

Premier Insight

20 July 2017

Vale Indonesia (INCO IJ; Buy)

Growing optimism

- Metal price recovery is a sign of improving China demand.
- Nickel inventory has decreased albeit still above LT average.
- INCO's earnings to remain weak in 2Q17 but should recover there after.
- Stock is cheap. We raise TP to Rp2,800 (1.08x FY18F P/B).

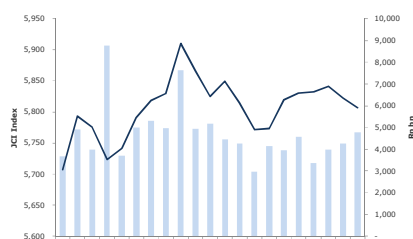
Signs of China demand recovery. Metals commodity markets show signs of optimism on the back of increasing China demand which also reflected in the country's better than expected GDP in 2Q17, export (+17% yoy vs. consensus expectation of 14.5%) and industrial production (+7.6% vs. +6.5% yoy) in June 2017. China's steel production accounted for 50% of global volumes in 5M17, while its nickel consumption formed 33% of global nickel consumption in 5M17. We note that in the past several weeks copper price increased by 5.5%, nickel up 11.4% and lead gained 10.6% which also help share price improvement of several mining giants (ie. Vale SA +18.5%, BHP +17.1% and Rio Tinto +18.7%) in the past several weeks.

Declining inventory. Combined nickel inventory in London Metal Exchange and Shanghai Futures Exchange has declined to 447k tons (Fig. 1). This represents approximately 81 days of global consumption which was a significant drop vs 90-100 days in 2014-2016 albeit still well above its LT average (10-yr) inventory level of 55 days. Thus, as global nickel demand showing the signs of recovery we believe the trend of decreasing nickel inventory will continue.

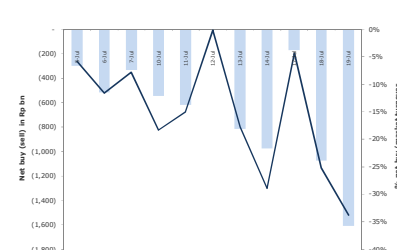
Positive LT outlook. We view that nickel price improvement will not be reflected in INCO's performance including its upcoming 2Q17 financial results. Nonetheless, we are becoming more optimistic to INCO's future performance as we are more bullish to nickel price long term outlook. Thus, we maintain our long-term nickel price assumption of US\$11k/ton but adjust long-term-growth estimate for nickel price from 3% per annum (pa) to 5% pa. On our sensitivity test, INCO's FY18F earnings will increase or decrease by 5.8% for every 1% change of our base nickel price assumption.

New TP of Rp2,800, upgrade to Buy. We raise our LT growth estimate for nickel price and upgrade our DCF-based (WACC: 12.7%, TG: 3%) target price for INCO to Rp2,800 (from Rp2,350). We like the company's good management and successful costs efficiency initiatives, including lower HSFO consumption which had decreased from 36.5 barrel per ton of nickel matte production in 2010 to only 20.1 barrel/ton in 2016 (Fig. 3). INCO currently trades at FY18F P/B of 0.81x, which in our view is attractively valued. We view that INCO's strong reputation in operational and financial management and good corporate governance, should deserve the stock valuation at above 1x P/B. Please note that our new TP implies FY18F P/B of 1.08x.

JCI Index



Foreign net buy (sell)



Key Indexes

Index	Closing	1 day	1 year	YTD
JCI	5,807	-0.3%	10.8%	9.6%
LQ45	972	-0.4%	7.3%	9.9%
DJI	21,641	0.3%	16.4%	9.5%
SET	1,576	0.3%	4.4%	2.1%
HSI	26,672	0.6%	21.9%	21.2%
NKY	20,021	0.1%	20.0%	4.8%
FTSE	7,431	0.6%	10.4%	4.0%
FSSTI	3,325	0.6%	12.9%	15.4%
EIDO	27	0.0%	5.7%	12.3%

Commodity price

Commodities	Last price	Ret 1 day	Ret 1 year
(in USD)			
Oil/barrel (WTI)	47.1	1.6%	5.5%
CPO/tonne	589.1	0.5%	9.6%
Soy/bushel	9.7	1.0%	-6.6%
Rubber/kg	1.8	-0.7%	-5.2%
Nickel/tonne	9,602	-1.4%	-8.8%
Tins/tonne	20,255	0.8%	14.6%
Copper/tonne	5,930	-0.7%	19.4%
Gold/try-oz (Spot)	1,241	-0.2%	-5.7%
Coal/tonne	85.9	0.4%	40.9%
Corn/bushel	3.6	1.4%	7.3%
Wheat/bushel*	146.5	5.8%	-7.0%

*: 1 month change

Source : Bloomberg

Year To 31 Dec	2015A	2016A	2017F	2018F	2019F
Revenue (US\$Mn)	790	584	629	699	717
EBITDA (US\$Mn)	228	145	156	213	196
EBITDA Growth (%)	(44.9)	(36.2)	7.6	36.1	(7.9)
Net Profit (US\$Mn)	51	2	13	56	46
EPS (US\$Cents)	0.5	0.0	0.1	0.6	0.5
EPS Growth (%)	(70.7)	(96.2)	566.8	337.2	(18.0)
Net Gearing (%)	(2.7)	(4.1)	(13.7)	(17.2)	(20.8)
PER (x)	31.5	834.3	125.1	28.6	34.9
PBV (x)	0.9	0.9	0.9	0.8	0.8
Dividend Yield (%)	0.0	0.0	0.0	0.0	0.0
EV/EBITDA (x)	6.8	10.4	8.5	5.9	6.0

Source: INCO, IndoPremier

Share Price Closing as of : 19 July 2017

Refer to Important disclosures in the last page of this report

Bank Mandiri (BMRI IJ; Buy)

Strong profit recovery

- **1H17 profit up 34% yoy (2Q: +32% qoq) as new NPLs have peaked**
- **Core profit grew a robust 11% despite lower NIMs (-31bps yoy)**
- **New NPL formation dropped to 1% in 2Q (1Q: 2.3%; 4Q: 5.9%)**
- **Maintain Buy with new TP of Rp15,500 (from Rp13,500)**

Strong results. BMRI reported net profit of Rp9.5tn in 1H17 (+34% yoy), which is above market expectation, with profits of Rp5.4tn in 2Q (1Q: Rp4.1tn) forming 28%/21% of FY17F consensus (Rp19.4n) as the strong profit recovery is likely to be sustained in the next 2 quarters given declining new NPLs. In 2Q, credit cost fell to 244bps (1Q: 347bps). Key drivers of the strong 1H results were: 1) loan growth of 12%, which was offset by lower NIM (-31bps); 2) strong NPL recovery income (+39%); restrained operating cost growth (+2.7%); 4) lower loan provisions (-5.6%). Meanwhile, core profit (PPOP) grew by 11% with ROAA/ROAE improving to 2.05%/14.1% in 2Q, from 1.57%/10.9% in 1Q.

Lower NIMs. NIM declined to 5.68% in 1H (our calculation) but stable in 2Q vs. 1Q, due to lower loan yields (-70bps) despite stable cost of funds. Going forward, we expect NIMs to remain stable as pressures to cut lending rates are diminishing (according to management) while the bank's higher-margin subsidiaries (eg. BSM, Bank Mantap) grew their loans faster than parent bank. However, we expect NIMs to be much lower vs. 2H16, which was boosted by one-off interest incomes from NPL restructuring.

Asset quality. Although BMRI's NPL ratio remained elevated at 3.8% in 2Q, more importantly its new NPLs dropped to 0.96% in 2Q, from 2.33% in 1Q (4Q: 4.34%) with improvements across nearly all of its loan segments in 2Q vs. 1Q: corporate (0.27%/0%); commercial (2.18%/4.49%); small loans (1.96%/5.05%); micro (0.64%/4.16%); consumer (0.25%/1.71%). This was in contrast to BBNI, which saw higher new NPLs in 2Q vs. prior 2 quarters. Management expects lower NPL downgrades of Rp2.5-3.0tn in 2H (1H: Rp4.9tn), largely from its small loans to reflect more conservative NPL recognition policy based on 3-pillars (from 1-pillar), which BMRI has previously implemented for its corporate/commercial loans. The bank also expects its provisions/NPL coverage to rise >140% to anticipate change in accounting policy (IFRS9) although the impact is not likely to be material.

Valuation. We raise our TP to Rp15,500 (from Rp13,500) due to our 50bps lower cost of equity assumption on the back of declining bond yields in Indonesia. Our TP is based on our GGM-derived target FY17F P/B of 2.18x assuming LT ROAE of 16.6%, growth of 9%, cost of equity of 12.5% (from 13%). We estimate BMRI's LT ROAE based on DuPont analysis, assuming LT ROAA of 2.08% and asset/equity leverage of 8x. BMRI remains our top sector picks (with BBTN). Reiterate BUY.

Year To 31 Dec	2015A	2016A	2017F	2018F	2019F
Operating income (RpBn)	63,706	70,824	73,965	81,038	90,714
PPOP (RpBn)	34,951	39,556	40,024	43,785	49,552
Net profit (RpBn)	20,335	13,807	20,459	26,262	29,399
Net profit growth (%)	2.3	(32.1)	48.2	28.4	11.9
FD EPS (Rp)	871	592	877	1,126	1,260
P/E (x)	15.3	22.5	15.2	11.8	10.6
P/B (x)	2.6	2.0	1.8	1.6	1.4
Dividend yield (%)	2.0	2.0	2.0	2.5	2.8
ROAA (%)	2.3	1.4	1.9	2.2	2.3
ROAE (%)	19.0	10.5	13.0	14.7	14.2

Source: BMRI, IndoPremier

Share Price Closing as of : 19-July-2017

News & Analysis

Corporates

PPRO: PT PP Properti (PPRO IJ; Rp2,960; Not Rated) will launch two new projects in 2H17. The first new project will be five apartment towers in Bandung and second in Surabaya. Note that company has purchased 2.4ha land in Surabaya. (Bisnis Indonesia)

Markets & Sector

Construction sector: Commission VI from Indonesia House of Representative (DPR) agreed to allocate state equity (PMN) to PT Kereta Api Indonesia worth of Rp4tn. The company is then expected to seek funding of Rp18.9tn to fund LRT. However, commission VI requested PT KAI to frequently report the use of the proceeds to DPR. (Bisnis Indonesia)

Comment: This is positive for Adhi Karya (ADHI IJ; Rp1,955; Buy) as LRT contractor given ADHI will receive the payment from PT KAI, although company doesn't know the schedule or the terms yet. Another crucial element is for PT KAI to seek bank loan with appropriate interest rate. At the meantime, maintain BUY on ADHI with TP of Rp2,500.

Mining sector: Coal price in China domestic market remained strong, reaching CNY581 per ton (US\$86) on the back of a short-term supply shortage, economic recovery, a hydropower shortage and a cut in oversupply, according to the statement of the nation's top economic planner. Demand also temporary improve, pushed by higher electricity demand for air conditioning in Northern part of China which struck by heat wave. (Shanghai Daily)

Comment: We expect positive sentiment for coal counters in our coverage, we reiterate our Buy rating for ADRO (TP: 2,200), UNTR (TP: 32,000) and PTBA (TP: 14,000).

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INVESTMENT RATINGS

BUY : Expected total return of 10% or more within a 12-month period
HOLD : Expected total return between -10% and 10% within a 12-month period
SELL : Expected total return of -10% or worse within a 12-month period

ANALYSTS CERTIFICATION.

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