

1 November 2021

Basic Materials | Metals

Vale Indonesia (INCO IJ)

Buy (Maintained)

3Q21: Strong Topline From Better Output; BUY

Target Price (Return): IDR6,500 (+34%)
 Price (Market Cap): IDR4,850 (USD3,401m)
 ESG score: 2.90 (out of 4)
 Avg Daily Turnover (IDR/USD) 70,644m/4.95m

- **Reiterate BUY, with new IDR6,500 TP from IDR6,200, c.34% upside and 2% FY22F yield.** Vale Indonesia's 3Q21 net income came in higher than expected (USD64m; +156% QoQ, +173% YoY) and brought 9M21 bottomline to USD123m (+60% YoY). Therefore, we fine tune our FY21F-22F earnings by +25% and +20%, as the increase in ASP and better cost management should improve overall margins (FY21F-22F NPM: c.18% vs c.8% of its 5-year average). We believe the uptrend in nickel prices will remain its main support.

- **Topline flourished.** 3Q21 net revenue booked at USD271m (+30% QoQ, +29% YoY), bringing 9M21 net revenue to USD686m (+20% YoY). Production charted higher during the quarter at 18,217 tonnes (+20% QoQ, -7% YoY), in conjunction with the continued rise in ASP of c.USD14,600/tonne (+11% QoQ, +38% YoY). We remain optimistic on management's effort in stabilising its output (9M21 production achievement: c.48,300 tonnes; -13% YoY or 76% of full-year guidance), despite the expected hindrance from the ongoing scheduled maintenance of its furnace facility (FY21F-22F nickel matte output growth: -11% YoY and +9% YoY). We believe nickel prices will remain elevated (INCO's FY21F-22F ASP growth: +40% YoY and +3% YoY), on the back of limited supply due to the rise in demand from the recovery in stainless steel and higher sentiment from electric vehicle (EV) battery development.

- **Positive trend of nickel prices** has significantly improved INCO's margins (3Q21 GPM expanded to 31% vs 5-year quarterly average at 14%), complimenting the slight decrease in the company's output throughout the year. Total cash cost remained manageable (3Q21: c.USD7,700/tonne; -12% QoQ, +34% YoY) despite the hike in fuel costs. Separately, management will remain disciplined to keeping its emission level from its production activity through limitation of fossil fuel usage – c.36% of INCO's electricity has been provided by hydro power.

- **Remarkable recovery in overall profits**, thanks to topline improvement – 3Q21 NPM expanded to 24% vs c.10% 5-year average. Healthy achievement was also seen through better balance sheet quality – 9M21 net cash was at USD465m (+29% YoY). Going forward, we see INCO's positive catalyst in the medium term will be to remain focused on developing Class II nickel products (gas-powered Fe-Ni smelters with c.73,000 tonnes pa of iron-nickel alloy output, 49% ownership, targeted by 2025) while awaiting the development progress of the high pressure acid leach (HPAL) smelter (final investment decision by mid-2022).

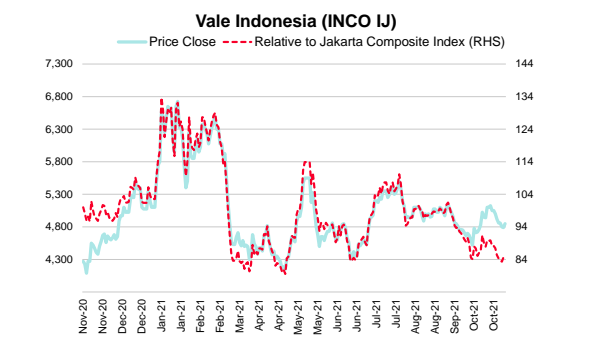
- **Downside risks to our call:** Downward trend of nickel prices, rising fuel costs, and under achievement on output target. Our new TP has factored in a 2% ESG discount, based on our proprietary in-house methodology with a score of 2.90. The stock stays reasonable, with 9.5x FY22F EV/EBITDA target, derived from its 5-year band (currently: 7.4x).

Analysts

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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(4.9)	3.9	(10.2)	4.3	19.8
Relative	(15.1)	(3.1)	(17.9)	(5.3)	(8.7)
52-wk Price low/high (IDR)				4,090	– 6,725



Source: Bloomberg

Overall ESG Score: 2.90 (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-19	Dec-20	Dec-21F	Dec-22F	Dec-23F
Total turnover (USDm)	782	765	947	1,059	1,175
Recurring net profit (USDm)	64	93	175	205	219
Recurring net profit growth (%)	6.9	44.5	88.7	16.9	7.0
Recurring P/E (x)	52.95	36.65	19.42	16.62	15.53
P/B (x)	1.8	1.7	1.6	1.4	1.3
P/CF (x)	108.67	11.44	8.95	31.09	15.88
Dividend Yield (%)	na	na	1.0	2.0	2.2
EV/EBITDA (x)	15.98	13.05	7.98	6.99	6.21
Return on average equity (%)	3.0	4.2	8.2	8.3	8.6
Net debt to equity (%)	net cash	net cash	net cash	net cash	net cash

Source: Company data, RHB

Financial Exhibits

Asia	Financial summary (USD)	Dec-19	Dec-20	Dec-21F	Dec-22F	Dec-23F
Indonesia	Recurring EPS	0.01	0.01	0.02	0.02	0.02
Basic Materials	DPS	-	-	0.00	0.01	0.01
Vale Indonesia	BVPS	0.20	0.20	0.22	0.24	0.26
INCO IJ	Return on average equity (%)	3.0	4.2	8.2	8.3	8.6
Buy						
	Valuation metrics	Dec-19	Dec-20	Dec-21F	Dec-22F	Dec-23F
	Recurring P/E (x)	52.95	36.65	19.42	16.62	15.53
	P/B (x)	1.8	1.7	1.6	1.4	1.3
	FCF Yield (%)	4.6	5.1	7.5	(0.2)	2.3
	Dividend Yield (%)	-	-	1.0	2.0	2.2
	EV/EBITDA (x)	15.98	13.05	7.98	6.99	6.21
	EV/EBIT (x)	30.17	25.49	12.13	10.51	9.27
	Income statement (USDm)	Dec-19	Dec-20	Dec-21F	Dec-22F	Dec-23F
	Total turnover	782	765	947	1,059	1,175
	Gross profit	118	124	241	267	294
	EBITDA	196	229	354	387	424
	Depreciation and amortisation	(92)	(112)	(121)	(130)	(140)
	Operating profit	104	117	233	258	284
	Net interest	(0)	1	11	20	30
	Pre-tax profit	89	105	220	254	301
	Taxation	(32)	(22)	(49)	(64)	(87)
	Reported net profit	57	83	172	191	214
	Recurring net profit	64	93	175	205	219
	Cash flow (USDm)	Dec-19	Dec-20	Dec-21F	Dec-22F	Dec-23F
	Change in working capital	(64)	57	115	(67)	(37)
	Cash flow from operations	31	297	380	109	214
	Capex	125	(123)	(125)	(115)	(135)
	Cash flow from investing activities	(166)	(151)	(125)	(115)	(135)
	Cash flow from financing activities	(24)	(2)	(33)	(69)	(77)
	Cash at beginning of period	301	249	389	531	586
	Net change in cash	(159)	145	222	(75)	3
	Ending balance cash	249	389	531	586	670
	Balance sheet (USDm)	Dec-19	Dec-20	Dec-21F	Dec-22F	Dec-23F
	Total cash and equivalents	249	389	545	656	728
	Tangible fixed assets	1,467	1,479	1,604	1,610	1,720
	Total investments	15	31	33	36	39
	Total assets	2,223	2,315	2,488	2,664	2,929
	Total long-term debt	0	0	(0)	(0)	(1)
	Total liabilities	281	294	295	281	333
	Total equity	1,942	2,020	2,192	2,383	2,597
	Total liabilities & equity	2,223	2,315	2,488	2,664	2,929
	Key metrics	Dec-19	Dec-20	Dec-21F	Dec-22F	Dec-23F
	Revenue growth (%)	0.7	(2.2)	23.9	11.8	11.0
	Recurrent EPS growth (%)	6.9	44.5	88.7	16.9	7.0
	Gross margin (%)	15.0	16.3	25.4	25.2	25.1
	Operating EBITDA margin (%)	25.1	29.9	37.3	36.6	36.1
	Net profit margin (%)	7.3	10.8	18.2	18.0	18.2
	Dividend payout ratio (%)	0.0	0.0	19.3	36.0	35.7
	Capex/sales (%)	(16.0)	16.1	13.2	10.9	11.5
	Interest cover (x)	20.2	31.8	(39.0)	(16.5)	(11.3)

Source: Company data, RHB

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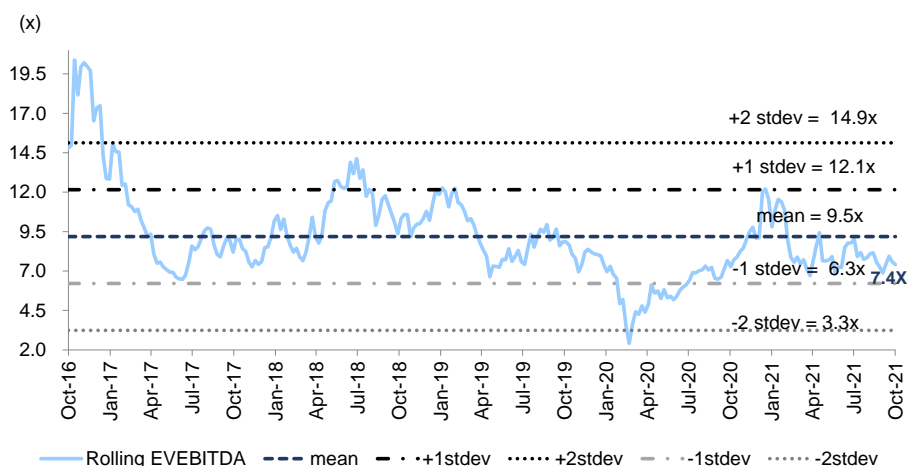
Figure 1: RHB vs Street estimates

(USDm)	RHB (new)			RHB (old)			Change			RHB vs Street		
	2021F	2022F	2023F	2021F	2022F	2023F	2021F	2022F	2023F	2023F	2022F	2023F
Revenue	947	1,059	1,175	886	1,045	1,014	7%	1%	16%	7%	8%	4%
Gross profit	241	267	294	221	244	191	9%	9%	54%	17%	11%	-4%
Operating profit	233	258	284	208	230	175	12%	12%	62%	27%	19%	2%
EBITDA	368	408	450	332	380	332	11%	7%	36%	10%	15%	8%
Net profit	172	191	214	138	159	136	25%	20%	58%	28%	23%	10%
Margin												
Gross	25%	25%	25%	25%	23%	19%						
EBIT	25%	24%	24%	23%	22%	17%						
EBITDA	39%	38%	38%	37%	36%	33%						
NPM	18%	18%	18%	16%	15%	13%						
Key assumptions												
Vol. production (m tonnes)	64,000	69,500	73,000	61,000	69,500	67,415	5%	0%	8%			
ASP (USD/tonne)	14,800	15,238	16,100	14,523	15,040	15,040	2%	1%	7%			
Cash cost (USD/tonne)*	8,805	9,127	9,674	8,753	9,242	9,766	1%	-1%	-1%			

Note: *Ex-royalty payments

Source: Company data, RHB

Figure 2: INCO's 5-year average EV/EBITDA band



Source: Bloomberg, RHB

◆ INCO is trading at slightly above -1SD from its 5-year forward-rolling EV/EBITDA band

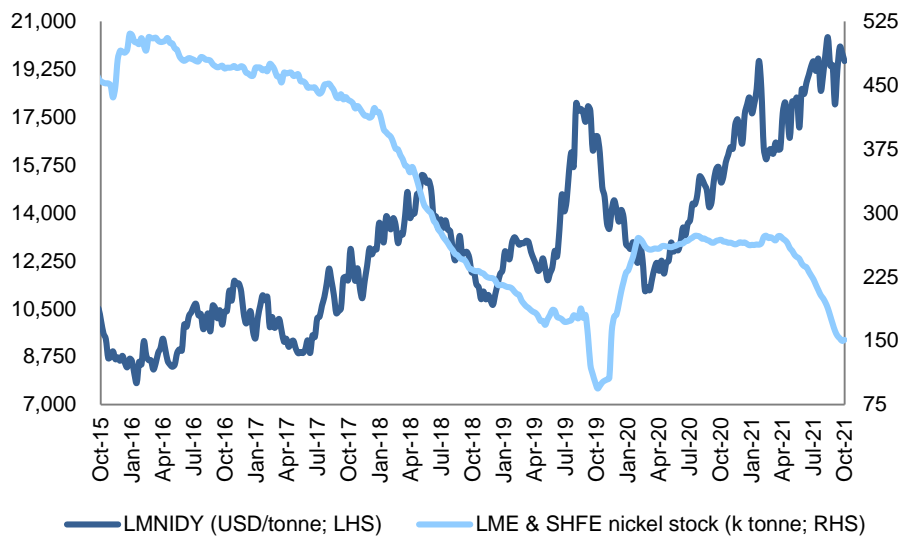
◆ Our new TP implies a c.34% upside from its target EV/EBITDA of 9.5x

Figure 3: INCO's 9M21 results highlights

(In USDm)	3Q20	2Q21	3Q21	QoQ	YoY	9M20	9M21	YoY	% of RHB	% of Cons
Revenue	211	208	271	30%	29%	571	686	20%	72%	78%
Gross profit	44	34	84	146%	89%	85	170	100%	70%	83%
EBIT	42	33	83	150%	95%	80	167	109%	72%	91%
Net profit	24	25	64	156%	173%	77	123	60%	71%	91%
Margins:										
Gross	21%	16%	31%			15%	25%			
EBIT	20%	16%	30%			14%	24%			
NET	11%	12%	24%			13%	18%			
ASP (USD/tonne)	10,556	13,152	14,619	11%	38%	10,097	13,934	38%		
Cash cost ex-royalty (USD/tonne)	5,782	8,818	7,723	-12%	34%	6,315	8,143	29%		
Production (tonnes)	19,477	15,048	18,127	20%	-7%	55,792	48,373	-13%		
Sales volume (tonnes)	19,954	15,845	18,571	17%	-7%	56,554	49,263	-13%		

Source: Company data, RHB

Figure 4: Nickel benchmark price vs inventory



◆ Higher nickel demand from the gradual recovery of the stainless steel industry, and rising sentiment from EV battery development surpassing its current supply has boosted the price of the mineral

Source: Bloomberg, RHB

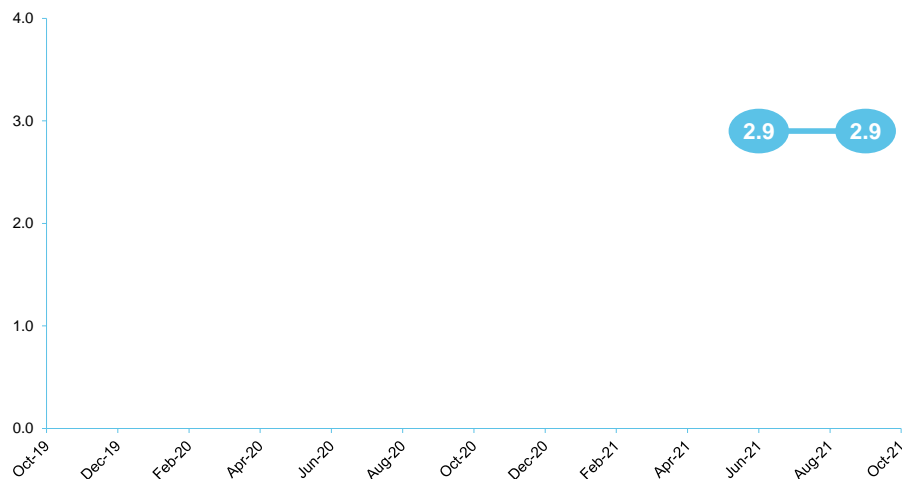
Recommendation Chart



Date	Recommendation	Target Price	Price
2021-08-15	Buy	6,200	5,100
2021-03-04	Neutral	6,600	5,525
2020-12-08	Buy	5,900	5,025

Source: RHB, Bloomberg

ESG Rating History



Source: RHB

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Analyst	Company
-	-

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