

19 December 2024

Basic Materials | Metals

## Vale Indonesia (INCO IJ)

**Buy** (from Trading Buy)

### Pushing Through Pain For Future Profit; Switch To BUY

Target Price (Return): IDR4,200 (12.0%)  
Price (Market Cap): IDR3,750 (USD2,455m)  
ESG score: 2.9 (out of 4)  
Avg Daily Turnover (IDR/USD) 55,963m/3.61m

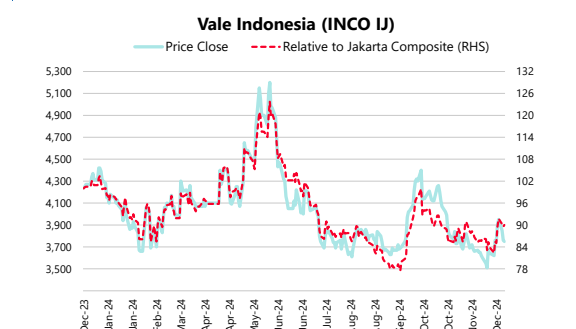
- **BUY (from Trading Buy) with new IDR4,200 DCF TP (from IDR4,300), 12% upside.** Despite a significant earnings adjustment (FY24F-25F: -26% and -32%) due to margin compression in the nickel matte segment (from higher energy costs owing to the use of lower-grade saprolite), Vale Indonesia's overall value still shows a long-term upside.
- **INCO's long-term upside** is supported by: i) Additional revenue from saprolite ore sales, ii) JV income from the high pressure acid leach (HPAL) smelter, and iii) positive sentiment from its sustainability practices (ie its collaboration with Ford). The additional income should be seen by late 2026, offsetting the valuation impact from our revised earnings estimate.
- **Stable output; conservative margins.** Aside from the risk of uncertain price trends (YTD LME nickel: c.USD16,800/tonne, FY25F onwards: c.USD16,500/tonne), the operational challenge faced by nickel smelter companies is the dwindling availability of feedstock ore (mainly saprolite), causing prices to be above usual levels. This has forced management to focus on preserving existing ore reserves by utilising lower-grade material (below 1.6% Ni-content), leading to a slight increase in operational costs to maintain stable output. Management also noted that there will be minor maintenance works next year, although this is not expected to significantly affect capacity (FY25F nickel matte assumption: 68,000 tonnes, -4% YoY). Despite expected margin pressure, INCO's overall cash cost remains at a favourable level (USD9,000-10,000/tonne vs nickel matte ASPs: c.USD12,500/tonne).
- **Unlocking future value via ore sales and JVs.** Construction works on the HPAL plant (see Figure 4) is expected to be completed by end-2026. We estimate additional JV income of c.USD150m (full utilisation from 2027), taking into account INCO's minority ownership in each project. The share divestment (to Mining Industry Indonesia or MIND ID) in August opened the door for INCO to utilise its large reserves (7-12m tonnes of saprolite will be absorbed by other smelters in Indonesia). Management expects the approval process for the Mineral Mining Business Plan (RKAB) to be more efficient next year, allowing INCO to achieve its desired ore output (Figure 5).
- **Risks and ESG.** While INCO's expansion plans are on track, short-term risks (weak global demand for base metals leading to potential oversupply, strengthening DXY, and geopolitical factors) continue to impact the share price. However, we expect these factors to stabilise next year, providing more clarity (as we anticipate a better-than-expected margin performance and a recovery in the global economy). Our TP includes a 2% ESG discount based on INCO's 2.9 ESG score (below the country median).

#### Analyst

Indonesia Research  
+6221 5093 9888  
[rhb.id.research@rhbgroup.com](mailto:rhb.id.research@rhbgroup.com)

#### Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(13.0)	1.6	1.9	(7.4)	(10.9)
Relative	(10.7)	2.0	11.1	(12.9)	(10.7)
52-wk Price low/high (IDR)				3,510	-5,200



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 include 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, it has 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	917	925	1,211
Recurring net profit (USDm)	216	273	64	76	80
Recurring net profit growth (%)	25.8	26.1	(76.5)	18.3	5.1
Recurring P/E (x)	11.35	9.00	38.37	32.43	30.87
P/B (x)	1.0	1.0	0.9	0.9	0.9
P/CF (x)	9.61	5.58	5.26	10.48	9.62
Dividend Yield (%)	na	na	na	na	na
EV/EBITDA (x)	4.01	3.67	8.12	7.94	7.57
Return on average equity (%)	8.9	11.2	2.5	2.9	3.7
Net debt to equity (%)	net cash	net cash	net cash	net cash	net cash

Source: Company data, RHB

## Financial Exhibits

<b>Asia</b>	<b>Financial summary (USD)</b>	<b>Dec-22</b>	<b>Dec-23</b>	<b>Dec-24F</b>	<b>Dec-25F</b>	<b>Dec-26F</b>
Indonesia	Recurring EPS	0.02	0.03	0.01	0.01	0.01
Basic Materials	BVPS	0.22	0.24	0.25	0.26	0.27
<b>Vale Indonesia</b>	Return on average equity (%)	8.9	11.2	2.5	2.9	3.7
INCO IJ						
Buy						
<b>Valuation basis</b>	<b>Valuation metrics</b>	<b>Dec-22</b>	<b>Dec-23</b>	<b>Dec-24F</b>	<b>Dec-25F</b>	<b>Dec-26F</b>
Medium-term DCF (WACC: 8%, TG: 3%)	Recurring P/E (x)	11.35	9.00	38.37	32.43	30.87
	P/B (x)	1.0	1.0	0.9	0.9	0.9
	FCF Yield (%)	3.0	6.9	(3.4)	(10.2)	(4.2)
	EV/EBITDA (x)	4.01	3.67	8.12	7.94	7.57
	EV/EBIT (x)	5.95	5.09	24.20	20.02	19.44
<b>Key drivers</b>	<b>Income statement (USDm)</b>	<b>Dec-22</b>	<b>Dec-23</b>	<b>Dec-24F</b>	<b>Dec-25F</b>	<b>Dec-26F</b>
i. Improved ASPs from the increase in nickel prices;	Total turnover	1,179	1,232	917	925	1,211
ii. Higher production and sales volumes;	Gross profit	314	347	106	132	139
iii. Lower fuel costs.	EBITDA	436	450	237	271	293
	Depreciation and amortisation	(143)	(126)	(157)	(164)	(179)
	Operating profit	294	325	79	108	114
	Net interest	4	26	3	(11)	(12)
	Pre-tax profit	276	353	84	100	133
	Taxation	(75)	(78)	(18)	(22)	(29)
	Reported net profit	200	274	65	78	103
	Recurring net profit	216	273	64	76	80
<b>Key risks</b>	<b>Cash flow (USDm)</b>	<b>Dec-22</b>	<b>Dec-23</b>	<b>Dec-24F</b>	<b>Dec-25F</b>	<b>Dec-26F</b>
i. Nickel price trends;	Change in working capital	(21)	59	153	16	2
ii. Rising fuel costs;	Cash flow from operations	255	440	467	234	255
iii. Lower-than-expected output;	Capex	(182)	(271)	(550)	(485)	(358)
iv. Shifts in domestic policies, ie higher royalty rates for certain nickel products.	Cash flow from investing activities	(218)	(286)	(609)	(485)	(358)
	Cash flow from financing activities	(1)	(65)	8	6	5
	Cash at beginning of period	506	634	699	427	184
	Net change in cash	36	89	(134)	(244)	(97)
	Ending balance cash	634	699	427	184	110
<b>Company Profile</b>	<b>Balance sheet (USDm)</b>	<b>Dec-22</b>	<b>Dec-23</b>	<b>Dec-24F</b>	<b>Dec-25F</b>	<b>Dec-26F</b>
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	427	184	110
	Tangible fixed assets	1,550	1,696	2,246	2,731	3,089
	Total investments	73	104	112	121	131
	Total assets	2,658	2,926	3,049	3,287	3,641
	Total long-term debt	0	0	4	5	6
	Total liabilities	303	361	378	385	452
	Total equity	2,355	2,565	2,671	2,902	3,190
	Total liabilities & equity	2,658	2,926	3,049	3,287	3,641
	<b>Key metrics</b>	<b>Dec-22</b>	<b>Dec-23</b>	<b>Dec-24F</b>	<b>Dec-25F</b>	<b>Dec-26F</b>
	Revenue growth (%)	23.7	4.5	(25.6)	0.9	30.9
	Recurrent EPS growth (%)	25.8	26.1	(76.5)	18.3	5.1
	Gross margin (%)	26.6	28.2	11.6	14.2	11.5
	Operating EBITDA margin (%)	37.0	36.6	25.8	29.4	24.2
	Net profit margin (%)	17.0	22.3	7.1	8.4	8.5
	Capex/sales (%)	15.4	22.0	60.0	52.4	29.6
	Interest cover (x)	42.6	32.2	8.0	6.9	7.1

Source: Company data, RHB

Figure 1: 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	917	925	1,211	916	948	1,029	0%	-2%	18%	-4%	-5%	7%
Gross profit	106	132	139	138	183	231	-23%	-28%	-40%	-20%	-20%	-42%
Operating profit	79	108	114	113	156	203	-30%	-31%	-44%	-9%	-12%	-47%
EBITDA	237	271	293	272	342	398	-13%	-21%	-26%	-9%	-11%	-30%
Net profit	65	78	103	88	114	132	-26%	-32%	-22%	-10%	-20%	-34%
<b>Margins</b>												
Gross	12%	14%	11%	15%	19%	22%						
EBIT	9%	12%	9%	12%	16%	20%						
EBITDA	26%	29%	24%	30%	36%	39%						
NPM	7%	8%	9%	10%	12%	13%						
<b>Key assumptions</b>												
Vol. production (m tonnes)	70,800	68,000	72,500	70,800	68,000	72,500	0%	0%	0%			
ASP (USD/tonne)	12,945	12,705	12,656	12,938	13,946	14,190	0%	-9%	-11%			
Cash cost (USD/tonne)*	9,117	8,727	10,359	8,638	8,410	8,201	6%	4%	26%			

Note: \*Ex-royalty payments

Source: Company data, RHB

Figure 2: Valuation

DCF calculation (USDm)	2025F	2026F	2027F	2028F	2029F	2030F
EBIT	108	114	179	166	182	170
EBIT (1-t)	84	89	132	123	135	126
Depreciation & amortisation	164	179	191	202	214	223
Changes in working capital	(2)	(1)	(4)	1	(1)	1
Capex	(485)	(358)	(200)	(200)	(200)	(150)
<b>Free cash flow</b>	<b>(239)</b>	<b>(90)</b>	<b>119</b>	<b>126</b>	<b>148</b>	<b>199</b>
Discounted FCF	(221)	(77)	94	92	100	124
<b>Terminal Value</b>						<b>2,471</b>
Terminal growth	3%					
WACC	8.2%					
Total discounted firm value	2,582					
25F Net cash	(165)					
25F Minority Interest	0					
Equity value (USDm)	2,747					
Equity value (IDRbn)	43,407					
Issued shares (bn)	10.5					
Discount ESG	-2%					
<b>Equity value per share</b>	<b>4,200</b>					

Source: Company data, RHB

◆ Despite having better margins and diverse market penetration for its nickel matte products (compared to traditional Class II product), investor expectations for a more stable long-term outlook have held the valuation from a higher re-rating despite additional JV income from its involvement in the HPAL space and ore sales.

◆ The best-case scenario for INCO to achieve above-mean levels of its valuation remain uncertain. Weaker-than-expected earnings throughout the year have added to concerns, given the higher energy requirements to process lower-grade ore and the weak trend in commodities.

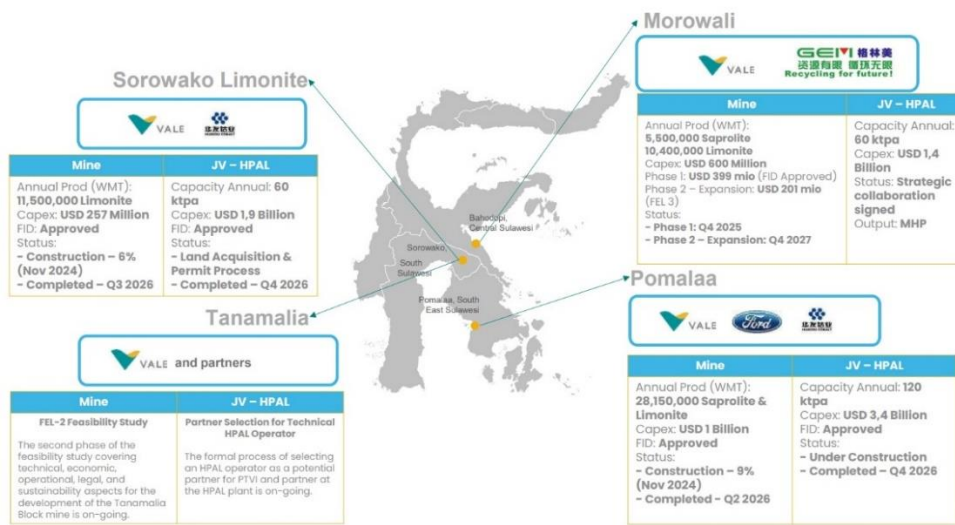
◆ We still believe the company has a decent upside (for trading purposes), although this will still depend on market expectations towards the sector in general

Figure 3: WACC breakdown

Percentage of equity	88%
Percentage of debt	12%
Tax rate (t)	22%
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%

Source: Company data, RHB

Figure 4: Opportunities from existing mining areas and additional downstream projects

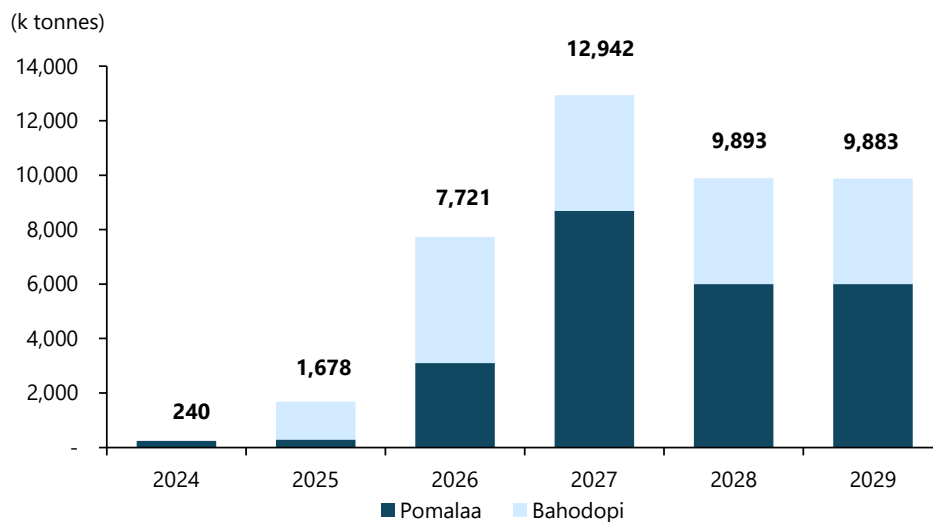


Source: Company data, RHB

◆ Several processes of the company's expansion projects are underway. Management assured that the increase in borrowings and financing to cover the required funds will not have a significant impact on its balance sheet.

◆ New cashflow streams from ore sales (to be significantly seen by 2026) will secure overall profitability.

Figure 5: Ore sales to improve company's value



Source: Company data, RHB

◆ Following the acquisition of INCO shares by MIND ID, the company's business decisions now allow for faster utilisation of the existing ore reserves.

◆ We believe that with the large number of nickel smelters (mostly Rotary Kiln-Electric Furnace or RKEF) domestically, demand for saprolite ore as the feedstock will remain high, amid dwindling supply from other mines in Indonesia. This could drive up INCO's premium (the price tends to be more defensive compared to its enhanced product, with larger margins). The ore sales segment will account for 30-40% of INCO's total revenue (the rest will come from regular nickel matte sales) by 2026-2027.

## Emissions And ESG

**Trend analysis**

INCO has not yet calculated its 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 Scope 1 and 2 GHG emissions 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 fulfilled by three hydropower plants (PLTA): Laron (165MW), Balambano (110 MW), and Karambe (90MW). Of the total 365MW of electricity output, c.11MW is distributed to residential areas and their surroundings.

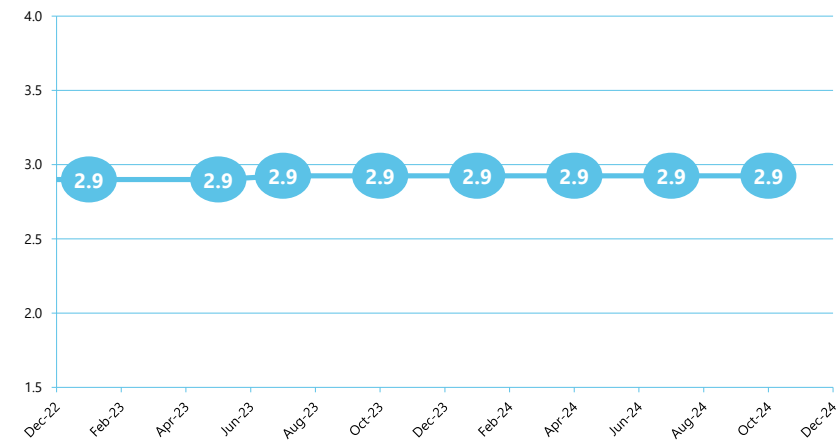
Emissions (tCO2e)	Dec-21	Dec-22	Dec-23
Scope 1	na	na	na
Scope 2	1,971,075	1,748,552	2,032,313
Scope 3	na	na	na
Total emissions	1,971,075	1,748,552	2,032,313

Source: Company data, RHB

## Latest ESG-Related Developments

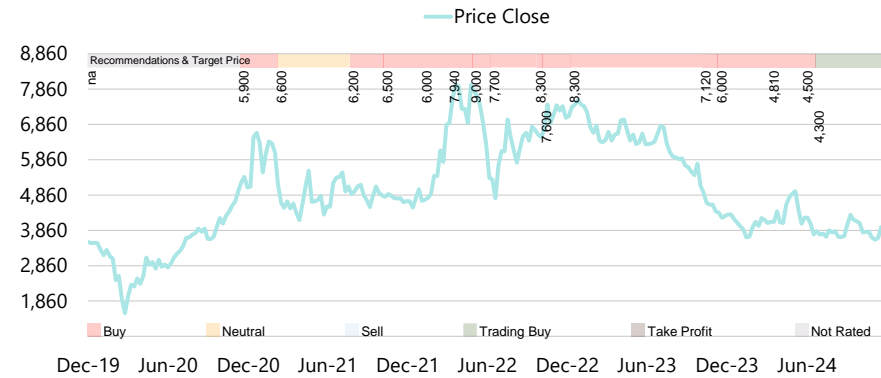
- INCO's main nickel plant in Sorowako has a carbon intensity of 27.3 tonnes of CO2eq/tonnes of nickel, giving the company amongst the lowest carbon intensity levels in Indonesia.
- It started testing electric cars and trucks for operational purposes in Jan and Aug 2022.
- INCO has been progressively reclaiming post-mining land, targeting the reclamation of 70% of the total area by 2025, and rehabilitation of watersheds.
- The area of land rehabilitated in 2022 spans 10,280ha. This comprises 10,000ha outside the operational area and 296ha 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
2024-07-16	Trading Buy	4,300	3,800
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

Source: RHB, Bloomberg



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<b>Buy:</b>	Share price may exceed 10% over the next 12 months
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#### KUALA LUMPUR

**RHB Investment Bank Bhd**  
Level 3A, Tower One, RHB Centre  
Jalan Tun Razak  
Kuala Lumpur 50400  
Malaysia  
Tel : +603 2302 8100  
Fax : +603 2302 8134

#### JAKARTA

**PT RHB Sekuritas Indonesia**  
Revenue Tower, 11th Floor, District 8 - SCBD  
Jl. Jendral Sudirman Kav 52-53  
Jakarta 12190  
Indonesia  
Tel : +6221 509 39 888  
Fax : +6221 509 39 777

#### BANGKOK

**RHB Securities (Thailand) PCL**  
10th Floor, Sathorn Square Office Tower  
98, North Sathorn Road, Silom  
Bangrak, Bangkok 10500  
Thailand  
Tel: +66 2088 9999  
Fax :+66 2088 9799

#### SINGAPORE

**RHB Bank Berhad (Singapore branch)**  
90 Cecil Street  
#04-00 RHB Bank Building  
Singapore 069531  
Fax: +65 6509 0470