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Nickel Mines Ltd (NIC)

Final Ranger line commences production

Recommendation

Buy (unchanged)

Price

\$0.41

Valuation

\$0.95 (unchanged)

Risk

Speculative

GICS Sector

Materials

Expected Return

Capital growth	131.7%
Dividend yield	0.0%
Total expected return	131.7%

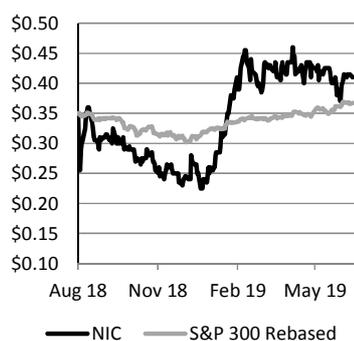
Company Data & Ratios

Enterprise value	\$489.1m
Market cap	\$569.1m
Issued capital	1,388m
Free float	51%
Avg. daily val. (52wk)	\$640,000
12 month price range	\$0.22-\$0.465

Price Performance

	(1m)	(3m)	(12m)
Price (A\$)	0.42	0.43	
Absolute (%)	-1.2	-3.5	
Rel market (%)	-3.7	-12.0	

Absolute Price



SOURCE: IRESS

Key milestone achieved – all RKEF lines up and running

NIC has announced that first Nickel Pig Iron (NPI) was achieved on 29 June 2019 from Rotary Kiln Electric Furnace (RKEF) line #2, at the Ranger Nickel Project in Indonesia. This final RKEF line is expected to ramp up to 80% of nameplate capacity in the next 2 months. Following a similar schedule to the two Hengjaya RKEF lines would then see all four RKEF lines at full production during the December 2019 quarter. In late July 2019 a shareholders' meeting will be held to approve NIC lifting its ownership of Ranger to 60%, which with its current 60% interest in Hengjaya, would result in NIC having attributable nickel production of ~20ktpa once the Ranger lines reach their nameplate capacity.

Excellent start being maintained – de-risking delivered

This milestone means that all four RKEF lines have been put into production within 18 months of dirt being broken on this project which is an impressive achievement. The commissioning of these RKEF lines ahead of schedule closes the first chapter of an excellent start. The momentum of this is being maintained according to the production update released in early June which showed production and costs for April and May tracking ahead of schedule (see 18 June [note](#)). This milestone has delivered on one of the key tenets of our investment thesis, being the de-risking of this project's development due to the established infrastructure and the construction and commissioning experience of NIC's partner, Shanghai Decent Investments (SDI).

Investment thesis – Speculative Buy, valuation \$0.95/sh

This latest update is very much consistent with our current modelled assumptions and valuation. Our NPV-based, 12-month forward valuation is unchanged at \$0.95/sh, but the announcement highlights the positive progress being made at the Hengjaya and Ranger Nickel Projects and is an opportunity to reiterate NIC as our top pick in the sector. We retain our Speculative Buy recommendation.

Earnings Forecast

Year ending 30 June	2018a	2019e	2020e	2021e
Sales (US\$m)	14	47	556	576
EBITDA (US\$m)	(2)	16	273	288
Attributable NPAT (reported) (US\$m)	(3)	2	150	160
Attributable NPAT (adjusted) (US\$m)	(3)	2	150	160
EPS (adjusted) (Aeps)	(0.9)	0.3	13.3	12.8
EPS growth (%)	nm	nm	4846%	-4%
PER (x)	nm	152.1	3.1	3.2
FCF Yield (%)	-41%	-34%	34%	55%
EV/EBITDA (x)	(219.4)	21.6	1.2	1.2
Dividend (Aeps)	-	-	-	-
Yield (%)	0%	0%	0%	0%
Franking (%)	0%	0%	0%	0%
ROE (%)	-8%	1%	67%	50%

SOURCE: BELL POTTER SECURITIES ESTIMATES

Final Ranger line commences production

Changes to our forecasts

This latest update is very much consistent with our current modelled assumptions and valuation. We have made no major changes to our forecasts, which 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)	5.83	7.15	7.45	5.83	7.15	7.45	0%	0%	0%
Nickel price (US\$/t)	12,859	15,763	16,424	12,859	15,763	16,424	0%	0%	0%
US\$/A\$	0.72	0.74	0.75	0.72	0.74	0.75	0%	0%	0%
Production & costs									
Ore mined (Mt, 100%)	581,380	1,571,656	1,564,545	581,380	1,571,656	1,564,545	0%	0%	0%
Nickel in ore (t, 100%)	7,176	17,823	17,742	7,176	17,823	17,742	0%	0%	0%
Nickel in ore (attributable)	5,741	12,476	11,177	5,741	12,476	11,177	0%	0%	0%
RKEF NPI production (t, 100%)	40,224	280,000	300,000	40,224	280,000	300,000	0%	0%	0%
Contained nickel (t, 100%)	5,390	33,150	33,000	5,390	33,150	33,000	0%	0%	0%
Contained nickel (t, attributable)	2,075	19,890	19,800	2,075	19,890	19,800	0%	0%	0%
Cash costs (US\$/t Ni)	-	7,792	7,974	-	7,792	7,974	na	0%	0%
AISC (US\$/t Ni)	-	7,841	8,023	-	7,841	8,023	na	0%	0%
Earnings									
Revenue (attributable, US\$m)	43	338	347	43	338	347	0%	0%	0%
EBITDA (attributable, US\$m)	15	165	173	15	165	173	0%	0%	0%
NPAT (reported, attributable, US\$m)	2	150	160	2	150	160	0%	0%	0%
EPS (reported) (Acps)	0	13	13	0	13	13	0%	0%	0%
PER (x)	152.1	3.1	3.2	152.1	3.1	3.2	-	-	-
EPS growth (%)	nm	4846%	-4%	nm	4846%	-4%	nm	0%	0%
DPS (Acps)	-	-	-	-	-	-	na	na	na
Yield	0%	0%	0%	0%	0%	0%	0%	0%	0%
NPV (A\$/sh)	0.82	0.95	1.18	0.82	0.95	1.18	0%	0%	0%
Price Target (A\$/sh)		0.95			0.95			0%	

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

NIC is now trading on a CY20 P/E of only 3.1x – very cheap for what is in many respects a high growth industrial story.

Our NPV-based, 12-month forward valuation remains unchanged at \$0.95/sh. With upside of 131.7% from the last closing price, we retain our Speculative Buy recommendation.

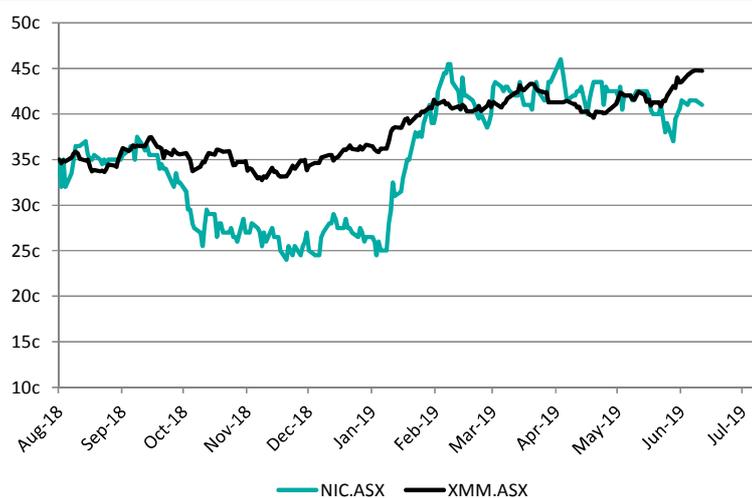
Upcoming catalysts

Upcoming catalysts for NIC include:

- Further production updates on ramp-up of the Hengjaya and Ranger Nickel RKEF lines. The Hengjaya Lines achieved nickel production above nameplate during the June quarter 2019 and the Ranger Lines are now both in production. The Ranger RKEF lines are expected to reach 80% of nameplate capacity in the September quarter 2019 and full production during the December quarter 2019;
- The June quarter production and cost report in July 2019; and
- The release of NIC's FY19 financial results in August 2019.

NIC vs the ASX Metals and Mining Index (XMM)

Figure 1 - NIC relative share price performance vs ASX Metals and Mining Index (XMM)



SOURCE: IRESS

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 (the Hengjaya lines) and a 17% interest in a further two RKEF lines (the 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), in Central Sulawesi, Indonesia. First production from the Hengjaya Lines was achieved on 31 January 2019 and these are on track to reach nameplate production of 16ktpa nickel in NPI (100% basis) during the June quarter 2019. The Ranger Lines are planned to commence production during the June 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 – Speculative Buy, valuation \$0.95/sh

This latest update is very much consistent with our current modelled assumptions and valuation. Our NPV-based, 12-month forward valuation is unchanged at \$0.95/sh, but the announcement highlights the positive progress being made at the Hengjaya and Ranger Nickel Projects and is an opportunity to reiterate NIC as our top pick in the sector. We retain our Speculative Buy recommendation.

Valuation: \$0.95/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 60% interest in the two Ranger Nickel RKEF lines. This includes assumptions around funding of the increased interest via the proposed US\$175m package of US\$80m debt and US\$95m of new equity, with US\$40m of this accepted by SDI in consideration for NIC's acquisition of a further 43% in the Ranger Nickel project.

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 \$0.95/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	46.7	555.6	575.6	VALUATION						
Expense	US\$m	(11.9)	(15.1)	(30.9)	(282.5)	(287.8)	Attributable NPAT	US\$m	(3.8)	(3.3)	2.1	150.2	160.4
EBITDA	US\$m	(3.3)	(1.6)	15.8	273.1	287.8	Attributable NPAT	A\$m	(5.1)	(4.4)	2.9	202.9	213.8
Depreciation	US\$m	(0.1)	(0.1)	(1.8)	(15.9)	(15.8)	Reported EPS	Ac/sh	(1.6)	(0.9)	0.3	13.3	12.8
EBIT	US\$m	(3.4)	(1.6)	14.0	257.2	272.0	Adjusted EPS	Ac/sh	(1.6)	(0.9)	0.3	13.3	12.8
Net interest expense	US\$m	(0.5)	(0.7)	0.0	(2.4)	(0.3)	EPS growth	%	nm	nm	nm	4846%	-4%
Unrealised gains (Impairments)	US\$m	-	-	-	-	-	PER	x	nm	nm	152.1x	3.1x	3.2x
Other	US\$m	-	-	(11.4)	-	-	DPS	Ac/sh	-	-	-	-	-
PBT	US\$m	(3.9)	(2.3)	2.7	254.7	271.7	Franking	%	0%	0%	0%	0%	0%
Tax expense	US\$m	0.2	(0.7)	-	(3.4)	(3.5)	Yield	%	0%	0%	0%	0%	0%
Consolidated profit (loss) for the year	US\$m	(3.7)	(2.9)	2.7	251.3	268.1	FCF/share	Ac/sh	(0.0)	(16.9)	(13.9)	14.0	22.4
Non-Controlling Interest	US\$m	0.1	0.4	(0.6)	(101.2)	(107.8)	FCF yield	%	0%	-41%	-34%	34%	55%
Attributable NPAT (reported)	US\$m	(3.8)	(3.3)	2.1	150.2	160.4	P/FCFPS	x	-3676.3x	-2.4x	-2.9x	2.9x	1.8x
NPAT (underlying)	US\$m	(3.8)	(3.3)	2.1	150.2	160.4	EV/EBITDA	x	-102.6x	-219.4x	21.6x	1.2x	1.2x
							EBITDA margin	%	nm	nm	34%	49%	50%
							EBIT margin	%	nm	nm	30%	46%	47%
							Return on assets	%	-27%	-5%	1%	54%	39%
							Return on equity	%	2029%	-8%	1%	67%	50%
							LIQUIDITY & LEVERAGE						
							Net debt (cash)	\$m	-	-	(107)	(167)	(343)
							ND / E	%	0%	0%	-35%	-37%	-56%
							ND / (ND + E)	%	0%	0%	-55%	-58%	-127%
							EBITDA / Interest	x	-6.1x	-2.4x	nm	112.4x	981.3x
							ATTRIBUTABLE DATA - NICKEL MINES LTD						
							Year ending 30 June	Unit	2017a	2018a	2019e	2020e	2021e
							Revenues	US\$m	6.9	10.8	43.1	337.7	346.7
							EBITDA	US\$m	(2.7)	(1.2)	14.9	164.8	172.5
							NPAT	US\$m	(3.8)	(3.3)	2.1	150.2	160.4
							Net distributable cash flow	US\$m	0.1	0.0	95.4	125.9	144.3
							EV/EBITDA	x	nm	nm	22.9	2.1	2.0
							PER	x	nm	nm	193.0	2.8	2.7
							P/FCF	x	nm	nm	nm	3.3	3.0
							ORE RESERVE AND MINERAL RESOURCE						
							Hengjaya Nickel Mine (HM)				Mdmt	% Ni	t 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	\$5.83	\$7.15	\$7.45
							Nickel	US\$/t	\$10,141	\$12,456	\$12,859	\$15,763	\$16,424
							Currency						
							AUD:USD		0.75	0.78	0.72	0.74	0.75
							ASSUMPTIONS - Production & costs						
							Year ending 30 June	Unit	2017a	2018a	2019e	2020e	2021e
							Hengjaya Mine						
							Ore mined	wmt	303,597	391,362	581,380	1,571,656	1,564,545
							Ore grade	% Ni	2.1%	2.1%	2.0%	1.8%	1.8%
							Nickel in ore	t Ni	6,254	8,062	7,176	17,823	17,742
							Nickel in ore (attributable)	t Ni	5,003	6,450	5,741	12,476	11,177
							RKEF (IMIP)						
							NPI production	t	-	-	40,224	280,000	300,000
							Contained nickel	t Ni	-	-	5,390	33,150	33,000
							Contained nickel (attributable)	t Ni	-	-	2,075	19,890	19,800
							Costs						
							Cash costs	US\$/t Ni	-	-	-	\$7.792	\$7.974
							All-in-Sustaining-Costs (AISC)	US\$/t Ni	-	-	-	\$7.841	\$8.023
							VALUATION						
							Ordinary shares (m)						1,664.9
							Options in the money (m)						-
							Total shares diluted (m)						1,664.9
							Share price	A\$/sh					0.410
							Market capitalisation	A\$m					569.1
							Net cash	A\$m					80.0
							Enterprise value (undiluted)	A\$m					489.1
							Options outstanding (m)	m					0.0
							Options (in the money)	m					0.0
							Issued shares (diluted for options)	m					1,664.9
							Market capitalisation (diluted)	A\$m					682.6
							Net cash + options	A\$m					80.0
							Enterprise value (diluted)	A\$m					602.6
							MAJOR SHAREHOLDERS						
							Shareholder	%					m
							Directors and Management	18.1%					302.0
							Shanghai Decent (SDI)	9.7%					161.7
							Shanghai Wanlu	9.0%					149.3
							BlackRock Investment Management	8.3%					137.9
							Regal FM	4.3%					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.

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