

31 March 2022

Basic Materials | Mining

Merdeka Copper Gold (MDKA IJ)

Buy (Maintained)

Long-Term Support Revealed; Stay BUY

- **Stay BUY, new SOP-based IDR5,600 TP from IDR5,300, c.22% upside.** Clarity on developments in the nickel sector will illuminate Merdeka Copper Gold's strategic pathways going forward, in our view, adding more positive diversifications in its portfolio. In line with that, we believe the positive trends in the commodity will endure for the time being. This will be boosted by strong demand for base metals, underpinned by higher price levels amidst a severed supply situation – we think this is medium-term catalyst for fair topline performances within the commodities sector.
- **Long-awaited strategic investment finally happens.** 99.99% indirectly owned Batutua Tambang Abadi (BTA) is acquiring Hamparan Logistik Nusantara (HLN) for IDR5.4trn (c.USD375m). The takeover of these shares will be carried out by BTA through the absorption of new shares to be issued by HLN, which translate into a 55.67% stake in the latter. Note: HLN recently completed the acquisition J&P Indonesia (JPI) and Jcorps Industri Mineral (JIM), whereby it owns 95.3% and 99.9% stakes in JPI and JIM (Figure 2). This new development also clarifies doubts over which party will eventually control JPI and JIM – in Oct 2021, Andalan Bersama Investama (ABI) declared it was acquiring major stakes in both.
- **We believe this move provides a clearer picture** of MDKA's future business strategy and should result in decent earnings contributions going forward. Besides ready smelter facilities under its units (Figure 3), JPI has another treasure waiting to be unearthed – a 51% stake in large nickel resources (Figure 5) located within the planned Indonesia Konawe Industrial Park (IKIP) (Figure 4) where JIM has acquired a 32% involvement stake in the ongoing project. We believe this will create good synergies between HLN's subsidiaries going forward (Figure 6).
- **Our TP includes a 4% ESG discount based on company's 2.80 ESG score.** We have put in a new valuation factor on MDKA's upgraded 12-month TP (+6% revision) from operating smelter facilities (Figure 1). We also want to emphasise that the transaction amount it declared for ownership in HLN is considerably fair, representing c.9x to the company's EBITDA portion, which is currently derived from JPI's smelter facility only. It will be booked under income from investments since MDKA represents a minority shareholder on the assets. The calculations do not yet include the untapped value of nickel resources and other future earnings from JIM's ownership in IKIP. We note that MDKA's balance sheet quality is still within manageable levels (FY21 net gearing has improved to 0.19x from FY20's 0.39x) and are insulated enough to cover upcoming costs from recent acquisitions and expansions.
- **Downside risks:** Softer global demand for commodities, slower-than-expected economic recovery from a prolonged pandemic, and production disruptions that impact output levels.

Forecasts and Valuation	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Total turnover (USDm)	322	381	448	591	681
Recurring net profit (USDm)	36	36	75	111	129
Recurring net profit growth (%)	(48.9)	(0.2)	106.4	49.4	15.9
Recurring P/E (x)	192.82	197.56	100.45	68.97	59.53
P/B (x)	13.0	9.7	8.9	7.9	7.0
P/CF (x)	85.70	49.63	42.06	37.44	33.44
Dividend Yield (%)	na	na	na	na	na
EV/EBITDA (x)	46.93	35.46	30.87	24.75	21.90
Return on average equity (%)	7.0	5.6	9.2	12.1	12.4
Net debt to equity (%)	28.5	6.3	22.5	20.6	7.3

Source: Company data, RHB

Target Price (Return):	IDR5,600 (22.3%)
Price (Market Cap):	IDR4,580 (USD7,300m)
ESG score:	2.80 (out of 4)
Avg Daily Turnover (IDR/USD)	264,166m/18.4m

Analysts

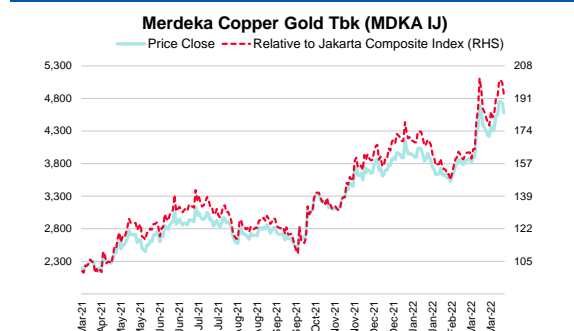
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	17.7	18.3	16.2	81.0	99.1
Relative	11.2	16.5	10.0	67.2	85.4
52-wk Price low/high (IDR)	2,140 – 4,750				



Source: Bloomberg

Overall ESG Score: 2.80 (out of 4)

E: GOOD

MDKA has implemented its Environmental Management Plan, which reports quarterly data to the provincial environmental agency at each mine site. Separately, one of the programmes (solar panels for internal ports) held at its Wetar Project has successfully cut energy usage (electricity and fuel) by 48% YoY in 2020.

S: GOOD

MDKA's community investment was implemented through the Community Development and Empowerment Programme (CDE). The social funds increased by 11% YoY in 2020 to USD3.4m, and was disbursed to communities in the three areas where it has operations – Banyuwangi District, Wetar Island, and Pohuwato District.

G: GOOD

MDKA has developed policies to support its corporate governance initiative, in accordance with regulations set by the financial services authority. The precautionary principles are applied by integrating risk-based management from input, and assessed by an audit committee.

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Financial Exhibits

Asia	Financial summary (USD)	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Indonesia	Recurring EPS	0.00	0.00	0.00	0.00	0.01
Basic Materials	BVPS	0.02	0.03	0.04	0.04	0.05
Merdeka Copper Gold	Return on average equity (%)	7.0	5.6	9.2	12.1	12.4
MDKA IJ						
Buy						
Valuation basis	Valuation metrics	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
SOP valuation of its existing operation and developing mines, combined with current multiple valuation to MDKA's existing business (FY22-23F Street P/E target at c.80x)	Recurring P/E (x)	192.82	197.56	100.45	68.97	59.53
	P/B (x)	13.0	9.7	8.9	7.9	7.0
	FCF Yield (%)	0.8	0.8	(0.9)	0.2	1.9
	EV/EBITDA (x)	46.93	35.46	30.87	24.75	21.90
	EV/EBIT (x)	75.42	77.00	51.13	36.19	29.92
Key drivers	Income statement (USDm)	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
i. Increase in gold and copper prices;	Total turnover	322	381	448	591	681
ii. Increase in gold and copper production;	Gross profit	114	120	157	222	265
iii. Faster-than-expected porphyry development;	EBITDA	151	197	243	311	346
iv. Potential exposure to nickel business.	Depreciation and amortisation	(57)	(106)	(96)	(98)	(93)
	Operating profit	94	91	147	213	253
	Net interest	(18)	(13)	(16)	(11)	(7)
	Pre-tax profit	56	57	108	172	216
	Taxation	(27)	(23)	(37)	(63)	(91)
	Reported net profit	36	36	75	111	129
	Recurring net profit	36	36	75	111	129
Key risks	Cash flow (USDm)	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
i. Softer global demand for commodities;	Change in working capital	(13.1)	(12.9)	(11.6)	(31.0)	(18.3)
ii. Slower-than-expected economic recovery from a prolonged pandemic;	Cash flow from operations	81.4	143.8	178.1	205.3	229.8
iii. Disruptions in production impacting output levels.	Capex	(28.8)	(84.9)	(247.0)	(187.0)	(83.0)
	Cash flow from investing activities	(49.5)	(106.3)	(268.4)	(208.4)	(104.4)
	Cash flow from financing activities	(77.9)	217.2	13.9	13.9	13.9
	Cash at beginning of period	49.6	51.0	185.5	270.3	114.7
	Net change in cash	(46.0)	254.7	(76.3)	10.8	139.4
	Ending balance cash	51.0	185.5	270.3	114.7	113.1
Company Profile	Balance sheet (USDm)	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
MDKA is a holding company with operating subsidiaries engaging in mining business activities, encompassing the exploration and future production of gold, silver, copper, and other related minerals, as well as mining services.	Total cash and equivalents	51	185	270	115	113
	Tangible fixed assets	297	298	487	588	589
	Total investments	72	222	222	222	222
	Total assets	925	1,230	1,498	1,472	1,484
	Short-term debt	87	86	172	97	22
	Total long-term debt	125	148	299	224	174
	Total liabilities	361	450	609	471	354
	Total equity	564	779	889	1,000	1,130
	Total liabilities & equity	925	1,230	1,498	1,472	1,484
	Key metrics	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
	Revenue growth (%)	(19.9)	18.4	17.5	32.0	15.2
	Recurrent EPS growth (%)	(50.6)	(2.4)	96.7	45.6	15.9
	Gross margin (%)	35.5	31.5	35.1	37.5	38.9
	Operating EBITDA margin (%)	47.0	51.8	54.2	52.6	50.8
	Net profit margin (%)	11.2	9.5	16.7	18.9	19.0
	Capex/sales (%)	8.9	22.3	55.2	31.6	12.2
	Interest cover (x)	5.13	6.99	9.07	19.31	37.68

Source: Company data, RHB

Figure 1: MDKA's SOP valuation

		(USDm)	In IDR/share
MDKA's existing valuation:			
FY22F-23F net income		93	
FY22F-23F rolling-forward EPS			55
Target P/E (x)*	82.0		
Total valuation		7,626	
Valuation in IDR/share			4,507
MDKA's TB copper valuation:			
Average greenfield copper project EV/resource valuation (USD/tonne)		111	
Total inferred TB copper resource (m tonnes)	8.8		
Total copper valuation (USDm)		971	
Total valuation (USDm)		971	
Valuation in IDR/share			576
MDKA's AIM project valuation:			
Projected 20-year project life cash flow (USDm)		1,740	
Project NPV (USDm)		558	
Discount	8%		
Total valuation (USDm)		513	
Valuation in IDR/share			304
MDKA's Pani project valuation:			
Acquisition cost		165	
Ownership	83%		
Total valuation (USDm)		138	
Valuation in IDR/share			82
Nickel value estimate			
Projected value on operated JPI's RKEF smelters**		2,151	
Ownership***	20%		
Total Valuation (USDm)		439	
Valuation in IDR/share			261
Total valuation (SOP, in USDm)		9,688	
SOP valuation (in IDR/share)			5,746
TP (rounded)			5,800
Discount factors from ESG rating	-4%		
Final TP			5,600

Note: *Consensus FY22-23F P/E average estimates to MDKA's existing business (current copper & gold production)

Note 2: **Based on peers' EV/EBITDA multiple of nickel sector in Indonesia (c.10x) to JPI's latest earnings data (Figure 3), disclosed by company

Note 3: ***Based on ownership schemes laid out in Figures 2 and 3

Source: RHB

Our latest SOP calculation translates into an overall value of c.USD9.7bn for MDKA, partly derived from the company's ongoing expansions:

- New potential of copper reserves at the Tujuh Bukit site (most of its current gold production is from this area while exploration for copper is still ongoing);
- The Wetar/Morowali Acid Iron Metal or AIM project. This is targeted to go operational in 2Q23 with 1.2m tonnes of acid production to extract more value from MDKA's existing Wetar concession (where most of its copper is sourced);
- The Pani gold project (c.250,000oz pa, operational in 2025). The dispute with J Resources Asia Pacific (PSAB IJ, NR) involving this project has been resolved, as MDKA – through ABI – has agreed to pay PSAB's portion of the Pani gold concession, at IDR2.1trn;
- A re-rating at the current market multiple target (FY22F-23F target P/E of 82x) of MDKA's existing gold and copper businesses;
- Peers' valuation (EV/EBITDA at c.10x) to JPI's operational rotary kiln-electric furnace or RKEF smelters.

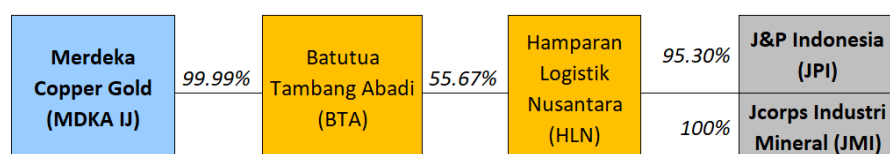
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The anticipated nickel development is also an open a path for MDKA to be further involved in the electric vehicle or EV industry, as potential nickel resources under Sulawesi Cahya Minerals' (SCM) assets are suited for nickel-sulphate production. From proven resources: At 13.8m tonnes of weight in nickel, c.70% comes from limonite, which can only be processed by high pressure acid leach (HPAL) smelters.

Aligned with that, the purpose of the IKIP project was to centralise HPAL facilities in Sulawesi, as most of the nickel resources come from adjacent areas. The hope is to mirror similar successes from the neighbouring Indonesia Morowali Industrial Park (IMIP) (Figure 4). IMIP is Indonesia's largest producer of processed nickel, with a national production share of more than half of the country's output.

Figure 2: MDKA's HLN ownership scheme



♦ Most of the additional earnings for MDKA will be supported by JPI's smelter facilities in the near term – this is while waiting for any progress on other developments, eg nickel ore mining from SCM and completion of IKIP

Source: Company, RHB

Figure 3: Brief details of assets owned by each subsidiaries

Company name	Subsidiary/associate	Prominent assets	Disclosed P&L summary
J&P Indonesia (JPI)	SCM (51% ownership)	<ul style="list-style-type: none"> Nickel mining permit or IUP holder with 21,000ha size (undeveloped); third-largest in the world Potential reserves of 1.1bn dry metric tonne (dmt) of nickel ore at 1.22% Ni grade (equal to 13.8m tonnes of nickel) Other content: Cobalt (0.08% grade) or equal to 1m tonnes 	N/A
	Cahaya Smelter Indonesia (CSI; 49.0% ownership)	<ul style="list-style-type: none"> Two RKEF lines with total production capacity of 19,000 tonnes NPI Commissioned in January 2020 	<ul style="list-style-type: none"> FY21 revenue: USD626m (+35% YoY) FY21 EBITDA: USD213m (+31% YoY); margin: 34%
	Bukit Smelter Indonesia (BSI; 28.4% ownership)	<ul style="list-style-type: none"> 2 RKEF lines with total production capacity of 19,000 tonnes of nickel pig iron or NPI Commissioned in Mar 2020 	<ul style="list-style-type: none"> FY21 earnings: USD188m (+36% YoY); margin: 30%
Jcorps Industri Mineral (JIM)	Cahaya Hutan Lestari (51% ownership)	<ul style="list-style-type: none"> Road access and plantation business 	N/A
	Anugerah Batu Putih (99.9% ownership)	<ul style="list-style-type: none"> Limestone IUP of 502ha 	
	Cahaya Energi Indonesia (98.3% ownership)	<ul style="list-style-type: none"> Hydropower project 	
	IKIP (32% ownership)	<ul style="list-style-type: none"> Nickel industrial park with 3,600ha of size Nickel processing and battery components (in development) 	

Source: Company, RHB

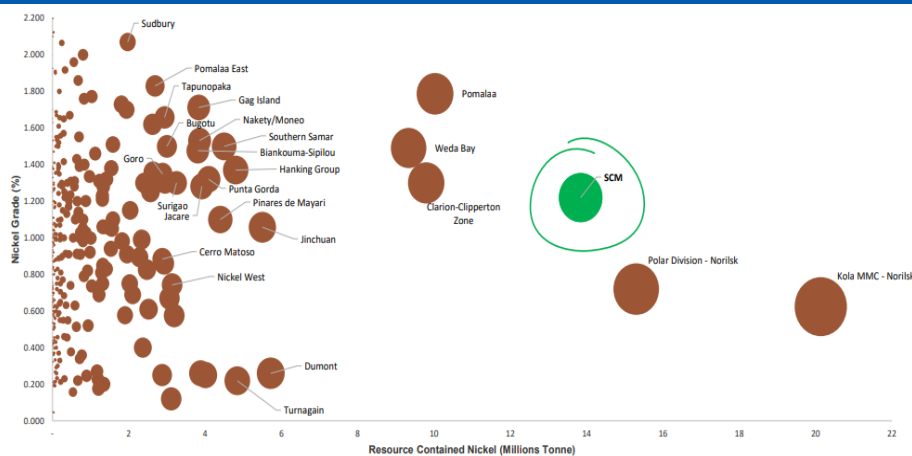
Figure 4: Centralised location of Indonesia's future nickel developments



Source: Company, RHB

- Two JPI subsidiaries engaged in the smelter business (CSI and BSI) are located adjacent to IMIP. Most of operations assets (RKEF smelters with total of nickel production of 500,000 tonnes) inside the industrial area are related to Tsingshan Group.
- Furthermore, a connecting road between SCM and IMIP is being upgraded to allow 3m tonnes pa of capacity to be sold to RKEF plants at IMIP

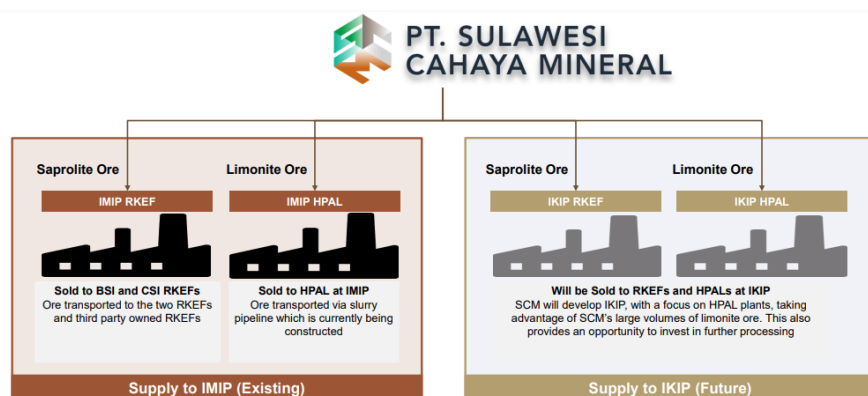
Figure 5: Comparison of global nickel site by potential resources



Source: Company, RHB

- SCM's undeveloped nickel assets are deemed to be the third-largest in the world in terms of resource size

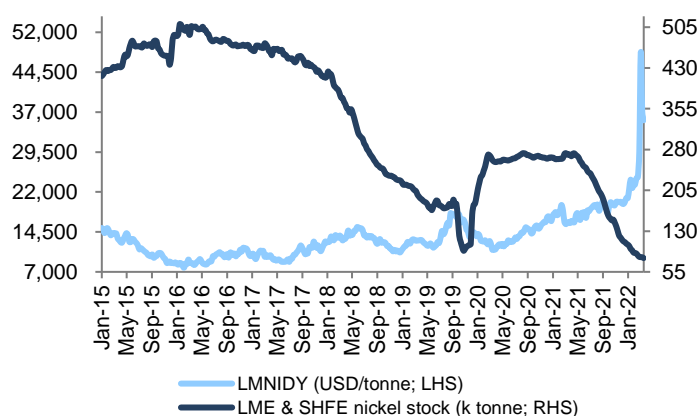
Figure 6: SCM roadmap



♦ SCM's mines will provide sapolite and limonite ore to RKEF and HPAL smelters at IMIP and – in future – IKIP

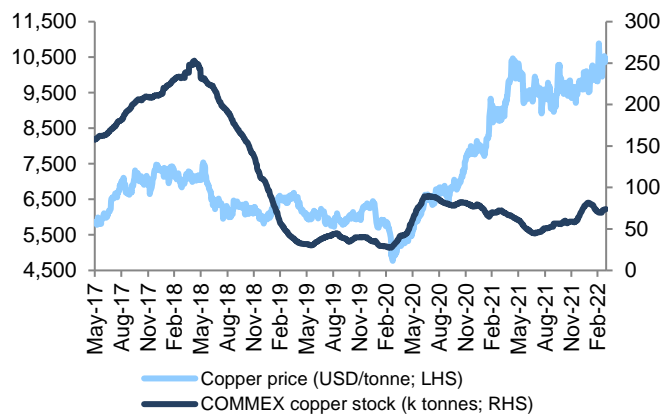
Source: Company, RHB

Figure 7: Nickel price trends vs inventory



Source: Bloomberg, RHB

Figure 8: Copper price trends vs inventory



Source: Bloomberg, RHB

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Recommendation Chart

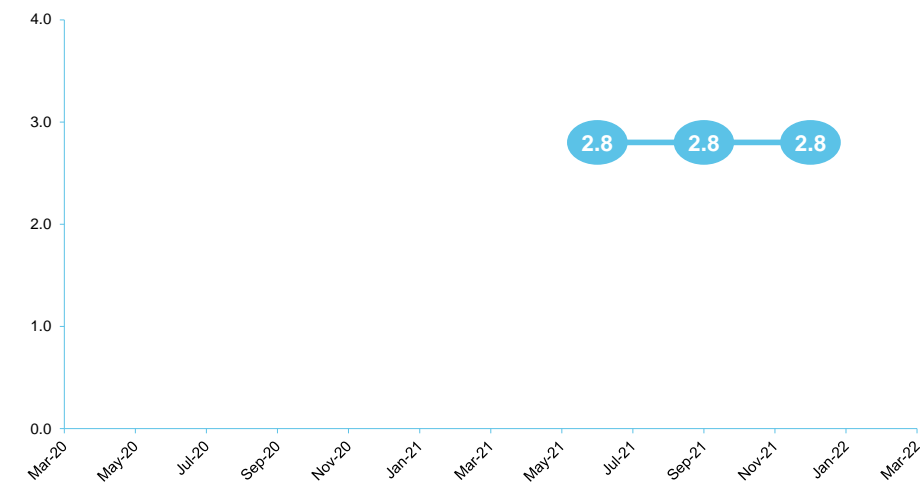


Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2022-03-25	Buy	5,300	4,750
2022-02-14	Buy	4,030	3,650
2021-12-23	Buy	4,320	3,890
2021-09-21	Buy	3,140	2,630
2021-04-15	Buy	2,750	2,190
2021-02-05	Buy	2,850	2,460
2021-01-04	Buy	3,000	2,590
2020-09-30	Buy	2,000	1,615
2020-08-10	Buy	2,500	1,980
2020-07-24	Buy	2,050	1,715
2020-05-20	Buy	1,575	1,350
2020-03-23	Buy	1,380	905
2020-01-07	Buy	1,450	1,195

Source: RHB, Bloomberg

ESG Rating History



Source: RHB

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