

Analyst

David Coates 612 8224 2887

Authorisation

Stuart Howe 613 9235 1856

Nickel Mines Limited (NIC)

First NPI production - well ahead of schedule

Recommendation

Buy (unchanged)

Price

\$0.315

Valuation

\$0.64 (previously \$0.62)

Risk

Speculative

GICS Sector

Materials

Expected Return

Capital growth	103.2%
Dividend yield	0.0%
Total expected return	103.2%

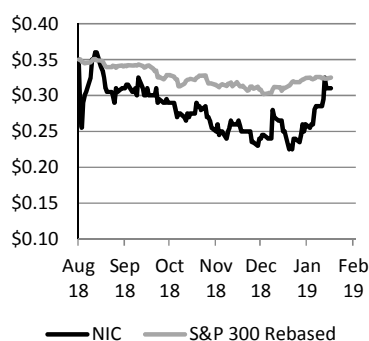
Company Data & Ratios

Enterprise value	\$416.4m
Market cap	\$437.2m
Issued capital	1,388m
Free float	55%
Avg. daily val. (52wk)	\$615,000
12 month price range	\$0.22-\$0.365

Price Performance

	(1m)	(3m)	(12m)
Price (A\$)	0.27	0.27	
Absolute (%)	17.0	17.0	
Rel market (%)	12.6	15.5	

Absolute Price



SOURCE: IRESS

Hengjaya lines to be at 80% capacity in May 2019

NIC has reported the major milestone of first Nickel Pig Iron (NPI) production from its 60%-owned Hengjaya Nickel Project in Indonesia. Shanghai Decent Investments (SDI), NIC's 40% operating partner, advised that first NPI had been produced from the first of Hengjaya Nickel's two Rotary Kiln Electric Furnace (RKEF) lines in a maiden production run on 31 January 2019. NPI production from this first RKEF line is now expected to ramp-up to 80% of its 75ktpa nameplate production by early April 2019. The second Hengjaya RKEF line is expected to be commissioned in early March 2019 and ramp-up to 80% of its 75ktpa nameplate production by early May 2019. The two Ranger Nickel Project RKEF lines, in which NIC currently holds a 17% interest, are also running ahead of schedule. We now expect them to be at +80% of their nameplate capacity by the end of July 2019, effectively 6 months early.

Impressive delivery track record being established

Other than the clear positive of earlier production and cash flow for NIC, we see this as a boost to sentiment around the stock as it continues to build a strong track record of delivery. The hard catalysts we are looking for to drive a re-rating of the stock in CY19 are advancing rapidly. As nameplate production is achieved the market will have to take a fresh look at NIC's production and cash flows and value it accordingly. NIC does plan to fund its growth, via increased ownership of the Hengjaya and Ranger RKEF lines. As long-life, low cost assets we see a wide range of funding options and NIC has an aligned partner in SDI, which invested US\$26m into NIC pre-IPO.

Investment thesis – Speculative Buy, valuation \$0.64/sh

The early achievement of first production and the accelerated ramp-up schedule reduces our forecast FY19 loss from US\$4m to US\$3m and our forecast FY20 earnings lift 12% to US\$85m. Our NPV-based, 12-month forward valuation is up 3% to A\$0.64/sh. NIC remains one of our top picks in the sector on excellent value, strong production growth profile and the quality of its assets.

Earnings Forecast

Year end 30 June	2018a	2019e	2020e	2021e
Sales (US\$m)	14	24	218	243
EBITDA (US\$m)	(2)	6	100	114
Attributable NPAT (reported) (US\$m)	(3)	(3)	85	98
Attributable NPAT (adjusted) (US\$m)	(3)	(3)	85	98
EPS (adjusted) (Acps)	(0.9)	(0.4)	8.2	9.4
EPS growth (%)	nm	nm	nm	16%
PER (x)	nm	nm	3.9	3.3
FCF Yield (%)	-54%	-47%	31%	32%
EV/EBITDA (x)	(193.7)	53.8	3.0	2.7
Dividend (Acps)	-	-	-	-
Yield (%)	0%	0%	0%	0%
Franking (%)	0%	0%	0%	0%
ROE (%)	-8%	-2%	34%	29%

SOURCE: BELL POTTER SECURITIES ESTIMATES

First NPI production ahead of schedule

Hengjaya lines to be at 80% capacity in May 2019

NIC has reported the major milestone of first Nickel Pig Iron (NPI) production from its 60%-owned Hengjaya Nickel Project in Indonesia. Shanghai Decent Investments (SDI), NIC's 40% operating partner, advised that first NPI had been produced from the first of Hengjaya Nickel's two Rotary Kiln Electric Furnace (RKEF) lines in a maiden production run on 31 January 2019. NPI production from this first RKEF line is now expected to ramp-up to 80% of its 75ktpa nameplate production by early April 2019. The second Hengjaya RKEF line is expected to be commissioned in early March 2019 and ramp-up to 80% of its 75ktpa nameplate production by early May 2019.

The ahead-of-schedule progress is also extending to the two Ranger Nickel Project RKEF lines, in which NIC secured an initial 17% interest for US\$50m in November 2018. Previously targeting commissioning in the September quarter of 2019, commissioning of the first line is now expected in April 2019 and the second line in May 2019: effectively 6 months ahead of schedule. The Ranger RKEF lines are subject to a similar production ramp-up profile, which implies that both the Ranger lines should be running at +80% of their nameplate capacity by the end of July 2019.

Impressive delivery track record being established

Other than the clear positive of earlier production and cash flow for NIC, we see this as a boost to sentiment around the stock as it continues to build a strong track record of delivery. Several value accretive announcements have been made since the August 2018 IPO, including:

- Securing the options to grow attributable production via increased ownership (up to 80% of the Ranger RKEF lines);
- The significant tax concessions that have been allocated to the Hengjaya RKEF lines (100% corporate income tax discount for the first 7 years of commercial production, plus 50% corporate income tax discount for the following 2 years);
- The MoU for the supply of limonite ore (currently mined as waste) from the Hengjaya laterite nickel ore mine to a proposed new nickel project in the area;

The hard catalysts we are looking for to drive a re-rating of the stock in CY19 are advancing rapidly and will result in realisation of value from these developments – in particular the tax concessions. As nameplate production is achieved the market will have to take a fresh look at NIC's production and cash flows and value it accordingly.

Funding of growth

One aspect of this is the funding of increased ownership levels in both the Hengjaya and Ranger projects.

The Hengjaya RKEF lines

The increase of ownership in the Hengjaya RKEF lines (currently at 60%) is quite straightforward: NIC has the option to acquire up to an additional 40% for US\$120m (implying a US\$300m pro-rata valuation) within 12 months of first nickel production, i.e. by end January 2020.

We understand that should NIC wish to lift its interest to just 80%, the same pro-rata valuation applies, which would require consideration of US\$60m (A\$83m) to be paid by

that time. The level of ownership is decided at NIC's election and it is SDI's election as to whether the consideration is in shares, cash, or a combination of both.

The Ranger RKEF lines

NIC currently has a 17% interest in the Ranger Lines, for which it paid US\$50m for in November 2018 (based on a US\$300m pro-rata valuation). This was the exercise of the First Acquisition.

NIC has further 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.

The main point of relevance on this latest announcement is that construction and commissioning of the Ranger Lines is also running ahead of schedule (now targeting April commissioning as opposed to September commissioning). The implication is that to take advantage of the discounted acquisition rate, NIC would pay between US\$95.2m (A\$131m) to lift to 51% and US\$120.4m (A\$166m) to lift to 60% sometime around June 2019.

Several potential funding sources

The Hengjaya and Ranger RKEF NPI production lines are long-life, low cost assets that are similar to industrial assets rather than standalone mining projects. For this reason we see a wider range of funding options and certainly cheaper and more flexible debt options than compared to a standard project financing facility.

We have also seen evidence of SDI being a flexible and aligned partner in relation to funding, recalling it invested US\$26m into NIC equity as part of its pre-IPO funding. As mentioned, consideration for the Hengjaya RKEF lines is at SDI's election as to whether it is paid in shares, cash, or a combination of both.

Changes to our forecasts

Taking into account the accelerated production ramp-up schedule disclosed in this latest update, we make the following changes to our modelled assumptions:

- Increase our NPI production forecast for FY19 by 25% from 10,000t NPI to 12,500t NPI from the Hengjaya RKEF lines. We see further potential upside to this as it makes no allowance for production from the Ranger lines, at this stage;
- Increase our NPI production forecast for FY20 by 12% from 250,000t NPI to 280,000t NPI, in total, reflecting the accelerated production ramp-up schedule; and
- Incrementally de-risk our valuation to reflect the achievement of first NPI production.

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	6.08	7.15	7.45	0%	0%	0%
Nickel price (US\$/t)	13,411	15,763	16,424	13,411	15,763	16,424	0%	0%	0%
US\$/A\$	0.73	0.75	0.75	0.73	0.75	0.75	0%	0%	0%
Production & costs									
Ore mined (Mt)	597,478	1,303,787	1,564,545	610,516	1,460,242	1,564,545	2%	12%	0%
Nickel in ore	7,129	14,785	17,742	7,277	16,559	17,742	2%	12%	0%
Nickel in ore (attributable)	5,703	10,349	11,177	5,821	11,591	11,177	2%	12%	0%
RKEF NPI production	10,000	250,000	300,000	12,500	280,000	300,000	25%	12%	0%
Contained nickel	1,100	27,500	33,000	1,375	30,800	33,000	25%	12%	0%
Contained nickel (attributable)	424	10,588	12,705	529	11,858	12,705	25%	12%	0%
Cash costs (US\$/t Ni)	-	7,828	7,974	-	7,805	7,974	na	0%	0%
AISC (US\$/t Ni)	-	7,886	8,023	-	7,856	8,023	na	0%	0%
Earnings									
Revenue (attributable, US\$m)	19	195	243	21	218	243	10%	12%	0%
EBITDA (attributable, US\$m)	5	89	114	6	100	114	17%	12%	0%
NPAT (reported, attributable, US\$m)	(4)	75	98	(3)	85	98	na	12%	0%
EPS (reported) (Acps)	(0)	7	9	(0)	8	9	na	12%	0%
PER (x)	(63.5)	4.3	3.3	(78.6)	3.9	3.3	(15.1)	(0.5)	(0.0)
EPS growth (%)	nm	nm	29%	nm	nm	16%	nm	nm	-14%
DPS (Acps)	-	-	-	-	-	-	na	na	na
Yield	0%	0%	0%	0%	0%	0%	0%	0%	0%
NPV (A\$/sh)	0.52	0.62	0.84	0.53	0.64	0.87	4%	3%	4%
Price Target (A\$/sh)		0.62			0.64			3%	

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Incorporating the updated production schedule into our modelled assumptions reduces our forecast FY19 loss from US\$4m to US\$3m and our forecast FY20 earnings lift 12% to US\$85m. Our NPV-based, 12-month forward valuation is up 3% to A\$0.64/sh.

Upcoming catalysts

Upcoming catalysts for NIC include:

- The release of NIC's interim financial results, expected in late February 2019;
- Further updates on the progress of construction and commissioning of the Hengjaya and Ranger RKEF lines, including first production from the Ranger lines in April 2019;
- The March quarter production and cost report in April 2019;
- The targeted ramp-up to 80% of nameplate production for both the Hengjaya lines by early May 2019;
- The targeted ramp-up to 80% of nameplate production for both the Ranger lines likely in early in 2HCY19; and
- Updates on the funding to acquire the remaining optioned interests in the Hengjaya and Ranger 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 \$0.64/sh

The early achievement of first production and the accelerated production ramp-up schedule reduces our forecast FY19 loss from US\$4m to US\$3m and our forecast FY20 earnings lift 12% to US\$85m. Our NPV-based, 12-month forward valuation is up 3% to A\$0.64/sh. NIC remains one of our top picks in the sector on excellent value, strong production growth profile and the quality of its assets.

Valuation: \$0.64/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 17% 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 \$0.64/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	24.2	218.0	242.7	VALUATION						
Expense	US\$m	(11.9)	(15.1)	(18.6)	(117.8)	(129.0)	Attributable NPAT	US\$m	(3.8)	(3.3)	(3.2)	84.6	98.2
EBITDA	US\$m	(3.3)	(1.6)	5.6	100.2	113.7	Attributable NPAT	A\$m	(5.1)	(4.4)	(4.4)	112.9	131.0
Depreciation	US\$m	(0.1)	(0.1)	(1.2)	(5.4)	(5.8)	Reported EPS	Ac/sh	(1.6)	(0.9)	(0.4)	8.2	9.4
EBIT	US\$m	(3.4)	(1.6)	4.5	94.8	107.9	Adjusted EPS	Ac/sh	(1.6)	(0.9)	(0.4)	8.2	9.4
Net interest expense	US\$m	(0.5)	(0.7)	0.0	0.5	3.0	EPS growth	%	nm	nm	nm	nm	16%
Unrealised gains (Impairments)	US\$m	-	-	-	-	-	PER	x	nm	nm	nm	3.9x	3.3x
Other	US\$m	-	-	(7.3)	-	-	DPS	Ac/sh	-	-	-	-	-
PBT	US\$m	(3.9)	(2.3)	(2.8)	95.3	111.0	Franking	%	0%	0%	0%	0%	0%
Tax expense	US\$m	0.2	(0.7)	-	(7.8)	(8.8)	Yield	%	0%	0%	0%	0%	0%
Comprehensive loss for the year	US\$m	(3.7)	(2.9)	(2.8)	87.5	102.2	FCF/share	Ac/sh	(0.0)	(16.9)	(14.9)	9.9	10.2
Non-Controlling Interest	US\$m	0.1	0.4	(0.4)	(2.8)	(3.9)	FCF yield	%	0%	-54%	-47%	31%	32%
Attributable NPAT (reported)	US\$m	(3.8)	(3.3)	(3.2)	84.6	98.2	P/FCFPS	x	-2824.5x	-1.9x	-2.1x	3.2x	3.1x
NPAT (underlying)	US\$m	(3.8)	(3.3)	(3.2)	84.6	98.2	EV/EBITDA	x	-90.6x	-193.7x	53.8x	3.0x	2.7x
							EBITDA margin	%	nm	nm	23%	46%	47%
							EBIT margin	%	nm	nm	18%	43%	44%
							Return on assets	%	-27%	-5%	-2%	31%	26%
							Return on equity	%	2029%	-8%	-2%	34%	29%
							LIQUIDITY & LEVERAGE						
							Net debt (cash)	\$m	-	-	(19)	(122)	(228)
							ND / E	%	0%	0%	-9%	-40%	-57%
							ND / (ND + E)	%	0%	0%	-10%	-68%	-133%
							EBITDA / Interest	x	-6.1x	-2.4x	nm	nm	nm
							ATTRIBUTABLE DATA - NICKEL MINES LTD						
							Year ending 30 June	Unit	2017a	2018a	2019e	2020e	2021e
							Revenues	US\$m	6.9	10.8	20.9	205.9	226.3
							EBITDA	US\$m	(2.7)	(1.2)	4.9	95.7	107.6
							NPAT	US\$m	(3.8)	(3.3)	(3.2)	84.6	98.2
							Net distributable cash flow	US\$m	0.1	0.0	16.4	92.5	95.4
							EV/EBITDA	x	nm	nm	61.6	3.1	2.8
							PER	x	nm	nm	nm	3.9	3.3
							P/FCF	x	nm	nm	nm	3.5	3.4
							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	\$6.08	\$7.15	\$7.45
							Nickel	US\$/t	\$10,141	\$12,456	\$13,411	\$15,763	\$16,424
							Currency						
							AUD:USD		0.75	0.78	0.73	0.75	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	11,858	12,705
							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)						1,388.0
							Options in the money (m)						-
							Total shares diluted (m)						1,388.0
							Sum-of-the-parts						
							RKEF (NPV12)	A\$m	802.1	0.58			
							Hengjaya Mine (NPV12)	A\$m	61.6	0.04			
							Other exploration	A\$m	25.0	0.02			
							Corporate overheads	A\$m	(18.6)	(0.01)			
							Subtotal	A\$m	870.0	0.63			
							Net cash (debt)	A\$m	20.8	0.01			
							Total (undiluted)		890.8	0.64			
							Dilutive effect of options		-	-			
							Add cash from options		-	-			
							Total (diluted)		890.8	0.64			
							MAJOR SHAREHOLDERS						
							Shareholder	%					m
							Directors and Management	13.7%					189.8
							Shanghai Decent (SDI)	11.6%					161.7
							Shanghai Wanlu	10.8%					149.3
							BlackRock Investment Management	9.9%					137.9
							Regal FM	5.1%					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.

Research Team

Staff Member	Title/Sector	Phone	@bellpotter.com.au
TS Lim	Head of Research	612 8224 2810	tslim
Industrials			
Sam Haddad	Industrials	612 8224 2819	shaddad
Chris Savage	Industrials	612 8224 2835	csavage
Jonathan Snape	Industrials	613 9235 1601	jsnape
John Hester	Healthcare	612 8224 2871	jhester
Tanushree Jain	Healthcare/Biotech	612 8224 2849	tnjain
Financials			
TS Lim	Banks/Regionals	612 8224 2810	tslim
Lafitani Sotiriou	Diversified Financials/Fintech	613 9235 1668	lsotiriou
Resources			
Peter Arden	Resources	613 9235 1833	parden
David Coates	Resources	612 8224 2887	dcoates
Stuart Howe	Resources	613 9235 1856	showe
Analysts			
James Filius	Analyst	613 9235 1612	jfilius
Alexander McLean	Analyst	612 8224 2886	amclean
Damien Williamson	Analyst	613 9235 1958	dwilliamson

Bell Potter Securities Limited

ACN 25 006 390 7721

Level 38, Aurora Place
88 Phillip Street, Sydney 2000

Telephone +61 2 9255 7200

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