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Nickel Mines Ltd (NIC)

Maiden dividend declared

Recommendation

Buy (unchanged)

Price

\$0.68

Target (12 months)

\$1.04 (previously \$1.07)

GICS Sector

Materials

Expected Return

Capital growth	52.9%
Dividend yield	2.9%
Total expected return	55.9%

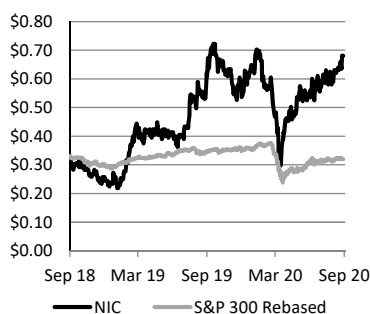
Company Data & Ratios

Enterprise value	\$1,397m
Market cap	\$1,447m
Issued capital	2,128m
Free float	76%
Avg. daily val. (52wk)	\$4.1m
12 month price range	\$0.29-\$0.73

Price Performance

	(1m)	(3m)	(12m)
Price (A\$)	0.59	0.53	0.56
Absolute (%)	16.2	29.5	22.4
Rel market (%)	15.3	24.5	28.4

Absolute Price



SOURCE: IRESS

1HCY20 financial result

NIC reported its 1HCY20 financial results for the six months to 30 June 2020, announcing revenues of US\$227.8m (vs BPe \$226.8m), EBITDA of US\$69.9m (vs BPe \$73.4m), consolidated NPAT of US\$45.5m (vs BPe \$52.4m) and attributable NPAT of US\$24.4m (vs BPe US\$26.6m). The main differences compared to our forecasts were higher administration and other expenses, an increased D&A charge and a foreign exchange loss. The key positive surprise in the result was the declaration of a maiden A1cps, unfranked dividend. The result translated to attributable EPS of US1.4cps (A2.0cps), or ~24% of our forecast CY20 earnings of A8.5cps. Our 2HCY20 forecast is predicated on i) a 15% higher nickel price vs 1HCY20; ii) NIC's ownership in the Ranger and Hengjaya RKEF lines lifting from 60% to 80%, effective 1 July 2020; and iii) expanded production at the Hengjaya Mine.

Dividend sends strong signal on cash flow

The main takeaway, in our view, from NIC's 1HCY20 result is the declaration of a maiden A1cps unfranked dividend. We have been of the view that NIC could afford to pay a dividend, particularly given the strong free cash flow growth we are forecasting as NIC's ownership of the Ranger and Hengjaya RKEF lines increases from 60% to 80%. Gearing is also low as a result of US\$35m of early, voluntary debt repayments against its US\$80m debt facility (NIC held net cash of US\$36.3m at end June). NIC has guided its intention to sustain this level of payout and we now forecast a dividend of A2cps for CY20, implying a yield of 2.9% (unfranked). In a rising nickel price environment, we see upside potential to this forecast.

Investment thesis – Buy, TP\$1.04/sh (from Buy, \$1.07/sh)

The higher depreciation charges are the main driver of a 15% cut to our CY20 earnings forecast, lowered to US\$100m. Our CY20 and CY21 earnings are also lowered 6% and 5% respectively. The new dividend forecast and associated cash payout of ~A\$43m plus the higher corporate costs reduces our NPV-based, sum-of-the-parts valuation by 3%, to \$1.04/sh. NIC remains one of our top picks in the Resources sector with total forecast returns of 56%. We retain our Buy rating.

Earnings Forecast

Year ending 31 December	2019a*	2020e	2021e	2022e
Sales (US\$m)	236	524	631	634
EBITDA (US\$m)	97	197	328	338
Attributable NPAT (reported) (US\$m)	57	100	230	250
Attributable NPAT (reported) (A\$m)	83	150	333	347
EPS (adjusted) (Acps)	4.4	8.5	15.7	16.3
EPS growth (%)	46%	23%	84%	4%
PER (x) ¹	6.7	8.0	4.3	4.2
FCF Yield (%) ¹	4%	17%	31%	33%
EV/EBITDA (x) ¹	10.6	5.2	3.1	3.0
Dividend (Acps)	-	2	-	-
Yield (%)	0%	3%	0%	0%
Franking (%)	0%	0%	0%	0%
ROE (%) ¹	49%	31%	38%	31%

SOURCE: BELL POTTER SECURITIES ESTIMATES *Transitional 6 month period to Dec-19. Change of Financial Year end from June to December
1: Metrics annualised for 6 month period to Dec-19

NIC declares maiden dividend

1HCY20 financial result

NIC reported its 1HCY20 financial results for the six months to 30 June 2019. This represents the first half-yearly report following the change to a December year-end, effective December 2019, when a set of transitional financial results was reported for that 6-month period.

NIC announced Revenues of US\$227.8m (vs BPe \$226.8m), EBITDA of US\$69.9m (vs BPe \$73.4m), consolidated NPAT of US\$45.5m (vs BPe \$52.4m) and attributable NPAT of US\$24.4m (vs BPe US\$26.6m). The main differences compared to our forecasts were higher administration and other expenses, an increased D&A charge and a foreign exchange loss. The key positive surprise in the result was the declaration of a maiden A1cps, unfranked dividend. In our view, this sends a strong positive signal on future shareholder returns and management's expectations for free cash flows, as well as being a major milestone for NIC.

The result translated to attributable EPS of US1.4cps (A2.0cps) which is ~24% of our forecast CY20 earnings of A8.5cps. Our forecast for a strong 2HCY20 is predicated on i) a 15% higher nickel price vs 1HCY20; ii) NIC's ownership in the Ranger and Hengjaya RKEF lines increasing from 60% to 80%, effective 1 July 2020; and iii) an improved performance from the Hengjaya Nickel Mine.

NIC ended 1HCY20 with cash of US\$91.3m and gross debt of US\$55.0m for net cash of US\$36.3m (from net debt of \$15.2m at end December). During the period NIC repaid US\$10m of its US\$80m debt facility and post period-end repaid a further US\$10m as an early, voluntary repayment, leaving a balance of US\$45m.

During the period NIC also exercised its option to increase its ownership of the Hengjaya and Ranger RKEF lines from 60% to 80%, for consideration of US\$120m plus US\$30m for undistributed retained earnings. This was funded by a 1 for 3.6 Entitlements Issue at A50cps, raising A\$231m. NIC's 80% ownership level became effective as of 1 July 2020.

Table 1 - NIC Financial result summary

Financials (Consolidated basis)	Dec-19 Actual (6 months)	Jun-20 Actual (6 months)	Jun-20 BPe (6 months)	Variance vs BPe	Variance vs pcp
Revenue (US\$m)	236.1	227.8	226.8	0%	-3%
EBITDA (US\$m)	97.2	69.9	73.4	-5%	-28%
NPAT reported (US\$m)	91.3	45.5	52.4	-13%	-50%
NPAT underlying (US\$m)	56.5	24.4	26.6	-8%	-57%
NPAT attributable (US\$m)	49.1	24.4	26.6	-8%	-50%
EPS attributable (Ac/sh)	5.1	2.1	2.3	-8%	-58%
Dividend (Ac/sh)	0.0	1.0	0.0	na	na
Free cash flow (US\$m)	14.44	-69.67	-57.0	22%	-583%
Cash balance (US\$m)	49.8	91.3	65.3	40%	83%
Debt (US\$m)	4.3	55.0	55.0	0%	1169%
Production, costs, prices					
Ni in NPI (t, Consolidated)	20,988	21,395	21,395	0%	2%
Ni in NPI (t, Attributable)	11,742	12,837	12,837	0%	9%
AIC (US\$/t)	\$7,804	\$7,315	\$7,315	0%	-6%
Nickel price (US\$/t)	\$15,483	\$12,456	\$12,456	0%	-20%

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

*Transitional 6 month period to Dec-19. Change of financial year end from June to December

Key takeaways

Other key takeaways from the result include:

- While no formal dividend policy has been put forward, NIC now sees itself as a dividend paying stock. On the conference call with management, guidance was provided that NIC intended to maintain the current rate of dividend payments of A1cps per half-year;
- Also stated on the conference call was that growth remains a high priority for NIC and that discussions with Tsingshan, NIC's partner at the IMIP, are ongoing. Capital efficient growth options at the IMIP (such as additional interests in other RKEF lines) are competing strongly for NIC's capital;
- The expansion of the Hengjaya Mine (NIC 80%) is again advancing following a rain-disrupted June quarter. Ore shipments on larger, 10,000t capacity barges have commenced through larger wharfing facilities and mine productivity has improved with the dryer weather; and
- No COVID-19 cases have been reported at any of NIC's operations following the implementation of strict access controls and screening measures in January 2020. Operations have maintained continuous production and been largely undisrupted during 1HCY20.

Changes to our forecasts

Beyond updating our forecasts for the 1HCY20 financial report, we have made the following changes to our modelled assumptions:

- Increased our forecast D&A charges from US\$23m to US\$36m, as well as minor increases to other corporate expenses, to align with the latest reported costs;
- Lifted our dividend forecast to reflect the payment of an interim dividend of A1cps and our updated forecast for a final dividend, also for A1cps; and
- Included the early repayment (post period-end) of a further US\$10m against NIC's debt facility, reducing its balance to US\$45m.

The net impact of these changes are summarised in the forecast changes table below:

Table 2 - Changes to our CY forecasts

Year end 30 December	Previous			New			Change		
	Dec-20	Dec-21	Dec-22	Dec-20	Dec-21	Dec-22	Dec-20	Dec-21	Dec-22
Prices & currency									
Nickel price (US\$/t)	13,393	16,424	17,527	13,393	16,424	17,527	0%	0%	0%
US\$/A\$	0.67	0.69	0.72	0.67	0.69	0.72	0%	0%	0%
Production & costs									
Ore mined (t)	799,628	1,560,000	1,560,000	799,628	1,560,000	1,560,000	0%	0%	0%
Nickel in ore (t)	14,440	28,080	28,080	14,440	28,080	28,080	0%	0%	0%
RKEF NPI production (t)	301,308	304,615	304,615	301,308	304,615	304,615	0%	0%	0%
Contained nickel (t)	42,718	41,123	38,077	42,718	41,123	38,077	0%	0%	0%
Contained nickel (t, attributable)	29,896	32,898	30,462	29,896	32,898	30,462	0%	0%	0%
Cash costs (US\$/t Ni)	7,424	7,664	7,962	7,424	7,664	7,962	0%	0%	0%
Earnings & valuation									
Revenue (consolidated, US\$m)	524	631	634	524	631	634	0%	0%	0%
Revenue (attributable, US\$m)	391	532	531	391	532	531	0%	0%	0%
EBITDA (attributable, US\$m)	146	261	272	143	258	268	-2%	-1%	-1%
NPAT (reported, attributable, US\$m)	118	244	264	100	230	250	-15%	-6%	-5%
EPS (reported) (Acps)	10.0	16.6	17.2	8.5	15.7	16.3	-15%	-6%	-5%
PER (x)	6.8	4.1	4.0	8.0	4.3	4.2	1.2	0.2	0.2
EPS growth (%)	44%	66%	4%	23%	84%	4%	-22%	18%	0%
DPS (Acps)	-	-	-	2	-	-	na	na	na
Yield	0%	0%	0%	3%	0%	0%	3%	0%	0%
NPV (A\$/sh)	1.07	1.28	1.41	1.04	1.26	1.38	-3%	-2%	-2%
Price Target (A\$/sh)	1.07			1.04			-3%		

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

The higher depreciation charges are the main driver of a 15% cut to our CY20 earnings forecast, down 15% to US\$100m. This shows the bulk of our CY20 earnings forecast weighted to 2HCY20. Our forecast for a strong 2HCY20 is predicated on i) a 15% higher nickel price vs 1HCY20; ii) NIC's ownership in the Ranger and Hengjaya RKEF lines increasing from 60% to 80%, effective 1 July 2020; and iii) an improved performance from the Hengjaya Nickel Mine. The new forecast for an unfranked CY20 dividend of A2cps implies a ~3% yield. The higher corporate costs and cash dividend payout also reduces our NPV-based, sum-of-the-parts valuation by 3%, to \$1.04/sh.

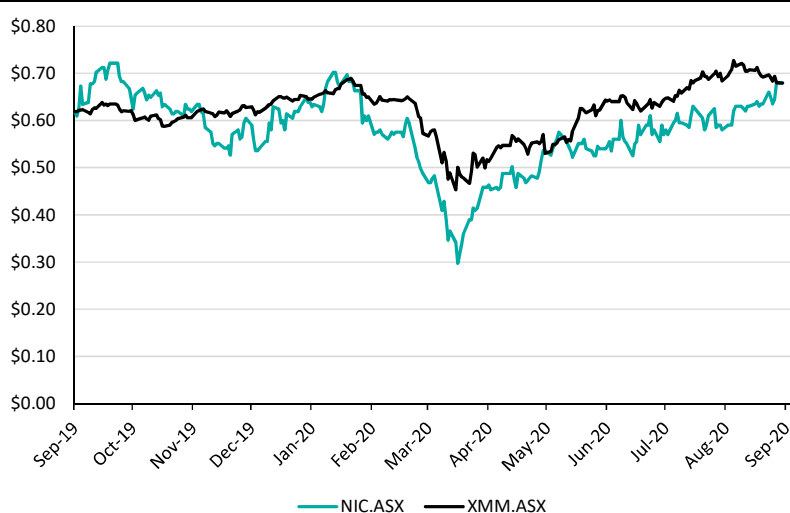
Upcoming catalysts

Upcoming catalysts for NIC include:

- Ongoing production updates from the Hengjaya and Ranger Nickel RKEF lines. Both projects have now achieved established production levels above nameplate. Ongoing updates will reinforce the sustainability of these production levels;
- Updates on Ni in NPI pricing and payabilities, which we would like to see sustained at 90% of the LME nickel price, or better;
- The release of NIC's September 2020 quarterly production and cost report, expected in late October 2020;
- Progress updates for the Hengjaya Mine, where a major production expansion is underway, targeting production of 150kt ore per month and costs of ~US\$18/t over the course of CY20; and
- Updates on the ownership levels of the 80%-owned Hengjaya Mine, which is subject to Indonesia's compulsory divestment laws.

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: fully integrated NPI 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 four Rotary Kiln Electric Furnace (RKEF) NPI production lines (the two Hengjaya lines and the two Ranger lines) with Shanghai Decent Investments (SDI) a subsidiary of Tsingshan Group, the world's largest stainless steel producer. In June 2020, NIC exercised its option to increase its ownership of both Hengjaya and Ranger to 80%, for US\$120m, becoming effective 1 July 2020.

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 exceeded their nameplate production run-rate of 16ktpa nickel in NPI (100% basis) during the September quarter 2019. The Ranger Lines commenced production during the September quarter 2019 and exceeded nameplate in the December 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 – Buy, TP\$1.04/sh (from Buy, \$1.07/sh)

The higher depreciation charges are the main driver of a 15% cut to our CY20 earnings forecast, down to US\$100m. Our CY20 and CY21 earnings are also lowered 6% and 5% respectively. The new dividend forecast and associated cash payout of ~A\$43m plus the higher corporate costs reduces our NPV-based, sum-of-the-parts valuation by 3%, to \$1.04/sh. NIC remains one of our top picks in the Resources sector with total forecast returns of 56%. We retain our Buy rating.

Valuation: \$1.04/sh

Our 12-month forward NIC valuation incorporates DCF models of its attributable interests in the Hengjaya laterite nickel ore mine (HM), an 80% interest in the two Hengjaya Nickel RKEF lines and an 80% 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 in production at Tsingshan's IMIP facility and a DCF calculation for NIC's current 80% interest (declining to 49% by 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 cash position. Our valuation is calculated on a fully diluted basis. Following the latest update, our valuation stands at \$1.04/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.
- **COVID-19 risks:** Mining companies' rely on freedom of movement of workforces, functioning transport routes, reliable logistics services including road, rail, aviation and ports in order to maintain operations and get their products to market. They also rely on liquid, functioning markets to sell their products. Measures being put in place to combat the COVID-19 pandemic are posing risks to these conditions.
- **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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Disclosure: Bell Potter Securities acted as Joint Lead Manager to the \$55m Placement of June 2019 and Joint Lead Manager to the \$231m Entitlements Issue of May 2020 and received fees for that service.

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