

Nickel Mines (NIC)

Rating: Hold | Risk: High | Price Target: \$1.26

Another solid quarter, but downgrading to Hold

Key Information

Current Price (\$ps)	1.40
12m Target Price (\$ps)	1.26
52 Week Range (\$ps)	0.24 - 1.40
Target Price Upside (%)	(9.7%)
TSR (%)	(7.9%)
Reporting Currency	USD
Market Cap (\$m)	3,521
Sector	Materials
Avg Daily Volume (m)	4.9
ASX 200 Weight (%)	0.17%

Fundamentals

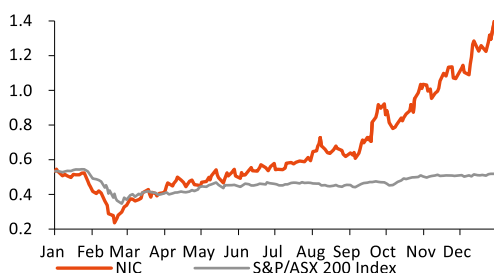
YE 31 Dec (USD)	FY19A	FY20E	FY21E	FY22E
Sales (\$m)	236	539	692	973
NPAT (\$m)	57	110	228	288
EPS (cps)	3.5	5.3	9.1	11.4
EPS Growth (%)	(42.3%)	49.1%	71.3%	26.5%
DPS (cps) (AUD)	0.0	2.9	6.5	11.7
Franking (%)	0%	0%	0%	0%

Ratios

YE 31 Dec	FY19A	FY20E	FY21E	FY22E
P/E (x)	13.0	20.5	11.9	9.4
EV/EBITDA (x)	27.5	14.4	8.1	5.9
Div Yield (%)	0.0%	1.9%	4.6%	8.3%
Payout Ratio (%)	0.0%	37.8%	55.2%	78.6%

Price Performance

YE 31 Dec	1 Mth	2 Mth	3 Mth	1 Yr
Relative (%)	29.2%	33.5%	45.8%	136.9%
Absolute (%)	31.2%	35.3%	56.1%	132.8%
Benchmark (%)	2.0%	1.8%	10.3%	(4.1%)



Price performance indexed to 100

Source:

Major Shareholders

Shanghai Decent (Tsingshan)	18.6%
PT Karunia Bara Perkasa	16.1%
BlackRock Investment Management (UK) Ltd	6.5%
Norm Seckold	5.8%
Shanghai Wanlu	5.7%

Event

Nickel Mines has released its December quarter activities report. It was another good quarter; production was strong although costs have increased from September. Nickel production is up 8% on a 100% basis. The company is in a strong cash position ahead of funding the Angel Project acquisition, but we downgrade our recommendation to Hold on valuation grounds after a period of strong performance.

Highlights

- Nickel Mines has an 80% economic interest in two Rotary Kiln Electric Furnace (RKEF) projects in the Indonesia Morowali Industrial Park (IMIP). The Chinese steel company Tsingshan holds the other 20%. Each project produces ~21ktpa nickel (100% basis) at a cost of ~US\$7,500/t. Nickel Mines is acquiring an 80% stake in the Angel Nickel Project at Weda Bay, also in Indonesia in partnership with Tsingshan.
- Production in the December quarter continued to recover from the rain affected June quarter. Total nickel production of 11,527kt is up 5% yoy and 8% on the Sept Qtr.
- Costs have increased to US\$7,526/t in the quarter (up from \$7,201/t in September), with Nickel Mines noting that nickel ore prices have increased, and there were a number of 'one-off' costs incurred in December relating to bonus payments, port charges and NPI processing charges. These should not recur in coming quarters although may remain a feature in future December months as books are closed and balanced.
- On a 100% basis the RKEFs generated revenue of US\$158.8m, record EBITDA of US\$71.6m and underlying NPAT of US\$67.8m.
- The Hengjaya mine had a record quarter as mining operations expand. Ore production more than doubled and costs have dropped to US\$25/t. However, the mine remains a marginal driver of Nickel Mines earnings and valuation.
- Nickel Mines finished the quarter with US\$351m cash, up from US\$93m at September 30th post the company's capital raise. Underlying free cash flow was positive \$71.9m.
- Subsequent to the quarter, Nickel Mines announced that the pricing of its nickel pig iron will no longer be linked to LME nickel prices, and instead will be linked to Chinese NPI prices. It will be interesting to monitor how this develops. It is possible that a two tiered nickel market evolves, one linked to battery grade nickel sulphate, and the other linked to NPI feedstock for the Chinese stainless steel industry. That is a potential negative for Nickel Mines if strong demand for battery grade nickel results in improving LME nickel prices, but not for NPI.
- We have modestly increased our earnings forecasts due to higher production (NPI grade) and slightly lower costs from 2021 than we were previously modelling. However, our valuation has reduced to \$1.26ps (from \$1.28ps) as we incorporate a higher AUD/USD exchange rate (75c v 72c previously).

	2020f			2021f			2022f			2023f		
	New	Old	Chg %	New	Old	Chg %	New	Old	Chg %	New	Old	Chg %
Revenue (US\$m)	539	531	n/a	692	674	3%	973	955	2%	1,233	1,216	1%
EBITDA (US\$m)	186	178	4%	328	303	8%	452	428	6%	552	528	5%
EBIT (US\$m)	156	148	5%	298	273	9%	422	398	6%	522	498	5%
NPAT (US\$m)	110	105	5%	228	207	10%	288	271	6%	365	348	5%
EPS (Acps)	5	5	5%	9	8	10%	11	11	6%	15	14	5%

Recommendation

Nickel Mines has a strong growth profile, but after a period of outperformance this is becoming priced. We are concerned that the change in the way NIC's NPI sales are priced will reduce the upside linked to strong EV demand for nickel. We downgrade our Recommendation to Hold.

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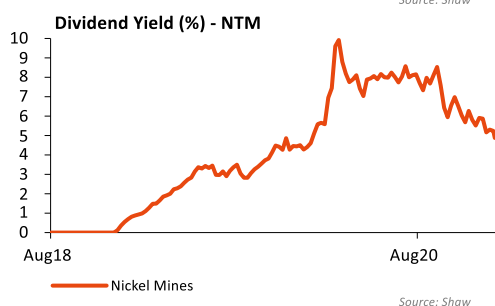
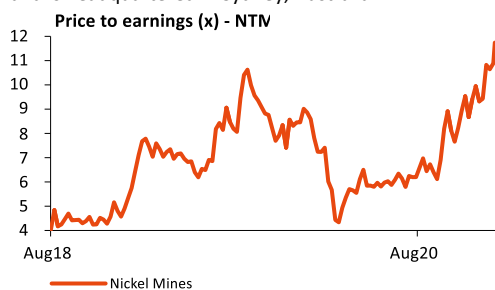
**Nickel Mines
Materials**

FactSet: NIC-AU / Bloomberg: NIC AU

Key Items	Data
Recommendation	HOLD
Risk	HIGH
Price (\$ps)	1.40
Target Price (\$ps)	1.26
52 Week Range (\$ps)	0.24 - 1.40
Shares on Issue (m)	2,515
Market Cap (\$m)	3,521
Enterprise Value (\$m)	3,456
TSR (%)	(7.9%)

Company Description

Nickel Mines Ltd. is a nickel producer with assets in Indonesia and operates in partnership with Tsingshan, the world's largest stainless steel producer. Nickel Mines produces nickel ore from the Hengjaya Mine which supplies feedstock to the Indonesia Morowali Industrial Park (IMIP). The company's main asset is an 80% stake in the Hengjaya and Ranger rotary kiln electric furnaces (RKEF) located in IMIP. The company was founded on September 12, 2007 and is headquartered in Sydney, Australia.



Financial Year End: 31 December

Investment Summary (USD)	FY19A	FY19A	FY20E	FY21E	FY22E
EPS (Reported) (cps)	6.1	3.5	5.3	9.1	11.4
EPS (Underlying) (cps)	6.1	3.5	5.3	9.1	11.4
EPS (Underlying) Growth (%)	n/a	(42.3%)	49.1%	71.3%	26.5%
PE (Underlying) (x)	4.7	13.0	20.5	11.9	9.4
EV / EBIT (x)	196.3	33.1	17.2	9.0	6.3
EV / EBITDA (x)	130.7	27.5	14.4	8.1	5.9
DPS (cps) (AUD)	0.0	0.0	2.9	6.5	11.7
Dividend Yield (%)	0.0%	0.0%	1.9%	4.6%	8.3%
Franking (%)	0%	0%	0%	0%	0%
Payout Ratio (%)	0.0%	0.0%	37.8%	55.2%	78.6%
Profit and Loss (USD) (m)	FY19A	FY19A	FY20E	FY21E	FY22E
Sales	65	236	539	692	973
Sales Growth (%)	n/a	263.5%	128.3%	28.3%	40.6%
Other Operating Income	3	1	1	1	1
EBITDA	20	97	186	328	452
EBITDA Margin (%)	31.5%	41.2%	34.5%	47.4%	46.4%
Depreciation & Amortisation	(7)	(16)	(30)	(30)	(30)
EBIT	14	81	156	298	422
EBIT Margin (%)	21.0%	34.2%	28.9%	43.1%	43.4%
Net Interest	58	11	(9)	(8)	(6)
Pretax Profit	72	91	147	290	416
Minorities	6	35	37	63	86
NPAT Underlying	66	57	110	228	288
Significant Items	0	0	0	0	0
NPAT Reported	66	57	110	228	288
Cashflow (USD) (m)	FY19A	FY19A	FY20E	FY21E	FY22E
EBIT	14	81	156	298	422
Payments to Suppliers	(28)	(170)	(354)	(365)	(522)
Receipts from Customers	33	213	540	693	974
Tax Paid	(1)	(5)	0	0	0
Net Interest	0	0	0	4	6
Depreciation & Amortisation	0	0	0	0	0
Other	0	0	(34)	7	(47)
Operating Cashflow	4	38	152	339	410
Capex	(20)	(30)	(13)	(3)	(3)
Acquisitions and Investments	(120)	(1)	(180)	(460)	0
Disposal of Fixed Assets/Investments	10	7	0	0	0
Other	(11)	0	0	0	0
Investing Cashflow	(141)	(24)	(193)	(463)	(3)
Equity Raised / Bought Back	173	(0)	409	0	0
Dividends Paid	0	0	(21)	(75)	(151)
Change in Debt	(2)	(30)	0	100	(100)
Other	15	17	(9)	(12)	(12)
Financing Cashflow	186	(13)	379	13	(263)
Exchange Rate Effect	(1)	(0)	0	0	0
Net Change in Cash	48	1	338	(111)	144
Balance Sheet (USD) (m)	FY19A	FY19A	FY20E	FY21E	FY22E
Cash	49	50	387	277	421
Accounts Receivable	44	97	140	133	187
Inventory	9	56	128	133	187
Other Current Assets	7	1	1	1	1
PPE	340	629	762	1,195	1,168
Total Assets	532	897	1,513	1,832	2,058
Accounts Payable	42	52	133	137	198
Short Term Debt	4	4	4	4	0
Long Term Debt	0	61	61	161	65
Income Taxes Payable	0	1	1	1	1
Other	30	57	57	58	99
Total Liabilities	77	175	256	361	363
Total Shareholder Equity	455	722	1,257	1,472	1,695
Ratios	FY19A	FY19A	FY20E	FY21E	FY22E
ROE (%)	n/a	15.3%	16.3%	22.7%	25.1%
Gearing (%)	(16.8%)	3.4%	(53.5%)	(11.6%)	(41.5%)
Net Debt / EBITDA (x)	(2.2)	0.2	(1.7)	(0.3)	(0.8)

Key risks

- The nickel price is volatile and is often driven by arbitrary policy changes such as the Indonesian export ban. As such, the price of nickel is relatively difficult to forecast and the actual price may differ substantially from our forecasts.
- Some investors may be concerned that the company operates in Indonesia, in partnership with a Chinese company and with Indonesian and Chinese strategic shareholders. However, Nickel Mines is 'inside the fence' and not an outsider. The relationship with Tsingshan is strong, and Tsingshan has a strong relationship with Indonesian authorities.
- Smaller companies carry more significant 'key personnel' risk than larger organisations. If senior management depart the company, then it could delay projects or exacerbate operational risks.

Core drivers and catalyst

- Nickel is predominantly used in the production of stainless steel (69% of consumption) but is finding growing use as a cathode in lithium ion batteries. The electrification of light vehicles is likely to see increased demand for nickel.
- Nickel Mines has an 80% economic interest in two RKEF projects in the IMIP. At a mid-cycle nickel price of US\$6.50/lb, the two projects will generate combined free cash flow of about US\$210mpa (100% basis).
- We value each RKEF project at US\$1,050m (100%, NPV @ 11%) and Nickel Mines recently exercised an option to increase its economic interest from 60% to 80% in both projects for US\$120m.
- Nickel Mines is acquiring an 80% interest in the Angel Nickel Project at Weda Bay in Indonesia, also in partnership with Tsingshan. This will double Nickel Mines' output.

Rating Classification

Buy	Expected to outperform the overall market
Hold	Expected to perform in line with the overall market
Sell	Expected to underperform the overall market
Not Rated	Shaw has issued a factual note on the company but does not have a recommendation

Risk Rating

High	Higher risk than the overall market – investors should be aware this stock may be speculative
Medium	Risk broadly in line with the overall market
Low	Lower risk than the overall market

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