Northbridge Industrial Services

21 February 2022

A flurry of good news

The combined trading and strategic update from Northbridge reports progress across several areas. Trading for FY21 was in-line with upwardly revised profit expectations, cash flow remained strong, and the new year has started positively. In addition, the Group has exchanged contracts to dispose of most of its Tasman division, with just its Middle Eastern operations remaining and related write-downs unchanged versus prior expectations.

Our fair value/share of 189p is underpinned by the positive start to the year and encouraging outlook, reinforced by a peer group comparison valuation model.

Trading in the year to December was encouraging, with revenues improving 14% overall and by 20% y-o-y within Crestchic. The combination of continued recovery from the pandemic, a return of large project work (highlighting confidence in markets), and continued growth within datacentre and energy markets drove the top-line. Progress was particularly marked within Europe and North America, with the former aided by the start of its contract with a major e-commerce retailer. Although manufactured sales improved y-o-y, capacity constraints have resulted in output plateauing over the last 18 months.

The improvement in the proportion of hire service revenues to c.61% (FY20: 58%), led to an **improvement in gross margins**, notwithstanding pressure from raw materials, the supply chain and higher payroll costs. The Group has met our upwardly revised profit expectations.

Cash flow was ahead of expectations, aided by the strong trading, cash deposits from loadbank customers and a modest slippage in the construction of the new manufacturing extension. Although some of this will reverse during H1, the strong start to the year supports both demanding profit expectations for FY22F and the likelihood of a return of dividend payments. Capex is set to increase to the highest level since FY14 in FY22F, reflecting spend on the new factory and the expansion in the hire fleet to fuel growth, not least at the important **new depot in Texas** (opening in Q2).

FY22 to date has witnessed the agreements to dispose of the bulk of the non-core oil drilling tools division, Tasman, with the operations in the Middle East remaining for now. The operations in Australia and New Zealand, the 'crown jewels' of the division, should generate consideration of £4.1m. **The proceeds will be invested in the expansion of Crestchic, where the return on investment has been consistently higher**. The exceptional costs related to the disposal of Tasman remain on track to be in the £6m to £7m range previously highlighted.

The disposal of Tasman Malaysia and Singapore in late 2021 resulted in the MD of Tasman, Ian Gardner, standing down from the Board and leaving the Group, albeit retained on a consultancy basis. A new Non-Executive Director, Nicholas Mills, has been added to the Board. Nicholas is an employee of Harwood Capital, a substantial shareholder in the Group. Nicholas also sits on the boards of two other UK-listed companies, Hargreaves Services and Circassia Group.

Rating yet to reflect strategic and operational progress

We are encouraged by the trading and strategic update. The positive trading YTD, coupled with the strong drivers of trading and the prospect of a dividend later in the year augur well for Northbridge, underpinning our confidence in the outlook for FY22F.

A peer group comparison valuation model further reinforces our fair value calculation which for now is conservatively held at 189p / share as we await confirmation of the strong start to trading this year continuing.

Company Data

EPIC	NBI
Price (last close)	174p
52 weeks Hi/Lo	185p/92p
Market cap	£48m
ED Fair Value/share	189p
Net debt (Dec '21)	£1.0m

Share Price, p

Source: ADVFN

Description

Northbridge Industrial Services ("Northbridge") is a holding company, which following the nearly completed disposal of its non-core division, Tasman, is focused on Crestchic.

Crestchic Loadbanks ("Crestchic"), is a specialist provider of electrical equipment used primarily to commission, test and service within the power reliability and power security markets globally.

Tasman Oil Tools ("Tasman") is a rental specialist of downhole tools to the oil & gas, geothermal energy, coal-bed methane, and carbon capture markets. Following the divestment of operations in Australia, New Zealand, Malaysia, and Singapore, only the business in the Middle East remains but is expected to be sold during FY22.

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Positive update on several counts

The year-end update for FY21 confirmed that trading was in-line with previously upgraded expectations, except for net debt, which was **pleasantly lower than anticipated**. The current year has started encouragingly, underpinning our financial expectations. In addition, the Group has exchanged contracts to dispose of the Australian and New Zealand assets of Tasman, its energy drilling rental tools business. Board changes reflect the disposal of the bulk of the Tasman business and the increased stake built by the Group's largest shareholder.

The Board will hold a Capital Markets Day on 10 March, outlining the strategic direction and outlook for the Group.

Strong trading in FY21

Group revenues increased 14.2% during FY21 to £38.8m (ED estimate: £37.6m). H1 revenues improved 22.5% reflecting a large, low margin project in Asia Pacific and set against a weak COVID-19 lockdown related comparative. Progress in H2 was always likely to be more modest, by comparison, although we think it proved very respectable at +6.8% y-o-y.

The driver of the strong top-line growth was Crestchic hire services, improving 33.9% y-o-y and in turn resulting in an improvement in the gross margin. Commencing the year with a third consecutive record order book, manufacturing revenues increased 6.9% to £14.0m. H2 revenues were broadly unchanged on the previous two halves, reflecting the manufacturing facility operating at capacity and highlighting the need for the new extension.

Good growth levels were experienced in Europe, North America, and Asia Pacific. In Europe, the significant contract with a major e-commerce retailer commenced during H1, which involved the sale of equipment. The positive trends within the datacentre and energy markets continue to be the main drivers within hire services within Crestchic. The re-emergence of large projects augurs well, highlighting that confidence is returning to some sectors following a fallow period in recent years.

Tasman contributed £9.4m of revenues, unchanged on FY20. Hire revenues within the division were modestly ahead y-o-y.

Gross margins improved, reflecting the rising proportion of hire revenues to c.61% of the Group total in FY21 and, compared to 58% in FY20. The rising proportion of hire services offset supplier led price increases and payroll-related costs. The FY20 gross margin stood at an impressive 43.2%, which increased to 44.7% in H1 '21. We estimate that the strong operational gearing is likely to have fed through to an improved EBIT margin (FY20: 5.0%), also helped by the improving performance at Tasman (to breakeven).

The Group remains strongly cash generative, notwithstanding the increase in working capital required to offset supply chain constraints. Period end net debt levels were ahead of our estimate (ED est.: -£3.2m), at just £1.0m, in part aided by a deferral of capex on the new facility into FY22 and higher than expected cash deposits on loadbank sales.

Strategic shift nearing completion

The future of the oil drilling rental tools division, Tasman, has been under review since April 2021 as the onset of the pandemic abruptly halted the burgeoning recovery in activity levels and focused the Board's thinking. The issue has been an inability to consistently match the Group's internal return on investment (RoI) target of 15%. Although the division saw an improvement in trading during H2 21, which resulted in it breaking even at the trading level, accounting for the Malaysian joint venture and finance costs it remained loss-making during the year.

The Board's preference is to **divert investment capital in favour of the higher margin Crestchic**, including the new factory extension in Burton-on-Trent (following a third consecutive year of record manufacturing orders in FY21) and in the purchase of rental equipment targeted towards the rapidly growing renewable energy, datacentre, and North American markets.

Significantly, to date the Group's loadbank sales/hire in North America have been outside of the sizeable and growing datacentre market. A freeing up of capital from the disposal of Tasman will not only result in a repayment of the Group's indebtedness but also fund rental equipment purchases and new depots to expand initially within North America and Europe.

In late 2021 progress was made with disposal of the loss-making Malaysia and Singapore portions finalised. No detail was provided in terms of consideration or purchaser. However, the fact that Tasman was a minority partner (49%) in the South-East Asian venture with OLIO Resources suggests that it was an asset only transaction.

The disposal of the largest regional operations within Tasman, Australia and New Zealand (ANZ), has just been finalised. Proceeds of £4.13m will be generated, with £3.16m payable on completion, with the remaining £0.97m due in three instalments in the 12-months to 28 February 2023, the first anniversary of completion. The purchaser is Well Integrity Group. The assets transferred to Well Integrity has a book value of £4.79m.

Negotiations on Tasman Middle East were temporarily placed on hold to enable management to focus on the disposal of the ANZ business. We anticipate that Tasman Middle East will be disposed of during FY22.

The exceptional cost associated with the restructure and disposal of Tasman is unchanged, versus previous estimates, at £6m to £7m. Most of the exceptional cost related to Tasman's disposal will be reported in the FY21 accounts.

Board changes

The Director responsible for Tasman, Ian Gardner, stepped down from the Board and left the Company in mid-January following the disposal in the Far East. Ian has been retained on an advisory basis until May, assisting the Board on the ongoing disposal of the constituent parts of Tasman.

With Harwood Capital increasing its stake to 22.6%, including the c.13% held by Gresham, Nicholas Mills has joined the Northbridge Board as a Non-Executive Director. Nicholas has been employed by Harwood Capital for three years, and previously as a Research Analyst for Gabelli Asset Management in New York for five years.

Nicholas is a NED on the boards of Circassia Group Plc ad Hargreaves Services Plc.

Financials

Aside from adjusting our FY21 revenue and net debt estimates, all our remaining core financial expectations are unchanged. In terms of the outlook for FY22, we believe it remains too early to adjust for the positive start to the year.

Encouraging start to the year

Crestchic entered FY22 with a fourth consecutive record manufacturing order book and hire revenues are markedly above the Q1 run-rate y-o-y. Visibility on loadbank/transformer hire services is typically a quarter forward, with a strong pipeline of datacentre activity in Europe and energy and marine projects elsewhere.

The strong progress has continued in North America and to maintain the momentum within the business, a new depot is due to open in Q2 in Texas. With the outlet requiring a rental fleet, an order has been placed with a US manufacturer to supply smaller loadbanks than those typically supplied by Northbridge and utilised in heat load testing within datacentres. The move will enable the Group to enter the US datacentre market, which has been one of the key drivers of revenue in the UK and Europe.

A new contract has been signed in the Middle East to supply loadbanks for testing of a datacentre, the first such major order outside of Europe.

Summary Profit & Loss

Year to Dec, £m	2018A	2019A	2020A	2021E	2022E
Crestchic	20.4	25.4	24.6	29.4	32.3
Tasman Oil Tools	6.6	8.2	9.4	9.4	2.0
Revenue	26.94	33.60	33.98	38.80	34.28
CoGS	-15.7	-17.8	-19.3	-21.4	-18.8
Gross profit	11.3	15.8	14.7	17.4	15.5
Gross margin (%)	41.8%	47.0%	43.2%	44.8%	45.2%
Op costs	12.3	13.6	13.4	13.5	11.2
Other operating income	0.0	-0.1	0.4	0.0	0.0
Operating profit	-1.4	1.2	1.7	3.9	4.3
Op margin (%)	-5.0%	3.5%	5.0%	10.0%	12.4%
Net Interest	-0.7	-0.9	-0.7	-0.5	-0.3
Associates/JVs	-0.4	-0.8	-0.6	-0.4	0.0
PBT (Adjusted)	-2.0	0.3	0.4	3.0	4.0
Exceptionals	-0.7	0.0	-7.8	-5.9	-2.0
PBT (Reported)	-2.7	0.3	-8.0	-2.9	2.0
Tax	0.3	-0.6	-0.1	-0.5	-0.8
PAT	-2.4	-0.2	-8.1	-3.4	1.2
Minority interests	0.0	0.0	0.0	0.0	0.0
Earnings	-2.4	-0.2	-8.1	-3.4	1.2
Ordinary Dividends	0.0	0.0	0.0	0.0	-0.4
Retained Profit	-2.4	-0.2	-8.1	-3.4	0.8
EPS (Adjusted) (p)	-5.9	-0.8	-0.7	8.7	11.0
DPS (p)	0.0	0.0	0.0	0.0	1.5
Ave no of shares (FD) (m)	28.8	28.2	28.2	28.7	29.4

Source: Company historics, Equity Development estimates

There are three key moving parts within the cash flow in FY22:

- The shift in the construction and fitting out costs of the new manufacturing facility extension
- The purchase of rental fleet to drive top-line growth across several markets
- The proceeds of the disposal of Tasman

As such, we anticipate FY22 end net cash of c.£2.5m, an improvement of some £2.2m compared to our previous estimate.

We remain of the opinion that NBI will re-commence the payment of dividends during the current year, reflecting the combination of the strong balance sheet, the positive outlook, and the changes in distributable reserves passed in the recent General Meeting.

Summary Cash Flow

Year to Dec, £m	2018A	2019A	2020A	2021E	2022E
Operating profit	-1.4	1.2	1.1	3.5	4.3
Depn. & Amortn.	6.0	5.8	5.3	4.9	4.1
Working capital movement	0.4	0.6	0.2	-1.3	-0.8
Other	0.0	0.0	0.0	-0.4	-0.5
Operating cash flow	5.0	7.6	6.6	6.6	7.0
Net Interest	-0.7	-0.9	-0.7	-0.5	-0.3
Taxation	-0.7	-0.6	-0.5	-0.5	-0.8
Net capex	-3.9	-2.2	-2.6	-2.3	-6.1
Operating FCF	-0.1	4.0	2.8	3.4	-0.1
Net (Acquisitions)/Disposals	-1.1	-0.1	0.0	0.0	4.2
Dividends	0.0	0.0	0.0	0.0	-0.1
Share Issues	2.4	0.0	0.0	1.0	-0.5
Minority payment	0.0	-1.4	-0.3	0.0	0.0
Other financial	-1.1	-0.3	-1.5	0.0	0.0
Increase Cash/(Debt)	0.1	2.3	1.0	4.4	3.5
Opening Net Cash/(Debt)	-8.7	-8.7	-6.4	-5.4	-1.0
Closing Net Cash/(Debt)	-8.7	-6.4	-5.4	-1.0	2.5

Source: Company historics, Equity Development estimates

Abbreviated Balance Sheet

Year to Dec, £m	2018A	2019A	2020A	2021E	2022E
Intangible Assets	12.3	11.6	4.5	4.3	3.3
Tangible Assets	28.9	25.6	24.5	22.1	19.3
Investments/other	0.0	0.9	1.0	1.0	1.0
Net Working Capital	6.2	5.8	5.2	6.5	7.3
Capital Employed	47.4	43.9	35.1	33.8	30.9
Other	0.0	0.0	0.0	0.0	0.0
Net Cash/(Debt)	-8.7	-6.4	-5.4	-1.0	2.5
Provisions Liabilities/Charges	-2.3	-2.2	-2.0	-2.0	-2.0
Net Assets	36.5	35.2	27.7	30.8	31.4

Source: Company historics, Equity Development estimates

Valuation

We have constructed a peer group comparison model to ascertain our fair value per share.

Comparative peer group valuation model

We have constructed a valuation model comparing Northbridge with hire services specialists listed on international public markets. Several operate on a global basis, not unlike Northbridge. With FY21 financials reported by several of its peers, we have focused on FY22 estimates.

The combination of an improved balance sheet and greater management focus should result in strong EPS growth for NBI during FY22F. However, the modest delay in the commissioning of the new manufacturing facility, the time required for investment in new depots and rental fleet to reach maturity suggest a very positive outlook for FY23F and beyond, with additional costs a factor of FY22F.

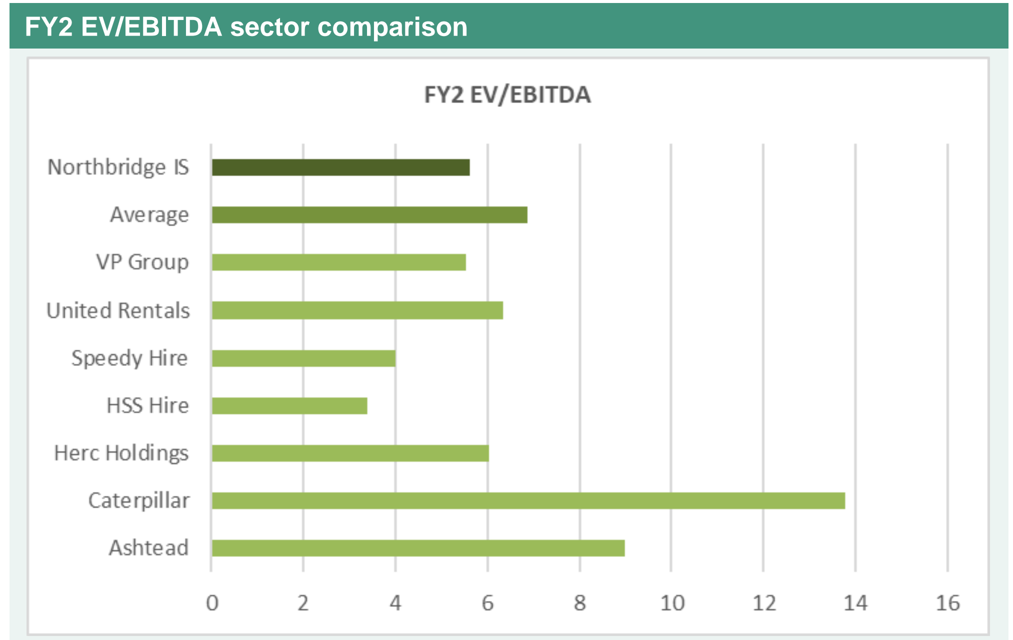
The PER comparison suggests that NBI is trading at a premium of 11.9% to the average of its peers. We will include this figure in the average of the FY2 PER, EV/EBTDA and EV/Sales ratios in calculating the fair value for the shares.

FY2 PER sector comparison

Source: Market Screener

The chart below highlights that the FY22 EV/EBITDA rating of NBI, at 5.63x sits at a discount of 18.0% to its peer group average.

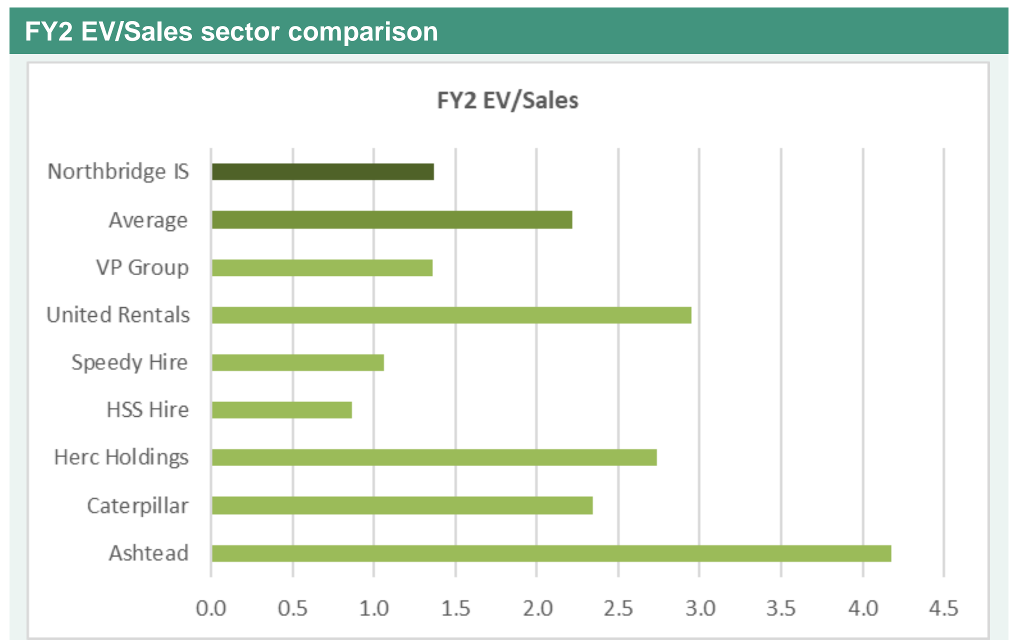
FY2 EV/EBITDA sector comparison



Source: Market Screener

The discount on FY2 EV/Sales is even greater, at 38.2% versus its peers.

FY2 EV/Sales sector comparison



Source: Market Screener

The average of the three suggests an existing fair value of 189p / share which stands 9% above the current share price.

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