Q2 2013 Earnings Call

Company Participants

- Galib Chaim, Executive Director
- Jose Carlos Martins, Executive Officer
- Luciano Siani, Executive Officer, CFO
- Murilo Ferreira, President & CEO
- Peter Poppinga, Executive Officer
- Roger Downey, Executive Director

Other Participants

- Andreas Bokkenheuser, Analyst
- Carlos de Alba, Analyst
- Daniel Rohr, Analyst
- Ivano Westin, Analyst
- John Tumazos, Analyst
- Marcelo Agular, Analyst
- Paul Massoud, Analyst
- Rodolfo De Angele, Analyst
- Terence Ortslan, Analyst
- Thiago Lofiego, Analyst
- Tony Rizzuto, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. Thank you for waiting. Welcome to Vale's conference call to discuss Second Quarter 2013 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. Operator Instructions). 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 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 and 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 to the presentation, and after that, we will open for question and answers. It is now my pleasure to turn the call over to Mr. Murilo Ferreira. Sir, you may now begin.

Murilo Ferreira {BIO 1921488 <GO>}

Good morning. Good afternoon, everybody. Thank you for having an opportunity to share some views with you.

As you note, Vale had a good performance in the Second Quarter 2013, regardless of the performance of the economy in the whole world, and declining minerals and metal prices.

We have continued to deliver on our promise, the (inaudible) initiative is underway, producing good improvements, mainly in total costs and expenses, and we can say about the numbers that we got in terms of decreasing costs, decreasing SG&A, R&D, and that these support our cost cutting efforts present us a very interesting EBITDA number, with it remain almost the same comparing with one year ago, the range of $10 billion for the first half of the year, regardless of a $2.1 billion fall in revenues, which was mainly regarding the price.

We must say that the cost performance of the Second Quarter 2013 was reached with an average Brazilian real/US dollars exchange rate of BRL2.07. Then, I can highlight that we have potential opportunities for the savings.

In terms of the debt, our total debt came into $29.9 billion from $30.2 billion. Again, it's almost the same number, comparing with at the end of the First Quarter 2013, despite paying $2.25 billion in dividends, and investing $3.6 billion in the Second Quarter of 2013.

We would like to highlight some events, like the impairment for the implementation of S11D. The improvement of the operational performance of Base Metals, we are very happy mainly with the ramp up of Salobo. We can stress that in the next coming months, we will be able to bring good news in terms of the coal, in terms of fertilizer. As you know, fertilizer is substantially stronger in the second half of the year, compared with the first half of 2013.

We note some (math) mainly in terms of the (price), regarding the hedging account, in order to minimize the volatility of our accounting earnings, and to allow our financial statements to better reflect economic performance of our Company. We are considering using, for future periods, the implementation of the hedging accounting programs. It would allow us to -- our revenues to serve, to be used as a hedging for accounting purpose.

We know that we need it to work with some key elements in this process, and we intend to consider for the future. Regardless of this, we did the presentation about what could be the numbers in case of having, using these (price) since the beginning of the year.

Again, it's mandatory to say that Vale is strongly committed to discipline and capital allocation, to bring return to our shareholders, with a good project execution. It's very important for us (inaudible) to bring mature design engineering and to focus in the construction and contract management, in order not having deviation as you had in the past.

R&D expense (inaudible) showed a big decrease comparing with it 2012, 2011, as a result of the decision to focus on a smaller and more selected pipeline of projects, which at the end will bring us high rate of return in our portfolio, and a very -- with world-class projects. This is very important.

And as an example of this capital discipline, the (detailed) engineering for the whole project S11D is almost completed, and we are with contracts, equipments, services, packages, almost 70% hired with firm proposals. And at the end, it can bring us the level of confidence about the future in order to complete this project on time and on budget. Very important for us.

I really appreciate your time, and I would like to share with my Executive Directors for question and answers, and I will be back in the end of the session. Thank you very much.

Questions And Answers

Operator

Thank you. Ladies and gentlemen. we will now begin the question and answer session. (Operator Instructions) Our first question comes from Mr. Rodolfo De Angele from JPMorgan.

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

Good morning. Again, congrats for the good numbers. We discussed a lot costs and the recovering volumes in the previous call. But I wanted to follow up with two things.

First, the -- I wanted to hear more details in your comments on a potential effect of a weaker real on the CapEx budget. In the release, you mentioned details of the S11D, how 90% of it is in the real. Could you comment a little bit more on the other projects? Is there upside, if you consider FX staying at around 2.30 for the CapEx budget this year and into next year?

And my second question, I just wanted to hear from management if there's anything new or what's the status of the tax discussions, so you do have (inaudible). Thanks.

Operator

Excuse me, ladies and gentlemen. please hold.

A - Luciano Siani {BIO 15951848 <GO>}

Okay, sorry for everyone. We had an audio problem. So now addressing Rodolfo's question on capital expenditures. We highlighted the share of Brazilian real expenditures for S11D, because it's really a large one, 90%. It's a similar share for similar projects here within Brazil. However, if you think about the entire portfolio of projects within Vale, the share is naturally lower. It's more close to 50%, rather than the 90%.

So it's not difficult to do the calculations. If you -- and that includes sustained investment as well, that share that I just gave you. So it's not so difficult from this share to have an estimate of the impact of any real depreciation over any period of time.

On the tax disputes, no, we have not had yet any meaningful development that should be conveyed to you.

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

Okay. Thanks, (Luciano).

Operator

Excuse me, our next question comes from Mr. Carlos de Alba from Morgan Stanley.

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

Thank you very much. Good afternoon. I've got two questions, and the first one is on the non-iron ore businesses. Clearly, the Company has been a very strong effort to reduce costs and expenses, and we have seen the results of it. But nonetheless, the nickel, the copper and the potash business continued to lose money at the EBIT level. I assume part of this obviously has to do particularly in nickel, with a pre-operating and stoppage cost. But I would really appreciate if you can give us a sense of when do you expect this business to be positive, assuming nickel prices and copper prices around these levels. Can they be profitable, and if not, would you consider selling them, or at least some of them?

Then the second question is on the working capital reduction, what's the very amazing, very strong results. Is this new level sustainable? Were there some one-offs that affected the development? What can we expect going forward? Thank you.

A - Luciano Siani {BIO 15951848 <GO>}

Okay, Carlos, thank you for the question. This is Luciano. If you look at the segment reporting footnote for the financial statements, it's footnote 25. So there, we can see very clearly for each business segment, and even within the segments, the revenues, costs and expenses in R&D and pure operating -- and idle capacity numbers for each of these segments.

If you look at these, I think we only have base metals on aggregate, as a whole. But if you look at the footnote, you have nickel and copper separated. And remember that nickel, in this case, includes all the byproducts, and copper is just -- this was (inaudible) and (inaudible), (inaudible) operations in Brazil.

So if you look at the performance of this quarter for nickel, you have a little under $1.4 billion in revenues, and $860 million in costs. So it's a $500 million margin on absolute terms, and that is basically coming from the assets in Canada and in Indonesia. So even at those depressed prices, and where we have reference to the prices, an average price of $15,000 for nickel in the Second Quarter, the nickel business, so to speak, and its byproducts, was able to generate $500 million in cash.

So this give us confidence that once we reign in the pre-operating and idle capacity expenditures, and once there is a medium term recovery of nickel prices, that this Brazil can be profitable on a -- on any accounts.

If you look at copper, we had just our first monthly EBITDA for Salobo. It was very small, around $5 million. But Salobo will be a very low cost producer. So the Salobo operations, the (premium) on the prices that you assume for copper and for gold can generate significantly high profits. And this should be reflecting on the copper line of the segment reporting. So Salobo can generate anywhere between $700 million and $1 billion of EBITDA, depending on the prices that you assume.

So going forward, we expect the performance of the base metals, and this is as a whole, to improve significantly. Remember that also, New Caledonia is not contributing to results. Much on the contrary. We are still going to lose money this year from New Caledonia, much less than last year, and we intend to break even next year. Actually, we intend New Caledonia to be cash flow-positive next year.

So the prospects for the base metals business are of significant improvement over the next quarters. And we have no intention for now on to do any divestment on this business.

On working capital, yes, we believe the levels are sustainable. And as I mentioned before, we still have opportunities on the supplier financing side, on the inventory side. Perhaps on the accounts receivable, the improvements are going to be more marginal from now on.

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

And any comment on (potash), Luciano?

A - Luciano Siani {BIO 15951848 <GO>}

I'll hand over to Roger Downey.

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

Thank you.

A - Roger Downey {BIO 7419641 <GO>}

Yes, hi, Carlos. Yes. Our potash operation today is a small operation. It is at the end of its life of mine. It's something that's been -- it's a mine that's been going on for in excess of 20 years.

It is a significant operation, in the sense that Brazil is so potash-dependent, so it really keeps a foot in the door in terms of the market that we want to secure. We are -- I mean, the operations of today are impacted by these non-recurring things that we are doing today at the mine. It is not a mine that we will sustain at an EBIT loss, of course, but you know, it's something that we want to -- it's a market that we want to invest in. It is very promising.

I consider Brazil as being the China of iron ore, in terms of potash. There is a lot of potential there. And as you guys know, we have been looking at prospects for this business, looking at new opportunities.

But you're -- answering your question more directly is, it's just a means to a greater end. We will maintain the operation at (inaudible), but not at any cost.

Operator

Excuse me, our next question comes from Andreas Bokkenheuser from UBS.

Q - Andreas Bokkenheuser {BIO 7182883 <GO>}

Good morning, gentlemen. Thank you very much for hosting the call. Just a single question from me. Can you give a little bit more clarity on your cost savings? Obviously, it's been something much talked about both in Q1 and Q2. I'm sort of curious, can you break it down for us a bit, and just also highlight whether there's any currency depreciation savings in that number of, what was it, $730 million-something? Thank you very much.

A - Luciano Siani {BIO 15951848 <GO>}

I believe we, on the press release, on each of the segments, that when we comment the costs, that we have separated the exchange rate effect. So we tried to convey some color on the changes, and the nature of those, net of depreciation charges and the exchange rate effect.

What I can tell you is that the exchange rate effect was very modest up until June. So June was a month where it started to kick in. So most of the positive exchange rate effect that you can read over the press release are related basically to the month of June. And as Murilo mentioned, on average for the quarter it was a 2.07 exchange rate.

So going forward, there should be a meaningful improvement. Every (BRL)0.10 of depreciation of the Brazilian real means an annual savings for -- of around $700 million.

On the nature of the cost savings, there has been a lot to do with -- so far, with the simplification of the Company, so a more focused company spends less money on distraction, so we can have leaner support structures, you have less expenditures in R&D, so it's a -- in net SG&A and R&D, it's a question of focus. When you go to the operations, it's a more comprehensive review of contracts, services, internal benchmarking, productivity improvements. We also have an ongoing cost cutting program in place with several hundreds of initiatives as well, so we're tracking -- we believe, some have already kicked in, some will take longer time. We mentioned six months ago, but we were doing a review of the procurement function.

So everything within Vale, maybe 12, 24 months ago, was geared towards -- speed was paramount, in the old days. Now we are looking for quality, for doing the right thing regardless of timing. So we're taking the time to plan better, and this has a number of implications across the Company, from, let's say, current investments, where you can package different work into a bigger contract, and then do a tender -- take your time to do a tender, call more suppliers, negotiate more, lower the prices, to get a (plan, your) maintenance stoppages, to revisit the scope of those maintenance stoppages in order to spend less and what is necessary.

So everything, when you do it more carefully and with more planning, planning more ahead, and you get more quality, you get lower costs.

Q - Andreas Bokkenheuser {BIO 7182883 <GO>}

Yes, I guess where I'm coming from, just to maybe ask my second question then, is that, well, if we sort of disregard the currency impact on your cost savings, I'm curious as to how much longer you can keep on cutting costs. I mean, presumably over the past five years in this somewhat horrible macro economy, you've been cutting costs. So I just wonder how much meat there is left on that bone, without basically jeopardizing the future of Vale's revenues and earnings.

And from what you were saying, you can still go on for a while longer. Is that correct? Is that the right interpretation?

A - Luciano Siani {BIO 15951848 <GO>}

Yes. All cost cutting measures that we are adopting are sustainable. We are not jeopardizing the future of the Company for the sake of the short term. So you shouldn't worry about the sustainability of the current level of cost reduction. It is here to stay. And there's no impact on the future earnings ability of the Company, of any of the cost reductions. Much, much to the contrary.

Operator

Excuse me, our next question comes from Mr. Thiago Lofiego with Merrill Lynch.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Hi, thank you for the call. I have two questions. The first question is on the regulatory framework definition in Brazil. What's your take on the recent developments? Do you think the final document will be significantly different from the original proposal? And also, what's the timing for the new rules to be effective, in your view?

And the second question, just a follow up from the Portuguese call regarding the CLN 150 logistics project, what's the additional rail capacity expected for 2014, and what capacity is actually tied to the S11D project? And also, what's the potential additional iron ore tonnage in terms of sales for next year, for 2014? Thank you.

A - Murilo Ferreira {BIO 1921488 <GO>}

So okay, on the mining code, as you saw, there were several amendments to the code. So obviously, without big knowledge of the political process, we cannot anticipate what the outcome is going to be, right? We remain confident that the ideas that were espoused by the government in the original bill should, at the end, prevail. That's our hope, and hopefully the government will be able to mobilize its (inaudible) in order to sustain those. But we have no forecast on how much it, it is going to take, and -- so what the process is going to be.

In terms of the logistics capacity, I will hand over to Galib.

A - Galib Chaim {BIO 17562473 <GO>}

Well considering the CLN 150 for 2014, we expect -- we have now already 14 million tonnes added to the logistic capacity just for the railway. And as I said, for the port, for the exportation, and we have 60 million tonnes of extra capacity for the -- from this exportation port. The total capacity -- with this 14 million tonnes, the total capacity will be (130) for 2014. Yes.

The (long) guidance that we gave at the Vale Day for last -- for next year, for 2014, is kept. And if you remind what we said back in November, the production increase should be a combination of the (inaudible) projects in the south, of south region, (inaudible) and others that should start up and recover a little bit of the performance. And a little bit from the north.

So in due time, in the Vale Day, we will give you more details on that.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Great. Thank you, guys.

Operator

Excuse me, our next question comes from Mr. Ivano Westin from Credit Suisse.

Q - Ivano Westin {BIO 17552393 <GO>}

Hi. Thank you very much for the question. The first point is on tax litigations. You reported total tax disputes of BRL37 billion. I just wondered what is going to stop this dispute. (inaudible) recently, we had a (inaudible) decision which was favorable to another mining company. So can you expect any potential reduction on this amount in the short term? And when do we expect to have a final outcome on this? This is the first question.

The second one is on the supply/demand equation. Martins mentioned on the Portuguese call that he is not concerned about (inaudible) China, which will remain resilient. I would like to add any -- I would just like to ask him to add to this discussion the supply side. What is the expectation of Vale team of the net growth of supply (inaudible) next year, and what is the average price for 2014, according to our numbers or according to our view? Thank you very much.

A - Murilo Ferreira {BIO 1921488 <GO>}

Well on the tax dispute, as I mentioned, there has been no significant recent developments on the side of Vale. But I'll hand over to our legal counsel, Clovis, which is on the call, to see if he wants to add anything else.

(multiple speakers)

Okay, so he's not on the call, so I reassure my -- we're sorry for that, so I reassure my last answer, which is that there has been no recent developments. And now, we haven't yet had a full assessment of the impact of the CFN, so the administrative win on our tax liabilities.

So handing over to Martins to speak on the supply and demand equation.

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

We continue to see the (inaudible) on our market very balanced. Sometimes they have a -- we see some additional supply that later can be absorbed by the markets (inaudible), mainly China, as we are used to seeing in the last three or four years.

We believe next year Europe could perform better. There is some signs of recovery in Europe. The United States is not a big market for iron ore. They have their own iron ore.

But we see also the economic policy in Japan improving also. This is (inaudible).

So we see next year with more supply coming to the market, but on the other hand, we see some positive signs coming from Europe and Asian countries, not including China.

So we do not see the picture too much different from what we see today. So I think the market, it continues to perform the same way it's performing this year, with some ups and down, volatility continues to be there, like we see all of this year. And I don't think volatility will change. But on average, I do not see big changes in the market situation as far as supply and demand is concerned. Supply will grow, but the demand will also grow.

Q - Ivano Westin {BIO 17552393 <GO>}

Okay. Thank you, (very much) Martins.

Operator

Excuse me, our next question comes from Mr. Daniel Rohr from Morningstar.

Q - Daniel Rohr {BIO 16138004 <GO>}

Hi, thanks for taking my question. Just one about unit cash costs in the iron ore business. The $24 a tonne figure you gave for Second Quarter, other than depreciation in seaborne freight, what else is excluded from that figure? It looks like you had about $245 million in expenses that aren't included. So I'm curious what's in that bucket.

A - Luciano Siani {BIO 15951848 <GO>}

Okay, the way to reach the $24 is simple. You take the -- again, you start from the segment footnote, the 25 note --

Q - Daniel Rohr {BIO 16138004 <GO>}

I don't want to interrupt you, but I'm clear how you get there. You had a helpful explanation of that. But the $245 million in expenses that are excluded from the numerator, is that --

A - Luciano Siani {BIO 15951848 <GO>}

Yes. Yes, exactly.

Q - Daniel Rohr {BIO 16138004 <GO>}

In that equation, what's in the $245 million, I guess?

A - Luciano Siani {BIO 15951848 <GO>}

What is in the $245 million? Okay. The iron ore business absorbs -- most of the SG&A is absorbed on our costing segment reporting process through the iron ore business. So for example, we are right now at the headquarters here within Vale, so it's -- all the expenditures, the air conditioning right now, it's being absorbed by the iron ore business.

So this is -- this has a lot of expenditures that relate to the corporate headquarter activities. So we are -- I guess, this is it. So we just take from the costs the freight, and divide by the sales of the quarter, then you get the $24.

Q - Daniel Rohr {BIO 16138004 <GO>}

Yes. Then for 2012, in that filing, you didn't break out costs versus expenses. So can you let us know what the equivalent unit cost would be for full year 2012?

A - Luciano Siani {BIO 15951848 <GO>}

We can give you that afterwards, so we don't have the information here.

Q - Daniel Rohr {BIO 16138004 <GO>}

All right. Thanks much.

A - Luciano Siani {BIO 15951848 <GO>}

Okay.

Operator

Excuse me, our next question comes from Mr. Paul Massoud from Stifel.

Q - Paul Massoud {BIO 15062046 <GO>}

Hi, thanks for taking my question. Last week -- and this is just a follow up on some of the commentary on potash, but last week, some news that came out of Russia, that a major Russian producer will be exiting its marketing arm, and increasing its production by 2.5 million tonnes. And the result of that is, I think, most expect pricing on the potash market over the next 6 to 12 months to climb by something close to 25%.

And so, I guess in the context of lower pricing, to me, it almost seems that developing greenfield potash projects in that pricing environment has become even more uneconomic. And so, just going back to previously stated strategies, and I think you even said it today, that potash is still a big focus in terms of growth, and in terms of Brazilian demand. Have -- has M&A become an even bigger part of a strategy, in terms of growing in these businesses, and given where pricing is at today, does it make more sense now to buy established production, rather than trying to build?

A - Roger Downey {BIO 7419641 <GO>}

Hi, this is Roger Downey here. I guess we always have to keep everything in mind, right? And I think we have to be anchored in the long-term. That's really where our business is, has to look at always.

There's no doubt that the recent developments in the industry have put a lot of pressure on prices. We can't look at our business from a very short-term, quarterly or annual perspective. We really have to focus on what there is out there in terms of an opportunity for our shareholders to make money with.

We are looking at the business from a perspective that we sit in a market that we think is probably one of the most promising markets for that commodity, for potash. Brazil can significantly increase its demand. We have a competitive advantage, and a sustainable competitive advantage, at that, in terms of reaching our customers, especially in the network of Brazil, with all the warehousing, logistics, our sales clientele, and of course, and especially, our ports into Brazil.

So if we can find ourselves in a business that is in the lowest quartile of CFR costs into these markets, and specifically into Brazil, into the promising market that is specifically Brazil, I think we should certainly look at and be in this industry, right? Brazil has a tremendous potential, in terms of growth. If you just compare our productivity levels in terms of agriculture productivity today with what we could be doing, we're talking about 4 or 5 times as much agriculture output. So there is -- and Brazil is totally dependent on potash, and they can't get enough. Our farmers can't get enough.

So certainly, I think we have to be conscious of what's happening in the short term, but focused on the long term. I think that that's really what it comes down to. And of course, we'll balance our entry into that business, if it really -- it's something we want to get into, as to what is the best door to get into it.

Q - Paul Massoud {BIO 15062046 <GO>}

Maybe just as a follow up, in trying to understand how you guys go about that process. I mean, do you have a long-term potash price that you think is reasonable? I mean, I certainly understand that current market dislocations may very well be temporary, but if you're looking out, say, call it 24 months and beyond, what's a reasonable price, or maybe what's the right price that you guys are looking at in terms of being a long-term price?

A - Roger Downey {BIO 7419641 <GO>}

Look, I'm not going to really --

Q - Paul Massoud {BIO 15062046 <GO>}

Delivered into Brazil, I should say.

A - Roger Downey {BIO 7419641 <GO>}

Yes. We go much further out than the next 24 months, of course, especially given that our mines -- even if we were going to get into the potash business or not, we have to think about project development, or whatever, we're taking more than 24 months. Then operating a mine is 20 years.

So we have a long term price that we work with, and which is our threshold. If we can be in a business that's in the lowest quartile of the delivered price into the promising markets, we certainly should be in there. And if it makes a decent margin, we should be there.

So I think in the process, especially after the developments we've had in -- the development of our other potassium project, potash projects in Argentina, we're in a stage where we're reviewing the whole thing. But look, as I said, it is a promising market, but we are taking a cautious thing -- cautious approach to it. And again, we certainly think the short-term issues may well result -- the full short-term issues in supply may well result in higher prices in the long term.

Operator

Excuse me, our next question comes from Mr. Marcelo Agular with Goldman Sachs.

Q - Marcelo Agular

Hi, everyone. Thank you, just for taking the question. The first question would be on research and development and sustained CapEx. I mean, you guys have been running a bit low, or your targets for the annual, both in the research and development and sustained CapEx. Can you -- can -- is this first half level for both expenses, and in CapEx, sustainable for the next -- let's say, next, second half, and the future? Or should we expect you guys to reach the budget that you outlined to us in the end of last year? That will be the first question.

A - Luciano Siani {BIO 15951848 <GO>}

On aggregate, we should expect to reach the budget that we outlined for last year, if you consider R&D sustaining and CapEx.

Q - Marcelo Agular

Okay. And the other one will be a little bit more color on the VNC comment you made earlier, Luciano, about that you see VNC already generating positive EBIT in 2014. I mean, can you just walk us on what -- not what happened, but what were the negative EBIT impact on VNC in 2012, so we can have an impression on the magnitude of that turnaround.

A - Luciano Siani {BIO 15951848 <GO>}

Okay, I will hand over to Peter Poppinga, but just before he talks a little bit about the perspectives, just to give you a few numbers, VNC lost $750 million in 2012. And we were expecting for this year a significant swing, so though we're still going to have a loss, you can expect a swing of several hundred million. So I'm not going to give you a precise figure, but the order of magnitude will be still in the loss, but the several hundred million less than last year.

For next year, we're going to -- so we're looking forward to breaking even, as Peter Poppinga will explain. Please, Peter.

A - Peter Poppinga {BIO 17245689 <GO>}

Okay, Marcelo, thanks for the question. In VNC, as you know, there's a major turnaround going on, although it's taking its time, because it's new technology, and it's very challenging, but it's going.

We know now that the process works, and there is no fatal flaws anymore expected in terms of new technology, it's for sure. Ramp up is progressing well. We had, in the month of June, you don't see that, because you see only the quarter results, but I'm very pleased to report that in month of June, we had a very successful month in terms of production VNC, because for the first time, we continuously ran with two autoclaves -- we have three. But on average, full capacity is meant to be with 2.5 on average, because always one is on maintenance or something. That's the design capacity.

So we ran with two autoclaves for -- continuously, for a long time, in June. So this was very good. This means that we can be cash flow positive in 2014, because you need two autoclaves to be under the current price environment. You need two autoclaves to be cash flow positive in 2014. That's what we are aiming at.

And that was a major milestone we achieved, and so we are positive that in 2014, we are setting up this Company to be positive.

Operator

Excuse me, our next question comes from Mr. Tony Rizzuto with Cohen & Cole, LLC.

Q - Tony Rizzuto {BIO 1490590 <GO>}

Thank you very much, and thanks for hosting this call and taking my question. I jumped on a bit late -- there was a conflict with another call, but -- so I apologize if my questions have been asked. I guess I want to drill down a little bit, firstly, in your assumptions on the global steel supply chain a little bit, if I may. And you talked about a floor, a strong floor at (110) per metric tonne. I was wondering if you could tell us what you're assuming for Chinese crude steel production and pig iron production, and maybe your assumptions for Chinese ore grades, depletion rates in the west, and how you view India.

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

Well you make a very difficult question to answer, because you've put a lot of things that are -- my crystal ball is not enough for it, okay? But we believe that steel production in China will continue to grow around the -- between 3% and 7% the second half of the year. This year, we will grow near 10%. We are talking this year about the near (700 and 8 million tonnes).

Pig iron production continues to be the big part of the production in China. We don't believe scrap will have any kind of an influence in the near term. We believe it's scrap, we will only have some influence up to 2025 or later.

So steel production in China continues to be based on pig iron ore production, so I don't see this impact on scrap.

But you have to believe that urbanization in China will continue to develop. Now it's 51%, something like that, and we believe that until 2030, we don't reach 70%, 72%, which is the Chinese government target for 2030.

So one year we'll be better. One other year, we will be worse. But on average, China's steel production will continue to grow, based on pig iron.

And so, iron ore, internally, (inaudible) in China, everybody knows that the quality is becoming worse, depletion rates is increasing. Iron ore content is decreasing. So a lot of those effects, and that's the reason we believe that price sustainability -- price will be sustainable in the range of $100, $110. So we do not see a big difference from what we see, and the positive -- we see a positive scenario.

A - Luciano Siani {BIO 15951848 <GO>}

Martins, if you allow me to complement, in the presentation that -- it's in our website, it's on page 25, we make an estimation for global demand and supply on the seaboard market for 2020 that factors in several of the variables that Martins described. And we do see 160 million tonnes of high cost producers being displaced from the market, of the starting level of over 350. And that includes also the opportunistic exporters to China, such as US, Iran, (inaudible) so several non-traditional countries that's supplied to.

So if you take the cost curve, even if you displace 150, 160 million tonnes of high cost production, if you consider the variables that he mentioned, cost increases, both geological and internal, because of the increase in labor costs in China, appreciation of the renminbi, you get a very clear picture that $110 is on the safe side for support.

Q - Tony Rizzuto {BIO 1490590 <GO>}

Thank you very much for that detail. If I could follow up with another question, this time on capital spending, and looking at a little bit longer term, over the medium term, should we still think about your CapEx levels being in the ballpark of $15 billion per year, and is there the potential there for some scope of reduction, and of that amount, what would be the sustaining level that we should think about?

A - Luciano Siani {BIO 15951848 <GO>}

The ballpark that you mentioned should prevail over -- at least, 2014 and 2015, which -- in which we have the bulk of our expenditures in S11D. Sustaining investment, we have an overall direction of not increasing it, so we believe that as a fraction of total assets, it should be at stable or decline, but we don't have precise figures to give you.

After the expansion of -- after 2014 and 2015, so after the bulk of the expenditures on S11D in (Macala) have been realized, one can expect a decrease in CapEx. But again, the details will be given to you in Vale Day in November.

Operator

Excuse me, our next question comes from Terence Ortslan from TSO & Associates.

Q - Terence Ortslan {BIO 1785453 <GO>}

Well thank you. I have a roundup question with respect to the Brazil change of the -- or, intended change of the policy and strategy and the fiscal regime and all. Why isn't -- I mean, mining is such a big component of Brazil. Why isn't Vale and (inaudible) and all those companies far more involved in the process, even at this scale, and leave it to the politicians to decide? I know you made (inaudible) permissions and all, but why aren't you driving this particular process, rather than politicians driving it?

A - Murilo Ferreira {BIO 1921488 <GO>}

There is an industry body that represents the entire industry, which is called IBRA, which is actively involved with the government in discussions. And Vale is one of the members of this body.

Operator

Excuse me, our next question comes from Mr. John Tumazos with JT Independent Research.

Q - John Tumazos {BIO 1504406 <GO>}

Thank you. You mentioned your long-term sustainable iron ore price expectation of $100 to $110 a tonne. What are the nickel and copper prices you use for your balance sheet analysis?

A - Peter Poppinga {BIO 17245689 <GO>}

Luciano, you want me to answer that?

A - Luciano Siani {BIO 15951848 <GO>}

Yes, Peter.

A - Peter Poppinga {BIO 17245689 <GO>}

John, thanks for the question, but -- so we are working very close to the industry average forecast. With copper, we are (inaudible) slightly lower price level than the coal one, around (7,000), slightly lower. Then for nickel, we are distinctly above (20,000), because we think the export ban in Indonesia will work in the long term, and in terms of, there is no new supply wave coming, and (multiple speakers) --

Q - John Tumazos {BIO 1504406 <GO>}

So China doesn't exist? 30% increase in output in China last year, and this year, it's not sustainable?

A - Peter Poppinga {BIO 17245689 <GO>}

No -- I don't understand your comments, John.

Q - John Tumazos {BIO 1504406 <GO>}

The reason we're suffering in the nickel business is that China increased output 30% last year and 30% so far this year, or 70%, cumulatively. And your planning is that they will not be able to import ore.

A - Luciano Siani {BIO 15951848 <GO>}

This is Luciano. Peter, let -- this is Luciano. We have views on the long-term prices for commodities for starting the opportunities. That -- in our capital allocation process, we have very (corridor) rates, and very high standards and the stress test, all the assumptions to make sure that the projects and the planning is robust, and their (inaudible) scenario.

So the long-term prices, they are not so meaningful for us in terms of approval of project. Which is more meaningful is the stress tests and the hard rates -- the long-term prices have more of a sense of sizing the opportunity, rather than manipulate us on the approval process.

Operator

Excuse me, ladies and gentlemen. this concludes today's question and answer session. Mr. Murilo Ferreira, at this time, you may proceed with your closing statement, sir.

A - Murilo Ferreira {BIO 1921488 <GO>}

Thank you very much for sharing your time with us. I would like to highlight again that we are not jeopardizing the future of the Company regarding the cost cut program. What we are doing, we must live with the simplicity, austerity, and very focus. We are not living the super cycle. We must provide good return to our shareholders, and the simplicity and austerities both are key elements in our strategy.

Regarding the mining law, I think that the government, the Brazilian government is very conscious in order to maintain the competitiveness of the mining sector in Brazil. I think that this is very important, and the Brazilian Mining Institute, IBRA, is helping into the Department in order to provide elements to the people and to see all developments, and to help the process.

Regarding M&A, in fact, we must say that we are very focused in two big projects, mainly S11D and Mozambique. In the next few years, we will spend it roughly $26 billion in both projects. And we are not considering M&A at this point in time. We can pursue with these two big projects high return, then to bring return to our shareholders.

And we are not able to forecast about the level of the capital that we spend, right after 2016. But based in our strategic planning, we must consider just world-class projects. We are not looking for -- to increase our volume, anyway. We must have good project, world-class projects, lost cost that we can expand in the future, looking for brownfields, with good technology, in order to stay in our business, in our portfolio.

Again, thank you very much for your time. And thank you very much for your support. And we are very happy to see the results in the price of our stock. Thank you very much.

Operator

That does conclude Vale's Second Quarter 2013 results conference call for today. Thank you very much for your participation. You may now disconnect.