



16 March 2011

Recommendation: Buy, for Sophisticated and Professional Investors Only

POSEIDON NICKEL LIMITED

Secured Funding: Catalyst for Development

VEG: "Value, Earnings and Growth"

The adopted tag line by Poseidon Management is "Poseidon Rising". In this research report we take a look at the ingredients of the "Poseidon Rising" recipe.

The key point is that now that the US\$20m funding (announced 23.12.10) is almost certainly in place (shareholders to vote at the 28th March 2011 EGM)

Poseidon is in a position to accelerate the development of their projects.

The long term development strategy remains unchanged, mine refurbishment, concentrator plant construction etc, however cash flows may be dramatically brought forward with an option to simply ship ore in the meantime to one of 3 possible local concentrator plants in 2012. The economics of this are very impressive given Poseidon's cost of production, the current nickel price and Poseidon's current market capitalisation.

Basic early economics are:

- They will be ready to mine ore within 12 months
- Average annual production, approx 5000 tonnes of contained Ni 11,023,000 lb of Ni against total resource 98,000k tonnes
- Mining, tolling (processing to concentrate) and haulage cost - \$4.20/lb average
- Payable Revenue – 67% of LME price – \$7.61/lb
- Profit margin per lb –circa \$3.41/lb
- Free cash flow (based on above) US\$37.5m
- No tax payable for the first year due to accumulated losses
- Corporate and other expenses approx \$4m pa
- Bottom line of approximately \$33m pa versus current undiluted mkt cap \$46.8m (dilution is 35m convertible notes and options as above).

Ticker	POS AU
Rating	BUY
Price (AU\$)	0.24
ST Target Price (AU\$)	0.50
12m Price Range (AU\$)	0.145 – 0.40
Market cap (undiluted) (AU\$m)*	46.8m
Daily t/o (No shares)	1.23m
Capital Structure*	
Shares on Issue 194.9M	
Options (at \$0.40 due 19.9.12) 115M	
Options (at \$0.25 due 31.8.12) 9.2M	
Options listed (at \$0.92 due 5.12.11) 6.1M	
Options (various) 13.5M	
Convertible Note (Harbinger Funds) US\$15M @ \$0.40 and US\$20M @ \$0.30.	
• Major Shareholders*	
- Harbinger Capital Partners (New York) 8.93%	
- Contango Asset Management 5.73%	
- Technical Investing 4.16%	
- Andrew Forrest (Australia) 2.57%	
- David Singleton 1.37%	

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- Stage two potentially goes to 10,000 tonnes in 2013
- Assumptions – LME Ni \$25,079.00/t and AUD/USD 1.00

The Asset

The Mt Windarra nickel deposit was previously owned by WMC and was discovered by Poseidon NL in 1969 with South Windarra discovered by Union Oil/Australian Hanna Homestake in 1971. WMC mined these deposits from 1974 to 1978 and then from 1981 to 1991 producing a total of 7.2mt @ 1.59% Ni for 84,600 tonnes of nickel. Mining ceased in 1991 due to low nickel prices. The current Board and Management took control of the assets in July 2007 and in this time have drilled up a JORC Resource of 97,767 tonnes of contained nickel at an average grade of 1.69%, although the average grade at Mt Windarra was higher during its life and we therefore see this as a conservative number. With over 24km of strike a new discovery “Cerberus” was made during the GFC and was largely overlooked by the market. The discovery was made using modern geological understanding and exploration tools that have been so successful at Western Areas, Independence and Jubilee (now part of Xstrata). Seven new targets have been identified and are yet to be tested and drilled. Refurbishment of the surrounding surface infrastructure has been carried out (which we value as a \$50m replacement saving to the forward Capex cost). This includes offices, accommodation, workshops, shaft headframe, power, water and tailings dam. The opening and initial refurbishment (first 110 vertical metres) of the Mt. Windarra decline was completed in 2008. A mining fleet was also secured and refurbished during the GFC. Santa Claus arrived a day early for Poseidon Nickel and on the 23rd December 2010 Poseidon Nickel announced the injection of US\$20m by way of a convertible note on the most favourable of terms seen in Australia for many years. Convertible at 30c/share with a 0.00% coupon for the first three years and 5.00% for the next three the cash injection is to be approved by shareholders at the upcoming EGM. The investor is Harbinger Capital who is also the major shareholder and was an early substantial holder of Fortescue Metals Group (FMG). In addition, an earlier note issued to Harbinger Capital 2½ years ago for \$15m, is to be re-priced from \$1.00 to \$0.40 and re-lifed with 3 years at 0.00% and the next 3 years at a coupon of 5.00%. Both convertible notes are unsecured.

It is important to note that Poseidon has a Mining Lease and Native Title approval conferred by a State Act of Parliament and that therefore licensing is not a significant issue.

The Board and Management (a selection only)

Non Executive Chairman – Mr. Andrew “Twiggy” Forrest is easily the most recognisable success story in the Australian Mining sector. Not only a household name in Australia but known to every materials and financial house throughout Asia and beyond. This analyst does note that Mr. Forrest is facing a ban from acting as a Company Director pending Mr. Forrest seeking leave to appeal the decision in The High Court of Australia in the case ASIC v Fortescue Metals.

CEO – Mr. David Singleton. An accomplished engineer with a long line of achievements. He was the Director in Charge of Strategy and Acquisitions worldwide for British Aerospace group, a company with a market capitalisation in excess of \$18Bn, Mr. Singleton came to Australia as CEO of Clough Engineering, a major listed West Australian construction company in Petrochemicals and Minerals.

COO – Mr. Robert Dennis is an Mining Engineer with 35 years experience in the mining industry. Previously the Mine Manager of the Mt

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Windarra Mine under the ownership of WMC, Mr. Dennis was at the Mt. Windarra Underground Mine Manager during the early 1980's, making him one of the more knowledgeable operatives of Mt Windarra today. Other major achievements have included overseeing the construction and commissioning of the \$200m Aditya Birla Nifty 2mtpa Copper Sulphide Underground Mine and Concentrator Plant and LionOre Australia \$70m Thunderbox CIL Gold Plant and Open Pit.

General Manager Exploration – Mr. Neil Hutchison. Previously a geologist with Jubilee Mines (taken over by Xstrata in 2008 for \$3.7bn) and a senior member of the highly successful exploration team that discovered the high grade massive sulphide nickel deposits Prospero, Tapinos and Alec Mairs using the CSIRO developed “lava channel model” technique and down hole electromagnetics which are also being applied on Poseidon's extensive exploration/mining tenements. The hugely successful model colloquially known as “The Cabbage Leaf Model” has been adopted by the majority of WA Nickel Producers such as Western Areas, Panoramic, Independence Nickel and Mincor leading to new and extensive discoveries.

The Strategy

\$8m has been committed to the balance of the de-watering and refurbishment of the Mt. Windarra Nickel Mine enabling Poseidon Nickel to potentially commence mining ore by year's end. As announced on the 15.2.11 an agreement with GSM Mining Pty Ltd was reached to commence operations at the Mt. Windarra Nickel Mine. This will primarily include the refurbishment of the mine to 550 metres below surface i.e. the remaining 3,500 metres of the decline as GSM successfully completed the initial refurbishment of the first 1,000 metres in 2008. \$7m will be directed towards exploration and drilling at Mt. Windarra, Cerberus and South Windarra to increase resources and reserves, again applying the highly successful “Cabbage Leaf Model” on highly prospective nickel ground. It is interesting to note that the average resource inventory build by Western Areas, Panoramic, Independence and Mincor is 30%pa over the last seven years. Poseidon Nickel announced at the last quarterly a resource re-calculation is pending post the successful pre-Christmas drilling program at Cerberus extending and defining the initial discovery. \$40m has been identified for a complete feasibility study, construction of a concentrator facility and restart working capital. Poseidon has previously announced an initial MOU has been signed for the concentrator plant with an Australian/Chinese Group. This would see Poseidon Nickel processing nickel concentrate in 24 months with the successful commissioning of a concentrator.

With Poseidon having the ability to mine ore by year's end a fast track to earnings is likely by tying up an offtake/tolling agreement with one of the three concentrators in the region. We believe that there are 3 potential parties in the region capable of toll treating the Mt Windarra ore of which BHP is the most obvious. (it should be noted that BHP in selling the Mt Windarra asset post the WMC takeover has a first right of refusal to toll treat ore from Mt. Windarra). Given the nickel price is currently trading around \$11.37/lb the fast tracking of earnings would be an appealing strategy coupled with the building of a concentrator for longer term production thus improvement in margins and expansion.

The Value

Undiluted market capitalisation of AU\$46.8m and US\$35m in convertible notes backed by 98,000 tonnes of contained Nickel Resource cum an upgrade, \$20m in cash and \$30m in infrastructure, equipment and exploration (an additional \$8m was paid to acquire the project) and strongest board and management team of any junior mining company in Australia. No significant environmental, native title, tax concerns.

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The Earnings

As detailed above, a fast track program delivered by management could see Poseidon Nickel into earnings in 2012.

The Growth

24km nickel strike using a proven exploration model has already lead to a substantial high grade discovery from the very first regional exploration program in 2008. Since then, the Company has identified 7 additional anomalies similar to Cerberus that remain largely untested. The Company also has the South Windarra open pit which has not yet been developed in the same way that Mt Windarra was so successfully. Poseidon clearly sees value at South Windarra as it commissioned an extensive seismic exploration programme in the area in December 2010 as a prelude to a concerted drilling programme.

The Risks and Assumptions

Nickel price: US\$/lb 11.37

AUD/USD: 1.00

Ni 2 year forward contracts: Poseidon Nickel, on the basis of locking in a toll treating agreement, could look to hedge up to 65% of the first year's production. Currently two year forward contracts are trading at LME spot prices given the discount on the currency forward AUD/USD0.85 at the time of writing this report.

Mine refurbishment: The refurbishment appears straightforward, pump out the water, mesh the decline roof to current codes and install power and communication services. More importantly, Poseidon has already completed 20% of the refurbishment without incident using the same equipment and contractors.

Ore production and Grade: 350,000 tonnes of ore at 0.018 for 80% recovery: Historic mining grades and metallurgical recoveries over 20 years of Western Mining records support these numbers.

Metallurgy: The metallurgy of the ore is well known from records. Poseidon has detailed data on nickel recoveries and concentrate grades from historic practice as well as completing its own laboratory test work in 2008, which not surprisingly, confirmed the results.

Exploration success: In 2007 the new Board said it was highly confident about exploration success given the modern understanding of nickel systems in WA and the availability of modern exploration techniques (such as electromagnetics and seismic for example). Poseidon proved that point when they discovered the first new ore body on the site since the early 1970's, barely a year after Neil Hutchison took over responsibility for exploration. Since then Neil has identified 7 similar anomalies on the site which remain virtually untested.

Cost overrun: The main potential area for overrun at the moment is in the refurbishment, although the work done to date gives some confidence. A 50% cost overrun would be \$4m which we do not see as material in the context of this project.

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Concentrator funding and commission: Poseidon has not yet funded the concentrator although it appears to have several options. If Poseidon can get into ore production at anything like the current LME prices, funding a concentrator should be straightforward.

Mining costs: Mt Windarra was mined using a bulk mining sub level cave system which should mean low extraction costs relative to the Kambalda nickel miners. Poseidon has not announced a mining cost only an all up C1 cost but this looks reasonable to us being an average cost for a WA nickel miner.

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