Equity Research

VALE

Mariana settlement: counterproposal rises value. Beware, it's worse than it looks

LatAm Metals & Mining

Main takeaways:

(i) The counter-proposal, offered by AGU +MPF + the governments of the states of Minas Gerais (MG) and Espírito Santo (ES), involves an **additional payment of R$109bn** (~US$20.7bn), to be paid over 12 years, **resulting in an agreement of ~R$146bn** or ~US$27.7bn (+12% vs. Genial Est.), considering the amount that has already been disbursed by Vale, BHP, Samarco and the Renova Foundation, which today stands at ~R$37bn (~US$7bn). **(ii)** The counterproposal comes in the wake of an imbroglio that has been going on for years, since the end of the renegotiation attempt in September 2022. **(iii)** The procedures for the agreement are guided by compensation amounts and repair improvements, following the failure of the Torto dam, located in the municipality of Mariana (MG), operated by Samarco (Vale's JV with BHP, each with 50%). **(iv)** It is also important to mention that **not included in the R$109bn package** are complementary amounts, estimated to carry out **obligations still "to do"**, which will remain the responsibility of the companies, such as the removal of tailings from the Doce river. These complementary obligations are **valued at ~R$18bn**. **(v)** We therefore conclude that the news is potentially negative, since both variables **(vi) value higher by +R$37bn vs. previous proposal** and **(vii) timeframe shorter by ~2 years**, contribute to a more detrimental NPV calculation. **(viii)** We believe that **Vale + BHP** will also receive the value of the counterproposal negatively and **will probably decline**, so this will not be the end of the imbroglio. **There are more chapters to come in this "soap opera" ...** For now, we reinforce our **BUY rating**, with a **12M Target Price** of **R$72.30** for **VALE3-B3** and **US$14.50** for the **ADRs-NYSE**, giving an **upside** of **+18.12%**.

The Federal Attorney General's Office (AGU) together with the state governments of Minas Gerais (MG) and Espírito Santo (ES) presented yesterday (June 06th) a new counterproposal to Mr. Ricardo Rabelo, mediator of the Federal Regional Court of the 6th Region (TRF-6), who is coordinating the process together with the efforts of the Federal Public Prosecutor's Office (MPF). **This counterproposal includes an additional amount of US$109bn for the renegotiation of the Mariana (MG) settlement**, due to the collapse of the Torto dam in 2015, which was operated by Samarco (JV between Vale and BHP). The official AGU publication is attached in Portuguese (AGU Counterproposal).

The counter-proposal comes after both the AGU and the government of Espírito Santo (ES) rejected the R$127bn proposal offered by Vale and BHP on May 3rd. When Vale made the proposal value known to the market through a material fact, we published a report, which explains our calculation and estimates for the agreement in more depth. This report can be found in attached (Vale Mariana Settlement: One less suspicion...).

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Company

VALE US Equity
Buy

Price: US$ 11.62 (06-Jun-2024)
Target Price 12M: US$ 14.50 (NYSE)

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

It's important to mention, as we have done in several other reports, that **our assumptions are tighter than the consensus**, especially regarding the payment period (and not the amount itself). Therefore, although we see the acceptance as a potential catalyst for value, **we still believe that the reaction of investors in general will not carry such a positive bias**.

The timeframe is shorter in the counter proposal. We know that the market debates the value of the proposal a lot, but for us the real discussion is about the term, not the value itself. The counterproposal is due to pay along 12 years, and bearing in mind the target date we made, Vale expected to pay the agreement in ~14 years, when it offered the R$127bn proposal. Therefore, the Government's counterproposal would shorten the payment flow by ~2 years vs. the pace at which Vale intended to disburse the amount.

We're still in our comfort zone. This is where we get comfort with the assumptions we drew in Vale's cash flow, in our proprietary financial model. The timeframe we took as a base assumption for payment is ~7 years Genial Est, which represented half of what Vale was supposed to have offered and a very elastic safety margin of 5 years in relation to the counterproposal. Considering R$146bn as the total agreement (excluding the R$18bn of "to do" obligations) the value is in fact higher (+12% vs. Genial Est.) than our terminal agreement projection of R$130bn Genial Est. However, even so, the much shorter term we used in our model (7 vs. 12 years) offsets this effect, by penalizing the company's cash flow more than the increase in value of the proposal. This still leaves us room to say that Vale's market valuation remains excessively discounted.

The counterproposal can be divided into 3 categories. It is important to separate the total amount into 3 categories: **(i)** unpaid additional, **(ii)** complementary obligations "to do" and **(iii)** amounts already disbursed. Thus, according to the AGU's (and other entities') counterproposal, Vale, BHP and Samarco would be responsible for paying R$109bn (additional unpaid) + R$18bn ("to do" complementary obligations) + R$37bn (already disbursed), totaling R$164bn (+29% vs. previous proposal). This terminal value of the deal would be above the upper band of R$126-155bn, which we know the vast majority of investors had in their models. In addition to a higher value, the counterproposal also shortens the payment stream by ~2 years, according to Vale's guidance, which runs until 2038.

For us, the news is potentially negative. We then conclude that the news is potentially negative, since both variables **(i)** value (higher by +R$37b vs. previous proposal) and **(ii)** term (shorter by ~2 years), contribute to a detractor NPV calculation of greater intensity. Looking at the projected cash flow, the **NPV we calculate for the disbursement corresponds to ~US$6.7bn** (-2.4% vs. Genial Est.) and is equivalent to 13% of the Market Cap. When we exclude the R$18bn of "to do" obligations that will be left out of the discussion at this point, the detractor NPV is slightly lower than our estimate, which contemplates a R$130bn Genial Est. terminal agreement, with R$93bn still to be paid over 7 years (vs. R$109bn over 12 years in the counterproposal).

Our Take on Vale

Where could the market's interpretation be mistaken? We believe that part of the market may be confused about some concepts of corporate finance, as well as making incorrect comparisons of values, since the situation is complex and the article published by the AGU may have left room for misinterpretation, due to the dubious nature that we identified in some passages.

By now we have had access to converging information that **part of the consensus believes that the negative impact of the counterproposal is small** (only a range between US$1.5bn and US$2bn of additional provision in relation to the NPV), **but our thinking differs from this opinion**. We believe that the tone used by the AGU in the official publication is not appeasing and offers a comparative basis of values far above Vale + BHP's proposal of R$127bn made in April. This situation seems to signal that the discussion still has "ground to cover" and the impact on the additional provision may be underestimated in a preliminary look by the street.

R$109bn vs. R$72bn, an increase of +51%. First, the correct value comparisons must be made. Vale + BHP's previous proposal totaled R$127bn, a resource that could be divided into: **(i)** R$72bn of unpaid additional; **(ii)** R$18bn of complementary obligations "to do" and **(iii)** R$37bn already disbursed. Therefore, we should compare the R$109bn of the counterproposal with R$72bn, giving an additional amount of +R$37bn (+51% vs. the previous proposal). In other words, curiously, the **AGU and other government entities disregard what has already been paid**, which is precisely the R$37bn that is added back to the R$72bn previously proposed by Vale + BHP, making up the subtotal of R$109bn (vs. R$93bn Genial Est.), what **we call the "Post-Final Agreement**".

As the excerpt from the AGU publication itself, translated into English, mentions, "the petition also emphasizes that the amount of R$109 billion does not include amounts already spent by the mining companies for any reparation measure". This sentence makes it clear to us that the comparative basis for the R$109bn would be the R$72bn, which was included in the R$127bn of the previous proposal, so living aside exactly the amount that had already been disbursed (~R$37bn).

R$18bn of complementary obligations "to do" are not of an indemnity nature. Complementary "to do" obligations include the removal of tons of tailings from the Doce river, for example. There may be some doubt as to whether or not this amount should be included to proper size a terminal agreement since it is not compensation but reparation.

Although Vale + BHP's proposal specifics conditions of R$127bn has not been made public, due to the confidential procedure protected by the courts, backed by the TRF-6, with only the amount being confirmed via a material fact by the company, nevertheless, a stream of press reports that we characterize as reputable (O Globo and Estadão groups) mentions the division of R$72bn in cash, over an undisclosed period (which we believe to be 14 years), to the federal government, Minas Gerais (MG) and Espírito Santo (ES) governments and the municipalities affected, as compensation. This amount would be increased by R$18bn in "to do" obligations, which in turn are intended for reparation movements.

To reach R$127bn, add the R$37bn already disbursed. Here it is important to clarify that “indemnification” and “reparation” are different situations. Indemnification refers to compensation for the environmental damage, material loss and loss of life caused by the dam collapse. This amount must be paid in cash. On the other hand, “reparation” has the idea of responsibility for bringing the environment back to the status quo ante, like the example mentioned about the removal of tailings from the Doce river. This reparation will not necessarily be paid for in cash but by carrying out improvements and waste management processes, and obviously this has a financial cost (estimated at ~R$18bn).

If we exclude the R$18bn from the bill, which a priori was also contained in the R$127bn proposal, with that amount being left out of this discussion at this point, we arrive at the amount of R$109bn (additional unpaid) + R$37bn (already disbursed), bringing the condition of the AGU's counter-proposal to a terminal value of R$146bn (vs. R$130b Genial Est.). If we include the R$18bn, the counter-proposal would go to a terminal value of R$164bn (+29% vs. a proposal of R$127b), above the upper band of the R$126-155bn range, which we found most investors were allocating in their models. **This situation strikes us as a very bad scenario**. At least if the term were longer, it would justify the increase in value, but that wasn't the case...

Term shortened, and the AGU's interpretation was clear: “victims were penalized by the delay”. Considering another excerpt from the AGU publication, which follows: "The counter-proposal provides for the amount to be paid over 12 years. The deadline considers the companies' own proposal (...) discounting the eight years that have already passed since the tragedy. According to the petition sent by the Government to the TRF6, the delay needs to be considered in the payment schedule, out of respect for those affected". According to our interpretation, it is also clear that the deadline is much shorter than the one claimed by Vale + BHP, who initially asked for 20 years to pay the terminal value (20 - 8 = 12 years).

On the other hand, Vale's revised guidance suggests the end of provisioning in 2038, days before the company itself made public that it had made a proposal of R$127b in April. Therefore, we understand that the term of this proposal was ~14 years (2024-2038), despite not having been officially revealed by the company. This means that, according to our analysis, the 12-year term of the AGU's counterproposal corresponds to a reduction of at least 2 years vs. the expected term that Vale had drawn up in the R$127bn proposal, made in April and denied by the AGU and the government of the State of Espírito Santo (ES).

Our peace of mind comes from more rigorous assumptions than the consensus. We've always mentioned that we were using more conservative assumptions than the street in our Vale model in order to demonstrate the upside that exists on shares, even in the worst scenarios that we can draw up as possible (even the unlikely ones). This means that although we weren't serving the model with a value in the upper band of the R$126-155bn range, we believed that we were purposely penalizing the NPV as we projected as a base scenario a payment period that seemed excessively short (7 years vs. 12 years in the counterproposal).

So even though the counterproposal worried us a bit by looking at the terminal value, our term assumption still paid off, making the projected NPV in the cash flow even lower than the detractor level we already have in our proprietary model.

Street seems to have done a simplified NPV calculation. Beware, it's worse than it looks. With our analysis, we found a cumulative NPV of -US$6.7bn (vs. -US$6.8bn Genial Est.) for the cash flow disbursement and -US$4bn NPV for the provision that still needs to be made (considering the ~US$4.2bn that Vale has provisioned on its balance sheet), making up 7.9% of the company's market cap.

Table 1 . Mariana Agreement Summary

Mariana Agreement	AGU Counter-proposal	Genial Est. Proposal
	R$ Millions	**R$ Millions**
Pre Final Agreement	146.086	130.086
(-) Accumulated Disbursements 2023	(37.000)	(37.000)
(=) Post Final Agreement	109.086	93.086
Vale's Stake (50%)	**R$ Millions**	**R$ Milhões**
(+) Payment Due Post Agreement	54.543	46.543
(-) Disbursements made up to 2Q24E	(974)	(974)
(=) Amount to Pay 3Q24E Onwards	53.569	45.569
(-) Accumulated Provisions up to 2Q24E	(22.617)	(22.617)
(=) Vale's Provision 3Q24E Onwards (R$)	30.952	22.952
(=) Vale's Provision 3Q24E Onwards (US$)	5.884	4.364
Conditions		
Upfront (%)	5%	20%
Timeframe -(Quarters)	47	27
Calculations	**R$ Millions**	**R$ Milhões**
Upfront Provision	1.548	4.590
Base for Provision 4Q24E Onwards	29.405	18.362
Percentage of Porvision in 4Q24E	5%	5%
Upfront Payment	2.678	9.114
Base for Payments 4Q24E Onwards	50.891	36.455
Ke	11,75%	11,75%
	US$ Millions	**US$ Millions**
NPV	(6.681)	(6.848)
% of Mkt Cap	13,07%	13,40%
% of Vale´s Fair Value (Genial Est.)	11,01%	11,29%
Provision Addition	6.680,86	
Simplified Provision NPV (US$)	**(1.600)**	
% of Mkt Cap	3,1%	
Cash Flow Adjusted Provision NPV (US$)	**(4.045)**	
% of Mkt Cap	7,9%	

Source: Genial Investimentos

It seems to us that **some other sell side firms and investors have made a simplified calculation of the NPV** by ignoring the fact that the rate of expenditure, both in terms of cash flow disbursements and provisions, does not occur in a linear fashion. A basic rule of corporate finance measured through financial mathematics is that flows that are closer to Year 1 have greater weight within the NPV composition (for better or worse). In other words, the closer to the start of the cash flow, the more weight that value will have within the discounted cash flow. The converse is also true: the further away a given cash flow is from Year 1, the less weight it will have in the total sum of the discounted cash flow when brought to present value.

This means that, **in order to calculate a range of -US$1.5bn to -US$2bn of additional NPV to the provisioning** already contained in Vale's balance sheet, we believe that the calculation made by some members of the market was to **uniformly discount the additional amount that would be missing from the provisioning**, which corresponds to ~R$31b (~US$5.8b) by a discount rate (Ke or WACC), ignoring the fact that, once the proposal is accepted, Vale would have a more severe rate of provisioning in the first 6 years than in the last 6 years of the total 12 years of the counter-proposal.

Therefore, the **market participants who concluded that the impact would only be US$1.5bn to US$2bn probably did not adjust the NPV for the non-linearity of the cash flow** of payments and provisions. This can be confirmed by the company's own provisioning guidance, which is non-linear and precisely follows this trend. With the first 6 years totaling US$3.6bn and the last 6 years totaling only US$800mn. The more weight the first years of the cash flow carry, the greater the detracting intensity of the NPV.

Our conclusion is that we are only certain that the NPV will be within fair value because we were already much more pessimistic than the consensus regarding the timeframe. As the term of our base scenario was very short, the cash flow in the first few years was highly concentrated, mainly because we were assuming a 20% upfront payment. This situation meant that our NPV was highly detrimental to cash flow, as can be seen in the expanded statements below.

Table 1 . Genial Est. Proposal (Disbursment vs. Provision NPVs)

Genial Est. Proposal	Disbursement (US$- Millions)		Provision (US$- Millions)	
Periods (Years)	Cash Flow	Discounted Cash Flow	P&L	P&L Discounted
1	(2.901)	(2.596)	(1.676)	(1.500)
2	(1.825)	(1.462)	(919)	(736)
3	(1.521)	(1.090)	(766)	(549)
4	(1.154)	(740)	(581)	(373)
5	(882)	(506)	(444)	(255)
6	(601)	(309)	(303)	(156)
7	(317)	(146)	(160)	(73)
8	-	-	-	-
9	-	-	-	-
10	-	-	-	-
11	-	-	-	-
12	-	-	-	-
	NPV =	(6.848)	NPV =	(3.641)

Source: Genial Investimentos

Table 1 . AGU Counter-Proposal (Disbursment vs. Provision NPVs)

AGU Counter-Proposal	Disbursement (US$- Millions)		Provision (US$- Millions)	
Periods (Years)	Cash Flow	Discounted Cash Flow	P&L	P&L Discounted
1	(1.597)	(1.429)	(1.129)	(1.011)
2	(1.559)	(1.248)	(901)	(721)
3	(1.413)	(1.012)	(816)	(585)
4	(1.201)	(770)	(694)	(445)
5	(1.078)	(619)	(623)	(358)
6	(949)	(487)	(548)	(281)
7	(812)	(373)	(469)	(216)
8	(682)	(280)	(394)	(162)
9	(549)	(202)	(317)	(117)
10	(416)	(137)	(240)	(79)
11	(283)	(83)	(163)	(48)
12	(150)	(39)	(86)	(23)
	NPV =	(6.681)	NPV =	(4.045)

Source: Genial Investimentos

We believe that Vale + BHP should decline the counteroffer and continue to fight for lower values. As we have commented that we are confident with our strict assumptions and considering that there is still no definition of the terminal value of the agreement, as well as the payment term, we therefore continue with our scenario without making any changes to our proprietary model. We believe that Vale + BHP will also receive the counterproposal value negatively and will probably decline, so this will not be the end of the imbroglio. There are more chapters to come in this "soap opera" ...On the one hand, the delay in reaching a definitive figure increases uncertainty and continues to generate the overhang that puts investors off the shares.

On the other hand, we believe that the conditions of the counterproposal were detrimental to Vale and well above the previous proposal at NPV levels, which should make Vale argue in the TFR-6 in favor of lowering the R$109bn. We see this as positive, as it would widen the gap to our NPV, which although there is still some residual, would have a much-reduced upside if the conditions of the counterproposal are final. For now, we reinforce our **BUY rating**, with a **12M Target Price** of **R$72.30** for **VALE3-B3** and **US$14.50** for the **ADRs-NYSE**, giving an **upside** of **+18.12%**

Source: Genial Investimentos

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)
Adjusted EBITDA	**12.824**	**15.437**	**16.030**	**17.078**	**17.049**	**18.243**
Adjusted EBIT	**9.633**	**12.081**	**12.518**	**13.417**	**13.247**	**14.307**
(-) 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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