MINING SECTOR/COMPANY UPDATE

Vale Indonesia

Continues its shines

Despite short-term volatility in nickel prices on lower than expected nickel demand in 2014 and high inventory level, we believe nickel market is expected to turn into deficit in 2015 on recovery in nickel consumption growth and the continuation of Indonesia's nickel ore export ban. This will put upward pressures on nickel prices going forward. Coupled with completion of CoW renegotiation to provide visible outlook for company's business strategy in the long-run, as such, we maintain our BUY call with a Target Price of Rp4,700 based on DCF valuation (WACC: 12.2% and long-term growth of 3%). Our Target Price implies 21x 2015F PE.

Stable nickel production for 2015

With the company plans to postpone the upgrade of its electric furnace (EF) No. 1 from the beginning of 2015 to the second or third quarter of 2016 to reap the benefits of expected better nickel prices in 2015, we believe the company will fully utilize its current capacity and maintain its nickel-in-matte production at a maximum level of 80,000 tons in 2015 (2014F: 79,600 tons). Although the upgrading of EF No. 1 will lower the nickel-in-matte production by about 10% yoy to around 72,000 tons in 2016, the company plans to sustain the production through further improvements and de-bottlenecking. Following the EF#1 upgrade, the company is expected to increase nickel-in-matte production to about 90,000 tons.

Higher nickel prices and cost efficiencies to boost margins going forward

We foresee gross margins improvement to 32% in 2015 from an estimated 29% in 2014 with the cost of production expected to be maintained at around US$9,000/ton (9M14 COGS per ton: US$9,136/ton). This will be attributable to: a) better average nickel price to US$20,000/ton (+17.6% yoy) in 2015 with the expectation nickel market deficit and, b) lower energy costs going forward following the full operation of coal conversion project phase 1 for dryers (CCP1) at end-3Q13 to reduce the usage of High Sulphur Fuel Oil (HSFO) and further declines in the crude oil price will lower HSFO prices.

Long-term capex of US$2bn to support business going forward

After renegotiation of the Contract of Work (CoW) with the government has been completed, the company plans to spend long-term capex of about US$2bn, consisting of US$1.5bn for Sorowako project developments and the remaining US$500mn for Bahodopi. In the first stage (2015 – 2017), US$500mn of capex will be used for a) EF #1 upgrade and b) further improvements and de-bottlenecking. This will increase nickel-in-matte production to 90,000 tons from 80,000 tons. In the second stage (2018 – 2020), the company plans to increase the nickel-in-matte production capacity further to 120,000 tons by adding the fifth furnace as well as its supporting facilities. Meanwhile, for Bahodopi, the company plans to build either a refinery or smelter, for which the ore-feed will come from Sorowako.

	2012	2013	2014F	2015F	2016F
Revenue, USD mn	967	922	1,069	1,138	1,242
EBITDA, USD mn	256	236	403	459	517
EBITDA Growth, %	-55.6	-8.0	70.9	13.8	12.6
Net profit, USD mn	67	39	155	191	234
EPS, USD	0.0068	0.0039	0.0156	0.0192	0.0236
EPS growth, %	-79.8	-42.7	302.2	22.6	22.9
BVPS, USD	0.1732	0.1725	0.1883	0.1956	0.2101
DPS, USD	0.0116	0.0050	0.0023	0.0094	0.0115
Net Gearing, %	4.8	1.1	-1.1	-3.0	-9.8
PER, x	48.0	83.8	20.8	17.0	13.8
PBV, x	1.9	1.9	1.7	1.7	1.6
EV/EBITDA, x	12.7	13.8	8.1	7.1	6.3
Yield, %	3.6	1.5	0.7	2.9	3.5

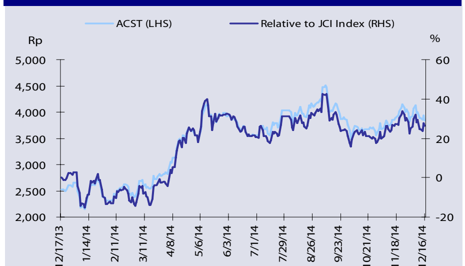
BUY

Target Price, Rp	4,700
Upside	22.7%
INCO IJ/INCO.JK	
Last Price, Rp	3,830
No. of shares (bn)	9,936
Market Cap, Rp bn	**38,055**
(US$ mn)	2.990
3M T/O, US$mn	2.9

Last Recommendation

21-Aug-2014	BUY	Rp 4,500
25-Jul-2014	BUY	Rp 4,500
22-May-2014	BUY	Rp 4,500

INCO relative to JCI Index



Consensus

	Our	Cons	% Diff
Target price, Rp	4,700	4,597	2.2
EPS 2014F, Rp	184	227	-18.9
PE 2014F, x	20.8	16.9	23.0

Market Recommendation

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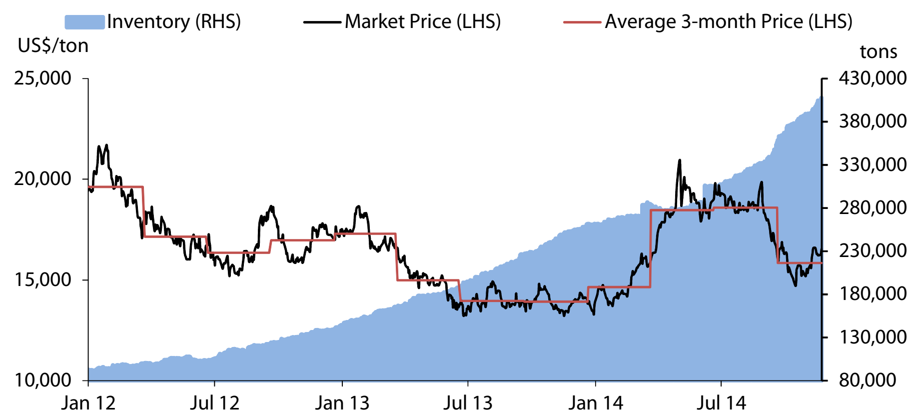
Danareksa research reports are also available at Reuters Multex and First Call Direct and Bloomberg.

See important disclosure on the back of this report

Expecting the nickel market to turn into deficit in 2015

With nickel demand shall recover in 2015 and the reaffirmation of Indonesia's nickel ore export ban and the slow progress on the development of smelters in Indonesia which will disrupt nickel supply, we therefore expect the nickel market to turn into deficit in 2015. As such, we foresee that the high inventory level of nickel will be lowered with nickel prices to rise in 2015. In our estimates, the nickel price is predicted to increase to US$20,000/ton in 2015 and 2016 from this year's expectation of US$17,000/ton.

Exhibit 1. Nickel prices and inventory level



Source: Bloomberg, Danareksa Sekuritas

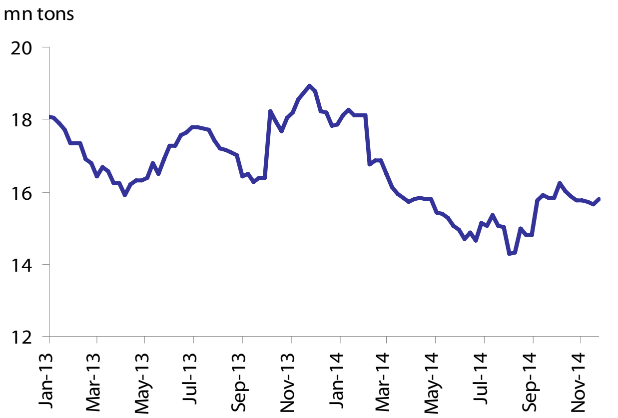
Demand growth to recover by 2015

After nickel demand posted a decline in 2014, we foresee a recovery in nickel demand by 8.3% yoy in 2015. This will be driven by: a) anticipated recovery in stainless steel demand in China for infrastructure and construction projects, b) the strong US economy which will boost nickel demand and c) persistently higher nickel demand in smaller markets as industrial activities in those countries are expected to remain on-track for growth and expansion. However, despite the introduction of new policies to stimulate economic growth by the European Central Bank (ECB), nickel demand from EU countries is expected to remain flat in 2015 and remain below 2012's level of about 302,000 tons.

Slow smelters progress and continuation nickel export ban to disrupt supply in 2015

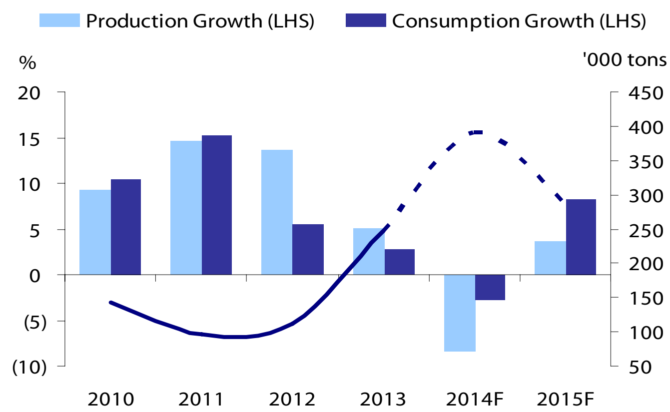
As the new government of Indonesia has reiterated its commitment to the nickel ore export ban, we expect this policy to affect the availability of nickel ore in the global market as Indonesia is considered to be the largest global mine producer (prior to the ban. Moreover, despite several nickel producers planning to develop smelters in Indonesia in the near future, we believe the replacement of nickel ore exports from Indonesia through building smelters will need some time, considering the substantial investment required to build those smelters and the supporting infrastructure, such as power plants and roads.

Exhibit 2. Declining trend on China's Ni laterite ore stocks



Source: Beijing UCST, Bloomberg

Exhibit 3. Nickel market deficit to lower stock in 2015

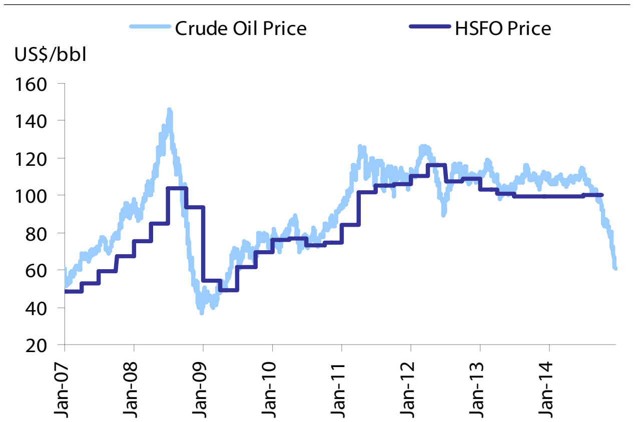


Source: WBMS, The EIU, Danareksa Sekuritas

Lower crude oil prices to benefit company to reduce cost further

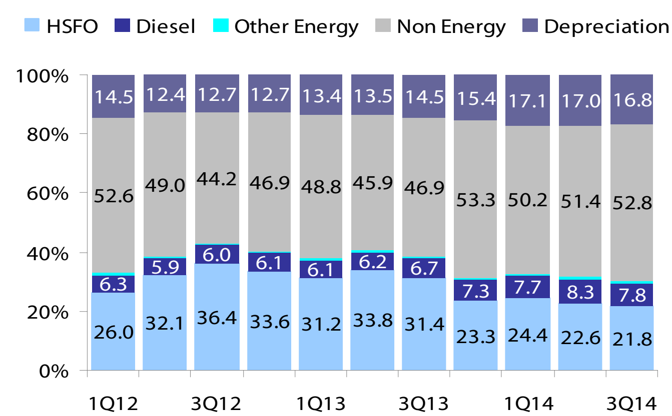
With crude oil (Brent) declined to the current level of around US$61/bbl, this may benefit the company as we believe this will lower the price of High Sulphur Fuel Oil (HSFO) further. With lower crude oil started to fall in 4Q14, we foresee lower HSFO price as well as diesel price in 1Q15. This is expected to reduce cost further as HSFO and diesel contributed for about 30% of total cost in 3Q14. Moreover, the operational coal conversion project phases 1 for dryers (CCP1) to reduce the usage of HSFO will also benefiting company amid unfavorable coal prices.

Exhibit 4. HSFO price to follow crude oil prices



Source: Company, Bloomberg

Exhibit 5. Energy contributed 30% of total cost



Source: Company

Exhibit 6. Profit and Loss (US$ mn)

	2012	2013	2014F	2015F	2016F
Turnover	967	922	1,069	1,138	1,242
COGS	(801)	(782)	(763)	(779)	(829)
Gross Profit	167	140	306	358	413
Operating Expenses	(13)	(13)	(16)	(17)	(19)
Operating Profit	154	127	290	341	394
Other Income/Expense	(48)	(57)	(67)	(70)	(70)
Net Interest	(15)	(14)	(16)	(17)	(12)
Pre-tax Profit	91	55	207	254	312
Tax	(24)	(17)	(52)	(64)	(78)
Minority Interest	0	0	0	0	0
Extraordinary Items	0	0	0	0	0
Net Profit	**67**	**39**	**155**	**191**	**234**

Source: Company, Danareksa Sekuritas

Exhibit 7. Balance sheet (US$ mn)

	2012	2013	2014F	2015F	2016F
Current Assets					
Cash and Cash Equivalents	172	200	284	334	405
Account Receivables	113	66	94	97	102
Inventories, Net	153	151	147	153	129
Other Current Assets	98	124	104	109	116
Total Current Assets	536	541	629	692	752
Fixed Assets	1,625	1,652	1,689	1,721	1,748
Goodwill	0	0	0	0	0
Other LT Assets	173	89	167	175	191
Total Assets	**2,333**	**2,281**	**2,484**	**2,587**	**2,691**
Current Liabilities					
ST Debt	36	36	75	38	0
Other Current Liabilities	130	133	127	140	161
Total Current Liabilities	166	169	202	178	161
LT Debt	220	183	188	238	200
Other LT Liabilities	226	215	224	228	243
Minority Interests	0	0	0	0	0
Shareholders' Equity	1,721	1,714	1,871	1,944	2,088
Total Equity & Liabilities	**2,333**	**2,281**	**2,484**	**2,587**	**2,691**

Source: Company, Danareksa Sekuritas

Exhibit 8. Cash flow (US$ mn)

	2012	2013	2014F	2015F	2016F
Net Profit	67	39	155	191	234
Depreciation and amortization	102	109	113	118	123
Change in Working Capital	(11)	20	(10)	(0)	29
Others Non-Cash	(84)	74	(70)	(1)	1
Operating Cash Flow	**75**	**242**	**189**	**307**	**387**
Capex	(148)	(138)	(150)	(150)	(150)
Investment	0	0	0	0	0
Others Investing Activities	(13)	17	0	(2)	(1)
Investing Cash Flow	**(161)**	**(121)**	**(150)**	**(152)**	**(151)**
Net Change in Debt	(37)	(37)	43	13	(75)
Dividend	(115)	(50)	(23)	(93)	(114)
Others Financing Activities	10	(6)	24	(24)	25
Financing Cash Flow	**(142)**	**(93)**	**44**	**(105)**	**(164)**
Net change in cash	(227)	28	84	50	71
Net Cash (debt) at beg.	**399**	**172**	**200**	**284**	**334**
Net Cash (debt) at end.	**172**	**200**	**284**	**334**	**405**

Source: Company, Danareksa Sekuritas

Exhibit 9. Selected ratios

	2012	2013	2014F	2015F	2016F
Gross Margin, %	17.2	15.2	28.6	31.5	33.3
EBITDA Margin, %	26.5	25.6	37.7	40.3	41.6
Operating Margin, %	15.9	13.8	27.1	30.0	31.8
Net Margin, %	7.0	4.2	14.5	16.8	18.9
ROE, %	3.9	2.3	8.7	10.0	11.6
ROA, %	2.8	1.7	6.5	7.5	8.9
Net Gearing, %	4.8	1.1	(1.1)	(3.0)	(9.8)

Source: Company, Danareksa Sekuritas

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