Canaccord Genuity Capital Markets

Initiation of Coverage

LaserBond Limited

Industrial Technologies

16 September 2020

Rating	Price Target
BUY	**A$0.90**
LBL-ASX	Price **A$0.53**

Market Data

52-Week Range (A$) :	0.23 - 0.97
Avg Daily Vol (000s) :	0
Market Cap (A$M) :	50.6
Shares Out. (M) :	95.4
Dividend /Shr (A$) :	1.10
Dividend Yield (%) :	2.1
Net Debt (Cash) (A$M) :	(0.4)
Enterprise Value (A$M) :	86.1
Cash (A$M) :	4.0
Long-Term Debt (A$) :	2.8

FYE Jun	2020A	2021E	2022E	2023E
Sales (A$M)	22.2	30.8	40.2	47.7
EBITDA (A$M)	6.2	8.1	9.9	11.6
Net Income Adj (A$M)	2.8	3.7	5.1	6.1
EPS Adj&Dil (A$)	0.03	0.04	0.05	0.06
EPS Growth (%)	0.0	34.2	35.1	23.7
DPS (A$)	0.01	0.01	0.01	0.01
P/E (x)	19.1	14.2	10.5	8.5
EV/EBITDA (x)	12.1	10.7	8.9	7.4
Div. Yield (%)	2.1	2.3	2.5	2.8

Source: FactSet

Priced as of close of business 15 September 2020

LaserBond engages in the reclamation and surface engineering of industrial components operating in severe environments and critical applications. It operates three business segments: the Services segment remediates a customer's own equipment; the Product segment produces new finished products; the Technology segment sells and licences the company's proprietary innovations. The company was founded in 1992 and has operations in NSW, Victoria and South Australia.

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Not even scratching the surface of what's possible

Investment Recommendation

LaserBond is a successful Australian engineering technology business that has grown its revenue organically at double-digit rates over a number of years. The quality of its work has cemented a high-quality customer base, which we think ensures repeat and growing business. Some time ago, the board established a revenue target of $40m in FY22, which would see revenues nearly double over the next two years. COVID-19 impacts mean that a small acquisition would lend a helping hand but, excluding that, we view the growth outlook in both revenue and earnings as robust. In addition to the current trajectory, the business has further growth options in int'l markets, where it has already made headway. Expanding operations to resource-rich states would also open up new opportunities both with existing and new customers. Our forecasts are consistent with mgmt's objectives, leading to strong projected EPS growth. The balance sheet is clean, with debt backed by equipment purchases and no goodwill. We value the business based on its growth outlook and believe it has the potential to increase significantly in value. Hence, we initiate with a BUY rating and a $0.90 TP.

Financial performance and strategy

LBL reports three segments: (1) Services - offering surface treatments to customers' parts which have worn out from use; (2) Products - the sale of surface-treated components produced by LBL and marketed to customers, with the successful steel mill roll a notable example; and (3) Technology - the sale of equipment, licences and consumables to customers in international markets. LBL has experienced strong growth in recent years, more than doubling revenue in the FY16-20A period, for a 21% pa CAGR. Strong earnings growth, incl. operating leverage, has accompanied that revenue growth. Services and Products have been the main drivers of growth, with Technology remaining at a somewhat nascent stage. Some time ago, LBL announced an objective of reaching $40m revenue in FY22, almost double FY20's $22m. All three segments have an important role to play in that growth, with new facilities in Victoria opening further capacity in Services; the US steel markets offering business development opportunities in the Products segment and the intent to sell up to two Technology packages pa to boost revenue in that area. The balance sheet is pristine, with only $21k of intangible assets (and no goodwill), and, excluding lease liabilities, $0.4m of net cash. The $5m debt on the balance sheet comes from equipment financing arrangements.

Forecasts

We have reflected the company's ambition to reach $40m revenue in FY22, although we put more emphasis on FY22 for growth given the ongoing restrictions around COVID-19, which inhibited growth somewhat in FY20. We estimate the recent United Surface Technology (UST) acquisition will contribute around $4-5m to the FY22 $40m forecast revenue total - not envisaged when the objective was originally struck but still implying underlying revenue growth at 26% pa over the next two years. Sales of new LBL-created Products should be important drivers of underlying revenue growth, along with continued consistent performance from Services and re-establishment of new sales in the Technology segment. We expect earnings to grow with revenue, with NPAT and EPS growth, around 30% CAGR.

Valuation & view

We believe LBL's shares very much fit into the "GARP" category, offering compelling value for investors given the company's growth profile and a clean balance sheet. At the $40m revenue level in FY22F, the shares are trading on PER and EV/EBITDA multiples of 10.5x and 8.9x, respectively. We believe a market-based multiple would not be unreasonable, but, given the modest profile and liquidity of the shares, we apply a 15% discount for a $0.90 per share target price, and we initiate with a BUY recommendation.

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The recommendations and opinions expressed in this research report accurately reflect the research analyst's personal, independent and objective views about any and all the companies and securities that are the subject of this report discussed herein.

For important information, please see the Important Disclosures beginning on page 23 of this document.

Figure 1: LaserBond financial summary

LaserBond Limited				
Profit & Loss ($m)	**2020A**	**2021F**	**2022F**	**FY23F**
Revenues	**22.2**	**30.8**	**40.2**	**47.7**
Gross profit	10.3	15.1	18.6	21.6
EBITDA	**6.2**	**8.1**	**9.9**	**11.6**
D & A	-2.0	-2.6	-2.6	-2.6
EBIT	**4.2**	**5.5**	**7.3**	**9.0**
Net Interest Expense	-0.4	-0.4	-0.4	-0.3
NPBT	**3.8**	**5.1**	**7.0**	**8.7**
Tax expense	-1.0	-1.4	-1.9	-2.6
NPAT underlying	**2.8**	**3.7**	**5.1**	**6.1**
Post tax NRI's	0.0	0.0	0.0	0.0
NPAT reported	**2.8**	**3.7**	**5.1**	**6.1**
EBITDA Margin (%)	*27.9%*	*26.3%*	*24.6%*	*24.3%*
EBIT Margin (%)	*19.0%*	*17.9%*	*18.3%*	*18.9%*
NPAT Margin (%)	*12.6%*	*12.0%*	*12.6%*	*12.7%*
Cash Flow ($m)	**2020A**	**2021F**	**2022F**	**FY23F**
Operating EBITDA	**6.2**	**8.1**	**9.9**	**11.6**
Change in working capital	-0.5	-2.6	-2.7	-2.2
Interest	-0.4	-0.4	-0.4	-0.3
Tax	-1.0	-1.4	-1.9	-2.6
Other	0.0	0.0	0.0	0.0
Operating Cashflow	**4.3**	**3.7**	**4.9**	**6.5**
Capex	-0.6	-2.5	-1.5	-1.5
Acquisitions	-2.0	-1.0	0.0	1.0
Sale of assets	0.0	0.0	0.0	0.0
Investing cash flow	**-2.6**	**-3.5**	**-1.5**	**-0.5**
Dividends	-0.6	-0.8	-0.8	-0.9
Equity issued	0.0	0.0	0.0	0.0
Change in borrowings	0.0	2.7	0.2	0.2
Lease payments	-1.2	-1.7	-1.8	-1.8
Financing cash flow	**-1.9**	**0.2**	**-2.4**	**-2.5**
Net Cashflow	**-0.2**	**0.4**	**1.1**	**3.4**
Cash at beginning of period	2.2	4.5	7.5	6.0
Cash at end of period	4.5	7.5	6.0	6.8
Balance Sheet	**2020A**	**2021F**	**2022F**	**FY23F**
Cash	4.0	4.4	5.5	7.9
Debtors	4.4	6.1	8.0	9.4
Inventory	3.5	4.8	6.3	7.4
PPE	6.6	8.5	8.5	8.5
Intangibles	0.0	0.0	0.0	0.0
Right of Use Assets	4.7	5.4	6.2	7.0
Other assets	0.4	0.4	0.4	0.4
Total Assets	**23.6**	**29.7**	**34.8**	**40.6**
Borrowings	3.6	6.3	6.5	6.7
Trade Creditors	1.3	1.7	2.4	2.9
Lease liabilities	4.9	4.9	4.9	4.9
Other Liabilities	1.6	1.6	1.6	1.6
Total Liabilities	**11.4**	**14.5**	**15.4**	**16.0**
NET ASSETS	**12.2**	**15.2**	**19.4**	**24.6**
Board of Directors / Substantial Shareholders				
Board of Directors		**Shareholding (m)**		**%**
Philip Suriano, Chairman		0.8		0.8%
Wayne Hooper, CEO		11.1		11.5%
Matthew Twist, Executive Director		0.1		0.1%
Significant shareholders				
Diane Hopper		9.8		10.2%
Greg Hooper		9.3		9.7%
Rex Hooper		7.2		7.6%
Lillian Hooper		6.2		6.5%

Source: Company Reports, Canaccord Genuity estimates

			Target Price	**$ 0.90**
			Share Price	**$ 0.53**
Valuation ratios	**2020A**	**2021F**	**2022F**	**2023F**
EPS underlying (cps)	2.8	3.7	5.0	6.2
EPS Growth (%)	*0%*	*34%*	*35%*	*24%*
P/E (x)	19.1	14.2	10.5	8.5
Enterprise Value ($m)	75	86	88	86
EV/ gross profit	7.3	5.7	4.7	4.0
EV / EBITDA (x)	12.1	10.7	8.9	7.4
EV / EBITA (x)	17.8	15.7	11.9	9.5
DPS (cps)	1.1	1.2	1.3	1.5
Dividend Yield (%)	2.1%	2.3%	2.5%	2.8%
Payout Ratio	40%	32%	26%	24%
Franking (%)	100%	100%	100%	100%
FCFPS - excl acq. (cps)	1.9	1.2	3.6	5.1
P / FCFPS (x)	48.6	73.7	25.3	17.6
Dupont Analysis	**2020A**	**2021F**	**2022F**	**2023F**
Net Margin	12.6%	12.0%	12.6%	12.7%
Asset Turnover	1.1	1.2	1.2	1.3
ROA (%)	14.0%	13.9%	15.7%	16.1%
Financial Leverage	1.8	1.9	1.9	1.7
ROE (%)	25.2%	27.0%	29.3%	27.6%
Balance Sheet ratios	**2020A**	**2021F**	**2022F**	**FY23F**
Net debt/ (cash)	-0.428	0.5	-0.6	-3.0
Net debt/ EBITDA	net cash	0.1	net cash	net cash
NTA per share ($)	0.13	0.16	0.20	0.25
Price / NTA (x)	7.0	5.7	4.5	3.6
EFPOWA (m)	95.0	95.9	96.7	97.7
Growth ratios	**2020A**	**2021F**	**2022F**	**FY23F**
Sales revenue	-2%	39%	31%	19%
EBITDA	30%	31%	22%	17%
EBIT	9%	31%	34%	23%
PBT	2%	35%	36%	25%
NPAT	6%	32%	37%	20%
$m	**2020A**	**2021F**	**2022F**	**FY23F**
Services	12.8	18.1	21.8	24.7
Products	9.2	11.0	13.7	15.8
Technology	0.2	1.7	4.6	7.2
Group revenue	**22.2**	**30.8**	**40.2**	**47.7**
Valuation				
One-year forward PER, Small Ords		20.7		
Discount		15%		
Target mutliple		17.6		
FY22F EPS		5.0		
Valuation		0.88		

Description

LaserBond engages in the reclamation and surface engineering of industrial components operating in severe environments and critical applications. The firm also provides thermal spraying, laser cladding, and welding technologies. It operates through the following business segments: Services, Product, and Technology. Broadly speaking the Services segment remediates a customer's own equipment; the Product segment produces new finished products and the Technology segment sells and licences the company's proprietary innovations. The company was founded in 1992 and has operations in New South Wales, Victoria and South Australia.

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Investment case

Value-added solutions for customers

LBL's surface engineering solutions offer customers genuine value in reclaiming and rejuvenating components which have worn out from use. Frequently returning products to customers with better performance characteristics than when new, LBL provides more certainty and less downtime for key processing equipment. LBL's wide array of services, highlighted by its laser cladding technology, means customers can select the optimum surface treatment based on budget, wear profile and required longevity. By lengthening the useful life of equipment and reducing total cost of ownership, LBL's products and services attract a significant amount of repeat customer work. LBL also contributes to wider societal benefits of reducing waste and scrap of worn components, with accompanying energy savings.

Revenue and earnings growth

To support its growth ambitions, LBL has articulated a clear strategy built around improving its capacity and capabilities through investment in people and equipment; geographic expansion to service customers closer to their operations; development of new products; and the licencing of LBL's technology in international markets. LBL has an established reputation for robust revenue growth over the last five years, and we expect it to continue with an objective to reach $40m revenue in FY22. Levers to deliver this growth include:

- Developing new markets in its Products division, with well-accepted steel mill rolls among the hero products with strong overseas potential.
- Widening its domestic offering by increasing both services offerings and its geographic presence.
- Continued investment and development of the group's flagship laser cladding technology.
- Further develop the Technology sales programme, which delivers equipment sales but also ongoing licence and consumables revenues.

Potential for accretive acquisitions

LBL's growth in recent years has been entirely organic. However, we believe there is scope for LBL to expand into resource-rich states, Western Australia and Queensland. Whilst LBL does carry out a significant amount of work for customers from those areas, downtime is a major consideration for operators, and transit times to and from repair facilities matter. Having a local presence in these states may also open up more business opportunities for LBL. The acquisition of United Surface Technology's assets in Victoria provides an ideal template where LBL can take on an existing business and augment its offering through the addition of laser cladding cells and other processes.

Pristine Balance Sheet

Excluding AASB16 lease liabilities, the only debt on the balance sheet is equipment financing, totalling $3.6m, with a closing FY20 cash balance of $4.0m. There are only $20k of intangibles and no goodwill on the balance sheet. As a result of its clean and uncluttered balance sheet, LBL's returns on capital are impressive, sitting comfortably above 20%.

Valuation

We believe LBL's shares very much fit into the "GARP" category, offering compelling value for investors given the company's growth profile and a clean balance sheet. At $40m revenue in FY22F, the shares are trading on PER and EV/EBITDA multiples of 10.1x and 8.7x, respectively. We believe a market-based multiple would not be unreasonable, but, given the modest profile and liquidity of the shares, we apply a 15% discount for a $0.90 per share target price, and we initiate with a BUY recommendation.

LaserBond Company profile

Founded in 1992, LaserBond (LBL) is a materials science technology business specialising in the application of sophisticated coating solutions to components that have suffered wear in the harshest of industrial environments, such as mining, minerals processing and steel manufacture. The repair, reclamation and rejuvenation of the surface-treated component often results in a product with better performance characteristics than a brand-new item. LBL operates in a fragmented market characterised by end users who may carry out remediation work of the own; by OEMs offering some repair services and by specialists like LBL who offer high-end services not undertaken by the other two groups. Headquartered in New South Wales with operations in South Australia and, most recently, Victoria, we believe LBL has the opportunity to develop its business further by extending its operations closer to customers in resource-rich states like Western Australia and Queensland. The recent purchase of the assets of United Surface Technologies (UST) offers a possible template for further domestic expansion by acquiring existing businesses to which LBL can augment its expertise in areas like Laser Cladding. The quality of LBL's work is evident in its blue-chip customer base, which boasts BHP, Rio Tinto, Caterpillar, BlueScope, Alcoa and Nucor.

LaserBond's Products & Services

Founded in 1992, LaserBond (LBL) is a specialist surface engineering company focusing on the development and application of materials, technologies and methodologies to improve operating performance and life cycle of machinery and parts in capital-intensive and heavy industrial applications like resources and energy, agriculture, advanced manufacturing, defence and infrastructure construction.

Within these industries, wear of components can have a profound effect on the productivity and total cost of ownership of a business's capital equipment. Many components fail at their surface due to abrasion, erosion, corrosion, cavitation, heat and impact. Bespoke surface metallurgical solutions can extend equipment life and, potentially, improve performance, even compared to new, after a suitable surface treatment.

LBL's growth has been based on innovation and technology leadership in three surface engineering foundations:

- The study of friction, wear and the performance of surfaces (tribology) in relative motion in heavy industrial settings.
- The metallurgy and science of high-performance materials.
- The optimisation of a wide range of materials and application methodologies.

Customers are typically internationally recognised Original Equipment Manufacturers (OEMs) and capital-intensive heavy industries that require high levels of equipment availability.

We believe LBL's customer base is an endorsement of the quality of the business's work and includes leading mining companies and the businesses that support them. We note, also, three major steel manufacturers in Alcoa, BlueScope and Nucor among the Manufacturing sector customers, offering validation of LBL's steel mill roll products, which are an important part of the international growth strategy.

Figure 2: A sample of LaserBond's customer base

Source: Company Reports

LaserBond's Technologies

LBL's surface technology centres around the creation of two types of bonds between a coating material and the surface of the component or part to be treated: mechanical and metallurgical bonds, with the choice, and cost, depending on the use and wear environment.

Mechanical Bonds versus Metallurgical Bonds

Metallurgical bonding is the result of chemical bonding that occurs between a substrate and coating areas that are in close contact or diffused evenly.

A mechanical bond is an entanglement in space between two or more component parts, such that they cannot be separated without breaking or distorting chemical bonds between atoms. It follows that a mechanical bond is as strong as the weakest participating chemical bond.

LBL offers many types of surface treatments, but we highlight two particularly important processes in the business: Laser Cladding and High-Pressure High Velocity Oxygen-Fuel (HVOF) spraying.

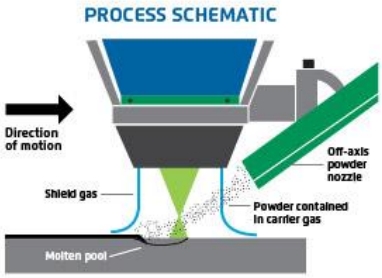
Laser Cladding

Laser cladding is the process of treating a metallic surface, which is melted for a very short period of time to enable the encapsulation of a cladding material (metallic or ceramic powder particles). A controlled laser beam is scanned over the substrate to melt and solidify the cladding material.

The cladding material solidifies rapidly, giving microstructures characterised by fine grain size and a uniform dispersion of microconstituents such as carbides or nitrides. Because of low heat input of the laser cladding process, distortion of the component is negligible, which is a very desirable feature.

A wide range of coating thicknesses is achievable and almost any size of component can be treated. This process is applicable to ferrous or non-ferrous metals and alloys. Laser cladding offers the possibility to develop deeply hardened surfaces up to 1 mm.

Figure 3: Laser cladding process



Source: LaserBond

Benefits of Laser Cladding:

- Limited dilution of coating for maximum purity and performance
- Precise, fully fused deposit layer
- Short processing time minimises heat spread and impact
- Improves component wear performance
- Cost effective component-life extension
- Can be used to reclaim worn or fatigued components
- Reduces maintenance and part replacement costs
- Suitable for sensitive components

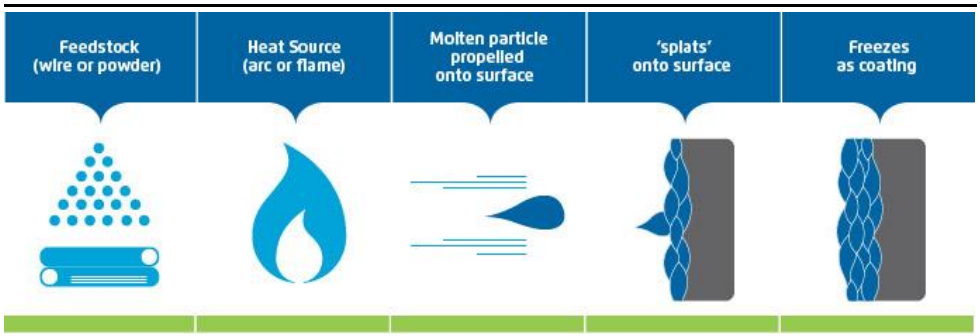
Applications for Laser Cladding:

- High erosion from liquid or gas flows
- High impact conditions
- Part-to-part wear and abrasion

High Pressure High Velocity Oxygen-Fuel (HVOF) spraying

HVOF is a thermal spray coating process whereby a coating material – often molten powder – is propelled at high velocity and pressure onto the surface of the component to be treated, with the coating material creating a chemical, rather than metallurgical, bond with the substrate.

Figure 4: HVOF spraying process



Source: LaserBond

Benefits:

- No dilution or distortion of components
- Wide range of coatings available, including ceramic and cermet
- Corrosion protection

- Electrical insulation
- Cost-effective life extension

Applications

- Knife edges, blades and cutting tools
- Wear surfaces
- Part-to-part sliding abrasion sites

Comparison of surface treatment techniques

- The choice of surface treatment is a balance between the customer's requirement for performance and budget. Laser Cladding, which is a metallurgical bond, offers the optimum performance but is also more expensive than Thermal Spraying and may not be required for the use case.
- The table below, from a 2017 literature review, offers a concise side-by-side comparison of the techniques.

Figure 5: Comparison of surface treatment techniques

Process	Thermal Spraying	Laser Cladding
Heat Source	Combustion flame, electric plasma arc	High intensity laser radiation
Bond Strength	Low to moderate, mechanical bonding	High metallurgical bonding
Coating structure	Lamellar, from porous to nearly dense	Dense, crack and pore-free layers
Heat load to work piece	Very low to moderate	Low to moderate
Dilution	Nil	Low
Coating thickness	0.05-several millimetres	Typically, 0.5-3mm
Coating materials	Wide range of metals, alloys, hard metal, ceramics, polymers	Metals and alloys, alloys with hard particles, hard metals, ceramics
Productivity	Low to high	Low to moderate/ high
Cost	Low to high	Moderate to high

Source: Comparison of Laser Cladding and Thermal Spraying Techniques Used For Wear Control. 2017. Singh, Garg, Goyal, http://ijoes.vidyapublications.com/paper/Vol25/27-Vol25.pdf

Laser Cladding Case Study: Mining Boom Cylinder Reclad and Repair

Road headers are flexible rock cutting machines widely used in mining, tunnelling and civil applications to cut soft-to-medium rock formations. The basic machine may be configured with a range of cutting heads to suit the application.

Within the boom a large diameter hollow hydraulic ram supports the rotating head, contains the driveline, and provides the thrust that keeps the cutters advancing into the rock face.

Damage to the hard chrome arises from impact abrasion and corrosion. Internal bearing surfaces wear with contamination of dust particles. This results in oil seal failure, machine downtime and lost productivity.

Laser cladding with advanced materials returned the ram to better-than-OEM standard at less cost.

Problem

- It is very difficult to protect the surface of the ram from rock cuttings and fine abrasive particles as impacts can dent the surface and chip the hard chrome.
- Hard chrome is a porous coating and in wet environments the moisture initiates rusting of the substrate steel, which results in delamination of the chrome coating.
- The nature of use often localises the wear into a narrow band.
- Internal driveline bearing surfaces wear and fail.
- Wear and damage to the ram surface damages the oil seal, which causes a deterioration in performance, and, importantly, oil is a pollutant.

Solution

- Hard chrome was machined from the damaged ram to prepare a clean substrate for subsequent laser cladding process. Internal machining prepares surface for cladding.
- Suitable cladding material was selected for the application's primary failure mechanism, in this case corrosion and impact resistance. Internal bearing surfaces were clad with different metallurgy.
- After laser cladding, the ram was machined in high capacity lathes and borer machines to restore OEM dimensions.

Benefits

- Better-than-OEM surface metallurgy provides longer wear life.
- Road headers can be worked harder for longer.
- Less downtime and maintenance costs.

Source: Company website

Case Study: Agricultural product conveyors

Pneumatic conveying and spreading of mulch, soil, sand and aggregate is a rapidly expanding application globally. One operator and blower truck can perform the tasks of many workers at a much greater level of safety.

Transport infrastructure requires the distribution of soil, sand, mulch and seeding over large areas. Another rapidly growing application is green roofs on urban and high-rise developments requiring high pressure blowers to convey product up to the height of many stories and onto the roof.

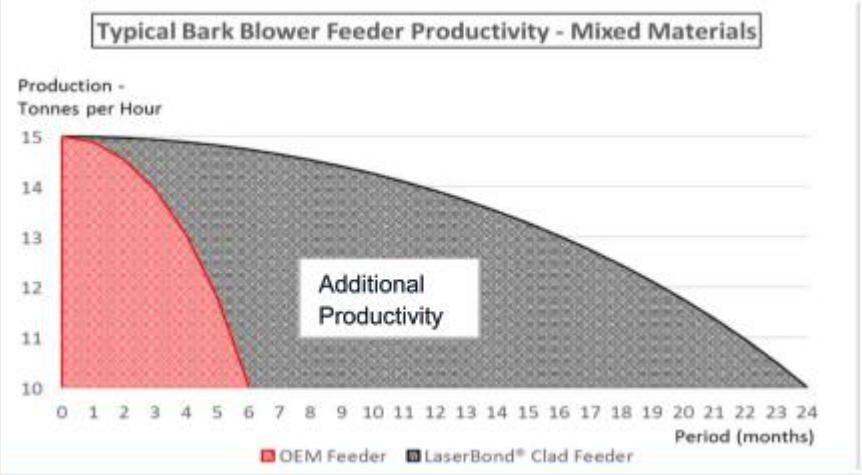
LaserBond manufactures replacement feeders for a local exchange service and is opening up export markets.

Problem

- Blower productivity is highly dependent on the condition of the seal on the rotary feeder which conveys material into the high-pressure zone for blowing.
- Conveying aggressive materials such as sand and gravel leads to accelerated wear in OEM feeders, lost productivity and high costs.

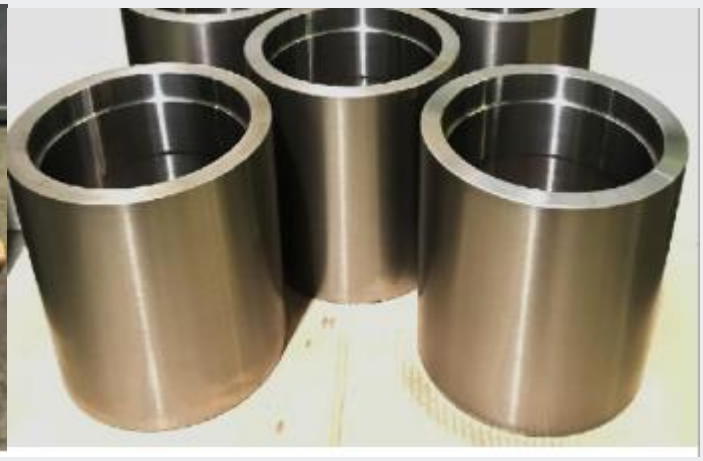
Solution

- LaserBond's surfaced engineered rotary feeders lead to a dramatic reduction in the wear rate. LBL's surface engineering performance has been proven over many years with customers enjoying 4-10x service life and dramatic improvements in throughput and productivity while delivering significant cost reductions.



Source: LaserBond company presentation

Case Study: Steel Mill Rolls



Rollers are an essential component of the steel making process conveying hot material between the forming and shaping processes. Rollers are designed with very specific applications depending on the final steel form and attributes required.

Due to heat, impact and friction, standard rollers wear rapidly and are a source of major production losses due to maintenance closures for replacement or refurbishment.

Problem

- Steel mill roller longevity is highly dependent on the surface engineering of the product. Too hard and the product risks cracking; too soft and it will wear prematurely.
- These two conditions need to be optimised with the roller usually operating in a very high temperature environment.
- LaserBond's task was to design bespoke mill rollers for every task and application to meet customers' functional requirements whilst saving maintenance, time and money.

Solution

- LaserBond surface engineered steel mill rollers and shells with a composite carbide, leading to a dramatic reduction in wear rates. LaserBond's surface engineering performance has been proven over many years, with customers seeing up to 20x the service life of standard OEM rolls, thereby delivering significant cost savings.

Product potential

- After proving out the product in the domestic Australian market, LaserBond is now targeting the much larger US sector, where there are more than 140 mills in operation.
- Until LaserBond's products became available, no comparable, ***laser clad*** composite carbide rollers were available in market.
- Within a short time frame, more than 10% of North American steel mills now buy LaserBond's steel mill rollers.

Source: LaserBond company presentation

LaserBond's Business segments

LBL segments its revenues three ways:

Services – repair, remediation and restoration of existing customer equipment that has worn down in service. LBL takes the part and restores it, often back to a better state than it was when new.

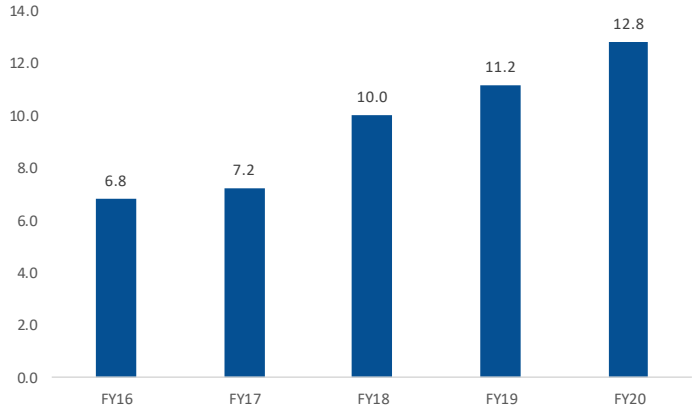
Products – new products that LBL manufactures and markets to end customers. A key product, which has gained wide acceptance domestically with the potential for international expansion, is steel rolls for use in steel mini mills. Like the proposition of the Services segment, LBL's products offer significantly longer life than existing products but priced at a level offering significant value to the customer.

Technology – LBL sells equipment, along with a recurring licence fee, and supplies consumable materials to customers in international markets where LBL is unlikely to establish a presence.

Services

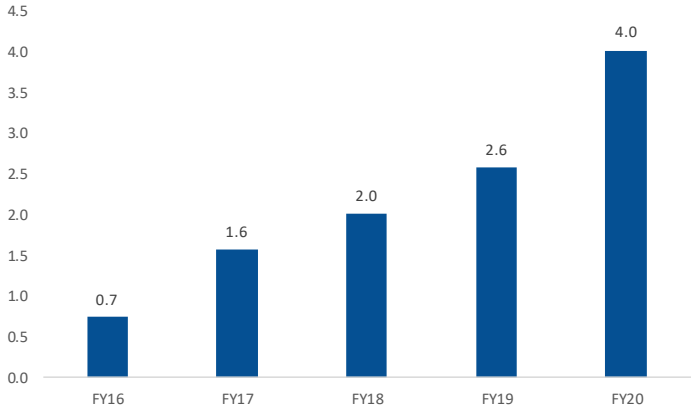
LBL's Services division has been a very steady performer over the last five years, nearly doubling revenues between FY16-20A at an all-organic CAGR of 17% pa. At the same, EBITDA has also increased at a rapid rate, albeit the FY20A figure is distorted upwards by the introduction of AASB16 accounting. Nonetheless, the segment's EBITDA margin increased from c10% in FY16 to 23% in FY19, on a consistent accounting basis and representing a 43c drop-through of every incremental dollar of revenue to the EBITDA line.

Figure 6: Services Division revenue, FY16-20A



Source: Company Reports

Figure 7: Services Division EBITDA, FY16-20A

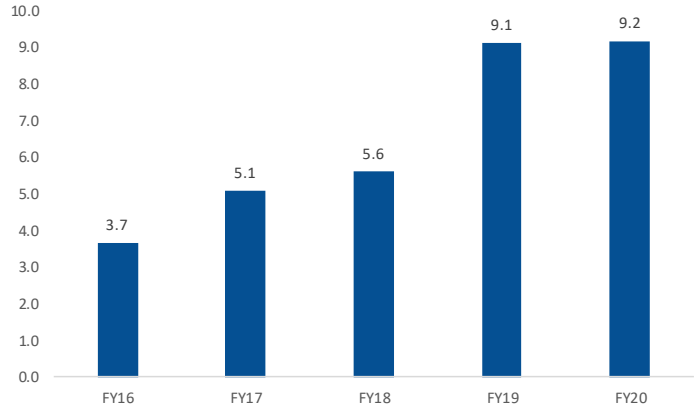


Source: Company Reports

Products

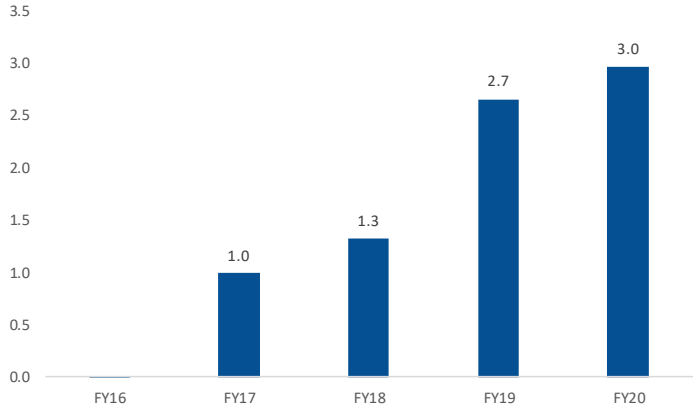
The Products segment has also grown its revenue materially since FY16, albeit with a less smooth trajectory. FY20A's $9.1m revenue was flat yoy, with growth held back by changes a specification by an OEM customer – work which will now be completed in 1H FY21. Earnings have also grown rapidly in the segments, from approximately break-even in FY16 to $3m EBITDA in FY20A. Operating leverage is also in evidence here as around 50c of every incremental dollar of revenue between FY16-19 (i.e., the period prior to AASB16) dropped to the EBITDA line.

Figure 8: Products Division revenue, FY16-20A



Source: Company Reports

Figure 9: Products Division EBITDA, FY16-20A

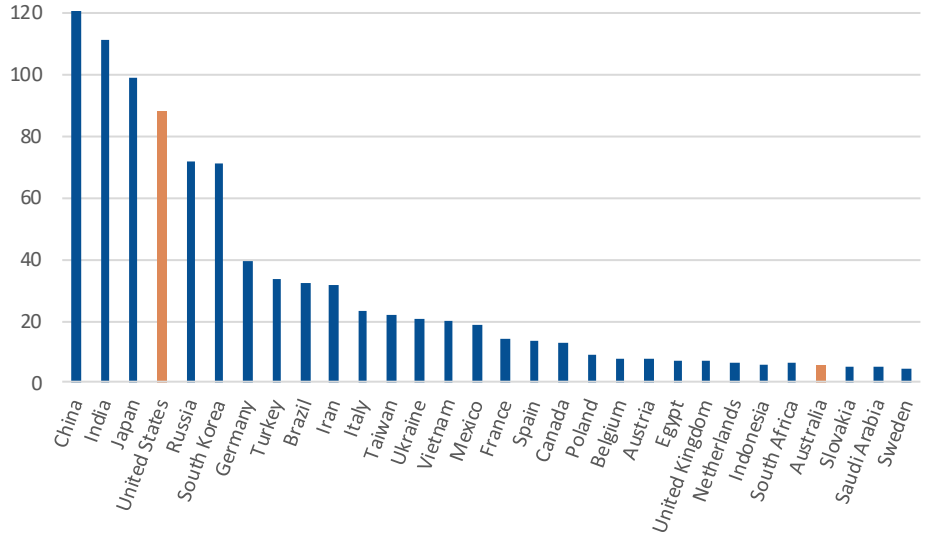


Source: Company Reports

Targeting US steel market

A key target market for the Products segment is the US steel market, which LBL management estimates is around fifteen times larger than the Australian market, as shown in Figure 11. Whilst LBL is able to highlight Alcoa and Nucor as customers, we understand procurement is decentralised among large US steel producing groups, offering significant upside for LBL in that important market.

Figure 10: Steel Production by country, 2019 (millions of tonnes)



Source: World Steel Association

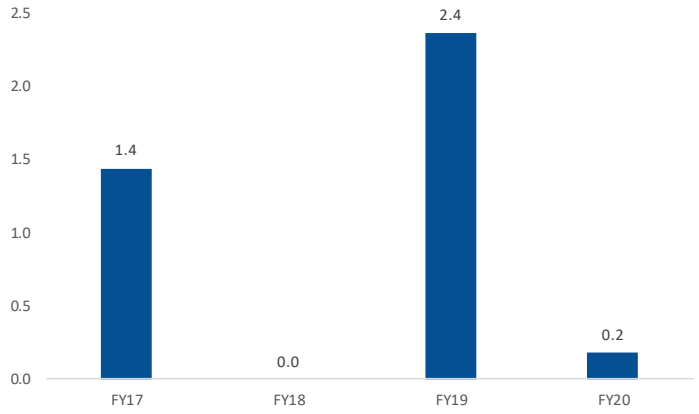
Technology segment

The Technology segment recorded its first revenue in FY17 with sale of equipment to a minerals processing equipment manufacturer. The next major sale was in FY19, with the agreement having been signed in FY18. That $2.4m of revenue comprised $1.9m for the sale of equipment and $0.4m for the sale of consumable items.

The FY19 Annual Report detailed the plan for the sale of LBL's laser cladding equipment, either off-the-shelf or bespoke, with the former expected to attract revenue in the $1.2-1.7m range. At the time, the plan was to complete another

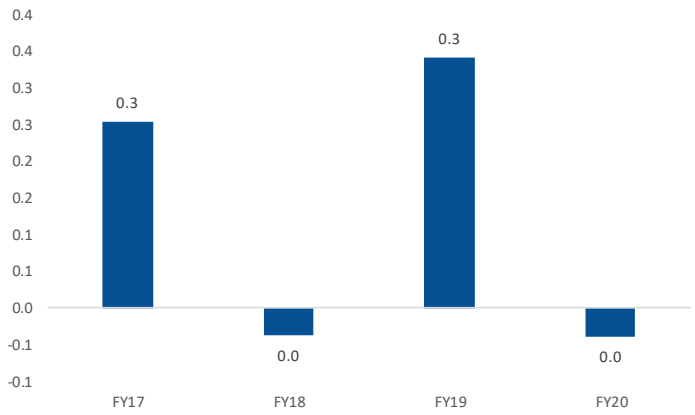
equipment sale in FY20, which did not eventuate, thereby causing a drag on revenue in FY20, where revenue was confined to licence fees and consumables. As part of the drive towards $40m revenue in FY22, the base plan is for two equipment sales each year.

Figure 11: Technology Division revenue, FY16-20A



Source: Company Reports

Figure 12: Technology Division EBITDA, FY16-20A

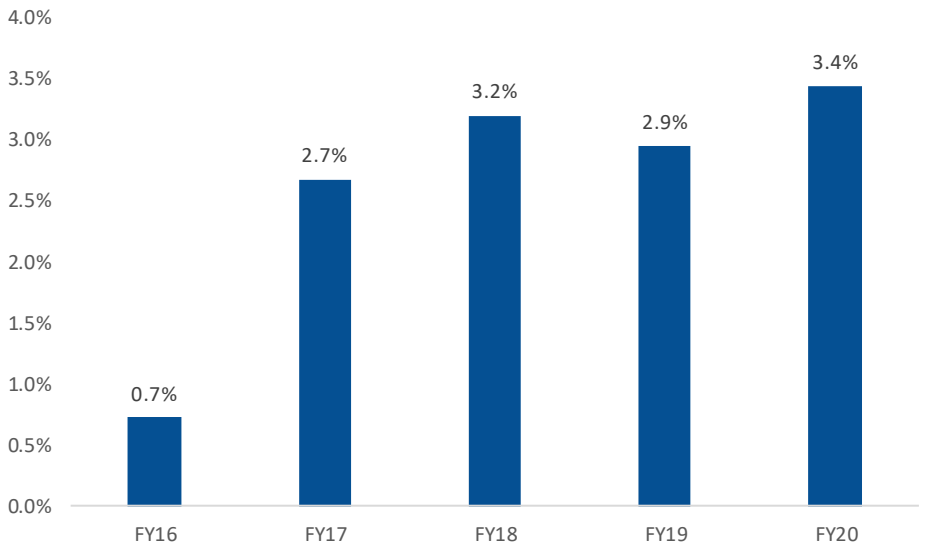


Source: Company Reports

Research & Development

Over the last four years, LBL has invested around 3% of its revenues in R&D, rising to 3.4% in FY20.

Figure 13: R&D spend as a proportion of revenue



Source: Company Reports, Canaccord Genuity estimates

Current areas of focus for the R&D group are:

Hard Chrome Replacement: chrome plating is an environmentally and occupationally hazardous process and therefore there is pressure from regulators to reduce and eliminate hexavalent chromium in industrial processes. LBL has developed specific solutions which offer superior in-use performance. LBL estimates that chromium plating is an estimated $1.2bn per annum global market and offers a

significant opportunity across the business. Recent company communications highlight hard Chrome replacement as a key initiative for FY21.

Drilling and Exploration: During FY20 LBL completed a project focusing on lifetime improvements for components used in explorative drilling with the University of South Australia (UniSA) and Boart Longyear. New surface engineering and additive manufacturing solutions demonstrated a substantial gain in life over conventional products.

Minerals processing: LBL will work with UniSA and a global OEM on mining and minerals processing that tackle wear and corrosion loads under the harshest environments. Successful applications would offer global opportunities for LBL.

Rail: LBL will partner with Monash University, ANSTO and Yarra Trams to study repair of damaged rail components with a view to significantly reduce rail maintenance costs.

Surface engineering control systems and additive manufacturing (SEAM): The SEAM project is supported by the Australian Research Council (ARC) and focuses on applied research. Working again with UniSA, LBL is developing 3D manufacturing from the laser cladding process. A second project looks at process control within the laser cladding process with a view to improving process stability. The final plank of the collaboration with SEAM and ARC is for LBL to develop a skilled workforce – a necessity for the business to continue its growth trajectory.

Balance sheet cash flow and dividend

We reviewed the historic performance of the segments in the previous section. The balance sheet is pristine, with only $21k of intangible assets (and no goodwill), $4m of cash, $3.6m of equipment lease liabilities and $4.9m of AASB16 lease liabilities.

Depreciation policy is conservative, with the written-down value of capital equipment negligible after around five years.

In keeping with a business with fast-growing revenues, LBL has seen working capital outflows in four of the past four financial years. Capital expenditures are modestly proportioned, averaging around 3% of revenue in years where no major capital equipment purchases are planned. The acquisition of the assets of UST as well as the procurement of a laser cladding cell for that facility, an automated laser cladding cell for NSW and a horizontal borer for SA sees a commitment of at least $2.85m in FY21, financed through existing facilities. LBL has secured a grant from the Manufacturing Modernisation Fund to part-finance the automated laser cladding cell in NSW.

LBL pays a fully franked dividend, and, although there is no formal policy, the payout has risen each year from FY16-20A, increasing from 0.4c per share to 1.1c per share over the period. The DRP has been well-supported, averaging around 33% participation over recent years.

Capex outlook

The company has committed to the purchase of a number of assets that will be funded through existing equipment financing facilities. The commitments total $2.85 million and include the purchase of the assets of UST in Victoria, an automated laser cladding cell for the NSW facility, a laser cladding cell for Victoria and a horizontal borer for the SA facility.

LaserBond's strategy

Geographic expansion

Push further into existing and new markets.

- The acquisition of United Surface Technologies in Melbourne widens market reach into Victoria and Tasmania.
- Further growth expected to be generated by integrating LBL's laser cladding technology capability into Melbourne facility – expected in 3Q FY21.
- Augmentation of sales capacity with recruitment of a Victorian representative in Melbourne.
- Consideration of additional bolt-on facilities in other key states as opportunities arise.
- Continued expansion into international markets for products.

Capacity & Capability

Invest in people and equipment to improve margins and build productivity.

- The purchase of a large Computer Numerical Control (CNC) vertical borer in FY20 opens up new business opportunities, increases internal capability, improves margins and lessens reliance on subcontractors.
- Similarly, the purchase of a new larger Okuma CNC lathe in FY20 improved capabilities in the production of larger rolls for steel and other industries, also improving margins and reducing reliance on subcontractors.
- Planned equipment purchases for FY21 include the automated LaserBond cladding cell in NSW (with federal government support under the Manufacturing Modernisation Fund), a new LaserBond cladding cell for VIC, and a large CNC horizontal borer for SA, all predominantly financed by existing bank facilities.
- Increased shift sizes and scheduled additional shifts to boost productivity and revenue.

Product Development

Innovate, build R&D capability and stay ahead of the market.

- Continued investment in structured R&D program in conjunction with OEM customers and, where appropriate, with universities and with the support of governments.
- During FY20, the company upgraded its Scanning Electron Microscope to allow more detailed investigation of applied surface engineering properties and performance.
- Recent development of rotary feeders for pneumatic conveying of mulch, soil, sand and aggregate, which is a rapidly expanding application globally.
- Commencement of marketing of replacement feeders for a local exchange service and exploring export markets.

Technology Licencing

Build a suite of technologies for sale under long-tailed licencing arrangements, with the objective of launching a hard chrome replacement technology in 1H FY21 and continued promotion and sales of technology licences globally.

Forecasts

Whilst the FY22 revenue target of $40m was established some time ago and did not, we believe, envisage acquisitions. COVID-19 has, no doubt, impeded LBL's ability to develop its overseas business, especially in the Products segment and, therefore, we include the UST acquisition in our $40m forecasts.

Based on historical performance, we would assess the potential for LBL to reach its revenue objectives as good: between FY16-20A, we estimate LBL grew its revenue, all organically, at 21% pa and, recall, Products revenues were disrupted by delays to a customer order. In order for LBL to reach $40m in FY22, and deducting an assumed $5m contribution from UST, implies an underlying revenue growth rate of 26% pa – higher than the past – but the business now comes equipped with new products, a revitalised Technology sales strategy as well as new capacity in Victoria.

Services segment

We forecast 13% pa underlying revenue growth in the Services segment, which is in line with recent trends. Augmenting that is the contribution from the recent United Surface Technologies (UST) business in Melbourne, which the acquisition announcement reported would report $4.0m revenue in FY20. We factor in that $4.0m contribution in FY21 and an incremental $1.0m in FY21 to complete the initial 12 months of ownership.

Given the $1.1m purchase price, we assume that UST's gross margin, although not disclosed, is lower than LBL's Services segment, which causes a softening compared to FY20.

Overall, we forecast a doubling of revenue between FY20A and FY23F and assume that opex rises to support the growth as well as absorbing the costs from UST. Our EBITDA forecast follows a similar path to revenue, implying only modest operating leverage.

In order to continue to grow at impressive rates, we believe LBL will seek to improve its production by adding a full second shift at Smeaton Grange in Sydney (currently the operation runs a day shift and a partial afternoon shift) with the new Victorian facility providing additional capacity, more so when its new Laser Cladding equipment is installed.

Figure 14: Services segment forecasts

	FY20A	FY21F	FY22F	FY23F
Revenue	12.8	18.1	21.8	24.7
Underlying revenue growth yoy		*10%*	*15%*	*13%*
Gross profit	6.6	8.1	9.6	10.9
Gross margin	*52%*	*45%*	*44%*	*44%*
Opex	-2.6	-2.5	-2.9	-3.3
EBITDA	4.0	5.6	6.7	7.6
EBITDA margin	*31%*	*31%*	*31%*	*31%*
Cut-through to EBITDA		*30%*	*30%*	*30%*

Source: Company Reports, Canaccord Genuity estimates

Products Segment

We forecast the Product Segment to do much of the heavy lifting in the drive to $40m revenue in FY22. Although revenue growth was sluggish in FY20, the segment has shown good momentum in the past, with the most recent year impacted by a change in a customer's specified material – work which subsequently fell into FY21.

We assume a flat gross margin during the forecast period with opex increasing to support the growth in revenue.

The challenge for growth in the Products Segment in the current environment is that international travel restrictions mean that LBL's push into overseas markets is impeded by the inability to meet customer representatives in person. Therefore, we put greater emphasis on growth in FY22 than FY21, although we believe sales of new products to the existing customer base should sustain solid growth in FY21.

Figure 15: Products segment forecasts

	FY20A	FY21F	FY22F	FY23F
Revenue	9.2	11.0	13.7	15.8
Underlying revenue growth yoy	*0%*	*20%*	*25%*	*15%*
Gross profit	4.8	5.8	7.3	8.4
Gross margin	*53%*	*53%*	*53%*	*53%*
Opex	-1.9	-2.5	-3.0	-3.3
EBITDA	3.0	3.3	4.3	5.1
EBITDA margin	*32%*	*30%*	*31%*	*32%*
Cut-through to EBITDA		*18%*	*36%*	*38%*

Source: Company Reports, Canaccord Genuity estimates

Technology Segment

LB earns revenues in its Technology segment in three forms: (1) outright sale of capital equipment to the customer; (2) ongoing licence fees, which allow the customer access to LBL's know-how and updates to processes and materials; and (3) the sale of consumable items – coating blends – to customers to use in processing. We believe the margin for these items varies widely from low (consumables) to very high (licence fees), which we estimate averages out in the mid-20% range.

Technology sales have been lumpy in the past and have depended on the timing of equipment sales. Having not executed a Technology transaction in FY20, segment revenues were modest but have an important role to play in reaching the $40m revenue target in FY20.

Figure 16: Technology segment forecasts

	FY20A	FY21F	FY22F	FY23F
Equipment		1.0	2.0	2.0
Licence fees		0.2	0.6	1.2
Consumables		0.5	2.0	4.0
Revenue	0.2	1.7	4.6	7.2
Underlying revenue growth yoy	*-18%*	*816%*	*179%*	*57%*
Gross profit	0.1	0.8	1.3	1.9
Gross margin	*30.8%*	*48.5%*	*27.2%*	*25.7%*
Opex	-0.1	-0.5	-0.8	-1.0
EBITDA	0.0	0.3	0.5	0.9
EBITDA margin	*-22%*	*18%*	*11%*	*12%*
Cut-through to EBITDA		*23%*	*7%*	*13%*

Source: Company Reports, Canaccord Genuity estimates

R&D investment

We assume that R&D investment will continue at around previous rates, implying a significant uplift over the next 2-3 years, creating future potential revenue opportunities for the business.

Figure 17: R&D spend

	FY20A	FY21F	FY22F	FY23F
R&D	-0.8	-1.1	-1.6	-1.9
% of revenue	*3.4%*	*3.6%*	*4.0%*	*4.0%*

Source: Company Reports, Canaccord Genuity estimates

Group forecasts

We model $40.2m revenue in FY22, in line with the company's objectives but put more onus on the FY22 year, allowing for COVID-19 impacts to at least somewhat impact FY21. We expect EBITDA to grow at a healthy rate, although at a slightly slower rate than revenue, given the lower gross margin associated with Technology revenues.

Figure 18: Group revenue and earnings forecasts for LaserBond

	FY20A	FY21F	FY22F	FY23F
Services	12.8	18.1	21.8	24.7
Product	9.2	11.0	13.7	15.8
Technology	0.2	1.7	4.6	7.2
Group revenue	**22.2**	**30.8**	**40.2**	**47.7**
Underlying change yoy		*21%*	*31%*	*19%*
Services	6.6	8.5	10.1	11.4
Product	4.8	5.8	7.3	8.4
Technology	0.1	0.8	1.3	1.9
Group Gross profit	**11.5**	**15.1**	**18.6**	**21.6**
Services	4.0	5.6	6.7	7.6
Product	3.0	3.3	4.3	5.1
Technology	0.0	0.3	0.5	0.9
R&D	-0.8	-1.1	-1.6	-1.9
Group EBITDA	**6.2**	**8.1**	**9.9**	**11.6**
D&A	-2.0	-2.0	-2.6	-2.6
Net interest	-0.4	-0.4	-0.4	-0.4
PBT	3.8	5.1	7.0	8.7
Tax	-1.0	-1.4	-1.9	-2.6
NPAT	2.8	3.7	5.1	6.1

Source: Company Reports, Canaccord Genuity estimates

Valuation & view

Returns on capital are excellent

The absence of goodwill from the balance sheet means that LBL's returns show all the benefits of organic growth over the year, and they are excellent. Return on Assets in the mid-teens would better many companies' Returns on Equity, and then the financial leverage component of the Dupont formula further enhances the Return on Equity to above 20%.

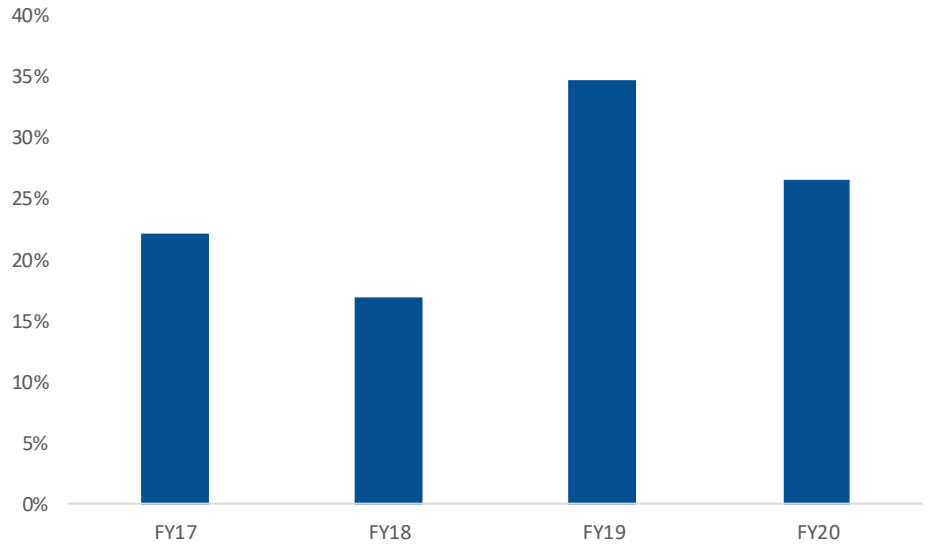
Figure 19: LaserBond's return on equity, FY17-20

	FY17A	FY18A	FY19A	FY20A
Net Margin	8.1%	6.2%	12.4%	12.6%
Asset Turnover	1.4	1.3	1.6	1.1
ROA (%)	12%	8%	19%	14%
Financial Leverage	1.5	1.6	1.6	1.8
ROE (%)	17%	13%	32%	25%

Source: Canaccord Genuity estimates

Similarly, Return on Capital Employed is extremely healthy, routinely running well above 20%.

Figure 20: LaserBond's Return on Capital Employed, FY17-20



Source: Company Reports, Canaccord Genuity estimates

With a register from which institutional investors are absent, liquidity which has been limited to date and a relatively low profile by listed company standards, perhaps it is not hugely surprising that the valuation does not, in our view, reflect the growth prospects of the business.

On our forecasts, the shares trade on 14.2x our FY21 EPS forecast and FY21F EV/EBITDA of 10.7x.

With equipment downtime a matter of the highest priority for customers, we see scope for LBL to expand operations into the resource-rich states of Western Australia and Queensland. Given the operating model, we believe an acquisition of an existing operation, along the lines of UST, with an existing customer and order

book, would be the optimum solution, especially one where LBL's Laser Cladding process could be added to the capabilities of an acquired business.

With the Small Ordinaries trading on a c20x one-year forward PER, LBL looks very attractively valued given its growth prospects. Applying a PEG ratio of 1.0x to the next three years' EPS growth, based on our forecasts, would imply a PER of over 30x.

Given the tightly held nature of the register, we apply a 15% discount to the market multiple for a 17.6x target PER, which equates to a valuation of $0.88 per share. We round our target price to $0.90, which is 70% above the current share price. We initiate with a BUY recommendation.

Risks to our view

- We believe the main risk to our view is the group failing to reach its $40m revenue target in FY22. Management has remained consistent in this ambition, even during COVID-19 restrictions, albeit with an allowance that the UST acquisition will now contribute to the bridge to that revenue target. Should the business not reach its objectives, the market may react negatively.
- LBL is heavily exposed to the Mining and Resources sector, with much of its revenue emanating either directly from customers or from OEMs servicing the sector. Therefore, changes in activity in the sector could impact LBL's revenues and earnings.
- One challenge facing LBL is that its coating and surface engineering solutions work "too well", reducing the frequency with which components are sent for repair and refresh. Therefore, LBL has to price its services in such a way as to reflect the value provided to customers as well as develop new solutions and continue to push into new markets to continue its growth trajectory.
- Acquisitions have not been a large part of LBL's historic growth, although the company expanded to South Australia in 2013. The company articulates potential geographic expansion in its strategy, and the UST acquisition in Victoria signals what could be the beginning of that trend. Integrating acquisitions into the business could present a challenge.

Appendix

Management and Board

Board of Directors

Philip Suriano - Non-executive Chairman

Mr Suriano has been a director since 2008. He holds a degree in banking & finance and began his career in corporate banking with the State Bank of Victoria (Commonwealth Bank). He spent 16 years in senior positions within the Australian Media industry, gaining wide knowledge & experience to give him a strong background in operations, sales and marketing in such roles as National Sales Director, MCN (Austar and Foxtel TV Sales JV) and Group Sales Manager at Network Ten. Prior to joining MCN, Mr Suriano was employed within the Victor Smorgon Group. For the past 15 years he has been working in corporate finance.

Wayne Hooper - Chief Executive Officer

Mr Hooper is a professional engineer with significant technical and management experience within the surface engineering, general engineering and manufacturing industries. His engineering experience includes design, maintenance and project management. He started his career within the electricity generation industry, followed by high volume manufacturing. Prior to joining the company in 1994, Mr Hooper also held senior roles in marketing within the building products industry. He holds degrees in Science, Engineering (Honours Class 1) and an MBA.

Matthew Twist - Executive Director, Chief Financial Officer and Company Secretary

Mr Twist has over 25 years' financial management experience, encompassing financial and operational control and systems development in manufacturing. He has been the company's Chief Financial Officer since March 2007 and was appointed Company Secretary in March 2009. Mr Twist has a Certificate in Governance Practice and is an affiliated member of the Governance Institute of Australia.

Key personnel

Gregory Hooper - Technical Consultant and Founder

Mr Hooper has a mechanical engineering background with over 35 years of hands-on experience, as well as sales and management experience in the engineering, metallurgy, welding and thermal spray industries. Before founding LaserBond he held key positions with multinational surface engineering equipment and speciality welding consumable manufacturers. Mr Hooper co-founded the company in 1992 and has been responsible for the research, integration and development of the company's materials and Thermal Spray and LaserBond cladding processes. Having retired from the board earlier in 2020, Mr Hooper provides technical support to the business related to Research & Development, Technology and Operations.

Thomas Schlaefer - R&D Manager

As part of a considered plan to succeed Greg Hooper, Mr Schlaefer joined LBL in 2017. He is a materials and process expert from Germany receiving his PhD in mechanical engineering at the Surface Engineering Institute of RWTH Aachen University, Germany, which is one of the leading research institutes for coating materials and processes. Mr Schlaefer has extensive experience and knowledge of materials and coating processes, and technical skills related to laser cladding, application-oriented coatings development, materials development, and materials and composites analysis.

Appendix: Important Disclosures

Analyst Certification

Each authoring analyst of Canaccord Genuity whose name appears on the front page of this research hereby certifies that (i) the recommendations and opinions expressed in this research accurately reflect the authoring analyst's personal, independent and objective views about any and all of the designated investments or relevant issuers discussed herein that are within such authoring analyst's coverage universe and (ii) no part of the authoring analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by the authoring analyst in the research, and (iii) to the best of the authoring analyst's knowledge, she/he is not in receipt of material non-public information about the issuer.

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Sector Coverage

Individuals identified as "Sector Coverage" cover a subject company's industry in the identified jurisdiction, but are not authoring analysts of the report.

Investment Recommendation

Date and time of first dissemination: September 15, 2020, 16:29 ET

Date and time of production: September 15, 2020, 16:23 ET

Target Price / Valuation Methodology:

LaserBond Limited - LBL

We value the business based on its growth rate and benchmark that against the wider market multiple, applying a 15% discount (for a 17.66x target PER) to account for the tightly held nature of the stock.

Risks to achieving Target Price / Valuation:

LaserBond Limited - LBL

- We believe the main risk to our view is the group failing to reach its $40m revenue target in FY22. Management has remained consistent in this ambition, even during COVID-19 restrictions, albeit with an allowance that the UST acquisition will now contribute to the bridge to that revenue target. Should the business not reach its objectives, the market may react negatively.
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Distribution of Ratings:

Global Stock Ratings (as of 09/15/20)

Rating	Coverage Universe		IB Clients
	#	%	%
Buy	523	61.17%	54.88%
Hold	173	20.23%	40.46%
Sell	14	1.64%	35.71%
Speculative Buy	121	14.15%	76.86%
	855*	100.0%	

*Total includes stocks that are Under Review

Canaccord Genuity Ratings System

BUY: The stock is expected to generate risk-adjusted returns of over 10% during the next 12 months.

HOLD: The stock is expected to generate risk-adjusted returns of 0-10% during the next 12 months.

SELL: The stock is expected to generate negative risk-adjusted returns during the next 12 months.

NOT RATED: Canaccord Genuity does not provide research coverage of the relevant issuer.

"Risk-adjusted return" refers to the expected return in relation to the amount of risk associated with the designated investment or the relevant issuer.

Risk Qualifier

SPECULATIVE: Stocks bear significantly higher risk that typically cannot be valued by normal fundamental criteria. Investments in the stock may result in material loss.

12-Month Recommendation History (as of date same as the **Global Stock Ratings** table)

A list of all the recommendations on any issuer under coverage that was disseminated during the preceding 12-month period may be obtained at the following website (provided as a hyperlink if this report is being read electronically) http://disclosures-mar.canaccordgenuity.com/EN/Pages/default.aspx

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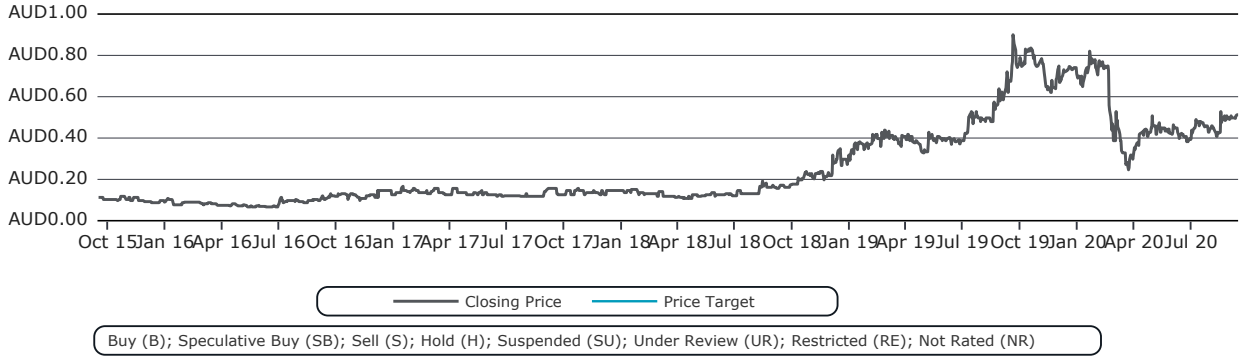
LaserBond Limited Rating History as of 09/14/2020



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