Company Name: Vale
Company Ticker: VALE5 BZ
Date: 2015-10-22
Event Description: Q3 2015 Earnings Call

Market Cap: 186,489.12
Current PX: 33.36
YTD Change($): +10.02
YTD Change(%): +42.931

Bloomberg Estimates - EPS
Current Quarter: 0.783
Current Year: 4.075
Bloomberg Estimates - Sales
Current Quarter: 27196.500
Current Year: 107335.950

Q3 2015 Earnings Call

Company Participants

- Murilo Pinto de Oliveira Ferreira
- Gerd Peter Poppinga
- Luciano Siani Pires
- Roger A. Downey

Other Participants

- Wilfredo Ortiz
- Carlos F. De Alba
- Andreas Bokkenheuser
- Amos C. Fletcher
- Jeremy R. Sussman
- Alexander Hacking
- Thiago Lofiego

MANAGEMENT DISCUSSION SECTION

Murilo Pinto de Oliveira Ferreira

Business Highlights

Adjusted EBITDA

- First of all, I'm pleased to report that Vale had a sound operational result, achieving a production record for iron ore
- And in Carajás also we had a record third quarter production
- Adjusted EBITDA was $1.9B, 15% lower than H2 2015 – second quarter, sorry – mainly as a result of lower sales prices in all our commodities except gold and phosphate

Gross Revenue

- Gross revenues amounted $6.6B, 7% lower than Q2 2015, also due to lower commodity prices
- Costs and expenses net of depreciation decreased by almost $300mm in Q3 2015 despite our higher sales volume
- For your reference, costs and expenses decreased by almost $2.7B in the first nine months of 2015 when compared to the same period in 2014 despite the higher sales volume

SG&A and Other Expenses

- Our SG&A and other expenses decreased by over 48% while R&D decreased by 28% and our pre-operating and stoppage expenses decreased by roughly 17% vs. the first nine months of 2014

CapEx

- Our CapEx was close to $1.9B in Q3 2015 while project execution was $1.2B and sustaining CapEx close to $700mm
- For your reference, CapEx was $6.2B in the first nine months of 2015, meaning a reduction of over $2B when compared to the first nine months of 2014

Divestment Plan and Net Debt

- In line with our divestment plan, we concluded the sale of a minority stake in MBR for over $1B and for Valemax to China Merchants for roughly $450mm in the quarter
- Net debt decreased $2.3B to $24.2B with a cash balance of $4.5B.
- Our average debt maturity was over 18 years, with cost of debt of 4.4% per annum

Ferrous Minerals

- Now to talk about Ferrous Minerals
- Above all, I'm proud to inform you that our iron ore cash cost decreased by $3.10 per ton and reached $12.07 per ton this quarter
- Our freight costs, excluding the effect of a hedging account for bunker oil decreased to $16.40 per ton due to lower bunker oil price in our charter contract

China

- Our unit cash cost and expenses for iron ore fines landed in China, adjusted for quality and moisture, went to $39.10 per ton, down to $34.20 per ton in Q3 in a dry metric ton basis
- Due to big reduction in cost and expenses, ferrous minerals EBITDA reached $1.7B, remaining stable when compared to Q2 2015, after adjusting for the effect of lower dividends received from Samarco and from the leased pellet plants during this quarter

EBITDA

- Still on our Ferrous Minerals EBITDA I would like to call your attention to the fact that our results decreased by more than $100mm to the impact of the hedging account for bunker oil
- We will not longer have this negative impact in our EBITDA as of 2016
- Fiscal progress on the S11D mining plant project reached 75% while the fiscal progress at the railway and port achieved 50% with 72% progress on the railway spur
- Base Metal EBITDA was about $200mm in Q3, having decreased due to lower price and the negative impact of adjustment IN the copper price and sales realized in the previous quarter and still outstanding at the end of this quarter
  - This provisional price had a negative impact of $9mm in the quarter

Nickel and Copper Production

- Nickel production amounted over 70,000 tons in Q3 2015, supported by higher production in Sudbury, Indonesia and New Caledonia, despite the planned shutdown in Sudbury and Thompson in Q3
- Copper production was about 100,000 tons in Q3 2015 with hopefully 40% coming from Salobo
- We expect to increase our production of copper and nickel in the last quarter of this year with the completion of our maintenance for the year, the ramping up of Salobo to 100% of its nominal capacity

Logistics Bottleneck

- With coal we continue our work to eliminate the logistics bottleneck in Mozambique
- In this regard we achieved 96% fiscal progress in Moatize II and 94% in Nacala Corridor
- With Fertilizer I'm very pleased to inform you that our adjusted EBITDA continues to improve and reached almost $200mm in Q3 2015, driven by higher sales volumes and lower costs
  - We remain confident in the long-term perspective of our Fertilizer business segment

Costs and Expenses

- In Q3 2015 we continue to reduce our costs and expenses, achieving lower cash cost in iron ore fines, continue our divestment program and reduce our net debt position
- We remain focused on keeping our operating discipline in preserving our balance sheet as we complete our investment cycle in the next few years

QUESTION AND ANSWER SECTION

<Q - Wilfredo Ortiz>: Just wanted to ask you as far as the cash costs for iron ore, given the progress we've been able to achieve thus far, where do you see the cash costs going towards the latter part of the year? And then once you have the ramp of S11D. And specifically, where were the Carajás cash costs as of now? And where do you think S11D's cash costs could be given all the progress you've been able to do and with the FX being right now in your favor? And secondly I wanted to ask you also regarding your freight strategy. Following the sale of some of the Valemax vessels and the current marketplace, how sticky would the freight rates be, given that you've sold some of your vessels and the market is one way and perhaps you have some contracted business and some open, and how are you viewing that? Thank you.

<A - Murilo Pinto de Oliveira Ferreira>: Thank you for your question. Peter and Luciano?

<A - Gerd Peter Poppinga>: Hi. Thank you very much for your question. So if you look at our cash cost this quarter, it's $12.7, and this wasn't only because of exchange rate and volume. There was a real gain in productivity as we had along the whole year already. If you look at our Carajás operation today and also the southeast system, which is becoming very competitive because of the new Itabiritos project already in production. Today both systems, they are already around $10 a ton C1 cash costs. So when you look a little further down the road and you can easily imagine that with the S11D coming, which we know will be distinctly below $10, at an exchange rate of 3.5, plus with the optimization of our south system because there we have still some work to do, you can imagine that at 3.5 exchange rate we will be around $10 a ton C1 cash costs for the whole volume.

<A - Luciano Siani Pires>: Luciano. On freight, we see three main levers for reducing freight costs going forward. The first one is we still didn't accrue all the benefits of the lower bunker prices; there's a lag because of the length of the voyage of the ships, the refueling cycling process. So we still had in the quarter markedly higher bunker prices than what we're having at the end of the quarter. So we should expect that this effect will lower bunker prices and thus lower freight rates going forward.

The second one is we believe our mix of contracts can, even the spot – usage of spot freight will improve going forward. And the lower spot rate also enables us better negotiating conditions going forward towards the renewal of existing contracts. So this should improve the mix overall and also lower freight going forward.

And finally we have logistics optimization, most notably the berthing of Valemaxes directly into China avoiding the stopover in the Philippines, for instance. That reduces also the freight costs going forward. So we have a positive view on the behavior of freight for the next few quarters.

<Q - Carlos F. De Alba>: So the first question is if you could give us some comments on the timing and the amount of the Nacala finance transaction that you expect to close I guess in the coming months. And also if you can highlight any other divestitures and perhaps hopefully expected proceeds that will definitely help you to keep on sustaining your net debt levels or improve them. And then also if you have any detailed guidance or more specific guidance as to when S11D production should start either next year or early in 2017. Thank you.

<A - Luciano Siani Pires>: There hasn't been any change on the perspectives for the project finance, so we're still looking at $2B plus and the closure of it at the end of Q1 next year. In terms of divestitures, we see less of a need for divestitures just for the sake of closing any cash flow gaps, because as you can see we are increasing our competitiveness and lowering CapEx, sustaining investments. So this quarter we had, it was a coincidence, EBITDA exactly equal to investments, and we expect to, going forward, to have a surplus on this simple measure going forward.

But we keep on looking for, let's say, opportunistic transactions over smaller amounts. As we said before, we keep on looking into sale of ships where these have been commanding good prices and it's a good transaction to relieve capital. As you saw also on the press we received a non-binding offer from Hydro for MRN. It's still – it's in early steps so there's a lot to do to see if we are going to have a transaction. But it's an encouraging sign as well. So therefore we keep on looking forward to optimizing our capital structure and simplifying the portfolio, but I would say with less of a pressure from a cash flow perspective.

<A - Murilo Pinto de Oliveira Ferreira>: Okay. And on the startup.

<A - Luciano Siani Pires>: Okay. For the startup of S11D, I think we commented on the earlier Portuguese call that we want to start doing the tests with ore in September next year. And at the same time running the first trains on the rails for – again, in September of next year.

<Q - Andreas Bokkenheuser>: Just a quick question from me on the inventory strategy. I think you mentioned on the morning call that you might be looking to potentially destock some 10% of your current inventories next year. What would be the strategy in terms of timing? Is this something where you're basically waiting to see whether iron ore prices are maintaining strength for you to start destocking or would you rather be looking to potentially destock into seasonally weaker volume quarters like first or second quarter? What's the thinking on the timing there? Thank you.

<A - Gerd Peter Poppinga>: Thanks for the question, Andreas. But to be clear, this is not seasonal and this destocking is just because we now have the means to do it. We have capacity at the MRS railway plus we have the Pico-Fábrica railroad from – linking Pico to Fábrica where we can ship then instead of [indiscernible] [19:38] we can ship to Tubarão. So because of this flexibility we can now reduce stock price. When we say reduce stock price it's really about some good material, old material stocked in the mines of Vargem Grande in the southern system. And progressively we want to reduce that because it's working capital and it will not jeopardize existing production or existing sales.

Our ideal stock level today would be something around, because we have floating inventory in vessels, we have some distribution centers offshore, a in the mines we should go to – in the next two to three years we should reach 30mm tons and today we have 55mm tons. So this is what we want to do. It takes – it is a working capital that we want to reduce and it's a good opportunity because we have now this flexibility but it's not seasonal.

<Q - Amos C. Fletcher>: I just had a couple of questions. The first one to ask with respect to the 13mm tons of capacity that you announced you would be taking offline in the production release. Could you explain, will that come – will that be seen through lower pellet production over time? And then I just wanted to get – the second question around the fact that it appears that you've built another 3mm tons of inventory in terms of iron ore fines in Q3 and obviously you've been saying that you're going to release inventory. What sort of timeframe can we start – expect you to see sales in excess of production in the iron ore business? Thank you.

<A - Murilo Pinto de Oliveira Ferreira>: Please could you repeat the second question?

<Q - Amos C. Fletcher>: Yeah. So the second question was just around the fact that in the quarter it looked like you built around 3mm tons of inventory in terms of your sales volumes being above – being 3mm tons below production. Obviously you've been making comments around releasing that inventory over the course of the last couple of quarters. And I was just wondering at what point will we start to see sales being greater than production? Thanks.

<A - Gerd Peter Poppinga>: So, quarter-to-quarter comparisons in terms of stock, I don't have the detail here. But it's certainly right that we have – in 2015 we will have – if you compare December 2014 and December 2015, we will have 2mm tons to 3mm tons less of stock in our inventories .That is for sure. And the big reduction will come in 2016 where we are going to reduce more than 10% of the existing stockpile, like I said before.

Now regarding the 13mm tons, it's a little confusing. But let me try to explain it once more. This is annualized capacity, okay? We stopped our – some of our not-so-high-margin mines, Feijão and Jangada, mainly in the southeast system. But we also bought less third-party oil. But this is annualized. So actually inside the quarter you will only see 2mm tons to 3mm tons reduction. Okay.

So this is not something we are sticking to that. We said once both together, the reductions in the mines and then the reductions in third-party fees could reach an annualized base of 25mm tons. It is not something which we will stick to this year. We are going this way. It depends on the margin optimization. It depends on the market. And this year we are, in spite of doing this, in spite of reducing these volumes, we are compensating the volumes in higher margin mines, and keeping roughly the 340mm tons production guidance for 2015.

<Q - Jeremy R. Sussman>: I just wanted to follow up real quickly on the – on your last answer. Did I hear you correctly? I think previously you talked about kind of a range of 340mm tons to 376 or so million tons of production in 2016. Should we now be looking at kind of closer to the 340mm range, just given the curtailment of some of the high cost production?

<A - Luciano Siani Pires>: 340mm is 2015. That's what Peter said. For 2016 we will announce guidance on the Vale Day.

<Q - Alexander Hacking>: Luciano, can you remind us of the CapEx guidance for next year and what FX rate that you're assuming on that guidance? And then a second question for Peter, if it's okay. Can you discuss maybe the dynamics of the pellet premiums? I – we can see that lump premiums have come off quite a bit recently. Are you seeing a similar dynamic in pellets? And would you consider rationalizing your pellet capacity a little bit like we saw in 2012? Thanks.

<A - Luciano Siani Pires>: Alex, thank you for your question. In the previous release you had a table in which we reproduced the CapExs guidance given December last year for different exchange rates. The reason we removed it is precisely because we're reviewing that right now. But you should expect the same ranges of the past tables. We shouldn't be far away from those ranges. So the information is on the release. And I believe we were talking about between $6.5B to $7B on – depending on the exchange rates that you look at.

<A - Gerd Peter Poppinga>: Yes. Alex, concerning the dynamics in the pellet market, as you know, pellets are much more volatile than other products. And you are right. There is a temporary weakening in the pellet market. Although I have to state that what you see published in the index and in the specialized magazines, this is not – these are not pellets from major suppliers. We have lots of high-silica-off-specs pellets floating around and also from Ukraine and countries like that. In our case we have – but we have a decrease in pellet premium compared to 2014, a couple of dollars. That is correct. And well, the pellet market – plainly is under stress. You have – Samarco and Vale ramped up expansions recently simultaneously, you have now no need for productivity in blast furnaces and MBR, the segment you know that the scrap price is very much under pressure due to the exports of Chinese steel semis and also there is a gas problem in

Egypt. So there is a temporary weakness and we are actually taking off some capacity in Q4, which is a cut of around 10% and we're going to sell pellet feed instead. But still we are going to produce in 2015 more pellets than we produced in 2014.

<Q>: I just have a question for Peter with regards to premiums for Brazilian fines. Would you expect that to maintain over time for this – at least for this quarter? And given that you have some cargos in the spot market, is that – has been well received on contract as well? Thank you very much.

<A - Gerd Peter Poppinga>: It's one of the best suppliers we had in Vale, our Brazilian Blend, which is in quality slightly superior than other blends in the market. And we have achieved premiums $4 a ton to $5 a ton. Even in the weakness of the market now they are being kept. And I can only say this blend will grow. You'll have – today we have around 30mm tons of this blend. It will come to 100mm tons and will leverage Vale's price realization a lot. For that you have to have liquidity, you have – and you have to have constant quality and that's what we are working towards. Thank you.

<Q - Thiago Lofiego>: Just a follow-up from the Portuguese call to Roger, if I may, on the fertilizers front. So would Vale consider ever spinning off the Fertilizers business at all, just as was the case at some point with base metals, meaning your profitability is robust right now, so with decent prospects. So would you consider eventually selling a stake to the market? That's the first question. And second question to Peter, on the third-party ore purchases, so from the numbers and from your comments as well it seems like you're running pretty close to zero purchases as of now. Is it fair to assume virtually no third-party purchases for 2016? Or do you still have a minimum level maybe due to attractive contracts that you may have in some systems?

<A - Roger A. Downey>: Okay, Thiago, let me start off then. What we're working on today is building a model that works and catapults our existing operations into a much more robust and much more profitable business in the fertilizers industry. Like I said earlier, we are in the sweet spot. Brazil is a fast-growing market. We're putting in some very structural changes to the business, productivity standards are growing. Our improvement is not just an FX-based improvement. It's – there's a lot of productivity and cost savings structurally in the business that we've managed to achieve. So going forward the strategy is maintained at building this, I guess, the champion in the fertilizer industry. We're looking at all options. But it's one step at a time. And we will certainly look at every option that we have to build this business.

<A - Gerd Peter Poppinga>: Regarding your question on third-party fees, yes we will reduce it. But it's very difficult to predict how much. There is purchase and purchase, we have also some contractors operating mines for us. So there's small amounts which we probably will keep, but it will be reduced.