EQUITY RESEARCH

VERITAS SECURITIES LIMITED

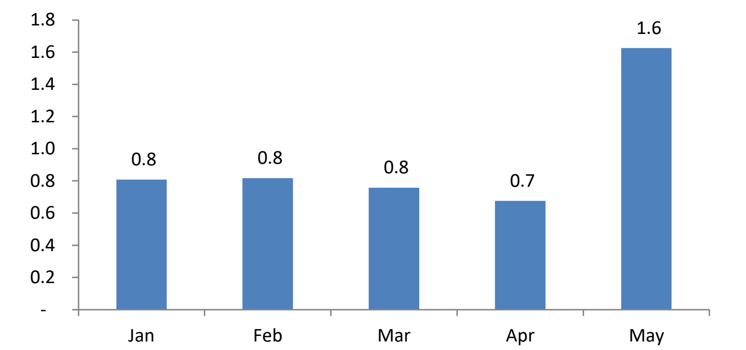
LaserBond Limited

Expanding footprint with acquisition of UST

LaserBond announced the acquisition of United Surface Technologies (UST) and provided a trading update on 15 June. The acquisition makes strategic sense and explains 2% upgrades to our EPS forecasts in FY21. We see >140% upside to our $1.00 per share fair value.

- **Compelling rationale for acquisition:** We see the company recouping the cost of the UST acquisition quickly due to the low multiple paid, the potential for cross selling and improved customer proximity. LaserBond plan to add laser cladding capability that is currently lacking to UST's Melbourne workshop. Gaining a Melbourne presence will make it easier for Victorian clients to access LaserBond's services.
- **Customer delays impact FY20 forecasts:** Increased difficulty in transacting business internationally due to COVID 19 means that Technology revenue we expected to occur in 2H20 should now fall later. Additionally, a major customer changed its product specification – leading to fewer orders in 2H20 than expected. The completion of this specification saw the volume of product orders increase 140% in May vs. April (Figure 1). We are lowering our FY20 revenue forecast by 8% to $22m in-line with updated company guidance.
- **Upgrading FY21 forecasts on UST acquisition:** Including the UST acquisition in our forecasts gives group revenue of $32.7m in FY21, 6% higher than previously. Our pre-tax profit forecast rises by 2%. Management reiterated guidance for $40m revenues in FY22.
- **Fair value $1.00 per share:** Our DCF derived fair value falls from $1.09 to $1.00 per share on the application of a more conservative terminal growth rate: 1.5% versus 2.7% previously. Our fair value puts the shares on a P/E of 18x in FY22 for 24% three-year EPS CAGR.

Figure 1: Value of orders in the Product division by month ($m)



Source: Veritas estimates, company data

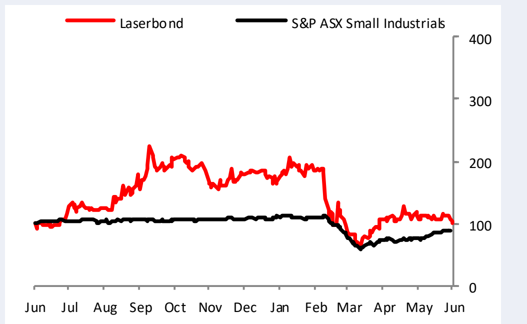
LBL.ASX BUY

Wednesday 17 June 2020

Share Price	$0.42
Price Target	$1.00
Valuation Method	DCF
Market capitalisation	$40m
Enterprise value	$46m
GICS sector	Engineering Services
12 month price range	$0.25 - 0.90
Average monthly t/o	1.8m
Shares in issue	95.4m
Top 20 holders	67.3m
Previous rating	Buy

Year ended June 30		FY19A	FY20E	FY21E	FY22E
Revenue	$m	22.7	22.1	32.7	40.6
Growth	%	44.9	-2.5	48.1	24.1
EBITDA	$m	4.9	5.4	7.7	10.1
Margin	%	21.6	24.6	23.5	25.0
NPAT	$m	2.8	2.3	3.7	5.5
EPS	¢ps	3.0	2.4	3.9	5.6
CFPS	¢ps	4.3	2.6	5.7	6.0
DPS	¢ps	1.0	1.1	3.0	3.8
Franking	%	100	100	100	100
Dividend Yield	%	2.4	2.6	7.1	9.0
PER	x	14.1	17.7	10.9	7.5
Price/Cash Flow	x	9.7	16.2	7.4	7.1
EV/Revenue	x	2.0	2.1	1.4	1.1
EV/EBITDA	x	9.4	8.5	6.0	4.5
EV/EBIT	x	11.5	13.1	8.4	5.8
EV/Capital	x	4.3	2.5	2.3	2.0
Gearing (net debt: capital)	%	6	36	28	22
Fixed charge cover	x	5	4	5.3	7
Return on capital	%	30.8	17.7	20.8	26.8

Laserbond vs. Small Industrials Index



Source: Factset, Veritas

Laserbond is an engineering company with expertise in laser cladding, HVOF and welding. Its technologies are used to extend the life of metal components used in mining and other industries.

https://www.laserbond.com.au

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LaserBond Limited

Share Price: $0.42 ps **Valuation: $1.00 ps**

Financial Performance (A$m)

Year ended June 30	FY17	FY18	FY19	FY20E	FY21E	FY22E
Revenue	**13.8**	**15.6**	**22.7**	**22.1**	**32.7**	**40.6**
Cost of goods	(6.6)	(8.7)	(11.9)	(11.0)	(17.0)	(20.7)
Gross profit	**7.2**	**7.0**	**10.7**	**11.1**	**15.8**	**19.9**
Operating costs	(4.7)	(4.7)	(5.8)	(5.6)	(8.1)	(9.8)
Normalised EBITDA	**2.4**	**2.2**	**4.9**	**5.4**	**7.7**	**10.1**
Depreciation and amortisation	(0.9)	(0.7)	(0.9)	(1.9)	(2.2)	(2.2)
Normalised EBIT	**1.6**	**1.5**	**4.0**	**3.5**	**5.5**	**7.9**
Associate income	0.0	0.0	0.0	0.0	0.0	0.0
Net interest	(0.1)	(0.1)	(0.2)	(0.4)	(0.4)	(0.4)
Normalised Pre-tax Profit	**1.5**	**1.4**	**3.8**	**3.1**	**5.1**	**7.5**
Normalised tax	(0.4)	(0.4)	(1.0)	(0.8)	(1.4)	(2.1)
Profit attributable to minorities	0.0	0.0	0.0	0.0	0.0	0.0
Normalised profit to holders	**1.1**	**1.0**	**2.8**	**2.3**	**3.7**	**5.5**
One off items (post-tax)	0.0	0.0	0.0	0.0	0.0	0.0
Reported profit to holders	**1.1**	**1.0**	**2.8**	**2.3**	**3.7**	**5.5**

Cash Flow Statement (A$m)

Year ended June 30	FY17	FY18	FY19	FY20E	FY21E	FY22E
Normalised EBITDA	**2.4**	**2.2**	**4.9**	**5.4**	**7.7**	**10.1**
Cash net interest	(0.1)	(0.1)	(0.2)	(0.4)	(0.4)	(0.4)
Cash tax (paid)/received	(0.2)	(0.4)	(1.0)	(0.8)	(1.4)	(2.1)
Working capital/other	(0.2)	(1.3)	0.4	(1.8)	(0.5)	(1.9)
Operating Cash Flow	**2.0**	**0.4**	**4.1**	**2.5**	**5.4**	**5.8**
Capex	(0.1)	(0.3)	(3.4)	(0.7)	(2.5)	(2.5)
Payments on finance leases	(0.4)	(0.5)	0.7	(0.7)	(0.9)	(0.9)
Free Cash Flow	**1.5**	**(0.3)**	**1.4**	**1.1**	**2.0**	**2.4**
Disposals/Acquisitions	0.0	0.0	0.0	(1.1)	0.0	0.0
Dividends paid	(0.2)	(0.3)	(0.5)	(0.7)	(1.1)	(1.8)
Equity raised/buybacks	0.0	0.0	0.0	0.0	0.0	0.0
Borrowings/(debt repayment)	0.0	0.0	0.0	0.0	0.0	0.0
Other	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)
Net increase/(decrease) cash	**1.2**	**(0.6)**	**0.8**	**(0.7)**	**0.9**	**0.6**
Cash at beginning	0.8	2.0	1.4	2.2	1.5	2.4
Cash at end (including bank deposits)	2.0	1.4	2.2	1.5	2.4	3.0

Balance Sheet (A$m)

Year ended June 30	FY17	FY18	FY19	FY20E	FY21E	FY22E
Cash	2.0	1.4	2.2	1.5	2.4	3.0
Receivables	4.1	5.4	5.4	6.0	7.2	8.9
Inventories	1.8	2.5	2.5	2.7	3.7	4.6
Current Assets	**7.9**	**9.2**	**10.1**	**10.1**	**13.2**	**16.4**
Property, Plant & Equipment	2.5	3.1	5.9	11.8	13.0	14.1
Intangibles	0.0	0.0	0.0	0.0	0.0	0.0
Other non current assets	0.2	0.3	0.4	0.4	0.4	0.4
Non Current Assets	**2.8**	**3.4**	**6.3**	**12.2**	**13.4**	**14.5**
Total Assets	**10.6**	**12.6**	**16.4**	**22.3**	**26.6**	**31.0**
Payables	1.4	1.9	2.0	1.2	2.9	3.6
Current tax	0.1	0.2	0.4	0.4	0.4	0.4
Employee benefits	0.7	0.8	1.1	1.1	1.1	1.1
Other liabilities	0.0	0.0	0.0	0.0	0.0	0.0
Total debt	1.4	1.9	2.9	7.9	7.9	7.9
Total Liabilities	**3.6**	**4.9**	**6.3**	**10.6**	**12.3**	**13.0**
Shareholder Funds	**7.0**	**7.8**	**10.1**	**11.7**	**14.3**	**18.0**

Directors and Key Management Personnel		Shares	Holding
Wayne Hooper	CEO & Executive Director	10.9m	11.5%
Greg Hooper	CTO & Executive Director	9.3m	9.8%
Philip Suriano	Non Exec Chairman	0.7m	0.7%
Matthew Twist	CFO & Company Secretary	0.1m	0.1%

Major Shareholders (excluding nominees)	Shares	Holding
Hooper Family	44.2m	46.3%
Peachey Family	4.9m	5.2%
Top 20 shareholders	**67.3m**	**70.5%**

Source: Company data, Veritas Research

Valuation Metrics		Valution
Price Target (ps)	$1.001	138%
Share Price (ps)	$0.420	
FY20E EV/EBITDA (x)	8.5	
Implied FY20 EV/EBITDA (x)	18.7	120%
Implied FY21 EV/EBITDA (x)	13.2	55%
Market Capitalisation (A$m)	40.1	
Enterprise Value (A$m)	46.1	

Valuation Multiples

Year ended June	FY17	FY18	FY19	FY20E	FY21E	FY22E
P/E (x)	34.4	40.4	14.1	17.7	10.9	7.5
Price/Cash Flow (x)	19.2	101.1	9.7	16.2	7.4	7.1
EV/Revenue (x)	3.4	2.9	2.0	2.1	1.4	1.1
EV/EBITDA (x)	18.8	20.7	9.4	8.5	6.0	4.5
EV/EBIT (x)	29.2	30.5	11.5	13.1	8.4	5.8
Equity FCF yield (%)	3.7	-0.9	3.5	2.6	5.1	6.0
Dividend yield (%)	1.2	1.4	2.4	2.6	7.1	9.0
EV/capital (x)	7.2	5.5	4.3	2.5	2.3	2.0
Price to book value (x)	5.4	5.0	3.9	3.4	2.8	2.3

Per Share Data

Year ended June 30	FY17	FY18	FY19	FY20E	FY21E	FY22E
EPS diluted - adjusted (¢ps)	**1.22**	**1.04**	**2.97**	**2.38**	**3.87**	**5.63**
EPS diluted (¢ps)	1.22	1.04	2.97	2.38	3.87	5.63
Cash flow per share (¢ps)	2.19	0.42	4.35	2.59	5.65	5.95
Free cash flow per share (¢ps)	1.64	(0.37)	1.48	1.12	2.12	2.48
Cash (¢ps)	2.23	1.48	2.34	1.56	2.50	3.06
Net assets (¢ps)	7.80	8.35	10.72	12.33	14.94	18.47
DPS (¢ps)	0.50	0.60	1.00	1.10	3.00	3.80
Franking (%)	100	100	100	100	100	100
Shares on issue - avg. basic (m)	90	93	94	95	96	97
Shares on issue - avg. diluted (m)	90	93	94	95	96	97

Segmental revenue, EBITDA and margins

Year ended June 30	FY17	FY18	FY19	FY20E	FY21E	FY22E
Services	7.2	10.0	11.2	13.2	19.8	21.8
Product	5.1	5.6	9.1	8.7	10.2	13.2
Tech	1.4	0.0	2.4	0.2	2.8	5.6
Revenue ($m)	**13.8**	**15.6**	**22.7**	**22.1**	**32.7**	**40.6**
Services		38.7	11.3	18.1	50.0	10.0
Product		10.5	62.8	(4.7)	17.0	30.0
Tech				(91.5)	1,275.0	103.8
Revenue growth (%)	**30.8**	**13.8**	**44.9**	**(2.5)**	**48.1**	**24.1**
Services	1.6	2.0	2.6	3.5	5.1	6.0
Product	1.0	0.8	2.7	2.5	2.9	3.9
Tech	0.3	(0.0)	0.3	0.1	0.5	1.2
R&D	(0.4)	(0.5)	(0.7)	(0.6)	(0.8)	(1.0)
EBITDA ($m)	**2.4**	**2.2**	**4.9**	**5.4**	**7.7**	**10.1**
Services	21.7	20.1	23.0	26.3	25.8	27.7
Product	19.5	13.4	29.1	28.2	28.6	29.4
Tech	17.7		14.5	65.0	18.1	21.6
R&D (as % of group sales)	(2.7)	(3.2)	(2.9)	(2.8)	(2.5)	(2.5)
EBITDA margin	**17.8**	**14.3**	**21.6**	**24.6**	**23.5**	**25.0**

Performance Ratios (%)

Year ended June 30	FY17A	FY18A	FY19A	FY20E	FY21E	FY22E
Gross margin	52.3	44.5	47.4	50.1	48.2	49.0
Operating cost margin	34.4	30.2	25.8	25.5	24.7	24.0
Gross profit growth		-3	54	3	43	26
Cost growth		0	23	-4	43	21
Normalised EPS growth		-15	186	-20	63	45
Tax rate	26.3	31.0	26.7	27.0	27.5	27.5
Return on capital	18.4	14.2	30.8	17.7	20.8	26.8

Balance Sheet Ratios

Balance Sheet (A$m)	FY17A	FY18A	FY19A	FY20E	FY21E	FY22E
Gross debt ($ m)	1.4	1.9	2.9	7.9	7.9	7.9
Net cash/(debt) ($ m)	0.7	-0.5	-0.7	-6.5	-5.6	-5.0
Gearing (net debt: capital)	-10	7	6	36	28	22
Fixed charge cover (x)	14.3	2.7	5.1	3.5	5.3	7.3

A compelling rationale for the UST acquisition

LaserBond announced the acquisition of United Surface Technologies (UST) on 15 June 2020. UST operates a thermal spraying workshop in Melbourne specialising in plasma and arc coatings – treatments also offered by LaserBond. It also has a similar customer base comprising of mining, energy and packaging companies. We see LaserBond recouping the cost of the acquisition quickly due to the low multiple paid, the potential for cross selling and improved customer proximity.

LaserBond are acquiring UST for an estimated P/E multiple of 3x in FY21E

LaserBond are to pay $1.1m for UST, funded by working capital. We forecast the acquisition of UST will contribute $0.4m to net income in FY21, implying an acquisition P/E multiple of just 3x (Figure 2). We understand the vendor wanted to sell for personal reasons.

Figure 2: United Spray Technologies income statement forecast

FY21E	$m	% of sales
Revenue	4.5	100%
Gross profit	2.0	45%
EBITDA	0.9	19%
D&A	-0.3	-6%
Interest	-0.1	-2%
Profit before tax	0.5	11%
Tax	-0.1	-3%
Net income	0.4	8%
Acquisition price	1.1	
P/E	3.1	
EV/EBITDA	1.3	

Source: Veritas estimates

The acquisition creates a significant cross-selling opportunity

UST currently do not currently offer the laser or HVOF claddings that LaserBond specialise in. LaserBond plan to add these capabilities. LaserBond also recently hired an experienced laser cladding sales person from a major competitor in Melbourne in order to drive demand for laser cladding services when these are added.

A Melbourne location gives proximity to potential Victorian customers

A Melbourne workshop will make it easier for Victorian clients to access LaserBond's services. Proximity is important for LaserBond's clients as it reduces costs and lead time.

Changes to estimates

Our FY20 revenue forecast falls by 9% due to COVID 19 related delays and changes to customer product specifications

The company also provided an update on the impact of COVID. Increased difficulty in transacting business internationally means a delay to Technology segment revenue we expected to occur in 2H20. Additionally, a major customer in the product division changed its specification – leading to lower orders in 2H20 than expected. The completion of the specification explains the 140% month on month order volume increase in May (Figure 1).

The net impact of these changes is that we expect FY20 revenue and pre-tax profit of $22m and $3.1m respectively, downgrades of 9% and 14% (Figure 3). This comprises of organic revenue growth of 8% in the core product and services division, slightly lower than prior company guidance for double digit growth due to the delays.

Our FY21 revenue forecast rises by 6% on the UST acquisition and due to an increase in organic growth

In FY21 we forecast $4.5m revenue from the UST acquisition (which is all attributed to services); 16% YoY organic revenue growth in the Product and Services division and $2.8m Technology revenue. This gives total revenue of $32.7m, 6% higher than previously forecast. Our pre-tax profit forecast rises by 2%.

Figure 3: Changes to Veritas forecasts for LaserBond

	FY20E			FY21E			FY22E		
Year ended June 30 ($m)	Old	New	Chg(%)	Old	New	Chg(%)	Old	New	Chg(%)
Revenue	24.2	22.1	-8.7	30.9	32.7	5.9	40.2	40.6	1.0
Growth (% YoY)	6.8	-2.5	-9.3	27.7	48.1	20.4	30.1	24.1	-6.0
EBITDA	5.9	5.4	-7.9	7.3	7.7	5.5	10.0	10.1	1.4
Margin (%)	24.4	24.6	0.2	23.6	23.5	-0.1	24.9	25.0	0.1
Profit before tax	3.6	3.1	-14.2	5.0	5.1	2.1	7.8	7.5	-3.2
Normalised dil. EPS (cps)	2.7	2.4	-12.0	3.8	3.9	1.9	5.8	5.6	-3.0
Capex	-0.7	-0.7	-0.6	-1.5	-2.5	66.7	-1.8	-2.5	38.9
Free Cash Flow	2.8	1.1	-62.2	1.7	2.0	19.3	2.9	2.4	-17.0

Source: Veritas estimates

Fair value of $1.00 per share

We are trimming our DCF derived fair value to $1.00 per share versus $1.09 previously. The main reason for the change is the application of a more conservative terminal growth rate of 1.5% versus 2.7% prior. The other primary assumptions are unchanged. These include: a terminal 25% EBITDA margin, capex to depreciation of 1.0x and a WACC of 8.5% (Figure 4).

Figure 4: DCF valuation for LaserBond

Year end June	Units	FY20	FY21	FY22	FY23	FY24	FY25	FY26	FY27	FY28	FY29	TV
Revenue	$m	22.1	32.7	40.6	46.7	51.4	53.9	56.1	57.8	58.9	60.1	61.0
Revenue growth	*%*	*-2.5*	*48.1*	*24.1*	*15.0*	*10.0*	*5.0*	*4.0*	*3.0*	*2.0*	*2.0*	*1.5*
EBITDA	$m	5.4	7.7	10.1	11.7	12.8	13.5	14.0	14.4	14.7	15.0	15.3
EBITDA margin	*%*	*24.6*	*23.5*	*25.0*	*25.0*	*25.0*	*25.0*	*25.0*	*25.0*	*25.0*	*25.0*	*25.0*
EBIT	$m	3.5	5.5	7.9	10.3	11.3	11.9	12.3	12.7	13.0	13.2	13.4
Tax rate	*%*	*27.5*	*27.5*	*27.5*	*27.5*	*27.5*	*27.5*	*27.5*	*27.5*	*27.5*	*27.5*	*27.5*
NOPAT	**$m**	**2.6**	**4.0**	**5.7**	**7.4**	**8.2**	**8.6**	**8.9**	**9.2**	**9.4**	**9.6**	**9.7**
DA	$m	1.9	2.2	2.2	1.4	1.5	1.6	1.7	1.7	1.8	1.8	1.8
Working capital	$m	-1.8	-0.5	-1.9	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0
Capex	$m	-0.7	-2.5	-2.5	-3.5	-2.3	-1.9	-1.7	-1.7	-1.8	-1.8	-1.8
Capex/D&A	*x*	*0.4*	*1.1*	*1.1*	*2.5*	*1.5*	*1.2*	*1.0*	*1.0*	*1.0*	*1.0*	*1.0*
FCF	**$m**	**2.0**	**3.2**	**3.5**	**5.5**	**7.5**	**8.3**	**9.0**	**9.2**	**9.4**	**9.6**	**9.8**
Discount factor	%	92%	85%	78%	72%	67%	61%	56%	52%	48%	44%	
NPV of FCF	**$m**	**1.8**	**2.7**	**2.8**	**3.9**	**5.0**	**5.1**	**5.1**	**4.8**	**4.5**	**4.3**	
Invested capital average		14.4	19.0	21.4	24.0	26.1	27.4	27.9	28.0	28.0	28.0	27.9
ROIC (post-tax)		18%	21%	27%	31%	31%	31%	32%	33%	34%	34%	35%

Item	Units	Value
NPV of the forecast period	$m	40.0
NPV of terminal value	$m	61.6
NPV of cash flows	**$m**	**101.6**
Less: net debt	$m	-6.1
Fair value of equity	**$m**	**95.5**
Fair value of equity per share	**$ps**	**1.00**
Share count	m	95

Item	Units	Value
WACC	%	8.5
Terminal growth	%	1.5
Terminal EBITDA margin	%	25.0
Terminal value nominal	$m	139
Terminal EV/EBITDA	x	9.1
Terminal EV/NOPAT	x	14.3

Source: Veritas estimates

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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