VALE

Company Note: Mariana settlement, one less suspicion...

LatAm Metals & Mining

Main takeaways:

(i) Vale has publicly disclosed a counterproposal to settle the legal dispute stemming from the 2015 collapse of the Samarco-operated Torto dam in Mariana, which it co-owns with BHP. **(ii)** This **latest proposal** to the Federal Regional Court of the 6th Region (TRF-6) aims to renegotiate the terms related to the disaster's consequences, **offering R$127bn** (-2.3% vs. Genial Est.), and a significant increase from R$42bn made in December 2023. Vale's strategy in revealing the proposal amount, disclosed few days later of the upward revision in provisional guidance on the release of 1Q24 results, is **(iii)** intended to support investor assessment of the financial impacts of the agreement and **(iv)** prove that the **recent adjustment in provisioning guidance is in line with the proposal**, also considering that the amount had already been leaked by the press. **(v)** We maintain strict assumptions and **have not altered the terminal value in our model**, pending a final decision from TRF-6. **(vi)** Despite adopting a conservative stance, we keep the 12-month Target Price unchanged despite adjustments to Samarco's provisioning and the US$127bn confirmation; **(vii)** The proposed settlement figure of R$127bn should reassure investors, **reflecting a less severe outlook than previously anticipated**. However, until confirmed by TRF-6, **our financial projections remain unaltered; (viii)** Currently, the company trades at **4.1x EV/EBITDA 24E** (vs. 4.9x historical average), which seems discounted considering that we are using purposely bearish assumptions to deliberately force cash flow generation down. We continue with our **BUY rating**, with a **12M Target Price** of **R$72.30** for **VALE3-B3** or **US$14.50** for **ADRs-NYSE**, which represents an **upside** of **+13.75%**.

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Company

VALE US Equity
Buy

Price: US$ 12.36 (29-Apr-2024)
Target Price 12M: US$ 14.50 (NYSE)

VALE3 BZ Equity
Target Price 12M: R$ 72.30 (B3)

Vale clarified in a material fact today (Monday April 29) about **the settlement proposal related to the Fundão dam collapse in Mariana (MG)**, after information about the negotiations was leaked by the press (O Globo) in recent days.

What is the new fact?

This proposal, **made official today through the material fact disclosed to the market by Vale**, seeks to resolve Samarco's obligations in relation to the accident in Mariana (MG), during a legal dispute that has lasted several years. The legal dispute stems from the renegotiation of the agreement related to the material, environmental and life consequences of the collapse of the Torto dam, operated by Samarco (JV between Vale and BHP) in 2015. The parties involved, including Vale, Samarco and BHP, submitted to the Federal Regional Court of the 6th Region (TRF-6) an indicative and non-binding counterproposal for the renegotiation, **totaling R$127bn** (-2.3% vs. Genial Est.), after having made an initial proposal of R$42bn in December 2023.

Why was disclosed today if the agreement is still being protected by the secrecy of the courts? The TRF-6 is coordinating the process at the request of the Federal Public Prosecutor's Office (MPF), in agreement with the Federal Government, as well as the governments of the states of Minas Gerais (MG) and Espírito Santo (ES). The renegotiation process is still being carried out under the secrecy of the courts, due to the confidential nature of the information. Vale ended up confirming these figures in response to the leaking of a portion of confidential information regarding the settlement negotiations. Remediation is a priority for the company, with ~R$37bn already spent on remediation and compensation until March 2024.

Our analysis suggests that Vale preferred to publicly announce the value of the proposal, as it probably believes that it is in the **final stages of closing the deal**. Therefore, the early announcement of the amount should **(i)** help investors to better price the extent of the impacts in their models, as well as **(ii)** offer a more appropriate comparison for the modification of the provisioning guidance, promoted by Vale together with the publication of the 1Q24 result, on April 24 (last Wednesday), after the market closed.

What is this report about?

In this report, since we were very precise in our analysis of the 1Q24 result, after Vale revisited the provisioning guidance related to the Mariana (MG) agreement, **we will publish the same excerpt from the previous report, but adding slight adjustments**, since the value of the proposal has already been confirmed. We always try to inform investors about what happens before the information is priced in, **getting ahead of the consensus in our analysis**. In order to confirm the facts, we have attached a version of our previous report ("1Q24 Review: Are overhangs still hampering the stock performance?").

In other words, if the investor reading this did not have the opportunity to read what we wrote in the attached report when we published it on Thursday of last week, before the market opened, then we suggest reading the excerpt from the chapter below "**Analysis of the Mariana settlement**". The excerpt is almost a faithful copy of what has already been written. As we know that our reports are long, we are basically replicating the same fragment on this subject, with slight adjustments to the value of the proposal, which we previously calculated through a back-of-the-envelope calculation, and which was confirmed to be accurate by Vale today.

Therefore, **today's material fact does not change our model assumptions at all**. But it shows that after the terminal value for the proposal was confirmed, the **more pessimistic approach of investors began to be reversed**, with the shares reacting well in today's trading session even with the price of iron ore down 62% Fe in the early hours of yesterday.

In this sense, our focus is on the **company's good operational performance**, and on the short-term movements in iron ore. We see Vale trading at **4.1x EV/EBITDA 24E** (vs.4.9x historical average). We reiterate our **BUY rating**, with a **12M Target Price** of **R$72.30** for **VALE3-B3** or **US$14.50** for **ADRs-NYSE**, which represents an **upside** of **+14.98%**.

Analysis of the Mariana settlement

How did we anticipate today's news through the guidance change announced in the 1Q24 results? Vale raised its provisioning guidance. We were considering a decrease in net income in 1Q24 contaminated by a US$270mn Genial Est. provision, which would be allocated to results of Affiliates and JVs, since the accident of the Torto dam rupture, in Mariana (MG), occurred through the operation of Samarco (JV between Vale and BHP) in 2015. Even though in 1Q24 no provision was made for this specific issue, Vale revisited its guidance and announced changes.

Although the amount related to Samarco in the new guidance remained stable at US$900mn for 2024, the total amount figured between the years 2024-2038 rose to US$4.4bn (+22% vs. previous guidance). The years 2026 and 2027 were the most penalized in the new guidance vs. the old one and are now disclosed at US$800m (2x more vs. US$400mn) and US$1bn (3.3x more vs. US$300mn), respectively. Meanwhile, the total dilution period was also announced at +3 years compared to the previous provision curve, which helps to reduce the impact of higher numbers on the NPV calculation.

Why did Vale raise its provision guidance? Our analysis suggests that the double-digit increase compared to the previous indication is a critical factor in this matter, as we interpret that Vale was previously underestimating the size of the potential agreement to be reached with the Federal Public Prosecutor's Office (MPF) and other government entities regarding the compensation and reparation movements linked to the Mariana (MG) accident, as we have already reported in different passages in our publications.

How did the market react to the increase in guidance? We believe that a significant portion of this increase in provisions was already priced in. From the contact we have with investors, we have learned that a large part of the market already put in their models an agreement that ranged from R$126-155bn, with 50% responsibility for Vale and 50% for BHP. The more pessimistic investors are about the case, the closer to the upper band of this range it is. It should also be remembered that we should exclude the amount that Samarco + Renova Foundation have already paid over all these years, which today stands at ~R$37bn (as we have already mentioned).

If we make a final tally, the accumulated sum of US$4.4bn from the new provision guidance would imply a terminal agreement of ~R$127bn (-2.3% vs. Genial Est.), which is ~R$3bn (or US$585mn) less than our projections and in line with a counter-proposal of R$126bn (or ~US$25bn) already offered by the MPF, which is coordinating the case before the Federal Regional Court of the 6th Region (TRF-6), in agreement with the governments of the states of Minas Gerais (MG) and Espírito Santo (ES). So, as you already know by now, this morning Vale confirmed that the official counterproposal is R$127bn.

Of course, beyond the estimate of the final value of the agreement, the impact on the NPV also depends on how each investor is modeling their assumptions, especially with regard to the pace of payment via cash flow disbursement vs. provision in the P&L.

In this case, from the feeling we get from rounds of conversations, our assumptions are tough compared to the vast majority of investors.

How do our projections look vs. official value of the proposal? We should remember that Vale made the value of the proposal official (R$127bn) but is not the final agreement yet. Although the terminal value we are projecting for the agreement is **R$130bn Genial Est**., which is not in fact in the upper band of the range we mentioned of R$126-155bn, on the other hand the pace of provisioning vs. disbursement of cash flow is very tight in our modeling, which causes the **NPV to be penalized on purpose**.

Remember that we are assuming the payment of **20% of the value upfront** with the renegotiation of the agreement **being closed in 3Q24E**, and with a **term of 7 years**, ending in 2030. The timeframe we have drawn as a basis seems very short to us in view of Vale's new expectations, which modified the guidance by extending the provisioning period to 2038 (+3 years vs. previous guidance), with an additional margin of **+8 years vs. Genial Est**.

Although the new guidance of US$4.4bn, accumulated between 2024-2038, suggests an increase of +22% vs. the US$3.6bn in the previous provisioning curve, with a positive nominal balance of +US$800mn, even so the implicit value of the agreement, which would come to ~US$127bn, **(i)** turned out to be slightly higher (by +0,8%) than that previously disclosed through public documents from the MPF (~R$126bn), **probably only due to monetary restatement**, since the MPF calculated R$126bn at the end of 2023 and **(ii)** is still below our estimate (~R$130bn). In addition, we are convinced that **(iii)** our assumptions, which allude to the rate at which this amount would be provisioned and subsequently disbursed, offer much tighter conditions in terms of cash flow than the new guidance released by Vale.

Our Take on Vale

We emphasize that **we are not going to converge our harshest assumptions in favor of the new guidance** and at this point, **not even the terminal value of the proposal**, since it is not yet a final decision of the TFR-6. We are purposely approaching exaggerated bearish assumptions as a perspective for defending the case, however contradictory it may seem at first glance.

Our idea, as mentioned in the last series of reports, was to **pessimistically tighten the assumptions and see how much upside our model could generate compared to the current valuation level of the shares**, a stance that seems to be adopted much more by investors on the buy side and less by other sell-side firms. This is an approach to try to convince investors that even under stressed scenarios, with pessimistic assumptions, we still see Vale with a **24E FCF yield** of **~13%** vs. **11.5%** in January (before our model update), which is an **attractive cash flow generation** figure vs. the current share price.

Just to remind you, our **most bearish assumptions**, inserted into the model in February, include: **(i)** an iron ore curve 62% Fe below consensus, with terminal value marked at US$75/t in 28E (flat until perpetuity), and average value of US$103/t in 24E; **(ii)** Payment of complementary grants on the EFVM and EFC railroads, also with 20% upfront; **(iii)** Conditions of the Mariana (MG) agreement, which have already been described; **(iv)** All-in premium projected at US$2.7/t in 24E, below guidance US$3-4/t and **(v)** C1 cost ex. purchase from third parties projected at US$22.9/t in 24E, within the upper band of the guidance of US$21.5-23/t.

These changes in assumptions led to a cut in the **24E FCFF** generation forecast to **US$6.8bn** (vs. US$7.2bn previously). Even so, the 24E FCF yield has curiously improved, now standing at **13% vs. 11.5%**, based on the estimate made in January, before the change in the model. This improvement occurred as Vale's share price fell to ~R$63.00 currently vs. ~R$71.00 in the same period (Jan-Apr), or to ~US$12.00 in the NYSE ADRs vs. ~US$14.40, suggesting a notable undervaluation of the company by the market.

In simpler words, even though our purposely more pessimistic assumptions forced cash flow generation downwards, the share price still fell more intensely than the cash generation outlook in our model, drawing on assumptions that we like to think would be part of the "**worst-case scenario**". For us, this is ample proof of the extent to which the market disproportionately penalizes shares in the face of a lack of precision about the future. We don't deny that the scenario is indeed uncertain, but the **level of discount implicit in the stock seems exaggerated**. Thus, despite the downward bias in our model, Vale still has **solid financial metrics**.

So, all in all, Vale's changes to its provisioning guidance could be interpreted as slightly negative for the market few days ago. However, we believe that they won't put so much selling pressure on the stock to further increase its already depressed levels. The reason for this would be that investors were already, for the most part, more pessimistic than the previous guidance. Now, **with the R$127bn proposal made official**, the **market can interpret it as positive stance**, since those who were modeling close to R$140-150bn will probably discard their assumptions, **generating an upside**.

Mariana settlement, one less suspicion... On our side, the changes to the provisioning for Samarco also do not imply a reduction in the 12M Target Price, since the conditions, although tighter than the previous guidance, are looser than those we already had in our model. We believe that **the official proposal figure (R$127bn) offers peace of mind to investors who were modeling a much worse scenario than this**. Even so, until it is validated by the TRF-6, we will not change any of our assumptions.

Currently, the company trades at **4.1x EV/EBITDA 24E** (vs. 4.9x historical average), which seems discounted considering that we are using purposely bearish assumptions to deliberately force cash flow generation down. We maintain our confidence in the operating performance. We continue with our **BUY rating**, with a **12M Target Price** of **R$72.30** for **VALE3-B3** or **US$14.50** for **ADRs-NYSE**, which represents an **upside** of **+13.75%**.

Appendix: Vale

Figure 1. Vale – Income Statement in US$ Millions (Genial Est. 2024-2029)

Income Statement	2024E	2025E	2026E	2027E	2028E	2029E
Net Revenue	**37.042**	**41.292**	**42.126**	**43.842**	**44.830**	**48.448**
(-) COGS	(23.944)	(26.237)	(26.383)	(27.586)	(29.085)	(31.495)
Gross Profit	**13.098**	**15.055**	**15.743**	**16.257**	**15.745**	**16.953**
(-) Expenses	(3.420)	(3.321)	(3.160)	(2.765)	(2.418)	(2.559)
Adjusted EBITDA	**12.824**	**15.437**	**16.030**	**17.078**	**17.049**	**18.243**
(-) D&A	(3.192)	(3.356)	(3.512)	(3.661)	(3.802)	(3.936)
EBIT	**9.633**	**12.081**	**12.518**	**13.417**	**13.247**	**14.307**
(+/-) Financial Result	(1.943)	(2.033)	(2.254)	(2.277)	(2.260)	(2.326)
(-) Taxes	(889)	(1.275)	(1.395)	(1.563)	(1.567)	(1.742)
Net income	**6.801**	**8.773**	**8.869**	**9.578**	**9.420**	**10.239**
Profitability						
Net margin (%)	18,36%	21,25%	21,05%	21,85%	21,01%	21,13%

Figure 2. Vale– Cash Flow in US$ Millions (Genial Est. 2024-2029)

Cash Flow (FCFF)	2024E	2025E	2026E	2027E	2028E	2029E
Net Revenue	**37.042**	**41.292**	**42.126**	**43.842**	**44.830**	**48.448**
(-) COGS	(23.944)	(26.237)	(26.383)	(27.586)	(29.085)	(31.495)
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(-) Taxes	(889)	(1.275)	(1.395)	(1.563)	(1.567)	(1.742)
(+) D&A	3.192	3.356	3.512	3.661	3.802	3.936
(+/-) Brumadinho and Samarco	(1.988)	(1.446)	(1.204)	(915)	(875)	(733)
(+/-) Δ WK	3.404	831	140	(27)	(149)	(51)
(-) Capex	(6.500)	(6.500)	(6.500)	(6.500)	(6.500)	(6.500)
FCFF	**6.852**	**7.048**	**7.071**	**8.074**	**7.958**	**9.216**

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under Review	Under review	**5%**

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