

26 Feb 2020

Share Price: \$5.72
12mth price target: \$6.57

LYCOPIDIUM LTD (LYL)

Solid as usual, though delays continue to impact

Lycopodium Limited (LYL) has delivered 1H20 NPAT of \$9.0m, representing growth of 5% on 1H19 (\$8.6m). An interim dividend of 15cps has been declared, in line with 1H19.

This was another solid result from LYL with management reporting that project execution continued to be strong.

Delays again impact guidance...

Unfortunately, a common theme for LYL, and indeed the broader sector, over the last 12-18 months has been continued delays to project commencements.

LYL has provided updated guidance for revenue of \$220m and NPAT of \$14.1m. Previous guidance was for revenue of \$220m and NPAT "generally in line with FY19" (\$16.5m).

LYL notes that guidance has been impacted by delays to new project commencement impacting on revenue. With project performance solid as expected, this implies that initial internal revenue expectations were likely higher than stated guidance. Our FY20 NPAT estimate reduces to be in line with updated guidance.

...though outlook remains strong

LYL advises that recent awards of several projects and studies will support revenue growth into FY21 as new projects ramp up later this year. Additionally, LYL notes that tendering activity remains strong, as does the pipeline of identified prospects.

The outlook for gold remains strong, with current prices of US\$1,640oz providing support for developments, though securing project financing continues to be a challenge for some.

Mondium (LYL 40%) has commenced work on its \$400m contract with RIO at Western Turner Syncline, which is expected to complete in 1H22. Meanwhile LYL continues work on its key EPC project at Yaouré for Perseus (PRU). PRU recently announced that the project remains on track to achieve its stretch target of first gold in December 2020.

Cash position very strong

LYL continues to maintain its focus on having a very strong balance sheet. At 1H20 net cash stood at \$111m, buoyed by receipt of material payments in advance during the period. We estimate that on a pro-forma basis LYL has net cash of ~\$77m (see page 4).

Buy; Price Target \$6.57

LYL is a very well-managed business. While project delays continue to impact, the outlook remains positive with LYL well-positioned to benefit.

We maintain our Buy recommendation. Our price target reduces to \$6.57 / share from \$6.76 / share previously.

Brief Business Description:

Engineering and project management business operating across a range of industries, primarily resource projects in Australia and internationally.

Hartleys Brief Investment Conclusion:

LYL is a well-managed, highly cash generative business, leveraged to the improving outlook for resource spend.

Chairman & CEO:

Michael Caratti (Non-Exec. Chairman)
Peter De Leo (MD / CEO)

Top Shareholders:

Michael Caratti	23%
Luala P/L	8%
Braeside Invest.	8%

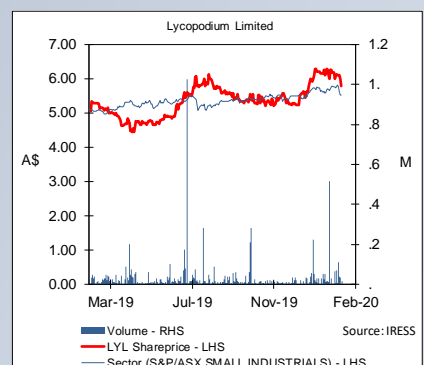
Company Address:

1 Adelaide Tce
East Perth WA, 6004

Issued Capital:	40m
- fully diluted	40m
Market Cap:	\$227m
- fully diluted	\$228m
Net Debt (1H20):	-\$77m

	FY19a	FY20e	FY21e
Revenue	151	220	220
EBIT (\$m)	21.1	15.3	18.1
NPAT (A\$m)	16.5	14.0	19.3
EPS (\$, dil)	41.5	35.3	48.7
P/E (basic)	13.8x	16.2x	11.8x
P/E (cash adj.)	9.9x	11.6x	8.2x
EV / EBIT	7.6x	7.6x	4.9x
DPS (cps)	30.0	25.0	31.6
Dividend Yield	5.2%	4.4%	5.5%
Net Cash (\$m)	60	82	93

Source: Hartleys Research.



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Disclaimer: The analyst has a beneficial interest in LYL shares.

SUMMARY MODEL

Lycopodium Limited (LYL)					Recommendation: Buy									
Company Information					Profit & Loss (\$m)									
Date	26 Feb 2020	1 Adelaide Tce			6/18A	6/19A	6/20F	6/21F	Operating Revenue	192.0	151.1	220.0	220.0	
Share Price	\$5.72	East Perth WA, 6004			Expenses	-167.9	-128.5	-196.7	-193.9	EBITDA	24.1	22.6	23.3	26.1
52 Week High-Low	\$6.14-\$4.35	Ph: (08) 6210 5222			Depn & Amort.	-1.2	-1.5	-8.0	-8.0	EBIT	22.9	21.1	15.3	18.1
Market Cap (\$m)	\$227	www.lycopodium.com.au			Net Interest	1.8	1.7	0.8	0.8	PBT	24.6	22.9	16.1	18.9
Net Debt (\$m)	-\$77				Tax	-7.1	-7.1	-4.8	-5.7	Associates Contribution	1.1	0.7	2.5	6.3
Enterprise Value (\$m)	\$150				NPAT pre Minorities	18.7	16.4	13.8	19.5	Minorities	0.2	-0.1	-0.2	0.2
Ordinary Shares	39.7				NPAT to LYL	18.5	16.5	14.0	19.3	Pre-tax Adjustments	0.0	0.0	0.0	0.0
Fully Diluted Shares	39.9				Adjusted EBITDA	24.1	22.6	23.3	26.1	Post-tax Adjustments	0.0	0.0	0.0	0.0
Price Target	\$6.57				Adjusted NPAT	18.5	16.5	14.0	19.3	Reported EPS (basic, wghtd)	46.5	41.5	35.3	48.7
Upside / Downside	15%				Reported EPS (dil, wghtd)	46.5	41.5	35.3	48.7	DPS (cps)	30.0	30.0	25.0	31.6
Dividend Yield - FY19	5%				Dividend Yield	5.2%	5.2%	4.4%	5.5%	Franking	100%	100%	100%	100%
Total Return	20%				EV/EBITDA multiple	6.0x	7.1x	5.4x	3.8x	Payout Ratio	64.5%	72.2%	70.7%	65.0%
Price Target					Cashflow Statement (\$m)									
12 Month Price Target	\$6.57				Cash from Operations	2.2	11.7	41.2	26.1					
P/E (FY20) at price target - Reported EPS	18.6x				Net interest Paid	1.8	1.8	0.8	0.8					
P/E (FY21) at price target - Reported EPS	13.5x				Tax Paid	-5.9	-12.4	-7.1	-4.8					
Div. Yld (FY20) at price target	3.8%				Net Operating Cash Flow	-1.8	1.1	34.8	22.1					
Div. Yld (FY21) at price target	4.8%				Capital Expenditure	-1.7	-1.6	-2.0	-2.0					
Multiples (\$/price at \$5.72)					Dividends from JV	0.6	2.0	1.3	3.1					
P / E (basic, weighted)	12.3x	13.8x	16.2x	11.8x	Other (inc Investments, Asset sales etc)	1.1	1.0	0.5	0.5					
P / E (norm, diluted, weighted)	12.3x	13.8x	16.2x	11.8x	Net Investing Cash Flow	0.0	1.4	-0.2	1.6					
Dividend Yield	5.2%	5.2%	4.4%	5.5%	Proceeds from Equity Issues	0.0	0.0	0.0	0.0					
EV/EBITDA multiple	6.0x	7.1x	5.4x	3.8x	Net Change in Debt & Leases	-0.4	-0.8	0.0	0.0					
EV/EBIT multiple	6.3x	7.6x	7.6x	4.9x	Dividends Paid	-8.3	-13.1	-12.0	-12.6					
Price / Book Value	2.9x	2.9x	2.6x	2.5x	Other	-0.4	0.7	0.0	0.0					
Price / NTA	3.1x	3.1x	2.8x	2.7x	Net Financing Cash Flow	-9.2	-13.2	-12.0	-12.6					
Ratios					Movement in Cash	-11.0	-10.7	22.6	11.2					
ROE (NPAT / Equity)	23%	21%	16%	21%	Balance Sheet (\$m)									
ROA (EBIT / Total Assets)	16%	18%	9%	10%	Cash	74.3	60.5	83.1	94.2					
ND / ND + Equity	-1155%	-303%	-1456%	7916%	Receivables	37.6	34.4	54.2	54.2					
ND / Equity	-92%	-75%	-94%	-101%	Inventories	0.8	0.9	1.3	1.3					
Net Interest Cover (EBIT)	-13.0	-12.2	-19.2	-22.6	Other	3.1	5.6	5.6	5.6					
Revenue growth	-11%	-21%	46%	0%	Total Current Assets	115.8	101.3	144.2	155.4					
EBIT growth	95%	-8%	-27%	18%	Property, Plant & Equipment	3.4	3.8	4.3	-1.7					
NPAT growth	80%	-11%	-15%	38%	Intangibles	6.8	6.7	6.7	6.7					
EPS (dil, wghtd) growth	80%	-11%	-15%	38%	Other	12.7	6.5	16.1	16.1					
EBIT Margin	12%	14%	7%	8%	Total Non Current Assets	22.9	17.0	27.2	21.2					
Cash Flow Analysis					Total Assets	138.7	118.4	171.4	176.5					
Net Operating Cash Flow	-1.8	1.1	34.8	22.1	Accounts Payable	31.7	34.2	72.3	72.3					
+ Tax Paid	5.9	12.4	7.1	4.8	Interest Bearing Liabilities	0.7	0.4	0.4	0.4					
+ Net Interest	-1.8	-1.8	-0.8	-0.8	Provisions	16.4	3.0	0.7	0.7					
Ungeared pre-tax cashflow	2.2	11.7	41.2	26.1	Other	10.3	1.1	7.3	8.2					
Reported EBITDA	24.1	22.6	23.3	26.1	Total Current Liabilities	58.4	38.3	80.3	81.2					
Cash Conversion	9%	52%	176%	100%	Interest Bearing Liabilities	0.6	0.3	0.3	0.3					
Capex / D&A	1.4x	1.1x	0.3x	0.3x	Other	0.4	0.3	2.7	2.7					
Share Data					Total Non Current Liabilities	1.0	0.6	3.0	3.0					
Ord Issued shares (m)	39.7	39.7	39.7	39.7	Total Liabilities	59.4	38.9	83.4	84.2					
growth	0.0%	0.0%	0.0%	0.0%	Net Assets	79.4	79.4	88.0	92.3					
Weighted ave shares (m)	39.7	39.7	39.7	39.7	Net Asset Value / Share (\$)	2.00	2.00	2.21	2.32					
growth	0.0%	0.0%	0.0%	0.0%	NTA / Share (\$)	1.83	1.83	2.05	2.15					
Diluted shares wghtd (m)	39.7	39.7	39.7	39.7	Net Debt (net cash)	-73	-60	-82	-93					
growth	0.0%	0.0%	0.0%	0.0%	Directors & Senior Mgt									
Substantial Shareholders					Analyst: Oliver Stevens									
Michael Caratti (Non-Exec. Chairman)	Michael Caratti 22.9%				Phone: +61 8 9268 2879									
Peter De Leo (MD / CEO)	Luala P/L 8.0%				Last Earnings Estimate Change: 26 February 2020									
Lawrie Marshall (NED)	Braeside Invest. 7.7%				Sources: IRESS, Company Information, Hartleys Research									
Steven Chadwick (NED)														
Rodney Leonard (NED)														
Robert Osmetti (NED)														
Bruno Ruggiero (Exec. Dir)														
Peter Dawson (Exec. Dir)														
Justine Campbell (CFO / Co. Sec.)														

1H20 RESULT SUMMARY

Fig. 1: 1H20 result summary

P&L	1H19	2H19	1H20	1H Chg
Revenue	71.9	79.2	108.6	51%
EBITDA	12.3	10.3	15.4	25%
Depn & Amort.	-0.7	-0.8	-4.0	
EBIT	11.6	9.5	11.3	-3%
Net Interest	1.0	0.8	0.4	
PBT	12.6	10.3	11.7	-7%
Tax	-4.2	-2.9	-3.8	
Associates contribution	0.2	0.5	0.9	
NPAT pre minorities	8.5	7.9	8.9	4%
OEI	0.0	-0.1	-0.1	
NPAT to LYL	8.6	7.9	9.0	5%
EPS	21.5c	20.0c	22.6c	5%
DPS	15.0c	15.0c	15.0c	
EBIT Margin	16.1%	12.0%	10.4%	-5.7%
Tax Rate	33.6%	28.3%	32.2%	
Dividend Payout Ratio	70%	75%	66%	

Source: LYL, Hartleys

- 1H20 NPAT of \$9.0m was up 5% on 1H19 (\$8.6m).
- An interim dividend of 15cps has been declared, in line with 1H19.
- The accounts reflect first time adoption of AASB16 with lease costs moving below the EBITDA line, largely into D&A.
- EBIT margin was well down on 1H19, though as we have noted previously, we expect this to be lumpy from period to period as LYL adopts a conservative accounting approach to EPC contracts.

In 1H20 EPC construction revenue of \$44m (largely related to work at Yaouré for PRU) was recognised.

BALANCE SHEET & CASH FLOW

- LYL generated operating cash flow of \$74.6m in 1H20, boosted by material payments in advance (now totalling \$86m) received for construction related work.
- As a result of this inflow, net cash at end 1H20 was \$111m, up from \$60m at FY19.
- During the period LYL also provided a short-term \$14.6m advance to its JV partner Mondium.

In Figure 2 we show our estimates of LYL's pro-forma cash position.

Fig. 2: LYL pro-forma cash

Pro-forma Cash	
Cash	113
Receivables	61
Loan to JV	15
Total	188
Debt	2
Payables	23
Payments in advance	86
Total	111
Pro-forma net cash	77

Source: LYL, Hartleys

FORECASTS

Fig. 3: Forecast Changes

Forecast Changes	FY20 old	FY20 new	Chg	FY21 old	FY21 new	Chg	1H20a	2H20e
Revenue	205.0	220.0	7%	219.4	220.0	0%	108.6	111.4
EBITDA	19.1	23.3	22%	22.8	26.1	15%	15.4	8.0
Deprn & Amort.	-1.5	-8.0		-1.5	-8.0		-4.0	-4.0
EBIT	17.6	15.3	-13%	21.3	18.1	-15%	11.3	4.0
Net Interest	2.0	0.8		2.0	0.8		0.4	0.4
PBT	19.6	16.1	-18%	23.3	18.9	-19%	11.7	4.4
Tax	-5.9	-4.8		-7.0	-5.7		-3.8	-1.1
Associates contribution	3.0	2.5		6.3	6.3		0.9	1.6
NPAT pre minorities	16.7	13.8	-17%	22.6	19.5	-14%	8.9	5.0
OEI	0.2	-0.2		0.2	0.2		-0.1	-0.1
NPAT to LYL	16.5	14.0	-15%	22.4	19.3	-14%	9.0	5.1
EPS	41.6c	35.3c	-15%	56.4c	48.7c	-14%	22.6c	12.8c
DPS	30.0c	25.0c	-17%	36.7c	31.6c	-14%	15.0c	10.0c
EBIT Margin	8.6%	7.0%		9.7%	8.2%		10.4%	3.6%
Tax Rate	30%	30%		30%	30%		32%	24%
Dividend Payout Ratio	72%	71%		65%	65%		66%	78%

Source: Hartleys

- LYL has provided guidance for revenue of \$220m and NPAT of \$14.1m. Previous guidance was for revenue of \$220m and NPAT “generally in line with FY19” (\$16.5m).
- LYL notes that guidance has been impacted by delays to new project commencement impacting on revenue. With project performance solid as expected, this implies that initial internal revenue expectations were higher than stated guidance.
- We reduce our NPAT expectations to move in line with updated guidance.
- LYL advises that recent awards of several projects and studies (Figure 4) support revenue growth into FY21 as new projects ramp up later this year.
- Additionally, LYL notes that tendering activity remains strong, as does the pipeline of identified prospects.

Fig. 4: Feasibility Studies

Sector – Resources				
Project	Client	Location	Commodity	Comments
Motheo	Sandfire Resources	Botswana	Copper	Optimised Feasibility Study (OFS) and commencement of front-end engineering design (FEED)
Toliara	Base Resources	Madagascar	Mineral sands	In conjunction with Mineral Technologies
Bomboré	Orezone Gold Corporation	Burkina Faso	Gold	Commenced FEED for oxide phase

Source: LYL

VALUATION & PRICE TARGET

We value LYL using an EV / EBIT methodology given the significant net cash held on LYL's balance sheet.

We apply an 8.0x EV/EBIT multiple to the average of our FY20 and FY21 EBIT forecast in deriving a price target of \$6.57 / share, down from \$6.76 / share previously.

LYL's implied valuation multiples based on our price target are shown in Figure 5.

Fig. 5: Price Target & Implied Multiples

Price Target	
Avg. FY20 & FY21 EBIT	\$23.0m
EV / EBIT	8.0x
Enterprise Value	\$184m
Add Net Cash (1H20)	\$77m
Equity Value	\$261m
Equity Value per Share	\$6.57

Implied Multiples at Price Target	FY19	FY20	FY21
EV/EBITDA	7.8x	6.8x	5.3x
EV/EBIT	8.3x	9.7x	6.8x
PER	15.8x	18.6x	13.5x
PER - Cash Adjusted	12.1x	14.2x	10.1x
Dividend Yield	4.6%	3.8%	4.8%

Source: Hartleys

Note:

- EBIT used in calculating our price target is based on our forecast LYL EBIT, plus the estimated EBIT contribution we forecast from Mondium, which is reported below the line.
- Net cash is as per our pro-forma calculation (Figure 2).

Key assumptions and risks for valuation

Assumption	Risk of not realising assumption	Downside risk to valuation if assumption is incorrect	Comment
Revenue \$220m in FY20 and \$220m in FY21.	Low	Medium	LYL generally only announces material contract wins, so visibility on revenue build (for external parties) can be low. Current contracts (e.g. Yaouré, Sanbrado) coupled with a strong pipeline, provide comfort around our revenue forecasts.
Successful delivery of WTS2	Low	High	WTS2, being Mondium's first major project is a key. Successful delivery will be beneficial for margins specifically related to this project, in addition to further building on the fledgling quality reputation that Mondium has established. Conversely were this project not to be delivered as expected, this would impact both the short and longer-terms.

Conclusion

*We believe our estimates to be reasonable given the current environment.
We see the key risks to LYL being:*

- **Project delays.** *As we have seen during FY19 and again into FY20, delays to client projects can push out expected timing of receipt of revenues and earnings.*
- **Weak macro environment** *that leads to reduced opportunities, resulting in tougher competition and lower margins. The effects of such a downturn have been experienced in recent years (FY14-FY16) by LYL. While LYL's profitability dropped materially, its strong balance sheet, discipline in bidding for work and focus on quality client outcomes saw the business emerge in great shape.*
- **Poor contract execution.** *This has historically not been an issue given the vast majority of LYL's work has been conducted on an EPCM basis. With LYL now tendering for more EPC work, the risk here rises, though we are comforted by LYL's prudent approach to tendering EPC opportunities.*
- **Stock illiquidity.** *LYL is a thinly traded stock, with little share market liquidity.*

Source: Hartleys

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Hartleys Recommendation Categories

Buy	Share price appreciation anticipated.
Accumulate	Share price appreciation anticipated but the risk/reward is not as attractive as a "Buy". Alternatively, for the share price to rise it may be contingent on the outcome of an uncertain or distant event. Analyst will often indicate a price level at which it may become a "Buy".
Neutral	Take no action. Upside & downside risk/reward is evenly balanced.
Reduce / Take profits	It is anticipated to be unlikely that there will be gains over the investment time horizon but there is a possibility of some price weakness over that period.
Sell	Significant price depreciation anticipated.
No Rating	No recommendation.
Speculative Buy	Share price could be volatile. While it is anticipated that, on a risk/reward basis, an investment is attractive, there is at least one identifiable risk that has a meaningful possibility of occurring, which, if it did occur, could lead to significant share price reduction. Consequently, the investment is considered high risk.

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