Q3 2021 Earnings Call

Company Participants

- Eduardo Bartolomeo, Chief Executive Officer
- Luciano Siani, Executive Vice President, Finance and Investor Relations
- Marcello Spinelli, Executive Vice President, Iron Ore
- VALE

Other Participants

- Alex Hacking
- Analyst
- Andreas Bokkenheuser
- Carlos de Alba
- John C. Tumazos
- Jonathan Brandt

Presentation

Operator

Good morning, ladies and gentlemen. Welcome to Vale's Conference Call to discuss the Third Quarter of 2021 Results. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session and the instructions will be given at the time. (Operator Instructions)

As a reminder, this conference is being recorded, and the recording will be available on the company's website at vale.com at Investors link. This conference call is accompanied by a slide presentation, also available at Investors link at the company's website and is transmitted via internet as well. By broadcasting the internet, both the audio and the slide chain has a split second delay in relation to the audio transmitted via phone.

Before proceeding, let me mention the forward-looking statements are being made under the Safe Harbor of the Securities Litigation Reform Act of 1996, actual performance could differ materially from that anticipated in any for the looking comments as a result of macroeconomic conditions, market risks and other factors.

With us today are Mr.Eduardo Bartolomeo, Chief Executive Officer; Mr.Luciano Siani, Executive Vice President, Finance and Investor Relations; Mr.Marcello Spinelli, Executive Vice President, Iron Ore; Mr Mark Traversr, Executive Vice President, Base Metals; and Mr.Alexandre D'Ambrosio, Executive Vice President, Legal and Tax.

First, Mr.Eduardo Bartolomeo will proceed through the presentation on Vale's Third Quarter 2021 Performance. And after that, he'll be available for questions and answers. It's now my pleasure to turn the call over to Mr.Eduardo Bartolomeo. Sir, you may now begin.

Eduardo Bartolomeo {BIO 15365202 <GO>}

Thank you. Good morning, everyone. I hope you are all fine. Regarding COVID, the vaccination of our employees is progressing very well, inline with actions of the public health care system. We have already 90% of our own workforce with at least one vaccine shot in Brazil. We are gradually resuming activities in our offices. Today, for example, we are almost all together at the company's headquarters for this conversation for the first time since the beginning of the pandemic. We forgot up, we are getting back to a normal routine, keeping our focus on safety and people.

We continue to work with the authorities to implement theBRL37.7 billion agreement for the integra reparation in Brumadinho, signed in February this year. By the end of the third quarter, we had disbursed almost BRL4 billion for our payable obligations and actions for environmental recovery. This expenditure should reach BRL13 billion by the end of 2021. The individual damage compensation also continues with over 11,400 people covered by civil or labor in the -- agreements entered we to value. We remain committed to repairing Brumadinho in an agile, fair, and quick way.

We are also advancing on our ESG agenda. In our new pact for society, we renounced our mining rights in indigenous lands in Brazil. On the social front, we donated more than 600,000 food baskets to the families in a situation of food insecurity in Brazil, an action in partnership with civil society to entities and volunteers. By the end of the year, we must reach 1 million food baskets for over 200,000 families. One of our purpose on the social front is to contribute to the strengthening of autonomous and resilient communities through education, health and income generation programs. To do this, we are defining our new our new social ambition and redesigning our goals, as we did on our journey towards a low-carbon mine. Our social agenda is increasing its strength and we expect to announce further details on the Vale Day 2021.

On the climate agenda, we are pleased to announce some important advances this quarter. In Scope 3 emissions reduction we achieved some milestones. In July, the quarter two (inaudible) received the first of our care with water sale system. And in August, our Ponta da Madeira terminal received the first vessel with air lubrication technology, which creates a sort of carpet of air bubbles between the ship and the water, both technologies increase energy efficiency by up to 8%. Still in August, we announced our partnership with Aperam [ph], the largest steelmaker in Latin America to develop decarbonization solutions. Finally, in September, we announced the briquette, an innovative iron ore glomerate which can curb CO2 emissions of our steel making clients by more than 10%, The briquette is the result of years of research and developed by Vale . We already have three plants under construction, and investment of $185 million. We are assessing the feasibility of building another five plants for a potential production capacity of 50 million tons per year. With that, we are well positioned to lead the way in reducing Scope 3 emissions with innovative technologies and a portfolio of high quality products, essential for the low carbon economy transition.

Now focusing on our performance this quarter. We produced close to 90 million tons of iron, 18% higher than the previous quarter. In this nine months, we increased our production by 8% compared to 2020. On the resumption, we had an important progress in the Vargem Grande complex. With the operational start up of the Maravilhas III dam and the commissioning of the long-distance conveyor belt. With this release, we unlocked another 6 million tons of annual capacity. We continue to move forward with a safe operational resumption in a year still marked by COVID-19 restrictions. Spinelli will give you more details about our performance in iron ore soon.

Well, in eco, our performance was impacted by two important events. First, the labor disruption in Sudbury. In August, we reached a five-year collective bargaining agreement, and we started operations in September. In OnASa Puma, we had a longer maintenance due to COVID safety measures with production resumption by the end of September as well. We will continue to work towards great operational reliability, particularly in the base metals business. Our entire management team is committed to this. And we continue with our discipline in capital allocation. Our cash generation, in addition to supporting the reparation, business safety and the resumption of operations, allow us to return value to our shareholders, as our recent track record of dividend payments makes clear.

We ended the quarter with a strong cash generation of $7.8 billion, $1.2 billion higher than the second quarter. Sticking to our value over volume strategy, we'll continue to create and share value with our shareholders. With consistency in dividend payout and with our buyback program almost 100% complete, our Board of Directors has just approved a new buyback program, this time for up to 200 million shares, equivalent to 4.1% of outstanding shares. Our buyback program shows our confidence in Vale's potential to create value.

To conclude, I want to reinforce that we are making progress with our derisking, reshaping and re-rating to build a better Vale, To recap, in the de-risking we are implementing the agreement for the integral reparation of Brumadinho with total payments of BRL13 million expected by the end of 2021. We're executing our Dam Decharacterization Program. We expect to eliminate one more structure by the end of this year, totaling seven completed structures. We continue to resume our production with the release of the long-distance conveyor belt and is the top of Maravilhas III dams in Vargem Grande. And our next big deliver Brucutu and Itabira. The works of the total dams are advancing and the filtration plants have a physical progress higher than 80% as you can see in these pictures.

Finally, we are committed to increase the reliability of our operations, transforming the base metals business is one of our top priorities for 2022. In reshaping, we are moving towards divesting the coal operation, with good prospects until the end of the year. In fact, in coal, we expect an important cash generation in the fourth quarter due to excellent market conditions. We also expect to complete the divestment of manganese assets, and as a result we will move forward with the divestment of other non-core access.

In the re-rating, we continue to implement our midway model, the VPS. We continue to work hard on Vale's cultural transformation. And we are moving forward with our agenda and commitments to transform ourselves into a more sustainable mining company and engaged in matters relevant to society.

I would like to conclude by thanking Luciano for his excellent work in charge of Vale's finance and investor relations area since 2012. And I'm sure that he'll make a significant contribution for the future of the company, as our new Executive Vice President of Strategy and Business Transformation. I also would like to welcome Gustavo Pimenta, our new Executive Vice President of Finance and Investor Relations. Gustavo brings his global experience in a renewed vision to our business.

Now, I hand it over to Spinelli who will give more details about the performance in iron ore. Thank you very much.

Marcello Spinelli {BIO 16240257 <GO>}

Thank you, Eduardo. Good morning. Good evening. I want to start my presentation giving you an update about the resumption plan. We had a chance to go in detail in our last investor tour. If you need more information, you can find in our website. But Vargem Grande, as Eduardo said, is almost there step-by-step. Maravilhas III is now running. And the long-distance conveyor belt just added 6 million tons of capacity. So we reached 341 million tons of capacity as we planned.

Now, moving to production overview. In Q3, we produced almost 90 million tons due to the seasonality coming from the rainy season to the dry season, improving the northern system. Vargem Grande, as I mentioned, is in ramp-up. Itabira is running really well, much more efficient. And we have the full operation in Fabrica. But I want to drag your attention to the Northern system. As we presented also in the last investor tour, we expect a smoother ramp-up to reach 240 million tons of production there. (inaudible) is a brand new project, you know very well, track-less system, low OpEx. But we are still in a learning curve in (inaudible).

We've been improving ore border knowledge. We found more just lite, then we expect -- just lite is a very compact waste material. And as the system there is less flexible than the conventional system, we need to crush this material in the mine side. So, to address these small rocks, we are installing the cable crushers. We have one already installed, now we have the other three. We're going to do this into the next quarters. And to solve bigger rocks, we need to install a bigger crusher, they will be ready in three years. But till then, we are going to stockpile these rocks in the mine side. But you have good news from the Northern system, several actions and assets are coming online such as the plus 10 expansion of (inaudible), plus 20 Gelato [ph], Northern Range we have N3, N2 and N1, and East Range. All of them together will support the ramp up of 240 million tons.

Well, you may ask us about the gap between production and sales. Last year, we had the same problem. And if you remember that we have -- and we will have a production seasonality comparing the Q2 and Q3. And we need to add the supply chain extension, the blending process time. Remember that we have some volume adjustments, don't forget as an example, if you produce pallets we reduce the 10% of the mass. But all this together, we could expect a gap of 8 million to 9 million tonnes, but we had an additional 4 million tons. We decide to delay the sales of the standalone high silica and blend (inaudible) to form the be RBF later. So, that's the beauty of the supply chain flexibility we have in Vale. We can't daily take decisions to maximize our margin.

You also you also may ask about why margin per volume at this level of price. So don't forget, we also have in this analysis the discount of the product totally related to the demand and the freight. And in this case, this time of the year we have this spot freight as a marginal product, we need to consider this spot freight. And we are participants of this market, the spot market. As if you put more pressure or less pressure, we can increase or decrease the impact for the whole portfolio Vale. So all these together, we decided to delay this sales. We didn't decide yet due to the market condition to replenish this high silica standalone product. So we're not producing this yet. That's the reason our production guidance is 315 to 335, we didn't change that. But we are in the lower than the middle of the range of the guidance.

What we can expect for the production in 2022. So, you always ask us about the guidance for next year. We are going to announce only in the validating at the end of November. But what we can consider in our rational to the define this range for next year? Firstly, the presumption plan. The following increase of capacity will come more in the end of next year. Like Torto (inaudible) will add more volumes. But as Eduardo said, don't -- we need to understand that the guidance is related to volumes, but we are increasing the quality since the beginning of the year with the filtration in Itabira and Brucutu. But we're going to increase more volumes in the end of the year. We're going to run most part of the year with 343 million tons of capacity.

(Inaudible) second point is our mantra. So, if you have capacity and you don't have demand, we're not going to use the total capacity. One example is, due to these market conditions today, we can reduce the production of the high silica standalone that is still available. Every time we increase the quality, the process to increase the quality, we're going to leave this kind of product. But we have 12 million to 15 million tons that we can reduce in our capacity introduced last year. That's an example. And third, we also consider buffers for some production setback if you have any in variation, any anomaly in our production we considered in our planning. So all of this together will be part of the definition of the production guidance for 2022.

I'll stay here for further questions, and pass now to Luciano Siani.

Luciano Siani {BIO 15951848 <GO>}

Okay. I'll start my commentary on the results by the elephant in the room, which is the wild variation of EBITDA estimates from what we actually posted. And this chart you see here, usually we bring this on our releases, but now we're bringing more detail. It shows the value realized prices compared to the average of the quarter. And there are two large red bars here that represent miss in revenue with a direct impact on EBITDA.

And why those large bars, because we had an unprecedent quarter in terms of price swings. Reminder, we started the quarter with $207 per ton prices, that was exactly what was provisioned for the sales which were open at the end of the second quarter. And we ended the third quarter with the same provisional prices for the sales open in the third quarter of $117, so it's a $90 swing in the space of three months that creates those types of effects.

The first effect, the minus 8.2 miss in realized prices relates exactly to the open sales. We bring the numbers here, 18 million tons. Which were open and provisioned at $207 per ton. They were actually realized at $176. So that difference of $30 was revenue and EBITDA that was recorded in the second quarter, that shouldn't have been recorded. So, the way to deal with that is you need to reduce revenues in the third quarter and give back those revenues in EBITDA when you account for this.

The second big effect you'll read on the column, provisional prices in the current quarter $14.8 negative per ton, and a total effect which -- with almost $1 billion, absolute numbers, is exactly the 22 million tons that we have outstanding, so sales which were not yet settled. Provisioned at $117 compared to the average of the quarter of $163. So, this is actually -- we can call it an opportunity cost, right. If I -- if we had sold those tonne at the average price for the quarter, we would have realized $1 billion additional revenue. But that's not the case, and some of you might have done the calculation with the entire volume sold by Vale at the average price for the quarter. And as I just explained, part of this is provision at much lower prices. So that's the reason behind the important decline in EBITDA compared to the -- when you look at the average prices for the quarter.

Moving into cash flows, you saw that the cash conversion was actually more than 100%, which means we generated more cash than EBITDA, which is also odd. And the reason for this is because of the cash collections of the open sales from the second quarter. And you might have noticed a variation of working capital above $3 billion, so about $2 billion of it is explained by the change in accounts receivable. So we collected lot of sales from previous periods at very high prices, and the open sales for this period are recorded at much lower prices.

And there's another $1 billion actually which is money from our clients that we still need to offset because of the decline in prices. And these offsets are ongoing in the quarter and will continue in the fourth quarter. So about a $1 billion of this positive release of working capital we will be reversed in the fourth quarter, as we do the settlements with our clients and give them back the excess invoices at much higher prices.

To notice as well that this quarter will be heavy in terms of Brumadinho cash outflows, Eduardo already mentioned that, BRL9 billion approximately. And also first quarter of '22 we will also have a heavy bill to be paid in terms of cash taxes collection. So, we -- if you notice, the cash taxes are -- there's a lag between cash taxes and the economic profit that we are generating. There's an annual settlement every first quarter of the year, they should be paid then.

Moving to iron ore, the commentary on costs. You see costs going sideways and a slight increase from 17.8 to 18.1. You are observing in the industry a lot of inflationary pressures, specifically in Brazil the price index reached two digits in the past 12 months in the quarter. And many of the contracts that were expired and being renewed were subject to renewal pressures from those indexes. So that's flowing through higher cost in the quarter. Another effect is that the cost of goods sold in this quarter is also tied to the production costs of the second quarter, which were -- production was of a smaller volume, less cost dilution.

It takes some time, a couple of months for that -- those production cost to flow through and become cost of goods sold. So, therefore that explains why costs haven't yet decreased due to cost dilution. That will happen in the next quarter, so we continue to expect because again, of the large 90 million ton production in the third quarter, we expect cost dilution to pour over into the fourth quarter. And still bring us about $1.5 per tonne reduction in costs.

There is a headwind which is the collective bargaining in Brazil. Whatever number we settle will be high because of high inflation. That goes -- that has one-off effects in terms of provisions for -- especially for profit sharing. But also we have tailwinds, the exchange rate is more depreciated in Brazil then we initially expected when we made that provision. Those effects may offset each other.

Another important cost component is freight. You saw the increased from 17.7 to 20.6, that obviously was because of the increasing bunker prices and the dramatic increase in spot freight rates. But as you can see, our sensitivity to those variables is nowhere near the market rate, so it shows how assertive is our strategy of having those very large (inaudible) contracted for the long run. For the fourth quarter, you should expect a small increase, other dollar per ton, basically because the average spot rate should be higher in the fourth quarter than in the third. However, as Spinelli, mentioned, we are taking some high silica material from the market from now on, so therefore we will be less exposed to spot and we'd initially in the vision. And so that compensates this slightly.

My last comment is on coal. First performance and then a comment on impairment. In terms of performance, September, we generated $43 million of EBITDA. In addition to that, we had a negative impact of 27 million because of thermal coal hatch, you can see that number in the foot notes to the financial statements. So therefore, if it wasn't for the hedge, we would have generated $70 million of EBITDA in just one single month. And also, if you look in the release, coal is very much influenced by lag prices. We have on average thermal and metallurgical coal, about $35 prices lower in September then we should have had because of those lag prices. So, we could have had another $30 million of EBITDA in the month if we had the proper price, which will come now in October.

So, I'm saying all of this just to highlight that the business is running at $100 million per month run rate at today's prices. So the question might be, so why impair the assets? The issue here is that, no potential buyer will buy the coal assets based on today's prices, nor it will buy the coal assets based on the business plan that we have we have not yet delivered. This asset under normalized conditions requires 12 million 13 million tons of production in order to break even, and we haven't achieved that. So, we expect most of the proceeds and economic value from a potential sale to come from a contingent, let's say, a contingent economic value based on volumes and on prices.

So probably, the upfront value to be received will be smaller. Because we will not be able, even if we do a sale with contingent receivables based on volume and on price, to record those as assets the good practice in accounting recommends us to impair the asset. And it wouldn't make sense to take out $2.3 billion. And try to find out exactly how much we would receive upfront, we don't know that, because we haven't yet received the binding offers. So we decided to be conservative and go all the way down to zero. But the consequences will be that probably we will have a sale for economic value and part of it will not, as I said, be recorded because it will be contingent.

So, we're almost at the half-hour. We will be opening up for questions and answers.

Questions And Answers

Operator

(Question And Answer)

Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. (Operator Instructions) Our first question comes from Carlos de Alba from Morgan Stanley.Mr.Carlos, your audio is available.

Q - Carlos de Alba {BIO 15072819 <GO>}

Good morning. Thank you very much Luciano it have been great working with you CFO of the best thing you -- in your new position. The question I have first is, if you could comment, maybe on an update of how do you see that revenue payment is scheduled in the coming quarters. They'll be quite useful, I think in both the income statement as well as the cash flow and second maybe just (inaudible) if you could clarify or maybe explain a little bit more. Maybe I missed that part.

But if you could explain the dynamics between iron ore production and shipment that you see for the four quarter and perhaps for the first and second quarter in light of the ramp up in production, but also the reduction in the steel production in China, that is taking place right now.

A - Luciano Siani {BIO 15951848 <GO>}

Carlos , thanks very much for your kind comments. The cash outflows for Brumadinho I believe in one of our prior presentation, which is on our website there is an estimate that we haven't been updating because it's still current. I don't have the numbers top of my mind, but I -- the numbers will still be very high in 2022 similar to this to this year, which I believe are going to be close to $2.5 billion. So, there will be a lot because although there's a heavy concentration of payments for the obligations to pay this year. Next year, we'll have less obligations to pay but there will be an acceleration of the obligations to perform the projects will start to come from design to execution. So we will have those sorts of payments and then we have for '23, then we start the decline also another heavy year, but significant released of outflows just from '24 onwards.

A - VALE {BIO 16148998 <GO>}

Carlos, thank you for your question. Dynamics between production and sales for next -- before next part of Q4, we believe we'll be like the last year the same level of production and say, we don't see any gap and even in the first quarter this supply-demand considering what's going on in China, we need to, we understand that we have a slowdown in China due to the disruption in energy rationing and also property, the industry is healthy. We have good margins. We have a good price offer for (inaudible) but they are tracking the -- to go after this. The target of energy consumption in the beginning of the next year, definitely there is another event that is the Olympics that can make some pressure in the downstream demand. And also the CSP production.

But we see a rebound after that. And the point we must check, not only our volumes, production and sales, but also the supply that we see in the, in the Seaborn [ph] Market, we --in China, we have a dynamics, but in the other part of the world, part of the world the ex-China we have a very heated market going really well today. And in terms of production and demand, and our check should be related to the Seaborn [ph] coming from other parts of the world. Like in Brazil, we expect to sell more in Brazil last year than this year. That's the trend we see in India, that's the trend we see in CIS, and even supply coming from Australia in the lower (inaudible) than this year. So that's the balance we can see in China that will be important for you. We have a number in the -- production 40 million tons of iron ore next year in supply of the Seaborn [ph] market. So that's the, that's the point but our gap will be zero in terms in terms of production and sales.

Q - Analyst

Our next question comes from Jonathan Brandt from HSBC. Mr.Jonathan. Your audio is available.

Q - Jonathan Brandt {BIO 5506998 <GO>}

Hi. Good morning. Good afternoon. Luciano just like to echo the comments it's been great working with you and best of luck in your new role. Spinelli, I'm hoping you can -- maybe elaborate a little bit more on Chinese demand next year. So, obviously it's going through a bit of a tough time now given the Olympics and the energy issues. But what do you think next year? What gives you the confidence to say that in Chinese steel production will pick up in 2022 rather than sort of trend along at current levels? I guess that's my first question.

And then my second question. It's kind of a generic one. I mean, obviously you've had a lot of disruptions in your operations, whether it's iron ore or base metals and, I guess I'm not necessarily talking about the labor issues in Canada. But more with the disruptions in Brazil from, the licensing issues that forces you to go to the courts and things like that. So obviously you React to each situation, but it certainly takes a lot of management time and effort. And, I know that there's this ambition to be, a more stable and sustainable mining company. So I'm hoping you can maybe touch upon what you can do to proactively minimize these disruptions and prevent them from happening going forward. Thank you.

A - Marcello Spinelli {BIO 16240257 <GO>}

Thank you. Jonathan, Spinelli here. Well, let me clarify what it was just mentioned to Carlos. We see definitely a slowdown China. A smooth slowdown, I think more now this year that they've already achieved the goals for the fourth -- 5 billion-- five-year plan, COVID is okay, GDP is okay. Energy conception is not okay yet now better than in the last quarter, so they need to reduce that's the point that I was mentioned, what I see for next year. For this year we see the goal to -- of CSP probably less or equal or less than last year, 1.65 billion, or less. We can consider a gap here. A range here of 10 -15 million tons less or the pecan can see -- the same of last year.

And for next year be above 1 billion or less than this year probably, what I'm saying that we can have a seasonality with more, without rebound after all this pressure coming in the short term that can bring more volatility to this moment, but can be more in place, the demand in place after the first quarter or in the end of the first quarter, what I was saying that despite China is slowing down, we have ex-China growing, the CSP that we see for next year, they're coming from 900 million tons of CSP, they can go to 940-950 million tons. And the other point is the balance of supply demand. When we see the, the seaborn that can supply China, we see some other forces coming when you have the domestic market of many of these producers like Brazil or India or other places they are consuming the iron ore in their domestic market. So that's, that's our view -- supply-demand are we more balanced after the first quarter. But definitely there will be a reduction in China but a growth in ex-China.

A - Eduardo Bartolomeo {BIO 15365202 <GO>}

Thank you, Spinelli. Jonathan. Thanks for your question. I think it's very appropriate because as in the court, it's Eduardo speaking okay. Is in the court of what we're doing here since I arrived and I think your question is extremely relevant to us. I would put the situation in two sides, one exogenous and one endogenous. If the word is right in English. Something that is up to us and -- something that is currently out of our control in --. When you see that the disruption in the licensing of OnASa Puma actually is a discussion between conditions in the license that we are believe are fulfilled. And that's a minor issue and didn't impact, by the way. Any moment and also from a production.

So I don't think it's a relevant issue here. I'm much more concerned about the endogenous issues that are related to our operational stability as you pointed out when we go, for instance, for the fire in Salobo mine and the problems that we have in mine movement during the year goes to the core of what we call and I've mentioned that in my speech, about our management model that were implemented or was implemented with extremely success in the railways of Vale. We have one of the best railways in the world. And is there where we can manage to see what means stability or stability means? So that's what we're trying to bring.

We assess that. We have levels of maturity for each of the dimension of this model, this is not from Vale. So, it's a whole other business have similar the obvious [ph] one, is the TPS. TPS is the father of the management model systems with acquainted with that. You will understand, what I'm trying to say. And obviously the maturity level and you look at the technical dimension or the leadership or the method at Vale's as a whole is still very low when you go to this excellence aisles that we have inside Vale there is high. So, I'm pretty comfortable that the work that we're doing together with a cultural transformation and safety is the same as production, we say here in Vale there is no production before saved.

Because there is no production really without, so being stable, being able to control the process have the people engaged in the right manner to do what is expected from him from that process will result in a in adequate result and stability and with less disruptions as we do have in the railway for instance as I have mentioned. We appreciate -- pretty comfortable even in base metals business, I've just been in long harbor, we have hitting the record in the production for long harbor and we are going to see what they've been doing there. Right people, right process, safety and production. So it's not rocket science Yes, but takes people takes engagement. So that's what I believe. And my team is committed to a fully committed with that. We understand that we have a gap with between our competitors. That is, by the way translated in our opportunity -- iron ore with less. I think iron ore , has this has had a good year and stability. I believe all the our plans that we were supposed to resume. We resumed on how we have planned. But anyhow, as I mentioned, in my speech, initially pace matters, the big focus, but we have very confident that we are doing the right thing and we'll get there for sure. Thanks for your question.

Operator

(Operator Instructions) Our next question comes from Andreas Bokkenheuser . From UBS. Mr.Andreas. Your audio is available.

Q - Andreas Bokkenheuser {BIO 7182883 <GO>}

Thank you very much. Thank you for taking my question. Also, echoing my appreciation to you Luciano. Thank you very much for all your time and availability over the years and especially your patience with us. Going through the numbers so thank you very much for that seems very fitting, that I kind of direct my first question to you. This is something we've been talking about, over the last 6-8 quarters. I think it's just kind of the longer term cost or unit cost outlook for Vale . Management has been saying that you still intend to get back to get back to come the early 30s levels. Overall where it used to be pre Brumadinho. Does that change now? Because you've already talked about maybe you're going to be producing less iron ore then you have capacity for. And, and if you don't produce as much iron ore does that mean that you're cause dilution effectively at something smaller and then your unit cost end up being high. Is that, is that how to think about it? Or just a still drop because you're taking high cost production offline is that, that the way to think about. That's the first question. Thank you.

A - Luciano Siani {BIO 15951848 <GO>}

Anders. Very much appreciate your kind words same for Jonathan. Thank you very much, and it has been a pleasure all these years as well. There's a number of effects playing right in our current cost position. So first effect is a procyclical increasing costs, right? Which you're seeing across the entire industry. So, we see this for example in higher oil costs, higher freight costs, higher royalties in the case of Vale, higher purchase price for third-party ores, which although the volume is small because the prices are so high. It makes a difference for the C1 base. So, this concerns as last because it's easily reversible over the long term.

The second theme is about what you just mentioned is normalize production. When it normalizes what to expect. We continue to believe that there's about a $5 gap that we can bridge just by bringing production to normalize levels. And that has a number of effect.

The first one is obviously, diluting costs you have operations have operations for example which take (inaudible) will do, for example, which could be operating a 30 million tons, we have everything there to do it all the fixed costs and you're still producing just 12 million tons and now with the high silica products in the past quarter 15 million tons. So, cost dilution is an important driver. The second thing is the elimination of distortions in the way we produce, again take (inaudible) for example instead of using a pipeline to deposit tailings on the dam, like we're basically trucking the tailings and sometimes with more than one operation. So you put the tailings on a particular appraise [ph], then you load it again, and you truck it again, and you deposit it by truck. So, this creates all sorts of additional cost.

And finally, third, even the, if you look at the release and you have that credit for quality even that is being jeopardized by the way we're producing today, Spinelli mention for example, that But when the filtrations come in, we're going to improve substantially the quality of the production that we already have. And therefore we will improve price realization and that will help bridge part of those $5. So with all of this is if you do the math and try to normalize, we still believe it's appropriate to target about $35 per ton all-in cost and including sustaining capital which again is distorted. As well, because we are spending a lot of money to build. For example, the filtration plants. I just mentioned.

So everything is tied into these post Brumadinho recovery of our entire production system. Specifically on your point about. Okay we're going to be producing less, so there will be less cost-dilution we intend to run the best mines at their full capacity. What eventually we may do, is if you adjust production if we remove it from the less competitive mine . So therefore, we don't expect this to be, lets say a drag in the overall cost performance. So we are targeting $35 per ton and we want to be there as soon as we reach normality in our operations.

Operator

Our next question comes from John Tumazos from John Tumazos Independent Research. Mr.John . Your audio is available.

Q - John C. Tumazos {BIO 1504406 <GO>}

Thank you. And once again all love and congratulations to Luciano it's been a tremendous joy, to talk to over the years. My question concerns end market diversification for iron ore, I'm a little shocked at the 0.8 million ton per day five months fall and Chinese steel output or 292 million tons crude steel annualized or almost 15% of world output I think that's the biggest non-recessionary decline in steel output any country history of the world. There's a lot of explanations reasons. It's not my business. But it raises the question as to the desirability of China as a customer. And the benefit of moving more iron ore to Europe or the middle east or DRI feeds [ph] or HBI feeds, pellets and other products that have their own markets outside from China. Excuse me for my question if it's a little difficult.

A - Marcello Spinelli {BIO 16240257 <GO>}

Thank you, John. It's Spinelli here. You're right, you know there is a trend that is now is there's no return that the quality trend to this new world of zero carbon. So that's the that's the trend, we have a delay if you compare China with the, with the other parts of the world. As you mentioned, Europe and Middle East. And the key point here is that we need to have high quality ore's to compete and we are the, the most important player in the world to, to supply this trend. So, how can you do that? We are returning with the filtration the full capacity of Itabira and also Brucutu and the end of the year we have Torto dam, if we could do that we can finally have back our pellet feed production.

So, we are bringing back the capacity of pellets coming from 30 million tons to 60 million tons direct reduction is a key point here, we are already developing the -- briquette as a part of our strategy to replace, in this transition next 10 years, we still have blast furnace, so we need to improve the efficiency in the blast furnace substitute the sinter with the briquettes with high-quality flexibility to develop this kind of product, that will be really helpful for Europe and also Middle East. In China,w e see the trend of quality despite the market can reduce. As you mentioned that is a big market there, too big market there we're talking about 1 billion of production of steel. But if you consider the increase of quality value, is it in really good shape to compete.

We see the trend in China. We are really close to them. To also develop the briquette there (inaudible) in the north of Brazil is a key product today. You can see the gap today. The premiums in(inaudible) even BRBF. So for this whole transition, we see in China, even in the rest of the world quality is a key, is the key point here and we are really prepared and in developing not only MOU's to understand what they need, but we are already investing new products to compete.

Operator

Our next question comes from Alex Hacking from City Research. Alex, your audio is available.

Q - Alex Hacking {BIO 6599419 <GO>}

Okay. Yeah. Thank you. And let me have my thanks to Luciano. You've been a great leader of Vale for some very difficult times, and I think all the shareholders and analysts appreciates it. With regards to freight costs, obviously, been pretty volatile recently. Do you think there's anything structural there, where you would be concerned that freight could be higher going forward? Or you think this is just a period of volatility and then we'll settle down Settle down. -- normalized. Freight rates again.

A - Marcello Spinelli {BIO 16240257 <GO>}

Thank you, Alex. Spinelli here. You know what happened in the market dynamics and Freight the early this year. We saw the, the supply chain disruption . In Other kind of markets, like container and Panamax has touching the cape sizes business. But what happened after that, it was a combination of other factors that we don't, we see a kind of one-off effect, we don't see it as a structural problem that can see in the future. First one is related to the efficiency in China to discharge the vessels waiting lines, two to three times more than the average.

It was related to do, Australia and China tensions and in all the problems should you charge the coal, and also the iron ore, vessels in all the ports. And the other point is related to the energy crisis. So we had a huge mass in this market, with thermal coal going to Europe going to China also met coal without the production in China can down with their catching up the production there, in stabilizing the demand. So we see now, movement that can organize better this, this market with the, the impact of the coal. And the, the last one that I can mention, Alex is the Seaborn market for iron ore for next year. We see last product coming from every place from Brazil from, from Australia, from, from India going to in to China because we see this market improving the consumption of iron ore in their domestic market. So they will relieve the freight market for the first and second quarter of next year.

A - Luciano Siani {BIO 15951848 <GO>}

Alex, and John, let me express here, my appreciation for your comments. I hope to be together in the future as well. Maybe welcoming both of you in our operations here in Brazil.

Operator

Our next question comes from Andreas Bokkenheuser from UBS. Mr.Andreas, your audio is available.

Q - Andreas Bokkenheuser {BIO 7182883 <GO>}

Thank you. Just. I just had a follow-up on the inventory strategy. So, obviously, in Q3 you build, some inventory. Can you just talk us through quickly? What the thinking is there, I understand is obviously a high silica product and you weren't happy with the price but just kind of thinking on where we are in the price cycle. I mean, iron ore still above $100 a ton, historically a very high level, arguably, I know price fundamentals are somewhat challenging inventories are rising China is cutting steel production. I'm just, I guess, I'm just worried that, is there a chance here that you basically need to de-stock this inventory at a later date at a lower price. And why not just sell it now when prices are still relatively high?

A - VALE {BIO 16148998 <GO>}

Thank you, Andreas. Sorry about the second question that we missed it from the first round. Well, we see again that the high silica product is not a common product that we already have in our operations, when we've increased the filtration and all the project we will reduce the exposure of high silica products. But that's a marginal product. We just sold independently this product because the market was really good. But what kind of impact we have? Not only the level of the price but this discount we need to count on that. And the other point was the freight as a marginal cost. We are considering that we need the spot freight to move from Brazil to China and the level of the spot freight was pressuring the margins there. So, wait to sell as a BRBF in the negative margin with the standalone high ceiling was a better solution for that.

But in that the reason we decided not to produce more high silica stand alone without (inaudible) to blend as BRBF. But again, that's a very dynamic decision, and this quarter we already assessed in every day this, if you have a chance to go to the market, we just can -- we have the flexibility to sell from the BRBF to sell as, as, as individual product every day we can do this. But that was the, the, the problem last month when we had a reduction in the--and the level of the spot freight was really high. That, that was based the decision in the last quarter, but we can change these every day and we already assessing the, the possibilities to, to make this happen this quarter.

Operator

This concludes It's today's question and answer session. Mr.Eduardo. Bartolomeo at this time. You may proceed with your closing statement.

A - Eduardo Bartolomeo {BIO 15365202 <GO>}

Okay, thank you. First of all, I would like to reinforce the congratulations to Luciano and just remind everyone he is still with us and is making -- will make a huge contribution in our future. And again, thanks a lot. Luciano. Welcome Gustav, It's what I'm going to coming back to you. It's the same every quarter but we had something last quarter or last six months. I was asked about supercycle now. We're talking China bust. As a mining company, we have to be ready for any cycle. So the question is being answered is by the de-risking by the reshaping. And by re- rating, the de-risking. Bring us to the level of the game. We need to (inaudible) we need to --. We need to get back to our structure to produce what is needed to attend the market embedded our ESG practice in our daily routine.

Our capital discipline is untouchable. So this is not done, but it's really, really ongoing, our reshaping has a lot of merits. We got out of that FB&C [ph]. We're going to get, we're going to Mozambique. We're going to focus on what we know to do in order to do good. And when we re rate, the company is going to exactly the answer that. The question that was began there -- that was being - was asked before is around being a stable, being a reliable, be a safe operator. That's when interruption on a coming and you're going to reward us as a C1 in the first quartile or iron ore, nickel of copper or any commodity that we'll be in. So again, I would like to thank you a lot for your attention for your interest in our call. And I hope to see either in the Vale Day or in the next call. Thanks a lot. Keep safe.

Operator

That does conclude vilest conference call for today. Thank you very much for your participation. You may not connect.