

Western Areas Limited

When does Western Areas make cash?

When will the nickel market recover?

Stainless steel production (2/3 of nickel demand) has been flat for 2 years globally & for 6 years outside China, a poor demand backdrop for nickel. On the supply side, lifting oil prices can drive cost reflation & pressure closures, which is a key catalyst for higher nickel prices. UBS estimates that a further 100-200ktpa of shuts are needed & looks for these to occur at the end of 2016 to early 2017. Nickel prices are volatile, and with as much as 60% of the industry losing cash on an all in basis, these low nickel prices look unsustainable long term. Our price forecasts are US\$4.20/lb for 2016 & US\$5.00/lb for 2017e, with a long-term price of US\$7.90/lb (real \$2016).

Western Areas needs US\$4.60/lb long term to make cash

At US\$3.80/lb nickel, we see Western Areas losing a small amount of cash (~A\$10mpa) despite deferring \$34m of capital costs from FY16 to FY17. We estimate that Western Areas can maintain this lower level of deferred capital spending for ~12-18 months before reinvestment is needed. On our numbers, with normalised sustaining & development capital expenditure of ~A\$38mpa, our forecast break-even price is closer to ~US\$4.60/lb. With a cash balance of ~A\$60m, we believe WSA can weather sub US\$4.00/lb nickel for ~2 years. However, our concern is that should nickel prices maintain at these low levels for another 9 months (early 2017), Western Areas may be put in a difficult position balancing reduced cash on hand and reinvestment requirements.

Sell rating – Higher nickel prices are needed, but it's already in our numbers

With cash balances topped up in early 2016, balance sheet concerns have been alleviated for now. However, nickel prices remain at multi-year lows, leaving a weak FCF position. While we could see further cost out over the next 12 months, ultimately we do not expect WSA to continue to just break-even, as we think spot (US\$3.80/lb) nickel is unsustainable long term. We note that industry shuts or re-stocking could cause a spike in the nickel price and drive short-term interest. Despite this, our earnings forecasts and target price are based on the UBS nickel price deck that already assumes lifting nickel prices; and subsequently, we maintain a Sell rating.

Valuation: A\$1.94/sh (DCF, 10% discount rate)

Our forecasts are unchanged. Target price remains set at 1.0x NPV.

Equities

Australia
Mining

12-month rating

Sell

12m price target

A\$1.94

Price

A\$1.94
RIC: WSA.AX **BBG:** WSA AU

Trading data and key metrics

52-wk range	A\$3.76-1.84
Market cap.	A\$0.51bn/US\$0.37bn
Shares o/s	262m (ORD)
Free float	100%
Avg. daily volume ('000)	2,059
Avg. daily value (m)	A\$4.7
Common s/h equity (06/16E)	A\$0.40bn
P/BV (06/16E)	1.3x
Net debt / EBITDA (06/16E)	NM

EPS (UBS, diluted) (A\$)

	UBS	Cons.
06/16E	(0.16)	(0.08)
06/17E	(0.07)	0.08
06/18E	(0.01)	0.17

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Highlights (A\$m)	06/13	06/14	06/15	06/16E	06/17E	06/18E	06/19E	06/20E
Revenues	307	320	313	203	223	245	317	376
EBIT (UBS)	43	61	59	(58)	(20)	(2)	64	117
Net earnings (UBS)	52	25	35	(43)	(19)	(2)	46	84
EPS (UBS, diluted) (A\$)	0.27	0.11	0.15	(0.16)	(0.07)	(0.01)	0.17	0.32
DPS (A\$)	0.02	0.05	0.07	0.00	0.00	0.00	0.06	0.11
Net (debt) / cash	(136)	18	68	56	64	71	115	181
Profitability/valuation	06/13	06/14	06/15	06/16E	06/17E	06/18E	06/19E	06/20E
EBIT margin %	14.1	19.1	18.8	-28.6	-9.1	-0.8	20.2	31.1
ROIC (EBIT) %	10.0	16.5	17.0	(17.0)	(6.0)	(0.6)	20.6	38.0
EV/EBITDA (core) x	6.9	5.6	7.8	76.0	9.5	6.8	3.4	2.4
P/E (UBS, diluted) x	14.4	29.0	27.4	(11.9)	(26.5)	NM	11.1	6.1
Equity FCF (UBS) yield %	7.2	10.1	9.4	(8.1)	1.5	1.4	9.6	11.7
Net dividend yield %	0.5	1.6	1.7	0.0	0.0	0.0	3.1	5.7

Source: Company accounts, Thomson Reuters, UBS estimates. Metrics marked as (UBS) have had analyst adjustments applied. Valuations: based on an average share price that year, (E): based on a share price of A\$1.94 on 23 May 2016 22:34 EST

www.ubs.com/investmentresearch

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UBS Research THESIS MAP a guide to our thinking and what's where in this report

[OUR THESIS IN PICTURES →](#)

PIVOTAL QUESTIONS

Q: Can Western Areas deliver positive FCF over the next 2 years?

At US\$3.80/lb nickel, we see Western Areas losing a small amount of cash (~A\$10mpa) despite deferring \$34m of capital costs from FY16 to FY17. We estimate that Western Areas can maintain this lower level of deferred capital spending for ~12-18 months before reinvestment is needed. On our numbers, with a normalised sustaining/development capital expenditure of ~A\$38mpa, the break-even price is closer to ~US\$4.60/lb.

Q: How long can Western Areas weather low nickel prices?

With a cash balance of just under A\$60m, we think WSA can weather sub US\$4/lb nickel prices for ~2 years. Our concern is that should nickel prices maintain at these levels for another 9 months (end CY16), Western Areas may be put in a difficult position balancing reduced cash on hand and reinvestment requirements.

["Placement buys ~2 years at spot nickel" 31/03/2016 →](#)

Q: Where could prices lift to under an industry on a sustainable footing?

Stainless steel production has been flat for 2 years globally & for 6 years outside China, a poor demand backdrop for Ni. On the supply side, a lifting oil price can drive cost reflation & pressure shuts which is a key catalyst for better Ni-prices. We think a further 100-200ktpa of shuts are needed, & look for these to occur at end of 2016 to early 2017. Our price forecasts are US\$4.20/lb for 2016 & US\$5.00/lb for 2017e.

["Nickel: Worth a Dime?" 19/05/2016 →](#)

UBS VIEW

Western Areas remains the 'go to' nickel producer for many investors, supported by operational stability, relatively low cash costs and cash position (no debt). However, nickel prices remain depressed and without a return to higher prices we see a risk that the market may begin to lose patience.

EVIDENCE

Long term, we estimate an All-In Sustaining Cost of ~US\$4.60/lb, this includes \$15m for corporate costs, \$15m for exploration and \$38m for sustaining capital. We note that this includes a payability estimate of 70%. Capex is lumpy and at this stage we have little visibility on where capex could head over the next 12-18 months.

WHAT'S PRICED IN?

At A\$1.95/sh, Western Areas is factoring in a flat nickel price of US\$5.80/lb. In our view, the market remains drawn to Western Areas' low reported cash cost guidance of A\$2.25-2.45/lb. However, this does not include key cost items such as smelting/refining charges, concentrate logistics and or royalties. In addition, it does not include sustaining capex, exploration or...

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UPSIDE / DOWNSIDE SPECTRUM



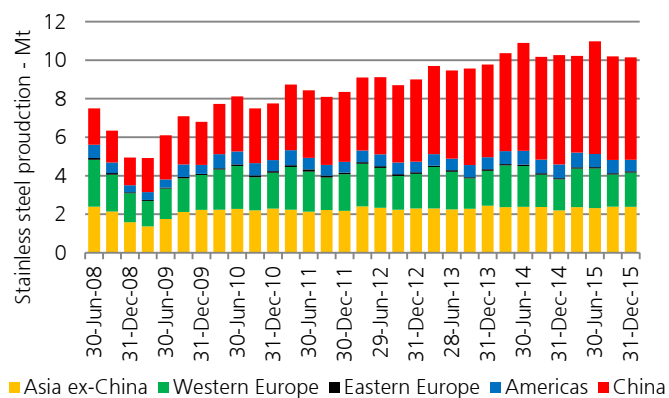
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COMPANY DESCRIPTION

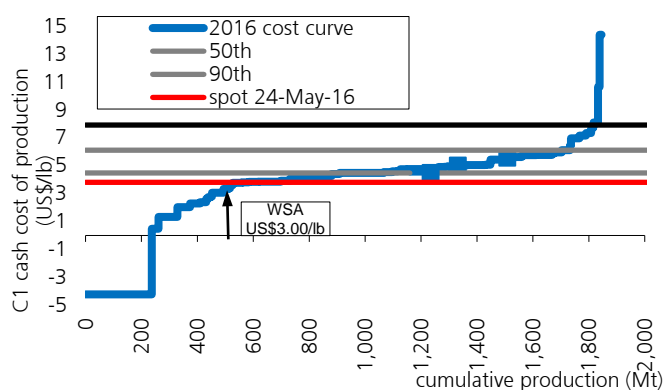
Western Areas operates the low-cost Flying Fox and Spotted Quoll nickel mines and the 550ktpa Cosmic Boy concentrator located in the Forrestania region of Western Australia. Flying...

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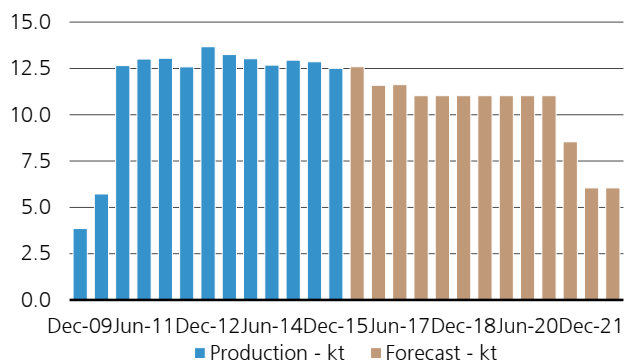
OUR THESIS IN PICTURES

[return](#) ↑

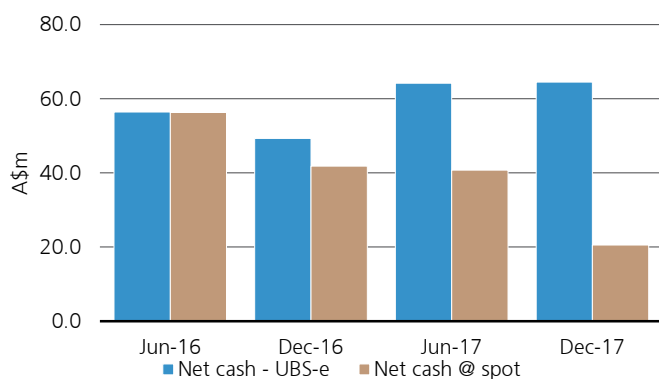
Stainless steel demand ex-China has been weak. The sector accounts for 2/3 of nickel demand



The nickel price is trading deep within the cost curve



We forecast stable & consistent production



At spot (US\$3.80/lb, A\$ 0.72), cash balances are sound, albeit declining for ~2 years to end CY17. Our numbers assume A\$38mpa of sustaining/development capex from early FY17.

Sources for exhibits above: Company data, UBS Research

WHAT'S PRICED IN?

[return](#) ↑**At A\$1.95/sh, Western Areas is factoring in a flat nickel price of US\$5.80/lb.**

In our view, the market remains drawn to Western Areas' low reported cash cost guidance of A\$2.25-2.45/lb. However, this does not include key cost items such as smelting/refining charges, concentrate logistics and or royalties. In addition, it does not include sustaining capex, exploration or corporate overheads. We estimate a fully loaded breakeven price of US\$4.60/lb.

The key risk to our break-even price is capex, which is lumpy and payability terms, which are tied to the nickel price as well as quality.

Reducing capex to A\$30m would lower the break-even price to US\$4.41/lb.

We assume 70% payability. If we reduce this to 68%, our break-even price lifts to US\$4.71/lb.

The below workings assume an A\$ of 0.75. At spot of 0.72, the break-even price reduces to US\$4.39/sh.

Figure 1: Summary break-even estimates

	MQ-16		Annualised	
	A\$/lb	A\$m	A\$m	US\$m
Mining	2.27	31	124	
Royalty	0.17	2	9	
Concentrate/logistics	0.32	4	17	
Sustaining/developing capex (normalised)			38	
Corporate (normalised)			15	
Exploration (normalised)			15	
Total costs			218	164
Production - kt				23.2
Payable production (UBS-e 70%) - kt				16.2
Payable production - Mlb				35.8
Break-even - US\$/lb				4.57

Source: UBS estimates. A\$ 0.75

How sensitive is the break-even to payability and capex estimates?

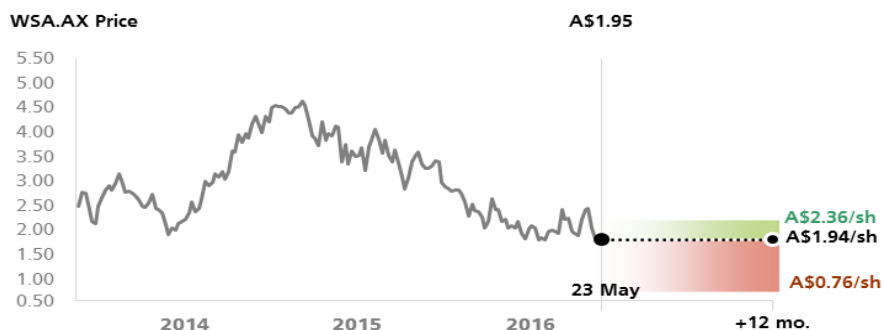
If we take a bearish scenario, where payabilities reduce to 68% and capex increases to ~A\$50m, our scenario analysis suggests we could see the break-even price approach US\$5/lb.

Figure 2: Break-even sensitivity to payability and capex

		Sustaining/development capex - A\$m			
		20	30	40	50
Payability - %	68%	4.32	4.54	4.75	4.97
	69%	4.26	4.47	4.68	4.89
	70%	4.20	4.41	4.62	4.83
	71%	4.14	4.34	4.55	4.76

Source: UBS estimates

UPSIDE / DOWNSIDE SPECTRUM

[return](#) ↑


WSA is trading
at A\$1.95
(as of 23 May).

Risk to the current share price is heavily skewed (1:3) to the downside

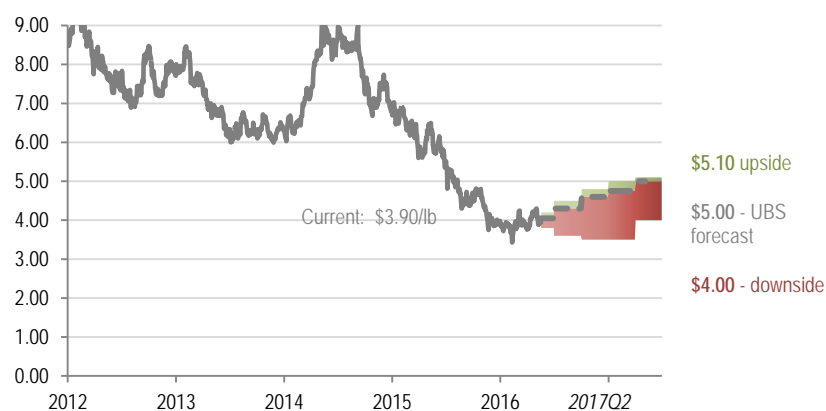
WSA is trading at **A\$1.95** (as of 23 May).

Upside scenario (A\$2.36): Our upside case assumes no cost inflation for 3 years and a lift in short term nickel prices to average US\$6.50/lb over the next 18 months.

Base case (A\$1.94): Our base case assumes relatively stable production to 2022 with mine development capex lifting back to A\$38mpa from end FY17. In addition, it assumes the UBS nickel price deck, which forecasts rising nickel prices to US\$7.90/lb (Real) by 2021. Our forecasts assume an average payability of 71%.

Downside scenario (A\$0.76): Our downside scenario assumes a flat spot nickel price of US\$4.00/lb with an A\$ of 0.75. We would regard this as a severe downside scenario as more than 50% of the nickel market is losing cash today.

Figure 3: UBS nickel upside downside spectrum



Source: UBS estimates

COMPANY DESCRIPTION

[return](#) ↑

Market Cap	A\$530m	Revenues by commodity (%)
Shares Outstanding	262m (COM)	100% nickel
Industry	Mining	EBIT by mine
Region	Australia	100% Forrestania, Western Australia.
Website	www.westernareas.com	

Western Areas operates the low-cost Flying Fox and Spotted Quoll nickel mines and the 550ktpa Cosmic Boy concentrator located in the Forrestania region of Western Australia. Flying Fox is an underground mine currently producing ~13ktpa Ni, the Spotted Quoll underground mine also produces ~13ktpa Ni. Concentrate sale agreements are in place with BHP (10-12ktpa) and Jinchuan (12.5-15ktpa). Mineral reserves are 6.4Mt at 3.2% Ni for 205.6kt of contained Ni with ongoing exploration aiming to establish a 10-year mine life at both assets.

Industry outlook

Short term: We think the current spot price appears oversold, industry shuts are needed but in our view will likely be a protracted affair. Longer term: 70% of the industry in a loss making position is not sustainable, shuts are needed. Another 12 months of elevated China imports of Ni-metal & FeNi products would see exchange inventory fall & supply anxiety lift.

Western Areas (WSA.AX)

Analyst/s: James Brennan-Chong
Email: james.brennan-chong@ubs.com
24-May-16

MARKET INFORMATION

Rating:	Sell
Price (as of 24-May-16):	1.91
Price Target (12 months):	1.94
Issued Capital:	262.1
Market Capitalisation:	507.2
Avg. daily turnover (US\$m)	3.5
Year end:	Jun 2016
Website:	http://www.westernareas.com.au
Major Shareholders:	Jungle Creek Gold Mines - 12.16%

INVESTMENT SUMMARY

(A\$m)	2015A	2016E	2017E	2018E
Net profit [reported] (\$m)	35.0	(42.7)	(19.1)	(2.0)
Net profit [adjusted] (\$m)	35.0	(42.7)	(19.1)	(2.0)
EPS [reported] (\$)	0.2	(0.2)	(0.1)	(0.0)
EPS [adjusted, diluted] (\$)	0.2	(0.2)	(0.1)	(0.0)
EPS Growth (%)	37.5	NM	55.3	89.4
PER [adjusted] (x)	12.6	<0.0	<0.0	<0.0
Dividend (\$)	0.07	0.00	0.00	0.00
Payout ratio (%)	46.2	0.0	0.0	0.0
Dividend Yield (%)	3.7	0.0	0.0	0.0
FCF Yield (%)	17.3	(13.3)	1.6	1.5
Franking (%)	0.0	0.0	0.0	0.0
Shares [period-average, diluted] (m)	231.3	262.1	262.1	262.1

VALUATION

Valuation per share [NAV @ 10%] (\$)	1.94
Share Price Target [12 months] (\$)	1.94
Price/NAV [10% disc rate] (x)	0.98

Operating Assets [JH16]

	A\$m	¢
Forrestania	325	124
Exploration	150	57

Gross Assets

	A\$m	¢
Net Cash (Jun-16)	56	22
Corporate costs	(22)	(8)

Net Asset Value @ 10% discount rate

	A\$m	¢
Net Asset Value @ 10% discount rate	509	194

ENTERPRISE VALUE

(A\$m)	2015A	2016E	2017E	2018E
Enterprise Value	1,107	645	645	645
EV/EBITDA (x)	7.8	110.1	13.7	9.9
EV/Operating Free Cash Flow (x)	16.3	<0	66.0	70.1

EPS SENSITIVITIES

Commodity	Base Change	FY16	FY17	FY18
		EPS Change		
Nickel price	10%	8%	103%	911%

CASH FLOW

(A\$m)	2015A	2016E	2017E	2018E
Operating income [EBIT, UBS]	59	(58)	(20)	(2)
Depreciation & Amortisation	83	64	67	67
Net change in working capital	(0)	0	0	0
Other (operating)	22	29	(3)	(2)
Pre-tax op cash flow	164	35	44	64
Interest (paid) / received	(6)	(3)	1	1
Tax paid	(9)	(18)	0	(1)
Other	0	0	0	0
Operating cash flow	148	14	45	63
Capital expenditure	(72)	(80)	(37)	(56)
Free cash flow	77	(67)	8	7
Net (acquisitions) / disposals	0	0	0	0
Dividends paid (Common)	(16)	(9)	0	0
Shares issued/(repurchased)	0	63	0	0

Source: Company accounts, UBS estimates. UBS valuations are stated before goodwill, exceptionals and other special items. Note: the data represents an extract of the full company accounts.

COMPANY DESCRIPTION

Western Areas operates the low-cost Flying Fox and Spotted Quoll nickel mines and the 550ktpa Cosmic Boy concentrator located in the Forrestania region of Western Australia. Flying Fox is an underground mine currently producing ~13ktpa Ni, the Spotted Quoll underground mine also produces ~13ktpa Ni. Concentrate sale agreements are in place with BHP (10-12ktpa) and Jinchuan (12.5-15ktpa).

OPERATIONAL ASSUMPTIONS

	1H16A	2H16E	2015A	2016E	2017E	2018E
Commodity Prices						
Nickel (US\$/lb)	453.6	395.6	701.6	424.6	466.3	537.5
Nickel Achieved Price (US\$/lb)	322.9	283.2	499.2	303.1	334.6	385.2
Production						
Flying Fox						
Nickel in ore mined	143.6	132.0	264.3	275.6	280.0	280.0
Spotted Quoll						
Nickel in ore mined	162.0	152.7	275.9	314.7	280.0	280.0
Total						
Contained nickel in concentrate	12.5	12.6	25.8	25.1	23.2	22.1
Cash Costs						
Cash cost Ni in Con	2.3	2.6	2.3	2.5	2.7	2.9
Cash cost Ni in Con - Payable	3.1	3.5	3.9	3.3	4.0	4.5

DIVISIONAL BREAKDOWN [EBIT]

(A\$m)	1H16A	2H16E	2015A	2016E	2017E	2018E
Forrestania (Group)	(25)	(33)	59	(58)	(20)	(2)

PROFIT & LOSS

(A\$m)	1H16A	2H16E	2015A	2016E	2017E	2018E
Sales Revenue	106	97	313	203	223	245
Operating Cash Profit	7	4	149	11	53	71
Depn & Amortisation	(30)	(34)	(83)	(64)	(67)	(67)
Operating Profit	(23)	(30)	65	(53)	(14)	4
Others	(2)	(3)	(7)	(5)	(6)	(6)
SGA	0	0	0	0	0	0
EBIT	(25)	(33)	59	(58)	(20)	(2)
Net interest	(1)	0	(11)	(0)	1	1
Profit before tax	(26)	(32)	48	(58)	(19)	(1)
Tax expense	6	10	(13)	16	0	(1)
Equity Associated NPAT	0	1	2	3	4	5
Minority Interests	0	0	0	0	0	0
Dividends [preferred]	0	0	0	0	0	0
Net Profit [reported]	(20)	(23)	35	(43)	(19)	(2)
Abnormal Gain/(Loss) after Tax	0	0	0	0	0	0
Net Profit [adjusted]	(20)	(23)	35	(43)	(19)	(2)
EBITDA margin (%)			45.5	2.9	21.1	26.7
Net Interest Cover [EBIT] (x)			(5.5)	125.8	(19.0)	(1.4)
Tax Rate (%)			27%	NM	NM	NM
EBIT/Total Assets (%)			9.8	(12.1)	(4.4)	(0.4)
NPAT/Equity (%)			8.7	(10.6)	(5.0)	(0.5)

BALANCE SHEET [Selected Items]

(A\$m)	2015A	2016E	2017E	2018E
Net Working capital	(2)	(12)	(9)	(8)
Fixed Assets	300	273	227	199
Net Other	35	88	104	120
Capital Employed	333	348	321	312
Net Cash / (Debt)	68	56	64	71
Total Equity [incl. minorities]	401	405	385	383
Minorities	0	0	0	0
Net Debt / Equity (%)	(17.0)	(13.9)	(16.7)	(18.6)
Book Value per Share(\$)	1.73	1.54	1.47	1.46

Forecast returns

Forecast price appreciation	+0.3%
Forecast dividend yield	0.0%
Forecast stock return	+0.3%
Market return assumption	6.7%
Forecast excess return	-6.4%

Valuation Method and Risk Statement

Investment risk inherent in the resource sector includes, but is not limited to movement of commodity price and currency which may differ materially from the assumptions used in this report. Furthermore the sector is subject to political, financial and operational risks, each of which has the potential to significantly impact industry performance. Our valuation is DCF-based, using a 10% discount rate.

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UBS Investment Research: Global Equity Rating Definitions

12-Month Rating	Definition	Coverage ¹	IB Services ²
Buy	FSR is > 6% above the MRA.	49%	32%
Neutral	FSR is between -6% and 6% of the MRA.	38%	26%
Sell	FSR is > 6% below the MRA.	14%	19%
Short-Term Rating	Definition	Coverage ³	IB Services ⁴
Buy	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%
Sell	Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%

Source: UBS. Rating allocations are as of 31 March 2016.

1:Percentage of companies under coverage globally within the 12-month rating category.

2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.

3:Percentage of companies under coverage globally within the Short-Term rating category.

4:Percentage of companies within the Short-Term rating category for which investment banking (IB) services were provided within the past 12 months.

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Company Disclosures

Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
Western Areas Limited ¹³	WSA.AX	Sell	N/A	A\$1.94	23 May 2016

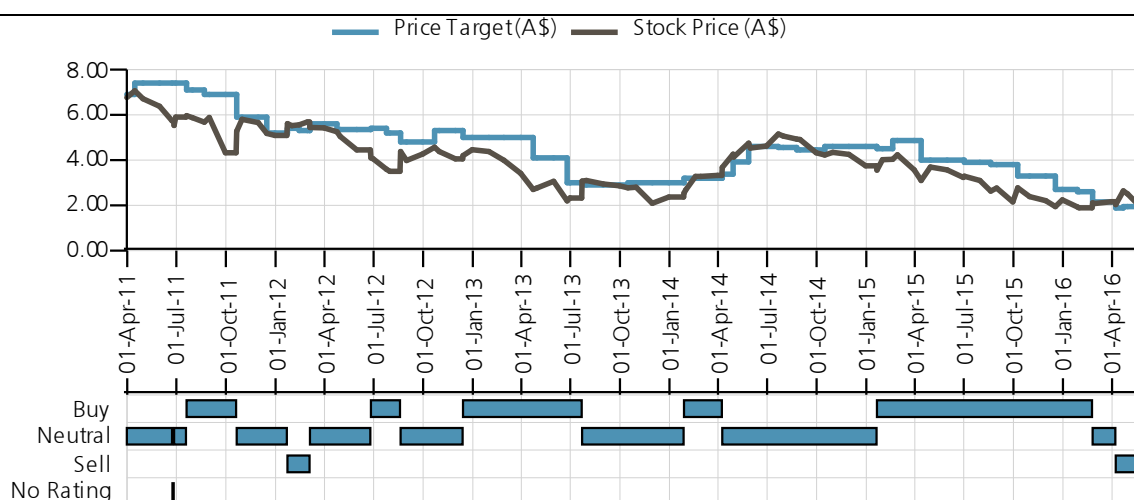
Source: UBS. All prices as of local market close.

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Western Areas Limited (A\$)



Source: UBS; as of 23 May 2016

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