Q3 2020 Earnings Call

Company Participants

- Alexandre D'Ambrosio, General Counsel
- Eduardo De Salles Bartolomeo, Chief Executive offcer
- Luciano Siani Pires, Chief Financial Officer
- Marcello Spinelli, Executive Director, Ferrous Minerals
- Mark Travers, Executive Officer, Base Metals
- Paulo Couto, Director of Coal

Other Participants

- Alfonso Salazar, Analyst
- Andreas Bokkenheuser, Analyst
- Carlos De Alba, Analyst
- Chris Terry, Analyst
- Christian Georges, Analyst
- Jon Brandt, Analyst
- Sylvain Brunet, Analyst
- Timna Tanners, Analyst
- Tyler Broda, Analyst

Presentation

Operator

Ladies and gentlemen, welcome to Vale's Conference Call to discuss 3Q '20 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. (Operator Instructions) As a reminder, this conference is being recorded and the recording will be available on the Company's website at vale.com at the Investors link. This conference call is accompanied by a slide presentation also available at the Investors link at the Company's website and is transmitted via Internet as well. The broadcasting via Internet both the audio and the slide changes has a few seconds delay in relation to the audio transmitted via phone.

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. Eduardo de Salles Bartolomeo, Chief Executive Officer; Mr. Luciano Siani Pires, CFO; Mr. Marcello Spinelli, Executive Officer for Ferrous Minerals; Mr. Mark Travers, Executive Officer for Base Metals; Mr. Carlos Medeiros, Safety and Operational Excellence Executive Officer; Mr. Luiz Eduardo Osorio, Executive Officer for Sustainability and Institutional Relations; Mr. Alexandre Pereira, Executive Officer for Global Business Support; Mr. Paulo Couto, Director of Coal; Mr. Alexandre D'Ambrosio, General Counsel; and Mrs. Marina Quental, Director of People. First, Mr. Eduardo Bartolomeo will proceed to the presentation on Vale's 3Q '20 performance. And after that, he will be available for question and answers.

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

Eduardo De Salles Bartolomeo {BIO 15365202 <GO>}

Okay. Thank you. Good morning everyone. First of all, I hope everybody is safe and sound. Well, it's been more than seven months since we've started managing Vale in a remote way. And one thing has not changed, the safety of our employees come first. Vale continued to face the COVID-19 pandemic with disciplined and sense of urgency. We maintain our guards very high. And our priorities remain intact, safety, people and the reparation of Brumadinho. We have been learning a lot since Brumadinho and transforming our culture and practices for a better Vale. With that in mind, I'm pleased to share that our process and results continue to improve, together with our de-risking process.

Please next one. Starting with the reparation. Our commitment to Brumadinho remains steady. We already disimbursed $2.6 billion on the reparation. The indemnification process continues with about 8,200 people covered by agreements for moral and material damage, 600 people more since our last call. The work store infrastructure and environmental recovery are progressing as well. We completed the water main at Para de Minas to ensure the supply of water to a city with a population close to 100,000 people. As well, we have concluded the tailing containment structures at the Paraopeba River. Since May the river has no longer received sediments. And most importantly, we continue open for dialogue and to active listening throughout the reparation process. This quarter, we delivered the integral reparation plan for Brumadinho which was built on the community's perspective and submitted in September to the municipality. We are certain that with this, we have a solid plan in our hands to repair the damage and support the development of Brumadinho.

Finally, we are having encouraging conversations with the state of Mina Gerais and other stakeholders to get a framework agreement for collective damage in the mitigation and compensation for the society and environment. With that, we continue to pursue our goal of reaching a stable agreement for reparation and compensation.

Please next one. As well, we continue to enhance our safety and dam management. The Engineer of Record is already implemented for 100% of our dams in the iron ore business with an improved continuous monitoring. In risk management, our risk indemnification program HIRA continues now including our dams. 59 operational units were assessed since '19, 42 in 2020 another 12 sites will be assessed until the end of this year. This program is being applied to our dams as well, with pilots underway in Sudbury and Long Harbour. The HIRA will be fully implemented by 2022 in Vale. Finally, our new tailing management system is under implementation and we are doing that by also complying with the ICMM standard launched in August. Our initial assessment indicates close to 60% of adherence to the ICMM recommendations. We want to be fully compliant by 2020. So our ambition is clear to be world-class and have effective standards in process in place with a safety driven culture. I can assure you that Vale is on a journey to become a safer and more reliable company.

Next slide please. Brumadinho required us to become better listeners. We are listening to the communities and society and building a strong and consistent relationship with all of our stakeholders. Based on their demands, we have mapped 52 ESG gaps, which have already closed 31 of them. In 2020, we already addressed 5 gaps and 5 more must be closed by the end of this year. Our ambition is to transform Vale into a benchmark in ESG practice. In this agenda, another important subject is the protection of the Amazon. Let me reinforce this. We have been operating in the Amazon for more than 30 years. During this time, we have helped to protect close to 800,000 hectares of rainforest, 5 times the size of Greater Lawn. In fact we already protect about 1 million hectares of forest globally. With those actions, I believe that we will contribute for sustainable mining and act accordingly with our new pact with society.

Next one please. Well, talking about the operational performance of our business, we continued with our plan to stabilize our production, a path that was detailed in great length during our Investor Tour in September. And I'm glad to share that the iron ore production results for this quarter was very strong, an increase of 21 million tons versus the second quarter, a 31% growth. We had an all-time production record in Carajas. That indicates that we are making progress with our plans for production stability and the initiatives for operational excellence.

Spinelli will come shortly to explain the dynamics between production and sales for the quarter. In base metals, as anticipated last quarter, some maintenance postponement was strategic before the pandemic. We have normalized that routine and expect better results for the fourth quarter. In relation to VNC, we are taking steps to place it in care and maintenance in 2021. We also have a new group of potential investors interested in the asset. However, all possible solutions contemplate Vale's exit. In coal this was also another challenged quarter, highly impacted by weak demand which continue to weight on our production. But on a positive note, we expect to finally start the plant revamp in the coming week. After that, we should reach a run rate of 50 million tons per year.

Next one please. Besides that, we are focused on recovering our production. But we are also taking important actions to make our production capacity more flexible. The launching of Serra Sul 120 product in Carajas is one of them. Sites creating an important buffer of production capacity ensuring operational flexibility will allow growth of 20 million tons in the longer term with the two logistics. Also we launched Project West III to expand the Shulanghu Port capacity in 20 million tons per year bringing this to a total capacity of 40 million tons securing strategic port capacity for Vale's BRBF in China. In summary, we are taking the necessary actions to ensure the stability we need to operate with efficiency and the growth options required by the market.

Please next one. Well, to finalize, we are derisking Vale to build a better Vale. Let me walk you through the most important steps on this journey. First, we are repairing Brumadinho in a fast way and with quality, listening and engaging with the families and community. Second, we are becoming a safer company. With discipline, we continue to make solid progress with our tailing management system and our operational safety process as well. Third, we are resuming production under safer conditions. I'm sure that we will achieve the 400 million ton run rate during 2022. We have a clear understanding of what we must do and we are fully capable of delivering it. And finally, we are building the conditions for a long-term stable business keeping focus on capital discipline. With that in mind, we resumed our dividend policy and paid a solid dividend last September.

Well, to conclude, we intend to continue creating and sharing value for our stakeholders. But most importantly, I assure you that we are doing everything we can to guarantee the safety of our employees, in our operations and in our communities.

Now I'll pass to Marcelo Spinelli, who will give some details, about our results in iron ore. Thank you very much for your attention. I will get back at the Q&A.

Marcello Spinelli {BIO 16240257 <GO>}

Thank you, Eduardo. Well, I have some information to share about iron ore production and sales. I think you have a lot of questions about sales. So let's start with the production. So you can pass please the slide. Some weeks ago, we had a chance to detail as Eduardo said the roadmap to reach a run rate of 400 million tons in 2022. So today, I think we have a checklist, transparent checklist, we can have some deviation quarter-by-quarter, but definitely now we can follow together the evolution of the recovery of production.

So in Q3, first information as Eduardo said, huge production in ore 57 million tons record, on track with production also all the projects around the North. And in the South and the Southeast so far so good on track, projects, production and the initiatives with the dams. For Q4, we are -- we've been running this -- running the production around 1 million tons a day, it's a good news, so far so good. Our target, we are in the lower level of the guidance around 310 million tons. It's very important to say that, at this time of the year, we don't have any more capacity to offset some deviations, if you face some problem. So you must deliver exactly what we have in our plan. And what kind of risk you have ahead. So I can say too. First one is related to the license of East range. We're still waiting for the license. We are in the last mile of that. No more information to the regulators, but we need to receive this to start this operation is -- we are waiting for that.

And we also -- we've been very caring about the rumor of lagging effect. Vale effect in Brazil, just to understand, that comes with more rainfalls in the North. We can anticipate this process in the North. And you have a dry season, in the very South of Brazil, without so many impacts in our operations. So we have to track this trend day-by-day. I let you know, if you have any change in our guidance. So let's focus on the sales now. I think it's the important information to the end of the year.

You can pass the slide please? Well, I have a rationale here to share with you in three steps. So I start with the number one. You know that we've been growing our production, our blending process in China. It's a very successful strategy, value over volume bring the high silica product from the South of Brazil. Today, we have discounted $30 for that and it meets with the IOCJ, Carajas mines. You can see the growth in this slide for 94 to 145. So we have a stable product, growing the market, our clients are very well satisfied. The second information here is about our exposure to China, where we are -- China in our sales are now reaching almost 70% of our sales. Why? This is due to COVID. Following that, China is in a V-shape rest of the world are struggling to recover the protection and the demand. So what does it mean? We have 45 days of transit time, just transit time the shipping part. And after that we'll have register, the blending time and also the retrieval period.

And remember that, the last quarter China suffered with a lot of delays in the short time congestion in the port. So, the lead time to close the sales is not the same as you have in FOB or a CFR traditional CFR. When you are more exposed to China, you're selling more BRBF. We had some questions about this in the last call. And it's very important to understand the difference between shipping the FOB sales, the CFR sales, and the blending sales in China. Because we -- sometimes in FOB you can define price. And this is right and the time that you sell. But when you have the CFR, you can sell during the shipping, but the price would be only when the product arriving the client and also the BRBF to spend more time ship, blend to have the product to blend.

Another information here to understand the whole picture, we have the inventories. You know that, in last year after Brumadinho, you have to reduce our inventories to keep the supply chain of our clients. So we reached the minimum level in the end of last year. So this quarter, last quarter, we had the first chance to fill the gap in our position to increase our production. And we need to have this time to put this product in China. So we are not talking about stake leading inventors that I heard about some ideas about this, that it's about operational inventors. So we need this to make it happen and we are more focused on China. The two main information here that I want to say to you for Q4.

First information, we have -- we don't have any intention, we don't have any planning the gap of inventories or debt for protection in Q4 and our forecast for Q4 in our production. So we don't see any necessity to have another kind of gap like we had in this quarter. The second information, we don't see many deviation between the Q4 sales, the Q4 production -- Q3 production. So as we are moving our inventory to part most probably in China, we have probably numbers closed sales and ventures as we are just moving this inventory to the sales after a lot of time that we need. So if you have further questions, I can help in the Q&A session.

Now I pass to Luciano Siani.

Luciano Siani Pires {BIO 15951848 <GO>}

Okay. A few selective remarks here starting on iron ore. In the cost side, you saw we reduced costs from $17.2 to $14.9 per ton. We have guided for $14.5 for the second half. We will not achieve that. And the reason is because of the price increase on the third-party ore that we purchased. Although, the volume is small, we have a C1 for third-party purchases of around $50 per ton. And the $25 increase in the 62% index impacted those purchases to the point that we decided to include information in our release about what the C1 for Vale looks like without those third-party purchases. And we have $12.5 per ton for the quarter. We also showed the numbers for past quarters. And that's the best measure of Vale's competitiveness because it shows how the operations are performing not the ore that we purchase from third party.

So something for you to track going forward. If we didn't have that price increase we would have gotten to our $14.5 guidance, but we're not going to for a good reason price increase. Q4 costs tend to trend down, because we had some maintenance especially in July in the northern system that we will not repeat this fourth quarter. For -- and that's all in assuming stable exchange rates right because they've been fluctuating a lot. So -- and they are a tailwind for us. For '21 costs tend to stay flat compared to 2020 counterintuitive but the reason is although costs will be diluted by bringing more volumes. The volumes will come from the less competitive operations in the South and in the Southeast. So the mix effect will offset the cost dilution effect. My remark on base metals goes to copper, all-time record for copper EBITDA. And also on the byproduct revenues just a reminder for you in '19 we have collected US$1.25 billion on byproducts other than nickel and copper. I'm talking about gold, palladium, platinum, cobalt and rhodium. And that amount will increase this year to approximately US$1.4 billion. So something to track because these byproducts especially palladium has been -- they have been increasing in price and there's US$150 million boost in our EBITDA compared to last year just for better byproduct prices.

And finally the fourth quarter will be strong because we don't have any planned maintenance in our nickel operations and we're going to have Onca Puma back on full steam, and depending on prices we expect Onca Puma to start generating between US$40 million to US$50 million every quarter in EBITDA. Going through the P&L, you saw financial expenditures some one-offs, these were fundamentally why we missed the consensus on earnings per share. We had a US$550 million expense on the debentures, the participation debentures. These debentures, there were issued at the privatization of Vale more than 20 years ago, and they work like a royalty and they therefore on iron ore sales. And they therefore are mark-to-market every time iron ore prices go up, they are mark-to-market. This is not a cash expense. And they flow through our balance sheet. And the news here is that, the most important holders of these debentures are the national treasury and the Brazilian development bank, they announced the intention to sell those debentures. That poses an opportunity to Vale because those debentures are a royalty or a leakage to our shareholders.

This year alone we're paying $200 million on those US on those royalties. So we have the fiduciary duty to work to look at this opportunity and eventually Vale, if we decide to repurchase those debentures that would entail a tender offer for repurchase and that would happen in the first quarter of '21, something that we are analyzing. We had also increases in the value of guarantees provided by Vale to some of its affiliate companies.

That relates to the depreciation of the Brazilian real all those indebtedness are in US dollars. So therefore the increase in value when translated to Brazilian reals and this flows through the balance sheet to the P&L. Other important thing, we updated the guidance for capital expenditures for this year. We have guided on Vale Day US$5 billion for this year. The exchange rate depreciation would bring that number down to $4.5 billion, but with COVID delays we're now into $4.2 billion territory. And those COVID delays they will necessarily impact capital expenditures for next year because the work needs to be done and it just shifted from '20 to '21.

Finally on cash generation, you saw robust cash generation this quarter, although working capital were still negative, the change in working capital for two reasons, as Spinelli talked about, inventory buildup still. And secondly, because the sales that were mark-to-market at the end of the quarter were marked to a higher price than the sales marked at the end of the second quarter. So that increased accounts receivable. So again all those two effects will revert next quarter and you're going to have a better conversion from EBITDA to cash on the fourth quarter. Financial net debt decreased despite the substantial dividend distribution and expanded net debt also decreased. And I assure you that -- and that wasn't -- and the expanding net debt is at 14.5% which is still far from the target of US$10 billion. Important here is that the US$10 billion target for expanded net debt is a long-term goal. It is not something to be reached on the short term and it will not prevent us from keep paying extraordinary dividend on the path which is our goal.

Now on to Q&A.

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 Carlos De Alba, Morgan Stanley.

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

Good morning, everyone. Thank you very much. I hope you are doing fine. My first question is regarding the potential agreement or the negotiation discussions that you are currently having with the authorities on the Brumadinho settlement. Could you explain us maybe what are the next steps and a roadmap on this process to the extent that you have it? And second on this same topic, it is my understanding that there are four big blocks of potential payments. One is the collective damages. Two, the socioeconomical damages. Three, individual socioeconomical damages. And four, environmental damages. Are all these four if I am correct included in the ongoing discussions that you are having or are only some of them are part of the discussions?

And then if I may ask just very briefly maybe an update on Samarco. And also given that Luciano spoke about potential opportunity for Vale to buy back the shareholders debentures, what about the potential sale of -- or divestment of shares owned by the -- still I guess controlling shareholders that is expiring in November. There might be some regulation that I think prevent you or may prevent you from buying those shares in the market or at least directly you might be able to buy it in the market. But if you could help us understand that situation, that would be great. Thank you very much.

A - Eduardo De Salles Bartolomeo {BIO 15365202 <GO>}

Okay, Carlos. We are fine. Thank you. The agreement -- let me -- I'll give you a broader picture and I'll ask Alex D'Ambrosio, our Legal Counsel to detail. I think it's everybody's question, so I think it's better to tackle everything so we don't leave any room for doubts. I think first of all, we've been discussing with you during the last calls and in the meetings that we have, that we were having discussions with all stakeholders. When we mean stakeholders, is the state, the prosecutors, the defendants, even Agus Brazilian entity at the federal level. So what is different now? It's different that now we are making a process of mediation that was brought to the Court of Justice and that improved in a way the convergency of the framework because one thing that we have been consistently saying is that we want a stable, but legal certainty that we can execute on the compensation and reparation of the strategy.

So the new is that now we are under a different environment on a different approach. And then I think we'll come to your question about our road map. There are steps that have to be taken. And I think Alex will can cover you, we will explain to you a little bit more detail on those kind of steps that are necessary to achieve this framework agreement. And secondly, it encompassed everything but I think Alex can manage it as well because you know, we have three civil actions that refers to those elements that you mentioned. And of course, they will have to be covered on this okay more holistic or whole agreement.

Can you help me with that, Alex?

A - Alexandre D'Ambrosio

Of course. Thank you, Eduardo. Hello, Carlos. Well, as Eduardo was saying, there's been very positive evolution as of last week, since the conversations have now moved to the mediation chamber of the court of appeals of Minas Gerais, get this of formal mediation chamber. They call it the (inaudible). As a result of the negotiations, it will now take place in a more structured environment with the support of mediators, who are judges themselves of the Court of Appeals. Indeed the President of the court of appeals himself is participating in this mediation process since he wants to see this agreement to succeed.

Now if we reach an agreement in this environment, we'll have much more legal certainty as it would be sanctioned by the court of appeals itself. So that's why we think it's positive. All the plaintiffs are invited to this mediation. And so it's a collective -- it's a large group of people and the conversation is mediated by the judges, as I mentioned. And so the idea is that it would be encompassing for all the parties involved. Conversations are indeed evolving and they're very constructive. But as you can expect there are many challenges to overcome. And the main one is to draft the document that would be acceptable for the many parties involved and that would offer legal certainty. So we need legal certainty that's been stated from the outset. We need governance that ensures speed of reparation. And there's still no definition of values, okay? And this will be discussed after we have this framework.

The second part of your question what will this cover? Well we have, as you said, four basic blocks. One, which is not in this agreement is the individual indemnification. So people are coming to discuss with Vale directly and that's Eduardo mentioned, 8,200 people as of this date approximately have already been indemnified. What we expect is that the agreement would sanction the individual discussions with these people. So that's been already agreed in concept so that would be part of it. There's environmental reparation, that would be in this agreement. Although, environmental reparation is an -- it's an obligation that we would undertake to deliver. We don't have a value. We may have estimates but that's not something that we will pay off. We would actually continue to pursue the reparation. There's a collective damages part that would be capped and that would be paid off. And there's what we call the social compensation part which would also be capped and that would be paid off. So I think I covered the four. And that's what we are proposing. That's what we are discussing at this time. I hope I answered your question. Thank you.

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

Okay. Samarco continues to be on track for a restart in December. It will produce to the capacity of 8 million tons, there will be a ramp up in '21. So probably by '21 the production will be somehow smaller than $8 million but it will reach -- definitely reach that production capacity somewhere in '21. As regards the potential sale from shareholders after the end of the shareholders' agreement, obviously that is a decision that pertains to them. But should it happen, Vale can eventually -- that would be a public offer, like a follow-on offer, a secondary offer in the capital markets. There will be a book building process. Demand could be X times higher than the supply.

And yes, Vale could theoretically put a bid on those shares. However, according to Brazilian legislation, if demand is higher than the supply of shares from any selling shareholder, Vale would be the first one to be cut because it is considered a related party in this process. So, if Vale wants to buy shares in the market, the most obvious way would be to launch a buyback program rather than go into such a follow-on because it's very unlikely that we will be able to buy those shares in such a process.

Operator

Thank you. Before proceed, please restrict your questions to two at a time. Our next question comes from Timna Tanners, Bank of America.

Q - Timna Tanners {BIO 6766897 <GO>}

Yeah. Hi. And hope everyone is doing well. Wanted to ask a bit more about your market outlook on iron ore if you could give some specific comments on the pellet premium outlook and premiums for higher iron ore grades. So along those lines just asking, I guess, about the better demand outlook for Europe that would support higher pellet premiums. And with the announcements recently have some additional supply coming on. How are you thinking about the outlook for supply and demand in the next year or two? Thanks.

A - Eduardo De Salles Bartolomeo {BIO 15365202 <GO>}

Go ahead, Spinelli.

A - Marcello Spinelli {BIO 16240257 <GO>}

Okay. Hi, Timna. Thank you for the question. Well, let's start with the pellet premium. Well, what we see as you know we have I think two main markets here in this case. The direct reduction pellets is more related to the Middle East. And in the US we see a recovery in these markets. Obviously, all the problems the COVID that we can have further problems, but we see these markets were stable and recovering for next year. And in case of direct reduction we have one thing that we must track that China is again opening the import of scraps. This can bother the scrapping market the seaborne marketing that is in around Turkey and the US. This can improve the price of the scrap and bring more margins to this -- the Middle East market. So much track on that. We see that trend for short-term is -- we just see a stable price, a stable premium, but we can have some cap between the blast furnace pallet and the direct reduction pellet for next year, but we must correct that.

On the other hand the blast furnace pallet, it's quite the same that is happening in the market of Europe or Japan. So we are struggling with this new lockdowns in COVID. We -- our number for this year that we have for the whole X China, a decrease of around 12% in this most developed countries we see 19%. But it depends of the new COVID outbreak. And we should have recovery for next year around 9%. So just to give outlook in what we are seeing in the market. The supply-demand balance, I see today during this quarter and the next quarter we are more balanced. We are returning around 60 million tons only in Vale. With the market we see some newer tactics producers that are coming to China like India or other regions like Europe going to China, I think they will -- probably will go back to their original market. That's a tendency that we see in India. And -- but we see a supply demand well balanced, our numbers are narrowing now the supply demand to 1% or 2%. That's what our forecast for next year.

Operator

Our next question comes from Jon Brandt, HSBC.

Q - Jon Brandt {BIO 5506998 <GO>}

Hi. Good morning. Good afternoon. Thanks for taking my questions. Luciano, I first wanted to ask you about the C1 cash costs. So I certainly appreciate the disclosure around, sort of your own C1 cash costs of 12.50%. If I'm not mistaken the target and the guidance that you've historically talked about has been sort of total C1 cash costs including third-party purchases. I'm wondering, if you can give some more guidance or target as it relates to your own C1 cash costs in the next three to four years as you ramp up production closer to that $400 million tons. I mean how much further should we expect that your own C1 cash costs to fall?

And my second question I guess is more related to nickel and the EV battery theme. Is this something that you're potentially looking to move further upstream in the battery supply chain given your exposure to nickel and cobalt. Especially, considering the government of Indonesia's ambitions to become a EV, sort of, battery destination and your relationship with the government. Could we see sort of more investments further upstream here? Thank you.

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

Okay. Jonathan, I'll give you numbers, the full numbers okay, including the third-party purchases. The best quarter we had was 12.8% fourth quarter of '18 when we were producing at a rate of 385 million tons. So that gives you an idea of where we can get with the adjustment for the new FX rate that 12.8% would be perhaps between $10 and $11 per ton. Yes we have had some depletion, which means transportation distances have increased. So -- but if we have the licenses for example we open up new mines at the rate that we would like to, then we could reasonably get when we get to 400 million tons to $10 to $11 per ton at existing FX rates. Mark?

A - Eduardo De Salles Bartolomeo {BIO 15365202 <GO>}

Yeah. I want to answer this question first. John thanks for the question, because I still have my foot on the base metal. So first of all there is a lot of interest on OEMs and the kinds to talk about BASF a lot of players are coming to talk to us. But we have no intention whatsoever to go upstream, we will focus on using our assets in our mining assets. That's a very important point as well. So there are initiatives that are looking to different mining assets that would require that kind of approach that you mention around governments and helping like in specific and in Canada we are having this kind of discussions. But we will stick where we know and where we are good at is at the mine site. Mark is still in the line. you could open please.

A - Mark Travers {BIO 16687422 <GO>}

Oh, yeah that's absolutely the case. And I would say that we already have some options for some participation. For example, we do have the Pomula [ph] project in Indonesia where the product would be suitable and would be directed towards the electric vehicle batteries. So those kinds of things are there is also we -- some of our products for example coming out of Sudbury and in UK refineries are suitable for electric vehicles. But as Eduardo said, if we see the kind of growth that we're anticipating in the electric vehicle market, the supply chain is going to look for some tremendous amount of supply. The typical source people are talking about our HPAL technologies out of Indonesia. But we would think that we're going to need more mines developed in the coming years to meet that supply. And obviously that's our interest is trying to find the right ways to get those mines up and running to support the electric vehicle industry and meeting the returns that we need to see.

Operator

Our next question comes from Andreas Bokkenheuser, UBS.

Q - Andreas Bokkenheuser {BIO 7182883 <GO>}

Thank you very much. I hope you are all well. Just a quick question on freight. How has it been so far over the past year in terms of your freight especially to China? Has that mostly been on Valemaxs and VLOCs? And equally as important as you kind of progress towards

2022 and aim to get close 400 million tons of production back. What is your vessel capacity there? Do you still have new vessels coming in, in the shape of Valemax VLOCs, or are you going to be more dependent on the third-party vessels possibly in the spot market in that scenario? Thank you very much.

A - Marcello Spinelli {BIO 16240257 <GO>}

Hi, Andreas. It's Spinelli here. I think your question of regarding freight, I think we have -- let's talk about the fleet firstly. We are improving our Guaibamax fleet, yeah, so the strategy is to have vessels, the big vessels are on track. So our trend in one year, two years is to reach our level what we consider the optimal level to 400 million tons. So that's -- that track is going on. So in the short-term, we are -- we have some exposure in the spot market not so high. We had some reflections in the freight this quarter and have some next quarter. But probably all the fluctuation in the bunker price there will be some offset in this trend. So we see a stable freight for the next short-term period.

There's not any commissions about the scrubbers and this come from the freight that we have -- we have with the global [ph] submission is almost on track. So today the gap between the high sulfur low sulfur [ph] lower than before, now it's 60. But most of our freight will be using this year and we count on that on next year is higher than 90%. So that's the trend. Keep this strategy to grow the fleet, but in the level that we can manage this part and the flexibility of this part and our investors.

Operator

Our next question comes from Chris Terry, Deutsche Bank.

Q - Chris Terry {BIO 16949971 <GO>}

Hi, Eduardo, Luciano and Marcello and team. Two questions from me. Just on the sales versus production. If I understand it correctly, you're saying sales should be close to production in 4Q. And as we focus on '21 and '22, as you ramp up to 400 million tons, can you just give us some color on what you expect the inventory build to be as you add additional blending sites over that period? And my second question is on coal. After you do the three-month revamp, how long will it take you to get to the 15 million ton run rate? Thank you.

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

Thank you, Chris for your questions. Spinelli?

A - Marcello Spinelli {BIO 16240257 <GO>}

Again, the -- it's important to understand that the situation related are most of it timed up. We should not compare the production in the quarter and the sale in the quarter. So I think the best comparison is between the -- in this case Q4 sales and Q3 production. So if you consider all the time of transit and lead time is the best comparison today. We can have some gaps of inventory in case of a gap of production like we have. So as you build, we've been building for a long time, we lost an inventory last year. Now we're going to return this inventory building, because it's the quantity we need to make the gap. So we see few gaps, probably two -- one, two years, every time you have a difference between production in one quarter.

But as we have the inventory in China, we have more flexibility. So, we don't have significant difference between sales and production during the period. So this was the first time we had this gap after the decrease of inventory, but there's not what we think in short and long-term, we're going to increase gradually this inventory and we have some differences but not significant.

A - Eduardo De Salles Bartolomeo {BIO 15365202 <GO>}

Paulo, can you go ahead?

A - Paulo Couto {BIO 21817028 <GO>}

Yeah. Thanks for the question. After the maintenance program, we'll have a small rent period and we expect to reach to date 15 million tons per year run rate starting from the second half of the year of 2021.

Operator

Excuse me, are you ready for the next question?

A - Eduardo De Salles Bartolomeo {BIO 15365202 <GO>}

Yes. Go ahead. I think he answered the question from Chris.

Operator

Yeah. Our next question comes from Alfonso Salazar, Scotiabank. Please proceed.

Q - Alfonso Salazar {BIO 18358082 <GO>}

Thank you. Thank you for taking my questions. I have two. The first one is regarding iron ore and the implications of the Chinese restrictions of medical imports on your iron ore operations. I don't know if you can explain, if you expect the use of different coals to change the needs of blending or adjust the marketing strategy of your products?

The second question is regarding your Base Metal division, and in particular, on copper. There is a lot of interest on good performing copper assets. But apparently, the ones that you own look buoyant in your iron ore and nickel portfolio. So just wondering if you can share thoughts on how to unlock value of those assets in particular copper assets and the expansion projects that you have on copper? And if it's possible to unlock that copper value before nickel? Those are the two questions, I had.

A - Marcello Spinelli {BIO 16240257 <GO>}

Thank you, Alfonso. It is Spinelli here. Well, if I understand your question. So, our product is very stable quality than BRBF in China. As we can have some demand regarding the problems now, they are increasing the cost of coke. And if they have a better margin, they can save some cost of energy, they can improve to better quality. So we can support this with iron ore IOCJ or the Carajas finds all our BRBF. Every time we discuss about quality because we adjust this, but we've been working on a very stable operation for BRBF. It's very important for the choice that Sumeka [ph] can take, when they want to change the blast furnace product. So, we must take the quality in a stable way.

A - Eduardo De Salles Bartolomeo {BIO 15365202 <GO>}

Okay. Alfonso, if I got your question clear, I agree with you that we have to unlock value in copper. There's a good discussion undergoing Vale now around exploring our Carajas province. We have a tremendous province there. There are some synergies with iron ore that we are unlocking. So we're talking about Alemao. We are talking about even solo before, if we can revise reserves. We can talk about, Alfonso, a series of assets that we have there. So, I think, there's a -- we call here copper dream. Everybody wants copper. It's obvious. It's the commodity. I think iron ore and copper are the no brainers.

And we do have exceptional assets in Carajas that need to be developed. And while you talk about unlocking value, I think, it's a more complex question, because since the beginning when we started the turnaround of the whole base metals business and we believe is undergoing pretty well as nickel has been proven. We need to fix the house as well. So there, I think, doubles, I would say, phase story here. One is to fix the assets that you have. And second is to grow the assets that you have on the ground. So we're extremely optimistic that we can and we're going to show that on Vale by the way on our expectations about copper. We are very upbeat on that.

So if we come back to the famous 30% of relevance of base metals inside Vale, we couldn't lock on that way, when people start to perceive value on the base metals business besides iron ore. Iron ore is too big still in relation to base metals. We won't have time to discuss in the call what kind of options we have, but one for sure is to do the right things, with the right assets and have something that the market, how could I say, values it. But I'd like to ask Mark as well, because Mark is very passionate about this theme as well.

A - Mark Travers {BIO 16687422 <GO>}

Eduardo, you're right. I am very passionate about the copper business and base metals. It's an excellent business. It generates a tremendous amount of free cash flow. And it's got tremendous opportunities going forward. We spend a lot of time stabilizing the business. We're seeing some good stability coming this year. Salobo is performing very well. We're now -- Sossego has performed extremely well this year and staying on budget. Next year, I think, we're moving more into a productivity type agenda to increase the returns of the base that we have right now. And as Eduardo mentioned, the growth opportunities are there, not only the ones we've talked about in terms of Cristalino and Alemao which are on our agenda, but also unleashing through synergies with iron ore and the railroad system that are there can bring us even further.

And finally, I will note that we have a very good world-class project and Project Hu'u in Indonesia. We've been releasing drill results. This is a world-class copper project in the making as well. So very excited about the copper business, as well as the nickel business. Thank you.

Operator

Our next question comes from Sylvain Brunet, Exane BNP Paribas. Please proceed.

Q - Sylvain Brunet {BIO 3194710 <GO>}

Good afternoon, gentlemen. So, two questions. The first one on iron ore, just to maybe get some sense of the demurrage costs you would guide us to for Q4, if we should assume some continued decline there? And my second question is on VNC. Should we assume zero production in Q4 as you're ramping down? And what is the value left on your books after the several impairments, please? Thank you.

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

Okay. The -- yes the -- Sylvain, the cost -- the iron ore costs will continue to come down on the fourth quarter. Because we don't have any major maintenances and we were going to spend less and dilute through the production. On the books VNC has zero value. We just wrote down the rest of the value that it had this quarter. Mark?

A - Mark Travers {BIO 16687422 <GO>}

Yes. And, Luciano, just in terms of production at VNC, the way the care and maintenance process works is, we do need to prepare for consultation with the Workers Council and we continue to operate at, I would say, sort of a stabilized rate and while we go through that. So you will see production of the nickel hydroxide in Q4, let's say, roughly what you would have seen in Q3.

Operator

Our next question comes from Christian Georges, Societe Generale.

Q - Christian Georges {BIO 1557701 <GO>}

Yes. Thank you very much. Luciano, can you just go through again your cash costs for the Vale iron ore operations. You mentioned 10%, 11% was your best performance in 4Q '18, that was at the FX rate of today, I understand. And you're saying that you can achieve again 10%, 11% in future. Is that also just for Vale, or that includes to purchase ore? That's my first question. And the second question is also on the debentures that you may be considering purchasing or bidding for into the New Year. What kind of order of the value magnitude should we take into consideration? Thank you.

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

Okay. Yes. The 12.8% of fourth quarter of '18 at today's exchange rate would be between 10% and 11%. And, yes, we may get to there, but also you should normalize by the price of iron ore. If the price of iron ore was the same price of the fourth quarter of '18, the third-party purchases costs would be lower and the overall aggregate C1 of today as we speak would be perhaps another $2 below what it is. So instead of 14.9%, it would be already be at 12.9%, and we would be targeting 10% to 11%. So those are important. I think on the last question, I had mistaken the -- my answer. The question was about the merge costs. So there's no meaningful decline of the merge costs from the third to the fourth quarter. And I think the next question is for Marcelo Spinelli, right?

Q - Sylvain Brunet {BIO 3194710 <GO>}

The volume for purchase. We don't have a lot of source of purchase in Brazil. So it must be a stable number comparing to this year.

Operator

Thank you. Our next question comes from Tyler Broda, RBC.

Q - Tyler Broda {BIO 16281303 <GO>}

Great. Thanks very much for the presentation. My questions have been answered, but I just have two quick follow-up ones. I guess with Project West if all goes to plan, when should we expect that inventory to start building for that extra 20 million tons? And then secondly, I guess just on VNC. In terms of -- I see you have bidders back in the table if nothing is able to be agreed, how -- what should we look at in terms of the shape of the closure costs? Thank you.

A - Marcello Spinelli {BIO 16240257 <GO>}

Thank you, Tyler. It's Spinelli here. Well, the West Project that's a -- we have this partner in China the Shulanghu Port. We already operate there. It's in the delta of the Yellow River -- the Yangtze River, sorry. So it's a very important position for our blending and our distribution in China. So when you're improving that, we don't -- we're not saying that we're going to use this -- increase this inventory considering the whole picture of us. So we -- that's our main market in that area. So we want to evolve there, sometimes we can offset with other ports. And we're expecting to run this new operation in 2.5 years. So it will give more flexibility rather than to increase our inventors.

A - Mark Travers {BIO 16687422 <GO>}

Hey, Tyler. Just on New Caledonia, as you mentioned, we -- there are some bidders that are looking at the asset. There's one group that is I would say put forward to, I would say, a rather fulsome offer. That's an offer by management working together with employees and supported by Trafigura. We'll know in the next -- in the coming week or so how that's panning out, but we haven't stopped on the planning for care and maintenance. And just in terms of estimates what we're planning for is care and maintenance rather than full closure. And just in terms of how that looks, it is quite a detailed process that's underway and we're preparing for it and it does require us to sit down with the Workers Council and talk about what that looks like.

So at this point, we don't have an estimate we can release. What we can say that is if you look at the requirements to fund New Caledonia, if we were to operate for the full year next year, we would estimate that the care and maintenance funding requirements would be roughly the same next year. And then the care and maintenance funding requirements for the following year would be a fraction of those operating costs. So, primarily next year so roughly equal to what we would require to fund the operations.

Operator

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

A - Eduardo De Salles Bartolomeo {BIO 15365202 <GO>}

Okay. Thank you. Thank you again for your questions, attention and the opportunity to sharing you our story. I think as you perceived, the quarter was really positive one. It encourages us that we are on the right track, but I'm being repetitive on this. We are not in a sprint. We are in a marathon. And I think we've been making strides in Brumadinho. I think we're repairing as I mentioned before with quality, with empathy, safety is a priority, we've been proving. We are very happy with the results in Carajas this quarter, because it shows us the potential that we have in that province in iron ore and we are on track to recover production.

And as everybody that knows Vale, we are extremely conservative on capital. We are going to return the capital to the shareholders to all stakeholders in place, we'll be extremely disciplined. So I think what we want to convey to you that we are striving to derisk the company, but that will make us a better company. And again, thanks a lot for your attention and let's see you in the next call. Have a good day and stay safe.

Operator

That does conclude this Vale's conference call for today. Thank you very much for your participation.