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Nickel Mines Ltd (NIC)

Tax breaks add value, input costs steady

Recommendation

Buy (unchanged)

Price

\$1.27

Target (12 months)

\$1.88 (previously \$1.76)

GICS Sector

Materials

Expected Return

Capital growth	48%
Dividend yield	3.9%
Total expected return	51.9%

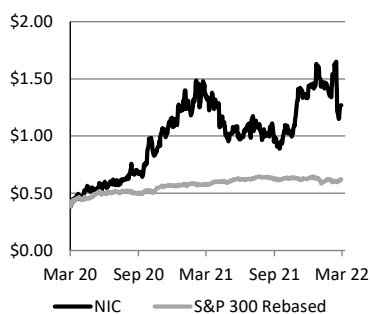
Company Data & Ratios

Enterprise value	\$3,441m
Market cap	\$3,331m
Issued capital	2,623m
Free float	77%
Avg. daily val. (52wk)	\$17.0m
12 month price range	\$0.885-\$1.79

Price Performance

	(1m)	(3m)	(12m)
Price (A\$)	1.38	1.37	1.46
Absolute (%)	-7.6	-7.0	-13.0
Rel market (%)	-8.6	-5.5	-19.7

Absolute Price



SOURCE: IRESS

Tax breaks add value

NIC has announced PT Oracle Nickel Industry (ONI), the operating entity housing the Oracle Nickel RKEF project, has been granted material corporate tax relief. The tax relief is consistent with the project's compliance with investment requirements outlined in legislation that regulates the granting of Corporate Income Tax Relief in Indonesia. It is broadly consistent with the terms of Tax Relief that has been granted to NIC's Ranger, Hengjaya and Angel Nickel projects. The key tax concessions include: Corporate Income Tax reduction of 100% for a period of ten years, starting from the year in which commercial production is achieved; and Corporate Income Tax Reduction of 50% of payable income tax for a period of two years, starting from the end of the initial ten-year period. On our current modelled assumptions for the Oracle Nickel project, the main tax concession eliminates an expense of ~US\$50m per annum for ten years. This flows directly through to the bottom line and to free cash flow, boosting earnings and our NPV-based valuation.

Input cost pressures steady qoq

We have also reviewed our near-term operating cost forecasts, finding that some key input costs have in fact stabilised quarter-on-quarter (qoq). These include NPI feedstock (laterite nickel ore), power costs (exposed to the thermal coal price), and reductant agent (metallurgical coal). Overall, we estimate that these changes translate into relatively steady operating costs as we progress through the March 2022 quarter. Notwithstanding this analysis, these key input costs have remained elevated longer than we had forecast. As a result, we have lifted our CY22e operating costs by 7%.

Investment thesis – Buy, TP\$1.88/sh (from Buy, TP\$1.76/sh)

We view NIC's steep price drop as an acquisition opportunity. The operating and development fundamentals of the business are unchanged and we view the perceived risk increase as tangential to NIC. We lower our CY22 and CY23 earnings forecasts by 15% and 9%, respectively, on higher costs, but continue to forecast aggressive EPS growth. Our target price increases by 7%, to \$1.88/sh as we factor in the latest tax concessions. We retain our Buy recommendation.

Earnings Forecast

Year ending 31 December	2021a	2022e	2023e	2024e
Sales (US\$m)	646	1,160	1,681	1,916
EBITDA (US\$m)	243	411	741	809
Attributable NPAT (reported) (US\$m)	138	216	446	499
Attributable NPAT (reported) (A\$m)	184	296	610	683
EPS (adjusted) (Acps)	7.3	11.3	22.3	24.9
EPS growth (%)	-11%	54%	98%	12%
PER (x) 1	17.4	11.3	5.7	5.1
FCF Yield (%) 1	-17%	3%	24%	30%
EV/EBITDA (x) 1	10.4	6.2	3.4	3.1
Dividend (Acps)	4.0	5.0	9.0	10.0
Yield (%)	3.1%	3.9%	7.1%	7.9%
Franking (%)	0%	0%	0%	0%
ROE (%) 1	18%	24%	39%	37%

SOURCE: BELL POTTER SECURITIES ESTIMATES

Tax breaks add value, input costs steady

Tax breaks add value

NIC recently announced that PT Oracle Nickel Industry (ONI), the operating entity housing the Oracle Nickel RKEF project, has been granted material corporate tax relief. The tax relief is consistent with the project's compliance with investment requirements outlined in legislation that regulates the granting of Corporate Income Tax Relief in Indonesia. It is also broadly consistent with the terms of Tax Relief that has already been granted to the Ranger, Hengjaya and Angel Nickel projects, in which NIC has interests.

The key tax concessions include:

- Corporate Income Tax Reduction of 100% for a period of ten tax years, starting from the tax year in which commercial production is achieved;
- Corporate Income Tax Reduction of 50% of payable income tax for a period of two tax years, starting from the end of the initial ten-year period; and
- exemption from withholding and tax collection by third parties on sales proceeds that would normally be remitted to the Indonesian Revenue Department for a period of ten tax years, also commencing from the tax year in which commercial production is achieved.

At steady state operations, on our current modelled assumptions for the Oracle Nickel project, the key tax concession eliminates an expense of ~US\$50m per annum for ten years. This flows directly through to the bottom line and to free cash flow, boosting earnings and our NPV-based valuation.

Input cost pressures steady qoq

We have also reviewed our near-term operating cost forecasts, finding that while elements are still rising, other key input costs have in fact stabilised quarter-on-quarter (qoq). Key inputs include NPI feedstock (laterite nickel ore), power costs (exposed to the thermal coal price), and reductant agent (metallurgical coal).

In order of weighted contribution to NIC's operating costs, we estimate the following quarter-on-quarter input price changes (March 2022 quarter to date vs December 2021 quarter):

- Laterite nickel ore: flat to down ~2% qoq (1.5% Ni, cif China basis);
- Indonesian thermal coal: flat to down ~4% (Kalimantan, 5,000kcal/kg basis); and
- Metallurgical coal: up ~25% (Hard coking coal, fob Australia basis).

Overall, we estimate that these changes translate into relatively steady operating costs as we progress through the March 2022 quarter. Notwithstanding this analysis, these key input costs have remained elevated longer than we had forecast, in part due to the impact on global energy prices resulting from the invasion of Ukraine by Russia. As a result, we have lifted our forecast operating costs for CY22-CY24 by 7-11%.

Changes to our forecasts

We have updated our financial forecasts and modelled assumptions to reflect the recent confirmation of tax concessions to the Oracle Nickel Project, specifically:

- Applying a 0% corporate income tax rate from the commencement of production (1QCY23) until end CY32;
- Applying a 12.5% corporate income tax rate from the end of the initial tax concession period (1QCY32) until end CY33; and
- Removed our withholding tax assumption from the commencement of production (1QCY23) until end CY32.

In addition to this we have also increased our forecast production costs, reflecting ongoing input cost pressure from elevated thermal coal, met coal and laterite nickel ore prices. This has resulted in a 7% increase to our CY22 cost forecast, to ~US\$11,500/t. We have also rolled our model forward. The net impacts 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-22	Dec-23	Dec-24	Dec-22	Dec-23	Dec-24	Dec-22	Dec-23	Dec-24
Prices & currency									
Nickel price (US\$/t)	19,456	18,629	18,739	19,456	18,629	18,739	0%	0%	0%
US\$/A\$	0.73	0.73	0.73	0.73	0.73	0.73	0%	0%	0%
Production & costs									
Ore mined (t)	2,400,000	2,400,000	2,400,000	2,400,000	2,400,000	2,400,000	0%	0%	0%
Nickel in ore (t)	43,200	43,200	43,200	43,200	43,200	43,200	0%	0%	0%
RKEF NPI production (t)	517,008	789,615	904,615	517,008	789,615	904,615	0%	0%	0%
Contained nickel (t)	66,771	100,846	114,646	67,646	100,823	114,623	1%	0%	0%
Contained nickel (t, attributable)	53,417	78,457	88,117	54,117	78,438	88,098	1%	0%	0%
Cash costs (US\$/t Ni)	10,700	8,674	8,858	11,493	9,626	9,762	7%	11%	10%
Earnings & valuation									
Revenue (consolidated, US\$m)	1,149	1,681	1,917	1,160	1,681	1,916	1%	0%	0%
EBITDA (consolidated, US\$m)	463	838	914	411	741	809	-11%	-12%	-11%
EBITDA (attributable, US\$m)	368	651	701	327	577	621	-11%	-11%	-11%
NPAT (reported, attributable, US\$m)	255	492	534	216	446	499	-15%	-9%	-7%
EPS (reported) (Acps)	13.3	24.6	26.7	11.3	22.3	24.9	-15%	-9%	-7%
PER (x)	9.6	5.2	4.8	11.3	5.7	5.1	1.7	0.5	0.3
EPS growth (%)	82%	85%	9%	54%	98%	12%	-28%	13%	3%
DPS (Acps)	6.0	10.0	11.0	5.0	9.0	10.0	-17%	-10%	-9%
Yield	4.7%	7.9%	8.7%	3.9%	7.1%	7.9%	-1%	-1%	-1%
NPV (A\$/sh)	1.76	2.16	2.66	1.88	2.18	2.38	6%	1%	-11%
Price Target (A\$/sh)		1.76			1.88			7%	

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Our CY22 and CY23 earnings are cut by 15% and 9% respectively, with higher costs in CY23 offset by the reduced income tax rate being applied. We continue to forecast aggressive EPS growth of 54% and 98% for FY22 and FY23, on what we view as conservative production forecasts. Our NPV-based valuation is increased by 7%, to \$1.88/sh.

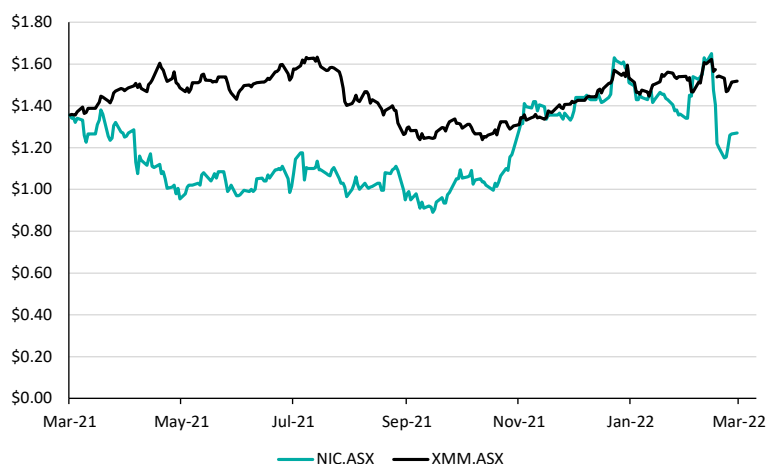
Upcoming catalysts

Upcoming catalysts for NIC include:

- Updates on Nickel Pig Iron (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 production ramp-up progress of ANI, in which NIC holds an 80% interest. We anticipate full production in the December quarter 2022;
- Further updates on the construction of ONI, comprising 4 next-generation RKEF lines being developed within the IMIP. Commissioning is to commence in 1QCY23;
- Progress updates for the Hengjaya Mine, where a major production expansion is complete. We will be looking for costs to track lower, towards ~US\$20/t and for the first commercial limonite nickel ore sales in 1QCY22;
- The release of the March 2022 quarterly production and cost report, expected in late April 2022;
- Exploration and development updates on the Siduars Nickel-Cobalt project in Papua province, Indonesia, in which NIC has recently acquired a 100% interest; 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.

NIC has also executed binding agreements to acquire an 80% interest in the Angel Nickel Project comprising four new generation RKEF NPI production lines currently in production ramp up production within the Indonesia Weda Bay Industrial Park (IWIP) on Halmahera Island in Indonesia and a 70% interest in the Oracle Nickel Project, comprising four new generation RKEF NPI production lines currently under construction within the IMIP.

NIC also holds an 80% interest in Hengjaya Mine ('HM'), a high-grade, long-life nickel laterite deposit, in close proximity to the IMIP. The HM produces Direct Shipping Ore (DSO), the bulk of which is sold into the IMIP facility.

Investment thesis – Buy, TP\$1.88/sh (from Buy, TP\$1.76/sh)

We view NIC's steep price drop as an acquisition opportunity. The operating and development fundamentals of the business are unchanged and we view the perceived risk increase as tangential to NIC. We lower our CY22 and CY23 earnings forecasts by 15% and 9%, respectively, on higher costs, but continue to forecast aggressive EPS growth. Our target price increases by 7%, to \$1.88/sh as we factor in the latest tax concessions. We retain our Buy recommendation.

Valuation: \$1.88/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 80% interest in the Angel Nickel Industry (ANI) project, its 70% interest in the Oracle Nickel Project (ONI) and 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 \$1.88/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 ~18% holding in NIC equity.

Table 2 - Financial summary

PROFIT AND LOSS						FINANCIAL RATIOS							
Year ending 31 Dec.	Unit	2020a	2021a	2022e	2023e	2024e	Year ending 31 Dec.	Unit	2020a	2021a	2022e	2023e	2024e
Revenue	US\$m	523.5	645.9	1,160.3	1,681.0	1,916.3	VALUATION						
Expense	US\$m	(329.0)	(402.7)	(749.1)	(939.5)	(1,106.8)	Attributable NPAT	US\$m	110.6	137.9	215.9	445.7	498.6
EBITDA	US\$m	194.5	243.2	411.2	741.5	809.4	Attributable NPAT	A\$m	160.1	183.6	295.8	610.5	683.0
Depreciation	US\$m	(36.8)	(36.0)	(67.2)	(97.0)	(111.4)	Reported EPS	US\$/sh	5.7	5.5	8.2	16.3	18.2
EBIT	US\$m	157.7	207.3	344.0	644.5	698.0	Reported EPS	Ac/sh	8.2	7.3	11.3	22.3	24.9
Net interest expense	US\$m	(4.7)	(12.7)	(24.9)	(24.6)	(10.4)	Adjusted EPS	Ac/sh	8.2	7.3	11.3	22.3	24.9
Unrealised gains (Impairments)	US\$m	-	-	-	-	-	EPS growth	%	62%	-11%	54%	98%	12%
Other	US\$m	1.6	(13.5)	(26.0)	(24.6)	(24.2)	PER ¹	x	15.5x	17.4x	11.3x	5.7x	5.1x
PBT	US\$m	154.6	181.0	293.1	595.3	663.4	DPS	Ac/sh	3.0	4.0	5.0	9.0	10.0
Tax expense	US\$m	(0.9)	(5.1)	(7.8)	(8.7)	(3.7)	Franking	%	0%	0%	0%	0%	0%
Consolidated profit (loss) for the year	US\$m	153.7	176.0	285.3	586.6	659.7	Yield	%	2.4%	3.1%	3.9%	7.1%	7.9%
Non-Controlling Interest	US\$m	43.1	38.0	69.4	140.9	161.1	FCF/share ¹	Ac/sh	(2.6)	(21.6)	3.9	30.4	38.7
Attributable NPAT (reported)	US\$m	110.6	137.9	215.9	445.7	498.6	PCF yield ¹	%	-2%	-17%	3%	24%	30%
NPAT (underlying)	US\$m	110.6	137.9	215.9	445.7	498.6	P/FCFPS ¹	x	-49.6x	-5.9x	33.0x	4.2x	3.3x
							EV/EBITDA ¹	x	13.1x	10.4x	6.2x	3.4x	3.1x
							EBITDA margin	%	37%	38%	35%	44%	42%
							EBIT margin	%	30%	32%	30%	38%	36%
							Return on assets ¹	%	17%	12%	14%	23%	24%
							Return on equity ¹	%	27%	18%	24%	39%	37%
							LIQUIDITY & LEVERAGE						
							Net debt (cash)	\$m	(306)	190	40	(329)	(845)
							ND / E	%	-33%	18%	3%	-20%	-44%
							ND / (ND + E)	%	-48%	16%	3%	-25%	-78%
							EBITDA / Interest	x	40.9x	19.1x	16.5x	30.1x	18.1x
							ATTRIBUTABLE DATA - NICKEL MINES LTD						
							Year ending 31 Dec.	Unit	2020a	2021a	2022e	2023e	2024e
							Revenues	US\$m	391.3	578.8	1,010.0	1,390.2	1,540.2
							EBITDA	US\$m	139.7	199.2	326.9	576.7	621.1
							NPAT	US\$m	110.6	137.9	215.9	445.7	498.6
							Net distributable cash flow	US\$m	269.3	(190.4)	212.8	197.3	306.9
							EV/EBITDA	x	17.0	13.0	7.7	4.4	4.0
							PER	x	15.5	17.4	11.3	5.7	5.1
							P/FCF	x	nm	nm	nm	12.3	7.9
							ORE RESERVE AND MINERAL RESOURCE						
							Hengjaya Nickel Mine (HM)						
							Mineral Resources						
							Measured			20,000	1.30%	260,000	
							Indicated			109,000	1.30%	1,417,000	
							Inferred			56,000	1.30%	728,000	
							Total			185,000	1.30%	2,405,000	
							ASSUMPTIONS - Prices						
							Year ending 31 Dec. (avg)	Unit	2020a	2021a	2022e	2023e	2024e
							Nickel	US\$/lb	\$6.25	\$8.37	\$8.83	\$8.45	\$8.50
							Nickel	US\$/t	\$13,775	\$18,460	\$19,456	\$18,629	\$18,739
							Currency						
							AUD:USD		0.69	0.75	0.73	0.73	0.73
							ASSUMPTIONS - Production & costs						
							Year ending 31 Dec.	Unit	2020a	2021a	2022e	2023e	2024e
							Hengjaya Mine						
							Ore mined	wmt	795,650	2,169,972	2,400,000	2,400,000	2,400,000
							Ore grade	% Ni	1.8%	1.8%	1.8%	1.8%	1.8%
							Nickel in ore	t Ni	14,479	38,165	43,200	43,200	43,200
							Nickel in ore (attributable)	t Ni	11,583	30,532	34,560	34,560	34,560
							RKEF (IMIP)						
							NPI production	t	295,897	298,352	517,008	789,615	904,615
							Contained nickel	t Ni	43,622	40,411	67,646	100,823	114,623
							Contained nickel (attributable)	t Ni	30,619	32,329	54,117	78,438	88,098
							Costs						
							Cash costs	US\$/t Ni	\$7,330	\$10,106	\$11,493	\$9,626	\$9,762
							All-in-Costs (AIC)	US\$/t Ni	\$7,414	\$10,225	\$11,586	\$9,731	\$9,868
							VALUATION						
							Ordinary shares (m)						2,623.2
							Options in the money (m)						-
							Total shares diluted (m)						2,623.2
							Valuation		CY22	CY23	CY24		
							Sum-of-the-parts	A\$m	A\$/sh	A\$m	A\$/sh	A\$m	A\$/sh
							IMIP RKEF (NPV12)	2,085.1	0.79	2,153.1	0.82	2,107.7	0.80
							IWIP RKEF (NPV12)	2,050.0	0.78	2,104.7	0.80	2,106.5	0.80
							ONI RKEF (NPV12)	785.7	0.30	1,444.0	0.55	1,580.8	0.60
							Hengjaya Mine (NPV12)	102.6	0.04	115.5	0.04	104.2	0.04
							Other exploration	120.0	0.05	120.0	0.05	120.0	0.05
							Corporate overheads	(106.5)	(0.04)	(112.2)	(0.04)	(112.9)	(0.04)
							Subtotal (EV)	5,036.9	1.92	5,825.1	2.22	5,906.3	2.25
							Net cash (debt)	(109.9)	(0.04)	(109.9)	(0.04)	329.3	0.13
							Total (undiluted)	4,927.1	1.88	5,715.3	2.18	6,235.6	2.38
							Dilutive effect of options						
							Add cash from options						
							Total (diluted)	4,927.1	1.88	5,715.3	2.18	6,235.6	2.38
							MAJOR SHAREHOLDERS						
							Shareholder	%					m
							Shanghai Decent (SDI)		17.9%				469.7
							Tanito Group (PT Karunia)		14.4%				378.4
							BlackRock Investment Management		7.5%				195.5
							Directors and Management		5.3%				137.9
							Shanghai Wanlu		4.6%				121.3

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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