

Subsequent to the auction for several years, the PRC government conducted an investigation into the conduct of certain individuals in connection with such transactions. In March 2009, Messrs. Yin, Wang and Zhou committed the crime of corruption by verdict of the Jinan Intermediate People's Court in the city of Jinan, Shandong Province. In November 2009, the Company became aware of the final verdict issued by the Supreme People's Court of Shandong Province. The Supreme People's Court upheld the initial verdict issued by the Intermediate court in March 2009. The March 2009 initial verdict sentenced Mr. Yin to death, with a stay of execution for two years, and the other two defendants, Mr. Zhou and Mr. Wang, each received life imprisonment. All of the personal property of the three individuals will be confiscated.

At the time of the our initial public offering, we had obtained an opinion of PRC counsel with respect to the validity of the auction proceedings under PRC law, although you should read the description of the opinion and the subsequent development in March 2009 described under the title "*Risk Factors — The circumstances under which we acquired ownership of our main productive assets may jeopardize our ability to continue as an operating business*". Certain of the assumptions relied upon in providing that opinion have been called into question by the verdict referred to above.

On May 9, 2011, we received a notification from the Weifang State-owned Assets Operation Administration Company, a wholly-owned subsidiary of Weifang State-owned Asset Management and Supervision Committee (the "Administration Company") regarding the transfer of the ownership of controlling shareholders.

According to the notification, our former controlling shareholders, Messrs. Jun Yin, Duo Wang and Tong Ju Zhou, had transferred their entire ownership in several intermediate holding companies to the Administration Company, Ms. Qing Liu and Mr. Zhixin Han. As a result of the transfers, and based on the information provided by the Administration Company, 52.90% of its outstanding ordinary shares are controlled indirectly by the Administration Company and 12.55% of its outstanding ordinary shares are jointly controlled indirectly by Ms. Liu and Mr. Han.

We received a second notification dated May 17, 2011 (the "Second Notification") from the Administration Company regarding the transfer of ownership of Fuwei stock previously controlled by our major shareholders.

As discussed in the Second Notification, Ms. Qing Liu and Mr. Zhixin Han transferred their entire ownership in the intermediate holding company, Easebright Investments Limited, to the Administration Company. As a result of the transfer, and based on the information provided by the Administration Company, 65.45% of its outstanding ordinary shares were controlled indirectly by the Administration Company and the sole director of each of the intermediate holding companies, Mr. Zheng Min.

On August 14, 2013, we received the first notice from our controlling shareholder, the Weifang State-owned Assets Operation Administration Company, a wholly-owned subsidiary of Weifang State-owned Asset Management and Supervision Committee (collectively, the "Administration Company") indicating that the Administration Company had determined to place control over 6,912,503 (or 52.9%) of its outstanding ordinary shares up for sale at a public auction to be held in China. Four public auctions were held in Jinan, Shandong Province, China. We learned that they failed due to a lack of bidders registered for the auction. On March 25, 2014, the fifth public auction was held in Jinan, Shandong Province, China and we became aware that the fifth public auction has resulted in the acceptance of a successful bid. Shandong SNTON Optical Materials Technology Co., Ltd. ("Shandong SNTON"), the successful bidder in the fifth public auction of 6,912,503 (or 52.9%) of the Company's outstanding ordinary shares (the "Shares") held on March 25, 2014, was entrusted by Hongkong Ruishang International Trade Co., Ltd., a Hong Kong corporation, ("Hongkong Ruishang") to handle all the formalities and procedure in connection with the public auction. As a result of the entrusted arrangement, Hongkong Ruishang is the party controlling the Shares acquired in the fifth public auction. According to publicly available information in the People's Republic of China, Shandong SNTON is a wholly owned subsidiary of Shandong SNTON Group Co., Ltd ("SNTON Group"). Mr. Xiusheng Wang, the chairman of the Board of Directors of SNTON Group, is also Hongkong Ruishang's chairman. This disclosure is based solely on information contained in a Schedule 13D amendment filed by Hongkong Ruishang with the SEC on November 12, 2014.

On May 14, 2014, we announced that we received a notification from Shandong Fuhua Investment Company Limited. ("Shandong Fuhua") with respect to an entire ownership transfer of our 12.55% outstanding ordinary shares from the Administration Company to Shandong Fuhua. The Administration Company originally held these shares indirectly through an intermediate holding company, Easebright Investments Limited ("Easebright"). As a result of this transfer, Shandong Fuhua indirectly owns 12.55% of the outstanding ordinary shares of the Company through Easebright. Mr. Jingang Yang has been appointed as the director of Easebright. This disclosure is based solely on information contained in a Schedule 13D filed by Shandong Fuhua with the SEC on December 30, 2014.

On December 5, 2016, we held an extraordinary general meeting of shareholders pursuant to which a 1-for-4 reverse stock split of our authorized ordinary shares, accompanied by a corresponding decrease in our issued and outstanding ordinary shares and an increase of the par value of each ordinary share from $0.129752 to US$0.519008 (the "Reverse Stock Split"), was approved by our shareholders of record.Our ordinary shares began to trade on the NASDAQ Stock Market on the post-Reverse Stock Split basis under the symbol "FFHL" at the open of business on December 6, 2016.

The Company's ordinary shares began to trade on the NASDAQ Stock Market on the post-Reverse Stock Split basis under the symbol "FFHL" at the open of business on December 6, 2016. The new CUSIP number for the Company's ordinary shares post-Reverse Stock Split is G3704F 110. The Company would round up to the next full share of the Company's ordinary shares any fractional shares that result from the Reverse Stock Split.

In December 2016, Fuwei Films USA, LLC was dissolved.

Key Factors Affecting Our Results of Operation

The following are key factors that affect our financial condition and results of operations and we believe them to be important to the understanding of our business:

Raw Material Prices

For the years ended 2016, 2015 and 2014, the total cost of raw materials made up approximately 67.4%, 66.4%, and 67.8% of production cost, respectively. The primary raw materials used in our production of BOPET film are polyethylene terephthalate (or PET) resin and additives, which made up approximately 77.0% and 23.0%, respectively, of our total cost of raw materials in 2016. PET resin trades as a commodity and its market price is influenced significantly by global energy prices, including the price of crude oil. In addition, PET resin is mainly used in textile industry and accordingly the demand from that industry will also affect the price of PET resin.

Although we try to pass on all increases in our raw material costs to our customers, we can only pass on a portion of the increase to our customers due to the increased supply than demand in the market. We obtain a significant amount of the PET resin used at our facilities from one supplier, who has agreed to supply us fixed quantities of PET resin monthly at the prevailing market price. We have not engaged in any hedging transactions to limit our exposure to fluctuations in the market prices of these raw materials or their components.

Prices of Our Products

Our BOPET film products generally fall into two categories: commodity products and specialty products. The price of commodity products, such as printing films, stamping and transfer films and metallized films, is typically driven by supply and demand conditions in the market. We have more control over pricing for our specialty products, such as dry films.

As selling prices are generally higher for those types of BOPET film products which require higher technical expertise, our revenue will be affected, to certain extent, by our product mix. Our product mix is dependent on, among other things, our production facilities, R&D abilities and new product commercialization.

Demand for Our Products

We have been able to expand our product range and markets by introducing new products required by customers. We believe that our technical expertise is important in introducing products that are in demand.

Our BOPET film products are mostly sold to customers in the flexible packaging industry for consumer products such as food, pharmaceutical products, cosmetics, tobacco, alcohol and beverage. Recently, the sales of the light-resistant dry film which is used in printed circuit board also significantly increased. In the fiscal years ended December 31, 2016, 2015 and 2014, approximately 83.5%, 78.0% and 84.9%, respectively, of our total revenue was derived from the PRC. The demand for our products is therefore, to a large extent, affected by the general economic conditions in the PRC. A significant improvement in the economic environment in the PRC will likely improve consumer spending and increase the demand for our products. However, the economic downturn of the PRC market will impact our customers' demand and will decrease the demand for our products.

Production Capacity and Utilization Rates

Our sales volume is limited by our operational annual production capacity and this depends largely on supply and demand in the market. The third production line has not been able to continue its production since April 2015 due to lack of purchase orders which is the result of greater supply than demand in the market.

As we grow our business in the future, our ability to fulfill more and larger orders will be dependent on our ability to increase our production capacity. As our business is capital-intensive, our ability to expand our production capacity will depend on, *inter alia*, the availability of capital to meet our needs of expansion or upgrading of production lines.

Competition

We believe that we are currently one of the few producers of BOPET films in the PRC with research and development capability. Our past financial performance is attributable to our market position in the industry. Over time, there may be new investors into our industry, and the current BOPET film manufacturers may expand their production capacity. We believe that currently our major competitors in the BOPET manufacturing market in the PRC include Dupont Hongji Films Foshan Co., Ltd., Yihua Toray Polyester Film Co., Ltd., and Ningbo Shunsu Film Co., Ltd.

Our ability to enhance existing products, introduce new products to meet customers' demand, deliver quality products to our customers and maintain our established industry reputation will affect our competitiveness and market position.

Our ability to compete against new and existing competitors to maintain or improve our market position and secure orders will affect our revenue and financial performance.

Description of Certain Statements of Income Line Items

Revenues

Revenue from the sale of our domestic BOPET film products is recognized when significant risks and rewards of ownership have been transferred to the buyer. No revenue is recognized if there are significant uncertainties regarding recovery of the consideration due, associated costs or the possible return of goods, or when the amount of revenue and costs incurred or to be incurred in respect of the transaction cannot be measured reliably. In respect of our overseas sales, we ship directly to the destinations of our overseas customers and our revenue is recognized at the time when we receive customs clearance of our exports. Most of our overseas sales are conducted on a Cost, Insurance and Freight (or "CIF") basis, meaning that we pay the costs and freight necessary to get the products to the port of destination, and the risk of loss is transferred from us to the buyer when the goods pass the ship's rail at the port of destination. In addition, we have to procure marine insurance against the buyer's risk of loss of damage to the goods during the carriage. Most of our sales invoices are denominated in the Chinese Yuan (Renminbi), although certain of our overseas sales are denominated in US dollars.

Cost of Goods Sold

Our cost of goods sold comprises mainly of materials costs, energy expenses, factory overheads, packaging materials and direct labor. The breakdown of our cost of goods sold in percentage is as follows:

	Year Ended December 31, 2016		Year Ended December 31, 2015		Year Ended December 31, 2014	
Materials costs	67.4	%	66.4	%	67.8	%
Energy expense	12.6	%	11.8	%	9.9	%
Factory overhead	10.3	%	13.5	%	16.4	%
Packaging materials	4.5	%	3.8	%	2.8	%
Direct labor	5.2	%	4.5	%	3.1	%

Material Costs

As noted above, the raw materials used in our BOPET film production are PET resin and additives, which made up approximately 77.0% and 23.0%, respectively of our total materials costs in 2016.

Energy expense

Energy expense includes electricity, gas and water costs, in which electricity is the main energy consumed.

Factory Overhead

Factory overhead comprises primarily of depreciation, electricity and water charges, and repair and maintenance of our machinery and equipment, etc. In 2016, the depreciation expense and repair and maintenance expenditure accounted for 72.5% and 16.9% of factory overhead, respectively.

Packaging Materials

Our packaging materials mainly comprise of, among other things, packaging pallets and carton cores, used for the packaging of our BOPET film products for delivery to customers. Generally, our unit cost of packaging materials does not fluctuate significantly and our total costs for packaging materials typically vary in line with our sales volume.

Direct Labor

Direct labor cost includes salaries, wages, bonuses and other payments to our employees in the PRC who are involved in the production of our products. The main factors affecting our direct labor cost are CPI, the changes of any government policies or laws and the demand and supply of skilled labor.

Operating Expenses

Our operating expenses comprise of administrative expenses, distribution expenses and other operating expense.

Our administrative expenses comprise mainly of administrative staff salaries and related welfare costs, research and development expenses, depreciation charges of office equipment, furniture and fixtures, amortization charges relating to land use rights, allowance for doubtful trade receivables, professional fees, government duties and fees, insurance expenses, rental expenses, travel expenses, entertainment expenses, office expenses and miscellaneous expenses.

Our distribution expenses comprise mainly of freight costs, travel expenses, marketing and promotion expenses as well as salaries and commission paid to our sales and marketing personnel.

Other operating expenses comprise mainly of loss on disposal of property, plant and equipment and miscellaneous expenses.

Finance Costs

Finance costs comprise mainly of interest expense relating to our loans, capital lease obligations, exchange deficit and bank charge.

Income Tax Expense

For the period from January 28, 2003 to December 31, 2004, Shandong Fuwei was granted certain tax relief under which it was exempted from PRC income tax. As of January 2005, Shandong Fuwei has been a wholly foreign-owned enterprise under the laws of the PRC. Accordingly, Shandong Fuwei is entitled to tax concessions whereby the profit for the first two financial years beginning with the first profit-making year (after setting off tax losses carried forward from prior years) is exempt from income tax in the PRC and the profit for each of the subsequent three financial years is taxed at 50% of the prevailing tax rates set by the relevant tax authorities.

On March 16, 2007, the National People’s Congress of the PRC passed the Enterprise Income Tax Law of the People’s Republic of China, which law took effect on January 1, 2008 (the “New Tax Law”). Under the New Tax Law, domestic enterprises and foreign-invested enterprises will generally become subject to a unified enterprise income tax rate of 25%, except that enterprises incorporated prior to March 16, 2007 may continue to enjoy existing preferential tax treatments until January 1, 2013. In addition, certain qualifying "High Technology Enterprises" may still benefit from a preferential tax rate of 15% under the New Tax Law if they meet the definition of "Government Advocated High Technology Enterprise" to be set forth in the more detailed implementing rules when they become adopted. Shandong Fuwei was designated as a High-and-New Tech Enterprise in December 2008 and will retain its status as a high-tech enterprise for three years commencing from 2011 enjoying a favorable corporate tax rate of 15% during the term from January 1, 2011 to December 31, 2013 pursuant to Enterprise Income Tax Law. In December 2014, Shandong Fuwei failed to be designated as a High Technology Enterprise and it became subject to a standard enterprise income tax at a rate of 25% in 2014 and 2015. In 2016, Shandong Fuwei was designated as a High-and-New Tech Enterprise and as a result, it is entitled to preferential tax treatment at an EIT rate of 15% for the years ended December 31, 2016, 2017 and 2018.

The US entity, Fuwei Films USA, LLC, is headquartered in South Carolina. As of December 31, 2016, the income tax rate is 39%, including 34% of federal income tax rate and 5% of state income tax rate. In December 2016, Fuwei Films USA, LLC was dissolved.

Inflation

According to the National Bureau of Statistics of China, the change in the consumer price index in China was 2.0%, 1.4% and 2.0% in 2016, 2015 and 2014, respectively.

Critical Accounting Policies

The SEC defines critical accounting policies as those that are, in management's view, most important to the portrayal of our financial condition and results of operations and those that require significant judgments and estimates. We prepare our financial statements in accordance with the U.S. GAAP, which requires us to make estimates and assumptions that affect the reported amounts of our assets and liabilities, to disclose contingent assets and liabilities on the date of the financial statements, and to disclose the reported amounts of revenues and expenses incurred during the financial reporting period. We continue to evaluate these estimates and assumptions based on the most recently available information, our own historical experience and various other assumptions that we believe to be reasonable under the circumstances. We rely on these evaluations as the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Since the use of estimates is an integral component of the financial reporting process, actual results could differ from those estimates. Some of our accounting policies require higher degrees of judgment than others in their application. We consider the policies discussed below to be critical to an understanding of our financial statements as their application assists management in making their business decisions.

Goodwill Impairment Goodwill represents the excess of purchase price and related costs over the value assigned to the net tangible and identifiable intangible assets of businesses acquired. Goodwill is not amortized but is tested for impairment annually, or when circumstances indicate a possible impairment may exist. Impairment testing is performed at a reporting unit level. An impairment loss generally would be recognized when the carrying amount of the reporting unit exceeds the fair value of the reporting unit, with the fair value of the reporting unit determined using a discounted cash flow (DCF) analysis. A number of significant assumptions and estimates are involved in the application of the DCF analysis to forecast operating cash flows, including the discount rate, the internal rate of return, and projections of realizations and costs to produce. Management considers historical experience and all available information at the time the fair values of its reporting units are estimated.

Collectibility of Accounts Receivable Our management has a credit policy in place and the exposure to credit risk is monitored on an ongoing basis. Credit evaluations are performed on all customers requiring credit over a certain amount. Generally, we offer our customers in the PRC credit terms of up to 30-45 days. Our international sales are settled through telegraphic transfer and letters of credit, which generally have payment terms of between 30 and 60 days.

We offer different credit terms to our customers based on criteria such as working relationship, payment history, creditworthiness and their financial position. All credit terms are to be approved by our finance department, in consultation with our sales and marketing department. For extension of larger credit limits, approvals have to be sought from our credit committee which is made up of members from our finance department, sales department and CFO. Our finance department and sales department review our outstanding debt account on a monthly basis and follow up with customers when payments are due. We do not impose interest charges on overdue account receivable.

As of December 31, 2016, our largest trade debtor was Zhuhai City Nengdong Technolgogy Optical Materials Co., Ltd., a company based in China, The balance of trade receivables from Zhuhai City Nengdong Technolgogy Optical Materials Co., Ltd. was RMB4.12 million.

We make specific allowance for doubtful trade receivables when our management takes the view (taking into account the aging of trade receivables and in consultation with our sales department) that we will not be able to collect the amounts due. Our customers pay by installments, creating long accounts receivable cycles. We provide for an allowance for doubtful accounts based on our best estimate of the amount of losses that could result from the inability or intention of our existing customers not to make the required payments. We generally review the allowance by taking into account factors such as historical experience, age of the accounts receivable balances and economic conditions.

Specific write-off of trade receivables is made when the outstanding trade receivables have been due for more than two years.

The analysis of the allowance for doubtful amounts for 2016, 2015 and 2014 is as follows (in thousands):

	December 31, 2016		December 31, 2015	December 31, 2014
	RMB	US$	RMB	RMB
Balance at beginning of year	747	108	825	795
Bad debt expense (recovery)	2,466	355	(78)	30
Write-offs	-	-	-	-
Balance at end of year	3,213	463	747	825

Impairment of Long-lived Assets

The Company recognizes an impairment loss when circumstances indicate that the carrying value of long-lived assets with finite lives may not be recoverable. Management's policy in determining whether an impairment indicator exists, a triggering event, comprises measurable operating performance criteria at an asset group level as well as qualitative measures. If an analysis is necessitated by the occurrence of a triggering event, the Company uses assumptions, which are predominately identified from the Company's strategic long-range plans, in determining the impairment amount. In the calculation of the fair value of long-lived assets, the Company compares the carrying amount of the asset group with the estimated future cash flows expected to result from the use of the assets. If the carrying amount of the asset group exceeds the estimated expected undiscounted future cash flows, the Company measures the amount of the impairment by comparing the carrying amount of the asset group with their estimated fair value. We estimate the fair value of assets based on market prices (i.e., the amount for which the asset could be bought by or sold to a third party), when available. When market prices are not available, we estimate the fair value of the asset group using discounted expected future cash flows at the Company's weighted-average cost of capital. Management believes its policy is reasonable and is consistently applied. Future expected cash flows are based upon estimates that, if not achieved, may result in significantly different results.

Results of Operations

The following discussion of our results of operations is based upon our audited consolidated financial statements beginning on page F-1 of this Annual Report.

The table below sets forth certain line items from our Statement of Income as a percentage of revenues:

	For the year ended December 31,		
	2016	2015	2014
	(% of Total Revenue)		
Gross profit	7.0	(0.0)	(6.0)
Operating expenses	23.6	(24.6)	(15.3)
Other expense	(2.7)	(0.4)	(4.0)
Income tax benefit (loss)	(2.1)	(2.8)	0.3
Net income (loss)	(21.5)	(27.8)	(25.1)

Fiscal year ended 2016 compared to fiscal year ended 2015

Revenues

Our revenue can be analyzed as follows (in thousands):

	For the year ended December 31,				
	2016			2015	
	RMB	US$	% of Total	RMB	% of Total
Stamping and transfer film	95,705	13,785	37.8 %	103,520	41.6 %
Printing film	20,366	2,933	8.0 %	29,605	11.9 %
Metallized film	7,391	1,065	2.9 %	9,010	3.6 %
Specialty film	96,091	13,840	37.8 %	73,851	29.7 %
Base film for other applications	34,373	4,950	13.5 %	32,876	13.2 %
	253,926	36,573	100 %	248,862	100 %

During the fiscal year ended December 31, 2016, net revenues were RMB253.9 million (US$36.6 million), compared to RMB248.9 million during the same period in 2015, representing an increase of RMB5.0 million or 2.0%. For further analysis of the factors causing revenue increase, the reduction of average sales price caused a decrease of RMB6.9 million and sales volume factor made an increase of RMB11.9 million.

In 2016, sales of specialty films were RMB96.1 million (US$13.8 million) or 37.8% of our total revenues as compared to RMB73.9 million or 29.7% in 2015, which was an increase of RMB22.2 million, or 30.0%, as compared to the same period in 2015. The increase was due to the increased sales volume.

Overseas sales were RMB41.8 million or US$6.0 million, or 16.5% of total revenues, compared with RMB54.6 million or 22.0% of total revenues in 2015. For further analysis of the factors causing overseas sales decrease, the decrease of average sales price caused a decrease of RMB4.1million and sales volume factor made a decrease of RMB8.7 million.

The following is a breakdown of domestic versus overseas sales for the periods ended December 31, 2016 and 2015 (amounts in thousands):

	For the year ended December 31,						
	2016				2015		
	RMB	US$	% of Total		RMB	% of Total	
Sales in China	212,129	30,553	83.5	%	194,226	78.0	%
Sales in other countries	41,797	6,020	16.5	%	54,636	22.0	%
	253,926	36,573	100.0	%	248,862	100.0	%

Cost of Goods Sold

Cost of goods sold during the year of 2016 totaled RMB236.2 million (US$34.0 million) as compared to RMB248.9 million in the prior year. This was RMB12.7 million or 5.1% lower than the same period in 2015. For further analysis of the factors causing cost of goods sold decrease, the reduction of unit cost of goods sold caused a decrease of RMB24.6 million and sales volume factor made an increase of RMB11.9 million. The decrease of cost of goods was mainly due to the price reduction of raw materials.

Gross (Loss) Profit

Our gross margin was 7.0% for the year of 2016, as compared to a gross margin of zero in 2015. Gross margin increased by 7.0 percentage points compared to the same period in 2015. Our average unit sales price decreased by 2.6% compared to last year. The unit sales cost decreased by 9.4% due to the price reduction of main raw materials. Consequently, the decrease in cost of goods sold per unit exceeded that in product sales price during 2016 compared with 2015, which contributed to the increase in our gross profit.

Operating Expenses

Our operating expenses during the year ended December 31, 2016 were RMB60.0 million, a decrease of RMB1.2 million, or 2.0%, as compared to 2015.

Other Expense

Total other expense is a combination result of interest income, interest expense and others income (expense). Total other expense during the year ended December 31, 2016 was RMB6.9 million (US$1.0 million), compared to total other expense of RMB0.9 million in 2015. This is mainly attributed to the previously recognized impairment losses relating to the long-term deposit reversed as a result of the refund of total long-term deposit received, offset by the higher interest charges due to capital lease obligations.

Income Tax Benefit (Expense)

Income tax expense during the year ended December 31, 2016 was RMB5.3 million (US$0.8 million) compared to an income tax expense of RMB7.0 million during 2015, which was mainly attributable to tax effect of changes in deferred tax during 2016. We only recognized deferred tax assets for the loss of 2016 after considering the possibility of realizing the benefits under the conservatism principle.

Fiscal year ended 2015 compared to fiscal year ended 2014

Revenues

Our revenue can be analyzed as follows (in thousands):

	For the year ended December 31,							
	2015				2014			
	RMB	US$	% of Total		RMB	% of Total		
Stamping and transfer film	103,520	15,982	41.6	%	118,560	41.7	%	
Printing film	29,605	4,570	11.9	%	32,987	11.6	%	
Metallized film	9,010	1,391	3.6	%	6,397	2.2	%	
Specialty film	73,851	11,401	29.7	%	79,609	28.0	%	
Base film for other applications	32,876	5,074	13.2	%	46,911	16.5	%	
	248,862	38,418	100	%	284,464	100	%	

During the fiscal year ended December 31, 2015, net revenues were RMB248.9 million (US$38.4 million), compared to RMB284.5 million during the same period in 2014, representing a decrease of RMB35.6 million or 12.5%, mainly due to the reduction of average sales price by 13.5% caused by the decrease in the price of main raw materials. For further analysis of the factors causing revenue decrease, the reduction of average sales price caused a decrease of RMB38.8 million and sales volume factor made an increase of RMB3.2 million.

In 2015, sales of specialty films were RMB73.9 million (US$11.4 million) or 29.7% of our total revenues as compared to RMB79.6 million or 28.0% in 2014, which was a decrease of RMB5.7 million, or 7.2%, as compared to the same period in 2014. The decrease was largely attributable to the decrease in sales average price by 8.9% for dry films and coated films due to the entrances of new competitors.

Overseas sales were RMB54.6 million or US$8.4 million, or 22.0% of total revenues, compared with RMB43.0 million or 15.1% of total revenues in 2014. For further analysis of the factors causing overseas sales increase, the decrease of average sales price caused a decrease of RMB8.0 million and sales volume factor made an increase of RMB19.6 million.

The following is a breakdown of domestic versus overseas sales for the periods ended December 31, 2015 and 2014 (amounts in thousands):

	For the year ended December 31,						
	2015				2014		
	RMB	US$	% of Total		RMB	% of Total	
Sales in China	194,226	29,984	78.0	%	241,446	84.9	%
Sales in other countries	54,636	8,434	22.0	%	43,018	15.1	%
	248,862	38,418	100.0	%	284,464	100.0	%

Cost of Goods Sold

Cost of goods sold during the year of 2015 totaled RMB248.9 million (US$38.4 million) as compared to RMB301.6 million in the prior year. This was RMB52.7 million or 17.5% lower than the same period in 2014. For further analysis of the factors causing cost of goods sold decrease, the reduction of unit cost of goods sold caused a decrease of RMB56.1 million and sales volume factor made an increase of RMB3.4 million. The decrease of cost of goods was mainly due to the price reduction of raw materials.

Gross (Loss) Profit

Our gross margin was zero for the year of 2015, as compared to a gross margin of (6.0) % in 2014. Gross margin increased by 6.0 percentage points compared to the same period in 2014. Our average unit sales price decreased by 13.5% compared to last year. The unit sales cost decreased by 18.4% due to the price reduction of main raw materials. Consequently, the decrease in cost of goods sold per unit exceeded that in product sales price during 2015 compared with 2014, which contributed to the increase in our gross profit.

Operating Expenses

Our operating expenses during the year ended December 31, 2015 were RMB61.2 million, an increase of RMB17.7 million, or 40.7%, as compared to 2014. This increase is mainly due to the accounting treatment that allocated certain amount of fixed overhead from cost of goods sold to general and administrative expense due to the fact that our third production line has not been able to continue its production since April 2015, in addition to impairment on assets incurred during 2015.

Other Expense

Total other expense is a combination result of interest income, interest expense and others income (expense). Total other expense during the year ended December 31, 2015 was RMB0.9 million (US$0.1 million), compared to total other expense of RMB11.4 million in 2014. This was mainly due to mainly attributed to decreased interest expense.

Income Tax Benefit (Expense)

Income tax expense during the year ended December 31, 2015 was RMB7.0 million (US$1.1 million) compared to an income tax benefit of RMB0.74 million during 2014, which was mainly attributable to tax effect of changes in deferred tax during 2015. We only recognized deferred tax assets for the loss of 2015 after considering the possibility of realizing the benefits under the conservatism principle.

Liquidity and Capital Resources

Since inception, our sources of cash were mainly from cash generated from our operations and borrowings from financial institutions and capital contributed by our shareholders.

Our capital expenditures in 2016 have been primarily financed through short-term borrowings from financial institutions and related party. The interest rates of short-term borrowings from financial institutions during the three-year period from 2014 to 2016 ranged from 0% to 7.5%, and these borrowings may not be paid prior to maturity.

Since inception, we have utilized significant amounts of secured short-term financing to fund our acquisition of Brückner, DMT and Dornier production lines and working capital needs. As of December 31, 2016, we had borrowings of RMB63.3 million from Bank of Weifang, SPD Bank and Weifang Dongfang State-owned Assets Management Co., Ltd. in the PRC.

Each of the related loan agreements contains provisions regarding collateral, covenants prohibiting us from engaging in certain activities (including selling, mortgaging or otherwise disposing of or encumbering all or substantially all of our assets or before any merger, acquisition, spin-off, or other transaction resulting in a change in our corporate structure) without the lenders consent and acceleration (and setoff) provisions in the event of default in payment or failure to comply with such covenants.

In April 2014, we obtained a loan for a total amount of RMB105 million from Shandong SNTON Optical Materials Technology Co., Ltd. (the “Shandong SNTON”) to pay off certain short-term loans due to Bank of Communications Co., Ltd. The interest shall be calculated at the benchmark rate, plus an additional 20% of the said benchmark rate, for the loan of the same term announced by the People’s Bank of China. The interest must be paid quarterly and settled in full at the end of the year. As of December 31, 2014, the principal of this loan and the interest have not been paid. In March 2015, we entered into a supplemental agreement with Shandong SNTON pursuant to which the parties agreed that we will pay off the principal of this loan plus interest upon availability of new loans from banks or other financial institutions.

As of December 31, 2016, the principal of this loan from Shandong SNTON was RMB104.71 million and the interest was RMB17.37 million.

In May 2014, we borrowed RMB15.0 million from Shandong SNTON Group Co., Ltd. (the “SNTON Group”) solely to purchase raw materials. The interest shall be calculated at the benchmark rate, plus an additional 20% of the said benchmark rate, for the loan of the same term announced by the People’s Bank of China. The interest shall be paid quarterly and settled in full at the end of the year. We agreed to repay this loan prior to December 31, 2014. In March 2015, we entered into a supplemental agreement with SNTON Group pursuant to which we agreed to pay off the principal of this loan plus interest upon availability of new loans from banks or other financial institutions.

In May 2015, SNTON Group provided us with a loan for the amount of RMB10.0 million.

In August 2016, we returned the principal of RMB25.0 million together with the interest of RMB1.97 million to SNTON Group.

As of December 31, 2016, the total principal of loans from SNTON Group was zero and the interest payable was zero.

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As of December 31, 2016, the total balance of principal of loans from related party was RMB104.71 million and the interest payable was RMB17.37 million.

On November 20, 2009, we signed a long-term loan agreement of RMB10.0 million (US$1.7 million) with Weifang Dongfang State-owned Assets Management Co., Ltd., with an eight-year loan term, which became effective on October 19, 2009 and will expire on October 18, 2017. From 2015 to 2016, we will make principal installment payments of RMB3.35 million (US$0.6 million) per year with the remaining principal balance of RMB3.3 million (US$0.5 million) due in 2017. The annual interest rate for the loan is the benchmark interest rate for over five-year loans announced by the People's Bank of China reduced by 10% and the applicable annual interest rate for the period ended December 31, 2015 is 4.41%. The loan is guaranteed by Shandong Deqin Investment& Guarantee Co., Ltd. and is used for our projects.

The credit lines amounting to RMB45.0 million (US$6.95 million) and RMB45.0 million, respectively granted by SPD bank and Bank of Weifang were secured by a pledge of plant and land use right. The credit lines were used to purchase raw materials. The term of the credit line granted by SPD bank is from December 19, 2014 to December 19, 2017. And the term of the credit line granted by Bank of Weifang is from July 2016 to July 2017. As of December 31, 2016, the amount of credit line granted by SPD bank used was RMB42,710,000 and the remaining balance was RMB2,290,000. The amount of credit line granted by Bank of Weifang was all used.

We believe that, after taking into consideration our present and future banking facilities, borrowing from related party, existing cash and the expected cash flows to be generated from our operations, we have adequate sources of liquidity to meet our short-term obligations and our working capital.

A summary of our cash flows for 2016, 2015 and 2014 is as follows (in thousands):

	2016 RMB	US$	2015 RMB	2014 RMB
Net cash provided by (used in) operating activities	(23,228)	(3,346)	(26,950)	(23,307)
Net cash (used in) provided by investing activities	(40,568)	(5,843)	23,610	(10,538)
Net cash provided by (used in) financing activities	60,123	8,660	(8,733)	31,318
Effect of foreign exchange rate changes	2,661	235	(58)	(31)
Net increase (decrease) in cash and cash equivalent	(1,012)	(294)	5,335	(2,558)

Cash and cash equivalent				
At beginning of the year	14,355	2,216	9,020	11,578
At end of the year	13,343	1,922	14,355	9,020

Net cash used in operating activities was RMB23.2 million for the year ended December 31, 2016 as compared to net cash used in operating activities of RMB27.0 million for the year ended December 31, 2015.

Net cash used in operating activities was RMB27.0 million for the year ended December 31, 2015 as compared to net cash used in operating activities of RMB23.3 million for the year ended December 31, 2014.

Net cash used in operating activities was RMB23.3 million for the year ended December 31, 2014 as compared to net cash provided by operating activities of RMB3.1 million for the year ended December 31, 2013.

Investing Activities

Net cash used in investing activities was RMB40.6 million in 2016 mainly attributable to increased restricted cash and fixed assets.

Net cash provided by investing activities was RMB23.6 million in 2015 mainly attributable to the receipt of long-term deposit.

Net cash used in investing activities was RMB10.5 million in 2014 mainly due to investment in the third production line project.

Net cash provided by financing activities was RMB60.1 million for the year ended December 31, 2016, which was mainly due to increased short-term loans from banks.

Net cash provided by financing activities was RMB8.7 million for the year ended December 31, 2015, which was mainly due to increased borrowing from related party.

Net cash provided by financing activities was RMB31.3 million for the year ended December 31, 2014, which was mainly due to increased borrowing from related party.

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Foreign Exchange Exposure

Translations

Our reporting currency is RMB. The functional currency of our operating subsidiary in the PRC is RMB and our operating subsidiary also maintains its books and records in RMB. Accordingly, we are not exposed to any material foreign currency translation effects.

Transactions

We are, to a certain extent, exposed to transaction foreign currency exposure arising from our operations in the PRC.

We began conducting part of our sales in foreign currency in 2004 with the commencement of our overseas sales business. During 2016, 2015 and 2014, approximately 83.5%, 78.0%, and 84.9% respectively, of our revenue was denominated in RMB and the remainder was in US dollar. The proportion of raw materials we purchased within the PRC during 2016, 2015 and 2014 were 100%, 100%, and 100.0%, respectively. The remainder was purchased in US dollars.

Our foreign currency exchange risk arises mainly from this mismatch between the currency of our sales, purchases and operating expenses. We may, therefore, be susceptible to foreign exchange exposure.

In addition, we also maintain US dollar accounts with financial institutions for our US dollar receipts and US dollar payments. We may also incur foreign exchange gains or losses when we convert the US dollar balances into RMB.

Currently, we do not have a formal foreign currency hedging policy as our foreign exchange gains and losses in 2016, 2015 and 2014 were insignificant. Our management believes that it is more efficient for us to assess the hedging need of each transaction on a case-by-case basis. We will continue to monitor our foreign exchange exposure in the future and will consider hedging any material foreign exchange exposure should such need arise.

Capital Expenditures and Contractual Commitments

Capital Expenditures

Our capital expenditures in 2016, 2015 and 2014 were as follows (in thousands):

	For the year ended December 31,		
	2016	2015	2014
	RMB	RMB	RMB
Buildings	57	-	-
Plant and equipment	12,443	661	5,353
Motor vehicles	-	-	-
Assets under construction	65	1,334	366
Others (computer and furniture fittings)	76	42	285
Total	12,641	2,037	6,004

The following table summarizes our contractual commitments as of December 31, 2016 and the effects caused by those commitments are expected to have on our liquidity and cash flow in future periods:

Contractual Commitments	Total	**Less than 1 Total Year**	**1-3 Years**	**3-5 Years**	**More than 5 Years**
	(RMB in thousands)				
Equipment Purchase Contract(i)	541	541	-	-	-
Due to related parties					
-Principal	105,000	105,000			
-Interest(iii)	5,481	5,481			
Bank loans(ii)					
-Principal	3,300	3,300			
-Interest(iii)	84	84			-
Obligations under capital lease(iv)					
-Carrying amount of lease obligation					
-Interest on unpaid obligation					
Operating leases(v)	143	143		-	-
Total	114,549	114,549		-	-

(i) The purchase of equipment will be financed by the sale of our ordinary shares or by bank borrowings or by funds generated from business operations.

(ii) We have a secured long-term and short-term loans of RMB63.3 million as of December 31, 2016. Our obligations under our existing loans have been mainly met through the cash flow from our operations and financing activities. In the past, cash flow from operations has been sufficient to meet payment obligations and/or we have been able to extend our borrowings. In the event that our cash flows are insufficient to satisfy these obligations, we may consider additional bank loans, issuing bonds, or other forms of financing to satisfy our capital requirements. December 31, 2016, our principal of loans from related parties was RMB104.7 million and the interest was RMB17.4 million.

(iii) The interest expenses are estimated based on the interest rate of borrowings adopted by the People's Bank of China on December 31, 2016 plus an estimated risk premium on borrowing.

(iv) The Group has commitments under capital lease agreements as for a part of new third production line and related equipment. The lease has terms of 3 years expiring by the end of December 2015.

(v) The operating leases mainly relate to our rental of staff dorms and offices. The term of these leases typically ranges from 1 year to two years, and are renewable subject to renegotiation of terms upon expiration. We intend to finance these operating leases from our cash flows from operations.

Off-Balance Sheet Arrangements and Contingent Liabilities

We do not have any off-balance sheet guarantees, any outstanding derivative financial instruments, interest rate swap transactions or foreign currency forward contracts.

Inflation

According to the National Bureau of Statistics of China, the change in the consumer price index in China was 2.0%, 1.4% and 2.0% in 2016, 2015 and 2014, respectively.

Recent Accounting Pronouncements

Revenue Recognition: In May 2014, the FASB issued Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers (Topic 606) (ASU 2014-09), which amends the existing accounting standards for revenue recognition. In August 2015, the FASB issued ASU No. 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date, which delays the effective date of ASU 2014-09 by one year. The FASB also agreed to allow entities to choose to adopt the standard as of the original effective date. In March 2016, the FASB issued Accounting Standards Update No. 2016-08, Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net) (ASU 2016-08) which clarifies the implementation guidance on principal versus agent considerations. The guidance includes indicators to assist an entity in determining whether it controls a specified good or service before it is transferred to the customers. The new revenue recognition standard will be effective for us in the first quarter of 2018, with the option to adopt it in the first quarter of 2017. We currently anticipate adopting the new standard effective January 1, 2018. The new standard also permits two methods of adoption: retrospectively to each prior reporting period presented (full retrospective method), or retrospectively with the cumulative effect of initially applying the guidance recognized at the date of initial application (the modified retrospective method). We currently anticipate adopting the standard using the modified retrospective method. We are still in the process of completing our analysis on the impact this guidance will have on our consolidated financial statements and related disclosures. The adoption of this ASU is not expected to have a material impact on the Company's consolidated financial statements.

Financial Instrument

In January 2016, the FASB issued ASU No. 2016-01, “Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities” (“ASU 2016-01”). The standard addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. ASU 2016-01 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2017, and early adoption is not permitted. Accordingly, the standard is effective for us on September 1, 2018. The Company is currently evaluating the impact that the standard will have on the Company’s consolidated financial statements.

Leases

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842) (“ASU 2016-2”), which provides guidance on lease amendments to the FASB Accounting Standard Codification. This ASU will be effective for us beginning in May 1, 2019. The Company is currently in the process of evaluating the impact of the adoption of ASU 2016-2 on the Company’s consolidated financial statements.

Stock-based Compensation

In March 2016, the FASB issued ASU 2016-09, Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting (ASU 2016-09). ASU 2016-09 changes how companies account for certain aspects of stock-based awards to employees, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. ASU 2016-09 is effective for us in the first quarter of 2018, and earlier adoption is permitted. We are still evaluating the effect that this guidance will have on our consolidated financial statements and related disclosures.

Financial Instruments - Credit Losses

In June 2016, the FASB issued ASU 2016-13, Financial Instruments - Credit Losses (Topic 326): The amendments in this Update require a financial asset (or a group of financial assets) measured at amortized cost basis to be presented at the net amount expected to be collected. The amendments broaden the information that an entity must consider in developing its expected credit loss estimate for assets measured either collectively or individually. The use of forecasted information incorporates more timely information in the estimate of expected credit loss, which will be more decision useful to users of the financial statements. ASU 2016-13 is effective for the Company for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is allowed as of the fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company is still evaluating the effect that this guidance will have on the Company's consolidated financial statements and related disclosures.

Other pronouncements issued by the FASB or other authoritative accounting standards group with future effective dates are either not applicable or not significant to the consolidated financial statements of the Company.

Research and Development, Patents and Licenses

We rely on copyright, patent, trademark and other intellectual property law, nondisclosure agreement and technical know-how to protect our intellectual property and proprietary rights. We enter into confidentiality and licensing agreements with the relevant employees. Our senior employees and employees who work in our research and development department and other technical departments have signed agreements acknowledging that we own the rights to all technology, inventions, trade secrets, works of authorship, developments and other processes generated in connection with their employment with us or their use of our resources or relating to our business or our property and that they must assign any ownership rights that they may claim in those works to us. As most of our business is currently conducted in mainland China, we have not taken any action outside mainland China to protect our intellectual property.

As of the date of this Annual Report, we have received 16 patents from the PRC authorities.

We currently sell our products in the PRC with the registered trademark of “Fuwei Films”. Our ability to compete in our markets and to achieve future revenue growth will depend, in significant part, on our ability to protect our proprietary technology and operate without infringing upon the intellectual property rights of others. An infringement upon these rights may reduce or eliminate any competitive advantage we have developed, causing us to lose sales or otherwise harm our business. We are not aware of any infringement or unauthorized use of our intellectual property rights. We will take appropriate legal actions to protect our rights if there is any unauthorized use or infringement of our rights in the future. To date, we have not been sued for infringement of intellectual property rights by any third party.

Trend Information

Since the second half of 2011, the international capacity of BOPET films surged especially in countries such as India and China which attributed to more supply than demand and reduced prices in the market. We expect this trend to continue in 2017, which will result in fierce price competition. We expect that in the next two to three years, the global BOPET production capacity will continue to increase while supply will continue to surpass demand in the market.

In addition, aiming at the rapidly developed thick films market (with applications in high value-added electronics, electrical, solar energy and other industries), giants including Mitsubishi Plastics, Inc., SKC, Inc. and China Lucky Film Corporation invested in and built production lines in China, which will bring challenges and fiercer competition to our thick film project.

Other than as disclosed elsewhere in this Annual Report, we are not aware of any trends, uncertainties, demands, commitments or events that are reasonably likely to have a material effect on our net sales, profitability, liquidity or capital resources, or that caused the disclosed financial information to not necessarily be indicative of future operating results or financial conditions.

Item 6. Directors, Senior Management and Employees

A. Directors and senior management.

The following table sets forth information regarding our directors and executive officers as of the date of this Annual Report on Form 20-F:

Directors and Executive Officers

Name	Age	Position
Zengyong Wang	51	Chairman, Director and Chief Executive Officer
Benjie Dong(1)	39	Chief Financial Officer and Director
Tee Chuang Khoo (2)(3)	71	Independent Director
Junying Liu(2)(3) (4)(5)	64	Independent Director
Shan Jiang (2)	70	Independent Director
Zhimei Liu	45	General Manager of Shandong Fuwei
Yong Jiang	43	Board Secretary and Vice President of Shandong Fuwei
Xiaoming Wang	57	Vice President of Shandong Fuwei
Xuehua Li	45	Vice President of Shandong Fuwei

(1) Mr. Benjie Dong was appointed as the Chief Financial Officer of the Company, effective April 1, 2016 to fill the vacancy caused by resignation of Mr. Xiuyong Zhang. Mr. Xiuyong Zhang tendered his resignation as the Chief Financial Officer and director of the Company, effective March 31, 2016. On the Annual General Meeting of 2016 held on December 30, 2016, Mr. Benjie Dong was elected as a director of the Company.

(2) Member of the Audit Committee.

(3) Member of the Compensation Committee.

(4) Member of the Corporate Governance and Nominating Committee.

(5) Mr. Junying Liu was appointed as a director of the Company, effective December 31, 2016 to fill the vacancy caused by resignation of Mr. Changrong Ji.

Mr. Zengyong Wang has been a director and Vice President of Shandong SNTON Group Co., Ltd. (the "SNTON Group") since February 2006, where he has been responsible for SNTON Group's business management affairs, production planning and management and the supply market of SNTON Group's subsidiaries. Mr. Wang has more than ten years of large-scale enterprise group management experience. From January 2001 to February 2006, Mr. Wang served as a member of the Board of Supervisors of SNTON Group. From October 2003 to February 2006, Mr. Wang was the director of human resources of SNTON Group. From January 1995 to October 2003, Mr. Wang was the General Manager responsible for the overall management of operations of SNTON Hualu New Materials Co., Ltd., of which the main products were new patterns of middle and high pressed glass fiber reinforced plastic composite pipe fittings used for oil translation. In 2009, Mr. Wang studied in a selected EMBA class in Tsinghua University School of Economics and Management. From 2000 to 2002, Mr. Wang studied Economics and Management in Shandong Provincial Committee Party School. In March 2001, Mr. Zengyong Wang received his professional title of Senior Engineer certificate awarded by Shandong Province Office of Personnel.

Mr. Benjie Dong has been a director of Shandong SNTON Group Co., Ltd. ("SNTON Group") since December 2012, and the vice president of SNTON Group since October 2005. From October 2005 to December 2012, Mr. Dong was the vice general manager and head of the finance department of SNTON Group and he was the finance minister of SNTON Group from May 2003 to October 2005. Prior to this, he was the vice finance minister of SNTON Group from June 2000 to May 2003. Mr. Dong joined SNTON Group in March 1996 as an accountant until June 2000. Prior to joining Shandong SNTON Group, he worked at Shandong Kenli County Oil Chemical Factory as an accountant from October 1995 to March 1996. Mr. Dong studied Business Management and received his postgraduate degree from the City University of Macau in 2009. From 2002 to 2005, he studied Economics and Management and received his bachelor degree from Shandong University of Technology. From 1997 to 1999, Mr. Dong studied Economics and Management and received his college degree from the Shandong Provincial Committee Party School. From 1993 to 1995, Mr. Dong studied at Dongying Television University where he obtained his degree in accounting.

Tee Chuang Khoo has been a director of our Company since November 2007. Mr. Khoo was a Senior Partner in Management Consulting at DENEC Management Consulting Co., Ltd. ("DENCE") in Shanghai from October 2005 to October 2007. From November 2000 to September 2005, Mr. Khoo was a Senior Partner at Improve Management Consulting Services in Malaysia where he was responsible for reducing manufacturing costs and process improvement. Mr. Khoo was an Executive Director at JPK (M) Sdn Bhd, a Malaysian-listed company, from October 1998 to September 2000, where he assisted the Managing Director with the entire operation of the company. From November 1996 to August 1998, he was the General Manager of Broadway Group's (a Singapore-listed company) product factories in Johor Baru, Malaysia, and in China. He also held managerial positions at the Malaysian conglomerate, The Lion Group, and he was a Human Resources Manager at Metal Box Singapore Ltd, a Singapore-listed company owned by the British Metal Box Group. Mr. Khoo received a Bachelor of Arts in Finance & Management from the University of Oregon (USA), a Masters in Business Administration (MBA) from University of Southern California (USA) and a diploma in Accounting from the Association of International Accountants from the United Kingdom.

Mr. Junying Liu has been a director of our Company since December 31, 2016. Mr. Liu acted as counsel to China Lucky Group Corporation (“Lucky Group”), a subsidiary of China Aerospace Science and Technology Corporation, a company mainly engaged in the research, design, manufacture and launch of space systems (“ASTC”) from December 2013 to December 2015. He received the title of senior research fellow in 2013 granted by ASTC. He was the General Manager of Hefei Lucky Science & Technology Industry Company where he was responsible for the company’s daily operation and was the Vice Chief Engineer of Lucky Group from February 2007 to November 2013 and retired from this position in 2013. Mr. Liu was the General Manager of both Lucky Group’s Films Business Division and Baoding Lucky Films Co., Ltd. from February 1997 to January 2007. Mr. Liu received his positional title of Senior Engineer in 1997. From February 1993 to January 1997, Mr. Liu was the President of the Film Base Factory of Lucky Group and was the director of Administrative Department of Lucky Group from January 1991 to February 1993. He was the Vice Chairman of Association of Science of Lucky Group from 1985 to 1991 and was a lab technician and an engineer at Lucky Group from 1980 to 1985. Mr. Liu graduated and obtained his bachelor’s degree in Photosensitive Materials in 1980 from East China University of Science and Technology.

Shan Jiang has been a director of our Company since August 2010. He is a Partner of C&I Partners Legal Firm in Beijing since 1995. Prior to that, he worked in Legal Affairs Center of China from 1986 to 1995; and he worked in maritime court office in Ministry of Communications from 1982 to 1986. Mr. Shan Jiang graduated from Renmin University of China majored in Economic Law in 1985.

Ms. Zhimei Liu has been appointed as the General Manager of Fuwei Films (Shandong) Co., Ltd ("Fuwei Shandong") by the Company since December 22, 2014, where she has been responsible for the overall business management, day-to-day operations and other affairs designated by the board of directors of Fuwei Shandong. From May 2012 to November 2014, Ms. Liu acted as the Director of Administration of Shandong SNTON Steel Cord Co., Ltd.("SNTON Steel Cord"), a subsidiary of Shandong SNTON Group Co., Ltd. where she was responsible for formulating and implementing business strategies and operation. From December 2008 to April 2012, Ms. Liu was the Manager of Corporate Planning Department and the Manager of Staff Training Center of SNTON Steel Cord as an Associate Senior Engineer. From April 2007 to November 2008, Ms. Liu served as the Manager of Administration Department of SNTON Steel Cord where she was in charge of overall corporate project planning. From November 2005 to April 2007, Ms. Liu was the assistant manager of supplies department of SNTON Steel Cord where she was overseeing matters related to raw materials, equipment and supplies with respect to production. Ms. Liu joined Shandong SNTON Group Co., Ltd. in 1996 as a technician, office clerk, purchasing officer, sales person, and accountant in the subsidiary and branch company of Shandong SNTON Group Co., Ltd. Ms. Liu studied Business Management in China University of Petroleum from 2007 to 2009.In 1994, Ms. Liu graduated from Shandong Vocational College of Industry where her major was Computer Application.

Yong Jiang has been the Board Secretary since April 2011. Since July 2014, Mr. Jiang is the vice president and in charge of the products sale of Fuwei Films (Shandong) Co., Ltd. He is also assistant President of Fuwei Films (Shandong) Co., Ltd. since 2007. From 2003 to 2006, he served as assistant manager, deputy manager and manager of the marketing department for Shandong Fuwei. In 1998, he joined Weifang Neoluck Plastic Co., Ltd. where he was responsible for overseas sales and production planning. In December 2015, Mr. Jiang obtained his EMBA degree in Nankai University. In 1998, he received his bachelor's degree in Information Management and Information System from Shandong University.

Xiaoming Wang has been Vice President of Shandong Fuwei since January 2005 and is responsible for the management of our production facilities, production planning and engineering until June 2014. From July 2014, Mr. Wang is in charge of managing products quality. Prior to joining us, Mr. Wang was the vice manager of Weifang Engine Manufacturing Co. from 1986 to 1998 and the deputy general manager of Shandong Neo-Luck from 1998 to 2003. Mr. Wang was the deputy general manager of Shandong Fuwei during 2004. Mr. Wang was certified as a professional economist by the Shandong Province Human Resources Committee in 2001 and obtained a certificate in Economics Management awarded by the PRC Central Party Learning Institute and obtained a certificate in Business Enterprises Operational Management from the Shandong Television University in 1986.

Xuehua Li has been the Vice President of Fuwei Shandong since July 1, 2014 and has been responsible for the management of the production facilities and electrical and mechanical engineering management. From September 2007 to June 2014, Mr. Li was the assistant president of Fuwei Shandong where he was responsible for production operation and management. From September 2006 to August 2007, Mr. Li was the manager of Guangdong Sales Department of Fuwei Shandong where he was responsible for products sales of South China region. Mr. Li joined Fuwei Shandong's marketing department in 1997. In December 2015, Mr. Jiang obtained his EMBA degree in Nankai University. Mr. Li obtained his bachelor degree from Nankai University majored in Business Management in 2013. In 1995, Mr. Li graduated from Shandong Administration Institute where his major was International Trade and

Economy.

None of our directors or officers is related to each other. To the best of our knowledge and belief, there are no arrangements or understandings with any of our principal shareholders, customers, suppliers, or any other person, pursuant to which any of our directors or executive officers were appointed.

The business address of our directors and executive officers is No. 387 Dongming Road, Weifang Shandong, People's Republic of China, Postal Code: 261061.

Board Committees

Our Board of Directors has established an Audit Committee, Compensation Committee and a Corporate Governance and Nominating Committee, and adopted charters for each of these committees. We have appointed independent directors to each of our committees.

Nasdaq Rule 5605(b)(1) requires that the Board be comprised of a majority of Independent Directors as such term is defined in Rule 5605(a)(2). The Company provided Nasdaq with a notice on December 25, 2007 stating that as a "Controlled Company", it is exempt from the requirements of Rule 5605(b)(1). Pursuant to Rule 5615(c)(1), a "Controlled Company" is a Company of which more than 50% of the voting power for the election of directors is held by an individual, a group or another company. As of December 31, 2016, Hongkong Ruishang International Trade Co. Ltd controlled 52.9% of the outstanding ordinary shares of Fuwei. As a result, Fuwei is considered to be a Controlled Company and relied upon the exemption from December 25, 2007.

Audit Committee

Our Audit Committee currently consists of Tee Chuang Khoo (chairman), Junying Liu and Shan Jiang. Mr. Junying Liu was appointed as a member of our Audit Committee on December 31, 2016 to fill the vacancy caused by resignation of Mr. Changrong Ji. The Audit Committee will oversee our accounting and financial reporting processes and the audits of our financial statements. The audit Committee is responsible for, among other things:

- selecting the independent auditors and pre-approving all auditing and non-auditing services permitted to be performed by the independent auditors;
- reviewing and approving all proposed related-party transactions;
- discussing the annual audited financial statements with management and the independent auditors;
- annually reviewing and reassessing the adequacy of our audit committee charter;
- meeting separately and periodically with management and the independent auditors;
- reviewing such other matters that are specifically delegated to our audit committee by our board of directors from time to time; and
- reporting regularly to the full board of directors.

Compensation Committee

Our Compensation Committee currently consists of Tee Chuang Khoo and Junying Liu. Mr. Junying Liu was appointed as a member of our Compensation Committee on December 31, 2016 to fill the vacancy caused by resignation of Mr. Changrong Ji. The Compensation Committee is responsible for, among other things:

- reviewing and determining the compensation package for our senior executives;
- reviewing and making recommendations to our board with respect to the compensation of our directors;
- reviewing and approving officer and director indemnification and insurance matters;
- reviewing and approving any employee loan in an amount equal to or greater than RMB100,000; and
- reviewing periodically and approving any long-term incentive compensation or equity plans, programs or similar arrangements, annual bonuses, employee pension and welfare benefit plans.

Corporate Governance and Nominating Committee

Mr. Junying Liu is the sole member of our Corporate Governance and Nominating Committee. Mr. Junying Liu was appointed as the sole member of our Corporate Governance and Nominating Committee on December 31, 2016 to fill the vacancy caused by resignation of Mr. Changrong Ji. The Corporate Governance and Nominating Committee is responsible for, among other things:

- identifying and recommending to the board nominees for election or re-election to the board;
- making appointments to fill any vacancy on our board;
- reviewing annually with the board the current composition of the board in light of the characteristics of independence, age, skills, experience and availability of service to us;
- identifying and recommending to the board any director to serve as a member of the board's committees;
- advising the board periodically with respect to significant developments in the law and practice of corporate governance as well as our compliance with applicable laws and regulations, and making recommendations to the board on all matters of corporate governance and on any corrective action to be taken; and
- monitoring compliance with our code of business conduct and ethics, including reviewing the adequacy and effectiveness of our procedures to ensure proper compliance.

Duties of Directors

Under Cayman Islands laws, our directors have a common law duty of loyalty to act honestly in good faith with a view to our best interests. Our directors also have a duty to exercise the skill they actually possess and such care and diligence that a reasonably prudent person would exercise in comparable circumstances. In fulfilling their duty of care to us, our directors must ensure compliance with our memorandum and articles of association. A shareholder has the right to seek damages if a duty owed by our directors is breached. You should read “Information - Differences in Corporate Law” for a more complete discussion of these matters.

B. Compensation

Compensation of Directors and Executive Officers

All directors receive reimbursements from us for expenses which are necessary and reasonably incurred by them for providing services to us or in the performance of their duties. Our directors who are also our employees receive compensation in the form of salaries, housing allowances, other allowances and benefits in kind in their capacity as our employees. Our directors do not receive any compensation in their capacity as directors in addition to their salaries and other remunerations as members of our management team. We pay their expenses related to attending board meetings.

The aggregate cash compensation and benefits that we paid to our directors and executive officers, a group of 7 persons for the year ended December 31, 2016 was approximately RMB1.47 million. No executive officer is entitled to any severance benefits upon termination of his or her employment with the Company.

Employment and Service Agreements

Executive Officers

Mr. Zengyong Wang, who was previously elected as a new director to the Board of Directors at the Annual General Meeting held on December 1, 2014, was appointed as the Chairman of the Board of Directors and Chief Executive Officer, effective January 1, 2015 to fill the vacancy caused by resignation of Mr. Xiaoan He. Mr. Xiaoan He tendered his resignation as the Chairman of the Board of Directors and Chief Executive Officer of the Company, effective December 31, 2014. Mr. Zengyong Wang has entered into Service Agreement with Shandong SNTON Group Co., Ltd. ("SNTON Group") since 1995 and his salary is paid by SNTON Group.

Ms. Zhimei Liu was appointed as the General Manager of Shandong Fuwei in December 2014. Ms. Zhimei Liu has entered into Service Agreement with Shandong SNTON Group Co., Ltd. ("SNTON Group"). We paid Ms. Zhimei Liu annual salary of RMB220,000 in 2016.

We entered into a Service Agreement with Mr. Xiuyong Zhang, our former Chief Financial Officer. The initial term of his Service Agreement began from March 1, 2006 to March 1, 2009. Upon the expiration of his Service Agreement, we extended the term of his Service Agreement for another three years to March 1, 2012. Mr. Zhang's Service Agreement was further renewed for a term of three years to February 28, 2015. On March 1, 2015, we entered into a new Service Agreement with Mr. Xiuyong Zhang with an unspecified term. Under the term of his new Service Agreement, effective from July 2014, Mr. Zhang's annual salary was adjusted to RMB 380,000. Mr. Zhang could terminate his Service Agreement upon three months prior written notice or by paying the Company a sum equaling to three months salary in lieu of such notice. Mr. Zhang tendered his resignation as the Chief Financial Officer and director of the Company, effective March 31, 2016, due to personal reasons.

Mr. Benjie Dong has entered into Service Agreement with Shandong SNTON Group Co., Ltd. ("SNTON Group") since 1996 and his salary is paid by SNTON Group.

We have also entered into Service Agreements with our other executive officers. Mr. Yong Jiang renewed his service agreement with the Company in December 2011 with an unspecified term. The initial term of Mr. Xiaoming Wang's Service Agreement was three years commencing from April 2, 2007. Upon expiration of his Service Agreement, it was renewed for two years to December 31, 2011. Mr. Wang's Service Agreement was further renewed in December 2011 with an unspecified term. We entered into a Service Agreement with Mr. Xuehua Li with an unspecified term.

We may only terminate the Service Agreement prior to the expiry (except by mutual agreement and except as provided in the Service Agreement) upon the occurrence of certain events including, without limitation, for cause, disability or personal bankruptcy. The term of service of each of our executive officers will be renewed for successive periods of one year each after the expiration of the initial period. The Service Agreement may be terminated by not less than three months' notice in writing served by either party to the Service Agreements. We have the option to pay the executive officer salary in lieu of any required period of notice of termination.

Under the terms of their respective Service Agreements, effective July 2014, Mr. Xiaoming Wang and Mr. Yong Jiang were entitled to an annual salary of RMB300,000 and RMB280,000, respectively. Mr. Xuehua Li's annual salary is RMB280,000. Their annual salaries of each of Xiaoming Wang, Xuehua Li and Mr. Yong Jiang may be adjusted at the discretion of our Compensation Committee. We may pay them discretionary management bonuses for any financial year, the payment and the amount of which are subject to the approval of the Compensation Committee.

Except for the payment in lieu of notice described above, there are no provisions for benefits for termination of employment of our executive officers under the Service Agreements.

Share Option Plan

We plan to adopt a share option plan that is a share incentive plan, the purpose of which is to recognize and acknowledge the contributions the eligible participants had or may have made to our company. The share option plan will provide the eligible participants an opportunity to have a personal stake in our company with the view to achieving the following objectives:

- motivate the eligible participants to optimize their performance efficiency for the benefit of our company; and
- attract and retain or otherwise maintain an on-going business relationship with the eligible participants whose contributions are or will be beneficial to our long-term growth.

Indemnification

Cayman Islands law does not limit the extent to which a company's articles of association may provide for indemnification of officers and directors, except to the extent any such provision may be held by the Cayman Islands courts to be contrary to public policy, such as to provide indemnification against civil fraud or the consequences of committing a crime. Pursuant to our memorandum and articles of association, our directors and officers, as well as any liquidator or trustee for the time being acting in relation to our affairs, will be indemnified and secured harmless out of our assets and profits from and against all actions, costs, charges, losses, damages and expenses that any of them or any of their heirs, executors or administrators may incur or sustain by reason of any act done, concurred in or omitted in or about the execution of their duties in their respective offices or trusts. Accordingly, none of these indemnified persons will be answerable for the acts, receipts, neglects or defaults of each other; neither will they be answerable for joining in any receipts for the sake of conformity, or for any bankers or other persons with whom any moneys or effects belonging to us may have been lodged or deposited for safe custody, or for insufficiency or deficiency of any security upon which any moneys of or belonging to us may be placed out or invested, or for any other loss, misfortune or damage which may happen in the execution of their respective offices or trusts. This indemnity will not, however, extend to any fraud or dishonesty that may attach to any of said persons.

Insofar as indemnification for liabilities arising under the Securities Act may be permitted to directors, officers or persons controlling us pursuant to the foregoing provisions, we have been informed that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Securities Act and is therefore unenforceable.

C. Board practices

Our Articles provide that our board of directors will consist of not less than two directors. At each annual general meeting, one-third of the directors (or, if their number is not a multiple of three, the number nearest to but not greater than one-third) shall retire from office by rotation except that the chairman of the board and/or the managing director of our company shall not be required to retire whilst holding such office nor be taken into account in determining the number of directors to retire in each year. A director who is appointed by the board must retire at our next annual general meeting of the shareholders following his or her appointment. A retiring director is eligible for re-election.

D. Employees

As of December 31, 2016**,** our total staff consisted of 232 employees.

We do not have any collective bargaining agreements with our employees. We have never experienced any material labor disruptions and are unaware of any current efforts or plans to organize employees. We believe we have good relationships with our employees.

Item 7. Major Shareholders and Related Party Transactions

A. Major shareholders.

The following table sets forth information with respect to the beneficial ownership, within the meaning of Rule 13d-3 under the Exchange Act, of our ordinary shares, as of April 6, 2017, for:

- each person known to us to own beneficially more than 5% of our ordinary shares; and
- each of our directors and executive officers who beneficially own our ordinary shares.

Beneficial ownership includes voting or investment power with respect to the securities. Except as indicated below, and subject to applicable community property laws, the persons named in the table have or share the voting and investment power with respect to all ordinary shares shown as beneficially owned by them. The number of our ordinary shares used in calculating the percentage for each listed person includes any options exercisable by such person within 60 days after the date of this Annual Report. Percentage of beneficial ownership is based on 3,265,837 (reflecting the Reverse Stock Split) ordinary shares outstanding as of April 6, 2017.

	Shares Beneficially Owned			
	Number		Percent	
Executive Officers and Directors:				
Zengyong Wang	—		—	
Benjie Dong (1)	—		—	
Tee Chuang Khoo	—		—	
Junying Liu	—		—	
Xiaoming Wang	—		—	
Shan Jiang	—		—	
Yong Jiang	—		—	
All directors and executive officers as a group (7 persons)	—		—	
5% Shareholders:				
Hongkong Ruishang International Trade Co., Ltd., Room 1401, 14 Floor, World Commerce Centre, Harbour City, 7-11 Canton Road, Tsim Sha Tsui, Kowloon, Hong Kong	1,728,126	(2)	52.9	%
Shandong Fuhua Investment Company Limited, No.189 Dongfeng East Street, Weifang, Shandong, People's Republic of China.	409,375	(3)	12.54	%

(1) Mr. Benjie Dong was appointed as the Chief Financial Officer of the Company, effective April 1, 2016 to fill the vacancy caused by resignation of Mr. Xiuyong Zhang. Mr. Xiuyong Zhang tendered his resignation as the Chief Financial Officer and director of the Company, effective March 31, 2016.

(2) The transfer of ownership of the 1,728,126 ordinary shares (reflecting the Reverse Stock Split) of the Company previously owned by the former shareholder of the Company, Weifang State-Owned Assets Operation Administration Company ("Administrative Company") through Apex Glory Holdings Limited, a British Virgin Islands corporation (Apex Glory"), was the result of a public auction held in Jinan, Shandong Province, China. Shandong SNTON Optical Materials Technology Co., Ltd. ("Shandong Optical"), who was entrusted to acquire the shares on behalf of Hongkong Ruishang, was registered as the successful bidder for the public auction. Shandong Optical is controlled by Mr. Xiusheng Wang and is a wholly owned subsidiary of Shandong SNTON Group Co., Ltd. (the "SNTON Group") and was entrusted to acquire the shares on behalf of Hongkong Ruishang, exercises no voting dispositive control over such shares. Mr. Wang is the chairman of the board of director of Hongkong Ruishang and SNTON Group and controls the power to vote and dispose of 1,728,126 ordinary shares of the Company. Apex Glory shares the power to vote and dispose of 1,728,126 ordinary shares of the Company. This information was derived from a Schedule 13D/A jointly filed by Apex Glory, Hongkong Ruishang and Mr. Wang on July 15, 2014 and as amended on November 12, 2014 with the SEC.

(3) Shandong Fuhua Investment Company Limited ("Shandong Fuhua") received ownership of the Company's 409,375 ordinary shares (reflecting the Reverse Stock Split) through an ownership transfer from the Administration Company. The Administration Company originally held these shares indirectly through an intermediate holding company, Easebright Investments Limited ("Easebright"). As a result of this transfer, Shandong Fuhua indirectly owns 409,375 ordinary shares of the Company through Easebright. Mr. Jingang Yang is as the director of Easebright. This information was derived from a Schedule 13D filed by Shandong Fuhuaon December 30, 2014 with the SEC.

Except as disclosed below, there were no related party transactions with major shareholders during the period commencing January 1, 2014 and ending December 31, 2016.

B. Related Party Transactions.

Our Related-Party Transaction Policies

We have conducted our related-party transactions on normal commercial terms that we believe are fair and reasonable and in the interests of our shareholders as a whole. We believe that the terms of our related-party transactions are comparable to the terms we could obtain from independent third parties. Our related-party transactions are subject to the review and approval of the Audit Committee of our board of directors.

The transactions and balances with related parties are analyzed as follows:

(a) Transactions with Related Parties

During the years ended 2016, 2015 and 2014, we paid approximately RMB67,635(USD$9,741), RMB112,312, and RMB143,921, respectively, to Fuhua Industrial Material Management Co., Ltd. as rental payments in connection with living quarters for our staff.

On January 22, 2015, Shandong Fuwei received a refund of RMB21,000,000 from Joyinn.

Obligations under sale-leaseback transaction amounting to RMB300,000 (US$46,312) were guaranteed by Weifang State-Owned Assets Operation Administration Company, Beijing Shiweitong Technology Development Co., Ltd., Fuwei Films (Holdings) Co., Ltd., and Fuwei Films (BVI) Co., Ltd., respectively. In August 2014, Shandong SNTON Group Co., Ltd. accepted the responsibility of guarantee for the Group's obligation from Beijing Shiweitong Technology Development Co., Ltd.

Due to related parties

In April 2014, we obtained a loan for a total amount of RMB105 million from Shandong SNTON Optical Materials Technology Co., Ltd. (the “Shandong SNTON”) to pay off certain short-term loans due to Bank of Communications Co., Ltd. The interest shall be calculated at the benchmark rate, plus an additional 20% of the said benchmark rate, for the loan of the same term announced by the People’s Bank of China. The interest must be paid quarterly and settled in full at the end of the year. As of December 31, 2014, the principal of this loan and the interest have not been paid. In March 2015, the Company entered into a supplemental agreement with Shandong SNTON pursuant to which the parties agreed that the Company will pay off the principal of this loan plus interest upon availability of new loans from banks or other financial institutions.

As of December 31, 2016, the principal of this loan from Shandong SNTON was RMB104.7 million and the interest was RMB17.4 million. The interest expense of the loans from Shandong SNTON for the year ended 2016, 2015 and 2014 are RMB5.5 million, RMB11.8 million and RMB17.4 million, respectively.

In May 2014, the Company borrowed RMB15.0 million from Shandong SNTON Group Co., Ltd. (the “SNTON Group”) solely to purchase raw materials. The interest shall be calculated at the benchmark rate, plus an additional 20% of the said benchmark rate, for the loan of the same term announced by the People’s Bank of China. The interest shall be paid quarterly and settled in full at the end of the year. The Company has agreed to repay this loan prior to December 31, 2014. As of December 31, 2014, the principal of this loan and the interest have not been paid. In March 2015, the Company entered into a supplemental agreement with SNTON Group pursuant to which that the Company agreed to pay off the principal of this loan plus interest upon availability of new loans from banks or other financial institutions.

In May 2015, SNTON Group provided the Company with a loan for the amount of RMB10.0 million.

In August 2016, the Company returned the principal of RMB25.0 million together with the interest of RMB1.97 million to SNTON Group.

As of December 31, 2016, the total principal of loans from SNTON Group was zero and the interest payable was zero.

The interest expenses of the loans from SNTON Group for the year ended 2016, 2015 and 2014 are RMB0.67 million, RMB1.57 million and zero, respectively.

As of December 31, 2016, the total balance of principal of loans from related party was RMB104.71 million and the interest payable was RMB17.37 million.

In 2016, we did not purchase any raw materials or final products from SNTON Group.

In 2015, we purchased 76 Metric Tons of raw materials from SNTON Group for a total amount of RMB0.4 million.

In 2014, we purchased 760 Metric Tons of raw materials from SNTON Group for a total amount of RMB4.66 million and 58 Metric Tons of final products of BOPET for a total amount of RMB0.49 million.

In 2016, we purchased 566 Metric Tons of final products of BOPET from Shandong SNTON for a total amount of RMB4.87 million and 1.1 Metric Ton of raw materials for a total amount of RMB5,295.

In 2015, we purchased 1,740 Metric Tons of raw materials from Shandong SNTON for a total amount of RMB9.12 million and 780 Metric Tons of final products of BOPET for a total amount of RMB7.04 million.

In 2014, we did not purchase any raw materials or final products from Shandong SNTON.

The related accounts payable as of December 31, 2016 and 2015 was RMB0.13 million and RMB0.16 million, respectively.

C. Interests of Experts and Counsel.

Not applicable.

Item 8. Financial Information

A. Consolidated Statements and Other Financial Information.

Our consolidated financial statements are included herein under Item 18.

We have not paid any dividends on our ordinary shares. The payment of dividends in the future, if any, is within the discretion of our Board of Directors and will depend upon our earnings, capital requirements and financial condition and other relevant factors. We do not anticipate declaring or paying any dividends in the foreseeable future.

Legal Proceedings.

From time to time, we may be subject to legal actions and other claims arising in the ordinary course of business. Shandong Fuwei is currently a party to two legal proceedings in China.

On July 9, 2012, a client filed a lawsuit in Beijing Daxing District People’s Court against Shandong Fuwei claiming RMB953,113 plus interest over disputes arising from a Procurement Contract between the parties. Shandong Fuwei raised a jurisdictional objection upon filing its plea, and Beijing Daxing District People’s Court overruled the objection. Shandong Fuwei filed an appeal against the judgment in the First Intermediate People’s Court of Beijing. The appeal was dismissed on January 23, 2013. On May 15, 2013, Beijing Daxing District People’s Court heard the case and adjourned the hearing due to the fact that plaintiff failed to provide sufficient evidence. On June 25, 2013, the case was heard in Beijing Daxing District People’s Court again and it was further adjourned due to plaintiff’s failure to provide sufficient evidence. The case was then scheduled to be heard on August 7, 2013. However, on the day prior to re-scheduled hearing, Shandong Fuwei was informed by Beijing Daxing District People’s Court that the hearing was adjourned further for the same reason that plaintiff failed to provide sufficient evidence. On April 21, 2014, the case was heard, and the plaintiff failed to provide sufficient evidence and the hearing was further adjourned. On May 28, 2014, the case was heard and the plaintiff provided some evidence. On August 25, 2014, the case was heard again. On November 5, 2014, the court accepted the withdrawal application from the plaintiff. On November 26, 2014, the plaintiff filed a second lawsuit in Beijing Daxing District People’s Court against Shandong Fuwei over disputes arising from the Procurement Contract between the parties claiming RMB618,230 plus interest as a result of non- payment. The case was heard on January 26, 2015, where the two parties testified over the relevant evidence. The case was heard on March 3, 2015, October 26, 2015 and May 11, 2016. To date, the case has not been decided.

On January 21, 2014, Shandong Fuwei received a complaint from Zeng Wenhong, a Hong Kong citizen, against Shandong Fuwei with a claim for a refund of US$500,000 (approximately RMB4,138,250) and related interest of RMB2,331,784. The plaintiff alleged that Shandong Fuwei has agreed to sell to the plaintiff ordinary shares of the Company pursuant to an oral agreement between the plaintiff and Shandong Fuwei in June 2005, and as a result the plaintiff transferred US$500,000 to Wellplus Investments (Hong Kong) Limited to be used for acquiring the ordinary shares of the Company. However, the plaintiff never received such shares. The case was heard by the Intermediate People's Court of Weifang on April 3, 2014 and October 28, 2014. On September 25, 2015, Shandong Fuwei received a written judgment issued by the Intermediate People’s Court of Weifang ordering Shandong Fuwei to refund US$500,000 together with its interest to the plaintiff. Shandong Fuwei filed for an appeal to the High People’s Court’s of Shandong Province within the appeal period. On April 29, 2016 and June 7, 2016, the case was heard by the High People’s Court’s of Shandong Province for the first time. On June 20, 2016, the High People’s Court’s of Shandong Province reversed the judgment issued by the Intermediate People’s Court of Weifang and dismissed the lawsuit filed by Zeng Wenhong. The plaintiff, Zeng Wenhong, became responsible for the court acceptance fees for first and second hearings. This was a final decision of High People’s Court of Shandong Province. On March 6, 2017, Shandong Fuwei received a notice of application for retrial from The Supreme People’s Court of The People’s Republic of China stating that Zeng Wenhong has filed for an appeal to The Supreme People’s Court of The People’s Republic of China regarding the decision issued by the High People’s Court’s of Shandong Province on June 20, 2016 requesting a retrial by The Supreme People’s Court of The People’s Republic of China. Shandong Fuwei has submitted its written response to The Supreme People's Court of The People's Republic of China and the case is currently under review.

B. Significant Changes.

No significant changes have occurred since the date of the consolidated financial statements.

Item 9. The Offer and Listing.

A. Offer and listing details.

On December 5, 2016, we held an extraordinary general meeting of shareholders ("EGM") pursuant to which a 1-for-4 reverse stock split of our authorized ordinary shares, accompanied by a corresponding decrease in our issued and outstanding ordinary shares and an increase of the par value of each ordinary share from $0.129752 to US$0.519008 (the "Reverse Stock Split"), was approved by our shareholders of record.

As a result, we have authorized capital of 5,000,000 ordinary shares, par value US$0.519008 per share. As of April 6, 2017, 3,265,837 ordinary shares were issued and outstanding.

The annual high and low market prices of our ordinary shares for the three most recent full financial years and subsequent period are as set forth below:

Ordinary Shares (Year Ended)	High	Low
December 31, 2016	$5.08	$1.40
December 31, 2015	$1.23	$0.50
December 31, 2014	$2.24	$0.58

The high and low market prices of our ordinary shares for each financial quarter over the two most recent full financial years and subsequent period are as set forth below:

Ordinary Shares (Quarter Ended)	High	Low
March 31, 2015	$0.70	$0.50
June 30, 2015	$1.23	$0.54
September 30, 2015	$1.20	$0.70
December 31, 2015	$1.03	$0.66
March 31, 2016	$3.28	$1.40
June 30, 2016	$4.24	$2.08
September 30, 2016	$5.08	$1.86
December 31, 2016	$3.96	$1.48

For the most recent six months, the high and low market prices of our ordinary shares are as set forth below:

Ordinary Shares (Month Ended)	High	Low
November 30, 2016	$3.96	$1.48
December 31, 2016	$2.96	$1.59
January 31, 2017	$5.20	$1.71
February 29, 2017	$3.72	$2.79
March 31, 2017	$3.39	$2.70
April 1, 2017 (through April 4)	$3.43	$3.15

B. Plan of Distribution.

Not applicable.

C. Markets.

Our ordinary shares were included for quotation on the Nasdaq Global Market on December 18, 2006 under the symbol “FFHL”.

D. Selling Shareholders.

Not applicable.

E. Dilution.

Not applicable.

F. Expenses of the Issue.

Not applicable.

Item 10. Additional Information.

A. Share Capital.

Not applicable.

B. Memorandum and Articles of Association.

We are a Cayman Islands company and our affairs are governed by our memorandum and articles of association and the Companies Law, Cap.22 (Law 3 of 1961, as consolidated and revised) of the Cayman Islands, or the Companies Law. We have filed copies of our complete Memorandum and Articles of Association as exhibits to our Annual Report on Form 20-F for the year ended 2006 filed with the SEC on April 2, 2007.

As of the date of this Annual Report, our authorized share capital consisted of 5,000,000 ordinary shares, par value US$0.519008 per share (reflecting the Reverse Stock Split). As of the date of this Annual Report, 3,265,837ordinary shares (reflecting the Reverse Stock Split) were issued and outstanding, and no preference shares were issued and outstanding.

Ordinary Shares

We were incorporated under the laws of the Cayman Islands as an exempted company. A Cayman Islands exempted company:

- is a company that conducts its business outside the Cayman Islands;
- is exempted from certain requirements of the Companies Law, including the filing of any annual return of its shareholders with the Registrar of Companies or the Immigration Board;
- does not have to make its register of shareholders open to inspection; and
- may obtain an undertaking against the imposition of any future taxation.

The following summarizes the terms and provisions of our share capital, as well as the material applicable laws of the Cayman Islands. This summary is not complete, and you should read our amended and restated memorandum and articles of association, filed as exhibits to this Annual Report.

The following discussion primarily concerns ordinary shares and the rights of holders of ordinary shares.

Protection of Minority Shareholders

The Grand Court of the Cayman Islands may, on the application of shareholders holding not less than one fifth of our shares in issue, appoint an inspector to examine our affairs and report thereon in a manner as the Grand Court shall direct.

Any shareholder may petition the Grand Court of the Cayman Islands which may make a winding up order, if the court is of the opinion that it is just and equitable that we should be wound up. Where any such petition has been presented by our shareholders, the Grand Court is permitted to make alternative order to a winding-up order including orders regulating the conduct of our affairs in the future, requiring us to refrain from doing an act complained of by the petitioner or for the purchase of our shares by us or another shareholder.

Claims against us by our shareholders must, as a general rule, be based on the general laws of contract or tort applicable in the Cayman Islands or their individual rights as shareholders as established by our amended and restated memorandum and articles of association.

The Cayman Islands courts ordinarily would be expected to follow English case law precedents which permit a minority shareholder to commence a representative action against, or derivative actions in our name to challenge:

- an act which is ultra vires or illegal;
- an act which constitutes a fraud against the minority shareholder and the wrongdoers are themselves in control of us; and
- an irregularity in the passing of a resolution which requires a qualified (or special) majority.

Pre-emption Rights

There are no pre-emption rights applicable to the issue of new shares under either Cayman Islands law or our amended and restated memorandum and articles of association.

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Modification of Rights

Except with respect to share capital (as described below) alterations to our amended and restated memorandum and articles of association may only be made by special resolution of no less than two-thirds of votes cast at a meeting of the shareholders.

Subject to the Companies Law, all or any of the special rights attached to shares of any class (unless otherwise provided for by the terms of issue of the shares of that class) may be varied, modified or abrogated with the sanction of a special resolution passed at a separate general meeting of the holders of the shares of that class.

The provisions of our amended and restated articles of association relating to general meetings shall apply similarly to every such separate general meeting, but the quorum for the purposes of any such separate general meeting or at its adjourned meeting shall be a person or persons together holding (or represented by proxy) not less than one third in nominal value of the issued shares of that class. Every holder of shares of the class shall be entitled on a poll to one vote for every such share held by such holder and that any holder of shares of that class present in person or by proxy may demand a poll.

The special rights conferred upon the holders of any class of shares shall not, unless otherwise expressly provided in the rights attaching to or the terms of issue of such shares, be deemed to be varied by the creation or issue of further shares ranking pari passu therewith.

Alteration of Capital

We may from time to time by ordinary resolution:

- increase our capital by such sum, to be divided into shares of such amounts, as the resolution shall prescribe;
- consolidate and divide all or any of our share capital into shares of larger amount than our existing shares;
- cancel any shares which at the date of the passing of the resolution have not been taken or agreed to be taken by any person, and diminish the amount of our share capital by the amount of the shares so cancelled subject to the provisions of the Companies Law;
- sub-divide our shares or any of them into shares of smaller amount than is fixed by our amended and restated memorandum and articles of association, subject nevertheless to the Companies Law, and so that the resolution whereby any share is subdivided may determine that, as between the holders of the share resulting from such

subdivision, one or more of the shares may have any such preference or other special rights, or may have such deferred rights or be subject to any such restrictions as compared with, the others as we have power to attach to unissued or new shares; and

- divide shares into several classes and without prejudice to any special rights previously conferred on the holders of existing shares, attach to the shares respectively as preferential, deferred, qualified or special rights, privileges, conditions or such restrictions which, in the absence of any such determination in a general meeting, may be determined by our directors.

We may, by special resolution, subject to any confirmation or consent required by the Companies Law, reduce our share capital or any capital redemption reserve in any manner authorized by law.

Transfer of Shares

Subject to any applicable restrictions set forth in our amended and restated memorandum and articles of association, any of our shareholders may transfer all or any of his or her shares by an instrument of transfer in the usual or common form or in any form prescribed by the NASDAQ Global Market or in any other form which our directors may approve. You should note that, under Cayman Islands law, a person whose name is entered on the register of members will be deemed to be a member or shareholder of our company. We have designated American Stock Transfer and Trust Company as our share registrar. Under Cayman Islands law, a share certificate constitutes admissible evidence as proof of title of its holder to the shares specified on such certificate.

Our directors may decline to register any transfer of any share which is not paid up or on which we have a lien. Our directors may also decline to register any transfer of any share unless:

- the instrument of transfer is lodged with us accompanied by the certificate for the shares to which it relates and such other evidence as our directors may reasonably require to show the right of the transferor to make the transfer;
- the instrument of transfer is in respect of only one class of shares;
- the instrument of transfer is properly stamped (in circumstances where stamping is required);
- in the case of a transfer to joint holders, the number of joint holders to whom the share is to be transferred does not exceed four; and
- a fee of such maximum sum as the NASDAQ Global Market may at any time determine to be payable or such lesser sum as our directors may from time to time require is paid to us in respect thereof.

If our directors refuse to register a transfer, they shall, within two months after the date on which the instrument of transfer was lodged, send to each of the transferor and the transferee notice of such refusal.

The registration of transfers may, on notice being given by advertisement in such one or more newspapers or by any other means in accordance with any requirements of the NASDAQ Global Market, be suspended and the register closed at such times and for such periods as our directors may from time to time determine; provided, however, that the registration of transfers shall not be suspended nor the register closed for more than 30 days in any year as our directors may determine.

Share Repurchase

We are empowered by the Companies Law and our amended and restated memorandum and articles of association to purchase our own shares, subject to certain restrictions. Our directors may only exercise this power on our behalf, subject to the Companies Law, our amended and restated memorandum and articles of association and to any applicable requirements imposed from time to time by the U.S. Securities and Exchange Commission, the NASDAQ Global Market, or by any recognized stock exchange on which our securities are listed.

Dividends

Subject to the Companies Law, we may declare dividends in any currency to be paid to our shareholders. Dividends may be declared and paid out of our profits, realized or unrealized, or from any reserve set aside from profits which our directors determine is no longer needed. Our board of directors may also declare and pay dividends out of the share premium account or any other fund or account which can be authorized for this purpose in accordance with the Companies Law.

Except in so far as the rights attaching to, or the terms of issue of, any share otherwise provides (1) all dividends shall be declared and paid according to the amounts paid up on the shares in respect of which the dividend is paid, but no amount paid up on a share in advance of calls shall be treated for this purpose as paid up on that share and (2) all dividends shall be apportioned and paid pro rata according to the amounts paid upon the shares during any portion or portions of the period in respect of which the dividend is paid.

Our directors may also pay any dividend that is payable on any shares semi-annually or on any other dates, whenever our financial position, in the opinion of our directors, justifies such payment.

Our directors may deduct from any dividend or other money payable to any shareholder all sums of money (if any) presently payable by such shareholder to us on account of calls or otherwise.

No dividend or other money payable by us on or in respect of any share shall bear interest against us.

In respect of any dividend proposed to be paid or declared on our share capital, our directors may resolve and direct that (1) such dividend be satisfied wholly or in part in the form of an allotment of shares credited as fully paid up, provided that our shareholders entitled thereto will be entitled to elect to receive such dividend (or part thereof if our directors so determine) in cash in lieu of such allotment, or (2) the shareholders entitled to such dividend will be entitled to elect to receive an allotment of shares credited as fully paid up in lieu of the whole or such part of the dividend as our directors may think fit. We may also, on the recommendation of our directors, resolve in respect of any particular dividend that, notwithstanding the foregoing, it may be satisfied wholly in the form of an allotment of shares credited as fully paid up without offering any right of shareholders to elect to receive such dividend in cash in lieu of such allotment.

Any dividend, interest or other sum payable in cash to any shareholder may be paid by check or warrant sent by mail addressed to the shareholder at his registered address, or addressed to such person and at such addresses as the shareholder may direct. Every check or warrant shall, unless the shareholder or joint shareholders otherwise direct, be made payable to the order of the shareholder or, in the case of joint shareholders, to the order of the shareholder whose name stands first on the register in respect of such shares, and shall be sent at their risk and payment of the check or warrant by the bank on which it is drawn shall constitute a good discharge to us.

All dividends unclaimed by shareholders for one year after having been declared may be invested or otherwise made use of by our board of directors for the benefit of our company until claimed. Any dividend unclaimed by shareholders after a period of six years from the date of declaration of such dividend may be forfeited and, if so forfeited, shall revert to us.

Whenever our directors have resolved that a dividend be paid or declared, our directors may further resolve that such dividend be satisfied wholly or in part by the distribution of specific assets of any kind, and in particular of paid up shares, debentures or warrants to subscribe for our securities or securities of any other company. Where any difficulty arises with regard to such distribution, our directors may settle it as they think expedient. In particular, our directors may issue fractional certificates, ignore fractions altogether or round the same up or down, fix the value for distribution purposes of any such specific assets, determine that cash payments shall be made to any of our shareholders upon the footing of the value so fixed in order to adjust the rights of the parties, vest any such specific assets in trustees as may seem expedient to our directors, and appoint any person to sign any requisite instruments of transfer and other documents on behalf of a person entitled to the dividend, which appointment shall be effective and binding on our shareholders.

Untraceable Shareholders

We are entitled to sell any shares of a shareholder who is untraceable, provided that:

- all checks or warrants in respect of dividends of such shares, not being less than three in number, for any sums payable in cash to the holder of such shares have remained uncashed for a period of twelve years prior to the publication of the advertisement and during the three months referred to in the third bullet point below;
- we have not during that time received any indication of the whereabouts or existence of the shareholder or person entitled to such shares by death, bankruptcy or operation of law; and
- we have caused an advertisement to be published in newspapers in the manner stipulated by our amended and restated memorandum and articles of association, giving notice of our intention to sell these shares, and a period of three months has elapsed since such advertisement and the NASDAQ Global Market has been notified of such intention.

The net proceeds of any such sale shall belong to us, and when we receive these net proceeds we shall become indebted to the former shareholder for an amount equal to such net proceeds.

Issuance of Additional Ordinary Shares or Preference Shares

Subject to the Companies Law and the rules of the NASDAQ Global Market and without prejudice to any special rights or restrictions for the time being attached to any shares or any class of shares, our board of directors may issue additional ordinary shares from time to time as our board of directors determines, to the extent of available authorized but unissued shares and establish from time to time one or more series of preference shares and to determine, with respect to any series of preference shares, the terms and rights of that series, including:

- the designation of the series;
- the number of shares of the series;
- the dividend rights, conversion rights, voting rights; and
- the rights and terms of redemption and liquidation preferences.

Subject to the foregoing, our board of directors may issue series of preference shares without action by our shareholders to the extent authorized but unissued. Accordingly, the issuance of preference shares may adversely affect the rights of the holders of the ordinary shares. In addition, the issuance of preference shares may be used as an anti-takeover device without further action on the part of the shareholders. Issuance of preference shares may dilute the voting power of holders of ordinary shares.

Subject to applicable regulatory requirements, our board of directors may issue additional ordinary shares without action by our shareholders to the extent of available authorized but unissued shares. The issuance of additional ordinary shares may be used as an anti-takeover device without further action on the part of the shareholders. Such issuance may dilute the voting power of existing holders of ordinary shares.

Our ordinary shares are listed on the NASDAQ Capital Market under the symbol “FFHL”.

Committees of Board of Directors

Pursuant to our amended and restated articles of association, our board of directors, we have established an audit committee, a compensation committee and a corporate governance and nominating committee.

Differences in Corporate Law

The Companies Law is modeled after similar laws in the United Kingdom but does not follow recent changes in United Kingdom laws. In addition, the Companies Law differs from laws applicable to United States corporations and their shareholders. Set forth below is a summary of the significant differences between the provisions of the Companies Law applicable to us and the laws applicable to companies incorporated in the United States, such as in the State of Delaware.

***Duties and Director*s**

Under Cayman Islands law, at common law, members of a board of directors owe a fiduciary duty to the company to act in good faith in their dealings with or on behalf of the company and exercise their powers and fulfill the duties of their office honestly. This duty has four essential elements:

- a duty to act in good faith in the best interests of the company;
- a duty not to personally profit from opportunities that arise from the office of director;
- a duty to avoid conflicts of interest; and
- a duty to exercise powers for the purpose for which such powers were intended.

In general, the Companies Law imposes various duties on officers of a company with respect to certain matters of management and administration of the company. The Companies Law contains provisions, which impose default fines on persons who fail to satisfy those requirements. However, in many circumstances, an individual is only liable if he knowingly is guilty of the default or knowingly and willfully authorizes or permits the default.

In comparison, under Delaware law, the business and affairs of a corporation are managed by or under the direction of its board of directors. In exercising their powers, directors are charged with a fiduciary duty of care to protect the interests of the corporation and a fiduciary duty of loyalty to act in the best interests of its shareholders. The duty of care requires that directors act in an informed and deliberative manner and inform themselves, prior to making a business decision, of all material information reasonably available to them. The duty of care also requires that directors exercise care in overseeing and investigating the conduct of the corporation's employees. The duty of loyalty may be summarized as the duty to act in good faith, not out of self-interest, and in a manner which the director reasonably believes to be in the best interests of the shareholders.

Under Delaware law, a party challenging the propriety of a decision of a board of directors bears the burden of rebutting the applicability of the presumptions afforded to directors by the "business judgment rule". If the presumption is not rebutted, the business judgment rule protects the directors and their decisions, and their business judgments will not be second guessed. Where, however, the presumption is rebutted, the directors bear the burden of demonstrating the entire fairness of the relevant transaction. Notwithstanding the foregoing, Delaware courts subject directors' conduct to enhanced scrutiny in respect of defensive actions taken in response to a threat to corporate control and approval of a transaction resulting in a sale of control of the corporation.

Interested Directors

There are no provisions under the Companies Law that require a director who is interested in a transaction entered into by a Cayman Islands company to disclose his interest. However, under our amended and restated memorandum and articles of association, our directors are required to do so, and in the event that they do not do so it may render such director liable to such company for any profit realized pursuant to such transaction.

In comparison, under Delaware law, such a transaction would not be voidable if (a) the material facts as to such interested director's relationship or interests are disclosed or are known to the board of directors and the board in good faith authorizes the transaction by the affirmative vote of a majority of the disinterested directors, even though the disinterested directors are less than a quorum, (b) such material facts are disclosed or are known to the shareholders entitled to vote on such transaction and the transaction is specifically approved in good faith by vote of the shareholders, or (c) the transaction is fair as to the corporation as of the time it is authorized, approved or ratified. Under Delaware law, a director could be held liable for any transaction in which such director derived an improper personal benefit.

Voting Rights and Quorum Requirements

Under Cayman Islands law, the voting rights of shareholders are regulated by the company's articles of association and, in certain circumstances, the Companies Law. The articles of association will govern matters such as quorum for the transaction of business, rights of shares, and majority votes required to approve any action or resolution at a meeting of the shareholders or board of directors. Under Cayman Islands law, certain matters must be approved by a special resolution which is defined as two-thirds of the votes cast by shareholders present at a meeting and entitled to vote or such higher majority as is specified in the articles of association; otherwise, unless the articles of association otherwise provide, the majority is usually a simple majority of votes cast.

In comparison, under Delaware law, unless otherwise provided in the corporation's certificate of incorporation, each shareholder is entitled to one vote for each share of stock held by the shareholder. Unless otherwise provided in the corporation's certificate of incorporation or bylaws, a majority of the shares entitled to vote, present in person or represented by proxy, constitutes a quorum at a meeting of shareholders. In matters other than the election of directors, with the exception of special voting requirements related to extraordinary transactions, the affirmative vote of a majority of shares present in person or represented by proxy at the meeting and entitled to vote is required for shareholder action, and the affirmative vote of a plurality of shares is required for the election of directors.

Mergers and Similar Arrangements

A merger of two or more constituent companies under Cayman Islands law requires a plan of merger or consolidation to be approved by the directors of each constituent company and authorization by (a) a majority in number representing seventy-five percent (75%) in value of the shareholders voting together as one class and (b) if the shares to be issued to each shareholder in the surviving company are to have the same rights and economic value as the shares held in the constituent company, a special resolution of the shareholders voting together as one class.

A merger between a Cayman parent company and its Cayman subsidiary or subsidiaries does not require authorization by a resolution of shareholders. For this purpose a subsidiary is a company of which at least ninety percent (90%) of the issued shares entitled to vote are owned by the parent company.

The consent of each holder of a fixed or floating security interest over a constituent company is required unless this requirement is waived by a court in the Cayman Islands.

Save in certain circumstances, a dissentient shareholder of a Cayman constituent company is entitled to payment of the fair value of his shares upon dissenting to a merger or consolidation. The exercise of appraisal rights will preclude the exercise of any other rights save for the right to seek relief on the grounds that the merger or consolidation is void or unlawful.

There are statutory provisions that facilitate the reconstruction and amalgamation of companies, provided that the arrangement in question is approved by a majority in number of each class of shareholders and creditors with whom the arrangement is to be made, and who must in addition represent three fourths in value of each such class of shareholders or creditors, as the case may be, that are present and voting either in person or by proxy at a meeting, or meetings convened for that purpose.

The convening of the meetings and subsequently the arrangement must be sanctioned by the Grand Court of the Cayman Islands. While a dissenting shareholder would have the right to express to the court the view that the transaction should not be approved, the court can be expected to approve the arrangement if it satisfies itself that:

- the company is not proposing to act illegally or ultra vires and the statutory provisions as to majority vote have been complied with;
- the shareholders have been fairly represented at the meeting in question;
- the arrangement is such as a businessman would reasonably approve; and
- the arrangement is not one that would more properly be sanctioned under some other provision of the Companies Law or that would amount to a “fraud on the minority”.

When a takeover offer is made and accepted by holders of 90% of the shares within four months, the offerer may, within a two-month period, require the holders of the remaining shares to transfer such shares on the terms of the offer. An objection may be made to the Grand Court of the Cayman Islands but is unlikely to succeed unless there is evidence of fraud, bad faith or collusion.

Cayman Islands laws do not require that shareholders approve sales of all or substantially all of a company's assets as is commonly adopted by U.S. corporations.

If the arrangement and reconstruction are thus approved, any dissenting shareholders would have no rights comparable to appraisal rights, which would otherwise ordinarily be available to dissenting shareholders of United States corporations, providing rights to receive payment in cash for the judicially determined value of the shares.

Shareholders' Suits

The Cayman Islands Grand Court Rules allow shareholders to seek leave to bring derivative actions in the name of the Company against wrongdoers. In principle, we will normally be the proper plaintiff and a derivative action may not be brought by a minority shareholder. However, based on English authorities, who would in all likelihood be of persuasive authority in the Cayman Islands, exceptions to the foregoing principle apply in circumstances in which:

- a company is acting or proposing to act illegally or beyond the scope of its authority;
- the act complained of, although not beyond the scope of its authority, could be effected duly if authorized by more than a simple majority vote which has not been obtained; and
- those who control the company are perpetrating a "fraud on the minority."

Class actions and derivative actions generally are available to shareholders under Delaware law for, among other things, breach of fiduciary duty, corporate waste and actions not taken in accordance with applicable law. In such actions, the court generally has discretion to permit the winning party to recover attorneys' fees incurred in connection with such action.

Corporate Governance

Cayman Islands laws do not restrict transactions with directors, requiring only that directors exercise a duty of care and owe a fiduciary duty to the companies for which they serve. Under our amended and restated memorandum and articles of association, subject to any separate requirement for audit committee approval under the applicable rules of the Nasdaq Stock Market, Inc. or unless disqualified by the chairman of the relevant board meeting, so long as a director discloses the nature of his interest in any contract or arrangement which he is interested in, such a director may vote in respect of any contract or proposed contract or arrangement in which such director is interested and may be counted in the quorum at such meeting.

Cayman Islands law does not limit the extent to which a company's articles of association may provide for indemnification of officers and directors, except to the extent any such provision may be held by the Cayman Islands courts to be contrary to public policy, such as to provide indemnification against civil fraud or the consequences of committing a crime. Our amended and restated memorandum and articles of association provide for the indemnification of our directors, auditors and officers against all losses or liabilities incurred or sustained by him or her as a director, auditor or officer of our company in defending any proceedings, whether civil or criminal, in which judgment is given in his or her favor, or in which he or she is acquitted provided that this indemnity may not extend to any matter in respect of any fraud or dishonesty which may attach to any of these persons.

Insofar as indemnification for liabilities arising under the Securities Act may be permitted to directors, officers or persons controlling us pursuant to the foregoing provisions, we have been advised that in the opinion of the SEC such indemnification is against public policy as expressed in the Securities Act and therefore is unenforceable.

We are managed by our board of directors. Our amended and restated memorandum and articles of association provide that the number of our directors shall not be less than two and there shall be no maximum number of our directors unless our shareholders in the general meeting otherwise determine a maximum number. Currently we have set our board of directors to have 5 directors. Any director on our board may be removed by way of an ordinary resolution of shareholders. At each annual general meeting, one third of our directors for the time being (or, if their number is not a multiple of three, the number nearest to but not greater than one-third) shall retire from office by rotation provided that the chairman of the Board and/or the managing director of the Company shall not, whilst holding such office, be subject to retirement by rotation. Any vacancies on our board of directors or additions to the existing board of directors can be filled by an ordinary resolution of our shareholders or the affirmative vote of a majority of the remaining directors, although this may be less than a quorum where the number of remaining directors falls below the minimum number fixed by our board of directors. Our directors are not required to hold any of our shares to be qualified to serve on our board of directors.

Meetings of our board of directors may be convened at any time deemed necessary by any one of our directors. Advance notice of a meeting is not required if each director entitled to attend consents to the holding of such meeting.

A meeting of our board of directors at which a quorum is present shall be competent to make lawful and binding decisions. At any meeting of our directors, each director is entitled to one vote.

Questions arising at a meeting of our board of directors are required to be decided by simple majority votes of the members of our board of directors present or represented at the meeting. In the case of a tie vote, the chairman of the meeting shall have a second or deciding vote. Our board of directors may also pass resolutions without a meeting by unanimous written consent.

Insofar as indemnification for liabilities arising under the Securities Act may be permitted to directors, officers or persons controlling us pursuant to the foregoing provisions, we have been advised that in the opinion of the SEC such indemnification is against public policy as expressed in the Securities Act and therefore is unenforceable.

Inspection of Corporate Records

Shareholders of a Cayman Islands company have no general right under Cayman Islands law to inspect or obtain copies of a list of shareholders or other corporate records of the company. However, these rights may be provided in the articles of association.

In comparison, under Delaware law, shareholders of a Delaware corporation have the right during normal business hours to inspect for any proper purpose, and to obtain copies of list(s) of shareholders and other books and records of the corporation and its subsidiaries, if any, to the extent the books and records of such subsidiaries are available to the corporation.

Shareholder Proposals

The Companies Law does not provide shareholders any right to bring business before a meeting or requisition a general meeting. However, these rights may be provided in the articles of association.

Unless provided in the corporation’s certificate of incorporation or bylaws, Delaware law does not include a provision restricting the manner in which shareholders may bring business before a meeting.

Approval of Corporate Matters by Written Consent

The Companies Law allows a special resolution to be passed in writing if signed by all the shareholders and authorized by the articles of association.

In comparison, Delaware law permits shareholders to take action by written consent signed by the holders of outstanding stock having not less than the minimum number of votes that would be necessary to authorize or take such action at a meeting of shareholders.

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Calling of Special Shareholders Meetings

The Companies Law does not have provisions governing the proceedings of shareholders meetings that are usually provided in the articles of association.

In comparison, Delaware law permits the board of directors or any person who is authorized under a corporation's certificate of incorporation or bylaws to call a special meeting of shareholders.

Staggered Board of Directors

The Companies Law does not contain statutory provisions that require staggered board arrangements for a Cayman Islands company. Such provisions, however, may validly be provided for in the articles of association.

In comparison, Delaware law permits corporations to have a staggered board of directors.

Anti-takeover Provisions

Neither Cayman Islands nor Delaware law prevents companies from adopting a wide range of defensive measures, such as staggered boards, blank check preferred, and removal of directors only for cause and provisions that restrict the rights of shareholders to call meetings, act by written consent and submit shareholder proposals.

C. Material Contracts.

1) Loan Contract

In April 2014, we obtained a loan for a total amount of RMB105 million from Shandong SNTON Optical Materials Technology Co., Ltd ("Shandong SNTON") to pay off five short-term loans to Bank of Communications Co., Ltd. The interest rate of both loans shall be calculated at the benchmark rate, plus an additional 20% of the said benchmark rate, for the loan of the same term announced by the People's Bank of China which is the same interest rate calculation method used by Bank of Communications Co., Ltd.

In May 2014, we borrowed RMB15.0 million from Shandong SNTON Group Co., Ltd. (the "SNTON Group") solely to purchase raw materials. The interest shall be calculated at the benchmark rate, plus an additional 20% of the said benchmark rate, for the loan of the same term announced by the People's Bank of China. The interest shall be paid quarterly and settled in full at the end of the year. We agreed to repay this loan prior to December 31, 2014. In March 2015, we entered into a supplemental agreement with SNTON Group pursuant to which we agreed to pay off the principal of this loan plus interest upon availability of new loans from banks or other financial institutions.

In May 2015, SNTON Group provided us with a loan for the amount of RMB10.0 million.

In August 2016, we repaid the principal of RMB25.0 million together with the interest of RMB1.97 million to SNTON Group.

As of December 31, 2016, the total principal of loans from SNTON Group was zero and the interest payable was zero.

We obtained five short-term loans from Bank of Weifang in July 2016 for the total amount of RMB45.0 million (US$6.7 million). In November 2016, we abtained one short-term loans from SPD bank for the total amount of RMB15.0 million. The principal amounts of the above short-term loans are repayable at the end of the loan period, and are secured by property, plant and equipment, and lease prepayments.

On November 20, 2009, we signed a long-term loan contract of RMB10 million with Weifang Dongfang State-owned Assets Management Co., Ltd. for a term of eight years effective October 19, 2009, which will expire on October 18, 2017. The loan is guaranteed by Shandong Deqin Investment & Guarantee Co., Ltd. and is used for the Company's key projects.

The credit lines amounting to RMB45.0 million (US$6.95 million) and RMB45.0 million, respectively granted by SPD bank and Bank of Weifang were secured by a pledge of plant and land use right. The credit lines were used to purchase raw materials. The term of the credit line granted by SPD bank is from December 19, 2014 to December 19, 2017. The term of the credit line granted by Bank of Weifang is from July 2016 to July 2017. As of December 31, 2016, the amount of credit line granted by SPD bank used was RMB42,710,000 and the remaining balance was RMB2,290,000. The amount of credit line granted by Bank of Weifang was all used.

2) Sale-Leaseback Contract

On December 21, 2012, Shandong Fuwei signed a sale-leaseback contract with International Far Eastern Leasing Co., Ltd. ("Far Eastern Leasing"). Far Eastern Leasing purchased certain equipment included in the third production line, and simultaneously leased them back to Shandong Fuwei. Shandong Fuwei will pay rent totaling RMB21.95 million (including interest) to Far Eastern Leasing for 36 months beginning on December 26, 2012 until December 26, 2015. In March 2013, Shandong Fuwei signed another sale-leaseback contract with Far Eastern Leasing, pursuant to which it has agreed to pay total rent of RMB5.49 million (including interest) to Far Eastern Leasing for 36 months beginning on March 27, 2013 until March 27, 2016. The financed equipment mentioned above is covered by an insurance policy, the premium of which will be paid by Shandong Fuwei. The contract was guaranteed by the following entities: Weifang State-owned Assets Operation Administration Company, Fuwei Films (Holdings) Co., Ltd, Fuwei (BVI) Co., Ltd., and Beijing Shiweitong Science and Technology Co., Ltd. In August 2014, Shandong SNTON Group Co., Ltd. accepted the responsibility of guarantee for the Group's obligation from Beijing Shiweitong Technology Development Co., Ltd.

3) Ownership of Property Transfer Agreement under Sale-Leaseback Contract

On December 21, 2012, Shandong Fuwei signed an ownership of property transfer agreement under sale-leaseback contract with Far Eastern Leasing. According to relevant laws and regulations, through a sale-leaseback, Shandong Fuwei transferred a portion of the third line equipment which valued at RMB20.26 million to Far Eastern Leasing for RMB20.0 million. Pursuant to the terms of the agreement, Far Eastern Leasing will make a payment of RMB20.0 million to Shandong Fuwei within 7 business days upon effective date of the agreement. The payment was received by Shandong Fuwei on December 26, 2012.

In addition, on March 26, 2013, Shandong Fuwei signed an ownership of property transfer agreement under sale-leaseback contract with Far Eastern Leasing. According to relevant laws and regulations, through a sale-leaseback, Shandong Fuwei transferred a portion of the third line equipment which was valued at RMB18.1 million to Far Eastern Leasing for RMB5.0 million. Pursuant to the terms of the agreement, Far Eastern Leasing will make a payment of RMB5.0 million to Shandong Fuwei within 7 business days upon effective date of the agreement. The payment was received by Shandong Fuwei on March 27, 2013. As of February 2016, the Company has fulfilled all the obligations under the sale-leaseback arrangement and related additional supplemental agreements between the Company and International Far Eastern Leasing Co., Ltd.

D. Exchange Controls.

Chinese government imposes control over the convertibility of RMB into foreign currencies. Under the current unified floating exchange rate system, the People's Bank of China publishes a daily exchange rate for RMB, or the PBOC

Exchange Rate, based on the previous day's dealings in the inter-bank foreign exchange market. Financial institutions authorized to deal in foreign currency may enter into foreign exchange transactions at exchange rates within an authorized range above or below the PBOC Exchange Rate according to market conditions.

Pursuant to the Foreign Exchange Control Regulations issued by the State Council on January 29, 1996 and effective as of April 1, 1996 (and amended on January 14, 1997) and the Administration of Settlement, Sale and Payment of Foreign Exchange Regulations which came into effect on July 1, 1996 regarding foreign exchange control, or the Regulations, conversion of Renminbi into foreign exchange by foreign investment enterprises for current account items, including the distribution of dividends and profits to foreign investors of joint ventures, is permissible upon the proper production of qualified commercial vouchers or legal documents as required by the Regulations. Foreign investment enterprises are permitted to remit foreign exchange from their foreign exchange bank account in China upon the proper production of, inter alia, the board resolutions declaring the distribution of the dividend and payment of profits. Conversion of RMB into foreign currencies and remittance of foreign currencies for capital account items, including direct investment, loans, security investment, is still subject to the approval of the State Administration of Foreign Exchange, or SAFE, in each such transaction. On January 14, 1997, the State Council amended the Foreign Exchange Control Regulations and added, among other things, an important provision, as Article 5 provides that the State shall not impose restrictions on recurring international payments and transfers.

Under the Regulations, foreign investment enterprises are required to open and maintain separate foreign exchange accounts for capital account items (but not for other items). In addition, foreign investment enterprises may only buy, sell and/or remit foreign currencies at those banks authorized to conduct foreign exchange business upon the production of valid commercial documents and, in the case of capital account item transactions, document approval from SAFE.

Currently, foreign investment enterprises are required to apply to SAFE for "foreign exchange registration certificates for foreign investment enterprises". With such foreign exchange registration certificates (which are granted to foreign investment enterprises, upon fulfilling specified conditions and which are subject to review and renewal by SAFE on an annual basis) or with the foreign exchange sales notices from the SAFE (which are obtained on a transaction-by-transaction basis), foreign-invested enterprises may enter into foreign exchange transactions at banks authorized to conduct foreign exchange business to obtain foreign exchange for their needs.

E. Taxation.

United States Federal Income Taxation

General

The following is a summary of the material U.S. federal income tax consequences of the acquisition, ownership, and disposition of our ordinary shares, based upon laws and relevant interpretations thereof in effect as of the date of this Annual Report on Form 20-F, all of which are subject to change. This summary does not deal with all possible tax consequences relating to an investment in our ordinary shares, such as the tax consequences under state, local or other tax laws.

The discussion below of the U.S. federal income tax consequences to "U.S. Holders" will apply to a beneficial owner of our ordinary shares that is for U.S. federal income tax purposes:

- an individual citizen or resident of the United States;
- a corporation (or other entity treated as a corporation) that is created or organized (or treated as created or organized) in or under the laws of the United States, any state thereof or the District of Columbia;
- an estate whose income is includible in gross income for U.S. federal income tax purposes regardless of its source; or
- a trust if (i) a U.S. court can exercise primary supervision over the trust's administration and one or more U.S. persons are authorized to control all substantial decisions of the trust, or (ii) it has a valid election in effect under applicable U.S. Treasury regulations to be treated as a U.S. person.

A beneficial owner of our ordinary shares that is described above is referred to herein as a "U.S. Holder". If a beneficial owner of our ordinary shares is not described as a U.S. Holder and is not an entity treated as a partnership or other pass-through entity for U.S. federal income tax purposes, such owner will be considered a "Non-U.S. Holder". The material U.S. federal income tax consequences applicable specifically to Non-U.S. Holders of owning and disposing of our ordinary shares are described below under the heading "Non-U.S. Holders".

This summary is based on the Internal Revenue Code of 1986, as amended, or the Code, its legislative history, Treasury regulations promulgated thereunder, published rulings and court decisions, all as currently in effect. These authorities are subject to change or differing interpretations, possibly on a retroactive basis.

This discussion does not address all aspects of U.S. federal income taxation that may be relevant to any particular holder based on such holder's individual circumstances. In particular, this discussion considers only holders that own and hold our ordinary shares as capital assets within the meaning of Section 1221 of the Code, and does not address the potential application of the alternative minimum tax. In addition, this discussion does not address the U.S. federal income tax consequences to holders that are subject to special rules, including:

- financial institutions or financial services entities;
- broker-dealers;
- persons that are subject to the mark-to-market accounting rules under Section 475 of the Code;
- tax-exempt entities;
- governments or agencies or instrumentalities thereof;
- insurance companies;
- regulated investment companies;
- real estate investment trusts;
- certain expatriates or former long-term residents of the United States;
- persons that actually or constructively own 5% or more of our voting shares;
- persons that acquired our ordinary shares pursuant to an exercise of employee options, in connection with employee incentive plans or otherwise as compensation;
- persons that hold our ordinary shares as part of a straddle, constructive sale, hedging, conversion or other integrated transaction;
- persons whose functional currency is not the U.S. dollar;
- controlled foreign corporations; or
- passive foreign investment companies.

This discussion does not address any aspect of U.S. federal non-income tax laws, such as gift or estate tax laws, or state, local or non-U.S. tax laws or, except as discussed herein, any tax reporting obligations applicable to a holder of our ordinary shares. Additionally, this discussion does not consider the tax treatment of partnerships or other pass-through entities or persons who hold our ordinary shares through such entities. If a partnership (or other entity classified as a partnership for U.S. federal income tax purposes) is the beneficial owner of our ordinary shares, the U.S. federal income tax treatment of a partner in the partnership will generally depend on the status of the partner and the activities of the partnership. This discussion also assumes that any distribution made (or deemed made) by us on our ordinary shares and any consideration received (or deemed received) by a holder in consideration for the sale or other disposition of our ordinary shares will be in U.S. dollars.

We have not sought, and will not seek, a ruling from the Internal Revenue Service , or the IRS or an opinion of counsel as to any U.S. federal income tax consequence described herein. The IRS may disagree with the description herein, and its determination may be upheld by a court. Moreover, there can be no assurance that future legislation, regulations, administrative rulings or court decisions will not adversely affect the accuracy of the statements in this discussion.

THIS DISCUSSION IS ONLY A SUMMARY OF THE MATERIAL U.S. FEDERAL INCOME TAX CONSEQUENCES OF THE ACQUISITION, OWNERSHIP AND DISPOSITION OF OUR ORDINARY SHARES. IT IS NOT TAX ADVICE. EACH HOLDER OF OUR ORDINARY SHARES IS URGED TO CONSULT ITS OWN TAX ADVISOR IN RESPECT TO THE PARTICULAR TAX CONSEQUENCES TO SUCH HOLDER OF THE ACQUISITION, OWNERSHIP AND DISPOSITION OF OUR ORDINARY SHARES, INCLUDING THE APPLICABILITY AND EFFECT OF ANY STATE, LOCAL, AND NON-U.S. TAX LAWS, AS WELL AS U.S. FEDERAL TAX LAWS AND ANY APPLICABLE TAX TREATIES.

U.S. Holders

Taxation of Cash Distributions Paid on Ordinary Shares

Subject to the passive foreign investment company or the PFIC rules discussed below, a U.S. Holder generally will be required to include in gross income as ordinary income the amount of any cash dividend paid on our ordinary shares. A cash distribution on our ordinary shares generally will be treated as a dividend for U.S. federal income tax purposes to the extent paid out of our current or accumulated earnings and profits (as determined under U.S. federal income tax principles). Such dividend generally will not be eligible for the dividends-received deduction generally allowed to domestic corporations in respect of dividends received from other domestic corporations. The portion of such distribution, if any, in excess of such earnings and profits generally will constitute a return of capital that will be applied against and reduce (but not below zero) the U.S. Holder’s adjusted tax basis in our ordinary shares. Any remaining excess generally will be treated as gain from the sale or other taxable disposition of such ordinary shares and will be treated as described under "- *Taxation on the Disposition of Ordinary Shares"* below.

With respect to non-corporate U.S. Holders, such cash dividends may be subject to U.S. federal income tax at the lower applicable regular long term capital gains tax rate (see "-*Taxation on the Disposition of Ordinary Shares*" below) provided that (a) our ordinary shares are readily tradable on an established securities market in the United States or, in the event we are deemed to be a PRC "resident enterprise" under the relevant PRC tax laws, we are eligible for the benefits of the Agreement between the Government of the United States of America and the Government of the People's Republic of China for the Avoidance of Double Taxation and the Prevention of Tax Evasion with Respect to Taxes on Income, or the U.S.-PRC Tax Treaty, (b) we are not a PFIC, as discussed below, for either the taxable year in which the dividend was paid or the preceding taxable year, and (c) certain holding period requirements are met. Under published IRS authority, shares are considered for purposes of clause (a) above to be readily tradable on an established securities market in the United States only if they are listed on certain exchanges, which presently include the NASDAQ Capital Market. Although our ordinary shares are currently listed and traded on the NASDAQ Capital Market, U.S. Holders nonetheless should consult their own tax advisors regarding the availability of the lower rate for any cash dividends paid in respect to our ordinary shares.

If a PRC income tax applies to any cash dividends paid to a U.S. Holder on our ordinary shares, such tax may be treated as a foreign tax eligible for a deduction from such holder's U.S. federal taxable income or a foreign tax credit against such holder's U.S. federal income tax liability (subject to applicable conditions and limitations). In addition, if such PRC tax applies to any such dividends, a U.S. Holder may be entitled to certain benefits under the U.S.-PRC Tax Treaty if such holder is considered a resident of the United States for purposes of, and otherwise meets the requirements of, the U.S.-PRC Tax Treaty. U.S. Holders should consult their own tax advisors regarding the deduction or credit for any such PRC tax and their eligibility for the benefits of the U.S.-PRC Tax Treaty.

Taxation on the Disposition of Ordinary Shares

Upon a sale or other taxable disposition of our ordinary shares, and subject to the PFIC rules discussed below, a U.S. Holder generally will recognize capital gain or loss in an amount equal to the difference between the amount realized and the U.S. Holder's adjusted tax basis in the ordinary shares.

The regular U.S. federal income tax rate on capital gains recognized by U.S. Holders generally is the same as the regular U.S. federal income tax rate on ordinary income, except that long-term capital gains recognized by non-corporate U.S. Holders generally are subject to U.S. federal income tax at a maximum regular rate of 20%. Capital gain or loss will constitute long-term capital gain or loss if the U.S. Holder's holding period for our ordinary shares exceeds one year. The deductibility of capital losses is subject to various limitations.

If a PRC income tax applies to any gain from the disposition of our ordinary shares by a U.S. Holder, such tax may be treated as a foreign tax eligible for a deduction from such holder's U.S. federal taxable income or a foreign tax credit against such holder's U.S. federal income tax liability (subject to applicable conditions and limitations). In addition, if such PRC tax applies to any gain, such U.S. Holder may be entitled to certain benefits under the U.S.-PRC Tax Treaty if such holder is considered a resident of the United States for purposes of, and otherwise meets the requirements of, the U.S.-PRC Tax Treaty. U.S. Holders should consult their own tax advisors regarding the deduction or credit for any such PRC tax and their eligibility for the benefits of the U.S.-PRC Tax Treaty.

Passive Foreign Investment Company Rules

A foreign (i.e., non-U.S.) corporation will be a PFIC if at least 75% of its gross income in a taxable year of the foreign corporation, including its pro rata share of the gross income of any corporation in which it is considered to own at least 25% of the shares by value, is passive income. Alternatively, a foreign corporation will be a PFIC if at least 50% of its assets in a taxable year of the foreign corporation, ordinarily determined based on fair market value and averaged quarterly over the year, including its pro rata share of the assets of any corporation in which it is considered to own at least 25% of the shares by value, are held for the production of, or produce, passive income. Passive income generally includes dividends, interest, rents and royalties (other than certain rents or royalties derived from the active conduct of a trade or business), and gains from the disposition of passive assets.

Based on the composition (and estimated values) of our assets and the nature of the income of us and our subsidiaries for our 2016 taxable year, we do not believe that we will be treated as a PFIC for such year. However, because we have not performed a definitive analysis as to our PFIC status for our 2016 taxable year, there can be no assurance in respect to our PFIC status for such taxable year. There also can be no assurance with respect to our status as a PFIC for our current taxable year (2017) or any future taxable year. The determination of whether we are or have been a PFIC is primarily factual, and there is little administrative or judicial authority on which to rely to make a determination of PFIC status. Accordingly, the IRS or a court considering the matter may not agree with our analysis of whether we are or were a PFIC during any particular year.

If we are determined to be a PFIC for any taxable year (or portion thereof) that is included in the holding period of a U.S. Holder of our ordinary shares, and, in the case of our ordinary shares, the U.S. Holder did not make either a timely qualified electing fund, or QEF, election for our first taxable year as a PFIC in which the U.S. Holder held (or was deemed to hold) our ordinary shares, or a mark-to-market election, each as described below, such holder generally will be subject to special rules for regular U.S. federal income tax purposes with respect to:

- any gain recognized by the U.S. Holder on the sale or other disposition of our ordinary shares; and
- any "excess distribution" made to the U.S. Holder (generally, any distributions to such U.S. Holder during a taxable year of the U.S. Holder that are greater than 125% of the average annual distributions received by such U.S. Holder in respect of the ordinary shares during the three preceding taxable years of such U.S. Holder or, if shorter, such U.S. Holder's holding period for the ordinary shares).

Under these rules,

- the U.S. Holder's gain or excess distribution will be allocated ratably over the U.S. Holder's holding period for the ordinary shares;
- the amount allocated to the U.S. Holder's taxable year in which the U.S. Holder recognized the gain or received the excess distribution, or to the period in the U.S. Holder's holding period before the first day of our first taxable year in which we are qualified as a PFIC, will be taxed as ordinary income;
- the amount allocated to other taxable years (or portions thereof) of the U.S. Holder and included in its holding period will be taxed at the highest tax rate in effect for that year and applicable to the U.S. Holder; and
- the interest charge generally applicable to underpayments of tax will be imposed in respect of the tax attributable to each such other taxable year of the U.S. Holder.

In general, if we are determined to be a PFIC, a U.S. Holder may avoid the PFIC tax consequences described above in respect to our ordinary shares by making a timely QEF election (or a QEF election along with a purging election). Pursuant to the QEF election, a U.S. Holder generally will be required to include in income its pro rata share of our net capital gains (as long-term capital gain) and other earnings and profits (as ordinary income), on a current basis, in each case whether or not distributed, in the taxable year of the U.S. Holder in which or with which our taxable year ends if we qualified as a PFIC in that taxable year. However, a U.S. Holder may make a QEF election only if we agree to provide certain tax information to such holder annually. At this time, we do not intend to provide U.S. Holders with such information as may be required to make a QEF election effective.

Alternatively, if a U.S. Holder, at the close of its taxable year, owns ordinary shares in a PFIC that are treated as marketable stock, the U.S. Holder may make a mark-to-market election in respect to such ordinary shares for such taxable year. If the U.S. Holder makes a valid mark-to-market election for the first taxable year of the U.S. Holder in which the U.S. Holder holds (or is deemed to hold) ordinary shares and for which we are determined to be PFIC, such holder generally will not be subject to the PFIC rules described above in respect to its ordinary shares as long as such shares continue to be treated as marketable stock. Instead, in general, the U.S. Holder will include as ordinary income for each year that we are treated as a PFIC the excess, if any, of the fair market value of its ordinary shares at the end of its taxable year over the adjusted tax basis in its ordinary shares. The U.S. Holder also will be allowed to take an ordinary loss in respect of the excess, if any, of the adjusted tax basis of its ordinary shares over the fair market value of such shares at the end of its taxable year (but only to the extent of the net amount of previously included income as a result of the mark-to-market election). The U.S. Holder's adjusted tax basis in its ordinary shares will be adjusted to reflect any such income or loss amounts, and any further gain recognized on a sale or other taxable disposition of the ordinary shares in a taxable year in which we are treated as a PFIC will be treated as ordinary income. Special tax rules may also apply if a U.S. Holder makes a mark-to-market election for a taxable year after the first taxable year in which the U.S. Holder holds (or is deemed to hold) our ordinary shares and for which we are determined to be PFIC.

The mark-to-market election is available only for stock that is regularly traded on a national securities exchange that is registered with the Securities and Exchange Commission, including the NASDAQ Capital Market, or on a foreign exchange or market that the IRS determines has rules sufficient to ensure that the market price represents a legitimate and sound fair market value. While our ordinary shares currently are listed and traded on the NASDAQ Capital Market, U.S. Holders nonetheless should consult their own tax advisors regarding the availability and tax consequences of a mark-to-market election in respect to our ordinary shares under their particular circumstances.

If we are a PFIC and, at any time, have a foreign subsidiary that is classified as a PFIC, a U.S. Holder of our ordinary shares should be deemed to own a portion of the shares of such lower-tier PFIC, and could incur liability for the deferred tax and interest charge described above if we receive a distribution from, or dispose of all or part of our interest in, or the U.S. Holder were otherwise deemed to have disposed of an interest in, the lower-tier PFIC. U.S. Holders are urged to consult their own tax advisors regarding the tax issues raised by lower-tier PFICs.

A U.S. Holder that owns (or is deemed to own) ordinary shares in a PFIC during any taxable year of the U.S. Holder may have to file an IRS Form 8621 (whether or not a market-to-market election is or has been made) with such U.S. Holder's U.S. federal income tax return and provide such other information as may be required by the U.S. Treasury Department.

The rules dealing with PFICs and mark-to-market elections are very complex and are affected by various factors in addition to those described above. Accordingly, U.S. Holders of our ordinary shares should consult their own tax advisors concerning the application of the PFIC rules to our ordinary shares under their particular circumstances.

Additional Taxes

Under current law, U.S. Holders that are individuals, estates or trusts and whose income exceeds certain thresholds generally will be subject to a 3.8% Medicare contribution tax on unearned income, including, without limitation, dividends on, and gains from the sale or other taxable disposition of, our ordinary shares, subject to certain limitations and exceptions. U.S. Holders should consult their own tax advisors regarding the effect, if any, of such tax on their ownership and disposition of our ordinary shares.

Non-U.S. Holders

Cash dividends paid to a Non-U.S. Holder in respect to our ordinary shares generally will not be subject to U.S. federal income tax, unless such dividends are effectively connected with the Non-U.S. Holder's conduct of a trade or business within the United States (and, if required by an applicable income tax treaty, are attributable to a permanent establishment or fixed base that such holder maintains or maintained in the United States).

In addition, a Non-U.S. Holder generally will not be subject to U.S. federal income tax on any gain attributable to a sale or other taxable disposition of our ordinary shares unless such gain is effectively connected with its conduct of a trade or business in the United States (and, if required by an applicable income tax treaty is attributable to a permanent establishment or fixed base that such holder maintains or maintained in the United States) or the Non-U.S. Holder is an individual who is present in the United States for 183 days or more in the taxable year of sale or other disposition and certain other conditions are met (in which case such gain from U.S. sources generally is subject to U.S. federal income tax at a 30% rate or a lower applicable tax treaty rate).

Cash dividends and gains that are effectively connected with the Non-U.S. Holder's conduct of a trade or business in the United States (and, if required by an applicable income tax treaty, are attributable to a permanent establishment or fixed base that such holder maintains or maintained in the United States) generally will be subject to regular U.S. federal income tax at the same regular U.S. federal income tax rates applicable to a comparable U.S. Holder and, in the case of a Non-U.S. Holder that is a corporation for U.S. federal income tax purposes, may also be subject to an additional branch profits tax at a 30% rate or a lower applicable tax treaty rate.

Backup Withholding and Information Reporting

In general, information reporting for U.S federal income tax purposes should apply to cash distributions made on our ordinary shares within the United States to a U.S. Holder (other than an exempt recipient) and to the proceeds from sales and other dispositions of our ordinary shares by a U.S. Holder (other than an exempt recipient) to or through a U.S. office of a broker. Payments made (and sales and other dispositions effected at an office) outside the United States will be subject to information reporting in limited circumstances. In addition, certain information concerning a U.S. Holder's adjusted tax basis in its ordinary shares and adjustments to that tax basis and whether any gain or loss with respect to such ordinary shares is long-term or short-term also may be required to be reported to the IRS, and certain holders may be required to file an IRS Form 8938 (Statement of Specified Foreign Financial Assets) to report their interest in our ordinary shares.

Moreover, backup withholding of U.S. federal income tax, at a rate of 28%, generally will apply to cash dividends paid on our ordinary shares to a U.S. Holder (other than an exempt recipient) and the proceeds from sales and other dispositions of our ordinary shares by a U.S. Holder (other than an exempt recipient), in each case who:

· fails to provide an accurate taxpayer identification number;
· is notified by the IRS that backup withholding is required; or
· in certain circumstances fails to comply with applicable certification requirements.

A Non-U.S. Holder generally may eliminate the requirement for information reporting and backup withholding by providing certification of its foreign status, under penalties of perjury, on a duly executed applicable IRS Form W-8 or by otherwise establishing an exemption.

Backup withholding is not an additional tax. Rather, the amount of any backup withholding will be allowed as a credit against a U.S. Holder's or a Non-U.S. Holder's U.S. federal income tax liability and may entitle such holder to a refund, provided that certain required information is timely furnished to the IRS. Holders are urged to consult their own tax advisors regarding the application of backup withholding and the availability of and procedures for obtaining an exemption from backup withholding in their particular circumstances.

Other Non-United States Taxation Treatment

The following discussion is a summary of certain anticipated PRC and Cayman Islands tax consequences of an investment in our ordinary shares. The discussion does not deal with all possible tax consequences relating to an investment in our ordinary shares and does not purport to deal with the tax consequences applicable to all categories of investors, some of which (such as dealers in securities, insurance companies and tax-exempt entities) may be subject to special rules. In particular, the discussion does not address the tax consequences under state, local and other national tax laws. Accordingly, each prospective investor should consult its own tax advisor regarding the particular tax consequences to it of an investment in our ordinary shares. The following discussion is based upon laws and relevant interpretations thereof in effect as of the date of this Annual Report, all of which are subject to change.

China Taxation

There are significant uncertainties under the new corporate income tax law of the PRC, or the New Tax Law, which became effective on January 1, 2008, regarding our PRC enterprise income tax liabilities, such as a tax on any dividends paid to us by our PRC subsidiary. The New Tax Law also contains uncertainties regarding possible PRC withholding tax on dividends we pay to our overseas shareholders and gains realized from the transfer of our shares by our overseas shareholders.

We are a holding company incorporated in the Cayman Islands, which indirectly holds, through Fuwei (BVI), our equity interest in Shandong Fuwei, our subsidiary and actual operating body in the PRC. Our business operations are principally conducted through Shandong Fuwei.

Under the New Tax Law, enterprises established under the laws of jurisdictions outside China with their “de facto management bodies” located within China may be considered to be PRC tax resident enterprises for tax purposes and subjected to the tax obligations of a PRC tax resident. If we or Fuwei (BVI) is considered as a PRC tax resident enterprise under the New Tax Law, then our global income will be subject to PRC enterprise income tax at the rate of 25%.

On April 22, 2009, the State Administration of Taxation issued a Notice Regarding Recognition of Overseas Incorporated Enterprises Controlled by PRC Domestic Enterprises as PRC Resident Enterprises Based on the De Facto Management Body Criteria (the "Tax Residency Notice"). Under the Tax Residency Notice, which was retroactively effective as of January 1, 2008, an overseas enterprise will be deemed to be a PRC resident enterprise and thus subject to Enterprise Income Tax of 25% on its global income if it satisfies four conditions: (i) the company's management team responsible for daily operations are located in China, or the location where the management team carries out their responsibilities is in China; (ii) finance and personnel decisions are made or need approval by institutions or people in China; (iii) the company's major property, accounting ledger, company seal and minutes of board meetings and shareholder meetings are kept in China; and (iv) at least half of the members of the board of directors with voting rights or the management team habitually live in China.

Although the Tax Residency Notice applies only to overseas registered enterprises controlled by PRC enterprises, not to those controlled by PRC individuals, the determining criteria set forth in the Tax Residency Notice may reflect the State Administration of Taxation's general position on how the "de facto management body" test should be applied in determining the tax resident status of offshore enterprises, regardless of whether they are controlled by PRC enterprises or individuals. If we are deemed a PRC resident enterprise, we may be subject to the Enterprise Income Tax at 25% on our global income. If we are considered a resident enterprise and earn income other than dividends from our PRC subsidiaries, a 25% Enterprise Income Tax on our global income could significantly increase our tax burden and materially and adversely affect our cash flow and profitability.

However, China-sourced income of foreign enterprises, such as dividends paid by a PRC subsidiary to its overseas parent, will normally be subject to PRC tax.

Furthermore, the implementation rules of the New Tax Law provide that (i) if the enterprise that distributes the dividends is domiciled in the PRC, or (ii) if gains are realized from transferring equity interests of enterprises domiciled in the PRC, then such dividends or capital gains are treated as China-sourced income. It is not clear how "domicile" may be interpreted under the New Tax Law, and it may be interpreted as the jurisdiction where the enterprise is a tax resident. Therefore, if we are considered as a PRC resident enterprise for PRC tax purposes, any dividends we pay to our overseas shareholders as well as gains realized by such shareholders from the transfer of our shares may be regarded as China-sourced income and, thus, may be subject to PRC tax.

As the New Tax Law and the implementation rules have only recently taken effect, it is uncertain as to how they will be implemented by the relevant PRC tax authorities. If dividend payments from Shandong Fuwei and from Fuwei (BVI) to us are subject to PRC withholding tax, our financial condition and results of operations and the amount of dividends available to pay our shareholders may be adversely affected. Also, if dividends we pay to our overseas shareholders or gains realized by such shareholders from the transfer of our shares are subject to PRC tax, it may materially and adversely affect your investment return and the value of your investment in us. There is an income tax treaty in effect between the United States and China, so U.S. shareholders may be entitled to certain benefits under such treaty.

Cayman Island Taxation

The Cayman Islands currently has no exchange control restrictions. The Cayman Islands currently levies no taxes on individuals or corporations based upon profits, income, gains or appreciation, and there is no taxation in the nature of inheritance tax or estate duty. There are no other taxes likely to be material to the Company levied by the government of the Cayman Islands, save certain stamp duties which may be applicable, from time to time, on certain instruments executed in or brought within the jurisdiction of the Cayman Islands. The Cayman Islands is not a party to any double tax treaties.

Pursuant to section 6 of the Tax Concessions Law (1999 Revision) of the Cayman Islands, the Company has obtained an undertaking from the Governor in Cabinet:

(a) that no law which is enacted in the Cayman Islands imposing any tax to be levied on profits or income or gains or appreciation shall apply to the Company or its operations; and

(b) in addition, that no tax is levied on profits, income, gains or appreciation or no tax which is in the nature of estate duty or inheritance tax shall be payable by the Company:

(i) on or in respect of the shares, debentures or other obligations of the Company; or

(ii) by way of withholding in whole or in part of any relevant payment as defined in section 6(3) of the Tax Concession Law (1999 Revision).

The undertaking is for a period of 20 years from August 24, 2004.

F. Dividends and Paying Agents.

Not applicable.

G. Statement by Experts.

Not applicable.

H. Documents on Display

We are subject to the periodic reporting and other informational requirements of the Securities Exchange Act of 1934, as amended, or the Exchange Act. Under the Exchange Act, we are required to file reports and other information with the Securities and Exchange Commission. Specially, we are required to file annually a Form 20-F no later than six month after the close of each fiscal year, which is December 31. Copies of reports and other information, when so filed, may be inspected without charge and may be obtained at prescribed rates at the public reference facilities maintained by the Securities and Exchange Commission at Judiciary Plaza, 100 F. Street, N.E., Washington, D.C. 20549. The public may obtain information regarding the Washington, D.C. Public Reference Room by calling the Commission at 1-800-SEC-0330. The SEC also maintains a Web site at www.sec.gov that contains reports, proxy and information statements, and other information regarding registrants that make electronic filings with the SEC using its EDGAR system.

As a foreign private issuer, we are exempt from the rules under the Exchange Act prescribing the furnishing and content of quarterly reports and proxy statements, and officers, directors and principal shareholders are exempt from the reporting requirements pursuant to Section 16 of the Exchange Act.

Documents concerning the Company that are referred to in this document may also be inspected at our office, which is at No. 387 Dongming Road, Weifang Shandong 261061, People’s Republic of China.

I. Subsidiary Information.

Not applicable.

Item 11. Quantitative and Qualitative Disclosures about Market Risk.

Foreign exchange risk

We are exposed to the risk of foreign currency exchange rate fluctuation. We have never used derivative instruments to hedge our exchange rate risks, do not plan to do so, and may not be successful should we attempt to do so in the future. Nevertheless, we believe such risk is low as no foreign currency liabilities are incurred and the principal operations are limited mainly to the market in China.

Our operating subsidiary, Shandong Fuwei's, functional currency is Renminbi while our functional currency is Hong Kong Dollars. Transactions in other currencies are recorded in Renminbi at the rates of exchange prevailing when the transactions occur. Monetary assets and liabilities denominated in other currencies are converted into Renminbi at rates of exchange in effect at the balance sheet dates. Exchange gains and losses are recorded in our statements of operations as a component of current period earnings.

The China State Administration for Foreign Exchange, under the authority of the People's Bank of China, controls the conversion of Renminbi into foreign currencies. The principal regulation governing foreign currency exchange in China is the Foreign Currency Administration Rules (1996), as amended. Under the Rules, once various procedural requirements are met, Renminbi is convertible for current account transactions, including trade and services, but not for capital account transactions, including direct investment, loan or investment in securities outside China, unless the prior approval of the State Administration of Foreign Exchange of China is obtained. Although the Chinese government regulations now allow greater convertibility of Renminbi for current account transactions, significant restrictions still remain. Currently, we are not involved in foreign exchange transactions as all transactions are conducted in China are in Renminbi and all exporting business is completed in U.S. dollars.

The value of the Renminbi is subject to changes in China's central government policies and to international economic and political developments affecting supply and demand in the China Foreign Exchange Trading System market. Since 1994, the conversion of Renminbi into foreign currencies, including U.S. dollars, has been based on rates set by the People's Bank of China, which are set daily based on the previous day's interbank foreign exchange market rates and current exchange rates on the world financial markets. Since 1994, the official exchange rate generally has been stable. The official exchange rate for the conversion of Renminbi into U.S. dollars remained stable until Renminbi was revalued in July 2005 and allowed to fluctuate by reference to a basket of foreign currencies, including the U.S. dollar. Under the new policy, Renminbi is permitted to fluctuate within a band against a basket of foreign currencies.

We conduct substantially all of our operations through Shandong Fuwei, and its financial performance and position are measured in terms of Renminbi. Any appreciation of the Renminbi against the United States dollar would consequently have an adverse effect on our financial performance and asset values when measured in terms of United States dollar. Our solutions are primarily procured, sold and delivered in China for Renminbi. The majority of our revenues are denominated in Renminbi. Should the Renminbi appreciate against United States dollar, such appreciation could have a material adverse effect on our profits and the foreign currency equivalent of such profits repatriated by the Chinese entities to us.

Interest rate risk

We are exposed to interest rate risk arising from having short-term variable rate borrowings from time to time. Our future interest expense would fluctuate in line with any change in our borrowing rates. We do not have any derivative financial instruments and believe our exposure to interest rate risk and other relevant market risks is not material.

Inflation

According to the National Bureau of Statistics of China, the change in Consumer Price Index in China was 2.0%, 1.4% and 2.0% in 2016, 2015 and 2014, respectively.

Credit and liquidity risks

We adopt a risk assessment model to our customer credit management system, and we offer different credit terms to our customers based on criteria such as working relationship, payment history, creditworthiness and their financial position. All credit terms are approved by our finance department, in consultation with our sales department. For extension of larger credit limits, approvals have to be sought from our credit committee which is made up of members from our finance department, sales department and the CFO. Our finance department and sales department review our outstanding debtor balances on a monthly basis and follow up with customers when payments are due. We believe that there would not material impact risk to our operations in our credit and liquidity risk from sales and customers and other relevant market risks.

Item 12. Description of Securities Other than Equity Securities

Not applicable.

PART II

Item 13. Default, Dividend Arrearages and Delinquencies

None.

Item 14. Material Modifications to the Rights of Security Holders and Use of Proceeds

Not applicable.

Item 15. Controls and Procedures

(a) Disclosure Controls and Procedures.

Under the supervision and with the participation of our management, including the principal executive officer and the principal accounting officer, we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as of the end of the period covered by this report (the “Evaluation Date”). Based on this evaluation, our principal executive officer and principal accounting officer concluded as of the Evaluation Date that our disclosure controls and procedures were ineffective due to the deficiencies described below in “Management’s annual report on internal control over financial reporting.” The material information required to be included in our Securities and Exchange Commission (“SEC”) reports is accumulated and communicated to management (including such officers) as appropriate to allow timely decisions regarding required disclosure and recorded, processed, summarized and reported within the time periods specified in SEC rules and forms relating to us, including our consolidated subsidiaries.

(b) Management’s annual report on internal control over financial reporting.

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f) and 15d-15(f). Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting. In making its assessment of the effectiveness of the Company’s internal control over financial reporting, management used the criteria issued by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control-Integrated Framework. Based on our evaluation, our principal executive officer and principal financial officer have concluded as of the Evaluation Date, our internal controls over financial reporting were ineffective as of December 31, 2016 due to the material weakness described below.

The Public Company Accounting Oversight Board defines a material weakness as a deficiency, or combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of our annual or interim financial statements will not be prevented or detected on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those responsible for oversight of our financial reporting. A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A deficiency in design exists when:

- a control necessary to meet the control objective is missing; or
- an existing control is not properly designed such that, even if the control operates as designed, the control objective is not always met.

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A deficiency in operation exists when a properly designed control does not operate as designed, or when the person performing the control does not possess the necessary authority or qualifications to perform the control effectively.

The material weaknesses identified result from inadequate technical accounting staff with knowledge of and experience with US generally accepted accounting principles, pursuant to which we prepare our consolidated financial statements, to support stand-alone external financial reporting under public company or SEC requirements.

We are in the process of developing and implementing a remediation plan to address the deficiencies in the areas of personnel with knowledge of and experience with US generally accepted accounting principles. However, additional measures may be necessary, and the measures we expect to take to improve our internal controls may not be sufficient to address the issues identified, to ensure that our internal controls are effective or to ensure that such material weakness or other material weaknesses would not result in a material misstatement of our annual or interim financial statements. In addition, other material weaknesses or significant deficiencies may be identified in the future. If we are unable to correct deficiencies in internal controls in a timely manner, our ability to record, process, summarize and report financial information accurately and within the time periods specified in the rules and forms of the SEC will be adversely affected. This failure could negatively affect the market price and trading liquidity of our common stock, cause investors to lose confidence in our reported financial information, subject us to civil and criminal investigations and penalties, and generally materially and adversely impact our business and financial condition.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can only provide reasonable assurances with respect to financial statement preparation and presentation. In addition, any evaluation of effectiveness for future periods is subject to the risk that controls may become inadequate because of changes in conditions in the future.

The Company’s independent auditor, KSP Group, Inc., has audited the consolidated financial statements of the Company for the fiscal year ended December 31, 2016.

(c) Attestation report of the registered public accounting firm.

This Annual Report on Form 20-F does not include an attestation report of the Company’s registered public accounting firm regarding internal control over financial reporting. Management’s report was not subject to attestation by the Company’s registered public accounting firm pursuant to the rules of the Securities and Exchange Commission that permit the company to provide only management’s report in this Annual Report.

(d) Changes in internal control over financial reporting.

There were no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act) that occurred during the year ended December 31, 2016 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting. It should be noted that while our management believes that our disclosure controls and procedures provide a reasonable level of assurance; our management does not expect that our disclosure controls and procedures or internal financial controls will prevent all errors or fraud. A control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

Item 16 [Reserved]

Item 16A. Audit Committee Financial Expert

Our Board of Directors has nominated Tee Chuang Khoo, Junying Liu, and Shan Jiang as members of the Audit Committee, all of whom are "independent" under the rules of Nasdaq Marketplace Rule 4200(a) (15). In addition, Tee Chuang Khoo qualifies as an audit committee as the financial expert as defined under the applicable rules of the SEC issued pursuant to Section 407 of the Sarbanes-Oxley Act of 2002.

Item 16B. Code of Ethics

The Code of Ethics for the members of our Board of Directors and Officers was approved by our Board of Directors on March 27, 2007.

Item 16C. Principal Accountant Fees and Services

Audit Fees

The audit fee of our current independent registered public accounting firm, KSP Group, Inc. (“KSP”) and our former independent registered public accounting firm, Kabani & Company, Inc. (“Kabani”), in connection with review and audit fee for 2016 was US$145,000 and the audit fee of Kabani, in connection with review and audit fee for 2015 was US$149,000.

Audit-Related Fees

The audit related fee of Kabani including expenses for responding to SEC comments and out-of-pocket expenses, such as traveling and lodging, for the fiscal years ended December 31, 2016 and 2015 amounted to US$2,587 and US$3,533, respectively.

All Other Fees

Not applicable.

Policy on Pre-Approval of Audit and Permissible Non-Audit Services of Independent Auditors

The policy of our directors who perform the functions customarily performed by an audit committee is to pre-approve all audit and permissible non-audit services provided by the independent auditors. These services may include audit services and other services.

Audit of Financial Statements

Kabani was responsible for the annual audit of financial statements for the years beginning 2007 to 2015. KSP is responsible for the annual audit of financial statements for the year of 2016.

Item 16D. Exemptions from the Listing Standards for Audit Committee

Not applicable.

Item 16E. Purchase of Equity Securities by the Issuer and Affiliated Purchasers

None.

Item 16F. Change in Registrant's Certifying Accountant.

Effective on March 10, 2017, the Company's principal accountant and auditor, Kabani & Company, Inc. ("Kabani") resigned as the Company's independent registered public accounting firm and auditor, as Kabani no longer provides audit services.

Kabani's issued report on the Company's financial statements for the fiscal years ended December 31, 2016 and 2015 did not contain an adverse opinion or disclaimer of opinion, and was prepared using U.S. generally accepted accounting principles applicable to a going concern.

As a result of Kabani's resignation, the Board of Directors of the Company approved the appointment of KSP Group, Inc. ("KSP") as the Company's new independent registered public accounting firm and auditor on March 14, 2017 to fill the vacancy in accordance with the Articles of Association of the Company.

In connection with the audit of the Company's consolidated financial statements for the years ended December 31, 2016 and 2015, and through the subsequent interim period preceding the dismissal of Kabani, there were no disagreements on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which disagreement(s), if not resolved to the satisfaction of Kabani, would have caused it to make reference to the subject matter of the disagreement(s) in connection with its report.

There are no reportable events as defined in Item 16F(a)(1)(v) of Form 20-F.

The Company has provided Kabani a copy of the statements made in response to this Item 16F and has requested Kabani to furnish it with a letter addressed to the Securities and Exchange Commission stating whether or not Kabani agrees with such statements. A copy of the letter of Kabani is filed as Exhibit 15.1 to this annual report on Form 20-F.

During the two most recent fiscal years, and the subsequent interim period prior to the engagement of KSP, neither the Company, nor anyone on its behalf, consulted KSP regarding either (i) the application of accounting principles to a specified transaction, either completed or proposed; or the type of audit opinion that might be rendered on the Company's financial statements, where either a written report was provided to the Company or oral advice was provided, that KSP concluded was an important factor considered by the Company in reaching a decision as to the accounting, auditing or financial reporting issue; or (ii) any matter that was either the subject of a disagreement (as defined in Item 16F(a)(1)(iv) of Form 20-F and the related instructions) or a reportable event (as described in Item 16F(a)(1)(v) of Form 20-F).

During the two most recent fiscal years, and the subsequent interim period prior to the engagement of KSP, neither the Company, nor anyone on its behalf, consulted KSP regarding either (i) the application of accounting principles to a specified transaction, either completed or proposed; or the type of audit opinion that might be rendered on the Company's financial statements, where either a written report was provided to the Company or oral advice was provided, that KSP concluded was an important factor considered by the Company in reaching a decision as to the accounting, auditing or financial reporting issue; or (ii) any matter that was either the subject of a disagreement (as defined in Item 16F(a)(1)(iv) of Form 20-F and the related instructions) or a reportable event (as described in Item 16F(a)(1)(v) of Form 20-F).

Item 16G. Significant Differences in Corporate Governance Practices.

NASDAQ Marketplace Rules and Home Country Practices

Pursuant to NASDAQ Listing Rule 5615(a)(3), as a foreign private issuer the Company may follow home country corporate governance practices in lieu of the requirements of the Rule 5600 series, provided that the Company (i) complies with certain mandatory sections of the Rule 5600 series, (ii) discloses each requirement of Rule 5600 that it does not follow and describes the home country practice followed in lieu of such other requirement and (iii) delivers a letter to NASDAQ from the Company's Cayman Islands counsel certifying that the corporate governance practices that the Company does follow are not prohibited by Cayman Islands law. The Company's independent Cayman Islands counsel has certified to NASDAQ that the Company's corporate governance practices are not prohibited by Cayman Islands law.

Item 16H. Mine Safety Disclosure

Not applicable.

Part III

Item 17. Financial Statements

The Company has elected to provide Financial Statements pursuant to Item 18 (see below).

Item 18. Financial Statements

The following documents are filed as Attachment A hereto and are included as part of this Annual report on Form 20-F.

Audited Consolidated Financial Statements of Fuwei Films (Holdings) Co., Ltd and Subsidiaries

Report of Independent Registered Public Accounting Firm.

Consolidated Statements of Operations and Comprehensive Income (Loss) for the year ended December 31, 2016, 2015 and 2014.

Consolidated Balance Sheets as of December 31, 2016 and 2015.

Consolidated Statements of Cash Flows for the year ended December 31, 2016, 2015 and 2014.

Consolidated Statements of Equity for the year ended December 31, 2016, 2015 and 2014.

Notes to Consolidated Financial Statements.

Item 19. Exhibits.

The following exhibits are filed as part of this Annual Report:

No.	Description
1.2	Form of Amended Memorandum of Association of Fuwei Films (Holdings) Co., Ltd. (2)
1.3	Articles of Association Fuwei Films (Holdings) Co., Ltd. (3)
4.1	Form of Underwriting Agreement.(1)
4.2	Loan Agreement between Bank of Communications and Fuwei Films (Shandong) Co., Ltd. dated January 15, 2007 (3)
4.3	Loan Agreement between Bank of Communications and Fuwei Films (Shandong) Co., Ltd. dated January 15, 2007 (3)
4.4	Asset Purchase Agreement between Fuwei Plastics and Shandong Weifang Auction Firm dated October 9, 2003 (2)
4.5	Purchase Agreement between Beijing Baorui and Weifang Jing Cheng Auction Co., Ltd. dated December 17, 2004 (2)
4.6	Service Agreement between Fuwei Films (Holdings) Co., Ltd. and Xiaoan He (2)
4.7	Employment Agreement between Fuwei Films (Holdings) Co., Ltd. and Xiaoan He (2)
4.8	Employment Agreement between Fuwei Films (Holdings) Co., Ltd. and Xiaoming Wang (2)
4.9	Employment Agreement between Fuwei Films (Holdings) Co., Ltd. and Xiuyong Zhang (2)
4.10	Equipment Contract between Fuwei Films (Holdings) Co., Ltd. and Brückner dated as of June 2005 (2)
4.11	Credit Letter from Communication Bank of China dated May 8, 2006 (2)
4.12	Contract between Fuwei Films (Shandong) Co., Ltd. and Lindauer Dornier GmbH, dated January 20, 2007 (4)
4.13	Amendment to the Contract of January 20, 2007 between Fuwei Films (Shandong) Co., Ltd. and Lindauer Dornier GmbH, dated February 2, 2007 (4)
4.14	Loan Contract between Fuwei Films (Shandong) Co., Ltd. and Bank of Communications, dated July 16, 2008 (4)

4.15	Loan Contract between Fuwei Films (Shandong) Co., Ltd. and Weifang City Commercial Bank, dated July 18, 2008 (4)
4.16	Loan Contract between Fuwei Films (Shandong) Co., Ltd. and Weifang City Commercial Bank, dated December 2, 2008 (4)
4.17	Loan Contract between Fuwei Films (Shandong) Co., Ltd. and Weifang City Commercial Bank, dated January 13, 2009 (4)
4.18	Loan Contract between Fuwei Films (Shandong) Co., Ltd. and Weifang City Commercial Bank, dated January 16, 2009 (4)
4.19	Loan Contract between Fuwei Films (Shandong) Co., Ltd. and Bank of Communications, dated June 9, 2009 (5)
4.20	Loan Contract between Fuwei Films (Shandong) Co., Ltd. and Bank of Communications, dated June 9, 2009 (5)
4.21	Loan Contract between Fuwei Films (Shandong) Co., Ltd. and the Weifang Dongfang State-owned Assets Management Co., Ltd., dated November 20, 2009 (5)
4.22	Loan Contract between Fuwei Films (Shandong) Co., Ltd. and Bank of Weifang, dated January 13, 2010 (5)

4.23 Loan Contract between Fuwei Films (Shandong) Co., Ltd. and Bank of Communications, dated June 7, 2010 (6)

4.24 Loan Contract between Fuwei Films (Shandong) Co., Ltd. and Bank of Communications, dated June 7, 2010 (6)

4.25 Loan Contract between Fuwei Films (Shandong) Co., Ltd. and Bank of Communications, dated June 7, 2010 (6)

4.26 Contract between Fuwei Films (Shandong) Co., Ltd. and Lindauer Dornier GmbH, dated March 30, 2011 (7)

4.27 Loan Contract between Fuwei Films (Shandong) Co., Ltd. and Bank of Communications, dated May 25, 2011 (8)

4.28 Loan Contract between Fuwei Films (Shandong) Co., Ltd. and Bank of Communications, dated May 25, 2011 (8)

4.29 Loan Contract between Fuwei Films (Shandong) Co., Ltd. and Bank of Communications, dated May 25, 2011 (8)

4.30 Loan Contract between Fuwei Films (Shandong) Co., Ltd. and Bank of Communications, dated May 30, 2011 (8)

4.31 Loan Contract between Fuwei Films (Shandong) Co., Ltd. and Bank of Communications, dated April 26, 2011 (8)

4.32 Amendment No. 1 to the Contract between Fuwei Films (Shandong) Co., Ltd. and Lindauer Dornier GmbH, dated July 22, 2011 (9)

4.33 Entrusted Loan Contract between Fuwei Films (Shandong) Co., Ltd. and Weifang High-Tech Investment Co., Ltd. dated October 28, 2011 (10)

4.34 Loan Contract between Fuwei Films (Shandong) Co. Ltd. and Bank of Communications Co., Ltd. dated April 18, 2013. (11)

4.35 Loan Contract between Fuwei Films (Shandong) Co. Ltd. and Bank of Communications Co., Ltd. dated April 19, 2013. (11)

4.36 Loan Contract between Fuwei Films (Shandong) Co. Ltd. and Bank of Communications Co., Ltd. dated April 25, 2013.(11)

4.37 Loan Contract between Fuwei Films (Shandong) Co. Ltd. and Bank of Communications Co., Ltd. dated May 2, 2013. (11)

4.38 Loan Contract between Fuwei Films (Shandong) Co. Ltd. and Bank of Communications Co., Ltd. dated April 23, 2013. (11)

4.39 Letter of Commitment between Fuwei Films (Shandong) Co. Ltd. and Shandong SNTON Optical Materials Technology Co., Ltd. dated April 1, 2014. (12)

4.40	Use of Capital Agreement between Fuwei Films (Shandong) Co. Ltd. and Shandong SNTON Optical Materials Technology Co., Ltd. dated April 2, 2014. (12)
4.41	Use of Capital Agreement between Fuwei Films (Shandong) Co. Ltd. and Shandong SNTON Group Co., Ltd. dated May 20, 2014. (12)
4.42	Use of Capital Supplemental Agreement for an amount of RMB105,000,000 between Fuwei Films (Shandong) Co. Ltd. and Shandong SNTON Optical Materials Technology Co., Ltd. dated March 9, 2015. (13)
4.43	Use of Capital Supplemental Agreement for an amount of RMB15,000,000 between Fuwei Films (Shandong) Co. Ltd. and Shandong SNTON Group Co., Ltd. dated March 9, 2015. (13)
4.44	Loan Contracts between Fuwei Films (Shandong) Co., Ltd. and Bank of Weifang, dated July 15, 2016. (14)
4.45	Loan Contracts between Fuwei Films (Shandong) Co., Ltd. and Bank of Weifang, dated July 20, 2016. (14)
8.1	List of the Company’s significant subsidiaries, their jurisdiction of incorporation and the names under which they operate business, if different from their name. (3)

11.1	Code of Ethics for CEO and Senior Financial Officers. (3)
12.1	Certification of Chief Executive Officer required by Section 302 of the Sarbanes-Oxley Act of 2002. *
12.2	Certification of Chief Financial Officer required by Section 302 of the Sarbanes-Oxley Act of 2002. *
13.1	Certification of Chief Executive Officer and Chief Financial Officer required by Section 906 of the Sarbanes-Oxley Act of 2002. *
15.1	Letter of Kabani *
101.INS	XBRL Instance *
101.SCH	XBRL Taxonomy Extension Schema *
101.CAL	XBRL Taxonomy Extension Calculation *
101.DEF	XBRL Taxonomy Extension Definition *
101.LAB	XBRL Taxonomy Extension Labels *
101.PRE	XBRL Taxonomy Extension Presentation *

(1) Filed with the Company’s amendment to Registration Statement on Form F-1/A filed with the SEC on December 12, 2006.

(2) Filed with the Company’s Registration Statement on Form F-1 filed with the SEC on November 24, 2006.

(3) Filed with the Company’s Annual Report on Form 20-F for the year ended December 31, 2006 filed with the SEC on April 2, 2007.

(4) Filed with the Company’s Annual Report on Form 20-F for the year December 31, 2008 filed with the SEC on March 30, 2009.

(5) Filed with the Company’s Annual Report on Form 20-F for the year ended December 31, 2009 filed with the SEC on April 21, 2010.

(6) Filed with the Company’s Quarterly Report on Form 6-Kfor the quarter ended June 30, 2010 filed with the SEC on August 16, 2010.

(7) Filed with the Company’s Quarterly Report on Form 6-Kfor the quarter ended March 31, 2011 filed with the SEC on May 10, 2011.

(8) Filed with the Company’s Quarterly Report on Form 6-Kfor the quarter ended June 30, 2011 filed with the SEC on August 10, 2011.

(9) Filed with the Amendment No. 2 to the Company's Annual Report on Form 20-F/A for the year ended December 31, 2011 filed with the SEC on September 4, 2012. Certain portions of this Exhibit were omitted based upon a request for confidential treatment and the omitted portions have been separately filed with the Securities and Exchange Commission.

(10) Filed with the Company's Annual Report on Form 20-F for the year December 31, 2011 filed with the SEC on April 12, 2012.

(11) Filed with the Company's Quarterly Report on Form 6-K for the quarter ended June 30, 2013 filed with the SEC on August 22, 2013.

(12) Filed with the Company's Quarterly Report on Form 6-K for the quarter ended June 30, 2014 filed with the SEC on August 21, 2014.

(13) Filed with the Company's Quarterly Report on Form 6-K for the quarter ended March 31, 2015 filed with the SEC on May 21, 2015.

(14) Filed with the Company's Quarterly Report on Form 6-K for the quarter ended September 30, 2016 filed with the SEC on November 28, 2016.

* Filed herewith.

SIGNATURES

The registrant hereby certifies that it meets all of the requirements for filing Form 20-F and has duly caused and authorized the undersigned to sign this Annual Report on its behalf.

Fuwei Films (Holdings) Co., Ltd.

By: /s/ Zengyong Wang
Name: Zengyong Wang
Title: Chairman, Chief Executive Officer

By: /s/ Benjie Dong
Name: Benjie Dong
Title: Chief Financial Officer

Dated: April 6, 2017

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Report of Independent Registered Public Accounting Firm

Board of Directors and Stockholders of

Fuwei Films (Holdings) Co., Ltd. and Subsidiaries

We have audited the accompanying consolidated balance sheets of Fuwei Films (Holdings) Co., Ltd. and Subsidiaries (the "Company") as of December 31, 2016 and 2015, and the related consolidated statements of operations and comprehensive income (loss), equity, and cash flows for the years ended December 31, 2016, 2015 and 2014, all expressed in Chinese Yuan (Renminbi or RMB), and US Dollar (USD) expressed only for the year ended December 31, 2016. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Fuwei Films (Holdings) Co., Ltd. and Subsidiaries as of December 31, 2016 and 2015, and the related consolidated statements of operations and comprehensive income (loss), equity, and cash flows for the years ended December 31, 2016, 2015 and 2014 in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. The Company has a working capital deficit of RMB170,128,000 or USD24,503,528 as of December 31, 2016. As more fully described in Note 3(t) to the consolidated financial statements, the Company has incurred a net loss of RMB54,483,000 or USD7,847,000, and the Company may not have sufficient working capital to meet its planned operating activities over the next twelve months. These conditions raise substantial doubt about the Company's ability to continue as a going concern. Management's plans regarding these matters are described in Note 3(t). The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ KSP Group, Inc.

Certified Public Accountants

Los Angeles, California

April 6, 2017

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FUWEI FILMS (HOLDINGS) CO., LTD and SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

As of December 31, 2016 and 2015

(amounts in thousands, except share and per share data)

	Notes	December 31, 2016		December 31, 2015
		RMB	US$	RMB
ASSETS				
Current assets				
Cash and cash equivalents		13,343	1,922	14,355
Restricted cash		73,421	10,575	43,215
Accounts and bills receivable, net	4	29,453	4,242	10,046
Inventories	5	25,153	3,623	29,574
Advance to suppliers	9	6,043	870	5,640
Prepayments and other receivables	6	6,489	935	20,334
Deferred tax assets – current	19	1,199	173	1,438
Total current assets		155,101	22,340	124,602
Property, plant and equipment, net	7	410,654	59,146	431,021
Construction in progress	7	431	62	1,700
Lease prepayments, net	8	17,358	2,500	17,882
Advance to suppliers - long term, net	9	1,861	268	1,440
Long-term deposit		-	-	-
Other Assets	10	-	-	11,607
Deferred tax assets - non current	19	8,032	1,157	15,519
Total assets		593,437	85,473	603,771
LIABILITIES AND EQUITY				
Current liabilities				
Short-term borrowings	11	60,000	8,642	-
Long-term loan, current portion	11	3,300	475	3,350
Due to related parties	20	131,747	18,976	156,040
Accounts payables		20,581	2,964	19,800
Notes payable	12	100,888	14,531	85,780
Advance from customers		3,509	505	2,247
Accrued expenses and other payables	13	5,204	750	8,682
Obligations under capital leases-current	14	-	-	302
Total current liabilities		325,229	46,843	276,201
Obligations under capital leases	14	-	-	-
Long-term loan	11	-	-	3,300
Deferred tax liabilities	19	2,997	432	5,406

Total liabilities	328,226	47,275	284,907
Equity			
Shareholders’ equity			
Registered capital(of US$0.519008 par value; 5,000,000 shares authorized; 3,265,837 issued and outstanding)	13,323	1,919	13,323
Additional paid-in capital	311,907	44,924	311,907
Statutory reserve	37,441	5,393	37,441
Retained earnings	(98,505)	(14,188)	(44,022)
Cumulative translation adjustment	1,045	150	1,049
Total shareholders’ equity	265,211	38,198	319,698
Non-controlling interest	-	-	(834)
Total equity	265,211	38,198	318,864
Total liabilities and equity	593,437	85,473	603,771

See accompanying notes to the consolidated financial statements.

FUWEI FILMS (HOLDINGS) CO., LTD and SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)

For the Years Ended December 31, 2016, 2015 and 2014

(amounts in thousands, except share and per share data)

	Notes	The Year Ended December 31, 2016 RMB	US$	2015 RMB	2014 RMB
Net sales	15	253,926	36,573	248,862	284,464
Cost of sales	16,17	236,190	34,018	248,866	301,617
Gross loss		17,736	2,555	(4)	(17,153)
Operating expenses:					
Selling expenses	16,17	13,764	1,982	14,404	15,202
Administrative expenses		46,211	6,656	39,559	28,337
Loss on impairment of assets		-	-	7,219	-
Total operating expenses		59,975	8,638	61,182	43,539
Operating loss		(42,239)	(6,083)	(61,186)	(60,692)
Other income (expense):					
- Interest income		735	106	1,236	1,297
- Interest expense	18	(7,865)	(1,133)	(8,333)	(12,486)
- Others income (expense), net		203	29	6,215	(203)
Total other income (expense)		(6,927)	(998)	(882)	(11,392)
Loss before provision for income taxes		(49,166)	(7,081)	(62,068)	(72,084)
Income tax (expense) benefit	19	(5,317)	(766)	(7,000)	740
Net loss		(54,483)	(7,847)	(69,068)	(71,344)
Net income (loss) attributable to noncontrolling interests		-	-	(3)	(17)
Net loss attributable to the Company		(54,483)	(7,847)	(69,065)	(71,327)
Other comprehensive income (loss):					
- Foreign currency translation adjustments attributable to noncontrolling interest		-	-	(37)	(18)
- Foreign currency translation adjustments attributable to the Company		(4)	(1)	(150)	(67)
Comprehensive income (loss) attributable to non-controlling interest		-	-	(40)	(35)

Comprehensive loss attribute to the Company		(54,487)	(7,848)	(69,215)	(71,394)
Net loss per share, Basic and diluted	25	(16.68)	(2.40)	(21.15)	(21.84)
Weighted average number ordinary shares, Basic and diluted		3,265,837	3,265,837	3,265,837	3,265,837

See accompanying notes to the consolidated financial statements

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FUWEI FILMS (HOLDINGS) CO., LTD and SUBSIDIARIES

CONSOLIDATED STATEMENTS OF EQUITY

For the Years Ended December 31, 2016, 2015 and 2014

(amounts in thousands, except share data)

	Ordinary Shares Number of shares	Amount	Additional paid-in capital	Statutory reserve	Retained earnings	Accumulated Other Comprehensive income	**Total** Shareholders equity	Non-controlling interest	Total equity
		RMB	RMB	RMB	RMB	RMB	RMB	RMB	RMB
Balance as of December 31, 2013	3,265,837	13,323	311,907	37,441	96,370	1,266	460,307	(759)	459,548
Net income (loss)	-	-	-	-	(71,327)	-	(71,327)	(17)	(71,344)
Transfer to statutory reserve	-	-	-	-	-	-	-	-	-
Foreign currency translation adjustment	-	-	-	-	-	(67)	(67)	(18)	(85)
Balance as of December 31, 2014	3,265,837	13,323	311,907	37,441	25,043	1,199	388,913	(794)	388,119
Net income (loss)	-	-	-	-	(69,065)	-	(69,065)	(3)	(69,068)
Transfer to statutory reserve	-	-	-	-	-	-	-	-	-
Foreign currency translation adjustment	-	-	-	-	-	(150)	(150)	(37)	(187)
Balance as of December 31, 2015	3,265,837	13,323	311,907	37,441	(44,022)	1,049	319,698	(834)	318,864

Net income (loss)	-	-	-	-	(54,483)	-	(54,483)	-	(54,483)
Transfer to statutory reserve	-	-	-	-	-	-	-	-	-
Effect of closure for Fuwei Films USA LLC								834	834
Foreign currency translation adjustment	-	-	-	-	-	(4)	(4)	-	(4)
Balance as of December 31, 2016	3,265,837	13,323	311,907	37,441	(98,505)	1,045	265,211	-	265,211
Balance as of December 31, 2016 US$	3,265,837	1,919	44,924	5,393	(14,188)	150	38,198	-	38,198

See accompanying notes to the consolidated financial statements.

FUWEI FILMS (HOLDINGS) CO., LTD and SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Years Ended December 31, 2016, 2015 and 2014

(Amounts in thousands)

	The Years Ended December 31,			
	2016		**2015**	**2014**
	RMB	US$	RMB	RMB
Cash flow from operating activities				
Net loss	(54,483)	(7,847)	(69,068)	(71,344)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities				
- Loss on disposal of property, plant and equipment	-	-	-	101
- Loss on Long-term assets impairment	-	-	7,219	-
- Depreciation of property, plant and equipment	43,193	6,221	44,515	47,701
- Amortization of intangible assets	524	75	524	524
- Deferred income taxes (benefit)	5,317	766	7,000	303
- Bad debt (recovery) expense	2,466	355	(4,484)	30
- Inventory provision	(226)	(33)	(1,106)	-
Changes in operating assets and liabilities				
- Investment income recorded on Fuwei Holdings' book	(1,722)	(248)	-	-
- Accounts and bills receivable	(21,873)	(3,150)	(103)	(1,524)
- Inventories	4,647	669	(4,434)	14,421
- Advance to suppliers	(403)	(58)	2,038	(535)
- Prepaid expenses and other current assets	18	3	1,347	1,417
- Accounts payable	(12,179)	(1,755)	(9,683)	(9,116))
- Accrued expenses and other payables	(3,597)	(518)	2,446	(744)
- Advance from customers	1,263	182	(1,145)	(11,273)
- Tax payable	13,827	1,992	(2,016)	6,732
Net cash provided by (used in) operating activities	(23,228)	(3,346)	(26,950)	(23,307)
Cash flow from investing activities				
Purchases of property, plant and equipment	(11,218)	(1,616)	(222)	(5,559)
Restricted cash related to trade finance	(30,198)	(4,349)	4,884	(6,656)
Advanced to suppliers - non current	(421)	(61)	(718)	1,412
Amount change in construction in progress	1,269	183	(1,334)	265
Interest capitalization related to CIP	-	-	-	-
Deposit for purchase	-	-	21,000	-
Net cash used in (provided by) investing activities	(40,568)	(5,843)	23,610	(10,538)
Cash flow from financing activities				
Principal payments of bank loans	(3,350)	(483)	(3,350)	(105,000)

Proceeds from short-term bank loans	60,000	8,642	-	-
Proceeds from related party	(11,333)	(1,632)	30,102	131,084
Payment of capital lease obligation	(302)	(43)	(8,260)	(8,315)
Change in notes payable	15,108	2,176	(9,759)	13,549
Proceeds from sale-leaseback equipment	-	-	-	-
Net cash provided by (used in) financing activities	60,123	8,660	8,733	31,318
Effect of foreign exchange rate changes	2,661	235	(58)	(31)
Net (decrease) increase in cash and cash equivalent	(1,012)	(294)	5,335	(2,558)
Cash and cash equivalent				
At beginning of period/year	14,355	2,216	9,020	11,578
At end of period/year	13,343	1,922	14,355	9,020
SUPPLEMENTARY DISCLOSURE:				
Interest paid	7,865	1,133	8,333	12,486
Income tax paid	-	-	-	-
SUPPLEMENTARY SCHEDULE OF NONCASH INVESTING AND FINANCIAL ACTIVITIES:				
Account payable for plant and equipment:	1,597	230	2,075	3,070
Obligations for acquired equipment under capital lease:	-	-	302	8,562

See accompanying notes to the consolidated financial statements

FUWEI FILMS (HOLDINGS) CO., LTD and SUBSIDIARIES

Notes to Consolidated Financial Statements

(amounts in thousands, except share and per share data)

(1) Principal Activities and Reorganization

Fuwei Films (Holdings) Co., Ltd and its subsidiaries (the “Company” or the “Group”) are principally engaged in the production and distribution of BOPET film, a high quality plastic film widely used in packaging, imaging, electronics, electrical and magnetic products in the People’s Republic of China (the “PRC”). The Company is a holding company incorporated in the Cayman Islands, established on August 9, 2004 under the Cayman Islands Companies Law as an exempted company with limited liability. The Company was established for the purpose of acquiring shares in Fuwei (BVI) Co., Ltd (“Fuwei (BVI)”), an intermediate holding company established for the purpose of acquiring all of the ownership interest in Fuwei Films (Shandong) Co., Ltd.

On April 23, 2009, Fuwei Films USA, LLC was set up and co-invested by Fuwei Films (Holdings) Co., Ltd. and Newell Finance Management Co., Ltd. Fuwei Films USA, LLC has a registered capital of US$10 and total investment amount of US$100. Fuwei Films (Holdings) Co., Ltd. and Newell Finance Management Co., Ltd. own 60% and 40% of the total shares of Fuwei Films USA, LLC, respectively. In December 2016, Fuwei Films USA, LLC was written off.

On August 14, 2013, the Company announced that it had received the first notice from the its controlling shareholder, the Weifang State-owned Assets Operation Administration Company, a wholly-owned subsidiary of Weifang State-owned Asset Management and Supervision Committee (collectively, the “Administration Company”) indicating that the Administration Company had determined to place control over 6,912,503 (or 52.9%) of its outstanding ordinary shares up for sale at a public auction to be held in China. Four public auctions were held in Jinan, Shandong Province, China. The Company learned that they failed due to a lack of bidders registered for the auction. On March 25, 2014, the fifth public auction was held in Jinan, Shandong Province, China. The beneficial ownership of 6,912,503 ordinary shares of the Company previously owned by the Administration Company through Apex Glory Holdings Limited, a British Virgin Islands corporation, was bid by Shandong SNTON Optical Materials Technology Co., Ltd (“Shandong SNTON”) through the public auction. Shandong SNTON got 6,912,503 (or 52.9%) of the Company’s outstanding ordinary shares at a price of RMB101,800 (approximately US$16,573) or approximately US$2.40 per ordinary share.

On May 12, 2014, the Company announced that it had learned that the successful bidder, Shandong SNTON in the fifth public auction of 6,912,503 (or 52.9%) of the Company’s outstanding ordinary shares (the “Shares”) held on March

25, 2014, was entrusted by Hongkong Ruishang International Trade Co., Ltd., a Hong Kong corporation, (“Hongkong Ruishang”) to handle all the formalities and procedure in connection with the public auction. As a result of the entrusted arrangement, the Company believes Hongkong Ruishang is the party controlling the Shares acquired in the fifth public auction. According to publicly available information in the People’s Republic of China, Shandong SNTON is a wholly owned subsidiary of Shandong SNTON Group Co., Ltd. (the “SNTON Group”). Mr. Xiusheng Wang, the chairman of the Board of Directors of Shandong SNTON Group Co., Ltd., is also Hongkong Ruishang’s chairman.

On May 14, 2014, the Company announced that it received a notification from Shandong Fuhua Investment Company Limited. (“Shandong Fuhua”) with respect to an entire ownership transfer of the Company’s 12.55% outstanding ordinary shares from the Administration Company to Shandong Fuhua. The Administration Company originally held these shares indirectly through an intermediate holding company, Easebright Investments Limited (“Easebright”). As a result of this transfer, Shandong Fuhua indirectly owns 12.55% of the outstanding ordinary shares of the Company through Easebright. Mr. Jingang Yang has been appointed as the director of Easebright.

(2) Basis of Presentation

The Group’s consolidated financial statements are presented in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”), as set forth in the Financial Accounting Standards Board’s (FASB) Accounting Standards Codification (ASC) and we consider the various staff accounting bulletins and other applicable guidance issued by the United States Securities and Exchange Commission (SEC).

This basis of accounting differs in certain material respects from that used in the preparation of the books of account of Shandong Fuwei, the Company’s principal subsidiary, which are prepared in accordance with the accounting principles and the relevant financial regulations applicable to enterprises limited by shares as established by the Ministry of Finance of the PRC (“PRC GAAP”), the accounting standards used in the country of its domicile. The accompanying consolidated financial statements reflect necessary adjustments not recorded in the books of account of the Company’s subsidiaries to present them in conformity with U.S. GAAP.

(3) Summary of Significant Accounting Policies and Practices

(a) Principles of Consolidation

The consolidated financial statements include the financial statements of the Company and its three subsidiaries, including, Fuwei Films (BVI) Co., Ltd., Fuwei Films (Shandong) Co., Ltd., and Fuwei Films USA, LLC. All significant intercompany balances and transactions have been eliminated in consolidation.

(b) Foreign Currency Transactions

The Group's reporting currency is the Chinese Yuan ("Renminbi" or "RMB").

The Company and Fuwei (BVI) operate in Hong Kong as investment holding companies and their financial records are maintained in Hong Kong dollars, being the functional currency of these two entities. Fuwei US company, a 60% owned subsidiary of the company, their financial records are maintained in US dollars. Assets and liabilities are translated into RMB at the exchange rates at the balance sheet date, equity accounts are translated at historical exchange rates and income, expenses, and cash flow items are translated using the average rate for the period. The translation adjustments are recorded in accumulated other comprehensive income in the statements of equity.

Transactions denominated in currencies other than RMB are translated into RMB at the exchange rates quoted by the People's Bank of China (the "PBOC") prevailing at the dates of transactions. Monetary assets and liabilities denominated in foreign currencies are translated into RMB using the applicable exchange rates quoted by the PBOC at the balance sheet dates. The resulting exchange differences are recorded in the statements of operations.

Commencing from July 21, 2005, the PRC government moved the RMB into a managed floating exchange rate regime based on market supply and demand with reference to a basket of currencies.

For the convenience of the readers, the RMB amounts for the year of 2016 included in the accompanying consolidated financial statements in our annual report has been translated into U.S. dollars at the rate of US$1.00 = RMB 6.9430, being the noon buy rate for U.S. dollars in effect on December 31, 2016 in the City of New York for cable transfer in RMB per U.S. dollar as certified for custom purposes by the Federal Reserve Bank. No representation is made that the RMB amounts could have been, or could be, converted into U.S. dollar at that rate or at any other certain rate on December 31, 2016, or at any other date.

RMB is not fully convertible into foreign currencies. All foreign exchange transactions involving RMB must take place either through the PBOC or other institutions authorized to buy and sell foreign currency. The exchange rate adopted for the foreign exchange transactions are the rates of exchange quoted by the PBOC which are determined largely by supply and demand.

(c) Cash and Cash Equivalents and Restricted Cash

For statements of cash flow purposes, the Company considers all cash on hand and in banks, including certificates of deposit and other highly-liquid investments with maturities of three months or less, when purchased, to be cash and cash equivalents.

As of December 31, 2016 and 2015, there were cash and cash equivalents of RMB13,343 (US$1,922) and RMB14,355, respectively.

As of December 31, 2016 and 2015, there were restricted cash of RMB73,421 (US$10,575) and RMB43,215, respectively, as deposit in bank for letters of credit and banker’s acceptance bill.

(d) Trade Accounts Receivable

Trade accounts receivable are recorded at the invoiced amount after deduction of trade discounts, value added taxes and allowances, if any, and do not bear interest. The allowance for doubtful accounts is the Group’s best estimate of the amount of probable credit losses in the Group’s existing accounts receivable. The Group determines the allowance based on historical write-off experience, customer specific facts and economic conditions.

The Group reviews its allowance for doubtful accounts monthly. Past due balances over 90 days and over a specified amount are reviewed individually for collectibility. All other balances are reviewed on a pooled basis by aging of such balances. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote. The allowance for doubtful accounts as of December 31, 2016 and 2015 was RMB3,213 (US463) and RMB747, respectively.

(e) Inventories

Inventories are stated at the lower of cost or market value as of balance sheet date. Inventory valuation and cost-flow is determined using Moving Weighted Average Method basis. The Group estimates excess and slow moving inventory based upon assumptions of future demands and market conditions. If actual market conditions are less favorable than projected by management, additional inventory write-downs may be required. Cost of work in progress and finished goods comprises direct material, direct production cost and an allocated portion of production overheads based on normal operating capacity.

(f) Property, Plant and Equipment

Property, plant and equipment are stated at cost less accumulated depreciation and allowance for fixed assets impairment.

Depreciation on property, plant and equipment is calculated on the straight-line method (after taking into account their respective estimated residual values) over the estimated useful lives of the assets as follows:

	Years
Buildings and improvements	25 – 30
Plant and equipment	10 – 15
Computer equipment	5
Furniture and fixtures	5
Motor vehicles	5

Depreciation related to abnormal amounts from idle capacity is charged to administrative expenses for the period incurred. Total depreciations for the years ended December 31, 2016, 2015 and 2014 were RMB43,193 (US$6,221), RMB44,515 and RMB47,701 respectively, of which 37.9%, 56.5% and 85.4% was recorded in cost of goods sold and 62.1%, 43.5% and 14.6% was recorded in administrative and selling expenses, respectively.

Construction in progress represented capital expenditure in respect of the BOPET productions line. No depreciation is provided in respect of construction in progress.

(g) Leased Assets

An arrangement, comprising a transaction or a series of transactions, is or contains a lease if the Group determines that the arrangement conveys a right to use a specific asset or assets for an agreed period of time in return for a payment or a series of payments. Such a determination is made based on an evaluation of the substance of the arrangement and is regardless of whether the arrangement takes the legal form of a lease.

Classification of assets leased to the Group. Assets that are held by the Group under leases which transfer to the Group substantially all the risks and rewards of ownership are classified as being held under capital leases. Leases which do not transfer substantially all the risks and rewards of ownership to the Group are classified as operating leases.

Assets acquired under capital leases. Where the Group acquires the use of assets under capital leases, the amounts representing the fair value of the leased asset, or, if lower, the present value of the minimum lease payments, of such assets are included in property, plant and equipment and the corresponding liabilities, net of finance charges, are recorded as obligations under capital leases. Depreciation is provided at rates which write off the cost or valuation of the assets over the term of the relevant lease or, where it is likely the Group will obtain ownership of the asset, the life of the asset. Finance charges implicit in the lease payments are charged to the consolidated income statement over the period of the leases so as to produce an approximately constant periodic rate of charge on the remaining balance of the obligations for each accounting period. Contingent rentals are charged to the consolidated income statement in the accounting period in which they are incurred.

Operating lease charges. Where the Group has the use of assets held under operating leases, payments made under the leases are charged to the consolidated income statement in equal installments over the accounting periods covered by the lease term, except where an alternative basis is more representative of the pattern of benefits to be derived from the leased asset. Lease incentives received are recognized in the consolidated income statement as an integral part of the aggregate net lease payments made. Contingent rentals are charged to the consolidated income statement in the accounting period in which they are incurred.

Sale and leaseback transactions. Gains or losses on equipment sale and leaseback transactions which result in capital leases are deferred and amortized over the terms of the related leases. Gains or losses on equipment sale and leaseback transactions which result in operating leases are recognized immediately if the transactions are established at fair value. Any loss on the sale perceived to be a real economic loss is recognized immediately. However, if a loss is compensated for by future rentals at a below-market price, then the artificial loss is deferred and amortized over the period that the equipment is expected to be used. If the sale price is above fair value, then any gain is deferred and amortized over the useful life of the assets.

(h) Lease Prepayments

Lease prepayments represent the costs of land use rights in the PRC. Land use rights are carried at cost and charged to expense on a straight-line basis over the respective periods of rights of 30 years. The current portion of lease prepayments has been included in prepayments and other receivables in the balance sheet.

(i) Goodwill

Goodwill represents the excess of purchase price and related costs over the value assigned to the net tangible and identifiable intangible assets of businesses acquired. Goodwill is not amortized but is tested for impairment annually, or when circumstances indicate a possible impairment may exist. Impairment testing is performed at a reporting unit level. An impairment loss generally would be recognized when the carrying amount of the reporting unit exceeds the fair value of the reporting unit, with the fair value of the reporting unit determined using a discounted cash flow (DCF) analysis. A number of significant assumptions and estimates are involved in the application of the DCF analysis to forecast operating cash flows, including the discount rate, the internal rate of return, and projections of realizations and costs to produce. Management considers historical experience and all available information at the time the fair values of its reporting units are estimated. Goodwill was determined to be fully impaired during the year ended December 31, 2012.

(j) Impairment of Long-lived Assets

The Company recognizes an impairment loss when circumstances indicate that the carrying value of long-lived assets with finite lives may not be recoverable. Management's policy in determining whether an impairment indicator exists, a triggering event, comprises measurable operating performance criteria at an asset group level as well as qualitative measures. If an analysis is necessitated by the occurrence of a triggering event, the Company uses assumptions, which are predominately identified from the Company's strategic long-range plans, in determining the impairment amount. In the calculation of the fair value of long-lived assets, the Company compares the carrying amount of the asset group with the estimated future cash flows expected to result from the use of the assets. If the carrying amount of the asset group exceeds the estimated expected undiscounted future cash flows, the Company measures the amount of the impairment by comparing the carrying amount of the asset group with their estimated fair value. We estimate the fair value of assets based on market prices (i.e., the amount for which the asset could be bought by or sold to a third party), when available. When market prices are not available, we estimate the fair value of the asset group using discounted expected future cash flows at the Company's weighted-average cost of capital. Management believes its policy is reasonable and is consistently applied. Future expected cash flows are based upon estimates that, if not achieved, may result in significantly different results. The accumulated loss on impairment of assets during 2016 and 2015 was zero and RMB7,219 (US$1,114), respectively..

(k) Revenue Recognition

Sales of plastic flexible packaging materials are reported, net of value added taxes (“VAT”), sales returns, trade discounts. The standard terms and conditions under which the Group generally delivers allow a customer the right to return product for refund only if the product does not conform to product specifications; the non-conforming product is initially identified by customer, and the customer notifies the Group about the situation. After receiving the Group’s permission, the non-conforming product may be returned for replacement or refund. The Group recognizes revenue when products are delivered and the customer takes ownership and assumes risk of loss, collection of the relevant receivable is probable, persuasive evidence of an arrangement exists and the sale price is fixed or determinable.

In the PRC, VAT of 17% on invoice amount is collected in respect of the sales of goods on behalf of tax authorities. The VAT collected is not revenue of the Group; instead, the amount is recorded as a liability on the consolidated balance sheet until such VAT is paid to the authorities.

(l) Research and Development Costs

Research and development expenditures are expensed as incurred. Research and development costs amounted to RMB3,577 (US$515), RMB3,619 and RMB8,005 for the year ended December 31, 2016, 2015 and 2014 and such costs were recorded in administrative expenses.

(m) Income Taxes

Income taxes are accounted for under the asset and liability method. Under guidance contained in FASB ASC 740-10, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. We follow the recognition and disclosure provisions under guidance contained in FASB ASC 740-10-25. Under this guidance, tax positions are evaluated for recognition using a more-likely-than-not threshold, and those tax positions requiring recognition are measured as the largest amount of tax benefit that is greater than fifty percent likely of being realized upon ultimate settlement with a taxing authority that has full knowledge of all relevant information. We only recognized deferred tax assets for the loss 2016 after considering the possibility of realizing the benefits under the conservatism principle.

(n) Loss per Share

Basic earnings (loss) per share is computed by dividing net earnings (loss) by the weighted average number of ordinary shares outstanding during the year. Diluted earnings (loss) per share is calculated by dividing net earnings (loss) by the weighted average number of ordinary and dilutive potential ordinary shares outstanding during the year. Diluted potential ordinary shares consist of shares issuable pursuant to stock option plan.

On December 5, 2016, we held an extraordinary general meeting of shareholders pursuant to which a 1-for-4 reverse stock split of our authorized ordinary shares, accompanied by a corresponding decrease in our issued and outstanding ordinary shares and an increase of the par value of each ordinary share from $0.129752 to US$0.519008 (the "Reverse Stock Split"), was approved by our shareholders of record. All references made to share or per share amounts in the accompanying consolidated financial statements and applicable disclosures have been retroactively adjusted to reflect the 1-for-4 reverse stock split.

(o) Use of Estimates

The preparation of the consolidated financial statements in accordance with U.S. GAAP requires management of the Group to make a number of estimates and assumptions relating to the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. On an ongoing basis, management reviews its estimates and assumptions including those related to the recoverability of the carrying amount and the estimated useful lives of long-lived assets, valuation allowances for accounts receivable and realizable values for inventories. Changes in facts and circumstances may result in revised estimates.

(p) Non-controlling interest

Non-controlling interest represents the portion of equity that is not attributable to the Company. The net income (loss) attributable to noncontrolling interests are separately presented in the accompanying statements of income and other comprehensive income. Losses attributable to noncontrolling interests in a subsidiary may exceed the interest in the subsidiary's equity. The related noncontrolling interest continues to be attributed its share of losses even if that attribution results in a deficit of the noncontrolling interest balance. In December 2016, Fuwei USA was written off. The non-controlling interest percent of entity Fuwei USA was 40%, with the deficit amount of zero and RMB(834) as of December 31, 2016 and 2015, respectively.

(q) Segment Reporting

The Group uses the “management approach” in determining reportable operating segments. The management approach considers the internal organization and reporting used by the Group’s chief operating decision maker for making operating decisions and assessing performance as the source for determining the Group’s reportable segments. Management, including the chief operating decision maker, reviews operating results solely by monthly revenue of BOPET film (but not by sub-product type or geographic area) and operating results of Shandong Fuwei, the operating subsidiary in the PRC. As such, the Group has determined that the Group has a single operating segment.

(r) Contingencies

In the normal course of business, the Group is subject to contingencies, including legal proceedings and claims arising out of the business that relate to a wide range of matters, including among others, product liability. The Group recognizes a liability for such contingency if it determines it is probable that a loss has occurred and a reasonable estimate of the loss can be made. The Group may consider many factors in making these assessments including past history and the specifics of each matter.

(s) Reclassification

Certain reclassifications have been made to the fiscal year 2016 and 2015 consolidated financial statements to conform to the fiscal 2016 consolidated financial statement presentation. These reclassifications had no effect on net loss or cash flows as previously reported.

(t) Going Concern Matters

The accompanying consolidated financial statements have been prepared in conformity with generally accepted accounting principles which contemplate continuation of the company as a going concern. However, as of December 31, 2016, the Company had a working capital deficiency of RMB170,128 (US$24,504) and accumulated deficit of RMB54,483 (US$7,847) from net losses incurred during the year of 2016. Confronted with the fierce competition in the BOPET industry in China, the Company may still witness losses over the next twelve months. The ability of the Company to operate as a going concern depends upon its ability to obtain outside sources of working capital and/or generate positive cash flow from operations. The Company may not have sufficient working capital to meet its planned operating activities over the next twelve months. These conditions raise substantial doubt about the Company’s ability to continue as a going concern. Management’s plans regarding these matters are described as per follows: The Company accordingly has developed an outside financing plan to meet the need of working capital for our operation or debts. At the same time, the Company will continue implementing cost reductions on both manufacturing costs and operating expenses to improve profit margins. The accompanying consolidated financial statements do not include any adjustments relating to the recoverability and classification of asset carrying amounts or the amount and classification of liabilities that might result should the Company be unable to continue as a going concern.

(u) Recently Issued Accounting Standards

Revenue Recognition: In May 2014, the FASB issued Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers (Topic 606) (ASU 2014-09), which amends the existing accounting standards for revenue recognition. In August 2015, the FASB issued ASU No. 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date, which delays the effective date of ASU 2014-09 by one year. The FASB also agreed to allow entities to choose to adopt the standard as of the original effective date. In March 2016, the FASB issued Accounting Standards Update No. 2016-08, Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net) (ASU 2016-08) which clarifies the implementation guidance on principal versus agent considerations. The guidance includes indicators to assist an entity in determining whether it controls a specified good or service before it is transferred to the customers. The new revenue recognition standard will be effective for us in the first quarter of 2018, with the option to adopt it in the first quarter of 2017. We currently anticipate adopting the new standard effective January 1, 2018. The new standard also permits two methods of adoption: retrospectively to each prior reporting period presented (full retrospective method), or retrospectively with the cumulative effect of initially applying the guidance recognized at the date of initial application (the modified retrospective method). We currently anticipate adopting the standard using the modified retrospective method. We are still in the process of completing our analysis on the impact this guidance will have on our consolidated financial statements and related disclosures. The adoption of this ASU is not expected to have a material impact on the Company's consolidated financial statements.

Financial Instrument

In January 2016, the FASB issued ASU No. 2016-01, “Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities” (“ASU 2016-01”). The standard addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. ASU 2016-01 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2017, and early adoption is not permitted. Accordingly, the standard is effective for us on September 1, 2018. The Company is currently evaluating the impact that the standard will have on the Company’s consolidated financial statements.

Leases

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842) (“ASU 2016-2”), which provides guidance on lease amendments to the FASB Accounting Standard Codification. This ASU will be effective for us beginning in May 1, 2019. The Company is currently in the process of evaluating the impact of the adoption of ASU 2016-2 on the Company’s consolidated financial statements.

Stock-based Compensation

In March 2016, the FASB issued ASU 2016-09, Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting (ASU 2016-09). ASU 2016-09 changes how companies account for certain aspects of stock-based awards to employees, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. ASU 2016-09 is effective for us in the first quarter of 2018, and earlier adoption is permitted. We are still evaluating the effect that this guidance will have on our consolidated financial statements and related disclosures.

Financial Instruments - Credit Losses

In June 2016, the FASB issued ASU 2016-13, Financial Instruments - Credit Losses (Topic 326): The amendments in this Update require a financial asset (or a group of financial assets) measured at amortized cost basis to be presented at the net amount expected to be collected. The amendments broaden the information that an entity must consider in developing its expected credit loss estimate for assets measured either collectively or individually. The use of forecasted information incorporates more timely information in the estimate of expected credit loss, which will be more decision useful to users of the financial statements. ASU 2016-13 is effective for the Company for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is allowed as of the fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company is still evaluating the effect that this guidance will have on the Company’s consolidated financial statements and related disclosures.

Other pronouncements issued by the FASB or other authoritative accounting standards group with future effective dates are either not applicable or not significant to the consolidated financial statements of the Company.

(4) Accounts and Bills Receivable, net

Accounts receivable consisted of the following:

	December 31, 2016		December 31, 2015
	RMB	US$	RMB
Accounts receivable	17,052	2,456	7,861
Less: Allowance for doubtful accounts	(3,213)	(463)	(747)
	13,839	1,993	7,114
Bills receivable	15,614	2,249	2,932
	29,453	4,242	10,046

An analysis of the allowance for doubtful accounts for 2016, 2015 and 2014 is as follows:

	December 31, 2016		December 31, 2015	December 31, 2014
	RMB	US$	RMB	RMB
Balance at beginning of year	747	108	825	795
Bad debt (recovery) expense	2,466	355	(78)	30
Write-offs	-	-	-	-
Balance at end of year	3,213	463	747	825

The Group has a credit policy in place and the exposure to credit risk is monitored on an ongoing basis. Credit evaluations are performed on all customers requiring credit over a certain amount. These receivables are due within 7 to 90 days from the date of billing. Normally, the Group does not obtain collateral from customers.

(5) Inventories

Inventories consisted of the following:

	December 31, 2016		December 31, 2015
	RMB	US$	RMB
Raw materials	21,463	3,091	16,819
Work-in-progress	1,072	154	1,667
Finished goods	6,796	979	15,483
Consumables and spare parts	602	87	611
Allowance for obsolescence	(4,780)	(688)	(5,006)
	25,153	3,623	29,574

(6) Prepayments and Other Receivables

Prepayments and other receivables consisted of the following:

	December 31, 2016		December 31, 2015
	RMB	US$	RMB
Lease prepayments, current portion	524	76	524
Other receivables	5,965	859	19,810
	6,489	935	20,334

(7) Property, Plant and Equipment

Property, plant and equipment consisted of the following:

	December 31, 2016		December 31, 2015
	RMB	US$	RMB
Buildings	68,319	9,840	68,261
Plant and equipment	799,067	115,088	774,546
Computer equipment	2,484	358	2,449
Furniture and fixtures	14,668	2,113	13,730
Motor vehicles	2,094	302	2,094
	886,632	127,701	861,080
Less: accumulated depreciation	(468,759)	(67,515)	(422,840)
Impairment of plant and equipment	(7,219)	(1,040)	(7,219)
	410,654	59,146	431,021

All of the Group's buildings are located in the PRC. As of December 31, 2016 and 2015, property, plant plus land use rights with carrying value totaling RMB57,144 (US$8,230) and RMB18,398 respectively were pledged to banks as collateral for credit limits and loans(see Note 12).

As of December 31, 2016, the mortgaged floor area of facilities and land use right to the bank is 46,196 square meters and 74,251 square meters, respectively.

(8) Lease Prepayments

The balance represents the lease prepayments of land use rights of the Group as follows:

	December 31, 2016		December 31, 2015
	RMB	US$	RMB
Non-current portion	17,358	2,500	17,882
Current portion - amount charged to expense next year	524	76	524
	17,882	2,576	18,406

As of December 31, 2016, part of prepaid land use rights were pledged to banks as collateral for credit limit in bank (see Note 12).

Land use rights amortization for the year ended December 31, 2016, 2015 and 2014 were RMB524 (US$75), RMB524 and RMB524, respectively.

As of December 31, 2016, prepaid land use rights of the Group included certain parcels of land located in Weifang City, Shandong Province, the PRC, with a net book value of RMB16,081 or US$2,316. The land use rights for land with area of approximately 43,878 square meters, 5,279 square meters and 25,094 square meters will expire in November 2050, May 2053 and February 2055, respectively.

(9) Advance to Suppliers

Historically, we have significant working capital commitments because suppliers of PET resin and additives -based raw materials require us to make prepayments in advance of shipment. Besides, we may make prepayments related to some equipment purchases based on arrangement of contract. Our prepayments to suppliers were recorded either as advances to suppliers, if they are expected to be utilized within 12 months as of balance sheet date, or as long-term prepayments, which was included in the line item “advance to suppliers –long term” in our consolidated balance sheet, if they represented the portion expected to be utilized after 12 months. As of December 31, 2016 and 2015, the current portion of advance to suppliers was RMB6,043 (US$870) and RMB5,640, respectively. The noncurrent portion of advance to suppliers was RMB1,861 (US$268) and RMB1,440, respectively.

(10) Other assets

Other assets represent loss on sale-leaseback arrangement with International Far Eastern Leasing Co., Ltd. The loss is treated as compensation for the future rentals paid by Shandong Fuwei at a below-market price. The artificial loss should be deferred and amortized in proportion to the amortization of the related leased assets. As of February 2016, the Company has fulfilled all the obligations under the sale-leaseback arrangement and related additional supplemental agreements between the Company and International Far Eastern Leasing Co., Ltd. As a result, International Far Eastern Leasing Co., Ltd. has transferred the ownership of objects under the sale-leaseback arrangement to the Company. The balance of deferred loss should be reversed based on the facts. As of December 31, 2016 and 2015, the total amount of the other assets was zero and RMB11,607, respectively.

(11) Short-Term Borrowings and Long-Term Loan

Short-term borrowings and long-term loan consisted of the following:

Lender	Interest rate per annum	December 31, 2016		December 31, 2015
		RMB	US$	RMB
BANK LOANS				
Bank of SPD.				
- November 16, 2016 to November16, 2017	5.22 %	15000	2,160	-
Bank of Weifang.				
- July 15, 2016 to July 15, 2017	7.5 %	19,500	2,809	-
- July 15, 2016 to July 15, 2017	7.5 %	15,000	2,160	-
- July 20, 2016 to July 20, 2017	7.5 %	6,400	922	-
- July 20, 2016 to July 20, 2017	7.5 %	1,800	259	-
- July 20, 2016 to July 20, 2017	7.5 %	2,300	331	-
Weifang Dongfang State-owned Assets Management Co., Ltd.				
- October 19, 2009 to October 18, 2017	4.41 %	3,300	475	6,650
		63,300	9,117	6,650
Less: amounts classified as short-term loan		(60,000)	(8,642)	-
Less: long-term loan, current portion;		(3,300)	(475)	(3,350)
Long-term Loan		-	-	3,300

Notes:

The principal amounts of the above loans are repayable at the end of the loan period.

On November 20, 2009, we signed a long-term loan agreement of RMB10,000 (US$1,612) with Weifang Dongfang State-owned Assets Management Co., Ltd., with an eight-year loan term, which became effective on October 19, 2009 and will expire on October 18, 2017. From 2015 to 2016, the Company will make principal installment payments of RMB3,350 (US$540) per year with the remaining principal balance of RMB3,300 (US$532) due in 2017. The annual interest rate for the loan is the benchmark interest rate for over five-year loans announced by the People's Bank of China reduced by 10% and the applicable annual interest rate for the period ended December 31, 2016 is 4.41%. The loan is guaranteed by Shandong Deqin Investment& Guarantee Co., Ltd. and is used for our projects.

In April 2014, the Company obtained a loan for a total amount of RMB105,000 from Shandong SNTON Optical Materials Technology Co., Ltd ("Shandong SNTON") to pay off five short-term loans to Bank of Communications Co., Ltd. In May, 2014 and 2015, we obtained loans for the amount of RMB15,000 and RMB10,000 from SNTON Group solely for the purpose of purchasing raw materials. The interest rate of both loans shall be calculated at the benchmark rate, plus an additional 20% of the said benchmark rate, for the loan of the same term announced by the People's Bank of China which was exactly the same interest rate calculation method when we paid off the loans to Bank of Communications. In August 2016, the Company returned the principle of RMB25,000 together with the interest of RMB1,970 to SNTON Group.

Bank loans outstanding, which are all denominated in Renminbi, are secured and guaranteed as follows:

	December 31, 2016		December 31, 2015	December 31, 2014
Secured by:	RMB	US$	RMB	RMB
Property plant and equipment, Land use right	60,000	8,642		
Bills receivable	-	-	-	-
Guarantee company	3,300	475	6,650	10,000
Restricted cash		-		
	63,330	9,117	6,650	10,000

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Long-term bank loans maturity for the next five years after December 31, 2016 are as follows:

	RMB	US$
Fiscal 2017	3,300	475

(12) Notes Payable

The credit lines amounting to RMB45,000 (US$6,950) and RMB45,000, respectively granted by SPD bank and Bank of Weifang were secured by a pledge of plant and land use right. The credit lines were used to purchase raw materials. The term of the credit line granted by SPD bank is from December 19, 2014 to December 19, 2017. And the term of the credit line granted by Bank of Weifang is from July 2016 to July 2017. As of December 31, 2016, the amount of credit line granted by SPD bank used was RMB42,710 and the remaining balance was RMB2,290. The amount of credit line granted by Bank of Weifang was all used.

As of December 31, 2016, Shandong Fuwei had banker's acceptances opened with a maturity from three to six months totaling RMB100,888 (US$14,531) for payment in connection with raw materials on a total deposits of RMB43,453 (US$6,259) and RMB29,968 (US$4,316) at SPD Bank and Bank of Weifang, respectively.

Notes payable consisted of the following:

Issuing bank	December 31, 2016		December 31, 2015
	RMB	US$	RMB
SPD Bank	70,920	10,215	85,780
Bank of Weifang	29,968	4,316	0
	100,888	14,531	85,780

(13) Accrued Expenses and Other Payables

Accrued expenses and other payables consisted of the following:

	December 31,2016		December 31,2015
	RMB	US$	RMB
Other payables	5,204	750	8,682

Predicted liability	-	-	-
	5,204	750	8,682

(14) Obligations Under Capital Leases

	31-Dec-16						31-Dec-15		
	RMB	US$	RMB	US$	RMB	US$	RMB	RMB	RMB
	Present value of the minimum lease payments		Total minimum lease payments		Interest		Present value of the minimum lease payment	Total minimum lease payments	Interest
Within 1 year	-	-	-	-	-	-	302	304	2
After 1 year but within 2 years -	-	-	-	-	-	-	-	-	
After 2 years but within 3 years -	-	-	-	-	-	-	-	-	
After 3 years	-	-	-	-	-	-	-	-	-
	-	-	-	-	-	-	302	304	2
Less: balance due within one year classified as current liabilities -	-								

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Details of obligations under capital leases are as follows:

	December 31,2016 RMB	December 31,2015 RMB
RMB denominated obligations		
Fixed interest rate of 6.49% per annum	-	302
	-	302

Guarantee deposit of RMB800 (US$129) over the capital leased assets concerned and relevant insurance policies were provided to the lessor as collateral and security. In addition, as is customary in the case of capital leases, the Group's obligations are guaranteed by Weifang State-Owned Assets Operation Administration Company, Beijing Shiweitong Technology Development Co., Ltd., Fuwei Films (Holdings) Co., Ltd., and Fuwei Films (BVI) Co., Ltd. In August 2014, Shandong SNTON Group Co., Ltd. accepted the responsibility of guarantee for the Group's obligation from Beijing Shiweitong Technology Development Co., Ltd.

(15) Revenues

The Company's revenue is primarily derived from the manufacture and sale of plastic flexible packaging materials.

During the fiscal year ended December 31, 2016, net revenues were RMB253,926 (US$36,573), compared to RMB248,862 during the same period in 2015, representing a decrease of RMB5,064 or 2.0%, mainly due to the reduction of average sales price by 2.6% caused by the decrease in the price of main raw materials. For further analysis of the factors causing revenue decrease, the reduction of average sales price caused a decrease of RMB6,840 and sales volume factor made an increase of RMB11,904.

The following table shows the distribution of the Company's revenue by the geographical location of customers, whereas all the Company's assets are located in the PRC:

	December 31, 2016		December 31, 2015	December 31, 2014
	RMB	US$	RMB	RMB
Sales in China	212,129	30,553	194,226	241,446
Sales in other countries (principally Europe, Asia and North America)	41,797	6,020	54,636	43,018

253,926	36,573	248,862	284,464

Overseas sales were RMB41,797 (US$6,020,) or 16.5% of total revenues, compared with RMB54,636 or 22.0% of total revenues in 2015. For further analysis of the factors causing revenue decrease, the reduction of average sales price caused a decrease of RMB4,080 and sales volume factor made a decrease of RMB8,759.

The Company’s revenue by significant types of films for 2016, 2015 and 2014 was as follows:

	December 31, 2016				December 31, 2015			December 31, 2014		
	RMB	US$	% of Total		RMB	% of Total		RMB	% of Total	
Stamping and transfer film	95,705	13,785	37.8	%	103,520	41.6	%	118,560	41.7	%
Printing film	20,366	2,933	8.0	%	29,605	11.9	%	32,987	11.6	%
Metallized film	7,391	1,065	2.9	%	9,010	3.6	%	6,397	2.2	%
Specialty film	96,091	13,840	37.8	%	73,851	29.7	%	79,609	28.0	%
Base film for other applications	34,373	4,950	13.5	%	32,876	13.2	%	46,911	16.5	%
	253,926	36,573	100.0	%	248,862	100.0	%	284,464	100.0	%

In 2016, sales of specialty films were RMB96,091 (US$13,840) and 37.8% of our total revenues as compared to RMB73,851 and 29.7% in 2015, which was an increase of RMB2,224, or 30.1%, as compared to the same period in 2015. The increase was largely attributable to the increase in sales volumes for dry films and coated films.

(16) Depreciation and Amortization

Depreciation of property, plant and equipment and amortization of intangible asset is included in the following captions:

	December 31, 2016		December 31, 2015	December 31, 2014
	RMB	US$	RMB	RMB
Cost of goods sold	16,354	2,355	25,139	40,728
Selling expenses	20	3	22	28
Administrative expenses	26,819	3,863	19,354	6,945
	43,193	6,221	44,515	47,701

(17) Freight Costs

The Group records freight costs related to the transporting of the raw materials to the Group's warehouse in cost of raw materials and all other outbound freight costs in selling expenses. For the year ended December 31, 2016, 2015 and 2014, freight costs included in cost of goods sold were RMB3,406 (US$491), RMB2,938 and RMB3,603, respectively, and RMB8,177 (US$1,178), RMB7,713, and RMB10,196, respectively, were included in selling expenses.

(18) Interest Expense

The Group capitalizes interest expense as a component of the cost of construction in progress. The following is a summary of interest cost incurred during the year ended December 31, 2016, 2015 and 2014:

	December 31, 2016		December 31, 2015	December 31, 2014
	RMB	US$	RMB	RMB
Interest cost capitalized	-	-	-	-
Interest cost charged to expense	7,865	1,133	8,333	12,486

7,865	1,133	8,333	12,486

Interest expense in 2016 was lower than that in 2015, which was mainly due to lower expense on discount for cash.

(19) Income Taxes

Cayman Islands Tax

Under the current Cayman Island laws, the Company is not subject to tax on income or capital gain. In addition, upon payments of dividends by the Company to its shareholders, no Cayman Islands withholding tax is imposed.

PRC Tax

Shandong Fuwei, being a Hi-Tech Enterprise in the Weifang Hi-Tech Industrial Zone in Shandong, the PRC, has been granted preferential tax treatments by the Tax Bureau of the PRC. According to the PRC Income Tax Law and various approval documents issued by the Tax Bureau, Shandong Fuwei's profit was taxed at a rate of 15%. In 2014, Fuwei Films failed to be designated as a Hi-Tech Enterprise and it became subject to a standard enterprise income tax at a rate of 25% in 2014 and 2015. In 2016, Shandong Fuwei was designated as a High-and-New Tech Enterprise and as a result, it is entitled to preferential tax treatment at an EIT rate of 15% for the years ended December 31, 2016, 2017 and 2018.

If our subsidiary Shandong Fuwei was not entitled to a reduced enterprise income tax, or EIT, rate of 15% for the year ended December 31, 2013, 2012 and 2011, it would have had an EIT rate of 25%, net income and basic and diluted earnings per share would be reduced by the following amounts:

	2013		2012	2011
	RMB	US$	RMB	RMB
Net income	-	-	-	(2,499)
Earnings per share				
- Basic	-	-	-	(0.19)
- Diluted	-	-	-	(0.19)

The Group had minimal operations in jurisdictions other than the PRC. Net (loss) income before income taxes consists of:

	2016		2015	2014
	RMB	US$	RMB	RMB
Cayman Islands	(1,352)	(195)	(2,379)	(2,267)
British Virgin Islands	(5)	(1)	(3)	(3)
PRC	(47,796)	(6,883)	(59,677)	(69,772)
U.S.A	(13)	(2)	(9)	(42)
	(49,166)	(7,081)	(62,068)	(72,084)

The Company has no material unrecognized tax benefit which would favorably affect the income taxes in future periods and does not believe there will be any significant increases or decreases within the next twelve months. No interest or penalties have been accrued at the date of adoption. As of December 31, 2016, we do not have any accrued liability for uncertain tax positions.

Shandong Fuwei was designated as a High-and-New Tech Enterprise in December 2008 and retained its status as a high-tech enterprise for three years commencing from 2011 enjoying a favorable corporate tax rate during the term from January 1, 2011 to December 31, 2013 pursuant to the Enterprise Income Tax Law. In 2014, Fuwei Films failed to be designated as High-and-New Tech Enterprise. In 2016, Shandong Fuwei was designated as High-and-new Tech Enterprise. Accordingly, the deferred taxes as of December 31, 2016 have been calculated employing the statutory rate of Shandong Fuwei of 15%.

Income tax benefit (expense) consists of:

	Current	Deferred	Total
PRC Income tax	RMB	RMB	RMB
Year ended December 31, 2014	1,043	(303)	740
Year ended December 31, 2015	-	(7,000)	(7,000)
Year ended December 31, 2016	-	(5,317)	(5,317)

Year ended December 31, 2016 (US$)	-	(766)	(766)

Income tax expenses reported in the consolidated statements of income differs from the income tax expense amount computed by applying the PRC income tax rate of 25%, 15%, 15% (the statutory tax rate of the Company's principal subsidiary) for the year ended December 31, 2016, 2015 and 2014 for the following reasons:

	2016 RMB	US$	2015 RMB	2014 RMB
Income (loss) before income taxes	(49,166)	(7,081)	(62,068)	(72,084)
Computed "expected" tax expense	(218)	(31)	(218)	(218)
Non-deductible expenses	-	-	-	-
Non-taxable income	131	19	218	218
Tax holiday	87	12	-	-
Tax effect of deferred tax and tax rates differential	(5,317)	(766)	(7,000)	740
Actual income tax benefit (expense)	(5,317)	(766)	(7,000)	740

Tax effects of temporary differences that give rise to significant portions of the deferred tax assets (liabilities) as of December 31, 2016 and 2015 are presented below.

	December 31, 2016		December 31, 2015
	RMB	US$	RMB
Current			
Accounts receivable	482	69	187
Other receivables	-	-	-
Inventory impairment	717	104	1,251
Estimated Loss due to Product Warranty	-	-	-
	1,199	173	1,438
Non-current			
Property, plant and equipment, principally due to differences in depreciation	917	132	1,763
Construction in progress, principally due to capitalized interest	(2,656)	(382)	(4,819)
Lease prepayments, principally due to differences in charges	(341)	(49)	(587)
Allowance for advanced to supplier-long term	16	2	27
Net loss carryforward	7,099	1,022	13,729
	5,035	725	10,113
Net deferred income tax assets	6,234	898	11,551

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. Considering the level of historical performance of Shandong Fuwei, we only recognized deferred tax assets for the loss of 2016 after considering the possibility of realizing the benefits under the conservatism principle.

(20) Related Party Transactions

Name of party	Relationship
Hongkong Ruishang International Trade Co., Ltd. (the "Hongkong Ruishang")	Shareholder of the Company(52.9%)
Shandong Fuhua Investment Company Limited. ("Shandong Fuhua")	Shareholder of the Company(12.54%)
Hongkong Ruishang International Trade Co., Ltd. (the "Hongkong Ruishang")	Subsidiary of Shandong SNTON Group Co., Ltd.("SNTON Group")
Shandong SNTON Optical Materials Technology Co., Ltd. ("Shandong SNTON")	Subsidiary of Shandong SNTON Group Co., Ltd.("SNTON Group")

Due to related parties

In April 2014, we obtained a loan for a total amount of RMB105,000 from Shandong SNTON Optical Materials Technology Co., Ltd. (the “Shandong SNTON”) to pay off certain short-term loans due to Bank of Communications Co., Ltd. The interest shall be calculated at the benchmark rate, plus an additional 20% of the said benchmark rate, for the loan of the same term announced by the People’s Bank of China. The interest must be paid quarterly and settled in full at the end of the year. As of December 31, 2014, the principal of this loan and the interest have not been paid. In March 2015, the Company entered into a supplemental agreement with Shandong SNTON pursuant to which the parties agreed that the Company will pay off the principal of this loan plus interest upon availability of new loans from banks or other financial institutions.

As of December 31, 2016, the principal of this loan from Shandong SNTON was RMB104,708 and the interest was RMB17,373. The interest expense of the loans from Shandong SNTON for the year ended 2016, 2015 and 2014 are RMB5,477, RMB11,800 and RMB17,373, respectively.

In May 2014, the Company borrowed RMB15,000 from Shandong SNTON Group Co., Ltd. (the “SNTON Group”) solely to purchase raw materials. The interest shall be calculated at the benchmark rate, plus an additional 20% of the said benchmark rate, for the loan of the same term announced by the People’s Bank of China. The interest shall be paid quarterly and settled in full at the end of the year. The Company has agreed to repay this loan prior to December 31, 2014. As of December 31, 2014, the principal of this loan and the interest have not been paid. In March 2015, the Company entered into a supplemental agreement with SNTON Group pursuant to which that the Company agreed to pay off the principal of this loan plus interest upon availability of new loans from banks or other financial institutions.

In May 2015, SNTON Group provided the Company with a loan for the amount of RMB10,000.

In August 2016, the Company returned the principal of RMB25,000 together with the interest of RMB1,970 to SNTON Group.

As of December 31, 2016, the total principal of loans from SNTON Group was zero and the interest payable was zero.

The interest expense of the loans from SNTON Group for the year ended 2016, 2015 and 2014 are RMB669, RMB1,572 and zero, respectively.

As of December 31, 2016, the total balance of principal of loans from related party was RMB104,708 and the interest payable was RMB17,373.

In 2016, we did not purchase any raw materials or final products from SNTON Group.

In 2015, we purchased 76 Metric Tons of raw materials from SNTON Group for a total amount of RMB414.

In 2014, we purchased 760 Metric Tons of raw materials from SNTON Group for a total amount of RMB4,657 and 58 Metric Tons of final products of BOPET for a total amount of RMB489.

In 2016, we purchased 566 Metric Tons of final products of BOPET from Shandong SNTON for a total amount of RMB4,870 and 1.1 Metric Ton of raw materials for a total amount of RMB 5.

In 2015, we purchased 1,740 Metric Tons of raw materials from Shandong SNTON for a total amount of RMB9,116 and 780 Metric Tons of final products of BOPET for a total amount of RMB7,041.

In 2014, we did not purchase any raw materials or final products from Shandong SNTON.

The related accounts payable as of December 31, 2016 and 2015 was RMB132 and RMB156, respectively.

During the years ended 2016, 2015 and 2014, we paid approximately RMB68 (USD$10), RMB112 and RMB144, respectively, to Fuhua Industrial Material Management Co., Ltd. as rental payments in connection with living quarters for our staff.

(21) Pension Plan

Pursuant to the relevant PRC regulations, the Group is required to make contributions at a rate of 20% of employees' salaries and wages to a defined contribution retirement scheme organized by the local Social Bureau in respect of the retirement benefits for the Group's employees in the PRC. The total amount of contributions of RMB1,384 (US$199), RMB1,238 and RMB1,097 for the year ended December 31, 2016, 2015 and 2014 respectively, was charged to administrative expenses in the accompanying consolidated statements of income. The Group has no other obligation to make payments in respect of retirement benefits of the employees.

(22) Fair Value of Financial Instruments

Our accounting for Fair Value Measurement and Disclosures, defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. This topic also establishes a fair value hierarchy which requires classification based on observable and unobservable inputs when measuring fair value. The fair value hierarchy distinguishes between assumptions based on market data (observable inputs) and an entity's own assumptions (unobservable inputs). The hierarchy consists of three levels:

Level one — Quoted market prices in active markets for identical assets or liabilities;

Level two — Inputs other than level one inputs that are either directly or indirectly observable; and

Level three — Unobservable inputs developed using estimates and assumptions, which are developed by the reporting entity and reflect those assumptions that a market participant would use.

Determining which category an asset or liability falls within the hierarchy requires significant judgment. The Company evaluates its hierarchy disclosures each quarter. The measurement basis used in the preparation of the consolidated financial statements is the historical cost basis except that the following assets and liabilities are stated at their fair value, such as derivative financial instruments and available-for-sale equity securities. The Company had no assets and liabilities measured at fair value on December 31, 2016.

The carrying amount of cash and cash equivalents, trade accounts receivable, prepayments and other receivables, amounts due from related parties, amounts due to related parties, and accrued liabilities and other payables, approximate their fair values because of the short maturity of these instruments.

The carrying amount of bank loans approximate the fair value based on the borrowing rates currently available for bank loans with similar terms and maturity.

(23) Business and Credit Concentrations

(a) Almost all of the Group's customers are located in the PRC. There is no individual customer with gross revenue more than 10% of total gross revenue during the year ended December 31, 2016, 2015 and 2014.

Each amount due from the following customers represented more than 10% of the outstanding accounts receivable on December 31, 2016 and 2015.

	Percentage of accounts receivable outstanding (%)	
	December 31, 2016	
Zhuhai City Nengdong Technology Optical Materials Co., Ltd.	24.2	%

	Percentage of accounts receivable outstanding (%)	
	December 31, 2015	
Zhuhai City Nengdong Technology Optical Materials Co., Ltd.	19.3	%
Yunnan Dexin Zhiye Co., Ltd.	18.3	%
Celplast Metallized Products Limited	13.9	%
Eternal Electronic Material (Guangzhou) Co., Ltd.	11.9	%

(b) The Group purchased a significant portion of PET resin required for the production of BOPET film from Sinopec Yizheng Chemical Fibre Company Limited ("Sinopec Yizheng") during the year ended December 31, 2016, 2015 and 2014. The Group believes that there are a limited number of suppliers in the PRC with the ability to consistently supply PET resin that meets the Group's quality standards and requirements. Currently, the Group has an annual supply agreement with Sinopec Yizheng pursuant to which Sinopec Yizheng has agreed to supply fixed quantities of PET resin to the Group on a monthly basis at the prevailing market prices. The terms of such supply agreement are reviewed annually. Although the Group believes that it maintains a good relationship with its major suppliers, there can be no assurance that Sinopec Yizheng will continue to sell to the Group under normal commercial terms as and when needed.

The following are the vendors that supplied 10% or more of our raw materials for each of the year ended December 31, 2016, 2015 and 2014:

Supplier	Item	Percentage of total purchases (%)					
		2016		2015		2014	
Sinopec Yizheng Chemical Fibre Company Limited	PET resin and Additives	60.3	%	52.0	%	60.0	%
Weifang Power Supply Company.	Electric power	12.3	%	12.8	%	11.4	%

The balance of advance to supplier to Sinopec Yizheng and Weifang Power Supply Company was RMB2,692 (US$388) and zero as of December 31, 2016, respectively.

The balance of advance to supplier to Sinopec Yizheng and Weifang Power Supply Company was RMB3,301 (US$787) and RMB0 as of December 31, 2015, respectively.

The balance of advance to supplier to Sinopec Yizheng and Weifang Power Supply Company was RMB3,468 and RMB0 as of December 31, 2014, respectively.

(c) Financial instruments that potentially subject the Company to concentrations of credit risk are cash and cash equivalents, accounts receivable and other receivables arising from its normal business activities. The Company places its cash and cash equivalents in what it believes to be credit-worthy financial institutions. The Company maintains large sums of cash in two major banks in China. The aggregate balance in such accounts as of December 31, 2016 was RMB10,460 (US $1,507). There is no insurance securing these deposits in China. The Company has a diversified customer base, most of which are in China.

(24) Commitments and Contingencies

(a) Operating lease commitments

Future minimum lease payments under non-cancelable operating leases as of December 31, 2016 are as follows:

	December 31, 2016	
	RMB	US$
Operating lease commitments	143	21

The Company leases warehouses, staff quarters and offices under operating leases. The leases duration is typically for one to three years, with an option to renew. None of the leases includes contingent rentals.

For the year ended December 31, 2016, 2015 and 2014, total rental expenses for non-cancelable operating leases were RMB291 (US$42), RMB206 and RMB436, respectively.

(b) Capital commitments

Capital commitments for purchase of property, plant and equipment as of December 31, 2016 were RMB541 (US$78).

(c) Outstanding bills receivable discounted

As of December 31, 2016, the Company had not retained any recourse obligation in respect of bills receivable discounted with and sold to banks.

(d) Legal Proceedings

From time to time, we may be subject to legal actions and other claims arising in the ordinary course of business. Shandong Fuwei is currently a party to two legal proceedings in China.

On July 9, 2012, a client filed a lawsuit in Beijing Daxing District People’s Court against Shandong Fuwei claiming RMB953 plus interest over disputes arising from a Procurement Contract between the parties. Shandong Fuwei raised a jurisdictional objection upon filing its plea, and Beijing Daxing District People’s Court overruled the objection. Shandong Fuwei filed an appeal against the judgment in the First Intermediate People’s Court of Beijing. The appeal was dismissed on January 23, 2013. On May 15, 2013, Beijing Daxing District People’s Court heard the case and adjourned the hearing due to the fact that plaintiff failed to provide sufficient evidence. On June 25, 2013, the case was heard in Beijing Daxing District People’s Court again and it was further adjourned due to plaintiff’s failure to provide sufficient evidence. The case was then scheduled to be heard on August 7, 2013. However, on the day prior to re-scheduled hearing, Shandong Fuwei was informed by Beijing Daxing District People’s Court that the hearing was adjourned further for the same reason that plaintiff failed to provide sufficient evidence. On April 21, 2014, the case was heard, and the plaintiff failed to provide sufficient evidence and the hearing was further adjourned. On May 28, 2014, the case was heard and the plaintiff provided some evidence. On August 25, 2014, the case was heard again. On November 5, 2014, the court accepted the withdrawal application from the plaintiff. On November 26, 2014, the plaintiff filed a second lawsuit in Beijing Daxing District People’s Court against Shandong Fuwei over disputes arising from the Procurement Contract between the parties claiming RMB618 plus interest as a result of non- payment. The case was heard on January 26, 2015, where the two parties testified over the relevant evidence. The case was heard on March 3, 2015, October 26, 2015 and May 11, 2016. To date, the case has not been decided. We are unable to predict the outcome of this lawsuit and therefore cannot determine the likelihood of loss nor estimate a range of possible loss.

On January 21, 2014, Shandong Fuwei received a complaint from Zeng Wenhong, a Hong Kong citizen, against Shandong Fuwei with a claim for a refund of US$500 (approximately RMB4,138) and related interest of RMB2,332. The plaintiff alleged that Shandong Fuwei has agreed to sell to the plaintiff ordinary shares of the Company pursuant to an oral agreement between the plaintiff and Shandong Fuwei in June 2005, and as a result the plaintiff transferred US$500 to Wellplus Investments (Hong Kong) Limited to be used for acquiring the ordinary shares of the Company. However, the plaintiff never received such shares. The case was heard by the Intermediate People's Court of Weifang on April 3, 2014 and October 28, 2014. On September 25, 2015, Shandong Fuwei received a written judgment issued by the Intermediate People’s Court of Weifang ordering Shandong Fuwei to refund US$500 together with its interest to the plaintiff. Shandong Fuwei filed for an appeal to the High People’s Court’s of Shandong Province within the appeal period. On April 29, 2016 and June 7, 2016, the case was heard by the High People’s Court’s of Shandong Province for the first time. On June 20, 2016, the High People's Court's of Shandong Province reversed the judgment issued by the Intermediate People's Court of Weifang and dismissed the lawsuit filed by Zeng Wenhong. The plaintiff, Zeng Wenhong, became responsible for the court acceptance fees for first and second hearings. This was a final decision of High People's Court of Shandong Province. On March 6, 2017, Shandong Fuwei received a notice of application for retrial from The Supreme People's Court of The People's Republic of China stating that Zeng Wenhong has filed for an appeal to The Supreme People's Court of The People's Republic of China regarding the decision issued by the High People's Court's of Shandong Province on June 20, 2016 requesting a retrial by The Supreme People's Court of The People's Republic of China. Shandong Fuwei has submitted its written response to The Supreme People's Court of The People's Republic of China and the case is currently under review.

(25) Earnings (Loss) Per Share

Basic and diluted earnings per share for the period/year ended December 31, 2016, 2015 and 2014 have been calculated as follows:

	2016 RMB	US$	2015 RMB	2014 RMB
Net (loss) income available to ordinary shareholders	(54,483)	(7,847)	(69,065)	(71,327)
Weighted average number of ordinary shares outstanding	3,265,837	3,265,837	13,062,500	13,062,500
Dilutive effect of share options	-	-	-	-
Diluted weighted average number of ordinary shares outstanding	3,265,837	3,265,837	13,062,500	13,062,500
Basic and diluted earnings (loss) per share	(16.68)	(2.40)	(5.29)	(5.46)

(26) Fuwei Films (Holdings) Co., Ltd (Parent Company)

Under PRC regulations, the Company's operating subsidiary, Shandong Fuwei may pay dividends only out of its accumulated profits, if any, determined in accordance with the accounting standards and regulations prevailing in the PRC ("PRC GAAP"). In addition, Shandong Fuwei is required to set aside at least 10% of its accumulated profits each year, if any, to fund the statutory general reserve until the balance of the reserve reaches 50% of its registered capital. The statutory general reserve is not distributable in the form of cash dividends to the Company and can be used to make up cumulative prior year losses, if any, and may be converted into share capital by the issue of new shares to shareholders in proportion to their existing shareholdings, or by increasing the par value of the shares currently held by them, provided that the reserve balance after such issue is not less than 25% of the registered capital. Further, Shandong Fuwei is also required to allocate 5% of the profit after tax, determined in accordance with PRC GAAP, to the statutory public welfare fund which is restricted to be used for capital expenditures for staff welfare facilities owned by the Company. The statutory public welfare fund is not available for distribution to equity owners (except in liquidation) and may not be transferred in the form of loans, advances, or cash dividends. As of December 31, 2016, an aggregate amount of RMB37,441 (US$5,393) has been appropriated from retained earnings and set aside for statutory general reserve and public welfare fund, by Shandong Fuwei.

As of December 31, 2016, the amount of restricted assets of Shandong Fuwei, which may not be transferred to the Company in the form of loans, advances or cash dividends by the subsidiaries without the consent of a third party, was approximately 58.9% of the Company's consolidated total assets as discussed above. In addition, the current foreign exchange control policies applicable in the PRC also restrict the transfer of assets or dividends outside the PRC.

The following presents condensed unaudited unconsolidated financial information of the Parent Company only.

Condensed unaudited Balance Sheet as of December 31, 2016 and 2015

	2016 RMB	US$	2015 RMB
Cash and cash equivalents	226	33	11
Other current assets	298,188	42,948	278,903
Investments in subsidiaries	-	-	389
Total assets	298,414	42,981	279,303
Current liabilities	67,626	9,740	60,426
Total shareholders' equity	230,788	33,241	218,877
Total liabilities and shareholders' equity	298,414	42,981	279,303

Condensed unaudited Statements of Operations (For the years ended December 31, 2016, 2015 and 2014)

	2016 RMB	US$	2015 RMB	2014 RMB
Interest income (expenses)	(15)	(2)	(12)	(11)
General and administrative expenses	(2,662)	(383)	(2,367)	(2,257)

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Steelmaking CSP(4) 1H15 261 563 2,648

(1) Projects approved by the Board of Directors.

(2) All figures presented on a cash basis.

(3) Estimated total capital expenditure cost for each project.

(4) Projects delivered in 2011.

(5) Expected capex is relative to Vale's stake in each project.

Bulk materials and logistics projects

Iron ore mining and logistics projects:

Carajás Additional 40 Mtpy. Construction of an iron ore dry processing plant located in Carajás, in the Brazilian state of Pará. The installation license was issued and civil engineering works and earthworks services to install the conveyor belt are in progress. The project has an estimated nominal capacity of 40 Mtpy. The project is 48% complete, with total realized expenditures of US$1.5 billion. Start-up is expected for the second half of 2013.

CLN 150 Mtpy. Expansion of Northern system railway and port capacity, including the construction of a fourth pier at the Ponta da Madeira maritime terminal in the Brazilian state of Maranhão. Offshore civil engineering works at Ponta da Madeira maritime terminal have started, and we are assembling the ship loaders and conveyor belts. The civil engineering necessary for the installation of the car dumpers has concluded, and mechanical assembly has begun. Earthworks in the railway line and terminal are in progress. One of the required railway installation licenses is expected to be issued in the second half of 2012. The project will increase EFC's logistics nominal capacity to approximately 150 Mtpy. The project is 67% complete, with total realized expenditures of US$2.3 billion. Start-up is expected for the first half of 2014.

Carajás Serra Sul S11D. Development of a mine and processing plant, located in the Southern range of Carajás, in the Brazilian state of Pará. We are investing capital for earthworks services and building the access road, prior to the issuance of environmental permits. We expect to receive the preliminary environmental license in the first half of 2012, with the installation license expected to be issued in the first half of 2013. The project has an estimated nominal capacity of 90 Mtpy. The project is 25% complete, with total realized expenditures of US$1.1 billion. Start-up is expected for the second half of 2016.

Serra Leste. Construction of a new processing plant located in Carajás, in the Brazilian state of Pará. Civil engineering works for the plant and excavation are underway. We expect the installation licenses to be issued in the first half of 2012. The project has an estimated nominal capacity of 6 Mtpy. The project is 26% complete, with total realized expenditures of US$143 million. Start-up is expected for the first half of 2013.

Conceição Itabiritos. Construction of a concentration plant, located in the Southeastern System. The mills assembly was finalized and the issuance of the pending installation license for the energy transmission line is expected in the first half of 2012. The project has an estimated nominal capacity of 12 Mtpy. The project is 86% complete, with total realized expenditures of US$553 million. Start-up is expected for the second half of 2013.

Vargem Grande Itabiritos. Construction of a new iron ore treatment plant in the Southern System, with an estimated nominal capacity of 10 Mtpy. The installation license was issued in 2009. We expect to receive the installation license for the energy transmission line and for the electrical sub-station in the first half of 2012. The project is 46% complete, with total realized expenditures of US$429 million. Start-up is expected for the first half of 2014.

Conceição Itabiritos II. Adaptation of the plant to process low-grade itabirites, located in the Southeastern System. The heavy equipment was received and assembly has started. Civil engineering works for the installation of primary crushers are ongoing. The installation license has been issued. The project has an estimated nominal capacity of 19 Mtpy. The project is 20% complete, with total realized expenditures of US$159 million. Start-up is expected for the second half of 2014.

Simandou I Zogota. Development of the Zogota mine and processing plant in Simandou South, Guinea. The project has an estimated nominal capacity of 15 Mtpy. The project is in an early stage of development and first production is expected in 2012.

Teluk Rubiah. Construction of a maritime terminal with enough depth for the 400,000 dwt vessels and a stockyard in Teluk Rubiah, Malaysia. The stockyard will be capable of handling up to 30 Mtpy of iron ore products. The preliminary environmental license, construction and installation licenses have been issued. The operation license is expected to be issued in the first half of 2014. The project is on schedule and we are executing earthworks. The project is 14% complete, with total realized expenditures of US$215 million. Start-up is expected in the first half of 2014.

Pellet plant projects:

Tubarão VIII. Eighth pellet plant at our existing complex at the Tubarão Port, Espírito Santo, Brazil. We are assembling equipment and metallic structures. Issuance of the operation license is expected for the second half of 2012. We expect the plant to have production capacity of 7.5 Mtpy. The plant is 80% complete, with total realized expenditures of US$612 million. Start-up is expected in the second half of 2012.

Samarco IV. Construction of Samarco's fourth pellet plant, and an expansion of the mine, pipeline and maritime terminal infrastructure. The project has an estimated nominal capacity of 8.3 Mtpy, increasing Samarco's capacity to 30.5 Mtpy. The project is 18% complete. The budget is fully sourced by Samarco. Start-up is expected for the first half of 2014.

Coal mining and logistics projects:

Moatize II. New pit and duplication of the Moatize CHPP, as well as all related infrastructure, located in Tete, Mozambique. Geological research studies and a detailed engineering project are in progress. There are no pending installation licenses. The project will increase Moatize's total nominal capacity to 22 Mtpy (70% coking coal and 30% thermal). The project is 4% complete, with total realized expenditures of US$73 million. Start-up is expected in the second half of 2014.

Nacala Corridor. Railway and port infrastructure connecting Moatize site to the Nacala-à-Velha maritime terminal, located in Nacala, Mozambique. The project comprises the recovery of 682 km of the existing railway in Malawi and Mozambique, the construction of a maritime terminal and 230 km of new railways, composed by a 201 km stretch connecting Moatize to Nkaya, Malawi, and 29 km linking the railway to Nacala-à-Velha. The concession agreement with the government of Malawi for a railway crossing the country has been signed. Development of the engineering project is in progress. Vegetation clearing licenses were obtained for the construction of the railway and maritime terminal in Mozambique. The project has an estimated nominal capacity of 18 Mtpy. The project is in an early stage of development, with total realized expenditures of US$38 million. Start-up is expected in the second half of 2014.

Eagle Downs. New underground mine development including CHPP, as well as all related infrastructure, located in the Bowen Basin, Queensland, Australia. The project is planned to be developed in a 50/50 JV with Aquila Coal Pty Ltd, a subsidiary of Aquila Resources Limited. The project has an estimated nominal capacity of 4 Mtpy (100% coking coal). The project was approved by both JV participant boards and is in an early stage of development, with total realized expenditures of US$19 million. Start-up is expected for the first half of 2016.

Base metal projects

Copper mining projects:

Salobo. Development of mine, plant and related infrastructure, located in Marabá, in the Brazilian state of Pará. The primary and secondary crushers, primary screening and conveyor belt have been commissioned. The project has an estimated nominal capacity of 100,000 tpy of copper in concentrate. The project is 97% complete, with total realized expenditures of US$2.0 billion. Start-up is expected for the first half of 2012.

Salobo II. Salobo expansion, raising of the tailing dam height and increasing the mine capacity, located in Marabá, in the Brazilian state of Pará. Civil works at the flotation circuit are in progress and the construction of the ball mill was initiated. The plant operating license is expected to be issued in the second half of 2013. The project is expected to provide an additional estimated nominal capacity of 100,000 tpy of copper in concentrate. The project is 49% complete, with total realized expenditures of US$354 million. Start-up is expected in the second half of 2013.

Nickel mining and refining projects:

Long-Harbour. Construction of a hydrometallurgical facility in Long Harbour, Newfoundland and Labrador, Canada. The plant is under construction and electromechanical assembly is in progress. The plant will have an estimated nominal refining capacity of 50,000 tpy of finished nickel, and associated copper and cobalt. The project is 59% complete, with total realized expenditures of US$1.7 billion. Start-up is expected in the second half of 2013.

Totten. Nickel mine (re-opening) in Sudbury, Ontario, Canada. The project has an estimated nominal capacity of 8,200 tpy. The project is 51% complete, and US$402 million of expenditures have been realized. Start-up is expected for the second half of 2013.

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Fertilizers nutrients projects

Potash mining and logistics projects:

Rio Colorado. Investments in a solution mining system, located in Mendoza, Argentina, including the renovation of railway tracks (440 km), construction of a railway spur (350 km) and a maritime terminal in Bahia Blanca, Argentina. An employee camp has been built in Malargue, Mendoza. The environmental licenses for the construction of the new railway and agreements with four Argentinian provinces have been obtained. The issuance of an installation license is expected for the first half of 2012. The project has an estimated nominal capacity of 4.3 Mtpy of potash (KCl). The project is 27% complete, with total realized expenditures of US$826 million. Start-up is expected in the second half of 2014.

Energy projects

Biodiesels. Project to produce biodiesel from palm oil. Plantation of 80,000 ha of palm trees located in the Brazilian state of Pará. The biodiesel plant's FEL III is expected for July 2013, while the preliminary environmental license and construction and installation license issuance are all expected for the second half of 2013. The project has an estimated nominal capacity of 360,000 tpy of biodiesel. US$343 million of expenditures have been realized. Start-up is expected for 2015.

Belo Monte. The Belo Monte Hydroelectric Power Plant will be built on the Xingu River, in the Brazilian state of Pará and will have an installed capacity of 11,233 MW. Vale has a 9% stake in NESA, the company established to develop and operate the Belo Monte hydroelectric plant. Vale's share of Belo Monte capacity will supply Vale's demand on the northern region of Brazil. The project is in an early stage of development, with total realized expenditures of US$85 million. Start-up is expected in the first half of 2015.

Steel projects

Companhia Siderúrgica do Pecém ("CSP"). Development of a steel slab plant in the Brazilian state of Ceará in partnership with Dongkuk Steel Mill Co. ("Dongkuk") and Posco, two major steel producers in South Korea. Vale holds 50% of the joint venture. The project implementation started in December 2011. Preliminary environmental and installation licenses were already obtained. The project will have an estimated nominal capacity of 3.0 Mtpy. Start-up is expected in the first half of 2015.

REGULATORY MATTERS

We are subject to a wide range of governmental regulation in all the jurisdictions in which we operate worldwide. The following discussion summarizes the kinds of regulation that have the most significant impact on our operations.

Mining rights

In order to conduct mining activities, we are generally required to obtain some form of governmental permits, which differ in form depending on the jurisdiction but may include concessions, licenses, claims, tenements, leases or permits (all of which we refer to below as "concessions"). Some concessions are of indefinite duration, but many have specified expiration dates and may not be renewable. The legal and regulatory regime governing concessions differs among jurisdictions, often in important ways. For example in many jurisdictions, including Brazil, mineral resources belong to the State and may only be extracted pursuant to a concession. In other jurisdictions, including Canada, a substantial part of our mining operations is conducted pursuant to mining rights we own or pursuant to leases, often from government agencies.

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The table below summarizes our principal mining concessions and other similar rights. In addition to the concessions described below, we have exploration licenses and Brazilian exploration applications with priority covering 7.03 million hectares in Brazil and 18.2 million hectares in other countries.

Location	Concession or other right	Approximate area covered (in hectares)	Expiration date
Brazil	Mining concessions(1)	650,810	Indefinite
Canada	Mining concessions (total)	265,804	2011-2032
Ontario	Mineral leases	20,994	2012-2032
	Patented mineral rights	82,969	None
	Mining license of occupation	3,075	Indefinite
Manitoba	Order in Council leases	109,043	2020-2025
	Mineral leases	4,854	2013
	Potash leases	6,533	2016-2030
	Patented mining claims	378	
Newfoundland and Labrador	Mining leases	1,599	2027
Saskatchewan	Potash leases	27,404	2029-2032
	Petroleum and natural gas leases	8,955	2013-2016
Indonesia	Contract of work(2)	190,510	2025
Australia	Mining tenements	26,917	2011-2041
New Caledonia	Mining concessions	21,269	2016-2051
Peru	Mining concessions(3)	187,617	Indefinite
Colombia	Mining concessions	10,730	2028-2032
Argentina	Mining concessions	88,707	Indefinite
Chile	Mining concessions	58,903	Indefinite
Mozambique	Mining concessions	23,780	2032
Zambia	Mining concessions(4)	68,550	2012-2033
China	Mining concessions(5)	12,383	2034
DRC	Mining concessions(4)	9,200	2039
Guinea	Mining concessions	102,400	2035

(1) Includes mining applications.

(2) Under the Mining Law that came into effect in 2009, we may be entitled to apply for at least one 10-year extension.

(3) The Peruvian mining regime comprises only a single license type. The area reported reflects only licenses involving mining activities.

(4) 50-50 joint venture with African Rainbow Minerals Limited.

(5) Joint Venture with Henan Longyu Energy Resources Co., Ltd. Vale has a minority equity interest of 25%.

Many concessions impose specific obligations on the concessionaire governing such matters as how operations are conducted and what investments are required to be made. Our ability to maintain our mineral rights depends on meeting these requirements, which often involve significant capital expenditures and operating costs.

Regulation of mining activities

Mining and mineral processing are subject to extensive regulation, which differs in each jurisdiction in which we operate. Our major operations are subject to legislation and regulations that apply to mining activities, which in many countries include state or provincial law in addition to national or federal law. Many of our concessions, particularly for large operations, impose additional obligations on us as the concessionaire.

The jurisdictions in which we operate typically have government agencies that are charged with granting mining concessions and monitoring compliance with mining law and regulations. For example, mining activities in Brazil are supervised by the National Department of Mineral Production (*Departamento Nacional de Produção Mineral DNPM*), an agency of the federal Ministry of Mines and Energy.

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Changes in mining legislation can have significant effects on our operations. Among the jurisdictions in which we currently have major operations, there are several proposed or recently adopted changes in mining legislation that could materially affect us. These include the following:

The Brazilian government is planning to propose changes to the Brazilian Mining Code, which if adopted may have important implications for mining operations in Brazil or require additional capital expenditures.

In Indonesia, a Mining Law, which came into effect in January 2009, introduced a new licensing regime and called for certain adjustments to mining contracts with the Indonesian government. Regulations implementing the Mining Law have gradually been promulgated by the government, but more are expected. The trend is towards a more regulated environment in the country, including benchmark price or reference price rules for nickel products, which have previously been unregulated. In addition, regulations requiring mining companies to process commodities before exporting them and mandating foreign companies to divest a portion of their stake to domestic entities have also recently been promulgated. In addition, the Indonesian Government has issued a list of nine principal items it intends to adjust in existing contracts of work, including area adjustments, taxes and non-tax state revenue obligations, domestic value added requirements, the duration of any extension, application of a license form for any extensions, priority for local and national contractors and restrictions on use of affiliated companies for mining services. PTVI has submitted to the government its positions regarding these nine items, but no further discussions were initiated by the government during 2011. PTVI continues to monitor developments with respect to the Mining Law and its implementing regulations and assess the impacts that these may have on PTVI's current operations and its future prospects in Indonesia. Until all of the implementing regulations are promulgated, we will be unable to fully determine how and to what extent PTVI's Contract of Work and operations will be affected.

In New Caledonia, a mining law was passed in March 2009 requiring new mining projects to obtain formal authorization rather than simply a declaration. Our application for authorization (replacing a 2005 declaration) must be made by April 2012 and, once submitted, we should obtain the authorization by April 2015. We believe it is unlikely that the application for the authorization will be rejected, but there is a risk that new conditions will be imposed.

In Guinea, a mining code adopted in 2011 imposes on all mining projects a requirement for 15% government participation. Additionally, the new code creates an obligation for an applicant for a mining concession to present a retrocession plan under which 50% of the area it researched during the exploration phase is retroceded to the government.

In Mozambique, the Ministry of Natural Resources is following other African countries in proposing a new mining code with more detailed provisions that reinforce the rights of local communities, give preference to domestic services and establish the possibility of government participation in the case of strategic projects, which have not yet been defined.

Environmental regulations

We are also subject to environmental regulations that apply to the specific types of mining and processing activities we conduct. We require approvals, licenses, permits or authorizations from governmental authorities to operate, and in most jurisdictions the development of new facilities requires us to submit environmental impact statements for approval and often to make additional investments to mitigate environmental impacts. We must also operate our facilities in compliance with the terms of the approvals, licenses, permits or authorizations. We are taking several steps to improve the efficiency of the licensing process, including stronger integration of our environmental and project development teams, the development of a Best Practices Guide for Environmental Licensing and the Environment, the deployment of highly-skilled specialist teams, closer interaction with environmental regulators and the creation of an Executive Committee to expedite internal decisions regarding licensing.

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Environmental regulations affecting our operations relate, among other matters, to emissions into the air, soil and water; recycling and waste management; protection and preservation of forests, coastlines, natural caverns, watersheds and other features of the ecosystem; water use; climate change and decommissioning and reclamation. In many cases, the mining concessions or environmental permits under which we operate impose specific environmental requirements on our operations. Environmental regulations can sometimes change and ongoing compliance can require significant costs for capital expenditures, operating costs, reclamation costs and compliance. For example, in Brazil, a suit challenging a Brazilian environmental decree that permits mining in certain subterraneous areas may adversely affect our ability to conduct some mining operations or even our reserves.

Environmental legislation is becoming stricter worldwide, which could lead to greater costs for environmental compliance. For instance, if we are required to modify installations, substitute carbon-intensive fuels and process inputs, develop new operational procedures or purchase new equipment, our environmental compliance costs could increase. In particular, we expect heightened attention from various governments to reducing greenhouse gas emissions as a result of concern over climate change. Some important environmental regulation and compliance initiatives are described below, but it is unclear whether additional operating or capital expenditures will be required to comply with enacted amendments or what effect these regulations will have on our business, financial results or cash flow from operations:

Our operations in Canada and at PTVI in Indonesia are subject to air emission regulations that address, among other things, sulfur dioxide ("SO2"), particulates and metals. In Canada, we are making significant capital investments to ensure compliance with these emissions standards. In Indonesia, PTVI and the Ministry of Environment have agreed upon an SO2 emission reduction plan, which is currently being implemented and is scheduled for completion in 2013.

The Canadian federal government's efforts to legislate greenhouse gas emission reduction targets for the industrial sectors have slowed down. The three provinces in which Vale operates, Ontario, Manitoba and Newfoundland, have made limited progress in setting greenhouse gas emission targets, with the exception of Manitoba, which has set a provincial target based on 1990 levels. The legislation enacted by the Manitoba government is not anticipated to impact our operations. The Ontario government has enacted legislation that requires annual reporting of greenhouse gas emissions. The provinces of Ontario and Manitoba are considering emissions trading schemes to limit greenhouse gas emissions. The three provinces have begun consulting with various stakeholders with respect to climate change initiatives and are also focusing on adaptation strategies.

In Canada, a number of studies have been completed or are in progress in Sudbury and Port Colborne related to contamination of soil and water from past and continuing activities. We are taking steps, in partnership with other stakeholders, to remediate the ecological impact of our activities.

The Australian government has recently introduced a carbon pricing scheme which will operate initially like a carbon tax with a fixed (but increasing) carbon permit price and will then transition into a cap and trade scheme after three years. The scheme takes effect on July 1, 2012 and will impact Vale's Australian operations.

In October 2009, Indonesia adopted legislation on Environmental Protection and Management. It sets out a broad regulatory structure and provides that many important details will be clarified in later implementing regulations.

Brazil adopted a decree under the federal carbon emissions law in December 2010 that contemplates specific limits on carbon emissions to be established in late 2011 and phased in through 2020. The law establishes a voluntary commitment to cut Brazil's greenhouse gas emissions between 36.1% and 38.9% by 2020, based on 2020 projected emissions, and several

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regulated industries, including the steel, forestry, agriculture and power generation sectors, have designed plans to reduce their greenhouse gas emissions. By 2012, the government plans to issue rules establishing specific limits on carbon emissions from other sectors of the economy, including mining and fertilizers. The Mining and Energy Ministry, with the participation of the Brazilian Mining Association (*Instituto Brasileiro de Mineração IBRAM*) presented the mining sector plan in December 2011.

As part of the Global Reporting Initiative, which provides a reporting framework for economic, environmental and social sustainability, we launched a Sustainability Action Plan (PAS) in 2008. The PAS deals with issues related to water resources, waste treatment and disposal, emissions and energy, which are also associated with the target variable compensation of all employees. The outcome of the PAS indicators provides the Board with relevant inputs for its decision-making process regarding the investments needed for improvement in these areas as well as further exploring their potential.

Royalties and other taxes on mining activities

We are required in many jurisdictions to pay royalties or taxes on our revenues or profits from mineral extractions and sales. These payments are an important element of the economic performance of a mining operation. The following royalties and taxes apply in some of the jurisdictions in which we have our largest operations:

In Brazil, we pay a royalty known as the CFEM (*Compensação Financeira pela Exploração de Recursos Minerais*) on the revenues from the sale of minerals we extract, net of taxes, insurance costs and costs of transportation. The current rates on our products are: 2% for iron ore, copper, nickel, fertilizers and other materials; 3% on bauxite, potash and manganese ore; and 1% on gold. The Brazilian government is preparing to propose changes in the CFEM regime. Any changes must be incorporated into a final proposal by the DNPM, which is then subject to approval by the Brazilian National Congress. We are currently engaged in several administrative and legal proceedings alleging that we have failed to pay the proper amount of CFEM. See *Additional information Legal proceedings CFEM-related proceedings*.

The Canadian provinces in which we operate charge us a tax on profits from mining operations. Profit from mining operations is generally determined by reference to gross revenue from the sale of mine output and deducting certain costs, such as mining and processing costs and investment in processing assets. The statutory mining tax rates are 10% in Ontario; with graduated rates up to 17% in Manitoba; and a combined mining and royalty tax rate of 16% in Newfoundland and Labrador. The mining tax paid is deductible for company income tax purposes.

In Indonesia, our subsidiary PTVI pays a royalty fee on, among other items, its nickel production on the concession area and has made certain other commitments. The royalty payment was based on sales volume (US$78 per metric ton of contained nickel matte, and US$140 or US$156 per metric ton of contained cobalt, based on total production). During 2011, the royalty payment was equal to 0.44% of revenues from the sale of nickel in matte products, while the average yearly royalty payment for the period from 2008 to 2011 was equal to 0.5% of revenues from the sale of nickel in matte.

In Australia, royalty is payable on revenues from the sale of minerals. In Queensland, it is 7% of the value (net of freight and late dispatch costs) up to A$100 per ton and 10% of the value thereafter. In New South Wales, it is a percentage of the value of production total revenue (which is net of certain costs and levies) less allowable deductions of 6.2% for deep underground mines, 7.2% for underground mines and 8.2% for open cut mines.

The Australian government has introduced a mineral resource rent tax ("MRRT"), which applies beginning in July 2012. The MRRT will tax profits generated from the exploitation of coal and iron ore resources in Australia. The tax will be levied at an effective rate of 22.5% of assessable profit and will be deductible for company income tax purposes. The difference between the MRRT and royalties paid to each state government is that the royalties are based on the volume and value of the resource, whereas the MRRT is based on profits. However, companies will be given a credit for any state-based royalties paid where the MRRT is payable.

In December 2011, the Brazilian states of Pará and Minas Gerais created a new tax on mineral production (*Taxa de Fiscalização de Recursos Minerais TFRM*), due beginning in April 2012. For 2012, the rate of TFRM will be (i) R$6.906 per ton of mineral produced in the state of Pará, and (ii) R$2.3291 per ton of mineral transferred or sold in the state of Minas Gerais. Industry associations believe that the TFRM is unconstitutional and plan to initiate legal proceedings challenging the applicability of the legislation.

Regulation of other activities

In addition to mining and environmental regulation, we are subject to comprehensive regulatory regimes for some of our other activities, including rail transport, electricity generation, and oil and gas. We are also subject to more general legislation on workers' health and safety, safety and support of communities near mines, and other matters.

Our Brazilian railroad business is subject to regulation and supervision by the Brazilian Ministry of Transportation and the transportation regulatory agency (*Agência Nacional de Transportes Terrestres ANTT*), and operates pursuant to concession contracts granted by the federal government. The concession contracts impose certain shareholder ownership limitations. The concession contract for FCA limits shareholder ownership to 20% of the voting capital of the concessionaire, unless such limit is waived by ANTT. We own 99.9% of FCA, which ANTT has authorized. The 20% ownership limitation does not apply to our EFVM, EFC and FNS railroads. ANTT also sets different tariff ceilings for railroad services for each of the concessionaires and each of the different products transported. So long as these limits are respected, the actual prices charged can be negotiated directly with the users of such services.

The MRS concession contract provides that each shareholder can only own up to 20% of the voting capital of the concessionaire, unless otherwise permitted by ANTT. As a result of our acquisitions of CAEMI and Ferteco, our share in the voting capital of MRS surpassed this threshold. As a result, Vale waived its voting and veto rights with respect to MRS shares in accordance with a 2006 ANTT resolution. We continue to have some voting rights with respect to shares owned by a subsidiary.

Our railroad concession contracts have a duration of 30 years and are renewable. The FCA and MRS concessions expire in 2026, and the concessions for EFC and EFVM expire in 2027. We also own the subconcession for commercial operation for 30 years of a 720-kilometer segment of the FNS railroad, in Brazil. This concession expires in 2037.

In 2011, ANTT approved new resolutions, which (i) expanded the trackage rights for concessionaires operating in the railway network and confirmed the ability of non-concessionaires to make investments in the railway network in order to accommodate increased demand, (ii) increased concessionaire obligations and customers rights, (iii) redefined the methodology for assessment of productivity targets by concessionaires and (iv) established a mechanism for ANTT to adjudicate disputes among concessionaires and between concessionaires and non-concessionaires with respect to railway use. Rail concessionaires and the National Association of Rail Carriers (*Associação Nacional dos Transportadores Ferroviários ATNF*), filed a petition with ANTT claiming that such regulatory changes would violate the concession agreements. Additionally, rail concessionaires are discussing with ANTT certain technical and economic aspects of these recent regulations in order to clarify the content of the new regulations, to conform them with Brazilian federal law and the relevant concession agreements, and to protect the investments made by concessionaires.

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In January 2012, ANTT submitted for public comment a proposed regulation to the tariffs charged by the rail concessionaires that would reduce the ceiling for the tariffs able to be charged by concessionaires, which could affect some of our contracts. We will provide comments to ANTT and will continue to work with ANTT so that any approved regulation conforms to the terms and conditions set forth at the time our concession contracts were executed and to applicable law.

In connection with the approval in 2006 of our acquisition of Vale Canada, we made a number of undertakings that expired in October 2011 to the Canadian Minister of Industry under the Investment Canada Act. We believe we were substantially in compliance with these undertakings, which included locating our global nickel business in Toronto, Canada; enhancing investments in a number of areas in Canada; and honoring agreements with provincial governments, local governments, labor unions and aboriginal groups.

Some of our products are subject to regulations applicable to the marketing and distribution of chemicals and other substances. For example, the European Commission has adopted a European Chemicals Policy, known as REACH ("Registration, Evaluation, and Authorization of Chemicals"). Under REACH, manufacturers and importers were required to register new substances prior to their entry into the European market and in some cases may be subject to an authorization process. A company that fails to comply with the REACH regulations could face restrictions to commercialize its products in Europe. We have complied with registration requirements for the substances we import into or manufacture in the EU in 2011 and continue to take measures to manage our exposure to the authorization process.

II. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

Overview

We recorded strong performance in 2011, which is reflected in all-time high figures for operating revenue, operating margin, cash generation and net earnings. Our shipments of iron ore and pellets, which totaled almost 300 million metric tons, were our highest ever, while our sales of nickel and copper were the highest since 2008.

Vale is deeply committed to creating shareholder value, with a strong focus on efficient capital management. To that end, we have implemented several initiatives aimed at minimizing risks of delays and cost overruns in the execution of our projects and have taken a more proactive stance towards returning excess cash to shareholders.

In successfully generating record levels of cash while prudently allocating our capital resources we continue to meet the challenge for growth companies: to finance growth, to maintain a sound balance sheet and to meet shareholders' expectations for capital return.

Below are the main highlights of Vale's performance in 2011:

- gross operating revenue of US$60.4 billion;
- operating income of US$30.1 billion;
- operating margin, measured as the ratio of operating income to net operating revenues, of 48.5% excluding the gain on the sale of our aluminum assets in February 2011;
- record return of capital to shareholders of US$12.0 billion, through cash dividends of US$9.0 billion, equal to US$1.74 per share, and US$3.0 billion in share repurchases;
- net income of US$22.9 billion, or US$4.33 per preferred and common share; and
- strong financial position, supported by cash holdings of US$3.5 billion, availability of significant medium and long-term credit lines and a low-risk debt portfolio.

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Demand and prices

The following table sets forth our average realized prices for our principal products for each of the periods indicated.

	Year ended December 31,				
	2007	2008	2009	2010	2011
	(US$ per metric ton, except where indicated)				
Iron ore	45.33	67.32	55.99	103.50	136.07
Iron ore pellets	78.62	131.76	73.75	161.29	193.79
Manganese	107.34	350.46	147.06	230.22	165.70
Ferroalloys	1,311.48	2,709.60	1,395.26	1,547.84	1,443.01
Nickel	37,442.28	21,662.14	14,596.55	21,980.19	22,680.41
Copper	6,611.27	6,331.07	5,229.39	7,730.09	8,420.73
Potash	264.09	591.18	521.46	410.56	505.28
Platinum (US$/oz)	1,314.25	1,557.07	1,073.98	1,661.20	1,716.81
Cobalt (US$/lb)	24.56	31.01	10.03	15.09	15.63
Coal:					
Thermal coal	53.73	85.38	66.60	70.40	95.54
Metallurgical coal	67.37	170.55	115.55	149.96	235.27
Phosphates:					
MAP				565.34	679.65
TSP				451.80	585.98
SSP				221.36	281.53
DCP				570.49	679.63
Nitrogen				450.86	612.01

Iron ore and iron ore pellets

Demand for our iron ore and iron ore pellets is a function of global demand for carbon steel. Demand for carbon steel, in turn, is strongly influenced by global industrial production. Iron ore and iron ore pellets are priced based on a wide array of quality levels and physical characteristics. Various factors influence price differences among the several types of iron ore, such as the iron content of specific ore deposits, the various beneficiation and purifying processes required to produce the desired final product, particle size, moisture content and the type and concentration of contaminants (such as phosphorus, alumina and manganese ore) in the ore. Fines, lump ore and pellets typically command different prices.

Demand from China has been a principal driver of world demand and of prices. Chinese iron ore imports reached 686.1 million metric tons in 2011, 10.8% above the 619.1 million metric tons imported in 2010 and 9.3% higher than 2009 levels, due mainly to the continued growth in Chinese steel production throughout 2011. We expect China's economic growth to continue at a high rate during 2012, mainly driven by domestic demand.

Our iron ore prices are based on a variety of pricing options, which generally use spot price indices as a basis for determining the customer price.

Manganese and ferroalloys

The prices of manganese ore and ferroalloys are mainly influenced by trends in the carbon steel market. Ferroalloy prices are also influenced by the prices of the main production inputs, including manganese ore, power and coke. We sell manganese ore mainly at spot prices or at prices established on a quarterly basis. Ferroalloy prices are negotiated on a quarterly basis.

Nickel

Nickel is an exchange-traded metal, listed on the LME. Most nickel products are priced using a discount or premium to the LME price, depending on the nickel product's physical and technical characteristics. Demand for nickel is strongly affected by stainless steel production, which represents, on average, 60-65% of global nickel consumption.

We have short-term fixed-volume contracts with customers for the majority of our expected annual nickel sales. These contracts, together with our sales for non-stainless steel applications (alloy steels, high nickel alloys, plating and batteries), provide stable demand for a significant portion of our annual production. In 2011, 66% of our refined nickel sales were made into non-stainless steel applications, compared to the industry average for primary nickel producers of 36%, bringing more stability to our sales volumes. As a result of our focus on such higher-value segments, our average realized nickel prices for refined nickel have typically exceeded LME cash nickel prices.

Primary nickel (including ferro-nickel, nickel pig iron and nickel cathode) and secondary nickel (i.e., scrap) are competing nickel sources for stainless steel production. The choice between different types of primary and secondary nickel is largely driven by their relative price and availability. In recent years, secondary nickel has accounted for about 43-48% of total nickel used for stainless steels, and primary nickel has accounted for about 52-57%. In 2011, Chinese nickel pig iron and ferro-nickel production is estimated to have exceeded 250,000 metric tons, representing 16% of world primary nickel supply, compared to 11% of the world's supply in 2010.

Long-term market fundamentals for nickel are expected to remain positive. While a number of nickel projects will be ramping-up in the short-term, future project development is becoming increasingly challenging. Nickel is widely used in consumer and industrial applications, and its use tends to grow as a country's economy develops. We anticipate continued income growth within emerging economies will drive higher nickel consumption over the medium-term.

Copper

Growth in copper demand in recent years has been driven primarily by Chinese imports, given the important role copper plays in construction in addition to electrical and consumer applications. Copper prices are determined on the basis of (i) prices of copper metal on terminal markets, such as the LME and the NYMEX, and (ii) in the case of intermediate products such as copper concentrate (which comprise most of our sales) and copper anode, treatment and refining charges negotiated with each customer. Under a pricing system referred to as MAMA ("month after month of arrival"), sales of copper concentrates and anodes are provisionally priced at the time of shipment, and final prices are settled on the basis of the LME price for a future period, generally one to three months after the shipment date.

Supply growth has struggled to keep pace with growing copper demand, with average mine growth of only 1.4% per annum over the past five years. These circumstances led to a strong 17% rise in copper prices in 2011, relative to 2010. We anticipate market fundamentals to remain strong as demand growth continues and the supply response remains challenging.

Fertilizer nutrients

Demand for fertilizers is based on market fundamentals similar to those underlying global demand for minerals, metals and energy. Rapid per capita income growth in emerging economies generally causes dietary changes marked by an increase in the consumption of proteins, which ultimately contributes to increased demand for fertilizer nutrients. Demand is also driven by the demand for bio-fuels, which have emerged as an alternative source of energy to reduce world reliance on sources of climate-changing greenhouse gases, because key inputs for the production of biofuels sugar cane, corn and palm are intensive in the use of fertilizers.

Sales of fertilizers are mainly on a spot basis using international benchmarks, although some large importers in China and India often sign annual contracts. Seasonality is an important factor for price determination throughout the year, since agricultural production in each region depends on climate conditions for crop production.

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Aluminum

We have a 22.0% interest in Hydro, a major aluminum producer, which we acquired in February 2011 when we transferred the major part of our aluminum businesses to Hydro. For the periods prior to the transaction, our sales of aluminum were made at prices based on the LME of the previous month. Our sales of alumina were based on a percentage of the aluminum price traded on the LME, and our prices for bauxite were determined by a formula linked to the price of aluminum for the three-month futures contracts on the LME and to the price of alumina FOB Australia.

Coal

Demand for metallurgical coal is driven by demand for steel, with growth expected especially in Asia. Demand for thermal coal is closely related to electricity consumption, which will continue to be driven by global economic growth, particularly in emerging market economies. Since April 2010, prices for metallurgical coal have been established on a quarterly basis for the majority of the seaborne term contract volumes, although some sellers have begun introducing monthly pricing and a minority of the seaborne trade volumes continue to employ annual pricing. Most of our term contracts have been priced on a quarterly basis since April 2010. Price negotiations for thermal coal are held both on a spot and an annual basis.

Logistics

Demand for our transportation services in Brazil is primarily driven by Brazilian economic growth, mainly in the agricultural and steel sectors. We earn our logistics revenues primarily from fees charged to customers for the transportation of cargo via our railroads, port and ships. Our railways generate most of these revenues. Nearly all of our logistics revenues are denominated in *reais* and subject to adjustments for changes in fuel prices. Prices in the Brazilian market for railroad services are subject to ceilings set by the Brazilian regulatory authorities, but they primarily reflect competition with the trucking industry.

Production and sales volumes

Our financial performance depends, among other factors, on the volume of production at our facilities. We publish a quarterly production report, which is available on our website and filed with the SEC on Form 6-K. Increases in the capacity of our facilities resulting from our capital expenditure program have an important effect on our performance. Our results are also affected by acquisitions and dispositions of businesses or assets, and they may be affected in the future by new acquisitions or dispositions. For more information on acquisitions since the beginning of 2011, see *Information on the Company Business overview Significant changes in our business*. We had no dispositions of businesses in 2011.

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The following table sets forth, for our principal products, the total volumes we sold in each of the periods indicated.

	Year ended December 31,				
	2007	2008	2009	2010	2011
	(thousand metric tons)				
Iron ore	262,687	264,023	229,174	254,902	257,287
Iron ore pellets	33,670	32,218	18,087	39,512	41,861
Manganese	708	759	986	1,119	1,032
Ferroalloys	488	396	253	401	386
Nickel	268	276	223	174	252
Copper	300	320	216	208	302
Potash	674	499	792	682	568
Platinum	345	411	233	97	446
Cobalt	2.494	3.087	1.854	0.902	2.721
Coal:					
Thermal coal	603	1,405	3,083	4,234	5,342
Metallurgical coal	1,894	2,682	2,590	3,150	2,330
Phosphates:					
MAP				703	907
TSP				461	594
SSP				1,533	2,501
DCP				284	556
Nitrogen				747	1,278

Currency price changes

Our results of operations are affected in several ways by changes in currency exchange rates. The most important of these are the following:

Most of our revenues are denominated in U.S. dollars, while most of our costs of goods sold are denominated in other currencies, principally the *real* (59% in 2011), the U.S. dollar (19% in 2011) and the Canadian dollar (15% in 2011). As a result, changes in exchange rates affect our costs and operating margins. Our margins are adversely affected by a decline in the value of the U.S. dollar.

Most of our long-term debt is denominated in currencies other than the *real* (US$14.703 billion at December 31, 2011), principally the U.S. dollar. Because our functional currency for accounting purposes is the Brazilian *real*, changes in the value of the U.S. dollar against the *real* result in an exchange gain or loss on our net liabilities.

We had *real*-denominated debt of US$7.997 billion at December 31, 2011. Since most of our revenue is in U.S. dollars, we use swaps to convert our debt service from *reais* to U.S. dollars. Changes in the value of the U.S. dollar against the *real* result in fair value variation on these derivatives, affecting our financial results. For more information on our use of derivatives, see *Risk management*.

A decline in the value of the U.S. dollar tends to result in: (i) lower operating margins and (ii) higher financial results due to currency gains on our net U.S. dollar-denominated liabilities and fair value gains on our currency derivatives. Conversely, an increase in the value of the U.S. dollar tends to result in: (i) better operating margins and (ii) lower financial results, due to exchange losses on our net U.S. dollar-denominated liabilities and fair value losses on our currency derivatives.

The U.S. dollar depreciated against both the *real* and the Canadian dollar during the first half of 2011 but began to appreciate in the second half of the year, after the aggravation of the Eurozone's debt crisis in late July. As of December 31, 2011, the U.S. dollar had appreciated 12.1% against the *real* and 2.2% against the Canadian dollar relative to December 31, 2010. The average value of the U.S. dollar in 2011, compared to 2010, was 4.8% lower against the *real* and 4.4% lower against the Canadian dollar. These currency price

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changes affected our operating margins and resulted in higher foreign exchange gains and gains on derivatives, as described under *Critical accounting policies and estimates Derivatives*.

Operating expenses

Our principal operating expenses consist of: (i) cost of goods sold, (ii) selling, general and administrative expenses and (iii) research and development expenses. Our cost of goods sold consists of costs of energy (fuel and electric energy), materials (such as components for railroad and mining equipment), outsourced services (especially ore and waste removal, transportation and maintenance), purchased products for processing or resale (such as iron ore, iron ore pellets, nickel and aluminum products), personnel, and depreciation and depletion. Our selling, general and administrative expenses consist principally of personnel expense, sales expense and depreciation. Our research and development expenses consist primarily of investments related to mineral exploration and studies for the development of projects, which are recorded as expenses until the economic viability of the related mining activities can be established.

Results of operations 2011 compared to 2010

Revenues

Our net operating revenues increased 30.2%, to US$58.990 billion, in 2011, primarily as a result of (i) higher prices for our major products, especially for iron ore and other bulk materials, (ii) the increase in nickel volumes following the end of labor strikes and resumption of our nickel production in Ontario and (iii) the inclusion of a full year of results for fertilizers compared to seven months in 2010. These effects were partly offset by the effect of the sale of our aluminum assets in February 2011. Of a total increase of US$13.697 billion in gross revenues, US$9.575 billion was attributable to higher prices for iron ore and iron ore pellets.

The following table summarizes our gross revenues by product and our net operating revenues for the periods indicated.

	Year ended December 31,		
	2010	2011	% change
	(US$ million)		
Bulk Materials:			
Iron ore	US$26,384	US$35,008	32.7
Iron ore pellets	6,402	8,150	27.3
Manganese	258	171	(33.7)
Ferroalloys	664	561	(15.5)
Coal	770	1,058	37.4
Subtotal	34,478	44,948	30.4
Base Metals:			
Nickel and other products(1)	4,712	8,118	72.3
Copper concentrate(2)	934	1,126	20.6
Aluminum products(3)	2,554	383	(85.0)
Subtotal	8,200	9,627	17.4
Fertilizers:			
Potash	280	287	2.5
Phosphates	1,211	2,395	97.8
Nitrogen	337	782	132.0
Others fertilizer products	18	83	361.1
Subtotal	1,846	3,547	92.1
Logistics:			
Railroads	1,107	1,265	14.3
Ports	353	461	30.6
Shipping	5		
Subtotal	1,465	1,726	17.8
Other products and services(4)	492	541	10.0
Gross revenues	46,481	60,389	29.9
Value added tax	(1,188)	(1,399)	17.8

Net operating revenues	US$45,293	US$58,990	30.2

(1) Includes nickel co-products and by-products (copper, precious metals, cobalt and others).

(2) Does not include copper produced as a nickel co-product.

(3) Reflects aluminum operations sold in February 2011.

(4) Includes kaolin, pig iron and energy.

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The following table summarizes, for the periods indicated, the distribution of our operating revenues based on the geographical location of our customers.

	Operating revenue by destination			
	2010		2011	
	(US$ million)	(% of total)	(US$ million)	(% of total)
North America				
Canada	US $1,126	2.4%	US $1,403	2.3%
United States	828	1.8	1,672	2.8
Mexico	74	0.2	102	0.2
	2,028	4.4	3,177	5.3
South America				
Brazil	8,150	17.5	10,914	18.1
Other	810	1.7	1,108	1.8
	8,960	19.3	12,022	19.9
Asia				
China	15,379	33.1	19,571	32.4
Japan	5,240	11.3	7,238	12.0
South Korea	1,934	4.2	2,779	4.6
Taiwan	1,179	2.5	1,281	2.1
Other	1,059	2.2	989	1.6
	24,791	53.3	31,858	52.8
Europe				
Germany	3,092	6.7	3,792	6.3
United Kingdom	1,060	2.3	1,351	2.2
Italy	1,043	2.2	1,908	3.2
France	716	1.5	801	1.3
Other	3,001	6.4	3,585	5.9
	8,912	19.2	11,437	18.9
Rest of the world	1,790	3.9	1,895	3.1
Total	US$ 46,481	100.0%	US$ 60,389	100.0%

Revenues by segment

Bulk materials

The 30.4% increase in revenues from sales of bulk materials primarily reflected higher prices for iron ore and iron ore pellets. Our average realized prices were up 31.5% for iron ore and 20.2% for iron ore pellets, due primarily to strong demand from China while demand remained slow elsewhere, particularly in Europe. Volume sold was also up for iron ore (0.9%) and for iron ore pellets (5.9%).

Revenues from bulk materials were also positively affected by higher prices for coal. Our average realized prices were up 35.7% for thermal coal, based on demand from the power industry, and 56.9% for metallurgical coal, based on demand from the steel industry, especially in China. The volume of metallurgical coal sold was adversely affected by heavy rains and flooding in Australia in the early part of 2011, while the volume of thermal coal sold increased based on higher production in Colombia and the start of production at Moatize.

Revenues from sales of both manganese and ferroalloys declined on lower prices and lower volumes sold.

Base metals

The 17.4% increase in gross revenues from sales of base metals primarily reflected higher volumes of nickel sold. With the end of labor strikes at our production sites in Sudbury and Voisey's Bay in the second half of 2010, the volume of nickel sold was 44.8% higher in 2011. The average sale price for nickel also

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increased 3.2%, reflecting an increase in the LME price due to continued strong demand. Revenues from sales of copper concentrate were also higher, based on higher prices. These effects were partly offset by the sale of our aluminum business in February 2011, because for 2011 we had only two months of aluminum sales.

Fertilizers

We acquired our principal phosphate operations in May 2010, and the 92.1% increase in revenues from sales of fertilizers in 2011 primarily reflects a full year of these operations compared to seven months in 2010. In addition, prices were up for both phosphates (13.1% higher average realized price) and nitrogen (35.7% higher average realized price), due to strong demand especially from the Brazilian agricultural sector.

Logistics

Gross revenues from sales of logistics services increased 17.8%. Revenues from railroad transportation increased 14.3%. Revenues from port operations increased 30.6% due to higher imports for the steel industry.

Operating costs and expenses

	Year ended December 31,		
	2010	2011	% change
	(US$ million)		
Cost of ores and metals	US$ 13,326	US$ 17,898	34.3
Cost of aluminum products	2,108	289	(86.3)
Cost of logistic services	1,040	1,402	34.8
Cost of fertilizer products	1,556	2,701	73.6
Others	784	1,283	63.6
Cost of goods sold	18,814	23,573	25.3
Selling, general and administrative expenses	1,701	2,334	37.2
Research and development	878	1,674	90.7
Gain on sale of assets		(1,513)	
Other costs and expenses	2,205	2,810	27.4
Total operating costs and expenses	US$ 23,598	US$ 28,878	22.4

Cost of goods sold

The following table summarizes the components of our cost of goods sold for the periods indicated.

	Year ended December 31,		
	2010	2011	% change
	(US$ million)		
Outsourced services	US$ 2,740	US$ 4,244	54.9
Materials costs	2,861	3,758	31.4
Energy:			
Fuel	1,880	2,182	16.1
Electric energy	1,211	967	(20.1)
Subtotal	3,091	3,149	1.9
Acquisition of iron ore and pellets	963	1,411	46.5
Acquisition of other products:			
Nickel	358	606	69.3
Aluminum	285	18	(93.7)
Other	58	239	312.1
Subtotal	701	863	23.1
Personnel	2,081	3,138	50.8

Depreciation and depletion	2,803	3,735	33.3
Others	3,574	3,275	(8.4)
Total	US$ 18,814	US$ 23,573	25.3

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The largest factors in the 25.3% increase in cost of goods sold were the resumption of normal nickel operations in Ontario, the inclusion of a full year of the phosphate business acquired in 2010 and the start-up of Onça Puma. Out of the total increase of US$4.759 billion, these three factors accounted for US$3.501 billion. Additional important factors were the appreciation on average of the Brazilian *real* against the U.S. dollar during 2011, which accounted for US$764 million of additional cost of goods sold, and higher sales volumes, which accounted for US$268 million of additional cost of goods sold.

The increases in costs of goods sold attributable to the resumption of Ontario operations and the start-up of Onça Puma were primarily in the following line items: outsourced services (US$441 million), materials (US$367 million), energy (US$242 million), personnel (US$492 million) and depreciation (US$502 million).

The increases in costs of goods sold attributable to the full year of fertilizer operations were primarily in the following line items: outsourced services (US$277 million), materials (US$656 million), energy (US$237 million), personnel (US$159 million) and depreciation (US$230 million), partially offset by the purchase price allocation in inventories in connection with our acquisition in 2010.

The increases in costs were partially offset by the sale of our aluminum assets, which reduced costs by US$1.819 billion, primarily in these line items: energy costs (US$712 million), materials (US$494 million) and product acquisitions (US$268 million). The reduction in energy costs was particularly significant.

These factors were partially offset by our efforts to reduce costs by optimizing the flow of materials, optimizing plant and labor utilization, and cutting administrative costs, among other measures.

In addition to the general factors described above: (i) higher outsourced services costs were affected by increased freight prices, (ii) higher costs for acquisition of products from third parties reflected higher nickel purchases because of operational problems at the Copper Cliff smelter and higher prices of iron ore and iron ore pellets, and (iii) higher personnel costs reflected the signing of a new collective agreement in Brazil.

Selling, general and administrative expenses

Selling, general and administrative expenses increased by 37.2%, or US$633 million, as a result of higher head count due to acquisitions, the signing of a new collective bargaining agreement in Brazil and the appreciation of the Brazilian *real* against the U.S. dollar.

Research and development expenses

Research and development expenses increased by 90.7%, which reflects expenditures for feasibility and other studies for new projects, mineral exploration, natural gas exploration and the development of new processes and technological improvements.

Other costs and expenses

Other costs and expenses increased by US$605 million, mainly due to pre-operating and start-up expenses related to our Onça Puma and Vale New Caledonia projects and contingency expenses.

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Operating income by segment

The following table provides information about our operating income by segment and as a percentage of revenues for the years indicated.

	Year ended December 31,			
	2010		2011	
	Segment operating income (loss)		Segment operating income (loss)	
	(US$ million)	(% of net operating revenues)	(US$ million)	(% of net operating revenues)
Bulk materials:				
Iron ore	US$ 17,347	66.7%	US$ 24,030	69.6%
Iron ore pellets	3,511	57.2	4,427	56.2
Manganese ore	105	41.8	(39)	
Ferroalloys	270	44.9	52	10.1
Coal	(169)		(484)	
Base metals:				
Nickel and other products	165	3.5	1,073	13.2
Copper concentrate	197	21.8	146	13.2
Aluminum products	286	11.3	73	19.3
Fertilizers:				
Potash	(29)		(87)	
Phosphates	(27)		243	10.6
Nitrogen	(41)		6	0.9
Other fertilizer products	1	8.3	70	100.0
Logistics:				
Railroads	85	9.2	(139)	
Ports	47	15.4	48	11.6
Shipping	(8)			
Other products and services	(45)		(820)	
Subtotal	21,695	47.9%	28,599	48.5%
Gain on sale of assets			1,513	
Total	US$ 21,695	47.9%	US$ 30,112	51.0%

Operating income as a percentage of net operating revenues increased from 47.9% in 2010 to 51.0% in 2011. In general, all segments benefited from higher prices and volumes sold. The improvement in operating margin in nickel also reflected the resumption of normal operations after the end of the labor disruption in Canada. Lower margins for manganese and ferroalloys reflected weak markets and lower volumes.

Non-operating income (expenses)

The following table details our net non-operating income (expenses) for the periods indicated.

	Year ended December 31,	
	2010	2011
	(US$ million)	
Financial income	US$ 290	US$ 718
Financial expenses	(2,646)	(2,465)
Gains on derivatives, net	631	75
Foreign exchange and monetary gains (losses), net	344	(1,641)
Non-operating income (expenses)	(US$ 1,381)	(US$ 3,313)

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We had net non-operating expenses of US$3.313 billion in 2011, compared to net US$1.381 billion in 2010. The principal factor in the change was the high level of foreign exchange losses in 2011. This and the other factors in the change are described below:

- The net impact of foreign exchange and monetary variations was a charge of US$1.641 billion, due to appreciation of the U.S. dollar (in which most our debt is denominated) against the Brazilian *real* (which is our functional currency). This compares with a gain of US$344 million in 2010, when there was a small depreciation of the U.S. dollar.

- The increase in financial income reflected the high level of cash we built up during late 2010 and 2011, prior to our dividend payments and share repurchases in the fourth quarter of 2011.

- Financial expenses declined by 6.8%, mainly due to a favorable change in the amount recognized for change in the fair value of our outstanding shareholder debentures.

- The net effect of fair value changes in derivatives had a positive impact on earnings of US$75 million in 2011 and US$631 million in 2010. This reflected the following categories of derivatives transactions:

  - Currency and interest rate swaps We recognized net expense of US$59 million in 2011, compared to net income of US$771 million in 2010. These swaps are primarily to convert debt denominated in other currencies into U.S. dollars to protect our cash flow from exchange rate volatility.

  - Nickel derivatives We recognized net income of US$103 million in 2011 and net expense of US$84 million in 2010. These derivatives are entered into as part of our nickel price protection program.

  - Bunker oil derivatives We recognized net income of US$37 million in 2011. These derivatives were structured to minimize the volatility of the cost of maritime freight.

Income taxes

For 2011, we recorded net income tax expense of US$5.282 billion, compared to US$3.705 billion in 2010. The effective tax rate on our pretax income was 19.7%, lower than the statutory rate, mainly because of the tax benefit of shareholder distributions categorized as interest on shareholders' equity. For more information, see Note 6 to our consolidated financial statements. Exchange variations directly impact the exchange gains or losses recognized on transactions between the parent company and certain subsidiaries with lower statutory tax rates. Although those gains and losses are eliminated from reported consolidated pretax amounts in the consolidation and currency re-measurement process, they are not eliminated for tax purposes since in Brazil there is no consolidated income tax regime. Our effective tax rate has historically been lower than the Brazilian statutory rate because: (i) income of some non-Brazilian subsidiaries is subject to lower rates of tax; (ii) we are entitled under Brazilian law to deduct the amount of our distributions to shareholders that we classify as interest on shareholders' equity; (iii) we benefit from tax incentives applicable to our earnings on production in certain regions of Brazil; and (iv) functional currency movements on some non-Brazilian subsidiaries are not taxable under Brazilian law. In addition, some of the foreign exchange variations that affect our operating results are not taxable.

Affiliates and joint ventures

Our equity in the results of affiliates and joint ventures resulted in a net gain of US$1.135 billion in 2011, compared to a net gain of US$987 million in 2010. Our joint venture Samarco represented US$878 million of the 2011 amount, and the increase in 2011 is attributable to higher sales volumes and higher prices for iron ore pellets.

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Results of operations 2010 compared to 2009

Revenues

Our net operating revenues increased 94.3%, to US$45.293 billion, in 2010, primarily as a result of higher prices for our major products. In response to strong demand, volumes sold increased for iron ore and other bulk materials, but not for nickel and copper due largely to the effect of the labor dispute at our Sudbury and Voisey's Bay operations, which has now ended. Of a total increase of US$22.542 billion in gross revenues, US$15.571 billion was attributable to higher prices for iron ore and iron ore pellets.

The following table summarizes our gross revenues by product and our net operating revenues for the periods indicated.

	Year ended December 31,		
	2009	2010	% change
	(US$ million)		
Bulk Materials:			
Iron ore	US$ 12,831	US$ 26,384	105.6
Iron ore pellets	1,352	6,402	373.5
Manganese	145	258	77.9
Ferroalloys	372	664	78.5
Coal	505	770	52.5
Subtotal	15,205	34,478	126.8
Base Metals:			
Nickel and other products (1)	3,947	4,712	19.4
Copper concentrate (2)	682	934	37.0
Aluminum products	2,050	2,554	24.6
Subtotal	6,679	8,200	22.8
Fertilizers:			
Potash	413	280	(32.2)
Phosphates		1,211	
Nitrogen		337	
Other fertilizer products		18	
Subtotal	413	1,846	347.0
Logistics:			
Railroads	838	1,107	32.1
Ports	264	353	33.7
Shipping	2	5	
Subtotal	1,104	1,465	32.7
Other products and services (3)	538	492	(8.6)
Gross revenues	23,939	46,481	94.2
Value added tax	(628)	(1,188)	89.2
Net operating revenues	US$ 23,311	US$ 45,293	94.3

(1) Includes nickel co-products and by-products (copper, precious metals, cobalt and others).

(2) Does not include copper produced as a nickel co-product.

(3) Includes kaolin, pig iron and energy.

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The following table summarizes, for the periods indicated, the distribution of our operating revenues based on the geographical location of our customers.

	Operating revenue by destination			
	2009		2010	
	(US$ million)	(% of total)	(US$ million)	(% of total)
North America				
Canada	US$ 886	3.7%	US$ 1,126	2.4%
United States	832	3.5	828	1.8
Mexico	24	0.1	74	0.2
	1,742	7.3	2,028	4.4
South America				
Brazil	3,655	15.3	8,150	17.5
Other	342	1.4	810	1.7
	3,997	16.7	8,960	19.3
Asia				
China	9,003	37.6	15,379	33.1
Japan	2,412	10.1	5,240	11.3
South Korea	883	3.7	1,934	4.2
Taiwan	681	2.8	1,179	2.5
Other	654	2.7	1,059	2.2
	13,633	56.9	24,791	53.3
Europe				
Germany	1,085	4.5	3,092	6.7
United Kingdom	492	2.1	1,060	2.3
Italy	335	1.4	1,043	2.2
France	336	1.4	716	1.5
Belgium	336	1.4	440	0.9
Other	1,452	6.1	2,562	5.5
	4,036	16.9	8,912	19.2
Rest of the world	531	2.2	1,790	3.9
Total	US$ 23,939	100.0%	US$ 46,481	100.0%

Revenues by segment

Iron ore. Gross revenues from sales of iron ore increased 105.6% in 2010 compared to 2009, primarily as a result of an 84.9% increase in the average sale price and an 11.2% increase in volume sold. The increase in the average sales price resulted from strong demand for iron ore. The increase in volume was a consequence of the worldwide economic recovery. Given strong demand pressure, the market for iron ore has been very tight, with rising spot prices and a decreasing stock-to-consumption ratio in China relative to last year.

Iron ore pellets. Gross revenues from sales of iron ore pellets increased 373.5%, driven by a 118.5% increase in volume sold due to increased utilization of production capacity and a 118.7% increase in the average sales price due to strong demand.

Manganese ore. Gross revenues from sales of manganese ore increased 77.9%, driven by a 56.5% increase in the average sale price and a 13.5% increase in volume sold due to the demand from the steel industry, partially offset by stoppage occurred in mines for operational maintenance.

Ferroalloys. Gross revenues from sales of ferroalloys increased 78.5%, due primarily to a 60.7% increase in volume sold in connection with the recovery of the steel industry and a 10.9% increase in the average sales price.

Coal. Gross revenues from sales of coal increased 52.5%, mainly due to the consolidation of sales from Vale Colombia, which Vale acquired in the first quarter of 2009, as well as higher average sales price reflecting better market conditions. The improvement in sales prices for metallurgical coal reflected new quarterly index-based pricing arrangements with our customers similar to those we adopted in our iron ore business. Metallurgical coal revenues increased by 57.9% due to high prices (29.8% higher than in 2009) and

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higher volumes sold (21.6% higher than in 2009). Thermal coal revenues increased by 44.7% due to higher prices (5.7% higher than in 2009) and higher volumes sold (37.3% higher than in 2009).

Nickel and other products. Gross revenues from this segment increased 19.4%, mainly due to an increase in prices, partially offset by a decrease in volumes as a result of the labor strikes at our production plants in Sudbury and Voisey's Bay. The segment includes sales of nickel (representing 57.5% of base metals gross revenues for 2010) and sales of copper that is a by-product of our nickel operations. Gross revenues from nickel sales increased 17.6%, primarily due to a 50.6% increase in the average sales price due to an increase in the LME price, which was partially offset by a 22.8% decrease in volume sold. Gross revenues from copper sales increased 50.1%, primarily due to a 59.5% increase in the average sales price, which was partially offset by a 23.0% decrease in the volume sold.

Copper concentrate. Gross revenues from sales of copper concentrate increased 37.0%, reflecting a 40.5% increase in the average sales price as a result of structural limitations on growth in the supply of concentrates. The increase was partially offset by a 2.6% decrease in volume sold.

Aluminum products. Gross revenues from sales of aluminum-related products increased 24.6%, primarily reflecting an increase in the average sales price as a result of an increase in the LME price. We transferred our aluminum business in Albras, Alunorte and CAP, among other items, to Hydro in February 2011.

Potash. Gross revenues from sales of potash decreased 32.2%, mainly due to a 21.2% decrease in the average sales price and a 13.9% decrease in volume sold explained by the recovery of inventories.

Phosphates and nitrogen. We had revenues from sales of phosphates and nitrogen for the first time in 2010 due to the acquisition of fertilizer assets in Brazil.

Logistics services. Gross revenues from sales of logistics services increased 32.7%. Revenues from railroad transportation increased 32.1%, primarily reflecting the rise in transportation of agricultural products and steel industry inputs and products in 2010. Revenues from port operations increased 33.7% due to changes in the mix of goods carried.

Other products and services. Gross revenues from sales of other products and services decreased 8.6%, primarily due to the classification of kaolin within discontinued operations in the first quarter of 2010.

Operating costs and expenses

	Year ended December 31,		
	2009	2010	% change
	(US$ million)		
Cost of ores and metals	US$ 9,853	US$ 13,326	35.2
Cost of aluminum products	2,087	2,108	1.0
Cost of logistic services	779	1,040	33.5
Cost of fertilizer products	173	1,556	799.4
Others	729	784	7.5
Cost of goods sold	13,621	18,814	38.1
Selling, general and administrative expenses	1,130	1,701	50.5
Research and development	981	878	(10.5)
Other costs and expenses	1,522	2,205	44.9
Total operating costs and expenses	US$ 17,254	US$ 23,598	36.8

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Cost of goods sold

The following table summarizes the components of our cost of goods sold for the periods indicated.

	Year ended December 31,		
	2009	2010	% change
	(US$ million)		
Outsourced services	US$ 2,264	US$ 2,740	21.0
Materials costs	2,698	2,861	6.0
Energy:			
Fuel	1,277	1,880	47.2
Electric energy	844	1,211	43.5
Subtotal	2,121	3,091	45.7
Acquisition of iron ore and pellets	155	963	521.3
Acquisition of other products:			
Nickel	271	358	32.1
Aluminum	279	285	2.2
Other	38	58	52.6
Subtotal	588	701	19.2
Personnel	1,939	2,081	7.3
Depreciation and depletion	2,332	2,803	20.2
Others	1,524	3,574	134.5
Total	US$ 13,621	US$ 18,814	38.1

Our total cost of goods sold increased 38.1% from 2009 to 2010. The increase is attributable to the increase in volume sold and to exchange rate variations, partially offset by our continuous efforts to reduce costs. Of the US$5.193 billion increase in cost of goods sold, higher volume sold and exchange rate variations were responsible for US$1.775 billion and US$1.323 billion, respectively. Also contributing to the increase was a higher level of purchases of third-party products for resale in order to meet excess demand, as well as our acquisition of fertilizer assets. These factors were partially offset by our efforts to reduce costs by optimizing the flow of materials, optimizing plant and labor utilization, and cutting administrative costs, among other measures.

Outsourced services costs (primarily for operational services such as waste removal, cargo freight and maintenance of equipment and facilities) increased 21.0%, driven primarily by higher volume sold and the appreciation of the Brazilian *real* against the U.S. dollar.

Materials costs increased 6.0%, driven primarily by higher volume sold and the appreciation of the Brazilian *real* against the U.S. dollar, partially offset by lower maintenance expense in 2010 reflecting accelerated expenditures in 2009.

Energy costs increased 45.7%, driven primarily by higher volume sold, higher average prices and the appreciation of the Brazilian *real* against the U.S. dollar.

Costs for the acquisition of products from third parties increased 124.0%, driven primarily by the purchase of iron ore and iron ore pellets. In 2009, Vale did not purchase iron ore pellets from third parties, due to the lower level of demand during the financial crisis.

Personnel costs increased 7.3%, due primarily to higher production volumes and the appreciation of the Brazilian *real* against the U.S. dollar, partially offset by lower production of nickel.

Depreciation and depletion expense increased 20.2%, driven primarily by the general increase in volume sold and the appreciation of the Brazilian *real* against the U.S. dollar, partially offset by lower volumes of nickel sold due to the strikes.

Other costs of goods sold increased 134.5%, primarily reflecting higher expenditures for mining royalties, inventory adjustments in the ferrous minerals business, the effects of fair value inventory adjustments made as part of the purchase price allocation of US$98 million in connection with our acquisition of the fertilizers business and increased demurrage costs as a result of greater activity during 2010.

Selling, general and administrative expenses

Selling, general and administrative expenses increased by 50.5%, or US$571 million, due primarily to higher volumes sold, increased personnel expenses, outsourced services and exchange rate variations.

Research and development expenses

Research and development expenses decreased by 10.5%. The US$103 million decrease primarily reflects changes in the status of some gas and energy projects that we determined were viable, so the related expenditures were recorded as capital expenditures rather than expenses, as in prior periods.

Other costs and expenses

Other costs and expenses increased by US$683 million, mainly due to provisions for losses on property, plant and equipment and disposal of materials, start-up expenses related to our New Caledonia operations and pre-operating expenses related to our Onça Puma, Salobo and Moatize projects.

Operating income by segment

The following table provides information about our operating income by segment and as a percentage of revenues for the years indicated.

	Year ended December 31,			
	2009		2010	
	Segment operating income (loss)		Segment operating income (loss)	
	(US$ million)	(% of net operating revenues)	(US$ million)	(% of net operating revenues)
Bulk materials:				
Iron ore	US$6,659	52.6%	US$17,347	66.7%
Iron ore pellets	19	1.5	3,511	57.2
Manganese ore	31	21.7	105	41.8
Ferroalloys	34	10.4	270	44.9
Coal	(105)		(169)	
Base metals:				
Nickel and other products	(361)		165	3.5
Copper concentrate	129	19.5	197	21.8
Aluminum products	(191)		286	11.3
Fertilizers:				
Potash	180	45.5	(29)	
Phosphates			(27)	
Nitrogen			(41)	
Others fertilizer products			1	8.3
Logistics:				
Railroads	65	9.3	85	9.2
Ports	36	15.9	47	15.4
Shipping	(7)		(8)	
Other products and services	(432)		(45)	
Total	US$6,057	26.0%	US$21,695	47.9%

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Operating income as a percentage of net operating revenues increased from 26.0% in 2009 to 47.9% in 2010. In general, the segments benefited from higher prices and volumes sold, as summarized in more detail below.

The increase in operating margin for iron ore and iron ore pellets primarily reflects higher average sales prices and volumes sold.

The increase in operating margins for manganese and ferroalloys is attributable to higher sales prices and volumes sold as a result of the recovery of the steel industry.

The decrease in operating margin for coal is attributable to higher expenses related to the pre-operating phase of Vale Moçambique.

The increase in operating margins for nickel and other products is attributable to higher market prices.

The negative operating margin for our fertilizer segment is attributable primarily to the fair value allocated to inventories as part of the purchase accounting adjustments in connection with the 2010 acquisitions.

The increase in operating margin in the aluminum products segment resulted primarily from higher average sales prices.

Non-operating income (expenses)

The following table details our net non-operating income (expenses) for the periods indicated.

	Year ended December 31,	
	2009	2010
	(US$ million)	
Financial income	US$ 381	US$ 290
Financial expenses	(1,558)	(2,646)
Gains (losses) on derivatives, net	1,528	631
Foreign exchange and monetary gains, net	675	344
Gain on sale of assets	40	
Non-operating income (expenses)	US$ 1,066	US$ (1,381)

We had net non-operating expenses of US$1.381 billion in 2010, compared to net non-operating income of US$1.066 billion in 2009. The change in net non-operating income (expenses) was affected by the following factors:

A decrease in financial income of US$91 million, mainly due to a lower average cash balance.

An increase in financial expenses of US$1.088 billion, principally due to fair value changes in our liability under our shareholder debentures, IOF (financial operations tax) charges related to the conversion of our mandatorily convertible notes due June 2010 and higher financial interest due to a higher average level of debt.

Lower foreign exchange and indexation gains due to foreign exchange loss, resulting from the combination of lower cash balances, treasury positions in U.S. dollars in 2010 and appreciation of the Brazilian *real* against the U.S. dollar in 2010.

No gain on sales of assets in 2010, compared to a US$40 million gain in 2009. The net gain in 2009 was mainly attributable to the sale of shares of Usiminas.

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Income taxes

For 2010, we recorded net income tax expense of US$3.705 billion, compared to US$2.100 billion in 2009. The effective tax rate on our pretax income was 18%, lower than the statutory rate, mainly because of a retroactive tax benefit eligible for recognition this year related to our Carajás iron ore operations and the tax benefit of shareholder distributions categorized as interest on shareholders' equity. For more information, see Note 6 to our consolidated financial statements.

Exchange variations directly impact the exchange gains or losses recognized on transactions between the parent company and certain subsidiaries with lower statutory tax rates. Although those gains and losses are eliminated from reported consolidated pretax amounts in the consolidation and currency re-measurement process, they are not eliminated for Brazilian tax purposes since in Brazil there is no consolidated income tax regime. Our effective tax rate has historically been lower than the Brazilian statutory rate because: (i) income of some non-Brazilian subsidiaries is subject to lower statutory rates of tax; (ii) we are entitled under Brazilian law to deduct the amount of our distributions to shareholders that we classify as interest on shareholders' equity; (iii) we benefit from tax incentives applicable to our earnings on production in certain regions of Brazil; and (iv) functional currency movements on some non-Brazilian subsidiaries are not taxable under Brazilian law. In addition, some of the foreign exchange variations that affect our operating results are not taxable.

Affiliates and joint ventures

Our equity in the results of affiliates and joint ventures resulted in a net gain of US$987 million in 2010, compared to a net gain of US$433 million in 2009. Our joint venture Samarco represents US$798 million of the 2010 amount, and the increase in 2010 is attributable to higher sales volume and higher prices for iron ore pellets.

LIQUIDITY AND CAPITAL RESOURCES

Overview

In the ordinary course of business, our principal funding requirements are for capital expenditures, dividend payments and debt service. We have historically met these requirements by using cash generated from operating activities and through borrowings, supplemented occasionally by dispositions of assets.

For 2012, we have budgeted capital expenditures of US$21.4 billion, and announced a minimum dividend payment of US$6.0 billion to be paid in two installments of US$3.0 billion, with the first installment in April and the second in October. We paid US$9.0 billion in dividends during 2011 and repurchased US$3.0 billion of our common and preferred shares during the second half of 2011.

We expect our operating cash flow and cash holdings to be sufficient to meet these anticipated requirements. We also regularly review acquisition and investment opportunities and, when suitable opportunities arise, we make acquisitions and investments to implement our business strategy. We may fund these investments with borrowings.

Sources of funds

Our principal sources of funds are operating cash flow and borrowings. Our operating activities generated cash flows of US$24.5 billion in 2011.

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Our major new borrowing transactions in 2011 and to date in 2012 are summarized below:

In January 2012, our wholly owned finance subsidiary Vale Overseas issued US$1 billion notes due 2022, guaranteed by Vale, with a coupon of 4.375% per year, payable semi-annually. In April 2012, Vale Overseas reopened the notes and issued an additional US$1.250 billion.

In August 2011, we entered into an agreement with a syndicate of financial institutions to finance the acquisition of five large ore carriers of 400,000 DWT and two capesize bulkers of 180,000 DWT. The agreement provides a secured term loan facility of up to approximately US$530 million, which corresponds to 80% of the contract price of the vessels. As of December 31, 2011, Vale had drawn US$178 million under the facility. The banks also have the benefit of an insurance policy provided by K-Sure (Korea Trade Insurance Corporation).

In January 2011, we entered into an agreement with a group of commercial banks with the guarantee of the official Italian credit agency, Servizi Assicurativi Del Commercio Estero S.p.A SACE, to provide us with a US$300 million facility with a final tenor of 10 years to guarantee lines of credit provided by commercial banks. As of December 31, 2011, we had drawn down all amounts available under this facility.

In addition to the transactions described above, during 2011 we also borrowed US$1.761 billion under our existing financing agreements.

In February 2011, we concluded the transfer to Hydro of a substantial portion of our aluminum assets, including our interests in Albras, Alunorte and CAP, together with off-take rights, outstanding commercial contracts and net debt of US$655 million. In this transaction we received US$503 million in cash and 22% of Hydro's outstanding common shares. Also as part of the transaction, we transferred the Paragominas bauxite mine and all of our other Brazilian bauxite mineral rights (apart from rights owned through our stake in MRN) to Paragominas, 60% of which we transferred to Hydro in exchange for US$578 million in cash. We will transfer our remaining interest in Paragominas to Hydro in two equal tranches in 2014 and 2016, each in exchange for US$200 million, subject to certain contingent adjustments.

In April 2011, we entered into a new revolving credit agreement with a syndicate of banks that added US$3 billion to the total amount available under our revolving credit facilities, which can be drawn by Vale S.A., Vale Canada and Vale International. As of December 31, 2011, none of the borrowers had drawn any amounts under these facilities.

Uses of funds

Capital expenditures

Capital expenditures amounted to US$18.0 billion in 2011, and we have budgeted US$21.4 billion for 2012. Our actual capital expenditures may differ from the budgeted amount for a variety of reasons, including unexpected changes in currency prices. These capital expenditure figures include some amounts that are treated as current expenses for accounting purposes, such as expenses for project development, maintenance of existing assets and research and development. For more information about the specific projects for which we have budgeted funds, see *Capital expenditures and projects*.

Distributions

We paid total dividends of US$9 billion in 2011 (including distributions classified as interest on shareholders' equity). In January 2011, we paid an extraordinary dividend of US$1 billion and announced a minimum dividend for the year of US$4 billion, consisting of US$2 billion in April 2011 and US$2 billion in October 2011. Subsequently, we also paid additional dividends of US$3 billion in August 2011 and

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US$1 billion in October 2011. The minimum dividend we have announced for 2012 is US$6.0 billion, payable in two equal installments in April and October.

Tax payments

We paid US$7.293 billion in income tax during 2011. This amount includes US$3.746 billion in social contribution tax (*Contribuição Social sobre o Lucro Líquido CSLL*) that we paid as a result of a recent adverse decision by a Brazilian court, in order to avoid a penalty that would otherwise have applied 30 days after the decision. Vale continues to dispute the merits of this proceeding, which relates to the exemption from CSLL for export revenues. The amount we paid had previously been provisioned.

Share repurchases

We repurchased US$3 billion of our common and preferred shares during the second half of 2011. For more information, see *Purchase of equity securities by the issuer and affiliated purchasers*.

Acquisitions

In December 2011, we concluded a tender offer to acquire up to 100% of the publicly held shares of our subsidiary Vale Fertilizantes. As a result of the public offer, we acquired 83.8% of the publicly held common shares and 94.0% of the publicly held preferred shares of Vale Fertilizantes, which correspond to 0.1% of the total common shares and 29.8% of the total preferred shares of Vale Fertilizantes. Both the common and preferred shares were acquired for R$25.00 per share, amounting to a total of R$2.1 billion (US$1.1 billion). Shortly thereafter, Vale Fertilizantes' registration as a publicly listed company in Brazil was cancelled. The shareholders of Vale Fertilizantes held a general shareholders meeting in January 2012 and approved the redemption of the remaining free floating common and preferred shares. As a result, Vale holds 100% of the common shares and 100% of the preferred shares of Vale Fertilizantes. For more information, see *Significant changes in our business*.

Debt

At December 31, 2011, we had aggregate outstanding debt of US$23.055 billion. Our outstanding long-term debt (including the current portion of long-term debt and accrued charges) was US$23.033 billion, compared with US$24.414 billion at the end of 2010. At December 31, 2011, US$648 million of our debt was secured by liens on some of our assets. At December 31, 2011, the average debt maturity was 9.81 years, compared to 9.92 years in 2010.

Our short-term debt consists primarily of U.S. dollar-denominated trade financing with commercial banks. At December 31, 2011, we had US$22 million of outstanding short-term debt.

Our major categories of long-term indebtedness are as follows. The amounts given below include the current portion of long-term debt and exclude accrued charges.

U.S. dollar-denominated loans and financing (US$3.189 billion at December 31, 2011). This category includes export financing lines, loans from export credit agencies, and loans from commercial banks and multilateral organizations. The largest facility is a pre-export financing facility linked to future receivables from export sales, which was originally entered in the amount of US$6.0 billion. The outstanding amount at December 31, 2011 was US$650 million.

U.S. dollar-denominated fixed rate notes (US$10.483 billion at December 31, 2011). Through our finance subsidiary Vale Overseas Limited, we have issued in public offerings several series of fixed-rate debt securities with a Vale guarantee, totaling US$9.131 billion. Our subsidiary Vale Canada has outstanding fixed rate debt in the amount of US$1.351 billion.

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Euro-denominated fixed rate notes (US$970 million at December 31, 2011). On March 24, 2010, we issued €750 million of fixed-rate notes in a global public offering. These notes are due in 2018 and have a coupon of 4.375% per year, payable annually.

Real*-denominated non-convertible debentures (US$2.505 billion at December 31, 2011).* In November 2006, we issued non-convertible debentures in the amount of approximately US$2.600 billion, in two series, with four- and seven-year maturities. The first series, approximately US$700 million at issuance, matured in 2010. The second series, approximately US$1.900 billion at issuance, matures in 2013 and bears interest at the Brazilian CDI interest rate plus 0.25% per year. At December 31, 2011, the total amount of the second series was US$2.157 billion.

Other debt (US$5.553 billion at December 31, 2011). We have outstanding debt, principally owed to BNDES and Brazilian commercial banks, denominated in Brazilian *reais* and other currencies.

We also have a variety of credit lines. At December 31, 2011, these included the following:

A credit line for US$530 million with a syndicate of financial institutions to finance the acquisition of five large ore carriers and two capesize bulkers at two Korean shipyards. As of December 31, 2011, we had drawn US$178 million under this facility.

A credit line for US$1 billion with Export Development Canada to finance our investment program. As of December 31, 2011, we had drawn US$500 million under this facility.

A US$1.2 billion facility with The Export-Import Bank of China and the Bank of China Limited to finance the construction of 12 very large ore carriers. As of December 31, 2011, we had drawn US$467 million under this facility.

Framework agreements signed in May 2008 with the Japan Bank for International Cooperation ("JBIC") and Nippon Export and Investment Insurance ("NEXI") for US$5 billion of financing for mining, logistics and power generation projects. We have a fully drawn US$300 million export facility, through our subsidiary PTVI, with Japanese financial institutions to finance the construction of the Karebbe hydroelectric power plant on the Larona River in Sulawesi, Indonesia.

Credit lines for R$7.3 billion, or US$4.0 billion, with BNDES to help finance our investment program. As of December 31, 2011, we had drawn the equivalent of US$1.496 billion under this facility.

Facilities with BNDES totaling R$877 million, or US$492 million, to finance the acquisition of domestic equipment. As of December 31, 2011, we had drawn the equivalent of US$329 million under these facilities.

We have revolving credit facilities with syndicates of international banks. At December 31, 2011, the total amount available under these facilities was US$4.1 billion. A portion of these facilities, US$1.1 billion, will expire in May 2012. As of December 31, 2011, we had not drawn any amounts under these facilities, but US$107 million of letters of credit were issued and outstanding under a facility of Vale Canada.

Some of our long-term debt instruments contain financial covenants. Our principal covenants require us to maintain certain ratios, such as debt to EBITDA and interest coverage. We believe that our existing covenants will not significantly restrict our ability to borrow additional funds as needed to meet our capital requirements.

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Shareholder Debentures

At the time of the first stage of our privatization in 1997, we issued shareholder revenue interests known in Brazil as "*debentures participativas*" to our then-existing shareholders. The terms of the debentures were established to ensure that our pre-privatization shareholders, including the Brazilian government, would participate alongside us in potential future financial benefits that we derive from exploiting certain mineral resources that were not taken into account in determining the minimum purchase price of our shares in the privatization. In accordance with the debentures deed, holders have the right to receive semi-annual payments equal to an agreed percentage of our net revenues (revenues less value-added tax, transport fee and insurance expenses related to the trading of the products) from certain identified mineral resources that we owned at the time of the privatization, to the extent that we exceed defined thresholds of sales volume relating to certain mineral resources, and from the sale of mineral rights that we owned at that time. Our obligation to make payments to the holders will cease when the relevant mineral resources are exhausted.

We have been making semi-annual payments to holders of shareholder debentures, which reached US$7 million in 2009, US$10 million in 2010 and US$14 million in 2011. See Note 20 to our consolidated financial statements for a description of the terms of the debentures.

CONTRACTUAL OBLIGATIONS

The following table summarizes our contractual obligations at December 31, 2011. This table excludes other common non-contractual obligations that we may have, including pension obligations, deferred tax liabilities and contingent obligations arising from uncertain tax positions, all of which are discussed in the notes to our consolidated financial statements.

	Payments due by period				
	Total	Less than 1 year	2013-2014	2015-2016	Thereafter
			(US$ million)		
Long-term debt(1)	US$22,700	US$1,162	US$4,415	US$2,559	US$14,564
Short-term debt	22	22			
Short-term debt associated with assets held for sale	8	8			
Interest payments(2)	14,324	1,311	2,353	1,891	8,769
Operating lease obligations(3)	1,537	153	255	220	909
Purchase obligations(4)	16,396	7,858	4,640	1,753	2,145
Total	US$54,987	US$10,514	US$11,663	US$6,423	US$26,387

(1) Amounts include the current portion of long-term debt and do not include accrued charges.

(2) Consists of estimated future payments of interest on our loans, financings and debentures, calculated based on interest rates and foreign exchange rates applicable at December 31, 2011 and assuming (i) that all amortization payments and payments at maturity on our loans, financings and debentures will be made on their scheduled payments dates, and (ii) that our perpetual bonds are redeemed on the first permitted redemption date.

(3) Amounts include fixed payments related to the operating lease contracts for the pellet plants.

(4) Obligations to purchase materials. Amounts are based on contracted prices, except for purchases of iron ore from mining companies located in Brazil, which are based on Q1 2012 average prices.

OFF-BALANCE SHEET ARRANGEMENTS

At December 31, 2011, we did not have any off-balance sheet arrangements as defined in the SEC's Form 20-F. For information on our contingent liabilities see Note 20 to our consolidated financial statements.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

We believe that the following are our critical accounting policies. We consider an accounting policy to be critical if it is important to our financial condition and results of operations and if it requires significant judgments and estimates on the part of our management. For a summary of all of our significant accounting policies, see Note 3 to our consolidated financial statements.

Mineral reserves and useful life of mines

We regularly evaluate and update our estimates of proven and probable mineral reserves. Our proven and probable mineral reserves are determined using generally accepted estimation techniques. Calculating our reserves requires us to make assumptions about future conditions that are highly uncertain, including future ore prices, currency prices, inflation rates, mining technology, availability of permits and production costs. Changes in some or all of these assumptions could have a significant impact on our recorded proven and probable reserves.

One of the ways we make our ore reserve estimates is to determine the mine closure dates used in recording the fair value of our asset retirement obligations for environmental and site reclamation costs and the periods over which we amortize our mining assets. Any change in our estimates of total expected future mine or asset lives could have an impact on the depreciation, depletion and amortization charges recorded in our consolidated financial statements under cost of goods sold. Changes in the estimated lives of our mines could also significantly impact our estimates of environmental and site reclamation costs, which are described in greater detail below.

Environmental and site reclamation costs

Expenditures relating to ongoing compliance with environmental regulations are charged against earnings or capitalized as appropriate. These ongoing programs are designed to minimize the environmental impact of our activities.

We recognize a liability for the fair value of our estimated asset retirement obligations in the period in which they are incurred, if a reasonable estimate can be made. We consider the accounting estimates related to reclamation and closure costs to be critical accounting estimates because:

- we will not incur most of these costs for a number of years, requiring us to make estimates over a long period;

- reclamation and closure laws and regulations could change in the future or circumstances affecting our operations could change, either of which could result in significant changes to our current plans;

- calculating the fair value of our asset retirement obligations requires us to assign probabilities to projected cash flows, to make long-term assumptions about inflation rates, to determine our credit-adjusted risk-free interest rates and to determine market risk premiums that are appropriate for our operations; and

- given the significance of these factors in the determination of our estimated environmental and site reclamation costs, changes in any or all of these estimates could have a material impact on net income. In particular, given the long periods over which many of these charges are discounted to present value, changes in our assumptions about credit-adjusted risk-free interest rates could have a significant impact on the size of our provision.

Our Environmental Department defines the rules and procedures that should be used to evaluate our asset retirement obligations. The future costs of retirement of our mines and sites are reviewed annually, in each case considering the actual stage of exhaustion and the projected exhaustion date of each mine and site. The future estimated retirement costs are discounted to present value using a credit-adjusted risk-free interest rate. At December 31, 2011, we estimated the fair value of our aggregate total asset retirement obligations to be US$1.77 billion.

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Impairment of long-lived assets and goodwill

We have made acquisitions that included a significant amount of goodwill, as well as intangible and tangible assets. Under generally accepted accounting principles, except for goodwill and indefinite-life intangible assets, all long-lived assets, including these acquired assets, are amortized over their estimated useful lives, and are tested to determine if they are recoverable from operating earnings on an undiscounted cash flow basis over their useful lives whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Factors that could trigger an impairment review include the following:

- significant underperformance relating to expected historical or projected future operating results of entities or business units;

- significant changes in the way we use the acquired assets or our overall business strategy; or

- significant negative industry or macroeconomic trends.

When we determine that the carrying value of definite-life intangible assets and long-lived assets may not be recoverable based upon verification of one or more of the above indicators of impairment, we measure any impairment loss based on a projected discounted cash flow method using a discount rate estimated pursuant to technical criteria to be commensurate with the risk inherent in our current business model.

We are required to assign goodwill to reporting units and to assess each reporting unit's goodwill for impairment at least annually and whenever circumstances indicating that recognized goodwill might not be fully recovered are identified. On September 15, 2011, FASB issued Accounting Standards Update (ASU) No. 2011-08, Intangibles Goodwill and Other (Topic 350): Testing Goodwill for Impairment. The standard provides the option to first assess qualitative factors to determine whether it is necessary to further perform the first and second steps of the goodwill impairment test. In assessing the qualitative factors, if it is more likely than not that the fair value of the reporting unit exceeds its carrying amount, the first and second steps of the goodwill impairment test are not required and no goodwill impairment charge is required. Otherwise, the entity will be required to perform the first and second steps of the goodwill impairment test to assess whether an impairment exists. In the first step of a goodwill impairment test, we compare a reporting unit's fair value with its carrying amount to identify any potential goodwill impairment loss. If the carrying amount of a reporting unit exceeds the unit's fair value, we carry out the second step of the impairment test to measure the amount, if any, of the unit's goodwill impairment loss. Goodwill arising from a business combination with a continuing non-controlling interest is tested for impairment by using an approach that is consistent with the approach that the entity used to measure the non-controlling interest at the acquisition date. For equity investees we determine annually whether there is an other-than-temporary decline in the fair value of the investment.

For impairment test purposes, management determined discounted cash flows based on approved budget assumptions. Gross margin projections were based on past performance and management's expectations of market developments. Information about sales prices is consistent with the forecasts included in industry reports, taking into account quoted prices when available and appropriate. The discount rates used reflect specific risks relating to the relevant assets in each reporting unit, depending on their composition and location.

Recognition of additional goodwill impairment charges in the future would depend on several estimates, including market conditions, recent actual results and management's forecasts. This information will be obtained when our assessment is updated during the fourth quarter of 2012, or earlier if impairment indicators are identified. It is not possible at this time to determine whether an impairment charge will be taken in the future and if it were to be taken, whether such charge would be material.

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Derivatives

We are required to recognize all derivative financial instruments, whether designated in hedging relationships or not, on our balance sheet and to measure such instruments at fair value. The gain or loss in fair value is included in current earnings, unless the derivative to which the gain or loss is attributable qualifies for hedge accounting. We have entered into cash flow hedges that qualify for hedge accounting. Unrealized fair value adjustments to cash flow hedges are recognized in other comprehensive income. We use well-known market participants' valuation methodologies to compute the fair value of instruments. To evaluate the financial instruments, we use estimates and judgments related to present values, taking into account market curves, projected interest rates, exchange rates, forward market prices and their respective volatilities, when applicable. We evaluate the impact of credit risk on financial instruments and derivative transactions, and we enter into transactions with financial institutions that we consider to have a high credit quality. The exposure limits to financial institutions are proposed annually by the Executive Risk Committee and approved by the Board of Executive Officers. The financial institution's credit risk tracking is performed making use of a credit risk valuation methodology that considers, among other information, published ratings provided by international rating agencies and other management judgments. During 2011, we implemented hedge accounting partially for strategic nickel hedge and for a foreign exchange hedge. At December 31, 2011, we had US$37 million of realized gains related to derivative instruments designated as cash flow hedges. In 2011, we recorded to the income statement gains of US$75 million in relation to derivative instruments.

Income taxes

We recognize deferred tax effects of tax loss carryforwards and temporary differences in our consolidated financial statements. We record a valuation allowance when we believe that it is more likely than not that tax assets will not be fully recoverable in the future.

When we prepare our consolidated financial statements, we estimate our income taxes based on regulations in the various jurisdictions where we conduct business. This requires us to estimate our actual current tax exposure and to assess temporary differences that result from deferring treatment of certain items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which we show on our consolidated balance sheet. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income. To the extent we believe that recovery is not likely, we establish a valuation allowance. When we establish a valuation allowance or increase this allowance in an accounting period, we record a tax expense in our statement of income. When we reduce the valuation allowance, we record a tax benefit in our statement of income.

Determining our provision for income taxes, our deferred tax assets and liabilities and any valuation allowance to be recorded against our net deferred tax assets requires significant management judgment, estimates and assumptions about matters that are highly uncertain. For each income tax asset, we evaluate the likelihood of whether some portion or the entire asset will not be realized. The valuation allowance made in relation to accumulated tax loss carryforwards depends on our assessment of the probability of generation of future taxable profits within the legal entity in which the related deferred tax asset is recorded, based on our production and sales plans, selling prices, operating costs, environmental costs, group restructuring plans for subsidiaries and site reclamation costs and planned capital costs.

Contingencies

We disclose material contingent liabilities unless the possibility of any loss arising is considered remote, and we disclose material contingent assets where the inflow of economic benefits is probable. We discuss our material contingencies in Note 20 to our consolidated financial statements.

We record an estimated loss from a loss contingency when information available prior to the issuance of our financial statements indicates that it is probable that a future event will confirm that an asset has been impaired or a liability has been incurred at the date of the financial statements, and the amount of the loss can be reasonably estimated. In particular, given the nature of Brazilian tax legislation, the assessment of potential tax liabilities requires significant management judgment. By their nature, contingencies will only be resolved when one or more future events occurs or fails to occur, and typically those events will occur a number of years in the future. Assessing such liabilities, particularly in the Brazilian legal environment, inherently involves the exercise of significant management judgment and estimates of the outcome of future events.

The provision for contingencies at December 31, 2011, totaling US$1.686 billion, consists of provisions of US$751 million for labor, US$248 million for civil, US$654 million for tax and US$33 million for other claims.

Employee post-retirement benefits

We sponsor defined benefit pension plans covering some of our employees. The determination of the amount of our obligations for pension benefits depends on certain actuarial assumptions. These assumptions are described in Note 18 to our consolidated financial statements and include, among others, the expected long-term rate of return on plan assets and increases in salaries. In accordance with U.S. GAAP, actual results that differ from our assumptions and are not a component of net benefit costs for the year are recorded in other comprehensive income (loss).

RISK MANAGEMENT

The aim of our risk management strategy is to promote enterprise-wide risk management that supports our growth strategy, strategic plan, corporate governance practices and financial flexibility to support maintenance of investment grade status. We developed an integrated framework for managing risk, which considers the impact on our business of not only market risk factors (market risk), but also risks arising from third party obligations (credit risk), risks associated with inadequate or failed internal processes, people, systems or external events (operational risk) and risks associated with political and regulatory conditions in countries in which we operate (political risk).

In furtherance of this objective and in order to further improve our corporate governance practices, our Board of Directors has established a company-wide risk management policy and an Executive Risk Management Committee. The risk management policy requires that we regularly evaluate and monitor the corporate risk on a consolidated basis in order to guarantee that our overall risk level remains in line with the guidelines defined by the Board of Directors and the Executive Board.

The Executive Risk Management Committee is responsible for supporting the Board of Executive Officers in performing risk analysis and for issuing opinions regarding proper risk management. The committee is also responsible for the supervision and revision of the principles and instruments of company-wide risk management, in addition to reporting periodically to the Board of Executive Officers regarding the major risks we are exposed to and the impact of new investments, projects and disinvestments in our risk profile. As of April 2012, the members of the Executive Risk Management Committee were: Tito Botelho Martins, Chief Financial Officer and Executive Director for Investor Relations, Procurement and Shared Services, José Carlos Martins, Executive Officer responsible for Ferrous Minerals Operations and Marketing, Sonia Zagury, Corporate Finance Director, Efrem José Daumas Junior, Planning, Development and Continuous Improvement Director and Roberto Moretzsohn, Marketing and Sales Base Metals Director.

Under our risk management policy, we may assign specific risk limits to certain management activities that require market, credit or sovereign risk limits. Those limits will be observed and evaluated using certain risk metrics, including Value at Risk (VaR).

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Market risk

We are exposed to various market risk factors that can impact our financial stability and cash flow. An assessment of the potential impact of the consolidated market risk exposure is performed periodically to inform our decision making processes and growth strategy, ensure financial flexibility and monitor future cash flow volatility.

When necessary, market risk mitigation strategies are evaluated and implemented. Some of these strategies may incorporate financial instruments, including derivatives. The financial instrument portfolios are monitored on a monthly basis, enabling us to properly monitor financial results and their impact on cash flow, and ensure correlation between the strategies implemented and the proposed objectives.

Considering the nature of our business and operations, the main market risk factors that we are exposed to are: interest rates, foreign exchange rates, product prices and input costs.

We recognize all derivatives on our balance sheet at fair value, and the gain or loss in fair value is recognized in our current earnings, except as described in the next paragraph. Fair value accounting of derivatives may introduce unintended volatility in our quarterly earnings. However, it does not generate volatility in our cash flows, given the nature of our derivatives transactions.

Under the Standard Accounting for Derivative Financial Instruments and Hedging Activities, all derivatives, whether designated as hedging relationships or not, are required to be recorded on the balance sheet at fair value, and the gain or loss in fair value is included in current earnings, unless the derivative is designated as in a hedging relationship, thereby qualifying as hedge accounting. In order to be deemed an effective hedging relationship, a change in the fair value of the derivative must be offset by an equal and opposite change in the fair value of the underlying hedged item. In accordance with these requirements, we perform effectiveness tests in order to assess the effectiveness of the hedging relationships and quantify ineffectiveness for all designated hedges.

At December 31, 2011, Vale had outstanding positions designated as hedging relationships, or more specifically, cash flow hedges. A cash flow hedge is a hedge of the exposure to the variability in expected future cash flows that is attributable to a particular risk, such as a forecasted purchase or sale. If a derivative is designated as cash flow hedge, the effective portion of the change in the fair value of the derivative is recorded in other comprehensive income and recognized in the income statement at the time the hedged item is recorded, enabling gains and losses on the hedging instrument to be recognized in the income statement in the same period as offsetting losses or gains on the hedged item. However, the ineffective portion of changes in the fair value of the derivatives designated as hedges is recognized in the income statement. Consequently, if a portion of a derivative contract is excluded for purposes of effectiveness testing, the value of such excluded portion is recognized on the income statement.

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The asset (liability) balances at December 31, 2011 and 2010 and the movement in fair value of derivative financial instruments are shown in the following table.

	Interest rates (LIBOR)/ Currencies	Aluminum products	Copper/ Coal	Nickel	Freight	Fuel/ Natural gas	Total
Fair value at January 1, 2010	US$870	US$(87)	US$	US$(28)	US$29	US$49	US$833
Financial settlement	(1,329)	63	3	97	(25)	(35)	(1,226)
Unrealized gains (losses) in the year	832	(36)	(5)	(137)	(5)	3	652
Effect of exchange rate changes	18	(1)		1	(1)	(1)	16
Unrealized gain (loss) at December 31, 2010	US$391	US$(61)	US$(2)	US$(67)	US$(2)	US$16	US$275
Fair value at January 1, 2011	US$391	US$(61)	US$(2)	US$(67)	US$(2)	US$16	US$275
Financial settlement	(435)	4	2	(89)	2	(49)	(565)
Unrealized gains (losses) in the year	(95)			317		37	259
Effect of exchange rate changes	(107)	57					(50)
Unrealized gain (loss) at December 31, 2011	US$(246)	US$	US$	US$161	US$	US$4	US$(81)

Foreign exchange rate and interest rate risks

Our cash flows are exposed to the volatility of several currencies against the U.S. dollar. While most of our product prices are indexed to U.S. dollars, most of our costs, disbursements and investments are indexed to currencies other than the U.S. dollar, principally the Brazilian *real* and the Canadian dollar. We frequently use derivative instruments, primarily forward transactions and swaps, in order to reduce our potential cash flow volatility arising from this currency mismatch.

We use swap transactions to effectively convert debt linked to Brazilian *reais* into U.S. dollars. These transactions typically have similar or sometimes earlier settlement dates than the final maturity dates of the associated debt instruments. Likewise, the notional amounts of the swap transactions are similar to the principal and interest payments of the debt, subject to liquidity market conditions. The swaps with shorter settlement dates are then renegotiated over time so that their final maturity matches, or approaches, the debt's final maturity. At each settlement date, the results of the swap transactions partially offset the impact of the foreign exchange rate in Vale's obligations, helping stabilize the cash disbursements in U.S. dollars.

In the event of an appreciation (depreciation) of the Brazilian *real* against the U.S. dollar, the negative (positive) impact on our *real*-denominated debt obligations (interest and/or principal payment) measured in U.S. dollars will be partially offset by an associated positive (negative) effect from any existing swap transaction, regardless of the U.S. dollar/*real* exchange rate on the payment date. The same rationale applies to debt denominated in other currencies and their respective swaps.

We are also exposed to interest rate risk on loans and financings. Our floating rate debt consists mainly of loans including export pre-payments, commercial bank loans and multilateral organization loans. In general, the U.S. dollar floating rate debt is subject to changes in LIBOR (London Interbank Offer Rate) in U.S. dollars. To mitigate the impact of interest rate volatility on our cash flows, we take advantage of natural hedges resulting from the correlation between commodity prices and U.S. dollar floating interest rates. If such natural hedges are not present, we may opt to obtain the same effect by using financial instruments.

Our floating rate debt denominated in *reais* includes debentures issued in the Brazilian market and loans provided by BNDES and commercial local banks. Interest on these obligations is mainly based on the CDI (Interbank Deposit Certificate), the benchmark interest rate in the Brazilian interbank market, and the TJLP, the benchmark Brazilian long-term interest rate.

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The following table sets forth our floating and fixed rate long-term debt, categorized by Brazilian *reais* and other currencies, and as a percentage of our total long-term debt portfolio at the dates indicated, except for accrued charges and translation adjustments, as reflected in our consolidated financial statements.

	At December 31,			
	2010		2011	
	(US$ million, except percentages)			
Floating rate debt:				
Real-denominated	7,476	30.2%	7,595	33.5%
Denominated in other currencies	4,969	20.1%	3,250	14.3%
Denominated in other currencies associated with assets held for sale(1)	702	2.8%		
Fixed rate debt:				
Real-denominated	123	0.5%	400	1.8%
Denominated in other currencies	11,503	46.4%	11,455	50.4%
Subtotal	24,773	100.0%	22,700	100.0%
Accrued charges	343		333	
Accrued charges associated with assets held for sale(1)	3			
Total	25,118		23,033	

(1) We transferred our aluminum business in Albras, Alunorte and CAP, among other items, to Hydro in February 2011, in exchange for a 22.0% equity interest in Hydro as part of the consideration.

The following table provides information about our debt obligations as of December 31, 2011. It presents the principal cash flows and related weighted average interest rates of these obligations by expected maturity date. Weighted average variable interest rates are based on the applicable reference rate at December 31, 2011. Actual cash flows of these debt obligations are denominated mainly in U.S. dollars or *reais,* as indicated.

	Weighted average interest rate(1)(2)	2012	2013	2014	2015	2016	To 2040	Total	Fair value cash flow at December 31, 2011(3)
	(%)	(US$ million)							
US$-denominated									
Fixed rate:									
Bonds	6.49	402	124		300	952	8,461	10,239	11,597
Loans	8.50						39	39	39
Floating rate:									
Loans	6.63	123	145	173	173	173	828	1,615	1,705
Trade finance	1.86	375	435	35	35	35	660	1,575	1,598
Subtotal		900	704	208	508	1,160	9,988	13,468	14,939
***Real*-denominated**									
Fixed rate loans	3.95	9	29	42	51	53	216	400	474
Floating rate loans	8.52	235	2,440	952	364	362	2,878	7,231	7,235
Subtotal		244	2,469	994	415	415	3,094	7,631	7,709
Denominated in other currencies									
Fixed rate									
Eurobonds	4.93						970	970	1,034
Loans	8.67	9	3	23	24	27	121	207	207

Floating rate loans	3.31	9	8	6	5	5	28	61	61
Subtotal		18	11	29	29	32	1,119	1,238	1,301
No maturity							363	363	363
Total		1,162	3,184	1,231	952	1,607	14,564	22,700	24,312

(1) Weighted average interest rates do not take into account the effect of the derivatives.

(2) Weighted average variable interest rates are based on the applicable reference rate at December 31, 2011.

(3) Includes only long-term debt obligations.

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As of December 31, 2011, the total principal amount and interest of our *real*-denominated debt converted through swaps into U.S. dollars was US$6.0 billion and the total principal amount and interest of our euro-denominated debt converted through swaps into U.S. dollars was US$649 million, with an average cost in U.S. dollars of 3.22% per year after swap transactions and with maturity until September 2029. Most of those contracts are subject to semi-annual interest payments.

Protection program for real-denominated debt indexed to CDI

In order to reduce cash flow volatility, we entered into swap transactions to convert to U.S. dollars the cash flows on debt instruments denominated in *reais* linked to CDI. In those swaps, Vale pays either fixed rates or floating LIBOR rates in U.S. dollars and receives payments linked to CDI.

These instruments were used to convert cash flows from: debentures issued in 2006 with a nominal value of R$5.5 billion (US$2.5 billion at the disbursement date), credit export notes issued in 2008 with a nominal value of R$2.0 billion (US$1.1 billion at the disbursement date) and procurement financing obtained in 2006 and 2007 with a nominal value of R$1.0 billion (US$464 million at the disbursement dates).

Flow	Notional value at December 31, 2011	2010	Index	Average rate	Final maturity	Fair value at December 31, 2011	2010
	(million)					(US$ million)	
CDI vs. fixed rate swap							
Receivable	R$ 5,542	R$ 5,542	CDI	103.03%	2015	3,049	3,447
Payable	US$3,144	US$3,144	USD	3.87%		(3,252)	(3,248)
Total						(203)	199
CDI vs. floating rate swap							
Receivable	R$ 428	R$ 428	CDI	103.51%	2015	242	272
Payable	US$ 250	US$ 250	LIBOR	0.99%		(260)	(262)
Total						(18)	10

Protection program for real-denominated debt indexed to TJLP

In order to reduce cash flow volatility, we entered into swap transactions to convert to U.S. dollars the cash flows related to indebtedness to BNDES indexed to TJLP. In these swaps, we pay either fixed or floating rates in U.S. dollars and receive payments linked to TJLP.

Flow	Notional value at December 31, 2011	2010	Index	Average rate	Final maturity	Fair value at December 31, 2011	2010
	(million)					(US$ million)	
TJLP vs. fixed rate swap(1)							
Receivable	R$ 3,107	R$ 2,418	TJLP	1.37%	2019	1,567	1,244
Payable	US$1,611	US$1,228	USD	2.65%		(1,576)	(1,180)
Total						(9)	64
TJLP vs. floating rate swap(1)							
Receivable	R$ 774	R$ 739	TJLP	0.96%	2019	372	371
Payable	US$ 365	US$ 372	LIBOR	(1.14)%		(309)	(343)
Total						63	28

(1) Due to TJLP derivatives market liquidity constraints, some swap trades were done through CDI equivalency.

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Protection program for real-denominated fixed debt

In order to hedge against cash flow volatility, we entered into a swap transaction to convert the cash flows from loans with BNDES in Brazilian *reais* linked to a fixed rate into U.S. dollars linked to a fixed rate. In these swaps, we receive fixed rates in *reais* and pay fixed rates in U.S. dollars.

Flow	Notional value at December 31, 2011	Notional value at December 31, 2010	Index	Average rate	Final maturity	Fair value at December 31, 2011	Fair value at December 31, 2010
	(million)					(US$ million)	
BRL fixed rate vs. USD fixed rate swap							
Receivable	R$ 615	R$ 204	Fixed	4.64%	2016	277	94.2
Payable	US$355	US$121	USD	(1.20)%		(300)	(93.6)
Total						(23)	0.6

Foreign exchange cash flow hedges

We entered into swap transactions to mitigate our exchange rate exposure arising from the currency mismatch between our revenues in U.S. dollars and our disbursements and investments in *reais*. Those transactions were designated as cash flow hedges.

Flow	Notional value at December 31, 2011	Notional value at December 31, 2010	Index	Average rate	Final maturity	Fair value at December 31, 2011	Fair value at December 31, 2010
	(million)					(US$ million)	
Receivable	R$ 820	R$ 880	Fixed	6.2%	2011	427	522
Payable	US$450	US$510	USD	0%		(440)	(500)
Total						(13)	22

Protection program for euro-denominated floating rate debt

We entered into a swap transaction to convert the cash flows from a 2003 euro-denominated loan linked to EURIBOR (Euro Interbank Offered Rate) to U.S. Dollars linked to LIBOR. In this trade, we received floating rates in euros (EURIBOR) and paid floating rates in U.S. dollars (LIBOR). This program ended in 2011.

Flow	Notional value at December 31, 2011	Notional value at December 31, 2010	Index	Average rate	Final maturity	Fair value at December 31, 2011	Fair value at December 31, 2010
	(million)					(US$ million)	
Receivable		€ 2	EUR		2011		3.2
Payable		US$3	USD				(2.7)
Total							0.5

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Protection program for euro-denominated fixed rate debt

We entered into a swap transaction to convert cash flows from loans in euros linked to a fixed rate to U.S. dollars linked to a fixed rate. In this swap, we receive fixed rates in euros and pay fixed rates in U.S. dollars. This trade was used to convert the cash flow of a debt denominated in euros, with a notional amount of €750 million that was issued in 2010.

Flow	Notional value at December 31, 2011	2010	Index	Average rate	Final maturity	Fair value at December 31, 2011	2010
	(million)					(US$ million)	
Receivable	€ 500	€ 500	EUR	4.375%	2014	723	760
Payable	US$675	US$675	USD	4.712%		(759)	(769)
Total						(36)	(9)

Protection program for US$ floating rate debt

Our wholly owned subsidiary Vale Canada entered into a swap to convert U.S. dollar floating rate debt into U.S dollar fixed rate debt in connection with debt issued in 2004 with a notional amount of US$200 million. In this swap, we paid fixed rates in U.S. dollars and received floating rates in LIBOR. This program ended in 2011.

Flow	Notional value at December 31, 2011	2010	Index	Average rate	Final maturity	Fair value at December 31, 2011	2010
	(million)					(US$ million)	
Receivable		US$100	USD		2011		100
Payable			USD				(104)
Total							(4)

Protection program for interest rates

In the fourth quarter of 2011, we entered into a forward transaction relating to 10-year U.S. treasury notes in order to help protect against certain insurance debt costs that are indexed to this rate.

Flow	Notional value at December 31, 2011	2010	Buy/Sell	Average rate	Final maturity	Fair value at December 31, 2011	2010
	(million)					(US$ million)	
Forward	US$900		Buy	1.9423%	2012	(5.3)	

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Foreign exchange protection program for fixed price coal sales

In order to reduce cash flow volatility associated with a fixed price coal contract, we entered into an Australian dollar forward purchase contract to equalize production cost and revenue currencies exposure. This program ended in 2011.

Flow	Notional value at December 31, 2011	2010	Buy/Sell	Average rate (AUD/USD)	Final maturity	Fair value at December 31, 2011	2010
	(million)					(US$ million)	
Forward		AUD$7	Buy		2011		2

Protection program for cash investment yield exposure

In order to link the returns of part of the cash invested on the Brazilian market to U.S. dollar yield, we entered into a swap transaction to convert *real*-denominated cash investments in CDI to a fixed rate in U.S. dollars. In these swaps, we received U.S. dollars at fixed rates and paid *reais* linked to CDI. This program ended in December 2011.

Foreign exchange protection program for Vale's bid offer for assets in the African copperbelt

In order to reduce the volatility of South African *rands* on the value of a bid, denominated in U.S. dollars, we had placed for assets in the African copperbelt, we entered into *rand*-denominated forward purchase transactions in April 2011. On July 2011, we terminated our offer to purchase these assets. The transactions relative to this program were settled on July 2011.

Foreign exchange protection program for cash flow

In order to hedge cash flow volatility, we entered into a swap transaction to convert part of our cash flow linked to *reais* to a fixed rate in U.S. dollars. In those swaps, Vale paid fixed rates in U.S. dollars and received fixed rates in *reais*. This program ended in December 2011.

Product price and input cost risk

We are also exposed to market risks associated with commodity price volatility. In line with our risk management policy, we also employ risk mitigation strategies, including forward transactions, futures contracts and zero-cost collars, to mitigate against the effects of commodity price volatility on our cash flows.

Nickel sales hedging program

In order to reduce cash flow volatility in 2011 and 2012, we entered into forward-sale transactions that were accounted for as cash flow hedges. These transactions fixed the prices of part of the sales in the period.

Flow	Notional amount at December 31, 2011	2010	Buy/Sell	Average strike (USD/ton)	Final maturity	Fair value at December 31, 2011	2010
	(ton)					(US$ million)	
Forward	19,998	18,750	Sell	25,027	2012	125	(52)

Nickel fixed price program

We entered into derivatives in connection with fixed price nickel sales contracts to preserve exposure to nickel price fluctuations. These transactions are intended to achieve a minimum price equal to the average LME price on the date of product delivery. These transactions normally involve buying nickel forwards (over-the-counter) or futures (exchange traded) contracts and are usually settled on the settlement dates of

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the related commercial contracts. We also have contracts subject to margin calls for some nickel trades executed by Vale Canada, but the total cash amount as of December 2011 was not material. Whenever the "Nickel sales hedging program", described above, is executed, this program is interrupted.

Flow	Notional amount at December 31, 2011	2010	Buy/Sell	Average strike (USD/ton)	Final maturity	Fair value at December 31, 2011	2010
	(ton)					(US$ million)	
Nickel futures	162	2,172	Buy	21,346	2012	(0.4)	13

Nickel purchase protection program

In order to reduce cash flow volatility and eliminate the mismatch between the pricing of purchased nickel (concentrate, cathode, sinter and other) and the pricing of the final product sold to our customers, we entered into hedging transactions. The items purchased are raw materials utilized to produce refined nickel. The transactions are usually implemented by the sale of nickel forward or future contracts at LME or over-the-counter operations.

Flow	Notional amount at December 31, 2011	2010	Buy/Sell	Average strike (USD/ton)	Final maturity	Fair value at December 31, 2011	2010
	(ton)					(US$ million)	
Nickel futures	228	108	Sell	18,744	2012	0.03	(0.2)

Bunker oil purchase protection program

In order to reduce the impact of bunker oil price fluctuation on our freight costs, we have entered into bunker oil derivatives, usually through forward purchases and swaps. We had no open positions on December 31, 2011.

Flow	Notional amount at December 31, 2011	2010	Buy/Sell	Average strike (USD/metric ton)	Final maturity	Fair value at December 31, 2011	2010
	(metric ton)					(US$ million)	
Forward		240,000	Buy		2011		11

Copper scrap purchase protection program

This program was implemented in order to reduce cash flow volatility due to the quotation period mismatch between the pricing period of copper scrap purchase and the pricing period of sale of final products to customers. Copper scrap, combined with other raw materials or inputs, is used to produce copper by Vale Canada, our wholly owned subsidiary. This program usually is implemented by the sale of forwards or futures on the LME or over-the-counter operations.

Flow	Notional amount at December 31, 2011	2010	Buy/Sell	Average strike (USD/lbs)	Final maturity	Fair value at December 31, 2011	2010
	(lbs)					(US$ million)	
Forward	892,869	386,675	Sell	3.5	2012	0.1	(0.3)

Embedded derivatives raw material and intermediate products purchase

Our cash flow is also exposed to various market risks associated with certain of our contracts that contain embedded derivatives or behave as derivatives. These derivatives may be embedded in, but are not limited to, commercial contracts, purchase agreements, leases, bonds, insurance policies and loans.

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Our wholly owned subsidiary Vale Canada has nickel concentrate and raw materials purchase agreements, in which there are provisions tied to the movement of nickel and copper prices, which function as embedded derivatives.

Flow	Notional amount at December 31, 2011	Notional amount at December 31, 2010	Buy/Sell	Average strike (USD/ton)	Final maturity	Fair value at December 31, 2011	Fair value at December 31, 2010
	(ton)					(US$ million)	
Nickel forwards	1,951	1,960	Sell	18,337	2012	(0.36)	(1.0)
Copper forwards	6,653	6,389		7,495		0.48	(3.2)
Total						0.12	(4.2)

Credit risk

Commercial credit risk management

We are exposed to credit risk arising from trade receivables, derivative transactions, payment guarantees and cash investments. Our credit risk management process provides a framework for assessing and managing counterparties' credit risk and for maintaining our risk at an acceptable level. In order to protect against commercial credit exposure, our Board of Executive Officers sets annually global credit risk limits and working capital limits, both monitored on a monthly basis, and the risk management department approves credit risk limits for each counterparty.

We assign an internal credit rating to each counterparty using our own quantitative methodology for credit risk analysis, which is based on market prices, external credit ratings and financial information of the counterparty, as well as qualitative information regarding the counterparty's strategic position and history of commercial relations.

Based on the counterparty's credit risk, or based on our consolidated credit risk profile, risk mitigation strategies may be used to minimize credit risk in order to meet the risk level approved by the Board of Executive Officers. The main credit risk mitigation strategies include credit risk insurance, mortgages, letters of credit and corporate guarantees, among others.

From a geographic standpoint, we have a well-diversified accounts receivable portfolio, with China, Europe, Brazil and Japan the regions with most significant exposure. According to each region, different guarantees can be used to enhance the credit quality of the receivables. Each counterparty position in the portfolio is periodically monitored and we automatically block additional sales to customers in delinquency.

Treasury credit risk management

To manage the credit exposure arising from cash investments and derivative instruments, our Executive Board approves, on an annual basis, credit limits by counterparty. Furthermore, the risk management department controls our portfolio diversification, the aggregate exposure related to counterparty credit spread volatility and the overall credit risk of the treasury portfolio. All positions are monitored daily and are reported monthly to the Executive Risk Management Committee and to the Board of Executive Officers.

To calculate the exposure we face to a counterparty that has entered into several derivative transactions with us, we consider the aggregate exposure of each derivative transaction executed with this counterparty. We also assess the creditworthiness of its counterparties in treasury operations, employing an internal methodology similar to that used for commercial credit risk management, which aims to define a default probability for each counterparty based on market prices, credit ratings and the counterparty's financial information.

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Our credit risk management processes provide a framework for assessing and managing counterparty credit risk and for maintaining our risk at an acceptable level. The Executive Risk Management Committee analyzes and recommends to the Board of Executive Officers the maximum credit risk exposure to trade receivables and the maximum credit risk exposure to financial institutions that are acceptable at both the counterparty and at the portfolio level.

Operational risk

Operational risk management is the structured approach we take to manage uncertainty related to inadequate or failed internal processes, people and systems and to external events.

We mitigate operational risk with new controls and improvement of existing ones, with transfer of risk through insurance and establishment of financial provisions. As a result, the Company seeks to have a clear view of its major risks, the best cost-benefit mitigation plans it must invest in and the controls in place to monitor the impact of operational risk closely and to efficiently allocate capital to reduce it.

More specifically, our operational risk management involves a consistent and systematic process to assess and manage risks that could prevent the Company from reaching its business objectives. The most important events are analyzed to understand the causes and respective controls that can prevent the event and/or respond and recover from the event. Standard risk measures such as the Most Foreseeable Loss and the Residual Risk, both based on Vale's Risk Matrix, are part of the risk management process, which enables consistent discussions by our management regarding whether additional resources are required to lower risk levels. The most significant risks identified in the process are reported to the Executive Risk Management Committee where decisions are made and action plans approved to further reduce risks where necessary.

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III. SHARE OWNERSHIP AND TRADING

MAJOR SHAREHOLDERS

Valepar is Vale's controlling shareholder. Valepar is a special-purpose company organized under the laws of Brazil that was incorporated for the sole purpose of holding an interest in Vale. Valepar does not have any other business activity. Valepar acquired its controlling stake in Vale from the Brazilian government in 1997 as part of the first stage of Vale's privatization.

The following table sets forth information regarding ownership of Vale shares as of March 31, 2012 by the shareholders we know beneficially own more than 5% of any class of our outstanding capital stock, and by our directors and executive officers as a group.

	Common shares owned	% of class	Preferred shares owned	% of class
Valepar(1)	1,716,435,045	52.7%	20,340,000	1.0%
BNDESPAR(2)	218,386,481	6.7%	69,432,771	3.3%
Aberdeen Asset Managers Limited(3)	1,257,000	Less than 1.0%	105,832,561	5.0%
Directors and executive officers as a group	54,344	Less than 1.0%	931,154	Less than 1.0%

(1) See the following tables for information about Valepar's shareholders.

(2) BNDESPAR is a wholly owned subsidiary of BNDES. The figures do not include common shares beneficially (as opposed to directly) owned by BNDESPAR.

(3) Based on a reported beneficial ownership dated March 23, 2012. Aberdeen Asset Managers Limited is a subsidiary of Aberdeen Asset Management plc.

The Brazilian government also owns 12 golden shares of Vale, which give it veto powers over certain actions, such as changes to our name, the location of our headquarters and our corporate purpose as it relates to mining activities.

The table below set forth information regarding ownership of Valepar common shares as of March 31, 2012.

	Common shares owned	% of class
Valepar shareholders		
Litel Participações S.A.(1)	637,443,857	49.00%
Eletron S.A.(2)	380,708	0.03
Bradespar S.A.(3)	275,965,821	21.21
Mitsui(4)	237,328,059	18.24
BNDESPAR(5)	149,787,385	11.51
Total	1,300,905,830	100.00%

(1) Litel owns 200,864,272 preferred class A shares of Valepar, which represents 71.41% of the preferred class A shares. LitelA, an affiliate of Litel, owns 80,416,931 preferred class A shares of Valepar, which represents 28.59% of the preferred class A shares. LitelB, also an affiliate of Litel, owns 21,932,068 preferred class C shares of Valepar, which represents 29.25% of the preferred class C shares.

(2) Eletron owns 27,755 preferred class C shares of Valepar, which represents 0.04% of the preferred class C shares.

(3) Bradespar is controlled by a control group consisting of Cidade de Deus Cia. Comercial Participações, Fundação Bradesco, NCF Participações S.A. and Nova Cidade de Deus Participações S.A. Bradespar owns 12,532,065 preferred class C shares of Valepar, which represents 16.71% of the preferred class C shares. Brumado Holdings Ltda., a subsidiary of Bradespar, owns 7,587,000 preferred class A shares of Valepar, which represents 10.12% of the class.

(4) Mitsui owns 17,302,209 preferred class C shares of Valepar, which represents 23.08% of the preferred class C shares.

(5)

BNDESPAR owns 15,598,969 preferred class C shares of Valepar, which represents 20.80% of the preferred class C shares.

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The table below sets forth information regarding ownership of Litel Participações S.A., one of Valepar's shareholders, as of March 31, 2012.

	Common shares owned	% of class
Litel Participações S.A. shareholders(1)		
BB Carteira Ativa	193,740,121	78.40%
Carteira Ativa II	53,387,982	21.60
Caixa de Previdência dos Funcionários do Banco do Brasil	19	
Others	219	
Directors and executive officers as a group	4	
Total	247,128,345	100.00%

(1) Each of BB Carteira Ativa and Carteira Ativa II is a Brazilian investment fund. BB Carteira Ativa is 100.00% owned by Caixa de Previdência dos Funcionários do Banco do Brasil ("Previ"). Carteira Ativa II is 59.36% owned by Funcef, 35.81% owned by Petros and 4.84% owned by Fundação Cesp. Each of Previ, Petros, Funcef and Fundação Cesp is a Brazilian pension fund.

The shareholders of Valepar are parties to a shareholders' agreement, ending in 2017. The Valepar shareholders' agreement also:

- grants rights of first refusal on any transfer of Valepar shares and preemptive rights on any new issue of Valepar shares;
- prohibits the direct acquisition of Vale shares by Valepar's shareholders unless authorized by the other shareholders party to the agreement;
- prohibits encumbrances on Valepar shares (other than in connection with financing an acquisition of Vale shares);
- requires each party generally to retain control of its special purpose company holding its interest in shares of Valepar, unless the rights of first refusal previously mentioned are observed;
- allocates seats on Valepar's and Vale's boards among representatives of the parties;
- commits the Valepar shareholders to support a Vale dividend policy of distributing 50% of Vale's net profit for each fiscal year, unless the Valepar shareholders commit to support a different dividend policy for a given year;
- provides for the maintenance by Vale of a capital structure that does not exceed specified debt to equity thresholds;
- requires the Valepar shareholders to vote their indirectly held Vale shares and to cause their representatives on Vale's Board of Directors to vote only in accordance with decisions made at Valepar meetings held prior to meetings of Vale's Board of Directors or shareholders; and
- establishes supermajority voting requirements for certain significant actions relating to Valepar and to Vale.

Pursuant to the Valepar shareholders' agreement, Valepar cannot support any of the following actions with respect to Vale without the consent of at least 75% of the holders of Valepar's common shares:

- any amendment of Vale's bylaws;

any increase of Vale's capital stock by share subscription, creation of a new class of shares, change in the characteristics of the existing shares or any reduction of Vale's capital stock;

any issuance of debentures of Vale, whether or not convertible into shares of Vale, participation certificates upon compensation (*partes beneficiárias*), call options (*bônus de subscrição*) or any other security of Vale;

any determination of issuance price for any new shares of capital stock or other security of Vale;

any amalgamation, spin-off or merger to which Vale is a party, as well as any change to Vale's corporate form;

any dissolution, receivership, bankruptcy or any other voluntary act for financial reorganization or any suspension thereof;

the election and replacement of Vale's Board of Directors, including the Chairman of the Board, and any executive officer of Vale;

the disposal or acquisition by Vale of an equity interest in any company, as well as the acquisition of any shares of capital stock of Vale or Valepar;

the participation by Vale in a group of companies or in a consortium of any kind;

the execution by Vale of agreements relating to distribution, investment, sales exportation, technology transfer, trademark license, patent exploration, license to use and leases;

the approval and amendment of Vale's business plan;

the determination of the compensation of the executive officers and directors of Vale, as well as the duties of the Board of Directors and the Board of Executive Officers;

any profit sharing among the members of the Board of Directors or Board of Executive Officers of Vale;

any change in the corporate purpose of Vale;

the distribution or non-distribution of any dividends (including distributions classified as interest on shareholders' equity) on any shares of capital stock of Vale other than as provided in Vale's bylaws;

the appointment and replacement of Vale's independent auditor;

the creation of any "in rem" guarantee, granting of guarantees including rendering of sureties by Vale with respect to obligations of any unrelated party, including any affiliates or subsidiaries;

the passing of any resolution on any matter which, pursuant to applicable law, entitles a shareholder to withdrawal rights;

the appointment and replacement by the Board of Directors of any representative of Vale in subsidiaries, companies related to Vale or other companies in which Vale is entitled to appoint directors and officers; and

any change in the debt to equity threshold, as defined in the shareholders' agreement.

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In addition, the shareholders' agreement provides that any issuance of participation certificates by Vale and any disposition by Valepar of Vale shares requires the unanimous consent of all of Valepar's shareholders.

RELATED PARTY TRANSACTIONS

We have arm's-length commercial relationships in the ordinary course of our business with Mitsui, a shareholder of Valepar (our controlling shareholder) and we have arm's-length financial relationships in the ordinary course of our business with Bradesco, which is controlled by the same controlling group as Bradespar, also a shareholder of Valepar.

BNDES is the parent company of one of our major shareholders, BNDESPAR. We and BNDES, the Brazilian state-owned development bank, are parties to a contract relating to authorizations for mining exploration. This contract, which we refer to as the Mineral Risk Contract, provides for the joint development of certain unexplored mineral deposits that form part of our Northern System (Carajás), as well as proportional participation in any profits earned from the development of such resources. Iron ore and manganese ore deposits already identified at the time we entered into the Mineral Risk Contract (in March 1997) were specifically excluded from the contract. In 2007, the Mineral Risk Contract was extended indefinitely, with specific rules for all exploration projects and exploration targets and mineral rights covered under the contract. In addition, BNDES has provided us with a R$7.3 billion, or US$4.3 billion, credit facility to help us finance our investment programs; BNDES holds a total of R$679.4 million, or US$363.6 million, in debentures of our subsidiary Salobo Metais S.A. with a subscription right, subject to certain conditions, for Salobo's preferred shares in exchange for such debentures; and its subsidiary BNDESPAR holds a total of R$1.406 billion, or US$816 million, in debentures, exchangeable into FNS shares, that were issued to finance the expansion of the FNS railroad. BNDES has also participated in certain of our other financing arrangements. For more information on our transactions with BNDES, see *Operating and financial review and prospects Liquidity and capital resources*.

For information regarding investments in affiliated companies and joint ventures and for information regarding transactions with major related parties, see Notes 14 and 24 to our consolidated financial statements.

DISTRIBUTIONS

Under our dividend policy, our Board of Executive Officers announces, by no later than January 31 of each year, a proposal to be approved by our Board of Directors of a minimum amount, expressed in U.S. dollars, that will be distributed in that year to our shareholders. Distributions may be classified either as dividends or interest on shareholders' equity, and references to "dividends" should be understood to include all distributions regardless of their classification, unless stated otherwise. We determine the minimum dividend payment in U.S. dollars, considering our expected free cash flow generation in the year of distribution. The proposal establishes two installments, to be paid in April and October of each year. Each installment is submitted to the Board of Directors for approval at meetings in April and October. Once approved, dividends are converted into and paid in *reais* at the Brazilian *real*/U.S. dollar exchange rates announced by the Central Bank of Brazil on the last business day before the Board meetings in April and October of each year. The Board of Executive Officers can also propose to the Board of Directors, depending on the evolution of our cash flow performance, an additional payment to shareholders of an amount over and above the minimum dividend initially established.

For 2012, our Board of Executive Officers has proposed a minimum dividend of US$6.0 billion. We pay the same amount per share on both common and preferred shares in accordance with our bylaws. This dividend is payable in two equal installments in April and October 2012. The first installment of this dividend, in the amount of US$3.0 billion, will be paid on April 30, 2012.

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Under Brazilian law and our bylaws, we are required to distribute to our shareholders an annual amount equal to not less than 25% of the distributable amount, referred to as the mandatory dividend, unless the Board of Directors advises our shareholders at our shareholders' meeting that payment of the mandatory dividend for the preceding year is inadvisable in light of our financial condition. For a discussion of dividend distribution provisions under Brazilian corporate law and our bylaws, see *Additional information*.

Distributions classified as dividends which are paid to ADR and HDR holders and to non-resident shareholders will not be subject to Brazilian withholding tax, except that a distribution from profits generated prior to December 31, 1995 will be subject to Brazilian withholding tax at varying rates. Distributions classified as interest on shareholders' equity which are paid to ADR and HDR holders and to non-resident shareholders are currently subject to Brazilian withholding tax. See *Additional information Taxation Brazilian tax considerations.*

By law, we are required to hold an annual shareholders' meeting by April 30 of each year at which an annual dividend may be declared. Additionally, our Board of Directors may declare interim dividends. Under Brazilian corporate law, dividends are generally required to be paid to the holder of record on a dividend declaration date within 60 days following the date the dividend was declared, unless a shareholders' resolution sets forth another date of payment, which, in either case, must occur prior to the end of the fiscal year in which the dividend was declared. A shareholder has a three-year period from the dividend payment date to claim dividends (or payments of interest on shareholders' equity) in respect of its shares, after which we will have no liability for such payments. From 1997 to 2003, all distributions took the form of interest on shareholders' equity. In many years, part of the distribution has been made in the form of interest on shareholders' equity and part as dividends. See *Additional information Memorandum and articles of association Common shares and preferred shares*.

We make cash distributions on the common shares and preferred shares underlying the ADSs in *reais* to the custodian on behalf of the depositary. The custodian then converts such proceeds into U.S. dollars and transfers such U.S. dollars to be delivered to the depositary for distribution to holders of ADRs and HDRs, net of the depositary's fees. For information on taxation of dividend distributions, see *Additional information Taxation Brazilian tax considerations*.

The following table sets forth the cash distributions we paid to holders of common shares and preferred shares for the periods indicated. Amounts have been restated to give effect to stock splits that we carried out in subsequent periods. We have calculated U.S. dollar conversions using the commercial selling rate in effect on the date of payment. Amounts are stated before any applicable withholding tax.

			Reais per share		
Year	**Payment date**	**Dividends**	**Interest on equity**	**Total**	**U.S. dollars per share at payment date**
2005	April 29	0.28		0.28	0.11
	October 31	0.22	0.17	0.39	0.18
2006	April 28	0.12	0.17	0.29	0.14
	October 31	0.01	0.28	0.29	0.14
2007	April 30	0.22	0.13	0.35	0.17
	October 31	0.01	0.38	0.39	0.22
2008	April 30	0.20	0.24	0.44	0.26
	October 31	0.14	0.51	0.65	0.30
2009	April 30	0.52		0.52	0.24
	October 30		0.49	0.49	0.29
2010	April 30		0.42	0.42	0.24
	October 31		0.56	0.56	0.34
2011	January 31		0.32	0.32	0.19
	April 29		0.61	0.61	0.38
	August 26	0.93		0.93	0.58
	October 31	0.39	0.63	1.02	0.58

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TRADING MARKETS

Our publicly traded share capital consists of common shares and preferred shares, each without par value. Our common shares and our preferred shares are publicly traded in Brazil on the BM&FBOVESPA, under the ticker symbols VALE3 and VALE5, respectively. Our common shares and preferred shares also trade on the LATIBEX, under the ticker symbols XVALO and XVALP, respectively. The LATIBEX is a non-regulated electronic market created in 1999 by the Madrid stock exchange in order to enable trading of Latin American equity securities.

Our common ADSs, each representing one common share, and our preferred ADSs, each representing one preferred share, are traded on the New York Stock Exchange ("NYSE"), under the ticker symbols VALE and VALE.P, respectively. Our common ADSs and preferred ADSs are traded on Euronext Paris, under the ticker symbols VALE3 and VALE5, respectively. JPMorgan Chase Bank serves as the depositary for both the common and the preferred ADSs. On March 31, 2012, there were 1,479,147,397 ADSs outstanding, 737,366,804 common ADSs and 741,780,593 preferred ADSs, representing 22.6% of our common shares and 35.2% of our preferred shares, or 27.6% of our total share capital.

Our common HDSs, each representing one common share, and our preferred HDSs, each representing one class A preferred share, are traded on the HKEx, under the stock codes 6210 and 6230, respectively. JPMorgan Chase Bank serves as the depositary for both the common and the preferred HDSs. On March 31, 2012, there were 1,153,600 HDSs outstanding, consisting of 1,122,200 common HDSs and 31,400 preferred HDSs.

SHARE PRICE HISTORY

The following table sets forth trading information for our ADSs, as reported by the New York Stock Exchange and our shares, as reported by the BM&FBOVESPA, for the periods indicated. Share prices in the table have been adjusted to reflect stock splits.

	BM&F BOVESPA ***(Reais per share)***				**NYSE (US$ per share)**			
	Common share		**Preferred share**		**Common ADS**		**Preferred ADS**	
	High	**Low**	**High**	**Low**	**High**	**Low**	**High**	**Low**
2007	65.90	29.40	55.62	25.42	37.75	13.76	31.59	11.83
2008	72.09	22.10	58.70	20.24	43.91	8.80	35.84	7.95
2009	50.30	27.69	43.37	23.89	29.53	11.90	25.66	10.36
2010	59.85	42.85	51.34	37.50	34.65	23.98	30.50	20.20
1Q	57.45	47.16	49.55	40.80	32.29	25.18	27.76	21.91
2Q	59.85	43.65	51.34	37.50	34.55	23.98	29.46	20.20
3Q	52.30	42.85	46.30	37.52	31.27	24.34	27.75	21.09
4Q	58.19	52.80	50.92	46.75	34.65	31.47	30.50	27.88
2011	60.92	38.59	53.41	36.54	37.08	20.51	32.50	19.58
1Q	60.92	50.75	53.41	44.70	37.08	31.04	32.50	27.01
2Q	54.40	47.22	48.30	42.15	34.27	29.40	30.40	26.14
3Q	52.35	39.81	47.05	36.54	33.55	22.80	30.39	21.00
4Q	46.00	38.59	42.64	36.80	26.62	20.51	24.86	19.58
Q4 2011 and Q1 2012								
October 2011.	44.81	39.65	41.69	37.21	26.62	21.86	24.86	20.28
November 2011.	46.00	41.30	42.64	38.85	26.47	21.90	24.54	20.58
December 2011	43.20	38.59	40.53	36.80	24.20	20.51	22.74	19.58
January 2012	44.70	39.45	42.69	37.82	25.30	21.45	24.21	20.60
February 2012.	45.87	42.93	43.97	41.98	26.61	24.96	25.53	24.42
March 2012	44.45	40.62	43.30	39.47	25.68	22.48	25.04	21.85

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DEPOSITARY SHARES

JPMorgan Chase Bank serves as the depositary for our ADSs and HDSs. ADR holders and HDR holders are required to pay various fees to the depositary, and the depositary may refuse to provide any service for which a fee is assessed until the applicable fee has been paid.

ADR holders and HDR holders are required to pay the depositary amounts in respect of expenses incurred by the depositary or its agents on behalf of ADR holders and HDR holders, including expenses arising from compliance with applicable law, taxes or other governmental charges, facsimile transmission or conversion of foreign currency into U.S. or Hong Kong dollars. In this case, the depositary may decide in its sole discretion to seek payment by either billing holders or by deducting the fee from one or more cash dividends or other cash distributions. The depositary may recover any unpaid taxes or other governmental charges owed by an ADR holder or HDR holder by billing such holder, by deducting the fee from one or more cash dividends or other cash distributions, or by selling underlying shares after reasonable attempts to notify the holder, with the holder liable for any remaining deficiency.

ADR holders are also required to pay additional fees for certain services provided by the depositary, as set forth in the table below.

Depositary service	**Fee payable by ADR holders**
Issuance, cancellation and delivery of ADRs, including in connection with share distributions, stock splits	US$5.00 or less per 100 ADSs (or portion thereof)
Distribution of dividends	US$0.02 or less per ADS
Withdrawal of shares underlying ADSs	US$5.00 or less per 100 ADSs (or portion thereof)
Transfers, combining or grouping of ADRs	US$1.50 or less per ADS

HDR holders are also required to pay additional fees for certain services provided by the depositary, as set forth in the table below.

Depositary service	**Fee payable by HDR holders**
Issuance, cancellation and delivery of HDRs, including in connection with share distributions, stock splits	HK$0.40 or less per HDS (or portion thereof)
Distribution of dividends and other cash distributions	HK$0.40 or less per HDS
Transfer of certificated or direct registration HDRs	HK$2.50 or less per HDS
Administration fee assessed annually	HK$0.40 or less per HDS (or portion thereof)

The depositary reimburses us for certain expenses we incur in connection with the ADR and HDR programs, subject to a ceiling agreed between us and the depositary from time to time. These reimbursable expenses currently include legal and accounting fees, listing fees, investor relations expenses and fees payable to service providers for the distribution of material to ADR holders and HDR holders. For the year ended December 31, 2011, the depositary reimbursed us US$19 million in connection with the ADR and HDR programs.

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PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS

On November 25, 2011, we announced the completion of the US$3 billion share repurchase program approved by the Board of Directors on June 30, 2011. Vale acquired 39,536,080 common shares, at an average price of US$26.25 per share, and 81,451,900 preferred shares, at an average price of US$24.09 per share (including shares of each class in the form of American Depositary Receipts), for a total aggregate purchase price of US$3.0 billion. The repurchased shares represent 3.10% of the free float of common shares, and 4.24% of the free float of preferred shares, outstanding before the launching of the program. The shares acquired will be held in treasury for cancellation. See Note 17 to our consolidated financial statements for further information.

The results of our share repurchase program for 2011 are set forth below.

Period	Total number of shares (or units) purchased	Average price paid per share (or units) (US$)	Minimum price paid per share (or units) (US$)	Maximum price paid per share (or units) (US$)	Total number of shares (or units) purchased as part of publicly announced plans or programs	Maximum number (or approximate US$ value) of shares (or units) that may yet be purchased under the program
Common shares						
August 2011	13,737,500	27.32	25.60	31.98	13,737,500	
September 2011	12,251,380	26.37	23.27	27.98	12,251,380	
November 2011	13,547,200	25.04	22.40	26.18	13,547,200	
Total	39,536,080	26.25	22.40	31.98	39,536,080	
Preferred shares						
August 2011	27,425,300	24.81	23.48	29.10	27,425,300	
September 2011	25,680,600	24.20	21.60	25.47	25,680,600	
November 2011	28,346,000	23.30	21.03	24.34	28,346,000	
Total	81,451,900	24.09	21.03	29.10	81,451,900	

On October 11, 2010, we completed a US$2 billion share repurchase program under which we acquired 21,682,700 common shares, at an average price of US$31.31 per share, and 48,197,700 preferred shares, at an average price of US$27.40 per share, corresponding respectively to 1.67% and 2.45% of the free float of each class at the outset of the program.

On May 29, 2009, we terminated a US$762 million share repurchase program under which we acquired 18,415,859 common shares, at an average price of US$12.35 per share, and 47,284,800 preferred class A shares, at an average price of US$11.31 per share, corresponding respectively to 1.5% and 2.4% of the outstanding shares of each class on the date the program was launched.

IV. MANAGEMENT AND EMPLOYEES

MANAGEMENT

Board of Directors

Our Board of Directors sets general guidelines and policies for our business and monitors the implementation of those guidelines and policies by our executive officers. Our bylaws provide that the Board of Directors consist of 11 members and 11 alternates, each of whom serves on behalf of a particular director. Each director (and his or her respective alternate) is elected for a two-year term at a general shareholders' meeting, can be re-elected, and is subject to removal at any time.

The Board of Directors holds regularly scheduled meetings on a monthly basis and holds additional meetings when called by the chairman, vice-chairman or any two directors. Decisions of the Board of Directors require a quorum of a majority of the directors and are taken by majority vote. Alternate directors may attend and vote at meetings in the absence of the director for whom the alternate director is acting.

Our bylaws establish the following technical and advisory committees to the Board of Directors.

The Executive Development Committee is responsible for reporting on general human resources policies, analyzing and reporting on the adequacy of compensation levels for our executive officers, proposing and updating guidelines for evaluating the performance of our executive officers and reporting on policies relating to health and safety.

The Strategy Committee is responsible for reviewing and making recommendations to the Board of Directors concerning the strategic guidelines and plan submitted annually to the Board by our executive officers, our annual and multi-annual investment budgets, investment or divestiture opportunities submitted by executive officers and mergers and acquisitions.

The Finance Committee is responsible for reviewing and making recommendations to the Board of Directors concerning our corporate risks and financial policies and the internal financial control systems, compatibility between the level of distributions to shareholders and the parameters established in the annual budget and the consistency between our general dividend policy and capital structure.

The Accounting Committee is responsible for nominating an employee to be responsible for our internal auditing, reporting on auditing policies and the execution of our annual auditing plan, tracking the results of our internal auditing, and identifying, prioritizing, and submitting recommendations to the executive officers and analyzing and making recommendations with regard to our annual report and financial statements.

The Governance and Sustainability Committee is responsible for evaluating and recommending improvements to the effectiveness of our corporate governance practices and the functioning of our Board of Directors, recommending improvements to the code of ethical conduct and our management system in order to avoid conflicts of interests between Vale and its shareholders or management, issuing reports on potential conflicts of interest between Vale and its shareholders or management and reporting on policies relating to corporate responsibility, such as environmental and social responsibility.

Ten of our 11 current directors (and nine of their respective alternates) were appointed by Valepar, our controlling shareholder, pursuant to Valepar's shareholders' agreement. One Director and his alternate were appointed by the employees, pursuant to our bylaws. Non-controlling shareholders holding common shares representing at least 15% of our voting capital, and preferred shares representing at least 10% of our total share capital, have the right to appoint one member and an alternate to our Board of Directors. Our

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employees and our non-controlling shareholders each have the right, as a class, to appoint one director and an alternate. All of our current directors were elected or re-elected, as the case may be, at our annual shareholders' meeting held on April 19, 2011. Their terms will expire in 2013.

The following table lists the current members of the Board of Directors and each director's alternate.

Director(1)	Year first elected	Alternate director(1)	Year first elected
Ricardo José da Costa Flores (chairman)	2010	Marco Geovanne Tobias da Silva	2011
Mario da Silveira Teixeira Júnior (vice-chairman)	2003	João Moisés de Oliveira	2000
José Ricardo Sasseron	2007	Deli Soares Pereira	2009
Robson Rocha	2011	Sandro Kohler Marcondes	2011
Nelson Henrique Barbosa Filho	2011	Eustáquio Wagner Guimarães Gomes	2011
Renato da Cruz Gomes	2001	Luiz Carlos de Freitas	2007
Fuminobu Kawashima	2011	Hajime Tonoki	2009
Oscar Augusto de Camargo Filho	2003	Eduardo de Oliveira Rodrigues Filho	2011
Luciano Galvão Coutinho	2007	Paulo Sergio Moreira da Fonseca	2008
José Mauro Mettrau Carneiro da Cunha	2010	Vacant	
Paulo Soares de Souza(2)	2011	Raimundo Nonato Alves Amorim(2)	2009

(1) Appointed by Valepar and approved at the shareholders' meeting unless otherwise indicated.

(2) Appointed by our employees and approved at the shareholders' meeting.

Below is a summary of the business experience, activities and areas of expertise of our current directors.

Ricardo José da Costa Flores, 48: Chairman of Vale's Board of Directors since November 2010.

Other current director or officer positions: Chief Executive Officer of Previ, the pension fund of the employees of Banco do Brasil, since June 2010; Chairman of the Board of Directors, since December 2010; and Chief Executive Officer of Valepar since November 2010.

Professional experience: President of Federação Nacional de Capitalização ("FENACAP") and Vice-President of Confederação Nacional das Empresas de Seguros Gerais, Previdência Privada e Vida, Saúde Complementar e Capitalização ("CNSeg"), both of which are insurance industry trade associations, from January 2008 to March 2011; Chairman of the Board of Directors of Brasilcap Capitalização S.A. ("Brasilcap"), a financial institution affiliated with Banco do Brasil, from October 2007 to March 2011; Vice-President of the Credit, Accounting and Global Risk Management committee of Banco do Brasil, a Brazilian state-owned and publicly held financial institution, from April 2009 to May 2010, where he also served as the Vice-President of Government Relations from June 2008 to April 2009, as the officer responsible for insurance, pension plans and capitalization from August 2007 to June 2008 and as the officer responsible for operational assets restructuring from May 2004 to July 2007; Chairman of the Board of Directors of Banco Nossa Caixa S.A. ("Nossa Caixa") from January 2009 to November 2009, and Ativos S.A. Securitizadora de Créditos Financeiros from May 2004 to August 2007; Director of Brasilveículos Companhia de Seguros S.A. ("Brasilveículos") from October 2007 to September 2008; Director of Brasilprev Seguros e Previdência S.A. ("Brasilprev"), and Brasilsaúde Companhia de Seguros S.A. from October 2007 to August 2008, both private companies engaged in insurance activity; member of the Fiscal Council of various energy companies, namely, Companhia Energética do Rio Grande do Norte ("COSERN") from April 2006 to January 2008, Companhia Energética de Pernambuco ("CELPE") from March 2004 to March 2006, CPFL Geração de Energia S.A. ("CPFL Geração") and Companhia Paulista de Força e Luz ("CPFL") from April 2006 to January 2008. Mr. Flores was also the Executive Officer of Federação Brasileira de Bancos ("FEBRABAN") from June 2009 to November 2009.

Academic background: Degree in Economics from the Centro de Ensino Unificado de Brasília ("CEUB"), Faculdade de Ciências Econômicas, Contábeis e Administração in Brasília; post-graduate degrees in Project Analysis from Fundação Getúlio Vargas ("FGV") and in Project Development from the Instituto

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de Planejamento Econômico e Social; Executive MBA degree from Universidade de São Paulo ("USP") and MBA Controller degree from FIPECAFI/USP.

Mario da Silveira Teixeira Júnior, 66: Director of Vale since April 2003, Vice-Chairman of Vale's Board of Directors since May 2003.

Other current director or officer positions: Vice-Chairman of the Board of Directors of Valepar since 2003; Member of the Board of Directors of Banco Bradesco S.A. ("Banco Bradesco"), a publicly-held financial institution, since 1999; Member of the Board of Directors of Bradespar S.A. ("Bradespar"), a publicly-held investment holding company; and Member of the Board of Directors of Bradesco Leasing S.A. Arrendamento Mercantil, a subsidiary of Banco Bradesco engaged in the provision of financial leasing operations.

Professional experience: President of Bradespar; Executive Vice-President, Executive Managing Officer and Department Officer at Banco Bradesco; Officer of Bradesco S.A. Corretora de Títulos e Valores Mobiliários, a subsidiary of Banco Bradesco that provides securities brokerage and research services, from March 1983 to January 1984; Executive Vice-President of the Associação Nacional dos Bancos de Investimento ("ANBID"), an association of investment banks; Member of the Board of Directors of the Associação Brasileira das Companhias Abertas ("ABRASCA"), an association of Brazilian publicly held companies; Vice-Chairman of the Board of Directors of BES Investimento do Brasil S.A. Banco de Investimento, an investment bank and subsidiary of Banco Espírito Santo, from 2001 to 2007; Member of the Board of Directors of CSN, a publicly-held steel company, Latasa S.A. ("Latasa"), now called Rexam Beverage Can South America S.A., an aluminum products manufacturer, São Paulo Alpargatas S.A., a clothing and sporting goods manufacturer, Tigre S.A. Tubos e Conexões, a pipe and construction materials manufacturer, Everest Leasing S.A. Arrendamento Mercantil, a leasing company affiliated with Banco Bradesco, as well as the electric utility companies CPFL, CPFL Geração, and Companhia Piratininga de Força e Luz and the electric utility holding companies CPFL Energia S.A. ("CPFL Energia") and VBC Energia S.A.

Academic background: Degree in Civil Engineering and post-graduate degree in Business Administration from Universidade Presbiteriana Mackenzie, São Paulo.

José Ricardo Sasseron, 56: Director of Vale since April 2007.

Other current director or officer positions: Social Security Officer of Previ since June 2006; Member of the Board of Directors of Valepar since April 2007.

Professional experience: Chairman of the Board of Directors of Sauípe S.A., a private hotel and resort development and management company, from 2005 to 2007; Member of the Advisory Board of Previ, from 2004 to 2006 and Chairman of the Fiscal Council of Previ from 1996 to 1998.

Academic background: Degree in History from USP.

Robson Rocha, 53: Director of Vale since April 2011.

Other current director or officer positions: Vice-President for Human Resources Management and Sustainable Development of Banco do Brasil since April 2009.

Professional experience: Vice-Chairman of CPFL Energia from April 2010 to April 2011; Member of the Board of Directors of Nossa Caixa from May to November 2009; Officer of Banco do Brasil from May 2008 to April 2009.

Academic background: Degree in Business Administration from UNICENTRO Newton Paiva, Belo Horizonte; post-graduate degree in Strategic Management from Universidade Federal de Minas Gerais

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("UFMG"); Master's degree in Marketing from Fundação Ciências Humanas Pedro Leopoldo; and an MBA degree in Finance from Fundação Dom Cabral.

Nelson Henrique Barbosa Filho, 42:   Director of Vale since April 2011.

Other current director or officer positions: Executive Secretary of the Ministry of Finance since 2011; Chairman of the Board of Directors of Banco do Brasil since 2009; Director of Brasilveículos, an insurance company affiliated with Banco do Brasil, since 2011.

Professional experience: Director of Brasilcap from 2010 to 2011; adviser to the Presidency of BNDES from 2005 to 2006; Director of EPE Empresa de Pesquisa Energética, a state-owned energy research company, from 2007 to 2009; Secretary of Economic Policy of the Ministry of Finance from 2008 to 2010, where he also served as Secretary of Economic Monitoring from 2007 to 2008 and Assistant Secretary for Economic Policy from 2006 to 2007.

Academic background: Degree and Master's degree in Economics from Universidade Federal do Rio de Janeiro ("UFRJ") and a Ph.D. in Economics from New School for Social Research.

Renato da Cruz Gomes, 59:   Director of Vale since April 2001.

Other current director or officer positions: Executive Officer and Member of the Board of Directors of Valepar since 2001; Investor Relations Executive Officer of Bradespar since 2000.

Professional experience: Various positions at BNDES from 1976 to 2000; Member of the Board of Directors of Iochpe Maxion S.A., a publicly-held company with investments in the auto parts and railway equipment industries, Globo Cabo S.A., now called Net Serviços de Comunicação S.A. ("Net"), a Brazilian cable TV operator, Latasa and the Brazilian pulp and paper manufacturers Aracruz Celulose S.A., now called Fibria S.A., and Bahia Sul Celulose S.A., now called Suzano Celulose S.A.

Academic background: Degree in Engineering from UFRJ and post-graduate degree in Management Development from Sociedade de Desenvolvimento Empresarial ("SDE").

Fuminobu Kawashima, 59:   Director of Vale since April 2011.

Other current director or officer positions: Representative Director of Mitsui, a publicly-held trading company, since June 2011.

Professional experience: Senior Executive Managing Officer at Mitsui from April 2011 to March 2012, where he also served as Executive Managing Officer and Chief Operating Officer of the Marine & Aerospace business unit from April 2010 to March 2011, Managing Officer and Chief Operating Officer of the Energy business unit from 2007 to 2010, General Manager of the Energy business unit of the LNG project division from 2005 to 2007 and General Manager of the Energy business unit of the Natural Gas division from May to September 2005; Director of Japan Australia LNG (MIMI) Pty Ltd., an oil and gas company, from 2005 to 2007; Director of Mitsui Oil Co. Ltd., a petroleum products company, from 2007 to 2009 and Director of Kyokuto Petroleum Industries Ltd., an oil refinery, from 2007 to 2009.

Academic background: Degree in Economics from Hitotsubashi University in Japan; post-graduate degree in Economic Development from Keble College, Oxford.

Oscar Augusto de Camargo Filho, 74:   Director of Vale since September 2003.

Other current director or officer positions: Director of Valepar since 2003; partner of CWH Consultoria Empresarial, a business consulting firm since 2003.

Professional experience: Chairman of the Board of Directors of MRS from 1999 to 2003 and Chief Executive Officer and Member of the Board of Directors of CAEMI Mineração e Metalurgia S.A. ("CAEMI"), a mining holding company that was acquired by Vale in 2006, from 1990 to 2003, where Mr. Camargo Filho also held various positions from 1973 to 2003; various positions at Motores Perkins S.A., including commercial officer and sales and services manager, from 1963 to 1973.

Academic background: Law degree from USP.

Luciano Galvão Coutinho, 65: Director of Vale since August 2007.

Other current director or officer positions: President of BNDES since 2007.

Professional experience: Partner of LCA Consultores, a business consulting firm, from 1995 until 2007 and partner of Macrotempo Consultoria, also a business consulting firm, from 1990 to 2007; member of the Board of Directors of Petrobras from 2009 to 2011, of Ripasa S.A. Celulose e Papel, a paper manufacturer, from 2002 to 2005, and of Guaraniana, now Neoenergia S.A., an energy company, from 2003 to 2004, and Executive Secretary of the Ministry of Science and Technology from 1985 to 1988. Mr. Coutinho is an invited professor at the Universidade Estadual de Campinas ("UNICAMP") and has been a visiting professor at USP, the University of Paris XIII, the University of Texas and the Ortega y Gasset Institute.

Academic background: Degree in Economics from USP; Master's degree in Economics from the Economic Research Institute of USP and a Ph.D. in Economics from Cornell University.

José Mauro Mettrau Carneiro da Cunha, 62: Director of Vale since June 2010.

Other current director or officer positions: Chairman of the Board of Directors of a number of publicly-held Brazilian telecommunication companies, including Tele Norte Leste Participações S.A., Telemar Norte Leste S.A., Coari Participações S.A. and Calais Participações S.A. since 2007, Tele Norte Celular Participações S.A. since 2008, and Brasil Telecom S.A. since 2009; Chairman of the Board of Directors of TNL PCS S.A. ("TNL"), a telecommunications company, since 2007; Member of the Board of Directors of Santo Antonio Energia S.A., a Brazilian energy company, since 2008, Log-In since 2007 and Lupatech S.A., a publicly-held oil and gas production support company, since 2006; Alternate Memer of the Board of Directors of Telemar Participações S.A., a Brazilian telecommunications company, since 2008.

Professional experience: Member of the Board of Directors of Braskem S.A., a Brazilian petrochemical company, from 2007 to April 2010, where he previously served as Vice-President of Strategic Planning from 2003 to 2005, Politeno Indústria e Comércio S.A., a manufacturer of polyethylene and thermoplastic resins, from 2003 to 2004, Banco do Estado do Espírito Santo ("BANESTES"), a financial institution, from 2008 to 2009, LIGHT Serviços de Eletricidade S.A., an energy distributor, from 1997 to 2000, Aracruz Celulose S.A., a paper manufacturer, from 1997 to 2002, and TNL from 1999 to 2003, where he also served as an Alternate Member of the Board of Directors in 2006.

Academic background: Degree in Mechanical Engineering from Universidade Católica de Petrópolis in Rio de Janeiro; executive education program in management at the Anderson School of Management at the University of California at Los Angeles.

Paulo Soares de Souza, 46: Director of Vale since April 2011.

Professional experience: Alternate Member of the Board of Directors of Vale from 2007 to 2009; union leader since 1997, and President of Itabira's Labor Union (*Sindicato dos Trabalhadores nas Indústrias de Extração Mineral e de Pesquisa, Prospecção, Extração e Beneficiamento do Ferro e Metais Básicos e demais Minerais Metálicos e não Metálicos*) since 2003.

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Academic background: Technical degree as an electrician from Serviço Social da Indústria (SESI) School of Technology.

Executive officers

The executive officers are responsible for day-to-day operations and the implementation of the general policies and guidelines set forth by the Board of Directors. Our bylaws provide for a minimum of six and a maximum of 11 executive officers. The executive officers hold weekly meetings and hold additional meetings when called by any executive officer. Under Brazilian corporate law, executive officers must be Brazilian residents.

The Board of Directors appoints executive officers for two-year terms and may remove them at any time. The following table lists our current executive officers.

	Year of appointment	Position	Age
Murilo Pinto de Oliveira Ferreira	2011	Chief Executive Officer	58
Tito Botelho Martins	2006	Chief Financial Officer and Executive Director for Investor Relations, Procurement and Shared Services	49
José Carlos Martins	2004	Executive Officer (Ferrous Minerals Operations and Marketing)	62
Eduardo de Salles Bartolomeo	2006	Executive Officer (Fertilizer and Coal Operations and Marketing)	48
Galib Abrahão Chaim	2011	Executive Officer (Implementation of Capital Projects)	61
Humberto Ramos de Freitas	2011	Executive Officer (Logistics and Mineral Exploration)	58
Gerd Peter Poppinga	2011	Executive Officer (Base Metals Operations, Marketing and Information Technology)	52
Vânia Lucia Chaves Somavilla	2011	Executive Officer (Human Resources, Health and Safety, Sustainability, Energy and Corporate Affairs)	52

Below is a summary of the business experience, activities and areas of expertise of our current executive officers.

Murilo Pinto de Oliveira Ferreira, 58: Chief Executive Officer of Vale and Member of Vale's Strategy and Disclosure Committees since May 2011.

Other current director or officer positions: President of the Board of Directors (*Conselho de Gestor*) of Associação Instituto Tecnológico Vale ITV, a non-profit entity sponsored by Vale engaged in technological development, since 2011.

Professional experience: Executive Officer of Vale with responsibility over several different departments from 2005 to 2008, including Aluminum, Holdings, Business Development, Energy, Nickel and Base Metals; Chief Executive Officer of Vale Canada from 2007 to 2008 and member of the Board of Directors from 2006 to 2007; Chairman of the Board of Directors of Alunorte from 2005 to 2008, MRN from 2006 to 2008 and Valesul Alumíno S.A., a subsidiary of Vale involved in the production of aluminum, from 2006 to 2008; Member of the Board of Commissioners of PTVI, from 2007 to 2008. Mr. Ferreira has been a Member of the Board of Directors of several companies, including Usiminas, a Brazilian steel company, from 2006 to 2008, and was a partner at Studio Investimentos, an asset management firm with a focus on the Brazilian stock market, from October 2009 to March 2011.

Academic background: Degree in Business Administration from FGV in São Paulo; post-graduate degree in Business Administration and Finance from FGV in Rio de Janeiro and an executive education program in M&A at the IMD, Lausanne, Switzerland.

Tito Botelho Martins, 49: Chief Financial Officer and Executive Officer for Investor Relations, Procurement and Shared Services of Vale since November 2011.

Other current director or officer positions: Chairman of the Board of Directors of MRN; Member of the Board of Directors of Hydro, a publicly held aluminum company in Norway.

Professional experience: Executive Officer of Vale with responsibility over several different departments since 2006, including Base Metals, Nonferrous Minerals, Energy, and Corporate Affairs; Chief Executive Officer of CAEMI, a mining company acquired by Vale, and Chairman and Chief Executive Officer of MBR from 2003 to 2006; and Managing Officer of the corporate finance department of Vale from August 1999 to September 2003. Previously, Mr. Martins was a Member of the Board of Directors of Fundação Vale do Rio Doce de Seguridade Social ("Valia"), a pension plan for Brazilian employees of Vale, Ferrovias Bandeirantes S.A. ("Ferroban"), a railway company, Aço Minas Gerais S.A. ("Açominas"), a steel company, Gulf Industrial Investment Company ("GIIC"), an iron ore pelletizing company in the country of Bahrain, and at our affiliated companies FCA, Samarco, Itabrasco and Hispanobras.

Academic background: Degree in Economics from the Universidade Federal de Minas Gerais; Master's degree in Business Administration from UFRJ; executive education programs at INSEAD (France) and at the Kellogg School of Management at Northwestern University.

José Carlos Martins, 62: Executive Officer for Ferrous Minerals Operations and Marketing of Vale since November 2011.

Other current director or officer positions: Member of the Board of Directors of Samarco.

Professional experience: Executive Officer of Vale with responsibility over several different departments since 2004, including Marketing, Sales and Strategy, Ferrous Minerals, and New Business Development. Member of the Board of Directors of Usiminas from 2005 to 2006 and from 2008 to 2009; President of South America Aluminum Can Production and Marketing for Rexam PLC, a global consumer packaging group; President of Latasa from 1999 until Rexam PLC bought Latasa in 2003; Executive Officer for Steel Production of CSN from 1997 until 1999; and Chief Executive Officer at Aços Villares, a steel manufacturer, where Mr. Martins also held several other important positions from 1986 until 1996.

Academic background: Degree in Economics from Pontifícia Universidade Católica in São Paulo.

Eduardo de Salles Bartolomeo, 48: Executive Officer for Fertilizer and Coal Operations and Marketing of Vale since November 2011.

Other current director or officer positions: Member of the Board of Directors of Log-In since 2007.

Professional experience: Executive Officer of Vale with responsibility over several different departments since 2007, including Integrated Operations, Logistics, Project Management, Sustainability, and Engineering. Mr. Bartolomeo was also President of Petroflex, a polyethylene duct and conduit manufacturer, from August to December 2006; Officer of the logistics operations department of Vale between January 2004 and July 2006; Manager of Corporate Planning, Plant Manager, Corporate Logistics Manager and Regional Director at Companhia de Bebidas das Américas ("Ambev"), a brewery company, from 1994 to 2003; and head of the steel conversion sector at COSIPA, a Brazilian steel producer, until 1991.

Academic background: Degree in Metallurgical Engineering from the Universidade Federal Fluminense and MBA from the Katholieke Universiteit in Leuven, Belgium.

Galib Abrahão Chaim, 61: Executive Officer for Implementation of Capital Projects of Vale since November 2011.

Professional experience: Project Director of Vale for the Department of Coal for projects in Australia, Mozambique, Zambia and Indonesia and Country Manager for Mozambique from 2005 to 2011; Industrial

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Director for Alunorte from 1994 to 2005; Industrial Superintendent for Albras from 1984 to 1994; and Technical Superintendent of MRN from 1979 to 1984.

Academic Background: Degree in Engineering from the Universidade Federal de Minas Gerais; Master's degree in Business Administration from Fundação Getulio Vargas.

Humberto Ramos de Freitas, 58: Executive Officer for Logistics and Mineral Exploration of Vale since November 2011.

Other current director or officer positions: Member of the Board of Directors of MRS since December 2010; Chairman of the Board of ABTP Associação Brasileira de Terminais Portuários, a non-profit organization that deals with issues related to Brazilian ports, since May 2009.

Professional experience: Logistics Operations Director of Vale from September 2009 to June 2010; Director for Ports and Navigation of Vale from March 2007 to August 2009; President, from August 2003 to February 2007 and Chief Executive Officer, from August 2003 to February 2007, of Valesul Alumínio S.A., a subsidiary of Vale involved in the production of aluminum; General Superintendent of Ports for CSN from December 1997 to November 1998.

Academic background: Degree in Metallurgical Engineering from the Ouro Preto School of Mines; Executive Development Program at the Kellogg School of Management at Northwestern University; Business Development Partnership (EDP) from Fundação Dom Cabral; senior executive education program at M.I.T.

Gerd Peter Poppinga, 52: Executive Officer for Base Metals Operations, Marketing and Information Technology of Vale since November 2011.

Other current director or officer positions: President Commissioner of PTVI since March 2010 and Member of the Board of Commissioners since April 2009; President and Chief Executive Officer of Vale Canada since January 2012; Chairman of the Board of Directors of VNC since June 2011, and a Member since November 2007.

Professional experience: Executive Vice President for Asia Pacific of Vale Canada from November 2009 to November 2011; Director for Strategy, Business Development, Human Resources and Sustainability of Vale Canada from May 2008 to October 2009; Director for Strategy and Information Technology of Vale Canada from November 2007 to April 2008. From 1985 until 1999, Mr. Poppinga also held several positions at Mineração da Trinidade S.A. SAMITRI, a publicly held mining company that was acquired by Vale in 2001.

Academic Background: Degree in Geology from Universidade Federal do Rio de Janeiro (UFRJ) and Universität Erlangen, Germany; post-graduate degree in Geology and Mining Engineering from the Universität Clausthal Zellerfeld, Germany; specialization in Geostatistics from the Universidade Federal de Ouro Preto (UFOP); Executive MBA from Fundação Dom Cabral; Senior Leadership Program at M.I.T.; Leadership Program at IMD Business School, Lausanne, Switzerland; and Strategic Megatrends with Asia Focus program at Kellogg Singapore.

Vânia Lucia Chaves Somavilla, 52: Executive Officer for Human Resources, Health and Safety, Sustainability, Energy and Corporate Affairs of Vale since May 2011.

Other current director or officer positions: Chairman of the Board of Directors of Vale Florestar S.A. since 2011.

Professional experience: Director of the Department of the Environment Sustainability at Vale from January 2010 until May 2011; Director for Energy Commercialization of Vale from March 2004 until January 2010; Chief Executive Officer of the Instituto Ambiental Vale from 2010 until 2011; Member of the Board of

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Directors of Albras from 2009 to 2011; Chief Executive Officer of Vale Florestar S.A., during 2010. In connection with her roles at Vale, Ms. Somavilla was also member of the executive board of several companies and consortia in the energy sector from 2004 until 2010. She was also head of New Business Development for Energy Generation and of Project Development and Implementation for large and small hydroelectric plant projects at Companhia Energética de Minas Gerais CEMIG, a publicly held company involved in the generation, transmission, distribution and sale of electricity, from 1995 until 2001.

Academic Background: Degree in Civil Engineering from UFMG; post-graduate degree in Dam Engineering from UFOP; specialization in Management of Hydro Power Utilities from SIDA, Stockholm, Sweden; MBA degree in Corporate Finance from IBMEC/Belo Horizonte; Transformational Leadership program from M.I.T. and Mastering Leadership program from IMD.

Conflicts of interest

Under Brazilian corporate law, if a director or an executive officer has a conflict of interest with the Company in connection with any proposed transaction, the director or executive officer may not vote in any decision of the Board of Directors or of the board of executive officers regarding such transaction and must disclose the nature and extent of the conflicting interest for transcription in the minutes of the meeting. In any case, a director or an executive officer may not transact any business with the Company, except on reasonable or fair terms and conditions that are identical to the terms and conditions prevailing in the market or offered by unrelated parties.

Fiscal Council

We have a fiscal council established in accordance with Brazilian law. The primary responsibilities of the fiscal council under Brazilian corporate law are to monitor management's activities, review the Company's financial statements, and report its findings to the shareholders. Pursuant to a written policy, our Fiscal Council requires management to obtain the Fiscal Council's approval before engaging any external auditor to provide any audit or permitted non-audit services to Vale or its consolidated subsidiaries. Under the policy, the Fiscal Council has pre-approved a detailed list of services based on detailed proposals from our auditors up to specified monetary limits. The list of pre approved services is updated periodically. Services that are not listed, that exceed the specified limits, or that relate to internal controls must be separately pre-approved by the Fiscal Council. The policy also sets forth a list of prohibited services. The Fiscal Council is provided with reports on the services provided under the policy on a periodic basis, review and monitor the Company's external auditor's independence and objectivity. The Fiscal Council has the power to review and evaluate the performance of the Company's external auditors on an annual basis and make a recommendation to the Board of Directors on whether the Company should remove and replace its existing external auditors. The Fiscal Council may also recommend withholding the payment of compensation to the independent auditors and has the power to mediate disagreements between management and the auditors regarding financial reporting.

Under our bylaws, our Fiscal Council is also responsible for establishing procedures for the receipt, retention and treatment of any complaints related to accounting, controls and audit issues, as well as procedures for the confidential, anonymous submission of concerns regarding such matters.

Brazilian law requires the members of a fiscal council to meet certain eligibility requirements. A member of our Fiscal Council cannot (i) hold office as a member of the board of directors, fiscal council or advisory committee of any company that competes with Vale or otherwise has a conflicting interest with Vale, unless compliance with this requirement is expressly waived by shareholder vote, (ii) be an employee or member of senior management or the Board of Directors of Vale or its subsidiaries or affiliates, or (iii) be a spouse or relative within the third degree by affinity or consanguinity of an officer or director of Vale.

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We are required by both the SEC and the NYSE listed company audit committee rules to comply with Exchange Act Rule 10A-3, which requires, absent an exemption, a standing audit committee composed of members of the Board of Directors that meet specified requirements. In lieu of establishing an independent audit committee, we have given our Fiscal Council the necessary powers to qualify for the exemption set forth in Exchange Act Rule 10A-3(c)(3). We believe our Fiscal Council satisfies the independence and other requirements of Exchange Act Rule 10A-3 that would apply in the absence of our reliance on the exemption. Pursuant to our undertakings to the HKEx, the Fiscal Council must be comprised of at least three members who satisfy specified independence requirements set out in the HKEx Listing Rules. We have received a written confirmation of independence pursuant to Rule 3.13 of the HKEx Listing Rules from eaech of the members of our Fiscal Council appointed by Valepar and consider them able to satisfy these independence requirements.

Our Board of Directors has determined that one of the members of our Fiscal Council, Mr. Aníbal Moreira dos Santos, is an audit committee financial expert. In addition, Mr. Moreira dos Santos meets the applicable independence requirements for Fiscal Council membership under Brazilian law and the NYSE independence requirements that would apply to audit committee members in the absence of our reliance on the exemption set forth in Exchange Act Rule 10A-3(c)(3).

Members of the Fiscal Council are elected by our shareholders for one-year terms. The current members of the Fiscal Council and their respective alternates were elected on April 19, 2011. The terms of the members of the Fiscal Council expire at the next annual shareholders' meeting following election.

Two members of our Fiscal Council (and the respective alternates) may be elected by non-controlling shareholders: one member may be appointed by our preferred shareholders and one member may be appointed by minority holders of common shares pursuant to applicable CVM rules.

The following table lists the current and alternate members of the Fiscal Council.

Current member	First year of appointment	Alternate	First year of appointment
Antônio Henrique Pinheiro Silveira(1)	2011	Marcus Pereira Aucélio(1)	2008
Arnaldo José Vollet(2)	2011	Cícero da Silva(2)	2009
Marcelo Amaral Moraes(2)	2004	Oswaldo Mário Pêgo de Amorim Azevedo(2)	2004
Aníbal Moreira dos Santos(2)	2005	Vacant	

(1) Appointed by preferred shareholders.

(2) Appointed by Valepar.

Below is a summary of the business experience, activities and areas of expertise of the members of our Fiscal Council.

Antônio Henrique Pinheiro Silveira, 47: Member of Vale's Fiscal Council since April 2011.

Other director or officer positions: Secretary of Economic Management of the Ministry of Finance since 2008; Director of Companhia de Seguros Aliança do Brasil, a private insurance company, since 2010, and of Norte Energia SA, a private energy company, since July 2010.

Professional experience: Assistant Secretary for Economic Management of the Ministry of Finance from 2007 to 2008 and Assistant Chief Economic Advisor of the Ministry of Planning, Budget and Management of Brazil from 2004 to 2007. He also served as Chairman of Banco Nordeste do Brasil, a privately-held bank, from 2008 to 2010; Director of Empresa Gestora de Ativos EMGEA, a private asset management entity, from 2007 to 2008; and member of the senior management of Companhia Docas do Estado da Bahia, a port services provider, from 2005 to 2007.

Academic Background: Bachelor's, Master's and Ph.D. degrees in Economics from UFRJ.

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Arnaldo José Vollet, 63: Member of Vale's Fiscal Council since April 2011.

Professional experience: Executive Officer of BB DTVM, a subsidiary of Banco do Brasil, from 2002 to 2009; Finance and Investor Relations Officer of Companhia de Energia Elétrica da Bahia Coelba, a publicly held electricity company, from 2000 to 2002; Member of the Fiscal Council of Telesp Celular Participações, a publicly held telecommunications company, from 1999 to 2000; Member of the Fiscal Council of CELP Companhia de Eletricidade de Pernambuco, a publicly held electricity company, from 2004 to 2009; Director of Guaraniana, now called Neoenergia S.A., a publicly held electricity holding company, from 2002 to 2003; Alternate Member of the Board of Directors of CEMIG Companhia de Energia de Minas Gerais, a publicly held electricity company, from 2003 to 2005; Member of the Board of Directors of Pronor and Nitrocarbono, both chemical companies, from 1997 to 1998.

Academic background: Degree in Mathematics from USP and MBA degree in Finance from IBMEC/RJ.

Marcelo Amaral Moraes, 44: Member of Vale's Fiscal Council since April 2004.

Other director or officer positions: Managing Executive Officer at Capital Dynamics Investimentos Ltda. since January 2012; Member of the Deliberative Council of ABVCAP since 2010.

Professional experience: Managing Executive Officer and partner responsible for specialized funds at Stratus Investimentos Ltda., a private equity and venture capital firm, from 2006 to 2010; Investment Manager at Bradespar from 2000 to 2006; worked in the mergers and acquisitions and capital markets departments of Banco Bozano, Simonsen from 1995 to 2000; Alternate Member of the Board of Directors of Net from 2004 to 2005; Alternate Member of the Board of Directors of Vale in 2003.

Academic background: Degree in Economics from UFRJ, an MBA with emphasis in finance from UFRJ/COPPEAD, and a post-graduate degree in business law and arbitration from FGV in São Paulo.

Aníbal Moreira dos Santos, 73: Member of Vale's Fiscal Council since April 2005.

Other director or officer positions: Member of Fiscal Council of Log-In since 2009.

Professional experience: From 1998 until his retirement in 2003, Mr. Moreira dos Santos served as Executive Officer of several CAEMI subsidiaries, including Caemi Canada Inc., Caemi Canada Investments Inc., CMM Overseas, Ltd., Caemi International Holdings BV and Caemi International Investments NV, and as Chief Accounting Officer of CAEMI from 1983 to 2003. He also served as Member of the Fiscal Council of CADAM from 1999 to 2003 and as an Alternate Member of the Board of Directors of MBR and Empreedimentos Brasileiros de Mineração, an iron ore asset holding company, from 1998 to 2003.

Academic background: Degree in Accounting from FGV in Rio de Janeiro.

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MANAGEMENT COMPENSATION

Under our bylaws, our shareholders are responsible for establishing the aggregate compensation we pay to the members of our Board of Directors and our Board of Executive Officers, and the Board of Directors allocates the compensation among its members and the Board of Executive Officers.

Our shareholders determine this annual aggregate compensation at the general shareholders' meeting each year. In order to establish aggregate director and officer compensation, our shareholders usually take into account various factors, which range from attributes, experience and skills of our directors and executive officers to the recent performance of our operations. Once aggregate compensation is established, the members of our Board of Directors are then responsible for distributing such aggregate compensation in compliance with our bylaws among the directors and executive officers. The Executive Development Committee makes recommendations to the Board concerning the annual aggregate compensation of the executive officers. In addition to fixed compensation, our executive officers are also eligible for bonuses and incentive payments.

For the year ended December 31, 2011, the amount paid to the executive officers is set forth in the table below.

	For the year ended December 31, 2011 (US$ million)
Fixed compensation and in kind benefits	11.7
Variable compensation	25.3
Pension, retirement or similar benefits	2.1
Severance	59.0
Social security contributions(1)	19.1
Total paid to the executive officers	117.1

(1) Social security contributions to the Brazilian government with respect to the executive officers.

We paid US$2.8 million in aggregate to the members of our Board of Directors for services in all capacities, all of which was fixed compensation. There are no pension, retirement or similar benefits for the members of our Board of Directors. As of March 31, 2012, the total number of common shares owned by our directors and executive officers was 54,344, and the total number of preferred shares owned by our directors and executive officers was 931,154. None of our directors or executive officers beneficially owns 1% or more of any class of our shares.

Fiscal Council

We paid an aggregate of US$660,409 to members of the Fiscal Council in 2011. In addition, the members of the Fiscal Council are reimbursed for travel expenses related to the performance of their functions.

Advisory committees

We paid an aggregate of US$189,538 to members of our advisory committees in 2011. Under Article 15 of our bylaws, those members who are directors or officers of Vale are not entitled to additional compensation for participating on a committee. Members of our advisory committees are reimbursed for travel expenses related to the performance of their functions.

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EMPLOYEES

The following tables set forth the number of our employees by business and by location as of the dates indicated.

	At December 31,		
By business:	**2009**	**2010**	**2011**
Bulk materials	35,760	40,986	48,362
Base metals operations	18,031	17,855	18,168
Fertilizer nutrients	1,156	6,054	6,903
Corporate activities	5,089	5,890	6,213
Total	60,036	70,785	79,646

	At December 31,		
By location:	**2009**	**2010**	**2011**
South America	47,242	57,525	64,766
North America	6,972	6,390	6,617
Europe	660	598	615
Asia	4,007	3,797	4,088
Oceania	1,040	1,845	2,186
Africa	115	630	1,374
Total	60,036	70,785	79,646

We negotiate wages and benefits with a large number of unions worldwide that represent our employees. We have collective agreements with unionized employees at our Argentine, Australian, Brazilian, Canadian, French, Indonesian, Malawian, Mozambican, New Caledonian, Norwegian, Paraguayan, Peruvian and U.K. operations.

We recently resolved two labor disputes that affected our Canadian operations. These were resolved in July 2010, with striking employees at our Canadian nickel operations in Sudbury and Port Colborne, Ontario, and in January 2011, with striking employees working in mining and mill operations at Voisey's Bay, Newfoundland, with the entering into of new five-year collective bargaining agreements with the unions representing the employees previously on strike. In September 2011, we entered into a three year collective agreement with the union representing the employees in our Thompson Manitoba Operations. The collective agreements include a defined contribution pension plan for new employees and adjustments in variable compensation programs that support the achievement of strategic objectives and rewards performance, among various other improvements to the collective bargaining agreement.

Wages and benefits

Wages and benefits for Vale and its subsidiaries are generally established on a company-by-company basis. Vale establishes its wage and benefits programs for Vale and its subsidiaries, other than Vale Canada, in periodic negotiations with unions. In November 2011, Vale reached a two-year agreement with the Brazilian unions. A salary increase of 8.6% was implemented in November 2011, and another salary increase of 8% will be implemented in November 2012 for our employees in Brazil as part of that agreement. The provisions of Vale's collective bargaining agreements with its unions also apply to Vale's non-unionized employees. Vale Canada establishes wages and benefits for its unionized employees through collective agreements. For non-unionized employees, Vale Canada undertakes an annual review of salaries. Vale and its subsidiaries provide their employees and their dependents with other benefits, including supplementary medical assistance.

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Pension plans

Brazilian employees of Vale and of most of its Brazilian subsidiaries are eligible to participate in pension plans managed by Valia. Sponsored by Vale and such subsidiaries, Valia is a nonprofit, complementary social security foundation with both financial and administrative autonomy.

Most of the participants in plans held by Valia are participants in a plan named "Vale Mais," which Valia implemented in May 2000. This plan is primarily a defined contribution plan with a defined benefit feature relating to service prior to May 2000 and another defined benefit feature to cover temporary or permanent disability, pension and financial protection to dependents in case of death. Valia also operates a defined benefit plan, closed to new participants since May 2000, with benefits based on years of service, salary and social security benefits. This plan covers retired participants and their beneficiaries, as well as a relatively small number of employees that declined to transfer from the old plan to the "Vale Mais" plan when it was established in May 2000.

Our wholly-owned subsidiary Vale Canada sponsors defined benefit pension plans and defined contribution pension plans, principally for employees in Canada, the United States, the United Kingdom and Indonesia. As a result of the collective bargaining agreement reached with the union representing employees at our Canadian nickel operations in Thompson, Manitoba, in September 2011, all of the defined benefit plans of Vale Canada are now closed to new employees. All new employees of Vale Canada participate in defined contribution pension plans. In addition, Vale Canada provides post-retirement benefits for eligible employees, including post-retirement health, dental and ophthalmological benefits.

In the Asia-Pacific region, the types of pension plans we provide varies. Defined benefit plans exist in Singapore, Mongolia, Malaysia, Kazakhstan, South Korea, and Japan. Defined contribution plans exist in China, Philippines, India, Hong Kong and Thailand, with Hong Kong having no company match and China having various plans with a company match portion, based on city. One location, Taiwan, offers a hybrid plan with a mix of a defined benefit and defined contribution plan.

Performance-based compensation

All Vale parent-company employees receive incentive compensation each year in an amount based on the performance of Vale, the performance of the employee's department and the performance of the individual employee. Similar incentive compensation arrangements are in place at our subsidiaries.

Certain Vale employees are also eligible to receive deferred bonuses with vesting periods of three years based on Vale's performance as measured by total shareholder return relative to a group of peer companies over the vesting period. Since 2008, qualifying management personnel have been eligible to participate at their option in a bonus program tied to preferred share ownership. Under the program, each qualified employee may elect to invest part of their bonus either in Vale preferred shares for eligible employees receiving an incentive payment in Brazil, or in ADRs representing Vale preferred shares for eligible employees receiving an incentive payment outside Brazil. If the employee continues to be employed by us and has held the preferred shares (or ADRs) for the entire duration of the relevant cycle of the matching program, at the expiration of the applicable three year term of the program, the employee will receive a cash payment to be applied to purchase in the open market a number of additional preferred shares (or ADRs) equal to the number of preferred shares (or ADRs) purchased by the employee pursuant to the program. During the three-year term of the incentive program, participating employees have the right to sell all or part of the preferred shares (or ADRs) purchased through the program, however such employees forfeit the right to the matching reward for all shares sold prior to the expiration of the term of the program. For the 2011-2013 cycle, 1,122 employees participated in the program.

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V. ADDITIONAL INFORMATION

LEGAL PROCEEDINGS

We and our subsidiaries are defendants in numerous legal actions in the normal course of business, including civil, administrative, tax, social security and labor proceedings. The most significant proceedings are discussed below. Except as otherwise noted below, the amounts claimed, and the amounts of our provisions for possible losses, are stated as of December 31, 2011. See Note 20 to our consolidated financial statements for further information.

Praia Mole suit

We are among the defendants in a public civil action filed by Brazilian federal government agencies in November 1997 seeking to annul the concession agreements under which the defendants operate the Praia Mole maritime terminal in the Brazilian state of Espírito Santo. The case was decided in our favor in November 2007 with a decision recognizing the validity of that concession agreement, however, the federal public prosecutor filed an appeal with the federal circuit court in April 2008, which is still pending.

Itabira suits

We are a defendant in two separate actions brought by the municipality of Itabira, in the Brazilian state of Minas Gerais. In the first action, filed in August 1996, the municipality of Itabira alleges that our Itabira iron ore mining operations have caused environmental and social harm, and claims damages with respect to the alleged environmental degradation of the site of one of our mines, as well as the immediate restoration of the affected ecological complex and the performance of compensatory environmental programs in the region. The damages sought, as adjusted from the date of the claim, amount to approximately R$2.686 billion (US$1.438 billion). There have been hearings in this action, a report favorable to Vale was issued, and a request for additional expert evidence presented by the municipality has been granted. A final decision is still pending.

In the second action, filed in September 1996, the municipality of Itabira claims the right to be reimbursed for expenses it has incurred in connection with public services rendered as a consequence of our mining activities. The damages sought, as adjusted from the date of the claim, amount to approximately R$3.111 billion (US$1.665 billion). This case had been suspended pending consideration of our request to include favorable evidence from a separate lawsuit. In January 2012, our request was denied and, once the court is notified, the lawsuit will resume.

CFEM-related proceedings

We are engaged in numerous administrative and judicial proceedings relating to the mining royalty known as the CFEM. For more information about CFEM, see *Regulatory Matters Royalties and other taxes on mining activities*. These arise out of a large number of assessments by the DNPM, an agency of the Ministry of Mines and Energy of the Brazilian government. The proceedings concern different interpretations of the deductibility of tax and transportation expenditures, DNPM's method of estimating sales, the statute of limitations, due process of law, payment of royalties on pellet sales and CFEM charges on the revenues generated by our subsidiaries abroad.

We believe that the DNPM's claims are without merit, and we are contesting them using the available avenues of recourse under Brazilian law, beginning with challenges in administrative tribunals and proceeding with challenges in the judicial courts. We have received some favorable decisions and some unfavorable decisions, but none of the disputes has been finally resolved and we cannot predict the amount of time required before final judicial resolutions. The federal government has established a working group with representatives of Vale and DNPM to review the basis of calculation of the CFEM, which is among the issues in dispute.

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The aggregate amount claimed in the pending assessments is approximately R$5.640 billion (US$3.019 billion) (including interest and penalties through December 31, 2011).

ICMS tax assessments

In December 2011, the tax authority of the Brazilian state of Minas Gerais issued six tax assessments (*autos de infração*) against us for additional payments of the value-added tax on services and circulation of goods (ICMS) on the iron ore we transport from our mining sites in the state of Minas Gerais to our facilities in the state of Espírito Santo. The tax authority asserts that the calculation of ICMS should be based on the market value of the iron ore transported, as opposed to the cost of production of the ore, which is the manner by which we calculated the ICMS owed in years past. These tax assessments cover the year 2006, in an aggregate amount of R$1.2 billion (US$642 million). We have already presented our defense against each of these assessments at the administrative level. While this issue remains unresolved, the tax authority is likely to issue additional assessments covering years subsequent to 2006.

Tax litigation in Switzerland

We are engaged in a dispute with Swiss authorities concerning the application of a tax exemption to our Swiss subsidiary Vale International. The exemption provides for a 60% tax exemption, which increases to 80% if certain employment and investment conditions are met. Our position is that these conditions have been met, and the Swiss federal authority contends that they were not met for the tax years from 2006 through 2009. The Vaud cantonal authority had originally accepted our position, but reversed itself after the federal authority commenced litigation challenging its application of the exemption. In March 2012, the cantonal tax authority issued tax assessments against Vale International in the aggregate amount of 212 million Swiss francs (US$226 million), reflecting the position that the conditions for the additional 20% exemption were not met. We believe these assessments are unjustified, and we will contest them before the Swiss courts.

Tax litigation

We are engaged in legal proceedings concerning the contention of the Brazilian federal tax authority (*Receita Federal*) that we should pay Brazilian corporate income tax and social security contributions on the net income of our non-Brazilian subsidiaries and affiliates. The position of the tax authority is based on Article 74 of Brazilian Provisional Measure 2,158-34/2001 ("Article 74"), a tax regulation issued in 2001 by Brazil's President, and on implementing regulations adopted by the tax authority under Article 74.

For accounting purposes, we have determined that the payment of additional taxes under Article 74 is reasonably possible, but not probable, and accordingly we have not established any provision. We intend to continue to vigorously defend our interests in all the related proceedings.

Our direct judicial challenge

In 2003, prior to receiving any assessment of taxes under Article 74, we initiated a legal proceeding (*mandado de segurança*) challenging the applicability of the regulation based on the following arguments: (i) Article 74 disregards certain provisions on the taxation of profits in double taxation treaties between Brazil and the countries where some of our subsidiaries and affiliates are based; (ii) the Brazilian Tax Code prohibits the establishment of conditions and timing of any such tax by means of a provisional measure; (iii) even if Article 74 is valid, currency exchange gains and losses must be excluded from the net income of our foreign subsidiaries and affiliates in the calculation of taxes owed; and (iv) the application of the regulation to net income generated before December 2001 would violate the constitutional principle prohibiting retroactive application of tax laws.

In 2005, the court of first instance ruled against us on the merits of the case, and we appealed. In 2011, our appeal was rejected by the Federal Court of Appeals (*Tribunal Regional Federal da 2ª Região*).

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In December 2011, we filed new appeals before the Superior Court of Justice, with respect to our arguments regarding the violations to federal law and international treaties, and the Supreme Court (*Supremo Tribunal Federal*), with respect to our constitutional arguments. In March 2012, we obtained a new ruling from the Superior Court of Justice suspending all collection efforts by the tax authorities in respect of Article 74 assessments, pending a final ruling on the merits of our challenge. The Brazilian federal tax authority has appealed from this decision.

Constitutional challenges to Article 74 are pending before Brazil's Supreme Court. CNI (*Confederação Nacional da Indústria*), a major national industry association, filed a direct constitutional challenge (*ação direta de inconstitucionalidade*) in 2001, and a decision in that case would have general applicability with respect to the constitutional arguments against Article 74. Other taxpayers and groups have also appealed from lower courts to the Supreme Court in cases challenging Article 74, and in April 2012 the Supreme Court determined that its decision to be made in an appeal brought by Cooperativa Agropecuária Mourãoense (Coamo) will be generally applicable with respect to the constitutional arguments. Even if the Supreme Court decides the constitutional questions against the taxpayers, we intend to continue pursuing our other legal arguments.

Tax assessments and our administrative claims

The tax authority has issued four tax assessments (*autos de infração*) against us for payment of taxes in accordance with Article 74, as follows (including interest and penalties through December 31, 2011):

Notice of assessment issued in 2007 covering the years 1996 2002, for taxes of R$992 million, plus interest and penalties of R$2.101 billion.

Notice of assessment issued in 2008 covering the years 2003 2006, for taxes of R$4.076 billion, plus interest and penalties of R$6.778 billion.

Notice of assessment issued in 2009 covering the year 2007, for taxes of R$5.742 billion, plus interest and penalties of R$7.497 billion.

Notice of assessment issued in 2010 covering the year 2008, for taxes of R$1.604 billion, plus interest and penalties of R$1.897 billion.

We have challenged each assessment with the tax authority and on appeal to the CARF (*Conselho Administrativo de Recursos Fiscais*), which is an appellate administrative tribunal within the tax authority. Although each assessment relates to different factual circumstances and not all of our arguments apply to all four assessments, these challenges generally assert that Article 74 conflicts with certain provisions of Brazil's international tax treaties on the taxation of dividends, and they dispute the application and calculation of fines on the claimed amounts. We have raised other arguments in respect of the validity of Article 74 in our direct judicial challenge to the regulation, as discussed above. While challenges to Article 74 remain unresolved, the tax authority is likely to issue additional assessments covering years subsequent to 2008 in order to preserve its rights in light of the applicable statute of limitations. We intend to challenge any such assessments.

Decisions of the tax administration may be challenged in judicial courts, with two or sometimes three levels of judicial review. While tax claims are being contested in administrative proceedings, the tax authority cannot seek to collect the assessed amounts. However, if the administrative review process concludes without dismissing the assessment, the tax authority can seek to collect payment, and the taxpayer can only suspend collection efforts if it challenges the administrative decision in the judicial courts. Under Brazilian law, a taxpayer that appeals to the courts must ordinarily provide a bond or security in commensurate amount with the court in order to suspend collection efforts. Although we may contest the application and scope of the bond requirement under the circumstances of our challenges to Article 74 if in the future we need to appeal administrative decisions to the judicial courts, it is likely that in such circumstances we would be required to post bond or some form of security with the court, and, depending on the nature, amount and scope of such bond, this may have a significant financial impact.

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During the first quarter of 2012, we received demands for payment in respect of these assessments, because the tax authorities asserted that no further disputes were pending at the administrative level with respect to those amounts. These demands are suspended by the March 2012 injunction of the Superior Court of Justice in our direct judicial challenge to Article 74. While this injunction remains in force, the tax authorities cannot seek collection from us in respect of any Article 74 assessments and, for such time, we are thus not required to post bond in order to avoid collection.

Railway litigation

In August 2006, the Brazilian federal rail network, *Rede Ferroviária Federal S.A. RFFSA*, filed a breach of contract claim against us for R$3.054 billion (US$1.641 billion) in damages, stemming from a 1994 agreement regarding the construction of two railway networks. The RFFSA has since been succeeded as plaintiff by the Brazilian government.

In 1994, prior to its privatization, Vale entered into a contract with RFFSA to build two railway networks in Belo Horizonte, Brazil, which were to be incorporated into an existing railway segment, in a project called "*Transposição de Belo Horizonte*." We subsequently entered into a related agreement with the Brazilian government to begin the construction of an alternative railway segment, because the initially agreed upon segments could not be built.

Before the RFFSA lawsuit was filed, we filed a claim against RFFSA, now succeeded as defendant by the Brazilian government, which challenged the inflation adjustment provisions in the contract with RFFSA. We contend that the method of calculation employed by the Brazilian government is not lawful under Brazilian law.

Pursuant to a partial settlement, the construction costs of the new segment will be set off against the damages sought under the original RFFSA claim, which would significantly reduce the amount we would be required to pay in damages if such claim is decided in the Brazilian government's favor.

Gold forward contracts litigation

We were a defendant in a case brought by the pension fund Petros with respect to certain gold forward contracts entered into in 1988 and 1989, which, following a resolution passed by the Brazilian government, through the Brazilian Central Bank, we were obligated to settle in cash instead of by physical delivery. In its suit, Petros claimed that the inflation adjustment provided for in the contracts did not adequately compensate it for monetary losses arising from the government's measures to control inflation.

In April 2011, the Superior Court of Justice ruled against us in this matter. Although this decision can still be reversed, we were required to pay the total amount of R$346.8 million (US$185.6 million) claimed by Petros in the lawsuit. If the decision is reversed, we will be entitled to recover this amount under a bank guarantee.

There are ten other cases arising under similar facts. The total amount claimed in these cases is R$130.4 million (US$69.8 million).

Transger suit

One of our subsidiaries, FCA, is a defendant in a suit first filed in state court in Minas Gerais by Transger S.A. ("Transger") and later moved to federal court. Transger seeks money damages and the annulment of certain General Meetings that occurred in early 2003, at which shareholders approved an increase in FCA's share capital, on the grounds of allegedly abusive acts by FCA's controlling group. The court of first instance initially ruled against the defendants, but subsequently rescinded the judgment to allow for the preparation of an additional expert report.

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MEMORANDUM AND ARTICLES OF ASSOCIATION

Company objectives and purposes

Our corporate purpose is defined by our bylaws to include:

- the exploration of mineral deposits in Brazil and abroad by means of research, extraction, processing, industrialization, transportation, shipment and commerce of mineral goods;

- the building and operation of railways and the provision of our own or unrelated-party rail traffic;

- the building and operation of our own or unrelated-party maritime terminals, and the provision of shipping activities and port services;

- the provision of logistics services integrated with cargo transport, including inflow management, storage, transshipment, distribution and delivery, all within a multimodal transport system;

- the production, processing, transport, industrialization and commercialization of any and all sources and forms of energy, including the production, generation, transmission, distribution and commercialization of our own products, derivatives and sub products;

- the engagement, in Brazil or abroad, of other activities that may be of direct or indirect consequence for the achievement of our corporate purposes, including research, industrialization, purchases and sales, importation and exportation, the development, industrialization and commercialization of forest resources and the provision of services of any kind whatsoever; and

- the establishment or participation, in any fashion, in other companies, consortia or associations directly or indirectly related to our business purpose.

Common shares and preferred shares

Set forth below is certain information concerning our authorized and issued share capital and a brief summary of certain significant provisions of our bylaws and Brazilian corporate law. This description does not purport to be complete and is qualified by reference to our bylaws (an English translation of which we have filed with the SEC) and to Brazilian corporate law.

Our bylaws authorize the issuance of up to 3.6 billion common shares and up to 7.2 billion preferred shares, in each case based solely on the approval of the Board of Directors without any additional shareholder approval.

Each common share entitles the holder thereof to one vote at meetings of our shareholders. Holders of common shares are not entitled to any preference relating to our dividends or other distributions.

Holders of preferred shares and the golden shares are generally entitled to the same voting rights as holders of common shares, except with respect to the election of members of the Board of Directors, and are entitled to a preferential dividend as described below. Non-controlling shareholders holding common shares representing at least 15% of our voting capital, and preferred shares representing at least 10% of our total share capital, have the right to appoint each one member and an alternate to our Board of Directors. If no group of common or preferred shareholders meets the thresholds described above, shareholders holding preferred or common shares representing at least 10% of our total share capital are entitled to combine their holdings to appoint one member and an alternate to our Board of Directors. Holders of preferred shares, including the golden shares, may elect one member of the permanent Fiscal Council and the respective alternate. Non-controlling holders of common shares may also elect one member of the Fiscal Council and an alternate, pursuant to applicable CVM rules.

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The Brazilian government holds 12 golden shares of Vale. The golden shares are preferred shares that entitle the holder to the same rights (including with respect to voting and dividend preference) as holders of preferred shares. In addition, the holder of the golden shares is entitled to veto any proposed action relating to the following matters:

- a change in our name;
- a change in the location of our head office;
- a change in our corporate purpose as regards mining activities;
- any liquidation of the Company;
- any disposal or winding up of activities in any of the following parts of our iron ore mining integrated systems:
  (a) mineral deposits, ore deposits, mines;
  (b) railways; or
  (c) ports and maritime terminals;
- any change in the bylaws relating to the rights afforded to the classes of capital stock issued by us; and
- any change in the bylaws relating to the rights afforded the golden shares.

Calculation of distributable amount

At each annual shareholders' meeting, the Board of Directors is required to recommend, based on the executive officers' proposal, how to allocate our earnings for the preceding fiscal year. For purposes of Brazilian corporate law, a company's net income after income taxes and social contribution taxes for such fiscal year, net of any accumulated losses from prior fiscal years and amounts allocated to employees' and management's participation in earnings represents its "net profits" for such fiscal year. In accordance with Brazilian corporate law, an amount equal to our net profits, as further reduced by amounts allocated to the legal reserve, to the fiscal incentive investment reserve, to the contingency reserve or to the unrealized income reserve established by us in compliance with applicable law (discussed below) and increased by reversals of reserves constituted in prior years, is available for distribution to shareholders in any given year. Such amount, the adjusted net profits, is referred to herein as the distributable amount. We may also establish discretionary reserves, such as reserves for investment projects.

The Brazilian corporate law provides that all discretionary allocations of net profits, including discretionary reserves, the contingency reserve, the unrealized income reserve and the reserve for investment projects, are subject to approval by the shareholders voting at the annual meeting and can be transferred to capital or used for the payment of dividends in subsequent years. The fiscal incentive investment reserve and legal reserve are also subject to approval by the shareholders voting at the annual meeting and may be transferred to capital but are not available for the payment of dividends in subsequent years.

The sum of certain discretionary reserves may not exceed the amount of our paid-in capital. When such limit is reached, our shareholders may vote to use the excess to pay in capital, increase capital or distribute dividends.

Our calculation of net profits and allocations to reserves for any fiscal year are determined on the basis of financial statements prepared in accordance with Brazilian corporate law. Our consolidated financial statements have been prepared in accordance with U.S. GAAP and, although our allocations to reserves and

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dividends will be reflected in these financial statements, investors will not be able to calculate such allocations or required dividend amounts from our consolidated financial statements.

Mandatory dividend

The Brazilian corporate law and our bylaws prescribe that we must distribute to our shareholders in the form of dividends or interest on shareholders' equity an annual amount equal to not less than 25% of the distributable amount, referred to as the mandatory dividend, unless the Board of Directors advises our shareholders at our general shareholders' meeting that payment of the mandatory dividend for the preceding year is inadvisable in light of our financial condition. To date, our Board of Directors has never determined that payment of the mandatory dividend was inadvisable. The Fiscal Council must review any such determination and report it to the shareholders. In addition to the mandatory dividend, our Board of Directors may recommend to the shareholders payment of dividends from other funds legally available therefore. Any payment of interim dividends will be netted against the amount of the mandatory dividend for that fiscal year. The shareholders must also approve the recommendation of the Board of Directors with respect to any required distribution. The amount of the mandatory dividend is subject to the size of the legal reserve, the contingency reserve, and the unrealized income reserve. The amount of the mandatory dividend is not subject to the size of the discretionary depletion reserve. See *Calculation of distributable amount*.

Dividend preference of preferred shares

Pursuant to our bylaws, holders of preferred shares and the golden shares are entitled to a minimum annual non-cumulative preferential dividend equal to (i) at least 3% of the book value per share, calculated in accordance with the financial statements which serve as reference for the payment of dividends, or (ii) 6% of their pro rata share of our paid-in capital, whichever is higher. To the extent that we declare dividends in any particular year in amounts which exceed the preferential dividends on preferred shares, and after holders of common shares have received distributions equivalent, on a per share basis, to the preferential dividends on preferred shares, holders of common shares and preferred shares shall receive the same additional dividend amount per share. Since the first step of our privatization in 1997, we have had sufficient distributable amounts to be able to distribute equal amounts to both common and preferred shareholders.

Other matters relating to our preferred shares

Our bylaws do not provide for the conversion of preferred shares into common shares. In addition, the preferred shares do not have any preference upon our liquidation and there are no redemption provisions associated with the preferred shares.

Distributions classified as shareholders' equity

Brazilian companies are permitted to pay limited amounts to shareholders and treat such payments as an expense for Brazilian income tax purposes. Our bylaws provide for the distribution of interest on shareholders' equity as an alternative form of payment to shareholders. The interest rate applied is limited to the Brazilian long-term interest rate, or TJLP, for the applicable period. The deduction of the amount of interest paid cannot exceed the greater of (1) 50% of net income (after the deduction of the provision of social contribution on net profits and before the deduction of the provision of the corporate income tax) before taking into account any such distribution for the period in respect of which the payment is made or (2) 50% of the sum of retained earnings and profit reserves. Any payment of interest on shareholders' equity is subject to Brazilian withholding income tax. See *Additional information Taxation*. Under our bylaws, the amount paid to shareholders as interest on shareholders' equity (net of any withholding tax) may be included as part of any mandatory and minimum dividend. Under Brazilian corporate law, we are obligated to distribute to shareholders an amount sufficient to ensure that the net amount received, after payment by us of applicable Brazilian withholding taxes in respect of the distribution of interest on shareholders' equity, is at least equal to the mandatory dividend.

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Mandatorily convertible notes

In 2009, our wholly owned subsidiary Vale Capital II issued mandatorily convertible notes in two series, both due June 15, 2012. The series VALE-2012 notes (US$293 million principal amount) are mandatorily convertible into ADSs representing an aggregate maximum of 18,415,859 common shares. The series VALE.P-2012 notes (US$649 million principal amount) are mandatorily convertible into ADSs representing an aggregate maximum of 47,284,791 preferred shares.

The mandatorily convertible notes of Vale Capital II can convert before maturity under specified circumstances. The conversion rate for all series will depend on the market price of the ADSs on the conversion date. Under the indentures governing the notes, additional remuneration is due to each noteholder in an amount in U.S. dollars equal to any cash distribution net of any applicable withholding tax and fees paid by the Depositary of our ADSs to the holder of one ADS, multiplied by the number of ADSs that would be received by the noteholder upon conversion of the notes at the conversion rate specified in the applicable indenture.

Voting rights

Each common share entitles the holder thereof to one vote at meetings of our shareholders. Holders of preferred shares are entitled to the same voting rights as holders of common shares except for the election of members of the Board of Directors, which will no longer apply in the event of any dividend arrearage, as described below. One of the members of the permanent Fiscal Council and his or her alternate are elected by majority vote of the holders of preferred shares. Holders of preferred shares and common shares may, in certain circumstances, combine their respective holdings to elect members of our Board of Directors, as described under *Common shares and preferred shares*.

The golden shares entitle the holder thereof to the same voting rights as holders of preferred shares. The golden shares also confer certain other significant veto rights in respect of particular actions, as described under *Common shares and preferred shares*.

The Brazilian corporate law provides that non-voting or restricted-voting shares, such as the preferred shares, acquire unrestricted voting rights beginning when a company has failed for three consecutive fiscal years (or for any shorter period set forth in a company's constituent documents) to pay any fixed or minimum dividend to which such shares are entitled and continuing until payment thereof is made. Our bylaws do not set forth any such shorter period.

Any change in the preferences or advantages of our preferred shares, or the creation of a class of shares having priority over the preferred shares, would require the approval of the holder of the golden shares, who can veto such matters, as well as the approval of the holders of a majority of the outstanding preferred shares, voting as a class at a special meeting.

Shareholders' meetings

Our Ordinary General Shareholders' Meeting is convened by April of each year for shareholders to resolve upon our financial statements, distribution of profits, election of Directors and Fiscal Council Members, if necessary, and compensation of senior management. Extraordinary General Shareholders' Meetings are convened by the Board of Directors as necessary in order to decide all other matters relating to our corporate purposes and to pass such other resolutions as may be necessary.

Pursuant to Brazilian corporate law, shareholders voting at a general shareholders' meeting have the power, among other powers, to:

- amend the bylaws;

- elect or dismiss members of the Board of Directors and members of the Fiscal Council at any time;

- establish the remuneration of senior management and members of the Fiscal Council;

- receive annual reports by management and accept or reject management's financial statements and recommendations including the allocation of net profits and the distributable amount for payment of the mandatory dividend and allocation to the various reserve accounts;

- authorize the issuance of convertible and secured debentures;

- suspend the rights of a shareholder in default of obligations established by law or by the bylaws;

- accept or reject the valuation of assets contributed by a shareholder in consideration for issuance of capital stock;

- pass resolutions to reorganize our legal form, to merge, consolidate or split us, to dissolve and liquidate us, to elect and dismiss our liquidators and to examine their accounts; and

- authorize management to file for bankruptcy or to request a judicial restructuring.

Pursuant to CVM recommendations and as stipulated in our undertakings to the HKEx, all general shareholders' meetings, including the annual shareholders' meeting, require no fewer than 30 days notice to shareholders prior to the scheduled meeting date. Where any general shareholders' meeting is adjourned, 15 days prior notice to shareholders of the reconvened meeting is required. Pursuant to Brazilian corporate law, this notice to shareholders is required to be published no fewer than three times, in the *Diário Oficial do Estado do Rio de Janeiro* and in a newspaper with general circulation in the city where we have our registered office, in Rio de Janeiro. Our shareholders have previously designated *Jornal do Commercio* for this purpose. Also, because our shares are traded on the BM&FBOVESPA, we must publish a notice in a São Paulo based newspaper. Such notice must contain the agenda for the meeting and, in the case of an amendment to our bylaws, an indication of the meeting's subject matter. In addition, under our bylaws, the holder of the golden shares is entitled to a minimum of 15 days prior formal notice to its legal representative of any general shareholders' meeting to consider any proposed action subject to the veto rights accorded to the golden shares. See *Common shares and preferred shares*.

A shareholders' meeting may be held if shareholders representing at least one-quarter of the voting capital are present, except as otherwise provided, including for meetings convened to amend our bylaws, which require a quorum of at least two-thirds of the voting capital. If no such quorum is present, notice must again be given in the same manner as described above, and a meeting may then be convened without any specific quorum requirement, subject to the minimum quorum and voting requirements for certain matters, as discussed below. A shareholder without a right to vote may attend a general shareholders' meeting and take part in the discussion of matters submitted for consideration.

Except as otherwise provided by law, resolutions of a shareholders' meeting are passed by a simple majority vote, abstentions not being taken into account. Under Brazilian corporate law, the approval of shareholders representing at least one-half of the issued and outstanding voting shares is required for the types of action described below, as well as, in the case of the first two items below, a majority of issued and outstanding shares of the affected class:

- creating a new class of preferred shares or disproportionately increasing an existing class of preferred shares relative to the other classes of preferred shares, other than to the extent permitted by the bylaws;

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- changing a priority, preference, right, privilege or condition of redemption or amortization of any class of preferred shares or creating a new class of shares with greater privileges than the existing classes of preferred shares;
- reducing the mandatory dividend;
- changing the corporate purposes;
- merging us with another company or consolidating or splitting us;
- participating in a centralized group of companies as defined under Brazilian corporate law;
- dissolving or liquidating us; and
- canceling any ongoing liquidation of us.

Whenever the shares of any class of capital stock are entitled to vote, each share is entitled to one vote. Annual shareholders' meetings must be held by April 30 of each year. Shareholders' meetings are called, convened and presided over by the chairman or, in case of his absence, by the vice-chairman of our Board of Directors. In the case of temporary impediment or absence of the chairman or vice-chairman of the Board of Directors, the shareholders' meetings may be chaired by their respective alternates, or in the absence or impediment of such alternates, by a director especially appointed by the chairman of the Board of Directors. A shareholder may be represented at a general shareholders' meeting by a proxy appointed in accordance with applicable Brazilian law not more than one year before the meeting, who must be a shareholder, a company officer, a lawyer or a financial institution.

Redemption rights

Our common shares and preferred shares are not redeemable, except that a dissenting shareholder is entitled under Brazilian corporate law to obtain redemption upon a decision made at a shareholders' meeting approving any of the items listed above, as well as:

- any decision to transfer all of our shares to another company in order to make us a wholly owned subsidiary of such company, a stock merger;
- any decision to approve the acquisition of control of another company at a price which exceeds certain limits set forth in Brazilian corporate law; or
- in the event that the entity resulting from (a) a merger, (b) a stock merger as described in clause (i) above or (c) a spin-off that we conduct fails to become a listed company within 120 days of the general shareholders' meeting at which such decision was taken.

Only holders of shares adversely affected by shareholder decisions altering the rights, privileges or priority of a class of shares or creating a new class of shares may require us to redeem their shares. The right of redemption triggered by shareholder decisions to merge, consolidate or to participate in a centralized group of companies may only be exercised if our shares do not satisfy certain tests of liquidity, among others, at the time of the shareholder resolution. The right of redemption lapses 30 days after publication of the minutes of the relevant general shareholders' meeting, unless, as in the case of resolutions relating to the rights of preferred shares or the creation of a new class of preferred shares, the resolution is subject to confirmation by the preferred shareholders (which must be made at a special meeting to be held within one year), in which case the 30-day term is counted from the publication of the minutes of the special meeting.

We would be entitled to reconsider any action giving rise to redemption rights within 10 days following the expiration of such rights if the redemption of shares of dissenting shareholders would jeopardize our financial stability. Any redemption pursuant to Brazilian corporate law would be made at no less than the

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book value per share, determined on the basis of the last balance sheet approved by the shareholders; provided that if the general shareholders' meeting giving rise to redemption rights occurred more than 60 days after the date of the last approved balance sheet, a shareholder would be entitled to demand that his or her shares be valued on the basis of a new balance sheet dated within 60 days of such general shareholders' meeting.

Preemptive rights

Each of our shareholders has a general preemptive right to subscribe for shares in any capital increase, in proportion to his or her shareholding. A minimum period of 30 days following the publication of notice of a capital increase is assured for the exercise of the right, and the right is transferable. Under our bylaws and Brazilian corporate law, and subject to the requirement for shareholder approval of any necessary increase to our authorized share capital, our Board of Directors may decide not to extend preemptive rights to our shareholders, or to reduce the 30-day period for the exercise of preemptive rights, in each case with respect to any issuance of shares, debentures convertible into shares or warrants in the context of a public offering. In the event of a capital increase that would maintain or increase the proportion of capital represented by preferred shares, holders of preferred shares will have preemptive rights to subscribe only to newly issued preferred shares. In the event of a capital increase that would reduce the proportion of capital represented by preferred shares, shareholders will have preemptive rights to subscribe for preferred shares, in proportion to their shareholdings, and for common shares only to the extent necessary to prevent dilution of their overall interest in us. In the event of a capital increase that would maintain or increase the proportion of capital represented by common shares, shareholders will have preemptive rights to subscribe only to newly issued common shares. In the event of a capital increase that would reduce the proportion of capital represented by common shares, holders of common shares will have preemptive rights to subscribe for preferred shares only to the extent necessary to prevent dilution of their overall interest in us.

Tag-along rights

According to Brazilian corporate law, in the event of a sale of control of a company, the acquirer is obliged to offer to holders of voting shares the right to sell their shares for a price equal to at least 80% of the price paid for the voting shares representing control.

Form and transfer of shares

Our preferred shares and common shares are in book-entry form registered in the name of each shareholder or its nominee. The transfer of such shares is made under Brazilian corporate law, which provides that a transfer of shares is effected by our transfer agent, Banco Bradesco S.A., upon presentation of valid share transfer instructions to us by a transferor or its representative. When preferred shares or common shares are acquired or sold on a Brazilian stock exchange, the transfer is effected on the records of our transfer agent by a representative of a brokerage firm or the stock exchange's clearing system. Transfers of shares by a foreign investor are made in the same way and are executed by the investor's local agent, who is also responsible for updating the information relating to the foreign investment furnished to the Central Bank of Brazil.

The BM&FBOVESPA operates a central clearing system through *Companhia Brasileira de Liquidação e Custódia*, or CBLC. A holder of our shares may participate in this system and all shares elected to be put into the system will be deposited in custody with CBLC (through a Brazilian institution that is duly authorized to operate by the Central Bank of Brazil and maintains a clearing account with CBLC). The fact that such shares are subject to custody with the relevant stock exchange will be reflected in our registry of shareholders. Each participating shareholder will, in turn, be registered in the register of our beneficial shareholders that is maintained by CBLC and will be treated in the same way as registered shareholders.

EXCHANGE CONTROLS AND OTHER LIMITATIONS AFFECTING SECURITY HOLDERS

Under Brazilian corporate law, there are no restrictions on ownership of our capital stock by individuals or legal entities domiciled outside Brazil. However, the right to convert dividend payments and proceeds from the sale of preferred shares or common shares into foreign currency and to remit such amounts outside Brazil is subject to restrictions under foreign investment legislation which generally requires, among other things, that the relevant investment be registered with the Central Bank of Brazil. These restrictions on the remittance of foreign capital abroad could hinder or prevent the depositary bank and its agents for the preferred shares or common shares represented by ADSs and HDSs from converting dividends, distributions or the proceeds from any sale of preferred shares, common shares or rights, as the case may be, into U.S. dollars or Hong Kong dollars and remitting such amounts abroad. Delays in, or refusal to grant any required government approval for conversions of Brazilian currency payments and remittances abroad of amounts owed to holders of ADSs and HDSs could adversely affect holders of ADRs and HDRs.

Under Resolution No. 2,689/2000 of the CMN, foreign investors may invest in almost all financial assets and engage in almost all transactions available in the Brazilian financial and capital markets, provided that certain requirements are fulfilled. In accordance with Resolution No. 2,689/2000, the definition of foreign investor includes individuals, legal entities, mutual funds and other collective investment entities, domiciled or headquartered outside Brazil.

Under Resolution No. 2,689/2000, a foreign investor must:

(1) appoint at least one representative in Brazil, with powers to perform actions relating to its investment,

(2) complete the appropriate foreign investor registration form,

(3) register as a foreign investor with the CVM, and register its foreign investment with the Central Bank of Brazil, and

(4) appoint a custodian, duly licensed by the Central Bank of Brazil, if the Brazilian representative in item (1) is not a financial institution.

Resolution No. 2,689/2000 specifies the manner of custody and the permitted means for trading securities held by foreign investors under the resolution.

Moreover, the offshore transfer or assignment of securities or other financial assets held by foreign investors pursuant to Resolution No. 2,689/2000 is prohibited, except for transfers resulting from a corporate reorganization, or occurring upon the death of an investor by operation of law or will.

Resolution No. 1,927/1992 of the CMN provides for the issuance of depositary receipts in foreign markets in respect of shares of Brazilian issuers. It provides that the proceeds from the sale of ADSs by holders of ADRs outside Brazil are not subject to Brazilian foreign investment controls and holders of ADSs who are not residents of a low-tax jurisdiction (*país com tributação favorecida*), as defined by Brazilian law, will be entitled to favorable tax treatment.

An electronic registration has been issued to the custodian in the name of the depositary with respect to the ADSs and HDSs. Pursuant to this electronic registration, the custodian and the depositary are able to convert dividends and other distributions with respect to the underlying shares into foreign currency and to remit the proceeds outside Brazil. If a holder exchanges ADSs or HDSs for preferred shares or common shares, the holder must, within five business days, seek to obtain its own electronic registration with the Central Bank of Brazil under Law No. 4,131/1962 and Resolution No. 2,689/2000. Thereafter, unless the holder has registered its investment with the Central Bank of Brazil, such holder may not convert into foreign currency and remit outside Brazil the proceeds from the disposition of, or distributions with respect to, such preferred shares or common shares.

Under Brazilian law, whenever there is a serious imbalance in Brazil's balance of payments or reasons to foresee a serious imbalance, the Brazilian government may impose temporary restrictions on the remittance to foreign investors of the proceeds of their investments in Brazil, and on the conversion of Brazilian currency into foreign currencies. Such restrictions may hinder or prevent the custodian or holders who have exchanged ADSs or HDSs for underlying preferred shares or common shares from converting distributions or the proceeds from any sale of such shares, as the case may be, into U.S. dollars or Hong Kong dollars and remitting such U.S. dollars or Hong Kong dollars abroad. In the event the custodian is prevented from converting and remitting amounts owed to foreign investors, the custodian will hold the *reais* it cannot convert for the account of the holders of ADRs or HDRs who have not been paid. The depositary will not invest the *reais* and will not be liable for interest on those amounts. Any *reais* so held will be subject to devaluation risk against the U.S. dollar or Hong Kong dollar.

TAXATION

The following summary contains a description of the principal Brazilian and U.S. federal income tax consequences of the ownership and disposition of preferred shares, common shares, ADSs or HDSs. You should know that this summary does not purport to be a comprehensive description of all the tax considerations that may be relevant to a holder of preferred shares, common shares, ADSs or HDSs.

Holders of preferred shares, common shares, ADSs or HDSs should consult their own tax advisors to discuss the tax consequences of the purchase, ownership and disposition of preferred shares, common shares, ADSs or HDSs, including, in particular, the effect of any state, local or other national tax laws.

Although there is at present no treaty to avoid double taxation between Brazil and the United States, but only a common understanding between the two countries according to which income taxes paid in one may be offset against taxes to be paid in the other, both countries' tax authorities have been having discussions that may result in the execution of such a treaty. In this regard, the two countries signed a Tax Information Exchange Agreement on March 20, 2007. We cannot predict whether or when such a treaty will enter into force or how, if entered into, such a treaty will affect the U.S. holders, as defined below, of preferred shares, common shares or ADSs.

Brazilian tax considerations

The following discussion summarizes the principal Brazilian tax consequences of the acquisition, ownership and disposition of preferred shares, common shares, ADSs or HDSs by a holder not deemed to be domiciled in Brazil for purposes of Brazilian taxation ("Non-Brazilian Holder"). It is based on the tax laws of Brazil and regulations thereunder in effect on the date hereof, which are subject to change (possibly with retroactive effect). This discussion does not specifically address all of the Brazilian tax considerations applicable to any particular Non-Brazilian Holder. Therefore, Non-Brazilian Holders should consult their own tax advisors concerning the Brazilian tax consequences of an investment in preferred shares, common shares, ADSs or HDSs.

Shareholder distributions

For Brazilian corporations, such as the Company, distributions to shareholders are classified as either dividend or interest on shareholders' equity.

Dividends

Amounts distributed as dividends, including distributions in kind, will generally not be subject to withholding income tax if the distribution is paid by us from profits of periods beginning on or after

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January 1, 1996 (1) to the depositary in respect of our preferred shares or common shares underlying the ADSs or HDSs or (2) to a Non-Brazilian Holder in respect of our preferred shares or common shares. Dividends paid from profits generated before January 1, 1996 may be subject to Brazilian withholding income tax at varying rates depending on the year the profits were generated.

Interest on shareholders' equity

Amounts distributed as interest on shareholders' equity are generally subject to withholding income tax at the rate of 15%, except where:

(1) the beneficiary is exempt from tax in Brazil, in which case the distribution will not be subject to withholding income tax;

(2) the beneficiary is located in a jurisdiction that does not impose income tax or where the maximum income tax rate is lower than 20% (a "Low Tax Jurisdiction") or where internal legislation imposes restrictions on the disclosure of the shareholding structure or the ownership of the investment, in which case the applicable withholding income tax rate is 25%; or

(3) the effective beneficiary is resident in Japan, in which case the applicable withholding income tax rate is 12.5%.

Interest on shareholders' equity is calculated as a percentage of shareholders' equity, as stated in the statutory accounting records. The interest rate applied may not exceed TJLP, the benchmark Brazilian long-term interest rate. In addition, the amount of distributions classified as interest on shareholders' equity may not be more than the greater of (1) 50% of net income (after the deduction of social contribution on net profits but before taking into account such payment of interest and the provision for corporate income tax) for the period in respect of which the payment is made and (2) 50% of the sum of retained earnings and profit reserves.

Payments of interest on shareholders' equity are deductible for the purposes of corporate income tax and social contribution on net profit, to the extent of the limits described above. The tax benefit to the Company in the case of a distribution by way of interest on shareholders' equity is a reduction in the Company's corporate tax charge by an amount equivalent to 34% of such distribution.

Taxation of capital gains

Taxation of Non-Brazilian Holders on capital gains depends on the status of the holder as either:

(1) (i) not resident or domiciled in a Low Tax Jurisdiction or where internal legislation imposes restrictions on the disclosure of shareholding structure or the ownership of the investment and registered its investment in Brazil in accordance with Resolution No. 2,689 (a 2,689 Holder), or (ii) a holder of ADSs or HDSs; or

(2) any other Non-Brazilian Holder.

Investors identified in item 1 are subject to favorable tax treatment, as described below.

According to Law No. 10,833, dated December 29, 2003, capital gains realized by a Non-Brazilian Holder from the disposition of "assets located in Brazil" are subject to taxation in Brazil.

Preferred shares and common shares qualify as assets located in Brazil, and the disposition of such assets by a Non-Brazilian Holder may be subject to income tax on the gains assessed, in accordance with the rules described below, regardless of whether the transaction is carried out with another Non-Brazilian resident or with a Brazilian resident.

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There is some uncertainty as to whether ADSs or HDSs qualify as "assets located in Brazil" for purposes of Law No. 10,833/03. Arguably, neither ADSs nor HDSs constitute assets located in Brazil and therefore the gains realized by a Non-Brazilian Holder on the disposition of ADSs or HDSs to another Non-Brazilian resident should not be subject to income tax in Brazil. However, it cannot be guaranteed that the Brazilian courts will uphold this interpretation of the definition of "assets located in Brazil" in connection with the taxation of gains realized by a Non-Brazilian Holder on the disposition of ADSs or HDSs. Consequently, gains on a disposition of ADSs or HDSs by a Non-Brazilian Holder (whether in a transaction carried out with another Non-Brazilian Holder or a person domiciled in Brazil) may be subject to income tax in Brazil in accordance with the rules applicable to a disposition of shares.

Although there are grounds to sustain otherwise, the deposit of preferred shares or common shares in exchange for ADSs or HDSs may be subject to Brazilian income tax if the acquisition cost of the preferred shares or common shares being deposited is lower than the average price of the preferred shares or common shares (as the case may be), which is determined as either:

(1) the average price per preferred share or common share on the Brazilian stock exchange in which the greatest number of such shares were sold on the day of deposit; or

(2) if no preferred shares or common shares were sold on that day, the average price on the Brazilian stock exchange in which the greatest number of preferred shares or common shares were sold in the 15 trading sessions immediately preceding such deposit.

The positive difference between the average price of the preferred shares or common shares calculated as described above and their acquisition cost will be considered to be a capital gain subject to income tax in Brazil. In some circumstances, there are grounds to sustain that such taxation is not applicable with respect to any 2,689 Holder, provided he is not located in a Low Tax Jurisdiction.

The withdrawal of ADSs or HDSs in exchange for preferred shares or common shares is not subject to Brazilian income tax, subject to compliance with applicable regulations regarding the registration of the investment with the Central Bank of Brazil.

For the purpose of Brazilian taxation, the income tax rules on gains related to disposition of preferred shares or common shares vary depending on:

- the domicile of the Non-Brazilian Holder;
- the method by which such Non-Brazilian Holder has registered his investment with the Central Bank of Brazil; and
- how the disposition is carried out, as described below.

The gain realized as a result of a transaction on a Brazilian stock, future and commodities exchange is the difference between: (i) the amount in Brazilian currency realized on the sale or disposition and (ii) the acquisition cost, without any adjustment for inflation, of the securities that are the subject of the transaction.

Any gain realized by a Non-Brazilian Holder on a sale or disposition of preferred shares or common shares carried out on the Brazilian stock exchange is:

- exempt from income tax where the Non-Brazilian Holder (i) is a 2,689 Holder; and (ii) is not located in a Low Tax Jurisdiction;

subject to income tax at a rate of 15% where the Non-Brazilian Holder either (A) (i) is not a 2,689 Holder and (ii) is not resident or domiciled in a Low Tax Jurisdiction or (B) (i) is a 2,689 Holder and (ii) is resident or domiciled in a Low Tax Jurisdiction; or

subject to income tax at a rate of 25% where the Non-Brazilian Holder (i) is not a 2,689 Holder and (ii) is resident or domiciled in a Low Tax Jurisdiction.

The sale or disposition of common shares carried out on the Brazilian stock exchange is subject to withholding tax at the rate of 0.005% on the sale value. This withholding tax can be offset against the eventual income tax due on the capital gain. A 2,689 Holder that is not resident or domiciled in a Low Tax Jurisdiction is not required to withhold income tax.

Any gain realized by a Non-Brazilian Holder on a sale or disposition of preferred shares or common shares that is not carried out on the Brazilian stock exchange is subject to income tax at a 15% rate, except for gain realized by a resident in a Low Tax Jurisdiction, which is subject to income tax at the rate of 25%.

With respect to transactions arranged by a broker that are conducted on the Brazilian non-organized over-the-counter market, a withholding income tax at a rate of 0.005% on the sale value is also levied on the transaction and can be offset against the eventual income tax due on the capital gain. There can be no assurance that the current favorable treatment of 2,689 Holders will continue in the future.

In the case of a redemption of preferred shares, common shares, ADSs or HDSs or a capital reduction by a Brazilian corporation, the positive difference between the amount received by any Non-Brazilian Holder and the acquisition cost of the preferred shares, common shares, ADSs or HDSs being redeemed is treated as capital gain and is therefore generally subject to income tax at the rate of 15%, while the 25% rate applies to residents in a Low Tax Jurisdiction.

Any exercise of pre-emptive rights relating to our preferred shares or common shares will not be subject to Brazilian taxation. Any gain realized by a Non-Brazilian Holder on the disposition of pre-emptive rights relating to preferred shares or common shares in Brazil will be subject to Brazilian income taxation in accordance with the same rules applicable to the sale or disposition of preferred shares or common shares.

Tax on foreign exchange and financial transactions

Foreign exchange transactions

Brazilian law imposes a tax on foreign exchange transactions, or an IOF/Exchange Tax, due on the conversion of *reais* into foreign currency and on the conversion of foreign currency into *reais*. Currently, for most foreign currency exchange transactions, the rate of IOF/Exchange is 0.38%.

Effective as of December 1, 2011, the inflow of resources into Brazil for the acquisition or subscription of common shares through public offerings in Brazilian financial and capital markets by a Non-Brazilian Holder are exempt from the IOF/Exchange rate, provided that the issuer has registered its shares for trading on the Brazilian stock exchange, as well as the inflow of resources into Brazil originating from the cancellation of depository receipts, provided that they are invested in the Brazilian stock exchange.

The outflow of resources from Brazil related to investments carried out by a Non-Brazilian Holder in the Brazilian financial and capital markets is currently subject to IOF/Exchange at a zero percent rate. In any case, the Brazilian government may increase such rates at any time, up to 25%, with no retroactive effect.

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Transactions involving bonds and securities

Brazilian law imposes a tax on transactions involving bonds and securities, or an IOF/Bonds Tax, including those carried out on the Brazilian stock exchange. The rate of IOF/Bonds Tax applicable to transactions involving publicly traded bonds and securities in Brazil is currently zero. However, the Brazilian Government may increase such rate at any time up to 1.5% of the transaction amount per day, but the tax cannot be applied retroactively. In addition, the transfer of shares traded on the Brazilian stock exchange to back the issuance of depositary receipts are subject to IOF/Bonds Tax at a rate of 1.5% starting November 19, 2009.

Other Brazilian taxes

There are no Brazilian inheritance, gift or succession taxes applicable to the ownership, transfer or disposition of preferred shares, common shares, ADSs or HDSs by a Non-Brazilian Holder, except for gift and inheritance taxes which are levied by some states of Brazil on gifts made or inheritances bestowed by a Non-Brazilian Holder to individuals or entities resident or domiciled within such states in Brazil. There are no Brazilian stamp, issue, registration, or similar taxes or duties payable by holders of preferred shares or common shares or ADSs or HDSs.

U.S. federal income tax considerations

This summary does not purport to be a comprehensive description of all the U.S. federal income tax consequences of the acquisition, holding or disposition of the preferred shares, common shares or ADSs. This summary applies to U.S. holders, as defined below, who hold their preferred shares, common shares or ADSs as capital assets and does not apply to special classes of holders, such as:

- certain financial institutions,
- insurance companies,
- dealers in securities or foreign currencies,
- tax-exempt organizations,
- securities traders who elect to account for their investment in preferred shares, common shares or ADSs on a mark-to-market basis,
- persons holding preferred shares, common shares or ADSs as part of hedge, straddle, conversion or other integrated financial transactions for tax purposes,
- holders whose functional currency for U.S. federal income tax purposes is not the U.S. dollar,
- partnerships or other holders treated as "pass-through entities" for U.S. federal income tax purposes,
- persons subject to the alternative minimum tax, or
- persons owning, actually or constructively, 10% or more of our voting shares.

This discussion is based on the Internal Revenue Code of 1986, as amended to the date hereof, administrative pronouncements, judicial decisions and final, temporary and proposed Treasury Regulations, all as in effect on the date hereof. These authorities are subject to differing interpretations and may be changed, perhaps retroactively, so as to result in U.S. federal income tax consequences different from those discussed below. There can be no assurance that the U.S. Internal Revenue Service (the "IRS") will not challenge one or more of the tax consequences discussed herein or that a court will not sustain such a challenge in the event of litigation. This summary does not address any aspect of state, local or non-U.S. tax law.

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YOU SHOULD CONSULT YOUR TAX ADVISORS WITH REGARD TO THE APPLICATION OF THE U.S. FEDERAL INCOME TAX LAWS TO YOUR PARTICULAR SITUATIONS AS WELL AS ANY TAX CONSEQUENCES ARISING UNDER THE LAWS OF ANY STATE, LOCAL OR NON-U.S. TAXING JURISDICTION.

This discussion is also based, in part, on representations of the depositary and the assumption that each obligation in the deposit agreement and any related agreement will be performed in accordance with its terms.

For purposes of this discussion, you are a "U.S. holder" if you are a beneficial owner of preferred shares, common shares or ADSs that is, for U.S. federal income tax purposes and are:

- a citizen or resident alien individual of the United States,
- a corporation created or organized in or under the laws of the United States or of any political subdivision thereof, or
- otherwise subject to U.S. federal income taxation on a net income basis with respect to the preferred shares, common shares or ADSs.

The term U.S. holder also includes certain former citizens of the United States.

In general, if you are the beneficial owner of American depositary receipts evidencing ADSs, you will be treated as the beneficial owner of the preferred shares or common shares represented by those ADSs for U.S. federal income tax purposes. Deposits and withdrawals of preferred shares or common shares by you in exchange for ADSs will not result in the realization of gain or loss for U.S. federal income tax purposes. Your tax basis in such preferred shares will be the same as your tax basis in such ADSs, and the holding period in which preferred shares or common shares will include the holding period in such ADSs.

Taxation of dividends

The gross amount of a distribution paid on ADSs, preferred shares or common shares, including distributions paid in the form of payments of interest on capital for Brazilian tax purposes, out of our current or accumulated earnings and profits (as determined for U.S. federal income tax purposes) will be taxable to you as foreign source dividend income and will not be eligible for the dividends-received deduction allowed to corporate shareholders under U.S. federal income tax law. The amount of any such distribution will include the amount of Brazilian withholding taxes, if any, withheld on the amount distributed. To the extent that a distribution exceeds our current and accumulated earnings and profits, such distribution will be treated as a nontaxable return of capital to the extent of your basis in the ADSs, preferred shares or common shares, as the case may be, with respect to which such distribution is made, and thereafter as a capital gain.

You will be required to include dividends paid in *reais* in income in an amount equal to their U.S. dollar value calculated by reference to an exchange rate in effect on the date such distribution is received by the depositary, in the case of ADSs, or by you, in the case of common shares or preferred shares. If the depositary or you do not convert such *reais* into U.S. dollars on the date they are received, it is possible that you will recognize foreign currency loss or gain, which would be ordinary loss or gain, when the *reais* are converted into U.S. dollars. If you hold ADSs, you will be considered to receive a dividend when the dividend is received by the depositary.

Subject to certain exceptions for short-term and hedged positions, the U.S. dollar amount of dividends received by certain noncorporate taxpayers, including individuals, prior to January 1, 2013 with respect to the ADSs will be subject to taxation at a maximum rate of 15% if the dividends are "qualified dividends." Dividends paid on the ADSs will be treated as qualified dividends if (i) the ADSs are readily tradable on an established securities market in the United States and (ii) the Company was not, in the year prior to the year in which the dividend was paid, and is not, in the year in which the dividend is paid, a passive foreign investment company ("PFIC"). The ADSs are listed on the New York Stock Exchange and will qualify as readily tradable on an established securities market in the United States so long as they are so listed. Based on Vale's audited financial statements and relevant market and shareholder data, Vale believes that it was not treated as a PFIC for U.S. federal income tax purposes with respect to its 2010 or 2011 taxable year. In addition, based on Vale's audited financial statements and its current expectations regarding the value and nature of its assets, the sources and nature of its income, and relevant market and shareholder data, Vale does not anticipate becoming a PFIC for its 2012 taxable year.

Based on existing guidance, it is not entirely clear whether dividends received with respect to the preferred shares and common shares will be treated as qualified dividends (and therefore whether such dividends will qualify for the maximum rate of taxation of 15%), because the preferred shares and common shares are not themselves listed on a U.S. exchange. In addition, the U.S. Treasury has announced its intention to promulgate rules pursuant to which holders of ADSs, preferred shares or common stock and intermediaries through whom such securities are held will be permitted to rely on certifications from issuers to establish that dividends are treated as qualified dividends. Because such procedures have not yet been issued, it is unclear whether we will be able to comply with them. You should consult your own tax advisors regarding the availability of the reduced dividend tax rate in light of your own particular circumstances.

Subject to generally applicable limitations and restrictions, you will be entitled to a credit against your U.S. federal income tax liability, or a deduction in computing your U.S. federal taxable income, for Brazilian income taxes withheld by us. You must satisfy minimum holding period requirements to be eligible to claim a foreign tax credit for Brazilian taxes withheld on dividends. The limitation on foreign taxes eligible for credit is calculated separately for specific classes of income. For this purpose dividends paid by us on our shares will generally constitute "passive income". Foreign tax credits may not be allowed for withholding taxes imposed in respect of certain short-term or hedged positions in securities or in respect of arrangements in which a U.S. holder's expected economic profit is insubstantial. You should consult your own tax advisors concerning the implications of these rules in light of your particular circumstances.

Taxation of capital gains

Upon a sale or exchange of preferred shares, common shares or ADSs, you will recognize a capital gain or loss for U.S. federal income tax purposes equal to the difference, if any, between the amount realized on the sale or exchange and your adjusted tax basis in the preferred shares, common shares or ADSs. This gain or loss will be long-term capital gain or loss if your holding period in the preferred shares, common shares or ADSs exceeds one year. The net amount of long-term capital gain recognized by individual U.S. holders prior to January 1, 2013 generally is subject to taxation at a maximum rate of 15%. Your ability to use capital losses to offset income is subject to limitations.

Any gain or loss will be U.S. source gain or loss for U.S. foreign tax credit purposes. Consequently, if a Brazilian withholding tax is imposed on the sale or disposition of ADSs, preferred shares or common shares, and you do not receive significant foreign source income from other sources you may not be able to derive effective U.S. foreign tax credit benefits in respect of such Brazilian withholding tax. You should consult your own tax advisor regarding the application of the foreign tax credit rules to your investment in, and disposition of, ADSs, preferred shares or common shares.

If a Brazilian tax is withheld on the sale or disposition of shares, the amount realized by a U.S. holder will include the gross amount of the proceeds of such sale or disposition before deduction of the Brazilian tax. See *Brazilian tax considerations* above.

Information reporting and backup withholding

Information returns may be filed with the Internal Revenue Service in connection with distributions on the preferred shares, common shares or ADSs and the proceeds from their sale or other disposition. You may be subject to United States backup withholding tax on these payments if you fail to provide your taxpayer identification number or comply with certain certification procedures or otherwise establish an

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exemption from backup withholding. If you are required to make such a certification or to establish such an exemption, you generally must do so on IRS Form W-9.

The amount of any backup withholding from a payment to you will be allowed as a credit against your U.S. federal income tax liability and may entitle you to a refund, provided that the required information is timely furnished to the Internal Revenue Service.

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

Our management, with the participation of our chief executive officer and chief financial officer, has evaluated the effectiveness of our disclosure controls and procedures as of December 31, 2011. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives.

Our chief executive officer and chief financial officer have concluded that our disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed by us in the reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the applicable rules and forms, and that it is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate to allow timely decisions regarding required disclosure.

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Our internal control over financial reporting includes those policies and procedures that: (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (ii) provide reasonable assurance that transactions are recorded to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of our assets that could have a material effect on the financial statements. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of the effectiveness to future periods are subject to the risk that controls may become inadequate and that the degree of compliance with the policies or procedures may deteriorate.

Our management has assessed the effectiveness of Vale's internal control over financial reporting as of December 31, 2011 based on the criteria established in "Internal Control Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). Based on such assessment and criteria, our management has concluded that our internal control over financial reporting was effective as of December 31, 2011. The effectiveness of our internal control over financial reporting as of December 31, 2011 has been audited by PricewaterhouseCoopers Auditores Independentes, an independent registered public accounting firm, as stated in their report which appears herein.

Our management identified no change in our internal control over financial reporting during our fiscal year ended December 31, 2011 that has materially affected or is reasonably likely to materially affect our internal control over financial reporting.

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CORPORATE GOVERNANCE

Under NYSE rules, foreign private issuers are subject to more limited corporate governance requirements than U.S. domestic issuers. As a foreign private issuer, we must comply with four principal NYSE corporate governance rules: (1) we must satisfy the requirements of Exchange Act Rule 10A-3 relating to audit committees; (2) our chief executive officer must promptly notify the NYSE in writing after any executive officer becomes aware of any non-compliance with the applicable NYSE corporate governance rules; (3) we must provide the NYSE with annual and interim written affirmations as required under the NYSE corporate governance rules; and (4) we must provide a brief description of any significant differences between our corporate governance practices and those followed by U.S. companies under NYSE listing standards. The table below briefly describes the significant differences between our domestic practice and the NYSE corporate governance rules.

Section	NYSE corporate governance rule for U.S. domestic issuers	Our approach
303A.01	A listed company must have a majority of independent directors. "Controlled companies" are not required to comply with this requirement.	We are a controlled company because more than a majority of our voting power for the appointment of directors is controlled by Valepar. As a controlled company, we would not be required to comply with the majority of independent director requirements if we were a U.S. domestic issuer. There is no legal provision or policy that requires us to have independent directors.
303A.03	The non-management directors of a listed company must meet at regularly scheduled executive sessions without management.	We do not have any management directors.
303A.04	A listed company must have a nominating/corporate governance committee composed entirely of independent directors, with a written charter that covers certain minimum specified duties. "Controlled companies" are not required to comply with this requirement.	We do not have a nominating committee. As a controlled company, we would not be required to comply with the nominating/corporate governance committee requirements if we were a U.S. domestic issuer. However, we do have a Governance and Sustainability Committee, which is an advisory committee to the Board of Directors and may include members who are not directors. According to its charter, this committee is responsible for: evaluating and recommending improvements to the effectiveness of our corporate governance practices and the functioning of the Board of Directors; recommending improvements to our code of ethical conduct and management system in order to avoid conflicts of interest between us and our shareholders or management; issuing reports on potential conflicts of interest between us and our shareholders or management; and reporting on policies relating to corporate responsibility, such as environmental and social responsibility The committee's charter requires at least one of its members to be independent. For this purpose, an independent member is a person who: does not have any current relationship with us other than being part of a committee, or being a shareholder of the Company; does not participate, directly or indirectly, in the sales efforts or provision of services by Vale;

is not a representative of the controlling shareholders;

has not been an employee of the controlling shareholder or of entities affiliated with a controlling shareholder; and

has not been an executive officer of the controlling shareholder.

Section	NYSE corporate governance rule for U.S. domestic issuers	Our approach
303A.05	A listed company must have a compensation committee composed entirely of independent directors, with a written charter that covers certain minimum specified duties. "Controlled companies" are not required to comply with this requirement.	As a controlled company, we would not be required to comply with the compensation committee requirements if we were a U.S. domestic issuer. However, we have an Executive Development Committee, which is an advisory committee to the Board of Directors and may include members who are not directors. This committee is responsible for: reporting on general human resources policies; analyzing and reporting on the adequacy of compensation levels for our executive officers; proposing and updating guidelines for evaluating the performance of our executive officers; and reporting on policies relating to health and safety.
303A.06 303A.07	A listed company must have an audit committee with a minimum of three independent directors who satisfy the independence requirements of Rule 10A-3 under the Exchange Act, with a written charter that covers certain minimum specified duties.	In lieu of appointing an audit committee composed of independent members of the Board of Directors, we have established a permanent *conselho fiscal*, or fiscal council, in accordance with the applicable provisions of Brazilian corporate law, and provided the fiscal council with additional powers to permit it to meet the requirements of Exchange Act Rule 10A-3(c)(3). The Fiscal Council currently has four members. Under Brazilian corporate law, which provides standards for the independence of the Fiscal Council from us and our management, none of the members of the Fiscal Council may be a member of the Board of Directors or an executive officer. Management does not elect any Fiscal Council member. Our Board of Directors has determined that one of the members of our Fiscal Council meets the New York Stock Exchange independence requirements that would apply to audit committee members in the absence of our reliance on Exchange Act Rule 10A-3(c)(3). The responsibilities of the Fiscal Council are set forth in its charter. Under our bylaws, the charter must give the Fiscal Council responsibility for the matters required under Brazilian corporate law, as well as responsibility for: establishing procedures for the receipt, retention and treatment of complaints related to accounting, controls and audit issues, as well as procedures for the confidential, anonymous submission of concerns regarding such matters; recommending and assisting the Board of Directors in the appointment, establishment of compensation and dismissal of independent auditors; pre-approving services to be rendered by the independent auditors;

		overseeing the work performed by the independent auditors, with powers to recommend withholding the payment of compensation to the independent auditors; and
		mediating disagreements between management and the independent auditors regarding financial reporting.
303A.08	Shareholders must be given the opportunity to vote on all equity-compensation plans and material revisions thereto, with limited exemptions set forth in the NYSE rules.	Under Brazilian corporate law, shareholder pre-approval is required for the adoption of any equity compensation plans.
303A.09	A listed company must adopt and disclose corporate governance guidelines that cover certain minimum specified subjects.	We have not published formal corporate governance guidelines.

Section	NYSE corporate governance rule for U.S. domestic issuers	Our approach
303A.10	A listed company must adopt and disclose a code of business conduct and ethics for directors, officers and employees, and promptly disclose any waivers of the code for directors or executive officers.	We have adopted a formal code of ethical conduct, which applies to our directors, officers and employees. We report each year in our annual report on Form 20-F any waivers of the code of ethical conduct granted for directors or executive officers. Our code of ethical conduct has a scope that is similar, but not identical, to that required for a U.S. domestic company under the NYSE rules. We also have a code of ethics that applies specifically to employees in the corporate finance, investor relations and accounting departments.
303A.12	a) Each listed company CEO must certify to the NYSE each year that he or she is not aware of any violation by the company of NYSE corporate governance listing standards. b) Each listed company CEO must promptly notify the NYSE in writing after any executive officer of the listed company becomes aware of any non-compliance with any applicable provisions of this Section 303A. c) Each listed company must submit an executed Written Affirmation annually to the NYSE. In addition, each listed company must submit an interim Written Affirmation as and when required by the interim Written Affirmation form specified by the NYSE.	We are subject to (b) and (c) of these requirements, but not (a).

CODE OF ETHICS

We have adopted a code of ethical conduct that applies to all Board members, executive officers and employees, including the chief executive officer, the chief financial officer and the principal accounting officer. We have posted this code of ethical conduct on our Web site, at: http://www.vale.com (under English Version/Investors/Corporate Governance/Code of Ethics). Copies of our code of ethical conduct may be obtained without charge by writing to us at the address set forth on the front cover of this Form 20-F. We have not granted any implicit or explicit waivers from any provision of our code of ethical conduct since its adoption.

PRINCIPAL ACCOUNTANT FEES AND SERVICES

PricewaterhouseCoopers Auditores Independentes billed the following fees to us for professional services in 2010 and 2011.

	Year ended December 31,	
	2010	2011
	(US$ thousand)	
Audit fees	11,752	10,354
Audit-related fees	496	794
Tax fees	106	
Total fees	12,354	11,148

"Audit fees" are the aggregate fees billed by PricewaterhouseCoopers for the audit of our annual financial statements, for the audit of the statutory financial statements of our subsidiaries, and reviews of interim financial statements and attestation services that are provided in connection with statutory and regulatory filings or engagements. They also include billed fees, which are services that only the independent auditor reasonably can provide, including the provision of comfort letters and consents in connection with statutory and regulatory filings and the review of documents filed with the SEC and other capital markets or local financial reporting regulatory bodies. "Audit-related fees" are fees charged by PricewaterhouseCoopers for assurance and related services that are reasonably related to the performance of the audit or review of our financial statements and are not reported under "Audit fees." In 2011 and 2010, "Audit-related fees"

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consisted primarily of fees for services related to due diligence and special reviews. "Tax fees" relate primarily to the review of annual tax returns and review of accuracy of the tax computation procedures with respect to income tax and sales taxes.

INFORMATION FILED WITH SECURITIES REGULATORS

We are subject to various information and disclosure requirements in those countries in which our securities are traded, and file financial statements and other periodic reports with the CVM, BM&FBOVESPA, the SEC, the French securities regulator Autorité des Marchés Financiers, and the HKEx.

Brazil. Vale's Common Shares and Class A Preferred Shares are listed on BM&FBOVESPA in São Paulo, Brazil, its primary listing venue. As a result, we are subject to the information and disclosure requirements of Brazilian Corporate Law, as amended. We are also subject to the periodic disclosure requirements of CVM rules applicable to listed companies and to BM&FBOVESPA's "Level 1" Corporate Governance Requirements. Our CVM filings are available from the CVM at http://www.cvm.gov.br or from BM&FBOVESPA at http://www.bmfbovespa.com.br. In addition, as with all of our security filings, they may be accessed at our website, http://www.vale.com.

United States. As a result of our ADSs being listed on the New York Stock Exchange, we are subject to the information requirements of the Securities Exchange Act of 1934, as amended, and accordingly file reports and other information with the SEC. Reports and other information filed by us with the SEC may be inspected and copied at the public reference facilities maintained by the SEC at 100 F Street, N.E., Washington, D.C., 20549. You can obtain further information about the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. You may also inspect Vale's reports and other information at the offices of the New York Stock Exchange, 11 Wall Street, New York, New York 10005, on which Vale's ADSs are listed. Our SEC filings are also available to the public from the SEC at http://www.sec.gov. For further information on obtaining copies of Vale's public filings at the New York Stock Exchange, you should call (212) 656-5060.

France. As a result of the admission to listing and trading of the ADSs on NYSE Euronext Paris, we must comply with certain French periodic and ongoing disclosure rules (for example, annual report with audited financial statements and interim financial statements) and anti-fraud rules, which prohibit market-abuse practices and devices, including insider trading, market manipulation and disclosure of false or misleading information. In general, the Company is deemed to comply with the French periodic and ongoing disclosure rules through its compliance with U.S. disclosure rules.

Hong Kong. As a result of the listing and trading of our HDSs on the HKEx, we must comply with the HKEx Listing Rules, subject to certain waivers granted by the HKEx, including certain periodic and ongoing disclosure rules, such as annual reports with audited financial statements and interim financial statements. In accordance with the HKEx Listing Rules, we are required to upload reports and other information onto the website of the HKEx.

EXHIBITS

Exhibit Number	
1	Bylaws of Vale S.A., as amended on May 18, 2011, incorporated by reference to the current report on Form 6-K furnished to the Securities and Exchange Commission on May 18, 2011 (File No. 001-15030)
8	List of subsidiaries
12.1	Certification of Chief Executive Officer of Vale pursuant to Rules 13a-14 and 15d-14 under the Securities Exchange Act of 1934
12.2	Certification of Chief Financial Officer of Vale pursuant to Rules 13a-14 and 15d-14 under the Securities Exchange Act of 1934
13.1	Certification of Chief Executive Officer and Chief Financial Officer of Vale, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
15.1	Consent of PricewaterhouseCoopers
15.2	Consent of IMC Mining Services
15.3	Consent of SRK Consulting
15.4	Consent of Echelon Mining Services
15.5	Consent of Snowden Mining Industry Consultants Pty Ltd
(101)	Interactive Data File*

* In accordance with Rule 406T of Regulation S-T promulgated by the Securities and Exchange Commission, Exhibit 101 is deemed not filed or part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, and otherwise is not subject to liability under these sections.

The amount of long-term debt securities of Vale or its subsidiaries authorized under any individual outstanding agreement does not exceed 10% of Vale's total assets on a consolidated basis. Vale hereby agrees to furnish the SEC, upon its request, a copy of any instruments defining the rights of holders of its long-term debt or of its subsidiaries for which consolidated or unconsolidated financial statements are required to be filed.

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GLOSSARY

Alumina	Aluminum oxide. It is the main component of bauxite, and extracted from bauxite ore in a chemical refining process. It is the principal raw material in the electro-chemical process from which aluminum is produced.
Aluminum	A white metal that is obtained in the electro-chemical process of reducing aluminum oxide.
Anthracite	The hardest coal type, which contains a high percentage of fixed carbon and a low percentage of volatile matter. Anthracite is the highest ranked coal and it contains 90% fixed carbon, more than any other form of coal. Anthracite has a semi-metallic luster and is capable of burning with little smoke. Mainly used for metallurgical purposes.
Austenitic stainless steel	Steel that contains a significant amount of chromium and sufficient nickel to stabilize the austenite microstructure, giving to the steel good formability and ductility and improving its high temperature resistance. They are used in a wide variety of applications, ranging from consumer products to industrial process equipment, as well as for power generation and transportation equipment, kitchen appliances and many other applications where strength, corrosion and high temperature resistance are required.
A$	The Australian dollar.
Bauxite	A rock composed primarily of hydrated aluminum oxides. It is the principal ore of alumina, the raw material from which aluminum is made.
Beneficiation	A variety of processes whereby extracted ore from mining is reduced to particles that can be separated into ore-mineral and waste, the former suitable for further processing or direct use.
CAD	The Canadian dollar.
CFR	Cost and freight. Indicates that all costs related to the transportation of goods up to a named port of destination will be paid by the seller of the goods.
Coal	Coal is a black or brownish-black solid combustible substance formed by the decomposition of vegetable matter without access to air. The rank of coal, which includes anthracite, bituminous coal (both are called hard coal), sub-bituminous coal, and lignite, is based on fixed carbon, volatile matter, and heating value.
Cobalt	Cobalt is a hard, lustrous, silver-gray metal found in ores, and used in the preparation of magnetic, wear-resistant, and high-strength alloys (particularly for jet engines and turbines). Its compounds are also used in the production of inks, paints, and varnishes.
Coke	Coal that has been processed in a coke oven, for use as a reduction agent in blast furnaces and in foundries for the purposes of transforming iron ore into pig iron.
Concentration	Physical, chemical or biological process to increase the grade of the metal or mineral of interest.
Copper	A reddish brown metallic element. Copper is highly conductive, both thermally and electrically. It is highly malleable and ductile and is easily rolled into sheet and drawn into wire.

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Copper anode	Copper anode is a metallic product of the converting stage of smelting process that is cast into blocks and generally contains 99% copper grade, which requires further processing to produce refined copper cathodes.
Copper cathode	Copper plate with purity higher than or equal to 99.9% that is produced by an electrolytic process.
Copper concentrate	Material produced by concentration of copper minerals contained in the copper ore. It is the raw material used in smelters to produce copper metal.
DRI	Direct reduced iron. Iron ore lumps or pellets converted by the direct reduction process, used mainly as a scrap substitute in electric arc furnace steelmaking.
DWT	Deadweight ton. The measurement unit of a vessel's capacity for cargo, fuel oil, stores and crew, measured in metric tons of 1,000 kg. A vessel's total deadweight is the total weight the vessel can carry when loaded to a particular load line.
Electrowon copper cathode	Refined copper cathode is a metallic product produced by an electrochemical process in which copper is recovered by dissolving copper anode in an electrolyte and plating it onto an electrode. Electrowon copper cathodes generally contain 99.99% copper grade.
Embedded derivatives	A financial instrument within a contractual arrangement such as leases, purchase agreements and guarantees. Its function is to modify some or all of the cash flow that would otherwise be required by the contract, such as caps, floors or collars.
Emissions trading	Emissions trading is a market-based scheme for environmental improvement that allows parties to buy and sell permits for emissions or credits for reductions in emissions of certain pollutants.
Fe unit	A measure of the iron grade in the iron ore that is equivalent to 1% iron grade in one metric ton of iron ore.
Ferroalloys	Ferroalloys are alloys of iron that contain one or more other chemical elements. These alloys are used to add these other elements into molten metal, usually in steelmaking. The principal ferroalloys are those of manganese, silicon and chromium.
FOB	Free on board. It indicates that the purchaser pays for shipping, insurance and all the other costs associated with transportation of the goods to their destination.
Gold	A precious metal sometimes found free in nature, but usually found in conjunction with silver, quartz, calcite, lead, tellurium, zinc or copper. It is the most malleable and ductile metal, a good conductor of heat and electricity and unaffected by air and most reagents.
Grade	The proportion of metal or mineral present in ore or any other host material.
Hard metallurgical coal	Metallurgical coking coal with the required properties to produce a stronger/harder metallurgical coke.
Hematite Ore	Hematite is an iron oxide mineral, but also denotes the high-grade iron ore type within the iron deposits.

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Iridium	A dense, hard, brittle, silvery-white transition metal of the platinum family that occurs in natural alloys with platinum or osmium. Iridium is used in high-strength alloys that can withstand high temperatures, primarily in high-temperature apparatus, electrical contacts, and as a hardening agent for platinum.
Iron ore pellets	Agglomerated ultra-fine iron ore particles of a size and quality suitable for particular iron making processes. Our iron ore pellets range in size from 8 mm to 18 mm.
Itabirite Ore	Itabirite is a banded iron formation and denotes the low-grade iron ore type within the iron deposits.
Kaolin	A fine white aluminum silicate clay derived from rock composed chiefly of feldspar, which is used as a coating agent, filler, extender and absorbent in the paper, paint, ceramics and other industries.
Lump ore	Iron ore or manganese ore with the coarsest particle size in the range of 6.35 mm to 50 mm in diameter, but varying slightly between different mines and ores.
Manganese	A hard brittle metallic element found primarily in the minerals pyrolusite, hausmannite and manganite. Manganese is essential to the production of virtually all steels and is important in the production of cast iron.
Metallurgical coal	A bituminous hard coal with a quality that allows the production of coke. Normally used in coke ovens for metallurgical purposes.
Methanol	An alcohol fuel largely used in the production of chemical and plastic compounds.
Mineral deposit(s)	A mineralized body that has been intersected by a sufficient number of closely spaced drill holes and/or underground/surface samples to support sufficient tonnage and grade of metal(s) or mineral(s) of interest to warrant further exploration-development work.
Mineral resource	A concentration or occurrence of minerals of economic interest in such form and quantity that could justify an eventual economic extraction. The location, quantity, grade, geological characteristics and continuity of a mineral resource are known, estimated or interpreted from specific geological evidence through drill holes, trenches and/or outcrops. Mineral resources are sub-divided, in order of increasing geological confidence, into Inferred, Indicated and Measured Resources.
Nickel	A silvery white metal that takes on a high polish. It is hard, malleable, ductile, somewhat ferromagnetic, and a fair conductor of heat and electricity. It belongs to the iron-cobalt group of metals and is chiefly valuable for the alloys it forms, such as stainless steel and other corrosion-resistant alloys.
Nickel laterite	Deposits are formed by intensive weathering of olivine-rich ultramafic rocks such as dunite, peridotite and komatite.
Nickel limonitic laterite	Type of nickel laterite located at the top of the laterite profile. It consists largely of goethite and contains 1-2% nickel. Also contains concentrations on cobalt.
Nickel matte	An intermediate smelter product that must be further refined to obtain pure metal.

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Nickel pig iron	A low-grade nickel product, made from lateritic ores, suitable primarily for use in stainless steel production. Nickel pig iron typically has a nickel grade of 1.5-6% produced from blast furnaces. Nickel pig iron can also contain chrome, manganese, and impurities such as phosphorus, sulfur and carbon. Low grade ferro-nickel (FeNi) produced in China through electric furnaces is often also referred to as nickel pig iron.
Nickel saprolitic laterite	Type of nickel laterite located at the bottom of the laterite profile and contains on average 1.5-2.5% nickel.
Nickel sulfide	Formed through magmatic processes where nickel combines with sulphur to form a sulphide phase. Pentlandite is the most common nickel sulphide ore mineral mined and often occurs with chalcopyrite, a common copper sulphide mineral.
Ntk	Net ton (the weight of the goods being transported excluding the weight of the wagon) kilometer.
Open-pit mining	Method of extracting rock or minerals from the earth by their removal from an open pit. Open-pit mines for extraction of ore are used when deposits of commercially useful minerals or rock are found near the surface; that is, where the overburden (surface material covering the valuable deposit) is relatively thin or the material of interest is structurally unsuitable for underground mining.
Oxides	Compounds of oxygen with another element. For example, magnetite is an oxide mineral formed by the chemical union of iron with oxygen.
Palladium	A silver-white metal that is ductile and malleable, used primarily in automobile-emissions control devices, jewelry, electrical and chemical applications.
PCI	Pulverized coal injection. Type of coal with specific properties ideal for direct injection via the tuyeres of blast furnaces. This type of coal does not require any processing or coke making, and can be directly injected into the blast furnaces, replacing lump cokes to be charged from the top of the blast furnaces.
Pellet feed fines	Ultra-fine iron ore (less than 0.15 mm) generated by mining and grinding. This material is aggregated into iron ore pellets through an agglomeration process.
Pelletizing	Iron ore pelletizing is a process of agglomeration of ultra-fines produced in iron ore exploitation and concentration steps. The three basic stages of the process are: (i) ore preparation (to get the correct fineness); (ii) mixing and balling (additive mixing and ball formation); and (iii) firing (to get ceramic bonding and strength).
PGMs	Platinum group metals. Consist of platinum, palladium, rhodium, ruthenium, osmium and iridium.
Phosphate	A phosphorous compound, which occurs in natural ores and is used as a raw material for primary production of fertilizer nutrients, animal feeds and detergents.
Pig iron	Product of smelting iron ore usually with coke and limestone in a blast furnace.

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Platinum	A dense, precious, grey-white transition metal that is ductile and malleable and occurs in some nickel and copper ores. Platinum is resistant to corrosion and is used in jewelry, laboratory equipment, electrical contacts, dentistry, automobile-emissions control devices, flat panel TVs and hard disk drives.
Potash	A potassium chloride compound, chiefly KCl, used as simple fertilizer and in the production of mixture fertilizer.
Precious metals	Metals valued for their color, malleability, and rarity, with a high economic value driven not only by their practical industrial use, but also by their role as investments. The widely-traded precious metals are gold, silver, platinum and palladium.
Primary nickel	Nickel produced directly from mineral ores.
Probable (indicated) reserves	Reserves for which quantity and grade and/or quality are computed from information similar to that used for proven (measured) reserves, but the sites for inspection, sampling and measurement are farther apart or are otherwise less adequately spaced. The degree of assurance, although lower than that for proven (measured) reserves, is high enough to assume continuity between points of observation.
Proven (measured) reserves	Reserves for which (a) quantity is computed from dimensions revealed in outcrops, trenches, working or drill holes; grade and/or quality are computed from the results of detailed sampling and (b) the sites for inspection, sampling and measurement are spaced so closely and the geologic character is so well defined that size, shape, depth and mineral content of reserves are well-established.
Real, *reais* or R$	The official currency of Brazil is the *real* (singular) (plural**:** *reais*).
Reserves	The part of a mineral deposit that could be economically and legally extracted or produced at the time of the reserve determination.
Rhodium	A hard, silvery-white, durable metal that has a high reflectance and is primarily used in combination with platinum for automobile-emission control devices and as an alloying agent for hardening platinum.
ROM	Run-of-mine. Ore in its natural (unprocessed) state, as mined, without having been crushed.
Ruthenium	A hard, white metal that can harden platinum and palladium used to make severe wear-resistant electrical contacts and in other applications in the electronics industry.
Secondary or scrap nickel	Stainless steel or other nickel-containing scrap.
Seaborne market	Comprises the total ore trade between countries using ocean bulk vessels.
Silver	A ductile and malleable metal used in photography, coins and medal fabrication, and in industrial applications.
Sinter feed (also known as fines)	Iron ore fines with particles in the range of 0.15 mm to 6.35 mm in diameter. Suitable for sintering.
Sintering	The agglomeration of sinter feed, binder and other materials, into a coherent mass by heating without melting, to be used as metallic charge into a blast furnace.

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Slabs	The most common type of semi-finished steel. Traditional slabs measure 10 inches thick and 30-85 inches wide (and average 20 feet long), while the output of the recently developed "thin slab" casters is two inches thick. Subsequent to casting, slabs are sent to the hot-strip mill to be rolled into coiled sheet and plate products.
Stainless steel	Alloy steel containing at least 10% chromium and with superior corrosion resistance. It may also contain other elements such as nickel, manganese, niobium, titanium, molybdenum, copper, in order to improve mechanical, thermal properties and service life. It is primarily classified as austenitic (200 and 300 series), ferritic (400 series), martensitic, duplex or precipitation hardening grades.
Stainless steel scrap ratio	The ratio of secondary nickel units (either in the form of nickel-bearing, stainless steel scrap, or in alloy steel, foundry and nickel-based alloy scrap) relative to all nickel units consumed in the manufacture of new stainless steel.
Thermal coal	A type of coal that is suitable for energy generation in thermal power stations.
Troy ounce	One troy ounce equals 31.103 grams.
Underground mining	Mineral exploitation in which extraction is carried out beneath the earth's surface.
U.S. dollars or US$	The United States dollar.

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SIGNATURES

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

VALE S.A.

By: /s/ Murilo Pinto de Oliveira Ferreira

Name: Murilo Pinto de Oliveira Ferreira
Title: Chief Executive Officer

By: /s/ Tito Botelho Martins

Name: Tito Botelho Martins
Title: Chief Financial Officer

Date: April 17, 2012

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Vale S.A.

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Report of independent registered public accounting firm

To the Board of Directors and Stockholders
Vale S.A.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, of comprehensive income, of cash flows and of changes in stockholders' equity present fairly, in all material respects, the financial position of Vale S.A. and its subsidiaries (the "Company") at December 31, 2011 and 2010, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2011 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express opinions on these financial statements and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Rio de Janeiro, February 15, 2012

/s/ PricewaterhouseCoopers

PricewaterhouseCoopers
Auditores Independentes
CRC 2SP000160/O-5 "F" RJ
Marcos Donizete Panassol
Contador CRC 1SP155975/O-8 "S" RJ

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Management's Report on Internal Control over Financial Reporting

The management of Vale S.A (Vale) is responsible for establishing and maintaining adequate internal control over financial reporting.

The company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. The company's internal control over financial reporting includes those policies and procedures that: (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of the effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, and that the degree of compliance with the policies or procedures may deteriorate.

Vale's management has assessed the effectiveness of the company's internal control over financial reporting as of December 31, 2011 based on the criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission COSO. Based on such assessment and criteria, Vale's management has concluded that the company's internal control over financial reporting was effective as of December 31, 2011.

The effectiveness of the company's internal control over financial reporting as of December 31, 2011 has been audited by PricewaterhouseCoopers Auditores Independentes, an independent registered public accounting firm, as stated in their report which appears herein.

February 15, 2012

/s/ Murilo Ferreira

Murilo Ferreira
Chief Executive Officer

/s/ Tito Martins

Tito Martins
Chief Financial Officer

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Consolidated Balance Sheets
Expressed in millions of United States dollars

	As of December 31,	
	2011	**2010**
Assets		
Current assets		
Cash and cash equivalents	3,531	7,584
Short-term investments		1,793
Accounts receivable		
Related parties	288	435
Unrelated parties	8,217	7,776
Loans and advances to related parties	82	96
Inventories	5,251	4,298
Deferred income tax	203	386
Unrealized gains on derivative instruments	595	52
Advances to suppliers	393	188
Recoverable taxes	2,230	1,603
Assets held for sale		6,987
Others	946	593
	21,736	**31,791**
Non-current assets		
Property, plant and equipment, net	88,895	83,096
Intangible assets	1,135	1,274
Investments in affiliated companies, joint ventures and others investments	8,093	4,497
Other assets:		
Goodwill on acquisition of subsidiaries	3,026	3,317
Loans and advances		
Related parties	509	29
Unrelated parties	210	165
Prepaid pension cost	1,666	1,962
Prepaid expenses	321	222
Judicial deposits	1,464	1,731
Recoverable taxes	587	361
Deferred income tax	594	
Unrealized gains on derivative instruments	60	301
Deposit on incentive / reinvestiment	229	144
Others	203	249
	106,992	**97,348**
Total	**128,728**	**129,139**

Consolidated Balance Sheets (Continued)
Expressed in millions of United States dollars
(Except number of shares)

	As of December 31,	
	2011	**2010**
Liabilities and stockholders' equity		
Current liabilities		
Suppliers	4,814	3,558
Payroll and related charges	1,307	1,134
Minimum annual remuneration attributed to stockholders	1,181	4,842
Current portion of long-term debt	1,495	2,823
Short-term debt	22	139
Loans from related parties	24	21
Provision for income taxes	507	751
Taxes payable and royalties	524	264
Employees postretirement benefits	147	168
Railway sub-concession agreement payable	66	76
Unrealized losses on derivative instruments	73	35
Provisions for asset retirement obligations	73	75
Liabilities associated with assets held for sale		3,152
Others	810	874
	11,043	**17,912**
Non-current liabilities		
Employees postretirement benefits	2,446	2,442
Loans from related parties	91	2
Long-term debt	21,538	21,591
Provisions for contingencies (Note 20 (b))	1,686	2,043
Unrealized losses on derivative instruments	663	61
Deferred income tax	5,654	8,085
Provisions for asset retirement obligations	1,697	1,293
Debentures	1,336	1,284
Others	2,460	1,985
	37,571	**38,786**
Redeemable noncontrolling interest	505	712
Commitments and contingencies (Note 20)		
Stockholders' equity		
Preferred class A stock 7,200,000,000 no-par-value shares authorized and 2,108,579,618 (2010 2,108,579,618) issued	16,728	10,370
Common stock 3,600,000,000 no-par-value shares authorized and 3,256,724,482 (2010 3,256,724,482) issued	25,837	16,016
Treasury stock 181,099,814 (2010 99,649,571) preferred and 86,911,207 (2010 47,375,394) common shares	(5,662)	(2,660)
Additional paid-in capital	(61)	2,188
Mandatorily convertible notes common shares	290	290
Mandatorily convertible notes preferred shares	644	644
Other cumulative comprehensive loss	(5,673)	(333)
Undistributed retained earnings	41,130	42,218
Unappropriated retained earnings	4,482	166
Total Company stockholders' equity	**77,715**	**68,899**
Noncontrolling interests	1,894	2,830
Total stockholders' equity	**79,609**	**71,729**

Total	**128,728**	**129,139**

The accompanying notes are an integral part of these financial statements.

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Consolidated Statements of Income
Expressed in millions of United States dollars
(Except per share amounts)

	Year ended as of December 31,		
	2011	**2010**	**2009**
Operating revenues, net of discounts, returns and allowances			
Sales of ores and metals	53,200	39,422	19,502
Aluminum products	383	2,554	2,050
Revenues from logistic services	1,726	1,465	1,104
Fertilizer products	3,547	1,845	413
Others	1,533	1,195	870
	60,389	**46,481**	**23,939**
Taxes on revenues	(1,399)	(1,188)	(628)
Net operating revenues	**58,990**	**45,293**	**23,311**
Operating costs and expenses			
Cost of ores and metals sold	(17,898)	(13,326)	(9,853)
Cost of aluminum products	(289)	(2,108)	(2,087)
Cost of logistic services	(1,402)	(1,040)	(779)
Cost of fertilizer products	(2,701)	(1,556)	(173)
Others	(1,283)	(784)	(729)
	(23,573)	**(18,814)**	**(13,621)**
Selling, general and administrative expenses	(2,334)	(1,701)	(1,130)
Research and development expenses	(1,674)	(878)	(981)
Gain on sale of assets	1,513		
Others	(2,810)	(2,205)	(1,522)
	(28,878)	**(23,598)**	**(17,254)**
Operating income	**30,112**	**21,695**	**6,057**
Non-operating income (expenses)			
Financial income	718	290	381
Financial expenses	(2,465)	(2,646)	(1,558)
Gains (losses) on derivatives, net	75	631	1,528
Foreign exchange and indexation gains (losses), net	(1,641)	344	675
Gain (loss) on sale of investments			40
	(3,313)	**(1,381)**	**1,066**
Income before discontinued operations, income taxes and equity results	**26,799**	**20,314**	**7,123**
Income taxes			
Current	(5,547)	(4,996)	(2,084)
Deferred	265	1,291	(16)
	(5,282)	**(3,705)**	**(2,100)**
Equity in results of affiliates, joint ventures and other investments	1,135	987	433
Net income from continuing operations	**22,652**	**17,596**	**5,456**
Discontinued operations, net of tax		(143)	

Net income	**22,652**	**17,453**	**5,456**
Net income (loss) attributable to noncontrolling interests	(233)	189	107
Net loss attributable to redeemable noncontrolling interests			
Net income attributable to the Company's stockholders	**22,885**	**17,264**	**5,349**
Earnings per share attributable to Company's stockholders:			
Earnings per preferred share	4.33	3.23	0.97
Earnings per common share	4.33	3.23	0.97
Earnings per convertible note linked to preferred share	6.39	4.76	1.71
Earnings per convertible note linked to common share	8.15	6.52	2.21

The accompanying notes are an integral part of these financial statements.

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Consolidated Statements of Comprehensive Income (deficit)
Expressed in millions of United States dollars

	Year ended as of December 31,		
	2011	**2010**	**2009**
Comprehensive income is comprised as follows:			
Company's stockholders:			
Net income attributable to Company's stockholders	22,885	17,264	5,349
Cumulative translation adjustments	(4,985)	1,519	9,721
Available-for-sale securities			
Gross balance as of the period/year end	(13)	12	(47)
Tax (expense) benefit	11	(9)	30
	(2)	**3**	**(17)**
Surplus (deficit) accrued pension plan			
Gross balance as of the period/year end	(740)	(53)	10
Tax (expense) benefit	232	32	(14)
	(508)	**(21)**	**(4)**
Participation on other comprehensive income from affiliated company			
Cash flow hedge			
Gross balance as of the period	130	(16)	11
Tax (expense) benefit	25	(10)	(9)
	155	**(26)**	**2**
Total comprehensive income attributable to Company's stockholders	**17,545**	**18,739**	**15,051**
Noncontrolling interests:			
Net income attributable to noncontrolling interests	(233)	189	107
Cumulative translation adjustments	(210)	104	823
Pension plan	4		
Cash flow hedge	1	40	(18)
Total comprehensive income (deficit) attributable to Noncontrolling interests	**(438)**	**333**	**912**
Total comprehensive income	**17,107**	**19,072**	**15,963**

The accompanying notes are an integral part of these financial statements.

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Consolidated Statements of Cash Flows
Expressed in millions of United States dollars

	Year ended as of December 31,		
	2011	**2010**	**2009**
Cash flows from operating activities:			
Net income	**22,652**	**17,453**	**5,456**
Adjustments to reconcile net income to cash from operations:			
Depreciation, depletion and amortization	4,122	3,260	2,722
Dividends received	1,038	1,161	386
Equity in results of affiliates, joint ventures and other investments	(1,135)	(987)	(433)
Deferred income taxes	(265)	(1,291)	16
Loss on disposal of property, plant and equipment	223	623	293
Gain on sale of assets available for sale	(1,513)		(40)
Discontinued operations, net of tax		143	
Foreign exchange and indexation gains, net	2,879	(787)	(1,095)
Unrealized derivative losses (gains), net	490	594	(1,382)
Unrealized interest (income) expense, net	194	187	(25)
Others	(183)	58	20
Decrease (increase) in assets:			
Accounts receivable	(821)	(3,800)	616
Inventories	(1,343)	(425)	530
Recoverable taxes	(563)	42	108
Others	(315)	307	(455)
Increase (decrease) in liabilities:			
Suppliers	1,076	928	121
Payroll and related charges	285	214	159
Income taxes	(2,478)	1,311	(234)
Others	153	192	373
Net cash provided by operating activities	**24,496**	**19,183**	**7,136**
Cash flows from investing activities:			
Short term investments	1,793	1,954	(1,439)
Loans and advances receivable			
Related parties			
Loan proceeds		(28)	(181)
Repayments			7
Others	(178)	(30)	(25)
Judicial deposits	(186)	(94)	(132)
Investments	(504)	(87)	(1,947)
Additions to property, plant and equipment	(16,075)	(12,647)	(8,096)
Proceeds from disposal of investments	1,081		606
Acquisition (sale) of subsidiaries		(6,252)	(1,952)
Net cash used in investing activities	**(14,069)**	**(17,184)**	**(13,159)**

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Consolidated Statements of Cash Flows (Continued)
Expressed in millions of United States dollars

	Year ended as of December 31,		
	2011	**2010**	**2009**
Cash flows from financing activities:			
Short-term debt			
Additions	859	2,233	1,285
Repayments	(955)	(2,132)	(1,254)
Loans			
Related parties			
Proceeds	19	24	16
Repayments	(1)	(25)	(373)
Issuances of long-term debt			
Third parties			
Proceeds	1,564	4,436	3,104
Repayments	(2,621)	(2,629)	(307)
Treasury stock	(3,002)	(1,510)	(9)
Mandatorily convertible notes			934
Transactions of noncontrolling interest	(1,134)	660	
Dividends and interest attributed to Company's stockholders	(9,000)	(3,000)	(2,724)
Dividends and interest attributed to noncontrolling interest	(100)	(140)	(47)
Net cash provided by (used in) financing activities	**(14,371)**	**(2,083)**	**625**
Increase (decrease) in cash and cash equivalents	(3,944)	(84)	(5,398)
Effect of exchange rate changes on cash and cash equivalents	(109)	375	2,360
Cash and cash equivalents, beginning of period	7,584	7,293	10,331
Cash and cash equivalents, end of period	**3,531**	**7,584**	**7,293**
Cash paid during the period for:			
Interest on short-term debt	(3)	(5)	(1)
Interest on long-term debt	(1,143)	(1,097)	(1,113)
Income tax	(7,293)	(1,972)	(1,331)
Non-cash transactions			
Income tax paid with credits	(681)		
Interest capitalized	234	164	266
Conversion of mandatorily convertible notes using 75,435,238 treasury stock (see note 17)			

The accompanying notes are an integral part of these financial statements.

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Consolidated Statements of Changes in Stockholders' Equity
Expressed in millions of United States dollars
(Except number of shares)

	Year ended as of December 31,		
	2011	**2010**	**2009**
Preferred class A stock (including twelve golden shares)			
Beginning of the period	10,370	9,727	9,727
Capital increase	6,358		
Transfer from undistributed retained earnings		643	
End of the period	**16,728**	**10,370**	**9,727**
Common stock			
Beginning of the period	16,016	15,262	15,262
Capital increase	9,821		
Transfer from undistributed retained earnings		754	
End of the period	**25,837**	**16,016**	**15,262**
Treasury stock			
Beginning of the period	(2,660)	(1,150)	(1,141)
Sales (acquisitions)	(3,002)	(1,510)	(9)
End of the period	**(5,662)**	**(2,660)**	**(1,150)**
Additional paid-in capital			
Beginning of the period	2,188	411	393
Change in the period	(2,249)	1,777	18
End of the period	**(61)**	**2,188**	**411**
Mandatorily convertible notes common shares			
Beginning of the period	290	1,578	1,288
Change in the period		(1,288)	290
End of the period	**290**	**290**	**1,578**
Mandatorily convertible notes preferred shares			
Beginning of the period	644	1,225	581
Change in the period		(581)	644
End of the period	**644**	**644**	**1,225**
Other cumulative comprehensive income (deficit)			
Cumulative translation adjustments			
Beginning of the period	(253)	(1,772)	(11,493)
Change in the period	(4,985)	1,519	9,721
End of the period	**(5,238)**	**(253)**	**(1,772)**
Unrealized gain (loss) available-for-sale securities, net of tax			
Beginning of the period	3		17
Change in the period	(2)	3	(17)

End of the period	**1**	**3**	
Surplus (deficit) of accrued pension plan			
Beginning of the period	(59)	(38)	(34)
Change in the period	(508)	(21)	(4)
End of the period	**(567)**	**(59)**	**(38)**
Participation on other comprehensive income of subsidiaries			
Cash flow hedge			
Beginning of the period	(24)	2	
Change in the period	155	(26)	2
End of the period	**131**	**(24)**	**2**
Total other cumulative comprehensive income (deficit)	**(5,673)**	**(333)**	**(1,808)**

Consolidated Statements of Changes in Stockholders' Equity (Continued)
Expressed in millions of United States dollars
(Except number of shares)

	Year ended as of December 31,		
	2011	**2010**	**2009**
Undistributed retained earnings			
Beginning of the period	42,218	28,508	18,340
Transfer from/to unappropriated retained earnings	13,221	15,107	10,168
Transfer to capitalized earnings	(14,309)	(1,397)	
End of the period	**41,130**	**42,218**	**28,508**
Unappropriated retained earnings			
Beginning of the period	166	3,182	9,616
Net income attributable to the Company's stockholders	22,885	17,264	5,349
Remuneration of mandatorily convertible notes			
Preferred class A stock	(97)	(72)	(58)
Common stock	(70)	(61)	(93)
Dividends and interest attributed to stockholders' equity			
Preferred class A stock	(2,143)	(1,940)	(570)
Common stock	(3,038)	(3,100)	(894)
Appropriation from/to undistributed retained earnings	(13,221)	(15,107)	(10,168)
End of the period	**4,482**	**166**	**3,182**
Total Company stockholders' equity	**77,715**	**68,899**	**56,935**
Noncontrolling interests			
Beginning of the period	2,830	2,831	1,892
Disposals (acquisitions) of noncontrolling interests	(631)	1,629	83
Cumulative translation adjustments	(210)	104	823
Cash flow hedge	1	40	(18)
Net income (loss) attributable to noncontrolling interests	(233)	189	107
Net income (loss) attributable to redeemable noncontrolling interests	207		
Dividends and interest attributable to noncontrolling interests	(105)	(104)	(56)
Capitalization of stockholders advances	31	27	
Pension plan	4		
Assets and liabilities held for sale		(1,886)	
End of the period	**1,894**	**2,830**	**2,831**
Total stockholders' equity	**79,609**	**71,729**	**59,766**
Number of shares issued and outstanding:			
Preferred class A stock (including twelve golden shares)	2,108,579,618	2,108,579,618	2,108,579,618
Common stock	3,256,724,482	3,256,724,482	3,256,724,482
Beginning of the period	(147,024,965)	(152,579,803)	(151,792,203)
Acquisitions	(120,987,980)	(69,880,400)	(831,400)
Conversions	1,924	75,435,238	43,800
End of the period	**(268,011,021)**	**(147,024,965)**	**(152,579,803)**
	5,097,293,079	**5,218,279,135**	**5,212,724,297**

The accompanying notes are an integral part of these financial statements.

Notes to the Consolidated Financial Statements

Expressed in millions of United States dollars, unless otherwise stated

1 The Company and its operations

Vale S.A., ("Vale", "Company" or "we") is a limited liability company incorporated in Brazil. Operations are carried out through Vale and our subsidiary companies, joint ventures and affiliates, and mainly consist of mining, basic metals production, fertilizers, logistics and steel activities.

At December 31, 2011, our principal consolidated operating subsidiaries are the following:

Subsidiary	% ownership	% voting capital	Location	Principal activity
Compañia Minera Miski Mayo S.A.C.	40.00	51.00	Peru	Fertilizer
Ferrovia Centro-Atlântica S. A.	99.99	99.99	Brazil	Logistics
Ferrovia Norte Sul S.A.	100.00	100.00	Brazil	Logistics
Mineração Corumbaense Reunida S.A. MCR	100.00	100.00	Brazil	Iron Ore and Manganese
PT International Nickel Indonesia Tbk	59.20	59.20	Indonesia	Nickel
Sociedad Contractual Minera Tres Valles	90.00	90.00	Chile	Copper
Vale Australia Pty Ltd.	100.00	100.00	Australia	Coal
Vale Austria Holdings GMBH	100.00	100.00	Austria	Holding and Exploration
Vale Canada Limited	100.00	100.00	Canada	Nickel
Vale Coal Colombia Ltd.	100.00	100.00	Colombia	Coal
Vale Fertilizantes S.A	99.05	99.98	Brazil	Fertilizer
Vale International S.A	100.00	100.00	Switzerland	Trading
Vale Manganês S.A.	100.00	100.00	Brazil	Manganese and Ferroalloys
Vale Mina do Azul S. A.	100.00	100.00	Brazil	Manganese
Vale Moçambique S.A.	100.00	100.00	Mozambique	Coal
Vale Nouvelle-Calédonie SAS	74.00	74.00	New Caledonia	Nickel
Vale Oman Pelletizing Company LLC	100.00	100.00	Oman	Pellets
Vale Shipping Holding PTE Ltd.	100.00	100.00	Singapore	Logistics

2 Basis of consolidation

All majority-owned subsidiaries in which we have both share and management control are consolidated. All significant intercompany accounts and transactions are eliminated. Subsidiaries over which control is achieved through other means, such as stockholders agreement, are also consolidated even if we hold less than 51% of voting capital. Our variable interest entities in which we are the primary beneficiary are consolidated. Investments in unconsolidated affiliates and joint ventures are accounted under the equity method (Note 14).

We evaluate the carrying value of our equity investments in relation to publicly quoted market prices when available. If the quoted market price is lower than book value, and such decline is considered other than temporary, we write-down our equity investments to the level of the quoted market value.

We define joint ventures as businesses in which we and a small group of other partners each participate actively in the overall entity management, based on a stockholders agreement. We define affiliates as businesses in which we participate as a noncontrolling interest but with significant influence over the operating and financial policies of the investee.

Our participation in hydroelectric projects in Brazil is made via consortium contracts under which we have undivided interests in the assets, and are liable for our proportionate share of liabilities and expenses, which are based on our proportionate share of power output. We do not have joint liability for any obligations. No separate legal or tax status is granted to consortia under the Brazilian law. Accordingly, we recognize our proportionate share of costs and our undivided interest in assets relating to hydroelectric projects (note 12).

Notes to the Consolidated Financial Statements (Continued)

Expressed in millions of United States dollars, unless otherwise stated

3 Summary of significant accounting policies

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Estimates are used for, but not limited to, the selection of useful lives of property, plant and equipment, impairment, provisions necessary for contingent liabilities, fair values assigned to assets and liabilities acquired in business combinations, income tax valuation allowances, employee post retirement benefits and other similar evaluations. Actual results could differ from those estimated.

a) Basis of presentation

We have prepared our consolidated financial statements in accordance with United States generally accepted accounting principles ("US GAAP"), which differ in certain respects from the accounting practices adopted in Brazil ("BR GAAP"), compliant with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standard Board ("IASB"), which are the basis for our statutory financial statements.

The Brazilian Real is the parent Company's functional currency. We have selected the US dollar as our reporting currency.

In 2011, based on entity business assessment, the subsidiary Vale International had its functional currency changed from Brazilian Real to US dollar. This change did not cause significant effects in the financial statements presented.

All assets and liabilities have been translated to US dollars at the closing rate of exchange at each balance sheet date (or, if unavailable, the first available exchange rate). All statement of income accounts have been translated to US dollars at the average exchange rates prevailing during the respective periods. Capital accounts are recorded at historical exchange rates. Translation gains and losses are recorded in the Cumulative Translation Adjustments account ("CTA") in stockholders' equity.

The results of operations and financial position of our entities that have a functional currency other than the US dollar, have been translated into US dollars and adjustments to translate those statements into US dollars are recorded in the CTA in stockholders' equity.

The exchange rates used to translate the assets and liabilities of the Brazilian operations at December 31, 2011 and 2010, were R$1.8683 and R$1.6662, respectively.

The net transaction gain (loss) included in our statement of income ("Foreign exchange and indexation gains (losses), net") was US$ (1,382), US$102 and US$665 in the years ended December 31, 2011, 2010 and 2009, respectively.

Notes to the Consolidated Financial Statements (Continued)

Expressed in millions of United States dollars, unless otherwise stated

3 Summary of significant accounting policies (Continued)

b) Information by Segment and Geographic Area

The company discloses information by consolidated operational business segment and revenues by consolidated geographic area, in accordance with the principles and concepts used by decision makers in evaluating performance. The information is analyzed by segment as follows:

Bulk Material includes the extraction of iron ore and pellet production and transport systems of North, South and Southeast, including railroads, ports and terminals, related to mining operations. The manganese ore and ferroalloys are also included in this segment.

Basic metals comprises the production of non-ferrous minerals, including nickel operations (co-products and byproducts), copper and aluminum includes the trading of aluminum, alumina refining and aluminum smelting metals and investments in joint ventures and associated bauxite mining.

Fertilizers comprises three major groups of nutrients: potash, phosphate and nitrogen. This business is being formed through a combination of acquisitions and organic growth. This is a new business reported in 2010.

Logistic services includes our system of cargo transportation for third parties divided into rail transport, port and shipping services.

Others comprises our investments in joint ventures and associate in other businesses.

c) Cash equivalents and short-term investments

Cash flows from overnight investments and fundings are reported net. Short-term investments that have a ready market and original maturities of 90 days or less are classified as "Cash equivalents". The remaining investments, between 91 day and 360 day maturities are stated at fair value and presented as "Short-term investments".

d) Non-current assets and liabilities

Assets and liabilities that are realizable or due more than 12 months after the balance sheet date are classified as non-current.

e) Inventories

Inventories are recorded at the average cost of purchase or production, reduced to market value (net realizable value less a reasonable margin) when lower. Stockpiled inventories are accounted as processed when they are removed from the mine. The cost of finished goods is comprised of depreciation and all direct costs necessary to convert stockpiled inventories into finished goods.

We classify proven and probable reserve quantities attributable to stockpiled inventories as inventories. These reserve quantities are not included in the total proven and probable reserve quantities used in the units of production, depreciation, depletion and amortization calculations.

Notes to the Consolidated Financial Statements (Continued)

Expressed in millions of United States dollars, unless otherwise stated

3 Summary of significant accounting policies (Continued)

We periodically assess our inventories to identify obsolete or slow-moving inventories and, if needed, we recognize definitive allowances for them.

f) Removal of waste materials to access mineral deposits

Stripping costs (the costs associated with the removal of overburdened and other waste materials) incurred during the development of a mine, before production takes place, are capitalized as part of the depreciable cost of developing the property. Such costs are subsequently amortized during the useful life of the mine based on proven and probable reserves.

Post-production stripping costs are included in the cost of the inventory produced (that is extracted), at each mine individually during the period that stripping costs are incurred.

g) Property, plant and equipment and intangible assets

Property, plant and equipment are recorded at cost, including interest cost incurred during the construction of major new facilities. We compute depreciation on the straight-line method at annual average rates which take into consideration the useful lives of the assets, as follows: 3.73% for railroads, 1.5% for buildings, 4.23% for installations and 7.73% for other equipment. Expenditures for maintenance and repairs are charged to operating costs and expenses as incurred.

We capitalize the costs of developing major new ore bodies or expanding the capacity of operating mines and amortize these to operations on the unit-of-production method based on the total probable and proven quantity of ore to be recovered. Exploration costs are expensed. Once the economic viability of mining activities is established, subsequent development costs are capitalized.

Separately acquired intangible assets are shown at historical cost. Intangible assets acquired in a business combination are recognized at fair value at the acquisition date. All our intangible assets have definite useful lives and are carried at cost less accumulated amortization, which is calculated using the straight-line method over their estimated useful lives.

h) Business combinations

We apply accounting for business combinations to record acquisitions of interests in other companies. The "purchase method", requires that we reasonably determine the fair value of the identifiable tangible and intangible assets and liabilities assumed of acquired companies and segregate goodwill as an intangible asset.

We assign goodwill to reporting units and test each reporting unit's goodwill for impairment at least annually, and whenever circumstances indicating that recognized goodwill may not be fully recovered are identified. We perform the annual goodwill impairment tests during the last quarter of each year.

Goodwill is reviewed for impairment utilizing a two step process. In the first step, we compare a reporting unit's fair value with its carrying amount to identify any potential goodwill impairment loss. If the carrying amount of a reporting unit exceeds the unit's fair value, based on a discounted cash flow analysis, we

Notes to the Consolidated Financial Statements (Continued)

Expressed in millions of United States dollars, unless otherwise stated

3 Summary of significant accounting policies (Continued)

carry out the second step of the impairment test, measuring and recording the amount, if any, of the unit's goodwill impairment loss.

i) Impairment of long-lived assets

All long-lived assets are tested to determine if they are recoverable from operating earnings on an undiscounted cash flow basis over their useful lives whenever events or changes in circumstance indicate that the carrying value may not be recoverable.

When we determine that the carrying value of long-lived assets and definite-life intangible assets may not be recoverable, we measure any impairment loss based on a projected discounted cash flow method using a discount rate determined to be commensurate with the inherent risk of our current business model.

j) Available-for-sale equity securities

Equity securities classified as "available-for-sale" are recorded pursuant to accounting for certain investments in debt and equity securities. Accordingly, we classify unrealized holding gains and losses, net of taxes, as a separate component of stockholders' equity until realized.

k) Compensated absences

The liability for future compensation for employee vacations is fully accrued as earned.

l) Derivatives and hedging activities

We apply accounting for derivative financial instruments and hedging activities, as amended. This standard requires that we recognize all derivative financial instruments as either assets or liabilities on our balance sheet and measure such instruments at fair value. Changes in the fair value of derivatives are recorded in each period in current earnings or in other comprehensive income, in the latter case depending on whether a transaction is designated as an effective hedge and has been effective during the period.

m) Asset retirement obligations

Our asset retirement obligations consist primarily of estimated closure costs. The initial measurement is recognized as a liability discounted to present value and subsequently accreted through earnings. An asset retirement cost equal to the initial liability is capitalized as part of the related asset's carrying value and depreciated during the asset's useful life.

n) Revenues and expenses

Revenues are recognized when title is transferred to the customer or services are rendered. Revenue from exported products is recognized when such products are loaded on board the ship. Revenues from products sold in the domestic market are recognized when delivery is made to the customer. Revenues from logistic services are recognized when the service order is fulfilled. Expenses and costs are recognized on the accrual basis.

Notes to the Consolidated Financial Statements (Continued)

Expressed in millions of United States dollars, unless otherwise stated

3 Summary of significant accounting policies (Continued)

o) Income taxes

The deferred tax effects of tax loss carryforwards and temporary differences are recognized pursuant to accounting for income taxes. A valuation allowance is made when we believe that it is more likely than not that tax assets will not be fully recovered in the future.

p) Earnings per share

Earnings per share are computed by dividing net income by the weighted average number of common and preferred shares outstanding during the period.

q) Interest attributed to stockholders' equity (dividend)

Brazilian corporations are permitted to distribute interest attributable to stockholders' equity. The calculation is based on the stockholders' equity amounts as stated in the statutory accounting records and the interest rate applied may not exceed the long-term interest rate (TJLP) determined by the Brazilian Central Bank. Also, such interest may not exceed 50% of net income for the year nor 50% of retained earnings plus revenue reserves as determined by "Brazilian GAAP".

The notional interest charge is tax deductible in Brazil. The benefit to us, as opposed to making a dividend payment, is a reduction in our income tax charge. Income tax of 15% is withheld on behalf of the stockholders relative to the interest distribution. Under Brazilian law, interest attributed to stockholders' equity is considered as part of the annual minimum mandatory dividend (Note 17). This notional interest distribution is treated for accounting purposes as a deduction from stockholders' equity in a manner similar to a dividend and the tax credit recorded in income.

r) Pension and other post retirement benefits

We sponsor private pensions and other post retirement benefits for our employees which are actuarially determined and recognized as an asset or liability or both depending on the funded or unfunded status of each plan in accordance with "employees' accounting for defined benefit pension and other post retirement plans". The cost of our defined benefit and prior service costs or credits that arise during the period and are not components of net periodic benefit costs are recorded in other cumulative comprehensive income (deficit).

4 Accounting pronouncements

Accounting standards adopted in 2011

Accounting Standards Update ASU number 2011-12 Comprehensive Income (Topic 220). The amendments in this update supersede certain pending paragraphs in Accounting Standards Update No. 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income, to effectively defer only those changes in update 2011-05 that relate to the presentation of reclassification adjustments out of accumulated other comprehensive income. The amendments in this Update are effective for public entities for fiscal years, and interim periods within those years, beginning after December 15, 2011.

Notes to the Consolidated Financial Statements (Continued)

Expressed in millions of United States dollars, unless otherwise stated

4 Accounting pronouncements (Continued)

ASU number 2011-11 Balance Sheet: Disclosures about Offsetting Assets and Liabilities (Topic 210). Entities are required to disclose both gross information and net information about both instruments and transactions eligible for offset in the statement of financial position and instruments and transactions subject to an agreement similar to a master netting arrangement. This scope would include derivatives, sale and repurchase agreements and reverse sale and repurchase agreements, and securities borrowing and securities lending arrangements. This pronouncement will be effective for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods.

ASU number 2011-08 Intangibles Goodwill and Other (Topic 350). The objective of this Update is to simplify how entities, both public and nonpublic, test goodwill for impairment. The amendments in the update permit an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test described in Topic 350. The amendments are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011.

ASU number 2011-05 Comprehensive Income (Topic 220): Presentation of Comprehensive Income. The objective of this update is to improve the comparability, consistency, and transparency of financial reporting and to increase the prominence of items reported in other comprehensive income, so an entity has the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income. The amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011.

ASU number 2011-04: Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in USGAAP and IFRSs. The amendments in this update generally represent clarifications of Topic 820, but also include some instances where a particular principle or requirement for measuring fair value or disclosing information about fair value measurements has changed. The amendments are effective during interim and annual periods beginning after December 15, 2011.

ASU number 2011-03: Transfers and Servicing (Topic 860): Reconsideration of Effective Control for Repurchase Agreements. The amendments in this update remove from the assessment of effective control (1) the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in the event of default by the transferee, and (2) the collateral maintenance implementation guidance related to that criterion. The Company adopted this standard with no impact on our financial position, results of operations or liquidity. The amendments in this update are effective for the first interim or annual period beginning on or after December 15, 2011.

ASU number 2011-02: Receivables (Topic 310) A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring. The amendments in this update would provide additional guidance to assist creditors in determining whether a restructuring of a receivable meets the criteria to be considered a troubled debt restructuring. The Company adopted this standard with no impact on its financial position, results of operations or liquidity. The amendments in this update are effective for the first interim or annual period beginning on or after June 15, 2011.

Notes to the Consolidated Financial Statements (Continued)

Expressed in millions of United States dollars, unless otherwise stated

5 Major acquisitions and disposals

a) Sale of aluminum assets

In February 2011, we concluded the transaction announced in May, 2010 with Norsk Hydro ASA (Hydro), to transfer all of our stakes in Albras-Alumínio Brasileiro S.A. (Albras), Alunorte-Alumina do Norte do Brasil S.A. (Alunorte) and Companhia de Alumina do Pará (CAP), along with its respective off-take rights and outstanding commercial contracts, and 60% of Mineração Paragominas S.A (Paragominas), and all our other Brazilian bauxite mineral rights. On December 31, 2010 these assets were demonstrated as assets held for sale in our balance sheet.

For this transaction we received US$ 1,081 in cash and 22% equivalent to 447,834,465 shares of Hydro's outstanding common shares outstanding (approximately US$ 3.5 billion according to Hydro's closing share price at the date of the transaction). Three and five years after the closing of the transaction, we will receive two equal tranches of US$ 200 each in cash, related to the remaining payment of 40% of Mineração Paragominas S.A. From the date of the transaction, Hydro has been accounted for by the equity method.

The gain on this transaction, of US$ 1,513 was recorded in the income statement in the line Gain on sale of assets.

b) Fertilizers Businesses

In 2010, we acquired 78.92% of the total capital and 99.83% of the voting capital of Vale Fertilizantes S.A and 100% of the total capital of Vale Fosfatados. In 2011 we concluded several transactions including a public offer to acquire the free floating shares of Vale Fertilizantes S.A. During this offer both the common and preferred shares were acquired for R$ 25.00 per share, amounting to a total of R$ 2,078 billion, equivalent to US$ 1,134 at the date the financial settlement of the transaction. After the public offer, we hold 99.05% of the total shares of Vale Fertilizantes S.A.

The purchase price allocation based on the fair values of acquired assets and liabilities was based on studies performed by us with the assistance of external valuation specialists and was finalized during 2011.

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Notes to the Consolidated Financial Statements (Continued)

Expressed in millions of United States dollars, unless otherwise stated

5 Major acquisitions and disposals (Continued)

The goodwill balance arises primarily due to the synergies between the acquired assets and the potash operations in Taquari-Vassouras, Carnalita, Rio Colorado and Neuquém and phosphates in Bayóvar I and II, in Peru, and Evate, in Mozambique. The future development of our projects combined with the acquisition of the portfolio of fertilizer assets will allow Vale to be one of the top players in the global fertilizer business.

Purchase price	5,795
Non-controlling consideration	767
Book value of property, plant and equipment and mining rights	(1,987)
Book value of other assets acquired and liabilities assumed, net	(395)
Adjustment to fair value of property, plant and equipment and mining rights	(5,146)
Adjustment to fair value of inventories	(98)
Deferred taxes on the above adjustments	1,783
Goodwill	**719**

c) Acquisition of NESA

In 2011, we acquired 9% of Norte Energia S.A. (NESA) from Gaia Energia e Participações S.A. (Gaia) for US$ 70. NESA was established with the sole purpose of implementing, operating and exploring the Belo Monte hydroelectric plant, which is still in the early development stage. Vale estimated an investment of R$ 2,300 billion (Equivalent to US$ 1.2 billion) of future capital contributions arising from the acquired stake, until December 31, 2011 the total capital contribution was US$ 84.

6 Income taxes

Income taxes in Brazil comprise federal income tax and social contribution, which is an additional federal tax. The statutory composite enacted tax rate applicable in the periods presented is 34%. In other countries where we have operations, we are subject to various taxes rates depending on the jurisdiction.

We analyze the potential tax impact associated with undistributed earnings by each of our subsidiaries. For those subsidiaries in which the undistributed earnings would be taxable when remitted to the parent company, no deferred tax is recognized, based on generally accepted accounting principles.

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Notes to the Consolidated Financial Statements (Continued)

Expressed in millions of United States dollars, unless otherwise stated

6 Income taxes (Continued)

The amount reported as income tax expense in our consolidated financial statements is reconciled to the statutory rates as follows:

	Year ended as of								
	December 31, 2011			December 31, 2010			December 31, 2009		
	Brazil	**Foreign**	**Total**	**Brazil**	**Foreign**	**Total**	**Brazil**	**Foreign**	**Total**
Income before discontinued operations, income taxes, equity results and noncontrolling interests	21,267	5,532	26,799	16,586	3,728	20,314	10,024	(2,901)	7,123
Exchange variation (not taxable) or not deductible		26	26		265	265		5,162	5,162
	21,267	**5,558**	**26,825**	**16,586**	**3,993**	**20,579**	**10,024**	**2,261**	**12,285**
Tax at Brazilian composite rate	(7,231)	(1,890)	(9,121)	(5,639)	(1,358)	(6,997)	(3,408)	(769)	(4,177)
Tax benefit on interest attributed to stockholders	1,655		1,655	995		995	502		502
Difference on tax rates of foreign income		1,415	1,415		1,673	1,673		1,079	1,079
Tax incentives	704		704	642		642	148		148
Social contribution contingency payment	506		506						
Reversal/Constitution of provisions for loss of tax loss carryforwards	129	(426)	(297)						
Other non-taxable, income/non deductible expenses	48	(192)	(144)	13	(31)	(18)	100	248	348
Income tax per consolidated statements of income	**(4,189)**	**(1,093)**	**(5,282)**	**(3,989)**	**284**	**(3,705)**	**(2,658)**	**558**	**(2,100)**

Vale and some subsidiaries in Brazil were granted with tax incentives that provide for a partial reduction of the income tax due related to certain regional operations of iron ore, railroad, manganese, copper, bauxite, alumina, aluminum, kaolin and potash. The tax benefit is calculated based on taxable profit adjusted by the tax incentive (so-called "exploration profit") taking into consideration the operational profit of the projects that benefit from the tax incentive during a fixed period. In general such tax incentives last for 10 years. The Company's tax incentives will expire in 2020. The tax savings must be registered in a special capital (profit) reserve in the Stockholders' equity of the entity that benefits from the tax incentive and cannot be distributed as dividends to the stockholders.

We are also allowed to reinvest part of the tax savings in the acquisition of new equipment to be used in the operations that have the tax benefit subject to subsequent approval from the Brazilian regulatory agencies Superintendência de Desenvolvimento da Amazônia SUDAM and Superintendência de Desenvolvimento do Nordeste SUDENE. When the reinvestment is approved, the corresponding tax benefit must also be accounted for in a special profit reserve and is also subject to the same restrictions with respect to future dividend distributions to the stockholders.

We also have income tax incentives related to our Goro project under development in New Caledonia ("The Goro Project"). These incentives include an income tax holiday during the construction phase of the project and throughout a 15-year period commencing in the first year in which commercial production, as defined by the applicable legislation, is achieved followed by a five-year, 50 per cent income tax holiday. The Goro Project also qualifies for certain exemptions from indirect taxes such as import duties during the

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Notes to the Consolidated Financial Statements (Continued)

Expressed in millions of United States dollars, unless otherwise stated

6 Income taxes (Continued)

construction phase and throughout the commercial life of the project. Certain of these tax benefits, including the income tax holiday, are subject to an earlier phase out, should the project achieves a specified cumulative rate of return. We are subject to a branch profit tax commencing in the first year in which commercial production is achieved, as defined by the applicable legislation. To date, we have not recorded any taxable income for New Caledonian tax purposes. The benefits of this legislation are expected to apply with respect to taxes payable once the Goro Project is in operation. We obtained tax incentives for our projects in Mozambique, Oman and Malaysia, that will take effects when those projects start their commercial operation.

We are subject to an examination by the tax authorities for up to five years regarding our operations in Brazil, up to ten years for Indonesia, and up to seven years for Canada for income taxes.

Tax loss carry forwards in Brazil and in most of the jurisdictions where we have tax loss carry forwards have no expiration date, though in Brazil, offset is restricted to 30% of annual taxable income.

The Company adopts the provision accounting for Uncertainty in Income Taxes.

The reconciliation of the beginning and ending amounts is as follows: (see note 20(b)) tax related actions)

	Year ended as of December 31,		
	2011	**2010**	**2009**
Beginning of the period	**2,555**	**396**	**657**
Increase resulting from tax positions taken	1,076	2,130	47
Decrease resulting from tax positions taken(a)	(3,409)	(24)	(474)
Cumulative translation adjustments	41	53	166
End of the period	**263**	**2,555**	**396**

(a) In July 2011, we made a payment as a consequence of a Brazilian court decision in a case related to the exemption of the Social Contribution (Contribuição Social sobre o Lucro Líquido).

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Notes to the Consolidated Financial Statements (Continued)

Expressed in millions of United States dollars, unless otherwise stated

6 Income taxes (Continued)

	December 31, 2011	December 31, 2010
Current deferred tax assets		
Accrued expenses deductible only when disbursed	**203**	**386**
Assets		
Related to provision for losses and write-downs of investments		
Employee postretirement benefits provision	640	665
Tax loss carryforwards	916	732
Fair value of financial instruments	610	379
Asset retirement obligation	389	322
Other temporary differences (mainly contingencies provisions)	794	855
	3,349	**2,953**
Liabilities		
Prepaid retirement benefit	(509)	(617)
Fair value adjustments in business combinations	(7,311)	(7,745)
Social contribution		(2,145)
Other temporary differences	(463)	(421)
	(8,283)	**(10,928)**
Valuation allowance		
Beginning balance	(110)	(106)
Change in allowance	(16)	(4)
Ending balance	**(126)**	**(110)**
Net long-term deferred tax liabilities	**(5,060)**	**(8,085)**
Asset	594	
Liabilities	(5,654)	(8,085)
Total	**(5,060)**	**(8,085)**

7 Cash and cash equivalents

	As of December 31,	
	2011	**2010**
Cash	945	560
Cash equivalents	2,586	7,024
	3,531	**7,584**

All the above mentioned short-term investments are made through the use of low risk fixed income securities, in a way that those denominated in Brazilian Reais are concentrated in investments indexed to the CDI, and those denominated in US dollars are mainly time deposits, with the original due date less than three months.

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Notes to the Consolidated Financial Statements (Continued)

Expressed in millions of United States dollars, unless otherwise stated

8 Short-term investments

	As of December 31,	
	2011	**2010**
Time deposit		1,793

Represent low risk investments with original due date over three months.

9 Accounts receivable

Accounts receivable from customers in the steel industry represent 70.36% of receivables at December 31, 2011.

No single customer accounted for more than 10% of total revenues.

Additional allowances for doubtful accounts charged to the statement of income as expenses in 2011, 2010 and 2009 totaled US$2, US$23 and US$48, respectively. We wrote-off US$1 in 2011, US$37 in 2010 and US$8 in 2009.

	As of December 31,	
	2011	**2010**
Customers		
Denominated in Brazilian Reais	1,228	1,227
Denominated in other currencies, mainly US dollars	7,382	7,102
	8,610	**8,329**
Allowance for doubtful accounts	(105)	(118)
Total	**8,505**	**8,211**

10 Inventories

	As of December 31,	
	2011	**2010**
Products		
Nickel (co-products and by-products)	1,771	1,310
Iron ore and pellets	1,137	825
Manganese and ferroalloys	240	203
Fertilizer	387	171
Copper concentrate	72	28
Coal	277	74
Others	91	143
Spare parts and maintenance supplies	1,276	1,544
	5,251	**4,298**

On December 31, 2011, the inventory includes provision for adjustment to market value for the products nickel and manganese in the amount of US$ 14 and US$ 9, respectively, there were no adjustments at December 31, 2010.

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Notes to the Consolidated Financial Statements (Continued)

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11 Recoverable taxes

	As of December 31,	
	2011	**2010**
Income tax	814	459
Value-added tax	997	484
Others brazilian federal contributions	1,006	1,021
Total	**2,817**	**1,964**
Current	2,230	1,603
Non-current	587	361
	2,817	**1,964**

12 Property, plant and equipment and intangible assets

By type of assets:

	As of December 31, 2011			As of December 31, 2010		
	Cost	**Accumulated Depreciation**	**Net**	**Cost**	**Accumulated Depreciation**	**Net**
Land	695		695	356		356
Buildings	7,912	(1,890)	6,022	6,087	(1,110)	4,977
Installations	14,886	(3,708)	11,178	14,904	(4,231)	10,673
Equipment	12,549	(4,243)	8,306	10,948	(3,637)	7,311
Railroads	6,575	(1,930)	4,645	7,337	(2,357)	4,980
Mine development costs	26,955	(5,180)	21,775	28,010	(4,071)	23,939
Others	14,556	(4,126)	10,430	12,088	(2,987)	9,101
	84,128	**(21,077)**	**63,051**	**79,730**	**(18,393)**	**61,337**
Intangible assets	1,201	(67)	1,134	1,316	(42)	1,274
Construction in progress	25,845		25,845	21,759		21,759
Total	**111,174**	**(21,144)**	**90,030**	**102,805**	**(18,435)**	**84,370**

Losses on disposal of property, plant and equipment totaled US$ 223, US$623 and US$ 293 in December 31, 2011, 2010 and 2009 respectively. This mainly related to write-offs of ships and trucks, locomotives and other equipment, which were replaced in the normal course of business.

Assets given in guarantee of judicial processes totaled US$ 97 as at December 31, 2011 (US$ 149 as at December 31, 2010).

Hydroelectric assets

We participate in several jointly-owned hydroelectric plants, already in operation or under construction, in which we record our undivided interest in these assets as Property, plant and equipment.

At December 31, 2011 the cost of hydroelectric plants in service totals US$2,261 (December 31, 2010 US$1,432) and the related depreciation in the year was US$428 (December 31, 2010 US$422). The cost

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Notes to the Consolidated Financial Statements (Continued)

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12 Property, plant and equipment and intangible assets (Continued)

of hydroelectric plant under construction totaled at December 31, 2011 totals US$59 (December 31, 2010 US$804). Income and operating expenses for such plants are not material.

Intangibles

All of the intangible assets recognized in our financial statements were acquired from third parties, either directly or through a business combination and have definite useful lives from 6 to 30 years.

At December 31, 2011 the intangibles amount to US$ 1,135 (December 31, 2010 US$1,274), and are comprised of rights granted by the government Ferrovia Norte Sul of US$ 896 and off take-agreements of US$ 239.

13 Impairment of goodwill and long-lived assets

As described in note 3(h), we test goodwill and long-lived assets for impairment when events or changes in circumstances indicate that they might be impaired. For impairment test purposes, goodwill is allocated to reporting units and are tested at least annually.

No impairment charges were recognized in 2011 and 2010, as a result of the annual goodwill impairment tests performed.

Management determined cash flows based on approved financial budgets. Gross margin projections were based on past performance and management's expectations of market developments. Information about sales prices are consistent with the forecasts included in industry reports, considering quoted prices when available and when appropriate. The discount rates used, reflect specific risks relating to the relevant assets in each reporting unit, depending on their composition and location.

Recognition of additional goodwill impairment charges in the future would depend on several estimates including market conditions, recent actual results and management's forecasts. This information shall be obtained at the time when our assessment is to be updated. It is not possible at this time to determine if any such future impairment charge would result or, if it does, whether such charge would be material.

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Notes to the Consolidated Financial Statements (Continued)
Expressed in millions of United States dollars, unless otherwise stated

14 Investments in affiliated companies and joint ventures

	December 31, 2011				Investments		Equity in earnings (losses) of investee adjustments			Dividends Received		
	Participation in capital (%)		Net equity	Net income (loss) of the period	2011	2010	2011	2010	2009	2011	2010	2009
	Voting	Total										
Bulk Material												
Iron ore and pellets												
Companhia Nipo-Brasileira de Pelotização NIBRASCO(1)	51.11	51.00	341	89	173	171	45	48	(12)	22	3	20
Companhia Hispano-Brasileira de Pelotização HISPANOBRÁS(1)	51.00	50.89	225	36	115	128	19	40	(12)	20		
Companhia Coreano-Brasileira de Pelotização KOBRASCO(1)	50.00	50.00	155	65	78	87	32	43	(17)	32	11	
Companhia Ítalo-Brasileira de Pelotização ITABRASCO(1)	51.00	50.90	158	93	80	86	47	18	12	38	25	
Minas da Serra Geral SA MSG	50.00	50.00	57	7	29	36	3	6	2			
SAMARCO Mineração SA SAMARCO(2)	50.00	50.00	941	1,754	528	561	878	798	299	812	950	190
Baovale Mineração SA BAOVALE	50.00	50.00	69	16	35	31	8	4	(3)			
Zhuhai YPM Pellet e Co,Ltd ZHUHAI	25.00	25.00	90	1	23	25		9	3			
Tecnored Desenvolvimento Tecnológico SA	43.04	43.04	107	(13)	48	40	(7)	(10)				
					1,109	**1,165**	**1,025**	**956**	**272**	**924**	**989**	**210**
Coal												
Henan Longyu Resources Co Ltd	25.00	25.00	1,128	336	282	250	85	76	74		83	
Shandong Yankuang International Company Ltd	25.00	25.00	(170)	(58)	(43)	(27)	(15)	(19)	(18)			
					239	**223**	**70**	**57**	**56**		**83**	
Base Metals												
Bauxite												
Mineração Rio do Norte SA MRN	40.00	40.00	357	19	144	152	8	(2)	(10)		10	42
					144	**152**	**8**	**(2)**	**(10)**		**10**	**42**
Copper												
Teal Minerals Incorporated	50.00	50.00	469	(12)	234	90	(6)	(10)	(18)			
					234	**90**	**(6)**	**(10)**	**(18)**			
Nickel												
Heron Resources Inc(3)					6	7						
Korea Nickel Corp	25.00	25.00	16		4	11		2				
Others(3)					1	5						
					11	**23**		**2**				

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14 Investments in affiliated companies and joint ventures (Continued)

	December 31, 2011				Investments		Equity in earnings (losses) of investee adjustments			Dividends Received		
	Participation in capital (%)		Net equity	Net income (loss) of the period	2011	2010	2011	2010	2009	2011	2010	2009
	Voting	Total										
Aluminium												
Norsk Hydro ASA(4)	22.00	22.00	14,668	449	3,227		99			52		
					3,227		**99**			**52**		
Logistic												
LOG-IN Logística Intermodal SA	31.33	31.33	338	(20)	114	135	(7)	4	2			3
MRS Logística SA	45.68	45.84	1,200	316	551	511	132	90	141	55	72	124
					665	**646**	**125**	**94**	**143**	**55**	**72**	**127**
Others												
Steel												
California Steel Industries Inc CSI	50.00	50.00	322	27	161	155	14	12	(10)	7	7	
CSP Companhia Siderurgica do PECEM	50.00	50.00	539	(7)	267	18	(3)					
THYSSENKRUPP CSA Companhia Siderúrgica do Atlântico	26.87	26.87	5,982	(658)	1,607	1,840	(177)	(85)	(6)			
Usinas Siderúrgicas de Minas Gerais SA USIMINAS									8			7
					2,035	**2,013**	**(166)**	**(73)**	**(8)**	**7**	**7**	**7**
Other affiliates and joint ventures												
Norte Energia S.A.	9.00	9.00	837		75							
Vale Soluções em Energia S.A.(1)	52.77	52.77	276	(32)	145	115	(16)	(33)				
Others					209	70	(4)	(4)	(2)			
					429	**185**	**(20)**	**(37)**	**(2)**			
Total					**8,093**	**4,497**	**1,135**	**987**	**433**	**1,038**	**1,161**	**386**

(1) Although Vale held a majority of the voting interest of investees accounted for under the equity method, existing veto rights held by noncontrolling shareholders.

(2) Investment includes goodwill of US$ 58 in December, 2011 and US$64 in December, 2010.

(3) Available for sale.

(4) The investment is adjusted based on our acquisition and the net income refers to the period from March onwards.

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15 Short-term debt

Short-term borrowings outstanding on December 31, 2011 are from commercial banks for import financing denominated in US dollars with average annual interest rates of 1.81%.

16 Long-term debt

	Current liabilities		Non-current liabilities	
	2011	**2010**	**2011**	**2010**
Foreign debt				
Loans and financing denominated in the following currencies:				
US dollars	496	2,384	2,693	2,530
Others	9	18	52	217
Fixed Rate Notes				
US dollars	410		10,073	10,242
EUR			970	1,003
Perpetual notes				78
Accrued charges	221	233		
	1,136	**2,635**	**13,788**	**14,070**
Brazilian debt				
Brazilian Reais indexed to Long-Term Interest Rate TJLP/CDI and General Price Index-Market (IGP-M)	246	76	5,245	3,891
Basket of currencies	1	1		125
Non-convertible debentures			2,505	2,767
US dollars denominated		1		738
Accrued charges	112	110		
	359	**188**	**7,750**	**7,521**
Total	**1,495**	**2,823**	**21,538**	**21,591**

The long-term portion at December 31, 2011 was as follows:

2013	3,184
2014	1,231
2015	952
2016	1,607
2017 and after	14,200
No due date	364
	21,538

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Notes to the Consolidated Financial Statements (Continued)

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16 Long-term debt (Continued)

At December 31, 2011 annual interest rates on long-term debt were as follows:

Up to 3%	4,738
3.1% to 5%(*)	2,301
5.1% to 7%	8,802
7.1% to 9%(**)	2,793
9.1% to 11%(**)	2,365
Over 11%(**)	2,033
Variable	1
	23,033

(*) Includes Eurobonds. For this operation we have entered into derivative transactions at a cost of 4.71% per year in US dollars.

(**) Includes non-convertible debentures and other Brazilian Real denominated debt that bear interest at the Brazilian Interbank Certificate of Deposit (CDI) and Brazilian Government Long-term Interest Rates (TJLP) plus a spread. For these operations, we have entered into derivative transactions to mitigate our exposure to the floating rate debt denominated in Brazilian Real, totaling US$ 6,005 of which US$ 5,041 has an original interest rate above 7% per year. The average cost after taking into account the derivative transactions is 2.98% per year in US dollars.

The average cost of all derivative transactions is 3.22% per year in US dollars.

Vale has non-convertible debentures in Brazilian Real denominated as follows:

Non Convertible Debentures	Quantity as of December 31, 2011 Issued	Outstanding	Maturity	Interest	Balance December 31, 2011	December 31, 2010
2nd Series	400,000	400,000	November 20, 2013	100% CDI + 0.25%	2,167	2,429
Tranche "B"	5	5	No date	6.5% p.a + IGP-DI	364	367
					2,531	**2,796**
Long-term portion					2,505	2,767
Accrued charges					26	29
					2,531	**2,796**

The indexation indices/rates applied to our debt were as follows (unaudited):

Year ended as of December 31,

	2011	2010
TJLP Long-Term Interest Rate (effective rate)		6.0
IGP-M General Price Index-Market	4.1	10.9
Appreciation (devaluation) of Real against US dollar	25.3	4.7

On January 4, 2012, (subsequent event) we issued US$1 billion notes due 2022 sold at a price of 98.804% of the principal amount and will bear a coupon of 4.375% per year, payable semi-annually though our wholly-owned subsidiary Vale Overseas Limited.

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Notes to the Consolidated Financial Statements (Continued)

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16 Long-term debt (Continued)

Credit Lines

Vale has available revolving credit lines that can be disbursed and paid at any time, during its availability period. On December 31, 2011, the total amount available under the revolving credit lines was US$4.1 billion, of which US$3 billion can be drawn by Vale S.A., Vale Canada Limited and Vale International, US$350 can be drawn by Vale International and the balance by Vale Canada Limited. As of December 31, 2011, none of the borrowers had drawn any amounts under these facilities, but letters of credit totaling US$107 had been issued and remained outstanding pursuant Vale Canada Limited's facility.

In August 2011, we entered into an agreement with a syndicate of financial institutions to finance the acquisition of five large ore carriers and two capesize bulkers at two Korean shipyards. The agreement provides a credit line of up to US$530. As of December 31, 2011, Vale had drawn US$178 under the facility.

In October 2010, we signed an agreement with Export Development Canada (EDC) to finance its investment program. Under the agreement, EDC will provide a credit line of up to US$1 billion. As of December 31, 2011, Vale disbursed US$ 500. In September 2010, Vale entered into agreements with The Export-Import Bank of China and the Bank of China Limited for the financing to build 12 very large ore carriers comprising a facility for an amount of up to US$1,229. The financing has a 13-year total term to be repaid, and the funds will be disbursed during 3 years according to the construction schedule. As of December 31, 2011, we had drawn US$467 under this facility.

In June 2010, Vale established certain facilities with Banco Nacional de Desenvolvimento Econômico Social BNDES for a total amount of R$774, (US$430), to finance the acquisition of domestic equipments. On March 31, 2011, Vale increased this facility through a new agreement with BNDES for R$ 103 (US$ 62). As of December 31, 2011, we had drawn the equivalent of US$329 under these facilities.

In May 2008, the Company has signed agreements with Japanese long term financing credit agencies in the amount of US$ 5 billion, being US$ 3 billion with Japan Bank for International Cooperation (JIBC) and US$ 2 billion with Nippon Export and Investment Insurance (NEXI), to finance mining projects, logistics and energy generation. Until December 31, 2011, Vale through its subsidiary PT International Nickel Indonesia Tbk (PTI) withdrew US$300, under the credit facility from NEXI to finance the construction of the hydroelectric plant of Karebbe, Indonesia.

In April 2008, Vale has signed a credit line in the amount of R$ 7.3 billion (US$ 4 billion) with Banco Nacional de Desenvolvimento Econômico e Social BNDES to finance its investment program. Until December 31, 2011, Vale withdrew R$ 2,795 (US$1,496) in this line.

Guarantee

On December 31, 2011, US$ 648 of the total aggregate outstanding debt was secured by fixed assets.

Covenants

Our principal covenants require us to maintain certain ratios, such as debt to EBITDA and interest coverage. We have not identified any events of noncompliance as of December 31, 2011.

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Notes to the Consolidated Financial Statements (Continued)

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17 Stockholders' equity

Each holder of common and preferred class A stock is entitled to one vote for each share on all matters brought before stockholders' meetings, except for the election of the Board of Directors, which is restricted to the holders of common stock. The Brazilian Government holds twelve preferred special shares which confer permanent veto rights over certain matters.

Both common and preferred stockholders are entitled to receive a mandatory minimum dividend of 25% of annual adjusted net income under Brazilian GAAP, once declared at the annual stockholders' meeting. In the case of preferred stockholders, this dividend cannot be less than 6% of the preferred capital as stated in the statutory accounting records or, if greater, 3% of the Brazilian GAAP equity value per share.

During 2011, Vale paid the minimum annual remuneration attributed to stockholder in 2010, as of interest on capital and dividends, and Vale paid the additional remuneration in amount of US$ 1,000. Additionally, we anticipate US$ 4,141 relating to dividends of annual remuneration attributed to stockholder in 2011.

In November 2011, as part of the share buy-back program approved in June 2011, we concluded the acquisition of 39,536,080 common shares, at an average price of US$ 26.25 per share, and 81,451,900 preferred shares, at an average price of US$ 24.09 per share (including shares of each class in the form of American Depositary Receipts), for a total aggregate purchase price of US$ 3.0 billion. The repurchased shares represent 3.10% of the free float of common shares, and 4.24% of the free float of preferred shares, outstanding before the launch of the program. The shares acquired will be held in treasury for cancellation.

In September, 2010, the Board of Directors approved a share buy-back program. The shares are to be held in treasury for subsequent sale or cancellation, amounting up to US$2 billion and involving up to 64,810,513 common shares and up to 98,367,748 preferred shares. As of December 31, 2010 we had acquired 21,682,700 common shares and 48,197,700 preferred shares.

In June 2010, the notes series Rio and Rio P were converted into ADS and represent an aggregate of 49,305,205 common shares and 26,130,033 preferred class A shares respectively. The conversion was made using 75,435,238 treasury stocks held by the Company. The difference between the conversion amount and the book value of the treasury stocks of US$ 1,379 was accounted for in additional paid-in capital in the stockholder's equity.

The outstanding issued mandatory convertible notes as of December 31, 2011, are as follows:

	Date		Value		
Headings	**Emission**	**Expiration**	**Gross**	**Net of charges**	**Coupon**
Tranches Vale and Vale P-2012	July/2009	June/2012	942	934	6.75% p.a.

The notes pay a quarterly coupon and are entitled to an additional remuneration equivalent to the cash distribution paid to ADS holders. These notes were classified as a capital instrument, mainly due to the fact that neither the Company nor the holders have the option to settle the operation, whether fully or partially, with cash, and the conversion is mandatory. Consequently, they were recognized as a specific component of shareholders' equity, net of financial charges.

Notes to the Consolidated Financial Statements (Continued)

Expressed in millions of United States dollars, unless otherwise stated

17 Stockholders' equity (Continued)

The funds linked to future mandatory conversion, net of charges are equivalent to the maximum of common shares and preferred shares, are as follows. All the shares are currently held in treasury.

	Maximum amount of action		**Value**	
Headings	**Common**	**Preferred**	**Common**	**Preferred**
Tranches Vale and Vale P-2012	18,415,859	47,284,800	293	649

In November 2011, Vale paid additional remuneration to holders of mandatorily convertible notes, series VALE-2012 and VALE P-2012, in the amount of US$ 1.657454 and US$ 1.917027 per note, respectively.

In September 2011, Vale paid additional remuneration to holders of mandatorily convertible notes, series VALE-2012 and VALE P-2012, in the amount of US$ 1.806046 and US$ 2.088890 per note, respectively.

In April 2011, Vale paid additional remuneration to holders of mandatorily convertible notes, series VALE-2012 and VALE P-2012, in the amount of US$ 0.985344 and US$ 1.139659 per note, respectively.

In January 2011, Vale paid additional remuneration to holders of mandatorily convertible notes, series VALE-2012 and VALE P-2012, US$ 0.462708 and US$ 0.535173 per note, respectively.

Brazilian law permits the payment of cash dividends only from retained earnings as stated in the BR GAAP statutory records and such payments are made in Brazilian reais. Pursuant to the Company's statutory books, undistributed retained earnings at December 31, 2011, total US$36,145, comprising of the unrealized income and expansion reserves, which could be freely transferred to retained earnings and paid as dividends, if approved by the stockholders, after deducting of the minimum annual mandatory dividend, which is 25% of net income of the parent Company.

No withholding tax is payable on distribution of profits earned, except for distributions in the form of interest attributed to stockholders' equity (Note 3 (q)).

Brazilian laws and our By-laws require that certain appropriations be made from retained earnings to reserve accounts on an annual basis, all determined in accordance with amounts stated in the statutory accounting records.

The purpose and basis of appropriation to such reserves is described below:

Unrealized income reserve this represents principally our share of the earnings of affiliates and joint ventures, not yet received in the form of cash dividends.

Expansion reserve this is a general reserve for expansion of our activities.

Legal reserve this reserve is a requirement for all Brazilian corporations and represents the appropriation of 5% of annual net income up to a limit of 20% of capital stock all determined under Brazilian GAAP.

Fiscal incentive investment reserve this reserve results from an option to designate a portion of income tax otherwise payable, for investment in government approved projects and is recorded in the year following that in which the taxable income was earned. As from 2000, this reserve basically contemplates income tax incentives (Note 6).

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17 Stockholders' equity (Continued)

Earnings per share

Earnings per share amounts have been calculated as follows:

	Year ended as of December 31,		
	2011	**2010**	**2009**
Net income from continuing operations	**22,885**	**17,407**	**5,349**
Discontinued operations, net of tax		(143)	
Net income for the period	**22,885**	**17,264**	**5,349**
Remuneration attributed to preferred convertible notes	(97)	(72)	(58)
Remuneration attributed to common convertible notes	(70)	(61)	(93)
Net income for the period adjusted	**22,718**	**17,131**	**5,198**
Earnings per share			
Income available to preferred stockholders	8,591	6,566	1,967
Income available to common stockholders	13,842	10,353	3,082
Income available to convertible notes linked to preferred	205	153	75
Income available to convertible notes linked to common	80	59	73
	22,718	**17,131**	**5,197**
Weighted average number of shares outstanding (thousands of shares) preferred shares	1,984,030	2,035,783	2,030,700
Weighted average number of shares outstanding (thousands of shares) common shares	3,197,063	3,210,023	3,181,706
Total	**5,181,093**	**5,245,806**	**5,212,406**
Weighted average number of convertibles outstanding (thousands of shares) linked to preferred shares	47,285	47,285	77,580
Weighted average number of convertibles outstanding (thousands of shares) linked to common shares	18,416	18,416	74,998
Total	**65,701**	**65,701**	**152,578**
Total			
Earnings per preferred share	4.33	3.23	0.97
Earnings per common share	4.33	3.23	0.97
Earnings per convertible note linked to preferred	6.39	4.76	1.71
Earnings per convertible note linked to common share	8.15	6.52	2.21
Continuous operation			
Earnings per preferred share	4.33	3.25	0.97
Earnings per common share	4.33	3.25	0.97
Earnings per convertible note linked to preferred	6.39	4.77	1.71
Earnings per convertible note linked to common share	8.15	6.56	2.21
Discontinuous operation			
Earnings per preferred share		(0.02)	
Earnings per common share		(0.02)	

Earnings per convertible note linked to preferred	(0.01)
Earnings per convertible note linked to common share	(0.04)

The Company does not include a calculation for diluted earnings per share because the effect is anti-dilutive.

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18 Pension plans

The Company is the sponsor of pension plans mixed with characteristics of benefit and defined contribution (such as benefit plan Vale Mais), which includes retirement income and the risk benefits (death pension, retirement for disability and sickness benefit). These plans are calculated based on length of service, age, salary base and supplement to Social Security benefits. These plans are administered by Fundação Vale do Rio Doce de Seguridade Social VALIA.

The Company also sponsors a pension plan with defined benefit characteristics. This plan was funded by monthly contributions made by the sponsor and employees, calculated on the basis of periodic actuarial estimates. With the creation of the plan Vale Mais in May 2000, more than 98% of active employees opted to transfer. The defined benefit is still there, covering almost exclusively retired participants and their beneficiaries. This plan is also administered by VALIA.

Additionally, a specific group of former employees are entitled to additional payments to the normal benefits of VALIA through Complementation Bonus plus a post-retirement benefit that covers medical, dental and pharmaceutical assistance to that specific group.

Vale Fertilizantes and its wholly owned subsidiaries pay to employees who are eligible to the FGTS' fine according to union agreement and provide certain health benefits for retired employees who are eligible.

The Company also has defined benefit plans and other post-employment benefits administered by other foundations and social security entities which, together, benefiting all employees.

The following information details the status of the defined benefit elements of all plans in accordance with employers disclosure about pensions and other post retirement benefits, as well as costs related to them.

We use a measurement date December 31 for our pension and post retirement benefit plans.

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18 Pension plans (Continued)

a) Change in benefit obligation

	As of December 31, 2011			As of December 31, 2010		
	Overfunded pension plans	Underfunded pension plans	Underfunded other benefits	Overfunded pension plans	Underfunded pension plans	Underfunded other benefits
Benefit obligation at beginning of year	**3,623**	**5,667**	**1,601**	**3,661**	**3,923**	**1,431**
Benefit initial recognized consolidation				385	12	58
Transfers	1,132	(1,132)		(936)	936	
Service cost	18	79	32	2	59	26
Interest cost	517	272	102	329	360	102
Plan amendment		2	(23)	(28)	10	(2)
Assumptions changes	141	39	10	87	65	6
Benefits paid/ Actual distribution	(345)	(363)	(82)	(237)	(364)	(78)
Plan settlements		(26)	(8)			
Effect of exchange rate changes	(539)	(138)	(67)	126	241	71
Actuarial loss	64	162	129	234	425	(13)
Benefit obligation at end of year	**4,611**	**4,562**	**1,694**	**3,623**	**5,667**	**1,601**

b) Change in plan assets

	As of December 31, 2011			As of December 31, 2010		
	Overfunded pension plans	Underfunded pension plans	Underfunded other benefits	Overfunded pension plans	Underfunded pension plans	Underfunded other benefits
Fair value of plan assets at beginning of year	5,585	4,645	13	4,996	3,229	11
Fair value initial recognized consolidation				451	10	
Transfers	1,105	(1,105)		(866)	866	
Actual return on plan assets	573	125		1,094	541	1
Employer contributions	65	512	82	2	169	80
Benefits paid/ Actual distribution	(345)	(363)	(82)	(265)	(364)	(80)
Plan settlements		(26)	(11)			
Effect of exchange rate changes	(706)	(126)	(1)	173	194	1
Fair value of plan assets at end of year	**6,277**	**3,662**	**1**	**5,585**	**4,645**	**13**

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18 Pension plans (Continued)

A special contribution was made to the Vale Canada Limited defined underfunded benefit plans of US$342 during the period. The contribution was made to bring the adequate ratios which provide Vale Canada with more certain funding requirements for 2011-2013.

Plan assets managed by Valia on December 31, 2011, December 31, 2010 and January 1, 2010 include investments in portfolio of our own stock of US$340, US$519 and US$587, investments in debentures worth US$63, US$64 and US$69 and equity investments from related parties amounting to US$84, US$81 and US$164, respectively. They also include on December 31, 2011, 31 December 2010 and January 1, 2010, US$3,552, US$4,150 and US$3,261 of securities of the Federal Government. The assets of the pension plans of Vale Canada Limited in securities of the Government of Canada on December 31, 2011, 2010 and January 1, 2010, amounted to US$653, US$436 and US$391, respectively. The assets of Vale Fertilizantes and Ultrafértil on December 31, 2011 and December 31, 2010 in securities of the Federal Government were worth US$149 and US$158, respectively.

c) Funded Status and Financial Position

	As of December 31, 2011			As of December 31, 2010		
	Overfunded pension plans	Underfunded pension plans	Underfunded other benefits	Overfunded pension plans	Underfunded pension plans	Underfunded other benefits
Noncurrent assets	1,666			1,962		
Current liabilities		(69)	(78)		(35)	(133)
Non-current liabilities		(831)	(1,615)		(987)	(1,455)
Funded status	**1,666**	**(900)**	**(1,693)**	**1,962**	**(1,022)**	**(1,588)**

d) Assumptions used (nominal terms)

All calculations involve future actuarial projections for some parameters, such as salaries, interest, inflation, the behavior of INSS benefits, mortality, disability, etc. No actuarial results can be analyzed without prior knowledge of the scenario of assumptions used in the assessment.

The economic actuarial assumptions adopted were formulated considering the long life of the plan and should therefore be examined in that light. So, in the short term, they may not necessarily be realized.

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Notes to the Consolidated Financial Statements (Continued)

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18 Pension plans (Continued)

For the evaluations the following economic assumptions were adopted:

	Brazil					
	December 31, 2011			December 31, 2010		
	Overfunded pension plans	Underfunded pension plans	Underfunded other benefits	Overfunded pension plans	Underfunded pension plans	Underfunded other benefits
Discount rate	10.78% p.a.	11.30% p.a.	11.30% p.a.	11.30% p.a.	11.30% p.a.	11.30% p.a.
Expected return on plan assets	14.25% p.a.	13.79% p.a.	N/A	12.00% p.a.	11.50% p.a.	N/A
Rate of compensation increase up to 47 years	8.15% p.a.	8.15% p.a.	N/A	8.15% p.a.	8.15% p.a.	N/A
Rate of compensation increase over 47 years	5.00% p.a.	5.00% p.a.	N/A	5.00% p.a.	5.00% p.a.	N/A
Inflation	5.00% p.a.	5.00% p.a.	5.00% p.a.	5.00% p.a.	5.00% p.a.	5.00% p.a.
Health care cost trend rate	N/A	N/A	8.15% p.a.	N/A	N/A	8.15% p.a.

	Foreign					
	December 31, 2011			December 31, 2010		
	Overfunded pension plans	Underfunded pension plans	Underfunded other benefits	Overfunded pension plans	Underfunded pension plans	Underfunded other benefits
Discount rate	N/A	5.43% p.a.	5.10% p.a.	N/A	6.21% p.a.	5.44% p.a.
Expected return on plan assets	N/A	6.51% p.a.	6.50% p.a.	N/A	7.02% p.a.	6.50% p.a.
Rate of compensation increase up to 47 years	N/A	4.10% p.a.	3.00% p.a.	N/A	4.11% p.a.	3.58% p.a.
Rate of compensation increase over 47 years	N/A	4.10% p.a.	3.00% p.a.	N/A	4.11% p.a.	3.58% p.a.
Inflation	N/A	2.00% p.a.	2.00% p.a.	N/A	2.00% p.a.	2.00% p.a.
Initial Health care cost trend rate	N/A	N/A	7.22% p.a.	N/A	N/A	7.35% p.a.
Ultimate Health care cost trend rate	N/A	N/A	4.49% p.a.	N/A	N/A	4.49% p.a.

e) Pension costs

	Year ended as of December 31, 2011		
	Overfunded pension plans	Underfunded pension plans	Underfunded other benefits
Service cost benefits earned during the period	18	79	32
Interest cost on projected benefit obligation	517	272	102
Expected return on assets	(785)	(258)	
Amortizations and (gain) / loss		24	(35)
Net periodic pension cost (credit)	**(250)**	**117**	**99**

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Notes to the Consolidated Financial Statements (Continued)

Expressed in millions of United States dollars, unless otherwise stated

18 Pension plans (Continued)

	Year ended as of December 31, 2010		
	Overfunded pension plans	**Underfunded pension plans**	**Underfunded other benefits**
Service cost benefits earned during the period	2	59	27
Interest cost on projected benefit obligation	329	361	97
Expected return on assets	(531)	(321)	
Amortizations and (gain) / loss		18	(14)
Net deferral	(1)		
Net periodic pension cost (credit)	**(201)**	**117**	**110**

	Year ended as of December 31, 2009		
	Overfunded pension plans	**Underfunded pension plans**	**Underfunded other benefits**
Service cost benefits earned during the period	11	43	17
Interest cost on projected benefit obligation	313	255	88
Expected return on assets	(431)	(202)	(1)
Amortizations and (gain)/loss	14	3	(19)
Net deferral		14	(14)
Net periodic pension cost (credit)	**(93)**	**113**	**71**

f) Accumulated benefit obligation

	December 31, 2011			December 31, 2010		
	Overfunded pension plans	**Underfunded pension plans**	**Underfunded other benefits**	**Overfunded pension plans**	**Underfunded pension plans**	**Underfunded other benefits**
Accumulated benefit obligation	4,610	4,404	1,694	3,612	5,540	1,601
Projected benefit obligation	4,611	4,562	1,694	3,623	5,667	1,601
Fair value of plan assets	(6,277)	(3,662)	(1)	(5,585)	4,645	(13)

g) Impact of 1% variation in assumed health care cost trend rate

	1% increase		1% decrease	
	2011	**2010**	**2011**	**2010**
Accumulated postretirement benefit obligation (APBO)	258	213	(206)	(172)
Interest and service costs	22	12	(18)	(17)

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Notes to the Consolidated Financial Statements (Continued)

Expressed in millions of United States dollars, unless otherwise stated

18 Pension plans (Continued)

h) Other Cumulative Comprehensive Income (Deficit)

	As of December 31, 2011			As of December 31, 2010		
	Overfunded pension plans	Underfunded pension plans	Underfunded other benefits	Overfunded pension plans	Underfunded pension plans	Underfunded other benefits
Net prior service (cost)/credit		(15)			(15)	
Net actuarial (loss)/gain	(181)	(885)	292	243	(628)	335
Effect of exchange rate changes	(24)	3		(1)		(1)
Deferred income tax	70	249	(76)	(82)	201	(111)
Amounts recognized in other cumulative comprehensive income (deficit)	**(135)**	**(648)**	**216**	**160**	**(442)**	**223**

i) Change in Other Cumulative Comprehensive Income (Deficit)

	As of December 31, 2011			As of December 31, 2010		
	Overfunded pension plans	Underfunded pension plans	Underfunded other benefits	Overfunded pension plans	Underfunded pension plans	Underfunded other benefits
Net prior service (cost)/credit not yet recognized in NPPC at beginning of period		(14)				
Net actuarial (loss)/gain not yet recognized in NPPC at beginning of period	242	(629)	334	(18)	(337)	297
Transfers				8	(8)	
Deferred income tax at beginning of period	(82)	201	(111)	3	111	(94)
Effect of initial recognition of cumulative comprehensive income (deficit)	**160**	**(442)**	**223**	**(7)**	**(234)**	**203**
Reclassifications						
Amortization of net transition (obligation)/asset		(5)				
Amortization of net prior service (cost)/credited		5				
Amortization of net actuarial (loss)/gain		19	2		(1)	9
Total net actuarial (loss)/gain arising during period	(423)	(290)	(48)	261	(277)	11
Transfers				(8)	8	
Effect of exchange rate changes	(24)	17	4	(1)	(28)	17
Deferred income tax	152	48	35	(85)	90	(17)
Total recognized in other cumulative comprehensive income (deficit)	**(135)**	**(648)**	**216**	**160**	**(442)**	**223**

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Notes to the Consolidated Financial Statements (Continued)

Expressed in millions of United States dollars, unless otherwise stated

18 Pension plans (Continued)

j) Plan assets

Brazilian Plans

The Investment Policy Statements of pension plans sponsored for Brazilian employees are based on a long term macroeconomic scenario and expected returns. An Investment Policy Statement was established for each obligation by following results of a strategic asset allocation study.

Plan asset allocations comply with pension funds local regulation issued by CMN Conselho Monetário Nacional (Resolução CMN 3792/09). We are allowed to invest in six different asset classes, defined as Segments by the law, as follows: Fixed Income, Equity, Structured Investments (Alternative Investments and Infra-Structure Projects), International Investments, Real Estate and Loans to Participants.

The Investment Policy Statements are approved by the Board, the Executive Directors and two Investments Committees. The internal and external portfolio managers are allowed to exercise investment discretion under the limitations imposed by the Board and the Investment Committees.

The pension fund has a risk management process with established policies that intend to identify measure and control all kind of risks faced by our plans, such as: market, liquidity, credit, operational, systemic and legal.

Foreign plans

The strategy for each of the pension plans sponsored by Vale Canada is based upon a combination of local practices and the specific characteristics of the pension plans in each country, including the structure of the liabilities, the risk versus reward trade-off between different asset classes and the liquidity required to meet benefit payments.

Overfunded pension plans

Brazilian Plans

The Defined Benefit Plan (the "Old Plan") has the most part of its assets allocated in fixed income, mainly in Brazilian government bonds (such as TIPS) and corporate long term inflation linked corporate bonds with the objective of reducing the asset-liability volatility. The target is 55% of the total assets. This LDI (Liability Driven Investments) strategy, when considered together with the Loans to Participants segment, aims to hedge the plan's liabilities against inflation risk and volatility. The target allocation for each investment segment or asset class is as follows:

	December 31, 2011	December 31, 2010
Fixed income	57%	52%
Equity	24%	28%
Structured investments	6%	6%
International investments	1%	2%
Real estate	8%	7%
Loans to participants	4%	5%

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Notes to the Consolidated Financial Statements (Continued)

Expressed in millions of United States dollars, unless otherwise stated

18 Pension plans (Continued)

The Investment Policy has the objective of achieving the adequate diversification, current income and long term capital growth through the combination of all asset classes described above to fulfill its obligations with the adequate level of risk. This plan has an average nominal return of 20% p.a. in dollars terms in the last 11 years.

The Vale Mais Plan (the "New Plan") has obligations with both characteristics of defined benefit and variable contribution, as mentioned. The most part of its investments is in fixed income. It also implemented a LDI (Liability Driven Investments) strategy to reduce asset-liability volatility of the defined benefits plan's component by using inflation linked bonds (like TIPS). The target allocation for this strategy is 55% of total assets of this sub-plan. The target allocation for each investment segment or asset class is as follows:

	December 31, 2011	December 31, 2010
Fixed income	56%	59%
Equity	24%	24%
Structured investments	3.5%	2%
International investments	0.5%	1%
Real estate	6%	4%
Loans to participants	10%	10%

The Defined Contribution Vale Mais component offers three options of asset classes mix that can be chosen by participants. The options are: Fixed Income 100%; 80% Fixed Income and 20% Equities and 65% Fixed Income and 35% Equities. Loan to participants is included in the fixed income options. Equities management is done through investment fund that targets Ibovespa index.

The Investment Policy has the objective of achieving the adequate diversification, current income and long term capital growth through the combination of all asset classes described above to fulfill its obligations with the adequate level of risk. This plan has an average nominal return of 16% p.a. in dollars terms in the last 11 years.

Fair value measurements by category Overfunded Plans

	As of December 31, 2011				As of December 31, 2010			
	Total	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3
Asset by category								
Cash and cash equivalents	2	2			6	6		
Accounts Receivable	15	15			81	81		
Equity securities liquid	1,508	1,425	83		1,396	1,321	75	
Debt securities Corporate bonds	560		560		420		420	
Debt securities Government bonds	2,134	2,134			2,114	2,114		
Investment funds Fixed Income	2,292	2,292			1,610	1,610		
Investment funds Equity	539	539			513	513		
International investments	13	13			23	23		
Structured investments Private Equity funds	194			194	128			128
Structured investments Real estate funds	21			21	19			19
Real estate	482			482	288			288
Loans to Participants	345			345	182			182
Total	**8,105**	**6,420**	**643**	**1,042**	**6,780**	**5,668**	**495**	**617**

Funds not related to risk plans	(1,828)	(1,195)
Fair value of plan assets at end of year	**6,277**	**5,585**

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Notes to the Consolidated Financial Statements (Continued)

Expressed in millions of United States dollars, unless otherwise stated

18 Pension plans (Continued)

Fair value measurements using significant unobservable inputs Level 3 (Overfunded)

	As of December 31, 2011					As of December 31, 2010				
	Private Equity Funds	Real State Funds	Real State	Loans to Participants	Total	Private Equity Funds	Real State Funds	Real State	Loans to Participants	Total
Beginning of the year	**128**	**19**	**288**	**182**	**617**	**97**		**249**	**282**	**628**
Actual return on plan assets	(8)		79	49	120	(3)	1	49	25	72
Initial recognized consolidation of Fosfertil								22	5	27
Assets sold during the period	(1)		(22)	(117)	(140)	(3)	(1)	(24)	(75)	(103)
Assets purchases, sales and settlements	37		135	116	288	43		25	62	130
Cumulative translation adjustment	(16)	(2)	(35)	(36)	(89)	4	1	9	7	21
Transfers in and/or out of Level 3	54	4	37	151	246	(10)	18	(42)	(124)	(158)
End of the year	**194**	**21**	**482**	**345**	**1,042**	**128**	**19**	**288**	**182**	**617**

The target return for private equity assets in 2012 is 11.94% p.a. for the Old Plan and 11.51% p.a.for the New Plan. The target allocation is 6% for the Old Plan and 5.3% for the New Plan, ranging between 2% and 10% for the Old Plan and ranging between 1% and 10% for the New Plan. These investments have a longer investment horizon and low liquidity that aim to profit from economic growth, especially in the infrastructure sector of the Brazilian economy. The fair value of usually non-liquid assets is close to acquisition cost or book value. Some private equity funds, alternatively, apply the following methodologies: discounted cash flows analysis or analysis based on multiples.

The target return for loans to participants in 2012 is 16% p.a. The fair value pricing of these assets includes provisions for non-paid loans, according to the local pension fund regulation.

The target return for real estate assets in 2012 is 12.80% p.a. Fair value for these assets is close to book value. The pension fund hires companies specialized in real estate valuation that do not act in the market as brokers. All valuation techniques follow the local regulation.

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Notes to the Consolidated Financial Statements (Continued)

Expressed in millions of United States dollars, unless otherwise stated

18 Pension plans (Continued)

Underfunded pension plans

Brazilian Obligation

The obligation has an exclusive allocation in fixed income. A LDI (Liability Driven Investments) was also used strategy for this plan. Most of the resources were invested in long term Brazilian government bonds (similar to TIPS) and inflation linked corporate bonds with the objective of minimizing asset-liability volatility and reduce inflation risk.

The Investment Policy Statement has the objective of achieving the adequate diversification, current income and long term capital growth to fulfill its obligations with the adequate level of risk. This obligation has an average nominal return of 16% p.a. in local currency in the last 6 years.

Foreign plans

All pension plans except PT Inco, have resulted in a target asset allocation of 60% in equity investments and 40% in fixed income investments, with all securities being traded in the public markets. Fixed income investments are in domestic bonds for each plan's market and involve a mixture of government and corporate bonds. Equity investments are primarily global in nature and involve a mixture of large, mid and small capitalization companies with a modest explicit investment in domestic equities for each plan. The Canadian plans also use a currency hedging strategy (each developed currency's exposure is 50% hedged) due to the large exposure to foreign securities. For PT Inco, the target allocation is 20% equity investment and the remainder in fixed income, with the vast majority of these investments being made within the domestic market.

Fair value measurements by category Underfunded Pension Plans

	As of December 31, 2011				As of December 31, 2010			
	Total	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3
Asset by category								
Cash and cash equivalents	41	17	24		52	22	30	
Accounts Receivable	11	11			20	20		
Equity securities	1,232	1,231	1		1,628	1,623	5	
Debt securities	259		259		175		175	
Debt securities Government bonds	660	33	627		786	370	416	
Investment funds Fixed Income	1,007	439	568		1,799	1,079	720	
Investment funds Equity	450	74	376		437	91	346	
International investments	2		2		6	3	3	
Investment funds Private Equity					216	216		
Structured investments Private Equity funds					15			15
Structured investments Real estate funds					1			1
Real estate					37			37
Loans to Participants					151			151
Total	**3,662**	**1,805**	**1,857**		**5,323**	**3,424**	**1,695**	**204**

Funds not related to risk plans		(678)
Fair value of plan assets at end of year	**3,662**	**4,645**

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Notes to the Consolidated Financial Statements (Continued)

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18 Pension plans (Continued)

Fair value measurements using significant unobservable inputs Level 3 (Underfunded)

	As of December 31, 2011					As of December 31, 2010				
	Private Equity Funds	Real State Funds	Real State	Loans to Participants	Total	Private Equity Funds	Real State Funds	Real State	Loans to Participants	Total
Beginning of the year	15	1	37	151	204					
Actual return on plan assets						(2)		4	20	22
Assets sold during the period						7		(2)	(57)	(52)
Assets purchases, sales and settlements								10	58	68
Cumulative translation adjustment								1	6	7
Transfers in and/or out of Level 3	(15)	(1)	(37)	(151)	(204)	10	1	24	124	159
End of the year						**15**	**1**	**37**	**151**	**204**

Underfunded other benefits

Fair value measurements by category Other Benefits

	As of December 31, 2011		As of December 31, 2010	
	Total	Level 1	Total	Level 1
Asset by category				
Cash	1	1	13	13
Total	**1**	**1**	**13**	**13**

k) Cash flow contributions

Employer contributions expected for 2012 are US$262.

l) Estimated future benefit payments

The benefit payments, which reflect future service, are expected to be made as follows:

	As of December 31, 2011		
	Overfunded pension plans	Underfunded pension plans	Underfunded other benefits
2012	282	403	89
2013	279	393	93
2014	279	387	96

2015	272	387	99
2016	269	383	101
2017 and thereafter	1,269	1,917	494

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Notes to the Consolidated Financial Statements (Continued)

Expressed in millions of United States dollars, unless otherwise stated

18 Pension plans (Continued)

m) Summary of participant data

	As of December 31, 2011			As of December 31, 2010		
	Overfunded pension plans	Underfunded pension plans	Underfunded other benefits	Overfunded pension plans	Underfunded pension plans	Underfunded other benefits
Active participants						
Number	202	67,951	74,729	245	59,923	67,990
Average age years	50.0	36	35.9	49.8	36	36.4
Average service years	27.2	7	7.7	27.1	8	8.5
Terminated vested participants						
Number		5,815			4,876	
Average age years		39			40	
Retirees and beneficiaries						
Number	18,380	18,189	32,633	18,496	18,078	32,765
Average age years	66.3	71	63.7	65.6	71	62.5

19 Long-term incentive compensation plan

Under the terms of the long-term incentive compensation plan, the participants, restricted to certain executives, may elect to allocate part of their annual bonus to the plan. The allocation is applied to purchase preferred shares of Vale, through a predefined financial institution, at market conditions and with no benefit provided by Vale.

The shares purchased by each executive are unrestricted and may, at the participant's discretion, be sold at any time. However, the shares must be held for a three-year period and the executive must be continually employed by Vale during that period. The participant then becomes entitled to receive from Vale a cash payment equivalent to the total amount of shares held, based on the market rates. The total shares linked to the plan at December 31, 2011 and December 31, 2010, are 3,012,538 and 2,458,627, respectively.

Additionally, as a long-term incentive certain eligible executives have the opportunity to receive at the end of the triennial cycle, a certain number of shares at market rates, based on an evaluation of their career and performance factors measured as an indicator of total return to stockholders.

We account for the compensation cost provided to our executives under this long-term incentive compensation plan, following the requirements for Accounting for Stock-Based Compensation. Liabilities are measured at each reporting date at fair value, based on market rates. Compensation costs incurred are recognized, over the defined three-year vesting period. At December 31, 2011, December 31, 2010 and December 31, 2009, we recognized a liability of US$109, US$120 and US$72, respectively, through the Statement of Income.

20 Commitments and contingencies

a) In connection with the Girardin Act tax advantaged lease financing arrangement sponsored by the French government, we provided guarantees to BNP Paribas for the benefit of the tax investors regarding certain payments due from VNC, associated with the Girardin Act lease financing. We also committed that

Notes to the Consolidated Financial Statements (Continued)

Expressed in millions of United States dollars, unless otherwise stated

20 Commitments and contingencies (Continued)

assets associated with the Girardin Act lease financing would be substantially complete by December 31, 2011. In light of the delay in the start-up of the VNC processing facilities, we have proposed an extension to the previously agreed substantial completion date of December 31, 2011 to December 31, 2012. The French Government and tax investors have been briefed on this request and a formal request for extension has been submitted to them. We believe the likelihood of the guarantee being called upon to be remote.

Sumic Nickel Netherlands B.V. ("Sumic"), a 21% stockholder of VNC, has a put option to sell to us 25%, 50%, or 100% of the shares they own of VNC if the defined cost of the initial nickel cobalt development project, as measured by funding provided to VNC, in natural currencies and converted to U.S. dollars at specified rates of exchange, in the form of Girardin Act lease financing, shareholder loans and equity contributions by shareholders to VNC, exceeded US$4.6 billion and an agreement cannot be reached on how to proceed with the project. On May 27, 2010 the threshold was reached. The put option discussion and decision period was stayed to January 1, 2012. We are currently in discussions with Sumic on their continued participation in VNC, and expect to reach a resolution during the second or third quarter of 2012 following a prescribed process which occurs over a five month period.

In addition, in the course of our operations we have provided letters of credit and guarantees in the amount of US$465 million that are associated with items such as environment reclamation, asset retirement obligation commitments, insurance, electricity commitments, community service commitments and import and export duties.

b) We and our subsidiaries are defendants in numerous legal actions in the normal course of business. Based on the advice of our legal counsel, management believes that the amounts recognized are sufficient to cover probable losses in connection with such actions.

The provision for contingencies and the related judicial deposits is as follows:

	As of December 31,			
	2011		2010	
	Provision for contingencies	Judicial deposits	Provision for contingencies	Judicial deposits
Labor and social security claims	751	895	748	874
Civil claims	248	151	510	410
Tax related actions	654	413	746	442
Others	33	5	39	5
	1,686	**1,464**	**2,043**	**1,731**

Labor and social security related actions principally comprise of claims by Brazilian current and former employees for (i) payment of time spent travelling from their residences to the work-place, (ii) additional health and safety related payments and (iii) various other matters, often in connection with disputes about the amount of indemnities paid upon dismissal and the one-third extra holiday pay.

Civil actions principally relate to claims made against us by contractors in Brazil in connection with losses alleged to have been incurred by them as a result of various past Government economic plans, during

Notes to the Consolidated Financial Statements (Continued)

Expressed in millions of United States dollars, unless otherwise stated

20 Commitments and contingencies (Continued)

which full inflation indexation of contracts was not permitted, as well as for accidents and land appropriation disputes.

Tax related actions principally comprise of challenges initiated by us, on certain taxes on revenues and uncertain tax positions. We continue to vigorously pursue our interests in all these actions but recognize that we probably will incur some losses in the final instance, for which we have made provisions.

Judicial deposits are made by us following court requirements in order to be entitled to either initiate or continue a legal action. These amounts are released to us upon receipt of a final favorable outcome from the legal action, and in the case of an unfavorable outcome, the deposits are transferred to the prevailing party.

Contingencies settled during the year ended December 31, 2011, December 31, 2010 and December 31, 2009, totaled US$658, US$352 and US$236, respectively. Provisions recognized in the year ended December 31, 2011, December 31, 2010 and December 31, 2009, totaled US$526, US$112 and US$294, respectively, classified as other operating expenses.

In addition to the contingencies for which we have made provisions, we are defendants in claims where in our opinion, and based on the advice of our legal counsel, the likelihood of loss is reasonably possible but not probable, in the total amount of US$ 22,449 at December 31, 2011, and for which no provision has been made (December 31, 2010 US$4,787). The increase in the values of reasonably possible tax contingencies refers mainly to tax assessments against us for regarding the payment of Income Tax and Social Contribution calculated based on the equity method in foreign subsidiaries.

c) At the time of our privatization in 1997, the Company issued debentures to its then-existing stockholders, including the Brazilian Government. The terms of these debentures were set to ensure that the pre-privatization stockholders, including the Brazilian Government, would participate in possible future financial benefits that could be obtained from exploiting certain mineral resources.

A total of 388,559,056 Debentures were issued at a par value of R$ 0.01 (one cent), whose value will be restated in accordance with the variation in the General Market Price Index (IGP-M), as set forth in the Issue Deed. In December 31, 2011 the total amount of these debentures was US$ 1,336 (US$ 1,284 in December 31, 2010).

The debenture holders have the right to receive premiums, paid semiannually, equivalent to a percentage of net revenues from specific mine resources as set forth in the indenture.

During 2011 we paid remuneration on these debentures of US$ 14.

d) Description of Leasing Arrangements

Part of our railroad operations include leased facilities. The 30-year lease is renewable for a further 30 years and expires in August, 2026 and is classified as an operating lease. At the end of the lease term, we are required to return the concession and the leased assets. In most cases, management expects that in the normal course of business, leases will be renewed.

Notes to the Consolidated Financial Statements (Continued)

Expressed in millions of United States dollars, unless otherwise stated

20 Commitments and contingencies (Continued)

The following is a schedule by year of future minimum rental payments required under the railroad operating leases that have initial or remaining non-cancelable lease terms in excess of one year as of December 31, 2011.

2012	87
2013	87
2014	87
2015	87
2016 thereafter	955
Total minimum payments required	1,303

The total expenses of operating leases for the years ended December 31, 2011, 2010 and 2009 were US$87, US$90 and US$80, respectively.

During 2008, we entered into operating lease agreements with our joint ventures Nibrasco, Itabrasco and Kobrasco, under which we leased four pellet plants. The lease terms are from 5 to 30 years.

The following is a schedule by year of future minimum rental payments required under the pellet plants operating leases that have initial or remaining non-cancelable lease terms in excess of one year as of December 31, 2011:

2012	66
2013	58
2014	23
2015	23
2016 thereafter	64
Total minimum payments required	234

The total expenses of operating leases for the years ended December 31, 2011, 2010 and 2009 were US$66, US$107 and US$114, respectively.

e) Asset retirement obligations

We use various judgments and assumptions when measuring our asset retirement obligations.

Changes in circumstances, law or technology may affect our cash flow estimates and we periodically review the amounts accrued and adjust them as necessary. Our accruals do not reflect unasserted claims because we are currently not aware of any such issues. Also the amounts provided are not reduced by any potential recoveries under cost sharing, insurance or indemnification arrangements because such recoveries are considered uncertain.

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Notes to the Consolidated Financial Statements (Continued)

Expressed in millions of United States dollars, unless otherwise stated

20 Commitments and contingencies (Continued)

The changes in the provisions for asset retirement obligations are as follows:

	Year ended as of December 31,		
	2011	**2010**	**2009**
Beginning of period	**1,368**	**1,116**	**887**
Accretion expense	125	113	75
Liabilities settled in the current period	(57)	(45)	(46)
Revisions in estimated cash flows	420	125	(23)
Cumulative translation adjustment	(86)	59	223
End of period	**1,770**	**1,368**	**1,116**
Current liabilities	73	75	89
Non-current liabilities	1,697	1,293	1,027
Total	**1,770**	**1,368**	**1,116**

21 Other expenses

The income statement line "Other operating expenses" totaled US$2,810 for the year ended December 31, 2011, (US$2,205 in 2010 and US$1,522 in 2009). It includes pre operational expenses of US$439 (US$360 in 2010 and US$0 in 2009), loss of materials of US$49 (US$108 in 2010 and US$9 in 2009) and idle capacity and stoppage operations expenses of US$854 (US$757 in 2010 and US$880 in 2009).

22 Fair value disclosure of financial assets and liabilities

The Financial Accounting Standards Board, through Accounting Standards Codification and Accounting Standards Updates, defines fair value and sets out a framework for measuring fair value, which refers to valuation concepts and practices and requires certain disclosures about fair value measurements.

a) Measurements

The pronouncements define fair value as the exchange price that would be received for an asset, or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability, in an orderly transaction between market participants on the measurement date. In determining fair value, the Company uses various methods including market, income and cost approaches. Based on these approaches, the Company often utilizes certain assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and or the inherent risks in the inputs to the valuation technique.

These inputs can be readily observable, market corroborated, or generally unobservable inputs. The Company utilizes techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. Under this standard, those inputs used to measure the fair value are required to be classified on three levels. Based on the characteristics of the inputs used in valuation techniques the Company is required to provide the following information according to the fair value hierarchy. The fair value hierarchy ranks the quality and reliability of the information used to determine fair values. Financial assets and liabilities carried at fair value are classified and disclosed as follows:

Level 1 Unadjusted quoted prices on an active, liquid and visible market for identical assets or liabilities that are accessible at the measurement date;

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Notes to the Consolidated Financial Statements (Continued)

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22 Fair value disclosure of financial assets and liabilities (Continued)

Level 2 Quoted prices for identical or similar assets or liabilities on active markets, inputs other than quoted prices that are observable, either directly or indirectly, for the term of the asset or liability;

Level 3 Assets and liabilities, for which quoted prices do not exist, or those prices or valuation techniques are supported by little or no market activity, unobservable or illiquid. At this point, fair market valuation becomes highly subjective.

b) Measurements on a recurring basis

The description of the valuation methodologies used for recurring assets and liabilities measured at fair value in the Company's Consolidated Balance Sheet at December 31, 2011 and December 31, 2010 are summarized below:

Available-for-sale securities

They are securities that are not classified either as held-for-trading or as held-to-maturity for strategic reasons and have readily available market prices. We evaluate the carrying value of some of our investments in relation to publicly quoted market prices when available. When there is no market value, we use inputs other than quoted prices.

Derivatives

The market approach is used to estimate the fair value of the swaps discounting their cash flows using the interest rate of the currency they are denominated it is also used for the commodities contracts, since the fair value is computed by using forward curves for each commodity.

Debentures

The fair value is measured by the market approach method, and the reference price is available on the secondary market.

The tables below presents the balances of assets and liabilities measured at fair value on a recurring basis as follows:

	December 31, 2011			
	Carrying amount	**Fair value**	**Level 1**	**Level 2**
Available-for-sale securities	7	7	7	
Unrealized losses on derivatives	(81)	(81)		(81)
Debentures	(1,336)	(1,336)		(1,336)

	December 31, 2010			
	Carrying amount	**Fair value**	**Level 1**	**Level 2**
Available-for-sale securities	12	12	12	
Unrealized losses on derivatives	257	257	1	256

Debentures	(1,284)	(1,284)	(1,284)

Notes to the Consolidated Financial Statements (Continued)

Expressed in millions of United States dollars, unless otherwise stated

22 Fair value disclosure of financial assets and liabilities (Continued)

c) Measurements on a non-recurring basis

The Company also has assets under certain conditions that are subject to measurement at fair value on a non-recurring basis. These assets include goodwill and assets acquired and liabilities assumed in business combinations. During the year ended December 31, 2011, we have not recognized any impairment for those items.

d) Financial Instruments

Long-term debt

The valuation method used to estimate the fair value of our debt is the market approach for the contracts that are quoted on the secondary market, such as bonds and debentures. The fair value of both fixed and floating rate debt is determined by discounting future cash flows of Libor and Vale's bonds curves (income approach).

Time deposits

The method used is the income approach, through the prices available on the active market. The fair value is close to the carrying amount due to the short-term maturities of the instruments.

Our long-term debt is reported at amortized cost, and the income of time deposits is accrued monthly according to the contract rate. The estimated fair value measurement is disclosed as follows:

	December 31, 2011			
	Carrying amount	Fair value	Level 1	Level 2
Long-term debt (less interests)(*)	(22,700)	(24,312)	(18,181)	(6,131)
Perpetual Notes(**)	(80)	(80)		(80)

	December 31, 2010			
	Carrying amount	Fair value	Level 1	Level 2
Time deposits	1,793	1,793		1,793
Long-term debt (less interests)(*)	(24,071)	(25,264)	(19,730)	(5,534)

(*) Less accrued charges of US$333 and US$343 as of December 31, 2011 and December 31, 2010, respectively.

(**) Classified on "LT Loans and related parties".

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Notes to the Consolidated Financial Statements (Continued)
Expressed in millions of United States dollars, unless otherwise stated

23 Segment and geographical information

The information presented to the Executive Board with the respective performance of each segment are usually derived from the accounting records maintained in accordance with the best accounting practices, with some reallocation between segments.

Consolidated net income and principal assets are reconciled as follows:

Results by segment

	Year ended as of															
	December 31, 2011						December 31, 2010						December 31, 200			
	Bulk Material	Base Metals	Fertilizers	Logistic	Others	Consolidated	Bulk Material	Base Metals	Fertilizers	Logistic	Others	Consolidated	Bulk Material	Base Metals	Fertilizers	Logisti
	44,948	9,627	3,547	1,726	541	60,389	34,478	8,200	1,845	1,465	493	46,481	15,205	6,679	413	1,104
	(14,466)	(6,350)	(2,753)	(1,467)	(958)	(25,994)	(11,589)	(5,916)	(1,669)	(1,120)	(354)	(20,648)	(7,127)	(5,580)	(158)	(812)
nt	(649)	(413)	(104)	(121)	(387)	(1,674)	(289)	(277)	(72)	(75)	(165)	(878)	(235)	(207)	(46)	(57)
		1,513				1,513										
nd	(1,847)	(1,572)	(458)	(229)	(16)	(4,122)	(1,536)	(1,359)	(200)	(146)	(19)	(3,260)	(1,205)	(1,322)	(29)	(126)
	27,986	**2,805**	**232**	**(91)**	**(820)**	**30,112**	**21,064**	**648**	**(96)**	**124**	**(45)**	**21,695**	**6,638**	**(430)**	**180**	**109**
	(2,966)	(1)	(55)	(207)	(84)	(3,313)	(332)	(80)	32	(43)	(958)	(1,381)	625	369		24
net of								(143)				(143)				
													87	(108)		
osses	1,095	101		125	(186)	1,135	1,013	(10)		94	(110)	987	328	(28)		143
	(4,202)	(954)	(114)	(12)		(5,282)	(3,980)	240	(12)	20	27	(3,705)	(2,613)	525		(11)
	105	88	(31)		71	233	5	(209)	19		(4)	(189)	17	(121)		
e to lders	**22,018**	**2,039**	**32**	**(185)**	**(1,019)**	**22,885**	**17,770**	**446**	**(57)**	**195**	**(1,090)**	**17,264**	**5,082**	**207**	**180**	**265**
aphic																
States	1,168	1,380	44		21	2,613	792	1,170	32	12	4	2,010	296	942		3
	98	1,571	1		2	1,672	73	740			15	828	15	744		
	8,766	2,456	153		62	11,437	6,797	2,067	4		44	8,912	2,184	1,755		
nia	1,743	150	1		1	1,895	1,562	217	11			1,790	413	118		
	5,987	1,243			8	7,238	3,859	1,371			10	5,240	1,473	913		
	18,237	1,235			99	19,571	14,432	923			24	15,379	8,171	821		
d	3,619	1,394	35		1	5,049	2,710	1,445	8		9	4,172	1,074	1,107		
	5,330	198	3,313	1,726	347	10,914	4,253	267	1,790	1,453	387	8,150	1,579	279	413	1,101
	44,948	**9,627**	**3,547**	**1,726**	**541**	**60,389**	**34,478**	**8,200**	**1,845**	**1,465**	**493**	**46,481**	**15,205**	**6,679**	**413**	**1,104**

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Notes to the Consolidated Financial Statements (Continued)

Expressed in millions of United States dollars, unless otherwise stated

23 Segment and geographical information (Continued)

Results by segment

	Year ended as of December 31, 2011									
	Revenue	Value added tax	Net revenues	Cost and expenses	Operating profit	Depreciation, depletion and amortization	Operating income	Property, plant and equipment	Additions to property, plant and equipment	Investments
Bulk Material										
Iron ore	35,008	(494)	34,514	(9,066)	25,448	(1,418)	24,030	32,944	7,409	112
Pellets	8,150	(266)	7,884	(3,261)	4,623	(196)	4,427	2,074	624	997
Manganese	171	(8)	163	(187)	(24)	(15)	(39)	81	137	
Ferroalloys	561	(48)	513	(407)	106	(54)	52	252	40	
Coal	1,058		1,058	(1,378)	(320)	(164)	(484)	4,081	1,141	239
	44,948	**(816)**	**44,132**	**(14,299)**	**29,833**	**(1,847)**	**27,986**	**39,432**	**9,351**	**1,348**
Base Metals										
Nickel and other products (*)	8,118		8,118	(5,558)	2,560	(1,487)	1,073	29,097	2,637	11
Copper (**)	1,126	(23)	1,103	(873)	230	(84)	146	4,178	1,226	234
Aluminum products	383	(5)	378	(304)	74	(1)	73		16	3,371
	9,627	**(28)**	**9,599**	**(6,735)**	**2,864**	**(1,572)**	**1,292**	**33,275**	**3,879**	**3,616**
Fertilizers										
Potash	287	(14)	273	(315)	(42)	(45)	(87)	2,137	532	
Phosphates	2,395	(95)	2,300	(1,760)	540	(297)	243	6,430	316	
Nitrogen	782	(103)	679	(557)	122	(116)	6	896	180	
Others fertilizers products	83	(13)	70		70		70	364		
	3,547	**(225)**	**3,322**	**(2,632)**	**690**	**(458)**	**232**	**9,827**	**1,028**	
Logistics										
Railroads	1,265	(222)	1,043	(1,003)	40	(179)	(139)	1,307	213	551
Ports	461	(48)	413	(315)	98	(50)	48	576	347	
Ships								2,485	308	114
	1,726	**(270)**	**1,456**	**(1,318)**	**138**	**(229)**	**(91)**	**4,368**	**868**	**665**
Others	541	(60)	481	(1,285)	(804)	(16)	(820)	1,993	949	2,464
Gain on sale of assets				1,513	1,513		1,513			
	60,389	**(1,399)**	**58,990**	**(24,756)**	**34,234**	**(4,122)**	**30,112**	**88,895**	**16,075**	**8,093**

(*) Includes nickel co-products and by-products (copper, precious metals, cobalt and others).

(**) Includes copper concentrate.

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Notes to the Consolidated Financial Statements (Continued)

Expressed in millions of United States dollars, unless otherwise stated

23 Segment and geographical information (Continued)

Results by segment

	Year ended as of December 31, 2010									
	Revenue	Value added tax	Net revenues	Cost and expenses	Operating profit	Depreciation, depletion and amortization	Operating income	Property, plant and equipment	Additions to property, plant and equipment	Investments
Bulk Material										
Iron ore	26,384	(366)	26,018	(7,364)	18,654	(1,307)	17,347	30,412	4,015	107
Pellets	6,402	(266)	6,136	(2,515)	3,621	(110)	3,511	1,445	353	1,058
Manganese	258	(7)	251	(136)	115	(10)	105	24	2	
Ferroalloys	664	(62)	602	(306)	296	(26)	270	292	26	
Coal	770		770	(856)	(86)	(83)	(169)	3,020	499	223
	34,478	**(701)**	**33,777**	**(11,177)**	**22,600**	**(1,536)**	**21,064**	**35,193**	**4,895**	**1,388**
Base Metals										
Nickel and other products (*)	4,712		4,712	(3,402)	1,310	(1,145)	165	28,623	1,880	23
Copper (**)	934	(29)	905	(621)	284	(87)	197	3,579	1,072	90
Aluminum products	2,554	(32)	2,522	(2,109)	413	(127)	286	395	342	152
	8,200	**(61)**	**8,139**	**(6,132)**	**2,007**	**(1,359)**	**648**	**32,597**	**3,294**	**265**
Fertilizers										
Potash	280	(11)	269	(269)		(29)	(29)	474	355	
Phosphates	1,211	(47)	1,164	(1,070)	94	(121)	(27)	7,560	438	
Nitrogen	337	(43)	294	(285)	9	(50)	(41)	809	47	
Others fertilizers products	17	(5)	12	(11)	1		1	146	3	
	1,845	**(106)**	**1,739**	**(1,635)**	**104**	**(200)**	**(96)**	**8,989**	**843**	
Logistics										
Railroads	1,107	(183)	924	(716)	208	(123)	85	1,278	160	511
Ports	353	(47)	306	(236)	70	(23)	47	297	36	
Ships	5		5	(13)	(8)		(8)	747	747	135
	1,465	**(230)**	**1,235**	**(965)**	**270**	**(146)**	**124**	**2,322**	**943**	**646**
Others	493	(90)	403	(429)	(26)	(19)	(45)	3,995	2,672	2,198
	46,481	**(1,188)**	**45,293**	**(20,338)**	**24,955**	**(3,260)**	**21,695**	**83,096**	**12,647**	**4,497**

(*) Includes nickel co-products and by-products (copper, precious metals, cobalt and others).

(**) Includes copper concentrate.

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Notes to the Consolidated Financial Statements (Continued)

Expressed in millions of United States dollars, unless otherwise stated

23 Segment and geographical information (Continued)

Results by segment

	Year ended as of December 31, 2009									
	Revenue	Value added tax	Net revenues	Cost and expenses	Operating profit	Depreciation, depletion and amortization	Operating income	Property, plant and equipment	Additions to property, plant and equipment	Investments
Bulk Material										
Iron ore	12,831	(172)	12,659	(4,956)	7,703	(1,044)	6,659	21,736	3,361	107
Pellets	1,352	(92)	1,260	(1,165)	95	(76)	19	947	84	1,050
Manganese	145	(2)	143	(103)	40	(9)	31	25	4	
Ferroalloys	372	(45)	327	(278)	49	(15)	34	261	112	
Coal	505		505	(549)	(44)	(61)	(105)	1,723	362	243
	15,205	**(311)**	**14,894**	**(7,051)**	**7,843**	**(1,205)**	**6,638**	**24,692**	**3,923**	**1,400**
Base Metals										
Nickel and other products (*)	3,947		3,947	(3,292)	655	(1,016)	(361)	23,967	1,464	30
Copper (**)	682	(19)	663	(470)	193	(71)	122	4,127	558	80
Aluminum products	2,050	(37)	2,013	(1,969)	44	(235)	(191)	4,663	143	143
	6,679	**(56)**	**6,623**	**(5,731)**	**892**	**(1,322)**	**(430)**	**32,757**	**2,165**	**253**
Fertilizers										
Potash	413	(17)	396	(187)	209	(29)	180	159		
	413	**(17)**	**396**	**(187)**	**209**	**(29)**	**180**	**159**		
Logistics										
Railroads	838	(137)	701	(524)	177	(97)	80	1,045	96	468
Ports	264	(38)	226	(161)	65	(29)	36	1,441	106	
Ships	2		2	(9)	(7)		(7)	1,104	738	125
	1,104	**(175)**	**929**	**(694)**	**235**	**(126)**	**109**	**3,590**	**940**	**593**
Others	538	(69)	469	(869)	(400)	(40)	(440)	6,439	1,068	2,339
	23,939	**(628)**	**23,311**	**(14,532)**	**8,779**	**(2,722)**	**6,057**	**67,637**	**8,096**	**4,585**

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Notes to the Consolidated Financial Statements (Continued)

Expressed in millions of United States dollars, unless otherwise stated

24 Related party transactions

Balances from transactions with major related parties are as follows:

	December 31, 2011		December 31, 2010	
	Assets	Liabilities	Assets	Liabilities
Affiliated Companies and Joint Ventures				
Companhia Hispano-Brasileira de Pelotização HISPANOBRÁS	177	162	264	300
Companhia Ítalo-Brasileira de Pelotização ITABRASCO				10
Companhia Nipo-Brasileira de Pelotização NIBRASCO	1	13		23
Companhia Coreano-Brasileira de Pelotização KOBRASCO		5		4
Baovale Mineração SA	8	20	3	30
Minas da Serra Geral SA MSG		9		9
MRS Logística SA	50	20	1	15
Mineração Rio Norte SA				25
Norsk Hydro ASA	489	80	2	
Samarco Mineração SA	47		61	
Mitsui & CO, LTD		37		61
Others	107	49	229	84
	879	**395**	**560**	**561**
Current	370	304	531	559
Long-term	509	91	29	2
Total	**879**	**395**	**560**	**561**

These balances are included in the following balance sheet classifications:

	December 31, 2011		December 31, 2010	
	Assets	Liabilities	Assets	Liabilities
Current assets				
Accounts receivable	288		435	
Loans and advances to related parties	82		96	
Non-current assets				
Loans and advances to related parties	509		29	
Current liabilities				
Suppliers		280		538
Loans from related parties		24		21
Non-current liabilities				
Long-term debt		91		2
	879	**395**	**560**	**561**

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Notes to the Consolidated Financial Statements (Continued)

Expressed in millions of United States dollars, unless otherwise stated

24 Related party transactions (Continued)

Income and expenses from the principal transactions and financial operations carried out with major related parties are as follows:

	December 31, 2011		December 31, 2010		December 31, 2009	
	Income	Expense	Income	Expense	Income	Expense
Affiliated Companies and Joint Ventures						
Companhia Nipo-Brasileira de Pelotização NIBRASCO		151		149	29	47
Samarco Mineração SA	511		448		97	
Companhia Ítalo-Brasileira de Pelotização ITABRASCO		150		50		18
Companhia Hispano-Brasileira de Pelotização HISPANOBRÁS	729	521	462	513	85	75
Companhia Coreano-Brasileira de Pelotização KOBRASCO		98		117		29
Usinas Siderúrgicas de Minas Gerais SA USIMINAS(*)					46	
Mineração Rio Norte SA				156		210
MRS Logística SA	16	759	16	561	12	484
Others	103	53	17	18	19	29
	1,359	**1,732**	**943**	**1,564**	**288**	**892**

(*) Sold in April 2009.

These amounts are included in the following statement of income line items:

	December 31, 2011		December 31, 2010		December 31, 2009	
	Income	Expense	Income	Expense	Income	Expense
Sales/Cost of iron ore and pellets	1,337	952	910	785	233	193
Revenues/expense from logistic services	16	759	23	603	26	457
Sales/Cost of aluminum products		18		156		210
Financial income/expenses	6	3	10	20	29	32
	1,359	**1,732**	**943**	**1,564**	**288**	**892**

Additionally we have loans payable to Banco Nacional de Desenvolvimento Social and BNDES Participações S.A in the amounts of US$ 2,954 and US$ 902 respectively, accruing interest at market rates, which fall due through 2029. These operations generated interest expenses of US$ 138 and US$ 57. We also maintain cash equivalent balances with Banco Bradesco S.A. in the amount of US$ 16 in December 31, 2011. The effect of these operations in results was US$ 73.

25 Derivative financial instruments

Risk management policy

Vale considers that the effective management of risk is a key objective to support its growth strategy, strategic planning and financial flexibility. Therefore Vale has developed its risk management strategy in order to provide an integrated approach of the risks the Company is exposed to. To do that, Vale evaluates not only the impact of market risk factors in the business results (market risk), but also the risk arising from third party obligations with Vale (credit risk), those inherent to inadequate or failed internal processes, people, systems or external events (operational risk), those arising from liquidity risk, among others.

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Notes to the Consolidated Financial Statements (Continued)

Expressed in millions of United States dollars, unless otherwise stated

25 Derivative financial instruments (Continued)

The Board of Directors established the corporate risk management policy in order to support the growth strategy, strategic planning and business continuity of the Company, strengthening its capital structure and asset management, ensure flexibility and consistency on the financial management and strengthen corporate governance practices.

The corporate risk management policy determines that Vale measures and monitors its corporate risk on a consolidated approach in order to guarantee that the overall risk level of the Company remains aligned with the guidelines defined by the Board of Directors and the Executive Board.

The Executive Risk Management Committee, created by the Board of Directors, is responsible for supporting the Executive Board in the risk analysis and for issuing opinion regarding the Company's risk management. It is also responsible for the supervision and revision of the principles and instruments of corporate risk management.

The Executive Board is responsible for the approval of the policy deployment into norms, rules and responsibilities and for reporting to the Board of Directors about such procedures.

The risk management norms and instructions complement the corporate risk management policy and define practices, processes, controls, roles and responsibilities in the Company regarding risk management.

The Company may, when necessary, allocate specific risk limits to management activities that need them, including but not limited to, market risk limit and corporate and sovereign credit limit, in accordance with the acceptable corporate risk limit.

Market Risk Management

Vale is exposed to the behavior of various market risk factors that can impact its cash flow. The assessment of this potential impact arising from the volatility of risk factors and their correlations is performed periodically to support the decision making process and the growth strategy of the Company, ensure its financial flexibility and monitor the volatility of future cash flows.

When necessary, market risk mitigation strategies are evaluated and implemented in line with these objectives. Some of these strategies may incorporate financial instruments, including derivatives. The portfolios of the financial instruments are monitored on a monthly basis, enabling surveillance of financial results and then impact on cash flow, and ensuring adherence to the objectives of the strategies proposed.

Considering the nature of Vale's business and operations, the main market risk factors which the Company is exposed to are:

- Interest rates;
- Foreign exchange;
- Product prices and input costs

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Notes to the Consolidated Financial Statements (Continued)

Expressed in millions of United States dollars, unless otherwise stated

25 Derivative financial instruments (Continued)

Foreign exchange rate and interest rate risk

Vale's cash flows are exposed to volatility of several currencies. While most of the product prices are indexed to US dollars, most of the costs, disbursements and investments are indexed to currencies other than the US dollar, namely the Brazilian Real and the Canadian dollar.

Derivative instruments may be used to reduce Vale's potential cash flow volatility arising from its currency mismatch.

For hedges of revenue, costs, expenses and investment cash flows, the main risk mitigation strategies used are currency forward transactions and swaps.

The swap transactions used to convert debt linked to Brazilian Real into US dollar have similar or sometimes shorter settlement dates than the final maturity of the debt instruments. Their notional amounts are similar to the principal and interest payments, subject to liquidity market conditions.

The swaps with shorter settlement dates are renegotiated through time so that their final maturity matches or becomes closer to the debts` final maturity. At each settlement date, the results of the swap transactions partially offset the impact of the foreign exchange rate in Vale's obligations, contributing to stabilize the cash disbursements in US dollar.

In the event of an appreciation (depreciation) of the Brazilian Real against the US dollar, the negative (positive) impact on Brazilian Real denominated debt obligations (interest and/or principal payment) measured in US dollars will be partially offset by a positive (negative) effect from a swap transaction, regardless of the US dollar/Brazilian Real exchange rate in the payment date. The same rationale applies to debt denominated in other currencies and their respective swaps.

Vale is also exposed to interest rate risks on loans and financings. Its floating rate debt consists mainly of loans including export pre-payments, commercial banks and multilateral organizations loans. In general, the US dollar floating rate debt is subject to changes in the LIBOR (London Interbank Offer Rate in US dollar). To mitigate the impact of the interest rate volatility on its cash flows, Vale considers the natural hedges resulting from the correlation of commodities prices and US dollar floating rates. If such natural hedges are not present, Vale may search for the same effect by using financial instruments.

Product price and Input Cost risk

Vale is also exposed to several market risks associated with commodities price volatilities. In line with the risk management policy, risk mitigation strategies involving commodities can also be used to adjust its risk profile and reduce the volatility of cash flow. In these cases, the mitigation strategies used are primarily forward transactions, futures contracts or zero-cost collars.

Embedded derivatives

The cash flow of the Company is also exposed to various market risks associated with contracts that contain embedded derivatives or behave as derivatives. The derivatives may be embedded in, but are not limited to, commercial contracts, purchase agreements, leases, bonds, insurance policies and loans.

Notes to the Consolidated Financial Statements (Continued)

Expressed in millions of United States dollars, unless otherwise stated

25 Derivative financial instruments (Continued)

Vale's wholly-owned subsidiary Vale Canada Ltd has nickel concentrate and raw materials purchase agreements, in which there are provisions based on the movement of nickel and copper prices. These provisions are considered embedded derivatives.

Hedge Accounting

Under the Standard Accounting for Derivative Financial Instruments and Hedging Activities, all derivatives, whether designated in hedging relationships or not, are required to be recorded in the balance sheet at fair value and the gain or loss in fair value is included in the statement of income, unless if qualified as hedge accounting. A derivative must be designated in a hedging relationship in order to qualify for hedge accounting. These requirements include a determination of what portions of hedges are deemed to be effective versus ineffective. In general, a hedging relationship is effective when a change in the fair value of the derivative is offset by an equal and opposite change in the fair value of the underlying hedged item. In accordance with these requirements, effectiveness tests are performed in order to assess effectiveness and quantify ineffectiveness for all designated hedges.

At December 31, 2011, Vale has outstanding positions designated as cash flow hedge. A cash flow hedge is a hedge of the exposure to variability in expected future cash flows that is attributable to a particular risk, such as a forecasted purchase or sale. If a derivative is designated as cash flow hedge, the effective portion of the changes in the fair value of the derivative is recorded in other comprehensive income and recognized in earnings when the hedged item affects earnings. However, the ineffective portion of changes in the fair value of the derivatives designated as hedges is recognized in earnings. If a portion of a derivative contract is excluded for purposes of effectiveness testing, the value of such excluded portion is included in earnings.

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Notes to the Consolidated Financial Statements (Continued)

Expressed in millions of United States dollars, unless otherwise stated

25 Derivative financial instruments (Continued)

The assets and liabilities balances of derivatives measured at fair value and the effects of their recognition are shown in the following tables:

	Assets				Liabilities			
	December 31, 2011		December 31, 2010		December 31, 2011		December 31, 2010	
	Short-term	Long-term	Short-term	Long-term	Short-term	Long-term	Short-term	Long-term
Derivatives not designated as hedge								
Foreign exchange and interest rate risk								
CDI & TJLP vs. USD fixed and floating rate swap	410	60		300	49	590		
EURO floating rate vs. USD floating rate swap			1					
USD floating rate vs. fixed USD rate swap							4	
EuroBond Swap					4	32		8
Pre Dollar Swap	19			1		41		
AUD floating rate vs. fixed USD rate swap			2					
Treasury future					5			
	429	**60**	**3**	**301**	**58**	**663**	**4**	**8**
Commodities price risk								
Nickel								
Fixed price program	1		13		1		12	
Purchase program							15	
Bunker Oil Hedge	4		16					
Coal							2	
Maritime Freight Hiring Protection Program							2	
	5		**29**		**1**		**31**	
Embedded derivatives:								
Derivatives designated as hedge								
Strategic Nickel	161							53
Foreign exchange cash flow hedge			20		14			
	161		**20**		**14**			**53**
Total	**595**	**60**	**52**	**301**	**73**	**663**	**35**	**61**

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Notes to the Consolidated Financial Statements (Continued)

Expressed in millions of United States dollars, unless otherwise stated

25 Derivative financial instruments (Continued)

	Amount of gain or (loss) recognized as financial income (expense) Year ended as of December 31,			Financial settlement (Inflows)/ Outflows Year ended as of December 31,			Amount of gain or (loss) recognized in OCI Year ended as of December 31,		
	2011	**2010**	**2009**	**2011**	**2010**	**2009**	**2011**	**2010**	**2009**
Derivatives not designated as hedge									
Foreign exchange and interest rate risk									
CDI & TJLP vs. USD fixed and floating rate swap	(92)	451	1,598	(337)	(956)	(243)			
EURO floating rate vs. USD floating rate swap		(1)			1	(1)			
USD floating rate vs. fixed USD rate swap		(2)	(2)	4	3	8			
EuroBond Swap	(30)	(5)		1	(1)				
Pre Dollar Swap	(23)	4		(1)	(2)				
Swap USD fixed rate vs. CDI	69			(68)					
South African Rande Forward	(8)			8					
AUD floating rate vs. fixed USD rate swap		3	14	(2)	(9)	(5)			
Treasury Future	(12)			6					
Swap Convertibles		37			(37)				
	(96)	**487**	**1,610**	**(389)**	**(1,001)**	**(241)**			
Commodities price risk									
Nickel									
Fixed price program	39	4	5	(41)	(7)	79			
Strategic program	15	(87)	(95)		105	73			
Copper	1								
Aluminum				7	16				
Bunker Oil Hedge	37	4	50	(48)	(34)	(16)			
Coal		(4)		2	3				
Maritime Freight Hiring Protection Program		(5)	66	2	(24)	(37)			
Natural gas			(4)			6			
	92	**(88)**	**22**	**(78)**	**59**	**105**			
Embedded derivatives:									
For nickel concentrate costumer sales			(25)			(14)			
Customer raw material contracts			(76)						
Energy Aluminum options	(7)	(51)							
	(7)	**(51)**	**(101)**			**(14)**			
Derivatives designated as hedge									

Bunker Oil Hedge			(16)		47	4			
Aluminum			13				4	31	(36)
Strategic Nickel	49	(1)		(48)			211	(52)	
Foreign exchange cash flow hedge	37	284		(50)	(330)		(60)	(5)	38
	86	**283**	**(3)**	**(98)**	**(283)**	**4**	**155**	**(26)**	**2**
Total	**75**	**631**	**1,528**	**(565)**	**(1,225)**	**(146)**	**155**	**(26)**	**2**

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Notes to the Consolidated Financial Statements (Continued)

Expressed in millions of United States dollars, unless otherwise stated

25 Derivative financial instruments (Continued)

Unrealized gains (losses) in the period are included in our income statement under the caption of gains (losses) on derivatives, net.

Final maturity dates for the above instruments are as follows:

Interest rates/Currencies	December 2019
Bunker Oil	December 2011
Nickel	December 2012