STOCKS DOWN UNDER

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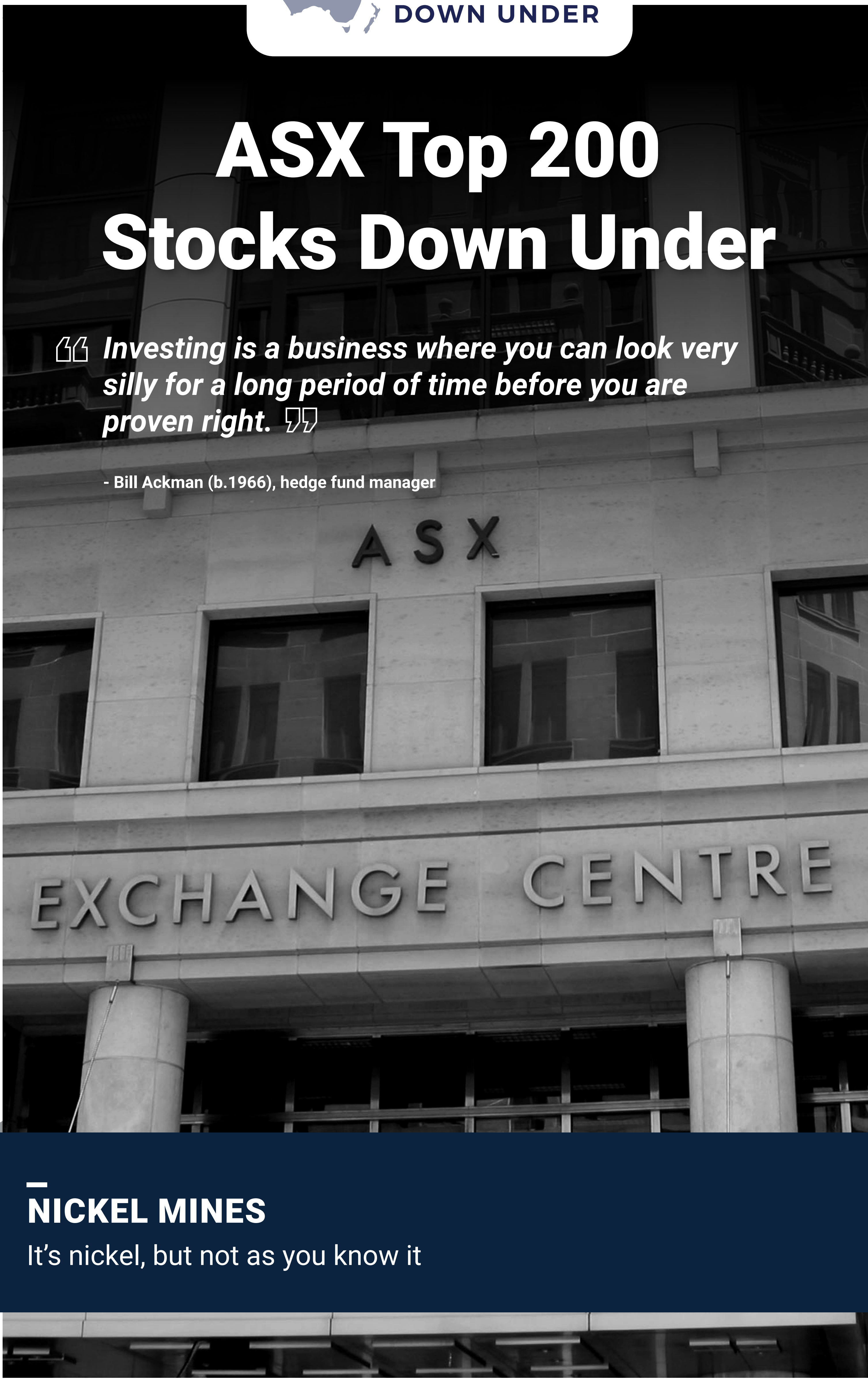
ASX Top 200 Stocks Down Under

> *Investing is a business where you can look very silly for a long period of time before you are proven right.*

- Bill Ackman (b.1966), hedge fund manager



NICKEL MINES

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Stocks Down Under rating: ★★★★

ASX: NIC
Market cap: A$3.4BN

52-week range: A$0.88 / A$1.79
Share price: A$1.28

Nickel Mines (ASX: NIC) is one of the few nickel producers on the ASX and arguably the most intriguing. Instead of exporting nickel ore direct from its projects, it smelts the ore in Indonesia and turns it into Nickel Pig Iron (NPI). It has a long-term partnership and shareholding from Tsingshan, the world's largest stainless-steel maker, which has helped it to a 250%+ return from its IPO in 2018. Despite that return, the company was trading at a discount to its peers – and that was before a recent nickel short trade by Tsingshan's billionaire boss gone wrong that spooked investors.

Share price chart

Source: Tradingview

Nickel pig iron – it's not what you think it is

Nickel Mines got started in 2007 by a Norm Seckold-led group of investors who had just sold another company, Bolnisi Gold, to US Group Coeur d'Alene for A$930m. Nickel was and still is valuable primarily for its use in stainless steel (although these days, nickel is also popular for use in electric vehicles), and prices were over US$50,000 back then.

But prices gradually came down when the GFC struck, leading the company to abandon its then flagship project on Santa Isabel Island in the Solomon Islands. In 2009, it picked up a project in Indonesia – the Hengjaya mine in Sulawesi – and has focused on Indonesia ever since. In 2014, Indonesia banned the export of unprocessed nickel ores, but the move was a blessing in disguise. The government wanted to encourage smelting and refining in Indonesia and this ultimately eventuated.

The world's biggest stainless-steel producer, Tsingshan Holding Group, spent US$5bn on the Morowali Industrial Park, which lies 15km to the north of Hengjaya and is now the world's largest vertically integrated stainless-steel facility with a capacity of 3m tonnes per annum. Tsingshan also bought 20% of NIC – a stake it still owns, but which has been diluted to 6.2%.

Nickel ore from Hengjaya and Ranger (the company's other actively producing nickel project) gets taken to Morowali and is turned into Nickel Pig Iron (NPI). Pig iron, in the context of iron and steel, is simply the crude iron obtained by smelting iron ore in a blast furnace and NPI is essentially the same thing, but in nickel production. Thanks to the iron-richness of the nickel mined at Hengjaya, product can be smelted, can go to nickel refineries and can be turned into stainless steel. This type of smelting is known as RKEF (Rotary kiln-electric furnace) and the first nickel pig iron from Morowali was poured in 2019.

The company had listed a year earlier, in mid-2018, raising $200m at 35 cents a share. After a nuanced debut, it closed 2019 77% higher than its listed price - 62 cents a share.

COVID safe financials

But the history lesson doesn't end there. The Corona Crash hit the company's share price - falling back to its listing price – while the nickel price on the London Metals Exchange simultaneously fell to US$10,800 – just over 20% of its all-time high in the June quarter of 2007. Both of these prices have recovered – NIC now trades at over $1.25 – and nickel is over US$35,000 a tonne.

Nickel Mines was still able to achieve record production of 43,621 tonnes of nickel metal produced in 295,867 tonnes of NPI. This led to US$523.5m in revenue and US$197.1m in EBITDA for FY20 (which for NIC is the calendar year), which was well ahead of 2019's figures of US$236.m and $97.2m respectively. It also paid its inaugural dividend. 2021 was another solid year with 298,353 tonnes of NPI produced, US$645.9m in revenue and US$242.5m in EBITDA – the latter two figures coming in 21% higher than CY2020.

Yet the company did not waste the opportunity to buy assets at deflated prices, increasing its equity holdings in Hengjaya and Ranger from 60% to 80% and purchasing stakes in two further projects - an 80% stake in the Angel Nickel project and a 70% stake in the Oracle Nickel. Angel and Oracle RKEF are also based in Indonesia but lie in different parts of the country. The company recently began production at Angel and expects this project will more than double the annual attributable nickel-metal capacity. Oracle, meanwhile, will begin in the March quarter of 2023.

Has "The Big short" created the opportunity for a Big Long?

Looking ahead, consensus estimates for Nickel Mines predict US$1.1bn in revenue and US$381.8m in EBITDA in 2022 – up 69% and 57% from 2021 respectively – followed by $1.6bn in revenue and $627.7m in EBITDA in 2023 – up 50% and 64% from 2022. This can be accounted for by Angel and Oracle coming online in both years. Yet, the company is very cheap at just 5.9x P/E and 4.7 EV/EBITDA for FY23. Western Areas (ASX: WSA), meanwhile is trading at 28.4x P/E and 7.5x EV/EBITDA for FY23 .

Admittedly, one reason for Western Areas' premium is the forthcoming takeover from IGO (ASX: IGO). Another is the 30% drop in NIC shares a month ago following a brief spike in the LME nickel price to US$100,000 per tonne. At first glance, you might imagine higher nickel prices would be a good thing for Nickel Mines. Unfortunately, Tsingshan's chairman built a massive short position on spot nickel, which hadn't paid off, sparking fears Tsingshan's stake in NIC might be sold or that NIC's operations would be affected. Even though the company denied Tsingshan would sell out and its nickel operations would be affected, it wasn't enough to soothe investors' nerves, although ultimately neither came to pass. The move forced NIC to drop its share purchase plan (SPP) even though applications well exceeded the company's $57m target.

We think so long as nickel prices remain stable, the company's production continues to grow and Oracle remains on track, Nickel Mines should bounce back from the recent dip. Four stars.

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