RPM Global Holdings

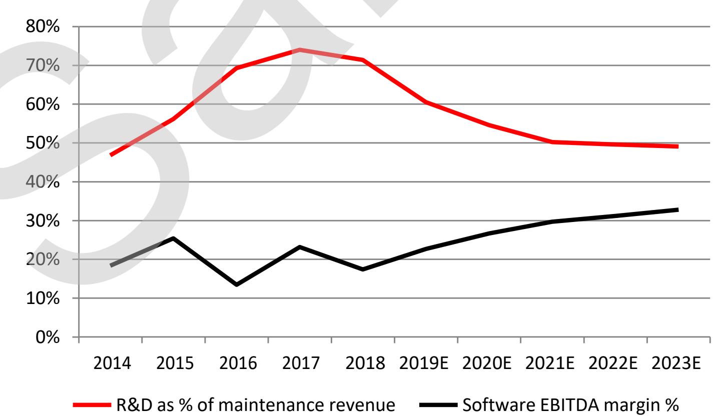
Time to reap the rewards of investment

Analyst coverage of RPM Global is transferring from Brent Mitchell to James Tracey. The company reported 1H19 results on Monday. Net revenue growth accelerated to 13% YoY in 1H19 vs. 1% YoY in FY18 and EBITDA improved to $0.9m vs. -$0.1m in 1H18. Seasonality in the software division means results are second half weighted. We now forecast FY19 EBITDA of $8.5m vs. $10.4m previously on an increased likelihood that future contracts will be subscription rather than up-front licences.

Our investment recommendation remains Buy, underpinned by:

- **An inflection in margins**: RPM has invested $51m over the past five years into R&D in order to move its software from its original XPAC platform into tailored solutions for each major commodity as well as the transition of products from desktop to enterprise. With the heavy lifting now complete we expect R&D expenses to fall relative to sales resulting in a rise in software (2/3 group profit) EBITDA margins towards management's medium term target of 40% (Fig 1).
- **A beneficiary of the mining cycle:** RPM Global is a leading provider of design and operational planning software to the mining industry. Earnings should continue to benefit from a recovery in commodity prices and improving profitability of global miners.
- **Growth at a value multiple:** RPM Global trades on P/E 11.6x on our FY21 estimates. Our upgraded DCF derived fair value of $1.0 per share (was $0.91/sh) puts the shares on a 20x multiple.

Figure 1: R&D expenses vs. Software EBITDA margin (%)



Source: Veritas, Company Data

RUL.ASX BUY

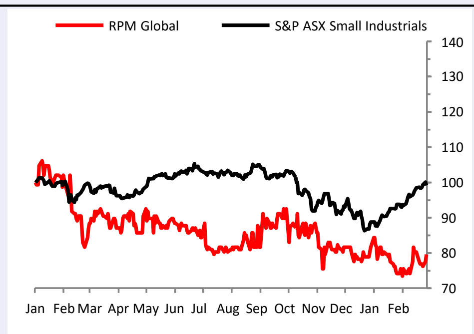
Wednesday 27 February 2019

Share Price	$0.59
Price Target	$1.00
Valuation Method	DCF
FD Market capitalisation	$129m
Enterprise value	$111m
GICS sector	Information Technology
12 month price range	$0.53 - 0.69
Average monthly t/o	3.4m
Shares in issue (diluted)	218.6m
Top 20	164.6m
Previous rating	Buy

Year ended June 30		FY18A	FY19E	FY20E	FY21E
Revenue	$m	67.6	73.7	78.7	85.0
Growth	%	1.2	9.0	6.9	7.9
EBITDA	$m	4.4	8.5	11.5	15.1
Margin	%	6.5	11.5	14.6	17.8
NPAT	$m	0.9	3.8	7.4	11.1
EPS	¢ps	0.4	1.7	3.4	5.1
CFPS	¢ps	3.2	4.0	5.1	6.8
DPS	¢ps	0.0	0.0	0.0	0.0
Franking	%	0.0	0.0	0.0	0.0
Dividend Yield	%	0.0	0.0	0.0	0.0
PER	x	147.0	33.8	17.4	11.6
Price/Cash Flow	x	18.2	14.7	11.6	8.7
EV/Revenue	x	1.6	1.5	1.4	1.3
EV/EBITDA	x	25.2	13.0	9.6	7.3
EV/EBIT	x	110.4	24.7	14.8	9.9
EV/Capital	x	2.6	2.7	2.7	2.9
Gearing (adj debt: capital)	%	-36.9	-50.3	-66.9	-102.4
Fixed charge cover	x	1.4	2.6	3.1	4.0
Return on capital	%	1.7	8.7	17.5	27.4

Gearing ratio adjusted by capitalising operating leases

RPM Global vs. Small Industrials Index



Source: Bloomberg, Veritas

A leading provider of software and advisory to the global resources sector. Clients include BHP, Glencore and Anglo American

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RPM Global

Share Price: $0.59 ps **Valuation: $1.00 ps**

Financial Performance (A$m)					
Year ended June 30	**FY17A**	**FY18A**	**FY19E**	**FY20E**	**FY21E**
Revenue	**66.8**	**67.6**	**73.7**	**78.7**	**85.0**
Field expenses	(40.1)	(40.7)	(43.8)	(46.2)	(48.7)
Gross profit	**26.7**	**26.9**	**29.9**	**32.6**	**36.3**
Development & corporate	(22.1)	(22.5)	(21.4)	(21.1)	(21.2)
Normalised EBITDA	**4.6**	**4.4**	**8.5**	**11.5**	**15.1**
Depreciation	(0.8)	(0.7)	(1.0)	(1.0)	(1.0)
Amortisation	(2.0)	(2.7)	(3.0)	(3.0)	(3.0)
Normalised EBIT	**1.8**	**1.0**	**4.5**	**7.5**	**11.1**
Associate income	0.0	0.0	0.0	0.0	0.0
Net interest	0.2	0.2	0.3	0.4	0.5
Normalised Pre-tax Profit	**2.0**	**1.2**	**4.8**	**7.9**	**11.6**
Normalised tax	(0.6)	(0.4)	(1.0)	(0.5)	(0.5)
Profit attributable to minorities	0.0	0.0	0.0	0.0	0.0
Normalised profit to holders	**1.4**	**0.9**	**3.8**	**7.4**	**11.1**
One off items (post-tax)	(1.4)	(0.6)	(0.3)	0.0	0.0
Reported profit to holders	**0.0**	**0.2**	**3.5**	**7.4**	**11.1**

Cash Flow Statement (A$m)					
Year ended June 30	**FY17A**	**FY18A**	**FY19E**	**FY20E**	**FY21E**
Normalised EBITDA	**4.6**	**4.4**	**8.5**	**11.5**	**15.1**
Exceptionals	(1.2)	(0.3)	0.0	0.0	0.0
Cash net interest	0.2	0.2	0.3	0.4	0.5
Cash tax (paid)/received	(1.0)	(0.8)	(0.9)	(0.5)	(0.5)
Normalised working capital	(6.6)	3.2	0.9	(0.3)	(0.4)
Other (impairment/share payments)	1.0	0.3	0.0	(0.0)	0.0
Operating Cash Flow	**(3.1)**	**7.0**	**8.8**	**11.1**	**14.8**
Capex	(2.2)	(1.5)	(0.9)	(0.9)	(0.9)
Free Cash Flow	**(5.3)**	**5.5**	**7.9**	**10.2**	**13.9**
Disposals/Acquisitions	(6.7)	(3.1)	(2.7)	(2.5)	0.0
Dividends paid	0.0	0.0	0.0	0.0	0.0
Equity raised/buybacks	14.4	0.3	0.0	0.0	0.0
Borrowings/(debt repayment)	0.0	0.0	0.0	0.0	0.0
Net increase/(decrease) cash	**2.4**	**2.7**	**5.2**	**7.7**	**13.9**
Cash at beginning	18.1	20.3	23.3	29.0	36.8
Cash at end	20.3	23.3	29.0	36.8	50.6

Balance Sheet (A$m)					
Year ended June 30	**FY17A**	**FY18A**	**FY19E**	**FY20E**	**FY21E**
Cash	20.3	23.3	29.0	36.8	50.6
Receivables	24.8	21.4	23.4	25.0	27.2
Work in progress	1.8	3.1	3.0	3.2	3.5
Other assets	1.9	1.5	1.5	1.5	1.5
Current Assets	**48.8**	**49.4**	**57.0**	**66.6**	**82.9**
Investments in associates	0.0	0.0	0.0	0.0	0.0
Property, Plant & Equipment	2.1	1.9	1.4	1.0	0.6
Intangibles	34.0	37.1	34.4	31.7	29.0
Other non current assets	9.4	9.4	9.4	9.4	9.4
Non Current Assets	**45.5**	**48.4**	**45.2**	**42.1**	**39.0**
Total Assets	**94.3**	**97.8**	**102.2**	**108.7**	**121.9**
Payables	8.6	7.5	8.1	8.6	9.3
Contingent consideration	5.8	4.8	2.5	0.0	0.0
Unearned income	11.9	13.5	15.7	16.8	18.2
Other liabilities	1.1	0.5	0.5	0.5	0.5
Provisions	5.1	6.1	6.1	6.1	6.1
Total debt	0.0	0.0	0.0	0.0	0.0
Total Liabilities	**32.5**	**32.5**	**32.9**	**32.0**	**34.1**
Shareholder Funds	**61.8**	**65.3**	**69.3**	**76.7**	**87.8**

Directors		Shares	Holding
Richard Mathews	Executive MD	8.2m	3.8%
Allan Brackin	Chairman	1.1m	0.5%
Ross Walker	Non-Exec Dir	1.0m	0.4%
Stewart Butel	Non-Exec Dir	0.1m	0.0%

Major Shareholders (excluding nominees)	Shares	Holding
Perennial Value Management	31.1m	14.4%
Ruffer LLP	26.8m	12.4%
Discovery Asset Management	14.2m	6.6%
Ian Runge	14.1m	6.5%
Top 20 including nominees (30/06/2018)	164.6m	76.2%

Source: Company data, Veritas Research

Valuation Metrics	Valution	Premium
Price Target (ps)	$1.00	69%
Share Price (ps)	$0.59	
FY19E EV/EBITDA (x)	13.0	
Implied FY19 EV/EBITDA (x)	23.6	81%
Implied FY20 EV/EBITDA (x)	17.4	33%
Market Capitalisation (A$m)	129	
Enterprise Value (A$m)	111	

Valuation Multiples					
Year ended June	**FY17A**	**FY18A**	**FY19E**	**FY20E**	**FY21E**
P/E (x)	89.9	147.0	33.8	17.4	11.6
EV/EBITDA (x)	24.1	25.2	13.0	9.6	7.3
Equity FCF yield (%)	-4.1	4.3	6.1	7.9	10.8
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0
EV/capital (x)	3.3	2.6	2.7	2.7	2.9
Price to book value (x)	2.1	2.0	1.9	1.7	1.5

Per Share Data					
Year ended June 30	**FY17A**	**FY18A**	**FY19E**	**FY20E**	**FY21E**
EPS diluted - adjusted (¢ps)	0.66	0.40	1.75	3.39	5.09
EPS diluted (¢ps)	0.02	0.11	1.60	3.39	5.09
Cash flow per share (¢ps)	-1.4	3.2	4.0	5.1	6.8
Free cash flow per share (¢ps)	-2.4	2.5	3.6	4.7	6.3
Cash (¢ps)	9.4	10.8	13.3	16.8	23.2
Net assets (¢ps)	28.5	30.1	31.7	35.1	40.2
Net tangible assets (¢ps)	12.8	13.0	16.0	20.6	26.9
DPS (¢ps)	0.0	0.0	0.0	0.0	0.0
Shares on issue - avg. basic (m)	203.3	214.0	215.9	215.9	215.9
Shares on issue - avg. diluted (m)	216.8	216.6	218.6	218.6	218.6

Segmental Revenue					
Year ended June 30	**FY17A**	**FY18A**	**FY19E**	**FY20E**	**FY21E**
Licence	23.4	13.6	13.5	13.5	13.5
Subscription	0.5	0.8	2.3	4.5	6.7
Maintenance	17.3	19.6	22.3	24.1	26.4
Consulting	9.0	10.7	12.8	13.9	15.0
Direct software costs	-4.0	-2.4	-2.4	-2.6	-2.9
Software	46.2	42.3	48.5	53.3	58.7
Advisory	16.4	20.2	19.7	20.3	20.9
GeoGAS	3.2	4.6	4.9	5.1	5.4
Other	1.0	0.5	0.6	0.0	0.0
Group Net Revenue (A$m)	**66.8**	**67.6**	**73.7**	**78.7**	**85.0**
Software	37.1	(8.4)	14.6	10.0	10.1
Advisory	(19.2)	23.2	(2.3)	3.0	3.0
GeoGAS	0.0	43.8	6.0	5.0	5.0
Group Net Revenue growth (%)	**26.3**	**1.2**	**9.0**	**6.9**	**7.9**

Segmental Normalised EBITDA and Margins					
Year ended June 30	**FY17A**	**FY18A**	**FY19E**	**FY20E**	**FY21E**
Software	10.7	7.3	11.0	14.2	17.4
Advisory	1.0	2.9	2.3	2.6	2.8
GeoGAS	1.1	2.1	2.5	2.6	2.8
Other	1.1	0.5	0.6	0.0	0.0
Corporate	(9.3)	(8.5)	(7.9)	(7.9)	(7.9)
Group EBITDA (A$m)	**4.6**	**4.4**	**8.5**	**11.5**	**15.1**
Software	23.2	17.4	22.6	26.7	29.7
Advisory	6.4	14.4	11.9	12.7	13.6
GeoGAS	34.4	45.7	50.8	51.0	51.7
Group EBITDA margin (%)	**6.9**	**6.5**	**11.5**	**14.6**	**17.8**

Performance Ratios (%)					
Year ended June 30	**FY17A**	**FY18A**	**FY19E**	**FY20E**	**FY21E**
Return on capital	3.7	1.7	8.7	17.5	27.4
Normalised EBITDA growth	-243.8	-4.3	92.8	35.5	31.6
Normalised EPS growth	-134.3	-38.8	335.3	94.1	50.0

Balance Sheet Ratios					
Balance Sheet (A$m)	**FY17A**	**FY18A**	**FY19E**	**FY20E**	**FY21E**
Gross debt ($ m)	0.2	0.2	0.2	0.2	0.2
Net debt (cash) ($ m)	-20.1	-23.1	-28.8	-36.6	-50.4
Gearing (adj. net debt (cash): capital)	-27	-37	-50	-67	-102
Fixed charge cover (x)	1.5	1.4	2.6	3.1	4.0

Updating estimates to reflect subscription model

Having digested the information from 1H19 results on Monday we are updating our estimates (Fig 2).

- We lower our revenue forecast by 4-5% over the next two years to reflect lower than expected Advisory revenues in 1H19 and a change of the mix in software revenues towards subscription.
- EBITDA cuts of 18-37% on delayed Software income as a result of the shift to a subscription model.
- EPS cuts of 30% in FY19 and 32% in FY20. The cuts are less pronounced than at EBITDA due to our forecast that RPM will maintain tax payments of less than $1m per year (over the forecast period) due to utilization of $50m of tax losses, of which around half are in Australia. The implication of this is that RPM could earn c$83m of PBT in Australia tax free. Note that the tax we forecast consists of taxes payable on earnings in Latam and Asian subsidiaries and minimal tax in Australia.
- Little change to our free cash flow forecast for FY19 based on $3m of working capital cash inflows expected in 2H19.

We forecast EPS will increase more than eightfold from 0.4cps in FY18 to 3.4cps by FY20

Figure 2: Changes to Veritas forecasts for RPM Global

	FY19E			FY20E		
Year ended June 30 ($m)	Old	New	Chg. (%)	Old	New	Chg. (%)
Revenue	76.4	73.7	-3.6	83.1	78.7	-5.2
Growth (% YoY)	13.1	0.0	-13.1	8.8	0.0	-8.8
EBITDA	10.4	8.5	-18.4	18.1	11.5	-36.5
Margin (%)	13.6	11.5	-2.1	21.8	14.6	-7.2
Profit before tax	6.9	4.8	-30.8	15.0	7.9	-47.4
Normalised dil. EPS (cps)	2.5	1.7	-30.1	5.0	3.4	-32.2
Capex	0.8	0.9	6.3	1.2	0.9	-25.0
Free Cash Flow	7.3	7.9	8.3	13.9	10.2	-26.3

Source: Veritas estimates

The introduction of the subscription model has a short term negative impact on estimates for superior long term cash flows.

The shift toward a subscription model means less income in the near term in return for superior overall value creation over the life of the contracts. The rationale is as follows: a hypothetical RPM licence deal with a $5m upfront licence fee would attract $1m (20%) of maintenance fees per year, for total income of $8m over three years. Under a subscription model, the company would receive $2.66m per year over three years. This is c50% less in year one and more than double in years two and three for the same total income.

The benefit of the subscription model is that RPM should be able to charge more than just the total cash flows amortised over the life of the contract ($2.66m per year in the example) due to the inclusion of product updates and the bundling of additional software into a single subscription. Other software companies that have made the same change, such as MYOB and Oracle, have delivered significant EBITDA uplifts as a result of the change. Furthermore, the shift should significantly reduce the volatility of RPM's profits and therefore justify the shares trading on a higher multiple.

An inflection in margins

Margins at RPM Global have been depressed by considerable R&D investment expensed over the past five years. The investments were in three primary areas:

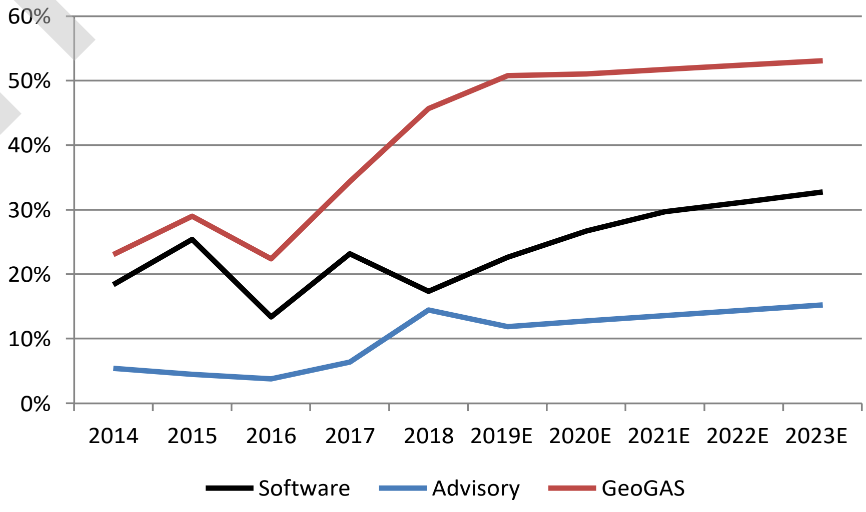
- **Converting XPAC into commodity specific solutions:** Historically the primary software solution provided by RPM to its clients was XPAC. This required considerable configuration in order to create production schedules. RPM invested heavily to convert this into several bespoke scheduling solutions for each commodity class that require far less consulting support to configure and include commodity specific IP. The company plans to release the final three solutions - underground coal, potash and alloys - in 2H19.

- **The development of simulation capabilities:** RPM claims to provide the mining industry's only discrete event simulation solution. The addition of simulation capabilities required considerable investment.

- **Shifting software from desktop to enterprise:** Five years ago most of the software sold by the company was installed on client desktops and did not interface with other client systems. A considerable amount of work has gone into converting the software to enterprise – which means it now interfaces with clients' other systems including SAP. This makes the software more robust and useful. RPM Global claims to provide the only mine planning software to interface directly with SAP.

The near completion of these major lines of work means software margins should increase as R&D falls as a percentage of maintenance revenue from 74% in FY17 to 62% in 1H19 and we forecast 50% by FY21. RPM management indicated that R&D spend at 50% of maintenance income is the sustainable level required for continuous innovation. The reduction in R&D spend is the major driver behind our forecast that Software EBITDA margins should rise from 17% in FY18 to 23% in FY19 and 27% in FY20 (Fig 3). The 500bp YoY increase in software EBITDA margins in 1H19 gives us confidence this can be achieved.

Figure 3: Segmental EBITDA margin forecasts (as % of net revenue)



Source: Veritas forecasts, company data for historic

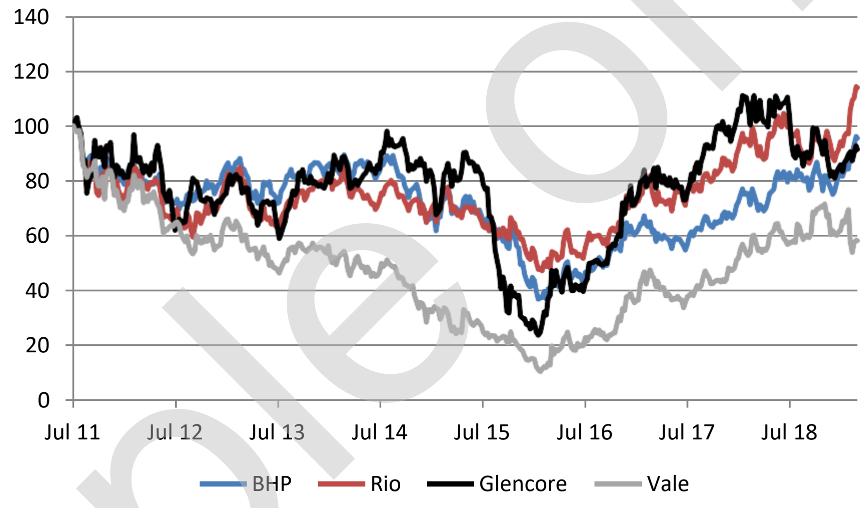
"During the gold rush is a good time to be in the pick and shovel business."
Mark Twain

A beneficiary of the mining cycle

RPM provides mining software to all of the major global mining players including Glencore, BHP, Rio Tinto and Vale. RPM estimates that its penetration of these customers is relatively low, with less than 10% of their mining sites using RPM software.

The share prices of the global miners have approximately doubled from the lows of FY16 (Fig 4) due to rising commodity prices and greater capital discipline. Both of these themes should prove beneficial to RPM over the coming years. Higher commodity prices mean that the miners have more free cash with which to purchase software. A greater focus on capital discipline plays to RPM's strengths as a provider of software that enables unrivaled visibility and control of capital and operating costs for miners.

Figure 4: The share prices of the major miners indexed to 100 in July 2011 (in A$)



Source: Bloomberg, Veritas. Note: We convert foreign share prices to A$ at the historic exchange rates

We see more than 70% share price upside

We derive a target price of $1.0 ps based on a DCF

The rapidness with which we expect profitability to improve at RPM means near term multiples are of limited relevance for a long term investor. Accordingly we believe that DCF is the most suitable valuation approach as it captures the interplay of revenue growth, rising margins, capital productivity and the benefits of utilising tax losses.

We derive a DCF based fair value of $1.00 per share, compared with $0.91/sh previously, on the basis of terminal EBITDA margin of 21% versus 18% forecast in FY20 (Fig 5). This is driven by the progression of software division margins (c2/3 of group profit) toward management's 40% medium term target. We also assume terminal growth fades to 1.0%, terminal capex/depreciation of 1.0x and a sector standard WACC of 8%.

We forecast a net cash position of $50m in FY21, 39% of the current market capitalisation

RPM looks cheap on P/E 11.6x in FY21. We forecast the net cash balance will rise from $23m in FY18 to $29m by FY19 and $50m by FY21, 39% of the current market capitalisation.

Figure 5: DCF valuation for RPM Global

Year end June	Units	FY19	FY20	FY21	FY22	FY23	FY24	FY25	FY26	FY27	FY28	TV
Revenue	$m	73.7	78.7	85.0	91.8	99.3	107.3	113.7	119.9	124.7	127.2	128.5
Revenue growth	*%*	*9.0*	*6.9*	*7.9*	*8.0*	*8.2*	*8.0*	*6.0*	*5.5*	*4.0*	*2.0*	*1.0*
EBITDA	$m	8.5	11.5	15.1	18.2	21.8	23.6	25.4	26.4	27.4	28.0	27.0
Margin	*%*	*11.5*	*14.6*	*17.8*	*19.8*	*21.9*	*22.0*	*22.3*	*22.0*	*22.0*	*22.0*	*21.0*
EBIT	$m	5.5	8.5	12.1	15.2	18.8	20.4	21.9	22.8	23.7	24.2	23.1
Tax rate	*%*	*20.0*	*6.0*	*4.5*	*4.0*	*3.0*	*30.0*	*30.0*	*30.0*	*30.0*	*30.0*	*30.0*
NOPAT	**$m**	**4.4**	**8.0**	**11.6**	**14.6**	**18.2**	**14.3**	**15.4**	**16.0**	**16.6**	**16.9**	**16.2**
DA	$m	3.0	3.0	3.0	3.0	3.0	3.2	3.4	3.6	3.7	3.8	3.9
Working capital	$m	0.9	-0.3	-0.4	-0.4	-0.4	-0.4	-0.3	-0.3	-0.2	-0.1	-0.1
Capex	$m	-0.9	-0.9	-0.9	-0.9	-0.9	-3.2	-3.4	-3.6	-3.7	-3.8	-3.9
FCF	**$m**	**7.4**	**9.8**	**13.3**	**16.3**	**19.9**	**13.9**	**15.0**	**15.6**	**16.4**	**16.8**	**16.1**
Discount factor	%	93%	86%	79%	74%	68%	63%	58%	54%	50%	46%	
NPV of FCF	**$m**	**6.9**	**8.4**	**10.6**	**12.0**	**13.5**	**8.7**	**8.8**	**8.5**	**8.2**	**7.8**	

Item	Units	Value
NPV of the forecast period	$m	93
NPV of terminal value	$m	107
NPV of cash flows	**$m**	**200**
Add: net cash	$m	23
Less: deferred consideration	$m	-5
Less: minorities	$m	0
Add: associates	$m	0
Fair value of equity	$m	**218**
Fair value of equity per share	**$ps**	**1.00**
Share count (diluted)	m	219

Item	Units	Value
WACC	%	8.0
Terminal growth	%	1.0
Terminal value nominal	$m	230
Terminal EV/EBITDA	x	8.5
Terminal EV/NOPAT	x	14.2

Source: Veritas research

Research

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RATING

BUY – anticipated stock return is greater than 10%
SELL – anticipated stock return is less than -10%
HOLD – anticipated stock return is between -10% and +10%
SPECULATIVE – high risk with stock price likely to fluctuate by 50% or more

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