

Attention : ASX Company Announcements Platform

Lodgement of 'Company Interview'



'COMPANY INTERVIEW'-MARKET PROFESSIONALS

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**Western Areas Limited**

**Date of lodgement: 8/4/2014**

**TITLE: "Company Interview. Outlook after Fund Raising"**

**Highlights:**

- **Reiterates upgraded operational guidance for FY14.**
- **Reasons for fund raising including earnings and EPS accretive. Reaction from market towards fund raising.**
- **Expects Net Profit Before Tax increases of approximately \$12m in FY15 and a further \$12m in FY16 as a result of paying down debt via cash, facilitated by the fund raising.**
- **Expect to be able to maintain much improved EBITDA margin on similar Ni prices.**
- **Explains why nickel market sentiment is improving.**
- **Media speculation on the potential sale of BHP Billiton's Nickel West assets.**
- **Outlines the main outcomes of discussion on recent road shows in North America & UK.**

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**Record of interview:**

**Company Interview question:**

Western Areas Limited (ASX code: WSA; market cap of ~\$800m) has two operating nickel sulphide mines, Flying Fox and Spotted Quoll, in Western Australia. The ore from these mines is processed through the 100% owned mill to produce a premium nickel concentrate. For the first half year to 31 December 2013, you recorded production of 13,020 tonnes of nickel in concentrate and a unit cash cost of A\$2.41/lb nickel in concentrate – both well ahead of guidance - resulting in EBITDA increasing by \$7.1 million to \$65.4 million (compared with the June 2013 half year). Can you give guidance for the full year to June 2014?

### **Managing Director, Dan Lougher**

On 10 February 2014, the Company released upgraded guidance around key operational metrics. Due to the outperformance in the first half we were able to reduce our full year unit cost guidance from between A\$2.80/lb to A\$2.90/lb to now less than A\$2.70/lb. Furthermore production increases from the mines and the mill resulted in upgraded full year guidance of 27,000t of nickel in ore and 25,000t of nickel in concentrate.

Western Areas will soon be reporting the March quarter, and we remain 100% committed to our full year guidance.

### **Company Interview question:**

You recently successfully completed an A\$89.0 million placement and a Share Purchase Plan which raised an additional A\$17.75 million. Can you explain your funding strategy with respect to the placement and SPP and the intended allocation of these funds? What was the response to the placement?

### **Managing Director, Dan Lougher**

I encourage readers to review the presentation the Company released to the market at the time of announcing the equity raising, however to summarise I'd make the following points:

- The equity raise was completed at a tight discount of 3.2% to the 5 day VWAP.
- Support for the raising was strong with the placement many times covered and significant demand from both local and international investors.
- Of the total equity raise the proportion attributable to the placement versus to the SPP reflected the ownership mix of Western Areas stock prior to the placement.
- Western Areas was satisfied that quality institutions were allocated stock and we believe this has resulted in strong after market support with the stock price trading around 15% above the issue price.
- I believe the positive sentiment towards nickel which has seen the Australian dollar nickel price rise \$1/lb over recent times, the related impact of the Indonesian ban on nickel laterite exports and the consistently strong track record of performance of the Western Areas team, contributed to the success of the equity raise.
- The main reason for the raise was to retire using cash the July 2014 convertible bonds of A\$110m and to provide majority coverage towards the cash retirement of the A\$125m July 2015 convertible bond. To this end, Western Areas announced on 28 February that we had purchased A\$15m face value of the July 2014 convertible bonds as it was NPV accretive to do so.

### **Company Interview question:**

Are you able to elaborate on any balance sheet and earnings implications the capital raisings will have?

### **Managing Director, Dan Lougher**

A major benefit of the equity raising will be the positive impact on earnings and EPS, as the July 2014 convertible bonds will be retired by cash, rather than a new convertible bond or further debt. From a Net Profit Before Tax (NPBT) perspective FY15 earnings will improve A\$11.7m, which comprises roughly A\$7m in reduced interest charges and the balance an accounting charge for bond accretion expenses. Roll forward to FY16 and a further A\$12m will be added to NPBT with the retirement of the July 2015 convertible bonds through cash. Therefore over a 2 year period to FY16, the combined improvement to NPBT from this raising totals around A\$24m.

### **Company Interview question:**

For the half year to 31 December 2013 the EBITDA margin improved by 20% to 45.6% compared with the half year to 30 June 2013. Assuming similar nickel prices, can you maintain that EBITDA margin? What further operational improvements might be possible?

### **Managing Director, Dan Lougher**

The Company has been very successful in removing costs out of the business and driving through with productivity improvements. The evidence of this success is translated in the half year EBITDA margin improvements we reported. The Company has a culture of continually challenging costs and we expect to be able to maintain margins around these levels. Credit for this improvement lays squarely with our operational team at Forrestania.

As part of the equity raising, the Company provided an example of a capital project designed to increase our already high recoveries from the mill. With this project about to go into feasibility, it demonstrates our desire to improve efficiency wherever possible and where the payback period is short.

### **Company Interview question:**

What's your view on the nickel market in terms of current supply and demand dynamics?

### **Managing Director, Dan Lougher**

If you look at the nickel price environment and sentiment of 2013 versus year to date in 2014 there is a stark difference. Firstly, the much talked about nickel laterite export ban from Indonesia was enforced on 12 January 2014 and remains in force today despite market conjecture that it would not occur. Our sources advise that no laterite is leaving the shores of Indonesia, and this supply is critical to the success of the Rotary Kiln Electric Arc Furnace nickel pig iron industry in China. Evidence supporting the impact of the ban includes market intelligence that suggests the stockpiled Indonesian laterite ore price in China has doubled from the 2<sup>nd</sup> half of 2013 and increased by a further 50% in the last few months. Our advice is that these stockpiles will be depleted during the last quarter of 2014.

Whilst we at Western Areas would never profess to be experts on Indonesian politics, we have noted that Presidential candidates for the elections in July have provided support to the ban.

With the Australian dollar trading around US\$0.92 and the nickel price improving to over US\$7/lb, Western Areas will benefit in the second half of this financial year. Any nickel price averaging above US\$6.80/lb also lifts the payability percentage we receive from our two customers, BHP Billiton's Nickel West (Nickel West) and Jinchuan Group (Jinchuan).

As a global industry we remain optimistic with the fundamentals. Stainless Steel demand continues to rise, and 70% of the world's nickel production ends up in 300 and 400 series stainless steel, which has high nickel content.

**Company Interview question:**

There has been plenty of media speculation recently regarding the potential sale of BHP Billiton's Nickel West assets including references to Western Areas. In your view, why is it that Western Areas is more often than not linked to such speculation?

**Managing Director, Dan Lougher**

As a rule, we don't like to comment on media speculation surrounding Nickel West. We do note however that this type of speculation is not new, particularly in Western Australia.

To make some observations however, I will say that we are also not surprised that Western Areas is linked to the speculated sale of Nickel West. To put it simply, Western Areas sells 12,000t per annum of nickel in concentrate to Nickel West pursuant to an offtake agreement which expires in 2017. The nickel concentrate produced by Western Areas is a premium blending product for nickel smelters as the concentrate contains an Iron to Magnesia (MgO) ratio of >15:1. Nickel smelters require this ratio to be at a minimum 5:1 otherwise costs rise and smelter efficiency deteriorates significantly. There are a number of nickel companies producing nickel concentrate that have ratios around 1:1 and 2:1. Consequently the Western Areas concentrate can be blended with those other concentrates to make them a suitable smelting product.

Western Areas also sells around 13,000t per annum of nickel in concentrate to Jinchuan pursuant to a contract which is forecast to complete in 10 months. This concentrate has the same Iron to Magnesia ratio as I just referred to.

Turning back to Nickel West, they have announced the closure of their Perseverance mine due to seismic issues. If I reference recent broker analyst reports, this means that Nickel West will be short of premium concentrate for their smelter and Western Areas is the only Australian producer that has premium concentrate available early next year.

I can confirm that Western Areas has received a number of expressions of interest regarding the concentrate almost a year before expiry of the Jinchuan contract. The parties making contact include global metals traders, nickel smelters, nickel downstream producers and stainless steel companies. Interestingly a number of these parties have not expressed interest previously.

In past years, Western Areas would go to tender around 6 months prior to the expiry of the Jinchuan contract. However, we maintain the option of securing a new and improved contract early without going to tender or keeping with historical practice. What is certain in my mind is the highly important and strategic nature of Western Areas' nickel concentrate.

### **Company Interview question:**

You have recently been on a roadshow after your profit results. What were the main areas of discussion and specifically the areas of positive or negative feedback?

### **Managing Director, Dan Lougher**

Following the equity raising, David Southam (Executive Director) and I travelled to North America and the UK to meet existing and potential new investors. We have also recently met with Asian based investors. The number, quality and tone of the meetings were very positive and we've noted that a number of investors have purchased Western Areas stock post the meetings. Since the beginning of the year we've seen very strong buying from international investors as they seek to cure their underweight positions in the resource sector, but particularly positions in mid-cap base metal companies. This momentum is on the back of positive sentiment towards the nickel price outlook.

With the raising answering any perceived balance sheet risks, we've also seen a number of institutions enter the register whose investment criteria are more aligned to our revised balance sheet. The investors I've spoken to have seen the absolute logic in the raising. I believe the repayment of the convertible bonds in cash and the flow on addition of approximately A\$12m NPBT in FY15 followed by a further A\$12m in FY16, combined with the EPS improvement and the company's history of paying dividends, places Western Areas in a very strong fiscal position.

### **Company Interview**

Thanks Dan.

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