


BBY Company Research		14 March 2014			
Poseidon Nickel Limited					
POS	A\$0.08	TARGET PRICE	A\$0.20		
Poseidon Nickel Limited is a mineral exploration company focusing on nickel and gold exploration projects.		Mike Harrowell +61 2 9226 0043 mrh@bby.com.au		Kurt Worden +61 2 9226 0100 kew@bby.com.au	

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Tolling deal to solve market recognition and funding issues

Poseidon Nickel (POS target A\$0.20/sh NPV A\$0.26/sh) announced that it is in negotiations to have its ore toll treated, at 350-700ktpa ore throughput for an initial 2 years. We value POS at A\$0.25/sh without any tolling, but a toll deal significantly improves the financing, and gets the company into positive cash flow as early as the March quarter 2015. If the tolling arrangement lasts indefinitely, the total initial capital requirement (equity and debt) will be around A\$15M for nickel and A\$10M for gold tailings reprocessing, plus A\$10M for working capital. We believe circumstances are now very favourable for the completion of a tolling agreement. As a result, we have moved our recommendation from Speculative Buy to Buy.

- ◆ **Early cash flow** – On consensus nickel prices of US\$7.10/lb, we forecast NPAT to be slightly positive in FY15 and A\$0.026/sh in FY16 at US\$7.80/lb. POS would be on a PER of 3.1x FY16 earnings, and the nickel price is already at US\$7.10/lb.
- ◆ **Valuation has plenty of upside** – On the last published DFS, and consensus assumptions, we value POS at A\$0.13/sh, but the DFS is now out of date, and we estimate a standalone concentrator operation would be worth A\$0.25/sh. The tolling of the first two years of production does not change the NPV, but vastly changes the funding and marketability, and if the tolling lasts life of mine, the NPV climbs to A\$0.50/sh.
- ◆ **Opex of tolling assumed same as stand alone** – We have assumed that a tolling deal net margin will be very similar to the standalone economics, with higher ore trucking costs and lower price realization offset by elimination of concentrate trucking and shipping costs. The key factor is the willingness of the tolling party to negotiate, and we take the announcement that there are negotiations as a major indicator of a change of heart.

Earnings Changes

- ◆ On the basis that a tolling agreement is concluded in the next 4 months, and the raising of an additional A\$36M in CY14, NPAT remains in small loss in FY14, but swings from loss to profit of A\$1.8M in FY15, & A\$18M in FY16.
- ◆ NPV has risen 23% from A\$0.21/sh to A\$0.26/sh on the positive cash flow prior to funding the concentrator by year 3.

Company Data

Number of shares	461M
Market capitalisation	\$38M
Free Float (%)	56.5
12 month high/low	\$0.25/\$0.07
Average monthly turnover	\$1M
% S&P/ASX 200	n/a
% All Ordinaries	n/a
ESG Disclaimer Score (Ranking)	n/a
GICS Industry Group	Materials

BBY vs Consensus

	BBY FY1	Consensus FY1	% Difference
EBITDA (\$m)	(1.7)		
NPAT (\$m)	(4.3)		
EPS (c/sh)	(0.9)		

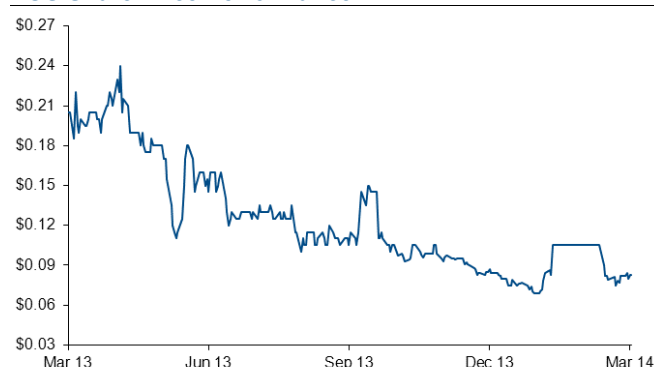
BBY Technical View – as at 13/03/2014

Short Term	Downtrend Resistance	\$0.098
Long Term	Downtrend Support	\$0.07
-		

Earnings summary (AUD)

Year end June	2013A	2014F	2015F	2016F
Net Attributable Profit (\$M)	(13.4)	(4.3)	18	18.0
Reported Profit (\$M)	(13.4)	(4.3)	18	18.0
EPS (¢)	(3.2)	(0.9)	0.3	2.6
P/E (x)	(4.0)	(9.3)	31.5	3.1
CFPS (¢)	(14)	(1.1)	2.1	7.8
P/CF (x)	(9.3)	(7.4)	3.9	1.1
DPS (¢)	0.0	0.0	0.0	0.0
EV/EBITDA (x)	(8.3)	(36.4)	5.7	3.4
Franking (%)	0.0	0.0	0.0	0.0

POS Share Price Performance



Financial Summary

Poseidon Nickel Limited

Share Price (A\$) **\$0.08**

Mkt Cap (A\$M)

38

Year ending June 30

Profit & Loss (A\$M)					Investment summary					
	2013A	2014F	2015F	2016F	2013A	2014F	2015F	2016F		
Total Revenue	0.5	4.4	71.6	154.7	NPAT reported	(13.4)	(4.3)	1.8	18.0	
Growth (%)	33.0	nm	nm	116.1	NPAT Underlying	(13.4)	(4.3)	1.8	18.0	
EBITDA	(6.5)	(1.7)	16.7	65.6	EPS Reported	(3.2)	(0.9)	0.3	2.6	
Growth (%)	(0.5)	73.7	nm	292.7	EPS Underlying	(3.2)	(0.9)	0.3	2.6	
Dep'n and amort'n	0.0	0.0	(14.2)	(27.7)	EPS Growth (%)	(58.2)	72.3	129.5	nm	
EBIT	(6.5)	(1.7)	2.5	37.9	P/E Underlying (x)	(4.0)	(9.3)	31.5	3.1	
Net interest expense	(6.9)	(3.5)	0.0	(12.2)	Dividend (¢/sh)	0.0	0.0	0.0	0.0	
PBT	(13.4)	(5.2)	2.6	25.8	Payout Ratio (%)	0.0	0.0	0.0	0.0	
Growth (%)	nm	61.1	149.3	nm	Gross Yield (%)					
Tax	0.0	0.9	(0.8)	(7.7)	Net Yield (%)					
NPAT Underlying attrib.	(13.4)	(4.3)	1.8	18.0	Franking (%)	0.0	0.0	0.0	0.0	
Growth (%)	nm	67.8	141.7	nm						
NPAT Reported	(13.4)	(4.3)	1.8	18.0						
Normalised NPAT	(13.4)	(4.3)	1.8	18.0						
Ord Shares	409.2	675.5	675.5	675.5						
Options	7.5	7.5	7.5	7.5						
Fully Diluted	416.7	683.0	683.0	683.0						
FD Wgtd Av Shares	415.8	483.3	683.0	683.0						
Cashflow (A\$M)					Key Ratios					
	2013A	2014F	2015F	2016F		2013A	2014F	2015F	2016F	
Customer receipts	0.2	0.6	71.6	154.7	Profitability (%)					
Supplier Payments	(5.6)	(5.6)	(54.9)	(89.1)	EBITDA	(6.5)	(1.7)	16.7	65.6	
Net interest paid	(0.5)	(0.5)	(2.2)	(6.4)	EBITDA/Rev (%)	(1,282.7)	(39.0)	23.4	42.4	
Taxes Paid	0.0	0.0	0.0	(6.1)	EBIT	(6.5)	(1.7)	2.5	37.9	
Net operating cash flow	(5.8)	(5.4)	14.5	53.2	EBIT/Rev (%)	(1,282.7)	(39.1)	3.6	24.5	
Capex	(13.6)	(13.6)	(59.3)	(182.7)	NPAT	(13.4)	(4.3)	1.8	18.0	
Net investing cash flow	(12.0)	(9.5)	(62.4)	(182.7)	NPAT/Rev (%)	(2,655.2)	(98.8)	2.5	11.7	
Dividends paid	0.0	0.0	0.0	0.0	ROE (%)	(28.6)	(8.4)	2.9	24.9	
Net financing cash flow	(0.1)	16.6	65.0	175.0	ROA (%)	(7.5)	(1.9)	1.9	13.6	
Net Change in cash	(18.0)	1.7	17.1	45.5	ROIC (%)	(6.6)	(1.5)	1.7	13.7	
Net cash at end of period	(3.8)	15.9	31.3	59.7	Financial Strength					
Free cash flow	(5.8)	(5.4)	10.2	45.5	Debt to equity (%)	91.9	45.2	122.6	310.1	
					Net debt (\$M)	34.7	23.6	56.5	186.0	
					Net debt to equity (%)	85.6	38.2	88.9	228.1	
					Net Debt to EBITDA (%)	(5.4)	(13.9)	3.4	2.8	
					Interest Cover EBIT (x)	(0.7)	(0.5)	na	3.1	
					Current Ratio (x)	0.1	0.7	1.6	2.2	
					Quick Ratio (x)	0.1	0.7	1.2	1.9	
Balance sheet (A\$M)					Valuation					
	2013A	2014F	2015F	2016F		2013A	2014F	2015F	2016F	
Cash	2.6	4.3	21.4	66.9	Operating cash flow	(5.8)	(5.4)	14.5	53.2	
Receivables	2.8	0.0	4.5	6.7	CFPS (¢ - FD)	(1.4)	(1.1)	2.1	7.8	
Inventories	0.0	0.0	8.8	11.5	Price/CF	(9.3)	(7.4)	3.9	1.1	
Current assets	5.4	4.3	34.7	85.1	BV per share (\$)	0.1	0.1	0.1	0.1	
Tangible Assets	74.9	84.8	129.9	284.9	Price/Book Value (x)	1.3	0.9	0.9	0.7	
Investments	0.0	0.0	0.0	0.0	NTA (\$)	40.6	61.7	63.5	81.5	
Goodwill	0.0	0.0	0.0	0.0	NTA per share (\$)	0.1	0.1	0.1	0.1	
Total assets	83.8	95.5	172.1	386.1	Price/NTA (x)	1.3	0.9	0.9	0.7	
Payables	2.3	2.3	15.1	31.4	EV/Sales (x)	106.2	14.2	1.3	1.4	
Current Term debt	37.3	0.0	0.0	0.0	EV/EBITDA (x)	(8.3)	(36.4)	5.7	3.4	
Long term debt	0.0	27.9	77.9	252.9	EV/EBIT (x)	(8.3)	(36.3)	37.3	5.9	
Total liabilities	43.2	33.8	108.6	304.6						
Total Shareholder Equity	40.6	61.7	63.5	81.5						
Key Assumptions					NPV Summary					
	2012A	2013A	2014F	2015F	2016F	A\$M	Resources			
Assumptions						Nickel Mines	208.9	Resource	Mt	Ni %
US\$/A\$	1.032	1.027	0.902	0.865	0.848	Gold North & South Dams	7.6	Total	4.8	1.7%
Nickel Ave US\$/lb	8.8	7.4	6.5	7.1	7.8	Nickel Leach	0.0	A Shoot	0.1	2.2%
Gold US\$/oz	1,671.9	1,605.4	1,267.0	1,242.2	1,271.7	Other Operations	0.0	A-HW Shoot	0.3	1.1%
						Total Operations	216.5	B Shoot	0.1	1.4%
						MRRT	0.0	C Deeps	1.9	2.1%
						Administration	(33.5)	D Deeps	0.5	1.5%
						Written Down Value of Assets	0.0	G Deeps	1.1	1.5%
						Realised FX Gains	0.0	G Shoot	0.4	1.2%
						Dividends	0.0	F Shoot	0.2	1.6%
						Proceeds from Asset Sales	0.0	H Shoot	0.0	1.7%
						Other	(3.5)	Mine Plan		
						Total	179.5	April DFS	4.4	1.8%
						Tax Losses	18.7	BBY Assum	6.0	1.7%
						Exercise of Options	0.0			
						Cash	4.3			
						Debt	(27.9)			
						NPV A\$m	174.6			
						NPV A\$/sh	0.26			
						WACC = 10.9%				

Source: BBY, Company Reports. BBY contributes all company estimates to Bloomberg, Thomson Reuters, FactSet and Capital IQ.

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Direct ore sale retains margin, defers capex

"Poseidon Nickel is in negotiations which could lead to an ore tolling and concentrate purchase agreement. If finalised the agreement would allow Poseidon to deliver 350,000 - 700,000 tonnes of ore per annum for an initial period of up to 2 years. The ore would be mined from the existing Mt Windarra mine and shipped for treatment to a third party facility." Announcement 12 February 2014.

While POS has not mentioned any connection, it seems highly likely that the tolling entity would be BHP Nickel, some 220Km by road to the north. The Leinster mill has 3Mtpa of installed capacity, and with the closure of Perseverance, would have spare capacity.

The announcement of negotiations follow closely on BHP Nickel's closure of the Perseverance mine at Leinster, which would leave its Kalgoorlie Nickel Smelter with a problem. The Smelter is required to take the bulk of its feed from Mt Keith, which has a high MgO content, and produces an excessively viscous slag. This can be handled by increased energy input, or by blending in low MgO ore feeds like Perseverance or Mt Windarra.

We also note that BHP has appointed an advisor to run the process for the sale of BHP Nickel. The sale process may be a positive or negative for the negotiations with POS, but any new owner would definitely want POS feed. In fact, a new more aggressive owner like Glencore or X2 would be highly likely to bid for POS outright. In the meantime, POS has positive cash flow at a nickel prices above A\$4.85/lb.

Table 1. NPV progression – Tolling helps funding significantly

The Toll 2 Year case assumed 2 years at 600Ktpa then 900Ktpa with the concentrator
The Toll Only case assumed tolling increases to 900Ktpa at the end of the two years.
The low cost case assumes A\$10/t and A\$15/t reduction in mining costs at Windarra and Cerberus respectively.

	DFS Case 720ktpa	Local Mill 900ktpa	Toll 2 yrs 900ktpa	Toll only 900ktpa	Toll only Low Cost
Nickel Mines	115.9	200.0	208.9	369.49	417.67
Gold North & South Dams	7.6	7.6	7.6	7.63	7.63
Nickel Leach	0.0	0.0	0.0	0.00	0.00
Other Operations	0.0	0.0	0.0	0.00	0.00
Total Operations	123.5	207.6	216.5	377.11	425.30
Administration	-33.5	-33.5	-33.5	-33.50	-33.50
Other	-7.8	-8.3	-3.5	-3.12	-2.59
Total	82.3	165.8	179.5	340.49	389.21
Cash	14.3	14.3	4.3	4.31	4.31
Debt	-27.9	-27.9	-27.9	-27.87	-27.87
NPV A\$m	85.7	171.4	174.6	339.66	385.41
NPV A\$/sh	0.127	0.254	0.259	0.50	0.57
Issued Shares M	683.0	683.0	683.0	683.00	683.00
NPV Split of Operations					
Revenue	924.6	1150.6	1235.6	1235.6	1235.6
Cash Costs	-486.9	-588.9	-640.9	-640.9	-573.5
Royalty	-13.9	-17.3	-18.5	-18.5	-18.5
EBITDA	423.8	544.4	576.2	576.2	643.6
Tax Paid (6mth lag)	-79.2	-104.3	-107.1	-107.1	-126.3
Capex	-228.7	-240.1	-260.2	-99.6	-99.6
Free Cash Flow After Tax	115.9	200.0	208.9	369.5	417.7

Source: BBY estimates

Our base case (Toll 2 Years) now assumes that POS tolls 600ktpa of nickel ore for two years, for an initial capex of A\$15M and builds the gold tailings retreatment plant for A\$10M, before building its own 1Mtpa mill and concentrator at Mt Windarra for A\$190M and before building the Cerberus mine for A\$20M.

If the tolling agreement was extended indefinitely, our NPV increases to A\$0.50/sh, due to the elimination of the A\$190M capex (A\$0.28/sh).

Funding a big difference

To get started as a tolling operation, we estimate A\$15M of capex and A\$10M of working capital will be required. The operating cash flow in the initial two years on consensus assumptions is estimated at A\$15Mpa rising to A\$70Mpa longer term. The difference is the low initial head grade of 1.35%, which rises to 1.75% by 2018. The quicker the higher grade can be accessed the better for the cash flow.

If the A\$190M mill, concentrator and Mt Windarra UG crusher and shaft winder are required, the funding risk is significantly reduced if it is attached to an operating mine with a solid track record. We have assumed 80% debt, 20% equity, but if the grade is lifted earlier, the equity could be supplied entirely from cash flow.

Table 2. Cost and treatment assumptions on Mt Windarra only

	DFS Windarra Only	BBY Windarra Only	Toll Windarra Only
Total Mined Ktpa	440	600	600
Grade % Ni	1.75%	1.75%	1.75%
Contained Ni Kt	7.7	10.5	10.5
Recovery	86%	86%	86%
Concentrate Kt	55	75	75
Ni in Conc	6.6	9.0	9.0
Payable Nickel	73%	73%	67%
Payable Ni Kt	4.8	6.6	6.1
Mining A\$/t ROM	57.0	57.0	57.0
Process (& Truck) A\$/t ROM	37.7	32.0	42.0
Admin A\$/t ROM	7.5	7.5	5.0
Road A\$/t conc	94	94	0
Shipping US\$/t conc	35	35	0
AUDUSD	0.90	0.90	0.90
Costs A\$M			
Mining	25	34	34
Ni Processing	17	19	25
Admin	3	5	3
Road	5	7	0
Ship	2	3	0
Total	52	68	62
Copper & Cobalt			
Net Cash Cost A\$M	52	68	62
Cost A\$/lb payable	4.91	4.67	4.68
Cost A\$/lb in conc.	3.58	3.41	3.13
Cost US\$/lb payable	4.42	4.20	4.21
Cost US\$/lb in conc.	3.22	3.07	2.82

Source: POS (DFS), BBY estimates

We have assumed that the cost of tolling is the same in a total sense at A\$4.68/lb payable, with a higher processing and ore trucking charge (A\$42/t vs A\$32/t) and a lower payable (67%) offsetting the elimination of concentrate haulage and shipping costs.

At US\$7/lb AUDUSD 0.90, and at the long term head grade of 1.75% Ni, the operational cash flow before sustaining capital would be A\$40M pa.

POS has still to clarify what the initial capex, opex and head grades will be. This will be done when the planned Bankable Feasibility Study is completed. However, the current reserve has an average grade of 1.79% Ni, up from the previous 1.22%, which was dragged down by legacy remnants that have since been discarded with the drilling success of the last 12 months. This reserve grade is a very solid guide to the likely initial production, and is well above the current DFS guidance.

Table 3. Reserves and Resources

	Reserves			Resources		
	Kt	Ni %	Ni Kt	Kt	Ni %	Ni Kt
Mt Windarra						
Apr-13	326	1.22%	4.00	3951	1.73%	68.3
Jul-13	498	1.79%	8.85	4770	1.68%	80.2
Cerberus						
Jul-13	1221	1.30%	15.88	4551	1.51%	68.6
Total	1719	1.44%	24.73	9321	1.60%	148.8

Source: POS

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Contact with POS has been made during the preparation of this report for assistance with verification of facts.

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It is permitted for the total expected returns to be temporarily outside the prescribed ranges due to extreme market volatility or other justifiable company or industry-specific reasons.

Free Float (float / current shares outstanding) *100 – This float figure is the number of shares that are available to the public and is calculated by subtracting the shares held by insiders and those deemed to be stagnant shareholders. Stagnant holders include ESOP's, ESOT's, QUEST's, employee benefit trusts, founding shareholder equity stake plus senior management equity stake, corporations not actively managing money, venture capital companies and shares held by Governments.

Terminal Value methodology - BBY's Discounted Cash Flow (DCF) valuation applies a terminal growth rate to the last forecast year's cash flow and discounts the amount using Weighted Average Cost of Capital (WACC). The Terminal Value is tested using ASX-listed company multiples. For resource companies there is no terminal value because cashflows are forecast to the end of mine life.

Valuation Methodology

BBY's methodology for assigning ratings may include the following: market capitalisation, maturity, growth/value, volatility and expected total return over the next 12 months. The price targets are based on several methodologies, which may include, but are not restricted to, analyses of market risk, growth rate, revenue stream, discounted cash flow (DCF), EBITDA, EPS, cash flow (CF), free cash flow (FCF), EV/EBITDA, P/E, PE/growth, P/CF, P/FCF, premium (discount)/average group EV/EBITDA, premium (discount)/average group P/E, sum of parts, net asset value, dividend returns, and return on equity (ROE) over the next 12 months.

Technical Analysis

BBY employs technical analysis for forecasting the direction of prices through the study of past market data, primarily price and volume.