Q3 2012 Earnings Call

Company Participants

- Jose Carlos Martins, Executive Officer, CFO
- Luciano Siani, Executive Officer, CFO
- Peter Poppinga, Executive Officer

Other Participants

- Alex Hacking, Analyst
- Carlos de Alba, Analyst
- Chelsea Konsko, CREF
- Felipe Hirai, Analyst
- Jonathan Brandt, Analyst
- Marcos Assumpcao, Analyst
- Marina Melanesian, Analyst
- Rodolfo de Angele, Analyst
- Rodrigo Barros, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. Thank you for standing by. Welcome to Vale's conference call to discuss the Third Quarter 2012 results. If you do not have a copy of the relevant press release, it is available at the Company's website at www.vale.com at the investors link. At this time, all participants are in a listen only mode. Later, we will conduct a question and answer session, and instructions will be given at that time. (Operator Instructions).

As a reminder, this conference is being recorded. To access the replay, please dial 55-11-46-88-6312, access code 6213907 hash key. The file will also be available at the Company's website at www.vale.com at the investor section.

This conference call and the slide presentation are being transmitted via Internet as well. You can access the webcast by logging on to the Company's website, www.vale.com, investor section, or at www.prnewswire.com.br.

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 comments as a result of macroeconomic conditions, market risks, and other factors.

With us today are Mr. Luciano Siani, Executive Officer of Finance and Investor Relations, CFO; Mr. Jose Carlos Martins, Executive Officer of Ferrous & Strategy; Mr. Galib Chaim, Executive Officer of Capital Projects Execution and Mr. Peter Poppinga, Executive Officer of Base Metals and Information Technology. First, Mr. Luciano Siani 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. Luciano Siani. Please sir, you may now begin.

Luciano Siani {BIO 15951848 <GO>}

Thank you. First of all, Mr. Murilo Ferreira apologizes for not being here. He had an emergency and could not attend.

Thank you, all for attending. We have a presentation that was put on our website. It has three parts. I'm not going to follow it on a slide-by-slide basis. I'm just going to remark some of the information which is in there. It starts with an overview of the approach that we're having to strategy and capital discipline. Then we will go into the details of the performance of the Second Quarter.

In the end of the presentation you see also a few figures on China, which is our main market, which displays additional data points and information for yourselves to make up your own opinions about how this important market will develop going forward. But certainly we will have the opportunity to talk more about this during the Q&A in this session here.

The very first thing that I would like to start is to re-emphasize that we will prioritize only investments in world-class assets going forward, which can provide the best return to shareholders. This is very important at a moment where we face the challenge of matching our cash flows to our investment program.

So in that respect, we're not pursuing diversification per se anymore. Diversification will be a consequence of us having world-class assets in different commodities, but it's not a goal per se. Having this goal also of operating and developing only world-class assets means that we are going to reassess very carefully all of our assets which do not fit that characteristic.

And we would like to re-emphasize our commitment to returning cash to shareholders and maintaining our investment grade in a prudent --- leveraging our balance sheet. So for us going forward, the most significant challenge is to how to solve the (dilemma) of adapting cash flows, dividend policy, investments and balance sheet.

Another important outcome of this strategy also is that we will reduce R&D expenditures. The need to reduce the investment program means that we now have more growth options than what we need for the coming year, so that it doesn't make sense to keep generating additional growth options, so there's an immediate consequence which is a reduction of R&D expenditures.

You should also bear in mind that CapEx will peak in 2012. It's not going to be as high as what we announced in 2011 when we made that plan, so we're making our effort to have a lower number. You can see by the accumulated figures for the first nine months of 2012. And certainly in 2013 our goal is still to have even a lower number still significant because we do have important growth options, but still a lower number than to be the trend for 2012.

Another important message is that in our core business, which is where the most important world-class assets are located, which is iron ore, we do believe that we are at a turning point. Reason being because now we have all the conditions to resume growth in our iron ore business. We're having a very good performance in environmental permitting this year. We have had already 72 licenses granted by the authorities against a little over 20 last year. That means that we're being able to open new pits, we're going to be able to develop our world-class projects and over time we will not only increase volume, but also recover the quality that has always characterized the Vale iron ore.

So in that respect, S11D is our priority. And also the Itabiritos projects in the south and southeastern system, which are described in the press release, which have a two-fold objective of not only replacing and marginally expanding capacity at the south and southeastern system, but also recovering quality.

So these are, together with the plus 40 in Carajas, the cornerstones of our growth in our ore going forward. So you should start to see growth in the production rates in the second semester of 2013 and more explicitly in 2014. Then going forward with S11D coming on stream in 2016 and all, you should see important growth. So iron ore remains our key priority.

Obviously we need also to finish the projects which are ongoing. Salobo, Long Harbour and so on, so this puts pressure in our CapEx over the shorter term as well. And outside of iron ore, we do have also world-class assets to keep investing on, which I would highlight the Moatize coal mine.

Important to notice as well that in the shorter term the fact that we have been granted the license to open an N5 south mine in Carajas is a short-term catalyst for recovery of quality and production specialty in the Carajas region.

You saw that in our production report released a few days ago that there was a drop in the northern system production of 4% when you compare to the first nine months of 2011, which is pretty much related to the environmental permit process. But as I mentioned, we've been working together with the authorities. We have improved our internal processes, we've been granted more licenses. So it's just a matter of time to get back the flexibility that we didn't have at the Third Quarter.

When you look outside of iron ore, our approach outside of iron ore is very vigorous, as I mentioned. Specifically base metals, which has been a source of concern for a few investors. We believe that we have a few good news to tell you, the one being the successful ramp-up of Salobo. We are already running at 40% of production capacity, so you're already starting to see some copper production in the production reports under the others account.

Gold production increasing, Salobo I and II is capable of producing over 300,000 ounces of gold. So it's very attractive at the current gold prices. So you should see normal ramp-ups in Salobo, adding results to base metals.

Also in New Caledonia we have resumed operations of all the circuits. So we intend to keep you posted once we have more clear signs that we're being able to resume ramp-up in Vale New Caledonia as well. But you should bear in mind that we already have resumed production in the plant.

We are committed to generating value across the nickel business. It is a core business. We have announced recently to shut down two mines for care maintenance. The two mines are mines which are not adding value at current prices. Much on the contrary, they were losing money. This is a different approach as well. In the past as we privileged volumes over value, we didn't do this sort of detailed analysis to try to understand what specific assets are contributing to value for shareholders, but now we're committed to not to operate those assets which are not value adding.

Important to note is that even if we shut down some mines in Canada, it doesn't mean that nickel production will diminish because expected growth in Indonesia, which is going quite well. So we will feed the processing plants in Canada with material mined from Indonesia. That's the strategy going forward. So you will see value improvement in the nickel business without loss in production. And finally, we will divest all no value adding assets of this business.

Another key message that I would like to leave with you is that as an important lever to adjust the size of the capital expenditure program going forward is partnerships. So Vale now is very keen and we are actively looking forward to partners for our most important projects, so we would rather develop an opportunity partnership if we have cash constraints. So with lower exposure, cash exposure to the opportunity rather than not doing it. So our first preferred option is to try to find partners to develop some of the opportunities. And this is something that I would like to leave with you because we might have news in the coming months. On Vale Day we will present more details on those partnerships.

So when you go to the actual results on the Third Quarter, I'm going to start first by talking about giving additional highlights on production, then talking about prices. Then going down the income statement we're going to talk a little bit about costs, expenditures and talk about the net income as well, the tax impact on the net income. Then I'm going to briefly talk about the balance sheet and then we'll move on to Q&A.

In terms of production, I already mentioned that we had a fall in production in iron ore Third Quarter '12 compared to '11. However, one thing that I would like to point out is because now we have an extended enterprise strategy and we have our own fleet of vessels and we have -- we do have iron ore inventories. Even finished product inventories across the supply chain. Which means that if you lose production in one quarter, that doesn't mean you're going to lose sales. So we have now buffers and flexibility to go for those variations. Which means that we're confident of recovering the production we lost and with no impact in sales as you saw.

In terms of the pellet plants, we also have halted production at three pellet plants. These are plants which are less competitive than the newer ones, so again the value equation comes in. Obviously we are reacting to the market conditions whereby the quality that is embedded in the project, such as pellets, is not being rewarded as it should. We're changing, so we do have the option of changing it from producing pellets to producing sinter and pellet feed, so we're opting to the alternative that brings more value to shareholders.

Just for a guidance as well, when you look at the realized prices -- when you compare the realized prices of pellets with the realized prices of iron ore, you see a very large premium when you look at the numbers. However, the iron ore prices are much influenced by the spot market and the -- whereas the pellet prices are -- pellets are mostly sold through contract, so they still reflect the lagged pricing formula, which carries the higher prices from the previous quarter.

So that's one reason because again -- behind this large difference. Marginally speaking, we're closely following the pellet premium and the cost of transformation to assess all the time the advantages and disadvantage of selling pellets in the market.

In terms of coal, we have had the -- we resumed production at Carborough Downs after the shutdown, which is good news. Our mines in Australia are finally running at very good rates, all of them. So we should see improvement in production in Australia.

In Mozambique, as you saw, the production this quarter was smaller than the quarter before. Reason not being any problems with the ramp up of the mine, but rather some (model) actually in the logistics. And we're not stocking coal, because coal is not a product that you should stock within inventory because it degrades its quality. So we're slowing down production within the mine, but we expect to de-bottleneck the railway to the Vale corridor and resume ramping up. There's not any ramp ups in the mine and the processing plant in Mozambique is going very well.

In terms of nickel, the production, if you look at the nine months, has been affected by the safety shutdown on the Second Quarter in Sudbury when we had -- we lost a few lives unfortunately and we decided to do that shutdown in order to reassess all our plants. This quarter the decrease in production in Ontario relates more to the planned maintenance shutdown than to any further problems. So we should see again Sudbury production -- Ontario production resuming.

In copper I already mentioned the successful ramp up of Salobo and to point out as well that now we had the first concentrate being produced at our Lubambe mine at our JV in Zambia, which is also marginally accretive on the medium term.

And also in fertilizers we had record production of phosphate rock, mainly from our Bayovar mine in Peru, which is doing very well.

Talking about prices, as you saw, the falling iron ore, the (ODEX) 62% prices has not reflected fully into the fall of Vale realized prices. There's a number of reasons for that. I'm certain that we will explore this in the Q&A session.

But in a nutshell, there were market factors for sure, but there were also the effect of successful commercial strategy that we have implemented in order to deal with an environment where clients they -- you have more spot sales and clients, they value also the lead times of delivery for our products.

Another highlight in terms of prices is I would say the fertilizer prices, they moved on a different direction than the other resource prices, which shows up the nature -- the counter cyclical nature of this business. And we have adapted our product mix in order to make the most of these opportunities in specific products as well.

So when you see how this has translated in a loss of revenue, this overall falling price is mitigated by a successful commercial strategy has yielded falling revenues of about $1.2 billion in the quarter, which translated directly into the bottom line and into EBITDA.

Reason being because the expense accounts were pretty much stable during the quarter, so we're talking about operational costs, we're talking about SG&A and R&D expenses.

When you look at cost of goods sold there are a number of analyses in the press release which show small items going up and down. But I would say the outlook is pretty much of stability, which I believe is good news in this inflationary environment. And we should start, we hope, to over the next few months to see if we can revert the trajectory, not only stabilize costs, but also make them go down. There are a number of initiatives to do that.

However, I can point out to you that for other accounts, we believe that the -- we can bet more confidently in a downward trend pat. The first one being R&D expenditures. If you compare R&D expenditures of the Third Quarter against the Second Quarter, they are stable. But if you compare to the Third Quarter of 2011, there's a significant decrease. The third and Fourth Quarter traditionally within Vale are quarters where you spend more in R&D and in sustaining investments and in capital projects. So that stability is already a first sign that we're containing that. There are a number of initiatives in place. I could mention for instance the closure of several exploration offices around the world, which we reassessed those. And we should see reduction of R&D expenditures like numerical absolute term reduction of R&D expenditures going forward.

The same would apply to SG&A, which is stable in this quarter, but we are also confident that they will resume a downward trajectory quite soon.

So that leads us to an EBITDA of $3.7 billion in the quarter, which is impacted by a provision for a tax dispute, the so-called CFEM, the royalties within Brazil. We made that provision I believe a month ago maybe. It was communicated to the market, I think it was in August. And that reflects our assessment of the likelihood of our payments going forward.

Also we are also provisioning amounts for the state mining taxes, which had development recently. So we're talking about the state of Para, the state of Minas Gerais. The state of Para issued a decree with the reduction of the state taxes. The state of Minas Gerais approved yesterday -- the legislative chamber approved yesterday the possibility that the state government also makes some adjustments.

So these are developments that certainly are in connection with the comprehensive conversation that we are entertaining with the government of Para and Minas Gerais with the goal of cleaning up all the tax issues, both past, present and going forward, of our operations within those two states. So it's a comprehensive effort. It's being done in partnership with the authorities, with mutual understanding from side-by-side. And it's been successful. We're waiting for the formal proceedings and documents that will confirm our understandings. And once they happen we can even make a specific conference about those issues. But I believe that the recent developments show that these issues are being well addressed.

On the state of Para for instance, the amount of the state tax has been reduced by two-thirds. So going forward, the provisions and/or payments should be only a third of what has been a provision for this quarter for the state of Para, which is the highest figure of the 145 with response to around $100 million.

So once you take that all into account, so adjusted EBITDA was $3.7 billion. If you compare just the EBITDA this quarter with the previous quarter as I said, the difference is $1.2 billion, which is basically the loss in revenue. And net income you can see how the various other accounts lead to a net income of $1.7 billion approximately.

Now talking about the balance sheet, I would really like to call your attention to page 18 on the presentation. And that's the only page I will highlight, which for those who don't have the presentation, I will describe it. It shows how we generated cash in the first nine months of 2012 and how we used that cash. And the main message here is that we have, yes, adapted our investment program to our cash inflows.

So you can see that the net debt increase in the period was only $1 billion. So the operational cash flows, plus the divestitures that we had -- net divestitures because we had some small acquisitions as well, was pretty much enough to -- not only to pay for the investment program, but also to return capital to shareholders. So that's the type of matching that we are targeting going forward.

So in the past we have talked about a moderate use of the balance sheet, and that's what we call moderate. You see $1 billion net debt increase in the past nine months, so that's something that we're very keen, as I've mentioned to keep our investment grade and to keep our rating as it is. So we're going to manage very prudently that equation going forward.

Well having said that, I will open the microphone for questions and answers. And me and my colleagues, we're here to address those.

Questions And Answers

Operator

(Operator Instructions) Felipe Hirai, Merrill Lynch.

Q - Felipe Hirai {BIO 15071781 <GO>}

I have two questions. The first one is related to the professional divestment of the assets that you mentioned that you could sell if they're not adding any value. I'd just like to understand when would you make these decisions. So if there is a kind of a deadline for these assets you become profitable or not.

And my second question is related to the potential impairment of assets, that we still haven't seen any significant impairment on some of your like non-performing assets. So could we see that happening until the end of this year? And if you could give us some idea of which assets we should think of this impairment.

A - Luciano Siani {BIO 15951848 <GO>}

The first question of sale of assets, I would say that we have a clear idea of what assets we want to divest or look for partners. Now we are in a question of these are transactions that as you know, they require time to be developed and they have the normal course of business. But in terms of a decision, we already made those.

One exception that you might be having in mind is New Caledonia, which as I mentioned, we are resuming ramp up successfully so we're still not in a position to make any decision about that asset. We need to await for the next development and we're probably going to make that decision by the end of First Quarter or beginning of Second Quarter of 2013 with respect to New Caledonia.

On the other fronts I think the decision has been made, but we're not -- we're still I would say exploring the markets to see what's the possibility to realize value on the sale as well. We're not going to fire sale any asset. We know what their values are. So it's a question of I believe we have many possibilities, but we will manage those very carefully.

In terms of impairment, as we pointed out in the press release, we will do an impairment in the Onca Puma asset this quarter. It will not wait for the closure of the Fourth Quarter and the full-year financial statement, so we will announce it in an interim basis.

We already have a revised business case for Onca Puma and we are waiting just to confirm our expectations on the values to be received from the insurance providers in order to have the final numbers. And as soon as we have them, we will announce the impairment numbers. But it's very likely that the revised asset value will be below $1 billion, so anything above that will need to be written off.

The other impairments, we are having a comprehensive assessment of the assets, which perhaps are less likely to return their full book value. But in that respect, we will probably have an assessment of all those assets and the impairments if any made at the moment of the issuance of the full-year financial statements.

Operator

Rodolfo de Angele, JP Morgan.

Q - Rodolfo de Angele {BIO 1541593 <GO>}

I just wanted to go back on the pricing discussion and ask looking forward, as you mentioned on the call, there were a few issues that caused the Company to post a better realized price than I think what investors are expecting. Some of them were related to commercial strategy of Vale. We discussed on the previous call specifically freight and other such as the level of (entities). Should we expect those to continue in place? I mean should we work with improved realized prices the next quarters?

My second question is on projects. I just wanted to hear from management an update on Simandou and Onca Puma, please.

A - Luciano Siani {BIO 15951848 <GO>}

I will start with the projects. I will address Simandou, then lead over to my colleague, Peter Poppinga to talk about Onca Puma. Then we're going to go back to Mr. Martins for the realized prices.

So on Simandou, it is an important growth option for the Company. As you know, our priority right now is S11D, so the resources of the Company will be concentrating on S11D rather than Simandou. However, we are waiting for the regulatory landscape and we need to become clearer. And that includes the logistic solution. It may change, according to the government it may change from what has been agreed like two years ago. So that change, if that happens, and it's likely to happen, it will entail additional studies, engineering studies in order to see the value of the new revised project.

The stake that the government of Guinea wants to have in the project is also undefined, and the royalties. So there's enough uncertainty I would say in the regulatory environment in Guinea that prevents us to making any advancement at this stage. And these are pre-conditions for us to make any more -- further decision on the asset. Our expectation is that the time required for these solutions to be reached, plus the time required for us to develop the studies for the project will pretty much match the ongoing strategy of the Company. So we will concentrate first on S11D on the current iron ore assets that we have in Brazil. Then only if all these assets are resolved, so Simandou will be a growth option for the upcoming future.

With regards to Onca Puma, I would like to ask my colleague, Mr. Peter Poppinga to address the (inaudible).

A - Peter Poppinga {BIO 17245689 <GO>}

The answer is pretty straightforward. The furnace problems at Onca Puma turned out to be more serious than we have anticipated. And we have had significant refractory damage due to some design flaws related to the refractory quality. And this led to some refractory hydration in certain layers. And so the furnace must be rebuilt. And we are anticipating that production will occur only towards mid of next year. That's the reality of Onca Puma.

A - Jose Carlos Martins {BIO 1715332 <GO>}

Rodolfo, actually we have a much better performance in this quarter than last quarter. The reasons are mainly freight performance, which is almost $2 better than last quarter in terms of costs. So then we have a much better FOB price after deducting the lower freight.

Also, the silica (penalty) that we saw appearing since we start selling in the spot basis is reduced also, is almost disappeared. And we have in our sales, mainly of Carajas ore on a spot basis we get even a better premium than Platts index show. So the $2.30 that normally you deduct -- you add as (GIU) in case of our sales on a spot basis of Carajas ore, we are able to get a better premium from them -- from it.

So in the end, we got a price realization that was almost in line with Platts after deducting freight, deducting humidity, moisture and also after adding the (DIO). Part of this performance was really caused by market -- better market conditions. And also because we learned. We have to recognize that Vale was a newcomer in this important market, so we are used to sell 100% of our sales on a contractual basis after a benchmark system we continue to sell on a quarterly price basis, but kind of at an (initiative) pricing. And now we are entering more of the (inaudible) on our sales on spot. So we are learning month after month how to put it better on this market.

I made this comment before. Timing to market is becoming a very important issue that on a fixed price system we don't have this, okay? But now that the pricing is mainly based on the market and Vale pricing, so the time for sales is very important. So we are managing better times to sales. We are managing better the quality that we offer in the market. So even the volume of our ships we needed to better manage the quantity that we well when we sell on a spot basis because sometimes customers want to buy a lower volume than a big ship can deliver.

So all of these things we are considering in our marketing strategy. But every quarter, every month is a different story. So you need it to adapt very fast and that's what we are doing. So as time goes by, we really believe that we always can command a premium on our ore considering our average quality, which is better than our competitor.

So those are the main issues that I would like to comment. And also I believe that our performance may improve going forward.

Operator

Rodrigo Barros, Deutsche Bank.

Q - Rodrigo Barros {BIO 5851294 <GO>}

I have two questions. First one, Martins, if you could do for pellets the same that you did for iron ore? Explain how much you are selling quarterly contracts in the VRN. How much in monthly contracts? And how much in the spot? Because that's the number that we've been getting consistently wrong in our case, we've been too conservative.

And my second question to Luciano, if I may, is regarding the corporate events. We saw Vale (inaudible) in the Oman pellets plant in this quarter. We also saw Vale increasing its stake in VNC. So if you could comment on those two events it will be great.

A - Jose Carlos Martins {BIO 1715332 <GO>}

As far as the pellet pricing system, we sell our average -- is that we sell 20% on these former quarter (lagged) pricing system, okay? And this helps pellets much more than helps iron ore, because a bigger part of our customers in pellets continues to buy under this system.

So I don't have a specific figure for that, but in case of pellets, we have more of them than our average of 20% in that -- that we have in this system.

So pellet prices were favored by this situation. As far as the price continues to go down on average, that will help, but when the price moves the other way around, that will be a -- it will have a negative influence on our price.

Our rule of thumb, but we always sell our pellets at least with our pelletizing costs because we could sell the pellets feed, so then we're always considering what will be the best option to sell pellets or to sell pellet feed. So you always continue to manage this difference.

Besides the pelletizing premium, we also have the policy premium, because the pellets has on average more iron ore content than you have in the regular iron ore. So those factors create a much better premium for pellets. But they are only effect -- mainly effect of this quarter because of this lagged system.

So going forward, we cannot expect the premium for pellets to be much bigger than $40 and then much lower than $35. So that could be the best guess, considering a stable pricing situation.

A - Luciano Siani {BIO 15951848 <GO>}

Martins, maybe you could address as well our sale of a stake in the Oman pellets plant. That's another question.

A - Jose Carlos Martins {BIO 1715332 <GO>}

So when we start building our pelletizing plant in Oman, we have made agreement with the local government to let them buy 30% of the pellets plant. But this has not an impact on the business in itself because the pelletizing plant it works as a service provider. And we only buy the (inaudible) of producing pellets there.

And it's very important to have the local government with us because we depend a lot on the infrastructure that is provided by the government to our operation, electricity, gas. So we believe it's a very good partnership for us and also that not being any burden on our profitability. Something that is fair, is on the return on capital of the pelletizing plant, so we believe that this operation is very good for the Company and very good for our shareholders.

A - Luciano Siani {BIO 15951848 <GO>}

On Vale New Caledonia, contrary to what you might be expecting, so you might be thinking well, Vale increases participation, so it puts money into the operation, which is not the case. I mean Vale New Caledonia, actually we are recognizing formally the situation the fact of which is that our partners as a (inaudible) joint venture between Sumitomo and Mitsui has stopped funding the project as of 2010 after the accident with the column. So Vale already put the money under what shouldn't have been put by this partner. So what we are doing here now is recognizing. So they have been diluted in order to and our participation is increasing, recognizing that reality.

But going forward, the good news is that they will resume funding the project. They are now confident that the project may succeed. They will resume funding the project at this new participation rate. And so that's the status going forward. So that does not involve any outflow of cash disbursement from Vale. Much to the contrary, we should expect now the partner resume bringing funding into the project.

Operator

Alex Hacking, Citibank.

Q - Alex Hacking {BIO 6599419 <GO>}

The first question is in regards to copper. Can you give us some guidance on how much copper sales we should expect next year from Salobo and also from Zambia?

And the second question relates to the possible partnerships. Obviously this has been discussed with Rio Colorado. But is there something that you're also considering in Mozambique with the coal? And does it make sense there to have some kind of partnership with Rio Tinto on the logistics platform?

A - Luciano Siani {BIO 15951848 <GO>}

So to talk about copper I will hand over to Mr. Peter Poppinga.

A - Peter Poppinga {BIO 17245689 <GO>}

So copper, as you know we are studying up Lubambe and we just did it in October. This is a 45,000 tons capacity, it's a JV actually between Vale and ARM. And there's some government participation in there as well. It's going very well. But of course the ramp up will be -- we expect no big hiccups during ramp up. It will be a normal ramp up. I would be hesitant to say to you how much are we going to produce next year. This would be a looking-forward statement. But I would expect that we passed easily the 50% capacity.

On Salobo, if you take -- we have produced this year already 5,000 tons containing nickel. If you take the last weeks of production and annualize that so you see the (rhythms), you see the pace, we are reaching 40% and surpassing probably 50% of the capacity in terms of pace, in terms of rhythms this year. So what we expect for next year is Salobo to be close to capacity, which actually is very similar what happened with our (inaudible) ramp up. We have learned some lessons there. The flow sheets are very similar and so we don't expect a major surprise in Salobo.

Regarding Canada, as you know Canadian copper comes as a consequence from our mines in Sudbury, which are gaining momentum again going back to the old levels of productivity we had before the strike. We still have some work to do. And so for next year, copper production for sure will be higher in the Sudbury basin as well. Don't know if I have answered your question, but that's what we have to say for the moment.

A - Luciano Siani {BIO 15951848 <GO>}

As regards partnership, as a general statement I would say that yes, we are looking actively forward to partnerships within many of our projects. We understand that this is a necessary condition for Rio Colorado. It is a necessary condition. We need a partner in order to go forward in Rio Colorado.

In Mozambique, it's an idea that we are entertaining as well. The only caveat that I would put is that we already have partners in Mozambique. The government is a partner in the railway corridor. There are a few private investors, so all conversations need to involve the government as well.

Operator

Carlos de Alba, Morgan Stanley.

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

The first one is on what is the rationale to keep the logistics service business? We have seen the performance has been sub par, but I want to know if there is anything that is related between this business and your mining operations in Brazil that may prevent you from potentially divesting these assets beyond the railroads.

And the second question is if you can, Martins, explain a little bit, or help me reconcile the fact that as you sell now more in the spot market, you may need to use smaller ships with the fact that Vale's getting more Valemax, that obviously are larger in size. So how does the Company think about reconciling these two trends?

A - Luciano Siani {BIO 15951848 <GO>}

Well on logistics I will give you the same answer. I would say that as we are reassessing all of our assets, as specifically the new regulatory environment in Brazil has changed and has incentivized the entity of logistics operator, so there has been a separation between the entity of the concession holder and the operator. And as you pointed out, the value brought by the business, maybe it's not in line with the best expectations of shareholders. This is also a business that we are constantly evaluating to see what are the best solutions and to see how we go forward.

For the second question on iron ore, I'll hand it over Mr. Martins.

A - Jose Carlos Martins {BIO 1715332 <GO>}

This is very interesting question and I have a great vessel to answer it. First of all, for sure that to minimize the freight costs you really need big vessel, okay? So the bigger the vessel the lower will be the freight cost. And most efficient will be -- more efficient will be the energy consumption. So not only costs, but those environmental impact.

As you probably know, there will be probably a new taxation on carbon emissions 6 so that would add additional advantages of using big ships with lower energy consumption.

But the other side is that mainly in the spot market in China is small customers. They prefer to buy lower quantities. And our competitors are closer and they sell normally 80,000 tons. So that makes them more palatable for those customers.

So what we are doing is we are -- as you know, we are building a distribution center in Malaysia that we want in operation by end of next year, beginning of 2014. So the big ships would make the big part of the journey, optimizing the freight costs. And later you can distribute with the small vessels. So you will be in middle of Asia and you distribute very easily using the right size of vessels for each situation.

On top of it, we have our floating transfer station in Philippines, Subic Bay, where we can move the ore from the big vessels to smaller vessels or even to storage in the floating station also. And we are building a second floating station and if it was needed, we can build another one.

But we believe that with the floating stations with our distribution center, we already have in Oman and the distribution center we are going to have in Malaysia we can solve this problem.

Valemax vessels is now being accepted in many other ports. We are now, besides Oman, (inaudible) and (inaudible). We are also berthing our big vessels in Japan, in (Oisa) and also in Philippines in the GFE sintering plant that they have there. And new ports will accept in the coming months the Valemax. So we are for sure that we have some setbacks on it. For sure we have some additional costs on it, but on average we are improving day after day our operations with big vessels, improving the solutions we have.

So we really believe that after Malaysia we will be in a very good position and for sure we also hope to deliver some big vessels in (China) for big customers, okay? The small customers that buy on the spot, they prefer smaller vessels, but bigger customers that buy on contract or basis prefer bigger vessels. So as time goes by, we see a lot of improvements that we can add to our price realization by improving our big ship operations.

Operator

Chelsea Konsko, TIAA-CREF.

Q - Chelsea Konsko {BIO 17438250 <GO>}

I was just wondering if you could please discuss what is driving greater demand for sinter feed versus pellets in the market. And when do you expect this to be reversed and for you to start operating your pelletizing plants that you closed down again?

A - Jose Carlos Martins {BIO 1715332 <GO>}

So pellets are always more volatile than sinter feed because customers use pellets mainly when they need the high productivity in the blast furnace. In a scenario that many of our customers are operating with at low rates, the use of pellets is not so convenient for them. So the answer to your question will depend on the market behavior. And as long as they need more productivity there you come back to pellets. But I cannot say for sure when that will happen.

Operator

(Marina Melanesian), Credit Suisse.

Q - Marina Melanesian

My question is relating to iron ore (inaudible) volumes. Year-to-date Vale has reached the amount of 220 million tons of (inaudible) and pellets. You have been guiding the volume of 310 million tons for the year, which would only imply strong volume increase in the last quarter. I just would like to know if you believe that this guidance is likely to be achieved. And if yes, where could we see production picking up?

A - Jose Carlos Martins {BIO 1715332 <GO>}

We keep our targets as Mr. Luciano Siani explained before, which is expanded enterprise. Besides the quantity that we can produce in the last quarter, we also have some iron ore available. Then we can invoice a little bit more if the market conditions allow us and if you don't have any unforeseen impact in our production. So we keep on target and we expect to reach it.

Operator

Jonathan Brandt, HSBC.

Q - Jonathan Brandt {BIO 5506998 <GO>}

The first question relates to the CapEx pressure and operating cost pressure. We've seen a lot of headlines from not only Vale, but some of the other majors and some of the minor companies as well, talking about cutting CapEx. Have you seen, or do you expect to see CapEx disinflation coming up? Or are things like trucks and tires still experiencing a lot of CapEx pressure?

And I guess related to that on the operating cost side, if you could explain a little bit more about what plans you have in place to cut operating costs? Or should we think of it more as tied to the BRL and potential weakness there?

Then secondly, if you could touch upon the debt levels. They've been increasing a little bit over the past few quarters. Is there a maximum level that you would take those to? Is there a maximum level that the rating agencies would allow you to take those to? And I guess lastly, would you consider -- if you need to raise more debt, would you consider doing another convertible?

A - Luciano Siani {BIO 15951848 <GO>}

Let me start by CapEx. It's a different situation in the equipment market and the services market. In the equipment market, we are seeing some softness and possibly the easing of cost inflation. Maybe even some disinflation. However on the service side, especially in Brazil, we haven't seen it that clearly. So the market for construction sales in Brazil continues to be very, very tight.

In terms of operating costs, beyond the BRL depreciation, we are targeting structural initiatives and beyond the usual more granular cost cutting programs I would say there are some structural initiatives in place. The first one is the reassessment of low value adding assets. So it's the same thing that we mentioned on the nickel mines, the (inaudible) and (inaudible) mines. So that kind of assessment is being conducted to all our mines and process plants. So we believe there is room for optimization of the flow sheets, the flows of materials to take the most. And maybe halt non-performing assets and get the most value of the operations.

The second one would be on the procurement side Vale traditionally has paid a lot of attention to the big ticket items, which are the ones which are usually procured globally. Now we're turning our attention to the small items that although are more, as I mentioned, small items, together they amount to a sizeable standing, about 50% of our total OPEC spending comes from smaller items. So now we're addressing this internally and trying to change our approach to that as well.

In terms of debt levels, I mentioned in the presentation that the net debt has increased slightly over the last nine months, so just $1 billion. It is true that gross debt has increased more, but we had made war chests in terms of cash going forward. So that was a deliberate strategy as well to operate with higher levels of cash in order to have more flexibility.

The rating agencies, they don't have a target level of debt. They penalize, I would say, a company with a high CapEx profile in what way. If you take the usual net debt over EBITDA, gross debt over EBITDA, or interest payment coverage, the usual ratios that rating agencies use to assign a rating to an issuer. The implied rating that Vale would have would be A-plus or A last time I saw it. But it's above the current assigned ratio that Vale has. The reason being because rating agents they will assign a penalty for the CapEx program.

They believe that they want to see that you have room to manage the CapEx program because they see it as a cash also that is not available for repaying that. So our belief is that as we show a capital discipline and we show that we can effectively manage the CapEx going forward, that this penalty will be -- over time be disregarded and we will be rated more in accordance to our fundamental ratios. So in that respect, the debt levels nowadays are not the most concern for the (rating agencies), but rather the current debt levels, which are low, we should look at the ratios, but in conjunction with the flexibility to manage the CapEx program.

And if we do have the funding program for next year, we're going to look at all alternatives and we have debt coming due next year, which will need to be refinanced, so as usual, we will be tapping different sources of funds in order to -- for our funding program.

Operator

Marcos Assumpcao, Itau BBA.

Q - Marcos Assumpcao {BIO 7474402 <GO>}

My question is on nickel. If you could comment a little bit on the production expected for VNC and Onca Puma in 2013. And also on the pre-operating expenses, how do you expect that that line to behave in 2013?

And my second question is related to the CFEM provision, if you could provide an update on the discussions between Vale and the government related to the difference in the calculations from past royalties? If this increase in provisions is showing that the Company is closer to a resolution in the short term with the government. And if this value on the provision is likely to be maintained at this level or it could be increased at any point in time?

A - Luciano Siani {BIO 15951848 <GO>}

I'm going to pass it on to Mr. Peter Poppinga.

A - Peter Poppinga {BIO 17245689 <GO>}

In terms of nickel, you mentioned specifically Onca Puma and VNC. So as I told you, Onca Puma is rebuilding the furnace and â€"; due to a design flaw. This furnace was built in 2008 and for safety reasons we must rebuild the furnace. So if we start up middle of next year, roughly we expect a number of ramp up profile and this would be not very different from normal ramp ups in furnaces like that now that the furnace would have the problem solved.

In terms of New Caledonia, we have, as I said and as Luciano mentioned, we have successfully restarted the production. All the (inaudible) columns are repaired, the design has been changed. We started up some weeks ago filling the pipeline still and now in November the asset plants start up again and finally nickel will be produced.

In Q1 2013 we are going to assess to decide if this is a viable operation in terms of capacity and how the ramp up goes. But for sure, if you produce with two autoclaves, there is three autoclaves which we produce with two autoclaves like we are forecasting to do, we should have nickel production next year, which should be close to half of the capacity. Then the rest will come in 2014.

A - Luciano Siani {BIO 15951848 <GO>}

In terms of pre operational expenses, just to highlight that if you can see on our balance sheet that has been dragging results. It's around $300 million every quarter I guess. I don't have the number on top of my head. But we will not tolerate this situation as an ongoing situation. So we're committed to reducing that level of -- and that pertains mostly to the two operations mentioned, Onca Puma and Vale New Caledonia. So the reason why we're going to have an assessment in the first half of next year for New Caledonia is to -- really to -- not to perpetuate that situation going forward.

In terms of the CFEM, so the provision was made when our talks would go forward as we recognized that amount of BRL1.2 billion, the provision in dollars, $540 million in dollars, was really part of our discussion that became very clear that the likelihood that we (wouldn't) lose this dispute is really high.

Talks and conversations continue. I don't know if we should expect a big bang in terms of comprehensive agreement that it will be finalized. I would say that the talks continue. A mutual understanding of the (thesis) involved continue, but we're quite confident that the amount that has been provisioned is the expected disbursement outcome. But yet the discussions have not been finalized.

Operator

This concludes today's question and answer session. Mr. Luciano Siani, at this time you may proceed with your closing statement, sir.

A - Luciano Siani {BIO 15951848 <GO>}

Well we believe that the message that we've been voicing recently of capital discipline and value to shareholders and cost consciousness has been very vocal and we made a point in repeating that over and over. But that has to be underscored with our results. And we believe that we have started to show a few instances and a few actions and also preliminary results in the numbers and in our decisions and actions that are quite well aligned with the strategy and the direction that we've been telling our investors.

So our belief is that going forward we will be able to generate a continued stream of additional improvement in the numbers and additional decisions that are aligned to that -- to our directions and let's say deliver on our promises to be succinct.

So I hope investors and shareholders, they give us -- with this preliminary result they give us that confidence vote and we're sure that Vale will deliver amongst its newly established direction and approach.

Thank you, all for attending. And our investor relation team is available for further questions after.

Operator

Thank you. That does conclude Vale's Third Quarter 2012 results conference call for today. Thank you very much for your participation. Have a good day.