Maybank Kim Eng

Materials

Indonesia

Vale Indonesia (INCO IJ)

Potential dividends?

BUY

Share Price	IDR 3,830
12m Price Target	IDR 5,000 (+31%)
Previous Price Target	*IDR 5,000*

Maintain BUY

Maintain BUY as we expect nickel prices will continue to recover, which will benefit INCO as it is a pure nickel player. Our TP remains unchanged at IDR5,000 based on 1.7x FY21E P/BV, in line with +0.5SD above the 10-year mean. Potential surprise on dividends could be a positive catalyst to the stock in our view. Nickel-price decline is the main risk to our call.

Upside to 2020 volume

We think there could be an upside to our 2020 volume assumption of 71,000 tonnes as 1) 1H20 volume of 36,315 tonnes (+18.2% YoY) already accounted for 51% of our assumption and 2) management has decided to delay rebuild of furnace #4 to 2021. Every 1% change in our 2020 volume assumption will change our earnings forecast by 3.5%.

2021 volume risk offset by ASP

We think downside risk to our 2021 earnings forecast is limited although volume could be lower than our assumption of 71,000 tonnes (due to rebuild of the furnace #4). This is because our 2021 nickel-price assumption of USD13,602/tonne is c.10% lower than the current nickel prices of USD15,000/tonne. Upside to our 2021 nickel-price assumption is possible due to potential demand recovery for nickel. A combination of a 5% decline in our volume assumption and 5% increase in our nickel-price assumption will raise our 2021 earnings forecast by 20.8%.

Dividend in the making?

In the recent Public Expose, the management hinted that INCO's dividend policy will have to accommodate the interest of Inalum, a mining SOE, as the new shareholder. This is in line with our view that post completion of the 20% divestment by end of 2020, INCO could start paying dividends as Inalum will require cash to pay the interest expense on the issuance of bonds that was used to acquire the 20% stake (refer to our report dated 22 Jun, titled Lower regulatory risk).

FYE Dec (USD m)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue	777	782	725	751	806
EBITDA	221	235	224	234	265
Core net profit	63	64	58	64	85
Core EPS (cts)	0.6	0.6	0.6	0.6	0.9
Core EPS growth (%)	nm	0.6	(9.4)	10.0	34.5
Net DPS (cts)	0.0	0.0	0.0	0.0	0.0
Core P/E (x)	35.1	40.7	44.9	40.8	30.4
P/BV (x)	1.2	1.3	1.3	1.3	1.2
Net dividend yield (%)	0.0	0.0	0.0	0.0	0.0
ROAE (%)	3.4	3.3	2.9	3.1	4.1
ROAA (%)	2.9	2.9	2.6	2.8	3.6
EV/EBITDA (x)	8.9	10.0	10.0	8.9	7.3
Net gearing (%) (incl perps)	net cash	net cash	net cash	net cash	net cash
Consensus net profit	-	-	58	78	103
MKE vs. Consensus (%)	-	-	(0.4)	(18.5)	(16.8)

Company Description

INCO is a subsidiary of Vale SA which produces nickel in matte.

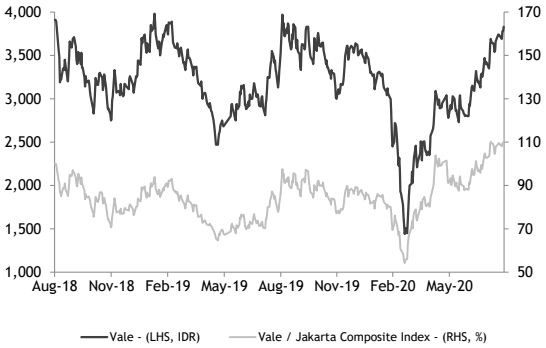
Statistics

52w high/low (IDR)	3,970/1,440
3m avg turnover (USDm)	4.0
Free float (%)	20.5
Issued shares (m)	9,936
Market capitalisation	IDR38.1T
	USD2.6B

Major shareholders:

Vale	59.3%
Sumitomo	20.1%

Price Performance



	-1M	-3M	-12M
Absolute (%)	10	32	20
Relative to index (%)	5	14	40

Source: FactSet

ESG Tear Sheet Insert

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ESG

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Business Model & Industry Issues

- The overall image of the mining industry from an ESG perspective is generally less positive due mainly to concerns about mismanagement of environmental issues, which could negatively impact valuations and investor appetite on the sector.
- However, INCO, in our view, has put ESG as one of its main priorities. It has been conducting rigorous mining best practices based on the International Council on Mining and Metals framework principles and benchmarks set up by its parent company (Vale SA). Some of the positive results include zero fatalities and improved relationships with its stakeholders.
- INCO's contract expiration in 2025 could be a concern, but we think this could be partially offset by its major shareholders' (Vale SA and Sumitomo) decision to divest a 20% stake to Inalum, an SOE mining company.

Material E issues

- INCO is committed to adhering to legal provisions on environmental management. In 2019, environmental costs accounted for 18% of net profit, up from 2018's 11%.
- Hydroelectric power, INCO's largest source of energy supply, accounts for c.36% of total energy consumption. In 2019 INCO allocated c.3% of total hydroelectric power, through PLN (SOE power company) to its surrounding areas. INCO's consumption of diesel is mixed with biodiesel (30%). Proportion of biodiesel to fossil fuel in 2019 was 5.6%, up from 2017's 3.3% and 2018's 3.8%.
- Since 2019 INCO has been operating renewable-based electric boilers, the first in Southeast Asia, which will increase efficiency, but will also reduce consumption of oil.
- INCO is committed to maintain the S02 emission levels to be below the government standard (0.86 mg/Nm3).
- In 2019 INCO was awarded the Green PROPER rating on environmental management and community empowerment from the Ministry of Environment and Forestry. It is the second highest and indicates that INCO's practices have exceeded compliance.
- INCO has ISO 14001: 2015 on environmental management.

Material S issues

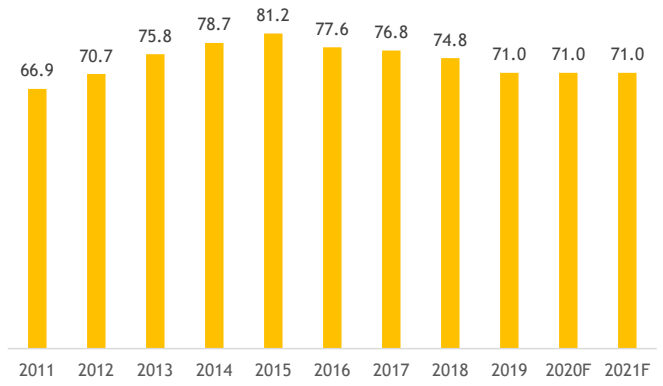
- INCO's Code of Ethics and Conduct covers health and safety, human rights, employee relationships, competition, business ethics, and corruption.
- INCO does not employ child and/or forced labour and is committed to no discriminatory practices against employees. Most of employees are male (92% in 2019). The proportion has been stable. In 2019 there were five employees with disabilities, four men and one woman.
- INCO is committed to empowering its surrounding communities. It has Community Development and an Empowerment Program (PPM) for 2018-22. In 2019 allocated PPM funds accounted for 6% of earnings.
- INCO uses Mining Safety Management Standards for management of Occupational Safety and Health (OHS) and recorded no fatal accidents in 2017-19.

Key G metrics and issues

- General meeting of shareholders is the Company's body with the highest authority.
- Board of Directors (BoD) run daily operations of the company. Based on INCO's Articles of Association, it consists of at least three members but not more than ten. It consists of six members; one of them (17%) is female.
- BoC supervises the BoD's activities and consists of five members (all male). Two of them (40%) are independent commissioners. There is no BoD member sitting in BoC and vice versa. The BoC holds a meeting at least once every two months.
- There is no disclosure on INCO shares that are owned by the BoC and BoD members.
- In 2019, total remuneration for the BoD was c. 6% of net profit, which consisted of salaries, short-term employee benefits and post-employment benefits. No percentage details on the breakdown of each component.
- The newly passed mining law gives central government more authority to both set mining policies and issue mining licences. We believe this will lower the probability of "regulatory conflict" between central and regional governments.
- INCO did not do any M&A in the past. It did not have any material related party transactions either that were negative to minority interests.
- PwC has been the auditor of the company for more than 15 years.

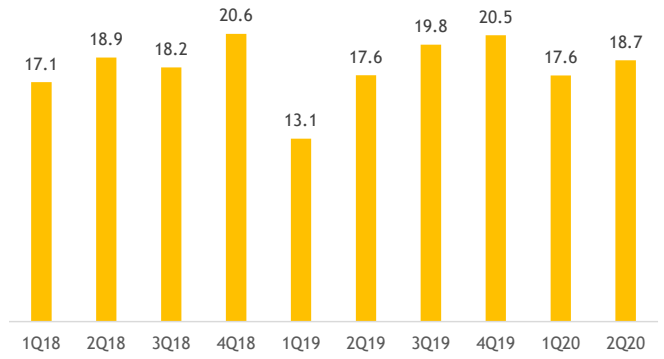
Key charts

Fig 1: Annual production (in 000 tonnes)



Source: Company, Maybank Kim Eng

Fig 2: Quarterly production (in 000 tonnes)



Source: Bloomberg

Fig 3: 2020 earnings sensitivities to production volume

	2020 earnings, USD m	Change
Base case	58	
Production +1%	60	3.5%
Production +2%	62	7.1%

Source: Maybank Kim Eng

Fig 4: 2020 earnings sensitivities to production volume and ASP

	2020 earnings, USD m	Change
Base case	64	
Production -5% and ASP +5%	77	20.8%
Production -10% and ASP +10%	87	37.6%

Source: Maybank Kim Eng

Fig 5: Main assumptions

	2020F	2021F	2022F
Nickel price, USD/tonne	13,007	13,602	14,330
growth	*-6.6%*	*4.6%*	*5.3%*
ASP, USD/tonne	10,206	10,571	11,130
growth	*-6.0%*	*3.6%*	*5.3%*
Sales volume, tonne	71,025	71,025	72,446
growth	*-1.4%*	*0.0%*	*2.0%*
Coal price, USD/tonne	62	67	70
growth	*-18.4%*	*8.1%*	*4.5%*
Brent oil price, USD/barrel	45	50	55
growth	*-29.7%*	*11.1%*	*10.0%*
WTI oil price, USD/barrel	41	45	50
growth	*-28.2%*	*11.1%*	*10.0%*
Total costs, USD/tonne	8,980	9,237	9,419
growth	*-4.9%*	*2.9%*	*2.0%*

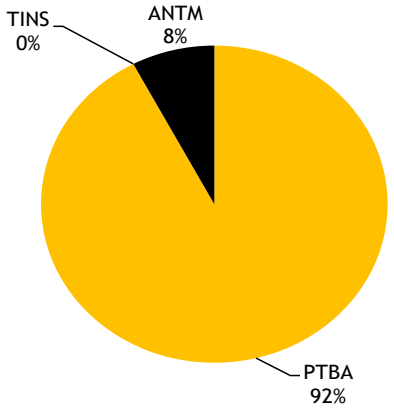
Source: Maybank Kim Eng

Fig 6: Inalum's increasing interest expense

	2019-end	2020-end
Principal, USD m		
Notes - 2021	1,000	
Notes - 2023	1,250	250
Notes - 2028	1,000	1,000
Notes - 2048	750	750
Notes - 2025		1,000
Notes - 2030		1,000
Notes - 2050		500
Total	**4,000**	**4,500**
Annual coupon		
Notes - 2021	5.23%	
Notes - 2023	5.71%	5.71%
Notes - 2028	6.53%	6.53%
Notes - 2048	6.76%	6.76%
Notes - 2025		4.75%
Notes - 2030		5.40%
Notes - 2050		5.80%
Weighted average	**6.0%**	**5.8%**
Annual coupon, USD m	**240**	**261**

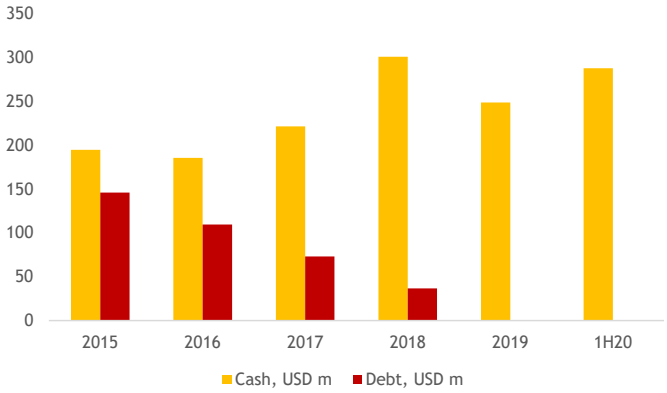
Source: Company, Maybank Kim Eng

Fig 7: Contributors to Inalum's 2020 dividend income



Source: Company

Fig 8: INCO's strong balance sheet to pay dividend

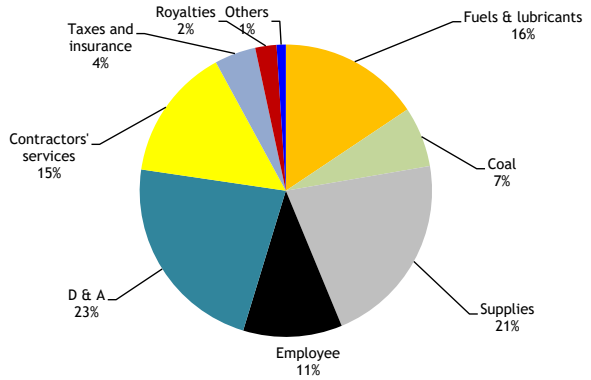


Source: Company

Value Proposition

- INCO is a subsidiary of Vale of Brazil and the only producer of nickel in matte in Indonesia.
- Cost efficiency has been INCO's strength. Costs have been declining in the past five years on the back of efficiency programmes to counter nickel-price drop.
- Production has been relatively flat over the past three years due to capacity constraints.
- ROE has been dragged down to below cost of equity due to declining nickel prices, which offset higher efficiency.

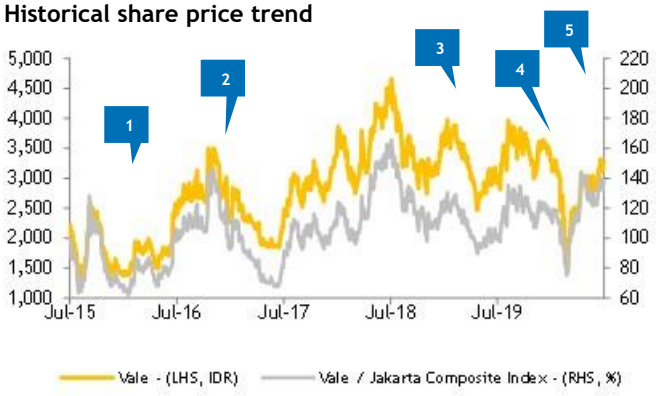
1H20 production cost breakdown



Source: Company

Price Drivers

Historical share price trend



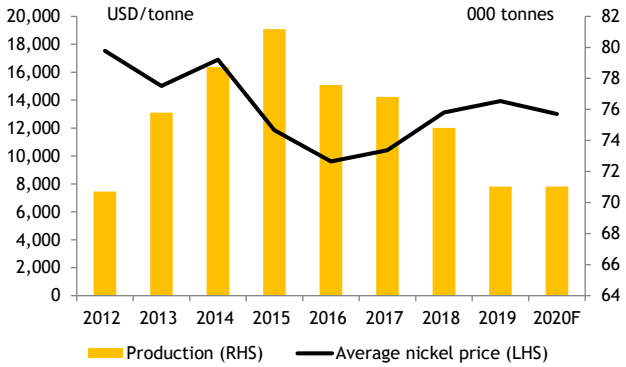
Source: Company, Maybank Kim Eng, Factset

1. Nickel-price rally due to improving demand in China.
2. Government relaxed a regulation on mineral-ore exports.
3. Nickel-price improvements on the back of government's plan to impose nickel-ore export ban policy.
4. Global economic slowdown due to COVID-19 outbreak.
5. Easing concern on the COVID-19 pandemic.

Financial Metrics

- Forecast earnings to decline 89% YoY due to lower volume and lower ASP as we factor in global economic slowdown.
- Costs will be decline 2% YoY on the back of lower commodity prices.
- Balance sheet will remain strong with a net cash position, which enable INCO to navigate difficult times.

Production vs nickel prices



Source: Company, Maybank KE

Swing Factors

Upside

- Persistently high nickel prices on the back of nickel-ore export ban policy and increasing demand of electric vehicles. Successful cost-efficiency programme.
- Successful monetization of Bahodopi and Pomala projects.

Downside

- Reversal of nickel-ore export ban policy, which will put downward pressure on nickel prices.
- No significant progress in expansion projects.
- Change of permit when the current one expires in 2025.

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FYE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
Key Metrics					
P/E (reported) (x)	38.4	36.9	44.9	40.8	30.4
Core P/E (x)	35.1	40.7	44.9	40.8	30.4
P/BV (x)	1.2	1.3	1.3	1.3	1.2
P/NTA (x)	1.6	1.8	1.8	1.9	2.1
Net dividend yield (%)	0.0	0.0	0.0	0.0	0.0
FCF yield (%)	4.9	nm	4.1	5.7	6.4
EV/EBITDA (x)	8.9	10.0	10.0	8.9	7.3
EV/EBIT (x)	21.2	22.9	25.8	22.1	15.5
INCOME STATEMENT (USD m)					
Revenue	776.9	782.0	724.8	750.8	806.3
Gross profit	104.0	116.4	102.1	110.1	140.0
EBITDA	221.3	234.9	223.6	234.0	265.0
Depreciation	(128.9)	(132.5)	(136.6)	(139.3)	(141.1)
Amortisation	0.0	0.0	0.0	0.0	0.0
EBIT	92.4	102.4	87.0	94.7	124.0
Net interest income /(exp)	(2.2)	0.9	0.0	0.0	0.0
Associates & JV	0.0	0.0	0.0	0.0	0.0
Exceptionals	0.0	0.0	0.0	0.0	0.0
Other pretax income	(4.8)	(7.9)	(10.0)	(10.0)	(10.0)
Pretax profit	85.4	95.4	77.0	84.7	114.0
Income tax	(22.1)	(31.7)	(19.3)	(21.2)	(28.5)
Minorities	0.0	0.0	0.0	0.0	0.0
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Reported net profit	63.3	63.7	57.8	63.5	85.5
Core net profit	63.3	63.7	57.8	63.5	85.5
BALANCE SHEET (USD m)					
Cash & Short Term Investments	301.2	249.0	354.6	502.4	669.3
Accounts receivable	124.2	107.3	99.5	103.0	110.6
Inventory	131.8	148.0	138.5	142.5	148.2
Reinsurance assets	0.0	0.0	0.0	0.0	0.0
Property, Plant & Equip (net)	1,433.5	1,466.5	1,429.9	1,340.6	1,249.5
Intangible assets	0.0	0.0	0.0	0.0	0.0
Investment in Associates & JVs	0.0	0.0	0.0	0.0	0.0
Other assets	211.7	251.9	251.9	251.9	251.9
Total assets	**2,202.4**	**2,222.7**	**2,274.3**	**2,340.4**	**2,429.6**
ST interest bearing debt	36.5	0.0	0.0	0.0	0.0
Accounts payable	91.2	97.5	91.4	93.9	97.6
Insurance contract liabilities	0.0	0.0	0.0	0.0	0.0
LT interest bearing debt	0.0	0.0	0.0	0.0	0.0
Other liabilities	191.0	184.0	184.0	184.0	184.0
Total Liabilities	**318.7**	**281.0**	**274.9**	**277.4**	**281.1**
Shareholders Equity	1,883.7	1,941.7	1,999.5	2,063.0	2,148.5
Minority Interest	0.0	0.0	0.0	0.0	0.0
Total shareholder equity	**1,883.7**	**1,941.7**	**1,999.5**	**2,063.0**	**2,148.5**
Total liabilities and equity	**2,202.4**	**2,222.7**	**2,274.3**	**2,340.4**	**2,429.6**
CASH FLOW (USD m)					
Pretax profit	85.4	95.4	77.0	84.7	114.0
Depreciation & amortisation	128.9	132.5	136.6	139.3	141.1
Adj net interest (income)/exp	2.2	(0.9)	0.0	0.0	0.0
Change in working capital	(0.6)	(7.4)	23.5	(10.1)	(17.0)
Cash taxes paid	(36.3)	(70.6)	(19.3)	(21.2)	(28.5)
Other operating cash flow	0.0	0.0	0.0	0.0	0.0
Cash flow from operations	193.0	129.3	205.6	197.9	216.9
Capex	(83.8)	(166.6)	(100.0)	(50.0)	(50.0)
Free cash flow	109.2	(37.3)	105.6	147.9	166.9
Dividends paid	0.0	0.0	0.0	0.0	0.0
Equity raised / (purchased)	0.0	0.0	0.0	0.0	1.0
Change in Debt	(37.5)	(37.5)	0.0	0.0	0.0
Other invest/financing cash flow	7.8	22.2	0.0	0.0	(1.0)
Effect of exch rate changes	0.0	0.0	0.0	0.0	0.0
Net cash flow	79.5	(52.6)	105.6	147.9	166.9

FYE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
Key Ratios					
Growth ratios (%)					
Revenue growth	23.4	0.7	(7.3)	3.6	7.4
EBITDA growth	81.7	6.1	(4.8)	4.7	13.3
EBIT growth	nm	10.8	(15.0)	8.9	30.8
Pretax growth	nm	11.7	(19.3)	10.0	34.5
Reported net profit growth	nm	0.6	(9.4)	10.0	34.5
Core net profit growth	nm	0.6	(9.4)	10.0	34.5
Profitability ratios (%)					
EBITDA margin	28.5	30.0	30.8	31.2	32.9
EBIT margin	11.9	13.1	12.0	12.6	15.4
Pretax profit margin	11.0	12.2	10.6	11.3	14.1
Payout ratio	0.0	0.0	0.0	0.0	0.0
DuPont analysis					
Net profit margin (%)	8.2	8.2	8.0	8.5	10.6
Revenue/Assets (x)	0.4	0.4	0.3	0.3	0.3
Assets/Equity (x)	1.2	1.1	1.1	1.1	1.1
ROAE (%)	3.4	3.3	2.9	3.1	4.1
ROAA (%)	2.9	2.9	2.6	2.8	3.6
Liquidity & Efficiency					
Cash conversion cycle	93.2	77.9	79.6	75.4	74.5
Days receivable outstanding	67.1	53.3	51.3	48.5	47.7
Days inventory outstanding	66.7	75.7	82.8	78.9	78.5
Days payables outstanding	40.7	51.0	54.6	52.1	51.7
Dividend cover (x)	nm	nm	nm	nm	nm
Current ratio (x)	3.6	4.3	5.2	6.3	7.4
Leverage & Expense Analysis					
Asset/Liability (x)	6.9	7.9	8.3	8.4	8.6
Net gearing (%) (incl perps)	net cash	net cash	net cash	net cash	net cash
Net gearing (%) (excl. perps)	net cash	net cash	net cash	net cash	net cash
Net interest cover (x)	42.0	na	nm	nm	nm
Debt/EBITDA (x)	0.2	0.0	0.0	0.0	0.0
Capex/revenue (%)	10.8	21.3	13.8	6.7	6.2
Net debt/ (net cash)	(264.7)	(249.0)	(354.6)	(502.4)	(669.3)

Source: Company; Maybank

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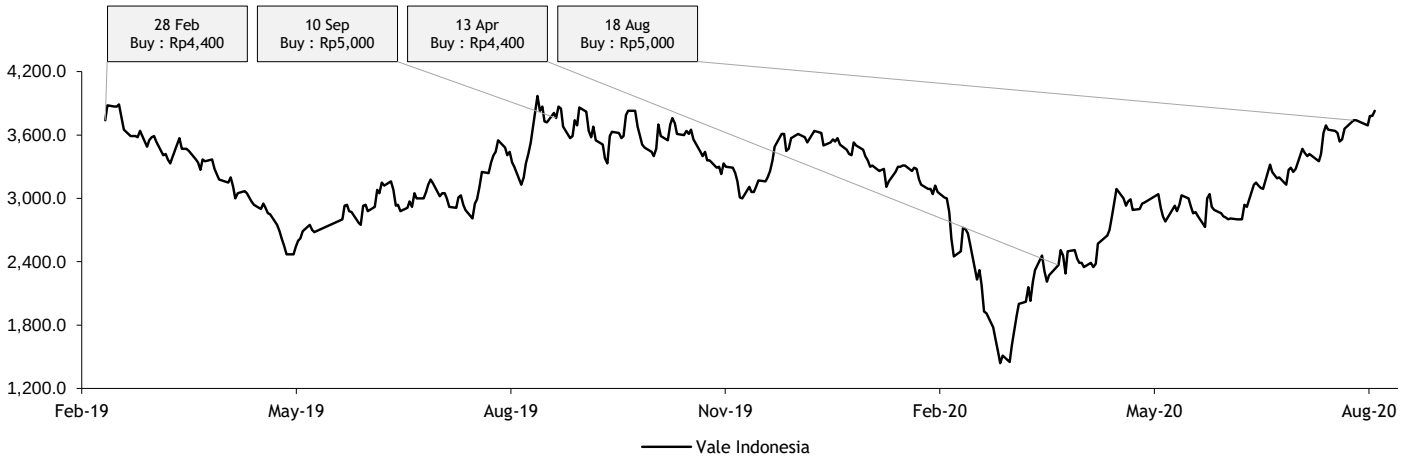

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