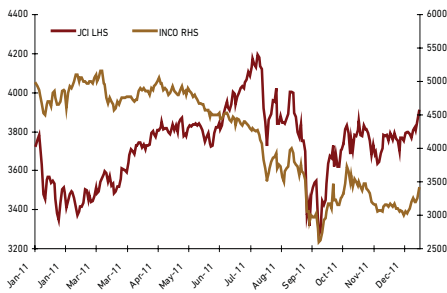




**Ciptadana**  
Research Report  
January 05, 2011

**PT International Nickel Indonesia Tbk**  
*Cost efficient company on a gloomy nickel price outlook*

JCI vs INCO



Source : Bloomberg

Target Price : 3.700/sh  
 Recommendation : HOLD  
 Current price (01/04/2012) : 3.400  
 52 Wk high (02/09/2011) : 5.200  
 52 Wk low (10/04/2011) : 2.525  
 Shares outstanding (mn) : 9,936.3  
 Market cap (Rp bn) : 33,783.5  
 Bloomberg code : INCO IJ

source : Bloomberg

PT INTERNATIONAL NICKEL INDONESIA - TP 3,700/sh

Cost efficient company on a gloomy nickel price outlook

We like International Nickel Indonesia (INCO) for its cost efficiency program through newly commenced hydro power plant and its growth expansion plan; nevertheless, we think the unexciting outlook of nickel price would hold back INCO's performance. In addition, due to the overhaul and rebuild program in late FY11 and continue in early this year, we expect INCO's production will slow down during FY11-12F period but will recover in FY13F. We re-initiate our coverage on INCO with HOLD recommendation and target price of Rp3,700/share (rounded up).

New low cost power from Karebbe to ramp up production

On October 4, 2011, INCO inaugurated its third hydroelectric power facility called Karebbe plant which has 90MW of average capacity and consumed a total capital US\$410mn. This will bring a total average capacity of 370MW from its hydro generating facilities consists of Karebbe (90MW), Balambano (110MW), and Larona (170MW). Previously, INCO would have to operate its fuel-based thermal power facility (about 70MW of total capacity) to support its production. With the commencement of Karebbe plant, INCO now has the capacity to ramp up its production using all hydro power which will strengthen its position as a low cost nickel producer.

Stalled short-term production but expect to surge in the following years

INCO's production faced challenges during FY11 which we expect to reach 66.5k metric tons (mt), down 12.5% yoy and in line with the Company's revised target of 66.7k mt due to temporary shutdown as a result of earthquake in 1Q11 combined with its overhaul and rebuild program for two of its furnaces that started in late 4Q11 and is expected to complete in 1Q12. We estimate FY12F's production to grow by 5.5% reaching 70.2k mt and further by 10.3% into 77.4k mt for FY13F after the completion of its rebuild program.

Gloomy nickel price

We put LME benchmark nickel price at US\$23,000/mt as our assumption for FY12F onwards, a decline by 6% as compared to our FY11F LME benchmark price at US\$24,500/mt, as we expect nickel price will still be unfavorable this year given the prolonged concerns over European debt crisis coupled with a relatively high level of nickel inventory. On top of that, we expect nickel demand to reach moderate levels this year amid global economy uncertainties that would put pressure on nickel price.

Re-initiate with HOLD

We re-initiate our coverage on INCO with a HOLD recommendation and a target price of Rp3,700/share, implying 11.2X and 9.8X FY12 and 13F PE, respectively. We derived our target price using a DCF valuation method assuming 12.3% of WACC and 3% of terminal growth. We identify several downside risks to our view, namely 1) significant correction in nickel price, 2) soaring oil price, 3) low rainfall, and 4) regulatory risk.

Tab1. Forecast and Valuation

Year-end 31-Dec	09A	10A	11F	12F	13F
Revenue (USD mn)	761	1,276	1,291	1,279	1,411
EBITDA (USD mn)	323	693	631	625	709
Net profit (USD mn)	170	437	386	376	430
EPS (USD/share)	0.017	0.044	0.039	0.038	0.043
DPS (USD/share)	0.011	0.034	0.025	0.019	0.020
ROE (%)	10.8%	26.0%	21.2%	18.7%	19.2%
Dividend yield (%)	-	-	6.6%	5.0%	5.4%
P/E ratio (x)	-	-	9.7	9.9	8.7
EV/EBITDA (x)	-	-	5.7	5.7	5.1

Source : Company & Ciptadana estimates

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### New low cost power from Karebbe to ramp up production

On October 4, 2011, INCO inaugurated its third hydroelectric power facility called Karebbe plant which has 90MW of average capacity. The new power plant adds up INCO's low-cost energy supply to total average power of 370MW consists of Karebbe (90MW), Balambano (110MW), and Larona (170MW). Previously, INCO would have to operate a higher cost-fuel based-thermal power facility (two diesel generators of 48MW and one steam turbine of 22MW) to fulfill the power shortage in its operation. With the commencement of Karebbe plant, INCO now has the capacity to ramp up its production using all hydro power which will strengthen its position as a low cost nickel producer.

Fig1. Karebbe Dam



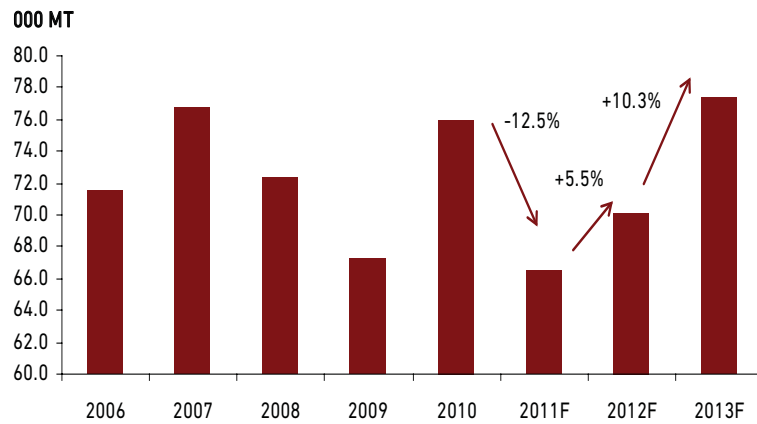
Source : Company



### Stalled short-term production but expect to surge in the following years

We expect INCO's production to be down by 12.5% yoy in FY11 reaching 66.5k mt due to temporary shutdown as a result of earthquake in 1Q11 combined with its overhaul and rebuild program for two of its furnaces that started in late 4Q11. The overhaul and rebuild program is expected to complete in 1Q12, thus we estimate it will slow down INCO's FY12F production with only 5.5% growth, reaching 70.2k mt. Furthermore, we foresee production to surge into 77.4k mt or increased by 10.3% yoy for FY13F after the completion of its rebuild program.

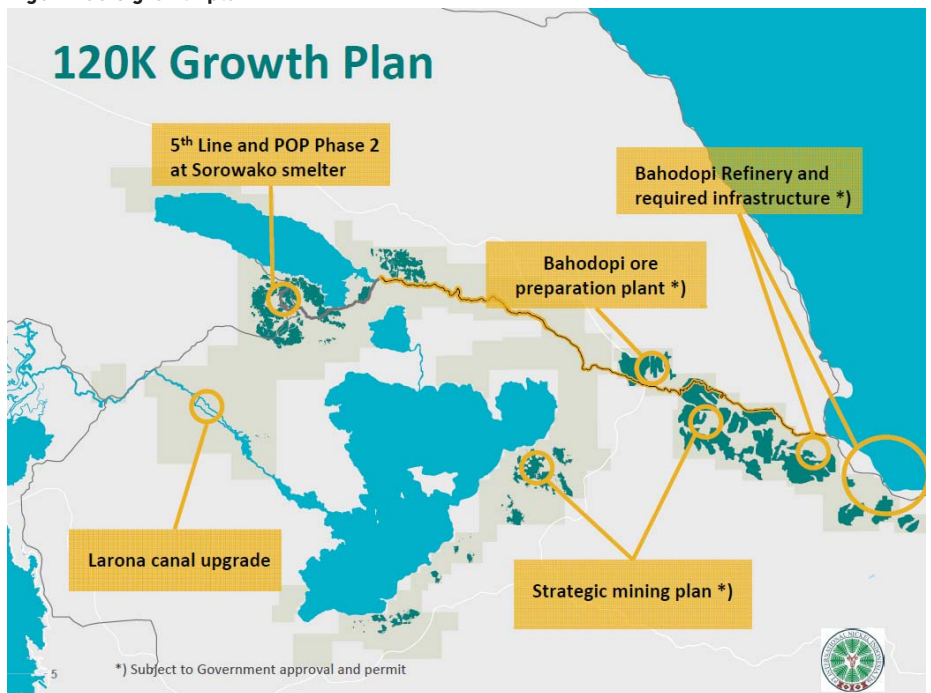
Fig2. INCO's nickel in matte production



Source : Company & Ciptadana Estimates

Moreover, INCO now has sufficient power to support its long-term production target. In the mid-term, the Company has been considering adding a fifth furnace for its processing plant and has set a production target of 90K mt in 2015. In the long-term, it has a target of 120K mt with additional ore supply from Bahodopi mine (still in evaluation process). However, we have not taken these both targets into account in our forecast as we wait for further progress on the projects.

Fig3. INCO's growth plan

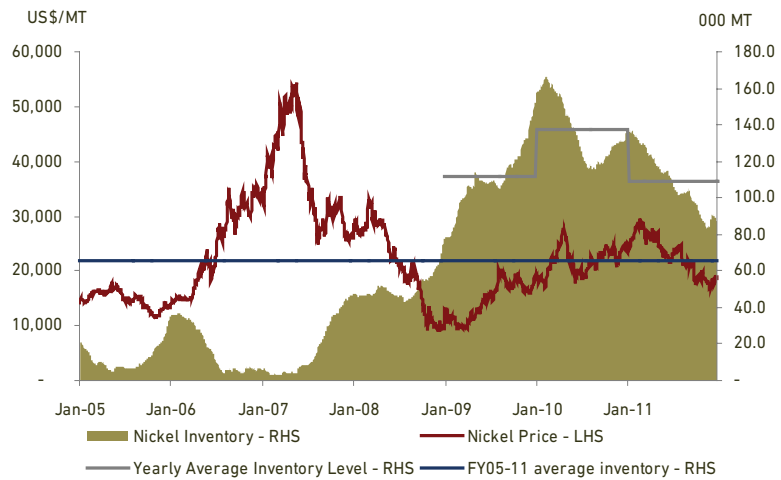


Source : Company

**Gloomy nickel price**

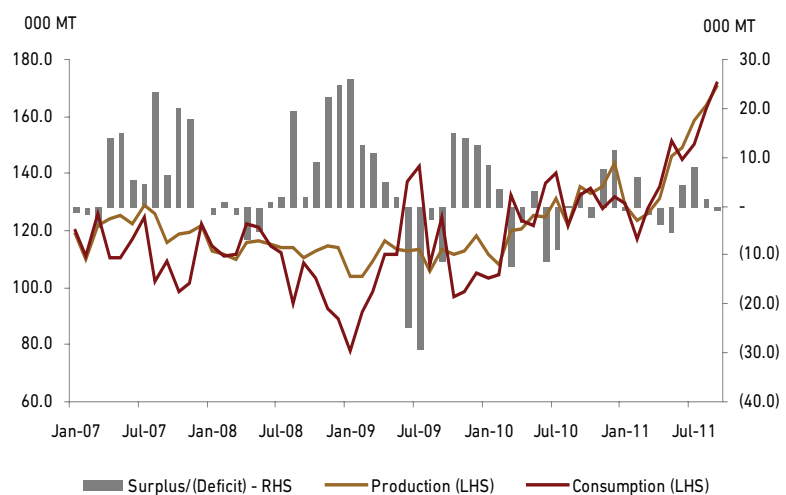
We expect nickel price will still be unfavorable this year given the prolonged concerns over European debt crisis coupled with a relatively high level of nickel inventory which was driven by production surplus over the past several years. The average nickel inventory during FY11 is about 109.2k mt, decreased by 21% from FY10's average inventory level; however we believe current inventory level is still relatively high which may curb the upside on nickel price (average FY05-11 nickel inventory was at 65.4k mt). As a result, we presume the LME benchmark nickel price is at US\$23,000/mt for FY12F onwards, a decline by 6% as compared to our FY11F LME benchmark price at US\$24,500/mt. Note that we apply 22% discount from LME benchmark nickel price for INCO's average selling price to account the 78% of nickel content in the Company's end product, nickel in matte.

**Fig4. Nickel price vs Inventory level**



Source : Bloomberg & Ciptadana

**Fig5. Refined nickel production and consumption vs Surplus/(Deficit)**



Source : Bloomberg & Ciptadana

## Valuation

We value INCO using DCF valuation method assuming a WACC of 12.3% and a terminal growth rate of 3% and arrive at a target price of Rp3,700/share (rounded up), implying 11.2X and 9.8X FY12 and 13F PE, respectively and re-iterate our HOLD recommendation due to limited upside potential. Currently, INCO is trading at 9.9X FY12F PE, below its 5yrs average PE of 12.6X and near -1 STD deviation caused by downward pressure on nickel price.

**Tab2. DCF valuation**

DCF Valuation (USD mn)	2013F	2014F	2015F	2016F	2017F	TV
EBIT	598	591	579	561	531	
Tax	(143)	(144)	(141)	(136)	(129)	
<b>NOPLAT</b>	<b>455</b>	<b>448</b>	<b>438</b>	<b>424</b>	<b>402</b>	
Depreciation	111	118	125	131	138	
Changes in working capital	(3)	(5)	(5)	(3)	(3)	
Changes in others	1	2	3	4	4	
Operating CF	564	563	561	556	540	
Capital expenditures	(144)	(143)	(143)	(143)	(142)	
<b>FCF</b>	<b>420</b>	<b>419</b>	<b>418</b>	<b>413</b>	<b>398</b>	<b>4,407</b>
Discount factor	1.12	1.26	1.42	1.59	1.79	
PV FCF	374	333	295	260	223	2,468
<b>NPV</b>	<b>3,952</b>					
Net debt	(251)					
<b>Equity value</b>	<b>4,203</b>					
<b>Equity value per share (USD/share)</b>	<b>0.4230</b>					
<b>FY12 YE USD/IDR rate</b>	<b>8,725</b>					
<b>Target Price (Rp/share)</b>	<b>3,691</b>					

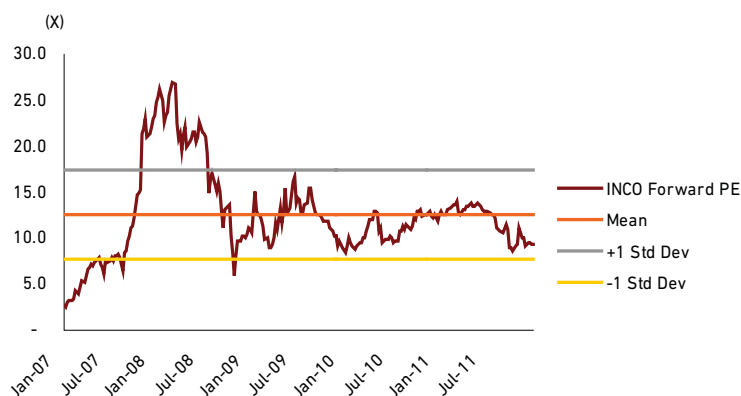
Source : Ciptadana estimates

**Tab3. Key DCF Valuation**

Key DCF Assumption	
Risk free rate	7.0%
Risk premium	5.0%
Beta	1.2
Cost of Equity	13.3%
Cost of Debt	6.8%
WACC	12.3%
Terminal growth rate	3.0%

Source : Ciptadana estimates

Fig6. Forward PE band



Source : Bloomberg & Ciptadana

Tab4. Peers Comparison

Company	Ticker	Country	Market Cap (Mn USD)	PE (X)		ROE (%)	
				2012F	2013F	2012F	2013F
<b>Metal Mining</b>							
Aneka Tambang	ANTM IJ Equity	INDONESIA	1,726.2	8.1	9.1	18.9	15.9
International Nickel Indonesia	INCO IJ Equity	INDONESIA	3,710.2	9.9	8.7	18.7	19.2
Timah	TINS IJ Equity	INDONESIA	932.8	7.8	7.7	25.0	23.5
<b>Simple Average</b>				<b>8.6</b>	<b>8.5</b>	<b>20.9</b>	<b>19.5</b>
<b>Market-weighted average</b>				<b>9.1</b>	<b>8.6</b>	<b>19.7</b>	<b>18.9</b>

Source : Bloomberg & Ciptadana

### Sensitivity Analysis

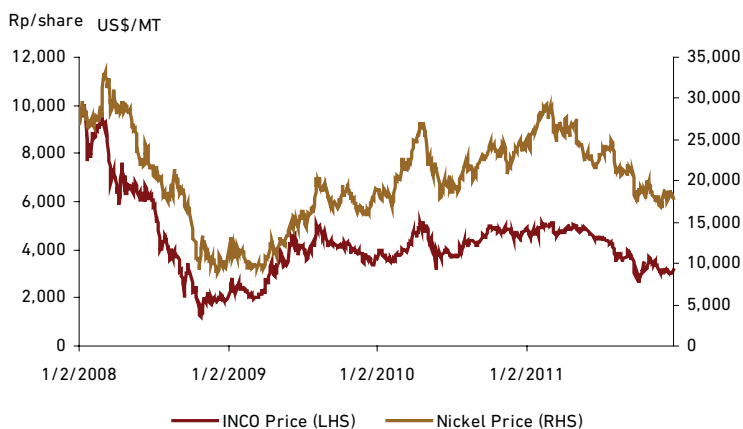
As a commodity-based Company which only sells one product, nickel in matte, INCO's result is highly related to the average nickel price it can realize during the year. Thus, we provide a sensitivity analysis to show how much are the impact for every change in nickel price assumption to the Company's earnings. Our analysis showed that for every decrease by 10% from our FY12F's assumption on nickel price, it will decrease INCO FY12F's net profit approximately by 24.1%.

Tab5. Net income sensitivity to nickel price

LME Nickel Price Assumption (US\$/MT)	FY12F Net Income (US\$ mn)	Change (%)
+10% - US\$25,300	467	24.1%
Base Case - US\$23,000	376	0.0%
-10% - US\$20,700	285	-24.1%

Source : Ciptadana Estimates

**Fig7. INCO's share price is highly correlated to nickel price (81% correlation during FY08-11)**



Source: Bloomberg

On the other hand, we also perform a sensitivity analysis to oil price to see the impact of rising oil price to INCO's bottom line as fuel and lubricants are accounted for 41% of its total COGS. For every 10% increase in our FY12F's oil price assumption, it would drag down FY12F's earnings by 5.1%.

**Tab6. Net income sensitivity to oil price**

Oil Price Assumption (US\$/barrel)	FY12F Net Income (US\$ mn)	Change (%)
+10% - US\$108.6	357	-5.1%
Base Case - US\$98.7	376	0.0%
-10% - US\$88.8	395	5.1%

Source: Ciptadana Estimates

## **Risk to our view**

### **Significant correction in nickel price**

Given its sole product called nickel in matte, INCO's operating result will be highly dependent of the global nickel price. Any significant drop in global nickel price would depress INCO's performance. We provide a sensitivity analysis for INCO's earnings from changes in nickel price in the section above.

### **Soaring oil price**

INCO is primarily using High Sulfur Fuel Oil (HSFO) and High Diesel Oil (HSD) to operate its processing plant. These fuels along with other lubricants were the largest component of INCO's production cost and accounted for 41% from its total COGS during FY10. Subsequently, soaring oil price could drag down the Company's gross margin and sequentially its net profit.

### **Low rainfall**

In order to supply its high power electricity, INCO utilizes three low cost hydro power plants which rely on the availability of water flowing to its turbines which is affected by the level of rainfall in the area. Lower than average water level in the river would reduce the power availability and in turn requires INCO to operate higher cost-fuel based-thermal power plants.

### **Regulatory risk**

INCO's mining operation will highly depend on the regulation and policy implemented by the Government of Indonesia as INCO operates under Contract of Work with the government. The introduction of new mining law or any changes and uncertainty in the regulation would influence the business continuity of the Company.

### Company Background

Established in 1968, INCO is the largest nickel producer in Indonesia with about 75.4mn dry metric tons of total proven reserves as end Sept-11. Its business operations includes mining and processing ore to an intermediate product named nickel in matte that consists of approx. 78% nickel content, 20% sulfur, and 1.2% of cobalt. It operates under Contract of Work with the Government of Indonesia which gives INCO the rights to exploit nickel and certain other minerals in a defined area in Sulawesi Island. The contract will expire in 2025 with the options for further extensions. INCO sells all of its products to its two biggest shareholders, Vale Canada Limited (59% share) and Sumitomo Metal Mining Co. Ltd. (20%), under a "must take" agreement.

### INCO's simplified operational highlights

INCO's operation begins from the nickel ore mining process which then the mined ore goes through various screening stations and places at the wet ore stockpile. From the stockpile, the wet ore is trucked to the process plant to be dried at the drying kiln (there are 3 dryers currently) using High Sulfur Fuel Oil (HSFO) and then stored the dried ores in the dried ore storage.

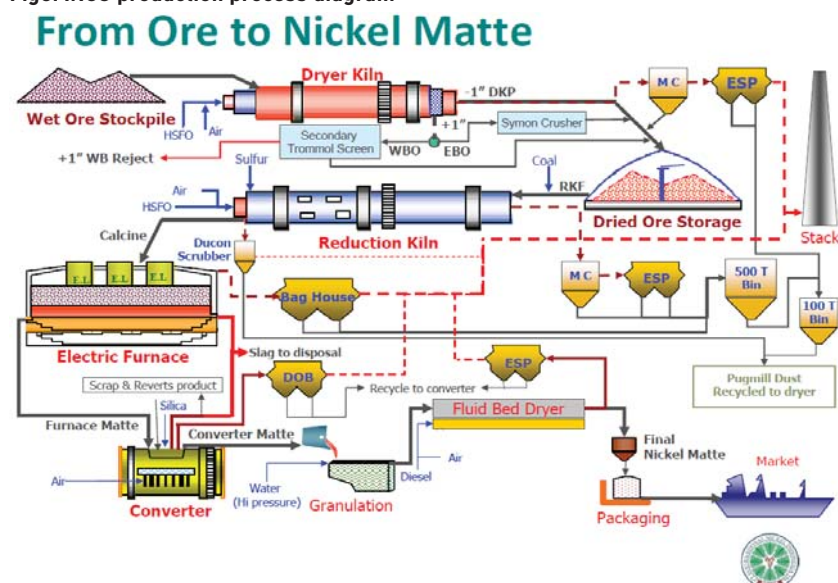
Next, the dried ores will be brought to the Reduction Kiln (RK - INCO has 5 RKs) and roasted there using HSFO and coal. This process will remove crystallized water and reduce oxygen content from the dried ore. At the end of the process, liquid sulfur is added to the RK to form a more stable nickel sulfide and produces the output called calcine.

Then, calcine will be put through the electric furnace/EF (there are 4 EFs) in which, using the high power electricity, the EF will smelt calcine and detach the nickel content from other elements by utilizing the differences in the melting point between elements. In the end of the EF process, there will be an output called furnace matte in liquid form which consists of Nickel (25-30%), Iron (55-60%), and sulfide bond (8-10%).

The next step takes place in the converter where the liquid furnace matte is sprayed with air and Silica to form Ferro Silica through oxidation process and it will reduce the iron element from the matte. The end product of this step is called converter matte which has 78-80% nickel content, <0.7% Iron, and 18-20% sulfur.

In the last step, the liquid converter matte will be sprayed with high pressured water and it will become a granular form. Those granules will be dried and become INCO's end product named nickel in matte which is ready to be exported.

Fig8. INCO production process diagram



Source: Company

**Tab7. Key Assumptions**

Year-end 31-Dec	09A	10A	11F	12F	13F
Production volume (000 MT)	67.3	76.0	66.5	70.2	77.4
Sales volume (000 MT)	66.9	75.8	66.5	70.2	77.4
ASP (USD/MT)	11,227	16,568	19,110	17,940	17,940

**Tab8. Income Statement**

Year-end 31-Dec (USD mn)	09A	10A	11F	12F	13F
Revenue	761	1,276	1,291	1,279	1,411
COGS	(516)	(652)	(725)	(726)	(777)
Gross Profit	245	624	566	553	634
Opex	(13)	(28)	(33)	(33)	(36)
Operating Profit	232	596	533	521	598
Other income/(expenses)	5	(15)	(19)	(19)	(25)
Profit before income tax	237	581	514	501	573
Income tax expenses	(66)	(144)	(129)	(125)	(143)
Minority interests	-	-	-	-	-
Net profit	170	437	386	376	430
EBITDA	323	693	631	625	709

**Tab9. Balance Sheet**

As at 31-Dec (USD mn)	09A	10A	11F	12F	13F
<b>Assets</b>					
Cash and equivalents	261	404	425	506	660
Receivables	98	124	112	111	123
Inventories	118	102	124	123	133
Others	153	82	119	117	130
Total current assets	629	712	779	858	1,044
Fixed assets - net	1,379	1,465	1,594	1,664	1,697
Long term investments	-	-	-	-	-
Others	19	14	16	16	18
Total non-current assets	1,398	1,479	1,610	1,680	1,715
<b>Total assets</b>	<b>2,028</b>	<b>2,190</b>	<b>2,389</b>	<b>2,538</b>	<b>2,759</b>
<b>Liabilities and equity</b>					
Short-term bank loans and current maturities	2	-	38	38	38
Trade payables	33	41	41	41	44
Others current liabilities	52	117	94	94	101
Total current liabilities	87	158	173	173	182
Long term debt	140	141	254	218	182
Others	220	212	141	137	157
Total non-current liabilities	359	352	395	356	339
<b>Total liabilities</b>	<b>446</b>	<b>510</b>	<b>568</b>	<b>528</b>	<b>521</b>
<b>Minority interests</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Shareholders' equity</b>	<b>1,581</b>	<b>1,680</b>	<b>1,821</b>	<b>2,010</b>	<b>2,238</b>

Source : Company and Ciptadana estimates

Tab10. Cash Flow

Year-end 31-Dec (USD mn)	09A	10A	11F	12F	13F
<b>CF from operation</b>					
Net profit	170	437	386	376	430
Depreciation/amortization	84	93	98	104	111
Change in working capitals	(16)	(2)	(10)	2	(18)
Others	(44)	134	(59)	1	(5)
CF from operation	194	663	415	483	517
<b>CF from Investments</b>					
Net capex	(127)	(179)	(227)	(175)	(144)
Others	3	6	(3)	0	(2)
CF from investments	(124)	(172)	(231)	(175)	(146)
<b>CF from financing activity</b>					
Increase/(decrease) in debt	134	(1)	151	(36)	(36)
Increase/(decrease) in equity	-	-	-	-	-
Dividend payments	(110)	(339)	(244)	(187)	(201)
Others	(2)	(15)	(71)	(3)	20
CF from financing activity	22	(355)	(164)	(227)	(218)
<b>Net changes in cash</b>	<b>92</b>	<b>136</b>	<b>21</b>	<b>82</b>	<b>153</b>

Tab11. Key Ratios

Year-end 31-Dec	09A	10A	11F	12F	13F
<b>Growth (%)</b>					
Revenue	-42.0%	67.7%	1.2%	-0.9%	10.3%
EBITDA	-42.8%	114.5%	-8.9%	-1.0%	13.4%
Net profit	-52.6%	156.6%	-11.8%	-2.5%	14.3%
<b>Profitability (%)</b>					
Gross margin	32.2%	48.9%	43.8%	43.3%	44.9%
Operating margin	30.5%	46.7%	41.3%	40.7%	42.4%
EBITDA margin	42.4%	54.3%	48.9%	48.9%	50.3%
Net margin	22.4%	34.3%	29.9%	29.4%	30.5%
ROE	10.8%	26.0%	21.2%	18.7%	19.2%
ROA	8.4%	20.0%	16.1%	14.8%	15.6%
<b>Leverage (X)</b>					
Current ratio	7.2	4.5	4.5	5.0	5.7
Quick ratio	4.1	3.3	3.1	3.6	4.3
Debt to equity	0.1	0.1	0.2	0.1	0.1
Net debt to equity	net cash	net cash	net cash	net cash	net cash

Source : Company and Ciptadana estimates

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## Analyst Certification

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