Locality Planning Energy (LPE)

LPE is an operator of embedded electricity networks. As an example, they might approach a strata building that had say 250 units. Each of those units will be paying a network charge and a metering charge. If LPE convert the building, they put a 'parent meter' in front of the 250 meters and now only a single metering and network charge must be paid. By doing this, LPE can offer significant electricity cost savings to the end users (almost 20%) and make a respectable profit in so doing (almost 20% gross).

The company backdoor listed in January 2016 and immediately commenced trading at around 3cpc. The market became excited with the story and the price rallied to 5cps, but as the slow-grind of executing the business plan wore investors down, it is now trading around 2.4cps or a market capitalisation of under $60m. This is despite the company being around 9 months ahead of plan.

At June 30 2016, LPE were billing 39.3GWh. By June 30 2017, they were billing 114.7GWh. Over FY17, on average they added 6.8GWh per month. I suspect they can accelerate this growth somewhat over coming years as systems improve, but for conservatism, we will assume they continue to add 7GWh per month going forward.

Because LPE are growing extraordinarily swiftly, modelling is difficult. They billed $3.83m in the first half of FY17 & $6.43m in the second half. I estimate they exited FY17 on an annualised billing rate of $15.5m.

In the first half of FY17, they achieved a gross margin of 14.2%. In the second half they achieved 18.95%. I will assume GM will top out at around 20%.

That being the case, on the exit run-rate of FY17, a condensed P&L would look something like this →

	June 30 2017 run-rate
Electricity Sale	15,500,000
Total COGS	12,400,000
Gain from trading	**3,100,000**
Employee Costs	2,600,000
Professional costs	500,000
Share Based Payments	-
D&A	500,000
Borrowing	120,000
Doubtful debts	100,000
Other Expenses	800,000
Total Expenses	**(4,620,000)**
Net Run-Rate Loss	**(1,520,000)**

If LPE continue to add 7GWh per month, I estimate they will bill between $22-23m in FY18 and exit FY2018 with run-rate billing of about $28-29m annualised. Management insist next to no additional costs are required to take the business to the interim billing target of 450GWh, but I would anticipate there will be some cost inflation creep in. That being the case, an estimated FY18 run-rate P&L would look something like →

	June 30 2018 run-rate
Electricity Sale	28,500,000
Total COGS	22,800,000
Gain from trading	**5,700,000**
Employee Costs	2,750,000
Professional costs	520,000
Share Based Payments	-
D&A	700,000
Borrowing	150,000
Doubtful debts	100,000
Other Expenses	980,000
Total Expenses	**(5,200,000)**
Net Run-Rate Profit	**500,000**

So from this (and I consider this modelling to be very conservative) we can see a business that has the capacity to add circa $2m or so per annum to its steady state earning capacity and given management has a history of accelerating their growth and bringing their targets forward, there is a reasonable chance that these figures are considerably too conservative. If the recently stated target of 200GWh in Q1 2018 is achieved, the run-rate (which above assumes June 2018 billing of 205GWh) at 30 June 2018 would likely be at least 10% higher, assuming costs are held steady, that would see FY18 run-rate profits closer to $1.1m per annum.

Now at $1.1m per annum, you might think 'this stock is almost 60x forward earnings', but be sure to consider the growth runway available to the business. They service a shade over 1% of the addressable strata/embedded market in Queensland and have the rest of the Australian market available to them once the business becomes self-funding which should be within 12-18 months.

If the business can go from a run-rate loss of $1.5m in FY17 to a run-rate profit of $1m in FY18, then all else equal, growth to a run-rate of at least $3.5m to $4m in FY19 should be achievable (likely a little better as operating leverage kicks in).

If successful execution continues, LPE should be capable of earning at least $6m in FY20, which again at 10x 3-years forward earnings may not immediately strike as cheap, but consider the average contracted revenue of 7.2 years, and how little weight in terms of valuation will be given to early revenues (that is to say as the model matures, the contracts rolling off will be dwarfed by the contracts being rolled on).

Revenue certainty of this kind, coupled with earnings growth of that magnitude would be valued at a fairly lofty multiple I would hazard.

Given an Enterprise Value at present of sub-$60m, $10.5m of profits retained over the next 3 years and a terminal valuation of the equity at 16x the FY20 profit of $6m, the IRR over the 3 years would comfortably exceed 20% annually.

I actually expect the multiple ascribed to a business with earnings with this level of certainty and earnings growth of the velocity described above would likely be higher than 16x. Furthermore, as the business improves in the execution, the above valuation makes no significant allowance for any acceleration in the growth the business is able to achieve. But I will leave you to generate your own 'blue-sky' valuations.

Key Risks:

1. A well-funded market giant taking a big push into the embedded network space is the main risk that exercises my mind. That would likely crimp future margins meaningfully, but depending on at what point the attack came, much value would have already been built due to long-term contracted revenues. It is really future growth that would be harmed.
2. The business is consuming working capital and in order to achieve self-funding status, my view is that a line-of-credit of $3-8m is required. If this proves difficult to get, returning to equity markets would likely be poorly received.
3. The way that very fast growing businesses can sometimes find unexpected ways to grow their cost base at faster than expected rates is another risk.

Outside of that, the model has been shown to work well, but any rapidly growing business has execution risks. With that said, you have two smart, energetic and aligned fellows leading the business in Damien Glanville & Ben Chester, so any flaw in execution will not stem from lack of effort or alignment.