

16 July 2024

Basic Materials | Metals

Vale Indonesia (INCO IJ)

Riding It Out; Now a TRADING BUY

Trading Buy (from Buy)

Target Price (Return):	IDR4,300 (16.5%)
Price (Market Cap):	IDR3,690 (USD2,405m)
ESG score:	2.9 (out of 4)
Avg Daily Turnover (IDR/USD)	82,251m/5.09m

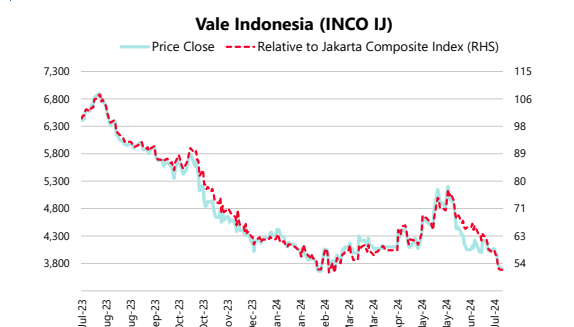
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- **Change to TRADING BUY from Buy, new IDR4,300 DCF TP (from IDR4,500), 17% upside.** Vale Indonesia's FY24-25 earnings projections are revised down by 31% and 8% due to its lower-than-expected 1Q24 margins. There are short-term upsides from an expected US Federal Reserve (US Fed) rate cut by the end of this year (a weaker USD could provide positive sentiment for commodity indexes), a potential normalisation of margins from 2Q (from better quarterly earnings), and higher quarterly nickel prices.
- **INCO has demonstrated stability in its operations so far**, as evidenced by its relatively higher volumes at the start of the year (in line, at c.18,200 tonnes of nickel matte; higher than previous seasonal 1Q achievements). However, it saw lower-than-expected margins due to higher energy usage to accommodate output from a "peculiar" feedstock situation (higher moisture, lower stockpile, and lower nickel grade) – management assured it will be able to contain such issues moving forward. INCO's total cash cost remains manageable, below the targeted limit of c.USD10,000/tonne (1Q24 cash cost: c.USD9,500/tonne, ASP: c.USD12,650/tonne). INCO is likely to start using higher nickel grade saprolites (above 1.75%) in 2H.
- **Clarity on divestment; finally priced in.** The share transfer from previous holders (including Sumitomo, Vale Japan, and Vale Canada (VCL)), and the completion of its right issuance have made Mining Industry Indonesia (MIND ID) the largest owner of INCO (34.03%; VCL is the second largest at 33.91%). The holding companies are entitled to have sales contracts for both INCO's saprolite and limonite ore from 2026. Management noted it will ensure the availability of its limonite ore for its upcoming high-pressure acid leach (HPAL) facility before considering ore sales for the domestic market.
- **Risks.** Given the downward pressure on nickel prices, management's strategy to maintain margins is crucial – unexpected patterns in energy usage and non-operational factors (revaluation of its derivative assets; directly linked to fluctuation in nickel benchmark prices) have presented risks. Therefore, we use a more conservative margin scenario for our valuation. Meanwhile, INCO's credit condition has not raised significant concerns – it is still operating in a net cash position (c.USD700) with minimum interest costs. Cash received from the divestment will be allocated for capex (close to USD1.6bn for the long term).
- **Short-term trading choice.** INCO's strengths – its utilisation of renewable energy and its fair governance – are somewhat still eclipsed by uncertainties in the outlook for nickel. Investors need to assess the possibility of nickel prices moving sideways for the long term (FY24F LME average estimate: USD17,250/tonne), impacting INCO's profit growth. The company is also required to submit 10% of its NPAT as government levy from FY26, following the renewal of its mining license. Our TP includes a 2% ESG discount, as INCO's 2.9 ESG score is below the country median.

Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(14.4)	(8.9)	(10.0)	(11.1)	(42.1)
Relative	(14.5)	(17.0)	(9.9)	(11.9)	(48.1)
52-wk Price low/high (IDR)				3,660	–6,900



Source: Bloomberg

Overall ESG Score: 2.9 (out of 4)

E: GOOD

INCO received a Green PROPER (beyond compliance) – Indonesia's pollution control, evaluation, and rating programme – recognition from the Ministry of Environment & Forestry in 2020. This is for its initiatives in environmental management systems, efficient utilisation of resources, and community empowerment. INCO will contribute to Vale Global's goal to reduce 33% of emissions produced by 2030.

S: GOOD

A community development programme was built through active participation between the company, the community, and the Government. INCO's successful programmes includes the organic rice and herbal garden businesses. In 2020, it disbursed c.USD4.1m (+21% YoY) for community development and empowerment.

G: EXCELLENT

INCO's sustainability management responsibilities and decision-making are carried out collectively by the board of directors, with the supervision of the board of commissioners. Moreover, the company has a strategic risk management, ie the Framework for Integrated Risk Management (FIRM), which is based on ISO 31000 standards.

Forecasts and Valuation	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
Total turnover (USDm)	1,179	1,232	916	948	1,029
Recurring net profit (USDm)	216	273	97	125	144
Recurring net profit growth (%)	25.8	26.1	(64.6)	29.3	15.7
Recurring P/E (x)	11.12	8.82	24.92	19.27	16.65
P/B (x)	1.0	0.9	0.9	0.9	0.8
P/CF (x)	9.42	5.46	7.71	8.27	10.74
Dividend Yield (%)	na	na	na	na	na
EV/EBITDA (x)	3.89	3.56	7.44	6.60	5.49
Return on average equity (%)	8.9	11.2	3.7	4.7	5.1

Source: Company data, RHB

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Financial Exhibits

Asia	Financial summary (USD)	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
Indonesia	Recurring EPS	0.02	0.03	0.01	0.01	0.01
Basic Materials	BVPS	0.22	0.24	0.25	0.26	0.28
Vale Indonesia	Return on average equity (%)	8.9	11.2	3.7	4.7	5.1
INCO IJ						
Trading Buy						
Valuation basis	Valuation metrics	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
Medium-term DCF (WACC 8%, TG 3.5%)	Recurring P/E (x)	11.12	8.82	24.92	19.27	16.65
	P/B (x)	1.0	0.9	0.9	0.9	0.8
	FCF Yield (%)	3.1	7.0	(14.1)	(10.8)	(1.1)
	EV/EBITDA (x)	3.89	3.56	7.44	6.60	5.49
	EV/EBIT (x)	5.78	4.93	17.96	14.43	10.75
Key drivers	Income statement (USDm)	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
i. Improved ASPs from the increase in nickel prices;	Total turnover	1,179	1,232	916	948	1,029
ii. Higher production and sales volumes;	Gross profit	314	347	138	183	231
iii. Lower fuel costs.	EBITDA	436	450	272	342	398
	Depreciation and amortisation	(143)	(126)	(159)	(185)	(195)
	Operating profit	294	325	113	156	203
	Net interest	4	26	9	2	(5)
	Pre-tax profit	276	353	124	161	202
	Taxation	(75)	(78)	(26)	(34)	(55)
	Reported net profit	200	274	98	127	147
	Recurring net profit	216	273	97	125	144
Key risks	Cash flow (USDm)	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
i. Nickel price trends;	Change in working capital	(21)	59	61	15	(30)
ii. Rising fuel costs;	Cash flow from operations	255	440	312	291	224
iii. Lower-than-expected output;	Capex	(182)	(271)	(650)	(550)	(250)
iv. Shifts in domestic policies, ie higher royalty rates for certain nickel products.	Cash flow from investing activities	(218)	(286)	(709)	(550)	(250)
	Cash flow from financing activities	(1)	(65)	7	6	5
	Cash at beginning of period	506	634	699	270	32
	Net change in cash	36	89	(390)	(253)	(21)
	Ending balance cash	634	699	270	32	92
Company Profile	Balance sheet (USDm)	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
Vale Indonesia produces nickel in matte, an intermediate product, from lateritic ores at its integrated metric and processing facilities near Sorowako, Sulawesi.	Total cash and equivalents	634	699	270	32	92
	Tangible fixed assets	1,550	1,696	2,346	2,896	3,146
	Total investments	73	104	112	121	131
	Total assets	2,658	2,926	3,034	3,344	3,694
	Total long-term debt	0	0	4	4	5
	Total liabilities	303	361	328	337	340
	Total equity	2,355	2,565	2,706	3,008	3,354
	Total liabilities & equity	2,658	2,926	3,034	3,344	3,694
	Key metrics	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
	Revenue growth (%)	23.7	4.5	(25.7)	3.5	8.5
	Recurrent EPS growth (%)	25.8	26.1	(64.6)	29.3	15.7
	Gross margin (%)	26.6	28.2	15.1	19.3	22.5
	Operating EBITDA margin (%)	37.0	36.6	29.7	36.0	38.7
	Net profit margin (%)	17.0	22.3	10.7	13.4	14.3
	Capex/sales (%)	15.4	22.0	71.0	58.0	24.3
	Interest cover (x)	42.6	32.2	9.2	9.3	10.2

Source: Company data, RHB

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The recent share price correction seems overdone (down by 38% since June), partly due to unexpectedly higher costs incurred early this year – although its topline was in line with estimates (1Q24: USD230m), net profit was only at USD6m (3% NPM vs 1Q's average of above c.15%). The relatively high 2Q24 average nickel price (LME at USD18,400/tonne; +11% QoQ) could create opportunities for a stronger topline, further bolstered by management's commitment to enhance cost efficiency. Our latest TP may materialise over the next six months. For longer-term upside, the key factors are: i) Regional economic stability, and ii) geopolitical factors (trade war, ongoing border disputes).

Figure 1: Valuation

DCF calculation (USDm)	2024F	2025F	2026F	2027F	2028F	2029F
EBIT	113	156	203	211	209	207
EBIT (1-t)	89	124	161	167	165	164
Depreciation & amortisation	159	185	195	207	220	232
Changes in working capital	19	(3)	(33)	(2)	(2)	(2)
Capex	(650)	(550)	(250)	(200)	(200)	(200)
Free cash flow	(383)	(244)	73	172	183	194
Discounted FCF	(383)	(226)	62	136	133	131
Terminal Value						2,744
Terminal growth	3.5%					
WACC	8%					
Total discounted firm value	2,598					
24F Net debt	(257)					
24F Minority Interest	0					
Equity value (USDm)	2,855					
Equity value (IDRbn)	45,111					
Issued shares (bn)	10.5					
Discount ESG	-2%					
Equity value per share	4,300					

Note: Figures were rounded up due to currency translation

Source: Company data, RHB

◆ Despite having better margins and diverse market penetration for its nickel matte products, investor expectations for a more stable long-term outlook have held the valuation from a higher re-rating – the best-case scenario for INCO to achieve above-mean levels remain uncertain. Weaker-than-expected earnings early this year have added to concerns on the company's ability to maintain cost efficiency.

◆ We still believe the company has a decent upside (for trading purposes), although it will still depend on market expectations towards the sector in general

Figure 2: WACC breakdown

Percentage of equity	89%
Percentage of debt	11%
Tax rate (t)	21%
Weighted average cost of capital (WACC)	8%
Cost of equity (CAPM)	8%
Risk free rate (Rf)	7%
Beta (b)	1.0
Market return (Rm)	10%
Risk premium	4%
Cost of debt (Kd)	7%
Terminal growth	3.5%

Source: Company data, RHB

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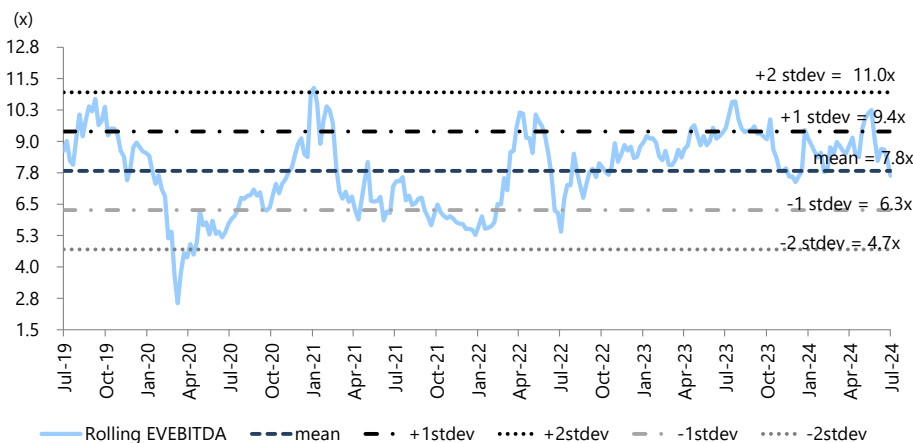
Figure 3: RHB vs Street estimates

(USDm)	RHB (new)			RHB (old)			Change			RHB vs Street		
	2024F	2025F	2026F	2024F	2025F	2026F	2024F	2025F	2026F	2024F	2025F	2026F
Revenue	916	948	1,029	989	1,019	1,104	-7%	-7%	-7%	-5%	-7%	-5%
Gross profit	138	183	231	190	188	244	-27%	-2%	-5%	-18%	-12%	-4%
Operating profit	113	156	203	170	167	228	-33%	-6%	-11%	-14%	-16%	-12%
EBITDA	272	342	398	340	371	436	-20%	-8%	-9%	-10%	-3%	-4%
Net profit	88	114	132	129	124	153	-31%	-8%	-13%	-20%	-21%	-25%
Margins												
Gross	15%	19%	22%	19%	18%	22%						
EBIT	12%	16%	20%	17%	16%	21%						
EBITDA	30%	36%	39%	34%	36%	39%						
NPM	10%	12%	13%	13%	12%	14%						
Key assumptions												
Vol. production (m tonnes)	70,800	68,000	72,500	70,800	68,000	72,500	0%	0%	0%			
ASP (USD/tonne)	12,938	13,946	14,190	13,973	14,985	15,228	-7%	-7%	-7%			
Cash cost (USD/tonne)*	8,638	8,410	8,201	8,731	9,048	8,825	-1%	-5%	-4%			

Note: *Ex-royalty payments

Source: Company data, RHB

Figure 4: INCO's 5-year average EV/EBITDA band



Source: Bloomberg, RHB

◆ INCO is now trading near its 5-year mean; short-term play is recommended, given the potential for better quarterly earnings ahead, and brief upward movement in commodity prices

◆ Our initial optimistic view has been challenged by persistent uncertainties from prolonged high inventories, while signs of ongoing recovery in regional economies (ie China) have yet to boost commodity prices

Figure 5: List of INCO's expansions and operating assets

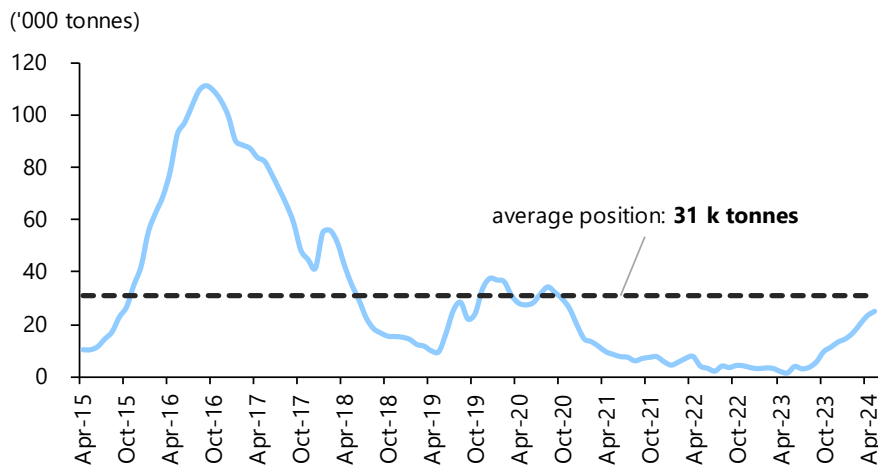
Specific locations (in Sulawesi)	Project	Total investment (USDbn)	INCO's ownership	Partnership	COD
Morowali	RKEF: 73-80k tonne capacity	2.6	49%	Tisco & Xinhai	2026
Pomalaa	HPAL: 120k tonne capacity	4.5	30%	Huayou & Ford	2026
TBA; still inside Sulawesi	SOA HPAL: 60k tonne capacity	2.0	-	-	-
	HPAL: 60k tonne capacity	2.0	30%	Huayou	2027
Sorowako	Electric furnace: c.70k tonne capacity	-	100%	-	Operational

Note: RKEF (Rotary Kiln-Electric Furnace); output is Fe-Ni. HPAL (High Pressure Acid Leach); output is MHP (mixed hydroxide precipitate). All ore feedstock needed (saprolite for RKEF (1.3-1.6% Ni content), limonite (1.0-1.2% Ni content) for HPAL) will come from INCO's concession area (adjacent to the smelter's location) which is 100% owned by the company. Currently INCO's nickel matte (c.78% nickel matte) production comes from the electric furnace facility in Sorowako.

Source: Company data, RHB

◆ Massive capex (vs 1Q24 net cash of c.USD700m) is needed. We remain optimistic on the realisation of these projects, given the support from major partners and goodwill from the Government.

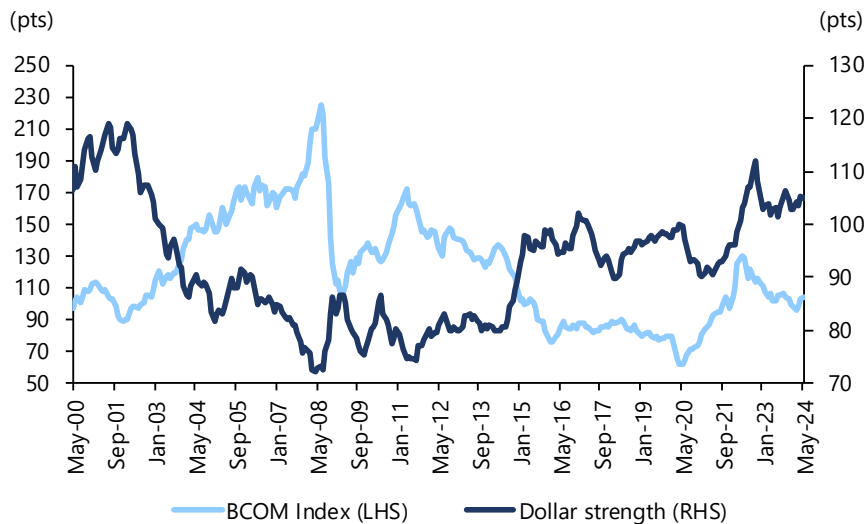
Figure 6: Shanghai Futures Exchange nickel inventory level



Source: Bloomberg, RHB

◆ Inventory levels seem higher due to slower-than-expected recovery in base metal hub regions (in this case, China).

Figure 7: LME nickel price trend vs the Dollar Index



Source: Bloomberg, RHB

◆ Historically, movements in the USD can slightly impact commodity prices (as seen in the chart; -0.6 correlation); a weaker USD typically prompts traders to take positions in commodities at "fairer" prices. The expectation of interest rate cuts (potentially in Sep and Dec 2024) could pave the way for a temporary boost in nickel prices.

Emissions And ESG

Trend analysis

INCO has not yet calculated scope 3 emissions but is gradually trying to reduce GHG emissions from its supply chain activities. Efforts to reduce emissions are progressing well despite fluctuations in the volume of GHG emissions every year (influenced by the proportion of fuel used in operations and amount of production). INCO is committed to reducing absolute GHG emissions from scopes 1 and 2 by 33% by 2030 and achieving net zero emissions by 2050.

For its nickel processing activities, INCO partly uses hydropower energy. Almost 94% of its electrical energy (besides fuel and coal) needs are obtained from three hydro-powered plants (PLTA): Larona (165 MW), Balambano (110 MW), and Karambe (90 MW). Of the total 365 MW of electricity output, c.11 MW were distributed to residential areas and its surroundings.

Emissions (tCO2e)	Dec-21	Dec-22	Dec-23
Scope 1	na	na	na
Scope 2	1,971,075	1,640,387	na
Scope 3	na	na	na
Total emissions	1,971,075	1,640,387	na

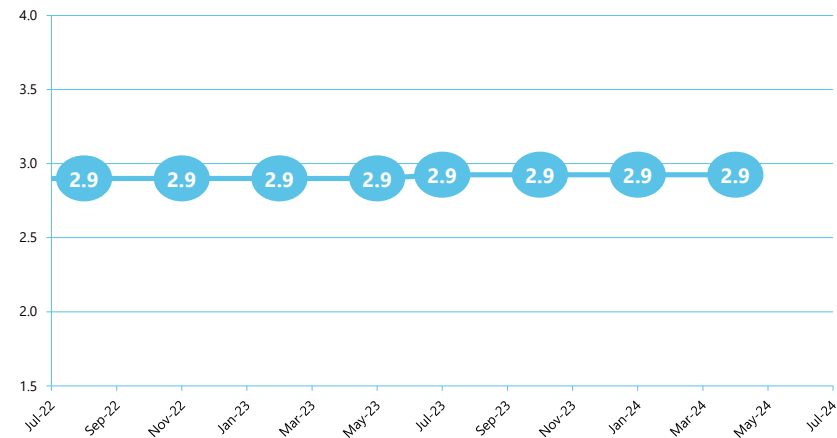
Source: Company data, RHB

Latest ESG-Related Developments

INCO's main nickel plant in Sorowako has a carbon intensity of 27.30 tonnes of CO2eq/tonnes Ni, giving the company amongst the lowest carbon intensity levels in Indonesia. INCO started testing electric cars and trucks for operational purposes in Jan and Aug 2022.

INCO has been progressively reclaiming post-mining land, targeting the reclamation of 70% of the total area by 2025, and rehabilitating watersheds. The area of land rehabilitated in 2022 is 10,280 hectares, comprising 10,000 hectares outside the operational area and 296 hectares within the operational area. The company also planted 3.7m trees, including endemic species.

ESG Rating History



Source: RHB

Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2024-06-19	Buy	4,500	4,120
2024-04-03	Buy	4,810	4,070
2024-02-13	Buy	6,000	4,050
2023-12-05	Buy	6,000	4,320
2023-10-30	Buy	7,120	5,225
2023-07-21	Buy	8,300	6,600
2023-02-17	Buy	8,300	6,775
2023-01-03	Buy	8,300	7,100
2022-10-31	Buy	7,600	6,500
2022-10-18	Buy	8,300	6,650
2022-07-04	Buy	7,700	5,450
2022-05-23	Buy	9,000	7,725
2022-04-04	Buy	7,940	6,975
2022-01-30	Buy	6,000	4,700
2021-11-01	Buy	6,500	4,800

Source: RHB, Bloomberg

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Buy:	Share price may exceed 10% over the next 12 months
Trading Buy:	Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain
Neutral:	Share price may fall within the range of +/- 10% over the next 12 months
Take Profit:	Target price has been attained. Look to accumulate at lower levels
Sell:	Share price may fall by more than 10% over the next 12 months
Not Rated:	Stock is not within regular research coverage

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