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# Western Areas Ltd (WSA)

## Christmas comes early

### Recommendation

**Hold** (Sell)

Price

**\$3.44**

Target (12 months)

**\$3.36** (previously \$2.90)

### GICS Sector

Materials

### Expected Return

Capital growth	<b>-2.3%</b>
Dividend yield	<b>0.0%</b>
Total expected return	<b>-2.3%</b>

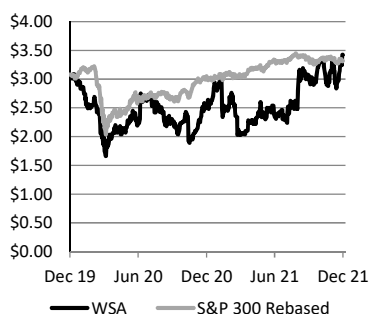
### Company Data & Ratios

Enterprise value	<b>\$959m</b>
Market cap	<b>\$1,107m</b>
Issued capital	<b>321.6m</b>
Free float	<b>85.3%</b>
Avg. daily val. (52wk)	<b>\$7.2m</b>
12 month price range	<b>\$1.92-\$3.51</b>

### Price Performance

	(1m)	(3m)	(12m)
Price (A\$)	3.14	3.08	2.50
Absolute (%)	8.9	11.0	36.8
Rel market (%)	11.0	12.4	26.4

### Absolute Price



SOURCE: IRESS

### All cash takeover from IGO

WSA has entered into a Scheme Implementation Deed (SID) with IGO Limited (IGO, under review) under which IGO will acquire WSA for A\$3.36/sh in cash, by way of a scheme of arrangement. On a fully diluted basis this implies an equity valuation of A\$1,096m and represents a 35.5% premium to WSA's undisturbed share price (prior to the announcement of a potential change of control transaction) of A\$2.48. WSA's Board has unanimously recommended the SID (in the absence of a superior proposal). Top shareholder, Perpetual Limited, which holds 14.7% of WSA, has announced its conditional support for the SID. IGO intends to fund the acquisition via a new A\$900m debt facility and its existing cash reserves of A\$552m. Provisionally, the SID is planned for implementation by April 2022.

### Cash consideration tops our expectations

This is a fantastic result for WSA shareholders. It effectively brings forward and de-risks the value of WSA's production and development portfolio, crystallised via a cash consideration. The equity valuation of A\$3.36/sh is well ahead of our previous target price of A\$2.90/sh, which was inclusive of a takeover premium. Our earnings forecasts for WSA show marginal profitability or losses for FY22 and FY23 and no dividends. WSA's prime asset, Odysseus, while progressing well towards first concentrate production by December CY22, remains exposed to scheduling, construction and cost risks. These risks are now transferred to IGO shareholders – to whom we also see no material earnings or free cash flow accretion until FY24 at the earliest. In this context we view IGO as having paid an unnecessarily high premium. Indeed, the solid strategic rationale for the deal which, in our view, delivers greater de-risking benefits to WSA shareholders, may well have justified a lower-than-benchmark premium be paid.

### Investment thesis – Hold, TP\$3.36/sh (was Sell, TP\$2.90/sh)

We make no changes to our earnings forecasts with this update. We adjust our valuation to reflect the acquisition consideration being offered by IGO, adding a \$285m premium to our underlying WSA valuation. We upgrade to a Hold recommendation.

### Earnings Forecast

Year end 30 June	2021a	2022e	2023e	2024e
Sales (A\$m)	257	314	224	338
EBITDA (A\$m)	73	95	73	145
NPAT (reported) (A\$m)	(8)	9	(19)	32
NPAT (adjusted) (A\$m)	(8)	9	(19)	32
EPS (adjusted) (cps)	(3)	3	(6)	10
EPS growth (%)	-123%	na	-314%	na
PER (x)	(128.5)	124.1	(57.9)	34.1
FCF Yield (%)	-8%	-8%	4%	10%
EV/EBITDA (x)	13.3	10.2	13.4	6.7
Dividend (cps)	-	-	-	-
Yield (%)	0%	0%	0%	0%
Franking (%)	0%	0%	0%	0%
ROE (%)	-1%	1%	-3%	5%

SOURCE: BELL POTTER SECURITIES ESTIMATES

# Christmas comes early

## Changes to our forecasts

The announcement of the SID with IGO does not result in any changes to our earnings forecasts for WSA. The only change to our valuation is the addition of a \$285m takeover premium to our base case valuation. This lifts our Target Price to \$3.36/sh, in-line with the cash consideration outlined in the SID.

Our updated forecasts and valuation are summarised in the table below:

Table 1 - Changes to our FY forecasts									
Year end 30 June	Previous			New			Change		
	Jun-22	Jun-23	Jun-24	Jun-22	Jun-23	Jun-24	Jun-22	Jun-23	Jun-24
<b>Production and costs</b>									
Ni in concentrate production (kt)	16.3	12.3	18.6	16.3	12.3	18.6	0%	0%	0%
Ni in concentrate cash costs (A\$/lb)	4.56	4.26	4.26	4.56	4.26	4.26	0%	0%	0%
Ni in concentrate cash costs (US\$/lb)	3.34	3.11	3.11	3.34	3.11	3.11	0%	0%	0%
<b>Price &amp; currency assumptions</b>									
Ni price (US\$/lb)	8.61	8.35	8.50	8.61	8.35	8.50	0%	0%	0%
Currency US\$/A\$	0.73	0.73	0.73	0.73	0.73	0.73	0%	0%	0%
<b>Financials</b>									
Revenue (\$m)	314	224	338	314	224	338	0%	0%	0%
EBITDA (\$m)	95	73	145	95	73	145	0%	0%	0%
NPAT (adjusted) (\$m)	8.9	(19.1)	32.4	8.9	(19.1)	32.4	0%	0%	0%
Adjusted EPS (Ac/sh)	3	(6)	10	3	(6)	10	0%	0%	0%
PER (x)	124.1	(57.9)	34.1	124.1	(57.9)	34.1	-	-	-
DPS (Ac/sh)	-	-	-	-	-	-	na	na	na
Yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Net debt (cash) (\$m)	(65)	(114)	(224)	(65)	(114)	(224)	0%	0%	0%
ND / (ND + E) (%)	-11%	-22%	-52%	-11%	-22%	-52%	0%	0%	0%
Valuation (\$/sh)	2.62	2.90	3.40	3.25	3.36	3.72	24%	16%	10%
<b>Target price</b>		2.90			3.36			16%	

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

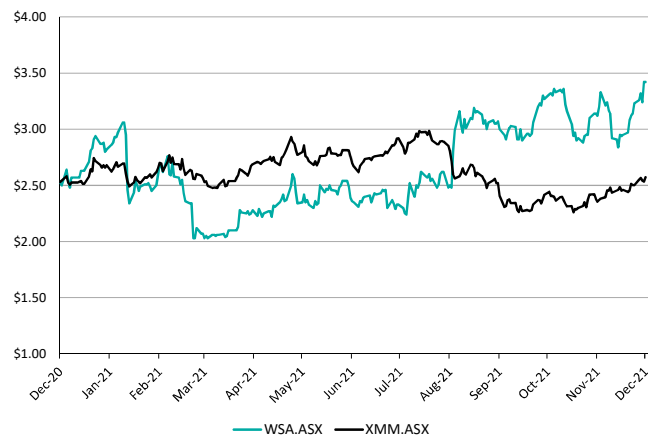
## Upcoming catalysts

Upcoming catalysts for WSA include:

- The conclusion of corporate developments, following engagement with potential acquirer, IGO, which is considering a takeover offer for WSA; the emergence of Dr Andrew Forrest-backed Wyloo Metals as a Substantial Shareholder on the WSA register and any concurrent developments relating to WSA's strategic 19.9% shareholding in PAN. We note that the current market price for WSA shares of \$3.44/sh is a 2.4% premium to the cash offer from IGO. While we view it as unlikely Wyloo, BHP or any other party will make a superior offer, the market appears to be pricing in a slim chance of such an eventuality;
- Progress reports on the development of the Odysseus nickel project and its possible further optimisation, particularly in relation to the AM5 and AM6 lodes;
- The December quarter production and cost report, expected in late January 2022; and
- Results from regional exploration programs at the Forresteria operations, ongoing results from the exploration drilling at Cosmos as well as the increased focus on the Western Gawler Project in SA.

### WSA vs the ASX Metals and Mining Index

Figure 1 - WSA relative share price performance vs ASX Metals and Mining Index (XMM)



SOURCE: IRESS

# Western Areas Ltd (WSA)

## Company description: high grade, steady state producer

WSA is an independent nickel sulphide producer in the Forrestania region, Western Australia. WSA operates two high-grade, underground nickel sulphide mines and an ore concentrator. Ore is currently mined and milled at a rate of 500-600ktpa to produce 16-17ktpa nickel in concentrate. WSA is also developing the Odysseus underground nickel mine at the Cosmos Nickel Complex (CNC), near Leinster in WA, where first concentrate production is scheduled for the December quarter 2022.

## Investment thesis – Hold, TP\$3.36/sh (was Sell, TP\$2.90/sh)

We make no changes to our earnings forecasts with this update. We adjust our valuation to reflect the acquisition consideration being offered by IGO, a \$285m premium to our underlying WSA valuation. We upgrade to a Hold recommendation.

## Valuation: \$3.36/sh

Our 12-month forward WSA valuation incorporates DCF models of WSA's Flying Fox, Spotted Quoll and Odysseus projects, a marked-to-market valuation of listed investments held by WSA, a notional value for exploration and development projects plus an estimate of corporate overhead costs. We also apply a takeover premium, reflecting the current cash offer from IGO to acquire WSA.

## Resource sector risks

Risks to WSA 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.
- **Sovereign risks:** Mining companies' assets are subject to the sovereign risks of the jurisdiction within which they are operating. WSA's assets are in Western Australia, one of the top-rated mining jurisdictions globally.
- **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.

Table 2 - Financial summary

PROFIT AND LOSS							FINANCIAL RATIOS						
Year ending 30 Jun	Unit	2020a	2021a	2022e	2023e	2024e	Year ending 30 Jun	Unit	2020a	2021a	2022e	2023e	2024e
Revenue	\$m	311	257	314	224	338	<b>VALUATION</b>						
Expense	\$m	(192)	(184)	(219)	(151)	(193)	NPAT (adjusted)	\$m	32	(8)	9	(19)	32
<b>EBITDA</b>	\$m	<b>120</b>	<b>73</b>	<b>95</b>	<b>73</b>	<b>145</b>	EPS (adjusted)	c/sh	11.7	(2.7)	2.8	(5.9)	10.1
Depreciation	\$m	(76)	(83)	(84)	(101)	(101)	EPS growth	%	125%	-123%	na	-314%	na
EBIT	\$m	44	(10)	11	(28)	45	PER	x	29.5x	-128.5x	124.1x	-57.9x	34.1x
Net interest expense	\$m	1	(1)	2	1	2	DPS	c/sh	2	-	-	-	-
<b>PBT</b>	\$m	<b>45</b>	<b>(11)</b>	<b>13</b>	<b>(27)</b>	<b>46</b>	Franking	%	100%	0%	0%	0%	0%
Tax expense	\$m	(13)	3	(4)	8	(14)	Yield	%	1%	0%	0%	0%	0%
<b>NPAT (reported)</b>	\$m	<b>32</b>	<b>(8)</b>	<b>9</b>	<b>(19)</b>	<b>32</b>	FCF	\$m	9	(84)	(86)	48	110
Impairments reversed	\$m	-	-	-	-	-	FCF/share	c/sh	3	(29)	(27)	15	34
<b>NPAT (underlying)</b>	\$m	<b>32</b>	<b>(8)</b>	<b>9</b>	<b>(19)</b>	<b>32</b>	FCF yield	%	1%	-8%	-8%	4%	10%
							EV/EBITDA	x	8.1x	13.3x	10.2x	13.4x	6.7x
PROFIT AND LOSS (INTERIM)							PROFITABILITY RATIOS						
Half year ending	Unit	Dec-20a	Jun-21a	Dec-21e	Jun-22e	Dec-22e	EBITDA margin	%	38%	28%	30%	32%	43%
Revenue	\$m	123	134	162	152	96	EBIT margin	%	14%	-4%	4%	-13%	13%
Expense	\$m	(99)	(85)	(114)	(105)	(69)	Return on assets	%	5%	-1%	1%	-2%	4%
<b>EBITDA</b>	\$m	<b>24</b>	<b>49</b>	<b>48</b>	<b>47</b>	<b>27</b>	Return on equity	%	6%	-1%	1%	-3%	5%
Depreciation	\$m	(39)	(44)	(38)	(47)	(53)	LIQUIDITY & LEVERAGE						
EBIT	\$m	(15)	5	11	1	(26)	Net debt (cash)	\$m	(141)	(151)	(65)	(114)	(224)
Net interest expense	\$m	(1)	(0)	1	1	0	ND / E	%	-27%	-24%	-10%	-18%	-34%
<b>PBT</b>	\$m	<b>(16)</b>	<b>5</b>	<b>11</b>	<b>1</b>	<b>(25)</b>	ND / (ND + E)	%	-37%	-31%	-11%	-22%	-52%
Tax expense	\$m	4	(1)	(3)	(0)	8	ASSUMPTIONS - Prices						
<b>NPAT (reported)</b>	\$m	<b>(12)</b>	<b>4</b>	<b>8</b>	<b>1</b>	<b>(18)</b>	Year ending 30 Jun	Unit	2020a	2021a	2022e	2023e	2024e
Impairments reversed	\$m	-	-	-	-	-	Nickel	US\$/lb	6.34	7.38	8.61	8.35	8.50
<b>NPAT (underlying)</b>	\$m	<b>(12)</b>	<b>4</b>	<b>8</b>	<b>1</b>	<b>(18)</b>	AUD/USD	US\$/A\$	0.67	0.75	0.73	0.73	0.73
										9.87	11.73		
CASH FLOW							ASSUMPTIONS - Production						
Year ending 30 Jun	Unit	2020a	2021a	2022e	2023e	2024e	Year ending 30 Jun	Unit	2020a	2021a	2022e	2023e	2024e
<b>OPERATING CASHFLOW</b>							<b>Nickel in ore mined</b>						
Receipts	\$m	311	254	322	226	334	Flying Fox	kt	10.1	5.7	5.3	-	-
Payments	\$m	(182)	(175)	(223)	(154)	(183)	Spotted Quoll	kt	13.3	11.1	12.1	11.5	9.7
Royalties	\$m	(13)	(10)	(9)	(6)	(5)	Odysseus	kt	-	-	-	2.8	12.6
Tax	\$m	(1)	(7)	(4)	8	(14)	Total	kt	23.4	16.8	17.4	14.3	22.3
Net interest	\$m	2	1	2	1	2	<b>Nickel in concentrate</b>						
Other	\$m	3	(2)	-	-	-	Production	kt	20.9	16.2	16.3	12.3	18.6
<b>Operating cash flow</b>	\$m	<b>120</b>	<b>60</b>	<b>87</b>	<b>76</b>	<b>134</b>	Sales	kt	19.9	15.5	16.5	12.3	18.6
<b>INVESTING CASHFLOW</b>							<b>Costs</b>						
Capex	\$m	(99)	(128)	(165)	(24)	(20)	Nickel in concentrate	A\$/lb	3.10	4.23	4.56	4.26	4.26
Exploration & evaluation	\$m	(16)	(16)	(8)	(4)	(4)	Nickel in concentrate	US\$/lb	2.10	3.15	3.34	3.11	3.11
Other	\$m	4	(0)	-	-	-	Nickel in concentrate payable (BPe)	US\$/lb	2.80	4.21	4.46	4.15	4.15
<b>Investing cash flow</b>	\$m	<b>(111)</b>	<b>(144)</b>	<b>(173)</b>	<b>(28)</b>	<b>(24)</b>	VALUATION						
<b>FINANCING CASHFLOW</b>							<b>Issued capital</b>						
Net equity proceeds	\$m	-	98	-	-	-	Shares on issue					m	321.6
Debt proceeds/(repayments)	\$m	-	-	-	-	-	Performance Rights / Options (in the money)					m	4.2
Dividends	\$m	(8)	(2)	-	-	-	<b>Total</b>					m	<b>325.9</b>
Other	\$m	(1)	(6)	-	-	-	SUM OF PARTS VALUATION						
<b>Financing cash flow</b>	\$m	<b>(9)</b>	<b>90</b>	<b>-</b>	<b>-</b>	<b>-</b>							
Change in cash	\$m	1	6	(86)	48	110							
BALANCE SHEET							MAJOR SHAREHOLDERS						
Year ending 30 Jun	Unit	2020a	2021a	2022e	2023e	2024e	Investment group					Shares	%
<b>ASSETS</b>							Perpetual					47.3	14.7%
Cash & short term investments	\$m	145	151	65	114	224	Metal Hawk					18.2	5.6%
Accounts receivable	\$m	18	23	15	13	17	Wyloo Consolidated					17.0	5.3%
Inventory	\$m	30	36	36	36	36	<b>Top 3</b>					<b>82.4</b>	<b>25.6%</b>
Property, plant & equipment	\$m	135	146	166	132	96							
Mine development	\$m	169	233	293	251	206							
Exploration & evaluation	\$m	120	134	142	146	150							
Other	\$m	38	84	84	84	84							
<b>Total assets</b>	\$m	<b>655</b>	<b>807</b>	<b>803</b>	<b>775</b>	<b>813</b>							
<b>LIABILITIES</b>													
Accounts payable	\$m	51	53	40	32	37							
Borrowings	\$m	4	-	-	-	-							
Other	\$m	74	118	118	118	118							
Total liabilities	\$m	129	171	158	150	155							
<b>SHAREHOLDER'S EQUITY</b>													
Share capital	\$m	444	543	543	543	543							
Reserves	\$m	48	69	69	69	69							
Retained earnings	\$m	34	23	32	13	45							
Non-controlling interest	\$m	-	-	-	-	-							
<b>Total equity</b>	\$m	<b>526</b>	<b>635</b>	<b>644</b>	<b>625</b>	<b>658</b>							
Weighted average shares	m	273	288	322	322	322							

SOURCE: BELL POTTER SECURITIES ESTIMATES

**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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