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Nickel Mines Ltd (NIC)

Fast forward to growth

Recommendation

Buy (unchanged)

Price

\$1.155

Target (12 months)

\$1.42 (previously \$1.39)

GICS Sector

Materials

Expected Return

Capital growth	22.9%
Dividend yield	3.5%
Total expected return	26.4%

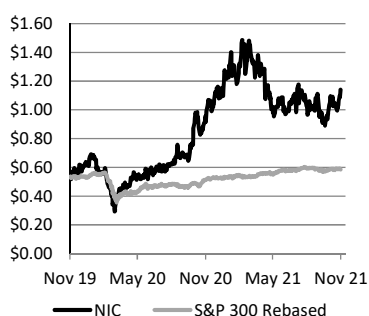
Company Data & Ratios

Enterprise value	\$3,230m
Market cap	\$2,905m
Issued capital	2,515m
Free float	76%
Avg. daily val. (52wk)	\$13.5m
12 month price range	\$0.885-\$1.54

Price Performance

	(1m)	(3m)	(12m)
Price (A\$)	0.98	1.10	0.89
Absolute (%)	16.9	4.1	28.0
Rel market (%)	16.0	6.7	12.4

Absolute Price



SOURCE: IRESS

Angel ahead of schedule

NIC has announced that first Nickel Pig Iron (NPI) production from its 80% owned Angel Nickel Project within the Indonesia Weda Bay Industrial Park (IWIP) is now expected in 1QCY22. This is well ahead of the October CY22 contractual delivery date for the commencement of commissioning. The updated ramp-up schedule now has all four Angel RKEF lines operational by June CY22. Reaching full nameplate production of 36ktpa Ni in NPI remains contingent upon commissioning of the dedicated ANI power plant, which is scheduled for commissioning by end September CY22. Full NPI production is expected around one month after its commissioning.

Earnings and production growth starts now

The latest update reports construction and development progress that is well ahead of our previous forecasts. We had modelled first production in 3QCY22 with ramp-up to full nameplate production around mid CY23. This has been brought forward by ~6-9 months and we now model full year production of 22.2kt Ni in NPI from Angel in CY22 (up from 8.4kt). On an attributable basis, this lifts our forecast for NIC's total CY22 production by 28% to 50.4kt (from 39.3kt), implying production growth of 55% vs CY21 (previously 21%). This flows directly through to our forecast annual earnings growth, which increases to 55% (previously 25%). It effectively fast forwards to CY22 the earnings growth profile that we had been looking for in CY23. With margins currently expanding and first production now less than two quarters away, NIC's aggressive growth profile to double nameplate production effectively starts now.

Investment thesis – Buy, TP\$1.42/sh (from \$1.39/sh)

Our accelerated production start and ramp-up assumptions are the key drivers of earnings and valuation upgrades of CY21: 0%, CY22: +24% and CY23: +4%. In our view, this reinforces the compelling valuation metrics NIC is trading on for an industrial style stock with an aggressive growth profile. P/E's are: CY21: 13.9x; CY22: 8.6x; and CY23: 5.2x. Dividend yields (unfranked) are also competitive and rising, at 3.5%, 5.2% and 7.0% for CY21, CY22 and CY23 respectively. We retain our Buy recommendation.

Earnings Forecast

Year ending 31 December	2020a	2021e	2022e	2023e
Sales (US\$m)	523	624	1,028	1,319
EBITDA (US\$m)	194	253	435	657
Attributable NPAT (reported) (US\$m)	111	157	243	408
Attributable NPAT (reported) (A\$m)	160	208	333	558
EPS (adjusted) (Acps)	8.2	8.3	13.3	22.2
EPS growth (%)	62%	1%	60%	68%
PER (x) 1	14.1	14.0	8.7	5.2
FCF Yield (%) 1	-2%	-9%	19%	28%
EV/EBITDA (x) 1	12.1	9.3	5.4	3.6
Dividend (Acps)	3	4	6	8
Yield (%)	3%	3%	5%	7%
Franking (%)	0%	0%	0%	0%
ROE (%) 1	27%	20%	29%	40%

SOURCE: BELL POTTER SECURITIES ESTIMATES

Changes to our forecasts

In reflecting this update we have made the following changes to our modelled assumptions:

- Brought forward our forecast for first production and NPI sales from the Angel Nickel Project to the June quarter of CY22, previously modelled to commence from the September quarter of CY22;
- Accelerated our production ramp-up forecast, now modelling full nameplate production from the December quarter of CY22, previously modelled to commence from the September quarter of CY23;
- Increased our forecast cash costs for the Angel Nickel RKEF lines, reflecting the market-driven input cost increases that have been experienced at the Ranger and Hengjaya RKEF lines; and
- Lift our forecast dividend distributions for CY22 and CY23 to A6cps (from A4cps) and A8cps (from A7cps) respectively. This increases our forecast (unfranked) yields to 5.2% and 6.9% respectively.

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

Table 1 - Changes to our CY forecasts									
Year end 31 December	Previous			New			Change		
	Dec-21	Dec-22	Dec-23	Dec-21	Dec-22	Dec-23	Dec-21	Dec-22	Dec-23
Prices & currency									
Nickel price (US\$/t)	18,323	18,519	18,629	18,323	18,519	18,629	0%	0%	0%
US\$/A\$	0.75	0.73	0.73	0.75	0.73	0.73	0%	0%	0%
Production & costs									
Ore mined (t)	2,035,486	2,000,000	2,000,000	2,035,486	2,000,000	2,000,000	0%	0%	0%
Nickel in ore (t)	36,062	36,000	36,000	36,062	36,000	36,000	0%	0%	0%
RKEF NPI production (t)	295,081	372,004	579,615	295,081	487,004	604,615	0%	31%	4%
Contained nickel (t)	40,516	49,171	75,646	40,516	62,971	78,646	0%	28%	4%
Contained nickel (t, attributable)	32,413	39,336	60,517	32,413	50,376	62,917	0%	28%	4%
Cash costs (US\$/t Ni)	9,521	9,796	8,738	9,521	9,825	8,723	0%	0%	0%
Earnings & valuation									
Revenue (consolidated, US\$m)	624	801	1,269	624	1,028	1,319	0%	28%	4%
EBITDA (consolidated, US\$m)	253	345	632	253	435	657	0%	26%	4%
EBITDA (attributable, US\$m)	202	275	504	202	347	524	0%	26%	4%
NPAT (reported, attributable, US\$m)	157	196	392	157	243	408	0%	24%	4%
EPS (reported) (Acps)	8.3	10.7	21.4	8.3	13.3	22.2	0%	24%	4%
PER (x)	14.0	10.8	5.4	14.0	8.7	5.2	-	(2.1)	(0.2)
EPS growth (%)	1%	29%	100%	1%	60%	68%	0%	31%	-33%
DPS (Acps)	4	4	7	4	6	8	0%	50%	14%
Yield	3.5%	3.5%	6.1%	3.5%	5.2%	6.9%	0%	2%	1%
NPV (A\$/sh)	1.14	1.39	1.80	1.16	1.42	1.86	2%	2%	3%
Price Target (A\$/sh)		1.39			1.42			2%	

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

These changes drive material earnings increases for CY22 and bring forward the earnings growth profile that had previously been weighted to CY23. Our accelerated production start and ramp-up assumptions result in the following changes to our earnings forecasts: CY21: unchanged, CY22: up 24%, CY23: up 4%. While these updates bring forward positive free cash flows, they have relatively minor impact on our NPV-based valuation due to the long-life nature of the assets. Our target price increases incrementally, to \$1.42/sh.

In our view, the accelerated ramp-up reinforces the compelling valuation metrics NIC is trading on for an industrial style growth stock: CY21 P/E of 14.0x and forward P/E's of 8.7x and 5.2x for CY22 and CY23 respectively. NIC's CY21 dividend yield is also competitive, at 3.5%, rising to 5.2% and 7.0% in CY22 and CY23 respectively (all unfranked).

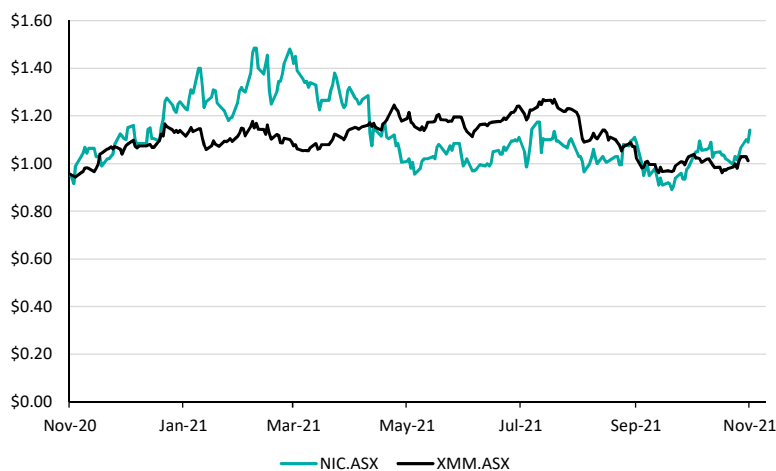
Upcoming catalysts

Upcoming catalysts for NIC include:

- Updates on NPI pricing and the effective Ni payability, which we believe the market will continue to consider as a measure of NIC's nickel price exposure;
- Further updates on the construction of the Angel Nickel project, comprising 4 next-generation rotary-kiln-electric-furnace (RKEF) lines being developed within the Indonesia Weda Bay Industrial Park (IWIP), in which NIC now holds an 80% interest;
- Progress updates for the Hengjaya Mine, where a major production expansion is complete and the sustainability of production of +150kt ore per month and costs of ~US\$20/t are targeted;
- Exploration and development updates on the Siduarsari Nickel-Cobalt project in Papua province, Indonesia, in which NIC has recently acquired a 100% interest;
- The release of NIC's December 2021 quarterly production and cost report, expected in late January 2022; 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') was formed in 2007 and listed on the ASX in 2018. Its operations are focused in Central Sulawesi, Indonesia, where it holds an 80% 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. The RKEF lines are located in an existing, fully integrated stainless steel production facility, the Indonesian Morowali Industrial Park (IMIP).

First production from the Hengjaya Lines was achieved on 31 January 2019 and the Ranger Lines commenced production during the December quarter 2019. Both projects have since achieved steady state production of ~20ktpa contained Ni in NPI, exceeding nameplate production of ~16ktpa each at lower than planned operating costs.

In November 2020 NIC executed a binding agreement to acquire a 70% interest (since increased to 80%) in the Angel Nickel Project comprising four new generation RKEF NPI production lines and a captive 380MW power station. Angel Nickel is currently under construction within the Indonesia Weda Bay Industrial Park ('IWIP') on Halmahera Island in Indonesia.

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 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\$1.42/sh (from \$1.39/sh)

Our accelerated production start and ramp-up assumptions are the key drivers of earnings and valuation upgrades of CY21: 0%, CY22: +24% and CY23: +4%. In our view, this reinforces the compelling valuation metrics NIC is trading on for an industrial style stock with an aggressive growth profile. P/E's are: CY21: 13.9x; CY22: 8.6x; and CY23: 5.2x. Dividend yields (unfranked) are also competitive and rising, at 3.5%, 5.2% and 7.0% for CY21, CY22 and CY23 respectively. We retain our Buy recommendation.

Valuation: \$1.42/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% in 2028) in the Hengjaya laterite nickel ore mine.

We also include a risk-adjusted, NPV-based valuation for NIC's prospective 80% interest in the Angel Nickel Industry (ANI) project, a notional value for other 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 \$1.42/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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