

3 April 2024

Basic Materials | Metals

Vale Indonesia (INCO IJ)

Buy (Maintained)

Short-Term Uncertainties Impacting Share Price; BUY

- **Still BUY, new IDR4,810 TP (DCF) from IDR6,000, 17% upside.** Stable cashflow from Vale Indonesia's nickel-matte exposure still presents a long-term upside. FY24F-25F earnings are revised by -39% and -32% following a cut in our ASP estimates. INCO's share price is also under pressure due to market concerns on its performance going forward, with potential further [structural changes in its management](#). We incorporated a 2% ESG discount into INCO's intrinsic value, as its 2.9 ESG score is below the country median.
- **Limited upside for volume growth, for now.** INCO's nickel matte production for this year is expected to be relatively flat (+1% YoY at 70,800 tonnes), as part of a strategy to stabilise overall margins (INCO's EBITDA has been relatively stable over the years; Figure 6) amidst the current downtrend in commodity prices (FY24F average: c.USD18,500/tonne; -16% YoY vs YTD: c.16,600/tonne). We expect lower production next year due to indications of heavy maintenance works, before output jumps back to optimal levels (Figure 5). Note that INCO's overall earnings are quite sensitive to changes in ASP ($\pm 1\%$ changes have $\pm 5\text{--}6\%$ impact on EPS) as it is the closest proxy to LME movement, given the high-grade nickel content produced by INCO.
- **Challenges will persist before upside factors emerge.** INCO is awaiting the official extension of its Special Mining Business Permit (IUPK; set to expire in Dec 2025) post its share divestment to Mineral Industri Indonesia (MIND ID). Note that a spokesperson from the Ministry of Energy and Mineral Resources had earlier confirmed that INCO's permit will be extended. The permit is crucial for the company to meet the targeted timelines for its current projects (Figure 7). While management will need more funding to support its future expansions (c.US\$800m shortfall vs latest net cash of c.US\$700m), it has decided not to pursue a bond issuance for this purpose.
- **We shift our valuation to DCF** (Figure 1) for a broader picture of INCO's profitability from its current businesses – its cash flow remains healthy for the foreseeable future. The share price has fallen by 39% in the past 12 months (-4% YTD, but moved up 7% post its share divestment at end-February). INCO is now trading at c.6x EV/EBITDA (relatively close to its mean valuation level; Figure 4).
- **We expect the share price overhang to remain in place** pending further clarity on domestic factors, especially political risks, as the new Government comes into power in early 4Q34. Further clarity on such factors will provide a better view of INCO's performance going forward, given the risk of an overhaul of the management team (still a possibility) and potential further stake divestments to the Government (in our view). Nevertheless, we expect INCO's resilience to help it manage the challenges ahead.

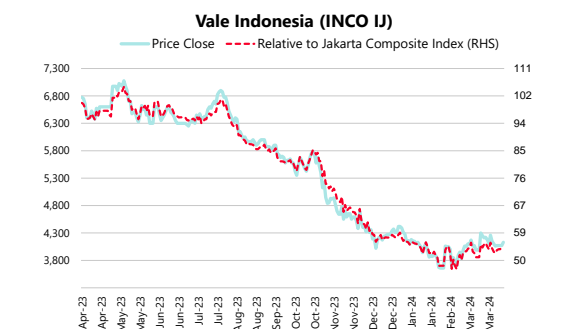
Target Price (Return):	IDR4,810 (16.5%)
Price (Market Cap):	IDR4,130 (USD2,615m)
ESG score:	2.9 (out of 4)
Avg Daily Turnover (IDR/USD)	59,132m/4.05m

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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(4.2)	0.7	(6.6)	(25.9)	(37.9)
Relative	(3.3)	2.2	(5.0)	(29.4)	(43.8)
52-wk Price low/high (IDR)				3,660	–7,075



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	1,032	974	1,086
Recurring net profit (USDm)	216	273	136	117	136
Recurring net profit growth (%)	25.8	26.1	(50.0)	(14.2)	16.5
Recurring P/E (x)	12.09	9.59	19.18	22.36	19.19
P/B (x)	1.1	1.0	1.0	0.9	0.9
P/CF (x)	10.24	5.94	6.69	8.07	8.28
Dividend Yield (%)	na	na	na	na	na
EV/EBITDA (x)	4.37	4.02	5.97	6.57	5.50
Return on average equity (%)	8.9	11.2	5.3	4.4	4.9
Net debt to equity (%)	net cash	net cash	net cash	net cash	net cash

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	0.24	0.26	0.27	0.28	0.30
Vale Indonesia	Return on average equity (%)	8.9	11.2	5.3	4.4	4.9
INCO IJ						
Buy						
Valuation basis	Valuation metrics	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
DCF, WACC at 9%, and TG at 3%	Recurring P/E (x)	12.09	9.59	19.18	22.36	19.19
	P/B (x)	1.1	1.0	1.0	0.9	0.9
	FCF Yield (%)	2.8	6.5	(9.9)	(8.6)	2.5
	EV/EBITDA (x)	4.37	4.02	5.97	6.57	5.50
	EV/EBIT (x)	6.49	5.58	11.47	15.66	12.41
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	1,032	974	1,086
ii. Higher production and sales volumes;	Gross profit	314	347	205	173	204
iii. Lower fuel costs.	EBITDA	436	450	362	369	418
	Depreciation and amortisation	(143)	(126)	(174)	(214)	(233)
	Operating profit	294	325	188	155	185
	Net interest	4	26	4	(3)	(8)
	Pre-tax profit	276	353	182	159	186
	Taxation	(75)	(78)	(42)	(37)	(43)
	Reported net profit	200	274	140	122	143
	Recurring net profit	216	273	136	117	136
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	81	20	(9)
ii. Rising fuel costs;	Cash flow from operations	255	440	391	324	316
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)	(613)	(250)
	Cash flow from financing activities	(1)	(65)	7	3	2
	Cash at beginning of period	506	634	699	346	73
	Net change in cash	36	89	(311)	(286)	67
	Ending balance cash	634	699	346	73	188
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	346	73	188
	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	3,052	3,177	3,339
	Total long-term debt	0	0	4	4	5
	Total liabilities	303	361	347	350	369
	Total equity	2,355	2,565	2,705	2,827	2,970
	Total liabilities & equity	2,658	2,926	3,052	3,177	3,339
	Key metrics	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
	Revenue growth (%)	23.7	4.5	(16.2)	(5.6)	11.5
	Recurrent EPS growth (%)	25.8	26.1	(50.0)	(14.2)	16.5
	Gross margin (%)	26.6	28.2	19.9	17.8	18.8
	Operating EBITDA margin (%)	37.0	36.6	35.1	37.9	38.5
	Net profit margin (%)	17.0	22.3	13.6	12.5	13.2
	Capex/sales (%)	15.4	22.0	63.0	56.5	23.0
	Interest cover (x)	42.6	32.2	10.8	7.2	7.8

Source: Company data, RHB

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Figure 1: TP calculation

DCF calculation (in USDm)	2024F	2025F	2026F	2027F	2028F	2029F	2030F	2031F	2032F	2033F	2034F
EBIT	188	155	185	177	173	149	145	136	124	111	98
EBIT (1-t)	145	119	143	136	133	115	112	105	95	86	76
Depreciation & amortisation	174	214	233	248	263	277	288	300	310	320	330
Changes in working capital	38	4	(9)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)
Capex	(650)	(550)	(250)	(200)	(200)	(200)	(150)	(150)	(135)	(135)	(135)
Free cash flow	(293)	(212)	117	183	194	191	249	253	268	269	269
Discounted FCF	(293)	(195)	99	143	140	127	152	143	140	129	119
Terminal Value											2,022
Terminal growth	3%										
WACC	9%										
Total discounted firm value	2,725										
24F Net debt	(333)										
24F Minority Interest	0										
Equity value (USDm)	3,058										
Equity value (IDRbn)	48,312										
Issued shares (bn)	9.9										
Equity value per share	4,900										
Discount ESG	-2%										
TP (final)*	4,810										

Note: Figure was rounded up due to currency translation

Source: Company data, RHB

Figure 2: WACC breakdown

Percentage of equity	89%
Percentage of debt	11%
Tax rate (t)	23%
Weighted average cost of capital (WACC)	9%
Cost of equity (CAPM)	9%
Risk free rate (Rf)	7%
Beta (b)	1.0
Market return (Rm)	10%
Risk premium	4%
Cost of debt (Kd)	9%
Terminal growth	3%

Source: Company data, RHB

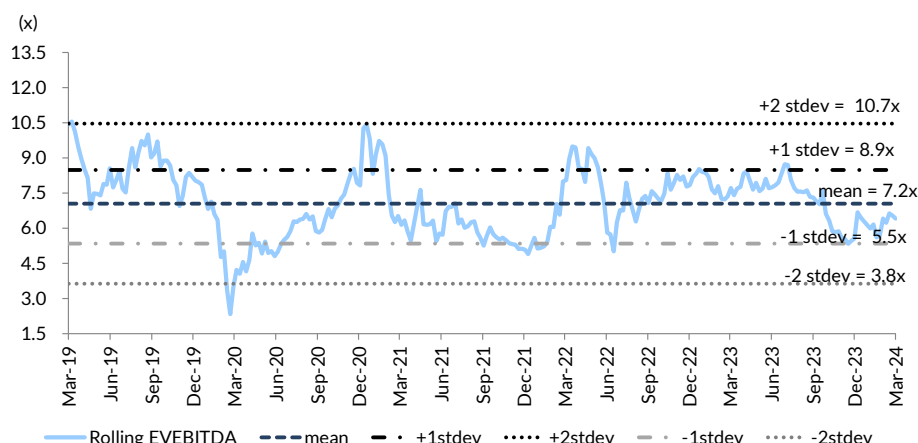
Figure 3: RHB vs Street's estimates

(USDm)	RHB (new)			RHB (old)			Change			RHB vs Street		
	2024F	2025F	2026F	2024F	2025F	2026F	2024F	2025F	2026F	2024F	2025F	2026F
Revenue	1,032	974	1,086	1,134	1,066	1,191	-9%	-9%	-9%	8%	-5%	-4%
Gross profit	205	173	204	305	271	309	-33%	-36%	-34%	8%	-17%	-25%
Operating profit	188	155	185	280	246	291	-33%	-37%	-36%	19%	-21%	-30%
EBITDA	362	369	418	415	355	453	-13%	4%	-8%	13%	2%	-6%
Net profit	140	122	143	231	181	219	-39%	-32%	-35%	11%	-21%	-29%
Margins												
Gross	20%	18%	19%	27%	25%	26%						
EBIT	18%	16%	17%	25%	23%	24%						
EBITDA	35%	38%	39%	37%	33%	38%						
NPM	14%	13%	13%	20%	17%	18%						
Key assumptions												
Vol. production (m tonnes)	70,800	65,000	72,500	70,000	65,000	72,500	1%	0%	0%			
ASP (USD/tonne)	14,580	14,985	14,985	16,200	16,400	16,432	-10%	-9%	-9%			
Cash cost (USD/tonne)*	8,961	8,804	8,739	9,628	10,260	9,635	-7%	-14%	-9%			

Note: *Ex-royalty payments

Source: Company data, RHB

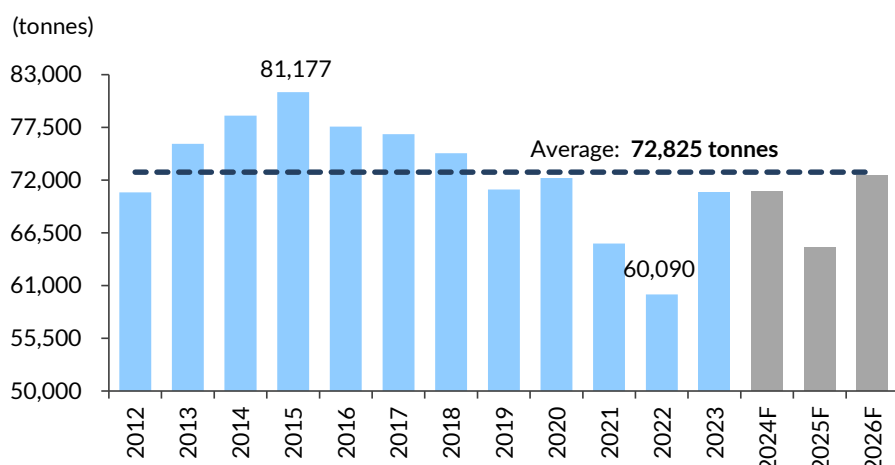
Figure 4: INCO's 5-year average EV/EBITDA band



Source: Bloomberg, RHB

- ◆ INCO is now trading near the mean level of its 5-year historical valuation (current FY24F EV/EBITDA at c.6x vs multiple target of c.7x)
- ◆ Although we have an optimistic view of a recovery in the global economy to spur demand for hard commodities in general (better selling prices), there is possibility of changes in INCO's management team ahead of MIND ID's increased control in the company. However, INCO's performance should continue regardless of these changes, in our view.

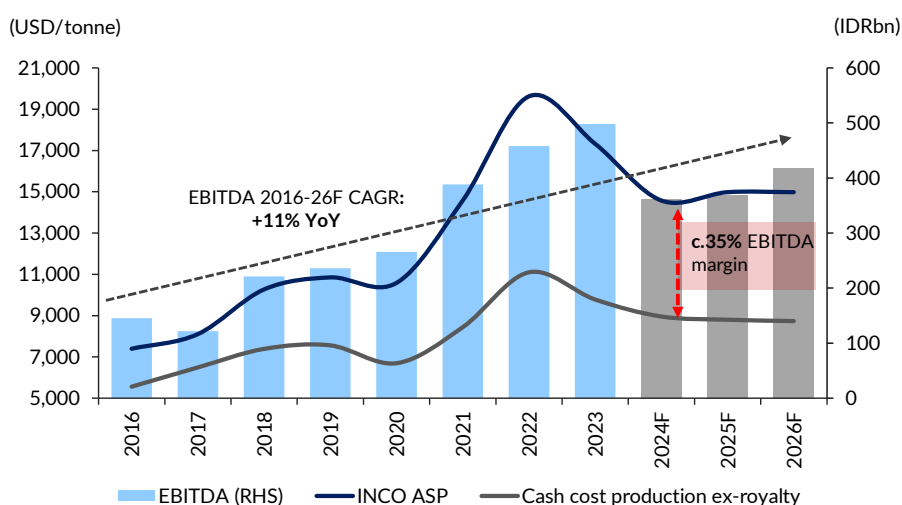
Figure 5: INCO's nickel matte production trend



Source: Bloomberg, RHB

- ◆ INCO's outlook for production activities will be better going forward, as major maintenance works on its facility have been completed.
- ◆ Demand for nickel matte (c.76% Ni content; Vale SA and Sumitomo as the offtakers) will remain stable, in our view, supported by growth in both stainless steel and EV supply chains.

Figure 6: INCO's ASP trend vs cash cost



Source: Bloomberg, RHB

- ◆ Despite risks of fluctuations in energy prices (c.20% of total cash cost; high-CV coal and diesel fuel), management should be able to manage the issue going forward via its renewable energy (since 1979) with c.365MW of hydro power, combined with future initiatives related to gas-powered utilities, and further trials on the use of EV trucks
- ◆ INCO's margins have been quite stable in recent years – FY24F EBITDA margin of c.35% vs 6-year average of c.30%.

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Figure 8: List of INCO's expansions and operating assets

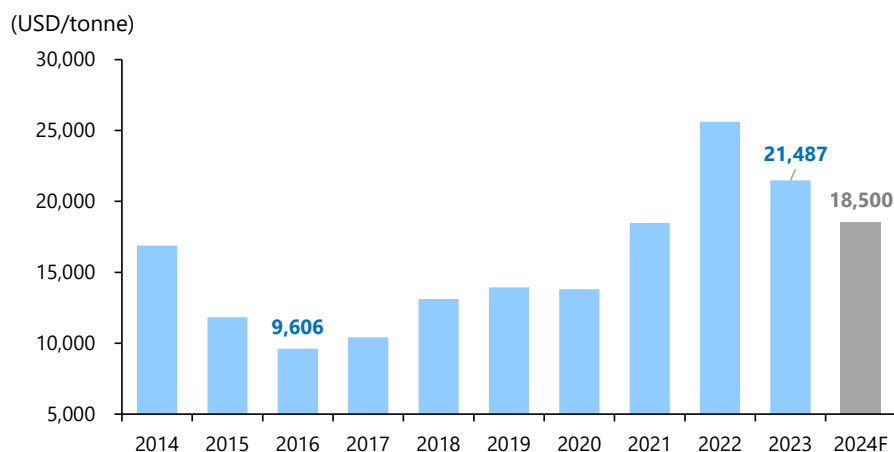
Specific locations (in Sulawesi)	Project	Total investment (USDbn)	INCO's ownership	Partnership	COD
Morowali	RKEF: 73-80k tonnes capacity	2.6	49%	Tisco & Xinhai	2026
Pomalaa	HPAL: 120k tonnes capacity	4.5	30%	Huayou & Ford	2026
TBA; still inside Sulawesi	SOA HPAL: 60k tonnes capacity	2.0	-	-	-
	HPAL: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

Note: RKEF (Rotary Kiln-Electric Furnace); output on Fe-Ni. HPAL (High Pressure Acid Leach); output on 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 smelters 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 FY23's net cash of c.USD700m) is needed – we remain optimistic on the realisation of these projects, given the support from major partners and also goodwill from the Government.

Figure 9: Average nickel prices still show a potential uptrend (excluding one-off factors from geopolitical tensions in 2022)



Source: Bloomberg, RHB

♦ At this point, we are conservatively optimistic of positive changes in nickel prices, based on progress in the regional economy (especially China) to push commodities closely related to the industrial and manufacturing sectors.

♦ Nickel prices (LME) are hovering at the support level of c.USD16,000/tonne – we see the possibility of average prices reaching USD18,500/tonne (requires +6% QoQ movement until end-FY24), as better demand coupled with lower supply streams (pending permits for many ore mines in Indonesia, mine closures, and stalled smelter investments globally) should reduce the surplus amount (Street's FY24F scenario is c.100-200k tonnes, from c.300-350k tonnes previously).

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.

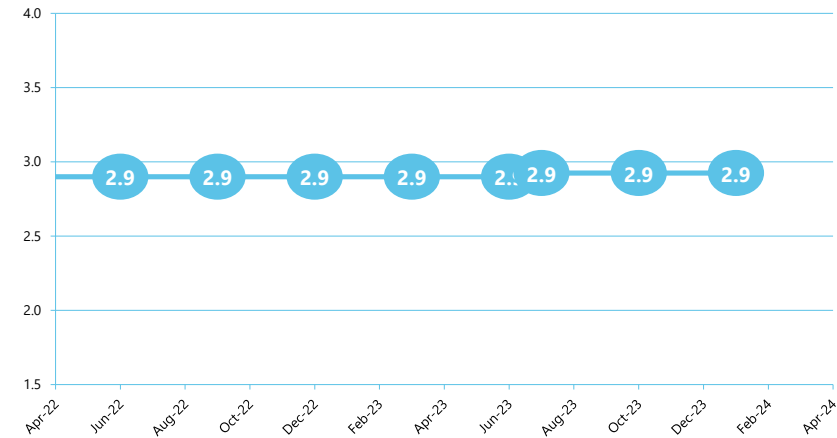
Emissions (tCO2e)	Dec-21	Dec-22	Dec-23
Scope 1	na	na	na
Scope 2	1,971,075	1,640,387	na
Scope 3	na	na	na
Total emissions	1,971,075	1,640,387	na

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
2024-02-13	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
2021-08-15	Buy	6,200	5,100
2021-03-04	Neutral	6,600	5,525

Source: RHB, Bloomberg

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Buy:	Share price may exceed 10% over the next 12 months
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