

13 Jan 2020

Share Price: \$5.89  
12mth price target: \$6.76

## LYCOPIDIUM LTD (LYL)

### Breakthrough \$400m win for Mondium

Lycopodium Limited (LYL) has today announced that Mondium (LYL 40% / MND 60%) has been awarded a ~\$400m contract with Rio Tinto (RIO).

The contract is for the design and construction of the Western Turner Syncline Phase 2 (WTS2) mineral processing facilities and associated infrastructure and forms part of the ~\$1bn investment into WTS2 announced by RIO in November 2019. Work under the contract has commenced with completion expected in 1H22.

### Mondium building prudently backed by two industry leaders

This is a significant win for Mondium and an equally significant endorsement of Mondium's capabilities from a global Tier 1 client in RIO.

Prior to today's announcement, Mondium's largest contract award had been its \$100m design and construction contract at Talison Lithium's Greenbushes operations in Western Australia, awarded in May 2019.

Mondium was established by MND and LYL as an incorporated JV in October 2016 specifically to "deliver EPC minerals projects domestically and in selected international markets".

In its early days, Mondium has been building and testing its capabilities through working on a number of smaller projects. Backed by two shareholders that are leaders in their respective fields we remain confident in the prospects over the longer term for Mondium.

### Accounting Treatment

Mondium profit contributions to LYL are recognised on an equity-accounted basis. No revenue from Mondium's activities will be recognised by LYL, only LYL's share of Mondium NPAT will be recognised in LYL's P&L. Mondium's policies around items such as project profit recognition and distribution of dividends to its two shareholders are a matter for the Board of Mondium.

As a broad guide, on a stand-alone basis, conservatively assuming this project delivers EBIT margins of 8%, this would imply project EBIT of \$32m and NPAT of ~\$22.4m, of which LYL's share would be ~\$9.0m.

### FY20 forecasts unchanged; FY21 up 11%

We maintain our FY20 NPAT forecast at \$16.5m while our FY21 forecasts increase 11% (see page 3).

### Buy; Price Target \$6.76

Today's announcement is a significant step for Mondium, providing a public acknowledgement of the last 3+ years of investment and largely under the radar work (from an equity market perspective) undertaken by its two shareholders. While project delays continue to impact the short-term the outlook remains positive with LYL well-placed to benefit. We upgrade our recommendation from Accumulate to Buy. Our price target moves to \$6.76 / share, from \$5.70 / 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%

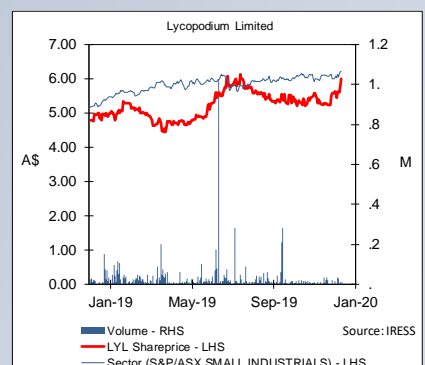
#### Company Address:

1 Adelaide Tce  
East Perth WA, 6004

<b>Issued Capital:</b>	40m
- fully diluted	40m
<b>Market Cap:</b>	\$234m
- fully diluted	\$235m
<b>Net Debt (FY19):</b>	-\$60m

	FY19a	FY20e	FY21e
Revenue	151.1	205.0	219.4
EBIT (\$m)	21.1	17.6	21.3
<b>NPAT (A\$m)</b>	<b>16.5</b>	<b>16.5</b>	<b>22.4</b>
EPS (\$, dil)	41.5	41.6	56.4
P/E (basic)	14.2x	14.2x	10.4x
P/E (cash adj.)	11.4x	11.5x	8.3x
EV / EBIT	7.9x	8.0x	5.7x
DPS (cps)	30.0	30.0	36.7
Dividend Yield	5.1%	5.1%	6.2%
Net Cash (\$m)	60	61	67

Source: Hartleys Research.



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

## SUMMARY MODEL

Lycopodium Limited (LYL)					Recommendation: <b>Buy</b>					
<b>Company Information</b>					<b>Profit &amp; Loss (\$m)</b>					
Date	13 Jan 2020	1 Adelaide Tce			6/18A	6/19A	6/20F	6/21F		
Share Price	\$5.89	East Perth WA, 6004			Operating Revenue	192.0	151.1	205.0	219.4	
52 Week High-Low	\$6.14-\$4.35	Ph: (08) 6210 5222			Expenses	-167.9	-128.5	-185.9	-196.6	
Market Cap (\$m)	\$234	www.lycopodium.com.au			<b>EBITDA</b>	<b>24.1</b>	<b>22.6</b>	<b>19.1</b>	<b>22.8</b>	
Net Debt (\$m)	-\$60				Depn & Amort.	-1.2	-1.5	-1.5	-1.5	
Enterprise Value (\$m)	\$174				<b>EBIT</b>	<b>22.9</b>	<b>21.1</b>	<b>17.6</b>	<b>21.3</b>	
Ordinary Shares	39.7				Net Interest	1.8	1.7	2.0	2.0	
Fully Diluted Shares	39.9				PBT	<b>24.6</b>	<b>22.9</b>	<b>19.6</b>	<b>23.3</b>	
					Tax	-7.1	-7.1	-5.9	-7.0	
Price Target	\$6.76				Associates Contribution	1.1	0.7	3.0	6.3	
Upside / Downside	15%				<b>NPAT pre Minorities</b>	<b>18.7</b>	<b>16.4</b>	<b>16.7</b>	<b>22.6</b>	
Dividend Yield - FY19	5%				Minorities	0.2	-0.1	0.2	0.2	
Total Return	20%				<b>NPAT to LYL</b>	<b>18.5</b>	<b>16.5</b>	<b>16.5</b>	<b>22.4</b>	
					Pre-tax Adjustments	0.0	0.0	0.0	0.0	
<b>Price Target</b>					<b>Adjusted EBITDA</b>	<b>24.1</b>	<b>22.6</b>	<b>19.1</b>	<b>22.8</b>	
12 Month Price Target	\$6.76				Post-tax Adjustments	0.0	0.0	0.0	0.0	
P/E (FY20) at price target - Reported EPS	16.3x				<b>Adjusted NPAT</b>	<b>18.5</b>	<b>16.5</b>	<b>16.5</b>	<b>22.4</b>	
P/E (FY21) at price target - Reported EPS	12.0x				<b>Reported EPS (basic, wghtd)</b>	<b>46.5</b>	<b>41.5</b>	<b>41.6</b>	<b>56.4</b>	
Div. Yld (FY20) at price target	4.4%				Normalised EPS (dil, wghtd)	46.5	41.5	41.6	56.4	
Div. Yld (FY21) at price target	5.4%				DPS (cps)	30.0	30.0	30.0	36.7	
					Franking	100%	100%	100%	100%	
<b>Multiples (\$/price at \$5.89)</b>		<b>6/18A</b>	<b>6/19A</b>	<b>6/20F</b>	<b>6/21F</b>	Payout Ratio	64.5%	72.2%	72.2%	65.0%
P / E (basic, weighted)	12.7x	14.2x	14.2x	14.2x	10.4x					
P / E (norm, diluted, weighted)	12.7x	14.2x	14.2x	14.2x	10.4x					
Dividend Yield	5.1%	5.1%	5.1%	5.1%	6.2%					
EV/EBITDA multiple	6.8x	7.4x	7.5x	7.5x	5.5x					
EV/EBIT multiple	7.1x	7.9x	8.0x	8.0x	5.7x					
Price / Book Value	2.9x	2.9x	2.8x	2.7x						
Price / NTA	3.2x	3.2x	3.1x	2.9x						
<b>Ratios</b>		<b>6/18A</b>	<b>6/19A</b>	<b>6/20F</b>	<b>6/21F</b>	<b>Cashflow Statement (\$m)</b>	<b>6/18A</b>	<b>6/19A</b>	<b>6/20F</b>	<b>6/21F</b>
ROE (NPAT / Equity)	23%	21%	20%	25%		Cash from Operations	2.2	11.7	18.7	22.7
ROA (EBIT / Total Assets)	16%	18%	13%	15%		Net interest Paid	1.8	1.8	2.0	2.0
ND / ND + Equity	-1155%	-303%	-289%	-323%		Tax Paid	-5.9	-12.4	-7.1	-5.9
ND / Equity	-92%	-75%	-74%	-76%		<b>Net Operating Cash Flow</b>	<b>-1.8</b>	<b>1.1</b>	<b>13.6</b>	<b>18.8</b>
Net Interest Cover (EBIT)	-13.0	-12.2	-8.8	-10.7		Capital Expenditure	-1.7	-1.6	-2.0	-2.0
Revenue growth	-11%	-21%	36%	7%		Dividends from JV	0.6	2.0	1.5	3.1
EBIT growth	95%	-8%	-17%	21%		Other (inc Investments, Asset sales etc)	1.1	1.0	0.5	0.5
NPAT growth	80%	-11%	0%	36%		<b>Net Investing Cash Flow</b>	<b>0.0</b>	<b>1.4</b>	<b>0.0</b>	<b>1.6</b>
EPS (dil, wghtd) growth	80%	-11%	0%	36%		Proceeds from Equity Issues	0.0	0.0	0.0	0.0
EBIT Margin	12%	14%	9%	10%		Net Change in Debt & Leases	-0.4	-0.8	0.0	0.0
						Dividends Paid	-8.3	-13.1	-11.9	-14.6
						Other	-0.4	0.7	0.0	0.0
						<b>Net Financing Cash Flow</b>	<b>-9.2</b>	<b>-13.2</b>	<b>-11.9</b>	<b>-14.6</b>
						Movement in Cash	-11.0	-10.7	1.6	5.9
<b>Cash Flow Analysis</b>		<b>6/18A</b>	<b>6/19A</b>	<b>6/20F</b>	<b>6/21F</b>	<b>Balance Sheet (\$m)</b>	<b>6/18A</b>	<b>6/19A</b>	<b>6/20F</b>	<b>6/21F</b>
Net Operating Cash Flow	-1.8	1.1	13.6	18.8		Cash	74.3	60.5	62.1	68.0
+ Tax Paid	5.9	12.4	7.1	5.9		Receivables	37.6	34.4	46.7	49.9
+ Net Interest	-1.8	-1.8	-2.0	-2.0		Inventories	0.8	0.9	1.2	1.3
Ungeared pre-tax cashflow	2.2	11.7	18.7	22.7		Other	3.1	5.6	5.6	5.6
Reported EBITDA	24.1	22.6	19.1	22.8		<b>Total Current Assets</b>	<b>115.8</b>	<b>101.3</b>	<b>115.6</b>	<b>124.8</b>
<b>Cash Conversion</b>	<b>9%</b>	<b>52%</b>	<b>98%</b>	<b>100%</b>		Property, Plant & Equipment	3.4	3.8	4.3	4.9
Capex / D&A	1.4x	1.1x	1.4x	1.4x		Intangibles	6.8	6.7	6.7	6.7
						Other	12.7	6.5	6.5	6.5
						<b>Total Non Current Assets</b>	<b>22.9</b>	<b>17.0</b>	<b>17.6</b>	<b>18.1</b>
						<b>Total Assets</b>	<b>138.7</b>	<b>118.4</b>	<b>133.1</b>	<b>142.9</b>
<b>Share Data</b>		<b>6/18A</b>	<b>6/19A</b>	<b>6/20F</b>	<b>6/21F</b>	Accounts Payable	31.7	34.2	46.4	49.7
Ord Issued shares (m)	39.7	39.7	39.7	39.7		Interest Bearing Liabilities	0.7	0.4	0.4	0.4
growth	0.0%	0.0%	0.0%	0.0%		Provisions	16.4	3.0	3.0	3.0
Weighted ave shares (m)	39.7	39.7	39.7	39.7		Other	10.3	1.1	0.4	1.5
growth	0.0%	0.0%	0.0%	0.0%		<b>Total Current Liabilities</b>	<b>58.4</b>	<b>38.3</b>	<b>49.9</b>	<b>54.2</b>
Diluted shares wghtd (m)	39.7	39.7	39.7	39.7		Interest Bearing Liabilities	0.6	0.3	0.3	0.3
growth	0.0%	0.0%	0.0%	0.0%		Other	0.4	0.3	0.3	0.3
						<b>Total Non Current Liabilities</b>	<b>1.0</b>	<b>0.6</b>	<b>0.6</b>	<b>0.6</b>
						<b>Total Liabilities</b>	<b>59.4</b>	<b>38.9</b>	<b>50.5</b>	<b>54.8</b>
						<b>Net Assets</b>	<b>79.4</b>	<b>79.4</b>	<b>82.6</b>	<b>88.0</b>
<b>Directors &amp; Senior Mgt</b>		<b>Substantial Shareholders</b>				Net Asset Value / Share (\$)	2.00	2.00	2.08	2.22
Michael Caratti (Non-Exec. Chairman)		Michael Caratti	22.9%			NTA / Share (\$)	1.83	1.83	1.91	2.05
Peter De Leo (MD / CEO)		Luala P/L	8.0%			Net Debt (net cash)	-73	-60	-61	-67
Lawrie Marshall (NED)		Braeside Invest.	7.7%							
Steven Chadwick (NED)										
Rodney Leonard (NED)										
Robert Osmetti (NED)										
Bruno Ruggiero (Exec. Dir)										
Peter Dawson (Exec. Dir)										
Justine Campbell (CFO / Co. Sec.)										
Analyst: Oliver Stevens						Last Earnings Estimate Change:				
Phone: +61 8 9268 2879						13 January 2020				
Sources: IRESS, Company Information, Hartleys Research										

## FORECAST CHANGES

LYL's current guidance, provided at the time of its FY19 result, was for FY20 revenue of \$220m, with NPAT to be "*generally in line*" with FY19.

As highlighted by LYL's Mondium JV partner, MND, at its AGM, while the broader outlook for the sector continues to be increasingly positive, current opportunities are advancing to execution later than expected; in other words, project delays persist.

Given this current broader environment we reduce our FY20 revenue expectations for LYL with associated flow through to the earnings lines. This is offset by our assumption that LYL receives an increased profit contribution from Mondium on the back of today's announcement, hence our FY20 NPAT expectations remain at \$16.5m.

We expect LYL to provide an update at the time of its 1H20 results.

Our FY21 NPAT forecast increases by 11%.

**Fig. 1: Forecast Changes**

Forecast Changes	FY19	FY20 old	FY20 new	Chg	FY21 old	FY21 new	Chg
Revenue	151.1	220.0	205.0	-7%	220.0	219.4	0%
Expenses	-128.5	-198.8	-185.9	-7%	-194.9	-196.6	1%
<b>EBITDA</b>	<b>22.6</b>	<b>21.2</b>	<b>19.1</b>	<b>-10%</b>	<b>25.1</b>	<b>22.8</b>	<b>-9%</b>
Depn & Amort.	-1.5	-1.5	-1.5		-1.5	-1.5	
<b>EBIT</b>	<b>21.1</b>	<b>19.7</b>	<b>17.6</b>	<b>-11%</b>	<b>23.7</b>	<b>21.3</b>	<b>-10%</b>
Net Interest	1.7	2.0	2.0		2.0	2.0	
<b>PBT</b>	<b>22.9</b>	<b>21.7</b>	<b>19.6</b>	<b>-10%</b>	<b>25.7</b>	<b>23.3</b>	<b>-9%</b>
Tax	-7.1	-6.5	-5.9		-7.7	-7.0	
Associates contribution	0.7	1.5	3.0		2.5	6.3	
<b>NPAT pre minorities</b>	<b>16.4</b>	<b>16.7</b>	<b>16.7</b>	<b>0%</b>	<b>20.5</b>	<b>22.6</b>	<b>11%</b>
OEI	-0.1	0.2	0.2		0.2	0.2	
<b>NPAT to LYL</b>	<b>16.5</b>	<b>16.5</b>	<b>16.5</b>	<b>0%</b>	<b>20.3</b>	<b>22.4</b>	<b>11%</b>
EPS	41.5c	41.5c	41.6c	0%	51.0c	56.4c	11%
EPS (adj., fully diluted)	41.5c	41.5c	41.6c	0%	51.0c	56.4c	11%
DPS	30.0c	30.0c	30.0c	0%	33.2c	36.7c	11%
EBITDA Margin	15.0%	9.6%	9.3%	-0.3%	11.4%	10.4%	-1.0%
EBIT Margin	14.0%	9.0%	8.6%	-0.4%	10.8%	9.7%	-1.0%
Dividend Payout Ratio	72.2%	72.2%	72.2%	-0.1%	65.0%	65.0%	0.0%

Source: LYL, Hartleys

## 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 (up from 7.0x previously, given the strengthening outlook) to the average of our FY20 and FY21 EBIT forecast in deriving a price target of \$6.76 / share, up from \$5.70 / share previously.

LYL's implied valuation multiples based on our price target are shown in Figure 2.

**Fig. 2: Price Target & Implied Multiples**

Price Target	
Avg. FY20 & FY21 EBIT	\$26.1m
EV / EBIT	8.0x
<b>Enterprise Value</b>	<b>\$209m</b>
Add Net Cash (FY19)	\$60m
<b>Equity Value</b>	<b>\$269m</b>
<b>Equity Value per Share</b>	<b>\$6.76</b>

Implied Multiples at Price Target	FY19	FY20	FY21
EV/EBITDA	9.0x	8.9x	6.6x
EV/EBIT	9.6x	9.5x	6.9x
PER	16.3x	16.3x	12.0x
<b>PER - Cash Adjusted</b>	<b>13.7x</b>	<b>13.8x</b>	<b>9.9x</b>
Dividend Yield	4.4%	4.4%	5.4%

Source: Hartleys

NB. 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.

**Key assumptions and risks for valuation**

Assumption	Risk of not realising assumption	Downside risk to valuation if assumption is incorrect	Comment
Revenue \$205m 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.
EBITDA margins of 12%-13%.	Low	Medium	Margins are above those achieved in the recent difficult years for the overall industry, though sit well below the ~15% margins LYL achieved between FY08 and FY12. Given LYL's conservative approach to profit recognition on EPC contracts we expect reported margins to be lumpy from period to period.
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:*

- *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.*
- *Project delays. As we have seen during FY19, delays to client projects can push out expected timing of receipt of revenues and earnings.*
- *Stock illiquidity. LYL is a thinly traded stock, with little share market liquidity.*

Source: Hartleys

# HARTLEYS CORPORATE DIRECTORY

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*Note: personal email addresses of company employees are structured in the following manner: firstname.lastname@hartleys.com.au*

## 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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