Q4 2017 Earnings Call

Company Participants

- Fábio Schvartsman, Chief Executive Officer
- Gerd Peter Poppinga, Executive Director-Ferrous Minerals and Coal
- Luciano Siani Pires, Chief Financial Officer

Other Participants

- Alex Hacking, Analyst
- Andreas Bokkenheuser, Analyst
- CJ Baldoni, Analyst
- Carlos F. De Alba, Analyst
- Chris Terry, Analyst
- Gustavo Gregori, Analyst
- Humberto Meireles, Analyst
- Jonathan Brandt, Analyst
- Marcos Assumpção, Analyst
- Novid Rassouli, Analyst
- Thiago Lofiego, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentlemen. Welcome to Vale Conference Call to discuss Fourth Quarter 2017 and Fiscal Year 2017 Results. At this time, all participants are in a listen-only mode. Later, we will conduct the question-and-answer session, and instructions will be given at that time. As a reminder, this conference is being recorded and the recording will be available on the company's website at vale.com at the Investors link.

This conference call and the slide presentation are being transmitted via Internet as well, also through the company's website.

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

With us today are Mr. Fábio Schvartsman, President and CEO; Mr. Luciano Siani Pires, CFO; Mr. Peter Poppinga, Executive Director, Ferrous Minerals and Coal; Mr. Eduardo

Bartolomeo, Executive Director, Base Metals; Mr. Luiz Eduardo Osorio, Executive Director, Sustainability and Institutional Relations; Mr. Alexandre Pereira, Executive Director, Business Support; and Mrs. Marina Quental, Global People Director.

First, Mr. Fábio Schvartsman will proceed to the presentation. And after that, we will open for questions and answers.

It is now my pleasure to turn the call over to Mr. Fábio Schvartsman. Sir, you may now begin.

Fábio Schvartsman

Good morning to all. Thank you very much for joining our conference call regarding the results of fourth quarter of 2017. I would like to start mentioning that we disclosed this result of 2017 that was, in our opinion, a very good result, and the quality of the balance sheet has improved meaningfully during the year.

Everything that we've been doing in the company in the last few months was related to become a more predictable company and this translates, for instance, in the fact that we anticipated the results of the first quarter – sorry, the fourth quarter of 2017 more or less in line with the actual results that were delivered, that we made of our focus in performance and in capital allocation, our main goal in the company and in this purpose – the first results of Base Metals are already showing the benefit for the company of this approach.

Because of this more careful capital allocation, we were able to contain investments below $4 billion, and the good news about that – that is – this is sustainable. We can make it this way in the next several years. Finally, regarding strategy, I would like to make a quick mention regarding the leveraging process of the company that is evolving in a very proper way. We are already reducing that by a lot and receiving the cash from the sale of Vale Fertilizers and of the Nacala Project. During the next few months, we are coming to a very comfortable indefinite (00:04:13) level with this more or less coming to an end in the necessity of the leveraging of the company.

Next, I would again emphasize that we want Vale to remain and to become a diversified company. But by that, I don't mean that we are going to acquire other companies or we are going to start in other businesses. But much on the contrary, we are going to start to realize more value from our existing assets, especially in Base Metals where we think that we have a big opportunity. And we are going to continue with the same discipline that we've shown in iron ore, being very cautious regarding how we evolve the production in order not to put too much pressure on the market.

A few things about 2018. First, I want to comment that we now have our team – the executive team of the company complete with a very good mixture of people that are coming from inside Vale and executives that are coming from outside in a very good balance for managing the company.

Next, commenting on our business in general. I would like to start with iron ore. Iron ore, our expectation regarding prices is that given the growth that we can see in all the major economies in the world, the expectation is that there will be no downward pressure on prices during 2018. So, we are optimistic regarding where prices will stay. And we are going to continue to invest in reducing cost in this iron ore division through supply chain optimization, starting in a very good dependent way in digital transformation, and we are going to continue the cost reduction process that started with Professor Falconi and in the market exposures of managing costs and expenses.

Obviously, it is of utmost importance to control the investments and therefore allocation capital will be key in this business during 2018.

In Base Metals, it's necessary to be a little bit more cautious given the volatility in the nickel prices. I think nobody can guarantee where prices of nickel will go in the near future. Nevertheless, we are investing heavily in the transformation of this business. We brought in Eduardo Bartolomeo to run this business with the purpose of restructuring and with the purpose in year of 2018 of putting focus in Sudbury and in Nueva Caledonia.

In Sudbury, trying to extract more value off this excellent asset that belongs to Vale. And in Nueva Caledonia is trying to move from the status of project that Nueva Caledonia had recently the status of reoperation, building all the profitability and the benefits for the company.

The purpose of all that is to be cash positive in all of our operations, and it is important to emphasize that it's the first time in many years that we are cash positive already in all of our sites. That happened in the last two months for the first time, I suppose, ever.

Finally, in Coal, we are going to complete the (00:09:05) of Moatize-Nacala and it's the purpose of diluting fixed cost. And we can expect the results to be better in the – the results of Coal can – to be better in the first quarter of 2018 than they were in the fourth quarter of 2017.

Regarding results in Vale as a whole, it is our expectation that even taking to consideration that the first quarter is typically more weak in seasonal basis that we'll be able deliver the same kind of result that we had in the fourth quarter of last year. And as a closing note, as we mentioned in our release, it is our purpose to deliver to the market a new dividend policy by the end of March. This policy that we'll aim to be at the same time more aggressive and sustainable for a long period of time.

This year, that was my opening statement and I am going to pass to Luciano to give a more detailed information on the results of the last quarter of 2017.

Luciano Siani Pires {BIO 15951848 <GO>}

So, good morning, everyone. My intention is to walk you through a one single analysis of the 2017 results, which fully shed some color on all of our strategy and some structural factors affecting Vale. For those who have the webcast, it's page 6, which shows a buildup from the EBITDA in 2016 to the EBITDA in 2017. For those who don't have it, I will give you the numbers.

So, we start with $12 billion of EBITDA in 2016 and the very first effect which boosted our results is obvious. It's increase in prices, a net effect of $3.8 billion. There's an important factor I would like to call your attention, which is we have netted in the $3.8 billion a downward effect of almost $700 million of what we'd been calling out. In the release, you're going to read, pro-cyclical effect of higher prices. What exactly is that? It is not a typical cost inflation that many of you are thinking about in the industry. It's the direct linkage between some of Vale's costs to the iron ore and pellet prices. We're talking about the purchase of third-party feed. We're talking about royalties. We're talking about the leasing of some of our pelletizing plants, the contracts provide for a lease price, a lease expense, which is directly linked to the pellet premiums. And we're talking about profit sharing.

The difference between this and other cost components is that if iron ore prices or pellet prices reverse, this immediately reverses as well. These are formula-based. This is different from cost inflation, which we are going to talk later. So this is the first component, $3.8 billion net of this cyclical effect in costs improving EBITDA.

The second effect is $1.4 billion approximately of improvement in premiums and commercial initiatives. So, as you all know, premiums for our high-end products have increased during the year but also Vale proactively managed its product mix, Vale proactively is gaining products, and is proactively also renegotiating contracts to take advantage of this market movement. And sometimes when you do that, you increase costs as a side effect.

For example, if you blend, you increase costs but you get better price realization. If you produce more pellets, which is the case this year, you also increase costs because you produce the concentrate iron ore into pellet feed. There's more cost associated. So, the key here is that one should not look into Vale's performance just from the perspective of cost, but has to have an integrated view and look at margins.

Now, we come to the next components of the results, which now all of them which I'm going to mention have diminished EBITDA. And now we come to the overall theme of cost inflation in the industry. We start with $725 million of foreign exchange effect both in Brazil and in Canada mainly. No comments on that.

We now come to $409 million of bunker oil increases and the key point here is that we're not going to just watch moves in the bunker oil prices. Vale has ongoing initiatives to reduce its short position and exposure to bunker oil prices over the long run. We're not talking about hedge here. I mean, at the right moment, you'll get to know what these initiatives are all about.

There's another component of them, freight. Freight increased Vale's cost by $267 million. And as you know, we've been trying to actively manage our exposure to freight. We just received the first ship from the second generation of Valemaxes, which are more efficient than the first generation. And this is the first of about 30 new ships that are going to be delivered to Vale in 2018 and 2019 to help us manage down freight costs.

The next component with a cost increase of $215 million is energy costs, electricity costs mainly in Brazil. And here, I have to tell you that we are open for business looking for opportunities to increase self-efficiency at Vale. We produce 60% approximately of our own energy needs and we intend to go as high as 100% to avoid those impacts going forward.

And finally, as the last component, there was indeed around $300 million of cost increases – endogenous cost increases in our operations, but they are all related to Base Metals and they are all related to the structural transition that went on in Sudbury in the second and third quarters, transition from two furnaces to one furnace, and the stoppages in Manitoba in the first quarter.

As a proof of that that these were one-off effects, if you look in the release at the fourth quarter cost performance for Base Metals, we have all of our operations performing at cost levels below the 16% and the 17% average levels with a highlight for Ontario as well where the furnace transition took place.

So all in all, that explains why the $12 billion came to be $15.3 billion in EBITDA. And in a nutshell, the key messages here is we are managing for margins and we're actively addressing the fundamental cost inflation factors that are starting to affect the industry.

And now, we can move for questions and answers.

Q&A

Operator

Our first question comes from Novid Rassouli, Cowen & Company.

Q - Novid Rassouli {BIO 17393901 <GO>}

Thank you for taking my questions. The first is on iron ore. You mentioned being cautious on how you progress iron ore production to not put too much pressure on the market. I just want to see if you can just speak to anything that would potentially make you adjust the current kind of 400 million metric ton run rate expected in 2019 and beyond or is that pretty much set in stone and you're talking about future increases from that point?

A - Fábio Schvartsman

Thank you. Look, our target of 400 million metric ton is here for staying. It's not something that we are going to change unless a structural change happens in the market because we do have this idle capacity that would allow us to go further than that. But we are not going to use it unless there is a meaningful change in the market. And this change is not anticipated by us in the next couple of years.

Q - Novid Rassouli {BIO 17393901 <GO>}

Got it. And then, in your release, you'd mentioned that you forecast coal prices to lose steam throughout first half of 2018 as supply normalizes. In the past, we've seen lower coal prices having the ability to weigh on iron ore prices as well. I was just wondering if you could speak to how you expect to get your coal forecast to potentially impact the iron ore prices throughout 2018?

A - Fábio Schvartsman

I think there is a correlation, like I said, but it's not coal. It's actually more coke. The coke price – when the coke price was very much up, then you have, in our case, a favorable development for premiums.

We are not a big player in the Coal business. I would say we have a view on the long-term coal price, which is a little lower than the prices of today. But the correlation you're mentioning is not a direct one, I would say.

Q - Novid Rassouli {BIO 17393901 <GO>}

Okay. And then just switching gears to copper for a second and these are my final questions. I just wonder if you can give us your expectation for Chinese copper demand in 2018, as well as if you have a surplus or deficit forecast for 2018?

A - Fábio Schvartsman

Yeah. From my limited knowledge, we are unstable since the last two years. There's going to be a small gap (00:20:02) this year not as high as nickel. Nickel is the one that is presenting that. And so coal is more or less stable. But you have to see the movements that are happening for copper. I mean, copper – on Chile on the labor movements, there are some noise there, but basically it would looking to be stable not as much as nickel.

Q - Novid Rassouli {BIO 17393901 <GO>}

Okay, got it. And you outlined the 800,000 tons of disruption in 2017. As you mentioned, there are significant labor contract negotiations taking place in 2018. Any thoughts on if the level of disruptions have the potential to reach what we saw in 2017?

A - Fábio Schvartsman

No. Not in our personal view (00:20:42).

Q - Novid Rassouli {BIO 17393901 <GO>}

Got it. Thank you for taking my questions.

Operator

Our next question comes from Thiago Lofiego, Bradesco BBI.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Hi. Thank you. I just had one follow-up question. I'm not sure if you addressed that for – I'm sorry if you did. Just to clarify about an update on VNC, the potential to sell a stake. How is that evolving? What's the timing? I remember, Fábio, you've mentioned before that the potential timing was end of this year. If you could refresh us on that? And also about the needed CapEx there as well. Are you already spending money on that or are you waiting for the deal to go through?

And the second question also related to the same thing, which would be on the cobalt's potential divestment. What kind of deal are we talking about here? What's the potential size in terms of synergies and also in terms of value and also timing? Thank you.

A - Fábio Schvartsman

Okay. Thiago, thanks for your question. No, we didn't comment on that yet. And thank you for giving us the opportunity of doing so now. In VNC in cobalt, the idea is to basically (00:22:19) in both cases. We are working in a way that will guarantee that each and single one of our site is cash positive throughout the years.

So, the reason for using this kind of, let's say, non-typical financing is with the objective of phasing the investments that we have to make. First in VNC because of the payment and then in Voisey's Bay because of the underground mine that we have to invest there. And the process continues moving forward in both cases. And the decision in the case of VNC is not expected before the end of the year where we have to come to a decision.

The size of the investment on the other hand has been recently reduced by the effort of further analyzing all the alternatives that could allow us to deploy less capital to do same in this investment. So, we have good news in this subject as well.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Okay. Thank you, Fábio.

Operator

Our next question comes from Humberto Meireles, Goldman Sachs.

Q - Humberto Meireles {BIO 16541842 <GO>}

Hi. Good morning, everyone. Question on iron ore production versus shipments. If you look at last year, production increased by around 30 million tons while shipments were flat. At the same time, you had offshore blending. Your blending capacity increased by roughly 30 million pounds. As we look into 2018, the expectation and the target is to increase blending by the same amount as last year. So, how should I think about the gap between production and shipments? Is it reasonable to expect a similar magnitude that we saw last year? And put this question in another way is, could you also provide the guidance not only on production but also shipments of iron ore for this year?

A - Fábio Schvartsman

Okay, Humberto. Thanks for the question. You're right. Since we were building up stocks in Malaysia and in China, the shipment production ratio was not normal. So, what is the normal shipment production ratio? It's around 97.5% to 98%. So, you lose some material during the process and the pelletizing. So that's the normal ratio. So, in 2017, instead of 97%, 98%, the ratio was 94%. This was in 2017. So, you saw in this quarter and the end of this quarter and you only take fourth quarter, you saw the ratio of 100% because we had – so we shipped actually more than we produced in the fourth quarter even though we are saying that we are going to – we postponed some sales into the first quarter of next year. The first quarter of next year, therefore, will be a normal ratio, which will be around 98%.

Now, the rest of 2018 will almost be there. We would still have some, let's say, around 1% difference of a normal ratio. And then in 2019, we will be fully normal again, 97% to 98%. So take away is first half – first quarter of 2018, you will have a normal ratio and then in the second half you will have maybe 1% plus still having some stocking, building in China. And then in 2019, it will be completely normal again. Hope that help. And the good thing is that in the first quarter, we are going to have a normal – since we postponed some sales, we'll have a normal ratio again in the first quarter.

Q - Humberto Meireles {BIO 16541842 <GO>}

Got it. Thank you. Just to make sure that I understand. So, if we look at last year, right, the offshore blending capacity increased by 30 million tonnes and as you described that required a lot of inventory buildup.

But if you go to this year, we have the same offshore blending capacity increasing at the same amount. So, technically, the inventory buildup will be the same. So, why isn't reasonable to work with a similar gap, delta that we saw last year?

A - Fábio Schvartsman

Because we are blending less and less. I mean, with the big blending – the big building of stocks happened last year, and this year it will be even less. There will be still some inventory building up, but much less than in 2017. And in 2019, it will be stable.

Q - Humberto Meireles {BIO 16541842 <GO>}

Got it.

A - Fábio Schvartsman

Thank you.

Q - Humberto Meireles {BIO 16541842 <GO>}

Thank you.

Operator

The next question comes from Carlos De Alba.

Q - Carlos F. De Alba {BIO 15072819 <GO>}

Yeah. Good morning, everyone. Thank you very much. I'll try to squeeze three quick questions, if I may. Fábio, if you could comment a little bit on the spirit of what you're trying to get in terms of the new dividend policy. You mentioned it's going to be more aggressive and more sustainable hopefully. But is the company trying to target a specific dividend yield? Is it you're trying to target a specific payout ratio or a percentage of cash flow generation? If you could just generally speak about the spirit of the new dividend policy, that would be useful.

Second is in the comments in the press release. Once again, you said that Vale should be a more predictable company. So, for me, to be honest, it is still difficult given that the link that it has to the commodity prices and we have seen in the last 18 months, 24 months, they have been quite volatile and have come as a surprise to many of the forecasters. So what – could you elaborate a little bit more about what is the cyclicality do you mean, or how you plan to achieve that goal despite the volatility that we see in commodity prices?

And then finally, Luciano, given the cost pressures that you alluded to in the call and also that were mentioned in the press release, do you expect material changes to the guidance or are you – that was provided in the Vale Day in New York and London back in December? There were a few slides there that talked about a great deal for iron ore as cost for nickel operations into 2020 year. Do you foresee many pressures or have you seen the company will work and try and offset some of the pressures by other management initiatives? Thank you.

A - Fábio Schvartsman

Carlos, thank you for your questions. Starting with the dividend policy. As we've been mentioning, we want the policy to be at the same time aggressive and sustainable. And the only way that I know to make it sustainable is to make it proportional to the cash generation of the company. Any other one will be outside of our control and so it's not going to be sustainable. That's the reason why you can expect something correlated with the cash generation of the company.

Now, regarding predictability, you're right, commodity prices are and will always be very volatile. It's true that we are making the efforts that we can to dilute this effect with the discipline in the production of iron ore, reducing capacity available of nickel in order to cope with that movements in the market. That helps in the sense of reducing volatility because of this behavior of ore. That's the purpose. But by predictability, I mean another thing. I mean that, obviously, we have to cope with changing prices environment all the time.

And to be predictable, in my way of thinking, is that in any given price scenario, you'll be – the market and everybody has to be able to easily identify how Vale will perform. This is predictability. This is only possible if you have full control in everything else than the price of the commodity, meaning we have to have a very strict capital allocation policy, we have to have a constant focus in improving performance, and we have to look very cautiously in all of our capital structure and cost structure in order to optimize it. By doing that, we certainly will become a company that everybody will understand better, and that's what I mean by predictability.

A - Luciano Siani Pires {BIO 15951848 <GO>}

Carlos, on the cost reductions, keeping constant the external factors that I mentioned, we continue to guide in iron ore to a $3 to $5 margin expansion until 2020. I mentioned in the earlier call that (00:33:06) should have a contribution of around $0.60 of a dollar this year, and that we are targeting to end the year below $14 per tonne. But having said that, on the external factors, that guidance does not include any initiative to control and to lower energy and bunker prices. So, there should be an upside.

In the nickel operations, we've already guided for CAD 200 million cost improvements over two years in Sudbury. That doesn't change. And for this year, across all the Base Metals operations, there is a target also for a cost reduction of around $200 million. That doesn't change.

Finally, in coal, because of the ramp-up, that needs – the costs need to come down, and they will come down simply because of higher volumes. You have seen that story, although in the short term we had a problem with an excavator which we will be fixing. So, no material changes to the guidance keeping external factors constant.

Q - Carlos F. De Alba {BIO 15072819 <GO>}

All right. Thank you very much.

Operator

The next question comes from Gustavo Gregori, Bradesco BBI.

Q - Gustavo Gregori {BIO 16209398 <GO>}

Hi. Congratulations on 4Q results. I have a quick question regarding debt. Given Vale's massive cash generation during fourth quarter and expected strong cash generation first and second quarter, I want to see if you guys could give us a little bit more clarity on the company strategy regarding what we can expect in terms of gross debt reduction and also take into account how relevant the market there has become in Vale debt portfolio if the company has any preferences in terms of what bonds they potentially (35:09) tender or call.

A - Luciano Siani Pires {BIO 15951848 <GO>}

Obviously, we will continue to reduce gross debt. You have seen in the fourth quarter some retirements of debt. We're kind of – we retired a lot of debt with bilateral operations with the banks. But now, naturally, there will come a time when we will have to be more active in the capital markets. So, we tendered for the 2019 and 2020 bonds last year and we will certainly – we will have to come back to repurchase some of our outstanding bonds. We cannot give more details about where in the curve we're going to act, but this is a natural consequence of having to retire that.

Capital markets today represent about 55, if I'm not mistaken, percent of Vale's total debt. So repurchase of that has to pass through capital markets debt as well.

Q - Gustavo Gregori {BIO 16209398 <GO>}

All right. Perfect. That's very clear. Thank you.

Operator

The next question comes from CJ Baldoni, Principal Global Investors.

Q - CJ Baldoni {BIO 15236102 <GO>}

Yes. Hi. I realized this is a small part of your business, but I'm curious with respect to your line in the Corumbá and the new port in Uruguay, do you intend to shift your minimum volumes under the agreement that you have or just pay the minimum guarantee?

Hello?

A - Fábio Schvartsman

Give us just a second.

Look, we were just wondering how much detail we have here, but maybe it is worth if we can – if you have – if you want to go into much detail, we could have a conversation later with Investor Relations. But what I can tell you now is that Corumbá has – we have done a very good work there in terms of reducing costs. We have also renegotiated some of our take-or-pay contracts with barges. But effectively, we have actually reduced the volume. The volume in the past was much higher. We are not dealing with fines today. We are much more dealing with land. We are focusing on land. And we have also renegotiated our contracts with our main clients, the Argentinians.

So overall, Corumbá is now more competitive. But if you wanted to have some details, I invite you to look through our Investor Relations. We can provide you those details. Thank you.

Q - CJ Baldoni {BIO 15236102 <GO>}

Okay then. Thank you. I'll follow up.

Operator

The next question comes from Alex Hacking, Citibank.

Q - Alex Hacking {BIO 6599419 <GO>}

Yes. Hi. Thanks for the questions. I have a couple of questions for Peter, if it's okay. First one, Peter, given that the cost – some of the cost issues that you're seeing, but also the ramp-up of S11D, how do you expect your C1 – your iron ore C1 cost to trend next year?

And then the second question, could you just talk a little bit about how you're seeing demand for iron ore evolving outside of China? It seems like you sold more material outside of China last year, and obviously we're seeing China exporting while the rest of the world picking up, but I'm curious on your perspective on that development. Thank you very much.

A - Gerd Peter Poppinga {BIO 17245689 <GO>}

Thanks, Alex, for the question. So, on the C1, I think Luciano gave you already some guidelines about what happened to the C1.

You can see that in 2017, we had a C1 of $14.8, right? Now, the main driver for the C1, of course, is S11D. There is a big – there's a reduction coming, which will be captured in 2018. We estimate it being $0.5. And then, we have the – our productivity work with Dr. Falconi and our management, cost management, fixed cost management. So, those things together we expect this to be around $1. And captured in 2018, of course, this will go on into 2019.

On the other hand, we had a cost inflation. But you also have probably a foreign exchange valuation. We are working – if you work, for instance with BRL 3.3 – if you take a number of BRL 3.3, this gives you probably an offset on the cost inflation, which we know that this is coming. There's energy, there is services, there is diesel. So, we should – just simply offsetting FX and cost inflation, if you do that, and we take the $1 I just spoke about, then you come to the figures Luciano's talked that we are aiming that it's going to be possible to be under $14 on the C1, right. This is concerning Vale.

And C1 and S11D, if you specifically take S11D, it's a very nice surprise. We are in the first two months. We are on a run rate of 46 million tonnes a year, which is exactly what we are targeting for a ramp-up. And this rainy season (00:41:33) is good. If you take the cost of that and exclude the capacity, which is not utilized and not accounted, so you come close – you come very close to those figures we presented in Vale Day in New York.

So, it's all going well in S11D. And, again, we are targeting – in spite of cost inflation, we are targeting a C1 cost slightly lower than $14 next year. And then the other markets, you mentioned outside China. That's the good thing. That's a good surprise that it's booming. We see the Middle East very demanding. We are increasing our shares in Eastern Europe.

Also, Europe is picking up strongly because it is like that, 2.5% high steel production and consumption probably happening this year. So, it's very positive. And China, of course, is our main market, but we shouldn't forget about the rest of the world. Thank you.

Operator

The next question comes from Marcos Assumpção, Itaú BBA.

Q - Marcos Assumpção

Hi. Good morning, everyone. Congratulations on the strong results. First question on pellets. If you think that the start-up of Tubarão and São Luís plants are expected for the coming quarters, if this could have an impact on the pellet premium in the coming quarters?

And the second question to Fábio, talking about governance in the future, a lot has been done in the past year, but what is your view or your vision for the corporate governance of the company? How do you think you could still improve in the coming years? And also considering the end of the lock-up period of some of the controlling shareholders, if you believe that sooner rather than later we could have a reshuffle on the board of the company? Thank you.

A - Gerd Peter Poppinga {BIO 17245689 <GO>}

Marcos, thanks for the question. On the pellet side, the only thing – I cannot speculate. It's too early to speculate on there how will be the premiums next year and the only thing I can tell you is that we have a huge overbooking, a huge overbooking and this earlier start-up in Tubarão I and II and the normal timing of the Northern (00:44:35) pellet plant in the second half of the year will only help us to reduce the overbooking.

So, it's a very stressful situation today because we have to manage all this overbooking and all this spot business and people coming on pellets. But maybe it's going to be slightly better in the second half because of the ramp-up, but it's too early to talk about premiums of next year.

A - Fábio Schvartsman

Okay, Marcos, regarding your question on governance. We are evolving in the process of perfecting governance of Vale. We are on the road to becoming a true corporation. And there is a lot to learn how to or how to work with the board. The relationship between the board and the executives, these are all new stuff for everybody.

And this transition is moving smoothly and we are – both sides, we are learning how to do this. Now, we have a number of committees that is starting to supervise everything that the company is doing. And we – executives, we have to participate in these committees and we have to fill these committees in order to make a better decision making process. So, we are learning and in the next couple of years we are going to become a real corporation and behave as a proper corporation.

Regardign lock-up, yes, the lock-up is gone. The compilation of holders would have – the formal controlling shareholders would have the alternative of selling the stock. They are certainly analyzing them. But one thing, you rest assure, nothing will be done in a not (00:46:54) way, meaning it will be organized. If it happens through a follow-on in order to preserve the value of the company. So, we are all very attentive to this fact given the size of the follow-on that can be possible out of the intention of the controlling shareholders.

Q - Marcos Assumpção

Okay. Thank you very much, Fábio and Peter.

Operator

The next question comes from Andreas Bokkenheuser, UBS.

Q - Andreas Bokkenheuser {BIO 7182883 <GO>}

Thank you very much for taking my question, and congratulations on the strong set of results. Just one question on the iron ore premium. You mentioned it a little bit this morning on the Portuguese call as well and you've said before that you think the iron ore or the high-grade iron ore premium is structural. But we're also seeing a lot of it having to do with steel profitability in China and we've got the whole pollution restriction debate in there as well. I guess my question is, if a lot of this is driven by steel profitability and of course steel profitably is extremely cyclical in nature, then how high is your conviction that the high-grade iron ore premium is really structural when it's tied into something that's cyclical as steel margins effectively (00:48:24)? Thank you. That's my question.

A - Gerd Peter Poppinga {BIO 17245689 <GO>}

Thank you for your question. Again, I think we have had a major shift in the industry. We have had a supply side reform where we have the capacity closures and moved to bigger blast furnaces. So, this is actually something interesting. It's not a Chinese invention. If you remember in the past how things happened in Japan and Korea, it was more or less the same. So, I guess China is more and more adopting the operating philosophy of other developed countries. And the coal price is expensive and it generates pollution, so less consumption is important.

Now, the third element in all this what you mentioned is the high steel margins. If you take this element out for short days, maybe it can be eased a little bit the need for high maturing – high-quality maturing. But you cannot simply – a move to big blast furnaces. And knowing that the coal inside China will be expensive and there is the pollution thing. It is simply impossible to improve productivity and utilization because you closed (00:50:05) capacity. The remaining blast furnace we have to produce more than the rest. It's impossible with this structure reality to reduce emissions without improving quality of your raw materials.

So, iron ore high grade, in our opinion, will be priced higher, substantially higher than just the value of the contained additional iron units. That is for sure. And I think maybe there will be some fluctuations, some productivity in the premiums. (00:50:45) factories will play a role, but the shift to the flight to quality is definitely a structural one. Thank you.

A - Fábio Schvartsman

If I can help here, with this combination of growth, as we (00:51:00) therefore increasing demand for steel everywhere plus the anti-pollution matters in China that are for real. It seems quite unlikely that we are going to see any change in the behavior of this market in the next couple of years at least.

Q - Andreas Bokkenheuser {BIO 7182883 <GO>}

That's clear. Thank you very much for taking my question.

Operator

The next question comes from Jon Brandt, HSBC.

Q - Jonathan Brandt {BIO 17988091 <GO>}

Hi. Good morning. Two questions from me. First on Samarco. Wondering if there's any update on a potential restart and if there have been any negotiations with BHP for potentially buying their stake. And the second, I guess, I just wanted to come back to the VNC, with cash costs dropping pretty substantially in the fourth quarter. How much of that was related to by-products credits, specifically cobalt? How much of it was related to better efficiency and sort of your own internal measures? And with the expectation that cobalt prices should continue to rise, given EV technology, how much does that play into whatever decision you make with VNC considering that asset? Thank you.

A - Fábio Schvartsman

Very good. Thank you for your questions. Regarding Samarco, I want to emphasize once again that we think, and you mentioned things in my name and the name of BHP as well. We both think that we have a responsibility in this case, a very special one given the disaster that happened in Samarco. We are trying everything that we can to make the restart of the plant of the mill feasible and this our main focus and we are not spending time on anything else at this point. Both of us we don't see Samarco as a business opportunity. We see Samarco as a social obligation where we are doing everything that we can to restart.

Regarding VNC, obviously, cobalt prices, the by-product in VNC, did play a role in the cost reduction, but this is then was the smallest part. We are talking like 30% of the cost reduction came from the cobalt and the 70% from the efficiency (00:54:04) That make us more optimistic about VNC, of course. And the recent improvement in prices are making us more optimistic as well.

The truth is that we are waiting to see where things are going to move forward in order to make a decision, how to view it within the situation. It's clear that the situation now is different from where we were six months ago. And so, we are reacting accordingly.

Q - Jonathan Brandt {BIO 17988091 <GO>}

Great. Thank you, Fábio.

Operator

The next question comes from Chris Terry, Deutsche Bank.

Q - Chris Terry {BIO 16949971 <GO>}

Hi, everyone. Few questions for me. I think on slide 6 when you stepped through the EBITDA from 2016 to 2017, you spoke about the energy cost a little bit and alluded to the fact that you might have some opportunities there. I just wondered if you could expand on that a little bit and perhaps just a bit more color on the bunker fuel costs, how you control those costs going forward? That's my first question.

The second question is just around – you're looking at the new dividend policy. So, obviously, the balance sheet is in good shape and net debt trending down. Can you perhaps just talk a little bit around (00:55:37) and potential opportunity to be made there?

And then, my last question is just on the cost efficiency program and the $150 million mentioned on potential cost reduction. Thank you.

A - Fábio Schvartsman

Let's start making a quick comment on bunker. On bunker, we are finding several different approaches. One of them (00:56:18) reducing our demand of bunker. We are working on changing the model that we operate our ships in order to have less dependence upon a bunker. This obviously will happen due in time.

A - Luciano Siani Pires {BIO 15951848 <GO>}

Okay, on energy costs. The total electricity bill around Vale is around $600 million per year. And about – as I said, about 60% of that is own production by Vale. And the rest is a mixture of long-term contracts and also spot transactions.

Spot prices in Brazil have been fluctuating a lot depending on the hydrologists because they were very dependent on hydropower generation. And sometimes spot prices can be three times as large as the internal self-generation of Vale. And the contracts, when they are renewed, they also reflect somehow the view on supply and demand of electricity in Brazil going forward.

So, we're still very exposed to energy. And rule of thumb would be that perhaps this 40%, where we are exposed to market forces, cost around twice the price of our own self-generated energy. So, from these numbers, I believe you can figure out what the size of the opportunity is if we generate 100% of our own units.

A - Fábio Schvartsman

Now, in your question regarding dividends. Vale is now in a very particular moment. We are the company in the iron ore universe that has the ability now of not investing to keep capacity. We had just need a huge investment in S11D. We have plenty of capacity, and therefore, we have the opportunity of enjoying this moment. And the way we are planning to enjoy is to be able to pay back to our shareholders dividend wise the patience that they gave us during the construction and the investment cycle that we (00:58:58). So, dividends, as I mentioned before will become a proportion of our cash flow generation in order to make it aggressive and sustainable.

A - Gerd Peter Poppinga {BIO 17245689 <GO>}

Okay. About the CAD 150 million of cost reduction, just to give more clarity. As Luciano mentioned in his initial remarks, we made the change in Sudbury for the single furnace. So, now it's time to harvest that investment. We are looking for a multi-year cost reduction over two – maybe two elements. One is rightsizing the organization for this new flow sheet (00:59:40). So, we still have a larger organization that is needed to run it. And the second one is the productivity wins from both the process plants and mainly down the ground mines. We see a huge gap on the underground mines. So, I think both areas will achieve this CAD 200 million. There are CAD 150 million. I hope it made it clear.

Q - Chris Terry {BIO 16949971 <GO>}

All right, guys. Thanks for...

A - Fábio Schvartsman

Only to comment on that just a little more color. We are planning to have in 2018 10% less cost in all of our nickel operations, and this is way more than CAD 150 million.

Q - Chris Terry {BIO 16949971 <GO>}

Okay. Thanks for that. And just following up on the second question related to the balance sheet. Is the timeline that you have in mind for making decision on this (01:00:46) expansion?

A - Gerd Peter Poppinga {BIO 17245689 <GO>}

(01:00:51). It's going to be taken the decision this year. So, it's a normal process. We're just finalizing the engineering studies and we're moving forward to the board in the end of the year normal procedures.

Q - Chris Terry {BIO 16949971 <GO>}

Okay. Thank you very much.

Operator

The next question comes from Tyler Broda, RBC. His line has dropped.

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

A - Fábio Schvartsman

Well, once again, we appreciate very much for having you in this call. And we are evolving in (01:01:54) towards becoming a more predictable company, and a company that you know what to expect in any given circumstance. And therefore, I ask you to join us again in the next call to give us a chance to show you that we've been walking the talk the way we had described. Thank you so much, and have a wonderful day. Bye-bye.

Operator

That does conclude Vale's conference for today. Thank you very much for your participation. You may now disconnect.