Marshall of Cambridge Holdings

13 June 2022

Motors disposal completes

The receipt of regulatory approval by the FCA has removed the final hurdle to completing the sale of Marshall Motor Holdings (MMH) to a subsidiary of Constellation Automotive Holdings. Marshall of Cambridge Holdings (MCH) received £202m in cash at the end of May. MCH is in a strong financial position and able to consider many options on how the proceeds will be utilised. To us, the likely uses might include the pay down of debt, a special dividend and strategic investment in the continuing businesses.

The disposal was the fourth completed or commenced during FY21, resulting in a greatly improved focus of the continuing Group. Stripping out the disposal proceeds of the motor retail business, the share price would indicate the value of the non-MMH businesses, stands at c. £80m. We think this represents an anomaly given those businesses generated £22m of EBIT pre-central costs in the last reported financial year, FY20.

Progress by division

The availability of the additional cash comes at an opportune time, with the preliminary decision made by the Group to move the Aerospace division's operating business to Cranfield Airfield by 2030, and the intention of the UK Ministry of Defence (MoD) to retire its remaining Hercules C-130J fleet. The MoD decision should accelerate MCH's plans to further internationalise the Aerospace division, which in turn raises the possibility of opening of a smaller version of the Cambridge Airport facility overseas, with N. America a likely location given strong existing client relationships. Furthermore, Marshall recently signed a new agreement to perform MRO services for the Indian Air Force, increasing its number of Hercules C-130 customers to 18.

With the first phase of the construction at the Marleigh site sold, the Property business is now in a position where profits and cash generation can improve markedly. Ramping up the US Marine Corps Hercules MRO contract can compensate for any reduced activity with the RAF over the medium term, with further contract wins resulting in improved profitability from FY20 levels. Fleet Services returned to profitability during H1 '21, with an improvement in EBIT margins anticipated.

No shortage of opportunity

Using a portion of the MMH proceeds to invest in the retained Group should enable management to accelerate the medium-term growth in revenue and EBIT. Investment is likely to occur in expanding the geographical, customer and product mix, whether in new facilities such as the one in New Brunswick, Canada (Land Systems), to facilitate new and potential contract wins, M&A, or additional services. Future profitability will be determined not just by top-line growth but also by management identifying further efficiencies across the simplified Group.

Inherent Group value being recognised

Based on the recent traded level of the NVPO and stripping out the net cash post receipt of disposal proceeds, the implied valuation of the continuing businesses amounts to some £80m which we regard as anomalous given its profitability. Particularly when one considers the ratings of its larger Aerospace & Defence peers. We shall update our previous fair value calculation of 611p / NVPO after the imminent release of results.

We remind readers that MCH is a unique business offering world-class services, notably within its ADG business, and is robustly backed by assets that include a 900-acre airport site within 2-3 miles of the centre of Cambridge.

Company Data

Last matched NVPO trade	425p
Implied market cap	£251.1m
ED fair value / NVPO	611p
Net debt (June '21)	£33.7m

NVPO Share Price, p

Source: James Sharp & Co, ED

Description

Founded in 1909, Marshall of Cambridge (Holdings) Ltd is a private, family-owned company. The business comprises six divisions, comprising Military Aerospace, Land Systems, Advanced Composites, Property (MGP), Marshall Fleet Solutions (MFS) and Futureworx. It provides world-class engineering and technology services to the aerospace and defence sectors (Marshall Aerospace and Marshall Land Systems) and is the core of the Group. Advanced Composites manufacture parts utilised within aerospace and naval applications. The property division is in the process of unlocking value from its 900-acre estate at Cambridge airport. MFS is the UK's largest independent commercial vehicle service organisation. Futureworx is the Group's innovation accelerator.

The non-voting priority ordinary shares (NVPOs) can be traded freely by an off-exchange matching facility administered by Stockbroker James Sharp & Co. The contact there is **Josh McArdle, Tel: 0161 764 4043**.

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Disposal of MMH

FY21 proved a pivotal year for MCH. We witnessed further Board changes, a tighter focus of the business portfolio and a significant decision taken by a major customer.

At the end of November 2021, CAG Vega 2 Limited, a wholly owned subsidiary of Constellation Automotive Holdings Limited, made a formal offer to acquire the entire issued share capital of Marshall Motor Holdings (MMH) at a price of 400p per share in cash. Marshall of Cambridge Holdings agreed to accept the offer in respect of its 64.41% shareholding in MMH. The Bidco held 19.90% of MMH shares at the close of business on 10th May 2022.

The offer price valued MMH at £325.3m and MCH's share at c.£200m net of costs. Adding the net debt of £33.5m following the purchase of Motorline in October, we estimate that the EV of MMH stands at £358.8m. MMH has provided updated profit guidance to investors, suggesting that underlying PBT would not be less than £50m (on an IFRS basis) for the 12 months to December 2021 and is after the repayment of all Coronavirus Job Retention Scheme and non-essential retail grants received during the year.

On this basis, EBITDA, and EBIT of c.£85m and £61.7m are likely outcomes (on an IFRS basis), suggesting FY21 exit multiples of 4.2x and 5.8x, respectively. However, most industry commentators anticipate the excess profits secured in the used vehicle market during FY21 will reduce markedly during FY22, with a standard supply of new vehicles unlikely before FY23.

The transaction received FCA approval on 11th May and with 94.77% acceptance by Marshall Motor Holdings shareholders on the same date, the cancellation of the public listing of the shares will occur in due course. For those who have yet to accept the offer, compulsory acquisition notices will be sent imminently.

We understand that MCH received c. £200m, net of taxes and expenses at the end of May. As MMH was a subsidiary of MCH, we note that no tax was payable on disposal. Deal related costs were relatively modest, with the bulk borne by the acquirer and its ultimate target, MMH.

Greater focus within the portfolio

MCH disposed of two businesses during FY21, before the announcement of the proposed acquisition of MMH by CAG Vega 2. The sale of one of the developments within East Cambridge, Land North of Cherry Hinton (LNCH) was also completed during the year: The remaining disposals comprised:

- Martlet Capital
- Aeropeople

The consideration for those two businesses includes sizeable, deferred elements, particularly in the case of the recruiter. The sale of the early-stage investor in October yielded c.£11m in total, of which c.80% has been received, with the remainder due in eight quarterly instalments commencing Q3 2022.

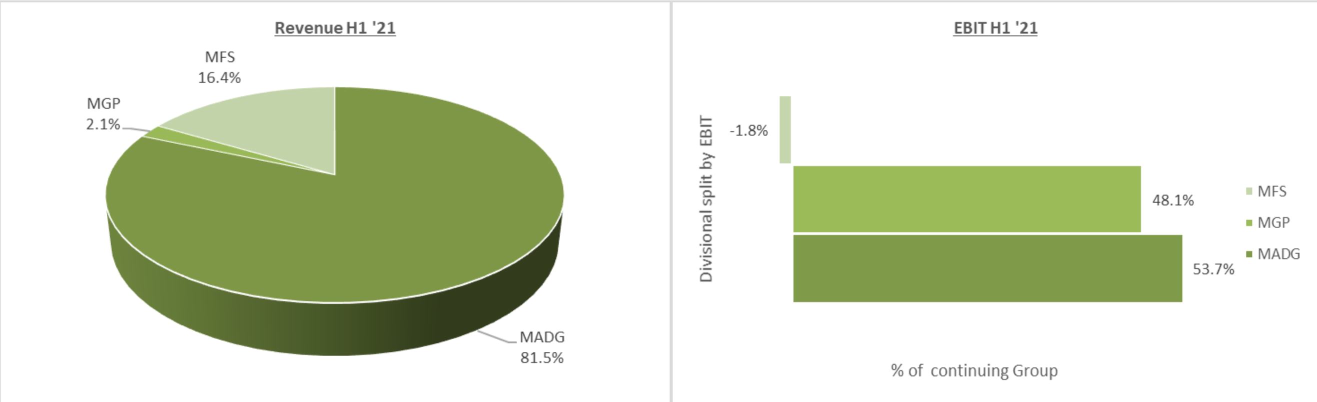
Aeropeople, a staffing and services provider to the aerospace sector, was disposed of in April 2021. The consideration amounted to £0.6m, or net asset value. A loan was provided to the new owners ahead of its sale, resulting in deferred consideration of £1.2m.

The LNCH development was sold to Bellway homes for £34.5m, resulting in a profit on disposal of £21.9m, including adjustments for land remediation and transaction costs. The consideration per acre (70 acres) amounted to £493k. Initial proceeds of £8m were received, with the remainder payable in four equal instalments of £6.625m.

Post-disposals, the Group now comprises six divisions, with the first three historically combined as Marshall Aerospace and Defence Group (MADG):

- Aerospace
- Land Systems
- Advanced Composites
- Property
- Fleet Solutions
- Futureworx, a relatively recent addition

A restructuring of the Group results in 3 historic areas of activity



Source: Company

For those less familiar with MCH, we summarise below the activities by division:

Aerospace

Military Aerospace, which accounted for 82% of the historical Aerospace and Defence division's revenues in the six months to June 2021, followed by Land Systems at 15%, with the Composites segment accounting for the remaining 3%.

The Aerospace division has locations in the UK, Europe, the Middle East, Canada, and the USA. The focus of the business is on the MRO/modification/repairs to the Lockheed Martin C-130 Hercules, following the completion of several recent special projects on other aircraft. Despite first entering service with the USAF in 1956, the newest version of the airframe (C-130J, Super Hercules) continues to be manufactured by Lockheed Martin (rising to 500 of the latest type).

Marshall is the first Lockheed Martin accredited Hercules service centre for legacy C-130 and heavy maintenance of C-130J. The OEM approves Marshall to manufacture C-130J parts for difficult to obtain and long-lead time items, utilising technical documentation from Lockheed Martin.

Aerostructures is a unit that specialises in the design and manufacture of auxiliary fuel systems and tanks, extending the range of multi-mission maritime aircraft. The business recently delivered its 1,000th auxiliary fuel tank supporting Boeing's Global P-8 programme.

Land Systems

This is headquartered in the UK with operations in Canada too. The business specialises in designing and manufacturing deployable operational infrastructure supporting humanitarian, defence, and security operations worldwide. The shelter products are designed to operate in hostile environments, with configurations from basic workshops to include complex equipment, such as CT scanners.

Additionally, systems are designed to integrate across several platforms, including land vehicles and other base structures. The platforms can then be equipped with specialist and bespoke capabilities used by the military and security services, including explosive ordinance disposal, battlefield ambulances, and command & control vehicles.

We note the new manufacturing facility in Moncton, New Brunswick, Canada (Land Systems), with its anticipated completion by the end of FY22, creating 65 jobs. This will aid Land System's goal of securing additional contracts under the latest Defence Investment Plan.

New facility in Moncton, New Brunswick, Canada

Source: CBC News

Marshall Slingsby Advanced Composites

This unit produces complex composite structures used in vital components for ships, submarines, and aircraft. Parts manufactured mostly range from bespoke one-offs to low volume production runs. Services range from R&D, design & qualification, design for manufacture, build to print and component-life support.

Marshall Group Properties

MGP includes the Cambridge Airport site, with one ongoing residential development (with the land north of Cherry Hinton development sold during FY21) plus several rental properties. In November 2021, planning approval was granted for the second phase of the Marleigh development, comprising 421 homes two miles from the centre of Cambridge. Construction of phase two commenced in Q1, with occupation from Q3 onwards.

The focus of the residential sales office has moved to phase 1b and now includes phase two. Construction of phase 1a has now been completed. The demolition and relocation of several properties previously utilised by the Aerospace and Land Systems businesses recently commenced in preparation for phase three of the development.

A further 670 acres of the 900-acre site remain available for development, although currently much of the land is occupied by Cambridge Airport, the Aerospace business, along with some farmland.

The entire 900-acre site can ultimately provide up to 12,000 homes and c.5m sq ft of commercial space, and MGP put the Cambridge Airport land forward for inclusion in the Greater Cambridgeshire Local Plan (created by Cambridge City Council and South Cambridgeshire District Council to oversee the City's growth from 2030 to 2050).

Breaking ground on the second phase of the Marleigh development

Source: Company

Marshall Fleet Services

MFS is the UK's largest independent commercial vehicle service business, operating from facilities in Tamworth (national call centre, operating 24/7/365) and 13 other locations nationwide, with c.200 engineers. There is a focus on refrigeration (including a UK dealership of Thermo King equipment), tail lift/lifting decks, drawbar couplings/vehicle mounted cranes, shutter doors, transport heating, and pharmaceutical support.

Futureworx

Marshall Futureworx is the Group's innovation accelerator, headed by Chris Walton. The business is based in one of Cambridge's key innovation parks and is an active member of the City's start-up scene. The collaborative approach is beginning to deliver tangible products and services with the potential to address the challenges of climate change.

Customer diversification

The decision by the UK MoD to retire the RAFs 14-strong C-130 fleet by March 2023, resulting in future modification work beyond the third aircraft in the fleet's centre wing replacement, surprised many observers. However, MRO activity on the RAF's fleet continued as anticipated during FY21, and five of the aircraft from the previous reduction in the fleet (from 22 to 14), were recently sold to Bangladesh. In advance of the disposal, Marshall carried out modification work to the specification of the new owners. One should anticipate similar actions on the remainder of the fleet. Marshall will also be looking to secure ongoing MRO contracts with the new owners of the fleet, representing a significant opportunity moving forward.

Having now secured the contracts to maintain/refurbish/modify the US Marine Corps (USMC) fleet of KC-130s and the Indian Air Force agreement, the RAF's 14 aircraft represents less than 10% of the total aircraft in Marshall's customer base (14/162). The international portion of Military Aerospace's order book comprises less than this fraction would suggest, as they have historically undertaken all the RAF's work but only a portion for international customers. We anticipate a further internationalisation of the Aerospace business with additional national air force customers added, as evidenced by the recent contract with the Indian government.

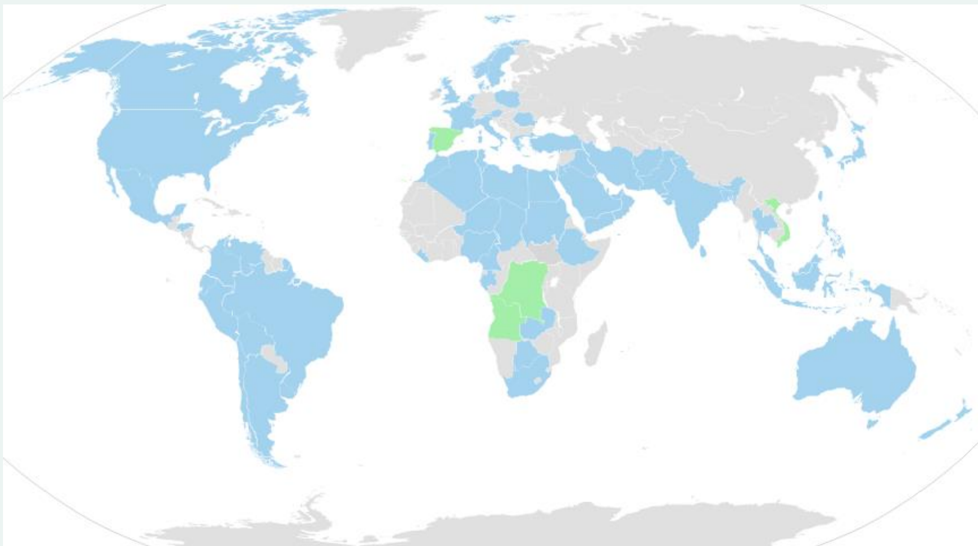
Plenty of work

More than 2,500 C-130s have been delivered to c. 70 nations since its inaugural flight in 1954, with c.1,200 still in operation. 18 air forces are currently MRO customers of Marshall. The USMC fleet remains a small portion of the C-130s operational with the US DoD.

The total US active fleet accounts for approximately 47% of the C-130s still flying, presenting a significant future opportunity for Marshall Aerospace.

The tragic events occurring in the Ukraine are also a stark reminder of the need for nations to maintain a viable defence capability. Marshall has built an enviable, and probably unrivalled, reputation for world-class skills and resources One wonders if the return of war to Europe may delay the MoD's decision, or perhaps whether it has a replacement programme in mind to use the scarce and proven services that Marshall delivers?

Countries operating the C-130 (blue, with former operators in green)



Source: Wikipedia

Management changes

Alex Dorrian has announced his intention to retire from his position as Chairman at the Group's AGM in June. His successor will be Jonathan Flint, a current Non-Executive of the Group since 2019. Jonathan previously held a combination of senior executive roles at Marconi, BAE Systems, and Oxford Instruments, where he was once the CEO. More recently, Jonathan was a Non-Executive Director at Cobham. Jonathan currently holds the positions of the Executive Chairman of Refeyn, Chairman of the QuantIC strategic advisory board, the President of the Council of the Institute of Physics, a NED at Oxford University Innovation. He sits on the advisory board for the proposed gravity wave instrument, AION.

Doug Baxter has been appointed Chief Financial Officer designate, joining the Company in late February and follows on Sean Cummins decision to retire from the Board and the Group. Doug has held several executive roles with large publicly listed companies and smaller PE-owned businesses, including GEC Marconi, BAE Systems, Selex Galileo, Survitec, and 3Si. Doug is also experienced in M&A, as well as turning around businesses.

Sean Cummins had been CFO of the Group for six years until March. During Sean's time as CFO, we witnessed a change in how the Group was run, from a large family business to one more akin to a publicly listed company.

Family member, Charlie Marshall, announced his decision to step down from his Non-Executive position on the Board, to focus on personal executive roles. Charlie is the founder and CEO of Loaf, the furniture retailer.

At the operational level, Neil McManus was recently promoted from the role of Transformation Director (appointed in September 2021) to Managing Director of Marshall Aerospace. Neil's career spans several Aerospace OEM and tier one suppliers, such as BAE Systems, Spirit AeroSystems, GKN Aerospace, Safran Seats, and Avic Cabin Systems.

Deployment of capital

The obvious question following the disposal of MMH and the two smaller businesses, Aeropeople and Martlet Capital, plus the LNCH development land is how will the incoming considerations be used?

We see several options that are available to the management team, not least:

- The replacement of the lost MMH income through investment to strengthen the product, regional and technological reach of the Aerospace and Defence businesses.
- The RAF's decision to retire its C-130 fleet and the subsequent securing of additional international contracts to maintain, repair and modify Hercules airframes might mean investment in new operations closer to its customer base, whether in Europe, North America, Asia Pacific, or Africa - hence reducing the UK footprint.
- Any further contracts with the US DoD wrt the C-130 Hercules would, in all probability, require a focused maintenance operation in North America and, specifically, in the US. The decision to establish an operation in the US would reflect further contract wins.
- Marshall will deliver comprehensive MRO services to the Indian Air Force and committed support to Lockheed Martin as part of their Foreign Military Sales contract. The agreement increases the number of air forces under contract currently to 18, and that number could be expanded further.
- Should the focus of the MRO/modification work switch from a strong bias favouring the UK to overseas operations, this could free up the Cambridge airport site for redevelopment earlier than expected.
- As of June 2021, MCH carried net debt of £33.7m. Following the disposals, we estimate net cash to be in the region of £170m. The current banking facility has a borrowing ceiling of £75m, suggesting significant headroom to facilitate the expansion of the MCH Group.
- We think there remains the potential for paying a special dividend following the repayment of indebtedness. However, the scale of any payment of this nature would also logically take account of the required investment in the remaining businesses.

Financials

We have not yet updated financial estimates for FY21, FY22 or FY23 as we regard it as sensible to only do so following the reporting of the second 'interim' results, covering the 12 months to December 2021 – expected shortly in June. The financial year-end was changed to 31 March, resulting in the period lasting 15 months. The second interim results should also include a trading update for Q1 of the new financial year, thereby ensuring greater detail on which to base financial projections. The results for the 15-month period should be delivered towards the end of 2022.

The divisional split of the business changes following the disposal of the motor retailing division from three divisions previously, to six on a continuing basis.

Valuation

With no financial projections, we have not yet updated valuation models. We expect to reinstate them following the reporting of the second interim results, expected in June 2022.

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