Q1 2016 Earnings Call

Company Participants

- Jennifer Anne Maki
- Luciano Siani Pires
- Murilo Pinto de Oliveira Ferreira
- Roger Allan Downey

Other Participants

- Alexander Hacking
- Alfonso Salazar
- Alon Olsha
- Andreas Bokkenheuser
- Anthony Rizzuto
- Christian Eric Andre Georges
- David Wang
- Felipe Hirai
- Ivano Westin
- Jeremy Sussman
- John C. Tumazos
- Mariya Entina
- Martin Roberto Pradier
- Rene Kleyweg De Monchy

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentlemen. Welcome to Vale's Conference Call to Discuss the First Quarter of 2016 Results. 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. As a reminder, this conference is being recorded and the recording will be available on the company's website at vale.com at the Investors link.

The replay of this conference call will be available by phone until May 4, 2016, on 55-113-193-1012 or 2820-4012, access code 3487527#. This conference call and this slide presentation are being transmitted via Internet as well, also through the company's website.

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

With us today are Mr. Murilo Ferreira, Chief Executive Officer, CEO; Mr. Luciano Siani, Executive Officer of Finance and Investor Relations, CFO; Mr. Roger Downey, Executive Officer of Fertilizers and Coal; Ms. Vania Somavilla, Executive Officer of Human Resources, Health and Safety, Sustainability and Energy; Mr. Humberto Freitas, Executive Officer of Logistics and Mineral Research; Ms. Jennifer Maki, Executive Office of Base Metals; and Mr. Clovis Torres, General Counsel.

First, Mr. Murilo Ferreira will proceed to do the presentation. And after that, we will open for the questions and answers.

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

Murilo Pinto de Oliveira Ferreira {BIO 1921488 <GO>}

Ladies and gentlemen, welcome to our webcast and conference call. Thank you, all, for joining us to discuss our first quarter 2016 results.

First of all, I'm pleased to report that, once again, we had a good operational performance, having reached several production records for the first quarter. For example, we achieved production records in total iron ore production, in Carajás, iron ore production, in Tubarão, pellets production and nickel and copper production.

Adjusted EBITDA was $2 billion, 44% higher quarter-on-quarter despite 3% lower revenues as a result of seasonally lower sales volumes. Cost and expenses, net of depreciation, decreased by almost $900 million quarter-on-quarter as a result of seasonally lower sales volumes and as a result of lower SG&A, R&D and pre-operating and stoppage expenses. SG&A decreased 26%, R&D decreased 50% and pre-operating and stoppage expenses decreased 27% quarter-on-quarter.

Our CapEx amounted to slightly more than $1.4 billion in first quarter 2016, with project execution, mainly the S11D amounted $900 million. Despite the $2 billion in EBITDA, cash generation was negatively impacted by the settlement of derivatives in the quarter and by the increase in working capital by $1.3 billion, stemming mainly from the increase in accounts receivable of over $1 billion. Accounts receivable increased mainly due to the concentration of iron ore sales volume at higher provisional price at the end of the quarter.

Working capital change should have a positive impact on cash flows in second quarter 2016, as sales collections increase throughout the quarter. Net debt increased and amounted $27.7 billion, with a cash position of $3.8 billion. The increase in net debt was mainly driven by the impact of the exchange rate on the translation of Brazilian reais denominated debt in U.S. dollars and by the negative free cash flow the first quarter 2016.

Now to talk about Ferrous Minerals. Above all, I'm proud to inform you that our iron ore and pellets EBITDA breakeven measured by unit cash cost and expenses on a landed-in-China basis decreased from $31 per dry metric ton in the last quarter 2015 to $28 per dry metric ton the first quarter 2016, just over a 10% reduction.

Our freight cost decreased by $2.08 per ton to $11.30 per ton due to the positive impact of lower bunker oil price in our chartered contract, the renegotiation of freight contracts and the higher exposure to the spot rate market. Our C1 cash cost FOB port per metric ton for iron ore fines ex-royalty amounted $12.30 per ton, remaining practically in line quarter-on-quarter despite less fixed cost dilution on a seasonally lower production volumes. Due to the big improvement in price realization and reduction in cash costs, our Ferrous Minerals EBITDA amounted $1.7 billion, increasing 23% quarter-on-quarter despite seasonally lower sales volumes.

Physical progress reached 85% at S11D mine and plant, 64% at S11D logistics sites and 85% at S11D railways port. We are very much on track with these milestone projects which will currently high quality, low-cost ore for a big period of time.

EBITDA from the Base Metal business segment amounted $329 million, almost 200% higher than the last quarter 2015, despite lower nickel and copper LME prices. The reduction in costs and expenses is a recurring theme throughout all the operations with highlight for VNC and Salobo. VNC unit costs and pre-operating expenses, net of byproduct credits achieved $12,700 per ton in the first quarter 2016, decreasing 27%. In spite of the improvement, VNC still post a negative EBITDA of $48 million. Salobo's EBITDA amounted about $130 million, being 75% higher quarter-on-quarter. This improvement was mainly driven by a more than 40% decrease in costs as we mined higher copper grades and benefited from higher byproduct credits.

With coal, we continue to focus on reducing cost, increasing profitability and ramping up the Nacala Logistics Corridor. Ramping up of the Nacala Logistics Corridor continue as planned, with close to $1 million tons of coal transported in 13 shipments concluded in the first quarter 2016. Coal EBITDA improved by 38% as a result of lower costs with the ramping up of the Nacala Logistics Corridor and the sound operational performance in Carborough Downs. Fertilizer EBITDA was impacted by lower market price and seasonal lower volumes amounting $70 million in the first quarter 2016.

I'm pleased to inform you that we reduced our costs and expenses in all of our business segments despite the seasonally lower production and sales volumes and that we progressed well with the implementation of our most important projects. We work resolutely together with Samarco and BHP to reach an agreement with the Brazilian authorities that can provide a good base for accelerating the environment remediation and the compensation for the area and people affected. We are conscious that this agreement will not bring back the lives lost and we also understand that this will be a long journey. But I'm confident that we are taking the right steps in moving in the right direction.

Finally, I would like to let you know that in spite of the increasing prices, we remain fully committed to the strengthening of our balance sheet through the reduction of our net debt, as previously informed. We remain focused on our operating and capital allocation discipline and on progressing our divestment and asset optimization progress. We have a clear destination and we have a clear road map. Our strategy is to use the map to the best possible advantage for Vale and our stakeholders.

Thank you for your attention, and now let's open this webcast for your questions.

Q&A

Operator

Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. Our first question come from Rene Kleyweg with Deutsche Bank.

Q - Rene Kleyweg De Monchy

Morning – afternoon, everyone, and congratulations on a good set of numbers and great to hear that focus remains on debt reduction and balance sheet repair. Two questions. One, in terms of S11D, nice to see the progress in terms of the rail and the mine. Could you provide some color on where we are with the truckless fleet? What has been assembled? What's on site? What sort of testing are you going – are you undertaking? And what sort of confidence or what – how we should see that evolving in terms of managing the ramp-up risk around that over the next 12 months?

And then the second one is on nickel, if there's any update that you could provide given the improvements in VNC's cost structure, Onça Puma breaking even? Both assets potentially under review, what's the latest thinking on that? And what sort of – when will you be in a position to make a firm decision on whether there's a care and maintenance program at either of the operations? Thank you.

A - Murilo Pinto de Oliveira Ferreira {BIO 1921488 <GO>}

Rene, thank you for your question. Let me start with nickel.

A - Jennifer Anne Maki {BIO 16392645 <GO>}

In New Caledonia, we continue our review of exploring our options for the asset and it will be later this year. I don't have an exact date, but later this year after the conclusion of the second half for sure. In terms of the operations, they're doing what they can and they know that everybody's patience with the operation is up and they're really focused on reducing their costs and stabilizing their production. And I think you see that in the first quarter results. And I think there's a lot more work to do, obviously, there, as we're still losing money on each ton of nickel sold.

And they have a plan for further cost reductions in terms of more contracted services. Contracts are being renegotiated. We also have a lower tier of contracts still to review.

We're improving programs to improve our consumption ratios on raw materials, as we process those. And I would say productivity improvements, especially in terms of labor from the mines through to the process plants.

And so with Onça Puma, they remain focused also on their cost reductions. They had a little hiccup in the furnace in February, and that's why you see a slight movement up in their unit cash costs this quarter. But they're really focused on reducing the cost and getting their production up and we expect to recover the production lost in the first quarter throughout the remainder of the year.

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

Rene, this is Luciano addressing your first question on the truckless. Let me first remind you that Vale already operates a truckless system in the existing Carajás mine to remove overburden. So obviously it's on a smaller scale, but we feel that we have a good start to operating the upcoming truckless system in S11D because of that. And we're doing a lot of very intensive training, not only on the – of the new operators, not only in the existing truckless system in the current mine in Carajás, but also abroad in Germany with the suppliers and specialized companies training on that.

The truckless system resembles a fork whereby the handle of the fork and the, let's say, the base where the teeth joins the fork will be ready to commissioning in June. And the first tests without ore in September, and the tests and the final operation with ore in November. The teeth of the fork will be installed one by one from the second half of this year until the first half of next year, but the substantial part of the truckless system will start to be loaded already in November, and therefore, feeding the mills in order to start producing at S11D.

So, just to give you a – the name of the company in Germany, which specialize on those systems, is RWE. So, we have hundreds of people being trained right now. I'd say we do not anticipate any major issue for the start-up of the truckless operations. The assembly, the final assembly is progressing really well and we look forward to the start of commission in June, July.

Operator

Our next question comes from Jeremy Sussman with Clarkson.

Q - Jeremy Sussman {BIO 15112588 <GO>}

Hi, and thanks very much for taking my question. I guess a month or two months ago you all came to an agreement with Fortescue for blending. And also I think the potential investment in Fortescue itself down the road. Can you just – can you walk us through the thought process here? And I guess what your plan is going forward?

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

Jeremy, this is Luciano. Just to recap, in the – the agreement with Fortescue had three major points: the first one about the blending; the second one about the possibly of joint investment in replacement projects in Australia; and the third one, the potential 15% participation within Fortescue.

For us, the two first ones are the most important. The blending agreement is being developed right now, is being detailed. It's important to manage the relative supply of our different products given the recent decline in the premiums for Carajás. I'd say this is something that the relative value of Carajás in the Brazilian Blend Fines is showing us that perhaps the best way to capture some value is to offer blending – blended products to the market at this point in time. So that was, I would say, one of the two major incentives for us to reach that agreement with Fortescue.

On the other hand as well, the joint investment in Australia is something that we need to have, especially in light of the regulations in Brazil. It's always very good to have an optionality, where to best invest in order to keep production stable as the mines naturally deplete. So, I would say, we have a hedge for future eventual regulation changes.

And finally, the participation – the 15% participation in Fortescue is more of a theoretical possibility. We take this as a statement that we are welcoming a controlling group. We obviously do not have the resources, nor the balance sheet to do it right now, so it's more of a long-term optionality. We didn't especially look for it, but it came as a part of the agreement, so it is welcome as an option, but nothing that we want to pursue in the short, nor even perhaps in the medium term.

A - Murilo Pinto de Oliveira Ferreira {BIO 1921488 <GO>}

Just to add one further information regarding the end of the process to finalize agreement with the five port facilities in China, looking to go ahead with the blending program. Thank you.

Operator

Our next question comes from Alex Hacking with Citi.

Q - Alexander Hacking {BIO 6599419 <GO>}

Hi. Thank you. Good morning. Congratulations on all the progress the company's making. It's great to see. I guess, couple of questions. Number one, you discussed last quarter the – that you would be thinking about strategic asset sales. Does the change in the iron ore price or the significant increase in the iron ore price, does that change your thinking on that either way? Make it more likely or less likely? Or it's still kind of the same thought process there?

And then secondly, regarding your freight cost, which was down to $11, I think, should we expect this to be relatively stable now? Or are there more – is a lower freight rate possible based on changes of mix of spot, fuel costs, more volume access? Thank you.

A - Murilo Pinto de Oliveira Ferreira {BIO 1921488 <GO>}

Alex, thank you for your question. We didn't – in spite of the increase in price, we remain fully committed to the strengthening of our balance sheet. Then in this point of time, what we are looking is to have some strategic transactions that could give us some flexibility in the financial context and deleverage our balance sheet is the target we are not – we are not looking to the monitor to see what's happening on a daily basis. We have our strategy and we must deliver. Now, Luciano?

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

Alex, on the freight costs, we have some headwinds now. The bunker price has slightly rebounded and the spot rate has increased more markedly. So, therefore, I would say to keep the current level stable, it's going to be a challenge, but we have some – also some potential improvements going forward. We still have contracts to renegotiate. We still can have more exposure to the spot market. And also just to remark that the effect of the berthing of Valemax directly in China is just starting to show up.

One of the key benefits of that is that we do not need to transship any more iron ore in our transshipment stations in the Philippines, which means that on all those barges, we're saving a good amount of money by not stopping at the Philippines and incurring cost for the transshipment and putting smaller vessels which are less efficient for the last leg of the voyage. So, I'd say good bet to – that we will pursue stability over the next quarter, even in light of the increase in bunker and spot rates. However, over the longer term, we'll still continue to work to reduce freight.

Operator

Our next question comes from Christian Georges with Société Générale.

Q - Christian Eric Andre Georges {BIO 1557701 <GO>}

Yes, thank you. A couple of questions. One is on your coal operations in Mozambique. We see you've had a lot of volume on thermal coal coming out in this quarter. And I wonder, how do you guide for – what we should expect for the rest of the year? And also your cost – your base has improved greatly. What's your outlook for 2017 and the speed at which you may be able to come closer to breakeven, it is my first question?

And the second one is about all the headline we've seen on fertilizers in Argentina and you're looking at perhaps finding a private equity to join. Is there anything official from your end with regards to the current negotiation on this? Thank you.

A - Murilo Pinto de Oliveira Ferreira {BIO 1921488 <GO>}

About Argentina, we are extremely focused and go ahead with our iron ore project, S11D, to deleverage the company. We don't intend this to have any new project looking to have a new investment. But we will provide all the assistance in case of having a third party with high interest in the implementation of the project.

Roger, please go ahead.

A - Roger Allan Downey {BIO 7419641 <GO>}

Yeah, hi. Regarding shipments from Mozambique, as we ramp up Nacala, we were aiming towards to shipping, but total just above – just around – just under 14 million tons this year. The Nacala ramp-up is going really well. We have – obviously, we have a production and an inventory in – at the mine, so it looks like our targets will be reached. Thank you.

Operator

The next question comes from Alfonso Salazar with Scotia Bank.

Q - Alfonso Salazar {BIO 18358082 <GO>}

Hello. Thank you. The first question I have is regarding the permit situation in Brazil, especially for the Fábrica mine and how – if you can give us an update on how is everything going after what happened in Samarco? And the second is regarding the expense reductions in research and development and the pre-operating expenses. They look much lower now, but what can we expect there going forward? Do you think that these levels are sustainable? Or they might go a little bit in the future? Thank you.

A - Murilo Pinto de Oliveira Ferreira {BIO 1921488 <GO>}

Alfonso, thank you very much for your question. In fact, we got environment permit for Brucutu, roughly 20 days ago and it was on Friday. And on Monday, we got for the Fábrica as well. And then I think that everything is going smoothly. We know that the government of Minas Gerais is having a big issue regarding the lack of people to work in the environment department. But regardless of this, we have this good movement in terms of environment permit in Brucutu and Fábrica.

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

In relation to the expenses, first R&D. Yes, we should expect some uptick in the following quarters. We do expect a reduction for the entire year, compared to last year, of around 20%. But still this level of R&D isn't the one which you should extrapolate for the rest of the year, so there should be an increase. Although for the entire year, there should be around a 20% decrease from last year. In terms of pre-operating expenses, we are very optimistic. We think we can continue to reduce it.

As you noticed, VNC is not posting pre-operating expenses anymore. That's the same to the Nacala Corridor, so two projects which now are beyond the point of posting pre-operating expenses. We still have sizeable stoppage expenses in Mariana, following the accident on the Samarco, as we repair the conveyer belt and go forward and resume production. This should go down as well.

And finally Long Harbour which is – which the ramp-up is progressing really well. We still posted around, I think, $48 million of pre-operating expenditures in the quarter, but we should expect along 2016, that number to reduce as well. So, I'd say on a normalized basis, going forward, we had last year almost $1 billion of pre-operating expenditures. With the completion of projects, you should expect this number to go really, really, really low.

A - Murilo Pinto de Oliveira Ferreira {BIO 1921488 <GO>}

Thank you.

Operator

Our next question comes from Andreas Bokkenheuser with UBS.

Q - Andreas Bokkenheuser {BIO 7182883 <GO>}

Thank you very much for taking my question. In your efforts to strengthen the balance sheet, obviously you're still maintaining focus on divestments and so on. Has there been any considerations to do – within the iron ore division what you usually did before within the precious metal division, which is to sell your streams of volumes? Have you considered selling iron ore streams forward? And if so, in an effort to raise capital, what would a potential structure look like if that was considered? Thank you.

A - Murilo Pinto de Oliveira Ferreira {BIO 1921488 <GO>}

In fact, we are open for all the options. We are analyzing carefully in terms of the tenor of the transaction, in terms of the flexibility. We don't have any constraints in this regard. I think that the process is doing very well and as I've had the chance to express in our conference – in our last conference, we don't have any constraints. We wanted to reach some goals in Vale and we'll deliver it. I think that this is the point that it's critical for us. Thank you.

Operator

Our next question comes from Tony Rizzuto with Cowen & Co.

Q - Anthony Rizzuto {BIO 1490590 <GO>}

Thank you very much for taking my questions. It's very good to see the progress on the cost side. My first question is in regards to China, and I'd like to know how you see prospects for crude steel production there for this year? And what you're estimates are for domestic iron ore production in China and also for seaborne imports?

My second question has to do with the announcements recently by your peers, and in addition to your own, about your production coming in at the lower end of the range of guidance. And I'm wondering specifically if this is a signal? Or should we read into this that this is a newfound discipline by the industry, just like, your thoughts on that?

A - Murilo Pinto de Oliveira Ferreira {BIO 1921488 <GO>}

Tony, thank you for your question. In fact, in our board meeting last March, I had the chance to share with the board members regarding the scenario that we had the chance to see China. I'm very frequent to China, I could say that four times or five times per year. And at that time, in the end of March, I had the chance to share with them that the – for the first time probably in one year, one year and a half, we note that the mood in China was different. And it was very clear. I know that we could consider as a result of the credit side – and there's some flexibility in this regard – for sure, very important. But even the property, the picture that we can see right now is much better.

You know that the last two years, we had a drop in new starts globally, around 27% – just in the first two months of the year, 2016. This year, 2016, we note an increase of 13.7%. And I could say, based in the numbers that I have in hand right now, it's above 27%, which is really very impressive.

I believe that China, in the property market, is doing much better that we can see most of the statement, most of the news around the world. And it was not something that I had the chance to share, right after this price increase, this new movement to reach $60 per ton. But it was previously, I think that the picture that we can see in China now, in the physical market, it's much better that I could imagine it, for instance, in August or September last year.

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

Ah, Tony, just some additional information on your sub-questions. So, maybe we will see flat production of crude steel this year, although on the first three months, we had a decline of 2.5%. As you saw, imports into China of iron ore have increased by 6.5% in the first three months of the year, compared to the first three months of last year.

If you do the math, as port inventories have not risen and as mill inventories, inventories at the mills are somewhat stable as well – the only possible conclusion is that the closure of mines in China is actually larger than even us would expect before. Like, we were working with the possibility of maybe 180 million tons of domestic production this year.

But I would guess the numbers are pointing more towards a lower number, perhaps 150 million tons of production. Obviously, you should not see the same pace going forward because of the recovering prices. But it is encouraging. Like, supply side is working in China.

In terms of discipline, we have always said that we will be careful in putting Carajás in the market, especially with the ramp up at S11D. We intend to offer the products in the pace that the market can absorb in a healthy way. We do not have any incentive today to force the mines beyond their limit. It's better to produce at lower cost and very profitably looking at the margin opportunization as a whole. So, therefore we feel that 340 million tons provides the best equation for us going forward this year.

Operator

Our next question comes from Alon Olsha with Macquarie.

Q - Alon Olsha {BIO 16548627 <GO>}

Hi. Thanks for taking my questions. Just three quick questions. Firstly on Samarco, you mentioned in your production report that the operation was expected to be commissioned again by the end of this year. Although timing was uncertain can you just run through the various variables we need to consider there for influence of timing of that ramp up and also what the ramp-up profile would look like into 2017? Secondly, just on working capital, there was a bit of a build in working capital in the first quarter. How much of that can we expect to reverse in the second quarter of the year? And then finally, could you just give a quick update on the Mozambique coal JV? The progress there as well as the MRN sale? Thanks.

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

On Samarco, the key variable to consider is not technical, it is the environmental permitting process. There are lots of details and technicalities which are involved which can – the timing of the permitting can vary by a few months. Depending on what the authorities believe, it's the most reasonable way to license. So, if you are going to use primary data or secondary data or whatever, so it's really technical, but – so there can be a variation of a few months. The production profile, I'd say we have to be very – Samarco has to come back on a reliable basis given all that's happened. So, we will be on the side of conservativeness. We don't want to incur any errors going forward, but obviously the assets are there and we have the condition to go as we please.

In terms of working capital, approximately, I would say between $300 million and $500 million could be reversed. That relates to the invoicing of adjustments for the provisional pricing. So, just to give an example, sales which were done within the quarter, let's say, sales that were done in February, they were provisionally invoiced at a particular, lower price. Those ships arrived at the ports within the quarter in May. But then the final price was greater so we had to issue this provisional invoice. And we still have to collect those amounts. So, as prices stabilize, we should collect these differences and then everything should be ongoing smoothly. Obviously, if prices go back then the accounts receivable will improve again, right. But this, assuming price is stable, they should improve by $300 million to $500 million.

In terms of the Mozambique coal JV, we're still working very hard on the technical aspects of the agreement. We have announced lastly that we had agreements from the Mozambican authorities. We had from the Ministry of Transport, which is the one leading the negotiations, that has been submitted to the Council of Ministers. We haven't got final approval yet. But I would say that's the key bottleneck for the successful completion of the term sheets, which still if that succeeds is expected for the month of May.

A - Murilo Pinto de Oliveira Ferreira {BIO 1921488 <GO>}

And about MRN, I think that important that we reach an agreement with one entity that is currently partner in MRN. Then we decided to open a discussion with a third party. And we are in the beginning of the process again. Thank you very much.

Operator

The next question comes from Maria Entina with Pacific Life.

Q - Mariya Entina {BIO 18726063 <GO>}

Thank you for taking my question. Just a couple questions on the Midwestern iron ore system. I know the annual filing last month indicated that reserves were – iron ore reserves were completely impaired. And based on the Q1 production report, volumes at Corumbá are down about 70% year-on-year and 25% at Urucum. What is the plan for these assets? And would it be a closure of the mines or a possible sale? And additionally with respect to the provisions for losses associated with the long-term river freight agreement, what will be the outcome with these? Is there any litigation pending?

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

The production at the Midwestern system is not economical right now. So, that's the reason why the reserves were marked down to zero. The reason why we continue to operate, it's because the cash flows are negative, yes, but better than if we close the mine because of the take-or-pay agreements that we have with some counterparties. So, some of these take-or-pay agreements are being renegotiated. So, final production would have to take this into account, but as we – where we stand, it's better to still operate at a loss than to close and pay in full the take-or-pays and the cash flow losses would be greater in this regard. But we're working very diligently in order to minimize those losses and talking to see if we can make agreements with the parties involved.

Operator

The next question comes from Felipe Hirai with Bank of America Merrill Lynch.

Q - Felipe Hirai {BIO 15071781 <GO>}

Hi. Good morning, good afternoon, everyone. So, just two questions on our side. First, Luciano you mentioned the reverse – potential reversal of the working capital. We just wanted to understand if this is somehow subject to iron ore prices because, our own impression is that as iron ore prices go up, your working capital might actually not come down as much as you were expecting in the second quarter. And my second question is related to the bunker hedge that is still flowing to your income statement, so could you just give us an idea of how much should we expect in terms of losses or payments for the bunker hedge for the – in the next two quarters? Thank you.

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

Okay. With the working capital, you're right. So, my answer had the assumption that prices would be stable, so because if prices go up or down, then there's important changes related to the outstanding sales at the end of a quarter in comparison to the outstanding sales at the end of this quarter. So, the assumption that I've made is constant prices.

In terms of the bunker hedge, the – we didn't bring this quarter on the release, the outstanding contracts, but you still have it on the financial statements. You have it on footnotes...

A - Roger Allan Downey {BIO 7419641 <GO>}

19.

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

...19? And the fair value of the – all the derivatives, it's a negative $644 million outstanding, so there was a reduction from December 31. Just to give you a brief idea, we had close to 6 million tons of bunker oil hedge positions outstanding at the December 31. That has reduced to around 4.5 million tons of bunker oil, so roughly a fourth of it has been paid off as well.

As we said, this will vanish in 2016. So, we paid around $250 million this quarter and we'll still have, if prices do not change, $644 million to be paid, so it's a heavy burden, we acknowledge that. But the good news is that there's only three other quarters to come and as we mentioned before, there's no more impact in the EBITDA because the open position, we're still even greater if you come back – go back two quarters or three quarters.

Operator

Our next question comes from Ivano Westin with Credit Suisse.

Q - Ivano Westin {BIO 17552393 <GO>}

Hi. Thanks for the question. Just would like to follow-up on a point I discussed on the Portuguese call. It's very clear that you recorded a sizeable reduction around cash cost in VNC. But if you extend this to your consolidated cash costs on both nickel and copper, what can you expect moving forward if it pays off quarter one, that volume in the part of the year? Or is there additional downside for that? Thank you.

A - Jennifer Anne Maki {BIO 16392645 <GO>}

I would expect the trend in Q1 to continue. Obviously, the Canadian dollar has appreciated a bit so that will impact us going forward in Q2. But we tend to have increased production throughout the year with the first quarter being the lowest. So, you'll see some dilution of the fixed cost as we increase our production to get the 320 million tons that we guided for the year. And in VNC, I would expect further reductions over the course of the year as they continue to implement their cost reduction programs that really there's more phases to go and still a lot of work to be done there.

Operator

The next question comes from John Tumazos with John Tumazos Independent Research.

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

Congratulations that selling prices are rising, volumes are rising, costs are falling, iron ore, copper, nickel. I feel like doing a celebration dance at my desk. How much do you expect roughly in a range to reduce debt, the June quarter, the September quarter, the December quarter? Virtuously, the biggest use of cash was putting $1 billion into receivables because you're selling more. That's another good thing.

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

John, Luciano. If we go back to Vale Day, we had an expectation at $40 per ton of a negative cash flow for the year between $2 billion and $2.5 billion, right? Roughly, so far, we've recovered around $1 billion from the forecast given the – how prices have behaved so far. Which means that if we all of a sudden collapse to $40 per ton, which obviously doesn't seem to be happening. We would still be short $1 billion to $1.5 billion in our goal to keep that stable outside the strategic transaction that we've been talking about to slash that.

So, depending on how you forecast prices to go forward, if you just assume the forward curves, then this $1 billion to $1.5 billion shortfall would be reduced by basically half or even $500 million or – to $500 million, so I didn't make the exact calculations.

So, my estimate would be that we're pretty close to ending 2015 with the same – 2016 with the same debt position of 2015 in the absence of transactions. So therefore, as we have increased that by around $2.5 billion this year, so far in the quarter, we should have this trending down towards the same level of December 31, absent any divestitures. So as we progress in the divestiture program, if we achieve, let's say $2 billion, $3 billion, perhaps even $4 billion aside the strategic transaction, you should see a corresponding reduction in debt again for the third time aside the strategic transactions.

Operator

Our next question comes from Rene Kleyweg with Deutsche Bank.

Q - Rene Kleyweg De Monchy

Thanks for the follow-up question. The – it was just going back to Mozambique, and I appreciate that the contracts are still doing the rounds, but are you in a position to say that the economic details of the contract have now been bedded down? Or are those still being discussed as well? I'm just trying to understand if it's purely an administrative process? Or if there's still a negotiating element to the terms and conditions as well? Thank you.

A - Murilo Pinto de Oliveira Ferreira {BIO 1921488 <GO>}

Rene, thank you again for your questions. About Mozambique, what we have and we will address permanently with them is mainly about the off-take contract. We have some rights and we gave to them some rights about the off-take and we are providing some adjustment in this regard. I think – but generally speaking, it's the same idea that – or the same context that we presented to the market when we did the transaction with Mitsui. Thank you.

Operator

Our next question comes from David Wang with Morningstar.

Q - David Wang {BIO 20343301 <GO>}

Hi. Thank you for taking my question. I was wondering with the recent going up in iron ore prices. Have you begun to see any supply response? Especially from the higher cost players that may have been thinking about exiting the market when prices were closer to 40 or below? I know for the large players, yourself and the large Australian players have guided towards a little bit of lower guidance for production, but mostly due to operational issues or things out of your control. For some of the higher cost players though that were perhaps thinking about exiting the market, are you seeing any of those tons coming back online?

A - Murilo Pinto de Oliveira Ferreira {BIO 1921488 <GO>}

I think that what we can feel right now in China is permanent shutdown. The action of most of the majority – absolutely majority is mainly regarding the quality and the volume in terms of exploration, in terms of production. For sure, the importance of the movement in the infrastructure and the real estate is – both are very important, but I think that unexpected way, it was mainly in the supply side.

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

Just to follow-up. Everyone is talking about the possible decline in iron ore prices in the second half, given seasonality, bigger supply and so on. So, this is the same picture that produces our scene. So therefore, there might be some opportunistic moves from people who are already producing in the market, maybe to increase life to their production, but we wouldn't see an incentive so far for people who have already decided to come out of the market and shutdown to really come back because it requires capital and renewed investment and the outlook is still very uncertain. However the players who are producing could bring marginal tons additionally, maybe changing mine plans and so on. So, that could happen. But other than that, still very, as Murilo said, those guys who went out, very unlikely that they will come back.

Operator

The next question comes from Martin Pradier with Westwood.

Q - Martin Roberto Pradier {BIO 1532154 <GO>}

Yes. Thank you for taking my question. My question is in terms of Mozambique, how many tons do you need to breakeven in that operation in terms of tons per quarter? Because obviously there is some decrease in fixed cost. So, if you could help us understand where is the breakeven assuming current pricing.

A - Roger Allan Downey {BIO 7419641 <GO>}

Yeah. That's a very good question. Obviously, and – as with any bulk commodity, we need to move volumes, right? It's a very volume-driven business. It also depends on where your price assumptions are. Obviously, when you say breakeven, at what prices? At current prices, as you can see from the improvements in our albeit negative EBITDA in Mozambique, that the volume effect is quite substantial. Costs do come down dramatically. So, I guess, with our expectations of shipping it back just under 14 million this year, we can probably be seeing – and obviously it depends on where prices go. But we should probably see numbers, which on a cash basis already show – moves us in to breakeven point.

A - Murilo Pinto de Oliveira Ferreira {BIO 1921488 <GO>}

Thank you very much for your time, for your attention, and having so many questions and interest points to be discussed in this call. All the best.

Operator

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