Q4 2012 Earnings Call

Company Participants

- Jose Carlos Martins, Executive Officer
- Luciano Siani, Executive Office
- Murilo Ferreira, CEO
- Peter Poppinga, Executive Officer
- Vania Somavilla, Executive Officer HR

Other Participants

- Carlos de Alba, Analyst
- Chelsea Konsko, CREF
- Daniel Rohr, Analyst
- Felipe Hirai, Analyst
- Gary Lampard, Analyst
- Ivano Westin, Analyst
- Jon Brandt, Analyst
- Marcelo Agular, Analyst
- Paul Massoud, Analyst
- Renato Antunes, Analyst
- Rodolfo De Angele, Analyst
- Terry Ortslan, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. Thank you for standing by. Welcome to Vale's conference call to discuss Fourth Quarter 2012 results. If you do not have a copy of the relevant press release, it's available at the Company's Website at www.Vale.com at the investors link.

(Operator Instructions). As a reminder, this conference is being recorded. (Operator Instructions). 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, investors 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 different 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. Murilo Ferreira, Chief Executive Officer; Mr. Luciano Siani, Executive Officer of Finance and Investor Relations; Mr. Jose Carlos Martins, Executive Officer of Ferrous and Strategy; Mr. Roger Downey, Executive Officer of Fertilizers and Coal Operations and Marketing; Ms. Vania Somavilla, Executive Officer of Human Resources, Health & Safety, Sustainability, and Energy; Mr. Galib Chaim, Executive Officer of Capital Projects Implementation; Mr. Humberto Freitas, Executive Officer of Logistics and Mineral Research; and Mr. Peter Poppinga, Executive Officer of Base Metals and Information Technology.

First, Mr. Murilo Ferreira will proceed with the presentation. And after that, we will open for question and answers.

It's now my pleasure to turn the call over to Mr. Murilo Ferreira. Sir, you may now begin.

Murilo Ferreira {BIO 1921488 <GO>}

Good morning. I will start my speech today by addressing one of the most important values, respect people. This means put health and safety first, being environmentally responsible, and supporting the communities where we operate.

As you know, 2012 was a challenging year for the global economy and, particularly, for the mining industry. The slow growth and uncertainty caused fall in minerals and metal prices. Iron ore prices became much more volatile than before and showed a downswing in the Third Quarter of the year.

Against this backdrop, our financial performance was impacted, and the main indicators showed a larger drop against (1211) when Vale attained the best financial performance since its incorporation in 1942.

Underlying earnings, which exclude the noncash, nonrecurring items, was $11.2 billion, and adjusted EBITDA reached $19.1 billion, the third highest in our history.

We distributed $6 billion in dividends, the highest figure since 2012 among the biggest mining companies. And for 2013, we announced last month a proposal to the board of directors to pay a minimum dividend of $4 billion.

Investment reached $17.7 billion, almost $4 billion below the original budget, already reflecting the great forecast on discipline and capital allocation. Moreover, capital expenditures and dividends must be in line with the expected cash flow, with a minimum use of the balance sheet giving our firm commitment to preserve our credit ratings.

The ramp up of Oman, Moatize, and Bayovar projects allowed for production record of pellets, coal, and phosphate. The performance of the iron ore operation in the last quarter of the year was very good. In addition, our marketing policy in iron ore is capturing more value in iron ore sales through higher prices. Our goal is to maximize shareholder returns through the cycles (inaudible).

Discipline and capital allocation is highly mandatory involving, primarily, the focus on world-class assets. As a consequence, you see a smaller portfolio of projects but with great potential to produce high returns on invested capital. There is a lot of value to be unlocked from (inaudible) operation and project (inaudible). The gold stream transaction is a good example of that.

Currently, we have -- there are several projects (inaudible) -- Salobo, New Caledonia, Lubambe. And as long as this process advances, variable costs will tend to decrease. Fixed costs are diluted. Thus, there will be a large swing in the cash flow of these projects from negative to strongly positive.

So far, New Caledonia is operating as expected, proving to be feasible. We expect to confirm its economic viability in about one month.

The Moatize operations are going very well. In 2012, they produced 3.8 million tons, and its main product, the Chipanga hard coking coal, has been received very well by our clients. However, the ramp-up will remain constrained by the capacity of the existing logistics infrastructure (inaudible) railway and port until the construction of Nacala corridor is concluded, which is expected to take place in the second half of 2014.

This year, there are four important projects coming on stream -- additional 40 million CLN, Conceicao Itabiritos, and Long Harbour. They have a large potential to create value over the next few years, being new platforms of shareholder returns. We will continue to deploy capital to our highest return business, and the iron ore projects delivered between 2013 and 2016 will add substantial value.

The progress achieved in environmental permitting in 2012 is a step change (forward) in our iron ore operation, allowing for lower cost, high quality, and production growth.

Unfortunately, we are forced to slow down the construction of the Rio Colorado project, a world-class asset, given that its economics were not in line with our principles of discipline in capital allocation. However, we hope to find a solution to allow us to resume its execution.

The tax disputes are being gradually solved, and we expect the conclusion to take place during this year. This will eliminate uncertainties about our cash flow and will free time to concentrate on managing the business. Although, in initial stage, we are starting to deliver on the commitment we have made.

The divestment program is fully underway, and measures adopted to improve efficiency in working capital management are already giving fruits.

R&D expenditures were curbed, as mentioned, and many expenses have dropped. We have clear signals of reduction in cost of goods sold. And we'll take discipline, persistence, and patience to produce a meaningful, quantitative change in our performance. But we are on track to deliver, helped by the hard work, highest use, and motivation of our personnel.

The global scenario for minerals and metals is gradually improving, and I haven't lost the faith in the future of their markets. Above all, I remain confident in our ability to produce maximum value for our shareholders, and we strongly believe that much better days are still ahead.

Now I will hand over to Luciano, who will discuss our results in more detail. And we will be happy to take your questions later on.

Luciano Siani {BIO 15951848 <GO>}

Good afternoon. I'm going to give some color on the performance of the Company, mainly in costs and expenses, then talk a little bit about our balance sheet, and then hand over to Mr. Martins to talk a little bit about our price realization.

So in terms of cost of goods sold, I would like to highlight to you the trend in the Fourth Quarter of reduction in outsourced services and in materials. You can refer to table 4 of cost of goods sold and expenses in the press release. These are structural components of our costs, and they have started to show a downward trend, although it's still early for the administration or management to give you some guidance as to what our objectives (inaudible). However, these are encouraging signs.

I would like to clarify also something that I didn't do in the previous conference, which is on acquisition of products. As you can see, there's an increase also from the Third Quarter to the Fourth Quarter. And it's mainly concentrating the acquisition of other products from $32 million in the Third Quarter to $148 million. This is not a structural increase in costs. This relates to the sale of our excess energy. Vale has a surplus of energy in 2013/2014. We sell the excess energy in the spot market. So this is the result of the depressed prices in the beginning of the Fourth Quarter. But with the increase in spot prices of energy, the sale of excess energy within Vale should yield better results, and this upward trend should be reversed.

In terms of SG&A, R&D, and other expenses, there has been for the first time in many years a decrease also in the full year numbers from 2011 to 2012. It was a small decrease. However, I would like to point out the relative performance between the Fourth Quarter of 2012 and the Fourth Quarter of 2011. There is, as some of you know, a strong seasonality in terms of expenses and capital expenditures, sustained investments within this Company. We're working hard to try to eliminate that. But however, some factors still exist.

For instance, in sales, general, and administrative expenses, usually, the salaries when they are -- they are usually increased at the end of the year. They have impacted many accounts, mainly provisions for the 13th salary in Brazil and for vacations and so on. So this all reflects at once, in the Fourth Quarter. In addition to that, there are some severance expenses being incurred with the restructuring. But despite that, the personnel account has posted a decrease compared to the Fourth Quarter of 2011.

We also posted strong reduction in services and other items of sales, general, and administrative expenses. As an example, travel expenses, for instance. We are running at a rate which is 50% below what we were running in the first semester of this year. I mention the number of $65 million of travel expenses for this year, of which, we had $40 million the first semester and so at a much stronger pace. Now we are running at only $11 million per quarter.

So this is just some color on the efforts that we're making. And we're strongly confident that we're going to reduce SG&A by at least 20% this year.

In terms of another big chunk of expenses, pre-operating, stoppage, and startup expenses, we have singled out this line. There has been an increase from 2011 to 2012. The increase has much to do with the ramp-up of Salobo. So the costs in 2011 were accounted for as CapEx and now have started to appear as pre-operation expenses.

A high cost in terms of the stoppage of the pelletizing plants. And what accounts for the most part of it is Vale New Caledonia. As Murilo said, the ramp-up of the project -- we're confident that we will reduce significantly the operational and idling expenses. So I would say that reducing it several hundred million dollars is an achievable goal for 2013.

Beyond those pre-operational expenses, you have other expenses, a large chunk. And these were mostly impacted this year by the extraordinary effects of the payments for the settling the disputes over the royalties (inaudible) and also the value-added tax in the state of Minas Gerais, which, these two, account for approximately $700 million. So they shouldn't repeat in 2013, as well, although the TFRM -- the new tax that was introduced by the states of Para and Minas Gerais really increases the level of these expenses on a recurring basis. But there are no recurring effects from the settling of the (inaudible).

So when we talk about our balance sheet, I would like you to, please, refer to the page 24 on the presentation, whereby we show on the left side that we have decreased our cash holdings by $2.6 billion and increased the gross debt in the quarter alone. However -- and the reasons for that can be seen in the right-hand side. So the acceleration of our spending on the last quarter of the year -- you know that we're not running at this $5 billion per quarter rhythm anymore -- the strong dividend which was distributed, and, as I mentioned, you have here $600 million already of cash outflows from the tax agreements, the settlement I just mentioned.

With all of that, we had to increase our net debt by $3.9 billion. But we're confident that we will revert back to the situation because of the strong cash inflows from the gold streaming transaction of $1.9 billion, higher prices than anticipated of iron ore in the First Quarter, and also some proceeds of receipts that were accounted for in the Fourth Quarter. However, they are only going to be cashed in the first months of this year (inaudible) pricing mechanism.

Now I'm going to hand over to Mr. Martins to briefly comment on the price realization. We have introduced a graph here in order to give you more color on the comparison between the Vale prices and the market prices, which is on page 8.

Jose Carlos Martins {BIO 1715332 <GO>}

Good morning, everybody. Good afternoon. Sorry.

The idea we put in this chart on page eight is to compare price realizations of Vale with the IODEX on the same basis. As you know, IODEX is a CNF price, China and also a dry basis. And our price realization normally is shown as an FOB price, our ports, and on a wet basis. So the idea was to show both prices in the same basis and also show the improvement that we are obtaining in our price realization.

By end of 2011 and beginning of 2012, the iron ore price went through a big change, moving from the quarterly prices into most daily price or even spot base price. And that affects our price realization a lot at the beginning. Many factors influence it. But we haven't been managing to improve our price realization, as we can see in this chart, when we compare in the same basis.

Actually, our sales in the last years are moving a lot from western world into eastern or to Asia. Today, we sell 70% of our sales in Asia and 30% in the western world. If you look back ten years ago, the situation was exactly the opposite.

Another issue is the pricing system. We moved from a benchmark pricing system, which was an FOB price, and on a yearly basis and on a negotiated price. We moved from benchmark to a more market price and on a daily basis. Today, 55% of our sales is done on a daily basis -- priced on a daily basis. And the remaining 45% is done in a price that is not more than a quarterly basis. So it's a big change in the price system.

Also, we moved from 100% FOB basis pricing to now almost 50% CNF price basis.

So those big changes have a big impact on pricing, the way we see our prices and also in the price realization.

In spite of all the difficulties, we are managing to improve our price realization, as we can see this comparison done on the same basis.

Looking forward, we see space for improvement based mainly on the quality issues. In the last year, we saw a deterioration on quality price for Vale. Basically, you can see it in 1% iron content in the ore that came from a price as high as $10 per 1% to as low as $2.50 for 1%. So it was a big drop in the price of quality. Two reasons behind that. The first was the price of coal that went down sharply in this period. And a big part of the quality price for Vale ore is because our ore demands less coke for reduction. So we save some costs by using Vale ore. And as the price of coal went down so that the advantage was not that big.

Another advantage of Vale ore is productivity in the blast furnace. As we have higher iron content, the productivity is higher. It generates (lag) in the production. So the customers are used to pay a premium for that. What happened is that, today, we have spare capacity in blast furnaces. So high productivity is not a big need. So the premium for quality also went down.

So those factors affected our price realization, but we have been improving our situation, as we can see by this comparison. And we looked at going forward. We expect some improvement to come, mainly because we believe the price of coal will move up a little bit. And also, blast furnace utilization will increase. We are forecasting something around the 3% to 4% growth in production this year, and that probably will bring higher utilization rates and also will require better ore to improve the productivity. And that probably will reflect on the premium.

So those are the points that I would like to raise to you. And our idea is to keep comparing price realization with the market price, as you see, by the IODEX on a same basis. So in the next report that we are going to make in the future, we intend to keep showing this comparison to you in order to allow you to get a better pulse on what we are doing as far as price realization.

Questions And Answers

Operator

(Operator Instructions) Please, restrict your questions to two at a time. Felipe Hirai, Merrill Lynch.

Q - Felipe Hirai {BIO 15071781 <GO>}

I have two questions. The first one is regarding what you have been saying, that costs might be lower than expected, and you kind of spending the CapEx in some of your projects, like Rio Colorado (inaudible). Iron ore prices are, surprisingly, on the upside. So it seems that you might have a higher than expected cash flow this year. So what are you intending to do with the excess cash flow that you're going to have? Can we expect to see a higher (inaudible) into buybacks again?

And the second question is related to your tax liability. Do you expect to see any kind of other negotiation with the government or there could be any negotiation with the government or just we're going to have to wait for the ruling from the supreme court? And have you heard anything or any negotiating with the tax assessment after 2009?

Those were two questions. Thank you.

A - Luciano Siani {BIO 15951848 <GO>}

In terms of the cash flow, the first priority is to keep leverage in check. The trend has been upwards in the past quarters. And we need to reverse that and keep it in check, bearing in mind that our CapEx program is still significant, especially for 2014, as well, because that's when the S11D project will be peaking its expenditures. And also, the volatility in the markets lead us to believe in a very conservative way in terms of managing cash.

Obviously, if things surprise even more on the upside, we can always consider returning more money back to shareholders. But at this particular moment, the priority is, first and foremost, to keep leverage in check not only in 2013 but also in 2014.

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

Regarding the tax issue, I think that we must consider two different levels. The first one is the supreme court. We have a discussion there, not just Vale but even the CNI. And I believe that, in the next few weeks, you will see this subject being discussed between the ministers of the supreme court. This is one thing.

The second one is that we have a team with people from different companies in discussion with the government regarding a new law and having this discussed -- being many, many months. I believe that we can see a decision or, at the least, the first minutes-- the first draft until the end of March.

Operator

Carlos de Alba, Morgan Stanley

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

The first question is -- I just want to revisit the other operational expenses, Luciano, that you had in the quarter. To me, that was the issue that single-handedly explained the quarter to me. So I think it's very important to focus on this. What can we expect in 2013? Did I hear you correctly that all the pre-operational expenses in VNC and in Salobo will be gone in 2013, because that would be a drop of around probably $300 million and change in that line, which is going to be quite important.

Then the second question is regarding the increased EBITDA per ton of iron ore that you get when you sell on a CFR basis versus an FOB basis. In other words, how much lower your internal freight costs would be versus when you have to buy into the market or you have to net back the spot freight prices that we see? Thank you.

A - Luciano Siani {BIO 15951848 <GO>}

Okay. So addressing the first question, first, on the pre-operating, stoppage, and startup expenses, we do have a trend towards significantly lower numbers. But it will all depend on the successful ramp-up, especially, of New Caledonia and, on a secondary basis, of Salobo.

If we are able to produce how much we have budgeted for this year, you can expect a drop in this line over -- of around between $300 million and $400 million for New Caledonia alone. Additional improvements will come in the following years as we progress on the ramp up.

Salobo is the same story. So we have $121 million of expenses with pre-operational expenses of Salobo. If we can successfully ramp up Salobo -- so these are issues that you should monitor -- we can zero in those pre-operational expenses.

However, there will be pre-operational expenses in the Plus 40 and the Conceicao Itabiritos projects in iron ore. So I would say there are room for additional improvements in the pelletizing companies, as we said. We spent more this year than we expect to spend next year.

But if I would be to give you some guidance, I think the target for the Company would be to reduce this line by between, let's say, to be conservative, $300 million and $500 million if everything goes well.

On the other line, the other expenses, as I mentioned, we had about -- around $700 million of extraordinary expenses with the settlement of tax disputes. But I would say that it's too early -- in addition to those $700 million that shouldn't repeat this year, it's too early to give you any guidance for reduction on the remaining amounts.

I'm handing over to Martins to talk about the comparison between the EBITDA per ton on a CFR basis when you take into account our own performance on freight costs rather than the market's.

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

As we already talked about it, our expectation is to have a cost of (inaudible) of $6 by selling CNF with our own big fleet of vessels. On top of it, to sell CNF is not only about cost but is also about the price realization. When you sell FOB, for instance, I have to sell 30 days before than my competitors, and that puts some pressure on price on us. So by selling CNF, I can sell my ore almost at the same time as our competitors sell. So then I can have -- we can catch up their pricing season. So today, the big advantage of selling CNF is just selling at the same time competitors sell. And this is translated much more in price than in cost.

Operator

Chelsea Konsko, TIAA-CREF.

Q - Chelsea Konsko {BIO 17438250 <GO>}

I noticed that, while iron ore prices were going up quarter over quarter, pellet prices came down. Is the reason for that similar to the reason why the premium for higher FE content was also lower?

And my second question would be -- you mentioned that you had poor results from your equity contributions from subsidiaries. And I was wondering if this is due to these lower pellet prices or other issues at subsidiaries, such as Samarco.

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

As far as iron ore prices are concerned, the premium for the iron content has not to do with the price of iron ore in itself. It's completely independent. So we have iron ore price as high as $180 and higher premium for iron content. At the same time, we have a very low iron ore price and a little bit different pattern for the iron content. The iron content pricing, what we call (VIU) is based mainly, as I said before, on capacity utilization at the blast furnace and the price of coal. So there is no link between both.

If you think that higher price means higher price -- higher capacity utilization, yes. The price for final content could move up. So the premium quality of the iron could move up.

But that cannot have the same pattern as always. We see different patterns, and we see different factors behind iron ore pricing, being the price of the iron ore in itself or being the price of the additional iron content. We see today this iron ore content pricing as low as (inaudible). And the main reason is based on coal price and in capacity utilization. So they are independent factors. We cannot make this relation so directly as you said.

A - Luciano Siani {BIO 15951848 <GO>}

With regards to equity income, you're right. Samarco makes up the bulk of equity income. So in 2012, the portion that came from Samarco is $639 million out of the -- it's about -- almost 100% of the $640 million that resulted in 2012, which means that all the other affiliates of Vale -- we had a mix of positive and negative results that netted out almost zero. But Samarco in itself came down from $878 million in 2011 to $639 million.

Overall, we had lower performance across the board, not only in Samarco but also in the smaller pelletizing companies where we have a stake and, also, coal joint ventures in China. And you have MRS, which is also a significant affiliated, posted flat performance.

But there are rooms for improvement, especially -- we had a swing in Hydro, in aluminum, from $99 million positive in 2011 to a negative $35 million. So it was -- accounted for a significant part of the decrease. I think there are some nonrecurring items in this loss, so this should be -- this shouldn't go back to $99 million. But I'm not forecasting Hydro earnings. But I think the $35 million loss should be perhaps on the conservative side the forecast for the future.

And also, CSA. Our stake in the equity income of CSA was responsible for a loss of $170 million in 2012, which was about the same as in 2011. However, there are some signs that we can do better this year, as well, because, now, the plant is operating more closer to full capacity, and it's being able to dilute its fixed costs.

So these are the explanations for the drop. And there are some directional indications that there can be better results in 2013, although I won't give you numbers.

Operator

Terry Ortslan, TSO Associates.

Q - Terry Ortslan {BIO 1785453 <GO>}

Is there any other assets or infrastructure you can free up in terms of packaging in such a way that's -- like they double track in points, whereby you can get (inaudible) capital and have user fees instead and, as a result, you get some of your money back and, as well as don't worry about the maintenance, number one.

Number two is that I'm trying to understand on the nickel front. Did Long Harbour -- ? The capital you have is $4.25 billion. And the output from there -- how will that work out with respect to the other nickel operations you have in Canada? How much Sudbury would be down versus Long Harbour being up and also the feed from the other operations in Manitoba? Thank you.

A - Luciano Siani {BIO 15951848 <GO>}

To address the freeing up of capital with infrastructure, currently, we have some leasing of rolling stock, and this is a model that we've been employing mostly in our general cargo operations. So this is already a practice within the Company. There are no initiatives, let's say, to scale this back, infrastructure, for instance, other than the mine warehouses and stuff, which is really small, which is not material.

A - Murilo Ferreira {BIO 1921488 <GO>}

And about the base metal, mainly our assets in Canada, please, Peter.

A - Peter Poppinga {BIO 17245689 <GO>}

$4.25 billion. That's the CapEx for Long Harbour. And as you know, it's on track with 80% or 85% of completion.

But if I understand your question well, you're worried about what is this -- has an influence on the other operations. So there is not much influence because Long Harbour is being fed by Voisey's Bay ore body and then will be fed by other ore bodies around. So our capacity when we ramp up in 2014 may be mainly on Long Harbour, which will produce 50% plating and 50% melting-rate nickel. We will have -- this will have no influence on whatever we are producing in our refineries in Sudbury because there is no connection in terms of feed. The feed which would go to Sudbury from the Voisey's Bay mine would now -- is now going to be more and more used at Long Harbour.

Regarding Manitoba, we have -- that's the only outstanding question we have. We have announced some time ago that the refinery and the smelter would shut down, mainly because of the new SO2 regulations and some sustaining CapEx we have to invest there. We are revising that. And the outcome could be that we continue one or two years more this refinery in Thompson.

And we are also looking for some major improvements in the mine so that, in total, the nickel output from the base of the business will, for sure, not decrease. It's likely that it will actually increase in terms of refinery output.

Operator

Gary Lampard, Canaccord.

Q - Gary Lampard {BIO 2019395 <GO>}

My first question is on iron ore costs, and the second one is on nickel business costs.

The iron ore question first. I'm trying to calculate a like-for-like Q4 iron ore cost comparison to the $36 a ton that you can calculate from Q3 financials. This is obviously difficult. It's not just the FOB to cost in freight accounting conversion. It's also to new segmentation of R&D costs and then having to back Q4 out of the full year. But so far, I'm getting a Q4 cost of $48 a ton, suggesting that, on a like-for-like basis, including R&D, iron ore unit costs have gone from $36 a ton in Q3 to $48 a ton in Q4. So my first question is -- is that number right?

A - Luciano Siani {BIO 15951848 <GO>}

Well the straightforward answer is no. However, I'm trying to back it up with some numbers here. Okay. So what we have here is, if you adjust for the freight on the Fourth Quarter of 2011 and adjust on the freight for the Fourth Quarter of 2012, you have a net increase -- I'm getting Fourth Quarter of 2011 against 2012.

Let me suggest one thing. Let me move on to the next question, and then I will get to that. I found the numbers. No. We don't have the numbers. Well we need to get back later on in this conference to get the precise numbers here on the (inaudible) materials. I'll get back to that question.

But the answer, straightforward, is no. And I'll try to back it up with numbers.

On nickel costs, they were stable. Actually, they have fallen a little bit from the Third Quarter to Fourth Quarter from -- of base metals. I'm sorry. Base metals, which is a segment that we report -- the base metals total cost -- they have fallen from $1.569 billion in the Third Quarter of 2012 to $1.538 billion on the Fourth Quarter. And that was not to be unexpected because there was a fall in volume, actually, in copper from the third to the Fourth Quarter. So part of the variation is actually explained by the falls in volume in copper.

Actually, there were some items that increased the cost that offset this decrease, which were increasing depreciation, which, by the way, is a factor across all these business segments. Depreciation costs are increasing. But there were also some royalties in Voisey's Bay that impacted more in the Fourth Quarter than in the Third Quarter. But overall, nickel -- base metals costs were flat, slightly, 2%, downwards from the third to the Fourth Quarter.

A - Murilo Ferreira {BIO 1921488 <GO>}

Later on, we'll go back to the first question.

Operator

Jon Brandt, HSBC.

Q - Jon Brandt {BIO 5506998 <GO>}

I just wanted to go back and just talk about the debt levels and the debt ratios that we've seen rise. I think, like you said, there is good reason to expect them to fall. But could you give us some indication as to what the maximum debt level you're comfortable with? And please, use whatever metric you feel is appropriate, if it's net debt or gross debt. Then, if you could, sort of walk us through sort of the line of thinking if you are able to increase cash flow this year and whether it comes from more noncore asset sales or higher iron ore prices. Is there a preference for returning capital to shareholders? Is it via cash dividends or share buybacks? Is there a preferred method?

And the second question is on Rio Colorado. I know you said there's a board of directors meeting in the next couple weeks. Is that your deadline for making a decision whether the project fully goes ahead? Or is this just something that you're going to discuss at the board of directors meeting? Thank you.

A - Murilo Ferreira {BIO 1921488 <GO>}

What I can tell you about our project in Argentina is that we will be present at the board level regarding several alternatives that must (inaudible). As you know, today, we have a gap in Argentina regarding the costs -- the cost of material, the cost of human resources. And the exchange rate is one of the key issues.

The second big issue is regarding some investment, some demands from the five programs we have (inaudible) five programs, and they are demanding some help, some projects that is not related to our projects. We'll present to the board in order to reserve the final recommendation.

A - Luciano Siani {BIO 15951848 <GO>}

Okay. As regards debt indicators, as you may know, we have different rating perspectives from S&P and Moody's, Moody's being much more conservative, one of the reasons being because of the volatility of our business and our CapEx commitment. That is to say that, in order to continue to have good ratings and access to the capital markets and preserve our ratings, we need to consider those two aspects, like the CapEx commitments for the future and the current volatility of the market. That tends to put us in a position to be more conservative in terms of ratios.

I would say the current ratio of debt to long-term EBITDA of 1.6, which is in the presentation, is something that we are still comfortable with. We wouldn't like to see it evolving further, given the timing of the cycle of our investment program.

Having said that, as I mentioned, the priority is to keep leverage in check. It's still too early to talk about additional dividends and returning back money to shareholders. We still need to go through a lot of periods of high iron ore prices, and we still need to go through our divestment program in order to recommend something around that.

Just going back, quickly, to the question on bulk materials, I am pretty sure, if you look at the personnel, material, gas and energy, acquisition accounts for bulk materials, and that includes iron ore and coal, that the increase that we see is 100% explained by higher volumes, which means that cost per ton on these lines should be stable or lower. Only outsourced services has fallen, as we mentioned, on absolute terms for bulk materials as well. Materials have fallen on absolute terms for bulk materials as well.

The only line that has increased substantially was the freight one. And so we need to then, offline, do some calculations that you can do with our Investor Relations team to take out the effect of the freight from the third to the Fourth Quarter and not only the effect on the freight in terms of the accounting adjustment but also the increase -- the de facto increase in freight from the third to the Fourth Quarter, which we highlight in the press release. So we can -- it won't be difficult to demonstrate, and we can do it offline -- that the cost per ton of bulk materials has remained stable from the third to the Fourth Quarter.

Operator

Daniel Rohr, Morningstar.

Q - Daniel Rohr {BIO 16138004 <GO>}

Hoping you could talk a little bit about the sustainability of the SG&A decline we saw, especially with much of the decline from 4Q 2011 to 4Q 2012 concentrated in the others and services categories. It looks like, in those two categories alone, costs were down $228 million.

A - Luciano Siani {BIO 15951848 <GO>}

It is quite sustainable. Actually, we believe that this decrease we saw from the Fourth Quarter 2012 to Fourth Quarter 2011 will be maintained on a quarter-by-quarter, the same period of the year comparison going forward. So that's why we're so optimistic that we can reduce the full year numbers by at least 20% in 2013 as compared to 2012.

Q - Daniel Rohr {BIO 16138004 <GO>}

Could you offer a little bit more color on -- ? So what of that $228 million that was being spent a year ago but not spent now -- what sort of stuff are we talking about? I know you mentioned airfare. But anything else?

A - Luciano Siani {BIO 15951848 <GO>}

I would say consulting fees, support services, in a general way, that do not relate directly to the operations. Personnel, because we're reducing and simplifying the overall corporate structure. So it's pretty much across the board.

Q - Daniel Rohr {BIO 16138004 <GO>}

All right. Thanks a lot.

Operator

Rodolfo De Angele, JPMorgan.

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

My question is on iron ore. First of all, we saw -- (inaudible) seems to be a bit delayed. Could you share with us your thoughts on the outlook for growth, especially if (inaudible) on the licensing (inaudible).

And I would also like to hear from Martins, his views on iron ore, which has been quite strong, surprising most, I guess. So I just wanted to hear thoughts on the market. Thank you.

A - Luciano Siani {BIO 15951848 <GO>}

Rodolfo, just briefly, on the outlook for growth, there's still -- we're still betting on the iron ore curve that we made public to you on Vale Day last year. That's our best forecast of how the iron ore production will evolve.

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

Well as far as iron ore price is concerned, what we are learning is that we manage much better on the prices going up and the prices went down. There is -- because of the difference between Brazil and Asia and we compete people that are nearby, so that's translating in better price realization when the prices are moving up than when the prices went down.

As you see, our price realization in the beginning of the year as price was going down -- we had much more difficulty in getting better price realization.

By this yearend -- next yearend --last yearend -- sorry -- end of 2012, the price was moving up. So we have a better position to get better prices. So I think that volatility affects us much more when the price is moving down and affects us positively when the price is moving up. And that's what I can tell you.

Another point is that we are improving. We're a company used to sell on a yearly basis. Our stock in the sales department had to have a big change. We moved our people to Singapore to develop a new excuse to work in this new price environment. And that takes time. So I think we were improving day after day.

Operator

Paul Massoud, Stifel.

Q - Paul Massoud {BIO 15062046 <GO>}

My first question is on the coal business, and second, around fertilizers.

On the coal business, obviously, you highlighted some of the logistic constraints that have impacted costs and getting from the (inaudible) to market. But when you look back over the history of the coal business, generally speaking, you've been running at operating losses. And so, if we're looking ahead, given what prices have done, can we expect any kind of an operating profit before the Nacala corridor expansion is complete? Or should we just expect that we should be expecting significantly higher costs until that's done?

On the fertilizer side, for my second question, what I'm curious about is, with Rio Colorado being sidelined or, at least, under review right now, and then some of the Canadian assets being sidelined -- with that in mind, in the past, fairly recently, you've said that your goal was to grow in phosphate and potash for (inaudible). If your main projects for potash are not being executed on, then should we be thinking about M&A as a more reasonable way for you to grow? Or are you going to be putting fertilizers on the sideline until you get some of the other restructuring done? Thanks.

A - Peter Poppinga {BIO 17245689 <GO>}

Okay. Starting with coal and Mozambique, obviously, our hurdle there has been the (inaudible) Rheidol railway. And we've had a very bad start to the year this year. So the challenge is on.

However, we have grown our output there considerably. If you look at our ramp-up at Mozambique, the mine itself has done very well. And we ship everything we can that the rail can carry.

I think the relationship with the CFM, which is the railway operator in Mozambique, is good. This is a learning curve we're on. And we are making progress. So it is not a case that we have to wait until Nacala to happen in order to have a viable and economically attractive business in Mozambique. We will make, I think, and I'm sure, actually -- we will make a lot of progress during the course of this year.

And you have to remember that this is a railway that hasn't been railing anything for 30 years. So there is a learning curve, and there is a ramp-up that has to take place.

In Australia, our coal assets are under a turnaround. The turnaround is well advanced. We have grown our volumes there by about 20%. Obviously, that filters down to the economics of the business. So we are seeing some improvement there. There's a lot of work that is being done both on the operational side and on the cost side. We will see a certain improvement or -- there's certainly going to be improvement in 2013 on those businesses. The message is very clear. The coal business has to stand on its own two feet. So we will have to make those hurdles.

Regarding our strategy for the fertilizer industry or the fertilizer business, we -- you're absolutely right. We want to grow in both phosphates and potash. We have options we are exploring. You mentioned Rio Colorado. Murilo has mentioned it during this call. And that's -- by March 11, we will come back to the markets with more (inaudible).

But we have alternatives. Canada is one of them. We also have (inaudible) centers in Brazil, up in the northeast. And that's -- what we have to do now is manage this portfolio of excellent options that we have.

Operator

Renato Antunes, Brasil Plural.

Q - Renato Antunes {BIO 17439917 <GO>}

The question goes on the S11D project. I just want to get an update about when you expect to get the installation license for the project and also if this is the one and only hurdle so you can bring this to the board's appreciation. That's my question. Thank you.

A - Vania Somavilla {BIO 15867577 <GO>}

We are very confident that we are going to have all these licenses by the end of April for S11D.

Operator

Ivano Westin, Credit Suisse.

Q - Ivano Westin {BIO 17552393 <GO>}

My first one was just your main improvement projects. You have a consistent (inaudible). If you include depletion ratio, what is the expected net growth you expect from those operations or special (inaudible) in the next four years?

Then the second question refers to pellets. This decrease in price on a quarter-on-quarter basis by 10% raises a question on pellet premium. I wonder what is your assumption for premium on a long-term basis and whether these premiums will remain above the cost of conversion. Thank you.

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

As far as the first question, we expect from this project to have an additional production of 20 million tons per year.

And about the second question, we expect the premium for pellets to stay around the $30 per ton, which is, hopefully, the conversion cost. It will depend very much on the market. So the price of pellets is very much relating to-- it's very volatile as far as market is concerned. But looking in the short term, medium term, we believe that $30 premium based on the conversion cost is a fair assumption.

Operator

Marcelo Agular, Goldman Sachs.

Q - Marcelo Agular

My other question has been answered.

But I would like to hear Martins' views on iron ore production growth in China. I mean, there's a lot of runoff mines to come online in the next two or three years in China. There are some numbers running around 450 million tons of runoff mine production. So I would like to hear what your guys -- what's the Vale view on the iron ore production growth in China and in terms of FE content and costs. This is the first question.

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

As far as iron ore in China, we do not believe local production will have a huge impact on the market because, although they are increasing the runoff mine production, the content is decreasing. So at the end, we do not expect any big increase in their local production based on the iron content.

So we see, on the other hand, that, as time goes by, this ore is becoming -- their cost is becoming higher and higher. And many of those mines will not support tougher regulations based on the environment. So we see China more and more concerned about the environment. And those mines generate a lot of waste. And they are a burden for the environment. And looking forward, we see -- we do not see their production increasing in terms of iron content. At the most, you would say, in the same range as they are today.

Q - Marcelo Agular

While the explanation that Peter gave to the Long Harbour -- if you can, repeat that and add a little bit on the color in terms of volumes with respect to Long Harbour this year and next year.

A - Peter Poppinga {BIO 17245689 <GO>}

The volumes this year will be small. It will be a startup in the Fourth Quarter, like I said. And next year, we are planning to ramp up. And probably, we will be around -- we are following the (inaudible) curve number two. For those who don't know what it means, it's, in the first year of the ramp-up, it means, then, something around 40% of the nominal capacity.

What I would like to propose you -- I just follow up on what we talked about the base metals and the nickel flows regarding to Long Harbour and affecting the other operations. I have this -- you know we have, mainly, two strategic drivers here in Canada and in the base metals and nickel business in general. One is it's self-funding. We are now standing on our own feet. You saw this through the gold transaction. And also, we will have some smaller divestments of noncore operations and do, of course, the ramp-ups, which are now delivering.

And the other one is the value of volume. It doesn't mean that we want to reduce volume. It means that what goes into the furnaces do have high value. So we idled two mines. One is the (inaudible) mine in Sudbury. The other one is the Birchtree mine and some care and maintenance. So what will go into the furnaces will have high value. So that means that we are going to operate with less furnaces in Canada, but they will be full and not half full like they are today and not to fee with no value in it. This will significantly reduce our sustaining investments in the following two years to come, including this year.

And you may ask -- well, where is the feed for the refineries going to come from, since Long Harbour is starting up? Well the refineries will -- and, since the furnaces are going to produce less material, the answer is that this material for the refineries will come from Indonesia, where we are increasing our production. You saw the Fourth Quarter this year was significantly higher, since we constructed the new furnace. And we will do another one next year. So this intermediate feed of Indonesia will then fill our refineries here in Canada to the extent that there will be no shortage of feed. Actually, it will be an increase of nickel production.

I hope this explains a little better the flows of the business.

A - Murilo Ferreira {BIO 1921488 <GO>}

Thank you very much for your time. I think that you can trust that we'll continue with the discipline in capital allocation, looking permanently to reduce costs, and working the forecasts in world-class assets. Thank you very much.

Operator

That concludes Vale's Fourth Quarter 2012 results conference call for today. Thank you very much for your participation. You may now disconnect.