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Nickel Mines Limited (NIC)

Tax concessions granted ahead of production start

Recommendation

Buy (unchanged)

Price

\$1.415

Target (12 months)

\$1.87 (previously \$1.74)

GICS Sector

Materials

Expected Return

Capital growth	32.2%
Dividend yield	2.8%
Total expected return	35.0%

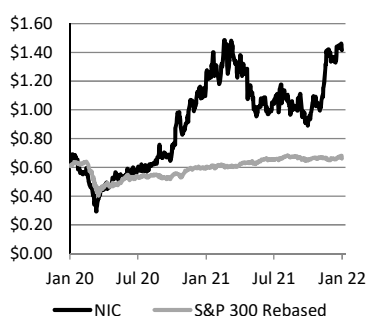
Company Data & Ratios

Enterprise value	\$3,843m
Market cap	\$3,559m
Issued capital	2,515m
Free float	76%
Avg. daily val. (52wk)	\$14.0m
12 month price range	\$0.885-\$1.54

Price Performance

	(1m)	(3m)	(12m)
Price (A\$)	1.41	0.91	1.11
Absolute (%)	0.7	55.5	28.1
Rel market (%)	-0.9	53.1	16.1

Absolute Price



SOURCE: IRESS

Tax concessions confirmed

NIC has announced that it has been granted material concessions on the corporate income tax payable at its 80%-owned Angel Nickel Project (ANI), that is in the final stages of construction within the Indonesia Weda Bay Industrial Park (IWIP). The concessions allow for a Corporate Income Tax Reduction of 100% for a period of ten tax years, starting from the tax year in which commercial production is achieved; and a reduction of 50% of payable income tax for a period of two tax years, starting from the end of the initial ten-year period. The tax concession has been granted under the same regulatory framework as that applied to the Ranger and Hengjaya projects, with the key difference being ANI's corporate income tax free period is for ten years, compared with seven years for the other projects. This is a function of the larger scale of ANI, which includes its own power station.

Earnings growth further enhanced

This is another very positive development for NIC. The corporate income tax holiday results in an effective 0% tax rate, compared with the standard 25% rate. This differential flows directly through to NIC's earnings and further enhances our forecast earnings profile, which already offers some of the strongest growth in the sector. The concessions have been granted in the lead-up to first production, which remains on track for the current quarter. While we had not previously incorporated the tax concessions into our forecasts, we had anticipated a seven year holiday was likely. That it is a ten year concession is ahead of our expectations. The deal further reinforces NIC's earnings growth outlook as a key tenet of our investment thesis.

Investment thesis – Buy, TP\$1.87/sh (from \$1.74/sh)

Updating for the tax concessions results in increases of 11% to our forecast earnings for both CY22 and CY23. We now forecast earnings growth of 78% and 94% for CY22 and CY23 respectively and forward P/E multiples of 9.6x and 5.0x. These metrics continue to offer excellent value for aggressive growth, in our view. Our NPV-based valuation lifts 7% to \$1.87/sh and NIC remains one of our top picks in the sector. Buy.

Earnings Forecast

Year ending 31 December	2020a	2021e	2022e	2023e
Sales (US\$m)	523	624	1,028	1,681
EBITDA (US\$m)	194	253	435	831
Attributable NPAT (reported) (US\$m)	111	157	270	524
Attributable NPAT (reported) (A\$m)	160	208	370	718
EPS (adjusted) (Acps)	8.2	8.3	14.7	28.6
EPS growth (%)	62%	0%	78%	94%
PER (x)	17.2	17.1	9.6	5.0
FCF Yield (%)	-2%	-9%	-1%	28%
EV/EBITDA (x)	14.2	10.9	6.3	3.3
Dividend (Acps)	3.0	4.0	6.0	11.0
Yield (%)	2.1%	2.8%	4.2%	7.8%
Franking (%)	0%	0%	0%	0%
ROE (%)	27%	20%	31%	50%

SOURCE: BELL POTTER SECURITIES ESTIMATES

Changes to our forecasts

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

- Lowered our modelled corporate income tax rate applied to the Angel Nickel Project from 25% to 0% from CY22 to CY32; and
- Lowered our modelled corporate income tax rate applied to the Angel Nickel Project from 25% to 12.5% from CY32 to CY34.

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	487,004	789,615	295,081	487,004	789,615	0%	0%	0%
Contained nickel (t)	40,516	62,971	100,846	40,516	62,971	100,846	0%	0%	0%
Contained nickel (t, attributable)	32,413	50,376	78,457	32,413	50,376	78,457	0%	0%	0%
Cash costs (US\$/t Ni)	9,521	9,825	8,674	9,521	9,825	8,674	0%	0%	0%
Earnings & valuation									
Revenue (consolidated, US\$m)	624	1,028	1,681	624	1,028	1,681	0%	0%	0%
EBITDA (consolidated, US\$m)	253	435	831	253	435	831	0%	0%	0%
EBITDA (attributable, US\$m)	202	347	647	202	347	647	0%	0%	0%
NPAT (reported, attributable, US\$m)	157	243	473	157	270	524	0%	11%	11%
EPS (reported) (Acps)	8.3	13.2	25.8	8.3	14.7	28.6	0%	11%	11%
PER (x)	17.1	10.7	5.5	17.1	9.6	5.0	-	(1.1)	(0.5)
EPS growth (%)	0%	60%	95%	0%	78%	94%	0%	18%	0%
DPS (Acps)	4.0	6.0	10.0	4.0	6.0	11.0	0%	0%	10%
Yield	2.8%	4.2%	7.1%	2.8%	4.2%	7.8%	0%	0%	1%
NPV (A\$/sh)	1.46	1.74	2.24	1.58	1.87	2.39	8%	7%	7%
Price Target (A\$/sh)		1.74			1.87			7%	

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

The primary changes to our forecasts and valuation is driven by the ten-year tax holiday, which results directly in increased earnings and free cash flow. It results in increases of 11% to our forecast earnings for both CY22 and CY23. We now forecast earnings growth of 78% and 94% for CY22 and CY23 respectively and forward P/E multiples of 9.6x and 5.0x respectively. Our NPV-based valuation lifts 7% to \$1.87/sh.

Upcoming catalysts

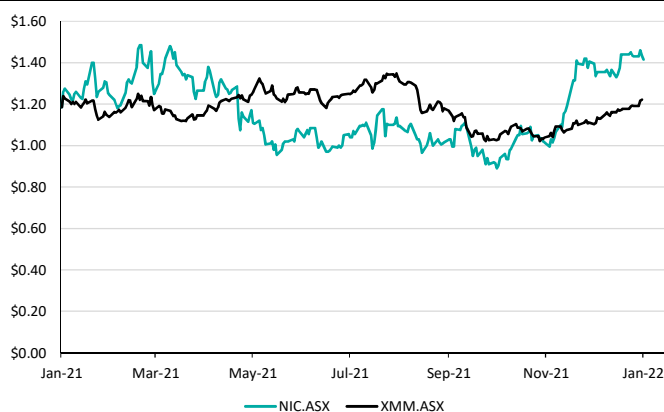
Upcoming catalysts for NIC include:

- 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 development of the Angel Nickel project, comprising 4 next-generation rotary-kiln-electric-furnace (RKEF) lines being constructed within the Indonesia Weda Bay Industrial Park (IWIP), in which NIC holds an 80% interest. Commissioning is on track for the March quarter of CY22, which is 6-9 months ahead of the original, contracted schedule;

- Further updates on the construction of the Oracle Nickel project, comprising 4 next-generation RKEF lines being developed within the Indonesia Morowali Industrial Park (IMIP). A binding agreement has been executed, formalising NIC's staged acquisition of a 70% interest and stating that commissioning is to commence in 1QCY23;
- 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.

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 under construction 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\$1.87/sh (from \$1.74/sh)

Updating for the tax concessions results in increases of 11% to our forecast earnings for both CY22 and CY23. We now forecast earnings growth of 78% and 94% for CY22 and CY23 respectively and forward P/E multiples of 9.6x and 5.0x. These metrics continue to offer excellent value for aggressive growth, in our view. Our NPV-based valuation lifts 7% to \$1.87/sh and NIC remains one of our top picks in the sector. Buy.

Valuation: \$1.87/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 \$1.74/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.

Table 2 - Financial summary

PROFIT AND LOSS							FINANCIAL RATIOS									
Year ending 31 Dec. (from 2020)	Unit	2019a*	2020a	2021e	2022e	2023e	Year ending 31 Dec. (from 2020)	Unit	2019a*	2020a	2021e	2022e	2023e			
REVENUE							VALUATION									
Revenue	US\$m	236.1	523.5	624.4	1,028.1	1,681.4	Attributable NPAT	US\$m	56.5	110.6	156.6	269.8	524.4			
Expense	US\$m	(138.9)	(329.0)	(371.3)	(593.3)	(850.0)	Attributable NPAT	A\$m	82.5	160.1	207.6	369.6	718.4			
EBITDA	US\$m	97.2	194.5	253.1	434.8	831.4	Reported NPAT	A\$/sh	5.1	8.2	8.3	14.7	28.6			
Depreciation	US\$m	(16.4)	(36.8)	(36.9)	(65.0)	(98.6)	Adjusted EPS	A\$/sh	4.4	8.2	8.3	14.7	28.6			
EBIT	US\$m	80.8	157.7	216.2	369.7	732.9	EPS growth	%	46%	62%	0%	78%	94%			
Net interest expense	US\$m	(2.1)	(4.7)	(10.8)	(20.4)	(16.1)	PER ¹	x	14.0x	17.2x	17.1x	9.6x	5.0x			
Unrealised gains (Impairments)	US\$m	7.4	-	-	-	-	DPS	A\$/sh	-	3.0	4.0	6.0	11.0			
Other	US\$m	5.4	1.6	-	-	-	Franking	%	0%	0%	0%	0%	0%			
PBT	US\$m	91.5	154.6	205.4	349.3	716.8	Yield	%	0.0%	2.1%	2.8%	4.2%	7.8%			
Tax expense	US\$m	(0.2)	(0.9)	(5.7)	(5.7)	(42.2)	FCF/share ¹	A\$/sh	2.6	(2.6)	(12.5)	(1.2)	40.0			
Consolidated profit (loss) for the year	US\$m	91.3	153.7	199.7	343.6	674.6	FCF yield ¹	%	2%	-2%	-9%	-1%	28%			
Non-Controlling Interest	US\$m	34.8	43.1	43.1	73.8	150.2	P/FCF ¹	x	54.7x	-55.3x	-11.3x	-121.7x	3.5x			
Attributable NPAT (reported)	US\$m	56.5	110.6	156.6	269.8	524.4	EV/EBITDA ¹	x	28.4x	14.2x	10.9x	6.3x	3.3x			
NPAT (underlying)	US\$m	49.1	110.6	156.6	269.8	524.4	EBITDA margin	%	41%	37%	41%	42%	49%			
CASH FLOW							LIQUIDITY & LEVERAGE									
OPERATING CASHFLOW							Return on assets ¹									
Receipts	US\$m	212.7	517.6	679.7	987.7	1,616.1	Return on equity ¹	%	49%	27%	20%	31%	50%			
Payments	US\$m	(169.9)	(358.9)	(318.8)	(537.8)	(785.8)	ATTRIBUTABLE DATA - NICKEL MINES LTD									
Tax	US\$m	(4.7)	(9.1)	0.9	(5.7)	(5.7)	Year ending 31 Dec. (from 2020)	Unit	2019a*	2020a	2021e	2022e	2023e			
Net interest	US\$m	0.1	0.3	(10.8)	(20.4)	(16.1)	Revenues	US\$m	95.7	391.3	559.6	865.6	1,372.0			
Other	US\$m	-	-	-	-	-	EBITDA	US\$m	35.6	139.7	201.5	346.8	646.7			
Operating cash flow	US\$m	38.2	150.0	351.0	423.8	808.5	NPAT	US\$m	56.5	110.6	156.6	269.8	524.4			
INVESTING CASHFLOW							Net distributable cash flow									
Property, plant and equipment	US\$m	(29.6)	(7.4)	(587.9)	(444.7)	(74.5)	EV/EBITDA	x	73.8	19.0	14.4	6.1	4.3			
Mine development	US\$m	-	(147.0)	-	(0.4)	(0.4)	PER	x	28.0	17.2	17.1	9.6	5.0			
Exploration & evaluation	US\$m	-	-	(0.2)	(0.4)	(0.4)	P/FCF	x	nm	nm	nm	nm	9.0			
Other	US\$m	5.8	(30.0)	-	-	-	ORE RESERVE AND MINERAL RESOURCE									
Investing cash flow	US\$m	(23.8)	(184.4)	(588.0)	(445.1)	(74.9)	Hengjaya Nickel Mine (HM)									
Free Cash Flow	US\$m	14.4	(34.5)	(237.0)	(21.3)	(73.6)	Mineral Resources				Mdmt	% Ni	t Ni			
FINANCING CASHFLOW							Measured							20,000	1.30%	260,000
Share issues/(buy-backs)	US\$m	-	430.0	-	-	-	Indicated				109,000	1.30%	1,417,000			
Debt proceeds	US\$m	-	-	325.0	-	-	Inferred				56,000	1.30%	728,000			
Debt repayments	US\$m	(29.9)	(25.3)	(45.0)	-	(150.0)	Total				185,000	1.30%	2,405,000			
Distributions to non-controlling interests	US\$m	17.0	(43.3)	(39.7)	(43.6)	(62.4)	ASSUMPTIONS - Prices									
Dividends	US\$m	-	(15.4)	(75.9)	(110.2)	(202.0)	Year ending 31 Dec. (from 2020) avg:									
Other	US\$m	(0.4)	(12.4)	-	-	-	Year ending 31 Dec. (from 2020) avg:	Unit	2019a*	2020a	2021e	2022e	2023e			
Financing cash flow	US\$m	(13.3)	333.6	164.5	(153.7)	(414.4)	Nickel	US\$/lb	\$7.02	\$6.25	\$8.31	\$8.40	\$8.45			
Change in cash	US\$m	1.1	299.2	(72.6)	(175.1)	319.3	Nickel	US\$/t	\$15,483	\$13,775	\$18,323	\$18,519	\$18,629			
BALANCE SHEET							ASSUMPTIONS - Production & costs									
Year ending 31 Dec. (from 2020)							Year ending 31 Dec. (from 2020)									
ASSETS							Hengjaya Mine									
Cash & short term investments	US\$m	49.8	351.4	278.9	103.8	423.1	Ore mined	wmt	428,382	795,650	2,035,486	2,000,000	2,000,000			
Accounts receivable	US\$m	97.2	117.8	62.4	102.8	168.1	Ore grade	% Ni	1.9%	1.8%	1.8%	1.8%	1.8%			
Property, plant & equipment	US\$m	628.5	600.8	1,160.0	1,539.6	1,515.6	Nickel in ore	t Ni	8,178	14,479	36,062	36,000	36,000			
Mine development expenditure	US\$m	-	-	-	-	-	Nickel in ore (attributable)	t Ni	6,542	11,583	28,849	28,800	28,800			
Exploration & evaluation	US\$m	-	-	0.2	0.6	1.0	RKEF (IMIP)									
Other	US\$m	122.0	164.7	164.7	164.7	164.7	NPI production	t	152,408	295,897	295,081	487,004	789,615			
Total assets	US\$m	897.5	1,234.7	1,666.2	1,911.5	2,272.5	Contained nickel	t Ni	20,988	43,622	40,516	62,971	100,846			
LIABILITIES							Contained nickel (attributable)									
Accounts payable	US\$m	52.5	40.3	92.8	148.3	212.5	Costs									
Income tax payable	US\$m	0.7	3.8	5.7	5.7	42.2	Cash costs	US\$/t Ni	\$7,689	\$7,330	\$9,521	\$9,825	\$8,674			
Borrowings	US\$m	65.0	45.0	337.9	337.9	187.9	All-in-Costs (AIC)	US\$/t Ni	\$7,804	\$7,414	\$9,627	\$9,956	\$8,807			
Other	US\$m	57.2	59.4	59.4	59.4	59.4	VALUATION									
Total liabilities	US\$m	175.4	148.4	495.8	551.3	502.0	Ordinary shares (m)									
SHAREHOLDER'S EQUITY							Options in the money (m)									
Share capital	US\$m	315.5	732.9	732.9	732.9	732.9	Total shares diluted (m)									
Reserves	US\$m	19.2	19.2	19.2	19.2	19.2	2,515.0									
Retained earnings	US\$m	92.8	187.9	268.6	428.3	750.8	Now									
Total equity to NIC holders	US\$m	427.5	940.1	1,020.8	1,180.4	1,502.9	+12 months									
Non-controlling interest	US\$m	294.7	146.2	149.6	179.8	267.6	+24 mths									
Total equity	US\$m	722.1	1,086.2	1,170.4	1,360.3	1,770.5	A\$m									
Weighted average shares	m	1,631.2	1,948.7	2,515.3	2,515.0	2,515.0	A\$/sh									
CAPITAL STRUCTURE							Now									
Shares on issue	m	-	-	-	-	2,515.0	A\$m									
Total shares on issue	m	(add 0.0m escrow and placement shares)	2,515.0	2,515.0	2,515.0	2,515.0	A\$/sh									
Share price	A\$/sh	-	-	-	-	1.415	Now									
Market capitalisation	A\$m	-	-	-	-	3,558.8	+12 months									
Net cash	A\$m	-	-	-	-	-284.6	+24 mths									
Enterprise value (undiluted)	A\$m	-	-	-	-	3,843.4	A\$/sh									
Options outstanding (m)	m	-	-	-	-	0.0	Now									
Options (in the money)	m	-	-	-	-	0.0	+12 months									
Issued shares (diluted for options)	m	-	-	-	-	2,515.0	+24 mths									
Market capitalisation (diluted)	A\$m	-	-	-	-	3,558.8	A\$/sh									
Net cash + options	A\$m	-	-	-	-	-284.6	Now									
Enterprise value (diluted)	A\$m	-	-	-	-	3,843.4	+12 months									
MAJOR SHAREHOLDERS							+24 mths									
Shareholder				%	m		A\$/sh									
Shanghai Decent (SDI)				18.7%	469.7		Now									
Tanito Group (PT Karunia)				15.0%	378.4		+12 months									
BlackRock Investment Management				7.8%	195.5		+24 mths									
Directors and Management				5.5%	137.9		A\$/sh									
Shanghai Wanlu				4.8%	121.3		Now									
SOURCE: BELL POTTER SECURITIES ESTIMATES							*Transitional 6 month period to Dec-19. Change of Financial Year end from June to December									
							¹ Metrics annualised for 6 month period to Dec-19									

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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