



Laserbond (LBL.ASX)

Recommendation Outperform

Initiating coverage: the clever Australian

Current Price: \$0.70

Summary (AUD)

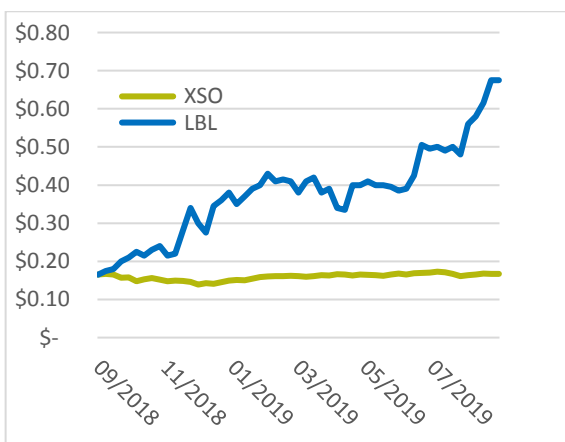
Market Capitalisation	66.15
Share Price	0.70
52 week low	0.17
52 week high	0.72
Ave Monthly Vol (year rolling)	1,616,400

Key Financials (AUD)

Year End (\$m)	FY19 Act.	FY20 Est.	FY21 Est.
Revenue	22.7	26.6	33.6
EBITDA	4.9	6.2	8.1
NPAT (adj)	2.8	3.6	5.0
PE Ratio (x)	23.9	18.2	13.4
DPS	0.009	0.015	0.02
Div Yield	1.29%	2.1%	2.9%
Franking	100%	100%	100%
EV	66.3	65.5	57.9
EV/EBITDA	13.6	10.5	7.2
ROIC (post tax)	13%	31%	36%
Payout ratio	31%	39%	38%

(Source: Actual + TC Estimates)

Share Price Graph (AUD)



(Source - IRESS)

Our view – initiate with outperform

TC initiates coverage of Laserbond with Outperform and a DCF price target of 84 cents.

- Laserbond is a specialised engineering business that provides laser cladding and other advanced services to repair and strengthen wearing surfaces of new and used large (and small) scale capital equipment.
- We like the fact the Hooper family patiently bootstrapped Laserbond out of a small shed in Western Sydney and have plenty of “hurt money” in the business.
- Laserbond has forecast sales to increase from \$22.7m in FY19 to \$40m in FY22.
- Laserbond has a strong competitive advantage by virtue of its solid reputation, in house expertise, location, in situ equipment, ability to price for value delivered and the ability to tailor a solution.
- The services division’s capacity utilisation can be improved by adding more shifts and people. Previous investment has set the business up to deal with increased demand. Capex should reduce, after material investment in FY19.
- The business can also grow the technology division via further sales of IP offshore (reference sites established).
- The products division can grow by expanding the market of products it has developed (such as hardened steel mill rolls) via recent major customer wins (Dec 18).
- Risks include a decline in the mining (China) and/or heavy industry capex cycle, dependence of key clients, emerging competing technology and greater organised activity from other competitors

Valuation and recommendation

Laserbond offers good value at current levels with a P/E of 18.2X FY20 and 13.4X FY21 driven strong eps growth profile. This growth is supported by a solid established competitive advantage, lowly geared balance sheet, a humble business culture and a good corporate governance. It is a quality business.

Macro conditions remains relatively favourable with many major commodity prices at solid levels, firm infrastructure spend and plethora of sunk heavy machinery investment that needs repair and /or improvement post the mining investment boom.

Laserbond		LBL.ASX			Price	\$	0.70		
PROFIT & LOSS SUMMARY (A\$m)				BALANCE SHEET SUMMARY					
Period		30-Jun-19	30-Jun-20	30-Jun-21	Period	30-Jun-19	30-Jun-20	30-Jun-21	
	Operating Revenue	22.7	26.6	33.6		Cash	2.2	2.7	0.7
	Total Revenue Adj.	22.7	26.6	33.6		Receivables	5.4	6.7	8.4
	EBITDA Adj.	4.9	6.2	8.1		Inventories	2.5	2.9	3.7
	Dep'n	-0.9	-1.1	-1.2		Other	0.0	0.0	0.0
	Amort'n	0.0	-0.1	-0.1		Total Current Assets	10.1	12.2	12.8
	EBIT Adj.	4.0	5.0	6.7		Property Plant & Equipment	5.9	6.4	6.9
	Net Interest	-0.2	-0.1	0.0		Intangibles	0.0	0.2	0.4
	Pre-Tax Profit	3.9	5.0	6.7		Other	0.4	0.4	0.5
	Tax Expense	-1.1	-1.3	-1.7		Total Non-Current Assets	6.3	7.0	7.8
	Minorities	0.0	0.0	0.0		Total Assets	16.4	19.3	20.6
	NPAT Adj.	2.8	3.6	5.0		Accounts Payable	2.0	2.4	3.0
	Abnormals	0.0	0.0	0.0		Borrowings	0.6	0.9	0.0
	Reported Profit	2.8	3.6	5.0		Provisions	1.0	1.2	1.5
						Other	0.4	0.5	0.6
						Total Current Liabilities	4.1	4.9	5.1
Margins on Sales Revenue						Accounts Payable			
	EBITDA Adj.	21.6%	23.4%	23.9%		Borrowings	2.2	2.0	0.0
	EBIT Adj.	17.8%	18.9%	20.0%		Provisions	0.0	0.0	0.0
	NPAT Adj.	12.2%	13.6%	14.8%		Other	0.1	0.1	0.2
Change on pcp						Total Non-Current Liabilities	2.3	2.1	0.2
	Total Revenue		17.4%	26.4%		Total Liabilities	6.3	7.0	5.2
	EBITDA Adj.	n/a	27.5%	29.1%		Total Equity	10.1	12.3	15.4
	EBIT Adj.	n/a	24.7%	34.2%		check	10.1	12.3	15.4
	NPAT Adj.	n/a	31.8%	37.2%					
PER SHARE DATA				CASH FLOW SUMMARY					
Period		30-Jun-19	30-Jun-20	30-Jun-21	Period	30-Jun-19	30-Jun-20	30-Jun-21	
	EPS Adj \$	0.029	0.038	0.052		EBIT	4.0	5.0	6.7
	<i>Growth (pcp)</i>	n/a	31%	36%	Add	Depreciation	0.9	1.1	1.2
	Dividend	0.009	0.015	0.020		Amortisation	0.0	0.1	0.1
	Franking	100.0%	100.0%	100.0%		Change in Working Capital	0.0	-1.0	-1.5
	Gross CF per Share	0.04	0.04	0.05		Other non cash/unusual items	0.0	0.0	-0.1
	NTA per share	0.11	0.13	0.16	Less	Tax Paid	1.1	1.3	1.7
						Net Interest	0.2	0.1	0.0
						Gross Cashflows	3.6	3.8	4.7
						Net Capex	3.4	1.6	1.7
						(Acquisitions)/Divestments	0.0	0.3	0.3
						Other Investments	0.0	0.0	0.0
						Free CF's Attributable	0.2	1.9	2.7
						Dividends Paid	0.5	1.4	1.9
						Debt Issued/(Repaid)	-0.7	0.5	0.8
						Equity Issued/(Buyback)	0.0	0.0	0.0
						Cash Flows	0.4	0.0	0.0
KEY RATIOS									
Period		30-Jun-19	30-Jun-20	30-Jun-21					
	Net Debt / EBITDA Adj. (x)	0.14	0.03	-0.08					
	Net Debt : Equity (%)	0.1	0.0	0.0					
	EBIT Interest cover (x)	-22.9	-94.9	-467.9					
	Current ratio (x)	2.5	2.5	2.5					
	ROE Adj. (%)	27.4%	29.6%	32.4%					
	ROIC Adj. (%)	12.6%	31.2%	35.9%					
	Adj. Dividend Payout Ratio	30.7%	39.0%	38.2%					
VALUATION MULTIPLES									
Period		30-Jun-19	30-Jun-20	30-Jun-21					
	PER Adj. (x)	23.9	18.2	13.4					
	Dividend Yield (%)	1.3%	2.1%	3%					
	Free CF Yield	5.5%	5.8%	7.2%					
	EV/EBITDA (x)	13.6	10.6	8.2					
	EV/EBIT (x)	16.5	13.2	9.8					

Initiating coverage: solving problems with clever technology and expertise

Our view – initiate with a outperform

- We are forecasting strong eps growth of 31% for Laserbond in FY20 and continued strong growth into the next few years driven by increased sales and EBITDA margins remaining firm.
- Laserbond has forecast sales of \$40m by 2022. Sales growth is being driven by: -
 1. the installation of additional machinery and staffing levels in both the Sydney and Adelaide plants that enables a greater range of services to be offered.
 2. Further sales of Laser cladding IP to offshore customers helped by recent reference wins.
 3. Further sales of value added products to large US steel players – helped by recent wins
 4. Strong industry demand driven by large capital intensive players such as mining, industrial and infrastructure who need to repair existing equipment and by OEM customers who want to economically bespoke value add their equipment for sale.
- The business has a strong competitive advantage by virtue of its solid reputation, in house expertise, location, in situ equipment, past track record, ability to price for value delivered and the ability to tailor a solution to the client’s individual requirements.
- Previous investment in people and equipment set the business up to deal with increased demand. Capex should reduce in absolute terms, after material investment in FY19 in an additional laser system in Adelaide and a large scale boring machine in Sydney.
- The business has the unpriced option of controlled geographical expansion and movement into adjacent value added capital equipment repair and OEM niches.
- Attractive features include no (low) debt balance sheet, clean corporate governance, dividend payment, capex sunk and the commitment, and ...dare we say, ... excitement that the staff exhibit in repairing (problem solving) machinery.
- **We like the culture and history of the business. The business and the Hooper family have patiently bootstrapped Laserbond out of a small shed in Western Sydney and have plenty of “hurt money” in the business.**
- Risks include a decline in the mining (China) and/or heavy industry capex cycle, dependence of key clients, emerging competing technology, failure to sell further IP systems, access to quality staff and greater organised activity from other competitors

Valuation and recommendation

Outperform. Laserbond offers good value at current levels with a P/E of 18.2X FY20 and 13.4X FY21 struck off a strong eps growth profile. The EV/EBITDA of 10.6X FY20 and 8.2X FY21 is reasonable. We have derived a DCF of 84 cents.

TC believes that Laserbond should trade at a premium to the Small Ordinaries market given the low gearing, strong demand, good growth rates that are clearly articulated, strong underlying customer demand, favourable macro conditions and strong competitive advantage.

Company overview

Laserbond is a specialist engineering business that specialised in the development and application of advanced 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 capital equipment and specialised labour.

Almost all components that wear at a surface, fail over time. Specialised, tailored treatment /processing can adapt equipment to perform in a more optimal way using Laserbond's services and manufacturing expertise. Many of these machines are used in highly specific circumstances with (not limited too) unique geological conditions, adverse climate and in individualised equipment combinations and use patterns. Some of the major customers of Laserbond are OEM's that need to offer a tailored performance that is unable to be mass produced when these machines are initially manufactured.

The business has two major operations – one located at Smeaton Grange (Campbelltown) in South Western Sydney (HQ) and a further location at Cavan in Adelaide in South Australia. TC recently visited the Smeaton Grange HQ and toured the shop floor.

Picture 1 – Laserbond's Smeaton Grange (Campbelltown) – Sydney HQ and plant



Source Laserbond

Key industries that Laserbond works for include:- mining equipment and service, advanced manufacturing, defence, agriculture, tunnelling and heavy construction, steel making and processing, slurry and submersible pumps, valve manufacturers, nonferrous metal manufacturers and processors, pulp and paper manufacturers and converters, brick and block makers, concrete product manufacturers, electrical power generation, hydraulic service, glass and glass wool manufacturers, timber, plastics and packaging, water and sewerage (pumps) and the series of smaller industrial based industries that sit around this eco system.

Laserbond has customers around Australia and offshore (China, UK, US), however high costs of transport and particularly high cost of downtime tend to make many service division customers more geographically nearby.

Business segments and operational analysis

The business is organised along 3 separate divisions

Table 1 – Segment sales /EBITDA June 2019A in \$m

	Services	Products	Technology	R and D	Total
Revenue	11.17	9.132	2.35		22.7
EBITDA	2.575	2.653	0.342	(0.667)	4.9
NPAT					2.81

Source - Laserbond

Services – the major and original division. It operates mainly out of NSW (South Western Sydney) and operates in the engineering and repair and reclamation market. Laserbond specialised in the use of laser cladding. Laser cladding offers benefits over other bonding and hardening techniques.

Laser cladding is the process of using a very high-powered laser to melt the pure metal powder which is then injected into the surface of the component and then simultaneously metallurgically bonds to the surface of the component. Benefits include no coating peeling off, no metallurgical defects, no cracking and no component distortion caused by heating due to very localised low heat input used the carry out the process.

The Laser cladding process handles very large, high-volume surfacing, complex geometries, irregularly shaped parts, multidimensional profiles, and threaded areas and offer this sort of specific benefits as below: -

1. Selective hardness ranges
2. Various levels of corrosion resistance
3. Matching substrate chemistry
4. Minimal inter-metallic dilution
5. Low heat input
6. Low thermal distortion
7. Narrow heat-affected zone

Increasingly a growing percentage of manufacturing is using extremely high specification machinery, in tight formations with thin supply chains, optimised by science and technology to yield productivity benefits.

Good enough... is now NOT good enough with industrial machinery... this suits Laserbond's precision approach.

Picture 2 – large drive shaft being serviced by Laserbond



Source - Laserbond

Traditional methods such as HVOF (high velocity oxygen fuel) do offer as secure metallurgical bond, can distort the parts and have other less beneficial technical aspects. Laser cladding offer other benefits (as outlined previously) compared other traditional technique such as PTA (plasma transferred arc) using welding to put down coating layers and chemical treatments (often highly toxic) and even mechanical coating (peels away).

Products – mainly located in (but not exclusively) in Adelaide – this business acts as a value-added contract manufacturer for OEM customers – adding value to various generally (new) parts of machinery that the OEM is making, selling. This division can develop new products or improvements on existing products. This division manufacturers and exports composite carbide steel mill rolls for a large US Steel mill operator (via a recent contract win (Dec 2018)).

Technology – sale of hard-won intellectual property (laser cladding systems) that the business has developed over many years. This can take the form of licensing, consulting, and royalties and consumables (metal powder). This business has had some considerable success in recent times in offshore markets (China OEM) and a second sale (single system) to major multinational UK manufacturer delivered in 2019. These sales help validates the quality of the IP and technology, systems and process that the entire business deploys.

The original development of the Technology IP was due to the fact that Laserbond could not afford a laser cladding system early on as a very small business and so embarked on building/engineering one from scratch – this led to a deep knowledge of how /why/when/how much and what of the laser cladding systems.

Competitive advantage

Laserbond has a solid competitive advantage (s) including being well located in Western Sydney and Adelaide – near major industrial markets and transport routes, sunk plant and equipment (heavily written down), established customer relationships, decent capitalisation, patient considered humble business culture, a business that has essentially funded itself via bootstrapping which many customers respect.

Within the service division many client's equipment is heavy, bulky, easily damaged, expensive and downtime is extremely expensive. This ensures that the business has no direct offshore competition (within the services division) and that speed and accuracy, and reliability really matter. It has a time and freight advantage.

Risk adverse clients. The customers also have massive capex, higher operating leverage, little tolerance for breakdowns, in very remote and/or operate in onerous locations and also want flawless performance... Laserbond tangibly can help because the proclivity of customers to **try to use a new supplier (upside vs downside risk) is mostly low** .

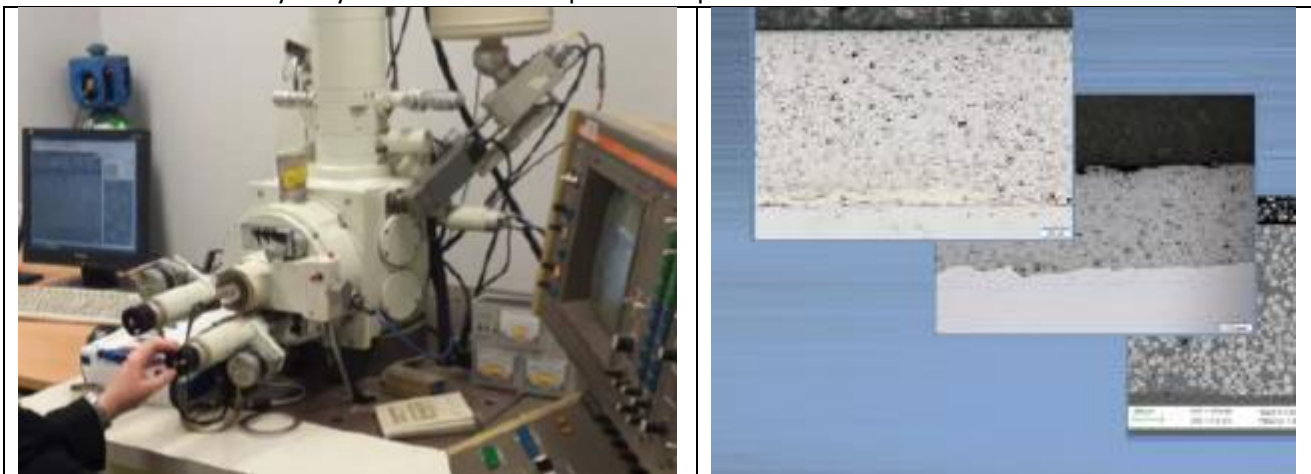
Small, bespoke – the Laserbond business can **economically handle small production** runs, fiddly requests, fast turnarounds compared to larger players.

Ability to price correctly and according to the value delivered to the end client.

Established track record. The business has operated in the high-performance market for many years. Customers are reluctant to try new approaches given the enormous down time and disruption caused if the engineering solution does not work

Ready access to high end in house equipment such as electron microscopes, highly powered lasers, software, specialised scientific and engineering expertise in all in a one stop shop. Ordinarily customers cannot easily establish this expertise due to both the equipment cost, unused capacity, wage cost and sourcing the expertise. Shared knowledge of engineering problems and their solutions over many customers (and situation) is knowledge that external customers cannot easily develop.

Picture 3 - Laserbond Sydney electron microscope and output



Source - Laserbond

The business has all the advanced equipment in house and ready to go

Picture 4 – Main floor of Smeaton Grange – with WIP (jobs) present



Source - Laserbond

OEM's who manufacture new capital equipment and parts on a semi mass basis normally have high labour costs, high operating leverage, long lead times, optimised factories, tight supply chains, established knowledge /processes and supply chains and simply **can't easily afford to highly customise equipment** for each customer's varying (and sometimes changing needs). The economics of what OEM's do mean that they must make equipment for the average customer in volume. This suits Laserbond as it can economically tailor OEM products for individual client needs.

It is then cheaper for Laserbond to optimise OEM equipment for each customer's individual highly specialised needs after this equipment when it is manufactured. Laserbond can also optimise equipment that has already been in the field ... another area where OEM's find the going tougher. OEM's want to mass produce the equipment, sell it quickly, sell standard maintenance and lots of spare parts and not have any issues in the field after the warranty period has expired. It is in the very nature of the industry that Laserbond have developed a competitive advantage.

Picture 5 – expensive equipment – no appetite for downtime



Source – Laserbond

The nature of the industry, the customers and the economics of it... is the competitive advantage

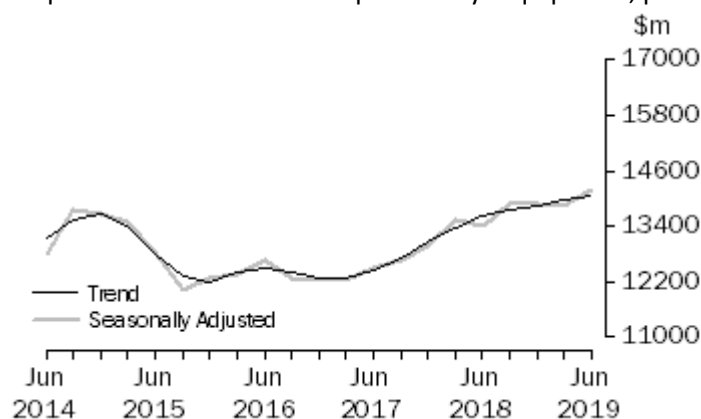
Heavy Engineering and capital equipment Industry

Laserbond operates in the heavy industry and manufacturing segments of the economy which tally to over 27% of GDP – well over \$230bn plus and is obviously very sizable however many segments sit within this part of the economy and many are not addressable to Laserbond. **The point is – it is a big segment.** Specific relevant segments to Laserbond include mining (c6% GDP), Manufacturing c13%, gas, water and electricity c3% and (some) construction c 5%.

The industrial economy is bifurcated with parts of the industry linked to housing and construction under pressure... Laserbond is less exposed to this segment and has a far greater linkage to the heavy machinery and heavy industrial parts of the economy which are performing well.

Heavy industry is benefitting for major infrastructure project both from government and from parts of the resource energy. These heavy industry parts of the economy according to the ABS (private new capital) expenditure survey (June 2019 quarter) are in good order and the pipeline of these large projects remains strong despite some retracement in iron ore prices. Capex is a \$110bn p.a market on a yearly basis according to the ABS. The ABS survey of seasonally adjusted estimate for equipment, plant and machinery rose 2.5% in the June quarter 2019.

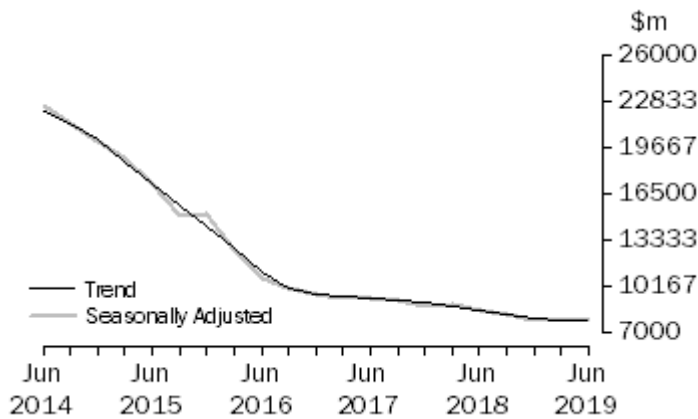
Graph 1 – ABS Private new capex survey- Equipment, plant and machinery capex – June 2019



Source: - ABS June capex – 5625.0

The seasonally adjusted estimate for Mining capex rose 1.7% in the June quarter 2019 and has bottomed and is set to resume growth again. Laserbond benefits from new capex (customisation, OEM sales/service in the products division) and importantly repair to the already existing installed base of equipment (services division).

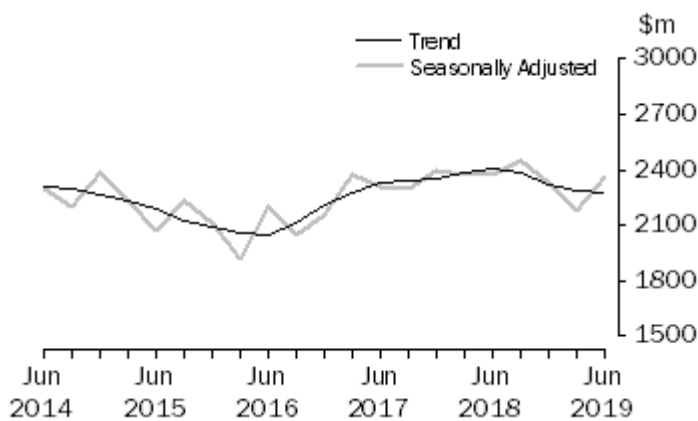
Graph 2 ABS private new capex - Mining capex



Source – ABS June capex - 5625

The seasonally adjusted estimate for Manufacturing capex rose 8.5% in the June quarter 2019 and has been a bright spot for the economy

Graph 3 – ABS private new capex Manufacturing capex

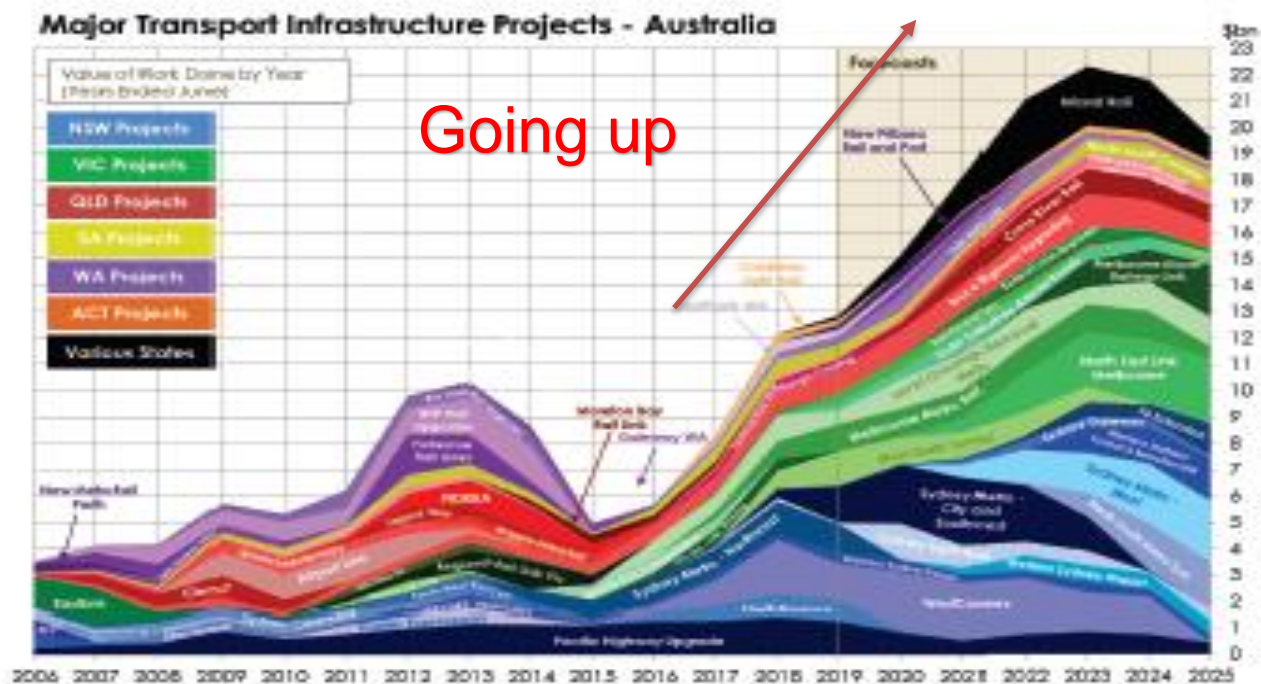


Source – ABS June Capex 5625.0

Transport, mining, some parts of heavy industry and infrastructure project are also supportive of Laserbond – with the more tunnels, digging, grinding, boring, milling, crushing, blasting, drilling, cutting, spinning, pumping, ... the better.

Graph 4 (next page) is hard to read but the main point is – infrastructure spend is going up.....other credible industry sources also marry up with Boral, (BLD, not covered) with a combined chart of transport and rail projects assembled by Deloitte Access economics showing similar spikes in project value.

Graph 4 - Boral table /Macro Monitor table of major transport infrastructure projects



Source – Boral presentation - Macro

The Macro environment for many of Laserbond’s key customers and markets is positive.

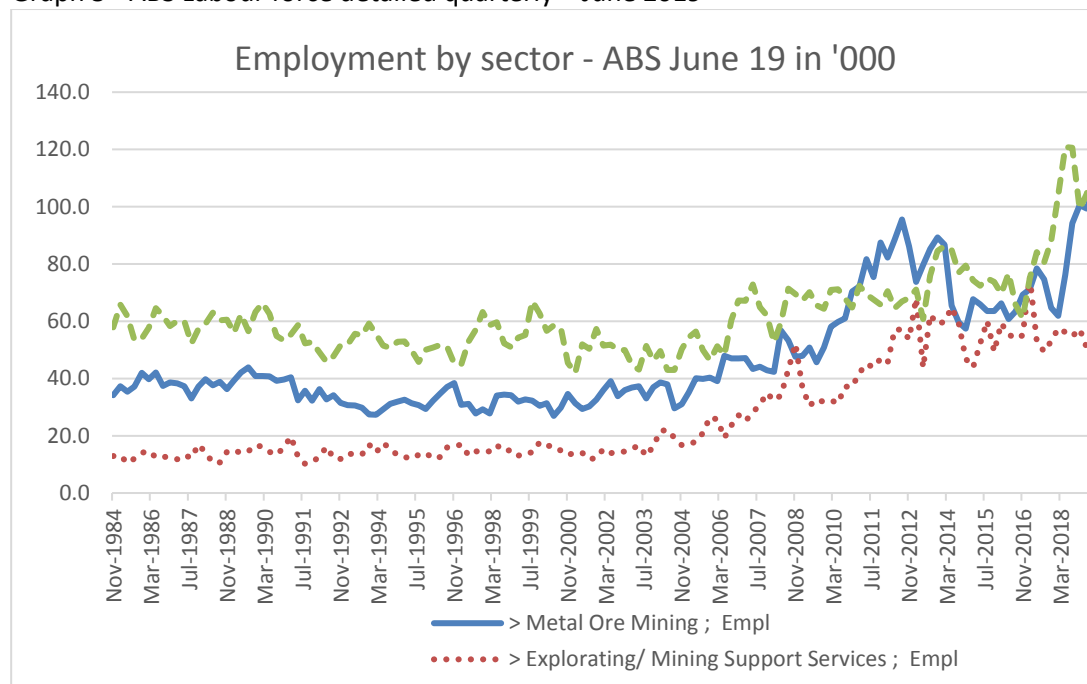
Employment

At TC we are keen to see what businesses are doing, not saying and we like to look employment levels in the industries that Laserbond operates in. People are being employed in many of the segments in which Laserbond services.

There is some capital/labour substitution in the medium term but in the short term greater demand is normally partly managed via hiring more people. It should also be noted the Laserbond are also hiring more permanent and apprentice staff.

Another key indicator of strong prospects within the resource industry includes employment. The ABS in June confirmed that employment in the resource industry of 11% in 2019. This is further backed up by a statement from the Mineral Council in June 2019 noting the strong jobs growth. The ABS and the Mineral Council also noted the extremely strong contribution minerals are making to Australia’s trade effort. In May 2019 the resource industry generated \$24.9bn in export income with minerals \$15.2bn of this income. Resource exports more than doubled in the last 10 years with over \$250bn in investment according to the Mineral Council.

Graph 5 - ABS Labour force detailed quarterly – June 2019



Source – ABS employment -6291.0.55

The relevant industries of Mining, Manufacturing, Gas/Water, Electricity employ 1.15m Australian out of a workforce of 6.7m Australians. Construction employs a further 1.1m (16%) Australians. Using employment as a proxy for the \$ size of the market suggests that Laserbond operates a big market (while acknowledging its niche position). This analysis also marries up with the implied share of GDP that the industrial market occupies in Australia based on our analysis.

The Chief Economist report (June 2019 quarter) issued by Department of Industry estimates that most major mine/commodity production volumes have enjoyed reasonably steady growth over 9 years despite commodities prices movements. This report also revised up many forecast volumes and noted resource investment should improve after bottoming out.

Other macro considerations

The decline of the AUD and reasonable major resource prices AT THE SAME time is quite rare and is helpful for many of Laserbond's customers.

Metallurgical coal and iron ore demand is obviously driven by the demand for steel used in construction and the production of steel intensive goods. Iron supply has also been constricted in Brazil also assisting the price. Australia has a competitive advantage being a low-cost reliable producer with a freight advantage.

Table 2 – Macro drivers

Minerals	Infrastructure	Heavy industrial/engineering	Energy
Raw materials supply/demand	GDP growth	GDP growth	Oil prices
Commodities prices relative to cost of production	Growing urbanisation	Lower AUD	Economic discoveries
China	Government spending		

Source – TC and various prospectuses

Gold prices are also reasonable and many large energy LNG projects have entered the production phase and will need maintenance.

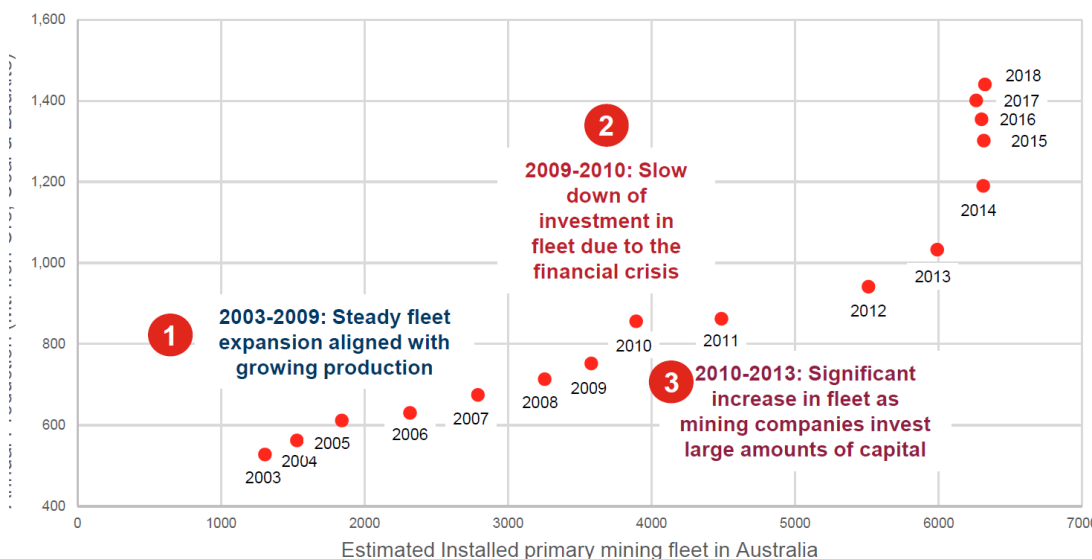
Monadelphous (MND, not covered) notes that both BIS and ABS stats show that total resources capex has risen from a low of \$15bn in 2017 to over \$25bn in 2019E and is forecast to continue to grow over the next 5 years. Total infrastructure capex is also expected to remain at elevated levels with it being \$45bn in 2018. Spend is expected to remain high in **BOTH heavy civil infrastructures spend AND resources capex**.

Monadelphous/BIS) recently suggested that maintenance capex is was projected to be c\$7bn level in 2018 and is set to retain this level into the future if not grow.

Essentially past underinvestment driven by volatile resource and macro-economic conditions has finally being rectified by the majors – helped by the insurance of higher short-term commodity prices to embolden capex shy executives within the resource industry.

Graph 6 - Emeco's careful assessment of mining fleet markets

Annual production vs fleet in Australia



Source – Emeco (EHL, not covered) investor presentation.

Emeco makes the following prescient commentary quote

“2013-16 investment in mining equipment ceased. Production continued with mining companies high grading to reduce costs creating a backlog of overburden stripping

2016- present - Investment in fleet stagnant. Mining companies have significantly increased material movement to address overburden backlog. Surplus fleet has been absorbed, creating shortage of mining equipment

2019 – equipment markets continued to be constrained due to long lead times (e.g. CAT 793 lead time = 18 months).”

Slow rates of economic growth from housing, retail, construction (and even the resource industry in the past) has led government to put in long dated civil infrastructure projects that helpfully span state and federal electoral cycles.

Management profile

Directors

Mr Philip Suriano – Chair – been a director since 2008. Expertise in banking, management, media and other manufacturing businesses.

Mr Greg Hooper – founder and executive director (Chief Technology Officer). Mr Hooper essentially established the business using his own engineering and business acumen in 1992. Mr Hooper is the brother of Wayne. Mr Hooper has over 35 years' experience in various aspects of the business from marketing, sales, and very high levels of technical expertise. Greg essentially oversees the shop floor and loves heavy machinery and getting it right for the customer.

Mr Wayne Hooper – founder and executive director (CEO). Been involved in the business since establishing it in 1994. Mr Hooper is a professional engineer and involved in management for many years. Mr Hooper's experience is in both the electricity and high-volume manufacturing industries. Wayne is focussed on the commercial development of the business and fine tuning the strategy.

Mr Wayne Hooper and Mr Greg Hooper work closely together. Importantly the HQ is next to the main plant...decisions can be made by going down to the floor and looking at work in progress for example. We like this...

The Hooper family established the business and hold both important executive positions along with being major shareholders in the business.

Mr Mathew Twist – company secretary and CFO. Long standing CFO. Been in the position since 2009. Mr Twist comes across as a careful and considered executive.

Mr Allan Morton resigned as chair in 2017. Mr Morton owned c1.4m units at that time.

As the business expands, moves offshore, licenses technology and over time the free float expands – it would make sense (in TC's opinion) for the board to add one or two additional non-executive independent directors to the business in our view. Clearly quality over quantity notions prevail.

The business has a series of long-standing executives working within management including an apprentice who is now in senior management.

History

1992 – Business established by Greg Hooper with the help of his parents as a small workshop in Ingleburn (South Western Sydney).

1993 - Starts trading as HVOF (High Velocity Oxy fuel) in early 1993 in modest circumstances in Western Sydney (and a major industrial area). HVOF was relatively new technology that the Hooper's viewed as revolutionary technology that opened new opportunities in Australia. Enters the thermal spraying market.

Business undertakes a multi-year reinvestment program and effectively bootstraps the business.

Wayne and Greg start to study the use of laser cladding. The cost of buying a full system is prohibitive given the financial resources of the business – so they look to build/ re-engineer a laser cladding system. This is a crucial decision because it means that they understand it intimately (and forever)and that they can sell this expertise to others into the future.

Develops a metallographic lab with an electron microscope.

1999 onwards installs a 6kW CO2 laser – used in at the time one of the most powerful cladding systems in the world.

2001 – completes, constructs and commissions the laser bond process. Laserbond provides a better metallurgical bond to substrate (welding bond) at very controlled heat input (makes the outcome more predictable and stronger). Main product and helps the business to grow.

2002 – wins Innovation award in NSW. Further awards won 2003 and 2006.

Sept 2007 IPO at 20 c per share. Raises \$2.5m. Shares on issues 65m. Issues 13.3m new units. Sales to 30 June 2006 - \$1.8m. NPAT \$244k.

2011/2012 raises an additional \$2m in capital at 23 cents in part to buy Peachey's engineering.

2012 – relocates to much bigger (better premises) at Smeaton Grange (south western Sydney).

2013 – opens South Australian business in Cavan South Australia. This is located near major customer HQ such as Boart Longyear (BLY, not covered).

2014/2015 – closes Gladstone business.

2016 – enters actual parts market with a new range of hardened DTH Hammers. Sales slower than expected due to entrenched established players defending positions.

2016 – essentially doubles capacity with the installation of a 16 Kw diode laser

September 2016 – Laserbond enters into a technology licensing agreement in China. License deal is via large mineral processing manufacturing business located in Henan province in China

August 2016/Feb 2017 - \$1.07m Commonwealth grant to help install advanced manufacturing facility in S.A and \$2.6m grant Cooperative research grant

2017 – reports extremely strong sales and profit growth.

Dec 2018 – enters the US export order to a US steel producer. This is a huge market and the first client creates future reference client for additional sales

August 2018 – announced second licensing deal with UK based multinational OEM customer for one laser cladding system and ongoing consumables deal

Industry players/customer analysis

Laserbond deals with a broad range of industrial customers. Two in the disclosed list are highly likely to be the major customers at make up 46% of sales in FY2019. We suggest that these players are likely to be big multinational/multidivisional players.

Snapshot 1 – Laserbond’s important clients

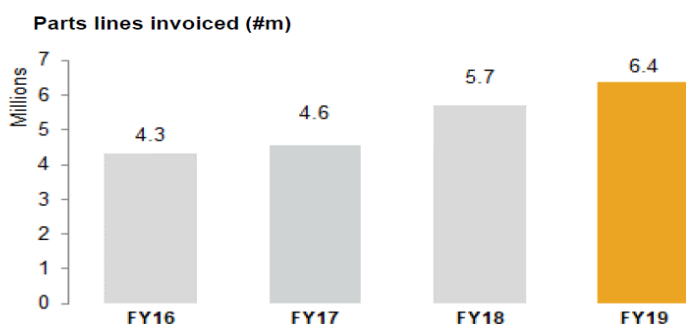
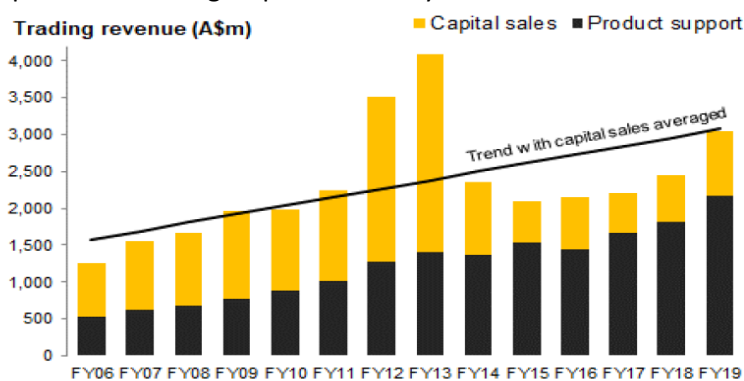


Source – Laserbond

Most of Laserbond’s listed customers are reporting strong results and good order books. Past cutbacks in capex and maintenance, higher installed bases and strong resources prices are all helpful to end demand for Laserbond

Seven Group’s (SVW, not covered) industrial businesses (Westrac and Coats hire) make similar commentary that industry conditions are good. Snap shot 2 shows that parts consumption is growing.

Snapshot 2 – Seven group commentary - Westrac



Source – Seven Group

Table 3 – selected customer commentary

Customer	Likely outlook	Notes
BHP	Strong	Recent results indicate continued capex, good commodity prices
Rio Tinto	Strong	Good results, strong outlook
Boart Longyear	Good outlook	Still remains highly geared, profitable but needs to de-gear. A risk here.
Caterpillar -Westrac	Strong	Both Westrac and Coates reporting strong order books, fleet expansion, committed sales up
Nucor	Reasonable	Real demand for products remains strong in key end-use markets. They see healthy conditions in end-use markets that typically account for more than two thirds of their steel shipments.
Schlumberger	Reasonable	Second-quarter revenue of \$8.3 billion increased 5% sequentially, driven by our international business that grew 8% and showed continued signs of a broad upturn in E&P investment and activity
Cross Yarra Partnership	Mid cycle of project	Concerns over cost overruns. Massive project – ramp up phase now complete
Bluscope (BSL, not covered)	Strong US, mixed AUD	Noted volumes in manufacturing/mining at good levels. Resi slowed. US expansion helpful to LBL
Cement Australia	Mixed.	Reduced residential, infrastructure remains strong
Relevant but may not be customers		
Monadelphous (MND, not covered)	Good outlook	WA capital works demand is strong both in sustaining and growth works. Iron ore strong, Li strong. Water, renewals and maintenance good pipeline
NWH (NRW, not covered)	Strong outlook	Overall business has \$8bn in addressable work. Continuing to win large amounts of civil work with \$473m secured, pipeline of \$8bn plus up to \$5bn in WA over next 10 year. Mining – customers looking to accelerate production - \$590m of work secured. Drilling growth - good start to FY20.
Emeco (EHL, not covered)	Good outlook	FY20 market conditions positive, strong material movement and equipment supply remain tight. Note majors not investing in new fleet – sweating current asset base, eventually this needs repair

Sources – various outlook statements

Relevant competitor analysis

Apathy/habit – many buyers of large-scale equipment – simply order a new part (or new machine) from the OEM as the quick and easy course of action. Apathy is a hard competitor to beat. Reference customers, experience, relationships, focus on ROI can all help to tame this form of competition

Mogas (www.mogas.com) has been around since 1973, when Louis Mogas founded the company in Texas. It is a private company. It has since expanded worldwide, with sales and service centres in China, Australia, South America and other geographies. Mogas offers extensive field experience, research & development breakthroughs **in design, materials and coatings**. Mogas has bought out its Australian partner Brenco (www.brenco.com.au) in very recent times (July 2019) and therefore appears to have bought existing laser cladding capacity in Australia (not new capacity). Mogas is a multinational and is likely much bigger than Laserbond and demands respect. Brenco also operates in the aerospace market. The Brenco business in that past had a relationship with Mogas and is not a new player in the Australian market, nevertheless it is a change to the market structure. Brenco is located in Sunshine (Western Melbourne) in Victoria.

Quote: -This acquisition allows MOGAS to bring the next generation of patented laser cladding technology in-house. It also allows MOGAS to expand its advanced coating, welding, cladding and material testing technologies to serve a range of customers in the region, especially those in autoclave, mining, minerals processing, oil & gas and aerospace industries," said Matt Mogas, CEO at MOGAS Industries.

"The sale of the company to MOGAS Industries is a natural fit due to Brenco's long standing relationship with MOGAS. The two companies share a common vision, and with MOGAS' strong marketing, engineering and financial capabilities, Brenco will be better positioned for growth," said Quyen Tran, Director at Brenco.

Swanston Industries (www.swanstonindustries.com) is also an established laser cladding multinational business based out of North America. It has 2 operations in NSW (Newcastle) and a further operation in Queensland. It offers repair, remanufacturing and manufacturing in Australia.

Swanston Industries was founded in 1964 by Paul Swanson. Swanson Industries provides an array of products and services for several industries, including fluid power, mining, off-highway, and steel. Swanson provides certified products and technical expertise that ranges from designing and manufacturing new products, remanufacturing and repairing components, engineering, design, and research and development and laser cladding. Swanston offers hydraulics, cylinders and even acts as a direct distributor for some OEM products. In September 2016 it acquired Waratah Engineering (Newcastle) in Australia.

Swanson CEO Steve Sangalli commented, *"We are very pleased to bring Waratah Engineering into the Swanson family. With Waratah's suite of capital equipment and its experience in remanufacturing longwall roof support systems and mobile equipment, the partnership fulfils another step in our strategy to be a full-service supplier to the Australian mining markets."*

Waratah complements Swanson's 2014 Australian additions of Jarvie Engineering and Goninan Platers, both located in Newcastle, NSW. This competitor also demands respect.

Each of the three (including Laserbond) players appears to operate in quite separate geographical markets.

OEM's - large OEM's, can over time, improve manufacturing and servicing of the equipment they sell – to offer laser cladding and other value-added services.

There is competition in Laserbond's markets however barriers to entry and competitive advantages, strong end demand dilutes the impact of this.

Risks (may include but is not limited to)

Customer concentration – about 46% of revenue relates to two major multinational/multi – divisional possibly OEM clients. We believe that it is likely that the weighting between the two large OEM clients is now more evenly split with the second one growing in recent times. Laserbond is working hard to reduce this risk by expanding into new markets, geographies and product sets to reduce this dependence.

Table 4 - Financial dependency

Year	Dependency \$m	% of total sales
FY2016A (one customer)	\$3.4	32%
FY2017A (two customers)	\$4.6	33%
FY2018A (two customers)	\$5.8	37%
FY2018A (two customers)	\$7.2	46%
FY2019A (two customers)	\$10.5	46%

Source – Laserbond – generally note 24-26 annual report

Sourcing skilled metal workers at reasonable rates, in at times competitive labour markets

IP theft – the business could have its IP and trade craft stolen by nefarious players both in Australia and overseas.

Enforcement of IP rights is difficult for a relatively small Australian based business (in our view).

Competition – both from new technologies, in house teams and original equipment manufacturers

Raw material/energy/input pricing – use of some metal powder, energy and related materials/services

Manufacturing downturn. The business is dependent on the overall health of medium and heavy manufacturing industry on the eastern seaboard.

Laserbond is **reliant on key equipment.** Breakdowns in long lead time advanced industrial equipment is a risk. The business now has 2 sites and multiple instances of many key bits of equipment – this helps to reduce this risk.

Key personal - the advanced engineering personnel are important to the business. The founders have a set of highly advanced skills and knowledge and relationships that are important to the business.

Safety -the business simply must have a high degree of safety.

Macro-economic risks - key clients in the mining and processing industries are dependent on resources prices. Weak economic growth may also impact the medium and heavy manufacturing industry clients in addition to the resources industry. AUD vs USD, Government infrastructure spend is also a risk.

Other risks include industrial problems, metallurgical problems, warranty claims, shortages of consumables

Competing with OEM players - The business services and collaborates with existing OEM players to service and add value to manufacturers parts. If the business attempts to remanufacture or directly manufacture parts -and go direct, it runs the risk of damaging OEM relationships and having access wound back.

China – a major disruption to China’s pace of economic growth and the related impact on commodity prices.

Investment quality checklist

Attached is the TC accounting quality and corporate governance checklist.

Laserbond performs very well against this checklist and it helps to build the investment case.

Table 5 – 21-point quality investment checklist

Issue	Yes/no/other	Comment
Cash flow = EBITDA	Yes	Greater than 100%
Continuous restructuring charges	No	
Rollup	No	Listed for many years
Legal action past/present	None apparent	Well run
Related party transaction(s)	Yes	Disclosed properly – appears to be family employed at normal rates
Revenue recognition	No problem	Appears sound – license sales are adding complexity
Low tax	No	Pays full rate
Contingent liabilities	Yes	Ordinary course of business – warranties, leases, performance
Pays a dividend	Yes	
History of controversy /investigation/media	No	
VC sellers	No	
Financial complex	No	Will change somewhat as it grows
Very high gearing	No	
Unexplained staff departure	No	Very long tenure
Overcrowded trade	Little institutional ownership	Hard to tell but appears to be the case
Tangible increase in competition	Some	Some degree of industry consolidation likely. Big players been acquiring
Complex/hard to visit offshore business	No	NSW and SA – able to be visited
Promotors have history of dishonesty	Not at all	
Was it a dirty shell	No	
Exogenous variables	Yes / mineral markets	
Other issues	A degree of customer concentration	46% ...being reduced as the business grows into new market/industries/applications

Source – TC checklist /analysis

Financial model/analysis

Table 6 - Balance sheet analysis

Item	FY18	FY19	Comment
<u>Current assets</u>			
Cash	1.4	2.2	better cash conversion, greater levels of profit
Trade receivables	5.4	5.4	Trade receivables grew in line with profit / others fell
Inventories	2.5	2.6	Mainly raw materials/some finished goods/WIP
Total current assets	9.2	10.2	
<u>Non current assets</u>			
PP an E	3.1	5.9	Mainly plant / prob very conservative /heavily written down
Deferred tax	0.3	0.4	
Intangibles	0.0	0.0	Extremely low - much higher - self made business
Non current assets	3.4	6.2	
Total assets	12.6	16.4	
<u>Current liabilities</u>			
Trade payables	1.9	2.0	Mainly trade /grown in line with sales
Employee benefits	0.8	1.0	Many long term employees
Financial liabilities	0.4	0.6	Likely equipment leases
Current tax liabilities	0.2	0.4	
Total current liabilities	3.3	4.1	
<u>Non Current liabilities</u>			
Financial liabilities	1.5	2.2	equipment leases
Employee benefits	0.0	0.1	
Total non current liabilities	1.5	2.3	
Total liabilities	4.8	6.3	
Equity	7.8	10.1	
Also of note is the \$2.25 m in franking credits			
No debt = great result			
Assets (in our view) understated in terms of value of intangibles and value of PP&E			

Cash flow analysis

Operating cashflow to EBITDA conversion is very good given the strong growth rates and use of working capital this entails (and some slow paying major customers). Cashflow has also helped over time from licensing sales that are highly cash generative. The improvement into FY2019 is likely from a IP sale recorded in FY18 – but not paid for until FY19.

Table 7 – cash flow conversion

Item	2017A	2018A	1H19A	2H19A	FY2019	Average
Cash oper. Activities	2.2	0.9	2.2	3.0	5.2	8.3
EBITDA	2.4	2.2	2.1	2.8	4.9	9.6
% conversion cash/EBITDA	90%	40%	106%	106%	106%	87%

Source Laserbond accounts

This high level of conversion also tends to suggest the business has a conservative approach towards its accounting – this is a true positive in our view.

Cost analysis

About c15% of the cost base is fixed hence Laserbond has operating leverage into FY20 on the larger sales base. We note that extra shifts can be added to the existing plant and this will lead to higher labour costs and COGS but many of the other costs are fixed or semi variable.

Table 8 – past cost performance

Cost analysis					
Item	FY2018	FY2019	% growth	% sales	Fixed/variable/semi variable
Revenue	15.6	22.6			
COGS	-8.7	-11.9			
Gross profit	6.9	10.7			Remains steady, mix matters
Other income	0.7	0.6			Grant income / falls away
Advertising/prom	-0.2	-0.2	12.3%	0.8%	variable likely grows /due to bigger business
Deprecation	-0.7	-0.9	23.6%	3.9%	variable / grows
Employment	-2.0	-2.6	26.4%	11.3%	variable grows / some leverage
Property	-0.7	-0.7	0.0%	3.2%	fixed / offers leverage /run more shifts
Admin	-1.6	-1.7	9.3%	7.6%	semi variable/ success sees this creep up
Repairs	-0.2	-0.2	49.7%	1.1%	variable
Finance	-0.1	-0.2	60.0%	0.8%	likely falls
R and D	-0.5	-0.6	17.4%	2.4%	likely falls for now
Other expense	-0.2	-0.4	64.1%	1.6%	
Total cost base	-5.5	-6.8	24.3%	30.3%	

Source – Laserbond and our assessment

Model assumptions

Divisional analysis	FY19A	FY20F	FY21	FY22	FY23	FY24
Sales				guided \$40m		
Services	11.2	12.5	14.0	15.7	17.6	19.7
Product	9.1	12.1	15.8	19.7	22.7	26.1
Technology	2.36	2.0	3.8	5.4	6.2	7.1
Other						
Corporate						
Total sales	22.67	26.6	33.6	40.8	46.4	52.9
		Tech = 1 u Tech = 2 units				
Sales growth rates						
Services	12%	12%	12%	12%	12%	12%
Product	63%	33%	30%	25%	15%	15%
Technology					15%	15%
Other						
Corporate						
Total sales	45.3%	17%	26%	21%	14%	14%
EBITDA						
Services	2.58	3.0	3.4	3.8	4.2	4.7
Product	2.65	3.6	4.7	5.9	6.8	7.8
Technology	0.34	0.4	1.0	1.3	1.5	1.8
Other						
Corporate	-0.68	-0.8	-1.0	-1.2	-1.4	-1.6
Total EBITDA	4.89	6.2	8.1	9.8	11.2	12.7
EBITDA Margin						
Services	23.0%	24%	24%	24%	24%	24%
Product	29.1%	30%	30%	30%	30%	30%
Technology	14.5%	20%	25%	25%	25%	25%
Other	-3.0%	3%	3%	3%	3%	3%
Corporate						
Total EBITDA Margin	21.6%	23.4%	23.9%	24.0%	24.1%	24.1%

Source TC forecasts

Sales

We have forecast continued strong sales organic growth rates into FY20 built up by analysis of each division and quite detailed guidance issued in the 2019 annual report

We don't assume any acquisitions in order to reach the stated goal of \$40m by 2022.

The Laserbond 2019 annual report has the stated revenue goal of \$40m by 2022 and therefore this implies some continued strong sales results in the near term for the business to reach this goal.

Into the medium term the business could undertake strategic expansion - ideally into other states to reduce transport costs /become more competitive and help to add to growth rates.

In 2020 Laserbond expects organic double-digit revenue growth assisted via the recent addition further laser cladding in Adelaide and a large-scale borer into Sydney.

Within Services – we have modelled organic growth similar rates (to FY19 which were 12%).

Products should benefit from repeat US steel carbonate mill roller orders

Technology growth depends on selling a further IP system in FY20 = c\$1.45m sale and two (\$2.9m) into FY21. Past sales should lead to some quite material consumable sales – we estimate up to \$400k pa form each laser cladding system that is sold.

If the business is unable to sell an additional system (IP) into FY20 – we would need to downgrade our forecasts for both margins and sales for both technology and the overall business.

EBITDA margins

We believe overall EBITDA margins should modestly improve compared to previous years due to sales mix and operating leverage. The business is moving to increased manning on afternoon shift is a positive - at both facilities which lead to overtime savings and greater capacity.

We also note a degree of fixed costs within the business and note our assumptions around operating leverage look reasonable compared to last year.

Services - growing profit margins - due to productivity (more staff) and recent laser cladding equipment investment

Products - growth continuing - due to productivity and addition of laser bond cladding system

We assume one high margin technology sale during the year at high margins.

What this table tells us – is that for \$1 increase in sales, 34 cents becomes EBITDA.

Table 9 – operating leverage

	FY18	1H19	2H19	FY19A	FY20F
Operating leverage					
Change in sales	1.80	3.27	3.80	7.07	3.95
Change in EBITDA	-0.24	1.49	1.19	2.68	1.35
% operating leverage	-14%	46%	31%	38%	34%

Source TC analysis

Capex -The business invested \$3.4m in capex last year vs \$273k prior. We assume some ongoing capex but believe for now the business should see absolute material declines from FY 19 levels. We have assumed \$1.6m in capex and a further \$200k in software (amortisation) in FY20.

Interest costs/debt - low debt levels. We do note that during the trading year some debt may be used, and the year end figures remain low. Management remain sensibly cautious of banks and debt.

Tax rate - The business does pay tax at the corporate tax rate of 27.5%, We expect this to remain the similar over time. The business however has moved past the \$20m R and D start cash grant level and will no longer get a cash grant but a reduction in its tax rate. Laserbond spent \$552k on R and D last year – this becomes a tax offset.

Valuation

We believe that the business offers good value and should trade a P/E premium to the small ordinaries industrial market given strong growth rates, high returns, a conservative balance sheet and improved margins and reducing capex requirements.

Table 10 – P/E valuation

Market PER:	18.0	DCF:	0.84
PE Relative Target:	1.25	LT Growth:	4.5%
Absolute PE:	22.50	WACC:	9.9%
EPS Pro-Rata: Pro Rata FY+1	0.041	RONIC:	15.0%
Target Share Price:	0.93		

Source - TC

DCF

The DCF supports the P/E based valuation

Table 11 – DCF valuation

<u>Free Cash Flow Valuation</u>		<u>Cost of Equity</u>	
Valuation year:	FY1	Risk Free Rate	6.0%
PV of FCF	14.8	Beta	1.00
PV of Terminal Value	70.6	Equity Risk Premium	4.0%
Add: Other assets not in cash flow	-	Cost of Equity	10.0%
Enterprise Value	85.4	Cost of Debt	6.0%
Less: Net debt	(0.2)	Debt Weight	1%
Less: Preference capital	-	Equity Weight	99%
Less: Minority Interest	-		
Equity Value	85.2		
Issued shares	94.5		
Yr end adjustment	0.928		
Value per share	\$ 0.84		
Assumptions			
LT Growth	4.5%		
WACC	9.9%		
RONIC after Yr 5	15.0%		

Source – TC forecasts

Comps

Comparable analysis does not show Laserbond to be at a discount to our quite diverse comps universe however with a strong organic EPS growth profile, high return on capital, good competitive advantage, relatively capital light, offshore expansion under, medium term guidance. the risk/reward is favourable, and this differentiates it compared to others.

EOS (not covered) is perhaps, not that comparable, given it services the defence market, however it has also issued extremely strong sales growth rates that have been firmed up with very solid trading and it now attracts a growth premium....we do not contend Laserbond should run to EOS P/E premium but that over time it can "earn" a premium with good results.

We strongly believe that Laserbond should at trade at a premium to the small ordinaries market and that on quality metrics Laserbond is far superior to many others that make up this universe.

Table 12 – comps

Name	code	Last price	Market cap	PE	EV/EBIDA	EV/sales
				FY20E	FY20E	FY20E
Bluescope	BSL	12.44	6,410	13.9	5.7	0.5
Lycododium	LYL	5.56	221	12.7	6.9	0.8
XRF	XRF	0.25	33	12.9	6.6	1.0
Korvest	KOV	3.19	36	11.2	5.6	0.5
Worley	WOR	14.17	7,354	15.1	9.9	0.8
SevenGroup	SVW	17.57	5,963	12.6	6.5	0.1
ALS	ALQ	8.14	3,927	20.9		2.5
Sims	SGM	10.64	2,158	13.3	6.9	0.4
GR Engineering	GNG	0.87	133	14.4	7.2	0.5
EOS	EOS	6.74	648	33.7	30.3	4.0
			Average	16.1	9.5	1.1
			Median	13.6	6.9	0.6
Laserbond	LBL	0.70	66	18.2	10.5	2.5
P/E Small Ords (PERXSO)				18.0		
P/E ASX 200 Ind (PERXNJ)				23.4		

source - Bloomberg estimates/ Iress PERXSO Aug

Source – TC/Bloomberg estimates. ALQ = TC estimates

Table 13 - shareholders

	As at:	29-Jul-19
Shareholders	Shares	% Held
Hooper family - various	44.5	47.1%
Lornat Pty Ltd <WK Peachey S/Fund>	4.9	5.2%
Mr Ian Davies	2.7	2.9%
Rest top 20	15.2	16.1%
Top 20 total	67.30	71%
Shares outstanding		94.50
Peachey sold a business to them some years ago		
comment - lots of family and friends		

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