Vale SA

Vale seeks new dividend policy as debt falls

Iron ore exporter has been deleveraging and selling non-core assets

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Joe Leahy in São Paulo MARCH 19, 2018

A new dividend policy to be announced by Vale should be based on a more sustainable cash flow generation rather than profits or debt, according to the chief executive of the world's largest iron ore exporter.

"The one who will decide on the new [dividend policy] is the board but my preference is that it be linked in some form to the company's cash generation, not necessarily the [financial] results," Fabio Schvartsman told the Financial Times in an interview.

Vale has been struggling with how to deal with an industry cyclical downturn while trying to reduce a massive debt load. Its board is expected to decide on the policy this month as the Brazilian miner aggressively cuts debt, setting the stage for steadier cash returns for shareholders in coming years, analysts say.

"What you can distribute without hurting the company is the cash you generate," said Mr Schvartsman.

After investing heavily during the commodity supercycle of the first decade of the century, Vale reported a net loss for the fourth quarter of 2015 of about $8.6bn on a slowdown in China and plunging iron ore prices. This was compounded by the disastrous collapse of a dam the same year at Samarco, a mine that Vale jointly owns with Anglo-Australian miner BHP.

But since then the company has been deleveraging and selling non-core assets, first under former chief executive Murilo Ferreira and now under Mr

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Schvartsman, who was hired nearly a year ago from paper company Klabin.

Now, said Mr Schvartsman, his aim was to turn Vale into a more “predictable” company. The company last month announced its results for 2017, in which net profit rose 38 per cent compared with a year earlier to $5.51bn on higher iron ore prices.

While commodity prices would always be volatile, the goal was to control what he called the “rest” — costs, volume, productivity and capital allocation.

“If you have the rest under control, to be predictable means that given a certain outlook for prices, I can quickly work out how Vale will perform,” he said.

Net debt fell from more than $25bn in 2016 to $18.1bn in 2017, with a further $3.7bn reduction already sealed this year from the divestment of fertiliser assets and other deals.

Stronger sales last year were driven by Chinese state-supported construction and buyers’ preference for high-grade iron ore, of which Vale is a supplier, to save on coking coal, UBS analyst Andreas Bokkenheuser said in a report.

Vale was also able to reduce capital expenditure in 2017 to below $4bn, the lowest level since 2005, with the conclusion of construction of its giant mine in northern Brazil, S11D.

“The target is $10bn . . . the sooner we get there, the sooner we can start paying good dividends,” said Mr Schvartsman of the company’s 2018 goal for debt.

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> **Luiz Otavio Laydner, head of research at Vinci Partners**

At $10bn of debt and an iron ore price this year of $67 per tonne, Vale’s net debt to ebitda would be 0.6 times, in line with its competitors, said Credit Suisse analyst Ivano Westin. He said he expected the $10bn target would be reached ahead of schedule.

“We expect from this year and for the year ahead double-digit free cash flow yield for Vale. It will be really a massive change in their overall business outlook,” said Mr Westin.

Some analysts warned Vale could see softer demand from China in the second half of this year, however, resulting in a 20 per cent fall in iron ore prices. “Our China macro team expects construction activity to slow through 2018,” Mr Bokkenheuser wrote.

Vale shares also face an overhang from the possible sale of part of a stake held by its former controlling shareholder group consisting of Japan's Mitsui, a unit of Brazilian bank Bradesco, and Brazilian government pension funds in conjunction with development bank BNDES.

The group formerly exercised control over Vale through an entity known as Valepar, which once had more than 53 per cent of voting shares. A lock-up on part of their remaining stake expired in February. The dismantling of Valepar is expected to improve governance at Vale, which investors had suspected was vulnerable to government interference, analysts said.

"This change in governance has been well received by the market," said Luiz Otavio Laydner, head of research at Vinci Partners, an investment house in São Paulo.

With additional reporting by Neil Hume in London

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