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Laserbond (LBL)

5 March 2020

1H20 Result Review – A Tale of Two Divisions

Our View

Sales growth within Laserbond's key Products Division was less than expected and this has necessitated a review and downgrade of our forecasts.

We retain our Outperform recommendation based on a 2H20 recovery of sales for the Products division, new steel roller sales, new long lead time OEM sales and the inflow of revenue for past Technology division sales. We have confidence around this recovery, having identified incremental sales of $700k for the Products division for 2H20. We believe continued sound industry conditions (heavy industry, infrastructure, utilities, bulk mine production), a lower AUD, past product trials converting to sales, and greater installed capacity should provide momentum.

Key Points

1H20 was a tale of two divisions: -

Group result

- Revenue of $11.22m was up 7.3% at a group level.
- The Services Division reported revenue growth of +21% - helped by robust demand but offset by a revenue decline of 9% in the Products division.
- The overall sales were disappointing for 1H20 - having started the year well with sales up 18% for the first quarter.
- The Products Division had some late orders that could not be filled and therefore not booked to revenue. Dollar value of orders increased +1.7%. We believe that these orders have now been filled and invoiced.
- Adjusted NPAT (before grants and AASB) grew 15.7% to $1.231m. Reported profit was down 2% to $1.18m.
- Laserbond has retained the 2022 goal of revenue of $40m as outlined at the AGM last year.

Balance sheet and cashflow

- The balance sheet now incorporates leased equipment via the AASB16 accounting standard ($5.4m liability/$5.4m asset) despite this, Laserbond is well positioned for growth with lower levels of gearing.
- Operating cashflow was weak pcp due to seasonality (pcp figure was high due to a technology receipt). We are forecasting a better 2H working capital performance. The 1H20 cash flow included advance payment for new equipment that should not repeat into 2H20.

Changes to forecasts/ recommendation

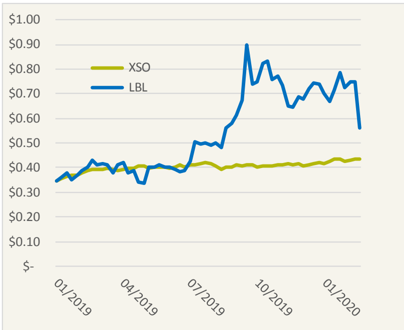
- We have reduced forecast sales from $26.6m to $24.0m, NPAT from $3.6m to $2.78m and EPS from 3.8 cps to 2.93 cps.
- We retain our Outperform recommendation. Laserbond offers the prospects of far better growth rates compared with many other similar industrial businesses, but at a P/E of 16.6X vs the Small Ordinaries (XSOPER) P/E of c18-19X.

Recommendation: Outperform

Summary (AUD)

Market Capitalisation	**$46m**
Share price	**$0.4875**
52 week low	$0.315
52 week high	$0.97

Share price graph (AUD)



Key Financials (AUD)

June	FY19A	FY20E	FY21E
Revenue ($m)	22.7	24.0	32.2
EBITDA ($m)	4.9	6.3	8.3
NPAT Adj.	2.76	2.78	4.30
EPS Adj. (c)	2.93	2.93	4.48
Growth (pcp)	n.a	0%	53%
PE Ratio (x)	16.6	16.6	10.9
DPS (c)	0.9	1.5	2.0
Div Yield	1.8%	3.1%	4.1%
Franking	100.0%	100.0%	100.0%
EV ($M)	46.4	45.8	46.9
EV/EBITDA	9.5	7.3	5.6

Laserbond - Summary of Forecasts

LBL $0.4875

PROFIT & LOSS SUMMARY (A$m)

Year end June	FY19A	FY20E	FY21E	FY22E
Total Revenue	**22.7**	**24.0**	**32.2**	**40.1**
EBITDA	4.9	6.3	8.3	10.4
Dep'n/Other Amort'n	(0.9)	(1.9)	(2.0)	(2.3)
EBIT	4.0	4.4	6.3	8.1
Net Interest	(0.2)	(0.6)	(0.4)	(0.5)
Pre-Tax Profit	3.9	3.8	5.9	7.6
Tax Expense	(1.1)	(1.0)	(1.6)	(2.1)
NPAT Adj.	**2.76**	**2.78**	**4.3**	**5.6**
Reported NPAT	2.76	2.78	4.30	5.6
Margins on Sales Revenue				
EBITDA	21.6%	26.1%	25.9%	25.8%
EBIT	17.8%	18.3%	19.7%	20.2%
NPAT Adj.	12.2%	11.6%	13.4%	13.8%
Change on pcp				
Total Revenue	45.3%	5.8%	34.3%	24.7%
EBITDA	121.2%	27.9%	33.2%	24.4%
EBIT	166.6%	8.6%	44.8%	27.9%
NPAT Adj.	205.4%	1.0%	54.6%	29.0%

PER SHARE DATA

Year end June	FY19A	FY20E	FY21E	FY22E
EPS Adj. (c)	**2.93**	**2.93**	**4.5**	**5.8**
Growth (pcp)	199.6%	-0.1%	52.9%	29.0%
Dividend (c)	0.9	1.5	2.0	2.9
Franking	100%	100%	100%	100%
Gross CF per Share (c)	4.4	4.4	4.8	6.4
NTA per share (c)	10.6	11.8	14.2	17.0

KEY RATIOS

Year end June	FY19A	FY20E	FY21E	FY22E
Net Debt : Equity (%)	6.6%	-4.6%	0.5%	-1.6%
EBIT Interest cover (x)	22.9	high	high	high
Oper CF/EBITDA	84.1%	66.6%	54.9%	59.3%
Current ratio (x)	2.5	2.5	2.5	2.4
ROE (%)	27.4%	24.4%	31.1%	33.4%
Dividend Payout Ratio (%)	30.7%	51.2%	44.6%	50.0%

VALUATION MULTIPLES

Year end June	FY19A	FY20E	FY21E	FY22E
PER (x)	**16.6**	**16.6**	**10.9**	**8.4**
Dividend Yield (%)	**1.8%**	**3.1%**	**4.1%**	**5.9%**
FCF Yield (%)	1.5%	5.5%	3.0%	6.8%
EV/EBITDA (x)	9.5	7.3	5.6	4.5
EV/EBIT (x)	11.5	10.5	7.4	5.7

Notes - guided to $40m in sales by FY22

BALANCE SHEET SUMMARY

Year end June	FY19A	FY20E	FY21E	FY22E
Cash	2.2	0.5	3.2	0.3
Receivables	5.4	6.0	8.0	10.0
Inventories	2.5	2.6	3.5	4.4
Other				
Total Current Assets	10.1	9.2	14.8	14.7
Right of use asset	0.0	5.0	5.0	5.0
Inventories	0.0	0.0	0.0	0.0
Property Plant & Equip	5.9	5.5	6.6	7.2
Intangibles	0.0	0.1	0.2	0.3
Other	0.4	0.4	0.5	0.6
Total Non-Current Assets	6.3	11.0	12.3	13.2
TOTAL ASSETS	**16.4**	**20.2**	**27.1**	**27.9**
Accounts Payable	2.0	2.2	2.9	3.6
Borrowings - debt	0.6	0.0	1.0	0.0
Income tax	0.4	0.4	0.5	0.7
Other	1.0	1.1	1.4	1.8
Total Current Liab	4.1	3.6	5.8	6.1
Borrowings	2.2	0.0	2.3	0.0
Borrowings - right of use	0.0	5.0	5.0	5.0
Other	0.1	0.1	0.2	0.2
Total Non-Current Liab	2.3	5.1	7.5	5.2
TOTAL LIABILITIES	**6.3**	**8.7**	**13.3**	**11.3**
TOTAL EQUITY	**10.1**	**11.4**	**13.8**	**16.6**

CASH FLOW SUMMARY

Year end June	FY19A	FY20E	FY21E	FY22E
EBIT	**4.0**	**4.4**	**6.3**	**8.1**
Add: Depreciation	0.9	1.9	2.0	2.3
Change in Pay.				
Less: Tax paid	(1.1)	(1.0)	(1.6)	(2.1)
Net Interest	(0.2)	(0.6)	(0.4)	(0.5)
Change in Rec.				
Change in Inv.				
Net working capital	0.5	-0.5	-1.7	-1.7
Gross Cashflows	4.1	4.2	4.6	6.2
Capex/software/aqn	(3.4)	(1.6)	(3.2)	(3.0)
Free Cashflows	0.7	2.5	1.4	3.2
Dividends Paid	(0.5)	(1.4)	(1.9)	(2.8)
Acquisitions/adj	0.7	(1.2)	0.6	(0.3)
Net Cashflows	**0.9**	**(0.1)**	**0.1**	**0.1**

SEGMENTALS

Year end June	FY19A	FY20E	FY21E	FY22E
Sales				
Services	11.2	13.5	16.4	19.8
Product	9.1	9.6	12.0	15.0
Technology	2.4	0.9	3.8	5.4
Corporate	0.0	0.0	0.0	0.0
Total sales	**22.7**	**24.0**	**32.2**	**40.1**

1H20 result

Laserbond's 1H20 result was a series of moving parts; the key problem was the reduced sales within the Products Division. We break down the analysis of each division in greater detail below. In our view - net/net the business has some tangible signs of likely improvement across all three division into 2H20.

Products Division

- Products – sales declined 9% to $4.631m. due to later than expected order inflow from key customers. Dollar orders value was actually up 1.7% during the period. Orders were likely received right in the last week before Christmas after the workforce was sent on (or was going on) a Christmas/January break. Given the difference – this could account for approximately $200-$300k in orders that can be booked and filled into 2H20 (revenue decline vs order growth approx..10% difference). Management has upbeat commentary about the market being positive for OEM value added equipment. The lower AUD is also helpful – particularly for the Products Division and its move into export sales.
- The Products Division also had an extremely strong performance in 1H19 and this created a harder comparable to lap into 1H20.
- Within Products, a new North American OEM customer started purchasing long lasting components in December 2019 and this is expected to add $700k per year.
- The nascent steel roller product line should also contribute to the 2H20. These rollers recorded sales of $232k (1H120) into the US steel roller market with sales to 8 mills US ($29k per mill 1H20). The products are already used within the much smaller Australian steel roller market. This could also continue to grow. There are other products in trial phase in other mills. Laserbond has said it has new relationships with "in excess of 20 US steel mills are currently being developed". If 50% convert – that is 5 * US $29k per half in new sales (US $290k pa).
- The American Iron and Steel Institute Steel *Profile 2019* report reveals 18 paid up members with well over a hundred sites/plants with gravitas (across Canada, US and Mexico) documented in this profile. ArcelorMittal for example, has 36 sites/plants in the US and a further 15 sites in Mexico and Canada. Arcelor handles 23mt of an apparent US market of 112mt according to the American Iron and Steel Institute profile.
- The combination of $200k- 300k in catch up orders, $350k in new consumables sales and perhaps $100k in incremental steel roller sales – underpins our assumption of improved trading for the Products Division into 2H20. The Products Division has also just installed a new high capacity lathe which will increase the capacity of the division and has greater levels of efficiency than older equipment. A new grinder will also be installed in March 2020 for the Products Division and this should also deliver greater efficiency.

Services Division

- Services – the traditional division of the overall business continued to perform well with sales up 21%. Margins remain good. Past investment in capacity and equipment helped this business win new work – with decreased lead times appealing to customers. This division is investing a new vertical borer – which will reduce the need to outsource work to a subcontractor and will save in subcontractor payments and reduce unacceptably high lead times (and deliver greater control). We continue to believe that Services are well placed (with past investment) to continue to grow – with lower lead times, relevant sectors such as heavy industry being busy and a greater desire by customers to fix/repair/improve equipment/reduce waste vs simply making do and/or buying replacement OEM parts.

Technology Division

- Technology – this division did not record any sales during the period – vs none in the pcp. No new Technology license/equipment sales were closed during 1H20. The Technology Division aims to close an equipment order during FY20. Laserbond commentary notes "promising enquiries and strong leads in the pipeline" within this division.
- The division will also record sales into 2H20 as royalties from the UK installation will start to flow as the equipment is being fully used. This should also result in some consumables sales as well (at lower margins). Past estimates put royalties at hundreds of thousands per year per system and consumables at up to $1m pa. We would expect that royalties are very profitable for Laserbond. This suggests that Technology will contribute to 2H20 both in terms of sales and profits. The full use of the equipment in the UK creates a very robust reference site for future interest.

Exhibit 1 – analysis of improvements

2H20 improvements	$k
Products division	
New customer - Products	350
Incremental roller sales	100
Catch up orders	250
Incremental Products	**700**
Technology division	
Royalties	100
Technology consumables	300
Incremental sales	**400**

(source – Taylor Collison analysis)

Changes to forecasts

Despite the various new initiatives within the business – we have revised down our sales and NPAT forecasts. The reduction in sales forecasts is due to lower sales growth rates within the Products Division. We do note that growth should resume into 2H20 based on our analysis. The past EBITDA forecast was like/ like prior to AASB 16 forecasts – we have previously previewed the impact of the change in past notes but had not formerly incorporated it into our forecasts. We include it now. Ordinarily the EBITDA would have increased materially and NPAT remained the same. We have modestly lifted EBITDA, but it is not offsetting the much higher depreciation and interest … hence the NPAT and EPS has been downgraded.

Exhibit 2 – changes to forecasts

Sm	FY20 - old	FY20 - new	FY21- old	FY21 - new
Sales	26.6	24.0	33.6	32.2
EBITDA	6.20	6.26	8.10	8.33
NPAT	3.60	2.78	5.00	4.30
EPS	3.80	2.93	5.20	4.48

(source -Taylor Collison estimates)

The divisional breakdown is reviewed below

Exhibit 3 - Divisional analysis in some detail

Divisional analysis	FY19A	1H20A	2H20F	FY20F
Sales				
Services	11.2	6.9	6.6	13.5
Product	9.1	4.4	5.2	9.6
Technology	2.36	0.0	0.9	0.9
Other				
Corporate				
Total sales	**22.67**	**11.25**	**12.7**	**24.0**
EBITDA	AASB16 changes			
Services	2.6	1.9	2.0	3.9
Product	2.7	1.2	1.6	2.9
Technology	0.3		0.3	0.3
Other				
Corporate	-0.7	-0.4	-0.38	-0.8
Total EBITDA	**4.9**	**2.75**	**3.51**	**6.26**

(source – Taylor Collison estimates)

We estimate that the AASB16 change added about $370k to Depreciation and about $120k to interest (offset by lower rental above the line costs) – so the underlying comparison was EBITDA of $1.81m in 1H19 vs $2.37m 1H20. The 1H19 EBITDA also included some grant income that relates to the next generation manufacturing program – so removing this from pcp depicts some underlying EBITDA growth during the period – despite the slowdown from the Products Division.

We also break down EBITDA for the changes in the following table, using our estimates of grant income and changes in Depreciation related to the new standard.

Exhibit 4 – Adjusting for AASB16 and grant income

Sm	1H19	1H20	% chg
EBITDA reported	2.07	2.73	32%
AASB difference - Dep `		0.37	
EBITDA - Underlying	1.81	2.37	31%
Approx Grants income	0.20	0.0	
EBITDA	2.01	2.37	18%

(source Taylor Collison and Laserbond)

We however prefer to focus on sales, NPAT and EPS rather than EBITDA – given the recent accounting standard changes.

The cashflow conversion was weak compared to EBITDA. Historically we'd expect a better second half. The previous period (1H19) was materially boosted by a large up-front payment for the Technology Division (and possibly a grant) and is perhaps not a true pcp. Laserbond will also use some working capital as is grows (which it did in 1H20) within the services division. It is an area we will be watching into the future. The 1H20 result also included an up-front payment for a major piece of equipment (estimated to be $600K) and this reduced conversion of EBITDA into cash. The equipment is financed via rental and will be operational into 2H20.

Valuation and recommendation

Despite the cuts to our estimates, we retain an Outperform recommendation with a DCF price target of 76c. The business now trades at a discounted P/E to the broader industrial small cap market (XSO). We believe the fundamentals remain strong.

1. Improved trading into 2H20 as larger than normal delayed sales resume.
2. Greater capacity within the Services Division and robust underlying conditions should continue.
3. The use of laser cladding as a superior technique (compared to many alternatives) for both OEMS and repair/maintenance is ongoing.
4. Sales should improve within Products Division as later orders are filled, new customers come on board and past trials convert to tangible sales.
5. The Technology Division will benefit from a past installation and with solid reference customers = convert the sales pipeline into closed deals.
6. New equipment in both services and technology should convert into shorter lead times, more work to be won and even improve working capital conversion.
7. The business has access to further capital and a reasonable balance sheet.
8. Barriers to entry remain solid.
9. As (and when) the business starts to gain material Technology licensing agreement sales, growth rates and estimates will improve, and this will provide it with a superior growth compared to other similar industrial businesses.
10. The falling AUD remains helpful for product exports.
11. Industry conditions – in terms of end markets such as infrastructure, heavy engineering and resource production volumes remain reasonable.

Risks to our forecasts and investment thesis relate to further sales delays within Products and a failure to crystallize a further technology license sales.

Laserbond - overview

Laserbond is an advanced engineering business that specialises in the development and application of sophisticated engineering and scientific methods that increases the performance of wearing parts of capital-intensive (both new and used) equipment. In a practical sense this might be increasing the hardness of a large expensive wearing part in a piece of mining/industrial equipment. This reduces the cost of down time and maintenance which can be a substantial cost in capital intensive equipment in remote locations, using expensive equipment and specialised labour.

Laserbond – risks

Risks include (but are not limited to) – capex and supply line disruption linked to the Covid19 virus, failure to secure new technology sales, customer concentration, sourcing skilled metal workers IP theft, enforcement of IP, competition, raw material/energy/input pricing, heavy manufacturing downturn, reliant on key equipment, key personnel, safety, macro-economic risks, industrial problems, metallurgical problems, warranty claims, shortages of consumables, competing (upsetting) OEM players/customers, complex supply chains and China

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