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Lynas Rare Earths (LYC)

2QFY24: Production upgrades vs howling headwinds

Recommendation
Buy (unchanged)
Price
\$5.87
Target (12 months)
\$7.60 (previously \$8.50)

GICS Sector
Materials

Expected Return

Capital growth	29%
Dividend yield	0%
Total expected return	29%

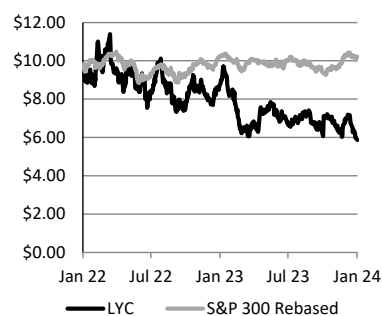
Company Data & Ratios

Enterprise value	\$4,989m
Market cap	\$5,587m
Issued capital	935m
Free float	95%
Avg. daily val. (52wk)	\$40m
12 month price range	\$5.75-\$9.85

Price Performance

	(1m)	(3m)	(12m)
Price (A\$)	6.75	6.73	8.48
Absolute (%)	-13.0	-12.8	-30.8
Rel market (%)	-12.8	-18.7	-31.6

Absolute Price



SOURCE: IRESS

2HFY24 guidance lifted, outlook tied to China

The result was on the weaker side, despite FY24 production upgrades, with management painting a potentially bleak outlook tied to a China recovery. 2QFY24 highlights; Revenue of A\$113m (BPe \$136m, -17%) was lower on product mix with greater Ce-La sales volume. NdPr production 901t (BPe 855t, +5%) was lower QoQ with the flagged Lynas Malasia (LAMP) shutdown part-way through the quarter. Guidance for 2HFY24 lifts slightly, with 3QFY24 NdPr production anticipated to be around 1,500t (previously 300t per month), with 4QFY24 production rates targeting a peak of 750t per month, for 2HFY24 guidance between 3,200-3,400t. Our production estimates lift towards the lower end of guidance (BPe FY24 NdPr 3,209). We have updated our model to incorporate the result, which sees our FY24 EPS decline by 4%. We make no changes to our FY25 or FY26 numbers in this note.

FY24 an adjustment year?

On the call, management referred to FY24 as an adjustment year, with Kalgoorlie feeding into an upgraded LAMP facility and ongoing construction at the Mt Weld Expansion (target CY24 completion). The question is, are we headed for an adjustment year from a valuation perspective? Whilst we remain positive on the long-term outlook for LYC, we can't help but highlight the potentially weaker short-term outlook for rare earths which may dent LYC's valuation over the next 12m. To account for this near-term weakness, we have reduced our EV/EBITDA valuation multiple to 8.0x from 12.0x and maintained our blended valuation approach.

Investment Thesis: Buy, Target Price \$7.60/sh

We have incorporated the above adjustments into our valuation which resulted in a 10.6% decrease in our target price to \$7.60/sh (previously \$8.50/sh) and we maintain our Buy recommendation. LYC remains a high-quality business, and a key supplier of separated rare earths to Western economies. Our valuation doesn't consider expansions beyond 12ktpa NdPr as timing and costs pertaining to this are unknown, however the upside scenario could be a meaningful contributor to value.

Earnings Forecast

Year end 30 June	2023a	2024e	2025e	2026e
Sales (A\$m)	739	626	1024	1902
EBITDA (A\$m)	378	253	481	1032
NPAT (reported) (A\$m)	311	167	336	836
NPAT (adjusted) (A\$m)	311	167	336	836
EPS (adjusted) (eps)	33.3	17.9	36.0	89.5
EPS growth (%)	-44%	-46%	101%	148%
PER (x)	32.8 x	16.3 x	6.6 x	5.2 x
FCF Yield (%)	-4%	-10%	4%	14%
EV/EBITDA (x)	18.4 x	10.8 x	4.8 x	3.3 x
Dividend (eps)	-	-	-	-
Yield (%)	0%	0%	0%	0%
Franking (%)	0%	0%	0%	0%
ROE (%)	16%	7%	13%	26%

SOURCE: BELL POTTER SECURITIES ESTIMATES

2QFY24 highlights

Figure 1 - LYC Quarterly result highlights

		2Q23A	3Q23A	4Q23A	1Q24A	2Q24E	2Q24A	QoQ	YoY	Var BPe
		31-Dec-22	31-Mar-23	30-Jun-23	30-Sep-23	31-Dec-23	31-Dec-23	%	%	%
NdPr Spot Price Ex Vat	A\$/kg	\$ 139	\$ 123	\$ 85	\$ 92	\$ 91	\$ 93	2%	-33%	3%
LYC Basket price	A\$/kg	\$ 58	\$ 48	\$ 36	\$ 45	\$ 35	\$ 29	-37%	-51%	-18%
Revenue	A\$m	\$ 206	\$ 237	\$ 144	\$ 128	\$ 136	\$ 113	-12%	-45%	-17%
Production NdPr	t	1,508	1,725	1,864	1,526	855	901	-41%	-40%	5%
Production Other rare earths	t	2,949	2,623	2,611	2,083	1,404	1,566	-25%	-47%	12%
Total REO production	t	4,457	4,348	4,475	3,609	2,259	2,467	-32%	-45%	9%

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

- **NdPr production** of 901t was 5% above our estimate of 855t and 41% lower than the prior quarter. **Other rare earths** production of 1,566t was 12% ahead of estimates and 25% lower than the previous quarter.
- **Sales** for the quarter were 3,916t REO at an average price of A\$28.7/kg (BPe A\$35/kg, -18%). The average sales price was dragged lower by higher volumes of lower value Ce-La (cerium & lanthanum) product over the quarter. Product mix should normalise in the next quarter.
- **Revenue** for the quarter was A\$113m (BPe \$136m, -17%). We had assumed an unwinding of inventory of ~453t NdPr buffering against lower production. LYC indicated that inventory volumes have now normalized.
- **Market** – Current sentiment in rare earths remains depressed as lower construction activity in China combines with greater production volumes (China Northern Rare Earths) to depress current pricing (US\$55/kg). Chinese production quotas for the first half of the year may be announced in early Feb-24 and could add increased downward pressure to pricing over the short-term should the quota lift.
- **LAMP upgrades** to increase the product finishing capacity were completed over the quarter. Construction activities at Kalgoorlie were also largely completed, with the first feed of material being introduced to the facility in Dec-23.
- **Mt Weld expansion/ exploration** – The Mt Weld expansion program remains on track, the WA EPA concluded its assessment for the life of mine plan clearing the path for further construction activities and project approvals. Mt Weld exploration results were also released to the market, with a resource update expected in 1HFY25.
- **Guidance for 3QFY24 lifts** to 1,500t NdPr, equating to a monthly run-rate of 500t (previous guidance was 300t per month). 2HFY24 guidance between 3,200-3,400t NdPr, with a target run-rate of 750t per month in 4QFY24.

Earnings adjustments

We have adjusted our model inputs for LYC, marking to market where possible key price and cost drivers. Adjustments to our model are outlined below:

- **Incorporation of 2QFY24 production results**, and the accompanying guidance which sees our FY24 NdPr production estimate lift 17% to 3,209t (at the lower end of guidance).
- The net result of a lower achieved basket price and greater production volumes **increases our revenue estimate for FY24 by 3%**.
- Unit operating costs in 2QFY24 were materially higher, and whilst we anticipate this to normalize over the next two quarters, the overall cost base for estimate FY24 lifts by 9%.
- The net impact sees a **3% reduction in EBITDA** and a **4% reduction in EPS for FY24**. We make no changes to our FY25 & FY26 figures in this note.

Table 1 - Earnings adjustments

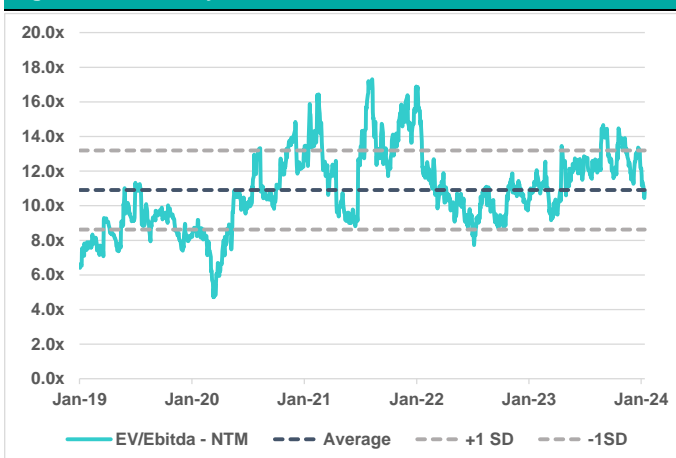
	Units	Prior estimates			Current estimates			% Change		
		FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
NdPr Spot Price	US\$/kg	73	96	114	73	96	114	0%	0%	0%
Other Rare earths	US\$/kg	13	13	13	13	13	13	0%	0%	0%
AUD/USD	A\$	0.66	0.70	0.70	0.66	0.70	0.70	0%	0%	0%
LYC Basket price	A\$/kg	47	52	59	42	52	59	-9%	0%	0%
Production NdPr	tpa	4,814	7,181	11,583	5,636	7,181	11,583	17%	0%	0%
Production Other rare earths	tpa	8,053	14,327	23,108	8,647	14,327	23,108	7%	0%	0%
Total REO production	tpa	12,867	21,508	34,691	14,283	21,508	34,691	11%	0%	0%
Revenue	A\$m	606	1,024	1,902	626	1,024	1,902	3%	0%	0%
Sulphuric acid prices	A\$/t	158	150	150	158	150	150	0%	0%	0%
Operating costs	A\$/kg	28	25	25	38	25	25	36%	0%	0%
COGS	A\$m	(297)	(495)	(821)	(324)	(495)	(821)	9%	0%	0%
EBITDA	A\$m	261	481	1,032	253	481	1,032	-3%	0%	0%
D&A	A\$m	(89)	(106)	(105)	(89)	(106)	(105)	0%	0%	0%
Ebit	A\$m	172	375	928	164	375	928	-5%	0%	0%
NPAT (Adj)	A\$m	177	350	849	170	349	849	-4%	0%	0%
EPS (Adj)	Acps	19	37	91	18	37	91	-4%	0%	0%

SOURCE: BELL POTTER SECURITIES ESTIMATES

LYC in an adjustment phase

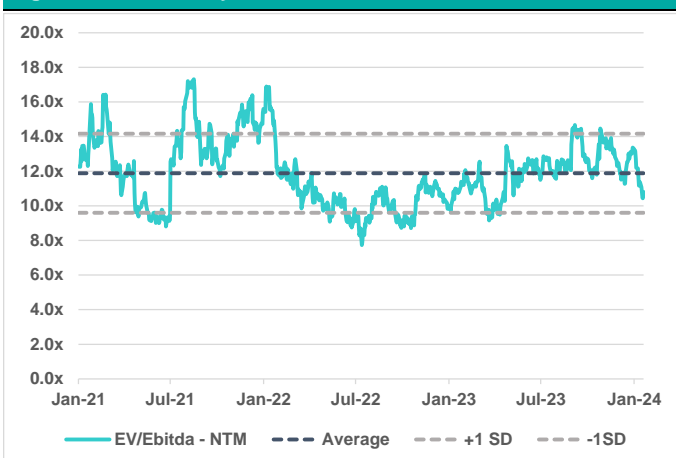
It's no secret LYC is in an adjustment phase, and whilst our long-term view of the business remains robust, we can't help but acknowledge the challenges facing the rare earth sector which could impact LYC's near-term valuation. On a five-year basis LYC has traded on a ~10.9x EV/EBITDA multiple, with the high of 17.3x being Aug-21 when NdPr traded around US\$100/kg shortly before beginning its 12m rally to US\$173/kg. We believe a lot of the valuation gain over the last five years had to do with the expansion of the EV and wind turbine thematic, and supply chain tightness which placed demand pressure on NdPr causing prices to roughly triple from historical averages. With the recent softness in demand and a current NdPr price of US\$56/kg a multiple de-rate could see LYC trade lower over the short-term.

Figure 2 - LYC five-year forward EV/EBITDA



SOURCE: FACTSET, BELL POTTER SECURITIES ESTIMATES

Figure 3 - LYC three-year forward EV/EBITDA



SOURCE: FACTSET, BELL POTTER SECURITIES ESTIMATES

To back solve for LYC's closing price of \$5.87 utilising our blended forward EBITDA estimates, which assume an average NdPr price of US\$73/kg in FY24 and US\$96/kg in FY25, you need a 12.5x EV/EBITDA multiple. Essentially above +1SD from the five-year average. At the five-year average of 10.9x LYC's valuation drops to \$4.96/sh whilst at -1SD (8.6x) the valuation drops to \$4.02/sh. Whilst we acknowledge that we don't value LYC on a pure EV/EBITDA basis, we can't help to highlight that the current valuation implies a potentially weaker outlook for the stock should NdPr prices remain depressed.

Table 2 - LYC - EV/EBITDA valuation

Metric	5 year Average		5 year average -1SD	
	A\$m	A\$/sh	A\$m	A\$/sh
FY24 EBITDA	\$253		\$253	
FY25 EBITDA	\$481		\$481	
Blended Forward 12 months	\$381		\$381	
Comparison multiple	10.9 x		8.6 x	
Enterprise value	\$4,151	\$4.43	\$3,275	\$3.49
+ Net cash/ (debt)	\$498	\$0.53	\$498	\$0.53
Equity value (diluted)	\$4,649	\$4.96	\$3,773	\$4.02

SOURCE: BELL POTTER SECURITIES ESTIMATES

Valuation and Recommendation

Recommendation

We have decreased our **target price for LYC by 10.6% to \$7.60/sh** (previously \$8.50/sh) resulting from our adjustments to forward earnings and costs mentioned above, as well as a reduction in our EV/EBITDA multiple to 8.0x from 12.0x and maintain our **Buy recommendation**.

Valuation

We have taken a blended approach to value LYC combining, i) an EV/EBITDA multiple, and ii) a sum-of-the-parts discounted cash flow (DCF) analysis applied to LYC's portfolio of production assets including: Mt Weld Mine, Kalgoorlie, Malaysia (LAMP) and the US heavy and light separation facilities (to be constructed). We have rounded our target price to the nearest 5c.

Table 3 - LYC Valuation

Approach	Weight	A\$m	A\$/sh
Ev/EBITDA Blended forward	40%	\$1,418	\$1.51
Sum-of-the-parts DCF	60%	\$5,740	\$6.12
	100%	\$7,157	\$7.63

SOURCE: BELL POTTER SECURITIES ESTIMATES

Table 4 - LYC sum-of-the-parts DCF valuation

	Prior valuation		Current valuation		% Variance
Ordinary Shares (basic)	m	934	m	934	0%
Options in the money	m	3	m	3	0%
Diluted	m	937	m	937	0%
Sum-of-the-parts	A\$m	A\$/sh	A\$m	A\$/sh	
Lynas Rare Earths Business (NPV 10%)	8,665	9.28	8,659	9.26	-2%
Exploration	500	0.54	500	0.53	-1%
Corporate overheads	(90)	(0.10)	(90)	(0.10)	-4%
Subtotal	9,075	9.72	9,068	9.70	-2%
Net cash (debt)	714	0.76	498	0.53	-30%
Total undiluted	9,789	10.48	9,566	10.23	-4%
Cash from options	0	0.00	0	0.00	0%
Total diluted	9,789	10.45	9,566	10.20	-4%

SOURCE: BELL POTTER SECURITIES ESTIMATES

Table 5 - LYC - EV/EBITDA valuation

	Prior valuation		Current valuation		% Variance
Metric	A\$m	A\$/sh	A\$m	A\$/sh	%
FY24 EBITDA	\$261		\$253		-3%
FY25 EBITDA	\$481		\$481		0%
Blended Forward 12 months	\$377		\$381		1%
Comparison multiple	12.0 x		8.0 x		-33%
Enterprise value	\$4,525	\$4.83	\$3,047	\$3.25	-33%
+ Net cash/ (debt)	\$714	\$0.76	\$498	\$0.53	-30%
Equity value (diluted)	\$5,239	\$5.59	\$3,544	\$3.78	-32%

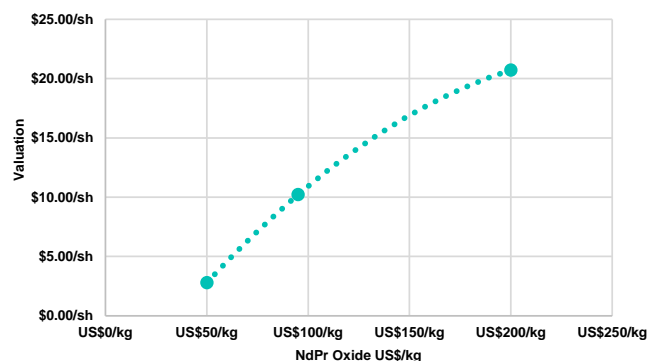
SOURCE: BELL POTTER SECURITIES ESTIMATES

Figure 4 – DCF valuation sensitivity

	Historical low	Bell Potter	Bull case
NdPr Oxide Price	US\$50/kg	US\$95/kg	US\$200/kg
Mt Weld + LAMP	1,696	8,659	18,529
Other	410	410	410
EV (risky)	2,106	9,068	18,938
Net debt/(cash)	-498	-498	-498
Equity value	\$2,604m	\$9,566m	\$19,436m
Diluted shares on issue	938m		
Equity value (diluted) \$/sh	\$2.78/sh	\$10.20/sh	\$20.72/sh
Share price	\$5.87/sh		
Uplift	-53%	74%	253%

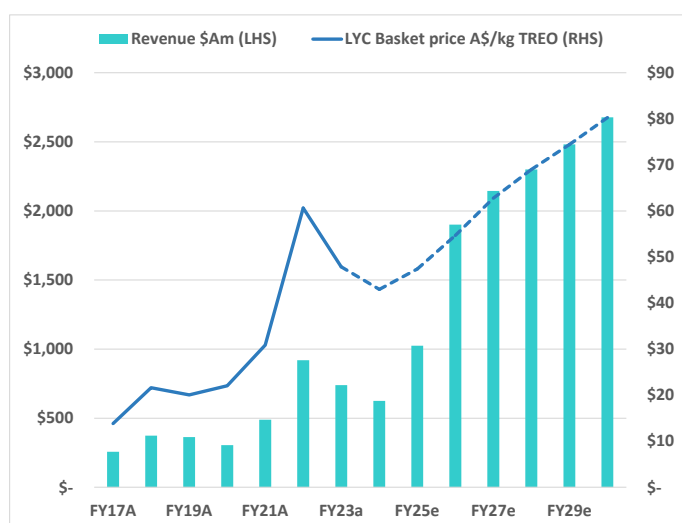
SOURCE: BELL POTTER SECURITIES ESTIMATES

Figure 5 - Valuation sensitivity graph



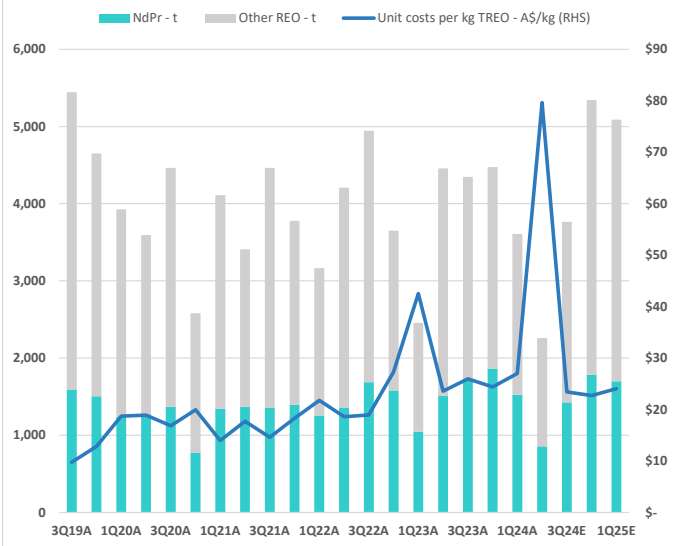
SOURCE: BELL POTTER SECURITIES ESTIMATES

Figure 6 - LYC - Revenue A\$m & basket price (A\$/kg Ex VAT)



SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Figure 7 - Quarterly production (t) and costs (A\$/kg TREO)



SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Table 6 - Rare earth comparison table

Company Name	Ticker	Last Price	EV (A\$m)	Mt	TREO %	Contained REO kt	Major Project, location, status	EV A\$/t Resource
Lynas Rare Earths Limited	LYC	5.87	5,462	55	5.40%	2,981	Mt Weld, Western Australia - Producing	1,832
Australian Strategic Materials Limited	ASM	1.06	154	75	0.74%	556	Dubbo, New South Wales - DFS	277
Hastings Technology Metals Ltd	HAS	0.64	166	30	0.93%	278	Yangibana, Western Australia - Construction	596
Arafura Rare Earths Ltd	ARU	0.14	254	56	2.60%	1,456	Nolans Bore, Northern Territory - DFS	174
Northern Minerals Limited	NTU	0.03	130	9	0.67%	62	Halls Creek, Western Australia - DFS	2,094
Peak Rare Earths Limited	PEK	0.29	59	214	2.15%	4,610	Ngulla/ Teeside, Tanzania/ UK - DFS	13
Ionic Rare Earths Limited	IXR	0.02	84	315	0.06%	202	Makutu, Uganda - SS	418
Rarex Limited	REE	0.02	15	19	1.15%	216	Cummins Range, Western Australia - Exploration	68
Australian Rare Earths Limited	AR3	0.14	10	81	0.08%	64	Koppamurra, South Australia - Exploration	159
Dreadnought Resources Ltd	DRE	0.03	91	14	1.13%	162	Yin, Western Australia - Exploration	292
Meteoritic Resources NL	MEI	0.20	439	409	0.26%	1,074	Caldeira, Brazil, Minas Gerais -	408
Mean								576
Median								292

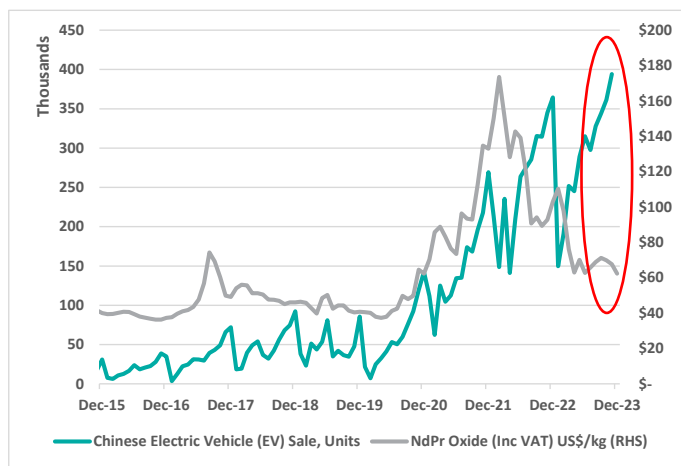
SOURCE: IRESS, BELL POTTER SECURITIES ESTIMATES, BLOOMBERG

Rare earth market

Disconnect in rare earth prices

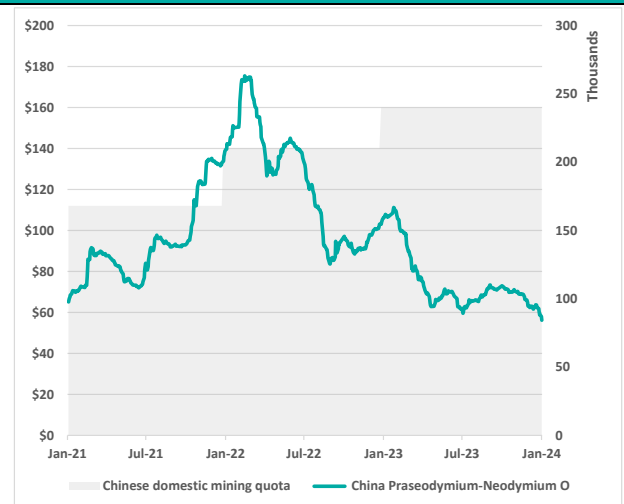
China NdPr prices are currently around US\$56/kg, down 44% YoY. The sell-off at the beginning of the new year was highlighted by China Northern Rare Earths in a statement announcing price cuts amid soft demand. Interestingly, there has been a disconnect between Chinese EV production and the NdPr price over the last six months, which historically shared a much closer relationship. Whether or not this turns around in the next six months is difficult to say, we do see slower demand from traditional sectors (consumer electronics, AC units, ICE vehicles) weighing on prices, however this could be offset by any stimulus measures within China.

Figure 8 - China EV production vs NdPr Spot Price (China) US\$/kg



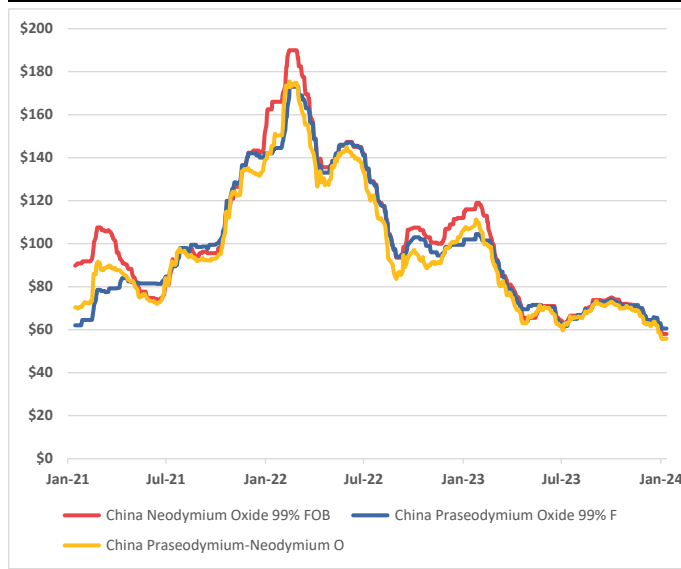
SOURCE: BLOOMBERG, BELL POTTER SECURITIES ESTIMATES

Figure 9 - China rare earth production quota, vs NdPr Spot Price



SOURCE: BLOOMBERG, BELL POTTER SECURITIES ESTIMATES

Figure 10 - NdPr China spot price - 3 years



SOURCE: BLOOMBERG

Figure 11 - Dy (RHS) + Tb (LHS) China spot price - 3 years



SOURCE: BLOOMBERG

Lynas Operations

Overview

LYC's current operating portfolio consists of the Mt Weld mine and concentrator and the Lynas Advanced Materials Plant (LAMP). A rare earth concentrate product is produced at Mt Weld and shipped to LAMP in Malaysia for separation into ~16 final products.

Mt Weld – 100%

Mt Weld consists of a conventional, open pit, mining operation with an onsite 370ktpa concentrator, located proximal to the West Australian town of Laverton. The deposit is a carbonatite intrusion, characterised typically as hosting high-grade long-life rare earth and niobium deposits. Mt Weld has been concentrating high-grade rare earth ore from the Central Lanthanide deposit since 2011. Mining is conducted in staged approaches, with the current program 4.1 underway.

Mt Weld has a current Ore Reserve of 18.6Mt @ 8.2% TREO for total contained REO of 1,527kt and a Mineral Resource Estimate of 54.7Mt @ 5.2% for 2,877kt contained REO. Given current operation trajectory we estimate Mt Weld to have a mine-life of 25 years. LYC have recently initiated an exploration project aimed at maintaining a constant 25+ year mining operation.

Lynas Advanced Materials Plant (LAMP)

Lynas Advanced Materials Plant (LAMP) is in Malaysia, in the Gebeng Industrial Estate near the region of Kuantan. LAMP was commissioned in 2012 and was specifically designed to treat concentrate from Mt Weld via three distinct steps, 1) cracking and leaching, 2) solvent extraction, and 3) product finishing.

Since commissioning, LYC have slowly ramped up production of finished product towards the name-plate capacity of 22ktpa TREO. During which time, LAMP has faced headwinds from the Save Malaysia Stop Lynas (SMSL) activist group around the processing of low-grade radioactive material. In 2020 LYC was alerted to the banning of importation of naturally occurring radioactive material (NORM) material by 1 July 2023. The consequence of this was the relocation of the cracking and leaching phase of the process to separate radioactive material from the Mt Weld concentrate prior to shipping. In October 2023, the ban was overturned, allowing LYC to continue processing lanthanide concentrate in Malaysia until March 2026. Over the next 2-3 years LYC will need to adjust and increase capacity at LAMP to accommodate treatment of the mixed rare earth carbonate material from Mt Weld and the production growth aspirations of 12,00tpa NdPr.

Investment Risks

Risks to resources sector equities include, but are not limited to:

- **Commodity price and exchange rate fluctuations.** The future earnings and valuations of exploration, development and operating resources companies are subject to fluctuations in underlying commodity prices and foreign currency exchange rates.
- **Infrastructure access.** Bulk commodity producers are particularly reliant upon access to transport infrastructure. Access to infrastructure is often subject to contractual agreements, permits, and capacity allocations. Agreements are typically long-term in nature (+10 years). Infrastructure can be subject to outages as a result of weather events or the actions of third party providers.
- **Operating and capital cost fluctuations.** Markets for exploration, development and mining inputs can fluctuate widely and cause significant differences between planned and actual operating and capital costs. Key operating costs are linked to energy and labour markets.
- **Resource growth and mine life extensions.** Future earnings forecasts and valuations may rely upon resource and reserve growth to extend mine lives.
- **Sovereign risks.** Mining companies' assets can be located in countries other than Australia and are subject to the sovereign risks of that country.
- **Regulatory changes risks.** Changes to the regulation of infrastructure and taxation (among other things) can impact the earnings and valuation of mining companies.
- **Environmental risks.** Resources companies are exposed to risks associated with environmental degradation as a result of their exploration and mining processes. Fossil fuel producers (coal) may be particularly exposed to the environmental risks of end markets including the electricity generation and steel production industries.
- **Operating and development risks.** Mining companies' assets are subject to risks associated with their operation and development. Risks for each company can be heightened depending on method of operation (e.g. underground versus open pit mining) or whether it is a single operation company. Development assets can be subject to approvals timelines or weather events, causing delays to commissioning and commercial production.
- **Occupational health and safety risks.** Mining companies are particularly exposed to OH&S risks given the physical nature and human resource intensity of operating assets.
- **Funding and capital management risks.** Funding and capital management risks can include access to debt and equity finance, maintaining covenants on debt finance, managing dividend payments, and managing debt repayments.
- **Merger/acquisition risks.** Risks associated with value transferred during merger and acquisition activity.
- **COVID-19 risks:** Mining companies rely on freedom of movement of workforces, functioning transport routes, reliable logistics services including road, rail, aviation and ports in order to maintain operations and get their products to market. They also rely on liquid, functioning markets to sell their products. Measures being put in place to combat the COVID-19 pandemic are posing risks to these conditions.

Recommendation structure

Buy: Expect >15% total return on a 12 month view. For stocks regarded as 'Speculative' a return of >30% is expected.

Hold: Expect total return between -5% and 15% on a 12 month view

Sell: Expect <-5% total return on a 12 month view

Speculative Investments are either start-up enterprises with nil or only prospective operations or recently commenced operations with only forecast cash flows, or companies that have commenced operations or have been in operation for some time but have only forecast cash flows and/or a stressed balance sheet.

Such investments may carry an exceptionally high level of capital risk and volatility of returns.

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Stuart Howe	Resources	613 9325 1856	showe
Brad Watson	Resources	618 9326 7672	bwatson
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