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# Nickel Mines Limited (NIC)

## Construction ahead of schedule

### Recommendation

**Buy** (unchanged)

### Price

**\$0.295**

### Valuation

**\$0.62** (previously \$0.65)

### Risk

**Speculative**

### GICS Sector

Materials

### Expected Return

Capital growth	<b>110.2%</b>
Dividend yield	<b>0.0%</b>
Total expected return	<b>110.2%</b>

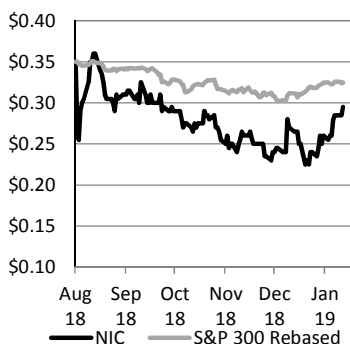
### Company Data & Ratios

Enterprise value	<b>\$388.7m</b>
Market cap	<b>\$409.5m</b>
Issued capital	<b>1,388m</b>
Free float	<b>55%</b>
Avg. daily val. (52wk)	<b>\$600,000</b>
12 month price range	<b>\$0.22-\$0.365</b>

### Price Performance

	(1m)	(3m)	(12m)
Price (A\$)	0.28	0.28	
Absolute (%)	5.4	7.3	
Rel market (%)	0.2	3.5	

### Absolute Price



SOURCE: IRESS

### December 2018 quarter report

NIC has released its December 2018 quarterly production and cost report. At this stage the focus is on the construction and commissioning of the Rotary-Kiln-Electric-Furnace (RKEF) lines at the Indonesia Morowali Industrial Park (IMIP) in Indonesia. NIC has a 60% interest in an initial 2 RKEF lines (the Hengjaya lines) and during the quarter secured an initial 17% interest in an additional 2 RKEF lines (the Ranger lines) for US\$50m. Key news in the quarterly is that construction of the Hengjaya lines is running ahead of schedule, with commissioning to commence early in the March 2019 quarter. Production is then expected to ramp up to 80% of capacity within 6-8 weeks of first nickel pig iron (NPI) production. In January 2019 test rotations and pre-heating of the first kiln were undertaken. Construction of the Ranger RKEF lines is also progressing well, with commissioning and production targeted for three months after the Hengjaya lines, i.e. early in the June 2019 quarter and reaching 80% capacity 6-8 weeks after that.

### Mined nickel units on track

The Hengjaya Mine, NIC's 80% owned laterite nickel ore mine, produced 123.2kt ore and sold 139.7kt at 2.02% Ni for 1,778 contained Ni tonnes (vs BPe 150kt @ 1.80% for 1,701 Ni tonnes sold). Mining production continues to expand to a targeted 150kt per quarter rate and total mining volumes increased to open up new areas in support of this. Contained nickel units sold were in-line with our forecasts and good margins were maintained due to the sliding price scale of high grade ore.

### Investment thesis – Speculative Buy, valuation \$0.62/sh

NIC remains one of our top picks in the resources sector and during the quarter delivered a number of key milestones. In our view these will gain greater recognition in the market as production and cash flow are achieved and the key update from the quarterly is that these are tracking ahead of schedule. Our price target is lowered 5% on a reduced cash balance but we reiterate our Speculative Buy recommendation.

### Earnings Forecast

Year ending 30 June	2018a	2019e	2020e	2021e
Sales (US\$m)	14	22	195	243
EBITDA (US\$m)	(2)	5	89	114
Attributable NPAT (reported) (US\$m)	(3)	(4)	75	98
Attributable NPAT (adjusted) (US\$m)	(3)	(4)	75	98
EPS (adjusted) (Aeps)	(0.9)	(0.5)	7.3	9.4
EPS growth (%)	nm	nm	nm	29%
PER (x)	nm	nm	4.1	3.1
FCF Yield (%)	-57%	-51%	30%	35%
EV/EBITDA (x)	(179.8)	58.6	3.1	2.5
Dividend (Aeps)	-	-	-	-
Yield (%)	0%	0%	0%	0%
Franking (%)	0%	0%	0%	0%
ROE (%)	-8%	-3%	31%	30%

SOURCE: BELL POTTER SECURITIES ESTIMATES

# Construction ahead of schedule

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Key news in the quarterly is that construction of the Hengjaya lines is running ahead of schedule, with commissioning to commence early in the March 2019 quarter. Production is then expected to ramp up to 80% of capacity within 6-8 weeks of first nickel pig iron (NPI) production. In January 2019 test rotations and pre-heating of the first kiln were undertaken.

Construction of the Ranger RKEF lines is also progressing well, with commissioning and production targeted for three months after the Hengjaya lines, i.e. early in the June 2019 quarter and reaching 80% capacity 6-8 weeks after that.

By the end of CY19 (and possibly by the start of the December 2019 quarter) all four lines expected to be up and running and NIC's current interests account for ~12ktpa of Ni in NPI production. NIC has options in place to acquire exposure to up to ~29ktpa Ni in NPI production.

Key production metrics are summarised below:

**Table 1 - Quarterly production summary**

	Sep-18 Actual	Dec-18 Actual	Dec-18 BP est.	Variance qoq %	Variance vs BP est. %
<b>Hengjaya Mine</b>					
Ore sales (t)	105,620	139,707	150,000	32%	-7%
grade (% Ni)	2.04%	2.02%	1.80%	-1.0%	12.2%
Contained nickel (t Ni)	1,357	1,778	1,701	31%	5%
Mine OPEX (US\$/t)	\$22.70	\$25.55	\$21.15	13%	21%
Avg price received (US\$/t)	\$32.44	\$31.78	\$23.00	-2%	38%
<b>RKEF NPI production</b>					
NPI production (t)	0	0	0	na	na
NPI grade (% Ni)	0.0%	0.0%	0.0%	na	na
Contained nickel (t)	0	0	0	na	na
<b>Costs</b>					
Cash costs (US\$/t Ni)	\$0	\$0	\$0	na	na
AISC (US\$/t Ni)	\$0	\$0	\$0	na	na

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Other key takeaways from the quarterly report include:

- Ore sales volumes increased back towards expectations following shipping disruptions in the September quarter;
- This was offset by higher mined grades which resulted in the contained nickel tonnes increasing 31% qoq. Combined with a higher ore sales price (calculated on a sliding price scale) our forecast revenues for FY19 are slightly increased compared with the sale prices we had forecast for lower grade ore;
- Operating costs were slightly higher on elevated strip ratios as two new pits were opened up. Other expansion activities included completion of an expanded jetty stockpile area and civil works for the jetty expansion. Access was approved to the Phase 2 mining area and construction of a new haul road (which will allow larger capacity trucks) will commence in the current quarter; and
- Key milestones from the quarter already incorporated into our forecasts are the granting of a 7 year 100% tax reduction, plus 2 year 50% tax reduction and the acquisition of the 17% interest (with an option to acquire up to 80%) in the Ranger RKEF lines.

## Changes to our forecasts

Beyond updating our forecasts for the December 2018 quarter production and cost report, we make the following changes to our modelled assumptions:

- Make minor increases to our FY20 NPI production forecast following the construction update in the December quarterly, which indicates that production will ramp-up ahead of our forecasts;
- Incorporate our latest currency and commodity price forecasts, which includes a 7% reduction to our FY19 nickel price; and
- Update for the latest capital structure and cash position, which captures the US\$50m payment during the quarter for the initial 17% interest in the two additional RKEF lines (the Ranger lines), currently under construction.

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

**Table 2 - 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
<b>Prices &amp; currency</b>									
Nickel price (US\$/lb)	6.55	7.15	7.45	6.08	7.15	7.45	-7%	0%	0%
Nickel price (US\$/t)	14,450	15,763	16,424	13,411	15,763	16,424	-7%	0%	0%
US\$/A\$	0.73	0.75	0.75	0.73	0.75	0.75	0%	0%	0%
<b>Production &amp; costs</b>									
Ore mined (Mt)	607,771	1,277,711	1,564,545	597,478	1,303,787	1,564,545	-2%	2%	0%
Nickel in ore	7,052	14,489	17,742	7,129	14,785	17,742	1%	2%	0%
Nickel in ore (attributable)	5,641	10,142	11,177	5,703	10,349	11,177	1%	2%	0%
RKEF NPI production	10,000	245,000	300,000	10,000	250,000	300,000	0%	2%	0%
Contained nickel	1,100	26,950	33,000	1,100	27,500	33,000	0%	2%	0%
Contained nickel (attributable)	424	10,376	12,705	424	10,588	12,705	0%	2%	0%
Cash costs (US\$/t Ni)	-	7,921	8,073	-	7,828	7,974	na	-1%	-1%
AISC (US\$/t Ni)	-	7,980	8,122	-	7,886	8,023	na	-1%	-1%
<b>Earnings</b>									
Revenue (attributable, US\$m)	18	191	243	19	195	243	4%	2%	0%
EBITDA (attributable, US\$m)	4	87	113	5	89	114	14%	3%	1%
NPAT (reported, attributable, US\$m)	(5)	73	97	(4)	75	98	na	3%	1%
EPS (reported) (Acps)	(1)	7	9	(0)	7	9	na	3%	1%
PER (x)	(50.9)	4.1	3.1	(57.4)	3.9	3.0	(6.6)	(0.1)	(0.0)
EPS growth (%)	nm	nm	32%	nm	nm	29%	nm	nm	-3%
DPS (Acps)	-	-	-	-	-	-	na	na	na
Yield	0%	0%	0%	0%	0%	0%	0%	0%	0%
NPV (A\$/sh)	0.55	0.65	0.82	0.52	0.62	0.84	-6%	-5%	3%
<b>Price Target (A\$/sh)</b>		0.65			0.62			-5%	

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

The key change to our valuation is the lower cash balance (down from A\$90m to A\$20m following the US\$50m payment for the Ranger RKEF lines).

## Upcoming catalysts

Upcoming catalysts for NIC include:

- Further updates on the progress of construction and commissioning of the Hengjaya and Ranger RKEF lines;
- The March quarter production and cost report in April 2019; and
- Updates on the funding to acquire the optioned interests in the RKEF lines.

# 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 \$0.62/sh

NIC remains one of our top picks in the resources sector and during the quarter delivered a number of key milestones. In our view these will gain greater recognition in the market as production and cash flow are achieved and the key update from the quarterly is that these are tracking ahead of schedule. Our price target is lowered on the reduced cash balance but we reiterate our Speculative Buy recommendation.

## Valuation: \$0.62/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 16.67% 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 \$0.65/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.



**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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