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Nickel Mines Ltd (NIC)

Clear path to growth

Recommendation

Buy (unchanged)

Price

\$0.435

Valuation

\$0.95 (previously \$0.72)

Risk

Speculative

GICS Sector

Materials

Expected Return

Capital growth	118.4%
Dividend yield	0.0%
Total expected return	118.4%

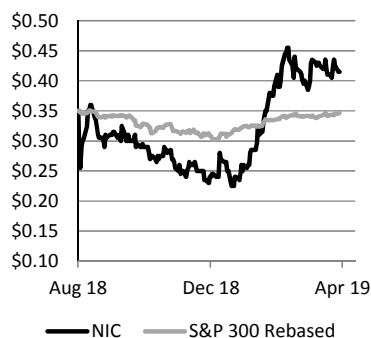
Company Data & Ratios

Enterprise value	\$583.0m
Market cap	\$603.8m
Issued capital	1,388.0m
Free float	55%
Avg. daily val. (52wk)	\$424,000
12 month price range	\$0.22-\$0.46

Price Performance

	(1m)	(3m)	(12m)
Price (A\$)	0.40	0.23	
Absolute (%)	3.8	84.4	
Rel market (%)	1.8	75.6	

Absolute Price



SOURCE: IRESS

Moving to 60% of the Ranger NPI lines

NIC has announced its intention to increase its current 17% interest in the Ranger Nickel Pig Iron (NPI) production lines to a 60% interest. The decision has been made in conjunction with NIC's operating partner, Shanghai Decent Investments (SDI) and in keeping with the terms of the Collaboration Agreement (CA), announced in November 2018. Under the terms of the CA, NIC has until 31 December 2019 to increase its ownership of the Ranger lines to between 51% and 60%. If this is executed within 60 days of first NPI production, NIC's increased interest will be calculated based on a discounted pro-rata valuation of US\$280m (i.e. US\$121.4m for the additional 43%).

Proposed US\$160m funding package, US\$20m available

A total potential funding package of US\$160m has been outlined by NIC, comprising a US\$100m senior secured debt facility and US\$40m consideration to SDI to be paid in NIC shares. This will leave just US\$20m to be placed to a selection of current and/or new professional investors.

Investment thesis – Speculative Buy, valuation \$0.95/sh

In our view this is a very strong, positive catalyst for NIC. It has been our perception that one overhang on the share price has been the means of funding NIC's expansion. Now, a clear plan has been laid out for the execution of NIC's growth path, which demonstrates strong support from SDI and requires only a modest contribution from the equity market. It also reinforces our view that this is a good value accretive transaction: Our FY20 earnings are up 44% to US\$136m (from US\$95m), FY20 EPS is up 28% (post new-equity basis) for 3.7x forward P/E, and our NPV-based target price is up 32% to \$0.95/sh. Attributable Ni in NPI production is up 56% to 19.8ktpa (from 12.7ktpa) at nameplate capacity, making NIC competitive with the established ASX-listed nickel producers. We also applaud that this deal has been brought forward, as it maximises NIC's exposure to the Ranger lines' future cash flows. NIC remains one of our top picks and we reiterate our Speculative Buy recommendation.

Earnings Forecast

Year end 30 June	2018a	2019e	2020e	2021e
Sales (A\$m)	14	24	516	576
EBITDA (A\$m)	(2)	5	254	288
NPAT (reported) (A\$m)	(3)	(7)	136	157
NPAT (adjusted) (A\$m)	(3)	(7)	136	157
EPS (adjusted) (cps)	(0.9)	(0.8)	11.7	11.8
EPS growth (%)	nm	nm	nm	1%
PER (x)	nm	nm	3.7	3.7
FCF Yield (%)	-39%	-35%	27%	48%
EV/EBITDA (x)	(269.7)	77.8	1.7	1.5
Dividend (cps)	-	-	-	-
Yield (%)	0%	0%	0%	0%
Franking (%)	0%	0%	0%	0%
ROE (%)	-8%	-4%	68%	54%

SOURCE: BELL POTTER SECURITIES ESTIMATES

Clear path to growth

Moving to 60% of the Ranger NPI lines

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Under the terms of the CA, NIC has until 31 December 2019 to increase its ownership of the Ranger lines to between 51% and 60%. If this is executed within 60 days of first NPI production, NIC's increased interest will be calculated based on a discounted pro-rata valuation of US\$280m (i.e. US\$121.4m for the additional 43%). Details of the key terms of the CA are summarised in Note 1, at the end of our report.

Proposed US\$160m funding package, US\$20m available

A total potential funding package of US\$160m has been outlined by NIC, comprising a US\$100m senior secured debt facility and US\$40m consideration to SDI to be paid in NIC shares. This will leave just US\$20m to be placed to a selection of current and/or new professional investors.

Details of the planned package are summarised below:

US\$100m senior secured debt with Sprott Private Resource Lending II L.P.

- 5 year term;
- Repayment – 15 equal quarterly payments starting 30 November 2020;
- Interest rate – LIBOR plus 7.00% and a 2.00% original issue discount; and
- The issue of 45m warrants, each for one fully paid ordinary share within 5 years at a strike price equal to a 25% premium to the 20 day VWAP of the lesser of NIC's current share price or at the closing of the facility.

US\$60m equity placement

- SDI has committed to accept US\$40m of NIC shares as partial consideration for NIC's increased interest in the Ranger RKEF lines.;
- US\$20m to be placed to a selection of current and/or new professional investors;
- Pricing to be determined. For the purposes of our modelling assumptions we have taken the current price of \$0.43/sh.
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New equity

Under our assumptions of a \$0.43/sh placement price and AUD:USD exchange rate of 0.72, a total of 193.8m new shares would be issued, of which 129.2m would be issued to SDI, lifting their shareholding to 289.6m shares in NIC and 18.3% of issued capital.

Changes to our forecasts

Following the update regarding the planned acquisition and funding, we make the following changes to our modelled assumptions:

- Assume that the US\$60m equity component is raised during the current June quarter 2019. For the purposes of our modelling we have assumed the current market price of A\$0.43/sh and a AUD:USD exchange rate of 0.72;
- Assume that the US\$100.0m debt facility is drawn down in the September quarter of 2019 and repaid in 15 equal, quarterly instalments of US\$6.67m from November 2020 through to May 2024. We have assumed that interest payments are paid quarterly, in arrears following drawdown of the facility;
- Added the Sprott warrants (assuming a 25% premium to a 40cps VWAP); and
- Updated for our latest commodity price and exchange rate assumptions.

The resulting changes to our forecasts and valuation are summarised in the table below:

Table 1 - Changes to our FY forecasts									
Year end 30 June	Previous			New			Change		
	Jun-19	Jun-20	Jun-21	Jun-19	Jun-20	Jun-21	Jun-19	Jun-20	Jun-21
Prices & currency									
Nickel price (US\$/lb)	6.08	7.15	7.45	5.83	7.15	7.45	-4%	0%	0%
Nickel price (US\$/t)	13,411	15,763	16,424	12,859	15,763	16,424	-4%	0%	0%
US\$/A\$	0.73	0.75	0.75	0.72	0.74	0.75	-1%	-2%	0%
Production & costs									
Ore mined (Mt)	610,516	1,460,242	1,564,545	610,516	1,460,242	1,564,545	0%	0%	0%
Nickel in ore	7,277	16,559	17,742	7,277	16,559	17,742	0%	0%	0%
Nickel in ore (attributable)	5,821	11,591	11,177	5,821	11,591	11,177	0%	0%	0%
RKEF NPI production	12,500	280,000	300,000	12,500	280,000	300,000	0%	0%	0%
Contained nickel	1,375	30,800	33,000	1,375	30,800	33,000	0%	0%	0%
Contained nickel (attributable)	529	11,858	12,705	529	18,480	19,800	0%	56%	56%
Cash costs (US\$/t Ni)	-	7,805	7,974	-	7,805	7,974	na	0%	0%
AISC (US\$/t Ni)	-	7,856	8,023	-	7,856	8,023	na	0%	0%
Earnings									
Revenue (attributable, US\$m)	21	211	233	21	314	347	-2%	48%	49%
EBITDA (attributable, US\$m)	5	101	114	5	153	173	-9%	51%	52%
NPAT (reported, attributable, US\$m)	(3)	95	110	(7)	136	157	na	44%	43%
EPS (reported) (Acps)	(0)	9	11	(1)	12	12	na	28%	12%
PER (x)	(117.3)	4.8	4.1	(52.4)	3.7	3.7	64.9	(1.0)	(0.4)
EPS growth (%)	nm	nm	15%	nm	nm	1%	nm	nm	-15%
DPS (Acps)	-	-	-	-	-	-	na	na	na
Yield	0%	0%	0%	0%	0%	0%	0%	0%	0%
NPV (A\$/sh)	0.60	0.72	0.97	0.81	0.95	1.20	34%	31%	24%
Price Target (A\$/sh)		0.72			0.95			32%	

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Incorporating our modelled assumptions for the proposed acquisition and its funding lifts our forecast FY20 and FY21 earnings 44% and 43% respectively to US\$136m and US\$157m respectively. Our NPV-based, 12-month forward valuation is up 32% to A\$0.95/sh.

We point out our NPV-based valuation of the asset has increased by A\$498m, net of the A\$168m investment and by 23cps on a post-deal basis, i.e. diluted for the additional equity.

Upcoming catalysts

Upcoming catalysts for NIC include:

- Further updates on the progress of construction and commissioning of the Hengjaya and Ranger RKEF lines, possibly reporting first production from the Ranger lines by end April 2019;
- The March quarter production and cost report in April 2019;
- Updates on the funding to acquire the remaining optioned interests in the Hengjaya and Ranger RKEF lines.
- The targeted ramp-up to 80% of nameplate production for both the Hengjaya lines during May 2019;
- The targeted ramp-up to 80% of nameplate production for both the Ranger lines around the end of the September quarter 2019; and

Note 1: Ranger Collaboration Agreement key terms

NIC holds options to increase its interest to up to 80% of the Ranger Lines as follows:

The Second Acquisition Option:

Provides for NIC to increase its interest to between 51% and 60% before 31 December 2019, potentially at a discounted rate of US\$280m on a pro-rata basis. The lower acquisition cost will be payable if it is completed within 60 days of the first batch of nickel pig iron (NPI) being produced from the Ranger Nickel RKEF lines. If it is completed more than 60 days after the first batch of NPI is produced, the additional percentage acquired will be calculated based on a pro-rata valuation of US\$300m.

The Third Acquisition Option (conditional on completion of the Second Acquisition Option):

Provides for NIC to increase its interest to up to 80% in the Ranger Nickel RKEF lines within 18 months of the first batch of NPI being produced. This will be based on a pro-rata valuation of US\$300m.

Nickel Mines Limited (NIC)

Company description: high grade, steady state producer

Nickel Mines Limited ('Nickel Mines' or 'NIC') is a newly listed ASX company, formed in 2007. Its operations are focused in Central Sulawesi, Indonesia, where it holds a 60% interest two Rotary Kiln Electric Furnace (RKEF) lines with Shanghai Decent Investments (SDI) a subsidiary of Tsingshan Group, the world's largest stainless steel producer. The RKEF lines are located in an existing, fully integrated stainless steel production facility, the Indonesian Morowali Industrial Park (IMIP), in Central Sulawesi, Indonesia. Construction of the NIC's two RKEF lines is advanced and commissioning on track for the end of the June quarter 2019, after which production is planned to ramp up to a targeted run-rate of 16ktpa nickel in NPI (100% basis).

NIC also holds an 80% interest in Hengjaya Mine ('HM'), a high-grade, long-life nickel laterite deposit, also in Central Sulawesi in close proximity to the IMIP. The balance of the asset is owned by NIC's local Indonesian partner. The HM produces Direct Shipping Ore (DSO), the bulk of which is sold into the IMIP facility for the production of Nickel Pig Iron (NPI), a key input into stainless steel production.

Investment thesis – Speculative Buy, valuation \$0.95/sh

In our view this is a very strong, positive catalyst for NIC. It has been our perception that one overhang on the share price has been the means of funding NIC's expansion. Now, a clear plan has been laid out for the execution of NIC's growth path, which demonstrates strong support from SDI and requires only a modest contribution from the equity market. It also reinforces our view that this is a good value accretive transaction: Our FY20 earnings are up 44% to US\$136m (from US\$95m), FY20 EPS is up 28% (post new-equity basis), and our NPV-based target price is up 32% to \$0.95/sh. Attributable Ni in NPI production is also up 56% to 19.8ktpa at nameplate capacity (from 12.7ktpa) making NIC competitive with the established ASX-listed nickel producers. We also applaud that this deal has been brought forward, as it maximises NIC's exposure to the Ranger lines' future cash flows. NIC remains one of our top picks and we reiterate our Speculative Buy recommendation.

Valuation: \$0.95/sh

Our 12-month forward NIC valuation incorporates DCF models of its attributable interests in the Hengjaya laterite nickel ore mine (HM), a 60% interest in the two Hengjaya Nickel RKEF lines and a 60% interest in the two Ranger Nickel RKEF lines. We have constructed a discounted cash flow (DCF) model for NIC's attributable interest in these RKEF lines that are under construction at Tsingshan's IMIP facility and a DCF calculation for NIC's current 80% interest (declining to 49% from FY2023) in the Hengjaya laterite nickel ore mine. We also include a notional value for exploration and development projects, an estimate of corporate overhead costs and NIC's last reported net debt position. Our valuation is calculated on a fully diluted basis. Following the latest update, our valuation stands at \$0.95/sh.

Risks

Key risks to our investment case include (but are not limited to):

- **Funding and capital management risks:** Funding and capital management risks can include access to debt and equity finance, maintaining covenants on debt finance, managing dividend payments and managing debt repayments. Exploration and development companies with no sales revenues are reliant on access to equity markets and debt financing to fund the advancement and development of their projects.
- **Operating and development risks:** Mining companies' assets are subject to risks associated with their operation and development. Risks for each company can be heightened depending on method of operation (e.g. underground versus open pit mining) or whether it is a single mine company. Development of mining assets may be subject to receiving permits, approvals timelines or weather events, causing delays to commissioning and commercial production.
- **Operating and capital cost fluctuations:** The cost and availability of exploration, development and mining inputs can fluctuate widely and cause significant differences between planned and actual operating and capital costs. Key operating costs are linked to energy and labour costs as well as access to, and availability of, technical skills, operating equipment and consumables.
- **Commodity price and exchange rate fluctuations:** The future earnings and valuations of exploration, development and producing Resources companies are subject to fluctuations in underlying commodity prices and foreign currency exchange rates.
- **Resource growth and mine life extensions:** The viability of future operations and the earnings forecasts and valuations reliant upon them may depend upon resource and reserve growth to extend mine lives, which is in turn dependent upon exploration success, of which there are no guarantees.
- **Regulatory changes risks:** Changes to the regulation of infrastructure and taxation (among other things) can impact the earnings and valuation of mining companies. NIC's assets are located in Sulawesi, Indonesia, which has in the past implemented regulatory changes related to mining project ownership, fiscal terms and mineral export requirements.
- **Sovereign risks:** Mining companies' assets are subject to the sovereign risks of the jurisdiction within which they are operating. NIC's assets are in Indonesia, a G20 country with one of the largest economies in SE Asia. Its sovereign debt is rated investment grade by the major ratings agencies.
- **Corporate/M&A risks:** Risks associated with M&A activity including differences between the entity's and the market's perception of value associated with completed transactions. NIC is the junior partner co-investing in production assets with a large, privately owned Chinese company. The strength and cohesiveness of this relationship over the long term has the potential to both add and reduce value to the partnership. One of the key mitigating factors in this respect has been the investment of a combined US\$50m by SDI and Wanlu Investments (US\$26m and US\$24m respectively) into NIC equity.

Table 2 - Financial summary

PROFIT AND LOSS						FINANCIAL RATIOS							
Year ending 30 June	Unit	2017a	2018a	2019e	2020e	2021e	Year ending 30 June	Unit	2017a	2018a	2019e	2020e	2021e
Revenue	US\$m	8.6	13.6	24.0	516.3	575.6	VALUATION						
Expense	US\$m	(11.9)	(15.1)	(18.6)	(262.7)	(287.8)	Attributable NPAT	US\$m	(3.8)	(3.3)	(6.5)	136.4	157.1
EBITDA	US\$m	(3.3)	(1.6)	5.4	253.7	287.8	Attributable NPAT	A\$m	(5.1)	(4.4)	(9.1)	184.3	209.5
Depreciation	US\$m	(0.1)	(0.1)	(1.2)	(14.9)	(16.0)	Reported EPS	Ac/sh	(1.6)	(0.9)	(0.8)	11.7	11.8
EBIT	US\$m	(3.4)	(1.6)	4.2	238.8	271.9	Adjusted EPS	Ac/sh	(1.6)	(0.9)	(0.8)	11.7	11.8
Net interest expense	US\$m	(0.5)	(0.7)	0.0	(5.2)	(3.5)	EPS growth	%	nm	nm	nm	nm	1%
Unrealised gains (Impairments)	US\$m	-	-	-	-	-	PER	x	nm	nm	nm	nm	3.7x
Other	US\$m	-	-	(10.3)	-	-	DPS	Ac/sh	-	-	-	-	-
PBT	US\$m	(3.9)	(2.3)	(6.1)	233.6	268.3	Franking	%	0%	0%	0%	0%	0%
Tax expense	US\$m	0.2	(0.7)	-	(3.2)	(3.5)	Yield	%	0%	0%	0%	0%	0%
Comprehensive loss for the year	US\$m	(3.7)	(2.9)	(6.1)	230.4	264.8	FCF/share	Ac/sh	(0.0)	(16.9)	(15.4)	11.6	20.9
Non-Controlling Interest	US\$m	0.1	0.4	(0.4)	(94.0)	(107.7)	FCF yield	%	0%	-39%	-35%	27%	48%
Attributable NPAT (reported)	US\$m	(3.8)	(3.3)	(6.5)	136.4	157.1	P/FCFPS	x	-3900.5x	-2.6x	-2.8x	3.7x	2.1x
NPAT (underlying)	US\$m	(3.8)	(3.3)	(6.5)	136.4	157.1	EV/EBITDA	x	-126.2x	-269.7x	77.8x	1.7x	1.5x
							EBITDA margin	%	nm	nm	22%	49%	50%
							EBIT margin	%	nm	nm	17%	46%	47%
							Return on assets	%	-27%	-5%	-3%	53%	40%
							Return on equity	%	2029%	-8%	-4%	68%	54%
							LIQUIDITY & LEVERAGE						
							Net debt (cash)	\$m	-	-	(76)	(120)	(295)
							ND / E	%	0%	0%	-28%	-29%	-52%
							ND / (ND + E)	%	0%	0%	-38%	-42%	-108%
							EBITDA / Interest	x	-6.1x	-2.4x	nm	48.5x	81.8x
							ATTRIBUTABLE DATA - NICKEL MINES LTD						
							Year ending 30 June	Unit	2017a	2018a	2019e	2020e	2021e
							Revenues	US\$m	6.9	10.8	20.7	313.8	346.7
							EBITDA	US\$m	(2.7)	(1.2)	4.7	153.0	172.5
							NPAT	US\$m	(3.8)	(3.3)	(6.5)	136.4	157.1
							Net distributable cash flow	US\$m	0.1	0.0	67.5	129.9	139.0
							EV/EBITDA	x	nm	nm	89.8	2.7	2.4
							PER	x	nm	nm	nm	3.3	2.9
							P/FCF	x	nm	nm	nm	3.4	3.3
							ORE RESERVE AND MINERAL RESOURCE						
							Hengjaya Nickel Mine (HM)				Mdmt	% Ni	kt Ni
							Mineral Resources						
							Measured				0.700	1.80%	12,600
							Indicated				15,000	1.90%	285,000
							Inferred				22,000	1.80%	396,000
							Total				38,000	1.80%	678,000
							ASSUMPTIONS - Prices						
							Year ending 30 June avg	Unit	2017a	2018a	2019e	2020e	2021e
							Nickel	US\$/lb	\$4.60	\$5.65	\$5.83	\$7.15	\$7.45
							Nickel	US\$/t	\$10,141	\$12,456	\$12,859	\$15,763	\$16,424
							Currency						
							AUD:USD		0.75	0.78	0.72	0.74	0.75
							ASSUMPTIONS - Production & costs						
							Year ending 30 June	Unit	2017a	2018a	2019e	2020e	2021e
							Hengjaya Mine						
							Ore mined	wmt	303,597	391,362	610,516	1,460,242	1,564,545
							Ore grade	% Ni	2.1%	2.1%	1.9%	1.8%	1.8%
							Nickel in ore	t Ni	6,254	8,062	7,277	16,559	17,742
							Nickel in ore (attributable)	t Ni	5,003	6,450	5,821	11,591	11,177
							RKEF (IMIP)						
							NPI production	t	-	-	12,500	280,000	300,000
							Contained nickel	t Ni	-	-	1,375	30,800	33,000
							Contained nickel (attributable)	t Ni	-	-	529	18,480	19,800
							Costs						
							Cash costs	US\$/t Ni	-	-	-	\$7,805	\$7,974
							All-in-Sustaining-Costs (AISC)	US\$/t Ni	-	-	-	\$7,856	\$8,023
							VALUATION						
							Ordinary shares (m)						1,581.8
							Options in the money (m)						-
							Total shares diluted (m)						1,581.8
							Share price	A\$/sh					0.435
							Market capitalisation	A\$m					603.8
							Net cash	A\$m					20.8
							Enterprise value (undiluted)	A\$m					583.0
							Options outstanding (m)	m	(wid avg ex. price \$0.50 per share)				45.0
							Options (in the money)	m					0.0
							Issued shares (diluted for options)	m					1,581.8
							Market capitalisation (diluted)	A\$m					688.1
							Net cash + options	A\$m					20.8
							Enterprise value (diluted)	A\$m					667.3
							MAJOR SHAREHOLDERS						
							Shareholder	%					m
							Directors and Management		12.0%				189.8
							Shanghai Decent (SDI)		10.2%				161.7
							Shanghai Wanlu		9.4%				149.3
							BlackRock Investment Management		8.7%				137.9
							Regal FM		4.5%				71.0

SOURCE: BELL POTTER SECURITIES ESTIMATES

Recommendation structure

Buy: Expect >15% total return on a 12 month view. For stocks regarded as 'Speculative' a return of >30% is expected.

Hold: Expect total return between -5% and 15% on a 12 month view

Sell: Expect <-5% total return on a 12 month view

Speculative Investments are either start-up enterprises with nil or only prospective operations or recently commenced operations with only forecast cash flows, or companies that have commenced operations or have been in operation for some time but have only forecast cash flows and/or a stressed balance sheet.

Such investments may carry an exceptionally high level of capital risk and volatility of returns.

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