

Investment Research Report:

Lynas Corporation (ASX:LYC)

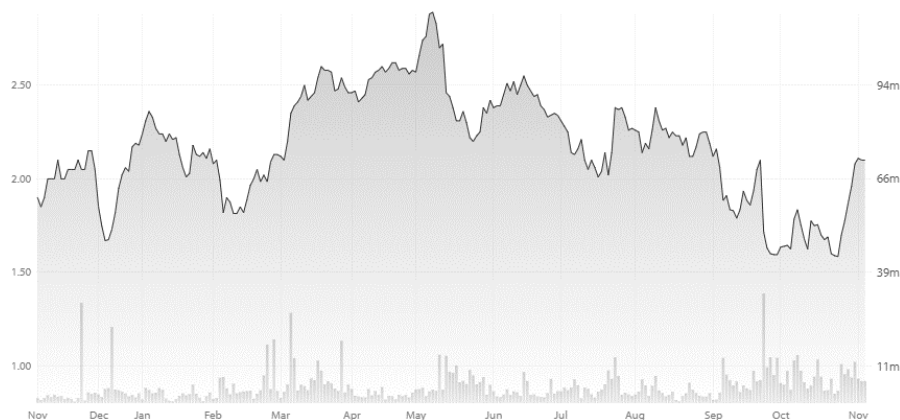
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Key Data¹:

Market:	Australia
Sector/Industry:	Materials (Diversified Metals & Mining)
Share Price:	A\$2.10
Market Capitalisation:	A\$1,397mn
Enterprise Value:	A\$1,580mn

Price Performance – 1 year:



Price Performance – 5 years:



¹ Data and charts as at, or up to, Friday, 2 November 2018

Lynas Corporation (ASX:LYC)

Balance Sheet (A\$ mn)

Ratios & Valuation

	6/15	6/16	6/17	6/18
P/E (X)	—	—	—	26.5
P/B (X)	0.6	2.6	0.3	3.6
EV/EBITDA (X)	—	—	15.0	13.6
CROCI (%)	—	(10.0)	1.4	13.5
ROE (%)	—	(74.0)	(0.6)	19.4
Net debt/equity (%)	281.0	775.4	407.9	42.1
Interest cover (X)	(2.1)	(1.8)	(0.5)	7.9
Days Sales Outstanding	—	5.6	2.9	4.1
Days Inventory Outstanding	—	98.0	68.6	64.3
Accounts Payable Turnover Days	—	27.1	16.2	14.5
Financial Leverage (X)	—	—	—	1.1

Growth & Margins (%)

	6/15	6/16	6/17	6/18
Total revenue growth	123.9	32.1	34.6	45.6
EBITDA growth	—	64.7	—	282.9
EPS (diluted) growth	77.9	29.3	94.4	—
DPS growth	—	—	—	—
EBITDA margin	(29.2)	(7.8)	12.9	33.9
Net income margin	(82.1)	(49.3)	(0.2)	14.2

Income Statement (A\$ mn)

	6/15	6/16	6/17	6/18
Total revenue	144.6	191.0	257.0	374.1
Cost of goods sold	(141.8)	(181.6)	(207.1)	(219.4)
SG&A	(28.4)	(22.8)	(21.3)	(27.3)
R&D	0.0	0.0	0.0	0.0
Other operating inc./ (exp.)	(16.6)	(1.5)	0.0	(0.7)
EBITDA	(42.2)	(14.9)	28.6	126.7
Depreciation & amortization	(39.1)	(41.8)	(39.3)	(40.5)
EBIT	(81.3)	(56.7)	(10.8)	86.1
Net interest inc./ (exp.)	(38.4)	(31.6)	(20.3)	(9.8)
Other inc./ (exp.)	1.1	(5.8)	6.8	(23.0)
Pre-tax profit	(118.6)	(94.1)	(24.3)	53.4
Provision for taxes	(0.1)	0.0	23.7	(0.3)
Net inc. (pre-exceptionals)	(118.7)	(94.1)	(0.5)	53.1
Post-tax exceptionals	0.0	0.0	0.0	0.0
Net inc. (post-exceptionals)	(118.7)	(94.1)	(0.5)	53.1
Basic EPS (\$)	(0.04)	(0.03)	(0.00)	0.09
Basic EPS from Cont Ops (\$)	(0.04)	(0.03)	(0.00)	0.09
Basic EPS from Cont Ops, Adj (\$)	(0.04)	(0.03)	(0.08)	0.09
Diluted EPS (\$)	(0.04)	(0.03)	(0.00)	0.08
Diluted EPS from Cont Ops (\$)	(0.04)	(0.03)	(0.00)	0.08
Diluted EPS from Cont Ops, Adj (\$)	(0.04)	(0.03)	(0.08)	0.08
DPS (\$)	0.0	0.0	0.0	0.0
Div. payout ratio (%)	0.0	0.0	0.0	0.0

	6/15	6/16	6/17	6/18
Cash & cash equivalents	31.3	10.4	35.9	42.3
Accounts receivable	4.3	1.5	2.6	5.8
Inventory	59.5	53.6	37.4	51.7
Other current assets	25.5	36.7	34.2	8.9
Total current assets	120.7	102.2	110.2	108.7
Net PP&E	704.1	656.3	580.4	613.1
Total investments	0.0	0.0	0.0	0.0
Other long-term assets	20.7	28.6	27.1	42.8
Total non-current assets	724.8	684.8	607.5	656.0
Total assets	845.5	787.0	717.7	764.6
Accounts payable	60.3	84.7	50.5	37.7
Short-term debt	267.8	26.9	19.5	0.0
Other current liabilities	0.0	1.6	0.3	0.4
Total current liabilities	328.1	113.1	70.3	38.0
Long-term debt	278.4	535.7	473.8	225.1
Other long-term liabilities	55.8	67.0	61.4	67.0
Total long-term liabilities	334.2	602.7	535.2	292.1
Total liabilities	662.3	715.8	605.6	330.2
Preferred shares	0.0	0.0	0.0	0.0
Total common equity	183.2	71.2	112.2	434.5
Minority interest	0.0	0.0	0.0	0.0
Total liabilities & equity	845.5	787.0	717.7	764.6
Net debt	514.8	552.2	457.5	182.8
Capital employed	496.7	645.3	620.2	683.8
BVPS (A\$)	—	(62.44)	1,394.05	(78.50)

Cash Flow (A\$ mn)

	6/15	6/16	6/17	6/18
Net income	(118.7)	(94.1)	(0.5)	53.1
D&A add-back	39.1	41.8	43.9	40.9
Net (inc)/dec working capital	(7.2)	16.4	0.4	(15.1)
Other non-cash add-back	39.8	39.9	(14.9)	11.9
Cash flow from operations	(47.0)	4.1	28.9	90.8
Capital expenditures	(10.0)	(10.6)	(2.3)	(24.2)
Chg. in long-term investments	0.4	0.4	(4.6)	(1.3)
Acquisitions	0.0	0.0	0.0	0.0
Divestitures	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	(29.1)
Cash flow from investing	(9.6)	(10.3)	(6.9)	(54.7)
Dividends paid	0.0	0.0	0.0	0.0
Inc/(dec) in debt	(11.4)	(2.8)	(4.0)	(65.5)
Other financing cash flows	78.3	0.2	6.1	7.6
Cash flow from financing	66.9	(2.6)	2.2	(57.9)
Foreign exchange effect	3.6	0.2	(3.5)	0.2
Total cash flow	13.8	(8.6)	20.6	(21.6)
Free cash flow	(57.0)	(6.6)	26.6	66.5

Key Growth Drivers:

Lynas Corporation Overview:

- Lynas Corporation is the only major producer of Rare Earth materials in the world outside of China², fulfilling a key need of customers who seek to diversify their material supply³
- Lynas Corporation operates transparent and compliant mining and processing operations in Australia and Malaysia⁴
- Lynas Corporation produces Neodymium and Praseodymium (NdPr) compounds that are extensively used in the production of durable, high-power magnets in the growing electronics, electric vehicle, and power generation industries

Our investment thesis for Lynas Corporation is optimistic, for the following reasons:

1. In the long-term, growing demand for advanced technology products and alternative energy solutions will support growing upstream demand for raw Rare Earth materials:
 - a. Research indicates that by 2030 Neodymium (Nd) demand from “wind power, electric vehicles, and NiMH batteries” is expected to increase to 199.2% of 2016 levels and will not be matched by a modest 3% annual growth rate in Rare Earth production.⁵
 - b. As of 2018, Lynas Corporation already reports “consistent demand for NdPr products above current capacity to supply”⁶
 - c. Material recycling is limited, with materials sourced from “batteries, permanent magnets, and fluorescent lamps”⁷
 - d. Historically, Neodymium and Praseodymium (NdPr) prices have been influenced by China’s efforts to control the country’s miners’ compliance with environmental regulations and to regulate the country’s unofficial Rare Earth mining operations. We believe such efforts are likely to intensify in the future and, given China’s concentrated production of Rare Earth materials, will contribute to upside volatility in the historically volatile NdPr prices
 - e. Any protracted trade disputes between China and other nations risk China imposing tariffs on Rare Earth material exports, which would also contribute to upside volatility in prices



2. In the short-term, Lynas Corporation is experiencing some political and regulatory uncertainty in its operations in Malaysia. A review committee has recently been tasked with evaluating certain Lynas Corporation operations, including “safety, health and environmental aspects, and residue storage”¹⁰. We are of the opinion that these uncertainties are weighing on investor confidence in the stock and believe that this review is likely to successfully pass with little disruption for future Lynas operations.

² For example, China accounted for over 80% of global Rare Earth mine production in 2017, followed by Australia at 15%, according to a 2018 U.S. Geological Survey report on Rare Earth materials (https://minerals.usgs.gov/minerals/pubs/commodity/rare_earths/mcs-2018-raree.pdf); Lynas Corporation Annual Report, 2018

(<https://www.lynascorp.com/Shared%20Documents/Investors%20and%20media/Reporting%20Centre/Annual%20reports/2018/180921%20Annual%20Report%202018%201846939.pdf>)

³ <https://www.reuters.com/article/us-china-rareearths-ahome/boom-bust-and-boom-again-for-rare-earths-idUSKCN1BC40F>

⁴ Lynas Corporation Annual Report, 2018

(<https://www.lynascorp.com/Shared%20Documents/Investors%20and%20media/Reporting%20Centre/Annual%20reports/2018/180921%20Annual%20Report%202018%201846939.pdf>)

⁵ Zhou, B., Li, Z. and Chen, C., 2017. Global potential of rare earth resources and rare earth demand from clean technologies. *Minerals*, 7(11), p.203.

⁶ Lynas Corporation Annual Report, 2018

(<https://www.lynascorp.com/Shared%20Documents/Investors%20and%20media/Reporting%20Centre/Annual%20reports/2018/180921%20Annual%20Report%202018%201846939.pdf>)

⁷ U.S. Geological Survey, 2018 (https://minerals.usgs.gov/minerals/pubs/commodity/rare_earths/mcs-2018-raree.pdf)

⁸ <https://www.kitco.com/strategic-metals/>

⁹ *Ibid.*

¹⁰ Lynas Corporation Announcement, 16 October 2018

(<https://www.lynascorp.com/Shared%20Documents/Investors%20and%20media/Announcements%20and%20media/2018/181016%20Review%20of%20Lynas%20Operations%20in%20Malaysia%201856958.pdf>)