Equities

15 November 2011 | 10 pages

Lonmin PLC (LMI.L)

Good 2011 but Reduced 2012 Guidance

- Company Update
- Target Price Change
- Estimate Change

- **EPS boosted by low tax** — Lonmin reported FY 2011 sales of 721k oz of platinum, in line with guidance and with Citi. Costs per ounce rose by 11.2% (normalised 8.0% if the strike is excluded), which was in line with guidance. EBITDA of $433m compared to our expectation of $428m, while EBIT of $311m compared to our expected $308m. Pre-tax of $315m was above our $300m but the big difference came in the tax line, with an effective tax rate of only 17.7% vs 33.7% in 2010. EPS was thus boosted to 111.6c (Citi 90c) against 70.2c in 2010.
- **Reserves and net Debt Improved** — LMI achieved a good ore reserve increase, with reserves rising by 8.8%. Capex of $410m was in line with guidance and net debt was reduced by 37.6% to $234m. The dividend has been maintained 15.0 cps.
- **Cautious Guidance** — While the 2011 EPS is a positive, production guidance is more conservative than we expected. LMI has previously guided to 850k oz in 2013. While it did not guide on 2012, a range of 775k oz to 800k oz seemed reasonable. LMI is now guiding to 750k oz in 2012 in spite of noting that it has the capacity to produce 800koz. This is not a big advance from 721k oz in 2011 considering the 850k oz 2013 target. Cautious 2012 guidance is being given in light of the risks from Section 54 safety stoppages (the rate in October was double the FY 11 average). Furthermore, LMI is putting some caveats on the 2015+ guidance of 950k oz, saying it will only push for that if PGM market conditions warrant it, i.e. they will only aim to produce profitable ounces.
- **EPS and NPV change** — Following the revised guidance, we have reduced our 2012E EPS forecast from 124c to 111.7c and our 2013E forecast from 169.3c to 153.6c. Our NPV has declined from £10.67 to £10.52 as a result of these negative earnings forecast changes, in combination with a positive change to our valuation of the chrome-tailings assets.
- **Valuation and Recommendation** — We have raised our valuation from 1.0x P/NPV to 1.05x P/NPV in recognition of market movements and set our target price at £11.05 (from £10.67) on that basis. We continue to rate Lonmin as Neutral.

Neutral	**2**
Price (14 Nov 11)	£10.77
Target price	£11.05
from £10.67	
Expected share price return	2.6%
Expected dividend yield	0.0%
Expected total return	**2.6%**
Market Cap	£2,183M
	US$3,507M

Price Performance
(RIC: LMI.L, BB: LMI LN)

Lonmin PLC (USD)

Year to 30 Sep	2010A	2011A	2012E	2013E	2014E
Sales ($M)	1,579.3	1,992.1	1,889.9	2,059.8	2,281.7
Profit Before Tax ($M)	231.1	313.6	350.4	481.4	596.4
Diluted EPS (¢)	67.7	110.5	111.7	153.6	190.4
Diluted EPS (Old) (¢)	67.7	88.9	124.0	169.3	na
PE (x)	25.6	15.7	15.5	11.3	9.1
EV/EBITDA (x)	8.3	6.4	5.7	4.3	3.5
DPS (¢)	15.0	28.0	28.3	38.8	48.0
Net Div Yield (%)	0.9	1.6	1.6	2.2	2.8

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

Fiscal year end 30-Sep	2010	2011	2012E	2013E	2014E
Valuation Ratios					
P/E adjusted (x)	25.6	15.7	15.5	11.3	9.1
EV/EBITDA adjusted (x)	8.3	6.4	5.7	4.3	3.5
P/BV (x)	1.2	1.2	1.1	1.0	0.9
Dividend yield (%)	0.9	1.6	1.6	2.2	2.8
Per Share Data (US¢)					
EPS adjusted	67.7	110.5	111.7	153.6	190.4
EPS reported	67.7	110.5	111.7	153.6	190.4
BVPS	1,400.5	1,443.8	1,543.5	1,670.5	1,831.7
DPS	15.0	28.0	28.3	38.8	48.0
Profit & Loss (US$M)					
Net sales	1,579	1,992	1,890	2,060	2,282
Operating expenses	-1,359	-1,683	-1,531	-1,569	-1,677
EBIT	**220**	**309**	**359**	**490**	**604**
Net interest expense	11	-5	-9	-9	-8
Non-operating/exceptionals	0	10	0	0	0
Pre-tax profit	**231**	**314**	**350**	**481**	**596**
Tax	-79	-57	-88	-121	-150
Extraord./Min.Int./Pref.div.	-21	-33	-35	-48	-60
Reported net income	**131**	**224**	**227**	**312**	**387**
Adjusted earnings	131	224	227	312	387
Adjusted EBITDA	342	431	479	622	749
Growth Rates (%)					
Sales	48.7	26.1	-5.1	9.0	10.8
EBIT adjusted	332.0	40.3	16.2	36.6	23.2
EBITDA adjusted	nm	26.0	11.1	29.8	20.6
EPS adjusted	214.8	63.2	1.1	37.5	24.0
Cash Flow (US$M)					
Operating cash flow	**505**	**12**	**409**	**493**	**611**
Depreciation/amortization	122	122	120	131	145
Net working capital	218	-319	23	23	46
Investing cash flow	**111**	**-204**	**-190**	**-200**	**-240**
Capital expenditure	-164	-194	-180	-190	-230
Acquisitions/disposals	285	0	0	0	0
Financing cash flow	**333**	**-321**	**-107**	**-124**	**-110**
Borrowings	126	-256	-50	-50	-25
Dividends paid	-22	-53	-57	-74	-85
Change in cash	**949**	**-512**	**113**	**169**	**261**
Balance Sheet (US$M)					
Total assets	**4,818**	**4,862**	**4,968**	**5,199**	**5,519**
Cash & cash equivalent	143	76	17	14	61
Accounts receivable	414	154	148	160	179
Net fixed assets	2,199	2,567	2,755	2,943	3,152
Total liabilities	**1,742**	**1,520**	**1,424**	**1,396**	**1,390**
Accounts payable	381	354	308	330	349
Total Debt	523	310	260	210	185
Shareholders' funds	**3,076**	**3,342**	**3,544**	**3,802**	**4,129**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	21.7	21.6	25.3	30.2	32.8
ROE adjusted	5.1	8.0	7.5	9.6	10.9
ROIC adjusted	5.5	9.0	9.1	11.6	13.3
Net debt to equity	12.3	7.0	6.9	5.1	3.0
Total debt to capital	14.5	8.5	6.8	5.2	4.3

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Good 2011 but reduced 2012 Guidance

Lonmin has guided to only 750k oz of platinum production in 2011 in spite of having capacity of 800k oz. The new caution arises from the very high level of Section 54 safety stoppages that have occurred so far in the FY 2012 year. Lonmin produced 721k oz of platinum in FY 11 despite losing 18k to Section 54 stoppages in that year, along with 20k from the Karee strike and 5k on one day stoppages. Production would have equated to 764k oz in FY 11 without these setbacks.

Tax kicks in for 2011

Lonmin reported FY 2011 sales of 721k oz of platinum, in line with guidance and with Citi. Costs per ounce rose by 11.2% (normalised 8.0% if the strike is excluded), which was in line with guidance. EBITDA of $433m compared to our expectation of $428m, while EBIT of $311m compared to our expected $308m. Pre-tax of $315m was above our $300m but the big difference came in the tax line, with an effective tax rate of only 17.7% vs 33.7% in 2010. EPS were thus boosted to 111.6c (Citi 90c) against 70.2c in 2010.

Reported tax for the current year was a credit of $28 million after exchange gains on the translation of Rand-denominated tax balances of $82 million and the tax effects of special items of $2 million. The underlying tax charge is $56 million, reflecting an effective rate of 17.7%. The underlying charge largely reflects deferred tax charges being recognised on accelerated capital allowances. The dilution in the effective tax rate is driven by exchange gains on translation of Rand-denominated working capital balances at year end.

New Guidance

LMI has previously guided to 850k oz in 2013. While it did not guide on 2012, a range of 775k oz to 800k oz was reasonable. LMI is now guiding to 750k oz in 2012 in spite of noting that it has the capacity to produce 800koz. This is not a big advance from 721k oz in 2011 considering the 850k oz 2013 target. Cautious 2012 guidance is being given in light of the risks from Section 54 safety stoppages (the rate in October was double the FY 11 average). Furthermore, LMI is putting some caveats on the 2015+ guidance of 950k oz, saying it will only push for that if PGM market conditions warrant it, i.e. they will only aim to produce profitable ounces.

2011 Performance

LMI FY 2011 unit cost was impacted by the production losses arising from the safety stoppages and illegal strikes. Excluding these two major factors, unit cost was up around 8.0% on a normalised basis and in line with original guidance.

The C1 cost per PGM ounce produced for the year to 30 September 2011 was R7,534. This was an increase of 11.2% compared to 2010. This increase was largely driven by higher than inflation increases in the wage bill (8%) and electricity tariffs (24%), as well as a lower grade due to the change in ore mix (increase in Merensky ore from open cast and underground operations and poorer geology at K3 shaft). These increases were not mitigated by the expected increase in production in the second half of the year due to the industrial action in May and management induced safety stoppages in March and April. Had the production interruptions arising from the safety-induced stoppages and the illegal strike at Karee not occurred, the year-on-year cost increase per PGM ounce would have been 8.0%.

LMI anticipates that 2012 unit cost will increase in line with wage increases. LMI concluded wage increases in January 2011 but hopes to conclude the next agreement before the 2011 Christmas break. LMI notes that negotiations are proceeding well.

Cash flow generated from operations in the FY 11 at $682m was significantly higher than the $133m recorded in 2010. This was driven off the back of improved operating profits, coupled with a much-improved working capital position, which saw debtors and inventory decrease by $260 million and $12 million, respectively, during the year, somewhat offset by a $27 million decrease in creditors.

In the 2010 financial year, smelter run-outs led to significant back-end loading of sales, resulting in unusually high debtors, as well as a stock build up at year-end. This had a significant impact on working capital. The working capital locked up in receivables at the 2010 year end has subsequently been realised. The ratio of consolidated net debt to underlying EBITDA decreased from 1.07 times at 30 September 2010 to 0.54 times at 30 September 2011. The reorganization of LMI's bank debt facilities has resulted in the debt maturity profile being extended. Gross bank debt facilities at year end amounted to $945 million, and consequently the balance sheet has strengthened over the year.

Immediately available ore reserves at the Marikana operations were 2.9 million centares at the end of 2011, up 8.8% on FY 2010 and constituting a very good performance from LMI.

EPS Forecast changes and Valuation

Following the revised guidance, we have reduced our 2012E EPS forecast from 124c to 111.7c and our 2013E forecast from 169.3c to 153.6c. Our underlying assumption is for production of 769k oz in 2012 (we think LMI is being too cautious re Section 54 stoppages) and 821 k oz in 2013. We had previously assumed that Lonmin would reach its guidance target of 850k oz in 2013.

Figure 1. LMI Forecasts

		2010	2011	2012E	2013E	2014E
Platinum	US$/oz	1539	1779	1633	1676	1713
Palladium	US$/oz	452	756	763	875	848
Platinum Productin	koz	706	722	769	821	889
Palladium Production	koz	330	338	360	385	416
Revenue	US$m	1579	1992	1890	2060	2282
EBITDA	US$m	345	434	482	625	752
EBIT	US$m	223	312	362	493	607
EPS - Reported	$	0.68	1.11	1.12	1.54	1.90

Source: Company Historic; CIRA Forecasts

Our NPV has declined from £10.67 to £10.52 as a result of these negative earnings changes, in combination with a positive change to our valuation of the chrome-tailings assets.

We have raised our valuation from 1.0x P/NPV to 1.05x P/NPV in recognition of market movements and set our target price at £11.05 on that basis. We continue to rate Lonmin as Neutral.

Lonmin PLC

Company description

Lonmin is the world's third-largest primary producer of PGMs. Platinum production is expected to be in the region of 720koz in 2011. Lonmin's operations are located in South Africa.

Investment strategy

We rate Lonmin Neutral. We think that management is steadily gaining market confidence following a consistently improving trend in operational efficiency. However, a strong SA rand is tending to offset the recent strength in the US$ price of platinum. The entire industry is facing cost challenges. Xstrata owns a 25% stake in the company and could aim to increase its ownership stake.

Valuation

Our target price for Lonmin is £11.04. We value Lonmin based on a sum-of-the-parts discounted cash flow (DCF) analysis. Our model uses a nominal WACC of 9% and discounts forecast cash flows over the life of the group's individual assets. We apply a 1.05 P/NPV multiple to our £10.52 NPV.

Risks

Our valuation of LON is exposed to macroeconomic developments affecting PGM prices and exchange rates, operational risks that might affect volumes and input costs, and political and regulatory risks that might affect costs and the company's reputation. **Macroeconomic risks:** Our valuation of LON is highly dependent on input assumptions for platinum, palladium, and rhodium prices, as well as the rand-dollar exchange rate. Upside risks to our view include higher-than-expected PGM prices and a weaker-than-expected rand. Conversely, downside risks to our view include lower-than-expected PGM prices and a stronger-than-expected rand.
Operational risks: We base our production and cost outlook for LON's individual mines on management guidance and by applying our discretion to management's guidance and targets. The main downside risk to our view is that significantly more capex is required in order to sustain current production levels than that assumed in our valuation model. We also caution downside risk to our generally favorable cost assumptions, given the inflationary environment in which LON operates. The main upside risk to our view is the platinum market moving into deficit, in which case LON might be able to expand production above our forecast levels.
Political and regulatory risks: LON's operations and future projects are based in SA. The company is subsequently exposed to government and regulatory-related risks in SA. Specific risks include higher-than-expected royalties, production delays from government intervention and labour unrest.
If the impact from any of these factors proves to be more negative than we anticipate, the stock will likely have difficulty achieving our financial and price targets. However, if any of these factors proves to have less of an effect than we anticipate, the stock could materially outperform our target.

Appendix A-1

Analyst Certification

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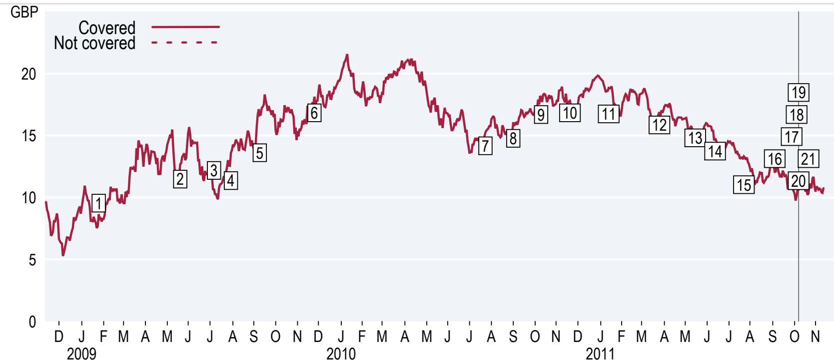
IMPORTANT DISCLOSURES

Lonmin PLC (LMI.L)

Ratings and Target Price History
Fundamental Research

Analyst: Jon H Bergtheil
Covered since March 25 2009



	Date	Rating	Target Price	Closing Price
1	25-Jan-09	*2H	*8.59	7.66
2	20-May-09	2H	*13.85	12.67
3	7-Jul-09	2H	*11.90	10.69
4	30-Jul-09	*1M	*16.18	13.60
5	9-Sep-09	1M	*20.60	16.64
6	25-Nov-09	1M	*21.00	18.13
7	23-Jul-10	1M	*19.25	15.25
8	1-Sep-10	*2M	*16.80	16.07
9	11-Oct-10	2M	*17.45	18.08
10	19-Nov-10	2M	*18.00	17.80
11	13-Jan-11	2M	*19.85	18.84
12	25-Mar-11	2M	*18.56	16.88
13	16-May-11	2M	*17.00	15.18
14	13-Jun-11	2M	*16.88	14.76
15	22-Jul-11	2M	*15.35	13.31
16	4-Sep-11	2M	*13.63	12.55
17	28-Sep-11	2M	*12.37	10.98
18	5-Oct-11	2M	*11.31	10.09
19	7-Oct-11	Stock rating system changed		
20	7-Oct-11	*2	11.31	10.63
21	21-Oct-11	2	*10.67	10.33

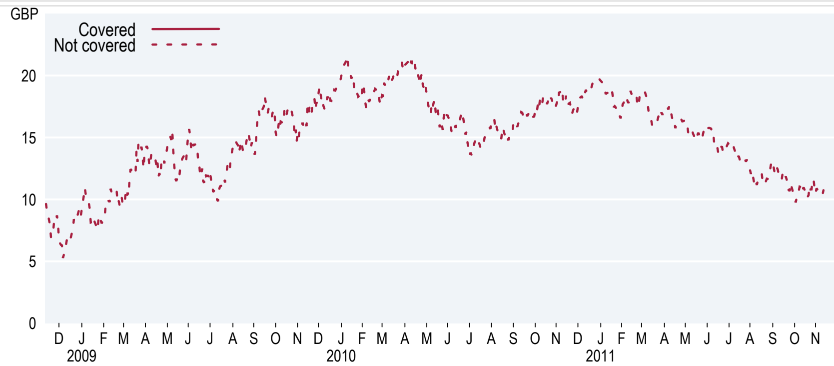
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Lonmin PLC (LMI.L)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Jon H Bergtheil
Covered since March 25 2009



* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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	12 Month Rating			Relative Rating		
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Citi Investment Research & Analysis Global Fundamental Coverage	59%	34%	7%	10%	79%	10%
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