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Nickel Mines Ltd (NIC)

Funding package finalised

Recommendation

Buy (unchanged)

Price

\$0.42

Valuation

\$0.93 (previously \$0.95)

Risk

Speculative

GICS Sector

Materials

Expected Return

Capital growth	121.4%
Dividend yield	0.0%
Total expected return	121.4%

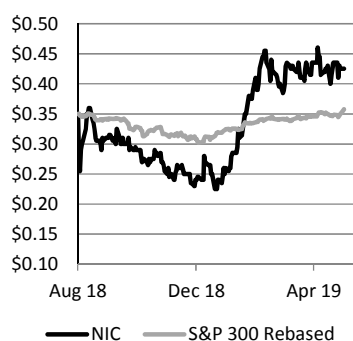
Company Data & Ratios

Enterprise value	\$562.2m
Market cap	\$583.0m
Issued capital	1,388.0m
Free float	55%
Avg. daily val. (52wk)	\$0.465
12 month price range	\$0.22

Price Performance

	(1m)	(3m)	(12m)
Price (A\$)	0.42	0.38	
Absolute (%)	2.4	13.3	
Rel market (%)	-0.7	6.7	

Absolute Price



SOURCE: IRESS

A little less debt, a little more equity

NIC has announced it has signed a binding debt Term Sheet and commitment letter with Decent Investment International (Decent), an associate of NIC's operating partner Shanghai Decent Investment (SDI). The proposed funding package totals US\$150m and comprises a debt facility with Decent of US\$80m and planned equity of US\$70m. The equity component includes US\$40m of NIC shares to be issued as partial consideration for the 43% interest in the Ranger Nickel Project, which will lift NIC's interest from 17% to 60%. The remaining US\$30m is planned to be raised as fresh equity from current and/or new professional investors. NIC has previously stated it is targeting the completion of the acquisition by end June 2019.

Mate's rates

This represents a tweaking of the funding package initially proposed in April 2019: The total size of the package has been reduced from US\$160m to US\$150m, including reduction of the debt component from US\$100m to US\$80m and it now being provided by Decent, as opposed to Sprott Private Resource Lending. Decent has offered a lower interest rate (LIBOR + 6%) vs Sprott (LIBOR + 7% + 2% fee + 45m warrants), which, in our view, justifies the change. The trade-off has been a higher equity component, now US\$70m (vs US\$60m) and incrementally more dilution. On our assumptions, SDI's shareholding in NIC would increase to ~18% following the raise.

Investment thesis – Speculative Buy, valuation \$0.93/sh

SDI has effectively gazumped the debt facility previously offered by Sprott. Overall this is a simpler, cheaper package and NIC management also has fewer stakeholders to satisfy. While this does result in minor dilution of our valuation, from \$0.95 to \$0.93, we point out that the 32m more shares we assume to be issued due to the larger equity component, is fewer than the 45m warrants to be issued to Sprott (which we had not modelled). This development further de-risks NIC's growth plans and we continue to rate NIC as our top pick in the sector.

Earnings Forecast

Year ending 30 June	2018a	2019e	2020e	2021e
Sales (US\$m, consolidated)	14	39	516	576
EBITDA (US\$m)	(2)	11	254	288
Attributable NPAT (reported) (US\$m)	(3)	(2)	139	160
Attributable NPAT (adjusted) (US\$m)	(3)	(2)	139	160
EPS (adjusted) (Aeps)	(0.9)	(0.2)	12.5	13.2
EPS growth (%)	nm	nm	nm	5%
PER (x)	nm	nm	3.4	3.2
FCF Yield (%)	-40%	-35%	29%	55%
EV/EBITDA (x)	(248.7)	34.7	1.5	1.3
Dividend (Aeps)	-	-	-	-
Yield (%)	0%	0%	0%	0%
Franking (%)	0%	0%	0%	0%
ROE (%)	-8%	-1%	65%	53%

SOURCE: BELL POTTER SECURITIES ESTIMATES

Funding package finalised

Changes to our forecasts

In reflecting the updated funding proposal, we make the following changes to our modelled assumptions:

- Lower our debt drawdown from US\$100m to US\$80m with a commensurate adjustment to our principal repayment schedule (instalments reduced from US\$6.7m per quarter to US\$5.3m per quarter, over 15 quarters commencing in November 2020);
- Lower our assumed interest rate from 9.5% to 8.5%; and
- Increased our equity component from US\$60m to US\$70m, resulting in an additional 2% dilution on our assumptions of a \$0.43/sh raising price and AUD:USD exchange rate of 0.72.

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)	5.83	7.15	7.45	5.83	7.15	7.45	0%	0%	0%
Nickel price (US\$/t)	12,859	15,763	16,424	12,859	15,763	16,424	0%	0%	0%
US\$/A\$	0.72	0.74	0.75	0.72	0.74	0.75	0%	0%	0%
Production & costs									
Ore mined (Mt)	668,624	1,460,242	1,564,545	668,624	1,460,242	1,564,545	0%	0%	0%
Nickel in ore	8,044	16,559	17,742	8,044	16,559	17,742	0%	0%	0%
Nickel in ore (attributable)	6,435	11,591	11,177	6,435	11,591	11,177	0%	0%	0%
RKEF NPI production	33,372	280,000	300,000	33,372	280,000	300,000	0%	0%	0%
Contained nickel	3,840	30,800	33,000	3,840	30,800	33,000	0%	0%	0%
Contained nickel (attributable)	1,478	18,480	19,800	1,478	18,480	19,800	0%	0%	0%
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)	35	314	347	35	314	347	0%	0%	0%
EBITDA (attributable, US\$m)	10	153	173	10	153	173	0%	0%	0%
NPAT (reported, attributable, US\$m)	(1)	137	157	(2)	139	160	na	2%	2%
EPS (reported) (Acps)	(0)	12	13	(0)	13	13	na	1%	-1%
PER (x)	(259.9)	3.4	3.2	(186.6)	3.4	3.2	73.3	(0.0)	0.0
EPS growth (%)	nm	nm	1%	nm	nm	5%	nm	nm	4%
DPS (Acps)	-	-	-	-	-	-	na	na	na
Yield	0%	0%	0%	0%	0%	0%	0%	0%	0%
NPV (A\$/sh)	0.81	0.95	1.20	0.80	0.93	1.19	-2%	-2%	-1%
Price Target (A\$/sh)		0.95			0.93			-2%	

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Revenues and EBITDA are unchanged, but the lower interest charges result in a 2% increase to NPAT over the forecast period. With the additional equity EPS are diluted, up 1% in FY20 (before repayments commence) and down 1% in FY21 (after repayments commence).

Our NPV-based, 12-month forward valuation is lowered by 2%, from \$0.95/sh to \$0.93/sh, courtesy of our Project NPV being essentially unchanged, while being incrementally diluted due to the increased share issuance.

We point out that we had previously modelled the 45m Sprott warrants with a \$0.50/sh exercise price. These were effectively out of the money and not diluted in our previous valuation. However, with a 5 year term, it is highly likely they would have been exercised at some point, with the dilutive impact dependent upon the VWAP defined exercise price.

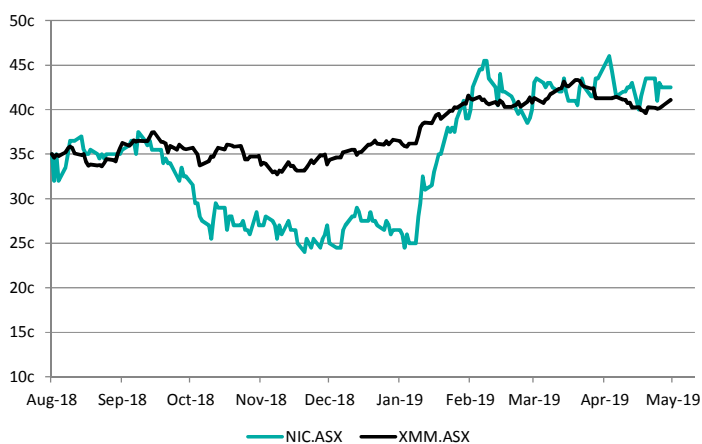
Upcoming catalysts

Upcoming catalysts for NIC include:

- Further updates on the progress of construction and commissioning of the Hengjaya and Ranger RKEF lines, likely reporting first production from the Ranger lines in May 2019 and the Hengjaya Lines reaching 100% of nameplate in the June quarter 2019;
- Updates on securing the funding to acquire the remaining optioned interests in the Hengjaya and Ranger RKEF lines;
- The June quarter production and cost report in July 2019; and
- The targeted ramp-up to 80% of nameplate production for both the Ranger lines around August 2019.

NIC vs the ASX Metals and Mining Index

Figure 1 - NIC relative share price performance vs ASX Metals and Mining Index (XMM)



SOURCE: IRESS

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 (the Hengjaya lines) and a 17% interest in a further two RKEF lines (the Ranger 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. First production from the Hengjaya Lines was achieved on 31 January 2019 and these are on track to reach nameplate production of 16ktpa nickel in NPI (100% basis) during the June quarter 2019. The Ranger Lines are planned to commence production during the June quarter 2019.

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 \$0.93/sh

SDI has effectively gazumped the debt facility previously offered by Sprott. Overall this is a simpler, cheaper package and NIC management also has fewer stakeholders to satisfy. While this does result in minor dilution of our valuation, from \$0.95 to \$0.93, we point out that the 32m more shares we assume to be issued due to the larger equity component, is fewer than the 45m warrants to be issued to Sprott (which we had not modelled). This development further de-risks NIC's growth plans and we continue to rate NIC as our top pick in the sector.

Valuation: \$0.93/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. This includes assumptions around funding of the increased interest via the proposed US\$150m package of US\$80m debt and US\$70m of new equity, with US\$40m of this accepted by SDI in consideration for NIC's acquisition of a further 43% in the Ranger Nickel project.

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 \$0.93/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						VALUATION							
Revenue	US\$m	8.6	13.6	39.1	516.3	575.6	Attributable NPAT	US\$m	(3.8)	(3.3)	(1.8)	138.9	159.6
Expense	US\$m	(11.9)	(15.1)	(27.9)	(262.7)	(287.8)	Attributable NPAT	A\$m	(5.1)	(4.4)	(2.5)	187.7	212.8
EBITDA	US\$m	(3.3)	(1.6)	11.1	253.7	287.8	Reported EPS	Ac/sh	(1.6)	(0.9)	(0.2)	12.5	13.2
Depreciation	US\$m	(0.1)	(0.1)	(1.7)	(14.9)	(15.9)	Adjusted EPS	Ac/sh	(1.6)	(0.9)	(0.2)	12.5	13.2
EBIT	US\$m	(3.4)	(1.6)	9.4	238.8	271.9	EPS growth	%	nm	nm	nm	nm	5%
Net interest expense	US\$m	(0.5)	(0.7)	0.0	(2.8)	(1.0)	PER	x	nm	nm	nm	3.4x	3.2x
Unrealised gains (Impairments)	US\$m	-	-	-	-	-	DPS	Ac/sh	-	-	-	-	-
Other	US\$m	-	-	(10.8)	-	-	Franking	%	0%	0%	0%	0%	0%
PBT	US\$m	(3.9)	(2.3)	(1.4)	236.0	270.9	Yield	%	0%	0%	0%	0%	0%
Tax expense	US\$m	0.2	(0.7)	-	(3.2)	(3.5)	FCF/share	Ac/sh	(0.0)	(16.9)	(14.5)	12.4	23.2
Consolidated profit (loss) for the year	US\$m	(3.7)	(2.9)	(1.4)	232.9	267.4	FCF yield	%	0%	-40%	-35%	29%	55%
Non-Controlling Interest	US\$m	0.1	0.4	(0.4)	(94.0)	(107.7)	P/FCFPS	x	-3766.0x	-2.5x	-2.9x	3.4x	1.8x
Attributable NPAT (reported)	US\$m	(3.8)	(3.3)	(1.8)	138.9	159.6	EV/EBITDA	x	-116.4x	-248.7x	34.7x	1.5x	1.3x
NPAT (underlying)	US\$m	(3.8)	(3.3)	(1.8)	138.9	159.6	EBITDA margin	%	nm	nm	29%	49%	50%
CASH FLOW						LIQUIDITY & LEVERAGE							
Year ending 30 June	Unit	2017a	2018a	2019e	2020e	2021e	Net debt (cash)	\$m	-	-	(92)	(138)	(315)
OPERATING CASHFLOW						ND / E							
Receipts	US\$m	9.1	13.5	35.6	468.6	569.7	ND / (ND + E)	%	0%	0%	-32%	-32%	-54%
Payments	US\$m	(8.8)	(21.5)	(23.8)	(204.0)	(281.5)	EBITDA / Interest	x	-6.1x	-2.4x	nm	90.6x	284.4x
Tax	US\$m	-	-	-	-	(3.2)	ATTRIBUTABLE DATA - NICKEL MINES LTD						
Net interest	US\$m	0.0	0.1	0.0	(2.8)	(1.0)	Year ending 30 June	Unit	2017a	2018a	2019e	2020e	2021e
Other	US\$m	(0.2)	(0.3)	-	-	-	Revenues	US\$m	6.9	10.8	35.3	313.8	346.7
Operating cash flow	US\$m	0.1	(8.2)	11.8	261.8	284.0	EBITDA	US\$m	(2.7)	(1.2)	10.4	153.0	172.5
INVESTING CASHFLOW						NPAT							
Property, plant and equipment	US\$m	(0.1)	(0.7)	(118.3)	(121.8)	(2.5)	Net distributable cash flow	US\$m	0.1	0.0	82.0	113.4	144.8
Mine development	US\$m	-	-	(7.6)	(2.5)	(0.4)	EV/EBITDA	x	nm	nm	37.2	2.5	2.2
Exploration & evaluation	US\$m	-	-	(0.2)	(0.4)	(0.4)	PER	x	nm	nm	nm	3.1	2.7
Other	US\$m	-	(50.0)	-	-	-	P/FCF	x	nm	nm	nm	3.8	3.0
Investing cash flow	US\$m	(0.1)	(50.7)	(126.1)	(124.7)	(3.3)	ORE RESERVE AND MINERAL RESOURCE						
Free Cash Flow	US\$m	(0.0)	(58.9)	(114.4)	137.1	280.7	Hengjaya Nickel Mine (HM)						
FINANCING CASHFLOW						Mineral Resources							
Share issues/(buy-backs)	US\$m	0.1	73.9	216.3	-	-	Measured	Mdmt	% Ni	kt Ni	0.700	1.80%	12,600
Debt proceeds	US\$m	-	-	-	80.0	-	Indicated	15,000	1.90%	285,000			
Debt repayments	US\$m	-	(13.2)	-	-	(16.0)	Inferred	22,000	1.80%	396,000			
Distributions to non-controlling interests	US\$m	-	-	-	(91.2)	(103.8)	Total	38,000	1.80%	678,000			
Dividends	US\$m	-	-	-	-	-	ASSUMPTIONS - Prices						
Other	US\$m	-	(1.8)	(10.8)	-	-	Year ending 30 June avg	Unit	2017a	2018a	2019e	2020e	2021e
Financing cash flow	US\$m	0.1	59.0	205.5	(11.2)	(119.8)	Nickel	US\$/lb	\$4.60	\$5.65	\$5.83	\$7.15	\$7.45
Change in cash	US\$m	0.1	0.0	91.1	126.0	160.9	Nickel	US\$/t	\$10,141	\$12,456	\$12,859	\$15,763	\$16,424
BALANCE SHEET						Currency							
Year ending 30 June	Unit	2017a	2018a	2019e	2020e	2021e	AUD:USD						
ASSETS						0.75 0.78 0.72 0.74 0.75							
Cash & short term investments	US\$m	0.3	0.8	91.9	217.9	378.8	ASSUMPTIONS - Production & costs						
Accounts receivable	US\$m	0.3	0.4	3.9	51.6	57.6	Year ending 30 June	Unit	2017a	2018a	2019e	2020e	2021e
Property, plant & equipment	US\$m	26.3	76.6	193.5	302.7	291.6	Hengjaya Mine						
Mine development expenditure	US\$m	-	-	7.3	7.7	5.9	Ore mined	wmt	303,597	391,362	668,624	1,460,242	1,564,545
Exploration & evaluation	US\$m	-	-	0.2	0.5	0.7	Ore grade	% Ni	2.1%	2.1%	1.9%	1.8%	1.8%
Other	US\$m	1.1	1.6	1.6	1.6	1.6	Nickel in ore	t Ni	6,254	8,062	8,044	16,559	17,742
Total assets	US\$m	27.9	79.4	298.5	582.0	736.3	Nickel in ore (attributable)	t Ni	5,003	6,450	6,435	11,591	11,177
LIABILITIES						RKEF (IMIP)							
Accounts payable	US\$m	12.3	2.9	7.0	65.7	72.0	NPI production	t	-	-	33,372	280,000	300,000
Income tax payable	US\$m	0.4	0.7	-	3.2	3.5	Contained nickel	t Ni	-	-	3,840	30,800	33,000
Borrowings	US\$m	13.5	-	-	80.0	64.0	Contained nickel (attributable)	t Ni	-	-	1,478	18,480	19,800
Other	US\$m	0.6	0.8	1.4	1.4	1.4	Costs						
Total liabilities	US\$m	26.8	4.3	8.4	150.2	140.9	Cash costs	US\$/t Ni	-	-	-	\$7,805	\$7,974
SHAREHOLDER'S EQUITY						All-in-Sustaining-Costs (AISC)							
Share capital	US\$m	26.2	103.1	319.4	319.4	319.4		US\$/t Ni	-	-	-	\$7,856	\$8,023
Reserves	US\$m	(0.6)	(0.6)	(0.6)	(0.6)	(0.6)	VALUATION						
Retained earnings	US\$m	(26.0)	(29.3)	(31.0)	107.8	267.4	Ordinary shares (m)						
Total equity	US\$m	(0.4)	73.2	287.8	426.6	586.3	Options in the money (m)						
Weighted average shares	m	316.6	461.8	1,094.2	1,497.0	1,614.1	Total shares diluted (m)						
CAPITAL STRUCTURE						1,614.1							
Shares on issue	m					1,107.7	Valuation						
Total shares on issue	m	(add 506.4m escrow and placement shares)				1,614.1	Sum-of-the-parts						
Share price	A\$/sh					0.420	RKEF (NPV12)						
Market capitalisation	A\$m					583.0	Hengjaya Mine (NPV12)						
Net cash	A\$m					20.8	Other exploration						
Enterprise value (undiluted)	A\$m					562.2	Corporate overheads						
Options outstanding (m)	m					0.0	Subtotal						
Options (in the money)	m					0.0	Net cash (debt)						
Issued shares (diluted for options)	m					1,614.1	Total (undiluted)						
Market capitalisation (diluted)	A\$m					677.9	Dilutive effect of options						
Net cash + options	A\$m					20.8	Add cash from options						
Enterprise value (diluted)	A\$m					657.1	Total (diluted)						
MAJOR SHAREHOLDERS						1,505.0 0.93							
Shareholder	%					m							
Directors and Management	11.8%					189.8							
Shanghai Decent (SDI)	10.0%					161.7							
Shanghai Wanlu	9.2%					149.3							
BlackRock Investment Management	8.5%					137.9							
Regal FM	4.4%					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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